Press Release

The Hong Kong Mortgage Corporation Limited
Half-year Financial Results for 2005

The Hong Kong Mortgage Corporation Limited (HKMC) announced today (Thursday) its half-year financial results for 2005.

The unaudited interim results show that the profit after tax (PAT) for the six months ended 30 June 2005 (1H 2005) was HK$338.1 million, a fall of 4.8% or HK$17.2 million below that of the first six months in 2004 (1H 2004). The shareholders' equity increased by HK$159.1 million to HK$4.3 billion. The annualised return on average shareholders' equity was 15.6% (1H 2004: 19.1%). The cost-to-income ratio increased to 13.1% (1H 2004: 11%). The capital-to-assets ratio remained strong at 11.5% at 30 June 2005 (or 23.8% when computed in accordance with the provisions in the Banking Ordinance). The financial results of the HKMC are at the Annex.

In overall terms, the market environment for 1H 2005 was much more challenging than for 1H 2004 when the Corporation was able to make substantial mortgage loan purchases, arrange early pre-funding of its liquidity needs early in the interest rate hike cycle and benefit from an exceptionally wide Prime-HIBOR spread.

For 1H 2005, while the local economy and the property market have both seen strong recovery, the market environment for the purchase of sizeable mortgage loan portfolios remained challenging. The HKMC's purchase of mortgage loans in 1H 2005 amounted to HK$0.9 billion. The HKMC will continue to seek to diversify its purchase opportunities. As there was also a high mortgage prepayment rate, the outstanding principal balance of the HKMC's retained mortgage portfolio decreased by 9.7% from HK$34.9 billion at the end of 2004 to HK$31.5 billion as at 30 June 2005. Total assets decreased by 10.4% from HK$45.3 billion to HK$40.6 billion.

The HKMC raised HK$2.6 billion through 15 debt issues in the first six months of 2005. The funds raised were used for mortgage purchase and redemption of matured debts. As at 30 June 2005, the total value of outstanding debt securities was about HK$30.5 billion.

The Mortgage Insurance Programme (MIP) recorded a significant business growth in the first six months of 2005 due to the rebound of the property market. During the period, the Corporation received 13,095

applications, involving a total mortgage loan amount of HK$27 billion. The penetration ratio of MIP mortgages was about 20.6% in the first five months of 2005. Secondary market transactions accounted for 92% of the applications received in the period. This shows that the MIP has helped to enhance the liquidity of the secondary property market.

Reflecting the prudent purchasing and insurance underwriting criteria adopted by the HKMC, the delinquency ratio of loans overdue for more than 90 days in the mortgage portfolio was 0.29% (a provisional figure) at the end of May (cf. banking industry average at 0.24%).

For the rest of 2005, the HKMC will strive to meet its business targets and continue to meet the needs of the banking sector and the homeowners, and promote the development of the debt market.

The Hong Kong Mortgage Corporation Limited
28 July 2005

Annex

THE HONG KONG MORTGAGE CORPORATION LIMITED
(Incorporated in Hong Kong with limited liability under the Companies Ordinance)

CONSOLIDATED FINANCIAL RESULTS

FOR THE SIX MONTHS ENDED 30 JUNE 2005

The Hong Kong Mortgage Corporation Limited (HKMC) is pleased to announce its unaudited consolidated half-year financial results for the six months ended 30 June 2005 as follows:

	Unaudited 6 months ended 30 June 2005	Unaudited 6 months ended 30 June 2004
	HK$'000	HK$'000
Interest income	**653,022**	477,045
Interest expense	**(323,941)**	(56,464)
Net interest income	**329,081**	420,581
Other income, net	**85,603**	105,339
Operating income	**414,684**	525,920
Operating expenses	**(54,507)**	(57,634)
Operating profit before provisions	**360,177**	468,286
Write-back of impairment losses on loans / (provisions) for bad and doubtful loans	**27,081**	(56,481)
Profit before taxation	**387,258**	411,805
Taxation	**(49,163)**	(56,524)
Net profit for the period	**338,095**	355,281

	Unaudited as at 30 June 2005	Audited as at 31 December 2004	
	HK$'000	HK$'000	
Assets			
Cash and short-term funds	**2,915,597**	5,338,017	
Mortgage portfolio, net	**31,478,916**	34,938,580	
Investment in debt securities			
Available-for-sale	**999,399**	-	
Held-to-maturity	**4,240,797**	4,093,253	
Derivative financial instruments	**243,284**	-	
Reinsurance assets	**443,407**	331,179	#
Other assets	**270,994**	565,452	
	40,592,394	45,266,481	#
Liabilities			
Other liabilities	**4,847,744**	5,053,600	
Derivative financial instruments	**128,952**	-	
Tax payable	**102,612**	47,229	
Insurance liabilities	**690,443**	508,981	#
Debt securities	**30,501,594**	35,494,740	
	36,271,345	41,104,550	#
Shareholders' equity			
Share capital	**2,000,000**	2,000,000	
Retained profits	**2,271,372**	1,870,261	
Contingency reserve	**49,700**	41,670	
Other reserve	**(23)**	-	
Proposed dividend	**-**	250,000	
	4,321,049	4,161,931	
	40,592,394	45,266,481	
Capital-to-assets ratio	**11.5%**	9.3%	#

	Unaudited as at 30 June 2005	Unaudited as at 30 June 2004
Return on shareholders' equity (annualised)	**15.6%**	19.1%
Return on total assets (annualised)	**1.6%**	1.4%
Cost-to-income ratio	**13.1%**	11.0%

Restated after adoption of HKFRS 4: Insurance Contracts

Financial Review

The unaudited consolidated profit after tax (PAT) was HK$338.1 million for the six months ended 30 June 2005, a fall of 4.8% or HK$17.2 million below that of the first six months in 2004 (1H 2004). The annualised return on shareholders' equity was 15.6% (1H 2004: 19.1%). The net interest margin of the average interest-earning assets decreased slightly to 1.6% (1H 2004: 1.7%). The reduction in profit after tax and return on shareholders' equity when compared to the corresponding period in the previous year mainly reflected the reduction of net interest income from the contraction of the mortgage portfolio and the narrowing of the Prime-HIBOR spread; which was partly negated by the write back of impairment losses on the mortgage portfolio from the continued recovery in property market.

The HKMC incurred interest expense of HK$323.9 million (1H 2004: HK$56.5 million) from debt securities issued and utilisation of bank lines. During the period, the HKMC issued HK$2.6 billion of notes for loan purchase and refinancing matured notes.

The HKMC's net interest income decreased by 21.8% to HK$329.1 million as compared to 1H 2004.

Other income was HK$85.6 million (1H 2004: HK$105.3 million). Major items include HK$44.2 million of net mortgage insurance premium, HK$24.5 million of MBS guarantee fee and related fee income; and HK$13.3 million of early prepayment fees.

The Mortgage Insurance Programme (MIP) continued to be well received by homebuyers. The total outstanding principal balance of the loans with mortgage insurance coverage amounted to HK$38.5 billion and the number of insured mortgage loans stood at 22,260 as at 30 June 2005. The net mortgage insurance premium earned was HK$44.2 million in the first half of 2005 (1H 2004: HK$27.7 million).

The HKMC continues to exercise tight control over its operating expenses. Total operating expenses were HK$54.5 million for the first half of 2005 (1H 2004: HK$57.6 million). Despite the operating costs being contained at the similar level, the contraction of the income base increased the cost-to-income ratio to 13.1% from 11% in the corresponding period of 2004.

The capital-to-assets ratio (CAR) of the HKMC stood at 11.5% as at 30 June 2005 (31 December 2004: 9.3%). This is comfortably above the minimum CAR of 5% stipulated in the guidelines issued by the Financial Secretary. Computed in accordance with the provisions in the Banking Ordinance, the CAR of the HKMC was 23.8% (31 December 2004: 20.8%).

Impact of Hong Kong Financial Reporting Standards (HKFRSs)

The financial results have been prepared in accordance with the Hong Kong Companies Ordinance and the HKFRSs issued by the Hong Kong Institute of Certified Public Accountants. The HKMC adopted the HKFRSs as stated below relevant to its operations for accounting periods commencing on or after 1 January 2005.

HKAS 1	Presentation of Financial Statements
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 12	Income Taxes
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 18	Revenue
HKAS 19	Employee Benefits
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 32	Financial Instruments: Disclosure and Presentation
HKAS 36	Impairment of Assets
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS-Int 12	Consolidation – Special Purpose Entities
HKFRS 4	Insurance Contracts

There were no material effects for the current period and prior year from the adoption of HKFRSs other than Hong Kong Accounting Standard 39 – Financial Instruments: Recognition and Measurement (HKAS 39). All relevant changes in the accounting policies have been made in accordance with the provisions of the respective standards.

Among the changes in accounting treatment, the more significant change in profit or loss arises mainly from the adoption of HKAS 39. The main changes are summarised as follows:

(a) the previous approach of maintaining general and specific provisioning on mortgage portfolio will be replaced by provision for impairment losses assessed collectively and/or individually when objective evidence of impairment exists. The difference between the carrying amount and the recoverable amount of the asset is recognised as impairment;

(b) hedge accounting is adopted for debt securities issued and the hedging derivatives. For derivatives qualifying as cash flow hedges, the fair value movements are initially recorded in equity and subsequently released to the income statement in the same period in which the hedged item affects profit or loss. For fair value hedges, the fair value changes of hedged item and its derivatives are reported in the income statement;

(c) derivatives and debt securities issued not qualified for hedge accounting are designated as fair value through profit or loss. They are carried at fair value in the balance sheet with the changes in fair value being recognised in the income statement; and

(d) investment in debt securities designated as available-for-sale are reported at fair value in the balance sheet, with changes in fair value recognised in a revaluation reserve in shareholders' equity.

The effect of the first-time adoption of HKAS 39 is reflected directly in the shareholders' equity as at 1 January 2005 by making a one-off adjustment to take account of the changes in accounting treatment for the period up to 31 December 2004 (such adjustments will therefore not feature in the income statement in 2005). The unaudited adjustments for the HKMC as required by HKAS 39 are as follows:

(a) the general and specific provisions net of the collective assessment for loan impairment of HK$44.9 million (net of tax), were written back to augment the shareholders' equity; and

(b) the fair values of derivatives not qualified for hedge accounting and the fair values difference between the debt issuance issued and the derivatives under fair value hedges were HK$26.1 million (net of tax), which were added to the shareholders' equity.

Other than the adjustments described above, the effects of adopting HKAS 39 on the financial statements for the first half of 2005 were as follows:

(a) HK$27.1 million of impairment losses on loans was written back to the income statement, thereby reducing the provision for impairment losses to HK$77.2 million as at 30 June 2005;

(b) HK$243.3 million of derivative assets and HK$129 million of derivative liabilities, both designated as fair value through profit or loss and fair value hedge, were recognised as separate financial

asset and liability as at 30 June 2005. For debt securities issued designated as fair value through profit or loss, HK$105.8 million was recorded to reflect the changes in fair value due to interest rate changes. As a whole, the fair value changes of the derivatives and the debt securities issued charged to income statement were HK$23.1 million during the first half of 2005; and

(c) a negative revaluation reserve of HK$23,000 was recorded in the equity as the unrealised fair value losses of available-for-sale debt investment as at 30 June 2005.