



# HKIMR BIS Conference on Property Markets and Finance

## **Recent Hong Kong Experience**

Peter Pang  
Deputy Chief Executive  
Hong Kong Monetary Authority  
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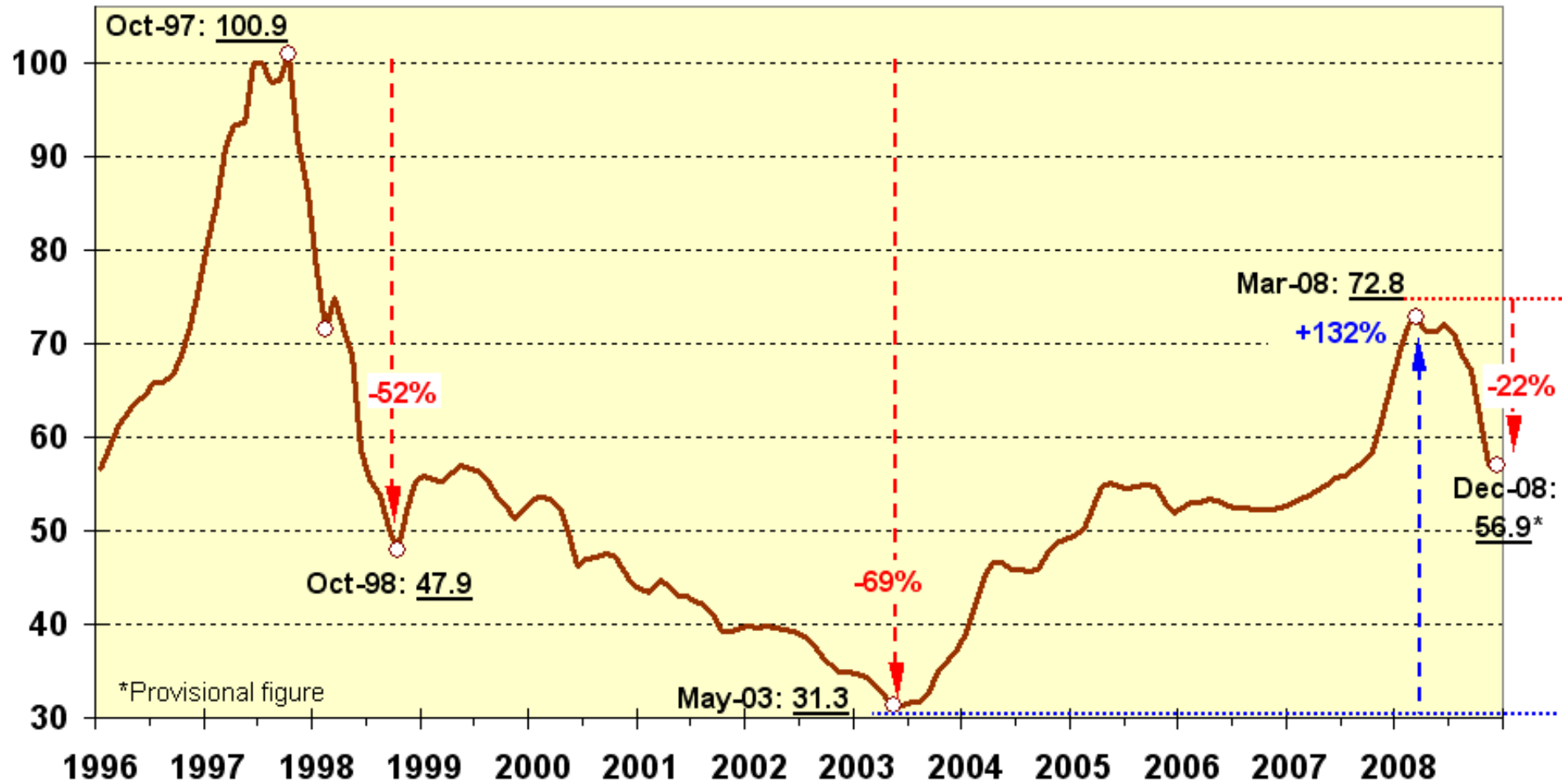
# Hong Kong Offers Some Interesting Contrast to US Sub-prime Experience

- ❖ Over 65% correction in residential property prices post-Asian financial crisis (“AFC”) but with minimal default
- ❖ Structural change in mortgage pricing since the AFC with a sharp fall of 400 bp
- ❖ A different approach in the use of government supported housing agencies in pursuing policy goals

# Market Key Facts

- ❖ Size of residential mortgage market: HK\$660 billion -- 25% of total bank lending or 40% of GDP
- ❖ Loan-to-Value (“LTV”) Ratio of mortgage loans: Capped at 70% but can go up to 95% with mortgage insurance
- ❖ Prevailing mortgage rate: Almost all are based on floating rates at Prime – 1% to Prime – 2% (i.e. 3.25% to 4.25%)
- ❖ Asset quality: The >90-day delinquency ratio at 0.05% and the combined ratio (incl. rescheduled loans) at 0.18%

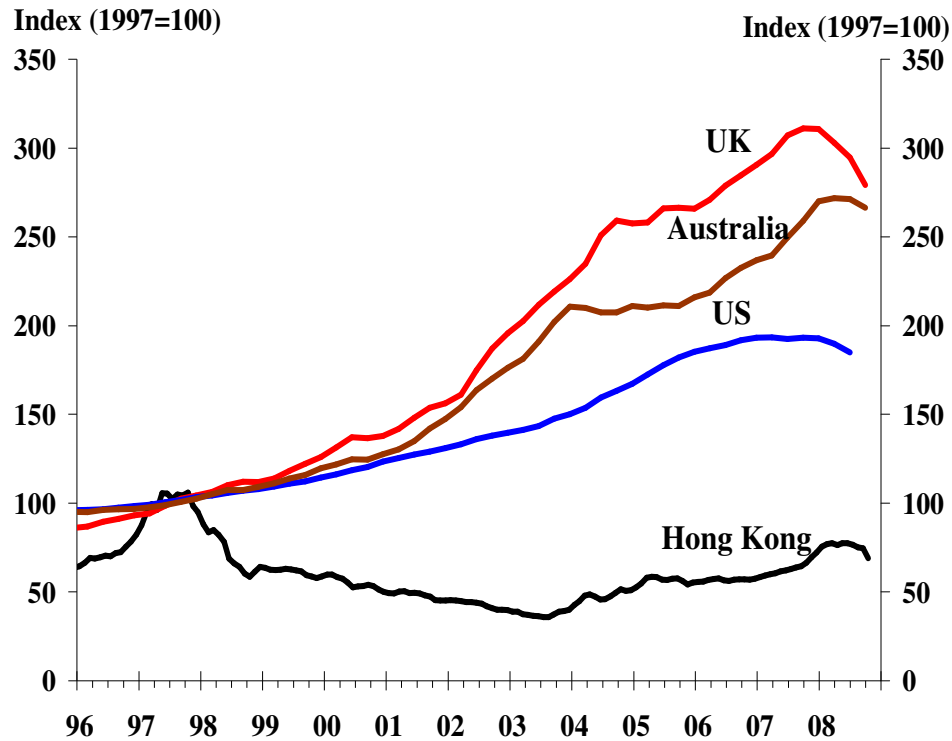
# Residential Property Price Index



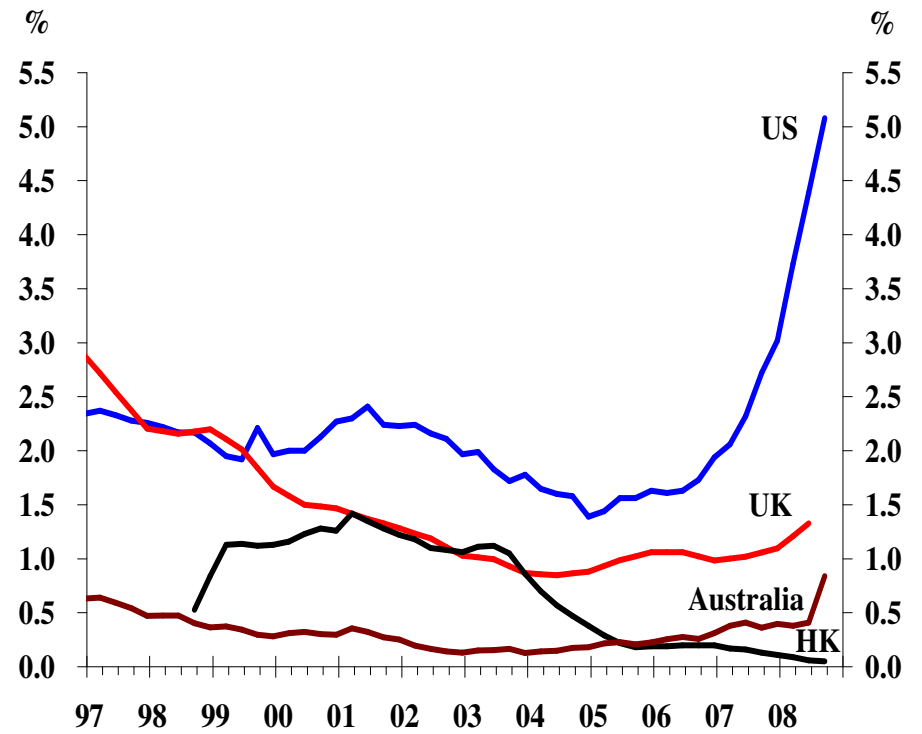
Data Source: Centaline Property Agency

# International Comparison

## Residential property price index



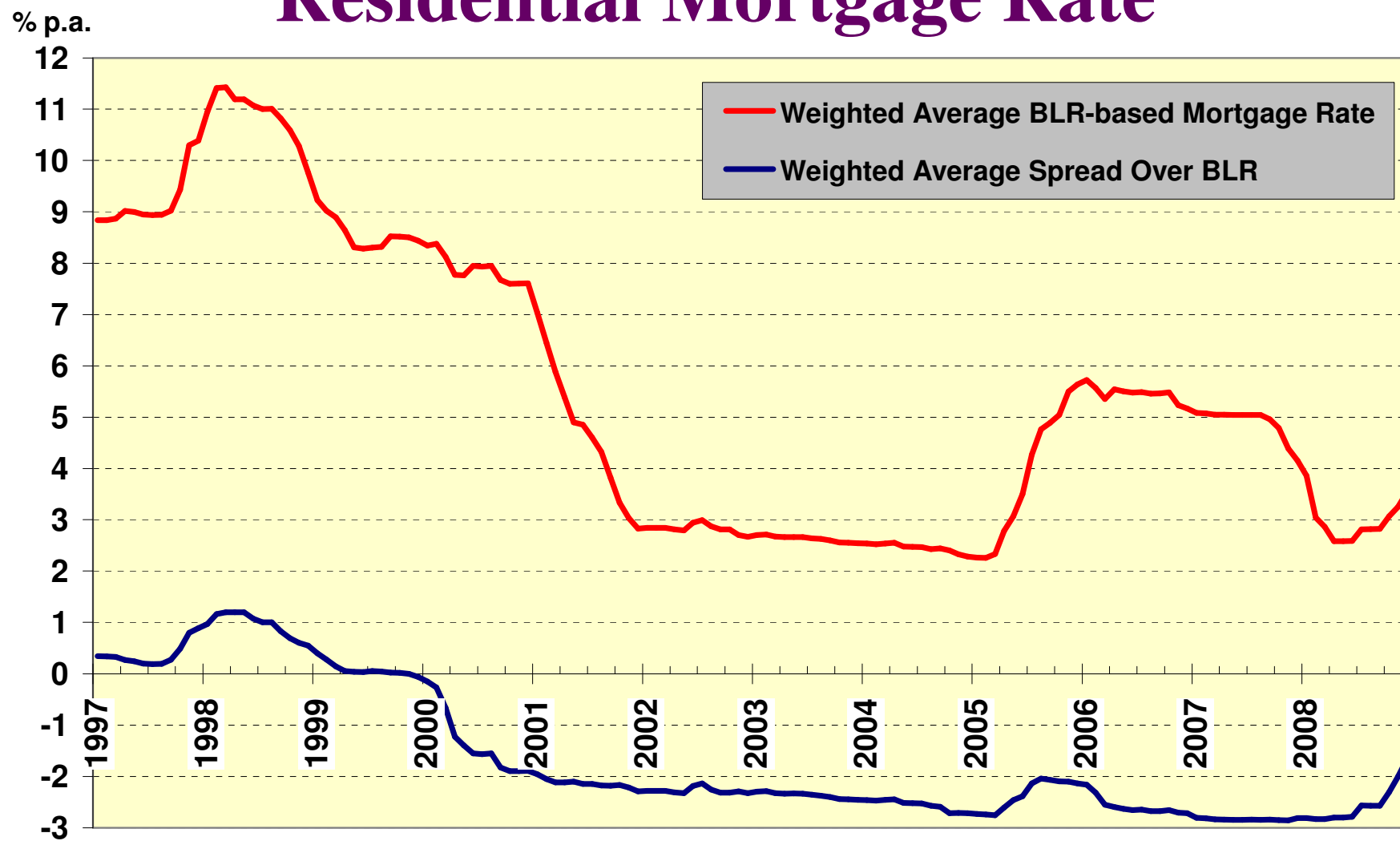
## Mortgage delinquency ratio



# Reasons of Minimal Default

- ❖ Low interest rate environment
- ❖ High savings rate
- ❖ Majority of households having two bread winners
- ❖ About half of the population living in public housing
- ❖ LTV Ratio of mortgage lending capped at 70%
- ❖ Banks took proactive steps to restructure mortgage repayment schedule

# Unprecedented Fall in Residential Mortgage Rate



Sources: Hong Kong Monetary Authority, Hong Kong Mortgage Corporation

BLR: Best Lending Rate

# Causes of Unprecedented Fall in Residential Mortgage Rate

- ❖ Slow loan growth in a highly competitive environment after Asian Financial Crisis
- ❖ Rational re-pricing – mortgage loans demonstrated more resilience than other bank lending during economic downturn
- ❖ Preferential regulatory capital treatment – 35% risk weighting for performing residential mortgages compared with 100% risk weight for loans
- ❖ Lack of a cost-based reference interest rate creating underpricing tendencies



# A Different Approach towards Mortgage Corporations

## Different Policy Missions

HKMC	Fannie Mae & Freddie Mac
<ul style="list-style-type: none"><li>• Promotion of financial stability through provision of liquidity to banks</li></ul>	<ul style="list-style-type: none"><li>• Promotion of homeownership with particular responsibility for purchasing mortgage loans of low-income borrowers to encourage affordable housing</li></ul>



**Different business models**



**Different risk profiles**

# Different Business Models

HKMC	Fannie Mae & Freddie Mac
<p style="text-align: center;"><u>Passive mode:</u></p> <p style="text-align: center;">Prudent “Mortgage Acquisition and Securitisation Model”</p>	<p style="text-align: center;"><u>Active mode:</u></p> <p style="text-align: center;">Aggressive “Mortgage Origination &amp; Securitisation Model”</p>
<ul style="list-style-type: none"> <li>• Deliberate policy not to engage in mortgage origination to avoid direct competition with banks</li> <li>• Mortgage sale are at banks’ discretion and conducted on arms-length commercial basis</li> <li>• Securitisation is for promoting mortgage-backed securities (“MBS”) market rather than regular funding</li> </ul>	<ul style="list-style-type: none"> <li>• Direct mortgage origination through over 1,000 agents / brokers</li> <li>• Securitisation is an important tool for funding</li> </ul>

# Different Capital Requirement & Leveraging

HKMC		Fannie Mae & Freddie Mac	
<b>Minimum Capital Charge Requirement</b>			
<u>Mortgages</u> 5%	<u>MBS</u> 2%	<u>Mortgages</u> 2.5%	<u>MBS</u> 0.45%
<b>Debt / Equity Ratio</b>			
8 times (Capped at 17.3 times)		<u>Fannie Mae</u> 66 times	<u>Freddie Mac</u> 79 times

# Different Alignment of Interest with Mortgage Originators

HKMC	Fannie Mae & Freddie Mac
<ul style="list-style-type: none"><li>• <u>Mortgage Purchase</u>: Originating banks must retain at least 50% of their mortgage portfolio<ul style="list-style-type: none"><li>➤ Combined Ratio: 0.18%</li></ul></li><li>• <u>Mortgage Insurance</u>: On top-up portion only so that banks need to retain the risk for LTV ≤ 70%<ul style="list-style-type: none"><li>➤ Combined Ratio: 0.02%</li></ul></li></ul>	<ul style="list-style-type: none"><li>• Originators offload entire mortgage portfolio to GSEs</li><li>• Fannie/Freddie delinquency ratio at 1.89% and 1.52% respectively</li><li>• GSEs in turn offloaded a big chunk (75% at end-2007) of mortgage portfolios through MBS</li></ul>

# A More Hands-on Regulatory Approach to Housing Related Financial Innovation

HKMC	Fannie Mae & Freddie Mac
<ul style="list-style-type: none"><li>• Financial Secretary and key regulators on the Board</li><li>• Prudent purchase criteria encourage banks to adopt prudent mortgage underwriting standards</li><li>• Quality assets as collateral for MBS</li><li>• Regulatory recognition of prudent underwriting standards for mortgage insurance arrangements</li></ul>	<ul style="list-style-type: none"><li>• Private sector profit driven approach</li><li>• Multiple regulators (OFHEO, HUD Treasury and the Fed)</li><li>• Liberal regulatory requirements</li><li>• Supervisory power with only conservatorship (going concern) authority but not receivership (closure) authority</li></ul>