Information Note for
the LegCo Panel on Financial Affairs

Residential Mortgage Loan in Negative Equity

Introduction

This paper summarises the recent measure introduced by the Hong Kong Monetary Authority ("HKMA") to allow authorized institutions ("AIs") to refinance residential mortgage loans[1] ("RMLs") for homeowners in negative equity[2] up to 100% of the current market value of the mortgage property.

The new measure

2. The HKMA was aware that the ability of AIs to refinance existing RMLs in negative equity was restricted by the 70% loan-to-value guideline for RMLs, which has been in existence since November 1991.

3. In order to remove this obstacle to banks which may wish to offer relief to homeowners in negative equity, the HKMA issued on 10 October 2001 a letter to all AIs stating that it would not object if AIs that judge it commercially desirable to do so were to depart from the 70% guideline in refinancing RMLs for homeowners in negative equity. Such loans should, however, not exceed 100% of the current market value of the mortgaged property and AIs are still required to

[1] Residential Mortgage Loans (RMLs) are loans (which include refinancing loans) to private individuals for the purchase of residential properties, including uncompleted flats, but other than flats under the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme.

[2] Refers to homeowners whose outstanding RML with an AI exceeds the current market value of the mortgaged property. This definition does not take into account other loans which a homeowner may have obtained to finance the purchase.

observe normal prudent lending criteria (such as the debt service ratio) when making these loans. Notwithstanding this relaxation, the HKMA pointed out that the 70% loan-to-value guideline remained generally appropriate as a long-term prudential measure and would continue to apply to new RMLs.

4. Banks are generally supportive of this move and a number of them have already launched schemes to offer refinancing loans to homeowners in negative equity. It is believed that the new measure will be helpful to some of the homeowners in negative equity to enable them to refinance their existing RMLs at a lower interest rate, thereby reducing their interest burden.

Results of Survey

5. In order to understand more clearly about the extent of the problem, the HKMA has also conducted an ad-hoc survey with 7 banks on RMLs in negative equity which are carried on their books. "Negative equity" is again defined as in footnote 2.

6. Based on the results of the survey, it is estimated that the total number of RMLs in negative equity in the banking sector might be around 65,000 or 14% of total mortgage borrowers as at 30 September 2001. The total value of RMLs in negative equity is estimated to be around HK$127 billion or 23% of total outstanding mortgage loans.

7. The number of 65,000 is somewhat lower than estimates made by some other quarters. It must be stressed that the HKMA's numbers represent the position only in relation to RMLs provided by the banking sector. They do not include borrowers in negative equity who have taken out a second mortgage from other parties such as a property developer or a money lender as banks do not have

information on customers' outstanding liabilities under the second mortgage. In addition, banks' lending to owners of properties acquired under the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme have not been included in the survey as such loans are outside HKMA's definition of RMLs in its regular monthly survey of RMLs with AIs.

8. The survey also suggested that 31% of customers whose loans were in negative equity were being charged at above Best Lending Rate (BLR), 15.6% at BLR and 50.8% at below BLR. Of those charged at above BLR, only 0.3% were being charged at BLR + 2% or above. The average rate being charged on all loans in negative equity worked out to be BLR - 0.27%. The fact that more than half of the RMLs in negative equity were charged below BLR suggests that banks are more willing to discuss mortgage terms with customers in the light of increased competition in the mortgage market.

Hong Kong Monetary Authority
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