HONG KONG MONETARY AUTHORITY
香港金融管理局

Annex 3

Our Ref.: B4/1C

Y. K. Choi JP
Deputy Chief Executive

蔡耀君 JP
副總裁

23 October 2009

The Chief Executive
All Authorized Institutions

Dear Sir/Madam,

Prudential measures for residential mortgage loans

Further to my letter of 17 September 2009 to the two industry Associations reminding authorized institutions (AIs) to be prudent in setting interest rates for residential mortgage by giving due regard to the long-term average Prime-HIBOR spreads, I am writing further to remind AIs to ensure that their lending criteria remain sound and prudent in the light of latest market conditions.

We note that the prices of luxury properties have risen rapidly in the last few weeks. In particular, prices of Class E properties (size 160 sq. m or above) have already exceeded their peak in the third quarter of 1997 and the risks of lending to this market segment have increased significantly. In view of this, the HKMA considers that it would be prudent and justified for AIs to adopt a more conservative loan-to-value (LTV) ratio for this segment of the property market. We are aware that some institutions have already tightened their LTV ratios for more expensive properties. With immediate effect therefore, AIs are required to reduce the maximum LTV ratio for properties with a value of HK$20 million or more to 60%.

Properties with a value below $20 million will continue to be subject to a maximum loan to value ratio of 70%. However, to avoid the anomaly that the maximum amount which the purchaser of a property with a value of just below $20 million could borrow would be higher than that for a property at $20 million[1], the 70% LTV ratio for properties valued below $20 million should be subject to a cap of $12 million.

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[1] For example the purchaser of a property valued at $19 million could borrow $13.3 million ($19 million x 70%), while the purchaser of a property valued at $21 million would only be able to borrow $12.6 million ($21 million x 60%).

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Although the 60% LTV ratio referred to in this letter will apply with immediate effect, to avoid causing hardship to borrowers who have already signed a provisional sales and purchase agreement on or before 23 October 2009, a transitional period of one month from that date is allowed for these borrowers to apply for a mortgage based on the existing 70% LTV ratio.

With regard to residential mortgage lending generally, AIs should, as always, adopt sound lending practices by giving adequate consideration to the borrower's repayment ability, and ensuring that the debt servicing ratio (DSR) and property valuation are computed prudently.

When computing the borrower's DSR, AIs should assess carefully the potential impact on the borrower's repayment ability if the current unusually low interest rates were to return to a more normal level. AIs should maintain proper records of such impact assessment to facilitate monitoring by their internal audit and the HKMA in its onsite examinations.

The HKMA has recently completed a round of thematic examinations on AIs asset quality, covering residential mortgages. We will be writing to institutions separately setting out our findings and relevant best practices that should be followed by AIs. The HKMA intends to conduct another round of onsite examinations in the near future to check compliance with the requirements set out in this letter and ensure that AIs have put in place appropriate measures to follow the best practices identified in the thematic examinations.

Yours faithfully,