HONG KONG MONETARY AUTHORITY
香港金融管理局

Our Ref.: B4/1C

14 September 2012

The Chief Executive
All Authorized Institutions

Dear Sir/Madam,

Prudential Measures for Property Mortgage Loans

The Hong Kong Monetary Authority (HKMA) notices that there have been renewed signs of heating up in the property market recently, with property prices reaching record high. The changes in the external environment in the past week also heightened the risk of a property price bubble in Hong Kong. This could in turn translate into significant systemic risks for our banking sector.

The HKMA is particularly concerned that borrowers with multiple outstanding mortgage loans may pose higher risks to authorized institutions (AIs). Experience has shown that these borrowers would be more adversely affected during a property market downturn, leading to a higher probability of default.

Separately, the HKMA notices that the average tenor for new mortgage loans has increased steadily to the current 25 years from 22 years in 2009. While most AIs are offering mortgage loan tenor of 30 years or below, there are some AIs which have extended the maximum loan tenor to 40 years. In this regard, long loan tenor not only increases the risk to AIs, but also weakens the ability of borrowers to withstand interest rate risk. In particular, when mortgage rate increases, borrowers with longer loan tenor will have less room to alleviate their monthly repayment burden by extending their loan tenor.

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In view of the above, the HKMA considers it necessary to introduce the following macroprudential measures to further strengthen the risk management of AIs' mortgage lending business.

New measures related to borrowers with multiple properties under mortgage

For property mortgage loan applicants, including those applying for cash out refinancing loans, who have already borrowed or guaranteed outstanding property mortgage loans for one or more properties at the time of a mortgage loan application:

(I) Lower the debt servicing ratio (DSR) limit from 50% to 40%; and the maximum stressed DSR limit from 60% to 50%;

(II) Lower the LTV limit to 30% for property mortgage loans assessed based on the net worth of mortgage applicants.

(III) Lower the applicable loan-to-value ratio (LTV) limits by another 10 percentage points for property mortgage loans to mortgage applicants whose income is derived mainly from outside Hong Kong; and

In order to minimise the impact of the above new measures on genuine users, exemption will be granted to those satisfying the relevant criteria. Details of the measures and exemption arrangements are specified in Annexes 1, 2 and 3.

New measures related to maximum loan tenor

For all property mortgage loan applicants,

(IV) Limit the maximum loan tenor to 30 years for all property mortgage loans

The above four measures take immediate effect. To avoid causing hardship to mortgage applicants who have signed provisional sales and purchase agreements on or before the date of this letter, AIs may assess mortgage loan applications of these applicants based on their existing underwriting criteria.

The HKMA will assess AIs' compliance with the guidance in this letter through its routine on-site examinations and off-site reviews. The HKMA will also continue to closely monitor the development of the property and mortgage markets and, where necessary, introduce additional prudential measures to strengthen the risk management of AIs and safeguard the stability of the banking system.

If your institution has any questions about this letter, please approach your usual contacts at the HKMA.

Yours faithfully,

Encl.

Annex 1

Prudential Measures for Property Mortgage Loans introduced on 14 Sept 2012

1. The following new measures (I), (II) and (III) are applicable to residential and non-residential property mortgage loan applicants, including those applying for cash-out refinancing loans, who have borrowed or guaranteed outstanding property mortgage loans for one or more properties at the time of a property mortgage loan application.

For the avoidance of doubt,

(i) mortgage loan applicants include borrowers and guarantors;

(ii) the new measures (I), (II) and (III) are not applicable to mortgage loan applicants applying for refinancing loans with no cash-out; and

(iii) in cases where more than one of the measures (I), (II), and (III) are applicable, AIs should adopt the lowest loan amount as dictated by the relevant measures.

(I) Lower the maximum debt servicing ratio (DSR) limit from 50% to 40%; and the maximum stressed DSR[1] limit from 60% to 50%

To avoid causing hardship, mortgage applicants will not be subject to the DSR limits reduction if they have borrowed or guaranteed outstanding mortgage loans for only **one** property at the time of their property mortgage loan application, **and** the new property mortgage loan is for:

(i) financing the purchase of a new property as a replacement of an existing mortgaged property, and the outstanding mortgage loans of the existing property will be repaid in full within 6 months upon the drawdown of the mortgage loan for the new property;

(ii) financing the purchase of a new self-use property[2]; or

(iii) cash-out refinancing loans secured by the existing mortgaged property.

AIs should have in place a robust mechanism to verify the eligibility of

[1] Assuming an interest rate rise of at least 2 percentage points as set out in the HKMA's circular letter of 13 August 2010.

[2] "Self-use" refers to occupancy by owners or their immediate family members (i.e. parents, spouse, children and siblings), or by the majority shareholder or his / her immediate family members if the property is held through a shell company.

mortgage applicants to the above exemption. In this connection, AIs are required to adopt the following practices:

(a) For mortgage applicants seeking exemption on the ground of purchasing a new property to replace the existing mortgaged property:

- If mortgage applicants have already entered into agreement (e.g. a provisional sales and purchase agreement) to sell their existing mortgaged property, AIs should obtain the relevant documents for evidence.

- If mortgage applicants intend to buy a new property before selling their existing mortgaged property, AIs should require applicants to sign an undertaking committing to sell the existing property and to repay the outstanding mortgage loans of the existing property in full within 6 months upon the drawdown of the mortgage loan for the new property.

  If mortgage applicants fail to sell their existing property within 6 months, AIs should pursue appropriate arrangements with the applicants for bringing the new property mortgage loan in line with new applicable regulatory limits within a reasonable period. AIs should **clearly** and **explicitly explain** such consequence to the applicants before granting the mortgage loan. AIs should also maintain proper audit trails confirming that the consequence has been fully explained to the applicants.

(b) For mortgage applicants seeking exemption on the ground of using the new mortgaged property for self-use, AIs should obtain a formal declaration from the applicants. AIs are expected to observe all the relevant requirements, including to remind the applicants of the possible legal consequences of making a false declaration and to take any false declaration seriously, specified in our circular of 13 August 2010.

(II) Lower the maximum LTV limit for property mortgage loans assessed based on the net worth of mortgage applicants to 30%, irrespective of the value of the properties

In view of the difficulties in verifying mortgage applicants' net worth regularly, it is considered prudent to lower the maximum LTV limit to this group of mortgage applicants who have borrowed or guaranteed outstanding property mortgage loans for one or more properties.

This requirement, as well as requirements (III)(a) to (III)(d) below, expect AIs to apply a maximum LTV limit of 50% or below under different circumstances. In cases where more than one of the requirements are applicable, AIs should

apply the lowest LTV cap dictated by the relevant requirements.

(III) Lower the applicable loan-to-value ratio (LTV) limits by another 10 percentage points for property mortgage loans to mortgage applicants whose income is derived mainly from outside Hong Kong

For self-use residential property mortgage loans

(a) Lower the maximum LTV limit to 30% for properties with a value of HK$10 million or above

(b) Lower the maximum LTV limit to 40% for properties with a value of HK$7 million or above but below HK$10 million, subject to a maximum loan amount of HK$3 million

AIs are required to limit the LTV cap to 40% for residential properties with a value at or above HK$7 million but below HK$10 million. However, to avoid the anomaly that the maximum amount a purchaser of a property with a value of slightly below HK$10 million could borrow would be higher than that for a property valued at HK$10 million[3], the maximum loan amount for properties with a value of HK$7 million or above but below HK$10 million should be subject to a cap of HK$3 million.

(c) Lower the maximum LTV limit to 50% for properties with a value below HK$7 million, subject to a maximum loan amount of HK$2.8 million

In other words, only properties with a value at or below HK$5.6 million are eligible for a maximum LTV limit of 50%, and the maximum mortgage loan amount for residential properties with a value between HK$5.6 million and HK$7 million is HK$2.8 million.

For other property mortgage loans

(d) Lower the maximum LTV limit to 30% irrespective of the value of the properties

However, mortgage applicants who can demonstrate that they have a close connection with Hong Kong will not be subject to the reduction of maximum LTV limits specified in items (III)(a) to (III)(d) above[4].

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[3] Had there not been a cap of HK$3 million, a purchaser of a property valued at HK$9 million would have been able to borrow HK$3.6 million (HK$9 million x 40%), whereas a purchaser of a property valued at HK$10 million would only have been able to borrow HK$3 million (HK$10 million x 30%).

[4] According to the HKMA's circular letter of 10 June 2011, a mortgage applicant can be regarded as

2. The following new measure is applicable to all property mortgage loan applications.

(IV) Limit the maximum loan tenor of all property mortgage loans to 30 years

The HKMA notices that the average tenor for new mortgage loans has increased steadily to the current 25 years from 22 years in 2009. Long loan tenor not only increases the risk of AIs, but also weakens the ability of borrowers to withstand interest rate risk. The HKMA therefore considers it prudent for AIs to limit the maximum tenor of all property mortgage loans to 30 years.

3. Requirements (I) to (IV) are summarised in **Annex 2**.

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having a close connection with Hong Kong under the following circumstances:

(i) Mortgage applicants are on secondment by local employers to work outside Hong Kong with documentary proof provided by the employers; or

(ii) Mortgage applicants' immediate family members (i.e. parents, spouse, and descendants) are residing in Hong Kong.

Annex 2

Prudential Measures for Property Mortgage Loans introduced on 14 September 2012

(I) Applicable to all property mortgage loans: Limit maximum loan tenor to 30 years

(II) Applicable to property mortgage loans to applicants who have borrowed or guaranteed outstanding property mortgage loans for one or more properties at the time of a mortgage loan application. Detailed guidance on the exemption arrangements for the new measures is at Annex 3.

Types of properties	Value of properties	Loan-to-value (LTV) ratio cap		Debt servicing ratio (DSR) cap	
		Applicants' income mainly derived in HK	Applicants' income mainly derived from outside HK*	Base cap	Stressed cap
			[current cap in bracket]	[current cap in bracket]	
DSR based lending					
Self-use residential properties	≥ HK$10 mn	50%	**30% [40%]**	**40% [50%]**	**50% [60%]**
	≥ HK$7 mn but < HK$10 mn	60% (subject to loan cap of $5 mn)	**40% [50%]** (subject to loan cap of **HK$3 mn [HK$4mn]**)		
	< HK$7 mn	70% (subject to loan cap of $4.2 mn)	**50% [60%]** (subject to loan cap of **HK$2.8 mn [HK$3.5mn]**)		
Non-self-use residential properties	Regardless of value	50%	**30% [40%]**		
Commercial and industrial properties	Regardless of value	50%	**30% [40%]**		
Net worth based lending					
All residential, commercial and industrial properties	Regardless of value	**30% [40%]**	N/A	N/A	N/A

* Mortgage applicants who can demonstrate that they have a close connection with Hong Kong (e.g. applicants who are seconded by local employers to work outside HK with documentary proof provided by the employers or applicants who have immediate family members (i.e. parents, spouse, and descendants) residing in Hong Kong will not be subject to the reduction in LTV caps.

Annex 3

Summary of exemption arrangements for the new measures introduced on 14 September 2012 on property mortgage loans to applicants who have borrowed or guaranteed outstanding property mortgage loans for one or more properties at the time of a mortgage loan application

Number of mortgage property with outstanding mortgage loans at the time of new mortgage loan application	**Application**
One	Applicable to all property mortgage loan applications **except** applications for: • Refinancing loans on the existing mortgaged property with no cash out; • Cash-out refinancing loans secured by the existing mortgaged property; • Property mortgage loan to finance the purchase of a new property as a replacement of the existing mortgaged property, and the outstanding mortgage loans of the existing property will be repaid in full within 6 months upon the drawdown of the mortgage loan for the new property; or • Property mortgage loan to finance the purchase of a new property **for self-use**[1].
Two or more	Applicable to all property mortgage loan applications **except** applications for: • Refinancing loans on the existing mortgaged properties with no cash out.

[1] "Self-use" refers to occupancy by owners or their immediate family members (i.e. parents, spouse, children and siblings), or by the majority shareholder or his / her immediate family members if the property is held through a shell company.