

## **Norman T L Chan: New round of countercyclical prudential measures for property mortgage lending**

Address by Mr Norman T L Chan, Chief Executive of the Hong Kong Monetary Authority, to the media, Hong Kong, 14 September 2012.

\* \* \*

1. I am going to announce a new round of countercyclical prudential measures for property mortgage lending.

2. Since the introduction of the fourth round of tightening measures for property mortgage loans by the Hong Kong Monetary Authority (HKMA) in June 2011, the local property market quieted down somewhat – but for just about seven months. The property market began to heat up again in February 2012, with significant increase both in transaction volume and prices. Cumulative growth in property prices was as much as 13% compared with the beginning of this year.

3. The evolution of the property market cycle in Hong Kong is affected by many factors, including the external environment. With the third round of quantitative easing announced by the US Federal Reserve last night, there can be more capital inflows through the US banking system into the emerging markets. Moreover, Europe has earned some respite from its debt crisis following the announcement by the European Central Bank of its bond-buying programme and related judgment by Germany's Constitutional Court. So the sentiment in financial markets is likely to stay calmer for a while. Against this background, the risk brought by the continued heating up of the Hong Kong property market on the banking sector will rise again. To enhance risk management of banks, the HKMA has just issued a set of guidelines to banks, requiring them to tighten the underwriting criteria for mortgages where borrowers already have one or more properties under mortgage.

4. Under these new measures, when handling new applications for mortgage loans for residential, industrial or commercial properties from borrowers who already have one or more properties under mortgage, banks must adopt the following three requirements:

First: for mortgage loans assessed based on the debt servicing ability of a mortgage applicant, the maximum debt servicing ratio (DSR) shall be lowered from the current 50% by 10 percentage points to 40%. Accordingly, the maximum stressed DSR shall also be lowered correspondingly from the current 60% by 10 percentage points to 50%.

However, an applicant with just one property with outstanding mortgage loan will not be affected by this new measure if the new mortgage loan is for self-occupied purpose, or for the replacement of an existing property.

Second: for mortgage loans assessed based on the net worth of a mortgage applicant, the maximum loan-to-value (LTV) ratio shall be lowered from the current 40% by 10 percentage points to 30%.

Third: for mortgage applicants whose principal income is derived from outside Hong Kong, the applicable maximum LTV ratio shall be lowered by 20 percentage points, instead of the current 10 percentage points.

5. Based on the experience in Hong Kong, borrowers with multiple outstanding mortgage loans have higher level of indebtedness and leverage. During property market and economic downturns, the chance of default for this group of borrowers can be significantly higher than those with only one property under mortgage. In view of this, the HKMA considers it necessary to require banks to further tighten the underwriting criteria for mortgage loans to borrowers with multiple property mortgages to reduce the risk of banks.

6. Besides, the HKMA notices a recent trend of lengthening average tenor of new mortgage loans. The average tenor for new mortgage loans now is 25 years, which is three years longer than that of 22 years in 2009. Some banks have extended the maximum tenor to even 40 years. Prolonged loan tenors will not only increase credit risk of banks, but may also weaken the ability of borrowers to withstand interest rate risk. In particular, when mortgage rates return to more normal levels, borrowers with a loan that already stretches to 30 or even 40 years simply cannot seek to reduce their monthly instalment payment burden by extending the tenor, and may therefore face financial difficulty. Therefore the HKMA has now required banks to set the ceiling for the maximum loan tenor for all new mortgage loans to not more than 30 years.

7. The above measures take effect immediately. However, loan applications in respect of property transactions with provisional sale and purchase agreements signed today or earlier will not be affected.

8. Mr Arthur Yuen, our Deputy Chief Executive, will explain the details of these measures later.

9. When introducing measures to tighten the underwriting criteria for mortgage loans, the HKMA has always strived to strike a balance to minimise the impact on end-users, particularly first-time homebuyers. Although we have already introduced five rounds of prudential measures on mortgage lending, we have sought to ensure that purchasers of residential properties at a value of HK\$6 million or below for self-occupied purpose would still be eligible for a maximum LTV ratio of 70%. In addition, purchasers who meet the eligibility requirements will be able to apply for mortgage loans of up to 90% LTV ratio under the mortgage insurance arrangements. According to figures provided by the Hong Kong Mortgage Corporation Limited, the value of properties involving mortgage loans with a 90% LTV ratio averages at around HK\$3.2 million. Therefore, I believe that the measures of the HKMA will have minimal impact on first-time homebuyers.

10. Changes in the property market cycle are affected by a host of internal and external factors, including land supply, interest rate movements, changes in household income as well as economic and financial market developments in Europe and the US. In view of the highly uncertain internal and external environments, the HKMA will continue to monitor the market situation closely and introduce appropriate measures in response to changes in the property market cycle to safeguard banking stability.