



HONG KONG MONETARY AUTHORITY
香港金融管理局

Our Ref.: B4/1C

19 August 2010

The Chief Executive
All authorized institutions

Dear Sir/Madam,

Prudential measures for residential mortgage loans

The HKMA issued a circular to all authorized institutions (AIs) on 13 August 2010 requiring them to observe a set of prudential measures in undertaking residential mortgage lending business. These measures include:-

- (i) applying a maximum loan-to-value (LTV) ratio of 60% to properties with a value at or above HK\$12 million;
- (ii) lowering the maximum LTV ratio for properties which are not intended to be occupied by the owners to 60%; and
- (iii) standardising the limit on debt servicing ratios (DSRs) of borrowers to 50%, stress testing borrowers' debt servicing ability assuming a rise in mortgage rates of at least 2 percentage points, and limiting the stressed DSR to a cap of 60%.

We also took the opportunity to formalise our supervisory guidance communicated to banks since early this year that they should use the prime-based interest rate cap or the prevailing prime-based mortgage rate to calculate DSRs in respect of HIBOR-based mortgage loans. This is a more prudent practice given the relatively high volatility of HIBORs and the unusually low HIBOR rates at the moment.

The above measures came into effect on 13 August 2010. However, since AIs need to amend their operational procedures before they can implement the stress testing requirement under measure (iii), the stress testing requirement will come into effect on 15 September 2010. For more details of these measures, please refer to the HKMA's circular.

The above measures will obviously affect the amount of bank credit a home buyer can obtain to finance the purchase of a property. It is therefore important that your staff involved in residential mortgage lending activities fully understand these measures and are able to explain them to mortgage loan applicants.

While measures (i) and (ii) are straightforward, it may be more complicated to fully appreciate the implications of measure (iii) on a home buyer's ability to obtain bank credit. We have therefore produced a table, enclosed at the **Annex**, to illustrate the impact of measure (iii) on home buyers. As shown in the table, after the implementation of the stress-testing requirement on 15 September 2010, together with the standardisation of DSR limits to 50%, the amount of mortgage loan home buyers can borrow may have to be reduced by up to 22% depending on their levels of income and the mortgage terms that they choose.

Let's take a household with an aggregate monthly income of \$50,000 as an example. Before the introduction of the HKMA's recent prudential measures, the household would normally be regarded by AIs as high income earners and thus would be eligible for a DSR limit of 60%. The household would be able to borrow a mortgage loan of an amount up to \$7.8 million (157 times of the household's monthly income) assuming that the mortgage rate is prime minus 3% (i.e. 2.25%) and the tenor of the mortgage loan that the household chooses is 30 years. After the standardisation of the DSR limits to 50% on 13 August 2010, the household will only be able to borrow up to \$6.5 million (131 times of its monthly income), or a reduction of 16.7%. When the stress-testing requirement comes into effect on 15 September 2010, the maximum amount that the household can borrow will be further reduced to \$6.1 million, equivalent to a reduction of 22% compared with the situation before the HKMA's recent prudential measures were introduced.

Your institution should ensure that your staff understand the HKMA's recent prudential measures and are able to explain them to mortgage loan applicants. In cases where your institution provides a financial calculator or similar facility on your website to help customers estimate the amount of mortgage loan they may borrow, the facility should be updated to reflect the HKMA's latest requirements. Before this is done, the use of the facility should be suspended.

Should you have any questions about this letter, please approach your usual contacts at the HKMA.

Yours faithfully,

Nelson Man
Executive Director (Banking Supervision)

Encl.

Annex

Standardisation of DSR limits to 50% and stress testing borrowers' repayment ability

Mortgage rate assumed: Prime - 3% (i.e. 2.25%)

Level of household income	(A) Before introduction of the new requirements				(B) After introduction of the new requirements (<u>excluding</u> stress testing)				(C) After introduction of the new requirements (<u>including</u> stress testing)			
	DSR limits	Max. amount of mortgage Loan (times of household income)			DSR limits	Max. amount of mortgage loan (times of household income)			DSR limits	Max. amount of mortgage loan (times of household income)		
		20 years	25 years	30 years		20 years	25 years	30 years		20 years	25 years	30 years
Ordinary households	50%	96.6	114.6	130.8	50%	96.6	114.6	130.8	50% (stressed 60%)	96.6	110.8*	122.0
					(% change vs scenario A)	(0%)	(0%)	(0%)	(% change vs scenario A)	(0%)	(-3.3%)	(-6.7%)
High income households	60%	115.9	137.6	157.0	50%	96.6	114.6	130.8	50% (stressed 60%)	96.6	110.8*	122.0
					(% change vs scenario A)	(-16.7%)	(-16.7%)	(-16.7%)	(% change vs scenario A)	(-16.7%)	(-19.5%)	(-22.3%)

* Assuming there is no scope for the home buyer to extend the loan tenor to reduce the mortgage payment so as to bring the stressed DSR back within 60%.