

For information

Legislative Council Panel on Financial Affairs

Sale of Civil Servant Downpayment/Housing Loans to Hong Kong Mortgage Corporation Limited ('HKMC')

PURPOSE

This paper informs Members of the arrangements in connection with a proposed sale of the downpayment/housing loans granted to civil servants under the existing housing benefits schemes.

BACKGROUND

2. At present, the Financial Secretary Incorporated (the 'FSI') on behalf of the Government, offers downpayment/housing loans to civil servants under the Home Financing Scheme ('HFS'), the Home Purchase Scheme ('HPS') and the Housing Loan Scheme ('HLS') (together referred to as the 'Schemes'). The loans offered under the Schemes (the 'loans') are mostly loans with first/second legal charge or first/second equitable mortgage in favour of the FSI.

3. As at 31 March 2003, there are about 12 400 loans under the Schemes with a total outstanding loan balance of some \$5.2 billion. Most of the properties involved are domestic properties located in Hong Kong with legal charges or equitable mortgages, except 62 cases involving overseas properties¹ and 78 cases drawn down under the HPS and HLS before 1 October 1990 involving local properties without legal charges or equitable mortgages. The total amount of outstanding loans covered by these 140 cases is about \$110 million.

4. The governing provisions of the terms and conditions of the Schemes are contained in the relevant Civil Service Regulations or Civil

¹ Under the terms of the HLS, an officer who is within 10 years of his statutory age of retirement or aged 45 or above may apply for a loan to purchase a property either within or outside Hong Kong.

Service Bureau ('CSB') Circulars/Circular Memoranda. A summary of the key terms and conditions of the Schemes concerning the loans is at **Annex A**.

5. The interest rate for the loans is set in accordance with the 'no-gain, no-loss' (NGNL) principle whereby the Government will neither seek to make a profit out of the loans nor incur a loss. Details of the mechanism for setting and revising the NGNL rate² are contained in the paper 'Review of the Concessionary Interest Rates for Certain Government Loan Schemes' dated 14 May 2001 issued to the Panel on Financial Affairs of the Legislative Council and attached at **Annex B**. Based on the established NGNL rate revision mechanism, the NGNL rate will be revised downwards from 3% to 2.826% with effect from 1 June 2003 if the average of the best lending rates of the note-issuing banks remains at 5% per annum at 31 May 2003.

6. As part of the asset disposal programme announced in the context of the Budget for 2003-04, we plan to dispose of the loans to bring in one-off capital revenue of about \$5 billion.

SALE TO HKMC

7. We plan to sell the loans to the HKMC because most of these loans involved properties already mortgaged to other authorized institutions under the Banking Ordinance. These institutions are subject to the regulatory limit of not lending more than 70% of the value of the property to the owner without mortgage insurance. It would not be feasible to structure the tender to cater for this limitation on the one hand and to maximize the proceeds to the Government on the other. Selling these loans to the HKMC will avoid this dilemma altogether.

² Since 1 April 1999, the NGNL interest rate has been set at a fixed percentage ("X") below the average of the best lending rates (BLRs) of the note-issuing banks. At the time of implementing the formula in 1999 and a subsequent review in 2001, the value of "X" was set and maintained at 2%, based on the average differential between the BLR and the 12-month Hong Kong Dollar Inter-Bank Offered Rates (HIBOR) over the past 10-year period at the time of review. Based on the result of a recent biennial review using the up-to-date interest rates data, the "X" factor will be revised from 2% to 2.174%.

MINIMISED IMPACT ON CIVIL SERVANTS

8. A key objective of the Government in this sale is to minimize the impact, if any, on the borrowers of the loans. We agreed with the HKMC that this sale would take the form of an equitable assignment of the loans and mortgages by way of a declaration of trust. Under this form of sale, the Government will pass only the beneficial interests in the relevant loans and mortgages to the HKMC with the Government retaining all the legal interests in the loans and mortgages on trust for the HKMC. This form of sale will enable the Government to retain the legal and statutory rights to continue to exercise all the rules and regulations of the Schemes and to continue to make deductions from the salaries and pension benefits payable to the borrowers under the loan documents and the pension legislation. The key terms and conditions of the loans under the Schemes could then be preserved. Particularly, the HKMC agreed to adhere to the existing mechanism for setting and revising the NGNL rate for the loans after the sale.

KEY TERMS OF THIS SALE

9. The key terms and conditions of this sale are summarised below –

- (a) Scope of loans : Subject mortgages must originate under the to be sold HFS, HPS or HLS and be secured by residential properties in Hong Kong with legal charges or equitable mortgages.
- (b) Selling price : At par (i.e. at the same amount of the outstanding balance of the loans sold)
- (c) Loan interest : At NGNL rate rate
- (d) Repayment : The Government would remit to the HKMC from borrowers on a monthly basis the repayments from borrowers.

- (e) Borrower's default : The Government would assist the HKMC in the recovery of any loan outstanding by continuing with the existing practice of deducting from the borrower any salary payable by the Government to the borrower or from the borrower's commuted pension gratuity or death gratuity. The HKMC shall be solely responsible for any other recovery actions which it may wish to institute against the defaulting borrower.

10. As a condition of this sale, without the prior written consent by the Government, the HKMC may not assign, charge or transfer any right or obligation, if any, under the loans sold to the HKMC.

POST-SALE ARRANGEMENTS

11. After the sale of the loans to the HKMC, the loans concerned will continue to be serviced/administered by the Treasury. The governing provisions of the terms and conditions of the Schemes will continue to be enforced/administered by the Civil Service Bureau/Treasury.

12. Applications for new or regrant of civil servant housing loans under the Schemes will continue to be processed and financed by the Government under the existing arrangement.

13. Subject to formal approval of sale and purchase by the two sides and satisfactory completion of all legal documentation, we expect to complete the sale of the loans by the end of May 2003.

Treasury Branch
Financial Services and the Treasury Bureau
7 May 2003

Home Financing Scheme (HFS)

Terms are set out in Civil Service Regulations (CSR) 1600-1799. Salient features of loans under the HFS which are relevant to this sale are as follows:

Development Type	A residential property as approved under the terms of the HFS.
Mortgage Terms	Second legal charge or second equitable mortgage.
Maximum Loan Amount	<ul style="list-style-type: none"> • 24 months' salary or 30% of the cost of the property, whichever is the less, or • earned maximum commuted pension gratuity.
Interest Rate	Government's "no-gain-no-loss" interest rate which is currently set at 2% below the average best lending rate of note-issuing banks.
Tenor	Maximum 10 years or until the officer's statutory age of retirement, whichever is the earlier.
Mortgage Deed	Officers can apply for a mortgage loan with first legal charge/equitable mortgage only from approved lending institution; the government will then have a second legal charge/equitable mortgage on the property.
Repayment of Loan	<ul style="list-style-type: none"> • Repayment of loan shall be effected by monthly deductions from an officer's salary through the Treasury payroll. • Eligible officers (within 10 years of his statutory age of retirement and with at least 10 years' continuous service which qualifies them for pension benefits) may apply to repay only the interest on the loan with repayment of principal to be recovered in full from his commuted pension gratuity or death gratuity.
Early Repayment of Loan	An officer may repay the whole or part of his outstanding loan at any time subject to any partial repayment being not less than HK\$10,000.
Amount of Loan for Second Property	The amount of downpayment loan for the second property will be subject to the terms of the HFS.

Home Purchase Scheme (HPS)

Terms are set out in the prevailing Civil Service Bureau Circulars. Salient features of loans under the HPS which are relevant to this sale are as follows:

Development Type	A residential property as approved under the terms of the HPS.
Mortgage Terms	Second legal charge or second equitable mortgage.
Maximum Loan Amount	24 months' salary of the officer or 30% of the cost of the property, whichever is the less.
Interest Rate	Government's "no-gain-no-loss" interest rate which is currently set at 2% below the average best lending rate of note-issuing banks.
Tenor	Maximum 10 years or until the officer's statutory age of retirement, whichever is the earlier.
Mortgage Deed	Officers can apply for a mortgage loan with first legal charge/equitable mortgage only from approved lending institution; the government will have a second legal charge/equitable mortgage on the property.
Repayment of Loan	<ul style="list-style-type: none"> • Repayment of loan shall be effected by monthly deductions from an officer's salary through the Treasury payroll. • Eligible officers (within 10 years of his statutory age of retirement and with at least 10 years' continuous service which qualifies them for pension benefits) may apply to repay only the interest on the loan with repayment of principal to be recovered in full from his commuted pension gratuity or death gratuity.
Early Repayment of Loan	An officer may repay the whole or part of his outstanding loan at any time subject to any partial repayment being not less than HK\$5,000.
Amount of Loan for Second Property	The amount of downpayment loan for the second property will be subject to the terms of the HPS.

Housing Loan Scheme (HLS)

Terms are set out in the prevailing Civil Service Bureau Circulars. Salient features of loans under the HLS which are relevant to this sale are as follows:

Development Type	<ul style="list-style-type: none"> • A residential property in Hong Kong as approved under the terms of the HLS. (Note: HKMC will not buy loans involving overseas property.)
Mortgage Terms	<ul style="list-style-type: none"> • First/second legal charge; or first/second equitable mortgage.
Maximum Loan Amount	<ul style="list-style-type: none"> • The maximum commuted pension gratuity; or • The cost of the property (including stamp duty and legal costs); or • The difference between the cost of property and any mortgage loan to be secured on the property; or • The outstanding balance of any existing mortgage, whichever is the less.
Interest Rate	Government's "no-gain-no-loss" interest rate which is currently set at 2% below the average best lending rate of note-issuing banks.
Tenor	<ul style="list-style-type: none"> • 10 years for officers repaying principal together with interest; or • until statutory age of retirement for officers repayment interest only.
Mortgage Deed	A first legal charge/equitable mortgage in favour of the Financial Secretary Incorporated, except when a mortgage loan with first legal charge/equitable mortgage is obtained from approved lending institution.
Repayment of Loan	<ul style="list-style-type: none"> • Equal monthly instalments of principal and interest for a maximum period of 10 years or until the officer's statutory age of retirement, whichever is the earlier. • Monthly instalments of interest alone, with the principal to be recovered in full from the commuted pension gratuity. • Monthly repayments to be effected by monthly deductions from an officer's salary through the payroll. • Outstanding loans to be recovered from commuted pension gratuity upon retirement from the service.
Early Repayment of Loan	An officer may repay the whole or part of his outstanding loan at any time subject to any partial repayment being not less than HK\$10,000.
Amount of Loan for Second Property	The amount of loan for the second property will be subject to the terms of the HLS.

For Information

Legislative Council Panel on Financial Affairs

Review of the Concessionary Interest Rates for Certain Government Loan Schemes

Purpose

This paper reports the findings of a review of the concessionary interest rates for certain government loan schemes operated on the “no gain, no loss” principle, and in the light of this informs Members that Government proposes not to change the existing basis for determining the interest rates for such schemes.

Background

2. The interest rate for loans for civil servants granted under the Home Purchase Scheme (HPS), Housing Loan Scheme (HLS) and Home Financing Scheme (HFS) has been set on the principle that the Government should not seek to make a profit out of the loans, nor incur a loss. This “no gain, no loss” interest rate also applies to other loan schemes, including -

- (a) loans to civil servants under Civil Service Regulation 633 which requires loans to be secured against the officer’s final leave salary and either contract gratuity in respect of the leave

or commuted pension gratuity;

- (b) the Non-means-tested Loan Scheme for eligible students of Government-funded tertiary institutions and the Open University of Hong Kong, etc.;
- (c) the Comprehensive Building Safety Improvement Loan Scheme;
- (d) the Slope Improvement Loan Scheme for Private Schools; and
- (e) the bridging loan to the Employees Compensation Assistance Fund Board.

3. Prior to April 1999, the “no gain, no loss” interest rate was linked to the return on the fiscal reserves. While this approach reflected the “no gain, no loss” principle in its purest terms, it became clear that its continued implementation could cause practical difficulties in view of the fluctuation in investment return following linkage in 1998 of the return on the fiscal reserves to the return achieved by the entire Exchange Fund (EF)¹.

¹ The return on the fiscal reserves for the past two financial years has fluctuated from about 11% for 1999-2000 to about 5% for 2000-01. This has confirmed our view that it is not appropriate to link the “no gain, no loss” rate to the return on the fiscal reserves as it is not fair to ask borrowers to accept wide fluctuations in interest rates that arise from volatility in investment performance.

4. We therefore conducted a review in early 1999 and concluded that it would be more appropriate to set the interest rate by reference to the market, at a fixed percentage (“X”) below the average of the best lending rates (BLRs) of the note-issuing banks. As the BLRs incorporated a profit element for the banks, we considered it reasonable to discount the BLRs by “X” to conform with the “no gain, no loss” principle.

5. After consulting Members in February 1999², we implemented the new formula on 1 April 1999. The value for “X” was set at 2% at that time, based on the average differential between the BLRs and the interest rates for the government housing loan schemes over the ten-year period from 1989 to 1998. The average differential between the 12-month Hong Kong Dollar Inter-Bank Offered Rates (HIBOR) and BLRs between 1993 and 1998 was also close to two percentage points.

6. To strike a balance between administrative efficiency and concerns about possible frequent fluctuation in the BLR, we have adopted a review mechanism whereby the interest rate will be adjusted only if the rate calculated under the formula differs from that prevailing by one percentage point or more, or when the prevailing interest rate has remained stationary for six months.

² LC Paper No. CB(1) 816/98-99(02)

Review of the existing Formula

7. In establishing the existing formula, we undertook to conduct a review of the suitability of “X” after two years.

8. We have therefore updated the average differential between the 12-month HIBOR and BLRs, taking into account the latest ten-year period figures. The result, as indicated at **Annex**, is that the average differential is still close to 2%. Furthermore, based on the Hong Kong Monetary Authority’s projections, the differential between the 12-month HIBOR and BLR in the longer term will still be maintained at around 2%.

9. We note that since the middle of 2000, the market mortgage rates have been easing. Before that, mortgage loans were mostly granted at BLR plus. At present, according to the Hong Kong Monetary Authority’s Residential Mortgage Survey Results, about 75% of new loans are granted at mortgage rates set at BLR minus 2% or slightly more. The decline in the mortgage rates is mainly due to keen competition for mortgage business among banks. As these mortgage rates are determined by banks on commercially competitive grounds, we do not consider it appropriate to benchmark the government “no gain, no loss” rate with them.

Conclusion

10. The available evidence does not support an adjustment to the value of “X” at this time. The “no gain, no loss” rate will therefore remain at BLR minus 2%. We will review it again in two years’ time. Meanwhile, under this formula and the review mechanism, the “no gain, no loss” rate will be reduced from 6.5% to 5.5% with effect from 1 June 2001 to reflect the two most recent reductions in BLR (assuming that BLR will not be changed further between now and end May). The formula will continue to reflect any future changes in the BLR.

Consultation

11. We have informed the four central staff consultative councils of the result of our review. The Senior Civil Service Council (SCSC) does not agree with the Administration’s decision and considers that the Government’s interest rate charged on housing loans should not be higher than the prevailing market mortgage rates. We have carefully considered this view. In view of the fact that the market mortgage rates are determined by banks commercially on competitive grounds which is very different from our principle of not seeking a profit or incurring a loss in government loans to civil servants, we maintain that the current level of “X” is appropriate. We expect that the financial pressure on the staff concerned will be lessened considerably following the forthcoming reduction of the “no gain, no loss” rate as described in para. 10 above.

12. Both SCSC and the Model Scale 1 Staff Consultative Council have requested the Administration to adjust the Government's "no gain, no loss" interest rate whenever there is a change in BLR. We have reviewed the present arrangements and would streamline them with a view to ensuring that the interest rate can be adjusted more in tandem with revisions in BLR. We shall consult the staff sides shortly on details of the proposed improvements.

Finance Bureau

Government Secretariat

14 May 2001

**Differential Between 12-month HIBOR and Best Lending Rates
from 1991 to 2000
(Period Average Figures)**

During	12-Month HIBOR (A)	Best Lending Rate (B)	Differential (B) - (A)
1991	6.96	9.41	2.45
1992	4.63	7.33	2.70
1993	4.03	6.50	2.47
1994	5.64	7.26	1.62
1995	6.64	8.95	2.31
1996	5.88	8.52	2.64
1997	7.47	8.83	1.36
1998	9.31	9.94	0.63
1999	6.88	8.49	1.61
2000	6.63	9.22	2.59
Average	6.41	8.45	2.04
	6.41	8.45	2.04