

Mortgage Refinance **Last Resort**

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[04September2003 issue Investors are willing to lend to Hong Kong's distressed mortgage holders ---at a price](#)

If ever there was a dead property market, surely it must be Hong Kong's. The market seems comatose with prices as much as 70% off 1997 highs and tens of thousands of owners of residential properties unable to repay their mortgages.

But Leland Sun, chief executive officer of Pan Asian Mortgage Company, sees the market as ripe with opportunity. He reckons that there are as many as 120,000 homeowners with negative equity, or mortgage debts that exceed the current value of their properties, in need of new financing. The Hong Kong Monetary Authority set the figure at about 106,000 as of the end of June, up from roughly 83,000 at the end of March. The sharp rise was blamed - like so many other economic woes of the moment - on Severe Acute Respiratory Syndrome. It is "not surprising since it reflects the downward shift in property prices which was aggravated by the Sars outbreak," says David Carse, deputy chief executive of the HKMA.

Sun, a former banker with Golden Sachs, figures the number is actually higher than indicated by the HKMA survey results released on August 14 because of what he describes as less-than-vigorous pressure on banks to fully disclose the number of negative-equity homeowners. Although most Hong Kongers have floating-rate mortgages, many negative-equity homeowners are still paying an above-market interest margin. So Sun tries to offer these customers lower refinance rates (*see chart*).

RATE CARD

Rates for current refinance loan-to-value bands:

100% to 110%	3.250%
111% to 120%	3.625%
121% to 130%	4.000%
131% to 135%	4.250%
136% to 140%	4.500%

Note: Assuming Prime Rate = 5% Plus an up-front Programme Participation Fee of 2.98% of the loan amount

Negative-equity holders in a depressed market may not seem particularly attractive as clients for refinancing loans, particularly when the housing market has yet to hit rock bottom. Worse, in the first seven months of 2003 a total of 17,186 bankruptcy orders have been passed, which puts Hong Kong on track to exceed last year's record 25,328 bankruptcies. So far this year the number of bankruptcies filed has been roughly 20 times that in 1998, during the Asian financial crisis. And the seasonally adjusted unemployment rate jumped to 8.7% in the three months from May-July from 8.6% in April to June, an uptick that

makes for yet another all-time record.

But the delinquency ratio of negative-equity residential mortgage loans in Pan Asian's portfolio is, at 0.2%, well below the industry average of 2.28%. And Pan Asian is aggressively looking for more business. In June, the company upped the loan limit it set for individual borrowers to HK\$12 million (\$1.54 million) from HK\$8 million. Why gamble by offering debtors even more money? Sun figures that most of these homeowners basically have nowhere to go. The speculative investors who bought into Hong Kong's property bubble, for the most part, cut their losses around the millennium. Now Sun estimates that about 95% of the negative-equity households are owner-occupied. "They're more likely to pay off their house payments, than their credit cards," says Sun. "It's not like the United States where people who live in New Jersey can pick up and move to Montana. There's no viable Montana option here. Hong Kongers want to stay in Hong Kong." So if you can't run, you might as well pay up. For the moment, Pan Asian doesn't have much competition because local banking guidelines allow banks to refinance only up to 100% of a mortgage loan---whereas a private financier can offer up to 140% of the original mortgage loan, which leaves a small window for nimble-footed players like Sun.

Pan Asian teamed up with Asia Commercial Bank, Citic Ka Wah Bank and Wing Hang Bank---which have approved HK\$2.5 billion worth of mortgage-refinancing deals in the year to May. These partner banks offer newly refinanced mortgage to a borrower and then sell it into a trust, which issues two certificates: The banks hold the senior debt and Pan Asian the junior debt. But even the latter has an investment-grade rating from Standard and Poor's. "We basically take the first-loss position so our returns are commensurate to the risks we take," says Sun, who adds that Pan Asian's position is yielding a rate similar to a second mortgage. He's the first to admit, with a ready smile, that it's a risky business. "We think we have the right financial structure...the patent for the business, if you will," says Sun, with an East Coast American accent. "I've taken some know-how or technology from the U.S. and applied it to a local Asian market situation."



Source by Leland Sun, Chairman of Pan Asian Mortgage Company Ltd.

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