

Fixed-rate second mortgages on the table

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[Banks are increasingly offering these loans because they are secured by the HKMC, but there are more efficient alternatives](#)

Banks are introducing fixed-rate second mortgages in the market. This has nothing to do with Hong Kong Monetary Authority relaxing its guidelines and permitting banks to offer top-up second mortgages over the 70 per cent loan-to-value limit. Second mortgages have been a useful financing product available from most property developers to entice potential buyers of their flats. Now, second mortgages are being offered in the primary and secondary market by the Hong Kong Mortgage Corp (HKMC), a 100 per cent owned government company.

There is nothing new about the short-maturity fixed-rate second mortgage. Many banks have offered fixed-rate first mortgages with maturities of one to three years. The primary difference is that this second mortgage is being offered by the HKMC through selective banks. The banks retain no additional credit or interest rate risk because the HKMC is funding the entire second mortgage at the time of origin. From the borrowers' viewpoint, second mortgages may have been useful when there was no alternative. But in today's highly developed financial market, there are cheaper, more efficient and consumer friendly alternatives (one-stop shopping mortgage plans) offered by non-bank financial institutions which reduce transaction and financing costs and streamline the process for the borrower (see table).

FIRST AND SECOND MORTGAGE FINANCING

- Apply for two separate mortgage loans
- Sign two sets of loan agreements, mortgage deeds, guarantees (if any)
- Pay additional transaction costs (such as legal and registration)
- Keep track of two mortgage loans and remit two monthly mortgage payments
- Pay additional costs at the time of sale of property to release two mortgages rather than one

ONE-STOP FIRST MORTGAGE PLAN

- Apply for one mortgage loan
- Sign one set of loan agreements, mortgage deeds, guarantee (if any)
- Remit one monthly repayment
- Pay lower up-front and back-end transaction costs

Borrowers also have the option to select mortgage insurance from various providers, which is again more simple and efficient for the borrower than two mortgages.

So, why the recent spate of fixed-rate second mortgages? One explanation could be the more stringent underwriting standards associated with mortgage insurance because the risk is being reinsured by third parties.

With a directly funded second mortgage, the lender is able to modify the underwriting and eligibility criteria more easily. For pricing, the second mortgage has typically been priced higher than a first mortgage because of the inferior credit position of the first loan. For example, if a first mortgage is offered at prime minus 2.5 per cent, the corresponding second mortgage could be priced from prime flat to prime plus 1.75 per cent. Therefore, as with all mortgage financing products, borrowers should determine the estimated actual holding period of their properties.

With fixed-rate second mortgages, the initial fixed rate may look attractive, but after the fixed-rate period expires the floating-rate interest and higher up-front transaction costs may be less attractive. I always tell potential homebuyers that they should explore as many mortgage financing plans as possible and then consult with qualified professionals before deciding which type of mortgage to take – it is all in the pricing.



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