The Effect of the Latest Amendments to the Housing Loan Corporation Law on the Residential Mortgage Business in Japan

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The latest amendments to the Housing Loan Corporation Law, which govern the introduction by the Housing Loan Corporation of a new type of residential mortgage, were passed on 4 June 2003. Under the new scheme, the Corporation will purchase mortgages from private-sector financial institutions and repackage them as securities.[1] As a result, the residential mortgage business in Japan is likely to undergo major changes.

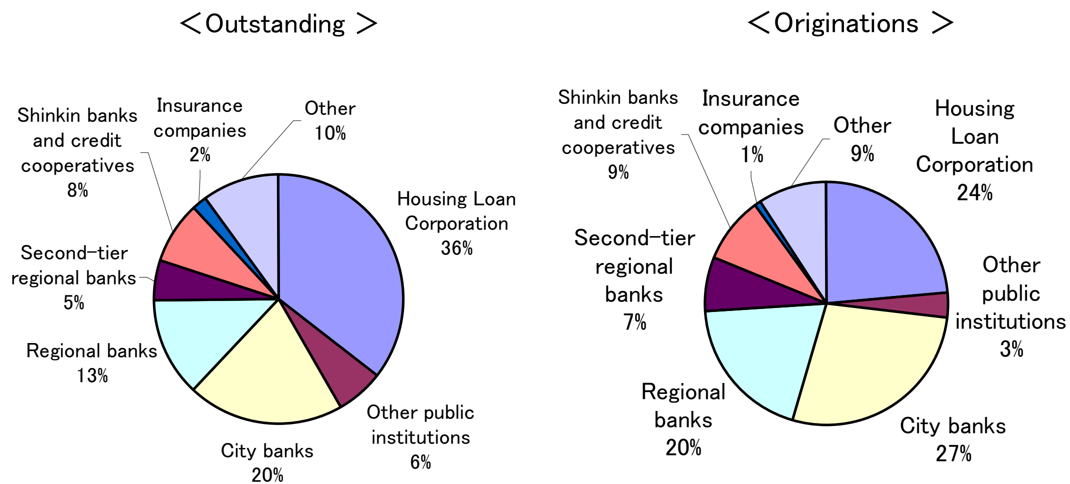
1. From Holding as Loans to Securitizing

Figure 1 shows each type of financial institution's share of the Japanese mortgage market as of the end of fiscal 2001. In terms of outstanding mortgages, roughly 40% is financed by public institutions—in particular, the Housing Loan Corporation ("the Corporation")—while the remaining 60% is provided by private-sector institutions. In terms of new mortgages, roughly 30% is originated by the public sector, and, while the share of the public sector has declined, the Corporation has been the source of some 30%-40% of residential mortgages over the past 10 years.

The Japanese system of financing residential mortgages, the aim of which has been to enable low- and middle-income families to buy their own homes, has been based on the provision by the Corporation of long-term, fixed-rate, low-cost mortgages that the private sector would have found virtually impossible to provide, and this is reflected in the Corporation's large share of the market.

[1] The recent legislation allows the Corporation to provide guarantees for RMBS backed by private-sector conventional mortgages, and the Corporation is planning to do this starting in fiscal 2004. This report, however, focuses on purchase-type mortgages. Another report will deal with guaranteed mortgages.

Figure 1 Japanese Residential Mortgage Lenders



Note: The figure for outstanding mortgages is as of end-March 2002; the figure for new mortgages is for fiscal 2001.
Source: NRI, from Annual Report, Housing Loan Corporation.

Figure 2 shows the outstanding balance of residential mortgages originated by different types of private-sector financial institution compared with the balance originated by them on behalf of the Corporation. The outstanding mortgage originated on behalf of the Corporation by regional and second-tier regional banks is clearly on a par with the outstanding balance on their own account—something that may reflect differences in the cost of housing in urban and rural areas.

Figure 2 Outstanding Balance of Residential Mortgages Originated by Private-Sector Financial Institutions

(￥100 mil)

		FY97	FY98	FY99	FY01	FY02
City banks	Own account	324,028	335,920	352,375	360,837	373,725
	Corporation agents	211,080	201,636	216,619	229,686	228,755
	Corporation agents/own account	65.1%	60.0%	61.5%	63.7%	61.2%
Regional banks	Own account	162,980	176,464	199,135	218,517	238,992
	Corporation agents	264,689	261,382	267,709	272,027	258,289
	Corporation agents/own account	162.4%	148.1%	134.4%	124.5%	108.1%
Second-tier regional banks	Own account	82,960	88,933	92,254	91,010	97,251
	Corporation agents	86,706	98,522	99,098	96,530	90,460
	Corporation agents/own account	104.5%	110.8%	107.4%	106.1%	93.0%
Shinkin banks	Own account	110,277	115,469	121,253	123,501	127,139
	Corporation agents	86,645	85,138	86,193	85,156	78,878
	Corporation agents/own account	78.6%	73.7%	71.1%	69.0%	62.0%
Credit cooperatives	Own account	14,063	14,817	15,669	15,749	16,018
	Corporation agents	10,325	10,042	10,033	9,721	8,627
	Corporation agents/own account	73.4%	67.8%	64.0%	61.7%	53.9%

Regional banks + Second-tier regional banks (FY02): Own account 336,243; Corporation agents 348,749

Source: NRI, from Annual Report, Housing Loan Corporation.

Because the commission that financial institutions could have earned as agents for the Corporation has been derisorily low,[2] much of the mortgage balance originated as agents of the Corporation can be said to have been the result of passive rather than active acquisition.

In recent years there has been criticism of the overgrown public sector and increasing calls to reduce subsidies to public-sector financial institutions, and, as a result, it was decided that the Corporation should be closed by fiscal 2006 as part of the program of reforming public corporations. The Corporation's business and its outstanding loans will be transferred to a new independent administrative entity (IAE), and its mortgage origination business will be gradually downsized, starting in fiscal 2002, with interest rate subsidies becoming the exception rather than the rule. In other words, the aim is to gradually reduce the Corporation's share of the mortgage market.

At the same time, however, opinion polls show that popular demand for long-term, fixed-rate, low-cost mortgages is unabated. There is therefore a continuing need for a system that can maintain a steady supply of such mortgages.

A new system will replace the existing system, where the Corporation lends directly to borrowers, with one where finance will come from the market and borrowers will continue to be able to obtain long-term, fixed-rate, low-cost mortgages.

What will happen is that the Corporation or IAE replacing the Corporation will purchase residential mortgages from the private sector, repackage them as securities and sell them to investors (see Figure 3). By (1) pooling mortgages on a large scale, thereby reducing their risk, and (2) securitizing them, thereby increasing their liquidity, it is hoped that the risk will be spread more effectively among market participants and that borrowers will be able to obtain long-term, fixed-rate mortgages more easily from individual financial institutions.

Another new development will be the launch of "the Corporation guarantee system" for private-sector-originated RMBS," in which the private sector will play a more proactive role, in fiscal 2004. Under this scheme, the Corporation will insure the mortgage-backed securities issued by private-sector institutions against credit risk as well as guarantee timely payment of principal and interest.

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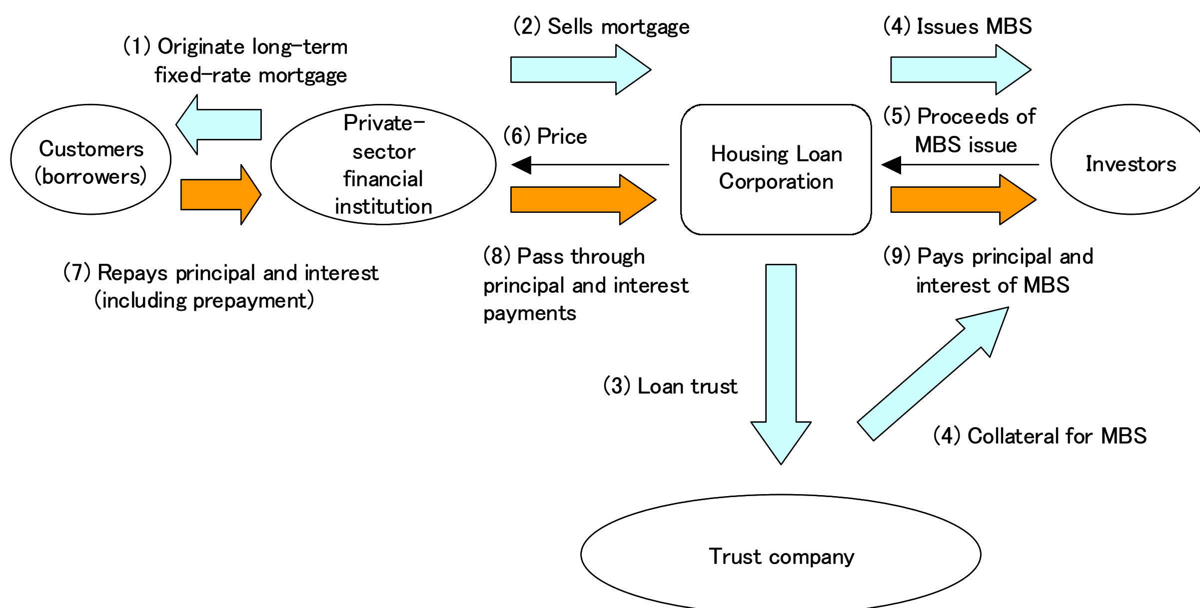
2 A simplistic calculation of the commission paid to financial institutions by the Corporation (based on the commission paid and loans outstanding in its financial statements) suggests that the rate of this commission is only 0.05%-0.07%, although the actual rate is more complicated and depends on the particular service provided.

Figure 3 Schematic Diagram of Corporation Purchase-Type Mortgages



Source: Housing Loan Corporation.

Figure 4 US Holders of Residential Mortgages

($ bil)

Holders		%	Investment in mortgage-backed	%	Mortgages + mortgage-backed securities	%
Public-sector mortgage-backed securities	2,830	46%				
Private-sector mortgage-backed securities	631	10%				
Fannie Mae	170	3%	535	15%	705	11%
Freddie Mac	63	1%	432	12%	494	8%
Commercial banks	1,109	18%	614	18%	1,722	28%
Savings & loan institutions	685	11%	197	6%	882	14%
Credit unions	141	2%	1,685	49%	2,390	39%
Finance companies	276	4%				
Other	289	5%				
Total	6,194	100%	3,462	100%	6,194	100%

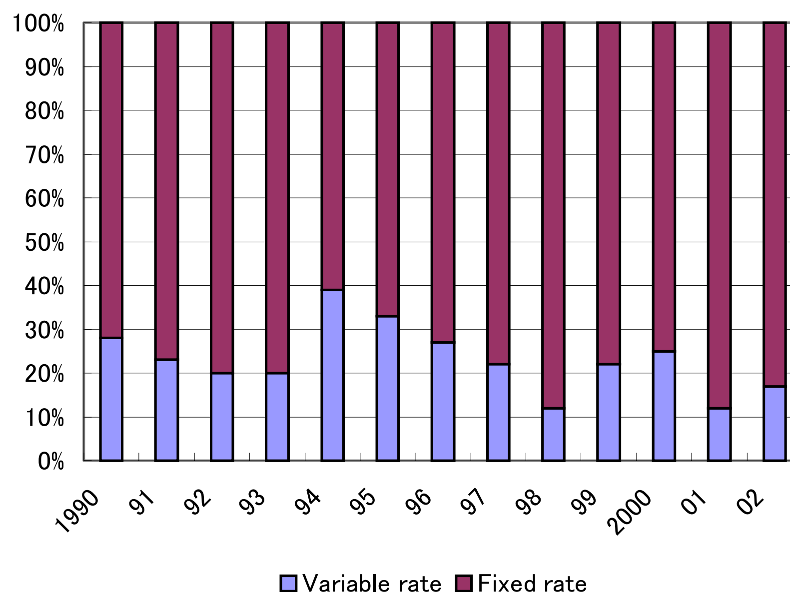
Note: As of end-2001.
Source: NRI, from Fannie Mae, "A Statistical Summary of Housing and Mortgage Finance Activities."

The new system is modeled on the US system of financing residential mortgages. Figure 4 shows the main holders of residential mortgages in the United States. More than 50% of US mortgages are financed by the market in the form of mortgage-backed securities: 46% issued by the public sector, 10% by the private sector. In other words, in the United States, public-sector mortgage-backed securities account for almost the same share of the residential mortgage market as loans from the

Corporation do in Japan. Originally, residential mortgages in the United States were also indirectly financed by public and semi-public institutions by purchasing them from the private sector. As the fiscal burden increased during the 1970s and 1980s, however, increasing use was made of securitization, and this took off in the late 1980s when the tax system was reformed and a secondary market established.

Figure 5 shows the proportion of fixed-rate and variable-rate mortgages in the United States. Although the proportion varies according to the level of interest rates, long-term, fixed-rate mortgages can be seen to account for at least 70% on average. The existence of an active secondary market in residential mortgages and mortgage-backed securities has ensured a steady supply of long-term, fixed-rate mortgages. The establishment of such a market in Japan should therefore give consumers access to a more abundant supply of long-term, fixed-rate mortgages than was possible when the Corporation was the sole source of such finance.

Figure 5 Proportion of New Variable-Rate and Fixed-Rate Mortgages in the United States



Note: Mortgages for 1-4 family
Source: HUD Survey of Mortgage Lending Activity, Mortgage Bankers Association of America, Federal Home Finance Board.

Figure 6 shows the amount of residential mortgages and mortgage-backed securities outstanding in the United States and Japan. In the United States, the level of outstanding mortgage-backed securities is comparable to that of Treasuries. Although the amount of residential mortgages outstanding in Japan is only a quarter of that in the United States, the amount that is securitized would increase to about a quarter of that of Japanese government bonds or double that of straight corporate bonds outstanding if the proportion that is securitized were to increase to the same level

(50%-plus) as in the United States. Such a development could have a major impact on the structure of the Japanese bond market.

Figure 6 Comparison of Mortgage-Backed Security Markets in Japan and the United States

(¥tril)

	United States (A)	Japan (B)	(A)/(B) (multiple)
Outstanding mortgages	755	185	4.08
Outstanding mortgage-backed securities	437	1	–
Outstanding Treasuries	441	461	0.96

Note: As of end-December 2001.
Source: NRI, from Bank of Japan Financial Markets Department, Takuto Ninomiya (et al.), "Beikoku MBS Shijo no Genjo to Wagakuni e no Impurikeshon" [The MBS Market in the United States and Its Implications for Japan], Market Review, August 2002.

2. What Would the New System of SecuritizingResidential Mortgages Mean for Financial Institutions in Japan?

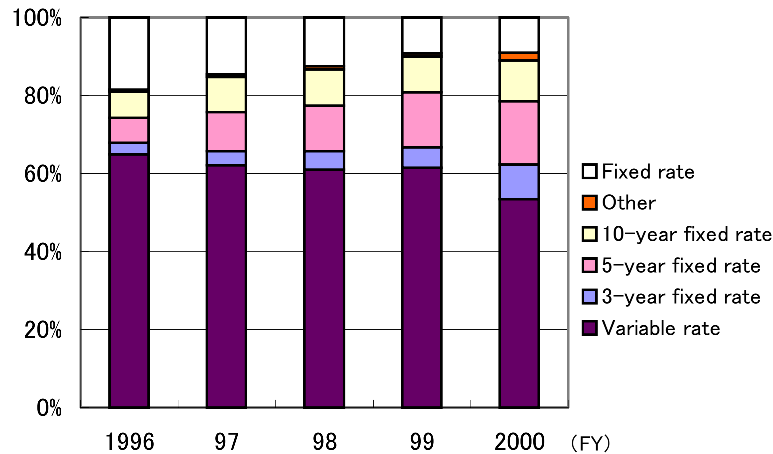
1) The supply of long-term, fixed-rate, low-cost mortgages

The new scheme would enable Japanese financial institutions to offer long-term, fixed-rate, low-cost mortgage products where interest-rate and prepayment risk once made this difficult.

The recent development of financial derivatives markets in Japan, which is essential to anyone seeking to hedge interest-rate risk (e.g., by means of swaps), has enabled private-sector institutions to offer a wide range of fixed-rate products. Nevertheless, it is still difficult to find means of hedging interest rate risk for more than 15 years. Therefore "fixed-rate" generally refers only to the first 3-10 years of a product's life (see Figure 7).

Some of these short-term fixed-rate products can naturally offer rates that are lower than the Corporation's basic offered rate, and consumers choose such products only because the short-term interest costs are less. However, the fact that most residential mortgages are repaid over a period of 30 years or more means that some consumers could find themselves unable to cope if the fixed-rate repayment period ended at a time when interest rates were rising. In other words, the fact that these private-sector products are not "long-term and fixed-rate" in the true sense means that they represent a growing credit risk.

Figure 7 Breakdown of Different Types of Interest Rate for Private-Sector Outstanding Mortgages



Source: NRI, from Annual Report, Housing Loan Corporation.

Securitization transfers the interest-rate risk to the market, while pooling on a large scale reduces credit risk and liquidity risk.

2) A steady source of fee income

As we saw above, financial institutions used to receive only a very small fee from the Corporation for acting as its agents. With the Corporation's new type of mortgage ("the Corporation purchase-type mortgage"), however, they will be able to charge a more commensurate servicing fee. As this fee will be included in the rate of interest quoted to customers, financial institutions will be able to decide the level of the fee by adjusting the lending rate they ultimately charge. Said to be about 0.5% in the United States, this fee could provide an important boost to the income of Japanese financial institutions. It would also appear that this level of fee would not increase the burden on current mortgage-lenders (see Appendix).

As financial institutions will be selling their residential mortgages, they will be able to enjoy a steady source of fee income without having to increase their asset risk. Furthermore, whereas in the past the fact that they could not invest in residential mortgages issued by the Corporation meant that they themselves could not profit from any interest-rate spread (i.e., obtain a return on their exposure to interest rate risk), they will now be able to do this by purchasing residential mortgage-backed securities. This will give them far greater liquidity and far less credit risk than if they originate the mortgages by themselves .

3) Considerable advantages for local areas and regional financial institutions

Some of the bigger Japanese banks are now actually able to offer long-term, fixed-rate mortgages at more favorable rates than the Corporation[3] and to do their own securitization. However, such institutions need to have either a large portfolio of residential mortgages diversified in terms of both locality and duration or sophisticated derivatives departments. In contrast, regional financial institutions, whose customers tend to be concentrated in particular areas, and smaller financial institutions, which may have only a relatively small portfolio of mortgages, will face difficulties not only with asset and liability management issues such as interest-rate and prepayment risk but also with credit risk and liquidity risk.

Figure 8 Number of Branches Offering Corporation Mortgages as Agents

(as of 31 March 2002)

Branches responsible for agencies	City banks	Long-term credit banks	Trust banks	Regional banks	Second-tier regional banks	Shinkin banks	Credit cooperatives	Labor banks	Norinchukin Bank, Shinkin Central Bank, Shoko Chukin Bank, Chuo Labor Bank	JA Bank (incl. agricultural cooperatives)	JF Marine Bank (incl. fishermen's cooperatives)	Public Housing Loan Corporations	Subtotal
Hokkaido	0	0	0	120	234	484	23	34	0	9	10	0	914
Tohoku	0	0	0	871	403	275	49	51	0	6	8	0	1,663
Northern Kanto	0	0	0	596	297	432	142	45	0	12	1	0	1,525
Tokyo	1,609	8	279	196	272	1,173	127	140	4	4	1	3	3,816
Southern Kanto	0	0	0	972	281	1,008	153	27	0	13	4	0	2,458
Nagoya	134	0	0	441	456	888	28	45	0	5	2	0	1,999
Hokuriku	0	0	0	351	149	307	11	33	0	3	3	0	857
Osaka	475	0	0	767	376	725	73	33	0	12	7	0	2,468
Chugoku	0	0	0	522	278	307	92	56	0	10	4	0	1,269
Shikoku	0	0	0	410	270	172	10	30	0	4	4	0	900
Fukuoka	0	0	0	639	262	127	13	80	0	5	4	0	1,130
Southern Kyushu	0	0	0	274	211	207	30	0	0	4	3	0	729
Subtotal	2,218	8	279	6,159	3,489	6,105	751	574	4	87	51	3	19,728

Source: NRI, from Annual Report, Housing Loan Corporation.

Figure 8 shows the number of branches of each type of financial institution and in each region offering Corporation mortgages. It is quite clear that outside the three largest cities (Tokyo, Osaka and Nagoya) regional financial institutions are far and away the main outlets for such mortgages.[4] Similarly, it is clear that the system of long-term, fixed-rate, low-cost mortgages offered by the Corporation which has dominated Japan's residential mortgage market has depended on the outlets provided by (mainly regional) financial institutions and on the Corporation's ability to pool this regional concentration of risk.

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3 MTFG, for example, is offering a 30-year fixed-rate mortgage for a limited period (until 30 December 2003) at a lower rate (1.9% for the first 10 years and 3.4% thereafter) than the Corporation's basic offered rate for the entire duration of the mortgage.

4 The agency business done by the provincial branches of the city banks, long-term credit banks and trust banks on behalf of the Corporation is counted as business done by their regional head offices. However, most of these institutions' provincial branches are located only in the bigger cities.

As can be seen from Figure 2, Japan's regional financial institutions have traditionally done as much residential mortgage business on behalf of the Corporation as on their own behalf. Given the risks and costs involved, it would be nigh impossible for them to replace the business they do on behalf of the Corporation with their own mortgage products without any restriction or changing the conditions, especially for the long-term, fixed-rate, low-cost mortgages that consumers want. However, the new securitization assistance scheme allows them (subject to certain conditions) to offer just such products to all their customers—something that would otherwise have been beyond their means. Although similar to the previous arrangement with the Corporation, there is one major difference: the fact that these financial institutions are now offering their customers their own mortgage products means that they have much more scope for customization and can give their profit margins a significant boost by adjusting their servicing fee.

Also, the fact that these institutions will not actually own these residential mortgages means, as in the case of the business they used to do on behalf of the Corporation, that, no matter how small their asset bases, they will be able to expand their residential mortgage business considerably and enjoy a steady increase in their fee income without having to worry about capital adequacy requirements or their ability to raise funds (i.e., attract deposits).

4) Devising a new residential mortgage business model

Banks will not be the only beneficiaries of the new securitization assistance scheme: it will also cover insurance companies, nonbanks, finance companies and housing finance companies. The result is likely to be increased competition, and a number of nonbanks have already been reported to be planning to join forces with construction companies to offer Corporation purchase-type mortgages.[5]

Increased competition changes products to commodities, and commodities generally mean low profit margins. Financial institutions with large numbers of employees and branches will therefore find that their cost structures will often make it difficult for them to compete purely in terms of price.

However, financial institutions offer a wide range of retail services besides residential mortgages, so they should be able to generate added value by offering their mortgages in combination with other services rather than as stand-alone products.

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5 Hitachi Capital, for example, set up a joint venture with Sekisui House and Daiwa House on 14 May of this year and is planning to offer residential mortgages under the new scheme from 1 October.

Unlike the Corporation's existing residential mortgages, which were typically mass-market, low-margin, commoditized products, the new Corporation purchase-type mortgages will allow financial institutions to charge a servicing fee. Now able to set their own prices, private-sector institutions should be able to diversify their products and services.

Whatever happens, Japan's residential mortgage market is likely to undergo major changes in the next few years, and financial institutions will have to devise a new residential mortgage business model. One option would be for them to focus on maximizing the origination of mortgages and selling them immediately in order to achieve economies of scale.[6] Another would be to take such products as a base on which to build customer relationships with a view to developing more customized, value-added services such as home improvement loans, home equity loans,[7] card loans and student loans.

3. Issues Outstanding

Although Japan's system of financing residential mortgages will continue to be dominated by the Corporation (at least formally) for the time being, a more market-based model that uses the country's securities markets can be expected to take its place. By pooling and spreading the risks that have hitherto been borne almost exclusively by public- and private-sector financial institutions and selling them to a wide range of investors, capital can be used more efficiently so that consumers will be able to obtain the long-term, fixed-rate, low-cost mortgages they need. However, the existing system has a number of shortcomings which need to be dealt with.

1) Risk that beneficiary rights might be exercised

One of these is the risk that, at some point in the future, the Corporation might be reorganized as a private company (rather than an IAE) that could become bankrupt under the Corporate Rehabilitation Law and that investors in residential mortgage-backed securities would exercise their beneficiary rights. Not only the residential mortgage-backed securities currently issued by the Corporation but also any issued under the new purchasing scheme could be converted to beneficial interests in trust if the Corporation or its successor IAE was privatized.

[6] In the United States more than half of all residential mortgages are originated by mortgage bankers—subsidiaries of the main commercial banks and specializing in selling and securitizing mortgages.

[7] Loans secured on the (net asset) value of a domestic property in excess of any outstanding mortgage.

Under the Corporation's current scheme for issuing residential mortgage-backed securities, the conditions and schedule of payments on loans used as collateral can be changed by the Corporation in the case of delinquency. Because of that the loan pools are not legally off-balanced but are held in trust for the beneficiaries (i.e., the investors who buy residential mortgage-backed securities) so that the Corporation can partly replace the loan pools in order to protect investors profits.

At the same time, however, there is the risk that, if at some stage in the future the Corporation was privatized (in spite of the fact that no such plans exist at the moment), it could, in theory, become bankrupt.[8] If that happened, the trust assets would automatically be treated as off-balance-sheet assets and the securities would be converted to beneficiary interests in trust in order to protect the rights of the investors.[9]

However, these beneficiary rights would not be regarded as securities under the Securities and Exchange Law. Instead, they would be designated monetary claims, and any transfer of ownership would have to be approved by the beneficiaries and the date of transfer attested by a notary —restrictions which would drastically reduce their liquidity. In addition, the conversion of the securities to beneficiary interests would oblige the financial institutions concerned to change their risk weighting in order to comply with capital adequacy requirements. Indeed, the former problem has led to calls for changes to be made to the enforcement ordinances of the Securities and Exchange Law so that the beneficiary interests could be treated as "quasi-securities" and for a settlement system for such interests .

2) Need for a secondary market

The second problem is the limited liquidity of residential mortgage-backed securities in Japan. Although efforts have been made to remedy this (e.g., by amending the implementation ordinances of the Corporate Bond Registration Law), certain aspects of settlement and taxation still restrict liquidity and will have to be addressed sooner or later.

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8 Japanese government corporations are not subject to the Corporate Rehabilitation Law, while under the Bankruptcy Law and the Reorganization Law any collateral they pledge is subject to the right of exclusion and any right to it can be exercised without having to follow the normal procedure. Even if the Corporation were closed and became an independent administrative entity, it would still not be subject to the Corporate Rehabilitation Law. However, if it were ever privatized, there is a risk that the organization might be subject to the Corporate Rehabilitation Law and that, if it became insolvent, the right to exercise individual claims on any collateral might be lost.

9 For further details, see the product description for mortgage-backed securities at http://www.jyukou.go.jp/support/index.html.

Japan's secondary markets for super-long-term bonds (i.e., bonds with a maturity of 15-30 years) and residential mortgage-backed securities are still in their infancy and lack depth. One solution would be to segment the cash flows from residential mortgage pools as collateralized mortgage obligations (CMOs) with different features and maturities (ranging from short- to super-long-term) that would attract new investors. One of the main reasons for the rapid growth of the residential mortgage-backed securities market in the late 1980s was apparently the adoption of tax measures that made it easier for mortgage lenders to issue collateralized mortgage obligations.[10]

Other measures that would help would be the development of TBA transactions,[11] which are now popular in the United States, as well as of securities lending and repo transactions, as this would enable investors either to take short positions or hedge existing long positions. Similarly, the Corporation could itself invest in residential mortgage-backed securities to improve liquidity in the same way as government-sponsored entities (such as Fannie Mae and Freddie Mac) do in the United States. However, care would have to be taken not to distort the market.

3) "Pipeline" risk

The third problem is the risk posed by the fact that there is a lag of about two months between the time when the interest rate on a residential mortgage is fixed and the time when that on the corresponding security is fixed. Since the Corporation purchases residential mortgages at face value, this means that the financial institutions involved have to bear the interest rate risk (so-called "pipeline risk") during this period. The fact that Japanese interest rates are at an all-time low means that there is a particular need for a means of hedging the rise in interest rates that can be expected. Although purchasing residential mortgages at market would help to reduce this risk, setting up a market for residential mortgage-backed securities in Japan with the same flexibility to go short as with TBA transactions in the United States or to do a wide range of other transactions should make it easier to hedge this risk

[10] In the case of collateralized mortgage obligations, the fact that cash flows were being managed within a trust meant that the trust itself became subject to tax, thereby making it difficult to deal with the mortgage pools off the balance sheet. As a result, "real estate mortgage investment conduits" (REMICs) were introduced in 1986 to ensure that no tax was payable even when cash flows were managed.

[11] In TBA transactions the actual underlying pools which have to be delivered are not specified at the time of the transaction. Instead, only some basic terms such as the issuer, initial maturity, and coupon are agreed along with the nominal value, price and settlement date. This arrangement permits a certain degree of flexibility (e.g., of ±0.01% per $1 million in the difference between the total nominal amount of the transaction to be delivered and the actual amount on delivery). TBA transactions take into account some of the idiosyncrasies of residential mortgage-backed securities in the United States (e.g., the fact that cash flows vary slightly from issue to issue, the fact that repayment of principal produces an odd principal, and the fact that nominal amounts are small).

4. Conclusion

Since 2001 the Corporation has made it a priority to securitize its loan portfolio. As of June 2003 the Corporation had carried out 11 issues of residential mortgage-backed securities worth a total of ¥950 billion. Given the trend towards market value accounting, institutions with super-long-term liabilities such as pension funds and insurance companies will find themselves obliged to buy large amounts of super-long-term investment products in order to balance their assets and liabilities. Recently there has been an increase in demand for residential-mortgage backed securities—partly as a result of their inclusion in the Nomura-BPI, a benchmark for institutional bond investors.

The debate about whether to set up a new market has been dogged by the chicken-and-egg question about which comes first: demand or market liquidity. In the present situation, where there is latent demand from both investors and lenders (and ultimately from the consumers who want to take out a mortgage), the market should develop rapidly provided the flow of capital is unobstructed.

Whether or not the Corporation will be able to gradually reduce the direct mortgage lending which Japan's financial institutions have criticized for many years will depend on the extent to which they are able to satisfy Japanese consumers' demand for long-term, fixed-rate, low-cost mortgages with market-based rather than traditional mortgages.

<Appendix> Procedure for determining interest rates for Corporation purchase-type mortgages

Let us now consider how exactly the interest rates on Corporation purchase-type mortgages would be determined. In order to be eligible for purchase by the Corporation, mortgages have to be long-term loans secured on new properties and satisfy certain criteria (Exhibit 9). The rate that consumers end up paying consists of three components: (A) the rate paid to those who invest in the residential mortgage-backed securities, which itself depends on the market rate; (B) the Corporation's own administration fee (a flat rate of 0.9%); and (C) the servicing fee charged by the private-sector financial institutions (Exhibit 10). Although financial institutions will be able to decide their servicing fee by themselves, competition is likely to mean that these fees will converge. In the United States, for example, government agencies and government-sponsored entities charge roughly 0.5% for servicing mortgage-backed securities.

Although some believe that the Corporation purchase-type mortgages will be uncompetitive because charging an administrative fee of 0.9% on top of the market interest rate for current marketed residential mortgage-backed securities will make them more expensive than the Corporation's current basic offered (10-year) rate, the fact that Corporation purchase-type mortgages will not involve paying the kind of premium currently required for a guarantee by the Housing Loan Guarantee Corporation (i.e., this will be included in the Corporation's administrative fee) means that financial institutions will be able to charge a correspondingly higher rate.

The actual guarantee premium depends on the purpose of the loan, but it is likely to be about 0.3% a year for a 10-year mortgage and about 0.16% for a 30-year one. Assuming a basic mortgage rate of 2.0%, the fact that there will be no guarantee premium means that financial institutions should be able to offer a rate of about 2.3%. Assuming that financial institutions charge a servicing fee of about 0.5% on top of the current marketed RMBS rate and 0.9% of the Corporation's administrative fee, they should be able to offer Corporation purchase-type mortgages at a rate of about 2.3%.

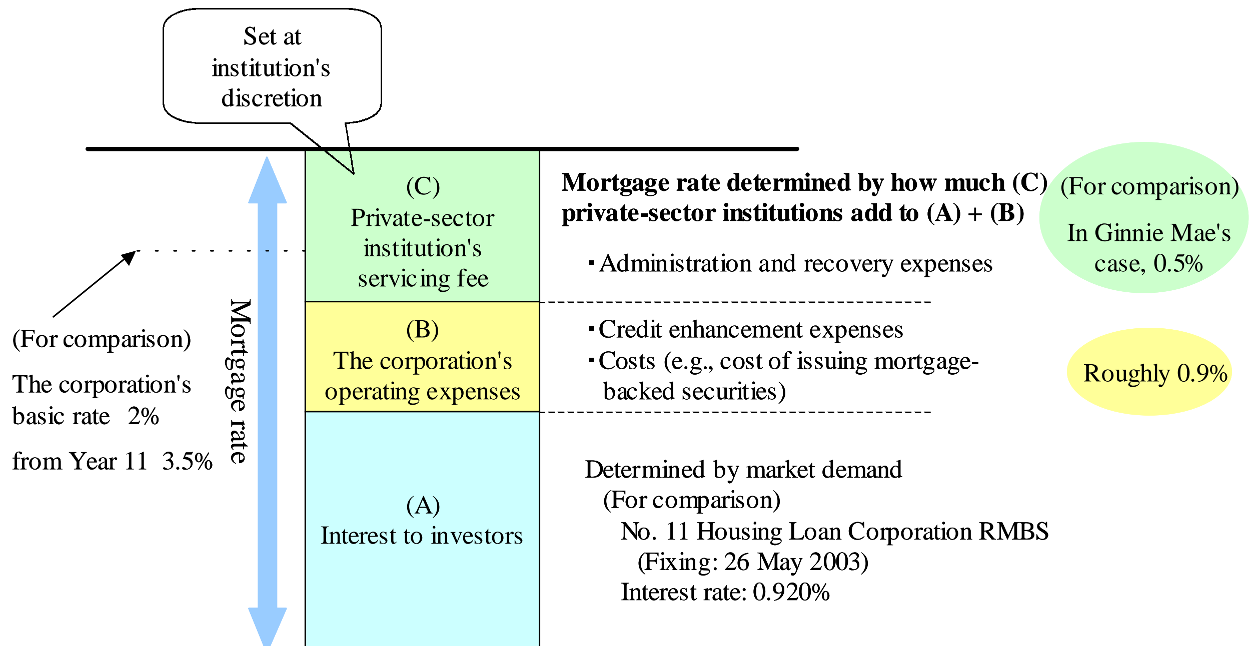
Moreover, the Corporation's current mortgages are subject to a higher rate of 3.5% after the first 10 years. In contrast, the fact that Corporation purchase-type mortgages will use securitizations means that institutions will be able to charge a fixed rate that is more than 2.0% but less than 3.5% for the entire period of the mortgage. Given the current market rate for residential mortgage-backed securities, this means that institutions should actually be able to charge a servicing fee of more than 0.5%.

Figure 9 Main Conditions of Corporation Purchase-Type Mortgages

① The loan must be for the construction or purchase of a new home
② The recipient of the loan must live in the home he builds or purchases with the loan
③ The home must comply with the Building Standards Act and offer a certain degree of durability
④ The cost of construction or purchase of one housing unit must not exceed ¥100 million
⑤ The maximum amount of the loan must not exceed 80% of the cost of construction or purchase or ¥50 million, whichever is less
⑥ The loan must be a long-term, fixed-rate mortgage
- The repayment period must be 20-35 years
- The interest rate must be fixed for the entire period

Source: Housing Loan Corporation.

Figure 10 Schematic Diagram of Interest Rate Structure of Corporation Purchase-Type Mortgages



Source: NRI, from Housing Loan Corporation data at 11st July, 2003.