

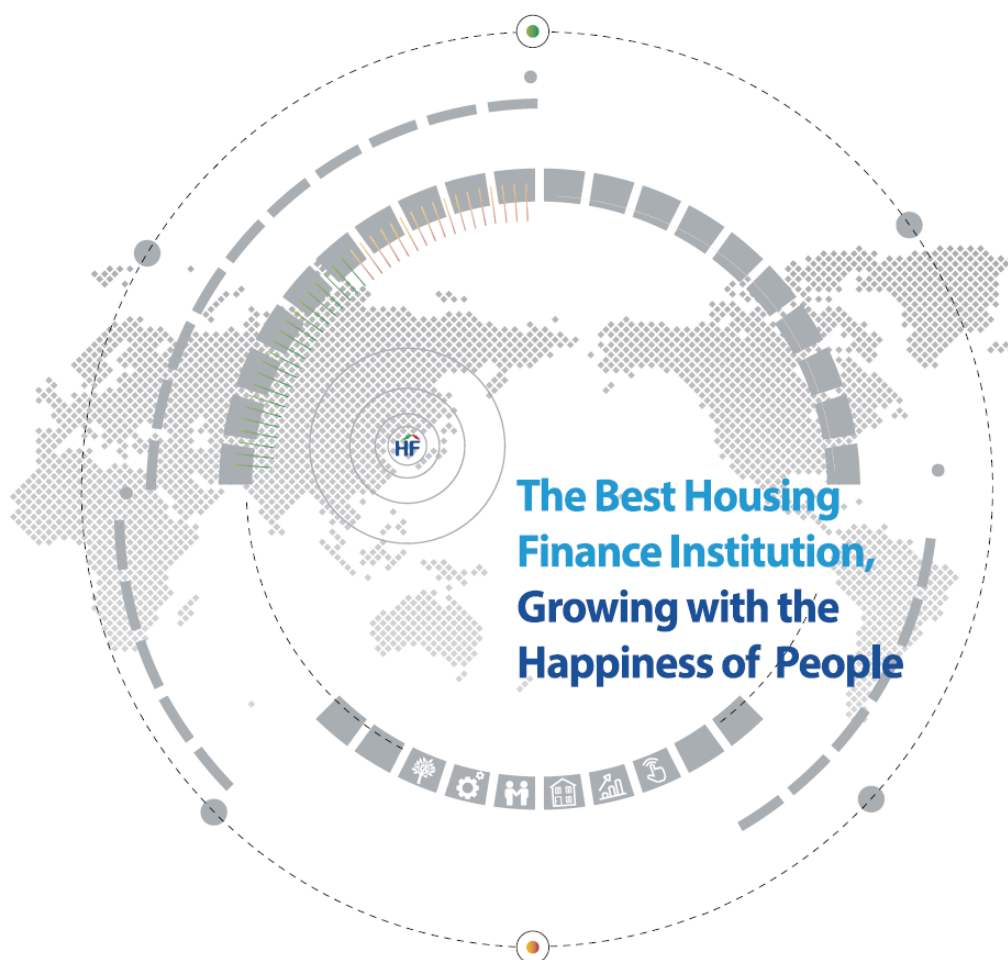


KOREA HOUSING FINANCE CORPORATION

Korea Housing Finance Corporation (KHFC)

Social Financing Framework

February 2019



Contribute to enhancing the welfare of people and national economic development through long-term and stable supply of housing finance

1. Introduction and Background

1.1 Korea Housing Finance Corporation (KHFC)

KHFC was established in March 2004 as a quasi-sovereign entity pursuant to the Korea Housing Finance Corporation Act No. 7030, 31 December 2003, as amended (the “KHFC Act”) with a mandate to support the Korean government’s housing welfare policy. KHFC provides long-term fixed rate amortized mortgage loans, housing finance credit guarantees and reverse mortgage guarantees to deliver on its mission ***to enhance the welfare of people and national economic development through long-term and stable supply of housing finance***. Since 2004 up to 2018-end, KHFC has assisted more than 2 million households to purchase their residential property by extending over KRW250 trillion of mortgage loans through its diverse mortgage products.

1.2 Korean Government’s Housing Welfare Policy

Providing affordable quality housing for its people is a national priority for the Korean government. Home ownership in Korea was approximately 61.6%¹ as of December 2017, in comparison to 65.5%² in Australia, 67.8%³ in Canada, 63.7%⁴ in the US and 63.4%⁴ in the UK, while the housing supply ratio has reached 101.2%⁵ since 2009, indicating a structural imbalance in the Korean housing market.

The government is committed to ensuring the adequate supply of housing, stabilizing housing prices by curtailing speculation, and providing people with practical solutions to

¹ Source: Statistics Korea as of Dec 2017

² Source: Australia Bureau of Statistics

³ Source: Statistics Canada

⁴ Source: Statista

⁵ Source: Statistics Korea

finance their residential housing needs. Enhancing housing welfare of low-income households and the underprivileged population has been a major focus in recent housing policy, and the Korean government has launched the Housing Welfare Road Map in November 2017, a targeted policy aimed at specific ages and income levels, in order to enhance the housing welfare of vulnerable households by supplying public rental units, providing concessional loans and implementing tax benefits for home purchases.

With the rapid growth of the Korean mortgage market, total outstanding mortgage loans have reached KRW752 trillion as of November 2018⁶. Presently, the mortgage market is dominated by adjustable-rate mortgage loans with bullet payments that require a lump-sum payment for the entire loan at maturity. The Korean government recognized that these mortgage loans could increase default risk of households, and especially low to moderate income households could be most impacted in their ability to repay the debt. With a commitment to develop a healthy and sustainable housing finance market, it launched a 3-year-roadmap to improve the housing loan structure, in February 2014, which saw an increase in the ratio of fixed rate mortgage loans to floating rate mortgage loans from 16% in 2013 to 44.3% in September 2018 and the ratio of amortizing mortgage loans to bullet mortgage loans from 18.7% in 2013 to 51.3% in September 2018⁷.

1.3 KHFC's Efforts in Addressing Challenges in the Korea Housing Finance Market

As a quasi-sovereign entity dedicated to the implementation of Korean Government's housing welfare policy, KHFC has been actively addressing these challenges through developing and purchasing KHFC mortgage loans, securitizing KHFC mortgage loans, and managing the Housing Finance Credit Guarantee Fund (HFCGF). The HFCGF is the source of (a) credit guarantees to financial institutions engaged in providing housing loans to

⁶ Source: The Bank of Korea

⁷ <https://www.fsc.go.kr/downManager?bbsid=BBS1000&no=89249>. For information in English, please refer to this news article - <http://koreajoongangdaily.joins.com/news/article/article.aspx?aid=3047032>

moderate and low income home owners or tenants and construction loans to small-sized home builders and (b) credit guarantees to financial institutions engaged in lending reverse mortgage loans to senior citizens.

KHFC's mortgage loans are long-term (up to 30 years) fixed rate amortizing products, designed to reduce the repayment burden for low to moderate income households for their home purchase and stabilize and improve the structure of the mortgage loan market. Low income borrowers that satisfy certain criteria may be eligible for discounts from the standard interest rates with such discount subsidized by the government. Borrowers can also enjoy less onerous regulatory requirements, such as a higher loan to value (LTV) ratio and debt to income (DTI) ratio. In 2018, KHFC disbursed KRW23.3 trillion of mortgage loans, assisting 184,307 households to become homeowners. On average, borrowers of KHFC Bogeumjari loans earned approximately KRW47 million annually, and have purchased property valued at approximately KRW286 million. 90% of the properties were smaller than 85m², which is the benchmark size for the Korean Government's housing policy. For Conforming Loans disbursed in 2018, the average house price was approximately KRW267 million, which is still lower than the average property price in Korea.

The KHFC Act enables KHFC to issue two types of mortgage-backed bonds:

1. Covered Bonds
2. Mortgage-Backed Securities (MBS)

Through its active securitization activities, KHFC aims to stabilize the Korean mortgage market by purchasing mortgage loans from other Korean financial institutions. Securitization provides KHFC with the primary funding source for the ongoing purchase of KHFC mortgage loans and provides Korean financial institutions originating other mortgage loans with a means to improve their liquidity position.

KHFC also provides a number of **housing finance credit guarantee programs and reverse mortgage programs**, specifically designed for target population of the government's housing welfare policy.

1.4 KHFC's Leadership in Supporting Sustainability

As a quasi-sovereign entity with a strong social mandate, KHFC recognizes the importance of sustainable management through its business activities, and has established "securing sustainable future growth engine" as its new strategic goal. KHFC has established the framework for sustainable growth, and has signed on to the UN Global Compact⁸ in 2008, and has signed on to the Fair Player Club⁹, promoting transparency and anti-corruption. KHFC has also received the grand prize for presenting the plan to "expand credit for the housing support for the disadvantaged class through building open partnership" in 2016 at the Government 3.0 competition.

Integrity and ethical management is a key part of its commitment towards sustainability. KHFC achieved the highest ranking among 573 institutions in the integrity evaluation of public institutions by the Anti-Corruption & Civil Rights Commission in 2017, receiving the designation as a Grade 1 agency, marking 8 consecutive years since 2010.

In December 2018, KHFC proclaimed Declaration of Human Rights, complying with the principles of the UN Global Compact and revealing KHFC's strong willingness towards sustainability. In KHFC's Declaration of Human Rights, KHFC indicated its aim to respect/protect human dignity and value, and constantly realize/enhance social values and sustainable development via KHFC's business activities. Through Human Rights Management, KHFC will endeavor to promote a cultural environment that respects human rights not only within KHFC but also to its counterparties as well.

⁸ <https://www.unglobalcompact.org/>

⁹ http://www.fairplayerclub.kr/index_e.html

2. Social Financing Framework

Under its mission to contribute to the welfare of the Korean population and the development of the Korean economy by facilitating a stable and long-term supply of housing finance in Korea, KHFC plans to issue multiple Social Covered Bonds and Social MBS, herein referred to as Social Financing, under this Social Financing Framework (the “Framework”). Following market best practices, KHFC aspires to fully comply with the [ICMA Social Bond Principles 2018](#), with the following four core components:

- Use of Proceeds
- Process for Project Evaluation and Selection
- Management of Proceeds
- Reporting

2.1 Use of Proceeds

KHFC Social Financing net proceeds will be allocated to mortgage assets supporting **affordable housing**.

ICMA 2018 SBP Eligible Project Category	United Nations Sustainable Development Goals	Goals/ Expected Social Benefits
Affordable Housing	 “Make cities inclusive, safe, resilient and sustainable”	1) Ensure access for all to adequate, safe and affordable housing 2) Develop healthy and sustainable housing finance market and reduce repayment burden

100% of the net proceeds of the Social Financing will be used exclusively to purchase KHFC’s mortgage loans, originated by partner financial institutions, in order to facilitate the supply of housing finance on a long-term and sustainable basis. All KHFC mortgage

loans are carefully designed in terms of eligibility criteria, to ensure that each mortgage product serves the intended social objectives that are in line with the government's housing welfare policy. KHFC mortgage loans are intended to reduce the repayment burden of borrowers by offering long-term fixed rate amortized loan products, when compared with many other types of mortgage loan products available in Korea.

New products can be launched and product features of existing products can change reflecting current government policies and market situation. Detailed product descriptions and eligibility criteria can be found at the KHFC website¹⁰.

The followings are currently available KHFC mortgage loans that will be (re)financed with the proceeds of the Social Financing:

1) Bogeumjari Loan

- Introduced in 2004, as the first and only long-term fixed rate instalment mortgage loans, while the market was dominated by short-term floating rate interest only mortgage products
- Designed for moderate to low income households¹¹
- **Social objective: Enabling people to own their residential house with an affordable mortgage loan through stable debt payment**

¹⁰ https://www.hf.go.kr/ehf/sub01/sub02_01.do

¹¹ Bogeumjari loans are only eligible for borrowers who own no more than 1 property, with maximum household annual income of KRW70 million. The value of the property should not exceed KRW600million, and more restrictive LTV and DTI rules apply for properties in Speculation Zones. In case of house change, borrowers can temporarily own 2 properties. The borrower should sell their existing property within two years of taking out the mortgage loan.

2) Didimdol Loan

- Introduced in January 2014, as an integration of KHFC's Prime Rate Bogeumjari Loan, National Housing Fund's Working Class Housing Loan and the First Home Buyer Loan
- Designed for low income households who do not own a property¹²
- **Social objective: Supporting low income families with their home purchase**

3) Conforming Loan

- Introduced in March 2012 by KHFC in partnership with certain commercial banks for the purpose of further promoting the origination of long-term amortizing fixed rate mortgage products in Korea
- Designed for new borrowers or borrowers with short term, floating rate loans subject to lump-sum payments at maturity with commercial banks¹³
- **Social objective: Increasing the share of long-term fixed rate amortized mortgage loans (seen as less risky for households in a rising interest rate environment) and helping households manage their mortgage payment burden in line with the Korean Government 3 Year Plan¹⁴**
- Additional eligibility conditions may apply (e.g. maximum value of the property) reflecting the government welfare & housing policy which aims at addressing social issues

2.2 Process for Project Evaluation and Selection

In line with KHFC's mandate as stated above, all KHFC mortgage loans are designed to address a specific social agenda from the Korean government, and have clearly defined eligibility criteria in terms of borrower and the residential property.

¹² Didimdol loans are only available for families who do not own a property, with a maximum household annual income of KRW60 million. The value of the property should not exceed KRW500 million, and the property should not be larger than 85 m².

¹³ Conforming loans are available for a property whose value does not exceed KRW900 million, and the maximum loan amount is KRW 500million. Detailed product features are decided by each partner financial institutions.

¹⁴ <https://www.fsc.go.kr/downManager?bbsid=BBS1000&no=89249>

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Launching of Mortgage Loan Products

Eligibility criteria of the mortgage loan products are suggested by KHFC reflecting the government's policy and market situation, and carefully reviewed and agreed by relevant government agencies, including the **Financial Services Commission (FSC)** and **Ministry of Land, Infrastructure and Transportation (MOLIT)**. When launching a new mortgage loan product, the **KHFC Public Mortgage Department** creates detailed guidelines on eligibility, underwriting and required documentation. This is reviewed by the **KHFC Risk Management Committee** chaired by KHFC's Vice President and approved by the Managing Director of the **Securitization Business Group**.

2

Loan Disbursement

Partner financial institutions will receive the product eligibility guidelines, together with underwriting guidelines, so that each mortgage loan application can be strictly reviewed based on the guidelines. Borrowers are required to provide written proof for all eligibility criteria as part of the underwriting process, and KHFC will also pre-screen a majority of the mortgage loan applications to confirm eligibility before the mortgage loan is disbursed to the borrower. All records will be kept in the systems of both the originating partner financial institutions and KHFC. During the life of the mortgage loan, if it is found that a borrower did not meet any eligibility criteria requirements, the originating partner financial institutions will be required to buy back the mortgage loan immediately. Detailed guidelines are uploaded at the KHFC website, together with its other internal governance policies and guidelines. With an aim to increase transparency and improve efficiency, KHFC also created the *Relief Wallet app* so potential borrowers can directly check their eligibility.

Social Financing Issuance

When issuing a Social Covered Bond or Social MBS, the **Securitization Department** will only select KHFC mortgage loans to create a pool. KHFC also conducts due diligence with a **3rd party auditor** on all the mortgage loans to be purchased by the partner financial institutions in order to test compliance with the required underwriting standards.

4

The **KHFC Securitization Working Group** conducts quarterly meetings to review pre-issued MBS and covered bonds and discuss overall strategy and planning on future issuance. The working group consists of members from diverse teams, including the **Financial Management Department, Housing Finance Research Center, Public Mortgage Department** and **Securitization Department**. This group will review the issued Social Covered Bond cover pool, Social MBS pools, and KHFC's annual reports.

2.3 Management of Proceeds

The net proceeds of the Social Financing will be fully used to purchase pre-determined pools of KHFC mortgage loans from its partner financial institutions on the closing date of each Social Financing, according to the Loan Purchase Agreements between KHFC and its partner financial institutions.

If the case may be, any unallocated proceeds will be invested in cash or cash equivalents, in accordance with KHFC's usual sound and prudent liquidity management policy.

According to Article 30 of the KHFC Act, KHFC is required to (a) physically separate the purchased mortgage loans from KHFC's other asset; and (b) separately manage the mortgage loans according to a securitization plan. Hence, KHFC will manage the purchased mortgage loans in each cover pool and MBS pool separately from its other mortgage loans in a manner consistent with the requirements of the KHFC Act. The documentation relating to the purchased mortgage loans will be held separately from that of KHFC's other mortgage loans and the cash collections and any liquidation proceeds of such mortgage loans will be held in designated accounts. KHFC will not commingle any of its other funds

with those held in the accounts relating to the purchased mortgage loans. For each Social Covered Bond and each Social MBS, KHFC is required to clearly designate the assets constituting the cover pool or MBS pool, and to identify the records of the mortgage loans which are to be included in each cover pool or MBS pool and to maintain a listing of such mortgage loan.

Social Covered Bond

Under the terms and conditions of each Social Covered Bond issuance, KHFC is required to maintain a minimum amount of committed over-collateralization of eligible mortgage loans over the life of the issuance. In order to ensure that the amount of eligible mortgage loans of each cover pool is sufficient to protect the holders of the Social Covered Bonds, an Asset Coverage Test is calculated by KHFC on a monthly basis, and a 3rd party auditor will conduct an annual review of the cover pool. Each month, KHFC must determine that the adjusted aggregate balance of the cover pool must be at least equal to the KRW equivalent amount of the Social Covered Bonds outstanding. KHFC may from time to time after each closing date of the Social Covered Bonds arrange for additional KHFC mortgage loans to be added to the cover pool to ensure that the Asset Coverage Test is satisfied.

Social MBS

KHFC will issue Social MBS by establishing a trust within KHFC for each MBS issue, in line with Article 32 of the KHFC Act. KHFC will manage the Social MBS pool with transparency by distinguishing the Social MBS pool from KHFC's other funds. In addition, the principal and interest payments of Social MBS are guaranteed by KHFC. When any loss has arisen at the closing of books of KHFC, it shall be covered by the financial resources reserved in accordance with the provisions of subparagraph 1 of Article 50, and when such reserve is insufficient, the government shall cover it.

KHFC's Social MBS pool consists of public mortgage loans all of which fulfill criteria set by the government. KHFC publicly discloses details of the pool including the number of accounts, outstanding balance and the average LTV via its webpage, which further adds transparency to the Social MBS pool and the cashflows.

2.4 Reporting

KHFC is committed to transparent reporting for its Social Financing. Following the first anniversary of the issuance of the Social Financing and on an annual basis until the maturity of the Social Financing, KHFC will communicate to its investors on how the proceeds of Social Financing are used as well as the expected social impact of the loans financed. The report will be reviewed and approved by the KHFC Securitization Working Group, and will be readily available on KHFC's website.

http://kmbs.hf.go.kr/biz/scBond/scBond.do?MENU_ID=SM2004&SES_MENU_ID=SM0002

2.4.1 Allocation Report

The Allocation Report aims to provide updated information on the mortgage loans that are purchased with the Social Financing proceeds. The Allocation Report will be provided for each individual Social Covered bond issue and Social MBS issue. The allocation report may provide the following information:

- Total eligible mortgage loan balance
- Number of eligible mortgage loans
- Split of mortgage loan by type (Bogeumiari Loan, Didimdol Loan and Conforming Loan)
- Balance (if any) of unallocated proceeds

2.4.2 Impact Report

Where feasible, the report may include qualitative and quantitative social performance indicators. If KHFC was to report on impact metrics, this would be displayed in the report once a year, or until full allocation of proceeds, and broken down into two sections covering: Social Covered Bonds and Social MBS. The following indicators are examples that can be included in the report:

- Number of households benefitting from eligible mortgage loans
- Average eligible loan balance per person
- Average house value
- Average household income of borrowers

3. External review

KHFC will engage Sustainalytics to provide a Second-Party Opinion on its Social Financing Framework, and it will be shared at the company's website.

http://kmbs.hf.go.kr/biz/scBond/scBond.do?MENU_ID=SM2004&SES_MENU_ID=SM0002