

## The Government Weighs in on Housing in Hong Kong

When the Chief Executive Leung Chun-ying took over in July 2012 as the head of government in Hong Kong, the property prices in Hong Kong were the highest in the world.

A survey done in July 2012 by the Chinese University of Hong Kong revealed that 90% of local residents thought that home prices were unaffordable. In a poll published in December 2012<sup>1</sup>, 41% of the people surveyed ranked housing as the number one issue for locals.

The year 2013 was a special year for housing in Hong Kong. It was the 60<sup>th</sup> anniversary of public housing development in Hong Kong and the 40<sup>th</sup> anniversary of the Housing Authority, the main organisation responsible for public housing. Ironically, in this historic year, the 2013 Demographia International Housing Affordability Survey<sup>2</sup> again identified Hong Kong as the most unaffordable place (in terms of housing) in the world.

The Hong Kong property market had been overheating since 2009 after a rebound in economic growth following the global economic crisis of 2008. The prevailing low interest rates and foreign investment, especially from the wealthy Chinese from mainland China, added fuel to the fire. As concerns over affordability of housing for the common man and the risk of an asset bubble<sup>3</sup> continued to rise, the government felt a political compulsion to act to dampen the property market in Hong Kong.

The measures implemented by the government thus far included more conservative loan-to-value ratios, an increase in the property transaction taxes and even a temporary removal of real estate as an asset allowed under the foreign direct investment scheme<sup>4</sup>.

David Chan<sup>5</sup> was the head of the Strategy Division (Housing) in the Transportation and Housing Bureau. The Bureau was responsible for the formulation and implementation of housing strategies in Hong Kong. As the affordability of housing continued to be an intractable problem, the Bureau needed to come up with a comprehensive review of the housing sector and propose housing strategies to ease the politically sensitive issue. With this

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<sup>1</sup> The poll was conducted by the University of Hong Kong Public Opinion Program.

<sup>2</sup> The Demographia annual survey compares housing affordability in major metropolitan cities.

<sup>3</sup> Asset bubble refers to a sharp increase in asset prices which is caused by speculation in the asset market.

<sup>4</sup> The Capital Investment Entrant Scheme was launched in 2003 by which foreigners were provided residency status if they made significant capital investments in Hong Kong in certain asset classes.

<sup>5</sup> Fictional person.

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This case was written by Rakhi Shankar under the guidance of Assistant Professor Yee Wai Hang, Lee Kuan Yew School of Public Policy (LKY School), National University of Singapore and funded by the LKY School. The case does not reflect the views of the sponsoring organisation nor is it intended to suggest correct or incorrect handling of the situation depicted. The case is not intended to serve as a primary source of data and is meant solely for class discussion.

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rich academic background in the area of public administration and his many years of service with the Bureau, Chan was assigned the task of preparing the initial proposal. He sat down to analyse the housing market and to identify possible housing strategies for the way ahead.

### **Housing price history in Hong Kong**

The main peak in housing prices in Hong Kong occurred in 1997. Under a Sino-British agreement, there was a limitation on the amount of land supply that could be released into the market and the increase in property prices during this time was believed to be due to land shortage although some argued that it was due to the rise in wealth that had accompanied economic growth during these years. The housing prices plummeted in 1998, soon after the handover of Hong Kong from the British to China, during the Asian Financial Crisis in 1997-98 (see Figure A).

The first Chief Executive of Hong Kong<sup>6</sup>, after the handover from the British government back to China, sought to provide 85,000 housing units (public and private) a year in order to ease the high costs of housing when he took over as the head of Hong Kong's government in 1997<sup>7</sup>. The policy was geared towards greater privatisation of public housing through ownership<sup>8</sup>, especially for the middle class, and towards social stability. However, as the Asian Financial Crisis unfolded in 1997-98 and new housing was brought into the market, the prices went into a steep decline and slowly moved down until 2003 when there was another slump during the SARS epidemic<sup>9</sup>. This exposed homeowners to the vagaries of the property market as the value of their housing assets plummeted. The government revised its strategy to minimise intervention in the property market and the home ownership schemes were suspended. The government shifted its policy from promotion of home-ownership to provision of public rental housing for the low income citizens<sup>10</sup>. The sale of land was also modified such that land sales would be triggered only if developers submitted minimum bids.

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<sup>6</sup> The Head of the Hong Kong government was called the Chief Executive who was appointed by the Chinese government based on the election by a select selection committee.

<sup>7</sup> From July 1, 1997, Hong Kong became a Special Administrative Region of China with a higher degree of autonomy under the 'One Country, Two Systems' governance mechanism.

<sup>8</sup> The government had set a target of increasing home ownership to 70% by 2007.

<sup>9</sup> The SARS epidemic was a healthcare crisis caused by the SARS virus which resulted in a sharp slowdown in economic growth in Hong Kong.

<sup>10</sup> Betty Yung, *Hong Kong's Housing Policy: A Case Study in Social Justice*, 2008, pp127-128.

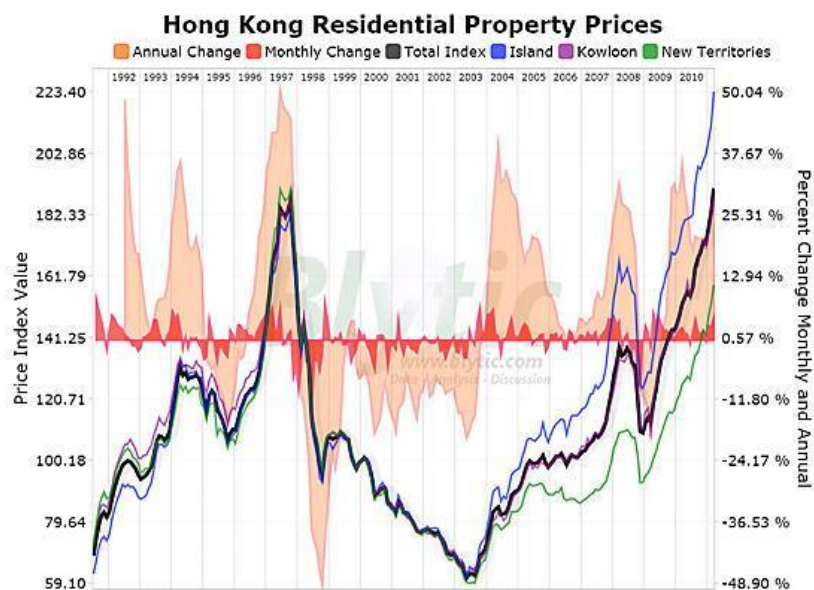


Figure A. Source: <http://www.csmonitor.com/Business/Paper-Economy/2011/0517/Hong-Kong-housing-prices-up-5-percent-in-a-month>

Thereafter, the housing prices rebounded and although it dropped again in 2008, since 2009, there has been a sharp upward movement. A household expenditure survey done in 2009-10 showed that rent or mortgage constituted an average of one-third of a family's monthly expenditure.

### Hong Kong housing market

Residential housing in Hong Kong was primarily in the form of high-rise apartment buildings with high population densities.

Roughly about half of Hong Kong's residents lived in public housing, many with the help of subsidies under various rental and home-ownership schemes by the government. About 30% of the population resided in public rental housing (Exhibit 1), usually for life due to the lack of a market for such rental housing. The secondary market in public housing through the home-ownership schemes was also not well developed due to conditions attached to resale and thus most of the owners of public housing also stayed in such houses for life.

A little over 50% of the households in Hong Kong were owner-occupiers<sup>11</sup>. While for some, home ownership was for self-occupation, many of the buyers of property in Hong Kong regarded a property purchase as an asset which could be traded and as an investment that would appreciate in value and provide financial security during retirement.

The main players in the housing market in Hong Kong were the developers of private housing, the various categories of buyers such as Mainlanders, other foreigners, citizens and the government. Among the private developers, four were dominant in the real estate market in Hong Kong and were widely believed to be powerful and influential not only due to their real estate interests but also since they had many other business portfolios important to the economy.

## ***Sub-divided housing***

The increasing inequality in Hong Kong and the inflow of wealth from outside its borders led to a dichotomy in the market. At one end of the housing market were the luxury residential houses for the affluent and, on the other, there were tiny homes for many of the lower and middle income group who could not afford the high rents. As hopes of owning a home became more and more out of reach for the masses and the waiting list for rental public housing lengthened, people resorted to staying in smaller and smaller housing spaces.

While developers started to offer smaller houses to meet affordability and yet maintain margins, illegal practices also became more commonplace. The practice of sub-dividing housing, where a single-family apartment was divided, usually illegally without the requisite permissions and in violation of codes, to enable multiple families to reside there, became widespread. Terms such as “slaughtered homes”<sup>12</sup>, “cage homes”<sup>13</sup> were used for the tiny forms of housing that developed, often in industrial buildings. The quality of life in such housing was unhealthy, unhygienic and often hazardous. These dwellings did not have essential facilities such as kitchen facilities or an independent toilet and water supply. The increase in sub-divided housing led to instances of building collapse and devastating fires which further mounted pressure on the government to take measures to address the issue.

## ***Buyer Beware***

Hong Kong’s property developers increasing built housing estates with various amenities provided within each housing estate. To better finance and manage the risks of such developments, the developers frequently sold uncompleted projects. Since the buyers of such housing projects did not have a finished product to evaluate, there were several complaints related to this practice such as delays in construction, the quality of finishing and fixtures delivered being different from those promised etc. In particular, there was no uniformity as to how the size of the unit was quoted and the different charges quoted and discounts offered led to confusion and a general feeling of distrust amongst the buyers. However, they had few other options available to own a house.

## **Measures taken to stabilise the housing market**

The high real estate prices in Hong Kong raised concerns about a real estate bubble and a high degree of speculation in the market. If there was a bubble, the consequences of a bubble burst could be disastrous for the economy of Hong Kong and could lead to financial instability in the banking industry. While there was a need to curb speculation, the value of savings that many Hong Kongers had invested in property also needed to be safeguarded.

The alarm raised about the sharp increase in property prices since 2009 led the government to implement a number of dampening measures.

In October 2009, the maximum loan-to-value was lowered to 60% for high-end residential properties above HK\$20 million which was expanded to properties above HK\$12 million in

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<sup>11</sup> General Household Survey Section (3), *Census and Statistics Department*, Hong Kong, <http://www.censtatd.gov.hk/hkstat/sub/sp150.jsp?tableID=005&ID=0&productType=8>.

<sup>12</sup> A term referring to sub-divided homes wherein the original home was ‘slaughtered’.

<sup>13</sup> Wire-mesh cages used as living spaces in houses, typically 1.5 square metres of space, stacked on top of one another.

April 2010. The Hong Kong Mortgage Corporation also lowered the maximum loan size that qualified for insurance. Mortgage insurance for non-owner occupied properties was suspended.

In April 2010, the stamp duty on property purchases was increased with rates varying from HK\$100 for properties valued up to HK\$2million to 4.25% for property valued over HK\$20million. Additional measures to improve access to finance for the lower income group and to improve infrastructure were also undertaken.

In November 2010, a Special Stamp Duty (SSD) came into effect. This was to be levied on resale of property within two years with the rate varying according to holding period. Although the SSD was effective in lowering the number of sales within 12 months of purchase, the government noted that the number of transactions for resale within 1-2 years of purchase had increased from 83 cases in March 2012 to 218 cases in September 2012<sup>14</sup>. It was also observed that the number of purchases by non-locals had risen from 3.1% in 2008 to 4.5% in 2010 and to 6.5% in 2011<sup>15</sup>. The contribution of non-local buyers was even more prominent in the primary market where their share had gone up from 5.7% in 2008 to 19.5% in 2011<sup>16</sup>.

In October 2012, a 15% buyer's stamp duty was imposed on purchases made by foreigners. In addition, the Special Stamp Duty (SSD) levied on property purchases was increased for different holding durations and extended from two to three years in order to curtail short-term investments and speculation (see Table A).

Table A.

<b>Special Stamp Duty (SSD)</b>		
<b>Resale period</b>	<b>SSD (old)</b>	<b>SSD (new)</b>
Within 6 months	15%	20%
More than 6mths but less than 12 months	10%	15%
More than 12 mths but less than 36 mths	5% (more than 12 mths but less than 24 mths)	10%

### ***Land supply***

Land was a scarce resource in Hong Kong, particularly land that could be developed and built-upon since Hong Kong was surrounded by water and had a hilly topography. As a result, the supply of land in the real estate market had a significant effect on property prices. The government, as the largest single owner of land, could affect prices through its land sales to private developers and for public housing. The government acquired land through reclamation, redevelopment and leasing modifications. To increase land supply, the government could re-zone specific land areas and acquire land for residential use from other uses such as industrial.

<sup>14</sup> [http://www.news.gov.hk/en/categories/finance/html/2012/10/20121026\\_172021.shtml](http://www.news.gov.hk/en/categories/finance/html/2012/10/20121026_172021.shtml)

<sup>15</sup> [http://www.news.gov.hk/en/categories/finance/html/2012/10/20121026\\_172021.shtml](http://www.news.gov.hk/en/categories/finance/html/2012/10/20121026_172021.shtml)

With the increase in public housing in the 1990s and the subsequent slump in property prices during the Asian Financial Crisis, the government stalled its public housing programmes and adopted a less interventionist role leaving market forces to guide the housing market. In 2002, the government introduced a land auction system whereby land sales were triggered only if developers expressed interest in a particular land parcel. The government now proposed to abolish this system in favour of a more pro-active approach to land sales.

In addition to increasing and expediting land sales, the government could increase new housing through administrative measures such as increasing development densities and improving and expediting connectivity and infrastructure. It could also establish rules to ensure that land with private developers did not lie idle.

The government also sought to take other supply-side measures especially in the mass market segment with developers focusing more on the larger, more profitable properties. It re-zoned some of the land marked for other uses towards residential use and identified new development areas. In September 2012, the Chief Executive announced the 'Hong Kong land for Hong Kong people' policy under which two land parcels were identified specifically for local permanent residents with a restriction that this could be resold only to other permanent residents for 30 years. Since Hong Kong had to grapple with limited land availability, the appropriate use was often contentious. Reclamation of land was also proposed to provide more land however, this was limited in its scope due to environmental and conservation concerns.

The Chief Executive of Hong Kong, Leung Chun-ying, said in his policy address in January 2013, "In recent years, our urban development has taken a disturbing turn. All too often, there are wrangles over land use and infrastructure projects, leading to sluggish land development and housing shortages." He added, "In cases of market failure, the government must take appropriate action to address the problem."

### **Public housing in Hong Kong**

Public Housing in Hong Kong was provided by two organisations, the Housing Authority which was a governmental body and the Housing Society, which was a non-governmental, non-profit organisation. The main provider was the Housing Authority.

#### *Housing Authority (HA)*

The early form of the Housing Authority came into being after a fire broke out in December, 1953, in the Shek Kip Mei squatter area of Hong Kong, leaving 50,000 people homeless. The political situation in mainland China led to a large influx of people who resided in such squatter areas. A Resettlement Estate consisting of eight-storey blocks was completed in 1954 to house the fire victims and others living in the squatter area. The early form of the Housing Authority was The Resettlement Department which was established in 1954 with the primary objective of resettling squatter areas and freeing up land in the process. In time, its role evolved into provision of low-cost housing for the lower income.

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<sup>16</sup> [http://www.news.gov.hk/en/categories/finance/html/2012/10/20121026\\_172021.shtml](http://www.news.gov.hk/en/categories/finance/html/2012/10/20121026_172021.shtml)

In 1973, the new Housing Authority was established as a statutory body under a Housing Ordinance charged with the planning, design, building and maintenance of all public estates in Hong Kong. The HA's operational arm, called the Housing Department, was headed by the Secretary of Transport and Housing who served as the Chairman of the Housing Authority.

Over time, as the HA developed more housing for the growing population, it also sought to meet the increasing demands of with later estates having taller buildings, better designs and with better facilities than the older estates and also undertook redeveloped of some of the older estates.

### *Housing Society (HS)*

The Housing Society was founded in 1948, through a philanthropic donation, in the milieu of an influx of refugees after World War II even as much of the housing was damaged and destroyed during the War. The government provided a low-interest loan to the Housing Society as well as land at a concessionary price. The Housing Society sought to fill-in the gaps between housing provided by the government and the private sector by building housing to meet the unmet needs.

The Housing Society provided subsidised rental housing for the low and low-to-middle income families and senior citizens and had various home ownership schemes. In addition to subsidised housing, the Housing Society also provided non-subsidised housing, especially in urban areas where its older estates were, under the Urban Improvement Scheme.

### *Public Rental Housing*

The public rental housing eligibility in Hong Kong was based on income and assets limits. In the early years, the tenants of such housing were provided lifelong tenancy but over time, as the tenants became wealthier, the tenancy was periodically re-evaluated for income and asset limits and the higher income tenants had to pay higher rent. The average waiting time for public housing flats was two to three years with around 200,000 applicants on the public rental housing waiting list in 2012<sup>17</sup>. The demand for public rental housing was high with the increase greatest from young, single applicants, a relatively newer category of applicants. The younger applicants had higher educational qualifications<sup>18</sup>. Around 30% of the applicants were married but had applied as single applicants since their spouse and children were residing in the Mainland<sup>19</sup>. The trend of increasing non-elderly one-person applicants led the Housing Authority to introduce a 'quota and points system' for this category of applicants in 2005 to prioritise the allocation of public rental housing to those most in need<sup>20</sup>.

### *Home Ownership Schemes*

Besides public rental housing, the Housing Authority and Housing Society also had home-ownership schemes to meet the ownership needs of the population.

The Home Ownership Scheme (HOS) was launched by the government in the 1970s and was intended to help the people in public rental housing to move up the social ladder to own a home, thus also freeing resources for the more needy. The HOS also aimed to help those who could not afford to own a home on the private market. Under this Scheme, the HA built housing for sale to eligible applicants at discounts of 30 to 40% on the market value, with some restrictions on resale. The property could only be sold to qualified applicants or in the

open market with a repayment of the current value of the discount obtained if the required holding period was not met. Initially, these units could be sold in the open market without any repayment of subsidy after a five- year holding period. However, in 1982, as property prices rose and the discount had to be increased to keep these units affordable, the sale of HOS units could only be made after 10 years and only after the premium (subsidy) was paid.

The private sector also participated in this Scheme through the Private Sector Participation Scheme (PSPS). In the 1980s, the Housing Society launched a similar scheme called the Flat-for-Sale Scheme under which housing was built for sale at discounts to eligible applicants.

In the 1990s, another scheme called the Sandwich Class Housing Scheme was launched by the Housing Society in consultation with the government for the lower-middle to middle class families, those who did not qualify for the HOS but still could not afford private housing.

In 1998, the HA launched the Tenant Purchase Scheme (TPS) which provided for the tenants of the public rental flats to buy their rented flats at deep discounts. This Scheme was terminated in 2002.

In 1997, the HA also established a secondary market for flats provided through its home-ownerships schemes (HOS, PSPS, TPS) for sales of such units to tenants of public rental housing. Secondary market sales to the specified categories did not require the payment of a premium but sales in the open market did.

In the early 2000s, as Hong Kong experienced a fall in housing prices, there was a suspension or termination of the building and sale of flats under these home-ownership schemes.

Post 2009, as the ever-increasing property prices b beyond the reach of many and there were cries for providing affordable housing, especially for the poor and the middle class, many contended that HA had not kept pace with the demand and needed to increase its housing supply to meet the urgent needs (Exhibit 2). The HOS scheme was restarted in October 2011. In addition to public rental housing tenants, the secondary market for public home-ownership housing was opened to applicants who were non-PRH tenants but met the income and asset requirements to purchase units without the payment of the premium.

In 2010, the government also launched a new scheme called ‘My Home Purchase Plan’ for the sandwich class which did not qualify for public rental housing but could not afford even the

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<sup>17</sup> The government’s aim was to keep the average waiting time within three years for public rental housing allotment.

<sup>18</sup> In 2005-06, 18% of the applicants in the age group 18-35 had academic qualifications up to post-secondary education and above. (Source: “The Survey on Waiting List Applicants for Public Rental Housing”, *Hong Kong Monthly Digest of Statistics*, October 2007)

<sup>19</sup> In 2005-06, 29% of the non-elderly one-person applicants were married. “The Survey on Waiting List Applicants for Public Rental Housing”, *Hong Kong Monthly Digest of Statistics*, October 2007, p14.

<sup>20</sup> Under the ‘quota and points system’, there was a quota of public rental housing for non-elderly one-person applicants and points were allocated to each applicant and those with higher number of points got faster allocation. The points were based on two primary factors namely, the age of the applicant and whether the applicant was a public rental housing tenant. The older the person, the higher the points were. If the applicant was a public rental housing tenant, points were deducted.



down payment for private housing. This scheme was intended to provide interim relief while people built up savings to purchase a home. Under this plan, no-frills housing would be built and leased to eligible applicants at prevailing market rents. However, thereafter, the rent would be fixed for five years with an option to purchase either the rented flat, another flat under the Plan or a flat from the private sector after two years. The residents would need to move out after five years. Half of the rent paid would be given as a subsidy towards the purchase. The first flats under this Scheme were to be ready by 2014. However, in 2012, due to an overwhelming response and an evident desire for home ownership, this scheme was changed from rent -to-buy to an outright purchase at a discount scheme. The land earmarked under this scheme was shifted to the HOS and the income ceiling for eligibility increased so that more people would be eligible for such units.

As the government sought to adjust its public housing policies to keep housing affordable, some had suggested that the revenue raised from the new taxes (in the form of buyer's stamp duty) should be directed towards new housing and housing subsidies.

### **Need for action**

As Hong Kong continued to suffer from the housing crisis, its government continued to grapple with the politics of land use and its responsibilities with regard to the provision of affordable housing. In his policy address in January, 2013, the Chief Executive had stated the government's guiding principle with regards to housing as follows,

“Some people believe home ownership is not the only way for meeting accommodation needs: it can be met just as well by rented flats. But I believe that home ownership by the middle class is crucial to social security. The Government is therefore determined to uphold the principle of assisting grassroots families in moving into public housing and the middle-income families in buying their own homes.”

In fact, Hong Kong's competitor city-state, Singapore, was often cited as a model, where home ownership in public housing was around 80%. However, even as government policy veered towards improving home-ownership through public housing, a developer opined, “If Hong Kong, as a society, says yes, we should increase help to the weak, by all means. But we should separate housing needs from ownership needs – ownership needs are not a basic need.”

As David Chan mulled over policy recommendations, he was well aware of the political compulsions facing the new Chief Executive. Housing continued to be the number one concern for people in Hong Kong. Since Hong Kong's return to China in 1997, Hong Kong had been operating as a Special Administrative Region of China, on the principle of ‘One Country, Two Systems’ and it strove to maintain its independence. Hong Kong did not have universal suffrage (though this was promised by 2017) and the Chief Executive was elected by a select group, the 1200-member Electoral Committee, and approved by Beijing. Many people saw him as too close to the Chinese government. In January 2013, there were street protests against his leadership amid grievances about his perceived backing by the Chinese government, high property prices and the influx of Chinese immigrants into Hong Kong.

David Chan recalled all the concepts he was well-versed with in relation to the formulation and implementation of public policy and started preparing his report.

**Exhibit 1**

<b>Population <sup>1</sup></b>			
	Thousands		
	2002	2007	2012
<b>Mid-year Population</b>	<b>6 744</b>	<b>6 916</b>	<b>7 136*</b>
<b>Distribution of Population by Type of Housing</b>			
	%		
	2001	2006	2011
<b>Public Permanent Housing <sup>2</sup></b>	50.1	48.4	46.2
<i>Public Rental Housing</i>	31.1	30.3	29.1
<i>Subsidized Home Ownership Housing</i>	19.0	18.1	17.1
<b>Private Permanent Housing <sup>3</sup></b>	48.8	50.9	53.2
<b>Temporary Housing <sup>4</sup></b>	1.0	0.7	0.6

\* Provisional figure

Source: Hong Kong Housing Authority's website, <http://www.housingauthority.gov.hk/en/common/pdf/about-us/publications-and-statistics/HIF.pdf>, accessed June 27, 2013.

## Exhibit 2

### Production of Major Types of Permanent Residential Flats



Source: Hong Kong Housing Authority's website,  
<http://www.housingauthority.gov.hk/en/common/pdf/about-us/publications-and-statistics/HIF.pdf>, accessed  
June 27, 2013.