

Executive Summary

1. The Contemporary Picture

In Hong Kong today, household dwellings are roughly evenly divided between the private and public sector. At the same time, Hong Kong also has a massive public sector housing programmes on a scale that is unprecedented in free-market economies.

Among the public housing sector, the government provides a substantial number of “subsidised sales flats” for eligible households to purchase. In essence, the prevailing mechanism of subsidised sales flats is as follows:

- (i) Assume a subsidised sales unit has an estimated market value of \$1 million (HK\$, same hereafter unless otherwise specified). It is first sold at a “discount” of, say, 30% against the market value (i.e. \$700,000) to an eligible household satisfying the relevant means test;
- (ii) The government also acts as the guarantor for the said property, allowing the household to obtain a mortgage up to 95% of the discounted price (i.e. \$665,000);
- (iii) The unpaid 30% of the house’s market value (i.e. \$300,000), is commonly termed the “unpaid (land) premium”, and is payable to the government when the unit is sold in the open market in the future upon satisfying other requirements; and
- (iv) The value of this unpaid premium is determined with reference to the market value not at the date of occupation of unit, but at the time when repayment is to be made. For example, if home prices double during this period (i.e. from \$1 million to \$2 million), the amount payable by the household before the unit can participate in the open market will also double (i.e. from \$300,000 to \$600,000).

This has made the term “homeownership” spurious in the public housing sector as very few “owners” of the “Homeownership Scheme” (HOS) (22%) and “Tenant Purchase Scheme” (TPS) (1%) can successfully settle the unpaid land premium, rendering the market for such units effectively non-existent and non-functional. This has grave socioeconomic consequences far beyond housing issues.

Additionally, the first generation of HOS units were built in the 1980s. Under the current mechanism, by the time redevelopment of these units is called for, the amount of unpaid premium will probably reach an astronomical level. Given that after settlement of unpaid premium to the government, the owners would be highly unlikely to be able to afford another unit in the market, they would therefore be reluctant to participate in private redevelopment. The city will then be left with numerous run-down HOS and TPS estates with shared ownership between the quasi homeowners and the government.

Furthermore, the present layout of HOS and TPS units is unfair. Unlike private owners who pays 100% of the maintenance fee and can subsequently enjoy 100% of the appreciation in value associated with the units, the owners of HOS and TPS units who are paying the full amount of maintenance fee will only be able to enjoy the capital appreciation minus the unpaid land premium. In the previous example, the owner can only enjoy 70% of any appreciation in capital values.

In terms of public finance, the public housing system is unsustainable. The average rent per public rental housing (PRH) unit is about \$1,700 per month. This figure falls significantly short of the market value, which was put at \$11,000 per month for a 360-sf private housing unit. On top of this, the government is subsidising on average \$158 per flat per month on maintenance and other operational services.

Assuming a discount rate of 4% and assuming that each PRH unit has an estimated useful life of 50 years, the government is actually, in present value terms, subsidising around \$2.4 million for each unit. Likewise, to meet the 10-year public housing supply target, the government has set aside its investment returns in 2015 and 2016 into the Housing Reserve which now stands at \$74 billion. This is a tremendous fiscal burden.

The current public housing policy has produced the gulf between the 'haves' and 'have-nots', which has been widening since the mid-2000s. Disturbingly, this is connected to an array of malign issues including (a) an unequal and inequitable allocation of public housing; (b) the increase in rate of divorce and family breakdown; (c) low intergenerational mobility and poverty; and (d) social injustices.

2. The Inequality and Inequity of Housing Units

The small size of PRH units relative to other types of housing is a historical product of Hong Kong's resettlement housing programme introduced in the 1950s. And given the large difference in the median size of the housing units between the private and public housing sectors, an efficient or optimal housing arrangement would require that there be very different income levels between the occupants of these sectors.

In reality, however, the PRH programme fails to achieve equity in housing consumption. In 1981, the incomes of the wealthy half of the public tenants were equal to the wealthy half of the private tenants. By 2011, there

was some improvement, but the problem of overlap in the distribution of public and private tenants remained substantial.

Distribution of working-aged households (household heads aged 20 – 65) by housing type and by income quartiles

%	Public tenants		Private tenants		Public homeowners		Private homeowners	
	1981	2011	1981	2011	1981	2011	1981	2011
Bottom quartile	23%	48%	31%	21%	4%	17%	20%	13%
2 nd quartile	28%	32%	26%	21%	13%	30%	20%	20%
3 rd quartile	29%	17%	22%	24%	36%	35%	24%	27%
Top quartile	20%	3%	21%	35%	47%	17%	36%	39%
Bottom 2 quartiles	51%	80%	57%	42%	17%	47%	40%	33%
Top 2 quartiles	49%	20%	43%	58%	83%	53%	60%	67%

Source: Census and Statistics Department.

3. Divorce and Family Breakdown

The crude divorce rate in Hong Kong was 3.1 per 1,000 people in 2013, nearly three times higher than that in 1991. This places Hong Kong in the top ten in the world in divorce. We believe that implicit in the PRH allocation criteria is an in-built incentive that provides encouragement for unhappy couples or low-income households to initiate divorce and remarry across the border. A low-income divorced parent could apply for readmission to the PRH programme, often with preferential consideration (compared with being a singleton), if he or she had dependent children or remarried, since the current PRH allocation criteria favour married couples but do not discriminate between first marriages and remarriages.

This perverse incentive further tilts the balance in favour of divorce among low-income families and generates a penalty on children who inevitably suffer from family breakdown. The growing number of divorced women living in PRH units implies a rising number of children growing up in broken families in PRH estates. This is not conducive to upward social mobility but sets the stage for the production of a new underclass that perpetuates intergenerational inequality and low social mobility.

4. Intergenerational Mobility and Poverty

Divorced men and women are heavily concentrated in PRH. It follows that the PRH estates have become a conglomeration of single parent households that will have an adversarial effect on a sizeable number of children. Their development is stunted, causing both income inequality and poverty.

Hong Kong's public housing estates are transforming into areas of concentrated poverty with more children living with a single parent. These children reside in poor neighbourhoods which might lack good role models

to learn from and to emulate. This might demotivate them, perpetuate dynamic poverty and affect their future likelihood of moving up the social ladder.

This Report believes that extending homeownership is essential to family investment in both human and social capital. Indeed, many studies have shown families who are homeowners are more likely to invest in childhood development and neighbourhood stability.

5. Public Housing Policy and Social Justice

The current public housing policy is unjust because the society loses the value inherent in the public sector housing unit, the physical premises itself and the land that it occupies. The evaporation of resources benefits no one.

First, the taxpayer hardly ever collects the unpaid land premium because very few households ever pay it. Second, the subsidy provided by taxpayers to the household is the difference between the market value of the unit and the price the household pays for its use as shelter. Over time, the amount of the subsidy will increase as land values increase. It is unjust that the taxpayer pays for the asset value of the unit, but the household receives only the shelter value of the unit.

6. The Subsidised Homeownership Scheme (SHS)

A faster, less expensive and non-wasteful solution to address these malign issues will be the implementation of the SHS, granting eligible families the option to either purchase, rent or the choice to “rent first, purchase later” new public housing units in the future. Also, under the SHS, the unpaid land premium will be considered as a “loan”, with its value fixed at the date of occupation, instead of effectively an “equity” under the existing system that fluctuates according to changes in market value of the unit.

This would render settlement of the unpaid land premium much easier, and a market for these units will quickly emerge. There would be an incentive for trading to take place and the re-matching of tenants’ needs and housing units would come into effect and the problem of inequity could be rectified.

Additionally, bona fide homeownership in public housing units would incentivise families to stay together and discourage family breakdown. This can therefore act as a barrier against the costs of a broken family among the children of the divorcees and prevent the build-up of bad neighbourhoods that fosters poverty and lowers social mobility.

Since social mobility is closely associated with homeownership, the SHS would relieve Hong Kong of the burgeoning problems of income

inequality and poverty. Not only can families stay together and children are benefited, the elderly population can also tap into the property asset as a form of retirement protection. With a home, a reverse mortgage can allow the elderly population to use the home equity for their retirement.

Furthermore, if we allow a market to exist, then less well-off households gain a share of the value of the land that would otherwise be lost, and in so doing they put the land resources to better use and raise the incomes of everyone. It is a win-win scenario. The outcome will be socially just. The SHS would allow for a more just society where resources are yielded for all, allowing people to have greater freedom of choice, and build a better community.

7. Concerns

A major concern about the privatisation of PRH and HOS units is that it may lead to a flood of new housing units into the market and trigger property prices to go down. However, the experience of the privatisation of social housing in the UK and our empirical findings suggest that granting more households the full property rights to their housing units does not necessarily lead to a drop in home prices.

Another major reservation to the SHS is the perception of unfairness, that public tenants will receive a 'double benefit' of a low rent and a discounted price from the government. However, under the SHS, the subsidised price will be repaid in full in the future. In effect, the government will merely be providing the financing which may be inaccessible for lower-income families, and the SHS would recover the full market price of the unit as the buyers pay the downpayment and service the mortgage loan, and upon their settling of unpaid premium, which would no longer be fluctuating with market value under the SHS.

8. Conclusion

Due to globalisation and technological advancement, wealth and income inequality is a worldwide phenomenon and is not constrained to Hong Kong alone. Governments from all over the world have sought to tackle this problem with little headway. Fortunately, the future of Hong Kong is more optimistic than others. Due to the fact that nearly half of the population of Hong Kong resides in public housing, this provides a golden opportunity to mitigate the unequal distribution of capital by providing homeownership and therefore an asset, possibly the most valuable form of capital, for the relatively lower-class citizens living in public housing.

Therefore, the Report is optimistic that the SHS will bring about positive externalities for the society of Hong Kong as a whole. An increased homeownership rate would narrow the disparity in asset distribution and hence the gap between the "haves" and "have-nots". The pursuit of a more equal and unified Hong Kong could be achieved.