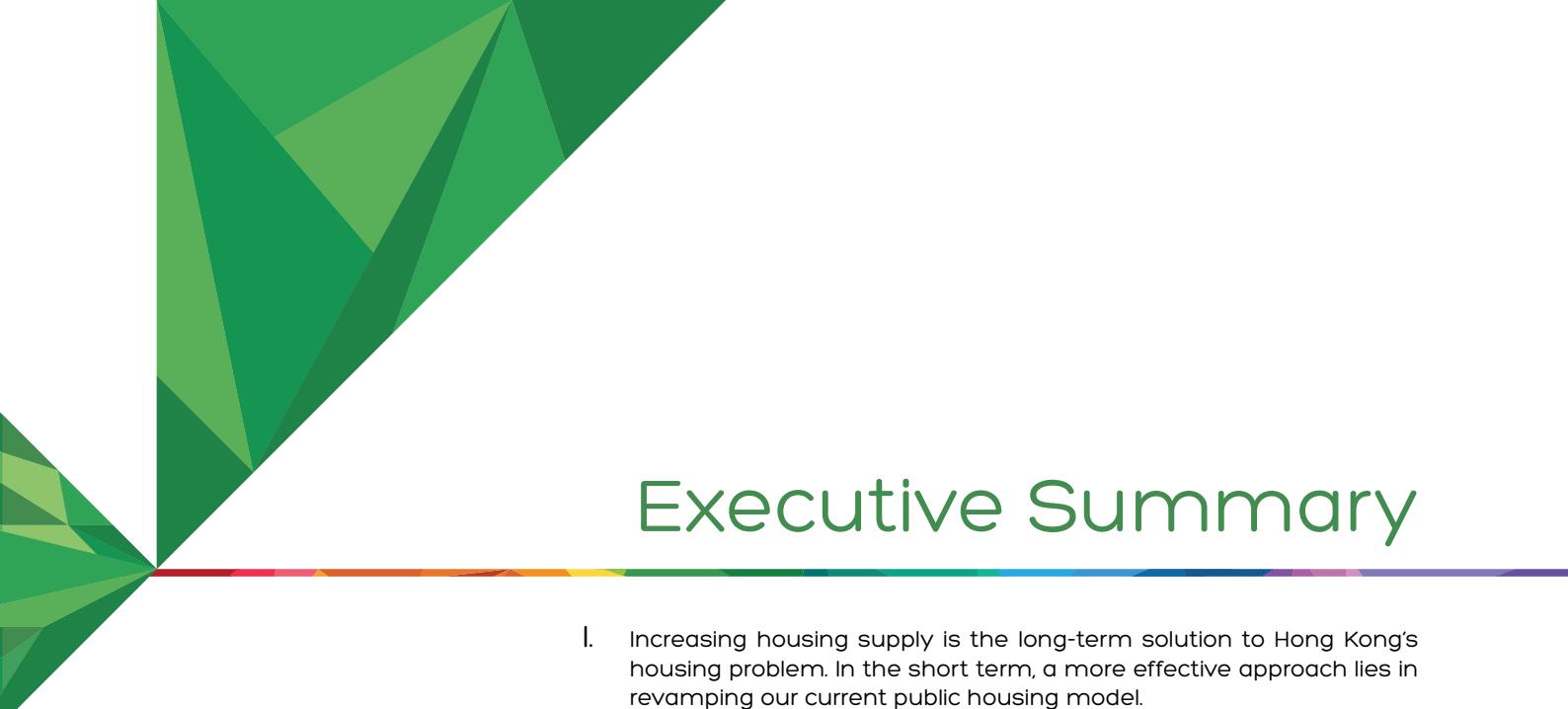


The background features a large, abstract geometric shape composed of various shades of green triangles and rectangles, creating a sense of depth and motion.

## Part 1: "Subsidized Homeownership Scheme"

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# Executive Summary

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- I. Increasing housing supply is the long-term solution to Hong Kong's housing problem. In the short term, a more effective approach lies in revamping our current public housing model.
  - II. As it is, Hong Kong's public housing, far from being cost-effective, has failed to address residents' needs. Mobility among public rental housing (PRH) tenants has remained low. Even after changing jobs, receiving a promotion, getting married, or having to take care of grandchildren or elderly parents, unless they voluntarily give up their housing units and rent subsidy, there is simply no way for them to move to another unit that suits their need better. The resources mismatch resulting from this rigid system is such that for every \$1 subsidized by taxpayers, \$0.25 to \$0.39 of public money goes to waste.
  - III. Over the last few decades, trapped in the public housing system, the increasingly impoverished tenants and growing numbers of elderly PRH tenants units have been hard pressed to gain wealth or unlikely to find the incentive to wean themselves off Government assistance. Coupled with an ageing population, this will put an ever-heavier welfare burden on the Government.
  - IV. Recent years have seen the rising prices and rents of private housing far outstripping the increase in median income, making homeownership well beyond the means of the general public. Sub-divided units (SDUs) have become ever more common, testifying to the increasingly abject living conditions. As the local community is divided into the "haves" and the "have-nots", social conflict has intensified, making effective governance even more of a challenge.
- V. The three future objectives of housing policy are as follows:
- i) Home ownership first, wealth gains later: Enabling citizens to gain wealth through subsidized homeownership.
  - ii) Enhanced efficiency and better use of resources: Increasing the value of public housing units through gradual marketization and recovering part of property prices to ease the long-term strain on housing and welfare expenditures; and
  - iii) Less polarization and a more unified Hong Kong: Bridging the gap between the haves and the have-nots, building a harmonious society, and unifying Hong Kong by helping aspiring home owners to realize their dreams.

**VI.** The Subsidized Homeownership Scheme proposes that, in future, all new public housing should be geared towards satisfying demand for homeownership, and that Rent-to-buy arrangements should be used as a stopgap measure before homeownership is affordable.

i) Subsidized-sale units are sold to eligible households at a preferential price.

ii) Rent-and-Buy units are available to new PRH tenants for renting before they have the means to buy the units at affordable prices below market value. Such units can always be bought at a preferential price throughout the tenancy and the prices will not be subject to market adjustments. After living in this kind of unit for a period of time, a tenant can choose to buy it. Even if they choose not to buy the unit, they can still continue to rent it. In the long run, more and more tenants of such units are likely to become home owners.

**VII.** The Government will, through guaranteed mortgage, help low-income families to buy units sold under the Scheme and enjoy 90% to 95% mortgage. This will serve to satisfy their financing needs.

**VIII.** The greatest advantage of the Scheme over Home Ownership Scheme (HOS) and the previous Tenants Purchase Scheme (TPS) lies in the fact that premium payment arrangement is easier with the proposed scheme. This will provide a stronger incentive for owners to make premium payment, thus facilitating unit circulation and enhancing market efficiency. Four methods are proposed in the following for public discussion:

i.) Zero premium payment: In other words, all subsidized by the government.

ii.) Discounted premium in year of occupation: Suppose the premium in year of occupation is \$2 million, with 20% discount rate, the discounted premium is 80% of \$2 million, which is \$1.6 million. Whenever premium payment is pursued it will be proceeded according to this price and the amount will not vary with market changes.

iii.) Either premium in year of occupation or market premium: If property prices rise, the owner will only need to pay the premium in year of occupation. If property prices enter a downward trend, the premium payment will be equal to the market premium. This arrangement allows the premium to be capped at the original level.

iv.) Either the average premium or market premium: If property prices rise, the owner will pay the average premium over the years of occupation. If property prices enter a downward trend, the premium payment will be equal to the market premium.

**IX.** The Subsidized Homeownership Scheme has the following advantages:

i) Enabling eligible members of the public to choose to rent or buy their units, giving them the flexibility in exercising their rights to meet their housing needs;

ii) Rebuilding the housing ladder by offering preferential prices and incentives to help home owners to move up the housing ladder one step at a time.

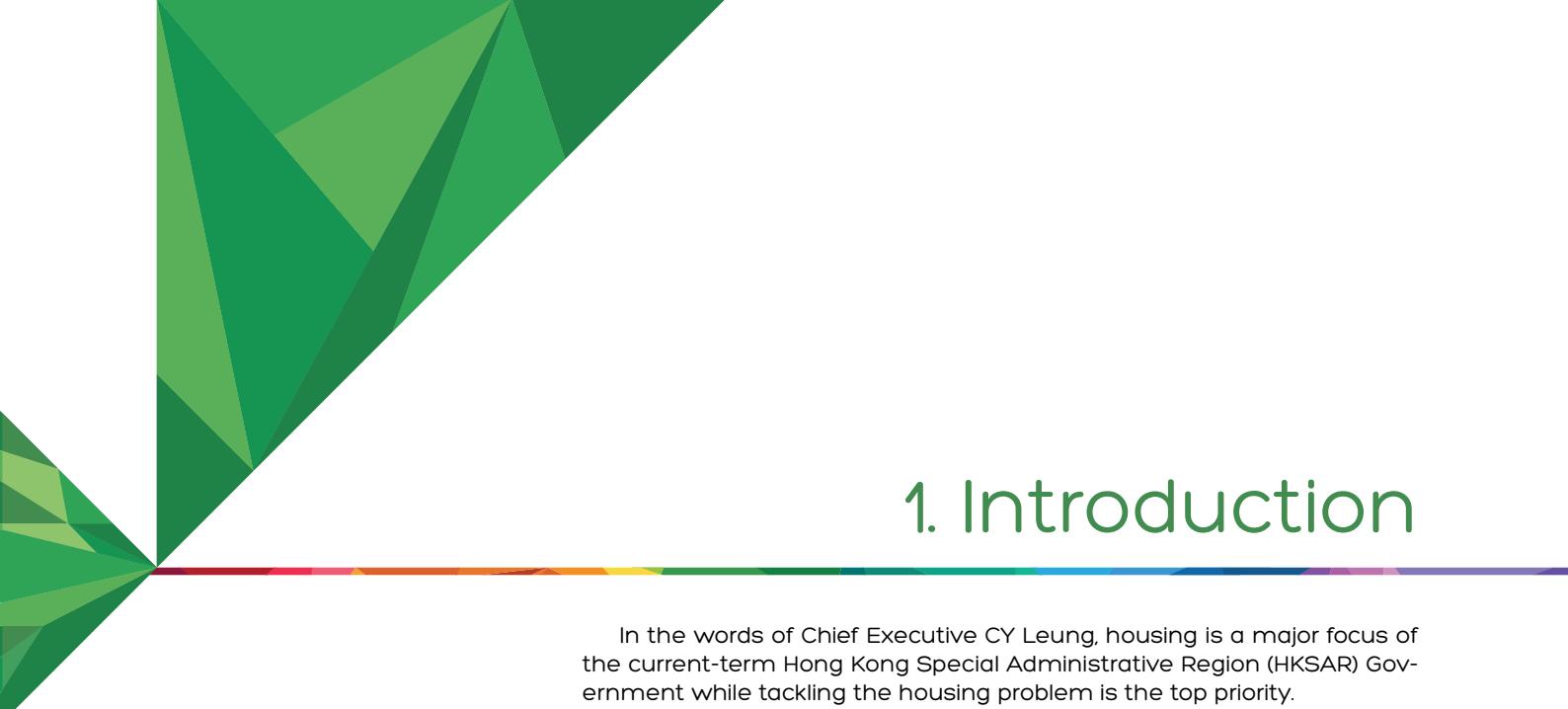
iii) Enhancing market efficiency, unlocking the full value of public housing units, and minimizing public housing resource mismatch;

iv) Alleviating conflict between "those with property" and "those without property", harmonizing society, and unifying Hong Kong;

v) Recovering part of public housing costs, easing financial pressure on the Hong Kong Housing Authority (HA); and

vi) Utilizing public resources more effectively and helping the general public to gain wealth in preparation for the challenge of an ageing population.

**X.** The Scheme is aimed at facilitating utilization of public resources and making good use of limited supplies. This will also enable members of the public to be home owners, thus enhancing their quality of life and redressing social problems.



# 1. Introduction

In the words of Chief Executive CY Leung, housing is a major focus of the current-term Hong Kong Special Administrative Region (HKSAR) Government while tackling the housing problem is the top priority.

The housing problem is not only about housing matters, but is also at the crux of political and economic issues. "Capital in the Twenty-first Century", a recent publication by the French economist Thomas Piketty which has generated widespread interest and discussion, draws attention to the fact that land and housing is the central issue faced by each and every modern-day capitalist society.

In addition to the traditional approach of continually coming up with new land and housing supply, revamping the current public housing model is a more effective solution to Hong Kong's housing problem in the short term.

**Apart from meeting the housing demand of the general public, the "Subsidized Home-ownership Scheme" ("the Scheme") serves to satisfy their need for homeownership.**

In a society where half of the population are home owners while the other half are not, ever-rising property prices will only have a decidedly divisive effect economically, socially, psychologically, and politically. Lack of shared interests among the general public will also make effective governance even more difficult to achieve. The Scheme is likely to help all aspiring home owners to realize their dreams by providing low-income families with a chance of homeownership. This will create access to upward social mobility and unify public interests, so that, without relying solely on Government subsidy, the low-income families can focus their efforts on increasing their productivity, thus bridging the wealth gap in society.

In terms of utilization of public resources, if public housing units can be gradually privatized, and the land value can thus be unlocked, the Government will be able to recover in part the value of public land resources to benefit the community at large by meeting ever-rising public expenditures as a result of the ageing population.



## 2. Policy Background

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### 2.1. Cost-ineffective public housing fails to satisfy residents' needs

Public housing is basically a non-market means of subsidizing housing. The beneficiaries receive neither cash allowances nor housing coupons to enable them to rent properties on the market. They can only choose to accept or refuse a public housing unit assigned to them, but do not have a choice of size, location, floor or layout of the unit.

Over the last six decades since their introduction, Hong Kong's PRH units have served the needs of more than two generations. However, even when a household has the financial means to rent a larger unit, unless its size exceeds the minimum average living space per person designated by the Housing Authority (HA), the tenants will not be allowed to move to ideal-sized units even if they are willing to pay higher rents.

The question is, given the growing prosperity of society and the different individual needs in various stages of life, a household's housing demand is also changing with the times. As people often change jobs, receive promotions, get married and raise kids, or go to school or change schools, it is also natural that different generations of the same family would like to live close by and take care one another. The community at large will have to pay a heavy price if PRH tenants are not allowed to move to more ideal units according to individual needs and social change.

Since PRH tenants are not allowed to choose their units, the value of the units in their own eyes will inevitably be lower than its potential value or that perceived by others. To appease the households who can afford to rent larger PRH units but are made to endure living in smaller ones, the HA have no choice but to offer huge discounts on rents.

In fact those who tend to underestimate the value of their own units are often the tenants themselves since the units they are forced to live in are not to their liking. However, if the units are made available to the market, depending on the size, location or floor, there may well be buyers out there. A unit renting for \$2,000 per month through the HA could fetch \$13,000 or even \$20,000 on the market.

As a hypothetical example, to a relatively well-off family living in a PRH flat in Ap Lei Chau, the daily commute to Kwun Tong and going to school in Kowloon for the children are not only frustrating, but also a bit costly. But the schools in Ap Lei Chau may not be good enough for the kids, and the wife has quit her job in Tsim Sha Tsui because of the long commute. Moreover, the mother-in-law who lives in Ho Man Tin hardly comes over to take care of the grandchildren. So the three generations of the family can only get together once a month. Nevertheless, since the rent is only \$2,000 per month, the household head has decided the family has no choice but to stay put.

However, if the family head rents out the PRH flat in Ap Lei Chau for \$13,000 per month, and gets an additional monthly income of \$11,000, he may be able to afford to rent a private property for \$16,000 in Sham Shui Po. With the money saved by reducing the commute cost, the wife can find a job in Tsim Sha Tsui and use the earnings to make up for the \$5,000 rent difference. With the wife's income, the family can move into a private property of a similar or even larger size. Daily traveling time for all family members is reduced and the three generations of the family can get together more often. All this happiness does not come from a PRH flat but can only be achieved with the help of the market.

In the above example, excluding operating costs, the HA's subsidy for the PRH household is \$11,000 (= \$13,000 - \$2,000). To the family in question, the advantages of moving to Sham Shui Po, paying an additional \$5,000 per month, outweigh those of staying in Ap Lei Chau. In other words, the advantages of moving to Sham Shui Po are worth more than \$5,000. In this hypothetical example, the efficiency of a PRH flat is actually below 46.2%. Over 53.8% of subsidy remains unrecognized by the tenants.

An estimation by Wai-Hin Yan (2000) of the utility gains of PRH tenants in 1976-96 worked out the average household incomes, costs of subsidy by the Government, the benefits enjoyed by the tenants, the efficiency ratio (gains divided by subsidy), and the tenants' average gains in housing consumption (see Table 1).

It is found that the tenants' gains are far less than the public subsidy. With relative efficiency ratio at 1 (maximum efficiency), the PRH scheme's efficiency ratio in 1976-96 only ranges from 0.61 to 0.75. In other words, for every \$1 of subsidy by taxpayers, the average tenant can only enjoy \$0.61 to \$0.75 of gains. Owing to resource mismatch resulting from the fact that most tenants are not satisfied with the PRH units they are assigned, \$0.25 to \$0.39 of subsidy goes to waste.

Table 1. Subsidy and benefit per household per month, and the efficiency ratio of the PRH Program, 1976-96

	1976	1981	1986	1991	1996
Average household income (\$)	\$1,560	\$3,374	\$5,680	\$10,072	\$16,547
Subsidy granted per household (\$)	\$399	\$559	\$1,167	\$1,696	\$2,971
Benefits received per household per month (\$)	\$243	\$351	\$873	\$1,231	\$2,090
Efficiency ratio	0.61	0.63	0.75	0.73	0.70
Estimated cost of inefficiency losses (\$bn)	\$0.65	\$1.04	\$1.82	\$3.21	\$6.95
Estimated cost of inefficiency losses as a percent of GDP	1.03	0.60	0.57	0.46	0.56
Gains in housing consumption per house	—	\$118	—	\$351	—
Ratio of gains in housing consumption to benefits received	—	0.34	—	0.29	—

In 1976-96, the annual underlying costs incurred by low-efficiency accounted for 0.46% to 1.03% of GDP. The waste of PRH should not be underestimated as the losses in dollar terms ranged from \$650 million in 1976 to \$6.95 billion in 1996. Although no relevant estimates for recent years are available, given the spiraling property prices in the intervening years, the underlying costs must have gone up.

At \$118 per month in 1981 and \$351 per month in 1991, the PRH tenants' gains in housing consumption increased twofold but paled in comparison with the respective amounts of subsidy at \$559 and \$1,696 by the HA over the ten-year period. The ratio of gains in housing consumption to benefits was 0.34 and 0.29 in 1981 and 1991 respectively. As indicated by the above two figures, although subsidy by the HA increased during the above period, the rigid PRH policy has hampered tenants' freedom to choose the size of their flats. If, instead of being assigned a PRH flat, the tenants had been given cash allowances, they would have opted for a bigger flat. Given the extremely low rent, the tenants are willing to endure living in smaller flats. Since the size of the flat is often less than ideal for tenants, the PRH subsidy is not properly utilized. In 1991, the underutilization effect became more evident as the ratio of gains in housing consumption to benefits dropped.

In assessing the efficiency of the PRH scheme, it is important to note that well-off tenants tend to regard their flats as being too small. Their actual housing consumption for their PRH is lower than that for the kind of flats they can afford (since the size of their flats is perceived to be less than ideal).

The root cause of low efficiency of public housing lies in the fact that PRH units have been prevented from being made available for rental or sale on the market, making it impossible for the units to be allocated more efficiently by the free market. Although many PRH tenants regard their units too small, they are unable to rent them out to private property tenants who are at the mercy of rent hikes, and move out to larger private properties themselves.

Free trading of PRH units may not be in the HA's playbook, but if the limitations persist, there will never be a proper match between tenants and PRH units and may even create a black market, albeit a small one, for these flats. Without a free market for renting and buying PRH units, tenants will never be able to trade up to larger flats and thus become stuck with the flats that are way too small for them.

## 2.2. Limited effect of well-off tenants policies and Home Ownership Scheme (HOS) on PRH unit circulation

Over the last few decades, there has been much overlap between the household incomes of public housing tenants and those of private housing tenants. As the incomes of a growing number of PRH tenants have risen significantly since they first moved in, many of them have become well-off enough to be home owners. The longer their tenancy, the more likely it is for them to become well-off tenants.

One of the main causes of the ongoing rise in sale prices of private properties in the 1980s and the 1990s was that many PRH tenants were not poor at all. Many of them bought private properties to improve their living conditions or to use them as investments. According to the HA's estimates, in the early 1990s, approximately 13% of PRH tenants, or 74,000 households, owned properties in Hong Kong. The private properties owned by PRH tenants accounted for 11% of total private properties in Hong Kong. Up to 84% of the private properties owned by PRH tenants were for self-occupation while only 16% of the properties were for rental. In other words, some of those registered on the PRH tenants' list, e.g., the children or parents of the household head, actually lived in a privately-owned property. In some cases, the whole household actually lived in a private property and used their PRH flat as a storage facility.

The number of PRH tenants who own private homes has been on an upward trend. Through a random sample of 2,000 property transactions between October 1992 and March 1993, an analysis by the Government's Rating and Valuation Department found that transactions in which the buyer is a PRH tenant accounted for 24% of the total. A survey by the HA in August 1992 found that the percentage of registered household members not living in the PRH flats was as high as 18%<sup>1</sup>.

However, some "well-off tenants" who already owned private properties refused to surrender their PRH flats. Owing to shortage of land supply in the 1980s, under the new public housing policy, PRH tenants were subject to means tests. If found to be "well-off tenants", they would be required to pay double rent. But since the rent would still be cheap, the tenants would still be unwilling to give up the flats. Instead of being subject to the tests, some of them even chose to voluntarily pay double rent.

Since the introduction of the "super well-off tenants" policy, the number of "well-off tenants" has remained stable.

Table 2. Number of PRH households paying additional rent

Rent / Year	1992	1994	1998	2002	2006	2010	2013
1.5 times net rent plus rates	0	10,417	15,656	9,429	14,654	20,560	1,8190
Double net rent plus rates	54,414	35,363	6,448	1,569	2,271	3,204	2,321
Market rent	0	0	1,774	79	16	37	15
Households paying additional rent	54,414	45,780	23,878	11,077	16,941	23,801	20,455
Percentage of all PRH households	10%	8%	4%	2%	3%	4%	3%

Source: Lau Kwok Yu (2013)

<sup>1</sup>Those whose income exceeds the income limit were required to pay double rent but not surrender their public rental flats.

Table 2 lists the number of “super well-off tenants” (who pay double rent and market rent) and “relatively well-off tenants” (who pay 15 times rent). Under the HA’s “Housing Subsidy Policy” amended in 1993, “relatively well-off tenants” are defined as those with household incomes between two to three times of Waiting List income limits. They are required to pay one and a half times net rent plus rates (commonly shortened to as “one-and-a-half-times rent”). If their household incomes exceed the income limits three times or they choose not to declare their household incomes, the tenants are required to pay double net rent plus rates.

Under the “Policy on Safeguarding Rational Allocation of Public Housing Resources” (or the so-called “super well-off tenants” policy) implemented in 1996, those who pay double rent under the “relatively well-off tenants” policy are required to declare their assets once every two years. Before 1999, if total household income and net assets exceed the limit, or the tenants choose not to declare their assets, they are required to pay market rent. After the policy was amended in 1999, such households are required to vacate and surrender their PRH flats.

Based on Professor Lau’s research, the percentage of “tenants paying additional rent” among PRH tenants has not been on the rise. In his opinion, this is due to the overly lenient income limits set by the “well-off tenants” policy. For example, in 2015/16, a three-member household will be required to surrender their PRH flat if their household monthly income is as high as \$59,460 and their assets exceed the prevailing limits. In the past few years, only a few hundred have been required to surrender their PRH flats because of the “well-off tenants” policy (see Table 3). This represents just a tiny fraction of the 700,000-plus PRH tenants, and thus has little positive effect on public flat circulation.

Table 3. Number of “well-off tenants” who surrendered their PRH flats

Year	2008/2009	2009/2010	2010/2011	2011/2012	2012/2013
Total number of “well-off tenants” who have moved out from their PRH flats	536	362	772	318	261
Number of “well-off tenants” who have moved out upon purchase of HOS flats (including the purchase of HOS flats put up for sale by the HA and from the HOS Secondary Market with premium not yet paid)	377	225	587	148	165
The percentage of “well-off tenants” who have moved out upon purchase of HOS flats to the total number of “well-off tenants” who have moved out	70%	62%	76%	47%	63%

Source: Government Press Release (2013)

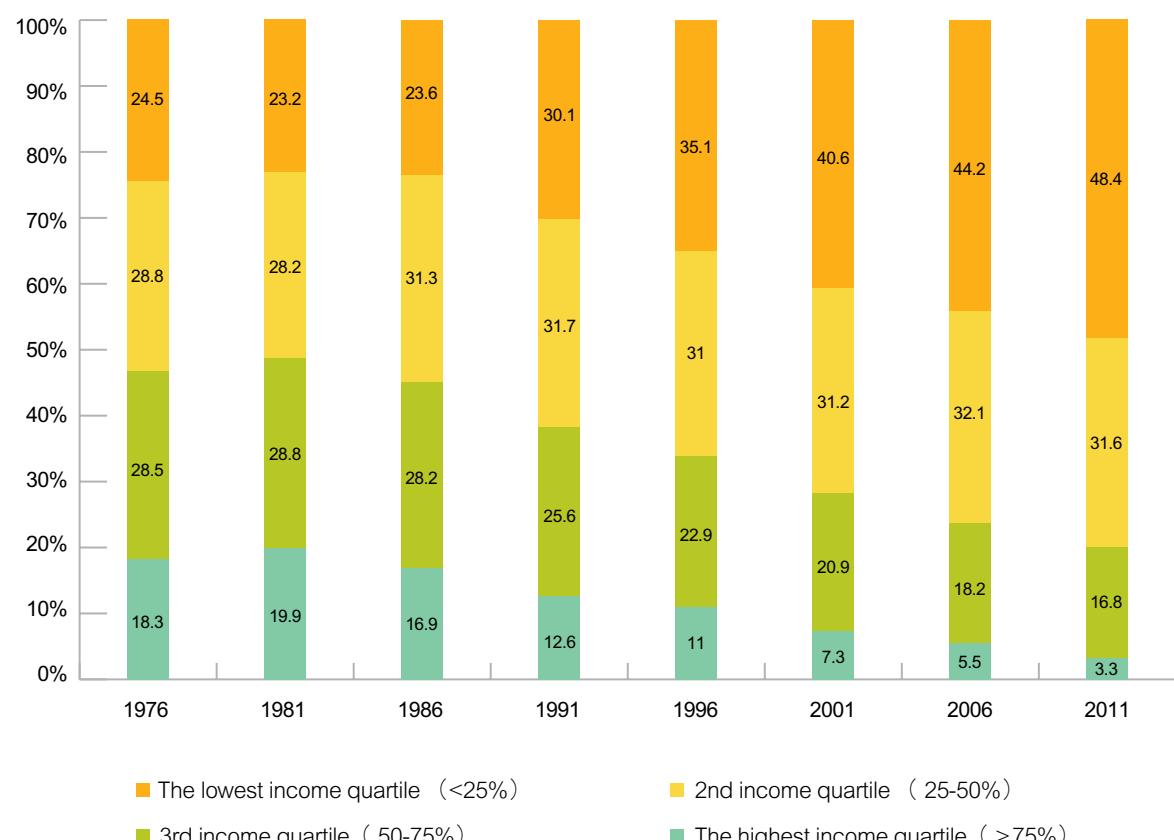
## 2.3. Impoverished tenants' growing dependence on Government assistance

Most people in Hong Kong think of the PRH program as a government subsidy to provide access to shelter to families without means. They expect most of the tenants in these housing estates to be predominantly low-income families.

This was not how the program was initially envisioned. Back in 1953, the Government introduced a resettlement program to house squatters cleared from the land they had occupied without permission. The resettlement policy not surprisingly created powerful incentives for individuals to turn themselves into squatters as a shortcut to receive public housing. In 1954 the estimated number of squatters was only 300,000, but eventually more than a million squatters were resettled. All of these were admitted into the subsidized housing program without a means test. Many living in the PRH flats were not poor.

In 1976, the proportion of PRH households with heads aged 20-65 and incomes in the lowest and second lowest income quartile was 24.5% and 28.8% respectively (see Figure 1). The income profile of these families was not very different from the general public except that their rents were lower because of public subsidy. A common perception that public housing estates over the past 30 or 40 years were providing accommodation for the poor was seriously mistaken.

Figure 1. Distribution of PRH households by income quartile (with head's age 20-65)

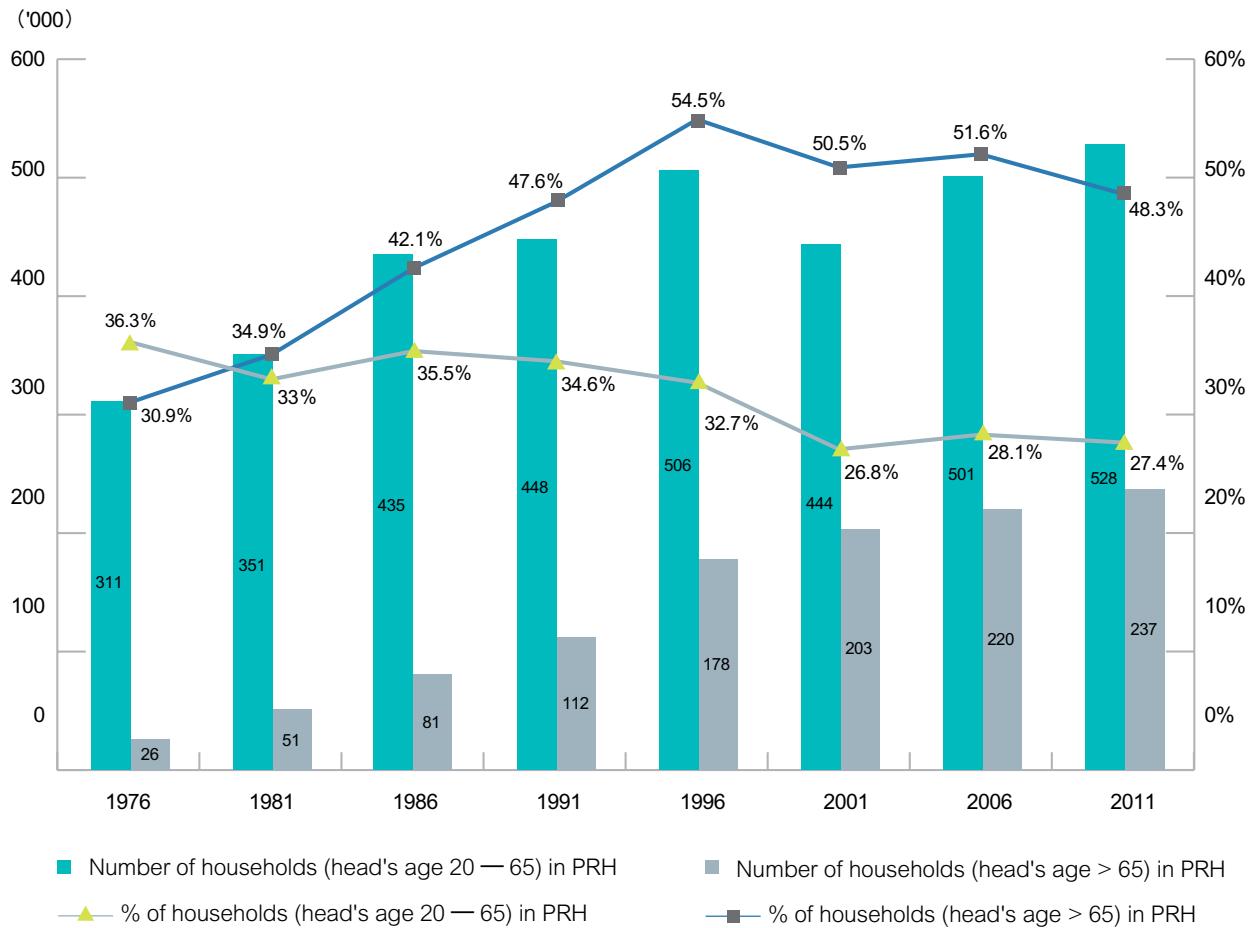


Source: Hong Kong Population Census and By-Census sample databases, 1976-2011

The situation has now changed as PRH tenants are genuinely poor. The proportion of them from the lowest income quartile has increased from an estimated 24.5% in 1976 to 48.4% in 2011, and the proportion below the median household income rose from 53.3% to 80.0% during the same period. Not surprisingly, the highest income quartile earners have mostly disappeared from PRH, decreasing from 18.3% to 3.3% within these 35 years.

Consider that the percentage of households with heads aged 20-65 living in PRH declined from 36.3% in 1976 to 27.4% in 2011 (see Figure 2). By contrast, the percentage of elderly households with heads aged above 65 increased from 30.9% to 48.3% during the same period. The number of elderly households was 237,000 in 2011, which, at 31%, was very high compared to the 528,000 aged 20-65.

Figure 2 PRH Households by Heads' Age



Source: Hong Kong Population Census and By-Census sample databases, 1976-2011

Unlike 30 or 40 years ago, PRH tenants today are poorer. There are not exciting role models for children to look up to. Many of the newer public housing estates are also in distant areas in the New Territories, and children growing up in these fairly isolated communities seldom visit the city center. With limited social capital, low-income families are unlikely to produce much synergy despite being concentrated together. Their social upward mobility is compromised because, as their only source of support, the community network in the housing estates is not enough to enable them to break through their limitations.

In the foreseeable future, the percentage of poor and old people among PRH tenants will continue to increase. Although the rental transfer has made life much easier for them, they will find it more and more difficult to stop depending on public subsidy, let alone buy their own homes. With no source of income, old people will be even more hard pressed to find financial support.

#### 2.4. Negative impacts of mounting rental pressures

Making up a sizable proportion of the population are those who are not yet home owners and are ineligible to be PRH tenants. Even for many of those who are eligible, they have no choice but to rent a private property while they remain on the Waiting List for PRH. Given the surging rents in recent years, according to data released by the Rating and Valuation Department, the average rents for small-ticket flats (under 40 square metres<sup>2</sup>) on Hong Kong Island and in Kowloon and the New Territories increased from \$192, \$166, and \$130 per square meter in 2000 to \$397, \$311, and \$253 per square meter respectively in 2014, representing increases of 1.8 to 2.06 times. However, the median household income increased only by 1.41 times over the same period, lagging noticeably behind housing rents.

Under mounting pressures from the exorbitant rent, people have no choice but to reduce the budget for other expenses, and more and more tenants have to move into smaller units. As a result, quality of life suffers, making it increasingly difficult for first-time home buyers to save for down payment.

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<sup>2</sup> Saleable area.

## 2.5. Increasingly unaffordable property prices

As urban expansion gathers pace, homeownership becomes the most convenient way for low-income families to make money. Property investment is also an easy form of investment that requires little knowledge, something even people with little expertise or education can do. A residential property can not only offer a pool of savings for a family in need of serious cash to tap into, but can also be mortgaged to a bank or be used for retirement protection. The market value of a residential property as a form of savings is determined by the degree of prosperity of its location. That is how personal interests become intricately linked to commitment to one's community. What is good for society also benefits individuals and vice versa.

While the fast-growing economy on the Mainland has contributed to rapid increase in incomes over the years, as its financial market is yet to be fully open, let alone mature, Hong Kong property market has been a magnet for Mainland Chinese investors. This is one of the reasons for the ongoing surge in property prices.

That is why reliable and safe assets suitable for middle- to low-income families have become scarce. The quicker the pace of price increases, the greater the gap between the real value of these families' savings and their age-, health- and death-related expenses. But spiraling property prices have made it impossible for these families to buy their homes while inflation has been eating into their cash savings year after year.

The staggering increase in property prices in recent years means that residential properties have become too expensive for most people looking to buy their homes. According to the Rating and Valuation Department, using the year 1999 as the base number (=1.0), property prices in 2014 are 2.57 times those in 1999. However, the median household income during the 15 years in between increased by just 1.41 times, lagging way behind the increase in property prices (Figure 3).

Figure 3. Comparison between median income and price increases for all classes of properties in 2000 – 2014 (1999=1.0)



Source: HKSAR Rating and Valuation Department, and Census and Statistics Department.

Nowadays a 400-square-feet starter home in the New Territories typically sells for \$4 million. Excluding the miscellaneous expenses, renovation costs, stamp duty, sale commission, and all the other additional costs, with 10% down payment, monthly income remaining unchanged throughout, and providing annual interest rate stands at 2.5% and hopefully will not go up, it will take 64 years for a median-income (i.e., \$23,500 per month, as per 2014 data) household to pay off its mortgage. With a typical working life spanning up to 40 years, failing significantly increased income, most people will never be able to pay off their mortgage in their lifetime.

## 2.6. The growing problem of sub-divided units

Published by the Census and Statistics Department in July 2015, the Thematic Household Survey Report - Report No. 57 (Report No. 57) examined the living conditions of sub-divided units (SDUs). It was found that there were a total of 86,400 SDUs in Hong Kong and the persons living in these units numbered 195,500. The SDUs enumerated in the survey only included those in private domestic/composite buildings (excluding village houses) aged 25 years or above. The median monthly income of SDU households was \$11,800. Among the SDU households, 51.9% lived in the units because of "more affordable rent" and 37.5% found it "convenient to go to work/school".

The persistence of the problem has to do with Hong Kong's public housing schemes. As priority is often given to married couples, particularly large families, low-income, single people have no choice but to live in private rented flats. Poverty and single status thus become two insurmountable obstacles: poverty minimizes their chance of getting married while being single means there is no one to share their financial burden.

Of the households living in SDUs, one-person households make up 31% of the total. Single persons, particularly those who are unable to find permanent jobs and work part time outside office hours, would rather pay high rent and live in SDUs in urban areas. If they move to isolated areas, even a more comfortable environment will never make up for the lack of job opportunities there.

According to Report No. 57, analyzed by district, 19.9% of SDUs were located on Hong Kong Island, 57.7% in Kowloon, and only 22.4% in the New Territories. That means about 80% of SDUs were located in urban areas on Hong Kong side and in Kowloon. The robust demand for SDUs is, after all, the result of scarce supply of small flats in urban areas. As many are drawn to the urban areas, where rents for whole properties have become too expensive, SDUs have sprung up to fill the supply gap.

Since Report No.57 excluded illegally subdivided units in factory buildings and buildings aged below 25, the actual problem of SDUs is likely to be more serious.

## 2.7. The divisive issue of surging property prices

Over the last three decades, Hong Kong has sustained a series of economic shocks with the overall result that the distribution of properties and wealth has deteriorated. In the wake of the 2008 financial tsunami, faced with weak US dollar and low interest rates, Hong Kong has been subject to another form of adjustment. Inflation, particularly rise in property prices, has driven a wedge between the "haves" and the "have-nots". The fact that wealth disparity has been even more serious than income disparity can be put down, to a large extent, to rising property prices over the past two decades. And this problem has been further magnified by the low-interest environment resulting from the peg between the Hong Kong dollar and the US currency.

Hong Kong's housing policy consists in a two-pronged approach, with 53% of its population living in private properties, and the other 47% living in central-planning-style, non-market properties. In times of rising property prices, those unable to own homes would clamour for government intervention. In times of falling property prices, those who own homes would insist the Government should reduce housing supply to prop up the market.

On the other hand, PRH tenants, who have become the vested interests under the current housing policy, just keep asking the Government for rent reduction and exemption, and even refuse to be subject to means tests. Unable to benefit from the rise in property prices, the more PRH tenants there are in society, the greater the obstacle to the upward social mobility of future generations. In the long run, this would even lead to further social polarization, leaving future generations at the mercy of government support.



## 3. Policy Objectives

Over the past three decades, Hong Kong's property market may have gone through some ups and downs but, on the whole, has remained on an upward trend. Who is to know how long it will take for the market to come down? But it would be impractical to expect families with few assets to bide their time, waiting for the prices to fall.

Those longing to buy their own homes are not limited to young men and women at the start of their careers and at the right age to get married. There are also the public housing residents accounting for 30% of the total number of local families, families on the Waiting List for PRH, and those in need of public housing but have so far been left out. These people, who make up over half of local population, should not be deprived of their dream of homeownership.

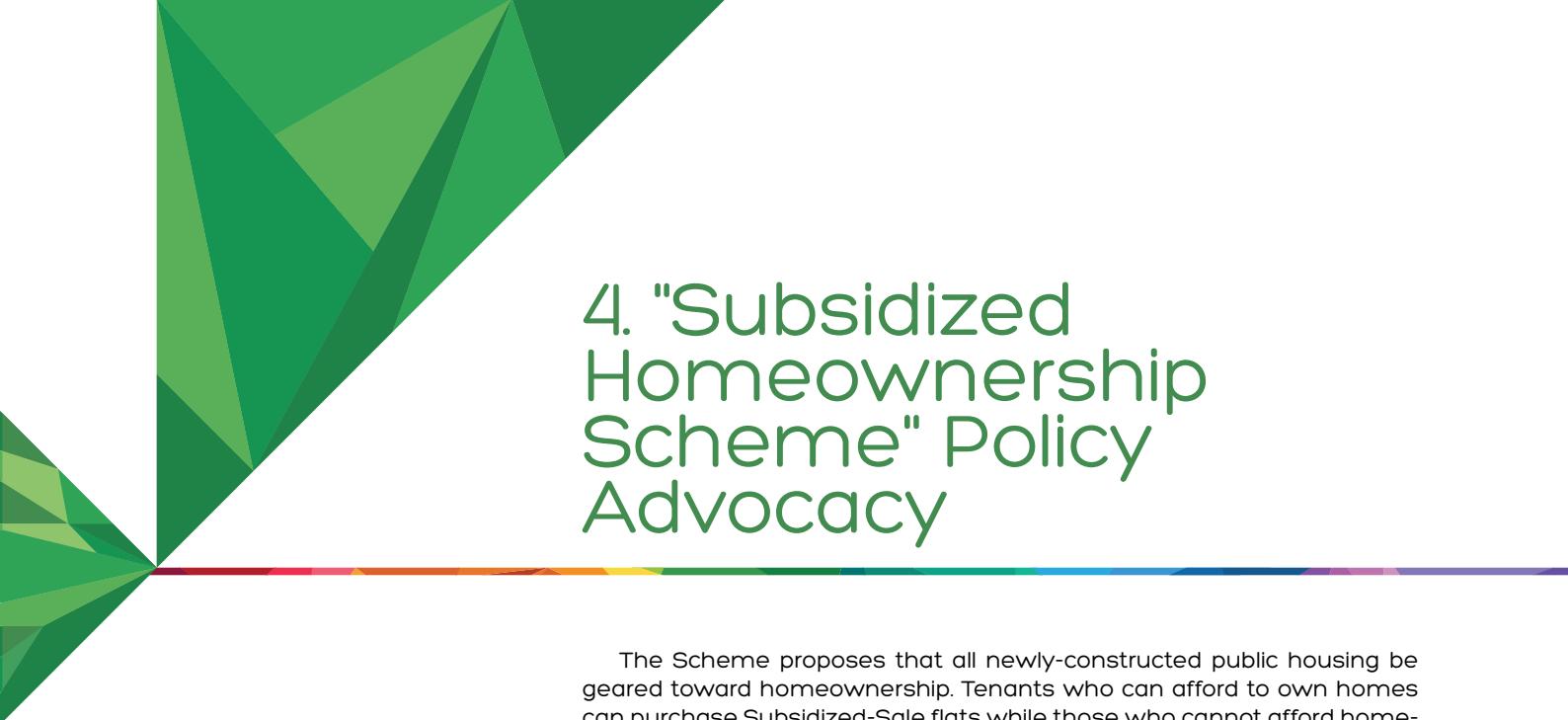
The proportion of PRH tenants from the lowest income quartile has increased from an estimated 24.5% in 1976 to 48.4%<sup>3</sup> in 2011. Thus the increase in poor people living in PRH units is likely to continue. The widening wealth gap will make it increasingly difficult for them to stop depending on welfare, putting an even heavier burden on the Government. The percentage of households with heads aged above 65 living in PRH also rose significantly over a 35-year period, increasing from 30.9% in 1976 to 48.3% in 2011. With no job and little income, old people are more likely to end up in poverty than others. Given the growing life expectancy, old age support has become a challenge to society.

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<sup>3</sup> Hong Kong Population Census and By-Census sample databases, 1976-2011.

Therefore, we propose that the Government should help aspiring home owners to enhance the utilization rate of newly-constructed public housing units and benefit more people. The new public housing policy is aimed at achieving the following objectives:

- Homeownership first, wealth gains later: With ever-rising property prices, the down payment and mortgage loan requirements have become too high. Even skimping on daily necessities, middle- to low-income families will still be hard-pressed to move up the housing ladder. The preferential arrangements and measures provided by the Government will not only help aspiring home owners in particular, but will also enable people in general to gain wealth to meet their needs in life, including those for old age support.
- Enhanced efficiency and better use of resources: The current public housing system is so rigid that tenants find it hard to move out, making it impossible to unlock the market value of the units they live in and keeping market efficiency at an extremely low level. As proposed in this Report, the Subsidized Homeownership Scheme (the Scheme) is aimed at helping tenants to gain ownership of their units step by step, so that the inherent value of public housing units can be enhanced and that, through gradual marketization, such units can be utilized more properly. Resources derived from housing sales can be used not only to support long-term operations of the housing policy but also to implement other measures to improve people's livelihood.
- Less polarization and a more unified Hong Kong: Helping permanent residents, particularly families in need, to own their homes will not only help people to improve their living conditions, and low- to middle-income people to gain wealth through homeownership, but will also enable share in the future of Hong Kong. Preventing our society from polarizing into the "haves" and the "have-nots" will also be conducive to social harmony.



## 4. "Subsidized Homeownership Scheme" Policy Advocacy

The Scheme proposes that all newly-constructed public housing be geared toward homeownership. Tenants who can afford to own homes can purchase Subsidized-Sale flats while those who cannot afford homeownership can rely on Rent-and-Buy arrangements, enjoying affordable rent by becoming PRH tenants before they choose to buy the flats eventually. With government guarantee, eligible buyers can enjoy 90% to 95% mortgage.

### 4.1 Subsidized-Sale flats

Eligibility requirements for purchase of Subsidized-Sale flats are the same as those for HOS flats. New flats available for sale in each phase of development will be open for a fresh round of applications.

### 4.2 Rent-and-Buy flats

For those who have passed the means tests and are on the Waiting List for PRH, once they become tenants, they have the right to choose whether to purchase the public housing flats they live in while enjoying affordable rents. There is no expiry date for the right, which can be retained by tenants for future use, for as long as they remain eligible for public housing. As long as the tenants' assets and incomes do not exceed the limit, they can freely choose whether to rent or buy. Tenants who choose to rent will pay the rent in accordance with the current public housing policy. The rent will be fixed according to current standards.

Those who choose to buy can buy their flats at a below-market-level, affordable price. The price will be fixed on the day of occupation and will remain unchanged regardless of future market fluctuations. In other words, tenants can choose to buy even after living in the flat for 20 years and the sale price will be the same as that 20 years ago.

Under the Rent-and-Buy Scheme, a tenant who could not afford down payment and mortgage payments at first, once their financial conditions have improved, can purchase the flat at the price fixed in the year of occupation. It is also entirely up to them to decide if they would choose to remain tenants, provided they meet the eligibility requirements.

Some public housing tenants take issue with the "well-off tenants" policy in that it requires tenants to be subject to means tests once every two years, and "super well-off tenants" to move out. With the Subsidized Homeownership Scheme, the "well-off tenants" can buy the flats they are living in at preferential price with no fear of being forced to move out.

### 4.3 Subsidized-Sale flats and Rent-and-Buy flats: ratio and allocation

The current ratio between PRH flats and HOS flats is around 2:1<sup>4</sup>. As specified in "Long Term Housing Strategy", the ten-year housing supply target ratio between PRH flats and HOS flats is set at 2.2:1<sup>5</sup>. Therefore, the ratio between Rent-and-Buy flats and Subsidized-Sale flats will be similar in the initial stage of implementation of the proposed Scheme. The exact ratio can be subject to adjustment according to public demand.

The allocation of the units will be in accordance with the current PRH and HOS systems. If there is general consensus in society that young people are in need of greater assistance, the Government can reserve a small portion of the units for young people to apply for.

#### 4.4. Super-high LTV ratio for subsidized housing guaranteed by the Government

The challenge facing grassroots populace is that their wealth and income simply are not enough for them to secure a loan for the down payment from the free market.

In view of the standing arrangement for mortgage loans for HOS unit purchases to be backed by government guarantee, we propose that the Scheme should also enjoy Government guarantee so that up to 95% mortgage<sup>6</sup> can be provided and information risk in the capital market can be optimized, and that the underprivileged can be enabled to overcome their hardship and be first-time home buyers. Take a \$4 million flat for example, the sale price of the flat at \$2 million offered by the Government plus 95% mortgage, i.e., down payment of \$100,000, would be affordable to a low-income family.

Default risk for guaranteed mortgage loans should not be a problem for the Government as it can repossess the property if necessary and allocate it to the next in line on the PRH Waiting List. Since data released by the Monetary Authority shows that the mortgage delinquency ratio has remained stable at between 0.02% and 0.03%<sup>7</sup> since 2010, default risk is extremely low.

#### 4.5. Pricing of subsidized housing

Since the Scheme is aimed at helping members of the public to be home owners, pricing of the units will be geared towards affordability for them.

Pricing will be based on the income limit of the Scheme at the time. For example, based on a \$4 million starter home, the upper income limit for a two-person household for 2014/15 would be \$14,970.

With down payment set at 10%, using half of income limit for a 30-year mortgage, and annual mortgage rate at 2.5%, the unit should be priced at \$2.1 million. Hence, a Rent-and-Buy unit that is worth \$4 million on the market will be priced at \$2.1 million and offered through the Government, and the difference of \$1.9 million will be the premium. With 30% of the income limit as the benchmark, and priced between \$1.2 million and \$1.3 million, the premium will be \$2.8 million. There will be much room for further discussion as to which benchmark to use for pricing.

<sup>4</sup>According to Housing in Figures 2014 published by the Hong Kong Housing Authority, there were a total of 782,000 PRH flats and 394,000 HOS flats in Hong Kong. The ratio between the two types of flats was approximately 2:1.

<sup>5</sup>200,000 PRH flats and 90,000 HOS flats.

<sup>6</sup>Up to 95% of loan-to-valuation ratio for Green Form applicants.

<sup>7</sup>Based on the residential mortgage survey results, the Monetary Authority collected data on mortgage loans overdue for three to six months.

Using the above benchmark, larger units will be priced at higher levels. More ideal units (with better location, higher floor, and more ideal orientation, etc.) will be priced higher. Less ideal units will be priced lower.

Every time a new batch of new units is launched, the units will be priced in accordance with the income limit under the Scheme rather than the actual income of each household. Therefore, even the actual incomes and the size of the household vary, households living in similar units pay exactly the same purchase price. Hence such a "same goods for the same price" principle of fairness will ensure that individual tenants will have little incentive to be evasive or hold back in their income declaration.

#### 4.6. The new premium-payment methods

At present, the premium for HOS units and units sold through the Tenants Purchase Scheme (TPS) are linked with market prices. The premium will go up when prices surge. The expensive premium payment as a result has been a major deterrent to owners who may want to make premium payment. The current policy has not been able to significantly increase the circulation of PRH units and HOS units in the open market. Owners of PRH units and HOS units have not been free to utilize the "flat for flat" arrangement to find a unit they are happy with. Thus the disconnect between PRH units and HOS units on the one hand and the open market on the other has compromised market efficiency.

One major feature of the Scheme is the improvement in premium-payment methods.

## 4.6.1. Four premium-payment methods

In the following, four methods of premium payment are presented for public discussion. We anticipate that one of the four will be chosen as the final method to settle premium payment.

### Method A: Zero premium payment

Suppose there is a five-year moratorium on the sale of the unit, after buying the unit for five years, the owner can enjoy full ownership of the unit and sell it at market price without having to pay the premium.

### Method B: Discounted premium in year of occupation

The premium is fixed at the level in the year of occupation with discount. Suppose the market value of the unit is \$4 million, the premium is \$2 million. With 20% discount rate, the discounted premium is 80% of \$2 million, which is \$1.6 million. The amount of premium is fixed in the year of occupation and will not vary with market changes.

### Method C: Either premium in year of occupation or market premium

This approach gives an owner the choice to pay either the premium in year of occupation or market premium.

Example 1: Premium in year of occupation is \$2 million. Though the unit appreciates in value, and the market premium rises to \$3 million, the owner will only need to pay a \$2 million premium.

Example 2: Premium in year of occupation is \$2 million. Followed by a market downturn, the market premium drops to \$1 million, the owner will only need to pay a \$1 million premium.

### Method D: Either the average premium or market premium

The average premium is calculated by summing up the annual values of premium from year of occupation to year of payment then dividing the total by number of years of occupation.

This approach gives an owner the choice to pay either the average premium or market premium.

Example 3: Market premium is \$2 million for year one, \$2.2 million for year two, \$2.4 million for year three, \$2.6 million for year four, and \$2.8 million for year five. The owner decides to pay the premium in year five and the average premium is the total premium over five years, i.e., \$12 million divided by 5, which equals \$2.4 million.

Market premium for year five is \$2.8 million and the average over five years is \$2.4 million. Though the unit appreciates in value, the owner will only need to pay a \$2.4 million premium.

Example 4: On the contrary, if property prices are on a downward trend, premium is \$2 million for year one, \$1.8 million for year two, \$1.6 million for year three, \$1.4 million for year four, and \$1.2 million for year five, and the owner decides to pay the premium in year five, the average premium is the total premium over five years, i.e., \$8 million divided by 5, which equals \$1.6 million.

Market premium for year five is \$1.2 million and the average over five years is \$1.6 million. The owner will only need to pay \$1.2 million premium.

In summary, Method A provides direct subsidy to the owner; Method B provides partial subsidy; Method C caps the premium payment; Method D provides a mechanism to hedge against upside market risk. As for the current policy which allows the premium to rise with market prices, as it will seriously dampen the incentive for premium payment, and is thus detrimental to unit circulation and market efficiency, it is not worth considering.

## 4.6.2. Subsidizing the time cost of premium payment

In theory, owners only acquire full ownership after premium payment is settled. When owners are allowed to postpone premium payment for public housing, time cost is incurred. Below are three suggestions to deal with the time cost issue of premium payment:

### Method 1: Market interest

Regardless of how the amount of premium is calculated, some regard the premium as a government loan to the owner. The government's role is to solve the owner's capital flow problem. Since who opt for payment of premium should have already completed their mortgage payment, they are not the ones who most need help from the government; therefore the government should not subsidize the time cost for making premium payment and an interest on the payment is justified.

Suppose, the premium payment is \$2 million, and after living in the unit for 10 years, the owner wants to pay the premium, he will need to pay the \$2 million plus interest for the 10 years. If the market interest rate is 2% and interest is compounded annually, the premium payment will be \$2.44 million.

### Method 2: Below market interest

The government can sponsor part of the time cost by offering a below market interest rate.

### Method 3: No interest

The government can generously subsidize all time cost without incurring any interest on the premium payment.

Figure 4. An overview of premium-payment methods

4 Premium- Payment Methods	Time Cost Subsidy
Zero premium payment	Market interest
Discounted premium in year of occupation	Below market interest
EITHER premium in year of occupation OR market premium	No interest
EITHER the average premium OR market premium	

Despite the fact that more subsidies lead to greater market efficiency, representatives from various social sectors may have different opinions. There are pros and cons to each of the above premium-payment methods. The question of which premium-payment method to use for the Scheme can be open for public discussion.

## 4.7 Limitations on the sale of units

Limitations on the sale of the units under the Scheme are similar to those for HOS units. Whether or not premium payment is necessary, to prevent speculation, the subsidized units are not allowed to be sold or let within five years of purchase.

## 4.8. Secondary market for HOS units pending premium payment

If it comes to paying the premium for units sold under the Scheme (by premium payment method B to D), the units pending premium payment can be exempt from such payment and sold to eligible applicants (the same as the White Form HOS Secondary market for White Form applicants). Following alienation of the unit, the new owners will still be required to pay the premium before they can freely sell or let the subsidized housing unit in the open market.

Letting subsidized housing units pending premium payment to eligible persons may involve property rights-related issues and thus legal risks. Nevertheless, if this can be resolved by legal and administrative means while letting the units to those on the Waiting List is also conducive to enhancing market efficiency.

If public opinion is in favor of premium payment method A, i.e., zero premium payment, there will be no Secondary Market for units pending premium payment and all subsidized units can be freely sold or let in the open market.

## 4.9. Enhanced premium-payment methods for HOS and Tenants Purchase Scheme units

At present, the premium payment method for HOS and Tenants Purchase Scheme (TPS) units can vary with the new premium payment methods of the Scheme.

## 4.10. Limitations of the Subsidized Homeownership Scheme

- **One-off benefits:** Eligible Hong Kong residents can each enjoy the subsidy only once. They can each choose to purchase a Rent-and-Buy or Subsidized-Sale unit at subsidized price once.

- **Priority to Hong Kong people:** The “majority” of the members of each eligible household must be permanent residents in Hong Kong for seven years. As for two-person households, both members must be permanent residents in Hong Kong for seven years. The requirement is in accordance with the 1998-99 eligibility criteria for PRH of the HA<sup>8</sup>.

In 1999 - 2000, the eligibility criterion was relaxed and only “at least half of” the members of each eligible household, e.g., either member of a two-person household, must be permanent residents in Hong Kong for seven years<sup>9</sup>. This caused the percentage of new immigrants from the Mainland living in Hong Kong for less than seven years who were PRH tenants to increase significantly from 26.2% in 1996 to 45.3% in 2001, 52.4% in 2006, and 45.1% in 2011<sup>10</sup>.

Sticking to its “priority to Hong Kong people” principle, the Scheme proposes to adopt the former criterion.

<sup>8</sup>The Hong Kong Housing Authority Annual Report 1998/99, Appendix 6A, pages 127-128.

<sup>9</sup>The Hong Kong Housing Authority Annual Report 1999/2000, Appendix 6A, pages 111-112.

<sup>10</sup>Population Census 2001 & 2011.

#### 4.11. Adjusted supply of public housing

As local society evolves, Hong Kong people's housing needs have also been changing. According to the HA's data, in late June 2015, among the total number of 282,200 applications for PRH, half of them - 142,000 were applications by Quota and Points System set for PRH non-elderly single applicants, but the percentage of one-person households among PRH tenants in Hong Kong only increased from 15.6% in 2001 to 17.1% in 2011. The chance for single persons to be allocated PRH units under the current mechanism is very low. The average number of household members decreased from 3.1 to 2.9<sup>11</sup> over the same period. Over 20 years, the percentage of one-person households and two-person households increased significantly from 12.34% and 18.39% (1995 Q1) to 16.86% and 27.52% (2015 Q1)<sup>12</sup> respectively.

Given the increasing number of single-person and two-person households, the decreasing number of household members, and rising demand for small units, future construction of public housing units should be geared towards providing smaller units. In line with the abovementioned Rent-and-Buy Scheme, small units are also more suitable for first-time home buyers. Over the years, the average living space per person for PRH tenants has been on the rise, increasing from 11.5 square meters in 2004 to 13 square meters in 2014<sup>13</sup>. Since the average number of household members has been decreasing on an annual basis, smaller units are unlikely to compromise the average living space per person for the tenants.

Therefore, the Government should focus on the construction of smaller units to help first-time home owners, satisfying the housing demands of modern-day tenants and benefiting more households.

#### 4.12. Next step for the Subsidized Homeownership Scheme

Initially, the Scheme only applies to tenants of newly-constructed units. If the Scheme runs smoothly, public opinion is in favor, and there is also demand from existing PRH tenants, the Scheme can be expanded to cover all PRH tenants in Hong Kong.

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<sup>11</sup>Population Census 2001 & 2011.

<sup>12</sup>Census and Statistics Department.

<sup>13</sup>"Housing in Figures 2014" published by the Hong Kong Housing Authority.



## 5. Advantages of the "Subsidized Homeownership Scheme"

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### 5.1. More choice and greater flexibility

Some people prefer to remain PRH tenants and enjoy affordable rent. Some people long to be home owners and reap the benefits of rising property prices. The Scheme will give people the flexibility to choose whether to rent, buy, or rent to buy, making it possible to fulfil both the wish of finding an affordable home and that of owning a home. The Government can meet public demand by adjusting the ratio between Rent-and-Buy units and Subsidized-Sale units with flexibility in accordance with market conditions.

### 5.2. A reconstructed housing ladder

The ever-rising property prices in recent years have resulted in a broken housing ladder. The exorbitant housing costs have left more people stuck with their public housing units and unable to stop depending on public housing subsidy, making it almost impossible for them to own homes. The Scheme will provide the preferential arrangements and incentives so that the housing ladder can be reconstructed to enable aspiring home owners to move up the ladder step by step and achieve homeownership eventually.

### 5.3. Higher market efficiency

Since under the Scheme, more public housing units will be made available to the open market in the long run, the existing public housing resource mismatch will be minimized. Tenants with the means can buy larger units in the open market. Those who want to shorten travel time to work and school can move to a more convenient location. This will mean greater choice for tenants and greater benefits for individuals, families and the community at large.

### 5.4. A more unified Hong Kong

The Scheme advocates homeownership for all to create access to upward social mobility. With more people from a lower social echelon joining the ranks of the haves, social harmony can be enhanced, thus alleviating conflicts between the haves and the have-nots, unifying public interests, and facilitating governance.

The Scheme aims to encourage PRH tenants to become home owners step by step so that public housing estates will no longer be “community of poor people”. This will also be conducive to social harmony while alleviating regional social problems associated with the concentration of the underprivileged in public housing.

## 5.5. Public housing cost recovery

As pointed out in “Long Term Housing Strategy”, “the supply of new PRH units cannot be unlimited from the perspective of both land and financial resources.” With a year-end surplus recorded at \$65 billion for 2014/15<sup>14</sup>, and its financial reserves expected to be reduced to \$28.3 billion by 2017/18<sup>15</sup>, and an additional 200,000 PRH and HOS units to be constructed between 2019 and 2023, the HA faces substantial financial pressure in the long run. Apart from construction and land development costs, rental income generated by completed units will not be enough to cover management and refurbishment costs. As construction costs and operating expenditure continue to rise, even the HA’s old practice of using surplus generated from HOS sales to finance public housing is unlikely to make up the deficit. As the Government may need to inject additional funding for public housing construction and operation by tapping into its tax revenue on a yearly basis, public expenditure is bound to increase.

The Scheme proposes to adopt a “land-for-flats” approach, unlocking land value as an additional source of funding to replace the model of funding the entire public housing system by tax-revenue alone. This will enable the HA to recover part of its costs and thus find some relief from financial stress. Resources saved from public housing expenditures can be used by the Government to meet other social needs. At least the public housing system will be self-sufficient enough to help the next batch of PRH applicants. Society as a whole will benefit if the value of public housing wealth can be unlocked.

## 5.6. Protection against challenges of an ageing population

In terms of utilization of public resources, as PRH units gradually become private property, the Government can recover part of the value of its land resources to meet increasing expenditures on old age support and health care, bringing tremendous benefit to society.

In addition, Hong Kong has always adhered to a low-tax policy and has followed the principle of keeping the expenditure within the limits of revenues. It does not have a large pool of income tax revenues to sustain an ageing population. “Homeownership as old age support” is a strategy for Hong Kong to move towards an “asset-based” welfare policy.

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<sup>14</sup> Corporate Plan 2015/16 of the Hong Kong Housing Authority, 7. Consolidated Budgets.

<sup>15</sup> Minutes of the Regular Open Meeting of the Hong Kong Housing Authority held on 24 January 2014, paper HA 11/2014.

Most European countries have relied on an “income-based” welfare policy. As welfare expenditures require the backing of a huge tax base, the financial strain has become unbearable while tax increase is out of the question. As a result, these countries have begun slashing welfare spending in recent years. An “asset-based” welfare policy is beneficial in that under such a policy the government encourages citizens to invest in assets and human resources to gain wealth for different purposes. Even if income dwindle eventually, they will be able to meet their consumption and welfare expense needs by tapping into their assets (Sherraden, 2003). Assets provide protection against emergencies in life, such as reduced income and increased expenses associated with unemployment and health deterioration. Such protection will also lessen people’s reliance on government, family or community support. Asset-based welfare will also promote economic and social development as well as encourage savings (Gamble and Prabhakar, 2005), and terminate the conflict between development and welfare (Doling and Ronald, 2010).

With almost half of elderly households (with heads aged over 65) now living in public housing estates, and further increase in their numbers to be expected, it seems obvious that old age support should naturally focus on selling our public housing estates to sitting tenants at an affordable price. In principle, recurrent Government funding is not required as it would be financed by land that currently has no market value because PRH units are non-traded assets. This would allow those still in their prime to cheaply acquire an asset that could provide for their old age support.

Encouraging homeownership will allow more people to share the benefits of rising property prices and use their property to secure a reverse mortgage or buy an annuity for financial support in their retirement. This will serve to exemplify the principle of “homeownership as old age support”, and will go a long way towards addressing the problems of elderly poverty support in Hong Kong. Turning most people into home owners will also enable the government to channel its resources towards helping those in need.



## 6. Concerns over the Scheme

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### 6.1. Adverse effect on private home price?

Some people worry that selling a large number of public housing units would cause overall property prices to tumble. However, the Scheme is aimed at enhancing market efficiency rather than increasing overall housing supply. Since the Scheme only covers newly-constructed public housing units, it will have little adverse effect on the overall housing market.

Theoretically, tenants who purchase Rent-and-Buy units are first-time home owners. Even if they gain full ownership and sell the unit in the open market, they will still have to find another unit to move into. Unless their Subsidized Homeownership unit has been unoccupied before sale, market supply will not increase. Even if it does, the rate of increase will be limited. As for Subsidized-Sale units, since the arrangements will be similar to those for the HOS Scheme, and supply will be limited, it is unlikely to topple the housing market.

Research shows that since homeownership schemes are aimed at wealth creation, the resulting “wealth effect” will become a driving force behind buying power and have a stabilizing effect on housing demand rather than being an unwanted drag on the housing market.

In the long run, if the Government focuses on the provision of small units, tenants of these small units, once they have the financial means, can trade up and move to medium-large ones. As more and more PRH units become available for sale or rent on the open market, and these are usually small units, this will serve to increase overall supply of small units on the market and mitigate the upward pressure on rents of SDUs and prices of starter homes.

### 6.2. Forced homeownership?

There is some concern that the Scheme may deprive people of their freedom of choice and force them to be home owners, even putting low-income families under pressure to buy homes.

It must be reiterated that the Scheme is merely intended to give people more choice by enabling aspiring home owners who cannot afford the daunting property prices to buy starter homes. As for those who have no wish for homeownership, so long as they are eligible, they will always be allowed to remain PRH tenants. With the access to homeownership provided by the Scheme, they will have the freedom to decide whether or not to exercise this right.

### 6.3. Risk of market downturn?

The Home Starter Loan Scheme was launched in the 1990s to help citizens purchase their own homes. However, the market reversal that followed led to the creation of many negative-equity home owners and the Government was criticized for “causing people to jump into the fire”. Hence some people worry that, by continuing to encourage homeownership, the Government will make the same mistake in case of market reversal.

Firstly, the Government only provides an option but not an obligation into homeownership. As long as their incomes or assets remain below “super well-off tenants” level, sitting tenants can live in the PRH units permanently.

Secondly, the units are already sold at preferential prices well below market levels, offering greater buffer against market movements than private properties. For example, a unit worth \$4 million on the open market is available for sale to tenants for \$2 million. Unless property prices plummet by 50%, the units are unlikely to be in negative equity.

### 6.4. Inducement to speculation?

Some worry that the Scheme will be an inducement to speculation, causing even the prices of public housing units to soar.

Firstly, owners are not allowed to alienate their units within the first five years of purchase. Secondly, theoretically speaking, a unit bought through the Scheme is the first property ever owned by the household. If they choose to sell it, they will have to find another home. Thirdly, it will not be easy for them to get a remortgage loan to buy a second home. With the Government’s help, an eligible household pays only 5% to 10% down payment for the first property but, for a second home, down payment will be at least 30% to 40%. Subject to pre-eligibility means tests, a household will be hard pressed to buy a second home when they are still saddled with the first mortgage loan and may not be able to pass a bank’s stress test. At present, a tenant must have good reason for remortgaging a flat pending premium payment before they can get permission from the Housing Department. Incorporating this requirement into the Scheme would limit the number of eligible tenants. Even if they can get a second mortgage, the loan amount will be limited and loan interest will be high.

Given the above conditions, speculation on homes bought through the Scheme will be extremely limited. So there is no cause for alarm over speculation and the Scheme is in line with the “homeownership first, wealth gains later” objective.

### 6.5. Unfair treatment to existing owners?

As for those who already own their homes and home owners who are ineligible for the benefits of the Scheme, they may take issue with the Government’s large-scale subsidy for home buyers, which is tantamount to giving away public resources to some people.

Firstly, at present, public housing involves huge expenditures and annual injection of substantial resources to help PRH tenants who make up 30% of the population. The rent is cheap but recovery of construction and land costs is out of the question.

For instance, a unit that rents for \$20,000 per month in the open market is rented to PRH tenants for just \$3,000 per month. In other words, the Government's monthly subsidy for the tenants amounts to \$17,000. Even without accounting for rent and market adjustments, accumulated subsidy will be more than \$2 million in 10 years and in excess of \$4 million in 20 years. That means actually subsidizing the housing unit for 20 years will be equivalent to giving away the cost of the unit in full.

In view of the fact that the cost of PRH units is virtually the same as that of selling them, what is being queried is just the subsidy approach. The Government may be sitting on a vast pool of assets in the form of PRH units. But the assets will go to waste if their true value stays locked while the PRH tenants remain unable to make good use of them. Capping the subsidy by selling the units will enable PRH residents to gain wealth and lessen their reliance on Government assistance on the one hand, and facilitate utilization of public resources and reduce the burden on tax-payers on the other hand. A truly two-for-one bargain.

Since house price prices are unlikely to plummet because of the wealth effect created by the Scheme, existing home owners are unlikely to suffer as a result.

While the Scheme proposes to sell PRH units to citizens at discounted prices, eligible buyers will have to pay the down payment and make mortgage payments for a time before they gain full ownership of the asset. Compared with endless monthly rental subsidy, the Scheme will provide a strong incentive for public housing residents to strive for home-ownership.

In addition, since the Scheme carries means tests while existing home owners are ineligible to be PRH tenants or buy HOS units anyway, theoretically speaking, only those who genuinely need to buy will be eligible. If the Scheme proves popular, it may be worth considering sharing the benefits by allocating some of the units for application by drawing lots for citizens above the means test limit. As such citizens tend to have higher incomes and more assets, Government subsidy for them will be lower.

## 6.6. Thorny issue of premium payment?

Given the unpopularity of premium-payment arrangements for both Tenants Purchase Scheme (TPS) and HOS, some people are skeptical about the supposed efficiency-enhancing effect of the Scheme on the housing market.

The Scheme will have the desired effect because to facilitate payment, premium-payment under the Scheme will not be linked to the rising market prices. Reforming both TPS and HOS accordingly will also help to boost the availability of homes in the open market.

Moreover, since under the Scheme all newly-constructed public housing units will be available for purchase, the market for housing units with premium-payment option will be expanded while the circulation of such units in the open market will also be increased.

Finally, the question of whether or not premium payment is necessary under the Scheme and how the payment should be made can be further discussed through public participation.

## 6.7. Tricky mixture of renters and owners?

In view of the fact that TPS has been criticized for creating management problems by mixing renters and owners, there is concern that the proposed Rent-and-Buy Scheme will also pose similar problems.

In the past, management problems were often caused by conflict between renters and owners resulting from lack of common goals and different needs. In the long run, the Scheme will enable renters to focus on their future interests. With the exception of those who have neither the means nor the intention to own their homes, aspiring home owners among the renters will adjust their behavior accordingly and adopt a more homeownership-oriented attitude. This will help to minimize differences over property management between renters and owners.

## 6.8. Corrupting influence of welfare?

There are those who worry that helping some people to buy their homes at below-market prices will induce more and more people to pass the means tests, by fair means or foul, just to be eligible for the benefits. For example, to qualify as PRH tenants, some may quit their full-time jobs or work part time rather than full time; a married couple may file for divorce for an additional PRH unit; and the young may hold off on finding full-time work until they secure a PRH unit.

Actually, even under the existing public housing system, such dishonest behavior already exists among potential tenants. Living in a low-rent PRH unit means being entitled to monthly income subsidy by the Government. For example, for a PRH unit to rent for just \$2,000 per month while the market rate is \$15,000 per month in the same district, the monthly welfare transfer amounts to \$13,000. Although the incentives for dishonest behavior tend to increase with rising property prices and rents, there is no reason to suggest the Scheme will suddenly boost the number of dishonest people.

In addition, under the current public housing system, tenants with assets above the limit are required to pay one and a half times rent while "super well-off" tenants are even required to move out. For tenants with incomes just slightly above the applicable limit, there is considerable incentive for them to lie about their incomes. Unless they can readily increase their incomes to such an extent as to exceed the limit, so that they can easily find a better place to live, the incentive for them to achieve upward mobility will still be compromised by the existing public housing system.

Those who are concerned about the so-called "corrupting influence" of the Scheme should be reminded that the potential for dishonest behavior also exists for the current public housing system. Surely it does not mean that, because of this, the current system should be abolished. A new policy is worth supporting so long as the potential benefits far outweigh any potential harm.

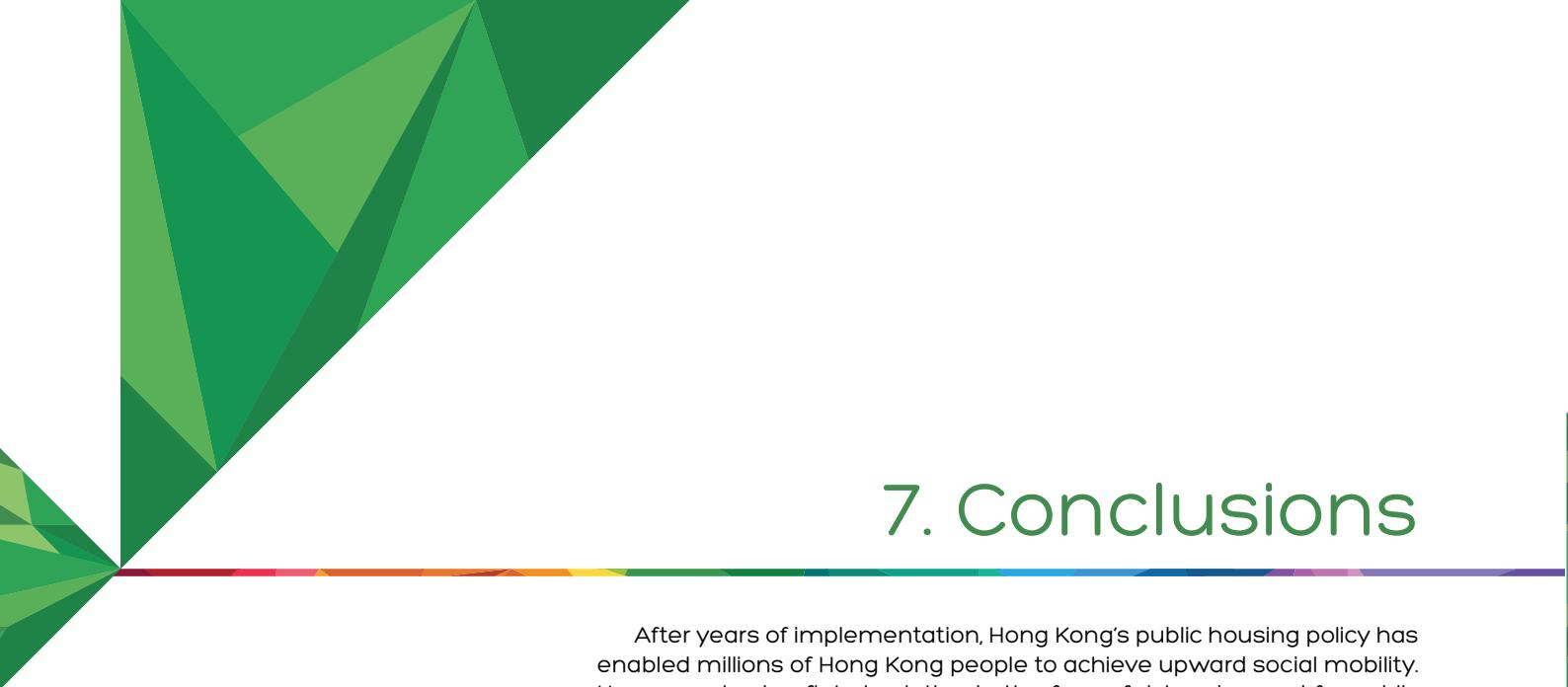
A good welfare system should encourage citizens to work harder for better gains, thus reducing the incentive for deception, but not to stop working hard when overall gains decrease, cutting their career development short.

The Scheme proposes to reform the current public housing system in such a way as to do away with means tests by enabling PRH tenants to become home owners. The Scheme will give tenants an achievable goal to strive for, i.e., through savings for down payment and monthly mortgage payments, so that they will acquire ownership and have the flexibility to move as well as a chance to increase the value of their housing asset and use it to secure financing. This will spur them on to work harder, providing them with a stronger motivation to participate in the labor market.

### 6.9. Privatization: obstacle to redevelopment?

Some people worry that privatization of PRH units will lead to fragmented ownership, making redevelopment difficult.

Given the units' nature as subsidized housing, we propose that, to redress the problem of fragmented ownership, consent from just 70% of owners should suffice for redevelopment to go ahead. This suggested percentage is less demanding than current requirements ranging from 80% to 90%.



## 7. Conclusions

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After years of implementation, Hong Kong's public housing policy has enabled millions of Hong Kong people to achieve upward social mobility. However, slowing flat circulation in the face of rising demand for public housing, and the inherent problems of efficiency have prevented the unlocking of the immense value of public housing resources. In their desperation to cling to their PRH units, many tenants have resorted to dishonest actions and thus have been unable to find the right way to live contentedly.

Rising property prices have made homeownership beyond affordable, thwarting the dreams of many aspiring home owners. Ongoing increases in property prices have also made it difficult for some people to gain wealth, leading to an ever-widening wealth gap with a polarizing effect on society.

Our Research Team believes that efficiency and equality are not mutually exclusive. We hope that by reforming the existing public housing policy, we can introduce a Rent-and-Buy approach to bridge the gap between past and future in public housing. What we hope to achieve is that, on the one hand, on condition that the interests of existing tenants and home owners are protected, a stable supply of affordable public housing for people in need will be maintained, and on the other hand, access to homeownership will be made more widely available to satisfy people's different needs in life. In the process, a more effective use of public resources will also help people to realize their dreams and enrich their lives.