

# Report on the Review of Schemes to Promote Home Ownership

## Hong Kong Housing Authority

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### TABLE OF CONTENTS

#### [INTRODUCTION](#)

#### [SECTION 1 : THE HOME OWNERSHIP SCHEME](#)

#### [SECTION 2 : THE HOME PURCHASE LOAN SCHEME](#)

#### [SECTION 3 : OPTION TO RENT OR BUY](#)

#### [SECTION 4 : THE SALE OF FLATS TO SITTING TENANTS SCHEME](#)

### INTRODUCTION

1. In November 1991, the Housing Authority decided that there should be a review of its various schemes for promoting home ownership, following the poor response to the Sale of Flats to Sitting Tenants Scheme.

#### **Terms of Reference**

2. The terms of reference of the review are -

To consider -

- (a) how the Authority can best promote home ownership among public housing tenants and that section of the general public that cannot afford to buy reasonable accommodation in the private sector; and
- (b) what modifications should be made to its existing and proposed schemes, and whether there should be other schemes, having regard to the need for a high level of private sector production and to ensure that the Authority has sufficient income to finance its construction and management programmes.

#### **Meetings and Consultations**

3. The Authority subsequently held six special meetings in the course of the review. A series of four consultation meetings on the Sale of Flats to Sitting Tenants Scheme was arranged between Authority members and members of District Boards and Area Committees, together with representatives of certain concern groups.

### SECTION 1

## **THE HOME OWNERSHIP SCHEME**

1. The Home Ownership Scheme (HOS) and the Private Sector Participation Scheme (PSPS) are the Authority's major schemes to promote home ownership. During the 13-year history of the HOS, 160,000 flats have been sold to lower middle income families from the private sector and to public housing estate tenants and prospective tenants.

2. The policies of the Authority for the HOS were examined in depth by the Home Ownership Committee in July 1991. The committee looked at the past performance of the Scheme and the various changes made over the years, concentrating on six major topics.

### **Management**

3. It was originally intended that management of HOS estates would be undertaken by the Housing Department. This led to ever increasing manpower requirements and, against a background of encouraging owners to play a part in the management of their estates, it was decided to introduce private sector management companies to several estates as a pilot scheme. These companies manage the estates on behalf of the Housing Authority. The pilot scheme proved successful and now all new HOS estates are managed by private agencies. This arrangement was reaffirmed by the Home Ownership Committee.

### **Mortgage Arrangements**

4. Mortgages for HOS and PSPS flats are provided by around 50 institutions at favourable interest rates. Purchasers may obtain mortgages of up to 20 years for up to 90% or 95% of flat prices, for white form and green form purchasers respectively.

### **Resale Restrictions**

5. HOS and PSPS flats are subject to restrictions on sale. During the first five years of ownership, an owner can only sell his flat to the Authority at its original price. During the second five years the price assessment is based on similar HOS flats for sale by the Authority at the time. After ten years an owner can sell on the open market but only by first paying to the Authority an amount equivalent to the updated value of the original discount at the time of purchase. The Committee concluded that these resale restrictions should remain unchanged.

### **HOS Income Limit**

6. Private sector purchasers of HOS flats are not allowed to own property and are subject to a limit on household income. Over the last few years the HOS income limit has been reviewed annually and has been set at a level at which a proportion of HOS/ PSPS flats for sale would be affordable by a typical four person family. The Home Ownership Committee decided that the basis for calculation should be changed so that the income limit would be the level below which average private sector flats were not affordable to the average family. This would result in a substantial increase in the income limit and accordingly it was decided to implement the change in the calculation in two stages. The first stage was reached during the course of the Authority's review and the HOS income limit for 1992/93 is \$18,000 per month, around 9% higher than it would have been using the previous method. This increase in the income limit also helps, to a certain extent, the lower portion of the "sandwich class".

### **Quota Allocation**

7. The current quota allocation is that one-third of flats for sale are reserved for private sector, white form, applicants, while two-thirds are for green form applicants. This group includes, in addition to housing estate tenants, clearerees and prospective tenants. These are households still living in the private sector, who have been vetted and found eligible for rental housing who are awaiting allocation of flats. The Committee concluded that this system should continue.

### **Prices of HOS Flats**

8. The prices of HOS and PSPS flats are set by applying a discount to their market values, that is the estimated prices

they would sell for in the open market. The discount needs to be adequate to offset the restrictions on resale, the prohibition on subletting, and the requirement to live in the flat. The precise level of the discount is set for each phase of HOS sales, three times a year, and the aim is to ensure that adequate numbers of flats are affordable to the target groups mentioned above. The surplus arising from the difference between the sales proceeds of flats and the actual costs of production form the main source of the Authority's income necessary to fund future HOS and rental housing construction.

9. After careful consideration the Committee decided that the guideline discount should be 30 %, but a different level of discount should be considered when special circumstances apply, e.g. a higher discount might be appropriate during a period of rapidly rising property prices to ensure that an adequate number of flats in each sale exercise would be affordable to families within the income limit.

10. The Housing Authority has reconsidered the review of the Home Ownership Scheme and has endorsed the Home Ownership Committee's decisions.

## **SECTION 2**

### **THE HOME PURCHASE LOAN SCHEME**

1. The Home Purchase Loan Scheme (HPLS) was first implemented in 1988 following Government's endorsement of the Long Term Housing Strategy. Its objectives are -

- (a) to widen the range of choices available to families seeking assisted home purchase;
- (b) to ensure full utilisation of private sector resources;
- (c) by helping to overcome the problems of initial financing faced by many families wishing to buy their homes;
- (d) by encouraging purchase of private sector flats by sitting or prospective public rental tenants, to release their rental flats for more needy families; and
- (e) to facilitate redevelopment of the older rental estates.

2. The major cause for concern with the HPLS has been the relatively low rate of take up, particularly over the last year, largely as a result of the amount of loan failing to keep pace with increases in prices in the private sector. The Authority looked carefully at the record of the Scheme in achieving its objectives as outlined above. Of the five objectives, it seems the first cannot fully be achieved except with a substantial increase in subsidy and therefore loan amount; the second is probably not needed given the current state of the construction and property development industry; and the third is incompatible with the recent anti-inflation measures encouraged by the Government. The contribution of the scheme to the fifth objective is slight. Only the fourth has met with limited success, and the HOS is a much more significant contributor to this aim.

3. The Authority decided that the HPLS still provided a useful, although limited, avenue to assist the aim of home ownership and decided to retain the Scheme with a slightly increased loan amount and with a more realistic reduced annual quota.

## **SECTION 3**

### **OPTION TO RENT OR BUY**

1. This scheme would allow qualified public rental applicants a choice between renting or buying flats in the same estate when their turns came for allocation of flats. A trial scheme had been endorsed previously by the Authority with two blocks reserved for the purpose. Prices and other conditions of sale would be similar to the HOS. The blocks will be offered to prospective tenants in the latter half of 1992.

2. Since the target group consists of families who have qualified for rental housing, whether through the Waiting List or the redevelopment and clearance programmes they already have a wide choice of HOS flats to buy, making use of their priority green status. Any flats unsold to prospective tenants would be sold in the main phase of the HOS sales.

The continuation of the scheme would be reviewed in the light of response to the trial scheme.

## **SECTION 4**

### **THE SALE OF FLATS TO SITTING TENANTS SCHEME**

1. The Sale of Flats to Sitting Tenants Scheme (SFSTS) became the major focus of the Review. The Authority looked in detail at the reasons for the failure of the first phase of the Scheme in 1991. Against a target of 50% positive response from tenants in the eleven selected blocks, the actual figures ranged from 1.5% to 15.3% with an overall average of 7.4%. It is true that some tenants would never wish to buy their flats; nevertheless the low response clearly indicated some problems in the conception or execution of the first stage of the Scheme. The factors contributing to the failure were examined in detail.

#### **Pricing and Affordability**

2. The prices of flats on offer in the Scheme represented only about one third of prices of private sector flats of similar sizes. Prices had been set by the Home Ownership Committee in a similar way to HOS flats. First, the open market values of the flats were assessed, taking account of location, age, design and standards of fixtures and fittings. Then a discount of 45% was applied to arrive at the sale price. This discount was 10% more than the HOS discount of 35% at that time in recognition of the fact that the flat could only be sold to the sitting tenant who already enjoyed low rents and security of tenure.

3. Nevertheless many tenants felt that the prices were too high. As the sale blocks were not selected on the basis of the tenants' income profile, there were many tenants who genuinely could not afford to buy. Even those on higher incomes felt that, in comparison to rents being paid, the increase in costs of home purchase, by 3.5 times on average, was not worthwhile, particularly as the purchaser would achieve no improvement in his living environment.

#### **Condition of the Block**

4. Some tenants were concerned about the condition of their flats and the likely future costs of repair and maintenance. The Authority had made arrangements for a condition survey and had undertaken to carry out necessary repairs at its own expense. Nevertheless, the problems which came to light during the sales exercise were more widespread than previously reported and led to a weakening of confidence.

### **MODIFICATIONS TO THE SCHEME**

5. Having considered the above factors, the Authority reached preliminary conclusions on modifications to the Scheme to enhance its appeal. These would be subject to further public consultation.

#### **Selection of Blocks**

6. The blocks offered for sale in 1991 were four to six years old, of the New Linear, Trident II and Trident III designs. This restriction was imposed because it was felt that blocks of these designs were the most suitable for sale, having multiple-room flats and a high standard of modern facilities, and that after five years in public rental housing many tenants may have improved their level of income to the point where they could afford to buy the flats. During the initial consultation meetings, there were some suggestions that the Scheme should cover a wider range of rental blocks, irrespective of age and design. The Authority considers that the Scheme should be relaunched on the basis of four to six year old blocks. However, consideration would be given to extending it to older blocks at a later stage, though it would not be the intention to sell blocks that were more than 10 years old.

#### **Pricing**

7. In order to improve the chances of success, prices would need to be substantially reduced. After considering a number of pricing methods, it was decided that prices should be based on the replacement cost. This cost is the estimated present-day cost of rebuilding the same flat. This figure, including overheads, is then discounted by a factor

to take account of the age of the flat. Based on evidence of private sector transactions a figure of 1.75% per annum is used to calculate the deduction for age.

8. The discounted replacement cost is then subject to an addition for location, by a percentage based on comparisons of prices of private sector flats in various districts. The precise amounts of location factor would depend on the locations of the blocks actually selected for sale. The examples shown below for typical average prices make use of preliminary estimates for location factors. To the total of the discounted cost plus location factor, it is necessary to add a Land Cost Payment. This is a payment required by the Government as representing the cost of the provision of formed sites. This payment is substantially below the level of land premium if the site were to be sold on the open market.

9. This method would produce estimated prices for typical five-year-old Trident 11 flats in various locations as shown below. It must be stressed that these prices are for illustration only and that actual prices would not be identical.

### Typical Estimated Average Prices

Location	Flat Size		Unit Price per m <sup>2</sup>	Price
	m <sup>2</sup>	m <sup>2</sup> Saleable	Saleable	
Tuen Mun	50.4	35.8	\$4,990	\$179,000
	64.4	45.7	\$4,990	\$228,000
Tai Po	50.4	35.8	\$6,040	\$216,000
	64.4	45.7	\$6,040	\$277,000
Tsing Yi	50.4	35.8	\$5,860	\$210,000
	64.4	45.7	\$5,860	\$268,000
Sha Tin	50.4	35.8	\$6,260	\$224,000
	64.4	45.7	\$6,260	\$287,000
Hong Kong East	50.4	35.8	\$6,640	\$238,000
	64.4	45.7	\$6,640	\$304,000
Kowloon	50.4	35.8	\$7,040	\$252,000
	64.4	45.7	\$7,040	\$322,000

10. On account of the addition for favourable locations, sales by this method should produce sufficient funds overall to replace the sale blocks with those of similar design. However, the proceeds would not be sufficient to replace them by the Authority's present standard of rental block, the Harmony design, which would cost more than a Trident II design for the same floor area.

### Affordability

11. In place of a typical rent payment of around \$920 per month, the purchaser of a flat would face total monthly expenditure of \$2,470 on mortgage repayments, rates and management fee, i.e. an increase by a factor of 2.7, based on current interest rates, fees etc. For a household on a monthly income of \$8,900, the estimated average for tenants in estates of four to six years old, this would represent 28% of their income. While this would pose a high initial burden, the real cost of a mortgage is expected to diminish over time, whereas rents should reflect rises in costs and will

inevitably increase. However, management fees and rates payable by purchasers are also likely to increase in future.

### **Threshold for Sale**

12. In the 1991 exercise, the sale of flats in any particular block would proceed only if over 50% of tenants opted to buy. This acceptance threshold was designed to ensure that, after sale, owners would be in a majority and would therefore have overall control of future management. In view of the very low percentage response, consideration was given to reducing or abandoning the acceptance threshold. However, during the initial consultations, some District Board and Area Committee members indicated that they would be opposed to the removal of the threshold, which would leave the Authority with a controlling interest in the sale block. While it would be desirable for the owners to constitute a majority in a sale block, it was doubtful whether this would be attainable, at least initially. It was considered that a 30% threshold would be more realistic, to begin with. The rate of participation is expected to increase over time.

### **Casual Vacancies**

13. Casual vacancies arising in a sale block would be offered first to other tenants in the same block and thereafter to other tenants in the same estate and subsequently to other public housing tenants if necessary. The selling price would be the same as would apply to a sitting tenant.

### **Resale Restrictions**

14. The original SFSTS adopted the same resale restrictions as for the HOS and PSPS-

- (a) For the first five years of ownership the Authority has the first option to buy back a flat at the original price.
- (b) In the second five years the Authority retains its first option to buy back. The price would be related to prevailing prices of flats in the scheme.
- (c) After ten years an owner may sell on the open market after paying a premium to the Authority equal to the updated value of the original discount at the time of purchase.
- (d) It has been decided that, for HOS and PSPS flats, the Authority will always exercise its option to buy back flats within the first ten years. If the Authority were to decide not to buy back a flat then the owner would be able to sell on the open market subject to payment of the premium in (c) above.

15. It was felt that because of the different pricing formula adopted for the SFSTS open market sales of flats after ten years would be inappropriate. This means that the arrangements in sub-paragraph (c) above would not apply; the situation in sub-paragraph (b) would continue and the Authority would retain its first option to buy indefinitely at prices related to prevailing sale prices for the scheme. This would not necessarily mean that the owners would receive less capital gain upon resale than if the HOS conditions were to apply, and they would obtain the advantage of having an immediate purchaser for their flats. However, the Authority would continue to have the option not to purchase the flat but instead to allow the owner to sell on the open market. In these circumstances the Authority would receive the updated value of the original discount, in the same way as for HOS and PSPS flats.

### **Management**

16. The 1991 Scheme proposed that management of a partially sold block should continue to be undertaken by the Housing Department for a period of two years after sale, during which period a pattern should have been set for resolving most of the issues of contention between owners and tenants, and that the Authority should appoint management agents thereafter.

17. With a reduction in the acceptance threshold, the Authority would have to continue to manage the block, until such time as the owners constitute a majority of occupants and decide to take over management.

### **Survey and Repairs**

18. Following the detailed reports on defects in the blocks selected for the 1991 exercise, the Authority has decided

that blocks for a future exercise should be surveyed prior to sale in order that any essential repairs could be attended to before an offer for sale is made. In addition, the repair guarantee period would be extended from one year to two years.

### **Retention of Tenants' Eligibility**

19. In order to allay tenants' concerns on their housing eligibility after purchase, the Authority has decided that sitting tenants who purchase their rental flats should continue to be eligible to apply for the HOS using green form applications. If successful they would be required to sell their flats back to the Authority, thus releasing the flats for further sale by the Authority.

20. In addition, in cases of genuine severe financial hardship, owners would be able to resell their flats to the Authority and revert to tenant status, thus easing their worries of becoming homeless due to a drastic change of circumstances. Proof of hardship would be subject to investigation. If their eligibility is established they would be reallocated to other self-contained flats and the resulting vacant flats would be sold to other sitting tenants.

The Authority wishes to gauge public opinion on the terms now proposed for the Sale of Flats to Sitting Tenants Scheme and any person wishing to express views on any matter in this report should write by 30 June 1992 to:-

The Committees' Secretary  
Hong Kong Housing Authority  
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Kowloon