Memorandum for the Subsidised Housing Committee of the Hong Kong Housing Authority

Income and Asset Limits for the Sale of Home Ownership Scheme Flats 2014

PURPOSE

This paper seeks Members' endorsement of the proposed income and asset limits for White Form (WF) applicants for the sale of Home Ownership Scheme (HOS) flats 2014.

BACKGROUND

2. In the 2014 Policy Address, the Government adopted the housing supply target of a total of 470 000 units in the coming ten years, with public housing (including public rental housing (PRH) and subsidised sale flats (primarily HOS flats)) accounting for 60%. To meet the target, the Government aims to provide an average of about 20 000 PRH units and about 8 000 HOS units per year. The first batch of new HOS flats will be completed in 2016/17 and the pre-sale is scheduled for December 2014. Following the established practice, we need to set the income and asset limits for WF applicants, taking into account the current economic situation.

THE REVIEW

3. Members endorsed in September 2012 (see Paper No. SHC 53/2012) the use of the established methodology under the traditional HOS to calculate the income and asset limits for WF applicants in future sales of HOS flats. Since then, the established methodology to calculate the HOS income and asset limits was adopted for the sale of surplus HOS flats under Phase 7 (see Paper No. SHC 8/2013) and the sale of HOS flats in Tin Lee Court (TLC) and Tin Chung Court (TCC) (see Paper No. SHC 20/2014).

------- 4. According to the established methodology (details at **Annex A)**, the amount of total household expenditure (i.e. both housing and non-housing expenditure) required to purchase a reasonably sized flat in the private sector constitutes the basis for assessing the income and asset limits. Households with income and assets below the prescribed limits are deemed to be unable to afford home ownership in the private sector and therefore eligible to apply for the HOS flats put up for sale by the Hong Kong Housing Authority (HA). In accordance with the established practice, if the income and asset limits so derived are lower than the PRH income limits (PRHILs) or PRH asset limits (PRHALs) for larger families, the PRH limits for the relevant household sizes would be applicable as the income and asset limits under the HOS.

Income limit

5. We have followed the established "household expenditure" approach, which comprises both housing and non-housing expenditure, plus a 5% contingency, to work out the income limit. On housing expenditure, mortgage payment, which is dependent on the prevailing property price and mortgage interest rate, is the main variable. Non-housing expenditure is calculated with reference to the average household expenditure of the middle one-third expenditure group of four-person households amongst tenant households in the private sector, using the findings of the latest Household Expenditure Survey (HES) conducted by the Census and Statistics Department (C&SD), and adjusted to the current price level according to the movement in the relevant Consumer Price Index (CPI) over the period.

6. The prevailing position of property prices, mortgage interest and non-housing costs based on the latest data from June to August of 2014 is set out below –

			June to August 2014
(a)	Price of a 10-year old 40 m^2 saleable area flat in Extended Urban Area or New Territories [Note 1] (the reference flat)		$3,980,000
(b)	Mortgage interest rate [Note 2] (average rate for the past 12 months or prevailing rate, whichever is higher)		2.25%
(c)	Non-housing household expenditure (the average household expenditure of the middle one-third expenditure group of four-person households amongst tenant households in the private sector)		$21,400

7. Before the sale of surplus HOS flats under Phase 6, mortgage payment was calculated on the assumption that 70% of the flat price would be mortgaged for the mortgage loan, i.e. a 70% mortgage loan-to-price ratio. For the sale of surplus HOS flats under Phase 6 and Phase 7 and the sale of HOS flats in TLC and TCC, a 90% mortgage loan-to-price ratio was adopted in the calculation of income and asset limits (as endorsed by the SHC (see Papers No. SHC 30/2010, SHC 8/2013 and SHC 20/2014)), in order to provide more relaxed income limits for WF buyers. This will allow higher liquidity for the prospective WF buyers, especially for younger persons, as they usually do not have many assets in hand and can only purchase a flat through securing a larger amount of mortgage loan, with a higher monthly repayment but a smaller amount of downpayment. Tools are available in the market for these buyers to arrange for a mortgage up to 90% of the value of the flat under the Hong Kong Mortgage Corporation's Mortgage Insurance Programme.

Note 1 The districts covered are Shatin, Tsuen Wan, Kwai Tsing, Tseung Kwan O, Tai Po, North (Fanling and Sheung Shui), Tuen Mun, Yuen Long and Islands.

Note 2 It refers to the effective interest rate charged on new mortgage loans by authorised institutions currently participating in the Hong Kong Monetary Authority's Monthly Survey of Residential Mortgage Lending (covering over 95% of the residential mortgage lending business in Hong Kong). The higher of either the prevailing rate or the average rate for the past 12 months is used. In this review, the prevailing rate (August 2014) is 2.25% and the average rate for the past 12 months (September 2013 to August 2014) is also 2.25%.

8. Using a mortgage loan-to-price ratio of 90% of the flat price, the monthly mortgage payment is calculated to be $18,548. Together with the rates, Government rent and management fee ($1,685), non-housing expenditure ($21,400) and salary tax ($2,299), the total household expenditure is calculated to be $43,932. Applying this to the established HOS formula (i.e. with a 5% contingency of total household expenditure added), **the proposed monthly income limit for family applicants** for the sale of HOS flats 2014 would be **$46,000** (as compared to the income limit of $44,000 for the sale of HOS flats in TLC and TCC). As the income limit so calculated is higher than the monthly PRHILs of all household sizes for 2014/15, it will be applicable as the income limit for the sale of HOS flats 2014. Detailed calculation is set out at **Annex B**.

Asset limit

9. Under the established methodology, the asset limit is derived from the amount of expenditure required to finance the downpayment and the related transaction costs and decoration expenses to acquire the reference flat. Taking into consideration the assumed mortgage loan-to-price ratio of 90% adopted in calculating the income limit, and to be in line with the methodology used to calculate the asset limit for the sale of surplus HOS flats under Phase 6 and Phase 7 and the sale of HOS flats in TLC and TCC, the downpayment expenditure is assumed to be 10% of flat price in deriving the asset limit. The downpayment expenditure so calculated is $398,000. Together with the related transaction costs and decoration expenses, **the proposed asset limit for family applicants** for the sale of HOS flats 2014 is **$1,010,000**. As the asset limit so calculated is higher than the PRHALs of all household sizes for 2014/15, it will be applicable as the asset limit for the sale of HOS flats 2014. Detailed calculation is also set out at **Annex B**.

Income and asset limits for one-person applicants

10. The existing practice is to set the income and asset limits for one-person applicants at half of that applicable to family applicants. This practice has been adopted since November 1999. When the SHC deliberated on the income and asset limits of the sale of HOS flats in TLC and TCC on 24 March 2014, some Members were concerned about whether one-person applicants below the income and asset limits could afford to buy the HOS flats, and asked the Housing Department to explore alternative means of setting the income and asset limits for one-person applicants.

11. We have accordingly explored whether we can adopt an alternative basis to set the income and asset limits for the one-person applicants, but considered it fraught with problems. First of all, we need to decide whether the housing expenditure should be determined using the same reference flat as that for family applicants (i.e. a 10-year old 40 m^2 saleable area flat in Extended Urban Area or New Territories), or whether a flat of smaller size, say half the size of that for family applicants, should be adopted. If we opt for a reference flat of smaller size, we are unable to produce a reliable estimate of the reference flat price on the same basis as that for family applicants given the small number of such transactions in the market. We have also taken an extra step to expand the sample cohort by drawing reference from some major developments (including private sector flats and HOS flats with premium paid) in the Urban, Extended Urban and the New Territories area with age over 10 years; of smaller flat sizes; and with transactions below $3,000,000 during the period from June to August 2014. Our research indicates that for transactions below $3,000,000 in each selected development, the average flat size ranges from 20 m^2 to 30 m^2; and the average sale price is $98,900/ m^2. Based on these sample data, the average selling price of a flat of 25 m^2 (i.e. the approximate average size of flats in the above sample) is calculated to be around $2,470,000. Using the flat price of $2,470,000 so derived and adopting the same set of parameters for determining the income and asset limits for family applicants under the established formula (except that the non-housing expenditure is based on the average of the middle one-third expenditure group of one-person tenant households in private housing instead of four-person tenant households), the income and asset limits for one-person applicants will be $24,000 and $610,000 respectively under this alternative method.

12. However, we have reservation adopting this alternative mechanism due to the following considerations –

(a) the sample size used in deriving the results is relatively small, when compared with the bigger and more representative sample used in deriving the average selling price for the reference flat for family applicants. The reference flat price for one-person applicants as derived may not be representative;

(b) due to the small number of transactions, the average selling price may not be indicative of market movements;

(c) the criteria for collection of the transaction data (i.e. older developments with age over 10 years in Urban, Extended Urban and New Territories and of smaller flat sizes, with transactions below $3,000,000) do not follow entirely the basis of deriving the reference flat prices for family applicants. Using the sample under the alternative mechanism would risk inviting criticism of data mining to justify a certain reference flat price;

(d) there is currently no restriction for a one-person applicant to buy a HOS flat of bigger size. Using a reference flat price of smaller sizes does not reflect the reality that some one-person applicants may choose to buy bigger flats, say for the purpose of forming a family after purchase; and

(e) the income and asset limits derived under the alternative method are actually rather close to the income limit of $23,000 and asset limit of $505,000 derived using the established method (i.e. by setting the income and asset limits for one-person applicants at half of those for family applicants).

13. In light of the above considerations, and given the fact that the income and asset limits derived under the alternative mechanism resemble closely with that derived under the established mechanism, we consider it prudent to stick to the existing and well-established formula of setting the income and asset limits for one-person applicants for HOS, i.e. keeping the limits at half of that for the family applicants. In other words, the **income limit for one-person applicants** for the sale of HOS flats 2014 would be **$23,000 per month**, while **the asset limit for one-person applicants** for the sale of HOS flats 2014 is proposed to be **$505,000.** As the income and asset limits so calculated are higher than the PRHIL and PRHAL of 2014/15 for one-person applicants, they would be adopted as the income and asset limit for one-person applicants for the sale of HOS flats 2014.

MINIMUM INCOME/ASSET LIMIT

14. At the SHC meeting on 24 March 2014, Members noted the Steering Committee on Long Term Housing Strategy (LTHS)'s observation that some of the applicants in the sale of Greenview Villa by the Hong Kong Housing Society and the HA's Interim Scheme to extend the HOS Secondary Market to WF buyers had unduly low income and assets, and that these applicants could not have afforded to purchase a property even on mortgage

terms. In order to better utilise limited resources and to improve the chance of eligible first-time home buyers with genuine housing needs, the LTHS Steering Committee recommends that a minimum income/asset level be set for WF applicants for future sale of HOS flats and other subsidised home ownership schemes.

15. We have considered the Steering Committee's proposal within the overall policy context of HOS at large. While we appreciate the LTHS Steering Committee's intention to prevent people from making home purchase decisions that are totally out of their affordability, and at the same time increase the chance for individuals who have saved up and could afford to buy properties with their own means to purchase HOS flats, we are concerned that by imposing a minimum income/asset limit on WF applicants, we may inadvertently affect those who have genuine need to purchase a HOS flat. Specifically, by imposing minimum income/asset limits, those with income and asset levels below the minimum limits would become ineligible for the HOS, even though they have genuine need for home ownership and have other means to help finance the purchase. It should be noted that it has been a long-standing practice, since the launch of the HOS in the 70's, for the HA to allow HOS flat buyers to accept financial support from family members and/or friends. According to results of the Survey on Applicants of Surplus HOS Phase 7, 33% of WF buyers in the sale of surplus HOS flats under Phase 7 received assistance from family members to support their downpayment or flat price. According to results of the Survey on Buyers of Second-hand HOS Flats 2013, 22% of buyers who purchased HOS flats in the HOS Secondary Market in 2011/12 and 2012/13 received assistance from family members. Obtaining financial assistance from families/friends for home purchase is a widely-adopted arrangement in Hong Kong and is generally accepted by the public. This is particularly true for younger people who otherwise may have difficulty saving sufficient money on their own for the downpayment to allow them to purchase a flat when the property prices are relatively high.

16. In addition, GF applicants are at present not subject to any income or asset limits. If we impose a minimum income or asset limit on WF applicants only, we may invite criticism from WF applicants since GF applicants may also have low income and/or no asset and yet they are not subject to any restriction. Therefore, there may be strong reaction from potential WF applicants if this measure is implemented. Criticism of such restriction would be particularly strong among younger people who already feel that they have less chance of buying properties under the current market condition.

17. In view of the above and on balance, we **recommend not** to impose a minimum income or asset limit on WF applicants for the future sales of HOS flats, including the sale of HOS flats 2014.

RECOMMENDATIONS

18. Members are recommended to endorse –

(a) the following income and asset limits for WF applicants for the sale of HOS flats 2014 (paragraphs 8, 9 and 13):

Household Size	**Income Limit** [Note 3]	**Asset Limit** [Note 4]
Two persons or above	$46,000 ($48,400)	$1,010,000
One person	$23,000 ($24,200)	$505,000

(b) not to impose a minimum income or asset limit on WF applicants for the future sales of HOS flats, including the sale of HOS flats 2014 (paragraph 17).

Note 3 Under the HOS, statutory contributions under the Mandatory Provident Fund (MPF) Scheme are deductible from a household's income for the purpose of vetting the applicants' eligibility. In other words, for households contributing 5% of their income under the MPF, the effective income limits applicable to them are about 5.26% higher. The equivalent income limits with the statutory MPF contribution included are shown in brackets in the table.

Note 4 For households of one to four persons of which all members are elderly (elderly households), their PRHALs are twice of the households of which not all members are elderly. Under the established methodology for HOS, the higher corresponding PRHALs would apply as the asset limits for HOS. As approved by Paper No. SHC 12/2014, the PRHALs for 2014/15 for elderly one-person, two-person, three-person and four-person households are $442,000, $598,000, $780,000 and $910,000 respectively. As the asset limits for one-person applicants and families with two persons or more are recommended to be $505,000 and $1,010,000 respectively for the sale of HOS flats 2014, which are higher than the PRHALs for 2014/15, the PRHALs for 2014/15 for elderly households will not apply in the sale of HOS flats 2014.

FINANCIAL AND STAFFING IMPLICATIONS

19. The recommendations in paragraph 18 should not have any major financial and staffing implications.

PUBLIC REACTION AND PUBLICITY

20. Our proposals should in general be accepted by the public at large. In particular, in recommending the income and asset limits for the sale of HOS flats 2014, we have already taken into account the latest property market and economic conditions based on the established HOS methodology. The public at large should also appreciate the proposal of not imposing minimum income and asset limits. A press release will be issued to announce the decision after the meeting on 10 November 2014.

DECLASSIFICATION

21. We recommend that this paper be declassified after the meeting. The paper will be made available to the public at the HA homepage, the Department's library and through the Departmental Access to Information Officer if it is declassified.

ADVICE SOUGHT

22. Members are invited to consider the recommendations in paragraph 18 above.

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(Strategy Division)
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Methodology as approved by SHC for setting the HOS Income and Asset Limits

HOS Income Limits

- The HOS income limits are derived under a “household expenditure” approach. The objective is to determine the amount of household income required to purchase a reasonably sized flat in the private sector. Households with income below the limits are deemed to be eligible for HOS.

- The “household expenditure” approach consists of housing costs and non-housing costs –

  (a) ***Housing cost*** - The monthly expenditure for owning a 10-year-old private flat of 40 m^2 saleable area in the Extended Urban area or the New Territories (the reference flat). It covers mortgage payment, Government rent, rates and management fees. Mortgage payment is worked out based on the prevailing assessed market value of the reference flat, with the assumption that 70% (or 90% in the sale of surplus HOS flats under Phase 6 and Phase 7 and the sale of HOS flats in TLC and TCC) of the flat price will be mortgaged for a term of 20 years at either the average mortgage interest rate in the past 12 months or the prevailing mortgage interest rate (whichever is the higher).

  (b) ***Non-housing cost*** - The average household expenditure of the middle one-third expenditure group of four-person households amongst tenant households in the private sector. The data are obtained from the latest HES [Note 1] conducted by the C&SD and adjusted to the current price level according to changes in the CPI(A) of non-housing items.

- The HOS income limits for family households are the sum of the above two major cost items, plus a 5% contingency.

Note 1 For example, the present review is based on data from the 2009/10 HES released in mid-2011.

HOS Asset Limits

- The HOS asset limits are equivalent to the amount of expenditure required to finance the downpayment, related transaction costs and decoration expenses for acquiring the reference flat.

Limits for One-person Applicants and Large Families

- The income and asset limits for one-person HOS applicants are half of those for families. For large families, the corresponding PRHILs and/or PRHALs would apply if they are higher than the prevailing HOS limits.

Annex B

Calculation of Income and Asset Limits for Sale of HOS flats 2014

			Notes
Assessment Period		Jun – Aug 2014	
Parameters			
Assessed Average Flat Price		$3,980,000	1
Mortgage Loan-to-Price Ratio		90%	
Mortgage Loan		$3,582,000	
Loan Repayment Period (years)		20	
Mortgage Rate		2.25%	2
CPI(A) for non-housing items (2009/10=100)		117.4	
Income Limit			
(1) Housing Expenditure			
(a) Mortgage Payment	$18,548		
(b) Rates, Government Rent and Management Fee	$1,685		3
		$20,233	
(2) Non-housing Expenditure		$21,400	4
(3) Salary Tax		$2,299	5
Total Household Expenditure		$43,932	
Contingency (5% of Total Household Expenditure)		$2,197	
Income Requirement		$46,128	
Proposed Income Limit		**$46,000**	
Asset Limit			
(1) Downpayment (10% of flat price)		$398,000	
(2) Transaction Cost:			
(a) Stamp Duty	$89,550		6
(b) Conveyancing & Mortgage Deed Fees (1.5%)	$59,700		
(c) Estate Agent's Commission (1%)	$39,800		
(d) Decoration Cost & Household Fittings (8%)	$318,400		
(e) Mortgage Insurance Premium	$106,744		7
		$614,194	
Asset Requirement		$1,012,194	
Proposed Asset Limit		**$1,010,000**	

<u>Notes</u>

1 Private flat of around 10 years old and 40 m^2 saleable area in the Extended Urban Area and the New Territories.

2 The higher of either the prevailing rate in August 2014 (2.25%) or the average rate for the past 12 months from September 2013 to August 2014 (2.25%) is used.

3 Based on latest management fees and rental data of private residential developments.

4 Non-housing expenditure is based on the average of the middle one-third expenditure group of four-person tenant households in private permanent housing and all households in private temporary housing. The expenditure is compiled based on data of the HES 2009/10 conducted by C&SD and adjusted to the June to August 2014 position with reference to CPI(A) of non-housing items.

5 As at 2014/15, a four-person household consisting of a married couple, earning a monthly income of $46,000 and having incurred a mortgage interest of $79,100 per annum is required to pay a salary tax of $2,299. As to whether the household would apply for various types of tax allowances, it would be up to individual family circumstances. It is therefore assumed that the household would only claim the married person's allowance.

6 With effect from 1 April 2010, the stamp duty on sale of property in Hong Kong with consideration higher than $3,290,320 but not exceeding $4,000,000 is 2.25% of the consideration.

7 The Mortgage Insurance Premium for 70% up to 90% loan-to-value ratio is 2.98% of the original principle balance, i.e. 2.98% x $3,582,000 = $106,744.