

Paper for the Legislative Council Panel on Housing

Proposed Framework for Reviewing Public Rental Housing Rents

PURPOSE

This paper seeks Members' views on the Housing Authority (HA)'s proposed framework for conducting the rent review as ordered by the High Court.

BACKGROUND

2. The HA last reviewed the rents of its public rental housing (PRH) estates in 1999. Since then, it has deferred all rent review exercises. In 2002, two PRH tenants applied for judicial review (JR) of the HA's decisions to defer rent reviews. The Court of First Instance of the High Court ruled in their favour on 11 July 2003.

3. In the Court Order delivered on 12 August 2003, the High Court directs the HA to "forthwith review and determine the variation of rents of the class (or batch) of public housing units to which the applicant's public housing unit is part, according to the true meaning and effect of Section 16(1A), Housing Ordinance (Cap. 283)"¹. Yet it also recognizes that "a rent review exercise is formidable and involves a sophisticated process". The HA has lodged an appeal against the High Court's ruling, which is expected to be heard by the Court of Appeal in April 2004. It further applied for a stay of execution of the Court Order pending outcome of the appeal. On 26 August 2003, the High Court granted the stay which was, however, conditional upon the HA undertaking to review and determine the variation of rents of the concerned public housing units.

4. On 16 March 2004, a brainstorming session was held with Members of the HA, the Subsidised Housing Committee and Finance Committee on how best we should take forward the rent review. Subsequently, the subject was formally discussed at the HA's meeting held on 18 March 2004.

¹ This full text of the Court Order is as follows -

"Without prejudice to the Respondent's right to conduct the rent review ordered by the Court in the same manner as the Respondent has adopted in previous rent reviews, the Respondent do and is hereby commanded to forthwith review and determine the variation of rents of the class (or batch) of public housing units to which the applicant's public housing unit is part, according to the true meaning and effect of Section 16(1A), Housing Ordinance (Cap. 283)."

PRINCIPAL CONSIDERATIONS

5. Before setting out the proposed framework for taking forward the rent review exercise as ordered by the High Court, we believe it is essential to re-visit the vexed questions of the operation of the statistical concept of median rent-to-income ratio (MRIR), the factors accounting for the rising trend of MRIR and the statutory obligations of the HA under the Housing Ordinance.

Operation of MRIR

6. For more than two decades, the HA has been making reference to MRIR as a broad-brush indicator of tenants' affordability. It has, however, never intended to use MRIR as a mechanism for adjusting rents. Following the amendments to the Housing Ordinance in 1997, once the statutory cap of 10% is exceeded, the MRIR turns into a rent adjustment mechanism insofar as it becomes the only factor determining whether and the extent to which rents should be reduced.

7. Despite repeated clarifications, there remains a perennial misunderstanding over the operation of MRIR, notably the confusion between individual tenants' rent-to-income ratios (RIRs) and the overall MRIR of all the PRH tenants. MRIR is derived by placing the RIRs of individual households in an ordered sequence. The middle RIR is the MRIR. As this is a "median" figure, about half of the households will have their RIRs above the median figure, and half will have their RIRs below it. Section 16(1A) of the Housing Ordinance² does not therefore require that following any rent adjustment, individual tenants would pay less than 10% of their income as rents. The 10% capping only applies to the overall MRIR of all the PRH tenants.

Factors Accounting for the Rising MRIR

8. The MRIR climbed from 9.3% in the third quarter of 1998 to 14.2% in the second quarter of 2003, despite no rent increase during the period. This upsurge was spurred by a host of interwoven and complicated factors other than rent increase -

- (a) the HA has been endeavouring to improve the living density of the

² Section 16(1A) of the Housing Ordinance provides that –

- (a) Any determination of variation of rent after the commencement of the Housing (Amendment) Ordinance 1997 (108 of 1997) by the Authority under subsection (1)(a) in respect of any class (whether determined by the nature of the land or status of the lessee) of land in an estate for residential purposes shall only take effect at least 3 years from the date on which any immediately preceding determination in respect of the same such class of land came into effect.
- (b) The rent determined under paragraph (a) in respect of any such class of land shall be of such amount that the median rent to income ratio in respect of all classes of land in all estates let for residential purposes, as determined by the Authority, shall not exceed 10%.

PRH tenants by increasing the supply of large flats. The living space per person improved from 9.8 m² internal floor area (IFA) in the first quarter of 1998 to 11.4 m² IFA in the second quarter of 2003. Rents are inevitably higher when tenants choose to be rehoused to larger flats. Our rough estimate shows that the increase in living space alone have uplifted the MRIR by about two percentage points during the said period;

- (b) as part of its overall efforts to improve tenants' living condition, the HA has been embarking upon the Comprehensive Redevelopment Programme (CRP) under which old estates are replaced by new ones. New estates come with better facilities, more space but also relatively higher rents. Given that the HA has adopted the benchmark of an MRIR not exceeding 18.5% for prospective tenants in fixing the rents of new estates comprising Harmony blocks since the early 1990's, it is inevitable that the MRIR would exceed 10% when new estates continue to come on stream to replace the old ones. It is estimated that the CRP has contributed to an increase in the MRIR by about one percentage point over the last five years;
- (c) a substantial rise in the number of households in receipt of Comprehensive Social Security Assistance (CSSA) from 75 200 (12.4% of all PRH households) in the fourth quarter of 1998 to 117 300 (19.3%) in the second quarter of 2003. Despite the fact that CSSA households usually have their rents fully paid by Government, and hence should not have any affordability problem per se, their RIRs have hitherto been included in the calculation of the MRIR. Had RIRs of the CSSA households not been counted, the MRIR in the second quarter of 2003 would have been reduced by about two percentage points³; and
- (d) the moving out of high-income tenants through various subsidized home ownership schemes and a sharp rise in the number of small and elderly households with relatively low income living in PRH are another two factors leading to the increase in MRIR. Since the second quarter of 1998, some 143 000 households (include HOS/PSPS and TPS buyers and successful housing loan applicants) have left PRH under the subsidized home ownership schemes while the proportion of small and elderly households have increased from 24.7% and 11.2% to 31.7% and 14.1% respectively

³ It should be stressed that the effects on MRIR as stated in items (a) to (c) above are broad-brush estimates based on some very bold assumptions. They are meant to illustrate the **independent effect** of each factor on the MRIR. Given that there are connections and overlaps among the factors, it is not possible to simply add the effects of individual factors together to derive the cumulative impact on MRIR.

during the same period.

9. As can be seen from the above, the upsurge in MRIR should not be taken at face value, nor should we draw any infinite inference that a rise in MRIR must necessarily represent a decrease in tenants' affordability. Indeed, given the way that the MRIR is being calculated, it is doubtful whether it could accurately reflect the movement in tenants' affordability.

Potential Conflict with Established Policies and Other Statutory Duties

10. We have been mindful of the severe constraints imposed by the statutory MRIR cap of 10% under Section 16(1A) of the Housing Ordinance on the HA's latitude of adjusting rents. To conduct a rent review under the existing statutory framework that premises on the 10% MRIR cap, other legitimate considerations that the HA used to take into account in previous rent reviews, such as inflation/deflation rate, wage movement, management and maintenance costs and the financial position of the HA, would sink into oblivion. It would also be in indirect conflict with other statutory duties that the HA is obliged to discharge under the Housing Ordinance. In particular, Section 4(1)⁴ calls upon the HA to "secure the provision of housing" to those as determined by the HA. Section 4(4)⁵ goes further to direct the HA to ensure that the revenue from its estates should be sufficient to meet the recurrent expenditure.

Review of Domestic Rent Policy

11. Against this background, the HA established an Ad Hoc Committee in early 2001 to undertake a root and branch review of the rent policy. The objective is to map out a rent adjustment mechanism that is more rational, draws a closer link with tenants' affordability and helps promote the long-term sustainability of the public housing programme. Meanwhile, the HA decided to defer all rent review exercises pending the outcome of that comprehensive policy review. However, the rapid train of events following the JR cases dashed any hope for an early conclusion of the rent policy review. The need to conduct a review of the rent level now is predicated by the High Court's ruling on the JR cases.

⁴ Section 4(1) of the Housing Ordinance provides that -

"The authority shall exercise its powers and discharge its duties under this Ordinance so as to secure the provision of housing and such amenities ancillary thereto as the Authority thinks fit for such kinds or classes of persons as the Authority may, subject to the approval of the Chief Executive, determine.

⁵ Section 4(4) of the Housing Ordinance provides that -

"The policy of the Authority shall be directed to ensuring that the revenue accruing to it from its estate shall be sufficient to meet its recurrent expenditure on its estates."

PROPOSED REVIEW FRAMEWORK

Basic Principles

12. To fulfil the Court Order, the HA has to review and determine the variation of rents of the concerned estates within the existing legislative framework. We believe the rent review should as far as possible be premised on the following broad principles -

- (a) any proposed variation of rents must comply with the Court Order and bring the MRIR down from 14.2% to 10% or below in accordance with Section 16(1A) of the Housing Ordinance;
- (b) it should not undermine our appeal which is now underway;
- (c) it should take into full account the affordability of PRH tenants;
- (d) it should be practicable and easy to implement so that, if required, it could be put in place within a relatively short period of time after conclusion of all the appeal proceedings;
- (e) it should be in line with the principle of rational utilization of public resources and cause the least damage to the financial integrity of the HA; and
- (f) it should as far as possible seek to strike a balance between the interest of PRH tenants and that of other sectors of the community.

Units Under Review

13. While the Court Order does not stipulate the exact number of PRH units that should fall under the scope of the current rent review, the judgment of the High Court holds that the HA is under a duty to review rents every three years. In the light of this judgment, we believe a prudent approach would be to cover all the PRH units that are due for review in 2003/04 under a three-year rent review cycle. Some 547 697 PRH units should be covered with break down as follows -

- (a) the batch of 519 589 PRH flats⁶ the rent review of which was deferred for one year from 1 December 2002 as approved by the then Rental Housing Committee (RHC) at its meeting held on

⁶ The number of affected PRH flats then was 540 686. Owing to the implementation of the redevelopment programme and the Tenants Purchase Scheme, the number has now been reduced to 519 589.

31 October 2002. Kwai Chung Estate, where the two applicants of JR on PRH rents reside, is included;

- (b) a new batch of 22 138 PRH flats that are due for rent review for the first time by end 2003; and
- (c) another batch of 5 970 PRH flats under the CRP⁷.

14. As the license fee of Interim Housing (IH) units is normally reviewed and adjusted in tandem with the rents of PRH, the results of the current rent review should also be applicable to some 12 472 IH units. Details are shown at **Annexes A and B**.

Possible Approaches

15. Taking account of the general principles set out in paragraph 12 above, we have examined different approaches for adjusting PRH rents so as to bring the MRIR down to 10% or below. Two broad approaches comprising five rent adjustment options are identified as follows -

- (a) a simple across the board approach whereby the rents of all units concerned would be reduced by 38%; and
- (b) a targeted approach whereby differential rent reductions are applied to different classes of tenants or estates with a view to addressing direct the main causes for the rise in the MRIR. Under this targeted approach, four rent adjustment options are set out as follows -
 - (i) reducing the rents of only those households with RIRs exceeding 10% by 40%;
 - (ii) adopting different rent reductions for different estates. Under this option, the rents of new estates, which are usually higher than those of the old ones, would be given a greater rate of reduction, i.e. 31% for estates completed before 1973 (the so-called pre-HA estates); 36% for estates completed between 1974 and 1992; and 41% for post-1993 estates (mainly comprising Harmony blocks and those converted from HOS courts).

⁷ Flats under CRP are normally excluded from the rent review exercise in accordance with the HA's policy. However, given that the Court has ruled that the HA is under a duty to review rent of its estates in cycles of every three year, we believe it would be prudent to cover the CRP estates in the current rent review exercise.

- (iii) waiving the rents of elderly households by invoking the power under Section 17 of the Housing Ordinance⁸ plus an across the board rent reduction of 17% for other non-elderly households; and
- (iv) waiving the rent of CSSA households (under Section 17 of the Housing Ordinance) plus an across the board rent reduction of 10% for other non-CSSA households.

----- Details of these rent adjustment approaches together with their respective financial implications, pros and cons are set out at **Annex C**.

----- 16. It should be stressed that in considering the extent of rent reduction under different options, we have to bear in mind the technical problem brought about by the uneven batching of estates to be covered in different rent review exercises over the three-year rent review cycle in meeting the basic statutory requirement of bringing the MRIR down to 10% or below following any rent adjustment. This technical problem is explained in detail at **Annex D**. For instance, under the simple across the board approach, strictly speaking a 32% reduction should suffice to bring down the MRIR to 10% in the current review. However, there is a distinct likelihood that we could not achieve this 10% requirement in the coming reviews even if we were to reduce the rents far beyond 32%. This is largely attributable to the uneven batching of estates with only around 60 000 and 19 000 PRH units⁹ to be covered by the reviews due in the coming two years respectively. Even if we were able to do so, these households would enjoy an absurdly large rent reduction, which would be grossly unfair to the other tenants.

17. Our proposed solution to this technical problem is to practise a greater percentage of rent reduction in this year's review so as to bring the MRIR down below 10% by a greater margin. In so doing, the MRIR in the coming two years would hopefully stay within the statutory cap of 10%. This would then enable the HA to ride the three-year rent review cycle smoothly by introducing the same rate of rent reduction for the next two batches of estates due for review, irrespective of their size. Assuming a stable economic outlook and that the income of the PRH tenants and proportion of CSSA households in

⁸ Section 17 of the Housing Ordinance stipulates that "The Authority may remit, in whole or in part and for such period as it thinks fit, the payment of any rent, premium or other consideration payable under any lease."

⁹ The estimated number of PRH units to be covered in the next two rent reviews as set out at **Annex D** was 54 400 and 15 900 units respectively. This estimation was made in August 2003 and the "handover dates" of the concerned estates were used for determining their respective timing of rent review. We have updated these two estimated batch sizes using the latest statistics and adopted "first intake dates" for counting the due dates of rent review. The latest estimation is that some 60 000 units would be due for rent review by end 2004 and some 19 000 units by end 2005.

PRH stay at roughly the same levels as at present, we reckon that a 38% rent reduction in the current as well as the next two reviews should be able to keep the MRIR within 10% throughout the three-year review cycle. We apply the same principle of ensuring that the MRIR would stay within 10% in the entire three-year rent review cycle when assessing the extent of rent reduction warranted under different rent adjustment options as set out at **Annex C**.

18. It should be stressed that irrespective of the rent reduction options to be adopted, the Social Welfare Department (SWD) would adjust correspondingly the amount of rent allowance payable to the affected CSSA households. The interest of the CSSA households would not be affected by any of the proposed rent reduction options nor would they receive any additional benefits.

19. It should also be noted that the option of rent waiver for CSSA households is not premised upon any change in the methodology for calculating the MRIR. The RIRs of the CSSA households would still be included for calculating the MRIR. Of course, their RIRs will be reduced to zero following the rent waiver, thereby bringing down the MRIR substantially.

WAY FORWARD

20. Following the brainstorming session held on 16 March, the Department have conducted in-depth briefings for the media, commentators, interest groups and a number of academics to explain to them the proposed framework and rent reduction options for taking forward the review. Given the potentially far-reaching implications of the review for the HA's financial conditions and the long-term sustainability of the public housing programme, we will continue to listen to the views of the community on the proposed approaches and options before taking a firm view on how the PRH rents are to be adjusted. Further briefings will be arranged for other interested parties. We will monitor closely the reaction from our tenants, media and other interest groups with a view to reverting to the HA with concrete recommendations towards the end of this month.

21. Whether and when the proposed rent reduction would be implemented depend crucially on the result and timing of conclusion of the appeal. In the event that the HA fails in the appeal and has to implement the proposed rent reduction, one month's notice would need to be given to the affected tenants in accordance with the tenancy agreement. The HA would also, as it has undertaken, refund the applicants of the JR cases and all other PRH tenants affected by the Court Order the difference between the rents at the existing levels and the reduced rents together with interest. According to the decision taken by the former RHC in 1999 that rent reviews should take effect on 1 December, the date for calculating the refund and interest payable would

be 1 December 2003.

ADVICE SOUGHT

22. Members are invited to comment on the rent reduction approaches set out at **Annex C**. Members' views will be duly reflected to the HA.

DISCLAIMER

23. The rent level review and the consequent determination of variation of rents is being done pursuant to the Court Order made by Mr Justice Chung in the two cases of Judicial Review on PRH rents (HCAL 174 & 198/2000). The HA is not obliged to implement the variation of rents so determined pursuant to the said Court Order in the event of its successful appeal in the coming appeal hearing on 20 April 2004.

Housing Department
March 2004

Proposed Public Rental Housing Flats that should be subject to the Current Rent Review

Types of Estates / Blocks	No. of Flats involved	Date of last Rent Review	Date originally scheduled for Rent Review	Remarks
Post 1973 Estates (Batch A) (excluding Harmony Blocks)	194,924 *	1.9.1996	1.9.1999	Deferral of Rent Review (Paper Nos. RHC 42/99, 96/2000, 108/2001 and 81/2002) New Batching System (Paper No. RHC 41/99)
Group B and Former Government Low Cost Housing	5,406**	1.12.1996	1.12.1999	Deferral of Rent Review (Paper Nos. RHC 42/99, 96/2000, 108/2001 and 81/2002)
Harmony Blocks (Batch A)	22,832	1.12.1996 (MOC 78/96)	1.12.1999	Deferral of Rent Review (Paper Nos. RHC 42/99, 96/2000, 108/2001 and 81/2002)
Former Housing Authority Estates (Batch A)	22,341	1.4.1997	1.4.2000	Deferral of Rent Review (Paper Nos. RHC 96/2000, 108/2001 and 81/2002) New Batching System (Paper No. RHC 41/99)
Harmony Blocks (First Time Review Deferred from 1999)	12,522	-	1.9.1999	Deferral of Rent Review (Paper Nos. RHC 42/99, 96/2000, 108/2001 and 81/2002) New Batching System (Paper No. RHC 41/99)
Harmony Blocks (First Time Review Deferred from 2000)	17,987	-	1.12.2000	Deferral of Rent Review (Paper Nos. RHC 96/2000, 108/2001 and 81/2002)
Harmony Blocks (First Time Review Deferred from 2001)	14,603	-	1.12.2001	Deferral of Rent Review (Paper Nos. RHC 108/2001 and 81/2002)
Harmony Blocks (First Time Review Deferred from 2002)	20,882	-	1.12.2002	Deferral of Rent Review (Paper No. RHC 81/2002)
Harmony Blocks (First Time Only)	22,138	-	1.12.2003	First time rent review
Post 1973 Estates (Batch B) (excluding Harmony Blocks)	156,223***	1.9.1998 (RHC 60/98)	1.12.2001	New Batching System (Paper No. RHC 41/99) Rent increase waiver (Paper No. RHC 60/98) Extension of rent increase waiver (Paper Nos. RHC 42/99 & RHC 68/2000) Deferral of Rent Review (Paper Nos. RHC 108/2001 and 81/2002)
Harmony Blocks (Batch B)	37,386	1.9.1998 (RHC 61/98)	1.12.2001	New Batching System (Paper No. RHC 41/99) Rent increase waiver (RHC 61/98) Extension of rent increase waiver (Paper Nos. RHC 42/99 & RHC 68/2000) Deferral of Rent Review (Paper Nos. RHC 108/2001 and 81/2002)
Harmony Blocks (Batch C)	3,994	1.12.1998 (RHC 70/98)	1.12.2001	Rent increase waiver (Paper No. RHC 70/98) Extension of rent increase waiver (Paper Nos. RHC 42/99 & RHC 80/2000) Deferral of Rent Review (Paper Nos. RHC 108/2001 and 81/2002)
Former Housing Authority Estates (Batch B)	10,489@	1.4.1999	1.12.2002	Rent Increase waiver (Paper Nos. RHC 5/99, 9/2000 & 14/2001) New Batching System (Paper No. RHC 41/99) Deferral of Rent Review (Paper No. RHC 81/2002)

	Subtotal:	541,727	(162 Estates)[#]
PLUS	Shek Kip Mei Phase 3 (Post 73 Batch A)	491 [^]	
	Wong Chuk Hang	5,479 [^]	
	Total:	547,697	(163 Estates)[#]

Note: * The number of flats has been reduced from 202,312 to 194,924 due to the implementation of the Tenants Purchase Scheme.
 ** The number of flats has been reduced from 10,885 to 5,406 due to redevelopment.
 *** The number of flats has been reduced from 164,444 to 156,223 due to the implementation of the Tenants Purchase Scheme.

@ The number of flats has been reduced from 10,494 to 10,489 due to deletion of housing stock.
 # The no. of estates may involve duplication because some estates have both harmony and other block types.
 ^ These estates are included in redevelopment program and should have rents frozen according to MOC paper 53/91.

Proposed Interim Housing Units that should be subject to Licence Fee Review

Name of Interim Housing	No. of Block(s) / Flats involved	Date of last Licence Fee Review	Date originally scheduled for Licence Fee Review	Remarks
Kwai Shing East Block 12	1 / 824	1.10.1998	1.12.2000	Licence fee increase waiver (Paper No. RHC 58/98) Extension of waiver (Paper No. RHC 42/99) Deferral of Licence Fee Review (Paper Nos. RHC 96/2000, 108/2001 & 81/2002)
Shek Lei (II) Block 11	1 / 852	1.4.1999	1.12.2001	Licence fee increase waiver (Paper No. RHC 4/99) Extension of waiver (Paper No. RHC 9/2000) Deferral of Licence Fee Review (Paper Nos. RHC 108/2001 & 81/2002)
Sai Kung Block 3 (First Time Review deferred)	1 / 144	-	1.12.2000	Deferral of Licence Fee Review (Paper Nos. RHC 96/2000, 108/2001 & 81/2002)
Long Bin Blocks 10-17 (First Time Review deferred)	8 / 840	-	1.12.2001	Deferral of Licence Fee Review (Paper Nos. RHC 108/2001 & 81/2002)
Shek Lei (II) Block 10 (First Time Review deferred)	1 / 1,076	-	1.12.2001	Deferral of Licence Fee Review (Paper Nos. RHC 108/2001 & 81/2002)
Po Tin Blocks 2-5 (First Time Review deferred)	4 / 4,032	-	1.12.2002	Deferral of Licence Fee Review (Paper No. RHC 81/2002)
Po Tin Blocks 1,6-9 (First Time Review)	5 / 4,704	-	-	First Time Licence Fee Review

Total: 21 / 12,472

Analysis of the Various Rent Adjustment Options

Financial Implications (\$B)

	(a) An Across the Board Rent Reduction of 38%		(b) A Targeted Approach of Rent Adjustment							
			(i) 40% rent reduction for households with RIRs exceeding 10%		(ii) Differential rent reductions for new and old estates/blocks ranging from 31% to 41% #		(iii) Rent waiver for elderly households plus 17% rent reduction for non-elderly households		(iv) Rent waiver for CSSA households plus 10% rent reduction for non-CSSA households	
			1 yr.	3 yrs.	1 yr.	3 yrs.	1 yr.	3 yrs.	1 yr.	3 yrs.
HA	-3.44	-11.20	-2.36	-7.95	-3.35	-10.99	-2.36	-7.41	-2.52	-7.76
Government*	0.56	1.91	0.54	1.82	0.57	1.85	0.89	2.71	1.78	5.34
Public Purse^	-2.88	-9.29	-1.82	-6.13	-2.78	-9.14	-1.47	-4.70	-0.74	-2.42

rent reduction of 31% for estates/blocks completed before 1973 (i.e. those pre-HA estates); 36% for estates/blocks completed between 1974 and 1992 and 41% for post-1993 estates/blocks (i.e. comprising mainly Harmony and HOS transferred blocks).

* Taking into account the corresponding reduction in CSSA payment by Government after the rent reduction.

^ The net financial implications for the public purse as a whole is derived by combining the respective financial gains or losses for Government and the HA under the various options.

Pros	Cons
(A) An Across the Board Rent Reduction of 38%	
<ul style="list-style-type: none"> • The simplest and most straight forward way of complying with the Court Order. • Would not affect the existing rent structure and implementation would be relatively easy. • Should be readily acceptable to the affected PRH tenants who would reap tremendous benefits from the drastic rent reduction. 	<ul style="list-style-type: none"> • Would deal a catastrophic blow to the HA’s finances, rendering it extremely difficult for the HA to fulfil its duties under S.4(1) and S.4(4) of the Housing Ordinance. • With a colossal revenue loss, the HA could hardly continue to manage and maintain the existing PRH stock effectively, let alone pump into the system major capital investment in new housing projects that is needed to sustain the average waiting time at three years. • Flawed insofar as it does not take into account whether the existing rent levels are beyond the affordability of the majority of the PRH tenants to the extent that it warrants such a major cut. • Other sectors of the community may find it difficult to accept that PRH tenants, who have already received substantial public subsidies, should have their subsidies further augmented at a time when both Government and the HA are in a state of dire financial stringencies.

Pros	Cons
<i>(B) A Targeted Approach of Rent Adjustment</i>	
(i) 40% rent reduction for households with RIRs exceeding 10% (some 346 700 households in total)	
<ul style="list-style-type: none"> • Could target rent reduction at those with a greater rental burden. • Would result in less financial loss when compared with an across the board 38% rent reduction, as no rent reduction is required for tenants with RIRs below 10%. 	<ul style="list-style-type: none"> • Extremely high administration costs as detailed income vetting for over 600 000 PRH tenants would have to be conducted every time rents are reviewed. There is also no guarantee of the accuracy of the income data so collected. • Would give rise to an anomalous and unfair situation whereby tenants would have their RIRs reduced from, say, 11% to 6.6%, whereas those with RIRs just below 10% would not get any rent reduction. • Would have major impact on the allocation policy as households would be more inclined to choose flats with rents exceeding 10% of their income in order to benefit from a huge rent reduction. • Tenants' income changes from time to time. However, it may neither be practically feasible nor legally permissible to adjust their rents according to their income movement.

Pros	Cons
<p>(ii) Differential rent reductions for new and old estates/blocks –</p> <ul style="list-style-type: none"> ➤ 31% for estates/blocks completed before 1973 (i.e. those pre-HA estates involving some 44 100 units); ➤ 36% for estates/blocks completed between 1974 and 1992 (involving some 350 500 units); and ➤ 41% for post-1993 estates/blocks (i.e. comprising mainly Harmony and HOS transferred blocks involving some 153 000 units). 	
<ul style="list-style-type: none"> • Could address the alleged problem of high rentals of new estates. 	<ul style="list-style-type: none"> • Would distort the overall rent structure as the rents of new estates with better facilities would be placed on a par with those of old estates. • There is no objective basis for drawing any distinction between new and old estates and for determining the relative degrees of rent adjustment. • Would result in huge financial loss.
<p>(iii) Rent waiver for elderly households (some 85 800 households) plus a 17% rent reduction for non-elderly households</p>	
<ul style="list-style-type: none"> • Could address the problem of high rental burden generally found among elderly households. • Would be relatively easy to implement. • Would result in less financial loss when compared with an across the board rent reduction of 38%. 	<ul style="list-style-type: none"> • Non-means-tested across the board rent waiver for elderly tenants runs contrary to the principle of rational allocation of resources. • Nearly 60% of the elderly households in PRH (48 700 households or 57% of total) are already in receipt of the CSSA. Another 4 000 (5% of total) are receiving 50% rent reduction under the Rent Assistance Scheme, the eligibility for which has been relaxed for elderly applicants. It is doubtful whether the current rent review exercise should provide further non-means-tested rent waiver to elderly households.

Pros	Cons
	<ul style="list-style-type: none"> • There is no objective basis for a 17% rent reduction for other non-elderly households. • Might encourage family splitting, both genuine and false, that could easily lead to major abuse. • The number of elderly households in PRH is expected to continue to increase, which would result in even greater financial loss over the long term.
<p>(iv) Rent Waiver for CSSA recipients (some 117 300 households) plus 10% rent reduction for other non-CSSA households</p>	
<ul style="list-style-type: none"> • Could address the problem of a rising MRIR at source. • Would provide a viable framework to practise a “reasonable” level of rent reduction of 10% (broadly equivalent to the rate of deflation since the HA last reviewed PRH rents in 1999) for all PRH tenants which would not otherwise be permissible under the current statutory MRIR cap. • Would cause the least financial damage to the public purse as a whole as Government could correspondingly reduce the amount of rent allowance payable to the CSSA households. 	<ul style="list-style-type: none"> • Might be mistaken as providing further benefits to the CSSA households. • Detailed implementation arrangements would need to be sorted out with SWD. • The HA might be accused of fiddling the MRIR figures. • Would result in huge financial loss to the HA.

Practical Difficulties in Complying with the High Court's Judgment on the Public Rental Housing Rents Judicial Review Cases

Purpose

This note explains the practical difficulties in complying with the High Court's judgment on the judicial review on public rental housing (PRH) rents cases, i.e. to review the rents of PRH units in a cycle of three years and to keep the overall median rent-to-income ratio (MRIR) of all PRH units at or below 10% following each rent review.

Definition of Overall MRIR

2. In determining the overall MRIR, the ratios of the amount of rents expressed as a percentage of the household income of individual households in PRH are first worked out. The figures so compiled are called rent-to-income ratios (RIRs). The RIRs for all the PRH households (around 600 000 as at present) are then placed in an ordered sequence, either in ascending or descending order, and the middle RIR is the MRIR. Therefore, half of the households are with RIRs above the overall MRIR and the other half are with RIRs below it.

3. Notwithstanding the fact that the Housing Authority (HA) has not implemented any rent adjustment in relation to its PRH estates since 1998, the overall MRIR has exceeded 10% since the second quarter of 2000. As at the first quarter of 2003, the overall MRIR was 13.8%. We forecast that even if the rents and household income remain unchanged, the MRIR will continue to rise in the years to come. This is mainly due to replacement of old estates by new ones with better facilities but higher rents, an improvement in the space allocation for PRH households with the increased supply of larger flats, a sharp rise in the number of PRH households receiving Comprehensive Social Security Assistance, the exit of tenants with higher income through various subsidised home ownership schemes, etc. Therefore, we can see that the rise of the MRIR does not necessarily mean that the rental affordability of PRH tenants has declined. Instead, it is significantly affected by other external factors.

Implications of a Three-year Rent Review Cycle and Rent Review in Batches

4. As noted in paragraph 2 above, half of the PRH households, i.e. around 300 000, have their RIRs above 13.8%. About 400 000 households are currently with RIRs above 10%. To maintain the overall MRIR at 10% or

below, we should only allow 300 000 households to have RIRs above 10% after each rent review. In other words, to bring down the overall MRIR from 13.8% to 10% or below, we have to reduce the rents of at least 100 000 households (i.e. 400 000 – 300 000 households) with RIRs above 10%.

5. However, it should be stressed that MRIR is compiled by way of random sampling as provided for under Section 16(1D) of the Housing Ordinance. The HA does not have the RIR information on all the 600 000 PRH households, and hence cannot locate those households with RIRs exceeding 10%. In addition, households with RIRs exceeding 10% are scattered in different estates. So in practice, we have to adjust the rents of a large proportion of the PRH estates in order to achieve any meaningful movement of the overall MRIR. Reducing the rents of a small number of households can only change the RIRs of these individual households, but will not have any meaningful effect on the overall MRIR.

6. The High Court has ruled that the HA is under a statutory duty to review the rents of PRH estates in a three-year cycle and to keep the overall MRIR at or below 10% following each rent review. Section 16 (1A) of the Housing Ordinance provides that any determination of variation of rent for any estates shall only take effect at least three years from the date of the preceding determination. The High Court has also made an Order that obliges the HA to review and determine the variation of rents of the batch of PRH units, to which the applicants' PRH units are part, according to the true meaning and effect of Section 16(1A) of the Housing Ordinance.

7. The ruling of the Court and the relevant legal provision impose a severe constraint on the number of households to be covered in each rent review exercise. With the continuous construction of new PRH estates, the rent review of PRH estates will have to be conducted in separate batches under the three-year rule. Each batch will contain different number of PRH estates, some large and some small. The HA cannot combine the review of one batch with a small number of PRH estates with another large batch at will because which estates are due for rent review is bound by the three-year restriction. There will be practical problems when a batch with a small number of PRH estates is due for review.

8. The batch sizes for rent review in the next few years are set out at the **Appendix**. The usual practice of the HA has been to conduct the rent review in October of the year and then, in case it is determined that the rent should be varied, give one month's notice of the variation of rent and for the rent determination to take effect in December of the same year. Under this practice, if the HA is to follow the Court Judgment, 547 697 PRH units (86% of the total number of PRH units) will be "due" for review in December 2003. Although the MRIR can be reduced to 10% after the rent review and variation in December 2003, as the proportion of newer PRH units (with higher rents)

increases with the completion of new PRH estates and due to various factors stated in paragraph 3 above, the MRIR will likely exceed 10% in 2004.

9. The batch of PRH units due for rent review on 1 December 2004 only comprises 54 431 units (8% of the total number of PRH units), namely, those units with first intake dates between 2 December 2000 and 1 December 2001 and will first be covered in the rent review exercise in 2004. Under such circumstances, the HA could, in an attempt to comply with the requirement of the Court Judgment, reduce the rents of all 54 431 units such that the RIRs of these households all fall to 10% or below or even reduce the rent of all those units to zero. Even so, it is doubtful whether the overall MRIR will fall to 10% or below, considering the small number of PRH units involved in the reduction which will only have very little, if any, effect on the RIR distribution of the overall PRH household population (i.e. 600 000 households). The problem will be even greater in 2005 when the batch of PRH units due for review only comprises 15 904 units, or 2% of the total number of PRH units.

Conclusion

10. Clearly, the MRIR is affected by many factors outside the HA's control and there is a distinct possibility that even exhausting all possible measures (say reducing the rents of all units due for review to zero), the HA cannot in practice comply with the requirement under Section 16(1A) of the Housing Ordinance and the ruling of the High Court.

11. It is noteworthy that even if the HA is able to substantially reduce the rents of a small batch of PRH units so as to maintain the MRIR below 10%, it will yield absurd results. The 54 431 units due for rent review in December 2004 are units completed around 2000. Since the rents for these units have been set with reference to the rent-setting benchmarks for new estates (i.e. the MRIR for households occupying these units should not exceed 15% or 18.5%), if we have to reduce sharply the rents for these units such that the overall MRIR of all the 600 000 households will fall to 10%, these households will enjoy an absurdly large rent reduction. This is done at the expense of other PRH tenants and to the detriment of the HA. It also violates the policy of rational and equitable allocation of resources.

Batch Size for PRH Rent Reviews in Different Years

Batch No.	Effective Date of Rent Adjustment (relevant Papers)	Batch Size (% of total number of PRH units at the time)^{Note 1}	Remarks
1	1 December 2001 (RHC 108/2001)	532 049 (81%)	Rent review deferred for one year. These units include the units which had their rent reviewed in 1998 and the 302 848 units which were originally scheduled for rent review in December 2000.
2	1 December 2002 (RHC 81/2002)	540 686 (85%)	Rent review deferred for one year. These units include the 509 308 units ^{Note 2} which were originally scheduled for rent review in December 2001 and the 10 494 units which had their rent reviewed in April 1999.
3	1 December 2003	547 697 (86%)	Including the 519 589 units ^{Note 2} which were originally scheduled for rent review in December 2002 and the 5 970 units in Shek Kip Mei Phase 3 and Wong Chuk Hang Estate announced for redevelopment under the Comprehensive Redevelopment Programme (CRP) ^{Note 3} .
4	1 December 2004	54 431 (8%)	Units with first intake dates between 2 December 2000 and 1 December 2001.

^{Note 1} The calculations are based on the total number of PRH units as at 30 June each year.

^{Note 2} The drop in the number of units is attributable to the exclusion of estates demolished under the CRP and units sold under the Tenants Purchase Scheme (TPS).

^{Note 3} The redevelopment programme for Shek Kip Mei Phase 3 was announced in September 2002 and that for Wong Chuk Hang Estate in July 2003. Although the past practice was to exclude those units announced for redevelopment from the batching for rent review, it is considered more appropriate to include them in the event of rent reduction.

**Appendix
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Batch No.	Effective Date of Rent Adjustment (relevant Papers)	Batch Size (% of total number of PRH units at the time)^{Note 1}	Remarks
5	1 December 2005	15 904 (2%)	Units with first intake dates between 2 December 2001 and 1 December 2002.
6	1 December 2006	479 955 (71%)	Including the 465 522 units ^{Note 2} in Batch 3 and the 14 433 units with first intake dates between 2 December 2002 and 1 December 2003.
7	1 December 2007	69 276 (10%)	Including the 54 431 units in Batch 4 and the 14 845 units with first intake dates between 2 December 2003 and 1 December 2004.
8	1 December 2008	40 449 (6%)	Including the 15 904 units in Batch 5 and the 24 545 units with first intake dates between 2 December 2004 and 1 December 2005.

The data compiled above are based on the following assumptions-

1. TPS will be terminated after Phase 6.
2. The number of units affected by redevelopment is derived from the CRP.
3. As PRH units completed from July 2003 onwards do not have actual intake dates, it is assumed that the first intake dates of these units will be one month after their completion dates.