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Panel on Housing

Meeting on 1 March 2010

**Updated background brief on the new rent adjustment mechanism
(position as at 23 February 2010)**

Purpose

This paper sets out the background to the new rent adjustment mechanism, and gives a brief account of the views and concerns expressed by the Panel on Housing (the Panel) regarding the progress of the first rent review.

Introduction

2. Under Section 16(1) of the Housing Ordinance (HO) (Cap.283), the Housing Authority (HA) may let to any person any residential unit in its estates subject to the payment of such rent as it may determine. In determining the rents of its public housing units, HA makes reference to tenants' affordability. HA has adopted the median rent-to-income ratio (MRIR)¹ as a general affordability indicator. Administratively, HA used two MRIR benchmarks² in setting public housing rents based on space allocation standards, and took into account a combination of other factors, such as the comparative values of estates, their locations and transportation, flat size, management and maintenance costs, inflation, wage movement, rates, HA's financial position, etc. Prior to 1998, review of rents of public rental housing (PRH) units was conducted by HA at two-year intervals.

3. On 27 June 1997, the former Legislative Council passed a Private Member's Bill, which was subsequently enacted as Housing (Amendment) Ordinance 1997 (Amendment Ordinance 1997), to amend section 16(1) of HO to the effect that any determination of variation of rent by HA should only take effect at least three years

¹ Rent-to-income ratio is the expression of rent as a percentage of household income. MRIR gives the median value of the rent-to-income ratios of all public rental housing households. By definition, 50% of the relevant households' rent-to-income ratios will be below MRIR and the other 50% above it.

² The two MRIR benchmarks are 15% for the minimum space allocation standard of 5.5 m² Internal Floor Area (IFA) per person (in place since 1986), and 18.5% for the higher space allocation standard of 7 m² IFA per person (adopted in 1991).

after the preceding rent determination came into effect, and that the rent determined should be of such amount that the MRIR for all public housing estates should not exceed 10%. After the enactment of the Amendment Ordinance 1997, HA had frozen the rents of newly completed PRH estates at the 1997 level and deferred rent reviews for existing estates since 1999. However, with the downturn of the economy since 1997, the income of the general public had been decreasing. Even without rental increase, the overall MRIR for the third quarter of 2 000 stood at 10.2%. There were strong calls from PRH tenants for the Administration to review PRH rents to comply with the 10% MRIR cap³.

4. In October and November 2002, two PRH tenants applied for judicial review in respect of HA's decisions to defer rent reviews. On 11 July 2003, the Court of the First Instance ruled in favour of the appellants. HA appealed to the Court of Appeal which ruled in favour of HA in November 2004. The case was subsequently brought to the Court of Final Appeal (CFA) which ruled in favour of HA on 21 November 2005⁴. The matters examined in the judicial review have raised important questions about HA's existing domestic rent policy and the long-term sustainability of its finances. In November 2006, HA endorsed a report submitted by the Ad Hoc Committee on Review of Domestic Rent Policy (the CDRP) which was set up in 2001 by HA to review its domestic rent policy with the major objective to establish a clear, objective and flexible rent adjustment mechanism to better reflect tenants' affordability and help ensure a sustainable development of the public housing programme.

5. The key recommendations of CDRP included amending HO to remove the MRIR cap to enable HA to introduce the new income-based rent adjustment mechanism to determine the extent of rent adjustments according to changes in PRH tenants' household income. To provide a fair starting point for the new adjustment mechanism to operate fairly and effectively, HA agreed to introduce an across-the-board rent reduction of 11.6% upon passage of the amendment bill, and to grant a one-off rent remission for the month of February 2007 to PRH tenants⁵.

6. On 31 January 2007, the Administration introduced the Housing (Amendment) Bill 2007 (the Bill) to replace the statutory 10% MRIR cap with a rent adjustment framework that provided for both upward and downward rent adjustments according to changes in PRH tenants' household income. The Bill was passed at the Council meeting on 13 June 2007 and came into operation on 1 January 2008. The report of the Bills Committee on Housing (Amendment) Bill 2007 is hyperlinked below for easy reference.

³ The MRIR reached 14.3% in the third quarter of 2006 as compared to 9.1 % when the statutory 10% cap was passed by the former Legislative Council under the Housing (Amendment) (No. 3) Bill 1996 in June 1997.

⁴ HO Choi-wan v Hong Kong Housing Authority (2005) 8 HKCFAR 628.

⁵ The rent remission has been granted to PRH tenants and Interim Housing licensees with the exception of those paying additional rent or licence fees.

New rent adjustment mechanism

7. Under the new rent adjustment mechanism, a review of PRH rent will be conducted once every two years. The PRH rent will be either adjusted upward or downward according to changes in the income index, which reflect changes in PRH tenants' household income in the first and second periods of the review. The income index will be computed by the Commissioner for Census and Statistics. For downward rent adjustment, the PRH rent shall be reduced according to the rate of reduction of the income index. In case of upward rent adjustment, the PRH rent shall be increased by the rate of increase of the index or 10%, whichever is less. To provide a new starting point for the income-based rent adjustment mechanism to operate effectively, HA reduced the PRH rent by 11.6% starting from August 2007.

First rent review

8. In relation to the first rent review conducted after 1 January 2010, section 16A(8) of HO defines that the first period as a period of 12 months expiring on 31 December 2007, and the second period as a period of 12 months expiring on 31 December 2009. For compiling the income index, HA commenced the "Survey on Household Income of PRH Tenants" in January 2007 under which a monthly sample of 2 000 households were drawn to collect data on their income in that month. In other words, a sample of 24 000 PRH households were respectively sampled in the first and second periods, and the first rent review would involve the income data of a total of 48 000 PRH households. The declarable income includes remuneration from employment and self-employment and other income (such as various employment-related allowances and income from investment). The Census and Statistics Department (C&SD) is responsible for the computation of the income index, including the respective income index of the first and second periods as well as the change in income index between the two periods.

9. Income data collection and various quality control and verification processes for the first period have been completed. The data collected have been passed to C&SD. The work on income data collection for the second period is still underway. According to the current procedure, it is expected that all the income data and the relevant documentary proof will be available by the end of March 2010. The first rent review is expected to be completed around mid 2010.

Major concerns raised by the Panel

10. The progress of the first rent review under the new rent adjustment mechanism for PRH was discussed at the Panel meeting on 7 January 2010.

11. Given that households were selected on the basis of household size distribution, some members queried the reliability of the income index if this was computed without making reference to the income levels of different districts which might vary. Other members however supporting the use of household size distribution

in computing the income index, but considered it not appropriate to apply one income index to all households since income changes of one-person households (comprising mostly elderly persons) were usually much less than that of three to four-person households. Consideration should be given to working out two income indices, one for two-person households and another for households with three or more persons. There was also concern that the findings, which were based on the income data of past year, would not be able to reflect the current and upcoming economic situation, which was expected to worsen in the next year. To this end, a threshold might need to be set such that HA would automatically review the income index if the economy dropped by 5% to 10% or more. To ensure transparency throughout the process, HA was requested to publish the income data of sampled households collected during the first period so that members could compare these with the data collected during the second period.

12. As HA was suffering and expected to suffer a deficit in the financial year 2009/2010, some members were concerned that HA would try to increase rather than decrease the PRH rent in order to cover the deficit despite a negative change in the income index. They called upon HA to re-launch the Home Ownership Scheme (HOS) to provide affordable housing on the one hand and secure stable income for its operation on the other. Besides, the re-launching of HOS would help dampen the surging property prices.

Latest development

13. In view of members' concern about the income data in the first period, and in order to further enhance the transparency of the rent review, the Administration has provided a paper on the methodology for compiling the income index and the income data collected for the first period of the first rent review. The paper will be discussed at the Panel meeting on 1 March 2010.

Relevant paper

Report of the Bills Committee on Housing (Amendment) Bill 2007 to the Council meeting on 13 June 2007

<http://www.legco.gov.hk/yr06-07/english/bc/bc01/reports/bc01cb1-1871-e.pdf>

Information paper provided by the Administration for the meeting of the Panel on Housing on 7 January 2010

<http://www.legco.gov.hk/yr09-10/english/panels/hg/papers/hg0107cb1-796-3-e.pdf>