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Panel on Financial Affairs and Panel on Housing

**Minutes of joint meeting on
Monday, 22 November 2010, at 4:30 pm
in the Chamber of the Legislative Council Building**

Members present : Members of the Panel on Financial Affairs

Hon CHAN Kam-lam, SBS, JP (Chairman)
Hon CHAN Kin-por, JP (Deputy Chairman)
Hon Albert HO Chun-yan
* Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP
* Hon James TO Kun-sun
* Hon Abraham SHEK Lai-him, SBS, JP
Hon Jeffrey LAM Kin-fung, SBS, JP
Hon Ronny TONG Ka-wah, SC
Hon CHIM Pui-chung
Hon KAM Nai-wai, MH
Hon Starry LEE Wai-king, JP
Dr Hon LAM Tai-fai, BBS, JP
Hon Paul CHAN Mo-po, MH, JP
Hon Mrs Regina IP LAU Suk-ye, GBS, JP

Members of the Panel on Housing

Hon LEE Wing-tat (Chairman)
Hon Mrs Sophie LEUNG LAU Yau-fun, GBS, JP
Dr Hon Joseph LEE Kok-long, SBS, JP
Prof Hon Patrick LAU Sau-shing, SBS, JP
Hon CHAN Hak-kan
Hon Alan LEONG Kah-kit, SC
Hon LEUNG Kwok-hung

Members attending : Hon LEE Cheuk-yan
Hon Paul TSE Wai-chun
Hon Albert CHAN Wai-yip

Member absent : Members of the Panel on Financial Affairs

Dr Hon David LI Kwok-po, GBM, GBS, JP

Dr Hon Philip WONG Yu-hong, GBS

Hon Emily LAU Wai-hing, JP

* Hon Vincent FANG kang, SBS, JP

Hon Andrew LEUNG Kwan-yuen, GBS, JP

Hon WONG Ting-kwong, BBS, JP

Members of the Panel on Housing

Hon WONG Kwok-hing, MH (Deputy Chairman)

Hon Fred LI Wah-ming, SBS, JP

Hon LEUNG Yiu-chung

Hon Frederick FUNG Kin-kee, SBS, JP

Hon WONG Kwok-kin, BBS

* Also members of the Panel on Housing

Public officers attending : Agenda item II

Financial Services and the Treasury Bureau

Prof K C CHAN, SBS, JP

Secretary for Financial Services and the Treasury

Ms Shirley KWAN

Principal Assistant Secretary for Financial Services
and the Treasury (Treasury)(R)

Transport and Housing Bureau

Ms Eva CHENG, JP

Secretary for Transport and Housing

Mr D W PESCOD, JP
Permanent Secretary for Transport and Housing (Housing)

Ms Annette LEE, JP
Deputy Secretary for Transport and Housing (Housing)

Mr Eugene FUNG
Principal Assistant Secretary for Transport and
Housing (Housing) (Private Housing)

Financial Secretary's Office

Mrs Helen CHAN, JP
Government Economist

Inland Revenue Department

Mr CHU Yam-yuen, JP
Commissioner of Inland Revenue

Mr WONG Kuen-fai, JP
Deputy Commissioner of Inland Revenue (Tech)

Hong Kong Monetary Authority

Mr Arthur YUEN, JP
Deputy Chief Executive (Banking)

Clerk in attendance : Ms Anita SIT
Chief Council Secretary (1)5

Staff in attendance: Mr Noel SUNG
Senior Council Secretary (1)4

Mr Daniel SIN
Senior Council Secretary (1)7

Ms Haley CHEUNG
Legislative Assistant (1)8

I Election of Chairman

Mr LEE Wing-tat was elected chairman of the joint meeting.

II New measures to curb speculation in residential properties

2. The Secretary for Transport and Housing (STH) said that with the announcement by the US Federal Reserve on the launching of the second round of "quantitative easing", more funds were expected to flow into Hong Kong, amongst other emerging markets. The abundant liquidity and ultra-low interest rates had intensified the risk of a housing bubble. The Administration had introduced various measures in four areas to ensure healthy and stable development of the property market. However, the exuberant state of the property market had spread to the mass market and the current property boom was fuelled by a heavy element of speculative activities. Against this background, the Administration proposed to curb speculation in residential properties by introducing a three-tier "Special Stamp Duty" (SSD) on residential properties of all values at the point of resale if the properties were acquired on or after 20 November 2010 and resold within 24 months after acquisition. The Administration also proposed to disallow deferred payment of the current ad valorem property transaction stamp duty for all residential property transactions. The measure would require amendments to the Stamp Duty Ordinance (Cap. 117).

Application of the Special Stamp Duty

3. Mr James TO asked when a property in a transaction was considered "acquired" under the SSD proposal. Mr Paul TSE asked whether a property was considered "acquired" when a Provisional Agreement for Sale and Purchase was signed, or only when the Agreement for Sale and Purchase (ASP) was signed. The Commissioner for Inland Revenue (CIR) said that a property was considered "acquired" when the buyer and seller signed a binding agreement that was enforceable in a court of law by way of specific performance. Such agreement could be a Provisional Agreement for Sale and Purchase if it contained a clause that bound the seller to sell and the purchaser to buy the subject property. In response to Mr TO's enquiry on whether the SSD proposal would cover land transactions, CIR responded in the affirmative.

4. Mr LEE Cheuk-yan said he came across a case where a buyer, on the advice of his lawyer, had signed an ASP on 18 November 2010, though the completion date of the transaction was 20 November 2010, on which the seller signed the agreement. He asked if the transaction could be exempted from SSD as the buyer was not aware of the proposed measures when he signed the agreement and would have otherwise withdrawn from the transaction. CIR said that based on the facts described by Mr LEE, the ASP would be considered to have been executed on 20 November 2010, and the proposed SSD, if approved, would apply to the property concerned when the properties were resold within 24 months.

5. In reply to Mr Paul TSE's enquiry, CIR said that SSD would not apply to residential properties acquired before 20 November 2010 even if they were sold within 24 months after acquisition.

Liability of buyers for the SSD

6. Regarding the proposal that both the seller and the buyer would be held jointly and severally liable for the SSD, Mr James TO and Ir Dr Raymond HO considered it unreasonable to hold property buyers liable for the SSD, given that the proposed measures were targeted at curbing speculative short-term resale of properties. Under the Administration's proposal, even if it was agreed in a property transaction that the SSD would be fully met by the seller and a clause to this effect was included in the transaction agreement, if, for any reason, the seller defaulted the SSD, CIR would be obliged to claim the buyer for the SSD. Dr HO said the legislation should specify that only the seller was liable to pay the SSD. Mr Ronny TONG said that he had reservation on the suggestion of not holding buyers liable to pay the SSD, because in so doing, the SSD measure would be less effective in containing speculative activities on the demand side, and the government revenue from the SSD would not be afforded sufficient protection.

7. STH said that under the current law, both buyers and sellers were held jointly and severally liable to pay ad valorem property transaction stamp duty. The proposed arrangement for the SSD was consistent with this current arrangement, and the parties to a transaction could negotiate how the SSD was to be shared between them. STH added that since the SSD would only apply to residential properties acquired on or after 20 November 2010, buyers had ample choices of other properties that were not subject to the SSD. Hence, where the property concerned was potentially subject to the

SSD, a prospective buyer would be in a favourable position to negotiate the SSD payment arrangement. Dr HO suggested that the Administration should reconsider the proposed arrangement as, unlike the current ad valorem stamp duty, the SSD could be as high as 15% of the property value. In response to Mr CHAN Kin-po's suggestion of publicizing the proposed arrangement, STH said that the Administration had approached the Law Society, the Estate Agents Authority and the major estate agency associations to remind those concerned to exercise professionalism to protect their clients' interests.

8. Mr Albert HO said that while he supported the proposed measures in principle, he considered that the implementation approach should be reviewed. While under the proposal, residential properties acquired on or after 20 November 2010 would be subject to payment of the SSD, it was uncertain when the relevant legislation would be enacted. In the meantime, lawyers performing the conveyancing procedures had no legal basis to withhold a certain amount of money from their clients for future SSD payment, unless a separate contractual agreement was made for the purpose. Mr HO commented that the approach was not desirable as it would disrupt normal conveyancing procedures and it would be necessary for the relevant legislation, upon enactment, to take retrospective effect. He also asked whether the Administration would consider introducing capital gains tax instead.

9. STH explained that the reason for arranging the SSD to take effect on 20 November 2010, i.e. one day after the Administration's announcement, rather than leaving it to a future date was to avoid aggravating further price escalation as buyers might rush to buy properties before the deadline to avoid the SSD. STH did not agree to introducing capital gains tax, since only property transactions resulting in profits would be subject to capital gains tax, as this would mean the speculators would bear little risk. As such, this measure would not be as effective in curbing speculative activities in the property market.

Property transactions through shell companies

10. Mr Paul CHAN said that while he supported the Administration's proposed measures, he was concerned that investors could circumvent the SSD through the transfer of shares in companies to effect property transactions. Mr CHAN Kin-po and Dr Joseph LEE expressed similar concern. Mr CHAN Kam-lam said speculative activities might resume through transfer of company shares once the market had digested the proposed measures. Mr Ronny TONG said the large difference between the

stamp duty rate on the transaction of company shares and that on residential properties provided a strong incentive for property speculation using shell companies. Mr Paul TSE said setting up shell companies to own properties and transferring ownership of these companies did not involve high costs and were procedurally simple. Many high-end properties were traded and confirmor transactions were made through the transfer of shell company ownership. The members asked whether the Administration would plug this loophole to assure the market that the Government was determined to take actions against speculative activities on residential properties.

11. STH said that only around 11% of all residential property transactions involved companies as buyers, and few of these transactions involved small or medium-sized units. The proposed measures had sent a strong signal to the market which would change people's expectation about the profitability of short-term property trading. STH said that there was no clear evidence that residential property dealings made through the transfer of company ownership were increasing. She cautioned that using this approach to acquire properties was risky as the buyer might have to take up the company's debts or liabilities that were concealed during the transaction, especially for companies incorporated outside Hong Kong. She added that confirmor transactions would also be subject to the payment of the SSD. CIR said that for property transactions effected through the transfer of shares in companies registered outside Hong Kong, the Inland Revenue Department (IRD) would not be able to trace such dealings as the Department did not have records on the changes in the ownership of such companies. There was, however, no indication that this approach of property trading had become prevalent.

12. While appreciating the Administration's difficulty in tracing ownership changes for companies registered outside Hong Kong, Mr Ronny TONG said that the Administration could at least take stronger actions by way of legislation to combat those property speculative activities made through the transfer of shares in Hong Kong companies. CIR said as transfer of Hong Kong companies' shares was subject to stamp duty, IRD could collect profits tax on profits arising from the speculative trading of residential properties by those companies. CIR explained that introducing legislation to extend the SSD to cover those property transactions effected through the transfer of company shares would involve complicated issues, and any such attempt would delay the implementation of the proposed measures. The Chairman said that the discussion on property speculation through the transfer of company shares could be followed up separately during the scrutiny of the relevant Bill.

Impact of the proposed measures on genuine home buyers

13. Mrs Sophie LEUNG supported the proposed measures. Mrs LEUNG, Mr James TO and Mr Abraham SHEK were concerned that the measures might affect ordinary home buyers. Mrs LEUNG said that following the Administration's announcement of the proposed measures, some banks had immediately tightened mortgage lending. Some home buyers who had committed in one way or another to purchasing a property before the announcement now faced unexpected difficulties as they needed to secure extra cash to complete the transaction. She asked if the Administration would introduce special measures to help these home buyers, especially those of the lower-end property market. Mr Paul TSE noted that since the announcement of the proposed measures, about 470 residential property transactions had been affected, and many of them did not involve speculation. He asked if these cases should be handled differently.

14. STH said the proposed measures were not designed to hit genuine home buyers, who would unlikely buy and sell their homes within 24 months. The Deputy Chief Executive (Banking), Hong Kong Monetary Authority (DCE/HKMA) said the new maximum LTV ratios would only apply to properties for which a Preliminary ASP was signed after 19 November 2010, and those home buyers referred to by Mrs Sophie LEUNG could apply for additional mortgage loans up to 90% of the property value through the Mortgage Insurance Programme provided by the Hong Kong Mortgage Corporation.

15. Mr James TO asked if certain measures such as providing more favourable mortgage loan terms could be offered to first-time home buyers to reduce the impact. DCE/HKMA said that HKMA had so far launched three rounds of measures to strengthen the risk management of banks in mortgage lending. Banks would not differentiate first-time home buyers from other property buyers so as to maintain a simple system. Guidelines had been issued to banks requiring them to take into account all the outstanding loans and debts held by mortgage loan applicants. As first-time home buyers would not have other outstanding mortgage loans, they would likely be more favourably assessed by banks on their debt repayment capability.

16. Dr LAM Tai-fai supported the introduction of the SSD. Dr LAM cautioned against the possible side effects of the measures on certain home buyers such as owners of small and medium-sized enterprises (SMEs). During financial downturn or adverse business conditions, SME owners

might be forced to sell their assets by their creditors to clear their debts. It would aggravate their financial burden if they had to pay the SSD under those circumstances. Mr CHAN Kin-po and Dr Joseph LEE pointed out that a property owner might need to sell his property to meet an emergency situation or was forced to do so when he defaulted a mortgage loan. They asked whether data were being collected to monitor the situation and whether exemptions could be given to these property owners.

17. STH said exemptions would be available for resale of properties due to bankruptcy or involuntary winding up of companies. She cautioned that SME owners should exercise extra care in making property acquisition decisions given the prevailing volatile market circumstances. CIR said that it was difficult to determine a property-owner's reason for selling his property; exemption based on personal reason for resale was not recommended otherwise the proposed scheme would become too complicated to operate effectively.

18. In response to Mr CHAN Kin-po's enquiries, CIR said there was no plan to introduce a mechanism to handle appeals against the refusal of exemption of the SSD. In response to Dr Joseph LEE's enquiry about monitoring of mortgage loan quality, DCE/HKMA said that HKMA conducted regular checks on banks' asset quality. It was found that the overall performance had so far been satisfactory; the worst delinquency ratio in the mortgage sector was around 1.6% during periods of economic downturn between 1997 and 2003. According to statistics collected for September this year, the average debt servicing ratio (DSR) for new mortgage loans was maintained at 39% to 40%. The risk of many property owners defaulting on mortgage payments was therefore well contained. But this was not to say that banks could be complacent about their risk management practices regarding mortgage loan business. Given the importance of mortgage lending for banks in Hong Kong, the HKMA would continue to monitor the situation closely.

19. Mr Albert HO echoed Dr LAM Tai-fai's concerns and asked whether the proposed measures would apply to properties sold under the Land (Compulsory Sale for Redevelopment) Ordinance (Cap. 545). The Chairman said that this issue could be further examined by the future Bills Committee.

Impact on other economic sectors

20. Mr KAM Nai-wai said that last year, the Chief Executive had said that the increasing exuberance in property trading was only observed in the high-end segment. Mr KAM asked why the Administration took a complete turnaround within just 12 months and decided to adopt such heavy measures. He asked by what indicators the Administration would assess the effectiveness of the proposed measures. STH said that the proposed measures were introduced to address the current exuberant state of the property market which had spread to the mass market and the heavy element of speculative activities in the property boom. She explained that a 32% surge in the number of resale within 24 months in the first nine months of 2010 among which the rapid increase by 114% in the number of resale within a 12 months period suggested a shift in speculative activities to a shorter horizon. The Secretary for Financial Services and the Treasury (SFST) added that the acceleration of speculative activities was also attributable to the increasing capital inflows to Asian economies including Hong Kong and the ultra-low interest rates. These economic conditions would likely continue for an extended period. The circumstances warranted extraordinary measures.

21. Mr LEE Cheuk-yan supported the Administration's proposals. He asked what measures the Administration would introduce to contain the impact of inflows of excessive capital. SFST said Hong Kong was an open economy and would not regulate the flows of capital. However, measures could be introduced to maintain the financial stability. He said that investors should also exercise extra vigilance in the highly volatile environment.

22. Dr LAM Tai-fai said that with the introduction of the SSD, the market in general anticipated property prices would fall; buyers would likely defer their acquisition decisions while property developers would postpone their building projects. He was concerned that once the market sentiment reversed, a large number of buyers would rush to scramble for limited residential units, and a surge of property prices would result. He opined that the Administration should provide more public and subsidized housing units in the meantime to absorb some of the housing demand.

23. Mr KAM Nai-wai, Mr Abraham SHEK and Mr Jeffrey LAM asked by what extent the Administration expected the residential property market would adjust with the implementation of the SSD. Mr KAM asked under what circumstances the Administration would consider introducing further measures if property prices continued to rise unabated. Mr SHEK and Mr LAM, on the other hand, asked what remedial measures the Administration would take if the market plunged as a result of the proposed

measures, and whether the Administration would review the "My Home Purchase Plan".

24. STH said the demand and supply of residential properties were affected by a host of factors. It was difficult to predict how the proposed measures would affect the market. She said if the measures were effective in reducing speculative activities, home buyers and the community at large would benefit. As regards "My Home Purchase Plan", STH said previous experience had shown that provision of subsidised housing would not affect property prices significantly; subsidised housing measures were introduced to address part of the housing needs in the community, rather than to counter rising property prices.

25. Mr Albert CHAN said the Administration's proposals were decisive, although the extent to which they would help reduce social discontent remained to be observed. Mr CHAN said that, despite the recent escalation of property prices, in some areas such as Tin Shui Wai, some residential units were still valued at about 60% lower than the 1997 level. If the proposed measures would cause the whole property market to fall, those property owners would see little prospect of ever getting breakeven with their properties.

26. Dr Joseph LEE asked if the Administration had established mechanisms to monitor the residential property market, and requested the Administration to release relevant information to Members on a quarterly basis. STH said that relevant statistics were made available to the public at regular intervals.

Diversion of speculative activities to other sectors

27. Mr Ronny TONG commended the Administration's proposed measures as decisive. He was however concerned that, following the implementation of the SSD and other related measures, speculative activities might be diverted from the residential property sector to other sectors notably commercial properties (e.g. offices and shops). Mr Albert CHAN was also concerned that speculative activities might shift to taxi or mini-bus operating licences. Mr TONG and Mr CHAN cautioned that the price escalation of public transport licences and prices/rentals of commercial premises would drive the costs of various goods and services up and fuel inflation. They asked what countervailing actions the Administration would take.

28. STH said that the Administration's proposed measures were mainly targeted at the residential property market where speculative activities were most exuberant. The Administration focused on the residential property market as it affected people's livelihood the most. While the increase in commercial property prices might add pressure on inflation, the Administration must be cautious about intervening commercial and investment activities. The Government Economist said that around 15% of all property transactions involved commercial properties. The new measures announced by HKMA to lower the maximum LTV ratio would apply to commercial properties and thus would help reduce speculative activities in the commercial property market. The Administration would not rule out additional measures when the situation warranted. As regards speculative activities on taxi or mini-bus licences, STH said the issue was of a different nature, and the relevant sectors were already under regulation.

Other measures to attain long-term healthy development of property market

29. Mr CHAN Kam-lam supported the Administration's proposed measures but he criticized that the measures were much belated, as residential property prices had increased by more than 50% over the past two to three years. Mr Abraham SHEK said that the proposed measures were not sufficient to solve the deep rooted problem of land supply shortage. Mr CHAN Kam-lam, Mr CHAN Kin-po and Dr Joseph LEE considered that the Administration should consider longer term strategies and relevant support measures to sustain a healthy and steady property market. Mr SHEK said the Administration should consider resuming the construction of subsidized housing.

30. STH said that the Administration had introduced various measures in four areas to ensure the healthy and stable development of the property market. These included increasing supply to tackle the problem at source, combating speculative activities, enhancing the transparency of property transactions, and preventing excessive expansion in mortgage lending. The Financial Secretary chaired a Steering Committee on Housing Land Supply to co-ordinate the efforts of departments concerned in the provision of land for housing development.

31. Ir Dr Raymond HO doubted if the Administration's target of providing an average of about 20 000 private residential units annually for the next 10 years could assure the market of a steady flat supply. He suggested that the Administration should take the initiative to auction land regularly rather than relying on developers to trigger land auctions under the

Application List System. STH undertook to convey members' views to the Development Bureau for consideration.

Other issues

32. The Chairman said while HKMA had required banks to lower the maximum LTVs for residential properties valued at \$8 million or above, some developers offered home buyers a second mortgage to top up their mortgage loans to 90% of the property value. He asked if a bank would know when a mortgagor had arranged, or intended to arrange, a second mortgage, and what measures a bank would take if a home buyer's total mortgage loan exceeded the permissible DSR.

33. DCE/HKMA said that in assessing a mortgage loan application, the home buyer's repayment capability including all outstanding debts and liabilities would be taken into account in determining his DSR. In this connection, the home buyer would be required to reveal whether he had arranged or intended to arrange a second mortgage loan. With the introduction of prudential measures on 13 August 2010, banks would also need to apply, starting from 15 September 2010, a stress test to assess if a home buyer's total DSR would exceed 60% in the event that the mortgage interest rate (including the interest rate of the second mortgage loan) increased by two percentage points. DCE/HKMA said that in some circumstances, developers might offer a concessionary interest rate for the second mortgage loan during the initial two years. HKMA required banks to apply the stress test using the normal interest rate (as opposed to the initial concessionary rate) for the second mortgage loan.

34. The Chairman asked if a home buyer needed to inform his bank if he had arranged a second mortgage after the first mortgage was approved. DCE/HKMA said as the bank would hold all the relevant documents related to a property upon completion of a property transaction, it would have information on all other liabilities related to the property. Banks were not allowed under the existing supervisory guidelines to let the home buyers draw down the first mortgage loan before a property transaction was completed, and home buyers would not be able to secure a second mortgage loan thereafter.

III Any other business

35. There being no other business, the meeting ended at 6:24 pm.

Council Business Division 1
Legislative Council Secretariat
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