

Initial Ideas on Price Setting and for Calculating the Premium Payable under the New Home Ownership Scheme (HOS)





Background

- On 12 October 2011, the Chief Executive announced in his 2011/12 Policy Address a new policy for the resumption of the HOS, in response to the aspirations of low and middle-income families to buy their own homes.
- The Housing Authority (HA) will be responsible for
 - producing the New HOS flats; and
 - working out the implementation details, including –
 - the allocation ratio between green form and non-green form applicants;
 - income and asset criteria for non-green form applicants;
 - price benchmarks based on affordability; and
 - premium payment arrangements.

Existing Formula for Price Setting

- For the traditional HOS, starting from 1982, the flat prices have been determined by applying a discount rate to the market value of flats.
- The discount rate is related to the affordability of the households within the HOS income limit.
- To determine affordability, there were two guiding principles –
 - (a) eligible households could afford the flats with a mortgage-to-income ratio of not more than 40%; and
 - (b) at least 50% of the flats for sale should be “affordable” as defined in (a) after applying a discount rate to the market value of flats.



Existing Formula for Price Setting

- In 1991, the HA agreed that, under normal circumstances, the HOS flats should be sold at 30% discount with respect to the market value, but a higher discount rate could be offered if the affordability test as mentioned in (b) above could not be satisfied.
- The 30% discount guideline was reaffirmed in 2006 for the Sale of Surplus HOS flats.



New Formula for Price Setting

- According to the 2011/12 Policy Address, the pricing of the New HOS will be unpegged from market price and based on target applicants' affordability.
- The yardstick for the New HOS is that the price of the flats would be set at a level affordable to the target applicants, rather than at least 50% as for the traditional HOS.
- Have to revise the existing formula to cater for the New HOS.
- Affordability is measured against the income limit for eligible households.



The Actual Flat Prices and Income Limit

- In accordance with the usual practice, before the sale of New HOS flats, the Department will calculate the applicants' affordability and set the prices of the flats in accordance with the endorsed formula by using the latest economic data, and submit for the HA's consideration.



Existing Methodology in Calculating Premium

- Traditional HOS flats were sold at a discounted price and are subject to alienation restrictions.
- Since Phase 3B in 1982 (when the selling prices have been tied to the prevailing market value and affordability of the applicants) –

Owners must pay a premium for removal of the restrictions before they can sell, let or assign the flats on the open market.



Existing Methodology in Calculating Premium

- As set out in the Schedule of the Housing Ordinance –

$$\text{Premium} = \text{Prevailing market value} \times \text{Discount rate}$$

where,

$$\text{Discount rate} = \frac{\text{Initial market value} - \text{Purchase price}}{\text{Initial market value}} \times 100\%$$



Premium Payment for the New HOS

2011/12 Policy Address

- Within the first five years from the date of purchase, owners may only sell their flats to green form applicants or the HA.
- After five years, owners may sell their flats on the open market after paying a premium to the HA.



Premium Payment for the New HOS

2011/12 Policy Address

- The guiding principle - when working out the details of the premium arrangements, the HA should ensure that the new arrangements are fair to existing HOS flat owners.
- As the arrangements will involve subsidising home ownership with public money, they should also be acceptable to the community as a whole.



Premium Payment for the New HOS

- One of the key features of the New HOS is the objective to facilitate upward mobility of the flat owners, i.e. to enable them to trade up and shift to the private residential market.
- Under the new price-setting mechanism, it is likely that the discount rates of the New HOS flats would be larger than those for the traditional HOS flats. Flat owners will need to pay a larger amount in premium payment. This may be a disincentive for the owners to pay the premium. To facilitate the upward mobility of the owners, we need a new formula for calculating the premium payable.



Premium Payment for the New HOS

- According to the 2011-12 Policy Address, when calculating the premium to be paid, the HA may take the subsidised portion of a unit's purchase price as a loan to the owner, the amount of which will not be adjusted even if the market value of the unit increases in future, and require the owner to repay this loan to the HA before selling the unit on the open market.



Characteristics of the New Premium Payment Arrangement

- The amount of premium payable is based on the concept that the subsidised portion of a unit's purchase price is regarded as a loan to the flat owner and is **unpegged from the market value**.
- The amount of premium payable is **more predictable from the flat owners' perspective**. It is easier for the flat owners to plan on the timing of payment to suit their own circumstances.



Possible Options on Premium Payment for the New HOS

- For the discussion of Members of the Subsidised Housing Committee (SHC) under the HA, and drawing reference to the existing loan and financial assistance schemes offered by the Government and public bodies, we have set out five variations on the two basic approaches, i.e. **“loan only”** and **“loan plus interest”**.



Possible Options on Premium Payment for the New HOS

Option 1

“Loan only”: the premium payable is the absolute amount of the “loan” with no interest required (i.e. the difference between the initial market value at the time of purchase and the “affordable” purchase price is treated as a “loan”).



Possible Options on Premium Payment for the New HOS

Option 2

“Loan plus interest at “no gain, no loss” (NGNL) rate each year”: the premium payable is the “loan” plus interest which is compounded yearly, where the floating interest rate is the NGNL rate of each particular year.

- The principle of “no gain, no loss” (NGNL) is that the loans are provided on the basis that the loan provider is not seeking to make a profit out of the loans, nor incur a loss.



Possible Options on Premium Payment for the New HOS

Option 3

“Loan plus interest at NGNL rate each year, plus 1.5% risk-adjusted factor”: the premium payable is the amount corresponding to the “loan” plus interest together with a risk-adjusted factor which is 1.5%* of the “loan”.

- * Reference has been drawn to the Non-means-tested Loan Scheme administered by the Student Financial Assistance Agency, only as an example for illustration purpose.



Possible Options on Premium Payment for the New HOS

Option 4

“Loan plus interest at NGNL rate fixed at the year of purchase”: the premium payable is the amount corresponding to “loan” plus interest which is compounded yearly, and where the interest rate is fixed at the NGNL rate of the year of purchase.



Possible Options on Premium Payment for the New HOS

Option 5

“Loan plus interest at 2%”: the premium payable is the amount corresponding to “loan” plus interest, where the interest rate is fixed at 2%*.

- * Reference has been drawn to the “Sandwich Class Housing Loan Scheme” and the “Home Starter Loan Scheme” administered by the Hong Kong Housing Society, only as an example for illustration purpose.



Financial Implications to the HA

- **Assessment:** based on a sample of HOS flats sold by the HA in previous years.
- Randomly selected ten HOS flats (five of SA of 40 m² and five of 50 m²) in each of the three districts of Urban, Extended Urban and New Territories, sold in 1985, 1990, 1995 and 2000 respectively.
- The premium payable for these selected flats under the possible options and the existing methodology were assessed.
- A total of 120 flats were selected.



Points to Note

- Our assessment involved only 120 selected HOS flats of flat sizes SA 40 m² and 50 m² sold in four specific years, and represented only a snapshot.
- The results only provide rough indications under the various premium payment scenarios.



General Observations

(a) Observation 1:

- There is a fundamental difference between the concept of calculating the premium payable under the existing methodology and the possible options.
- The premium payable under the existing methodology hinges on the prevailing market value at the time of premium payment and to some extent will be affected by market volatility.
- The possible options are based on the “loan” concept, and thus from the point of view of flat owners, the premium payable under these options is **more predictable** as compared to the existing methodology.



General Observations

(b) Observation 2:

- The premium payable by all selected flat owners will be less under the “loan only” approach (Option 1) when compared with that under the existing methodology, save for five cases.
- As regards the “loan plus interest” approach (Options 2 to 5), as compared to the existing methodology, flat owners **may have to pay more or pay less premium** under the possible options.



General Observations

(c) Observation 3:

- Comparing the options using a fixed interest rate to a floating rate (Options 4 and 5 vs. Options 2 and 3) –
 - **A floating rate option appears to have an averaging effect** over the years on the premium amount.
 - The premium amount for the selected flat owners under Option 4 hinges on the interest rate of a particular year, while the interest rate is fixed at 2% under Option 5, and thus these options would not be able to reflect the changing economic circumstances.



For Members' Discussion

- The SHC will continue to discuss price setting and premium payment arrangements, as well as other implementation details under the New HOS at its next meeting.
- We welcome Members' views on the initial ideas on price setting and for calculating the premium payable under the New HOS, and will pass Members' comments to the SHC for reference in its further deliberations.