

Legislative Council Panel on Housing

Review of Domestic Rent Policy

PURPOSE

This paper briefs Members on the Housing Authority (HA) Report on the Review of Domestic Rent Policy and the legislative amendments proposed by the Administration to the Housing Ordinance (Cap 283) to enable the HA to implement the new rent adjustment mechanism.

HA REPORT ON REVIEW OF DOMESTIC RENT POLICY

2. On 26 September and 6 November 2006, we briefed this Panel on the initial recommendations of the HA's Ad Hoc Committee on Review of Domestic Rent Policy (the Ad Hoc Committee). On 27 November 2006, the HA approved the Report on the Review of Domestic Rent Policy drawn up by the Ad Hoc Committee. The relevant HA Paper and Report are at **Annex**.

3. One of the most important recommendations in the Report is the introduction of a new rent adjustment mechanism based on the changes in the household income of public rental housing (PRH) tenants. The HA would develop an income index to track the "pure changes" in PRH tenants' household income to guide future rent adjustments, including adjustments of the "best rent" for newly completed PRH estates.

4. The HA would introduce its own mandatory declaration system to collect more reliable household income data for compiling the income index. An independent party, such as the Census and Statistics Department, would be appointed to compile the income index on behalf of the HA.

5. On rent review cycle, the HA would adopt a biennial cycle to help achieve a more moderate rent adjustment in every review and allow the HA to react more quickly to changes in socio-economic circumstances. The rent of the entire PRH stock would be reviewed and adjusted in one go.

6. The HA accepts that the current level of PRH rent should be adjusted to provide an appropriate starting point for the new income-based rent adjustment mechanism to operate effectively and fairly. To ensure coherence and consistency, the new rent level should be determined with reference to the income index. Given that the rent of the majority of the existing PRH units and the “best rent” for newly completed units were last reviewed in 1997, the HA has decided to adopt the extent of changes in the income index since 1997 to adjust rent, including the “best rent” for newly completed PRH estates. This would mean an across-the-board rent reduction of 11.6% upon the introduction of the new rent adjustment mechanism.

RENT REMISSION

7. To address the strong demand from some political parties and tenant groups that the HA should implement short-term measures to remit or reduce rent pending the introduction of the new rent adjustment mechanism and the new rent level, the HA agreed on 27 November 2006 to grant a one-off rent remission for the month of February 2007 to PRH tenants and Interim Housing licensees (excluding those paying additional rent or licence fees). The rental revenue foregone arising from the rent remission proposal is estimated to be \$963 million.

PROPOSED AMENDMENTS TO THE HOUSING ORDINANCE

8. Section 16(1A) of the Housing Ordinance provides, inter alia, that the median rent-to-income ratio (MRIR) of all rental estates shall not exceed 10% following any decision by the HA to increase PRH rent. The practical effect of the statutory MRIR provisions is such that PRH rent can only go down once the 10% MRIR cap is exceeded, despite the fact that the increase in MRIR is caused by factors unrelated to changes in individual PRH tenants’ household income or rent such as an increase in small and CSSA households which tend to have a lower level of household income. We need to amend the provisions in order to enable HA to implement the proposed income-based rent adjustment mechanism so that PRH rent can move both upwards and downwards according to the variations in the income index. To this end, we intend to introduce an Amendment Bill into the Legislative Council around end January 2007.

9. The Amendment Bill will repeal the MRIR provisions under sections 16(1A), (1B), (1C), (1D) and (1E) of the Housing Ordinance and replace them by new provisions to –

- (a) require HA to vary PRH rent according to the rate of the increase or decrease of an income index to be compiled to reflect the household income of PRH tenants;
- (b) specify the period to be covered by the income index in a rent review;
- (c) allow HA to refrain from varying PRH rent if the amount of the variation required after a rent review is, in its opinion, insignificant but require it to take into account that income change in the next review;
- (d) provide for a two-year rent review cycle and the first rent review to take place two years after the commencement of the Amendment Ordinance;
- (e) empower HA to determine how the income index is to be compiled and to entrust the compilation of the income index to a public body or tertiary institution; and
- (f) exempt the application of the new rent adjustment mechanism to tenants paying additional rent or those who are eligible for the Rent Assistance Scheme.

CONCLUSION

10. Members are invited to note the HA Report on the Review of Domestic Rent Policy and to offer their views on the proposed amendments to the Housing Ordinance.

THE HONG KONG HOUSING AUTHORITY

Memorandum for the Housing Authority

Report on the Review of Domestic Rent Policy

PURPOSE

This paper seeks Members' endorsement of the Report on the Review of Domestic Rent Policy.

BACKGROUND

2. In February 2006, having considered Paper No. HA 10/2006, the Housing Authority (HA) agreed to launch a three-month public consultation on the initial findings of the Ad Hoc Committee on Review of Domestic Rent Policy (CDRP). The public consultation concluded on 9 June 2006. Having carefully considered the public responses, CDRP put together a number of initial recommendations which were considered by Members at two brainstorming sessions on 6 and 22 September 2006. We also briefed the Legislative Council Panel on Housing on the initial recommendations on 26 September 2006 and 6 November 2006. Taking account of all the views received, CDRP has drawn up the report at **Annex** setting out its final recommendations on improving the way HA fixes and adjusts the rent of public rental housing (PRH).

KEY RECOMMENDATIONS

3. Among the most important recommendations put forth by CDRP is a new rent adjustment mechanism based on changes in the household income of PRH tenants. Key features of the proposed income-based rent adjustment mechanism are highlighted below –

- (a) ***income index*** – CDRP recommends developing an income index tracking the movement in PRH tenants' household income to determine future rent adjustments. Compared with other possible income indicators such as median household income, the main advantage of the proposed income index is that it can reflect more accurately the “pure income changes” of the PRH tenants and discount the potential distortion of the overall household income brought about by variations in household size distribution;
- (b) ***new rent level*** – for the proposed income-based rent adjustment mechanism to operate effectively and fairly, CDRP accepts that the current PRH rent should be adjusted to provide a new starting point that is considered appropriate and acceptable to the community. To ensure coherence and consistency, the new rent level should be determined with reference to the proposed income index. Given that the rent of the majority of the existing PRH units and the “best rent” for newly completed units were last reviewed in 1997, CDRP recommends to adopt a uniform rate of adjustment according to the extent of changes in the income index since 1997, i.e., an across-the-board rent reduction of 11.6%. The same rate of adjustment should also be applied to the “best rent” for newly completed PRH estates; and
- (c) ***data collection*** – the Authority should operate its own mandatory declaration system to collect more reliable household income data for compiling the income index. Consideration should also be given to engaging an independent party, such as the Census and Statistics Department, to compile the income index.

4. CDRP has also reviewed and made a number of recommendations concerning the following aspects of HA's domestic rent policy –

- (a) ***improvements to the assessment of median rent-to-income ratio (MRIR)*** – following the implementation of the proposed income-based rent adjustment mechanism, MRIR would be used to assist us in tracking tenants' affordability. The current two MRIR benchmarks, i.e. 15% and 18.5% for the respective space allocation standards of 5.5 m² internal floor area (IFA) and 7 m² IFA per person, should remain applicable. The methodology for its assessment should be improved by –

- (i) collecting income data through a mandatory declaration system; and
 - (ii) excluding Comprehensive Social Security Assistance households and additional-rent payers from the calculation of MRIR;
- (b) ***differential rent*** – public responses to the idea of differential rent were extremely divided. CDRP believes that it is not advisable to pursue differential rent in the circumstances. However, it accepts that suitable incentives should be provided to enhance the occupancy rate of “unpopular flats”. It therefore recommends offering four to six months’ rent-free period for tenants moving to units which have been vacant for 12 months or above;
- (c) ***rent fixing and review cycle*** – the current arrangements of having two rent fixing exercises every year for newly completed estates should be maintained. On rent review cycle, CDRP recommends a biennial cycle which would help achieve a more moderate rent adjustment in every review and allow the Authority to react more quickly to changes in socio-economic circumstances. CDRP also reaffirms its proposal that the rent of the entire PRH stock should be reviewed and adjusted in one go;
- (d) ***exclusive vs inclusive rent*** – while noting the advantages of charging net rent exclusive of rates and management expenses, CDRP is concerned about the practical difficulties in doing so and the potential inconvenience to tenants. It recommends a more pragmatic alternative to continue to charge inclusive rent and to send tenants an annual statement setting out separately the amount of rates and management fees to enhance transparency;
- (e) ***fixed-term tenancy*** – CDRP considers that the current system of monthly tenancy should be maintained. Compared to fixed-term tenancy, monthly tenancy provides a more flexible framework for the Authority to take tenancy enforcement actions and introduce rent adjustments. The issue of perpetual stay by tenants who are no longer in need of housing subsidies should, if necessary, be dealt with more effectively through a review of the Housing Subsidy Policy and the Policy on Safeguarding Rational Allocation

of Public Housing Resources;

- (f) *relationship between flat size, rent and tenants' affordability* – to better match tenants' affordability, CDRP recommends that the planning and allocation of PRH should follow more closely the established space allocation standards and the general trend towards formation of small households; and
- (g) *Rent Assistance Scheme (RAS)* – taking account of the major enhancements introduced in recent years, CDRP believes that the present RAS should be able to provide an effective safety net for needy families. To further enhance its effectiveness, it recommends stepping up publicity on the Scheme and drawing up more detailed guidelines for frontline staff to follow, particularly concerning when and how the requirement to move to flats with lower rents should be applied.

LEGISLATIVE AMENDMENTS

5. To enable proper operation of the new rent adjustment mechanism so that PRH rent can move both upwards and downwards, suitable amendments to the Housing Ordinance to remove the 10% MRIR cap are required. Amendments to the Housing Ordinance would also be required to effect a biennial rent review cycle. Removal of the relevant MRIR provisions from the Housing Ordinance would also avoid legal doubts about the introduction of the rationalized methodology for assessing MRIR. Subject to the Authority's endorsement of CDRP's recommendations, an amendment bill will be introduced into the Legislative Council (LegCo) in the first quarter of 2007.

IMPLEMENTATION FRAMEWORK

6. Implementation of the proposed income-based rent adjustment mechanism is contingent upon successful passage of the necessary legislative amendments. As noted in paragraph 5 above, the Administration aims to submit an amendment bill to LegCo in the first quarter of 2007. We expect that it would take at least a few months for LegCo to scrutinize the amendment bill before enactment.

7. As regards the proposed across-the-board rent reduction of 11.6%, both CDRP and we believe it is prudent for HA to introduce this long-term rent

reduction when an effective administrative and legal framework is put in place to enable both upward and downward rent adjustments as and when circumstances justify.

8. For other recommendations which can be effected administratively, the tentative implementation plan is as follows –

- (a) *income data collection* – we aim to collect income data from 1 500 to 2 000 sampled PRH households every month through a mandatory declaration system under section 25 of the Housing Ordinance starting from January 2007;
- (b) *rent-free period for tenants moving to units vacant for 12 months or above* – detailed implementation framework for the scheme would be mapped out and submitted to the Subsidised Housing Committee in early 2007; and
- (c) *annual statement setting out the amount of rates and managements fees* – the first annual statement shall be issued in the fourth quarter of 2007 upon finalization of the Authority’s financial statements for 2006/07.

FINANCIAL AND STAFFING IMPLICATIONS

9. The proposed rent reduction of 11.6% would result in an annual rental loss of around \$1,410 million. Implementation of an income-based rent adjustment mechanism would enable PRH rent to move both upwards and downwards in tandem with tenants’ household income. Over the long run, the new system should provide a more stable stream of rental revenue and is far more sustainable than the existing statutory 10% MRIR cap under which PRH rent can only go down once the cap is exceeded.

10. On the face of it, offering a rent-free period for tenants moving to units which have been vacant for 12 months or above may result in a loss in rental revenue. However, by enhancing the occupancy rate of those units which may otherwise be left vacant, the scheme is expected to actually help increase HA’s rental revenue.

11. We shall publish the review report and produce a leaflet summarizing the recommendations of the review. The costs for publishing the review report and the leaflet are estimated to be in the order of \$350,000.

12. There will be additional workload generated from collecting and vetting household income data, compiling the income index and preparing annual statements showing the breakdown of rates, management fees and net rent payable. This extra work would be absorbed by the existing staff.

PUBLIC REACTION AND PUBLICITY

13. The proposals for improving HA's domestic rent policy have been drawn up following a comprehensive review straddling over five years. An extensive public consultation was conducted before CDRP finalized its recommendations. The majority of the public and the media at large are supportive of the proposed income-based rent adjustment mechanism which provides an objective and far more sustainable basis for guiding future rent adjustments according to tenants' affordability. Nonetheless, some resident groups may still oppose amending the MRIR provisions. They may continue to clamour for retaining the statutory 10% MRIR cap which would effectively debar HA from making any rent increase in the foreseeable future.

14. The proposed across-the-board rent reduction of 11.6% should be welcomed by PRH tenants. Some legislators, politicians and resident groups have been criticizing HA and Government for deferring the implementation of the rent reduction until the enactment of the legislative amendments to the Housing Ordinance. Some of them are also pressing for a higher level of rent reduction and some form of short-term rent remission measures pending completion of the legislative process.

15. A press release will be issued explaining CDRP's recommendations and HA's decision.

ADVICE SOUGHT

16. Members will be asked to endorse the Report on the Review of Domestic Rent Policy at **Annex**.

Kenneth MAK
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**REPORT ON
THE REVIEW OF DOMESTIC RENT POLICY**

Contents

		Page
Chapter 1	Introduction	1
Chapter 2	The Need for Reform	2-8
Chapter 3	Guiding Principles	9-10
Chapter 4	A New Rent Adjustment Mechanism	11-20
Chapter 5	Measure of Affordability	21-26
Chapter 6	Differential Rent	27-29
Chapter 7	Rent Fixing and Review Cycles	30-32
Chapter 8	Exclusive vs Inclusive Rent	33-34
Chapter 9	Fixed-Term Tenancy	35-36
Chapter 10	Relationship between Flat Size, Rent and Tenants' Affordability	37
Chapter 11	Rent Assistance Scheme	38-39
Chapter 12	Summary of Recommendations	40-43
Annex A	Membership and Terms of Reference of the Ad Hoc Committee on Review of Domestic Rent Policy	44-45
Annex B	Review of Domestic Rent Policy Summary of Public Responses	46-82
Annex C	Explanatory Note on the Computation and Operation of the Proposed Income Index	83-96

Chapter 1 - INTRODUCTION

1.1 The mission of the Housing Authority (the Authority) is to provide assistance to low-income families who find private rental accommodation beyond their reach. This mission is fulfilled by way of a public rental housing (PRH) programme now providing accommodation to some 30% of Hong Kong's population. PRH is one of the public services most valued by the Hong Kong people and it has been the Authority's long-standing policy to keep the rent of PRH affordable.

1.2 In January 2001, the Authority set up an Ad Hoc Committee to review its domestic rent policy. The objective of the review is to map out a rent policy that is affordable and flexible, provides greater choice to tenants, and contributes to the long-term sustainability of the public housing programme. The terms of reference and membership of the Ad Hoc Committee on Review of Domestic Rent Policy (the Committee) are set out at **Annex A**.

1.3 The work of the Committee was interrupted between 2002 and 2005 by the judicial review cases concerning PRH rents. The Committee resumed its work upon conclusion of the judicial review and conducted a public consultation between 9 March and 9 June 2006 to gauge the public's views on the initial findings of the Committee. To assess the views of those who may otherwise not be forthcoming to express their opinions in writing, the Authority also commissioned an independent consultant to conduct a telephone opinion survey. A summary of the public responses to the Consultation Paper on Review of Domestic Rent Policy is at **Annex B**.

1.4 This Report sets out the findings and recommendations of the Committee to improve the current system for setting and adjusting the rents of PRH. The Committee is grateful to the general public, Legislative Council, District Councils and all the interested organizations for their consideration of the issues relevant to the formulation of the Authority's domestic rent policy. Their invaluable views and constructive criticism have helped shape the contents of this Report.

Chapter 2 - THE NEED FOR REFORM

General Framework of the Existing Domestic Rent Policy

Overview

2.1 The Authority operates a stock of some 683 700 PRH units in 194 estates, offering a broad variety of flat types with different rent levels. Some 30% of Hong Kong's population are living in PRH. PRH units are let on a month-to-month term until termination by either the Authority or tenants with one month's notice.

2.2 The Authority is committed to keeping the rent for public housing at affordable levels. Existing rent ranges between \$252 and \$3,810 per month and is inclusive of rates, management and maintenance costs. Some 61% of public housing tenants are paying less than \$1,500 monthly for rent.

Rent Setting for New Estates

2.3 The Authority conducts two rent fixing exercises annually to determine the rents for newly completed PRH estates. For rent setting purposes, the Authority divides the territory into six broad districts. The rent of newly completed estates is fixed according to the so-called "best rent" for each district, which is expressed in terms of per m² of internal floor area (IFA) and is determined having regard to the location and value of the estates concerned. In general, rent per m² IFA is uniform across all the units in the same block irrespective of floor levels and orientation. The existing "best rent" levels in the six districts are set out below -

District	Current "Best Rent" ¹ \$/m ² IFA
Urban	63.4
Shatin / Tsuen Wan / Tsing Yi / Kwai Chung	61.2
Tai Po / Tseung Kwan O / Ma On Shan	55.4
Fanling / Sheung Shui / Tung Chung	44.8
Tin Shui Wai / Yuen Long / Tuen Mun	42.2
Islands	36.4

¹ Rent of PRH flats transferred from Home Ownership Scheme projects are set at 5% (for Harmony blocks built to Home Ownership Scheme standard) or 10% (for Concord blocks and New Cruciform blocks) above the respective district "best rent".

Affordability Benchmarks

2.4 To help gauge tenants' affordability, the Authority adopts the median rent-to-income ratio (MRIR)² as a general affordability indicator. Two MRIR benchmarks of 15% and 18.5% have been used. The former has been in place since 1986 for a space allocation standard of 5.5 m² IFA per person. The latter was adopted in 1991 in anticipation of improvement in the space allocation standard to 7 m² IFA per person made possible by the introduction of the Harmony blocks. The rent levels are deemed affordable to the majority of the tenants if the MRIRs do not exceed the two benchmarks for the respective allocation standards.

2.5 It should be stressed that the two MRIR benchmarks only serve as a general affordability indicator. It has never been the Authority's intention to use them to determine the rent for PRH, which is fixed and adjusted on account of a combination of factors such as location, flat size, consumer price index, wage movement, estate operating costs, rates charged by Government, the Authority's financial position, etc.

Additional Help for the Needy

2.6 To provide extra help for tenants who cannot afford paying normal rent due to temporary financial difficulties, the Authority introduced the Rent Assistance Scheme in 1992. The Scheme provides for 25% to 50% rent reduction to households with rent-to-income ratios exceeding 20% or with income below 60% of the Waiting List Income Limits. For those households facing long-term financial problems, they can apply for Comprehensive Social Security Assistance (CSSA) under which a rent allowance, adequate to cover the full amount of rent payable in most cases, is provided by Government. Recipients of CSSA and rent assistance together account for some 22% of the total number of PRH households.

² Rent-to-income ratio is the expression of rent as a percentage of household income. The MRIR gives the median value of the rent-to-income ratios of all the PRH households. By definition, 50% of the relevant households' rent-to-income ratios will be below the MRIR and the other 50% above it. Chapter 4 provides a more detailed elaboration of the concept of MRIR.

Rational Allocation of Public Housing Resources

2.7 The Authority has to ensure that public housing subsidies are available only to families in genuine need, and that the continuing needs of those living in PRH are regularly reviewed and properly assessed. This objective is achieved through two important policies - the Housing Subsidy Policy introduced in 1987 and the Policy on Safeguarding Rational Allocation of Public Housing Resources in 1996.

2.8 Under the Housing Subsidy Policy, tenants who have resided in PRH for 10 years or more are required to declare household income at a biennial cycle. Households with income exceeding two times the Waiting List Income Limits have to pay 1.5 times net rent plus rates. Those with income exceeding three times the Waiting List Income Limits, or who choose not to declare their income, have to pay double net rent plus rates.

2.9 The Policy on Safeguarding Rational Allocation of Public Housing Resources further requires tenants paying double net rent plus rates to declare their assets at the next cycle of declaration if they wish to continue to live in PRH. Households with income exceeding three times the Waiting List Income Limits and net asset value exceeding the prescribed asset limits (currently set at 84 times of the Waiting List Income Limits), or who choose not to declare their assets, are required to vacate their flats. These households may apply for a licence to stay in their PRH units for a period of not more than one year, during which a licence fee equivalent to market rent will be levied.

Rent Review and Constraints under the Housing Ordinance (Cap. 283)

2.10 It has been the Authority's practice to review the rent of its PRH units in batches. Each review may comprise a mix of units completed at different points in time.

2.11 Section 16(1A)³ of the Housing Ordinance, which was introduced by way of a Private Members' Bill in 1997 and came into effect in March 1998, imposes tight restrictions on the level and frequency by which the Authority may adjust its domestic rent. It provides that any determination of variation of rent by the Authority for any particular estate shall only take effect at least three years after the preceding determination for that estate, and that the overall MRIR of all rental estates shall not exceed 10% after a rent determination in any estate⁴.

2.12 On the other hand, section 4(1)⁵ of the Housing Ordinance calls upon the Authority to "secure the provision of housing" to those in need. Section 4(4)⁶ goes further to direct the Authority to ensure that the revenue from its estates "shall be sufficient to meet the recurrent expenditure on its estates". The Authority's rental operating account accumulated a deficit of \$11.4 billion over the period between 1993/94 and 2004/05 and achieved a moderate surplus of about \$0.4 billion for 2005/06.

2.13 The legislative constraints on rent adjustments have made it very difficult for the Authority to secure the necessary resources from its rental income to fund the recurrent expenditure of its estates. The law, as it currently stands, contains provisions which may not be easily reconciled.

³ 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 three 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 MRIR in respect of all classes of land in all estates let for residential purposes, as determined by the Authority, shall not exceed 10%.

⁴ The Court of Final Appeal's interpretation of section 16(1A) is set out in para. 2.18 of this Report.

⁵ 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.

⁶ 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 estates shall be sufficient to meet its recurrent expenditure on its estates.

Background to the Review

Rent Increase Waivers and Deferrals of Rent Reviews

2.14 To help PRH tenants cope with the economic downturn brought about by the Asian financial turmoil, the Authority waived the rent increases (ranged from 13.7% to 24.7%) approved in 1998 and 1999, except for additional rent payers. It has also deferred all rent adjustments since 1999. As a result, the rent of about one-third each of the public housing units were last adjusted in 1995, 1996 and 1997.

2.15 In December 2001, in view of the continuing difficult economic conditions, the Authority further decided to grant a one-month rent holiday for all PRH tenants, except for those who were paying additional rent.

Judicial Review

2.16 Notwithstanding the above rent relief measures, the MRIR has been increasing gradually and exceeded 10% in the second quarter of 2000. As at the second quarter of 2006, the MRIR reached 14.8%. The upsurge in the MRIR has been brought about by a host of extraneous factors other than changes in rent or PRH tenants' household income. These factors, which are discussed in greater detail in Chapter 4, include a soaring number of households receiving CSSA, rising proportion of small and elderly households living in PRH, increase in tenants' space allocation, redevelopment of old estates, etc.

2.17 In October and November 2002, two PRH tenants applied for judicial review of the Authority's decisions to defer rent reviews. At the heart of the judicial review lies an important question as to whether under the Housing Ordinance, the Authority has a statutory duty to review rent every three years and to ensure that the MRIR does not exceed 10%.

2.18 The Court of First Instance and Court of Appeal respectively ruled in favour of the judicial review applicants and the Authority. The case eventually went to the Court of Final Appeal. In November 2005, the Court of Final Appeal handed down its judgment in favour of the Authority. In brief, it ruled that -

- the Authority’s decisions to defer rent reviews did not amount to determinations of variation of rent;
- the Authority is not under a statutory duty to review rent and revise them so as to ensure that the 10% MRIR is not exceeded;
- the Appellant did not have a legitimate expectation that rent would be revised at three-year intervals or at all so as to ensure that the 10% MRIR is not exceeded;
- the words “any determination of variation of rent” in section 16(1A) of the Housing Ordinance mean any decision to increase rent and do not extend to a decision to reduce rent;
- 10% MRIR is not a statutory definition of affordability; and
- the Authority is under a statutory duty to ensure that the revenue accruing from its estates shall be sufficient to meet its recurring expenditure.

2.19 The relevant judgment of the Court of Final Appeal on this judicial review case (Ho Choi Wan v. Hong Kong Housing Authority) can be accessed on the Judiciary website (<http://legalref.judiciary.gov.hk/lrs/common/ju/judgment.jsp>).

Problems of the Current Rent Policy

2.20 The continuing surge of the MRIR has aroused public concern and raised important questions about the Authority’s existing domestic rent policy and the long-term sustainability of its finances. It was against this background that the Committee was commissioned by the Authority to develop and recommend on a domestic rent policy framework that could strike a balance between the sustainability of the public housing programme and the need to ensure that PRH rent remains within the affordability of our tenants.

2.21 Taking account of the Court of Final Appeal’s ruling, the Committee has identified a number of key problem areas in the current rent policy framework that need to be addressed. These include –

- The statutory 10% MRIR provision following any rent increase has imposed an unprecedented constraint upon the Authority's power to adjust its domestic rent to meet its policy and financial objectives.
- The MRIR has been contrived as a general measure of tenants' affordability rather than a mechanism for rent adjustments. The requirement under the existing Housing Ordinance that the MRIR should not exceed 10% following any rent increase has confused the role of MRIR and imposed tight restriction on rent increases. Yet it provides no objective basis for the Authority to consider when and, if so, to what extent a rent reduction is warranted. We need a more well-defined and viable mechanism to guide rent adjustments.
- The recent increase in the MRIR was brought about by a combination of many extraneous factors other than changes in rent and PRH tenants' household income. There is a clear case to examine whether the current methodology for its assessment has scope for improvement. It also calls into question whether the MRIR as a measure of tenants' affordability still meets modern day requirements.
- The rigidity of the existing rent structure has restricted the Authority's flexibility in setting different rent level and the choice available to tenants to select flats that suit their needs and affordability is limited.

Chapter 3 - GUIDING PRINCIPLES

3.1 The Committee has thoroughly examined and reaffirmed the following guiding principles that underpin the Authority's domestic rent policy-

- ***Tenants' Affordability*** - The Authority's PRH programme plays a central role in providing accommodation to those who find private housing beyond their affordability. Tenants' affordability should therefore be central to the Authority's consideration of its domestic rent policy.
- ***Long-term Sustainability of the PRH Programme*** - The provision of suitable and adequate PRH to maintain the average waiting time at around three years is a long-term commitment of the Authority. Meeting this commitment requires substantial and continuous investment by the Authority in the PRH programme. In addition, pursuant to sections 4(1) and 4(4) of the Housing Ordinance, the Authority has a statutory duty to secure the provision of housing to those in need and to ensure that the revenue accruing from its estates shall be sufficient to meet the recurrent expenditure of its estates. The long-term sustainability of the PRH programme must therefore be an important consideration in framing our domestic rent policy.
- ***Rational Allocation of Resources*** - The Committee maintains the principle that housing resources should be allocated to those in genuine need. The level of housing subsidies should generally correspond with the households' financial means.
- ***Respect for Tenants' Choice*** - The Committee recognizes that many of the PRH applicants would like to have a wider choice of flats that match their individual preferences and affordability. The Committee believes that, resources permitting, we should give due respect for tenants' choice.

- *Estate Value* - The rental value of individual estates and housing units varies according to factors such as location, size, age, design of the properties, estate facilities, surrounding environment, transportation and other amenities. The Committee believes that it is appropriate to continue to set rent to reflect the comparative value of different estates.

3.2 The Committee has considered the appropriateness for the Authority to make reference to the rent levels in the private sector in the determination and adjustment of its domestic rents. It believes that it is not appropriate to do so as market rent is driven not so much by tenants' affordability as other external factors such as supply of private housing stock and the prevailing economic conditions. Reference to market rent is only relevant to assessing the extent of public subsidies for providing PRH.

Chapter 4 - A NEW RENT ADJUSTMENT MECHANISM

Drawbacks of the Existing Framework

4.1 The requirement under the Housing Ordinance that the MRIR should not exceed 10% following any rent review was set without reference to any clearly defined principles. It was introduced merely as a measure to restrict the Authority's powers to increase rent and has over the past few years brought to light the following problems -

- The statutory cap effectively means that, regardless of the underlying and extraneous factors accounting for the changes in the MRIR, PRH rents can only go down but not go up once the MRIR has exceeded 10%. Such a domestic rent regime is neither rational nor sustainable in the long run.
- Movement in the MRIR is subject to the influence of a wide range of external factors other than the income of households and the rent they pay. These include, inter alia, -
 - a sharp rise in the number of CSSA recipients who account for some 20% of the PRH households. Although they do not have any affordability problem per se as their rent is fully covered by the CSSA allowance in most cases, they tend to have higher "rent-to-income" ratios so long as their social security allowance is counted as "income" in the calculation of MRIR. The greater the number of CSSA households, the greater the MRIR will be inflated;
 - a huge surge in the proportion of small and elderly households living in PRH who usually have lower income than large households. One and two-person households now account for 35% of the total number of PRH households whereas elderly households constitute 14.4%;
 - major improvement in the space allocation standard. The average living space per person has reached 12 m² IFA, as opposed to the allocation standard of 7 m² IFA per person;

- exit of high income tenants. Some 185 100 PRH tenants left PRH and became home owners through various subsidized home ownership programmes over the past ten years; and
 - replacement of old estates by new ones. Between 1996/97 and 2005/06, some 109 200 old PRH units were demolished. These were replaced by 224 100 new units which are more spacious and with better facilities.
- To determine the extent of rent adjustments on the basis of the movement in MRIR may produce results that are highly distorted and not practicable. This was clearly demonstrated in the rent review exercise ordered by the High Court in 2004 which suggested that an across the board rent reduction of 38% would be required to bring the then MRIR of 14.2% to below 10%.
 - As the Authority continues to build new Harmony estates with better facilities to replace old ones, the MRIR will increase even when there is no change in PRH tenants' income and the prevailing levels of "best rent". This rising trend will continue unless the rent levels of Harmony estates are drastically lowered to the levels of old estates.
 - The Court of Final Appeal ruled that the 10% MRIR cap applies only to any decision to increase rent and does not extend to rent reduction. Although the current system only imposes restrictions on rent increases, it falls short of providing any objective basis for the Authority to consider when a rent reduction is warranted. Nor does it help define the extent of such a reduction.

4.2 As most of the extraneous factors contributing to the surge in the MRIR are unlikely to go away, the MRIR will continue to exceed the 10% ceiling in the foreseeable future. The statutory MRIR cap does not provide a sound basis for guiding rent adjustments. We need a more rational and sustainable system to allow for upward or downward rent adjustments as and when circumstances warrant. The results of the recent public consultation also revealed strong support for putting in place a more transparent and well-defined rent adjustment system to give tenants more certainty over how and the extent to which their rent is to be adjusted.

Proposed Income-based Rent Adjustment Mechanism

4.3 The Committee put forth in the Consultation Paper the following four possible reference indexes (based on movement in consumer price or tenants' household income) to guide rent adjustments –

- ***Consumer Price Index (A) (CPI (A))*** - The Consumer Price Index (CPI), which measures movement in the price levels of consumer goods and services purchased by households over time, is the most commonly used indicator of inflation/deflation. The CPI (A) covers households with monthly expenditure ranging from \$4,000 to \$15,499⁷, excluding recipients of CSSA. It is compiled by the Census and Statistics Department (C&SD) on a monthly basis. As the expenditure of most PRH tenants falls within the range of expenditure covered by the CPI (A), this index is considered suitable for reflecting the price levels that have the most direct bearing on PRH tenants.
- ***CPI(A) Excluding Housing Expenditure*** - As PRH rent constitutes an important component in compiling the CPI (A), changes in PRH rent are likely to cause the price index to change in the same direction. Using the CPI (A) to guide rent adjustments may have circular effect leading to sequential upward or downward movements in the price index and rent level. To avoid this spiral effect, one possible option is to exclude housing expenditure from the CPI (A) and only take account of the movement in price levels for non-housing expenditure.
- ***Median Monthly Household Income*** - A simple income-based system is to adjust rent based on the changes in the median monthly household income of PRH tenants. However, as with MRIR, changes in households' median income are subject to many external factors other than household income. For instance, the median household income of PRH tenants would drop simply as a result of an increase in the number of small households living in PRH even though the income of individual households remains unchanged.

⁷ The expenditure range relates to prices in the base period from October 2004 to September 2005.

- ***Income Index*** - A more sophisticated system is to develop an index tracking the movement in PRH tenants' household income which only takes account of the "pure income changes" of the PRH tenants and discounts the impact of the changes in the distribution of household size. The note at **Annex C** explains in detail how this income index operates. In a nutshell, the household size distribution of PRH tenants would be kept constant in any one particular rent review cycle for the purpose of assessing the weighted average household income of all the PRH tenants so that only the changes in household income are reflected in the index.

4.4 The majority of the public responses supported an income-based rent adjustment mechanism which could provide a stronger connection between future rent adjustments and tenants' affordability. Many of the respondents were concerned that an increase in consumer price may not necessarily imply an improvement in tenants' affordability. They pointed out that too often the increase in household income could not catch up with the rate of inflation. The Committee shares similar concern. As long as the Authority maintains the principle of determining PRH rent on account of affordability, the Committee is of the view that an income-based rent adjustment system would match more closely with tenants' affordability.

4.5 On the choice of the most appropriate income-based index, it is apparent that median monthly household income is deficient in that, similar to MRIR, its movement is affected by factors other than changes in households' income. Since the income of small households is usually lower than that of large households, even if there is no change in the income of individual households, the median household income of all PRH households may fall simply because the number of small households soars. The Committee believes that the proposed income index set out at **Annex C**, which discounts the effects of the changes in household size distribution and assesses the "pure income changes" of the PRH tenants, provides a more objective and fairer income indicator for the purpose of rent adjustments. Compared with the existing statutory 10% MRIR cap under which PRH rent can only go down once the cap is exceeded due to non-income related factors, using the proposed income index to guide future rent adjustments would enable PRH rent to move both upwards and downwards according to changes in tenants' household income. It would take account of tenants' affordability while promoting the sustainability of the public housing programme in the long run. The same

income index should also be applied to guide the adjustments of the “best rent” for newly completed PRH estates.

Implementation Framework

A New Rent Level

4.6 The Committee is conscious that the principal objective of the current Review is to recommend a more viable policy framework for fixing and adjusting PRH rent rather than to determine an appropriate rent level. However, many respondents expressed during the public consultation serious concerns about the rent level upon which the new rent adjustment mechanism should operate. They were of the view that as both tenants’ household income and consumer price had undergone major downward adjustments since the Authority last adjusted PRH rent in 1997, it would not be reasonable to adopt the existing rent level as the basis for future rent adjustments under the new mechanism. The Committee accepts that for the proposed income-based rent adjustment mechanism to operate effectively and fairly, it is necessary to look into whether and, if so, how the current PRH rent should be adjusted to a level that is considered appropriate and acceptable to the community.

4.7 To ensure coherence and consistency of the entire rent adjustment framework, the Committee is of the view that should it consider necessary to adjust the current PRH rent, the new rent level should be determined according to the proposed income index. The same rate of adjustment should also be applied to the “best rent” for newly completed PRH estates. The following four possible options to adjust the existing level of rent have been examined.

Option A

4.8 The findings of the telephone survey show that 78.3% of all the respondents (65.8% if only PRH tenants are counted) considered the current PRH rent reasonable or even on the low side⁸. An option available to the Authority therefore would be to adopt the current rent level as the basis upon which the new mechanism should operate.

⁸ The findings of the telephone survey are set out at Appendix II to Annex B of this Report.

Option B

4.9 If it is considered appropriate to adjust the current PRH rent, the new starting point should make reference to the changes in the proposed income index over the past few years. Owing to the Authority's previous practice of reviewing PRH rent in batches and the rent increase waivers in 1998 and 1999, around 30% of the current PRH units have their rent last adjusted in 1995, some 34% in 1996 and the remaining 36% in 1997. The following table sets out the respective changes in the income index for PRH households since 1995, 1996 and 1997.

Changes in the Income Index⁹ for PRH Households

	From Jan 95 – Dec 95 to Apr 05 – Mar 06	From Jan 96 – Dec 96 to Apr 05 – Mar 06	From Jan 97 – Dec 97 to Apr 05 – Mar 06	Weighted changes in the income index since 1995 – 1997
Income index	2.8%	-5.2%	-11.6%	-5.1%

4.10 An objective way of assessing the new rental basis would be to apply different rates of rent adjustments to individual PRH units according to the respective changes in the proposed monthly income index since 1995, 1996 and 1997. Under this option, the rent of those units with their rent last adjusted in 1995 should be increased by 2.8%. For units with their rent last adjusted in 1996 and 1997, a respective rent reduction in the order of 5.2% and 11.6% would be warranted. The Authority's annual rental revenue foregone under this option is around \$730 million.

⁹ Key assumptions for calculating the changes in the "income index" include -

- (a) the income index has been compiled on an annual basis to facilitate the calculation of its changes over time and minimize the impact of seasonal variations;
- (b) at the time when we began to draft this Report, the latest income statistics available from the General Household Survey conducted by the C&SD were up to March 2006. The extent of rent adjustments has therefore been estimated with reference to the periods between the respective base years (i.e. 1995, 1996 and 1997) and March 2006;
- (c) of the current PRH stock, some 30% of the flats have their rent last reviewed in 1995; 34% in 1996; and 36% in 1997. The weighted average takes into account this percentage distribution of the PRH flats; and
- (d) the income index has been re-based by incorporating the changes in the household size of PRH tenants at two-year intervals. This would eliminate almost all of the variations in household income resulting from changes in household size distribution.

Option C

4.11 Adopting a differential treatment for different categories of PRH tenants might not live up to the general expectation of the tenants that they would be subject to the same rate of adjustment across the board. An alternative therefore would be to identify a uniform rate of rent adjustments for all PRH tenants. One possibility is to weight the changes in the income index since 1995, 1996 and 1997 by the respective proportion of PRH stock with rent last adjusted in these three years. An across the board rent reduction of 5.1% may be warranted under this “weighted average” approach. The annual rental foregone is in the order of \$620 million.

Option D

4.12 While the “weighted average” could provide an objective basis for assessing a uniform rate of rent adjustment, the relatively moderate percentage of rent reduction so derived may not be acceptable to many of the tenants, particularly those with their rent last reviewed in 1997. Another possible option is to make reference to 1997 as the base year for rent adjustment in which case a reduction of 11.6% may be required. This option would result in an annual rental loss of \$1,410 million.

4.13 Overall, the Committee is in favour of **Option D** having regard to the following considerations -

- Apart from the choice of the most appropriate index, for any index-linked rent adjustment mechanism to operate fairly it is essential that the basis upon which the new mechanism begins to operate is considered appropriate and acceptable to PRH tenants and the community at large. Given the downward adjustments in both the household income and general price level since the Authority last varied PRH rent in 1997, there is a reasonable case to adjust the current rent level to reflect the changes in tenants’ household income over the past few years.

- Applying the same rate of adjustment to all PRH units is preferred in order to garner the maximum support from PRH tenants and the community as a whole. It is also in line with another recommendation of the Committee that in future the rent of all PRH estates should be reviewed and adjusted in one go (please see Chapter 7 for details).
- The existing “best rent” levels for new estates, which have been criticized by some as being on the high side, were last reviewed in 1997. There is a justifiable case to bring down the rent of the newly completed estates as well as those to be completed in the near future according to the changes in the proposed income index since 1997.
- The rent of the largest proportion of the existing PRH stock (36%) was last reviewed in 1997. This proportion is expected to increase as more new estates at the 1997 “best rent” levels continue to come on stream.

Legislative Amendments

4.14 The existing statutory MRIR provision effectively means that, despite the extraneous factors accounting for the changes in the MRIR, rent can only go down once the 10% MRIR cap is exceeded. To allow for the proper operation of the new income-based rent adjustment mechanism so that PRH rent can move both upwards and downwards, suitable amendments to the Housing Ordinance to remove the 10% MRIR cap are required.

4.15 Ideally the proposed income-based rent adjustment mechanism should be implemented by the Authority through administrative means. This would provide the Authority with the flexibility to decide on the exact degree of rent adjustment taking account of the prevailing socio-economic circumstances, the operating costs of managing and maintaining the PRH stock and the Authority’s state of finances.

4.16 The Committee, however, recognizes that there exists a strong demand from certain quarters, particularly the political parties and some resident groups, to have the new rent adjustment mechanism set out in the

Housing Ordinance to provide tenants with a “statutory safeguard”. As implementation of the proposed income-based rent adjustment mechanism would ultimately require the Legislative Council’s endorsement to amend the Housing Ordinance, the Committee believes that the Administration and Legislative Council should work out the necessary legislative amendment to enable early implementation of the new system. Should it prove unavoidable to give statutory effect to the income index, the Committee is of the view that the statute should only set out the basic principles governing the application of the proposed income index for rent adjustment purpose and allow adequate flexibility for the effective operation of the adjustment mechanism.

Data Collection

4.17 The validity of the proposed income index for guiding future rent adjustments hinges crucially on the reliability of the household income and rental data used for its computation. Instead of relying on the income data collected from the General Household Survey conducted by the C&SD which are intended for general statistical analysis, the Authority should collect suitable income data through a mandatory declaration system similar to that under the Housing Subsidy Policy to meet the specific data requirements of the proposed rent adjustment mechanism. To mitigate potential disturbance to PRH households, it is proposed that a sample of 1 500 to 2 000 households would be selected each month to furnish the Authority with their household income on a mandatory basis. The Authority could then be able to obtain a stream of income data continuously throughout the year. Statistically this would help produce a more representative income index for the entire year and provide a high degree of flexibility to compile the income index as and when necessary. To allay the concerns over the use of the income data, the Authority should make clear that the income information so collected would be used for the sole purpose of conducting statistical analyses.

Computation

4.18 The Committee notes that although the Housing Department has the necessary expertise and capability to compile the income index, consideration should be given to engaging an independent party to undertake the computation on behalf of the Authority. This would go some way in instilling a sense of impartiality and objectivity to the income index so compiled.

The Committee's Recommendations

4.19 The Committee recommends that -

- The Authority should develop an income index tracking the movement in PRH tenants' household income to guide future rent adjustments.
- The same income index should also be applied to guide the adjustments of the "best rent" for newly completed PRH estates.
- The Authority should adjust the existing PRH rent as well as the "best rent" for newly completed estates to provide an appropriate starting point for the proposed rent adjustment mechanism to operate fairly and effectively. Consideration could be given to determining the new rent level with reference to the extent of changes in the income index since 1997, i.e., an across the board rent reduction of 11.6%.
- Legislative amendments to the Housing Ordinance should be introduced to remove the statutory MRIR cap to enable proper operation of the new rent adjustment mechanism.
- Should statutory effect be given to the new rent adjustment mechanism, the legislation should only set out the broad principles that PRH rent would be adjusted according to the changes in the proposed income index.
- For compiling the income index, the Authority should operate its own system to collect more reliable household income data through a mandatory declaration system. Consideration could also be given to engaging an independent party to compile the income index.

Chapter 5 - MEASURE OF AFFORDABILITY

The Case for Having an Affordability Indicator

5.1 As the Authority should have regard to its tenants' affordability when setting PRH rent, the Authority has been using for a long time MRIR as a broad-brush indicator for assessing the overall affordability of all PRH households. Questions have been raised as to whether there is still a need to retain any form of affordability indicator following the implementation of the proposed income-based rent adjustment mechanism which should reflect closely changes in tenants' household income and hence their affordability. There is a concern that having an affordability indicator alongside the proposed income index would confuse the public. The eligibility threshold for applying for rent reduction under the Rent Assistance Scheme, i.e., a rent-to-income ratio of 20% or above¹⁰, has effectively set an affordability benchmark for individual households.

5.2 The Committee has considered carefully the arguments for doing away with an affordability indicator. Overall, it believes that it would be useful to retain some form of affordability indicator as an administrative reference. The proposed income index is designed to determine the extent of rent adjustments. It is not an affordability indicator per se. Following any adjustment of the "best rent" for newly completed estates or the rent of existing estates according to the changes in the income index, it would still be useful to assess in broad terms whether the new rent level is affordable to PRH tenants in general.

Alternative Affordability Indicators

5.3 The Committee does recognize the shortcomings of the MRIR as an indicator of tenants' affordability. The movement in MRIR is affected by many external factors other than changes in household income and rent. There has also been criticism that adopting an overall MRIR for all PRH tenants is unable to address the situation where the rent-to-income ratios of low-income or disadvantaged groups are usually higher than those of the more well-off tenants. The Committee has therefore examined the following alternative methods for measuring affordability –

¹⁰ Please refer to Chapter 11 for details of the Rent Assistance Scheme.

- ***MRIR Variants*** - Instead of using a single MRIR for measuring the affordability of all PRH households, it is possible to adopt different MRIRs for different categories of households. For instance, higher MRIRs can be applied to households with higher income, comprising larger number of household members or living in new block types.
- ***Fixed Rent-to-Income Ratio*** – A straight-forward and equalitarian approach to ensure affordability is to charge all households a fixed portion of their income as rent irrespective of the size and location of the flats in which they live.
- ***Residual Income Approach*** - Under this option, an affordable level of rent is defined as the residual amount of tenants' household income after deducting the non-housing expenditure required to maintain an appropriate standard of living.

5.4 While appreciating the advantages of these alternative propositions from the perspective of equity, the Committee is concerned that most of them require an individual assessment of the household income of all the PRH households. Given that there are about 645 000 households in the Authority's PRH estates, the administrative costs of implementing these options would be enormous, which would easily outweigh any intended benefits. The Committee considers that for the purpose of establishing a broad-brush affordability benchmark, tenants' affordability should best be assessed generally and collectively. The procedures for assessing tenants' affordability must be transparent and can be easily applied and administered. The affordability problem faced by individual tenants should be dealt with by the safeguards provided under the CSSA and Rent Assistance Scheme.

Improvements to the Assessment of MRIR

5.5 In the absence of more viable alternative, the Committee accepts that the MRIR should continue to be used as a broad-brush indicator to measure tenants' affordability. While the MRIR will no longer play any role in determining the extent of rent adjustment and would only be served as a general indicator of affordability, the Committee believes that the Authority should strive to rationalize its assessment. The Consultation Paper suggested and invited views on the following possible measures to improve its assessment –

- Collecting more reliable and accurate income data from sampled households by way of mandatory income declaration.
- Excluding CSSA cases and households paying additional rent from the compilation of the MRIR.
- Excluding rates and management fees from the calculation of the MRIR.

5.6 Public responses to the proposed measures for improving the assessment of the MRIR were diverse. There was considerable support for the Authority to operate its own system to collect tenants' income data. Views on whether CSSA cases should be excluded from the MRIR compilation were more divided. There was grave public reservation about excluding rates and management fees from the calculation of the MRIR.

5.7 Having considered the public responses, the Committee suggests the following measures for rationalizing the methodology for assessing the MRIR.

Data Collection

5.8 To enhance the reliability of the assessment, the income data collected under the proposed mandatory declaration system discussed in para. 4.17 for compiling the income index for PRH household should also be used to calculate the MRIR.

CSSA Cases and Households Paying Additional Rent

5.9 As the rental expenditure of CSSA households is fully covered by Government in most cases, the question of affordability is largely irrelevant to this group of PRH tenants. Inclusion of the CSSA households in the MRIR calculation has distorted the reliability of the MRIR as a general indicator of affordability. The distortion is aggravated by the drastic increase in the number of CSSA households in recent years, which reached 130 800 and accounted for 20% of all PRH households as at June 2006.

5.10 By the same token, for those “better-off” households who are required to pay additional rent under the Housing Subsidy Policy, their household income is well above those of the average PRH tenants. Their inclusion in the MRIR assessment would undermine its validity as an affordability indicator.

5.11 The Committee therefore reaffirms its view that both CSSA households and households paying additional rent should be excluded from the compilation of the MRIR.

5.12 As at the second quarter of 2006, the MRIR assessed after excluding CSSA households and households paying additional rent was 13.0%, as opposed to 14.8% assessed under the previous assessment method.

Rates and Management Fees

5.13 Many respondents in the public consultation held the view that rates and management fees were part and parcel of the tenants’ overall housing expenditure and should be taken into account in the assessment of the tenants’ affordability. The Committee accepts their arguments and recommends to continue to include rates and management fees in the MRIR calculation.

MRIR Benchmarks

5.14 Since 1986 and 1991 the Authority has been making reference to two MRIR benchmarks for measuring the affordability of the prospective tenants moving to newly completed estates, i.e. 15% for a space allocation standard of 5.5 m² IFA per person adopted in 1986 and 18.5% for an allocation standard of 7 m² IFA per person adopted in 1991. The Authority also makes reference to these MRIR benchmarks when reviewing the rent of existing estates. Some respondents suggested that the MRIR benchmarks should be lowered in order to bring down the rent of the new estates which very often are much higher than those of the older estates.

5.15 The Committee has considered carefully these suggestions and reviewed the validity of the two MRIR benchmarks of 15% and 18.5%. It believes that these two benchmarks should remain applicable under the present-day circumstances because –

- These two MRIR benchmarks were set in 1986 and 1991 following two comprehensive reviews by the Authority to cater for the respective allocation standards of 5.5 m² and 7 m² IFA per person. The average space allocation standard for newly rehoused households has improved substantially over the past decade to 12.3 m² IFA in the second quarter of 2006. This standard has far exceeded the upper tier allocation standard of 7 m² IFA per person to which the MRIR benchmark of 18.5% applies.
- The two MRIR benchmarks compare very favourably with similar affordability indicators adopted internationally. The United Nations Centre for Human Settlement (Habitat) sets the housing affordability indicator at a rent-to-income ratio of 30% for households with income within the lowest 40th percentile of the overall population. The US Department of Housing and Urban Development also adopts a rent-to-income ratio of 30% as a benchmark for housing affordability.
- The MRIR benchmarks are much lower than the MRIR of households living in private permanent housing. The latter stood at 25.5%¹¹ as at the second quarter of 2006.
- Another important consideration is that MRIR will only be used as a general affordability indicator rather than rent adjustment mechanism. Following the implementation of the income-based rent adjustment mechanism, PRH rent will be adjusted according to the movements in the proposed income index.

Legislative Amendments

5.16 The MRIR should only be used administratively as a general affordability indicator and future rent adjustment should be done according to the change in the proposed income index. The Committee is of the view that references in the Housing Ordinance to the MRIR should be removed. As noted in para. 4.14, implementation of the proposed income-based rent

¹¹ Rent of public rental housing is inclusive of rates, government rent and management fees. For private permanent housing, whether the rent is inclusive of rates, government rent or management fees depends on the terms of the tenancy.

adjustment mechanism would require removal of the statutory MRIR provisions from the Housing Ordinance.

The Committee's Recommendations

5.17 The Committee recommends that -

- The MRIR should continue to be used as an affordability indicator but not a mechanism to determine rent adjustments. Legislative amendments should be introduced to remove the provisions concerning the MRIR from the Housing Ordinance.
- The assessment of the MRIR should be improved by –
 - the Authority collecting income data from sampled households through a mandatory declaration system; and
 - excluding both CSSA households and additional-rent payers from the MRIR calculation.
- Rates and management fees should continue to be included in the MRIR calculation.
- The Authority should continue to adopt the MRIR benchmarks of 15% and 18.5% for the respective allocation standards of 5.5 m² IFA and 7 m² IFA per person.

Chapter 6 - DIFFERENTIAL RENT

Possible Improvement Options

6.1 PRH rent is set uniformly in the same housing block and differ only according to the size of the flats. Tenants living in the same housing block pay the same unit rent irrespective of floor levels and external views of their units. To give tenants more choice to select flats that suit their own preference and affordability, the Committee broached the idea of introducing “differential rent” into the Authority’s rent regime. Two possible models were mooted for discussion in the Consultation Paper –

- ***A Moderate Model*** – Rent would be adjusted having regard to internal factors such as floor level and proximity to unwelcome facilities. We reckon that for a unit located on the first floor in proximity to a refuse chamber, its rent may be reduced by as much as 11%. As for a unit on 39th floor, its rent may be increased by some 4% – 5% at most. The maximum rental differential of similar-sized units would therefore be around 15%. The overall effects on the Authority’s rental income within the same block should largely be neutral. In addition, each of the current six broad districts for rent setting purpose would be further divided into three sub-groups. The “best rent” for each sub-group would be adjusted upwards or downwards to reflect the varying conditions in terms of location, transportation facilities and other supporting amenities, etc.
- ***A Comprehensive Model*** – In addition to the features of the moderate model, it would take account of the external factors such as the views and orientation of the PRH flats. The maximum rental differential of similar-sized units would be expanded to around 30%. For instance, we reckon that a unit located on the first floor, close to a refuse chamber and has its external views obstructed by other buildings may have its rent lowered by as much as 20%. On the other hand, for a unit located on 39th floor and commanding an open view, its rent may be set at around 10% above the normal rent.

6.2 The Consultation Paper also raised a number of practical issues for implementing a system of differential rent. These include the need to improve the flat allocation process to provide tenants with greater choice in flat selection; whether differential rent should only be applied to newly completed estates or to existing PRH estates as well; and whether flats of higher rental value should be allocated to CSSA households.

Public Feedback

6.3 Views expressed by different quarters and collected through different channels were extremely divided. Findings of our telephone survey show that the majority of the public, including sitting PRH tenants, were in favour of introducing some form of differential rent. A considerable number of written submissions also subscribed to the notion of differential rent. However, there was strong resistance to the idea from participants at local forums, resident groups and District Councils. Most of the opponents were concerned that varying the rent according to floor levels, external view or orientation of the flats would be divisive and discriminatory and have labelling effects on tenants living in units with lower rent.

6.4 Despite our emphasis in the Consultation Paper and repeated clarifications at numerous consultation forums that the principal objective of putting forward the option of differential rent for consultation is to allow greater choice for tenants to select flats according to their preference and affordability, there remain serious doubts from certain sectors of the community about the merits of differential rent. Given the circumstances, the Committee believes that it is not advisable to pursue the idea of differential rent .

“Unpopular” Units

6.5 A key message that emerged from the consultation on differential rent was that the Authority should consider providing incentives to encourage more people to take up PRH flats in “unpopular” locations or vacant for a long time in order to enhance their letting rate. Some suggested that should a system of differential rent be introduced, it should only be confined to “unpopular” units to boost their occupancy rate. The Committee agrees that the Authority should make positive response to this suggestion. To encourage prospective tenants to take up “unpopular” flats, the Committee suggests to

offer a rent-free period of, say, four to six months to those opting to move into flats which have been vacant for 12 months or above¹². The proposed scheme has the following advantages –

- long vacancy is a more objective indicator of “unpopularity” than floor levels or proximity to “unwelcome” facilities; and
- offering a relatively long rent-free period could maximize the impact of the scheme and is more cost-effective than permanent rent reduction.

6.6 Further study will be required to map out details of the implementation framework for the scheme.

The Committee’s Recommendations

6.7 The Committee recommends that -

- The idea of differential rent should not be pursued.
- The Authority should consider offering four to six months’ rent-free period for tenants moving to units which have been vacant for 12 months or above. It should commission further study to map out details of the scheme.

¹² According to the Authority’s administrative records, after excluding flats which have been kept vacant arising from management actions (such as flats reserved for the Urban Renewal Authority), there were some 5 300 PRH flats vacant for 12 months or above as at 2Q 2006.

Chapter 7 - RENT FIXING AND REVIEW CYCLES

Present Arrangements

7.1 The Authority conducts two rent fixing exercises every year for newly completed PRH estates. On rent review, the Authority used to review the rent of PRH units in batches. Each batch comprised different number of units in different locations. In general, the rent of individual PRH units was reviewed every two years prior to 1998. Following the amendments to the Housing Ordinance that came into effect in March 1998, section 16(1A)(a) provides that any determination of variation of rent in a PRH estate shall only take effect at least three years from the date on which any immediately preceding determination came into effect. Having considered the then prevailing circumstances, the Authority decided to defer all the rent review exercises since 1999.

Rent Fixing

7.2 Public consultation generated limited discussion on this subject. Given the staggered completion of new PRH estates, the Committee considers that the current arrangement of conducting two rent fixing exercises each year should continue in order to ensure that a proper rent schedule is fixed for new estates prior to intake of tenants.

Rent Review Cycle

7.3 Responses from public consultation on how frequent the Authority should review PRH rent were divided. Overall more people expressed a preference for a longer rent review cycle, such as three years, on the ground that it would provide tenants with a stronger safeguard against frequent rent increase. There was also considerable support for a two-year cycle to avoid drastic rent adjustments accumulated over a long period of time.

7.4 The Committee has considered carefully both sides of the arguments. It is concerned that the cumulative effects of the changes in the income index, which would be used to guide rent adjustments, over a relatively long period of three years may result in a large degree of rent adjustments to which tenants may find it difficult to adapt. On balance, it maintains its views that a shorter rent

review cycle of two years should be adopted. This would help achieve a more moderate rent adjustment in every review and allow the Authority to react more quickly to changes in socio-economic circumstances.

Coverage of PRH for Rent Review

7.5 Under the proposed income-based rent adjustment mechanism, rent would be adjusted with reference to the income index of PRH households, which should move in tandem with the general performance of the economy. Accordingly, the index so derived, and hence the rate of rent adjustments that follows, would vary at different points in time. The past practice of reviewing the rent of PRH units in different batches may give rise to a less than equitable situation in which the rent of a batch of units could be adjusted downwards in one year due to a drop in household income, whereas the rent of another batch of units to be reviewed in the next year could be raised when household income records an increase.

7.6 To avoid potentially inequitable treatment to different tenants, the Committee reaffirms its proposal set out in the Consultation Paper that the rent of the entire PRH stock should be reviewed and adjusted in one go¹³. All tenants would then receive the same treatment and have their rent adjusted by the same rate. Public consultation demonstrated support for this approach.

Legislative Amendments

7.7 Section 16(1A)(a) of the Housing Ordinance provides that any determination of variation of rent of land in a PRH estate shall only take effect at least three years from the date on which any immediately preceding determination in respect of the same such class of land came into effect. To allow for the operation of a biennial rent review cycle, this provision in the Housing Ordinance will have to be suitably amended.

¹³ For new estates subject to the first rent review since completion, their first rent review cycle may be shorter than two years to tie in with the review cycle for the entire PRH stock.

The Committee's Recommendations

7.8 The Committee recommends that -

- The current arrangement of having two rent fixing exercises for newly completed estates every year should be maintained.
- A biennial rent review cycle should be adopted. Suitable amendments to the Housing Ordinance will be required to enable the introduction of a biennial rent review cycle.
- The rent of all PRH units should be reviewed in one go.

Chapter 8 - EXCLUSIVE VS INCLUSIVE RENT

Existing Arrangements

8.1 Prior to 1980, rent for public housing estates were exclusive of rates¹⁴. In 1980, the Authority decided to collect rent inclusive of rates for all of its estates to address the concern that it was imposing too frequent rent adjustments due to increases in rates. In addition to rates, PRH rent also covers management costs and maintenance expenses.

8.2 The major drawback of this system of “all-inclusive rent” is that the public at large and PRH tenants in particular are not fully aware of the various components underlying the rent so charged. Nor do they understand that the “net rent” collected by the Authority, after deducting rates, management costs and maintenance expenses, are far lower than the “nominal rent” they pay.

Exclusive Rent

8.3 The Committee has examined the case for charging net rent exclusive of rates and management expenses. Setting rent on an exclusive basis will more accurately reflect the Authority’s rental charges. Tenants would better understand the operating and management costs of PRH and the amount of housing subsidies they are receiving. Any rent variations will no longer be distorted by adjustments in the amount of rates payable to Government which is beyond the Authority’s control.

8.4 The Committee, however, is concerned about the practical difficulties for charging rent separately from rates and management fees. For instance, the existing tenancy agreement provides for the charging of rent inclusive of rates and management fees. Persuading the existing 645 000 PRH tenants to accept and sign a new tenancy agreement providing for charging net rent exclusive of rates and management fees would be a formidable task. Assessing the ratable values of all the existing PRH units is also a very complex and time consuming exercise. From tenants’ perspective, separating the payment of rates and management fees from rent is likely to cause inconvenience.

¹⁴ Except for Group B Estates and Former Government Low Cost Housing Estates.

An Alternative Option to Enhance Transparency

8.5 The majority of the public views received expressed reservation about the idea of separating the collection of rates and management fees from PRH rent. Taking account of the public responses and all the practical constraints, the Committee reaffirms that a more viable and pragmatic alternative is to continue to charge all-inclusive rent but issue an annual statement to tenants setting out the rental components, including the amount of rates, management fees and net rent charged by the Authority. This should serve the purpose of enhancing transparency without causing inconvenience to tenants. As regards the evaluation of management fees, they should cover such expenditure items as security, cleansing, minor maintenance and improvement works in common with private sector practice.

The Committee's Recommendations

8.6 The Committee recommends that -

- The Authority should continue to collect rent inclusive of rates and management fees.
- The Authority should issue an annual statement to tenants setting out the amount of rates and management fees included in the latter's rental payment to enhance transparency.

Chapter 9 - FIXED-TERM TENANCY

Existing Tenancy Arrangements

9.1 Since the development of public housing in 1954, all PRH units are let on a month-to-month term until termination by notice in accordance with the provisions of the tenancy agreement or the Housing Ordinance. Monthly tenancy provides the Authority with a high degree of flexibility in enforcing management actions and effecting rent adjustments.

9.2 It is clear that monthly tenancy does not confer any legal right on the tenants to perpetuate their stay in PRH. However, the apparent lack of an established mechanism to review and renew the tenancy agreements has been criticized for giving tenants a false impression that their tenure would continue for as long as they wish.

Fixed-Term Tenancy

9.3 The Committee has looked into the possibility of replacing the current monthly tenancy by fixed-term tenancy. The principal merit of fixed-term tenancy is that it will help get across a clear message to the tenants that enjoyment of public housing subsidies is by no means a perpetual right and PRH should only be provided to those in genuine need subject to periodic review of their eligibility.

9.4 Despite its potential benefits, fixed-term tenancy is inherently less flexible than monthly tenancy in respect of rent adjustments and tenancy enforcement. As the level of rent within the term of the tenancy has to be clearly prescribed in the tenancy agreement, it would also be difficult to fit a system of fixed-term tenancy into the proposed income-based rent adjustment mechanism. In addition, since PRH tenants have different intake dates, should fixed-term tenancy be introduced their tenancy agreements would expire on different dates. This would make it impossible to review and adjust the rent of all PRH units in one go as proposed in Chapter 7.

9.5 Public responses on this subject were rather divided. On the whole, more people preferred to continue to adopt monthly tenancy. The Committee is of the view that the current system of monthly tenancy provides a

flexible framework for the Authority to take effective tenancy enforcement actions and implement rent adjustments. Adopting fixed-term tenancy may compromise the Authority's flexibility in these important areas. There are already existing policies, namely, the Housing Subsidy Policy and Policy on Safeguarding Rational Allocation of Public Housing Resources, which specifically deal with the eligibility of sitting tenants to continue to stay in PRH. The Committee is of the view that, if necessary, a review of the relevant policy should be conducted to introduce changes to the eligibility criteria.

The Committee's Recommendations

9.6 The Committee recommends that -

- The Authority should continue to adopt a system of monthly tenancy.
- The issue of perpetual stay in PRH by tenants who are no longer in need of housing subsidies should be dealt with more effectively through a review of the Housing Subsidy Policy and the Policy on Safeguarding Rational Allocation of Public Housing Resources.

CHAPTER 10 - RELATIONSHIP BETWEEN FLAT SIZE, RENT, AND TENANTS' AFFORDABILITY

Flat Size and Rent

10.1 Rent and tenants' affordability are closely related to flat size. There has been a marked improvement in tenants' living space in recent years. The average living space per person grew by 29% from 9.3 m² IFA in the third quarter of 1996 to 12.0 m² IFA in the second quarter of 2006. For newly let units, it further reached 12.3 m² IFA, exceeding the upper tier of the existing allocation standards of 7 m² IFA per person by 76%. The sharp increase in average living space per person is mainly the result of the conversion of a significant number of surplus Home Ownership Scheme flats into PRH; increase in the number of one-person households who normally occupy more living space per person; demolition of smaller flats in old estates under the Comprehensive Redevelopment Programme; reduction in household size following moving out of family members, etc.

10.2 When tenants are allocated flats that far exceed the allocation standards, both their rental burden and the MRIR will increase. We reckon that the increase in the average living space per person has raised the average rent payable by PRH tenants by 29% over the past ten years. To address the problem, the Committee believes that the planning and allocation of PRH should follow more closely the established space allocation standards and the general trend towards formation of small households.

The Committee's Recommendations

10.3 The Committee recommends that -

- The Authority should follow the established allocation standards as far as possible.
- The flat mix of new PRH projects should match as far as possible the household size of future tenants, and should be reviewed and adjusted as necessary.

Chapter 11 - RENT ASSISTANCE SCHEME

Improvements to the Scheme

11.1 The Rent Assistance Scheme was introduced in 1992 offering 50% rent reduction¹⁵ to tenants facing temporary financial hardship. To provide timely relief to needy tenants, the Committee decided in 2002 to put its recommendations on improving the operation of the Scheme to the Authority in advance of other proposals covered by the current review. These improvements, endorsed by the Authority and took effect on 31 October 2002, include –

- Relaxing the eligibility criteria by reducing the income limits for elderly households from below 50% of the respective Waiting List Income Limits to below 60%, and lowering the rent-to-income ratio threshold from 25% to 20%.
- Allowing tenants affected by redevelopment to apply for rent assistance immediately upon being re-housed to new or refurbished flats.
- Extending the grace period for moving to cheaper flats from two to three years. Elderly households and households with disabled members will continue to be exempt from this requirement.

11.2 On 29 December 2005, the Subsidized Housing Committee further endorsed the following enhancements to the Rent Assistance Scheme, which took effect on 1 March 2006 -

- Offering 25% rent reduction to those non-elderly households with rent-to-income ratios exceeding 20% or with income below 60% of the Waiting List Income Limits.
- Lifting the requirement that applicants have to live in their flats for at least three years for tenants of older block types¹⁶.

¹⁵ Only 25% rent reduction was offered when the Scheme was first introduced in 1992. The extent of reduction was increased to 50% in 1995. Cumulatively the Rent Assistance Scheme has benefited 35 000 households since 1992. As at the second quarter of 2006, some 14 000 households were receiving rent assistance under the Scheme.

¹⁶ Older block types cover those completed before 1992 and exclude all Harmony blocks and those converted from Home Ownership Scheme/Private Sector Participation Scheme/Buy-or-Rent Scheme.

Possible Areas for Further Improvements

11.3 During the public consultation, some respondents requested further relaxation of the eligibility criteria of the Scheme. The Committee has carefully considered this suggestion. It notes that the Authority has taken major steps in recent years to enhance the operation of the Scheme. The recent relaxation to allow all tenants with rent-to-income ratio exceeding 20%, as opposed to 25% previously, to apply for rent reduction under the Scheme is a major step forward. It has effectively ensured that for the great majority of PRH households they would have to pay no more than 20% of their income as rent. To further enhance the effectiveness of the Scheme as an additional safety net for needy families, the Committee suggests that the Authority should step up publicity to enhance tenants' awareness of the Scheme and the procedures for application.

11.4 Another area which has been subject to frequent criticism is the requirement for non-elderly households to move to flats with lower rent if they wish to continue to receive rent assistance after a continuous period of three years. In order to uphold the principle of rational allocation of housing resources, the Committee considers that it is necessary to retain this provision. In practice, the Authority would consider carefully the actual circumstances of individual households to determine if they have to move to flats with cheaper rent in order to continue to receive rent assistance. Since the introduction of the Rent Assistance Scheme in 1992, only 23 families have been requested to move to more affordable flats in the same district. The Committee suggests that more detailed guidelines should be provided for frontline staff to follow, particularly over when and how the requirement to move to flats with lower rent should be applied.

The Committee's Recommendations

11.5 The Committee recommends that -

- The Authority should step up publicity on the Rent Assistance Scheme.
- More detailed guidelines should be drawn up for frontline staff to follow, particularly concerning when and how the requirement to move to flats with lower rents should be applied.

Chapter 12 - SUMMARY OF RECOMMENDATIONS

A New Rent Adjustment Mechanism

- *The Authority should develop an income index tracking the movement in PRH tenants' household income to guide future rent adjustments.(paragraphs 4.3 to 4.5)*
- *The same income index should also be applied to guide the adjustments of the “best rent” for newly completed PRH estates.(paragraph 4.5)*
- *The Authority should adjust the existing PRH rent as well as the “best rent” for newly completed estates to provide an appropriate starting point for the proposed rent adjustment mechanism to operate fairly and effectively. Consideration could be given to determining the new rent level with reference to the extent of changes in the income index since 1997, i.e., an across the board rent reduction of 11.6%.(paragraphs 4.6 to 4.13)*
- *Legislative amendments to the Housing Ordinance should be introduced to remove the statutory MRIR cap to enable proper operation of the new rent adjustment mechanism.(paragraph 4.14)*
- *Should statutory effect be given to the new rent adjustment mechanism, the legislation should only set out the broad principles that PRH rent would be adjusted according to the changes in the proposed income index. (paragraphs 4.15 to 4.16)*
- *For compiling the income index, the Authority should operate its own system to collect more reliable household income data through a mandatory declaration system. Consideration could also be given to engaging an independent party to compile the income index.(paragraphs 4.17 to 4.18)*

Measure of Affordability

- *The MRIR should continue to be used as an affordability indicator but not a mechanism to determine rent adjustments. Legislative amendments should be introduced to remove the provisions concerning the MRIR from the Housing Ordinance.(paragraphs 5.1 to 5.2 and 5.16)*
- *The assessment of the MRIR should be improved by –*
 - *the Authority collecting income data from sampled households through a mandatory declaration system; and*
 - *excluding both CSSA households and additional-rent payers from the MRIR calculation.
(paragraphs 5.7 to 5.12)*
- *Rates and managements fees should continue to be included in the MRIR calculation.(paragraph 5.13)*
- *The Authority should continue to adopt the MRIR benchmarks of 15% and 18.5% for the respective allocation standards of 5.5 m² IFA and 7 m² IFA per person.(paragraphs 5.14 to 5.15)*

Differential Rent

- *The idea of differential rent should not be pursued.(paragraphs 6.3 to 6.4)*
- *The Authority should consider offering four to six months' rent-free period for tenants moving to units which have been vacant for 12 months or above. It should commission further study to map out details of the scheme.(paragraphs 6.5 to 6.6)*

Rent Fixing and Review Cycles

- *The current arrangement of having two rent fixing exercises for newly completed estates every year should be maintained.(paragraph 7.2)*
- *A biennial rent review cycle should be adopted. Suitable amendments to the Housing Ordinance will be required to enable the introduction of a biennial rent review cycle.(paragraphs 7.3 to 7.4 and 7.7)*
- *The rent of all PRH units should be reviewed in one go.(paragraphs 7.5 to 7.6)*

Exclusive vs Inclusive Rent

- *The Authority should continue to collect rent inclusive of rates and management fees.(paragraphs 8.3 to 8.5)*
- *The Authority should issue an annual statement to tenants setting out the amount of rates and management fees included in the latter's rental payment to enhance transparency.(paragraph 8.5)*

Fixed-Term Tenancy

- *The Authority should continue to adopt a system of monthly tenancy.(paragraphs 9.3 to 9.5)*
- *The issue of perpetual stay in PRH by tenants who are no longer in need of housing subsidies should be dealt with more effectively through a review of the Housing Subsidy Policy and the Policy on Safeguarding Rational Allocation of Public Housing Resources.(paragraph 9.5)*

Relationship between Flat Size, Rent, and Tenants' Affordability

- *The Authority should follow the established allocation standards as far as possible.(paragraphs 10.1 to 10.2)*
- *The flat mix of new PRH projects should match as far as possible the household size of future tenants, and should be reviewed and adjusted as necessary.(paragraphs 10.1 to 10.2)*

Rent Assistance Scheme

- *The Authority should step up publicity on the Rent Assistance Scheme.(paragraph 11.3)*
- *More detailed guidelines should be drawn up for frontline staff to follow, particularly concerning when and how the requirement to move to flats with lower rents should be applied.(paragraph 11.4)*

**Hong Kong Housing Authority
Ad Hoc Committee on
Review of Domestic Rent Policy**

Membership

Chairman

Mr NG Shui-lai, BBS, JP

Members

Mr Walter CHAN Kar-lok, SBS, JP

Mr CHAN Bing-woon, SBS, JP

Dr LAU Kwok-yu, JP
(from March 2001 to March 2002)

Mr WONG Kwun, BBS

Mr KWOK Kwok-chuen, BBS
(from March 2001 to December 2003)

Ms LUI Lai-bing

Director of Housing, or his representative

Principal Assistance Secretary, Housing Bureau or his representative
(from March 2001 to July 2002)

Secretary

Senior Administrative Officer (Strategic Planning) 2

Terms of Reference

Having regard to the evolving profile of both tenants and rental housing stock under the Housing Authority, the Committee should –

- (a) review the current domestic rent policy, taking into account –
 - (i) the need to reflect tenants' affordability while ensuring public housing subsidy is given in relation to need;
 - (ii) the existing legislative provisions of having a 10% cap of the MRIR after rent adjustment as stipulated in the Housing Ordinance; and
 - (iii) the financial performance of the rental business.
- (b) consider whether there should be changes to the domestic rent policy in respect of, but not limited to, the following issues –
 - (i) methodology for assessing tenants' affordability;
 - (ii) financial assistance for tenants in need;
 - (iii) composition of PRH rents; and
 - (iv) rent fixing and review mechanism.
- (c) consult the public on any proposed changes and to make recommendations on necessary changes to the Authority with reference to the views of the public.

REVIEW OF DOMESTIC RENT POLICY

SUMMARY OF PUBLIC RESPONSES

INTRODUCTION

1. On 9 March 2006, the Authority published a Consultation Paper setting out the initial findings of the Committee. The three-month consultation closed on 9 June 2006. This report provides a summary and analysis of the responses to the Consultation Paper.

Written Submissions

2. We received a total of 425 written submissions (including those making their submissions through Legislative Council and District Councils). Of these, 70 were submitted by organizations and 355 by individuals. There are 21 submissions which have contents outside the scope of the rent policy review. These include, for example, enquiries about the eligibility criteria of the rental assistance scheme, reporting of cases suspicious of abusing public housing resources and requests for transfer, etc. It should also be noted that there are 33 identical copies of submissions issued by the same organizations or persons. Separately, we received ten late submissions¹⁷ after the close of the consultation. In addition, we also received 27 submissions referred by the Office of the Chief Executive. The Committee has noted the contents of these submissions.

3. Except for those not related to the review, all submissions (including identical and late submissions) are posted on the Authority's website (<http://www.housingauthority.gov.hk>) for public inspection. The public can also inspect the submissions at the Housing Department.

Forums and Meetings Attended

4. Members of the Committee and Housing Department's representatives attended a total of 106 forums/meetings in connection with the consultation exercise. Details are set out below –

¹⁷ The cut-off time of the consultation period for submissions through the designated fax number and email address is before mid-night of 9 June 2006, and for submissions through mail is on or before 10 June 2006 (according to the date chop shown on the envelope).

	<u>Total</u>
Public forums organized by Housing Department	4
Local forums organized by outside parties	64
Legislative Council Panel on Housing Meetings	4
District Council Meetings	18
Meetings with political parties/ interest groups/academics	16
	<hr/> <u>106</u>

Public Affairs Forum

5. We posted the Consultation Paper on the on-line Public Affairs Forum¹⁸ of the Home Affairs Bureau for discussion by forum members. A total of 82 messages were received. A summary is at **Appendix I**.

Telephone Opinion Survey

6. We also commissioned an independent consultancy firm to conduct a telephone opinion survey to gauge the opinions of the community at large. The field work was conducted between 27 March 2006 and 10 May 2006. A sample of 5 381 households was randomly selected with 3 011 of them successfully interviewed. A summary of the survey findings is at **Appendix II**.

¹⁸ The Public Affairs Forum is a consultative forum established in 2005 by the Home Affairs Bureau to advise Government on major public issues in Hong Kong. It currently comprises about 520 members who are mainly salaried employees from the business, professional and academic fields who have attained tertiary education level or obtained professional qualifications.

GENERAL RESPONSES

7. The consultation generated animated public discussions on the proposals for reforming the Authority's domestic rent policy. Responses from resident groups, Legislative Council and District Council members, written submissions, local forums and the telephone opinion survey varied greatly. The subject of differential rent attracted a large amount of public attention at the beginning of the public consultation. The proposed index-linked rent adjustment mechanism, which is probably the most important reform proposal set out in the consultation paper, featured much more prominently towards the latter half of the consultation. Many interested parties made substantial comments on its operation, particularly over the choice of index for guiding rent adjustment and the question of adjusting the existing PRH rent to a suitable level upon which future adjustments are to be based.

Rent Reduction

8. A considerable number of respondents, especially the more vocal resident groups, called for a rent reduction before reviewing the rent adjustment mechanism. They argued that the Authority had failed to reduce PRH rent in the past few years despite a substantial drop in both the consumer price and tenants' income.

9. Regarding the extent of rent reduction, views were very diverse. Some respondents suggested an across-the-board reduction of 10% to 20%. Some requested the Authority to reduce PRH rent to the extent that it would bring down the MRIR to below 10%. There were also suggestions for a one-off rent reduction in the form of a rent holiday so that early rent relief could be granted prior to the establishment of a new rent adjustment mechanism.

10. Instead of an across-the-board rent reduction, there were a number of respondents who recommended a more targeted approach to assist tenants in financial hardship. Some academics held the view that how the current PRH rent was to be adjusted should be considered alongside the new rent adjustment mechanism.

Consultation Period

11. There were quite a few respondents requesting an extension in the consultation period. They maintained that as the domestic rent policy had wide and profound implications, PRH tenants should be given ample time to understand and comment on the proposals. Some of them felt that there was insufficient public discussion on the new rent adjustment mechanism. A number of respondents suggested to launch a second round public consultation with focus on the proposed rent adjustment mechanism and the rent level upon which the future mechanism should operate.

RENT ADJUSTMENT MECHANISM

12. The case for establishing a new mechanism to guide adjustments of PRH rent gained general support as indicated by responses in telephone survey (65.2%), views expressed in many of the written submissions, local forums and by District Council Members who commented on this issue. The main reasons put forward by those supporting the establishment of a new mechanism include –

- (a) it is imperative to put in place a new mechanism with greater flexibility in order to enable PRH rent to be adjusted to a reasonable level;
- (b) it is advantageous to adjust rent according to a clearer and more objective mechanism;
- (c) there should be a new mechanism capable of adjusting rent according to tenants' affordability; and
- (d) with the Court of Final Appeal's judgment handed down in 2005, the statutory MRIR provision is practically no longer operative. A new rent adjustment mechanism is therefore required.

13. Among those respondents holding opposite views, they were mainly concerned that –

- (a) the introduction of an index-linked adjustment mechanism might lead to possible rent increase, given the likelihood of a return to an inflationary trend;
- (b) the new mechanism was too complicated to be understood by PRH tenants; and
- (c) the new adjustment mechanism might be an attempt by the Authority to link domestic rent policy with private market practices.

14. A number of respondents suggested that if a new index-linked mechanism was to be adopted, a statutory rent increase ceiling should be introduced to ensure that PRH rent is affordable to the tenants. Some also held the view that it was necessary to give legislative effect to the new rent adjustment mechanism.

15. On the other hand, some respondents suggested that the new mechanism should not be prescribed in the law books so as to maintain the necessary flexibility. Some respondents criticized the current statutory MRIR cap for failing to take account of the varying quality of PRH flats and financial circumstances of individual PRH tenants. Some pointed to the necessity to review the current statutory MRIR provisions in order to introduce the new adjustment mechanism.

Rent Adjustment Reference Index

16. As regards which reference index should be adopted, there was a clear preference for adopting household income over consumer price index as the basis for rent adjustments. Specifically, 57.8% of the respondents in the telephone survey favoured an income-based reference index. Many of the respondents considered that household income could better reflect the affordability of PRH tenants.

17. Among those supporting household income as a basis for rent adjustments, many of them did not indicate clearly whether they prefer median monthly household income or the average monthly income index. Some respondents supported using the median monthly household income. There

were others, including many of the academics submitting their views on this issue, who rendered their support for the average monthly income index which takes account of pure income changes and discounts the impact on household income brought about by household size changes.

18. A relatively small number of respondents supported using consumer price index to guide rent adjustments. They believed that tenants' affordability was also affected by changes in their expenditure level. For those who were against adopting consumer price index, they were concerned that future changes in tenants' income might not keep pace with the movement in consumer price. In particular, they feared that consumer price might go up faster than income during inflationary period. For some, they considered that the consumer price index reflected tenants' expenditure level rather than their affordability.

19. Some respondents suggested that a hybrid of the consumer price index and the average monthly income index could be adopted to smooth out the different patterns of movements of the two indexes.

New Rent Level

20. A considerable number of respondents suggested that for the proposed index-linked mechanism to operate fairly, it was important to reduce the existing PRH rent to a suitable and acceptable level.

21. However, not many respondents gave their views on how the current rent level should be adjusted. A few respondents suggested referring to the second quarter of 2000 when the MRIR exceeded 10% for the first time as the base year for rent adjustment. Some proposed using 1998 as the reference year because the Authority had since then not effected any rent adjustment. Some suggested 1997 as the base year as they were under the impression that the rent of most PRH flats were frozen at the 1997 level¹⁹.

¹⁹ The Authority waived the rent increases approved in 1998 and 1999. It has also deferred all rent reviews since 1999. As a result, the majority of the PRH units (about two-thirds) have their rent last reviewed in 1995 and 1996. About one-third of the PRH units have their rent last reviewed in 1997.

DIFFERENTIAL RENT

22. The issue of differential rent attracted a great deal of interest from different quarters in the community. Views of the respondents, particularly when analyzed by different sources, were extremely divided. A large majority of the respondents in the telephone survey (73.8%) agreed that factors other than flat size, such as floor levels, proximity to certain unwelcome facilities and external views of the flat, etc., should be taken into account for determining rent of PRH units. Responses from the written submissions were more or less equally divided on whether a system of differential rent should be introduced. However, participants at district forums, resident groups and District Council Members expressed strong objection to the notion of differential rent.

23. Among those respondents in favour of differential rent, many of them considered that the proposal would provide more choice and flexibility to the tenants. Some believed that it was unfair to pay the same rent for flats at different floors, or with different views. Most of them also supported a comprehensive model, i.e. to take account of both internal factors (floor levels, proximity to unwelcome facilities, etc.) and external factors (views and orientation of the units) and extension of differential rent to existing PRH estates. Some thought that flats with higher rent should not be allocated to CSSA recipients.

24. A few respondents supported the division of the current six geographic districts into further sub-groups to reflect the varying conditions, such as local environment and transportation network, for rent setting purpose.

25. Among those who opposed the idea of differential rent, their main concerns are as follows –

- (a) differential rent would cause stigmatization and labeling effects on those tenants living in flats with lower rent;
- (b) the scheme is divisive and not conducive to the promotion of a harmonious society;

- (c) introduction of a system of differential rent could be a prelude to injecting further private market practices into the public housing programme; and
- (d) it would be unfair to sitting tenants if the scheme is to be applied to the existing PRH estates;
- (e) huge administrative costs would be incurred to implement the system;
- (f) it would be extremely difficult to objectively assess the rent of individual flats and make adjustments should there be subsequent change in the views of the concerned flats; and
- (g) there would likely be mismatch between flat types and preference of prospective PRH tenants. The Authority has to enhance the flexibility in respect of its allocation and transfer policies if a differential rent regime is to operate fairly and effectively.

26. Quite a number of respondents, while disagreeing with the idea of differential rent, requested the Authority to consider possible measures to improve the letting rate of flats which are in “unpopular” locations or have been vacant for a long time. They flagged up a number of possible options, including reducing the rent of these flats to reflect their proper rental value, enhancing the Expressed Flat Allocation Scheme for Waiting List applicants, and converting these flats to other usage such as interim housing and hostels to be operated by non-government organizations.

MEASURE OF AFFORDABILITY

MRIR and Alternative Measures of Affordability

27. A clear majority of the respondents who commented on the subject did not support the use of alternative affordability measures such as MRIR variants, fixed rent-to-income ratio and “residual income approach” put forward in the Consultation Paper. Many expressed concern over the potentially huge administrative costs and disturbance caused to tenants in assessing individually the household income of all PRH tenants should these alternative measures be

implemented. A number of them considered that setting rent at a fixed rent-to-income ratio was technically difficult since many PRH tenants were self-employed or did not have stable income. Some respondents were of the view that under the “residual income approach”, it would be highly contentious to determine the minimum standard of non-housing consumption, which varied with the tenants’ individual financial circumstances.

28. A large number of written submissions, participants at district forums and District Council Members expressed support for the continuing adoption of the MRIR. While many of them made clear their support for MRIR as an indicator of affordability, there was also a sizeable number of respondents who actually suggested retaining the MRIR for rent adjustment purpose.

29. On the proposals to improve the methodology for calculating MRIR, views were more divided. These are summarized below.

Data Collection

30. There was considerable support for the Authority to collect more accurate and reliable income data for calculation of MRIR. The majority of the respondents in the telephone survey (59.8%) agreed to the adoption of a declaration system to collect data on tenants’ household income. Many District Council Members and local forum participants also indicated their support for a declaration system. Some respondents suggested that the Authority should appoint an independent agent to conduct a survey on tenants’ household income in order to obtain more accurate information.

31. Views set out in the written submissions were more divided. Overall, a slight majority of the respondents expressed reservation about the proposed declaration system. Many of them saw the proposal as an extension of the Housing Subsidy Policy. They were concerned that the income information so collected might be used for income checking purpose. On the other hand, supporters of a declaration system accepted that the Authority would require sufficient and accurate income information in order to assess whether PRH rent was affordable to the tenants. Nevertheless, many of them considered that the disturbance to tenants should be kept to the minimum should the declaration system be implemented.

CSSA Cases and Households Paying Additional Rent

32. Views were diverse on whether CSSA recipients and households paying additional rent should be excluded from the calculation of MRIR.

33. On the proposal for excluding CSSA households, the findings from the telephone survey were more or less equally divided between those who supported (42.2%) and opposed (45.3%) the proposal. Likewise, views expressed by the participants at local forums were equally divided on the matter. On the other hand, a strong body of opinion expressed in the written submissions and by District Council Members was against the proposal. On exclusion of households paying additional rent, the majority of the telephone survey respondents (58.7%) were against the proposal, so were the views expressed in written submissions and by District Council Members.

34. The following are among the main arguments in support of exclusion of CSSA and additional rent paying households from the MRIR calculation –

- (a) in most CSSA cases, PRH rent is fully covered by Government. The question of affordability is therefore not relevant to the CSSA households. Inclusion of the CSSA households would distort the calculation of MRIR which aims to assess the affordability of those tenants who are required to pay the rent out of their own pockets;
- (b) the social assistance received by CSSA households should not be deemed as income per se;
- (c) the MRIR should reflect the general affordability of PRH tenants paying normal rent. Households paying additional rent should therefore be excluded; and
- (d) the income of the additional rent paying households far exceeds the Waiting List income limits applicable to prospective PRH households. The general affordability of PRH tenants would be misrepresented by their inclusion in the MRIR calculation.

35. As for those who took exception to the proposal, their reservation is mainly founded on the following grounds –

- (a) the proposal would lower the MRIR and hence pave way for the Authority to increase rent;
- (b) it is seen as an attempt by the Authority to bypass the Legislative Council and the existing legislation to introduce rent increase through administrative means;
- (c) any changes to the methodology for calculating MRIR should be endorsed by Legislative Council through legislative amendments. Otherwise, it might give rise to possible judicial challenge on the definition of PRH tenants and the interpretation of section 16(1A) of the Housing Ordinance, particularly over the question of whether all PRH flats should be included in the MRIR calculation; and
- (d) the proposal discriminates against CSSA households and is divisive.

Rates and Management Fees

36. The majority of the respondents opposed the proposal for excluding Government rates and management fees from MRIR calculation. Amongst the respondents in the telephone survey, 67.2% and 72% of them supported respectively the inclusion of rates and management fees in MRIR compilation. Similar views were found in the majority of the written submissions and discussions at local forums and District Council meetings.

37. Many of the respondents were concerned that the proposed exclusion of rates and management fees was an attempt by the Authority to lower the MRIR through administrative means so as to pave way for rent increase. Some also believed that the legislative intent of section 16(1A) of the Housing Ordinance provided for inclusion of both rates and management fees in the definition of PRH rent. They therefore considered that the proposal must be endorsed by the Legislative Council through legislative amendments. Some respondents were of the view that the concept of “net rent” exclusive of

rates and management fees was a private market practice and should not be applied to PRH. There were others who objected to the proposal on the ground that rates and management fees were part of tenants' housing expenditure and should be taken into account in the assessment of tenants' affordability.

RENT LEVEL OF NEW PRH ESTATES

38. There were quite a number of respondents who regarded the rent of new PRH flats too high. To address this issue, some requested the Authority to review the current MRIR benchmarks of 15% (for an allocation standard of 5.5 m² IFA per person) and 18.5% (for an allocation standard of 7 m² IFA per person) adopted for rent setting purpose. While most of them did not specify how the MRIR benchmarks should be adjusted, a few suggested using a single MRIR benchmark such as 15% or 13%. Some also advocated relaxing the current transfer arrangements so that sitting tenants could apply for transfer to new PRH estates with higher rent levels.

39. A few respondents, on the other hand, considered the current MRIR benchmarks reasonable compared with similar affordability benchmarks in other overseas countries. A respondent suggested that the current benchmarks should be increased to 18% and 25% respectively for the allocation standards of 5.5 m² IFA per person and 7 m² IFA per person.

RENT FIXING AND REVIEW CYCLES

Rent Fixing for Newly Completed PRH Estates

40. There was limited public discussion on the rent fixing arrangements for newly completed PRH estates. Among the few who commented on this subject, most of them supported the continuation of the current practice to conduct two rent fixing exercises each year.

Rent Review Cycle

41. On the question of how frequent the rent of PRH units should be reviewed, more people, particularly PRH tenants, preferred a longer rent review cycle. The telephone survey showed that 52% of the respondents preferred a

review cycle of three years or above whereas 42.2% preferred a shorter review cycle of two years or below. Similar views were also expressed in written submissions and at local forums and District Council meetings.

42. For those in favour of a longer review cycle, they believed that it would help stabilize the PRH rent especially during an inflationary period, cause less disturbance to the PRH tenants and incur less administrative expenses. Some considered that a three-year cycle would be more consistent with the current legislation.

43. Supporters of a shorter review cycle, such as a biennial cycle, considered that it would probably result in more moderate, be it upward or downward, rent adjustments which should be more acceptable to the PRH tenants.

Coverage of Estates for Rent Review

44. Only a handful of respondents commented on the past arrangement of reviewing the rent of PRH units in batches. Most of them supported that the rent of all PRH estates should be reviewed in one go instead of staggering the review of different estates in batches.

EXCLUSIVE VS INCLUSIVE RENT

45. The vast majority of respondents objected to separating the collection of rates and management fees from the PRH rent. The main reasons for their objection include –

- (a) it would cause inconvenience to the tenants;
- (b) some believed that it was a common practice in the private market for owners to collect all-inclusive rent and pay rates and management fees for the tenants. As owners of PRH flats, the Authority should follow the same practice;
- (c) however, there were others who considered that separate collection of rates and management fees was a private market practice and should not be applied to PRH;

- (d) charging net rent exclusive of rates and management fees would lead to a decrease in the MRIR and hence a possible room for rent increase; and
- (e) as there is no statutory control over management fees, it would be possible for the Authority to impose de facto rent increase by raising management fees.

46. A few respondents supported the exclusion of rates from rent on the ground that rates were merely received by the Authority on behalf of Government and did not form a part of the Authority's revenue.

47. The proposal for setting out the amount of rates, management fees and net rent in an annual statement to tenants did not attract too many responses. The majority of those commented on this issue agreed to the proposal because an annual statement would enhance transparency and facilitate the PRH tenants to monitor the costs incurred in operating PRH estates.

FIXED-TERM TENANCY

48. Responses to whether a system of fixed-term tenancy should be introduced to replace the current monthly tenancy varied. On balance, more people were against the idea. Results of the telephone survey showed that 48.8% of the respondents supported monthly tenancy and 45.5% favoured fixed-term tenancy. However, the majority of the views expressed in written submissions and by participants at local forums and District Council Members commented on this issue were against the adoption of fixed-term tenancy.

49. Respondents' main concerns about fixed-term tenancy are as follows –

- (a) the existing policies such as Housing Subsidy Policy, Policy on Safeguarding Rational Allocation of Public Housing Resources and the Marking Scheme for Tenancy Enforcement have already provided adequate vehicles for the Authority to determine whether tenancies should be renewed and to ensure rational allocation of housing resources. It is not necessary to introduce a new tenancy system to replace the monthly tenancy;

- (b) fixed-term tenancy would cause inconvenience to tenants and adverse impact on the security of their tenancies;
- (c) the Authority would incur huge administrative costs in converting the existing monthly tenancy to fixed-term tenancy and the subsequent renewals;
- (d) it is seen as an attempt by the Authority to enhance the turnover of PRH flats with a view to scaling down its production of new PRH flats; and
- (e) the existing monthly tenancy provides more flexibility and facilitates the enforcement of tenancy conditions.

50. For those who supported fixed-term tenancy, they pointed out that the occupancy of PRH flats is not a perpetual right and the public rental housing resources should be provided to those in real need. However, this observation was also shared by a number of respondents who did not subscribe to the idea of fixed-term tenancy.

FLAT SIZE, RENT AND TENANTS' AFFORDABILITY

51. A small number of respondents commented on the issues of flat size, production mix and allocation standards. Their views, which were diverse, are summarized below –

- (a) the Authority should plan its PRH projects taking account of the changes in the demographic profile of the prospective tenants. Small PRH flats should be built if the household size of prospective tenants is on a decreasing trend;
- (b) some respondents objected to reducing the size of small PRH flats to 14 m²;
- (c) the Authority should plan new PRH projects in accordance with the income levels and affordability of the prospective tenants;

- (d) the Authority should adopt a cost-effective design and provide only basic facilities for PRH;
- (e) some respondents criticized the Authority's lenient approach in PRH flat allocation which was the main reason behind the increase in the average PRH rent in recent years; and
- (f) there were views suggesting that the Authority should further relax its allocation standards.

RENT ASSISTANCE SCHEME

52. Respondents who commented on the Rent Assistance Scheme generally welcomed the enhancements introduced to the scheme in 2002 and 2006.

53. A number of respondents considered that the current Rent Assistance Scheme was not effective in providing relief to tenants in financial hardship. They suggested further relaxation in the following areas –

Eligibility Criteria

- (a) to relax the three-year residence requirement for tenants living in new PRH block types²⁰;
- (b) to reduce automatically the rent of all elderly and disabled households by 50%;
- (c) to lower the income eligibility threshold;
- (d) to simplify and streamline the Rent Assistance Scheme application procedures;

²⁰ New PRH block types cover those completed after 1992, all Harmony blocks and those PRH flats converted from Home Ownership Scheme/Private Sector Participation Scheme/Buy-or-Rent Scheme.

Level of Assistance

- (e) to provide different levels of rent reduction to cater for the need of PRH tenants with different levels of income;
- (f) to raise the current maximum level of rent assistance;

Requirement to move to flats with lower rents

- (g) to abolish the requirement of Rent Assistance Scheme recipients to move to flats with lower rent after having received Rent Assistance Scheme for three years.

OTHER VIEWS

54. A number of respondents submitted views on public housing issues which were outside the scope of the current review. Topics on which they commented include –

- (a) the role and functions of PRH;
- (b) Government's pledge to keep the average waiting time at around three years and land supply for PRH development;
- (c) the financial and administrative arrangements between the Authority and Government;
- (d) the financial forecast and accounting treatment of the Authority's rental operating account;
- (e) the Housing Subsidy Policy and the Policy on Safeguarding Rational Allocation of Public Housing Resources;
- (f) the production and sale of Home Ownership Scheme flats;
- (g) the sale of Tenants Purchase Scheme flats; and
- (h) the income and asset eligibility limits for Waiting List applicants.

**Public Affairs Forum
Summary of Comments on
Review of Domestic Rent Policy**

Introduction

Forum members posted 82 messages in response to the Review of Domestic Rent Policy. This report summarizes members' views on various consultation points.

Guiding Principles

2. Overall, members were supportive of reviewing the Domestic Rent Policy. Many of them were concerned about the direction of the review. They suggested that the Authority should take into consideration the following guiding principles when formulating the Rent Policy –

- (a) enhancing the flexibility of rent policy;
- (b) ensuring that the policy is easy to understand and implement;
- (c) ensuring rational allocation of PRH resources; and
- (d) ensuring that tenants' affordability should sit at the very heart of the Authority's rent policy.

Alternative Options for Assessing Affordability

3. Only a few members commented on this consultation point. Their views are summed up as follows –

- (a) a member suggested that "Affordability Measures" should be given statutory definition to avoid different interpretations by different quarters in the community;

- (b) a member supported developing different MRIR variants to cater for different household requirements;
- (c) a member supported setting rent based on a fixed rent-to-income ratio;
- (d) a member supported adopting “Residual Income Approach” to ascertain tenants’ affordability while maintaining a certain standard of living. Another member held the view that in addition to maintaining basic living standard, a certain amount of contingency savings, e.g. medical expenditure, should also be taken into account. A member opposed the proposal on the ground that it was too complicated to operate; and
- (e) a member criticized that the alternative options outlined in the Consultation Paper were not viable and would incur potentially huge administrative costs.

Improvement to the Assessment of the Median Rent-to-Income Ratio

4. Members’ comments on the proposed improvement measures are summed up as follows –

- (a) a member criticized that there were flaws in the existing MRIR model. It failed to reflect the financial situation of some of the tenants, thereby inevitably causing distortion in assessing tenant’s affordability;
- (b) some members accepted that the existing MRIR model and the benchmarks of 15% (adopted for a space allocation standard of 5.5 m² IFA per person) and 18.5 % (adopted for a space allocation standard of 7 m² IFA per person) should be maintained. However, a member considered that the existing MRIR model and benchmarks lacked flexibility and hence should be repealed;
- (c) in respect of data collection, some members supported establishing a system to collect tenants’ income data on a mandatory basis. Amongst those supporters, some suggested collecting income data

annually or biennially to enhance the reliability of the database for assessing MRIR. Another member suggested that the Authority should require tenants to submit their Mandatory Provident Fund or tax returns used for the purpose of collecting income data;

- (d) some members considered that rents of the CSSA households were indeed paid from the housing allowance under CSSA which was not the income of the concerned households per se. CSSA recipients should therefore not be included in MRIR calculation; and
- (e) views were divided on whether government rates and management fees should be excluded from MRIR calculation.

Rent Adjustment Mechanism

5. Those members who commented on this main consultation point in general supported the establishment of an index-linked mechanism to guide rent adjustments. As to which reference index is to be adopted, members had different views –

- (a) some members supported adopting Consumer Price Index (A) (CPI (A)) or CPI (A) excluding housing expenditure on the ground that the relevant data were transparent and could accurately and readily reflect tenants' costs of living;
- (b) some members opposed to adopting CPI (A) which was considered a macro indicator that could not directly reflect PRH tenants' costs of living;
- (c) some members supported using the Average Monthly Income Index for rent adjustment. However, some held opposite views and were concerned with the potentially huge administrative costs and difficulties in collecting the necessary income data;
- (d) some members believed that both CPI and Income Index should be considered in order to comprehensively gauge the changes in tenants' financial conditions;

- (e) a member suggested adjusting rent according to the changes in individual household's income to better reflect tenants' affordability;
- (f) a member suggested adopting the median figures from various economic statistics obtained from the past four quarters to form the basis for rent adjustments;
- (g) some members opined that it was necessary to give statutory effect to the proposed rent adjustment mechanism; and
- (h) a member supported applying similar index-linked mechanism to guide the adjustment of the "best rent" of new estates.

Differential Rent

6. Most of the members participated in the discussion expressed their views on differential rent. Relatively more members were in support of the proposal. Their views are summed up as follows –

- (a) the majority of supporters believed that differential rent would provide greater choice to tenants, thereby allowing them to choose their flats according to their preference and affordability. It would help enhance the policy flexibility and facilitate rational allocation of resources;
- (b) some members believed that differential rent would not have labelling effect on tenants living in flats with lower rent because rent levels were not indicators of tenants' household income;
- (c) in respect of implementation models, more members were in favour of the comprehensive model than moderate model;

- (d) a member said that should tenants be allowed to choose their flats according to their own wishes, the Authority could do away with the existing arrangement of providing three offers to applicants and save administrative cost;
- (e) to avoid unfair treatment to existing tenants, some members were of the view that differential rent should only be implemented in new estates. However, there were also views supporting gradual extension of differential rent to existing estates.

7. Amongst those in favour of the proposal, some were concerned that the implementation of differential rent would encounter difficulties and incur huge administrative costs. In this connection, they suggested streamlining the operating procedures to control costs and resolve potential allocation problems. Suggestions put forward by members are summed up as follows –

- (a) some members suggested streamlining the rent structure to avoid excessive classification. For example, rent could simply be divided into three levels, namely, high, medium and low;
- (b) a member suggested reserving certain number of flats for selection. After the selection procedures, any residual units that were left behind should be made available for allocation by random draw. This would help prevent vacancy arising from mismatch between flat types and preference of prospective PRH tenants;
- (c) a member suggested that a pilot scheme be launched first;
- (d) a member pointed out that apart from providing choice to tenants, the Authority should also ensure that rent was affordable. When allocating flats with higher rent, the Authority should ensure that tenants' rent-to-income-ratio does not exceed 10% to 15% ; and
- (e) a member was concerned that if CSSA recipients were to select flats with higher rent, the subsidies for CSSA would increase. Another member believed that CSSA recipients would not intentionally choose flats with higher rent and worsen their rental burden.

8. For those members who opposed the proposal, their views are summed up below –

- (a) some opined that differential rent would divide tenants into different classes, thereby causing labelling effects on those tenants living in flats with lower rent and hampering social harmony;
- (b) some worried about the possible mismatch between flat types and preference of prospective PRH tenants;
- (c) some members held the view that the policy objective of the Authority should be to provide basic accommodation to people in need. However, differential rent would “marketize” and complicate the PRH, hence deviating from the policy objective;
- (d) one member was concerned that differential rent may set a precedent for other public service providers (such as education and medical services) to adopt differential service charges; and
- (e) quite a few members believed that such a policy would be difficult to implement and drastically increase administrative costs which may outweigh the revenue received.

Exclusive vs Inclusive Rent

9. Those members who responded to this consultation point in general did not support separating the collection of rent, rates and management fees. They were concerned that exclusive rent may invite unnecessary disputes and increase administrative costs.

Fixed-Term Tenancy

10. The majority of members subscribed to the notion of fixed-term tenancy. They believed that fixed-term tenancy could ensure that for those tenants who could afford private accommodation, they would leave PRH so that their flats could be re-allocated to other people in genuine need. Such a policy is therefore in line with the principle of rational allocation of resources and will enhance policy flexibility.

11. On the term of tenancy, views were divided. Suggestions on the length of tenancy ranged from three to less than 15 years. One member proposed to offer a longer term on the condition that the tenancy would not be renewed upon expiry. There were also suggestions that the Authority should conduct income assessment prior to the expiry of tenancy agreement, but exemption should be given to elderly or disabled people. Some members submitted that PRH tenancy should not provide for any hereditary rights.

12. For those members objecting to fixed-term tenancy, they considered monthly tenancy a better system to provide security of tenure and avoid causing disturbance to tenants and increasing the Authority's administrative costs.

Rent Fixing and Review Cycles

13. Amongst the members who commented on this subject, the majority of them supported a biennial review cycle to keep PRH rent in line with market changes and avoid excessive rent adjustments. One member suggested that rent review exercise should not take place too frequently, lest it would raise administrative cost and cause disturbance to tenants.

Rent Assistance Scheme

14. Only a few members commented on the Rent Assistance Scheme. A member was content with the existing arrangements under Rent Assistance Scheme. Another member said that given the lack of a general community consensus on the interpretation of affordability, it would be difficult to determine the eligibility for Rent Assistance Scheme that was accepted by the public at large. In addition, there were no supporting statistics to show that Rent Assistance Scheme could resolve the affordability problem of Rent Assistance Scheme recipients effectively. The member also criticized the restrictions associated with the Rent Assistance Scheme, such as debarring tenants affected by redevelopment from applying²¹ and requiring Rent Assistance Scheme recipients to move to flats with lower rent after receiving Rent Assistance Scheme for a certain period of time.

²¹ Since 31 October 2002, tenants affected by redevelopment have been allowed to apply for rent assistance immediately upon being re-housed to new or refurbished flats.

Other Comments

15. In addition to the issues set out in the consultation paper, members also expressed their views on other areas as follows –

- (a) a member commented that the size of existing PRH units was too small and suggested the Authority to improve the living environment of PRH by providing more spacious units;
- (b) a member expressed concern over the Authority's financial position and said that the Authority should clearly explain to the public its accounts and the financial arrangements with Government;
- (c) a member pointed out that given the requirement under section 4(4) of the Housing Ordinance that the Authority has to balance its book and the fact that the quality of estate management was affected by the operating cost, tenants have to choose between service quality and rent level. Another member suggested that determination of rent should be de-linked from section 4(4) of the Housing Ordinance to ensure that rent would not be affected by operating costs;
- (d) some members held the view that the Authority should reflect the market value of PRH units. They suggested that apart from MRIR, market rent should also be one of the factors for determination of PRH rent;
- (e) a member criticized the Authority for lacking a long-term PRH development strategy. It was suggested that the Authority should develop a comprehensive plan for PRH development;
- (f) quite a few members considered that as PRH resources were contributed by taxpayers, the HA was duty bound to step up enforcement to prevent abuses of PRH resources;

- (g) a member suggested that for tenants with household income exceeding a certain threshold, the Authority should charge “progressive rent”, i.e., the higher the household income, the higher the rent payment;
- (h) a member suggested that the Authority should provide low interest home loans to encourage tenants to buy their own flats and leave PRH; and
- (i) a member suggested extending the consultation period to provide more opportunities for the community to express their views.

Survey on Domestic Rent Policy

INTRODUCTION

1. As part of the public consultation, the Committee commissioned an independent consultancy firm to conduct a telephone survey to collect the opinions from the general public towards the various issues raised in the Consultation Paper. The survey was targeted at people aged 18 or above who were living in different types of housing (PRH, subsidized sale flats and private housing) and could be reached by domestic telephone lines. The data and information required by the survey was collected through telephone interviews during the period from late March to early May 2006.

2. A random sample of about 5 380 domestic telephone numbers were drawn from a telephone directory for the survey. Some 3 010 people were successfully interviewed, constituting a response rate of 56%.

PROFILE OF RESPONDENTS

3. Of the 3 010 people taking part in the survey, 30.7% were living in PRH, 15.7% in subsidized sale flats and 53.6% in private housing. The pattern of distribution of housing type of the respondents is largely in accord with that estimated by the C&SD. The corresponding statistics based on the C&SD's General Household Survey were 30.7%, 18.7% and 50.6% in the first quarter of 2006. For statistical purposes, the overall survey results have been weighted using the C&SD's statistics for reflecting more precisely the aggregate views of the respondents residing in different types of housing.

MAIN SURVEY FINDINGS

Rent adjustment mechanism

4. On the question of whether a rent adjustment mechanism should be established to provide for both upward or downward adjustment with reference to some pointer index, some 65% of the people under the coverage of the survey were in favour of establishing such a mechanism; 17% of them held the opposite view and the remaining 18% had no comments. More people living in the subsidized sale flats (SSF) and private housing than their counterparts in PRH tended to support the establishment of a rent adjustment mechanism. Some 71% - 72% of the residents in SSF and private housing were in support of such a mechanism and 11% - 12% against it. For the tenants in PRH, 52% of them were supportive of the proposal and 28% opposed it.

Opinions on establishment of a rent adjustment mechanism

	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
Supported	51.6	72.1	70.9	65.2
Not supported	27.7	11.2	11.6	16.5
No comment	20.7	16.7	17.5	18.3
Overall	100.0	100.0	100.0	100.0

Note: Percentage may not add up to 100% due to rounding.

5. The main reasons given by those who supported a rent adjustment mechanism were “it is a fair arrangement if the overall rent level can be adjusted upward or downward” (47%) and “the rent level can accord with the changes in economic situation” (35%).

Top three reasons for supporting a rent adjustment mechanism

	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
It is a fair arrangement if the overall rent level can be adjusted upward or downward	49.2	45.2	47.4	47.4
It can accord with the changes in economic situation	29.0	39.0	36.0	34.9
It is a flexible system	2.9	5.0	6.6	5.4

Note: A respondent could give multiple answers.

6. Among those who opposed the setting up of a rent adjustment mechanism, they mainly cited such reasons as “it is useless as rent of PRH will definitely rise only”, “the current adjustment system is alright”, “objection to any rent increase for PRH” and “rent adjustments should take account of the circumstances of individual households”.

Top five reasons for opposing a rent adjustment mechanism

	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
It is useless as rent of PRH will definitely rise only	42.6	28.3	25.1	34.6
The current adjustment system is alright	16.8	15.1	15.5	16.1
Object to any rent increase for PRH	14.8	11.3	6.4	11.4
Rent adjustments should take into account the circumstances of individual households	5.9	15.1	15.0	10.3
The mechanism is not fair	3.9	9.4	12.3	7.6

Note: A respondent could give multiple answers.

7. The respondents supporting the establishment of a rent adjustment mechanism were further enquired about whether the CPI, income-based index of households in PRH or the cost of operating PRH should be adopted as a reference for rent adjustment. Of those in support of a rent adjustment mechanism, 58% opted for income-based index of households in PRH, 26% preferred CPI and 9% went for the operation cost of PRH.

Views on the preferred rent adjustment reference index

	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
Income-based Index	64.3	56.3	55.5	57.8
CPI	20.0	25.8	29.4	26.4
Operating cost of PRH	7.6	11.1	9.1	9.1
Others	7.4	6.5	5.7	6.2
No comment	0.8	0.3	0.3	0.4
Overall	100.0	100.0	100.0	100.0

Note: Percentage may not add up to 100% due to rounding.

8. The overall views from members of the public on whether a rent adjustment mechanism for PRH should be set up and, if so, the options of the reference index to be adopted, are summarized in the following table.

Views on the rent adjustment mechanism and the preferred reference index

	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
Supported a rent adjustment mechanism	51.6	72.1	70.9	65.2
Reference index to be adopted				
— Income-based Index	33.2	40.6	39.4	37.7
— CPI	10.3	18.6	20.9	17.2
— Operating cost of PRH	3.9	8.0	6.4	6.0
— Others	3.8	4.7	4.0	4.1
— No comment	0.4	0.2	0.2	0.3
— Total	51.6	72.1	70.9	65.2
Not supported a rent adjustment mechanism	27.7	11.2	11.6	16.5
No comment	20.7	16.7	17.5	18.3

Note: Percentage may not add up to total due to rounding.

Frequency of rent review

9. Opinions on the frequency of the rent review cycle for PRH were diverse. Some 33% of the members of the public considered that the rent of PRH should be reviewed every three years; 29% every two years; 19% every four years or even longer; and 13% every year. Detailed statistics are set out below.

Views on rent review cycles for PRH

	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
1 year	8.3	12.3	15.9	12.9
2 years	23.5	33.8	31.2	29.3
3 years	32.5	33.8	32.9	33.0
4 years or longer	27.4	16.1	14.9	19.0
No comment	8.2	4.0	5.0	5.8
Overall	100.0	100.0	100.0	100.0

Note: Percentage may not add up to 100% due to rounding.

Monthly tenancy vs fixed-term tenancy

10. The views on whether PRH flats should be leased on a monthly tenancy (i.e. the current arrangement) or a fixed-term tenancy were mixed, with about 49% of the members of the public in support of maintaining the existing monthly tenancy system and 46% in favour of introducing fixed-term tenancy. In addition, there was a marked difference in the views on this issue amongst the residents living in different types of housing. An overwhelming 75% of the tenants in PRH opted for the current system of monthly tenancy. However, over half of the residents in SSF and private housing preferred fixed-term tenancy for PRH.

Preference on monthly tenancy or fixed-term tenancy

	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
Prefer monthly tenancy	74.8	41.9	35.7	48.8
Prefer fixed-term tenancy	19.8	51.2	58.9	45.5
Prefer neither of the above	1.0	3.2	2.4	2.1
Others	3.7	2.7	2.3	2.8
No comment	0.8	1.1	0.7	0.8
Overall	100.0	100.0	100.0	100.0

Note: Percentage may not add up to 100% due to rounding.

Differential rent

11. On the proposal of differential rent, about 60% of the public considered that the rent should take into consideration both the internal factors (such as floor level and proximity to unwelcome facilities, e.g. refuse chamber, pump generator) and external factors (such as views and orientation); another 14% said that either the external or internal factors should be considered; and 23% were opposed to any form of differential rent for PRH. In percentage terms, more tenants in SSF and private housing supported the proposal of differential rent.

Opinions on differential rent for PRH

	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
Both internal and external factors should be considered	45.3	64.3	66.4	59.5
Only internal factors should be considered	12.9	10.1	9.5	10.7
Only external factors should be considered	3.5	3.6	3.7	3.6
Object to any form of differential rent	32.6	20.3	18.1	23.0
Others	2.2	0.4	0.7	1.1
No comment	3.6	1.3	1.5	2.1
Overall	100.0	100.0	100.0	100.0

Note: Percentage may not add up to 100% due to rounding.

12. Regarding the allocation of PRH flats to CSSA recipients should differential rent be implemented, 57% of the public said that CSSA recipients should preferably be allocated PRH flats with relatively lower rent value and 33% considered that they should be provided with PRH flats in the same way as other potential PRH tenants.

Opinions on allocation of flats to CSSA recipients should HA introduce differential rent

Type of flats allocated to CSSA recipients	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
Should allocate PRH flats with lower rent value	47.5	60.7	60.7	56.7
Should allocate PRH flats in the same way as other potential PRH tenants	38.7	31.5	30.1	33.0
Should allocate PRH flats with higher rent value	2.2	1.9	2.2	2.1
No comment	11.7	5.9	7.0	8.2
Overall	100.0	100.0	100.0	100.0

Note: Percentage may not add up to 100% due to rounding.

Whether affordability indicator should include CSSA recipients and “well-off” tenants

13. The views were quite diverse on whether CSSA recipients should be included when assessing the rental affordability of PRH tenants, with some 45% of the members of the public expressing support for their inclusion and about 42% disapproving of their inclusion. On the issue of “well-off” tenants in PRH, around 59% of the members of the public supported inclusion of these tenants in measuring rental affordability and around 29% objected to their inclusion. In addition, about 32% of the members of the public supported covering both the CSSA recipients and “well-off” tenants in measuring rental affordability of PRH tenants.

Opinions on the inclusion of CSSA recipients and “well-off” tenants in measuring PRH tenants’ affordability

CSSA recipients	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
Include CSSA recipients	43.6	44.8	46.5	45.3
Exclude CSSA recipients	37.6	45.2	44.0	42.2
Well-off tenants				
Include “well-off” tenants	50.5	61.9	62.4	58.7
Exclude “well-off” tenants	29.4	29.2	28.5	28.9
CSSA recipients and well-off tenants				
Include both CSSA recipients and well-off tenants	27.1	33.0	34.6	32.0

Whether rent should include rates and management fees

14. The majority of the public (some 60%) thought that the rent of PRH should be inclusive of management fees and rates. The people living in different types of housing held similar views on this issue.

Opinions on whether rent should include management fees and rates

Management fees	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
Rent should include management fees	75.6	75.3	68.5	72.0
Rent should exclude management fees	20.7	21.6	27.2	24.2
Rates				
Rent should include rates	71.0	68.9	64.2	67.2
Rent should exclude rates	24.7	25.8	30.0	27.6
Management fees and rates				
Rent should include both management fees and rates	65.0	63.6	55.7	60.1

Method of collecting tenants' income data

15. On the method of collecting income information from PRH tenants, some 60% of the public considered that the Authority should operate its own system to collect income data from the PRH tenants on a mandatory basis. About 34% of the public said that the current method of deriving tenants' income data from a survey conducted by C&SD should continue to be adopted. It is of interest to note that views from respondents living in PRH differ quite substantially from those living in SSF and private housing. Over half (54%) of the tenants in PRH preferred to maintain the current method of collecting income data. However, some 67% - 72% of the residents living in SSF and private housing were in favour of the Authority operating its own system to obtain tenants' income data on a mandatory basis.

Opinions on the method of collecting PRH tenants' income data

	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
HA should operate its own system on a mandatory basis	34.9	66.8	72.3	59.8
HA should use the existing data collection method (i.e. based on a survey conducted by C&SD)	53.8	29.6	23.5	33.9
No comment	11.3	3.6	4.3	6.3
Overall	100.0	100.0	100.0	100.0

Note: Percentage may not add up to 100% due to rounding.

Current rent level of PRH

16. Some 65% of members of the public considered the rent level of PRH to be reasonable. About 13% regarded it as low and an equal percentage considered it high. A relatively higher proportion of the people living in PRH than those residing in SSF and private housing felt that the rent of PRH was high. For the PRH tenants, 26% of them said the rent of PRH was high. In comparison, only 7% - 12% of the residents living in SSF and private housing held that the rent level of PRH was on the high side. Relevant statistics are set out in the following table.

Opinions on current rent level of PRH

	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
High	25.7	11.8	6.6	13.4
Reasonable	62.8	67.0	65.3	64.9
Low	3.0	13.5	19.6	13.4
No comment	8.5	7.6	8.4	8.3
Overall	100.0	100.0	100.0	100.0

Note: Percentage may not add up to 100% due to rounding.

Proportion of income used for rent

17. On the issue of how much of the household income of PRH tenants should be used for paying rent, tenants in PRH tended to suggest a figure on the lower end of the spectrum than their counterparts in SSF and private housing. On the basis of the views from the residents in PRH, the MRIR so derived is around 12%. According to the opinions of the people residing in SSF and private housing, the MRIR so derived is about 20%.

Opinions on percentage of PRH tenants' income used for rent

Suggested % of income for paying rent	PRH (%)	SSF (%)	Private Housing (%)	Overall (%)
Below 5%	2.2	3.4	1.7	2.2
5% – 9.9%	6.0	2.3	1.8	3.2
10% – 14.9%	36.8	20.9	15.5	23.1
15% – 19.9%	13.1	12.9	11.8	12.4
20% – 24.9%	17.2	26.4	26.4	23.6
25% – 29.9%	2.8	5.5	6.7	5.3
30% and above	6.3	18.6	27.2	19.2
No comment	15.6	9.9	8.8	11.1
Overall	100.0	100.0	100.0	100.0
Mean (%)	14.7	18.9	21.3	18.9
Median (%)	12.0	20.0	20.0	20.0

Note: Percentage may not add up to 100% due to rounding.

Explanatory Note on the Computation and Operation of the Proposed Income Index

Computation Methodology

The proposed income index is essentially an income-based rent adjustment mechanism which seeks to track the movement in the household income of PRH tenants for determining the extent of rent adjustments.

2. Changes in the average household income of PRH households between any two periods are affected by two main factors, namely, changes in individual households' income and changes in household size distribution. For an income-based rent adjustment mechanism to operate properly, the impact of the changes in the household size pattern on average household income should be eliminated to enable an assessment of the "pure income change" over time, the extent of which would be used to determine the rate of rent adjustments. The statistical process to assess the "pure income change" of PRH tenants can be expressed by way of an income index. Assuming a biennial rent review cycle, a pair of income indexes for the two years corresponding to a particular rent review cycle should be worked out for assessing the change in the income level of the PRH households during the two-year period in question. **Appendix I** gives hypothetical examples to illustrate the calculation and operation of the proposed income index. A technical note on the mathematical formulae for deriving the income index is set out at **Appendix II**.

Data Collection

Mandatory Declaration System

3. Hitherto the data on household income are based on the General Household Survey conducted by the C&SD. The existing data collection method has two major shortcomings -

- (a) the General Household Survey is a voluntary survey. The sampled households are free to decide whether to participate in it or not. Income information may be a sensitive issue to many people. As with other household surveys, some respondents to the General Household Survey may feel inhibited to disclose their true household income. The statistical imputation from such cases may not meet the requirements of the Authority; and
- (b) the General Household Survey is not specifically designed to suit the needs of the Authority. The statistical concepts adopted by the General Household Survey are not entirely in line with those used by the Authority. A case in point is the concept of household size. For the General Household Survey, household size refers to those household members who are usually living in the flat. As regards the Authority, it includes all the household members on the tenancy record.

4. To ensure the reliability and accuracy of the data for compiling the income index, the Authority should operate its own system of data collection. We propose to adopt a system similar to the “income declaration” under the Housing Subsidy Policy to make the reporting of household income by sampled households mandatory.

Sample Size

5. The income information of PRH tenants will be collected from a sample survey to be conducted by the Authority on a continuous basis throughout a year. The random sample of the survey should be representative of the profile of PRH tenants and comprise around 1 500 – 2 000 households per month. The cumulative sample size of the survey for any given year will therefore be about 18 000 – 24 000 households, which should be large enough for the purpose of compiling the proposed income index with reasonably good precision.

Mode of Data Collection

6. A self-administered questionnaire will be designed for the purpose of obtaining the essential information and data from PRH tenants. The questionnaires will be despatched to the sampled households in batches on a monthly basis. Households selected for participation in the survey are required to submit the duly completed forms to the Housing Department by a specified deadline under section 25 of the Housing Ordinance.

Computation Agent

7. To enhance the impartiality and objectivity of the income index, consideration can be given to engaging an independent party to undertake the computation on behalf of the HA.

Coverage of the Income Index

8. CSSA and additional rent paying households should be excluded from the coverage of the income index. As the “income” of CSSA household is effectively social security allowance provided by Government, changes in the amount of CSSA allowance should not be included in the calculation of the income index for PRH tenants. As for tenants paying additional rents, they are substantially better off than other PRH households. Their inclusion in the coverage of the income index may distort the outcome of the computation.

9. To deal with the so-called “outliers” (i.e. those households with extremely high and low income levels), we may also consider excluding the top and bottom 1% of the household income in each household size category from the calculation of the index.

Compilation and Operation of the Proposed Income Index

Why Changes in Household Size Distribution Should be Discounted?

Movement in the overall household income of PRH tenants is attributable to, inter alia, two main factors –

- (a) changes in individual household's income; and
- (b) changes in the distribution of household size.

2. Income of small households is usually lower than that of large households²². Even if the income of individual households remains unchanged, the overall household income of all the PRH tenants (either measured in terms of median or average income) may drop simply due to a surge in the number of small households.

3. The following hypothetical examples illustrate how the median or average income of PRH households is affected by changes in household size distribution –

²² As at the first quarter of 2006, the average household income of PRH tenants was \$4,685 for 1-person households; \$8,892 for 2-person households; \$13,564 for 3-person households; \$16,124 for 4-person households and \$19,383 for 5-person or above households.

Example A : *Effects of Changes in Household Size Distribution on Median Household Income (assuming no change in the income of individual households)*

<u>Period (1)</u>				<u>Period (2)</u>			
Household Number	Household Size	Household Income (\$)	Median Household Income by Household Size (\$)	Household Number	Household Size	Household Income (\$)	Median Household Income by Household Size (\$)
1	1-person	4,000		1	1-person	4,000	
2	(27.3%)	5,000		2	(36.4%)	5,000	
3		5,500	5,000	3		5,000	
4	2-person	6,500		4		5,500	5,000
5	(27.3%)	7,500		5	2-person	6,500	
6		8,000	7,500	6	(36.4%)	7,500	
7	3-person	8,500		7		7,500	
8	or above	9,000		8		8,000	7,500
9	(45.5%)	9,500		9	3-person	8,500	
10		10,000		10	or above	9,500	
11		11,000	9,500	11	(27.3%)	11,000	9,500
Median household income (\$)			8,000	Median household income (\$)			7,500

4. As can be seen from the above table, the median household income drops from \$8,000 in Period 1 to \$7,500 in Period 2 even though there is no change in the income of individual households. The decline in the median household income is primarily due to an increase in the number of 1-person and 2-person households in Period 2 rather than a drop in the income of individual households.

Example B : *Effects of Changes in Household Size Distribution on Median Household Income (assuming an increase of \$300 in the monthly income of all households)*

<u>Period (1)</u>				<u>Period (2)</u>			
Household Number	Household Size	Household Income (\$)	Median Household Income by Household Size (\$)	Household Number	Household Size	Household Income (\$)	Median Household Income by Household Size (\$)
1	1-person	4,000		1	1-person	4,300	
2	(27.3%)	5,000		2	(36.4%)	5,300	
3		5,500	5,000	3		5,300	
4	2-person	6,500		4		5,800	5,300
5	(27.3%)	7,500		5	2-person	6,800	
6		8,000	7,500	6	(36.4%)	7,800	
7	3-person	8,500		7		7,800	
8	or above	9,000		8		8,300	7,800
9	(45.5%)	9,500		9	3-person	8,800	
10		10,000		10	or above	9,800	
11		11,000	9,500	11	(27.3%)	11,300	9,800
Median household income (\$)			8,000	Median household income (\$)			7,800

5. Notwithstanding an increase in the income of individual households, the median household income still registers a downward adjustment from \$8,000 in Period 1 to \$7,800 in Period 2. Again, this is mainly due to an upsurge in the number of small households over the same period.

Example C : Effects of Changes in Household Size Distribution on Average Household Income (assuming an increase of \$300 in the monthly income of all households)

<u>Period (1)</u>				<u>Period (2)</u>			
Household Number	Household Size	Household Income (\$)	Average Household Income by Household Size (\$)	Household Number	Household Size	Household Income (\$)	Average Household Income by Household Size (\$)
1	1-person	4,000		1	1-person	4,300	
2	(27.3%)	5,000		2	(36.4%)	5,300	
3		5,500	4,833	3		5,300	
4	2-person	6,500		4		5,800	5,175
5	(27.3%)	7,500		5	2-person	6,800	
6		8,000	7,333	6	(36.4%)	7,800	
7	3-person	8,500		7		7,800	
8	or above	9,000		8		8,300	7,675
9	(45.5%)	9,500		9	3-person	8,800	
10		10,000		10	or above	9,800	
11		11,000	9,600	11	(27.3%)	11,300	9,967
Average household income (\$)			7,689	Average household income (\$)			7,398

6. The potential distortion brought about by an increase in the number of small households would also be felt when assessing the average income of all the households. In spite of a rise in the income of individual households, the average household income drops from \$7,689 in Period 1 to \$7,398 in Period 2.

7. The above illustrations clearly show that the movement in both median or average household income could be affected by changes in household size distribution. It does not necessarily stem from any variations in individual households' income. Nor does it imply any changes in tenants' affordability. For rent adjustment purpose, a more objective and fairer income indicator should therefore discount the effects of the changes in household size distribution and embrace only the changes in the household income of the PRH tenants.

Compilation of the Income Index

8. To discount the effects of household size distribution and track the “pure income change” of the PRH tenants, the household size distribution of PRH tenants would be kept constant in any one particular rent review cycle for the purpose of assessing the weighted average household income of all PRH tenants, so that only the changes in the income of individual households are reflected in the calculation.

9. Based on the household size and income distribution in “Example C” above, the calculation of the respective income indexes for Period 1 and Period 2 is set out below –

	Household Distribution (%) (Period (1))	Average Household Income (\$) (Period (1))	Average Household Income (\$) (Period (2))
1-person	27.3%	4,833	5,175
2-person	27.3%	7,333	7,675
3-person or above	45.5%	9,600	9,967
Weighted average household income based on household size distribution in Period (1) (\$)		7,689 (4,833 x 27.3% + 7,333 x 27.3% + 9,600 x 45.5%)	8,043 (5,175 x 27.3% + 7,675 x 27.3% + 9,967 x 45.5%)
Income index (Period (1) as base year)		100.0	104.6

$$\text{Income index for Period (1) (i.e. base year)} : \frac{\$7,689}{\$7,689} \times 100 = 100$$

$$\text{Income index for Period (2) (i.e. current period)} : \frac{\$8,043}{\$7,689} \times 100 = 104.6$$

10. The change in the income index between Period 1 and Period 2 can be computed as follows –

$$(104.6 - 100.0) / 100.0 \times 100\% = 4.6\% \quad (\text{change in income index} = \text{pure income effect})$$

11. Using the change in the income index as a guide, the rent of all PRH flats would need to be adjusted upwards by 4.6% should a rent review be conducted in Period 2.

Re-basing the Household Size Distribution

12. Instead of fixing the household size distribution perpetually at one particular period, we would make reference to the more updated pattern of household size distribution in PRH each time we conduct a rent review. Such regular “re-basing” could strike a balance between the need to exclude the undue impact of changes in household size distribution in assessing the income index within the two-year rent review cycle and the need to make reference to a more updated pattern of household size distribution in PRH for deriving the income index.

13. Assuming that another rent review exercise is to be conducted in the next period, i.e. Period 3, the household size distribution in Period 2 would be adopted to compile the respective income indexes for both Period 2 and Period 3 as follows –

Income and Household Size Distribution in Period 2 and Period 3

	Period (2)			Period (3)		
Household Number	Household Size	Household Income (\$)	Average Household Income (\$)	Household Size	Household Income (\$)	Average Household Income (\$)
1	1-person (36.4%)	4,300	5,175	1-person (45.5%)	3,800	4,800
2		5,300			4,800	
3		5,300			4,800	
4		5,800			5,300	
5	2-person (36.4%)	6,800	7,675	2-person (36.4%)	5,300	4,800
6		7,800			6,300	
7		7,800			7,300	
8		8,300			7,300	
9	3-person or above (27.3%)	8,800	9,967	3-person or above (18.2%)	7,800	7,175
10		9,800			8,300	
11		11,300			10,800	9,550

Calculation of the Respective Income Indexes for Period 2 and Period 3

	Household Distribution (%) (Period (2))	Average Household Income (\$) (Period (2))	Average Household Income (\$) (Period (3))
1-person	36.4%	5,175	4,800
2-person	36.4%	7,675	7,175
3-person or above	27.3%	9,967	9,550
Weighted average household income based on household size distribution in Period (2) (\$)		7,398 (5,175 x 36.4% + 7,675 x 36.4% + 9,967 x 27.3%)	6,966 (4,800 x 36.4% + 7,175 x 36.4% + 9,550 x 27.3%)
Income index (Period (2) as base year)		100.0	94.2

$$\text{Income index for Period (2) (taking Period 2 as base year)} : \frac{\$7,398}{\$7,398} \times 100 = 100$$

$$\text{Income index for Period (3)} : \frac{\$6,966}{\$7,398} \times 100 = 94.2$$

14. Compared to Period 2, the income index decreases by 5.8% in Period 3. Using this as a guide, the rent of all PRH flats would need to be adjusted downwards by 5.8% should a rent review be conducted in Period 3.

**Technical Note on the Mathematical Formulae for Deriving the
Income Index**

Rate of Change in Average Household Income

1. Assuming that the average household income of the PRH tenants in a particular period, say year 0, is Y_0 and in another period, say year t, is Y_t , the rate of change in the average household income (ΔY) of PRH tenants between these two periods can be expressed by the following equation -

$$\Delta Y = \frac{Y_t - Y_0}{Y_0}$$

2. The average household income of PRH tenants in any period can be computed by aggregating the household incomes of individual tenants and dividing the total income sum by the number of households in PRH. Alternatively, it can be obtained by working out the weighted average household income of PRH tenants, i.e. the average household incomes of PRH tenants of different household sizes weighted by the household size distribution in terms of proportion. Mathematically, the weighted average household income of PRH tenants in year t (Y_t) can be expressed by the following formula -

$$Y_t = \sum H_{it} I_{it}$$

Where,

H_{it} = proportion of PRH tenants with household size i (i = 1,2,3,4, etc.)
in year t (i.e. household size distribution in year t),

I_{it} = average household income of PRH tenants with household size i in
year t (i.e. average income by household size in year t),

The average household income of PRH tenants in year 0 (Y_0) can be expressed as follows -

$$Y_0 = \sum H_{i0} I_{i0}$$

Where,

H_{i0} = proportion of PRH tenants with household size i ($i = 1, 2, 3, 4, \text{ etc.}$)
in year 0 (i.e. household size distribution in year 0),

I_{i0} = average household income of PRH tenants with household size i in
year 0 (i.e. average income by household size in year 0)

3. The rate of change in the average household income discussed in paragraph 1 can be expressed as follows -

$$\Delta Y = \frac{Y_t - Y_0}{Y_0}$$

$$\Delta Y = \frac{\sum H_{it} I_{it} - \sum H_{i0} I_{i0}}{\sum H_{i0} I_{i0}}$$

$$\Delta Y = \frac{\sum H_{i0} (I_{it} - I_{i0})}{\sum H_{i0} I_{i0}} + \frac{\sum (H_{it} - H_{i0}) I_{i0}}{\sum H_{i0} I_{i0}} + \frac{\sum (H_{it} - H_{i0}) (I_{it} - I_{i0})}{\sum H_{i0} I_{i0}}$$

For PRH, it is found that the value of $\frac{\sum (H_{it} - H_{i0}) (I_{it} - I_{i0})}{\sum H_{i0} I_{i0}}$

is small if the time interval between 0 and t is not too far apart from each other and can be ignored.

Thus, the above equation can be approximately expressed as follows -

$$\Delta Y \cong \begin{array}{l} \text{Income change} \\ \text{due to pure} \\ \text{income effect} \end{array} \left(\frac{\sum H_{i0} (I_{it} - I_{i0})}{\sum H_{i0} I_{i0}} \right) + \begin{array}{l} \text{Income change} \\ \text{due to household} \\ \text{size effect} \end{array} \left(\frac{\sum (H_{it} - H_{i0}) I_{i0}}{\sum H_{i0} I_{i0}} \right)$$

Income index

4. According to the above equation, the income component of any change in the average household income between two periods is given by the following formula -

$$\frac{\sum H_{i0}(I_{it} - I_{i0})}{\sum H_{i0}I_{i0}} \quad \text{or} \quad \frac{\sum H_{i0}I_{it}}{\sum H_{i0}I_{i0}} - \frac{\sum H_{i0}I_{i0}}{\sum H_{i0}I_{i0}}$$

5. The above statistical formula can be expressed by way of an income index (ID) for the purpose of guiding rent adjustments between two periods, say, every t years (the time interval corresponding to a rent review cycle of t years apart). The income index for year 0 (ID_0) can be compiled by using the following formula -

$$ID_0 = \frac{\sum H_{i0}I_{i0}}{\sum H_{i0}I_{i0}} \times 100$$

The income index for year t (ID_t) is -

$$ID_t = \frac{\sum H_{i0}I_{it}}{\sum H_{i0}I_{i0}} \times 100$$

6. It can be seen from the above formulae that there are two parameters we have to work out for compiling the income indexes for each cycle of rent adjustment, namely $\sum H_{i0}I_{i0}$ and $\sum H_{i0}I_{it}$. In specific terms,

$\sum H_{i0}I_{i0}$ = weighted average household income of PRH tenants in year 0

$\sum H_{i0}I_{it}$ = weighted average household income of PRH tenants in year t calculated by adopting the household size distribution in year 0 (instead of the household size distribution in year t)

Extent of Rent Adjustments Calculated Using the Income Index

7. The extent of rent adjustments calculated using the income index would be equivalent to the extent of the changes in household income between year 0 and year t. In percentage terms, this can be computed using the following formula -

$$\frac{ID_t - ID_0}{ID_0} \times 100\%$$

- 0 - 0 - 0 -