THE HONG KONG INSTITUTE OF SURVEYORS
香港測量師學會

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Clerk to Bills Committee on Stamp Duty (Amendment) Bill 2017
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong

Dear Sirs

Stamp Duty (Amendment) Bill 2017

On behalf of the Hong Kong Institute of Surveyors (HKIS), I have much pleasure in submitting our views on the Bill. Please find attached document for your information.

Thank you for your attention.

Yours faithfully,

Sr Thomas Ho
President
The Hong Kong Institute of Surveyors

Encl.

cc Dr Hon Yiu Chung-yim (Fax no.: 3705 0025)

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香港測量師學會

Stamp Duty (Amendment) Bill 2017

Bills Committee Meeting on Tuesday, 28 March 2017

Subject: How various stamp duty measures have distorted the property market

Executive Summary

On 4 November 2016, the Government announced to increase the ad valorem stamp duty rates to a flat rate of 15% (except for specified exemptions). On 17 January 2017, the Executive Council and the Chief Executive ordered to introduce the Stamp Duty (Amendment) Bill 2017 to the Legislative Council (LegCo) to promulgate the higher ad valorem stamp duty rates. Some of the justifications raised by the Government, according to paragraph 5 of the LegCo Brief included:

1.	The reacceleration of investment demand in the third quarter of 2016 is expected to aggravate the already tight demand-supply imbalance.
2.	The market carries a high risk of an unabated upward spiral in residential property prices, eventually precipitating a very costly adjustment.
3.	The demand-side management measure should help cool down the residential property market.

In response to the Government's justifications, we do not support the Stamp Duty (Amendment) Bill 2017. More importantly, we would like to address the following implications arising from the implementation of the various stamp duty measures since 2010, which have caused a considerable degree of distortion to the property market:

1.	Prices of residential properties in the overall market have climbed to their highest level on record as of February 2017, up 111% since the first stamp duty measure was implemented in April 2010, according to Rating and Valuation Department data.
2.	The market faces increased difficulty in fulfilling upgrading demand against a dramatic reduction in secondary sales volume. In 2016, second hand sales amounted to 37,908, a 60% drop from the annual average recorded between 2005 and 2010 (prior to implementation of stamp duties). Using residential Double Stamp Duty (DSD) as a proxy, upgrading demand represented only 30% (15,537 transactions) of overall market activity between January and November 2016.
3.	A stamp duty raise can trigger a pricing increase in first hand units on face value. By providing higher stamp duty rebates, developers could react by increasing list prices.
4.	The government's stamp duty revenue from property assignments and chargeable agreements registered an 82% increase over the two five-year periods before and after 2010. Part of this gain would have gone to sellers of their units if the stamp duties had not been imposed. Buyers may find it harder to climb up the property ladder as a result of high upfront transaction costs.
5.	High stamp duties and spiraling up property prices encouraged the production of more "nano" units in the private residential market. Since the early 2000s, the average size of domestic units for new developments commencing general building works has shown a general upward trend to reach 1,062 sq ft (gross) in 2010, before shrinking 43% to 607 sq ft (gross) in 2016 which is the smallest average unit size in the past 16 years.
6.	There are various factors which the government needs to take into account: the depreciation of the RMB since 2014 which make HK residential properties becoming more expensive to individual PRC buyers, the increase in US interest rate, the increase in land prices as more PRC developers enter into the land sale market, which could potentially drive prices of future developments further up.

In sum, despite the series of demand-management measures implemented since 2010, prices of residential properties have reached their highest level on record, flagging the urgency to resolve the distortions in the property market and affordability issues in the city. Under the current stamp duty measures, the market has seen a dramatic reduction in transaction volumes, when compared with historical levels. Much of the market's upgrading demand has not been met, given the high upfront transaction costs and reduced supply of secondary homes for sale. With the upward mobility of households being restricted, units in the secondary market have not been freed to fulfil strong demand from first-time homebuyers. Prices in the primary market have also been inflated on face value, leading to the emergence of nano-flats as developers strive to keep lump sums affordable for first-time purchasers. These nano-flats raise considerable liveability issues, and may have limited resale value in the future.

Looking ahead, more factors are likely to impact the residential market direction, including depreciation of the RMB making residential properties more expensive to individual PRC buyers, increasing land prices as PRC developers enter the land sale market driving prices up further and rising interest rates stemming from moves made by the US Federal Reserve.

Given the importance for Hong Kong to maintain its image as a world class city, enhance liveability and be prepared for future risks, it is imperative that the government:

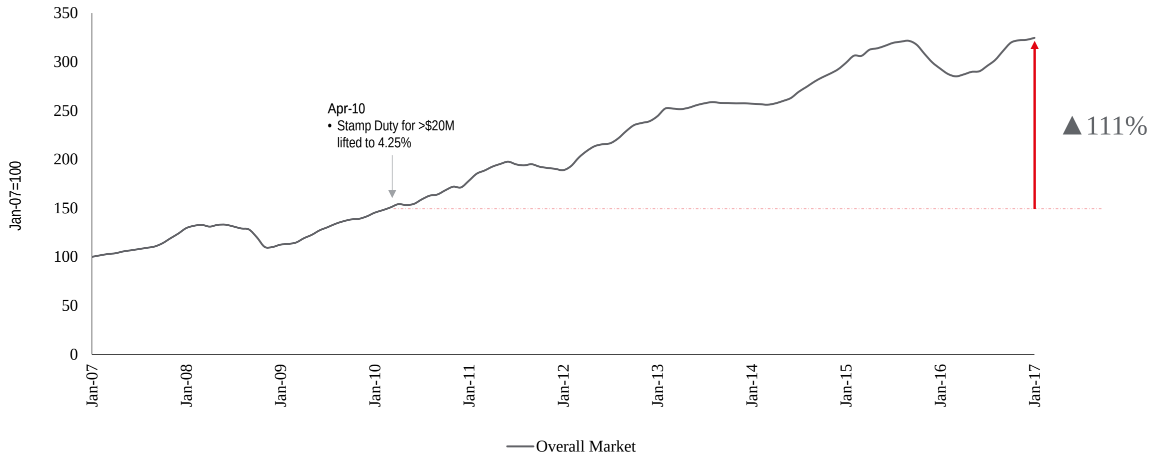
1.	Examines and considers the implications highlighted in this report, arising from the demand-side management measures; and
2.	Reviews the possibility of taking away the various stamp duty measures in an orderly manner in the near term to prevent further distortions of the property market.

Main Implications

The following section elaborates on the implications raised in the Executive Summary.

1. Prices of residential properties in the overall market have climbed to their highest level on record as of February 2017, up 111% since the first stamp duty measure was implemented in April 2010, according to Rating and Valuation Department data.

Figure 1. Residential Price Index

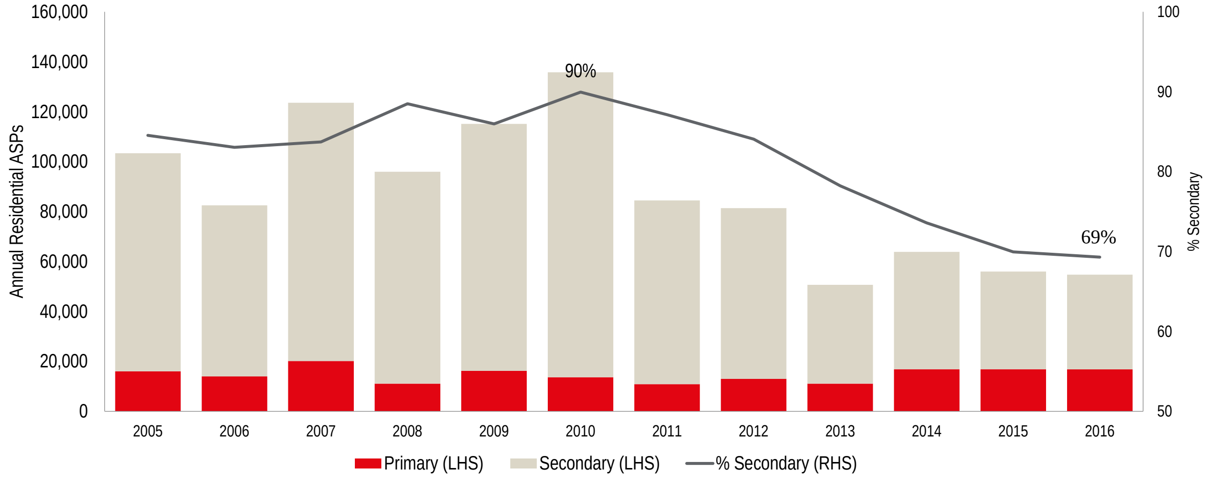


Source: Rating and Valuation Department

- Residential prices have increased 111% from when the first demand-management measure was implemented in April 2010 *[summarised in Appendix 1]* to reach their highest level on record *[Figure 1]*. This suggests that the measures have not addressed the continued upward spiral in residential property prices.

2. The market faces increased difficulty in fulfilling upgrading demand against a dramatic reduction in secondary sales volume. In 2016, second hand sales amounted to 37,908, a 60% drop from the annual average recorded between 2005 and 2010 (prior to implementation of stamp duties). Using residential Double Stamp Duty (DSD) as a proxy, upgrading demand represented only 30% (15,537 transactions) of overall market activity between January and November 2016.

Figure 2. Annual home sales in the primary and secondary sales market and proportion of secondary home sales



Source: Land Registry

Figure 3. Comparison of annual residential sales volumes, sales consideration and average deal size before (2005-2010) and during (2011-2016) implementation of stamp duty measures

Residential Sales Volume	Annual Average 2005-2010 [A]	Annual Average 2011-2016 [B]	% Change between [A] and [B]	2016 [C]	% Change between [A] and [C]
Primary ASPs	15,159	14,228	-6.1%	16,793	+10.8%
Secondary ASPs	94,209	50,932	-46.0%	37,908	-60.0%
Total ASPs	109,368	65,160	-40.4%	54,701	-50.0%

Source: Land Registry, JLL

Residential Sales Consideration (HKD million)	Annual Average 2005-2010 [D]	Annual Average 2011-2016 [E]	% Change between [D] and [E]	2016 [F]	% Change between [D] and [F]
Primary ASPs	99,943	146,916	+47.0%	186,589	+86.7%
Secondary ASPs	284,930	266,545	-6.5%	250,500	-12.1%
Total ASPs	384,874	411,954	+7.0%	428,041	+11.2%

Source: Land Registry, JLL

Consideration per Sale (HKD million)	Annual Average 2005-2010 [G]	Annual Average 2011-2016 [H]	% Change between [G] and [H]	2016 [I]	% Change between [G] and [I]
Primary ASPs	6.6	10.3	+56.6%	11.1	+68.5%
Secondary ASPs	3.0	5.2	+73.0%	6.6	+118.5%
Total ASPs	3.5	6.3	+80.0%	7.8	+122.4%

Source: Land Registry, JLL

- *Figure 3* compares the annual average residential sales volume in 2005-2010, six years prior to the first implementation of stamp duty measures, to the six-year period after. Average home sales have diminished significantly, down 40.4%.The annual average between 2011-2016 is even lower than the annual sales volumes of 71,576 during SARS in 2003.
- The secondary home sales dropped 46% in the recent six-year period, from the period between 2005-2010. In 2016, only 37,908 secondary home sales were recorded, down 60% from the annual average in 2005-2010. Meanwhile, the share of secondary transactions has also dropped from 90% in 2010 to 69% in 2016. *[Figure 2]*
- The annual difference in secondary home transactions between the two six-year periods being compared equates to 43,277, roughly 2.4 times the government's annual housing supply target of 18,000 units, suggesting that the secondary home market serves as a very important source of supply in meeting housing demand, especially upgrading demand.
- As an indication of maximum upgrading demand, the number of residential DSD cases accounted for just about 30% of overall residential transactions (1,481 per month) between August 2014 to November 2016 (per data provided by the Inland Revenue Department). Residential DSD cases represent transactions where buyers already own an existing property or are non-local or corporate entities. Typically, home-upgraders can seek a stamp duty rebate within six-months of conveyance of their existing flats. Assuming that post-stamp duty transactions have already reflected a drop in upgrading demand, the number of residential transactions involving upgraders prior to implementation of stamp duty measures could possibly have been at least 2,734 transactions per month (between 2005-2010). This means, a lot of this demand, especially upgrading demand, has not been fulfilled, in recent years.
- The consideration per sale, on average, has more than doubled to HKD 7.8 million in 2016 compared with HKD 3.5 million in 2005-2010. Moreover, the consideration per sale in the secondary sales market were, on average, (HKD 6.6 million) 41% less than in the primary sales market (HKD 11.1 million) in 2016. However, with the current demand-management measures restricting upward mobility, first-time buyers were faced with fewer options in the secondary market.

3. A stamp duty raise can trigger a pricing increase in first hand units on face value. By providing higher stamp duty rebates, developers could react by increasing list prices.

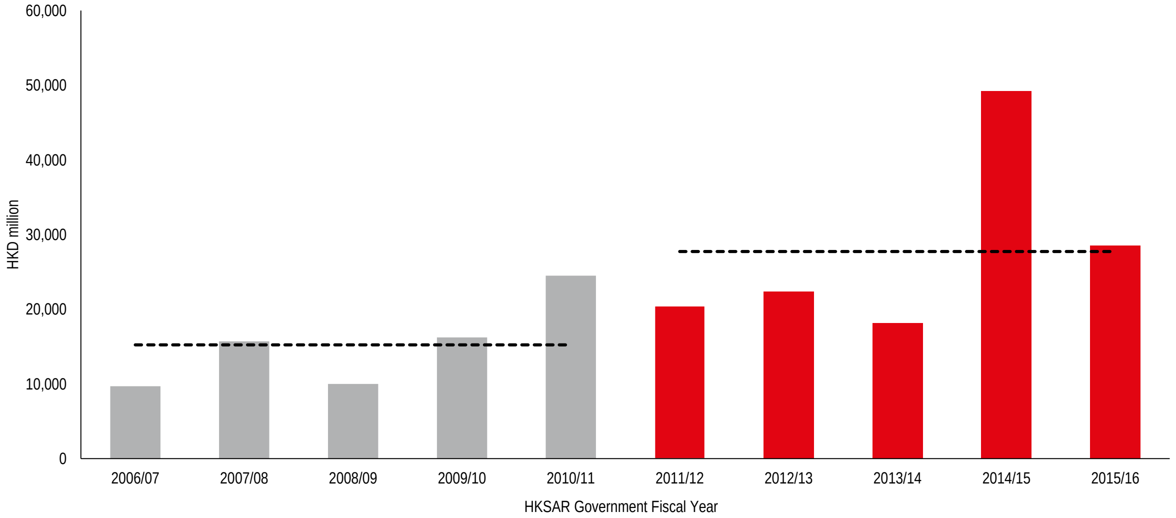
Figure 4. Listing prices of select developments before and after announcement of 15% stamp duty

Development Name	District	Developer	Average price after discount (excluding cash rebates) (HKD per sq ft, SA)				Increase in pricing (%)
			Before announcement of 15% stamp duty	Price List (Date of Printing)	After announcement of 15% stamp duty	Price List (Date of Printing)	
Lime Gala #	Shau Kei Wan	Sun Hung Kai Properties	18,400	Price List No.1 (07-Aug-2016)	22,500	Price List No.6A (07-Mar-2016)	22%
One Kai Tak	Kai Tak	China Overseas	14,500 (Phase I)	Price List No.1 (25-Aug-2016)	17,600 (Phase II)	Price List No.1 (05-Jan-2017)	21%
Grand Yoho #	Yuen Long	Sun Hung Kai Properties	12,000 (Phase I)	Price List No.1 (17-Aug-2016)	14,500 (Phase II)	Price List No.1 (03-Jan-2017)	21%
The Cullinan #	Jordan	Sun Hung Kai Properties	47,600	Price List No. 2 (28-Oct-2016)	58,200	Price List No. 2 (16-Jan-2017)	8%

Developers offer additional cash rebates; assumed maximum discount offer
All pricing figures rounded to the nearest hundred.

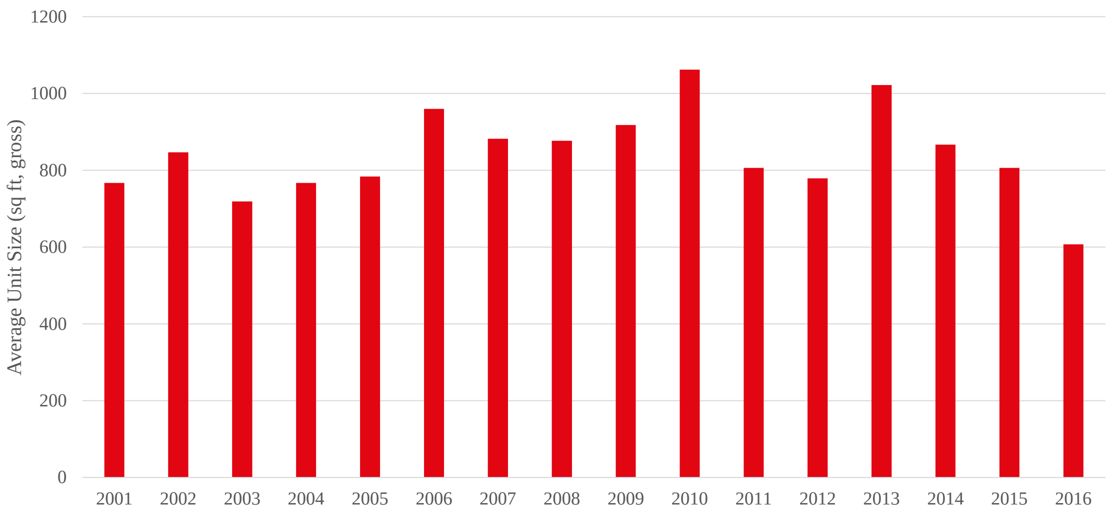
Source: Market Sources, JLL

- One of the potential implications of raising the stamp duty on residential properties to 15% is that developers have generally sought to increase listing prices. To draw buyer interest, developers then usually offer more substantial stamp duty rebates to offset the heftier stamp duty payments imposed on buyers. These higher rebates, however, are usually offset by a general increase in listing prices, for developers to keep their bottomline broadly unchanged. A few developments have adopted this strategy, when comparing listing prices before and after the stamp duty raise. *[Figure 4]* (Note, however, that the batches being compared may not be identical and hence price difference could be affected by batch differences (i.e. level, view, size of the flats).
- Secondary homeowners, cognizant of the general increase in prices, may hold firm on their asking prices as well. As such, this is potentially one of the reasons why we continue to see residential price indices, which generally track secondary home sales, show sustained increases. Looking at JLL's in-house index, mass residential prices rose 2.0% between November 2016 (after Stamp Duty was raised to 15%) and February 2017.

4.	The government's stamp duty revenue from property assignments and chargeable agreements registered an 82% increase over the two five-year periods before and after 2010. Part of this gain would have gone to sellers of their units if the stamp duties had not been imposed. Buyers may find it harder to climb up the property ladder as a result of high upfront transaction costs.
	Figure 5. Stamp duties on property assignments and chargeable agreements
	 Source: Inland Revenue Department
	• Prior to the implementation of the stamp duty-related measures, the government's revenue from stamp duties on property assignments and chargeable agreements averaged at about HKD 15.2 billion per fiscal year over the five-year period between 2006/2007 and 2010/2011. Between 2011/2016 and 2013/2014, the figure increased an annual average of HKD 27.7 billion, reflecting a 82% increase over the two five-year periods, against a drop of declining transaction volumes. *[Figure 5]* • The stamp duty payment, when considered together with the total transaction cost, represents a buyer's willingness to pay, and which hypothetically, could have been transferred to the seller instead of the government, as a gain in the transaction. • If the buyer did not have to pay so much upfront in stamp duties, then some of the savings could potentially be used to close the expectation gap between buyers and sellers, which in turn could release more stock onto the secondary market.

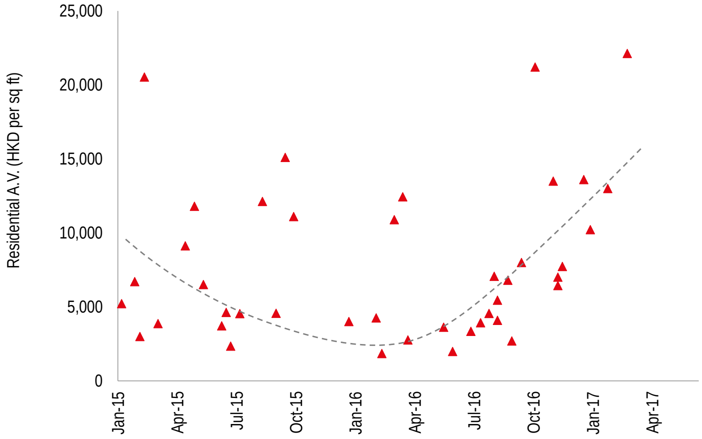
5. High stamp duties and spiraling up property prices encouraged the production of more “nano” units in the private residential market. Since the early 2000s, the average size of domestic units for new developments commencing general building works has shown a general upward trend to reach 1,062 sq ft (gross) in 2010, before shrinking 43% to 607 sq ft (gross) in 2016 which is the smallest average unit size in the past 16 years.

Figure 6. Average unit size of domestic units with approval for the commencement of general building works



Source: Buildings Department, JLL

- Since introduction of demand suppression measures, higher barriers to entry have pushed developers to build smaller-sized flats, in order to keep lump sums more affordable. This has pushed capital values of Class A units up 227% between the lows of the Global Financial Crisis and 2016, compared with a 193% increase in the overall market, according to data from the Rating and Valuation Department.
- Though the 15% stamp duty levy is expected to have a larger impact on lower-priced residential properties, demand for these units remains strong since most buyers of these smaller units are first-time homebuyers that are exempt from the higher stamp duty rates.
- Developers will likely continue to match such demand by building smaller flats, in order to maximize the achievable unit rate out of an affordable lump sum. Looking at JLL’s forecast for future supply, an annual average of 6,400 Class A units will be produced over the next three years, more than three times the annual average produced over the last 10 years.
- Since the early 2000s, the average size of domestic units for developments commencing general building works has been on a general increase, reaching 1,062 sq ft in 2010. From 2010, this indicator has shrunk 43% to 607 sq ft (gross) in 2016; the smallest average unit size in the past 16 years. *[Figure 6]*
- The rise of smaller-sized flats, aside from raising livability concerns, could see owners of these flats face a limited resale potential given the unfavourable layouts and cramped living conditions associated with these flats.

6.	There are various factors which the government needs to take into account: the depreciation of the RMB since 2014 which make HK residential properties becoming more expensive to individual PRC buyers, the increase in US interest rate, the increase in land prices as more PRC developers enter into the land sale market, which could potentially drive prices of future developments further up.
	*Figure 7. Residential land prices achieved in the government land sales market between 2015 and 2017 year-to-date**
	 * 2017 year-to-date cut-off date: 28 February 2017 Source: Lands Department
	• The ad valorem stamp duty raise to 15% does not bar the appetite of developers for land acquisitions in Hong Kong. Among the bidders, mainland Chinese developers have been increasingly active, on the back of the ongoing depreciation of the RMB. • Given that no stamp duty is required to be paid on site acquisition through the government's land tender process, the bidding war among developers could continue, resulting in a continued increase in land prices. This means the pricing of future developments will likely be pushed up, should developers wish to maximize their returns. • On the back of rising prices, the increase in US interest rate could pose more pressure on the repayment ability of some homeowners over the short-term.

Appendix Section

1.	**Quick Summary of Government policy measures since 2010 (Hong Kong)** (Stamp duty-related measures highlighted in ***bold italics***)
Nov 2016	***1. Increase the Ad valorem stamp duty (AVD) for residential property transactions to a flat rate of 15% (can be exempted for first-time homebuyers and upgraders of residential properties [those trading flats within a 6-month period] who are Hong Kong permanent residents, but upgraders will still need to pay the double stamp duty upfront.)***
Feb 2015	1. Maximum LTV ratio for self-use residential properties valued below HKD 7mil lowered from 70% to 60% 2. Maximum LTV ratio under the Mortgage Insurance Programme lowered by 10 ppts from 90% to 80% (except for first-time buyers for self-use who meet certain income requirements 3. Maximum debt servicing ratio (DSR) lowered by 10 ppts from 50% to 40% for borrowers buying a second residential property for self-use, and stressed-DSR cap lowered by 10 ppts from 60% to 50% 4. Maximum DSR lowered by 10 ppts from 50% to 40% for mortgages of all types of non-self-use properties, including residential, commercial and industrial properties and stressed-DSR cap lowered by 10 ppts from 60% to 50%
Jan 2015	1. Discount rate on net rental income of investment properties in calculating the DSR increased from the previous 20% to at least 30-40%
May 2014	***1. Relaxation of Double Stamp Duty for home upgraders.***
Feb 2013	***1. Double the ad valorem stamp duty for all property types (can be exempted for first-time homebuyers and upgraders of residential properties [those trading flats within a 6-month period] who are Hong Kong permanent residents, but upgraders will still need to pay the double stamp duty upfront first.)*** 2. Stress-test new mortgage applicants (spot rate + 300 bps) 3. LTV for non-residential properties lowered by 10 ppts 4. Max. LTV for standalone car parks capped at 40% with maximum loan tenor at 15 years 5. Raising the risk weight floor for all residential mortgage loans to 15% 6. Revision of Mortgage Insurance Programme
Oct 2012	***1. Extending Special Stamp Duty (SSD):*** ***a. Increasing the SSD rate from 5-15% of the transacted value to 10-20%*** ***b. Extending the restriction period on resale from 2 years to 3*** ***2. A 15% of Buyer's Stamp Duty to be imposed on non-local and company buyers***
Sep 2012	Applies to applicants who have already borrowed outstanding loans for one or more properties: 1. DSR will be lowered from 50% to 40% 2. Maximum stressed DSR shall also be lowered to 50% 3. LTV for net-worth based applicants lowered from 40% to 30% 4. Mortgage applicants whose principal income is derived from outside HK, applicable maximum LTV shall be lowered by 20 ppts 5. Limit the max. loan tenor to 30 years for all property mortgage loans

Jun 2011	1. Maximum LTV ratio for residential properties with a value between HKD 10mil and HKD 12 mil lowered from 60% to 50% 2. Maximum LTV ratio for residential properties with a value between HKD 7 mil and HKD 10 mill lowered to 60%, with maximum loan amount capped at HKD 5 mil 3. Maximum LTV ratio for residential properties with a value below HKD 7 mil stayed at 70%, but the maximum loan amount capped at HKD 4.2 mil 4. Borrowers whose principal income is from outside of HK, LTV to reduce by at least 10 ppts 5. LTV capped at 40% for net-worth based loans
Nov 2010	***1. Special Stamp Duty for properties resold within 2 years, ranging from 5-15% of transacted value*** 2. Maximum LTV ratio for residential properties with a value of HKD 12 mil or above lowered from 60% to 50% 3. Maximum LTV ratio for residential properties with a value at or above HKD 8 mil and below HKD12 mil lowered from 70% to 60%, the maximum loan amount capped at HKD6 mil 4. Maximum LTV ratio for residential properties with a value below HKD 8 mil stayed at 70%, but the maximum loan amount capped at HKD 4.8 mil 5. Maximum LTV ratio for investment properties, properties held by a company and industrial and commercial properties lowered to 50%
Aug 2010	1. Maximum LTV lowered from 70% to 60% for residential properties ≥ HKD 12 mil and those for investment purposes 2. Maximum debt servicing ratios (DSRs) capped at 50% 3. Stress test for all mortgage applicants (spot rate + 200bps) and maximum DSR capped at 60% 4. Forfeiture of deposit on cancelled sales raised from 5% to 10% of purchased value 5. Confirmor sales of first-hand uncompleted flats banned
Apr 2010	***1. Stamp duty for >$20m properties lifted from 3.75% to 4.25%***