

Why is housing supply such a challenge?

Introduction

Hong Kong has experienced an almost unprecedented period of turmoil since June 2019 with an extended period of social unrest followed by the dramatic implications of dealing with the public health issues and the economic consequences of the Covid 19 pandemic. These back-to-back crises have distracted attention from some of the important underlying issues which afflict our society, but which will inevitably return to prominence as crises subside.

Foremost amongst these issues is the extreme wealth gap, much of which is caused by the unprecedented rise in real estate values in recent years that has exacerbated the difference between those who own property assets and those who do not. However, history has clearly shown that suppressing values through policy means not only destroys wealth but creates consequential damage to the economy and impacts the less well-off members of society. Far better to rebuild the housing ladder and facilitate more people to become home owners thereby giving them an equity stake in economic growth as well as protection against rising costs of living.

How best is this achieved?

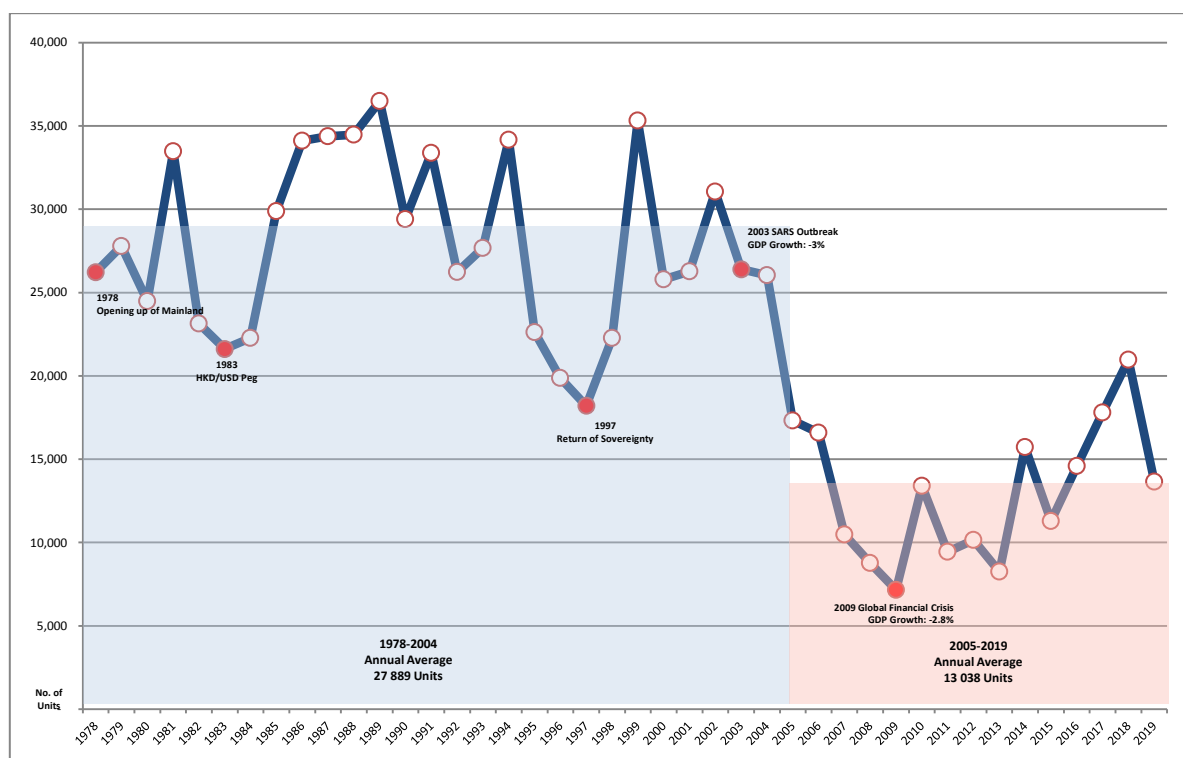
A clearer analysis of the circumstances creating the high property price regime would both pinpoint a more exact source of the problem as well as possibly indicate a potential route towards to a solution to this long outstanding, and seemingly unsurmountable, challenge.

Background

Chart 1 shows the number of private residential units completed in Hong Kong from 1978-2019. It is clear from this chart that between

- 1978-2004 the private sector produced a fairly consistent average of about 28,000 residential units per annum, but in the period
- 2005-2019 the equivalent annual production was approx. 13,000 homes per annum, a drop of over 53%.

Chart 1
Private Residential Supply



Notes

1. Source: Rating and Valuation Department.
2. Completion excluding village housing after 2001.

These figures beg the questions:

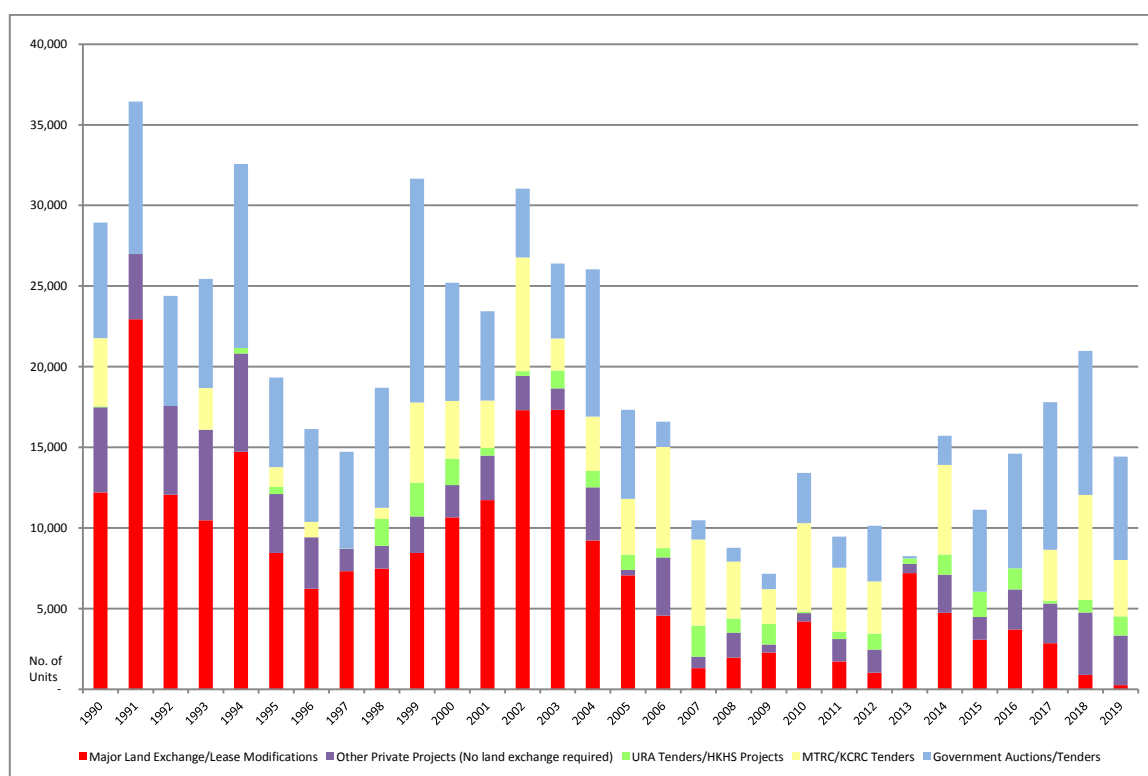
- what were the sources of land supply in these periods and
- what was cause of this abrupt drop in private sector production?

Chart 2 shows the source of land for the production of private residential units from 1990-2019 (earlier data is not readily available), broken into five sectors:

- land exchanges/lease modifications of private land (in red),
- privately held land for which no land exchange or lease modification is required (in purple),
- URA tenders/HKHS projects (in green),
- Government land released for (re)development via MTRC and KCRC tenders (in yellow) and
- Government land sold via auction or tender (in blue),

Chart 2

**Total Number of Private Residential Units Completed (Issuance of OP)
between 1990 and 2019 (By Source of Land Supply)**



Source: Buildings Department

The principal sources of land supply were land exchanges/lease modifications, MTRC/KCRC projects and Government land sales although development of land not requiring exchange / modification has again represented an increasing proportion more recently. Allowing a development period of 3-4 years from site acquisition and clearance, the following deductions can be made from Chart 2:

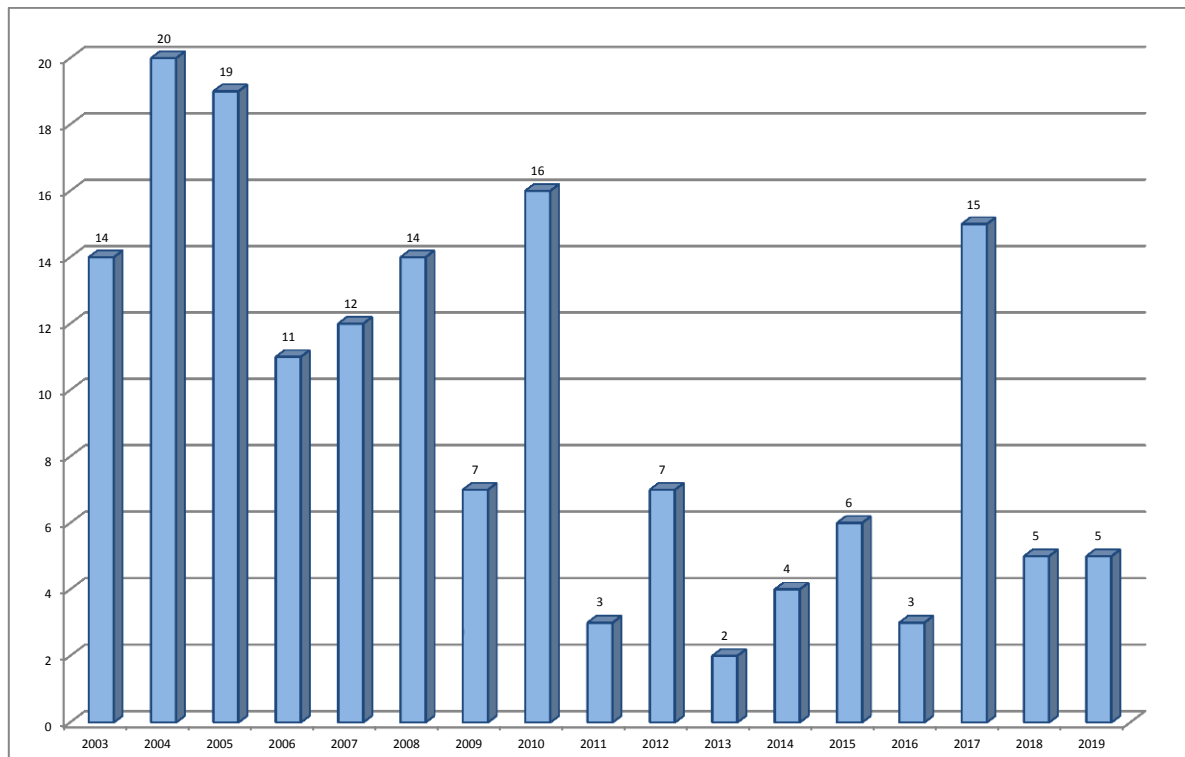
- It is clear that the near absence of Government land sales 2002-2010 (blue) had a material impact on supply in 2006-2014.
- Similarly, the modest number of land exchanges/lease modifications (red) since 2002 has significantly reduced new supply (also see Chart 3).
- Supply via MTRC related projects (yellow) is naturally variable as this depends on implementation of new rail infrastructure.

To illustrate the decline in supply from land exchanges/lease modifications, Chart 3 shows the number of completed applications in the period 2003-2019.

This Chart 3 does not show the number of flats produced from each completed transaction, but it is appropriate to note that one or two major land exchanges in 2017, with significant premiums attached, illustrate the potential housing production which can be generated from this form of land conversion.

Chart 3

Number of Completed Land Exchanges/Lease Modifications that have Significant Housing Production



Notes:

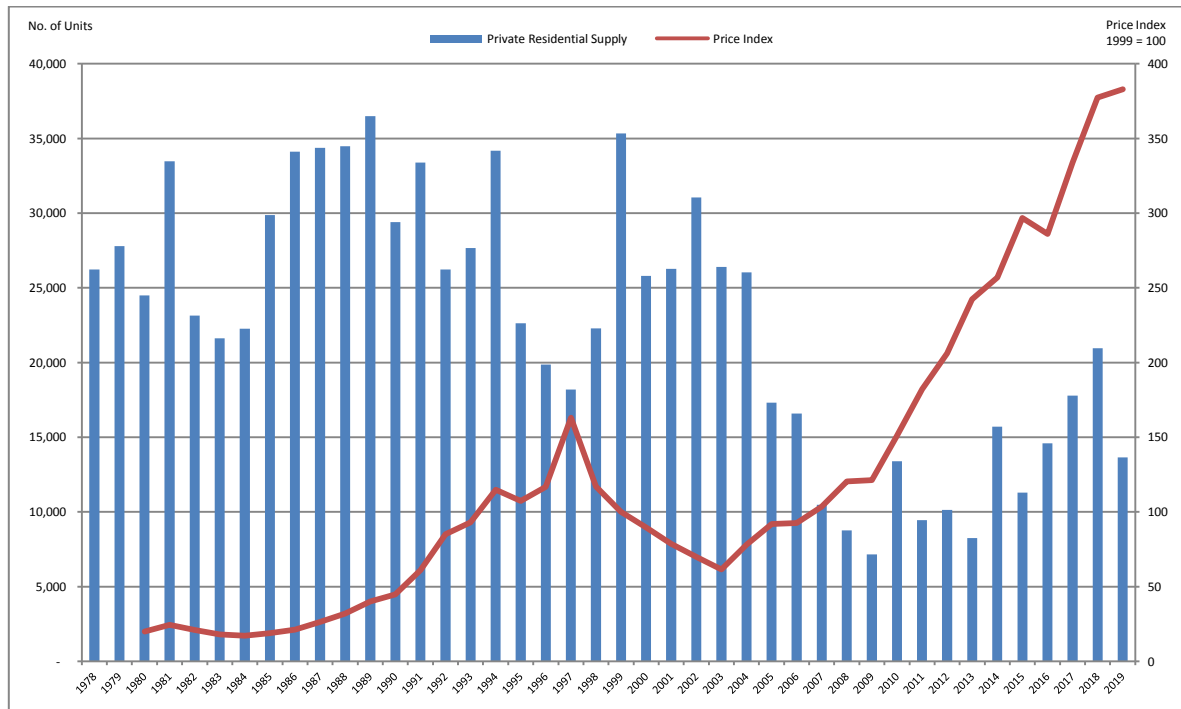
1. Source: Lands Department.
2. Residential uses only.
3. MTRC/KCRC, URA, HKHA and HKHS projects excluded.
4. Luxurious projects of less than 5 houses excluded.

Having established the principal reasons for the drop in the supply of private residential housing, what has been the impact on prices?

Chart 4 shows the combined effects over the same 1978-2019 period as Chart 1 of:

- (in blue/left scale) private residential housing supply from Chart 1, but shown in a bar format and
- (in red/right scale) the residential price index as prepared by the Rating & Valuation Department.

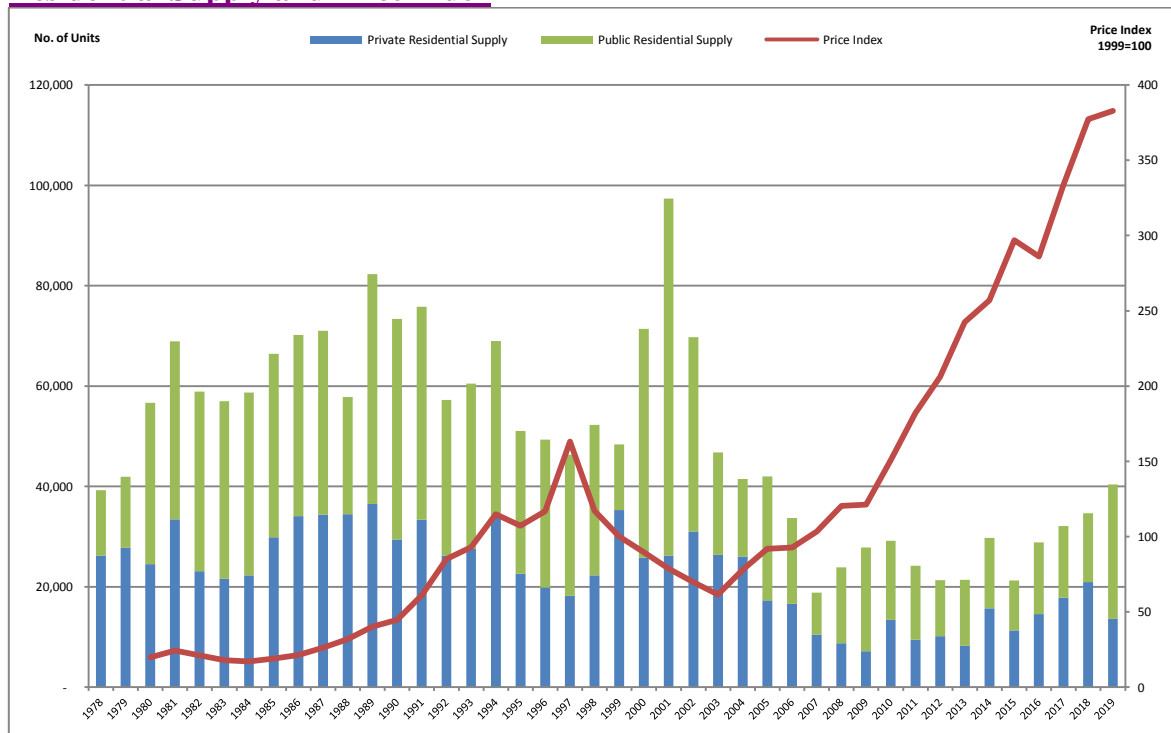
Chart 4
Private Residential Supply and Price Index



Source: Rating and Valuation Department

For reference, Chart 5 shows the same information but including the public housing component in green.

Chart 5
Residential Supply and Price Index



Sources: Rating and Valuation Department, Census and Statistics Department, Housing Department

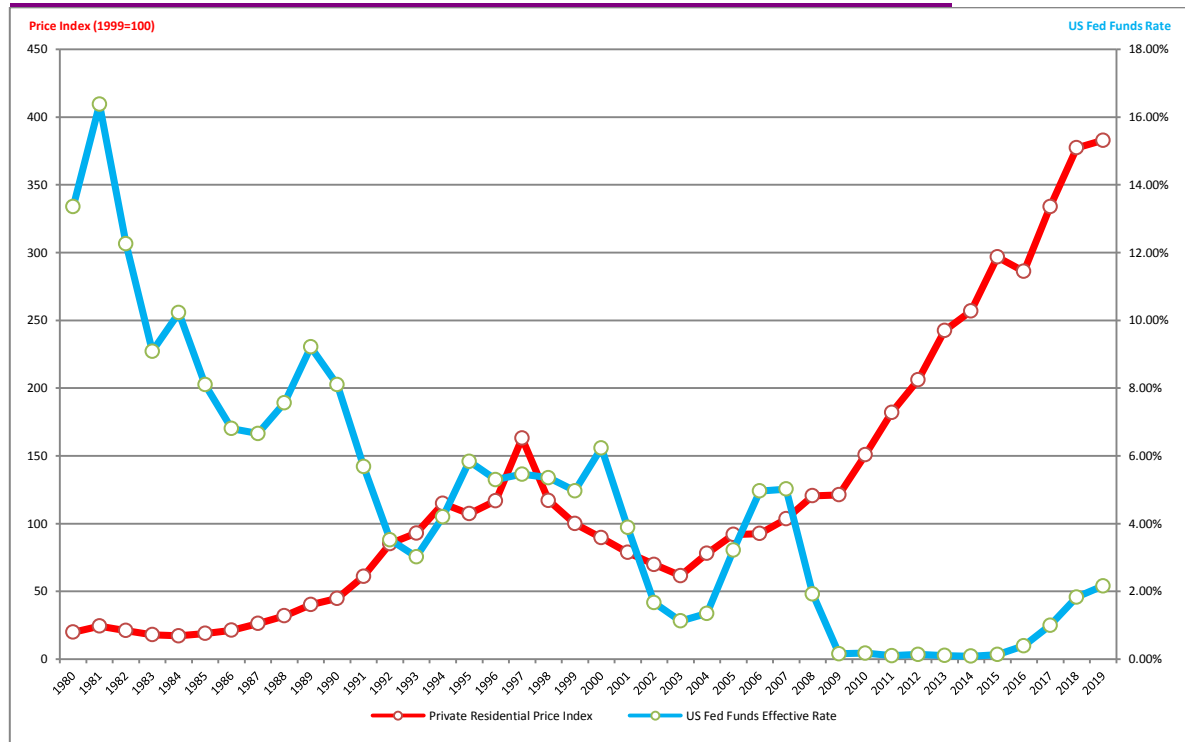
It is quite clear that a significant cause of price rises is the drop off in Government land sales and land exchanges/lease modifications since 2001/2002, but this is not the only factor at play. Prices are also a function of (real) interest rates, overall demand and rising wealth.

Interest rates

Chart 6 shows the relationship between the residential price index and the US Federal Funds Effective Rate (a proxy for borrowing costs since the introduction of the HKD/USD peg in October 1983).

Chart 6

Private Residential Price Index and US Federal Funds Effective Rate



Sources: Rating and Valuation Department, US Federal Reserve

The relatively stable relationship between prices and interest rates from 1992-2007/8 was torn apart by the financial crisis of 2008/9 when the Quantitative Easing (QE) policies of central banks flooded markets with liquidity, drove interest rates to the floor with the consequent rise in asset prices, including Hong Kong real estate. At the time of writing, interest rates are again at rock bottom due to the economic impact of the Covid 19 pandemic but demand may also be affected.

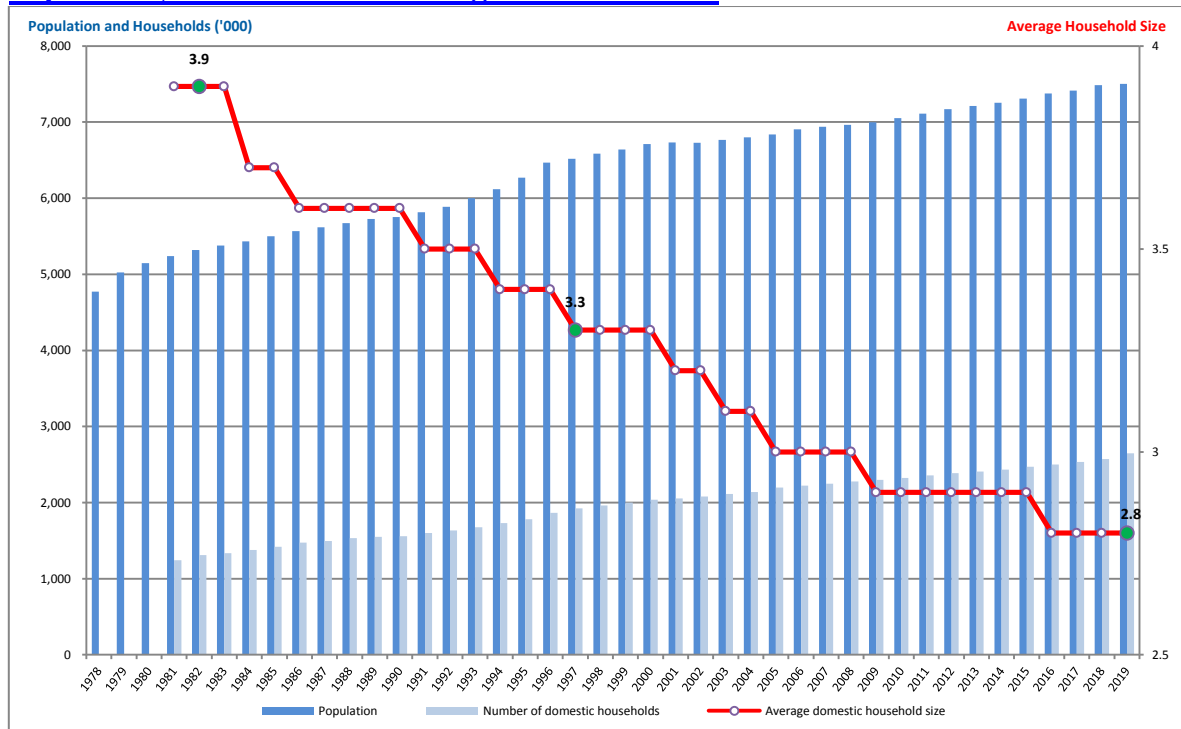
Demand

It is difficult to simply illustrate demand, whether in terms of the requirement for numbers of units for both accommodation and investment or the natural desire for increased living space per capita, but Chart 7 provides some context for the 1978-2019 period:

- (in blue and light blue/left scale) population growth and new household formation, and
- (in red/right scale) average household size.

Chart 7

Population, Household and Average Household Size



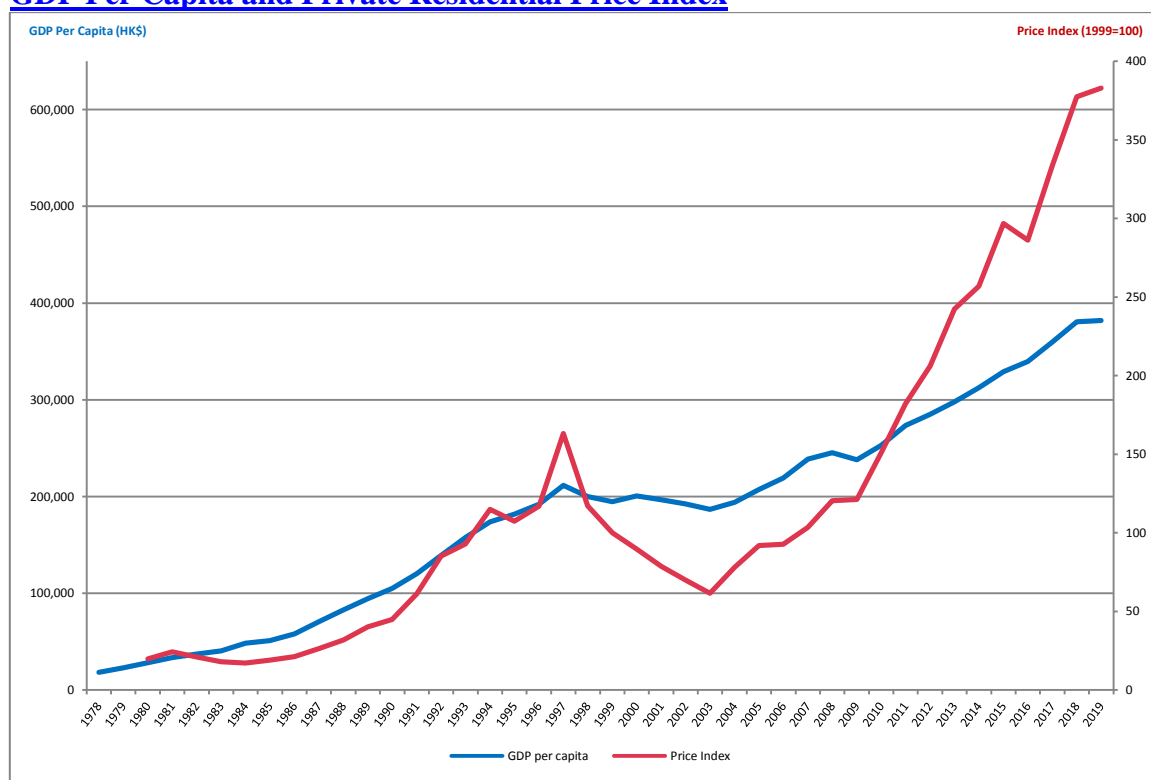
Source: Census and Statistics Department

As can be deduced from Chart 7, there was an increase in population of approximately 30% during the period under review and a corresponding 28.2% decrease in household size. The combined effect of these natural phenomena was to significantly increase the demand for housing, both in number of units as well as space per capita. If the housing problem is to be ameliorated then it is not only a matter of quantity but also of quality to meet the aspirations of people wanting reasonable living conditions with adequate minimum space standards, as well as provisions for an increasingly ageing society. To this one might add the public health aspect as more housing units of sufficient size would not only reduce social stress but also the risk of contagion brought about by living in extremely close quarters.

Rising wealth

Finally, Chart 8 illustrates the impact of rising wealth (GDP per capita in blue/left scale) on the residential price index (in red/right scale)

Chart 8
GDP Per Capita and Private Residential Price Index



Source: Rating and Valuation Department, Census and Statistics Department

The approximate correlation between per capita GDP and the residential price index from 1978/9 – 1997 was clearly disrupted by local policy changes (supply, as shown in Chart 2) as well as international policies (interest rates, as illustrated in Chart 6) which, in turn, has led to more extreme price volatility and therefore social and political concerns. However, it is to be expected that prices will rise with increasing wealth per capita and policy makers must take proper account of this factor in planning future supply.

Not surprisingly, the causes of the housing problem can therefore be summarised as a combination of:

- the reduction in supply since 2005/6 as a result of:
 - a drop in Government land sales, especially from 2002-2010 and
 - the very modest supply coming from the traditional source of land exchange/lease modification commencing sometime around 2004 and continuing until today;
- the very low interest regime (through the HKD/USD peg) since the financial crisis of 2008;
- a natural increase in demand through population growth, a reduction in household sizes and a natural desire for increased space per capita and
- steady economic growth (albeit distributed unequally) which impacts the desire for, and price of, housing.

So what can be done to improve the situation?

A Way Forward?

An analysis of the causes leaves few options available because:

- low interest rates are a global phenomenon with no policy option available to the Hong Kong Monetary Authority due to the HKD/USD peg;
- a population policy is certainly not the subject of this paper but, as noted, increases in household formation and a desire for more living space per capita are natural outcomes of an increasing GDP (which is to be encouraged);
- the introduction of ‘demand management’ measures have had a distortional effect on the market without positively impacting the problem

therefore leaving an increase in supply as the only available, and valid, policy tool.

Chart 9 illustrates the land use distribution of 111,100 hectares comprising the HKSAR.

Source: Planning Department

The pie chart was derived from the land use statistics of the *Land Use Utilisation of Hong Kong (LUHK) 2018*. The land use data was an estimate of the broad land uses of Hong Kong as around end of 2018, compiled using satellite images dated December 2018 and January 2019, in-house survey information of the Planning Department (PlanD) up to end of 2018 and other relevant information from various government departments, without verification through site visits. The land area figures were to the nearest square kilometre. Also, the methodology of "pre-dominant land use" was adopted to derive the broad land uses. The level of details is not designed or intended for detailed analysis and comparison purposes. The figures are for general reference only. Please also refer to the associated Remarks and Notes provided in [PlanD's webpage](#).

The LUHK does not provide any information about the statutory provisions with regard to land development.

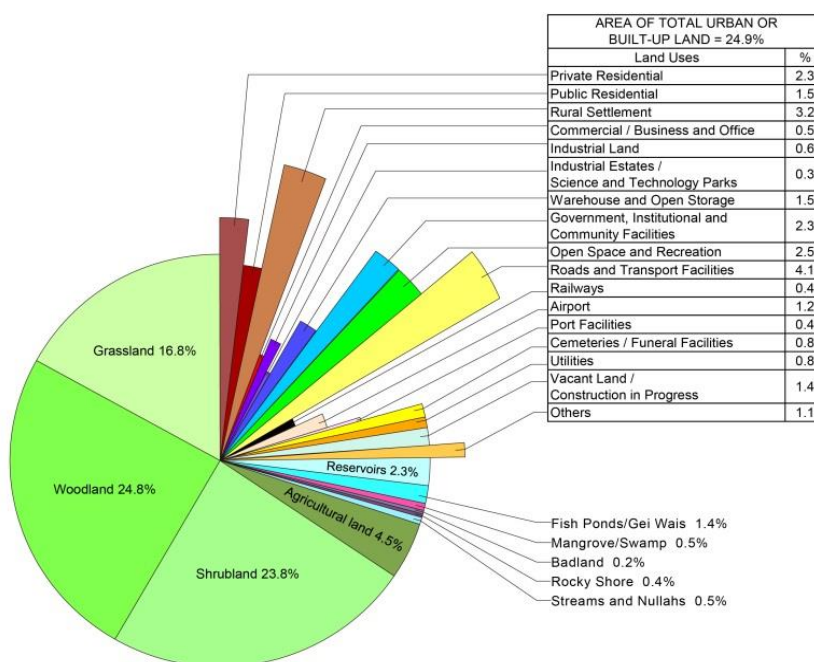
While endeavours have been made to ensure the accuracy of the data, no express or implied warranty or representation is given to the accuracy or completeness of the data or its appropriateness for use in any particular circumstances.

Chart 9 - Hong Kong Land Use Distribution (2018)

Land Use	Area (ha)	%	Land Use	Area (ha)	%
Residential			Other Urban or Built-up Land		
Private Residential (Note 1)	2,600	2.3	Cemeteries/Funeral Facilities	900	0.8
Public Residential (Note 2)	1,700	1.5	Utilities	900	0.8
Rural Settlement (Note 3)	3,500	3.2	Vacant Land/Construction in Progress	1,500	1.4
Commercial			Others	1,200	1.1
Commercial/Business & Office	500	0.5	Agricultural		
Industrial			Agricultural Land	5,000	4.5
Industrial Land	700	0.6	Fish Ponds/Gei Wais	1,600	1.4
Industrial Estates/Science & Technology Parks	300	0.3	Woodland/Shrubland/Grassland/Wetland		
Warehouse & Open Storage	1,700	1.5	Woodland	27,600	24.8
Institutional/Open Space			Shrubland	26,400	23.8
Government, Institutional & Community Facilities	2,500	2.3	Grassland	18,700	16.8
Open Space & Recreation (Note 4)	2,800	2.5	Mangrove/Swamp (Note 5)	600	0.5
Transportation			Barren Land		
Roads & Transport Facilities	4,600	4.1	Badland	200	0.2
Railways	400	0.4	Rocky Shore	400	0.4
Airport	1,300	1.2	Water Bodies		
Port Facilities	400	0.4	Reservoirs	2,500	2.3
			Streams and Nullahs	600	0.5
			Total (Note 6)	111,100	100

- Notes:
1. Including residential area developed by private developers (excluding village house, subsidised housing and temporary housing area).
 2. Including subsidised housing and temporary housing area.
 3. Including village house and temporary structures.
 4. Including parks, stadiums, playgrounds and recreational facilities.
 5. Including about 4km² mangrove and swamp areas below the High Water Mark.
 6. Including Country Parks, Special Areas and Mai Po Ramsar Site over about 41.7% of the land area of Hong Kong

LAND AREA ANALYSIS



Total land area = 1,111 km² (including about 4 km² of Mangrove and Swamp below the High Water Mark).
Country Parks, Special Areas and Mai Po Ramsar Site cover about 41.7% of the land area of Hong Kong.

It is clear from Chart 9 that the options to increase supply fall into three main categories:

- intrude into protected green areas, country parks etc. which is politically sensitive and highly controversial (although there may be some scope for considering degraded fringe area or zones which have become wastelands);
- create new land i.e. reclamation, which is potentially very expensive, time consuming and subject to challenge on environmental (and other) grounds and
- make better use of existing, available, land resources which is cheaper, faster and more effective.

If an increase in supply from existing land resources is considered to be the most viable solution then it is abundantly clear that:

- urban land (27,660 ha/25%) needs to be utilised more efficiently especially the limited amount available for public and private housing, and
- agricultural / fishpond / warehouse & open storage land (8,300ha/7.5%) must be developed effectively. (Note: For reference, it is understood by REDA that some 1,000 ha (12%) of this land is held by major developers of which over 50% is already in the conversion process whilst the remainder is still in the site assembly stage. Whilst undoubtedly significant it does not appear that hoarding by developers is the root cause of the housing problem as has been suggested in some quarters)

In recent years Government has made concerted efforts to increase supply through land sales and the release of sites via MTRC, URA etc, but the opportunities to maintain, let alone increase, such supply is limited. The alternative source of land exchanges/lease modifications therefore becomes ever more important, but with the exception of 2010 and 2017 (see Chart 3) this source has contributed little to the overall supply chain since 2004/5.

The key question is “why” and what options are available to increase the number of successfully completed land exchanges/lease modifications, as resolution to this problem would also indicate a possible solution to the housing problem?

Before an applicant (developer) can complete a land exchange/lease modification, the following steps must be taken:

- complete the site assembly process;
- proceed through the planning process;
- agree Basic Terms and, most importantly, a premium with the Lands Department (LandsD).

Each of these different phases have their own challenges and can be very time consuming:

Site assembly

In the urban area the challenge lies in extensive strata ownership and the increasingly restrictive application of the compulsory sale process under Cap. 545 Land (Compulsory Sale for Redevelopment) Ordinance.

Outside the core urban area (NT), consolidation of fragmented small lots, the complications of Tso / Tong land and a lack of any compulsory sale process pose the principal difficulties.

The wholesale use of Land Resumption Ordinance (LRO) has been suggested, but is not considered to be a practical solution because it:

- is only applicable to lots required for “public purpose” and plays no role in the provision of private housing so would be open to challenge if applied incorrectly;
- has very limited application in the urban area where there is enormous latent development potential yet to be realised, and
- does nothing to speed the inbuilt inefficiencies of the complicated plan-making process.

Planning

Can range from a matter of months for simple cases to a multi-year process for more complex situations.

In the urban area this is generally simpler due to existing zoning restrictions, but nonetheless often requires submissions to achieve compliance with CDA requirements, re-zoning applications, Sec.16 applications for a change of use, applications for minor relaxations to height restrictions etc.

In the case of NT farmland, it is usually necessary to go through a complicated and lengthy plan-making process under the supervision of the Planning Department (PlanD) and the Town Planning Board (TPB).

Premium

There is a well-established mechanism for processing land exchange / lease modification premiums, but the absence of a clear resolution procedure to settle

disputes on both the basis of valuation as well as the quantum of premium involved means that many modifications are not implemented or lay unresolved for years.

As illustrated in Charts 2 and 3, these issues lie at the core of the land and housing supply problem.

In summary, each Bureau and every Department involved in the development approval process has endeavoured to ensure that each of their requirements are satisfied in order to produce the best outcome for the community at large, but no official or high-level Government committee is mandated to override conflicts in order to facilitate development and produce a timely supply of land and housing. This well-intended, rigorous system means that the community pays an enormous price through the under provision of housing which becomes ever more expensive as illustrated by the charts in this paper. To quote the old adage: “Operation successful but patient died”.

There is no single panacea to solve these issues but the following steps would go a long way towards addressing the problem:

- simplify the land conversion process and the associated planning approval procedures by better and more efficient co-ordination between the various Government departments responsible for lands, planning, transport and environment-related regulations;
- the establishment of a high-level Government committee chaired by a very senior official mandated to resolve conflicts and with specific responsibility to facilitate land and housing production;
- to utilise land more efficiently by permitting higher plot ratios especially in the NT and even parts of Kowloon which the rail transport infrastructure can now support;
- expedite provision of essential infrastructure such as roads, drainage, sewage etc including re-adopting the concept of Entrusted Works whereby the private sector implements public works to requisite specification as part of a (re)development project and
- **of critical importance**, review the role of the LandsD, a private landlord not subject to public law, including the establishment of a credible dispute resolution / arbitration procedure to resolve disagreements regarding both:
 - the interpretation of lease conditions so as to be more pragmatic and realistic (a particular challenge with regard to old leases) **and**
 - the quantum of premium applicable to land exchanges/lease modification.

If the current role of LandsD is not re-defined to facilitate land conversion in both urban and rural areas, if necessary with ExCo support, it is highly likely other policy initiatives will flounder.

Conclusion/Summary

Hong Kong's housing crisis is a problem of policy and not a shortage of land.

History has shown that an effective, functioning system focussed on housing production is perfectly capable of producing 28,000 private residential units per annum and a similar level of public housing production. It is the policy failures of the last 15-20 years which have led to the crisis which the community faces today. If this situation is to be resolved then the roles of relevant Government departments have to be refocussed on working together to resolve problems and to facilitate housing production in **both** the public and private sectors. It was **the spirit of collaboration** which enabled the city to grow and prosper, to create job opportunities as well as homes for the 1,000,000+ private households existing today, this needs to be rekindled.

It is perfectly natural that Hong Kong people want better living standards and more space per capita at an affordable price, but this goal will not be achieved by means of the current regulatory regimes operating independently each with their own interpretation of "public interest". The solutions set out in this paper are not a panacea, but are offered as a basis on which to move forward and start to bring the community together again.

Corollary

The Development Bureau have now formally launched the Land Sharing Pilot Scheme (LSPS) which is aimed to address some of the challenges set out in this paper, including the provision of "one-stop advisory and facilitation services to LSPS applicants". Whilst this is clearly a step in the right direction, and implicitly acknowledges the underlying issues, this policy is focussed on very specific situations subject to tightly drawn criteria. If the challenge of housing supply is to be truly confronted, then the more innovative features incorporated in the LSPS will need to be applied to the market as a whole.

The Real Estate Developers Association of Hong Kong

18 May 2020

Acknowledgements

We would like to express gratitude to the following Government Departments for providing the information that this paper has used:

Buildings Department

Census and Statistics Department

Housing Department

Lands Department

Planning Department

Rating and Valuation Department