# Cooling Measures in the Hong Kong Real Estate Market

## An assessment on their effectiveness and market reaction

The government has introduced a number of cooling measures during the past three years. The first was the Special Stamp Duty (SSD), which was implemented in November 2010 to curb excessive property speculation and short-term trading activities in the residential sector. However, following a brief pause in the sales volume and a mild dip in property prices just after this was announced, the market began edging up again, with cumulative price growth of 11% during 2011 and 20% in the first nine months of 2012.

In October 2012, government stepped in again, this time to curb investment and buying activities attributed to non-local buyers. Its new measures included a five-percentage-point increase in the SSD rate and an extension of the restriction period from two to three years. Then, the government introduced a Buyers' Stamp Duty (BSD) for the first time ever. This imposed an extra 15% charge on top of the existing stamp duty for residential properties bought by corporate and non-local buyers.

## LATEST STAMP DUTY MEASURES

With all these measures in place, the overall sales volume fell by 23% during the last two months of 2012, yet prices remained relatively resilient. In fact, they went up by about 2% in the first month of 2013 alone, an indication that growth was accelerating once again.

On 22 February 2013, the government introduced two demand-side management measures. These took immediate effect, and they were intended to curb local investment demand, not just for residential but also non-residential properties.

**They were:**

- Doubling the existing rate of ad valorem stamp duty on most property sales. The stamp duty was increased from HK$100 to 1.5% of the transaction amount for properties valued at HK$2 million or less; whereas the highest rate of stamp duty was raised from 4.25 to 8.50% for properties valued at HK$21.7 million or more (see table below).

| Price Range | Before 23 February 2013 Stamp Duty Charge | On or after 23 February 2013 New Stamp Duty Charge |
|---|---|---|
| <HK$2 million | HK$100 | 1.50% |
| HK$2.0 - 2.4 million | HK$100 + 10% of excess over HK$2.0 million | HK$30,000 + 20% of excess over HK$2.0 million |
| HK$2.4 - 3 million | 1.50% | 3.00% |
| HK$3.0 - 3.3 million | HK$45,000 + 10% of excess over HK$3.0 million | HK$90,000 + 20% of excess over HK$3.0 million |
| HK$3.3 - 4.0 million | 2.25% | 4.50% |
| HK$4.0 - 4.4 million | HK$90,000 + 10% of excess over HK$4.0 million | HK$180,000 + 20% of excess over HK$4.0 million |
| HK$4.4 - 6.0 million | 3.00% | 6.00% |
| HK$6.0 - 6.7 million | HK$180,000 + 10% of excess over HK$6.0 million | HK$360,000 + 20% of excess over HK$6.0 million |
| HK$6.7 - 20.0 million | 3.75% | 7.50% |
| HK$20.0 - 21.7 million | HK$750,000 + 10% of excess over HK$20.0 million | HK$1,500,000 + 20% of excess over HK$20.0 million |
| Above HK$21.7 million | 4.25% | 8.50% |

- Stamp duty is now charged on an agreement of sale and purchase of non-residential properties, including commercial premises, offices, industrial premises and parking spaces. The measure aims to increase the cost of the transaction if a buyer makes a sub-sale before the date when the property is delivered.

## MORTGAGE FINANCING MEASURES

In a determined attempt to curb investment demand, the Hong Kong Monetary Authority has issued the following directives to local banks, regarding offers of mortgage financing for real estate purchases.

- **Stricter requirements for approval of mortgage loans**
  When stress testing the ability of applicants to repay loans, banks are now required to assume a mortgage rate increase of 300, instead of 200 basis points. This measure will apply to mortgage loans for all types of properties.

- **Lower maximum loan-to-value (LTV) ratios for mortgage loans for commercial and industrial properties**
  The maximum LTV ratios for all commercial and industrial properties, whether or not for self-use, will be lowered from the existing applicable levels by 10 percentage points.

- **New LTV restrictions on car parking spaces**
  The maximum LTV ratio of mortgage loans for stand-alone car parking spaces will be set at 40% and the maximum loan term at 15 years.

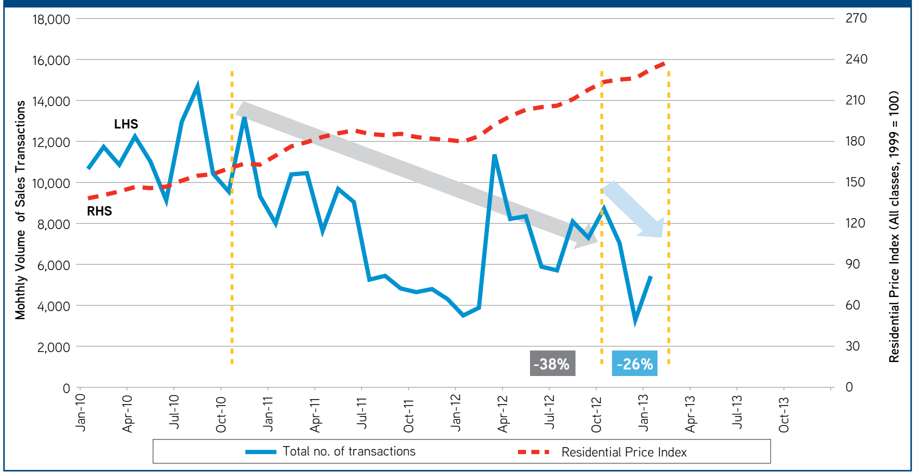
- **Measures announced by the Hong Kong Mortgage Corporation**
  The Hong Kong Mortgage Corporation has announced that only mortgage loans on properties with a value of HK$4 million or less will be eligible for the maximum mortgage insurance cover of 90% LTV. Properties with a value of HK$4.5 million or more will only be eligible for the maximum insurance cover of 80% LTV, with the cap remaining unchanged at HK$6 million.

# Colliers' Views

## VOLUME CONSOLIDATION

The average transaction volume was the most obvious indicator of the market's reaction to previous government measures to cool short-term trading activities and buying demand from non-local purchasers. For example, the average volume of residential sales transactions fell by 38% during the 22 months from the date when the SSD was first implemented in November 2010 and its revision in October 2012. The volume dipped further by 26% within three months of the introduction of BSD and the extension of SSD in October 2012.

HONG KONG RESIDENTIAL SALES TRANSACTIONS




*Source: Land Registry; Rating and Valuation Department, HKSAR Government*

In effect, prospective buyers factored these additional charges into their total acquisition costs with the expectation that further capital appreciation would remain intact. This is demonstrated by the fact that prices started to edge up again, despite mild corrections just after each new measure was announced.

We therefore believe the same is going to happen again after the latest measures, even though the level of stamp duty has doubled with the latest cooling measures in February 2013.

## DESPERATE SELLERS

There has recently been speculation in the market that the next interest rate cycle will come earlier than expected. Realistically, even if interest rates do rise, they are unlikely to go back up to the pre-global financial crisis period levels in the near future. With interest rates remaining well below inflation, most vendors will continue to enjoy good potential capital growth on their real estate assets, and there is no compelling reason for them to sell at a discount.

## THE IMPACT OF LOWERING LTVS

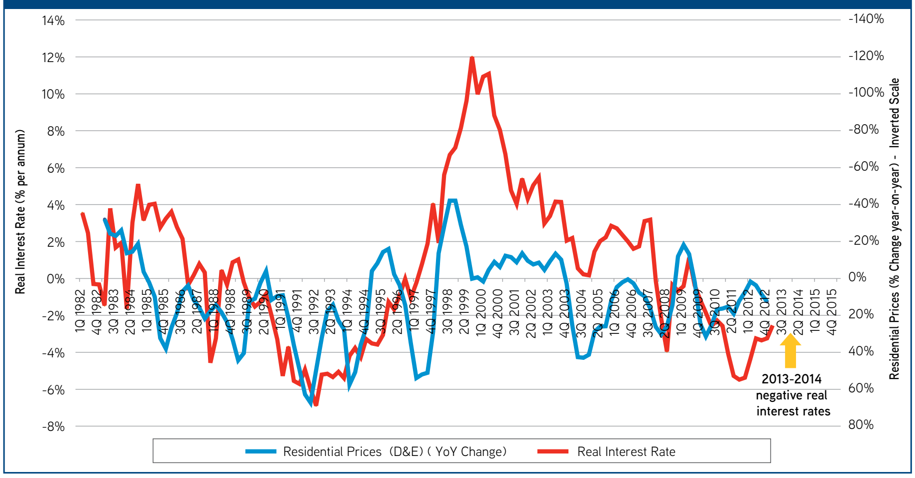
Regarding the availability of mortgage financing, the further lowering of LTVs implies that local banks have built up even stronger firewalls to protect the system from any unforeseen market volatility. However, we question the effectiveness of marginally decreasing the overall LTVs from 50 to 40%. Most purchasers are not constrained by their access to debt.

Distressed sales will remain rare, since over-leveraging of real estate has been largely limited by the prudent lending policies that banks have been implementing in the past couple of years.

## BET ON THE GOOD MACRO-ENVIRONMENT

With no dramatic change in the external environment, such as interest rate and market liquidity, we believe property prices may undergo a short-term correction, but they will rise again during the rest of 2013. Prospective real estate buyers will be willing to bear a higher transaction cost, and it is unlikely to deter them from entering the market as their expectations of potential capital appreciation are supported by positive fundamentals in the macro-environment.

**HONG KONG RESIDENTIAL PRICE GROWTH**
(vs REAL INTEREST RATES)




*Note: Real Interest rate = 3M-HIBOR minus Composite CPI*

*Source: HKSAR Government*

According to our research, residential prices are negatively correlated to the trend in real interest rates. Given the expectation that real interest rates will remain in the negative zone, residential prices are likely to rise, although a short-term correction of about 10% is possible.

## DON'T FORGET THE LEASING MARKET

With all of these demand-side measures in place, prospective buyers, including genuine end-users, are expected to stay on the sidelines, and some might resort to the leasing market. The shift of demand from the sales market to leasing will mean an increase in rental rates, which will in turn boost capital values. That will result in the complete opposite of the original objective of all the government's cooling measures.

## GO FOR CHEAPER UNITS

The differences in stamp duty between price brackets will mean less-expensive residential properties will become more appealing to investors. For example, buyers will have to pay a 4.5% stamp duty for residential units priced at HK$4 million or below compared to the maximum 8.5% for higher-priced units. We believe this will deepen market segmentation, with more-significant price growth in the lower-price segment.

## LOOKING FOR OPPORTUNITIES IN OTHER ASIAN MARKETS

The increase in stamp duties and the impact of SSD and BSD lead us to believe there is only very limited room for short-term investors to play in the local residential market. The government is now actively monitoring developments in the non-residential property sectors as well. Hypothetically, if it implements similar SSD and BSD in non-residential real estate sectors, we would not rule out the possibility that real estate players, including some long-term investors, will leave Hong Kong to seek real estate opportunities with better risk-adjusted returns in other markets.

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