Savills World Research
Hong Kong

Asian Cities Report
Hong Kong Residential

1H 2015

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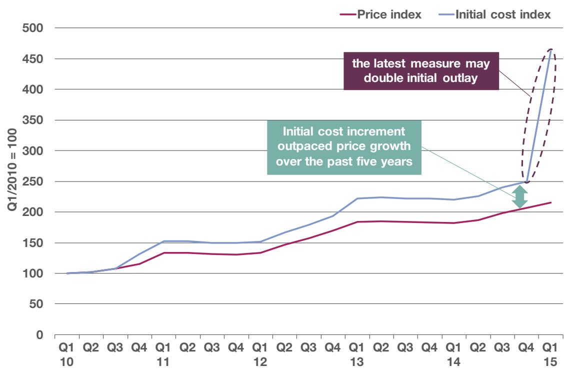
GRAPH 1

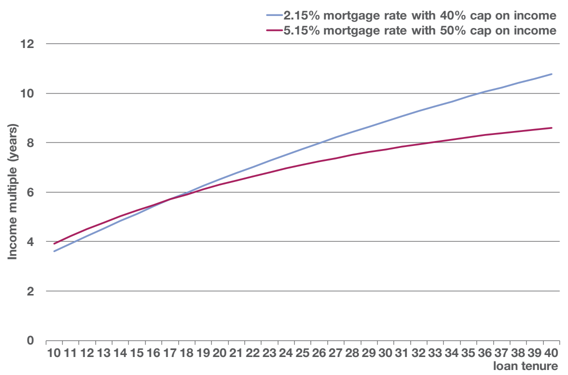
Initial cost, Q1/2010–Q1/2015



Source: ERPC, HKMC, IRD, Savills Research & Consultancy
Note: For illustrative purposes this calculation is based on a 284-sq-ft unit in Cityone Shatin.

GRAPH 2

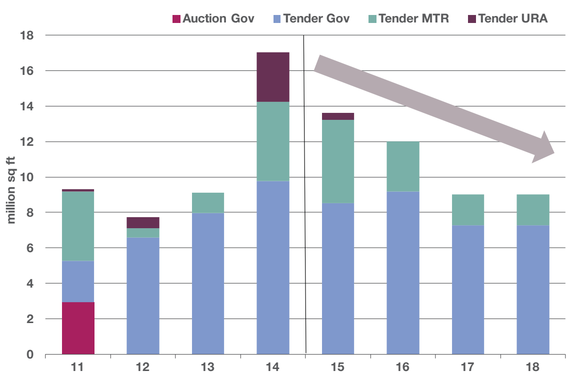
Stress test for residential mortgages, Q1/2015



Source: HKMA, Savills Research & Consultancy

GRAPH 3

Shrinking land supply, 2011–2018E



Source: Lands Department, Savills Research & Consultancy

New policies target residential LTVs

On February 27 2015, the Hong Kong Monetary Authority (HKMA) and the Hong Kong Mortgage Corporation (HKMC) announced the latest round of prudential measures on property mortgages, which are summarised below:

HKMA

- The maximum loan-to-value (LTV) ratio for self-use residential properties with value below HK$7 million will be lowered by a maximum of 10 percentage points, i.e. the highest LTV will be reduced from 70% to 60%.

- The maximum debt-servicing ratio (DSR) for borrowers who buy a second residential property for self-use will be lowered to 40% from 50%, and the stressed-DSR cap will be lowered to 50% from 60%.

- The maximum DSR of mortgage loans for all non-self-use properties, including residential properties, commercial and industrial properties and car park spaces, will be lowered to 40% from 50%, and the stressed-DSR cap will be lowered to 50% from 60%.

HKMC

- The maximum Mortgage Insurance Policy (MIP) cover for eligible properties will be reduced from 90% LTV ratio to 80% LTV ratio, except for those first-time homebuyers with a regular salary and stronger repayment ability.

While most previous measures were aimed at curbing escalating residential prices and to make lives easier for first-time homebuyers, these new measures suggest an acknowledgement by the government that these in fact may have had some negative impact on users and first-time homebuyers. What exactly is the impact this time round?

Intended impact: residential down payment to double and residential sector to feel the heat

The most significant impact is the LTV reduction for small lump sum (>HK$7 million) buyers, who may face a doubling of their down payment after the measures come into effect, assuming these buyers need to top up their bank LTV by MIP from HKMC. In fact, even before the latest measures, given the various previous measures which increased transaction costs, the total initial cost of purchasing a small lump sum property has risen by 150% from Q1/2010 to Q4/2014 – faster than the price increment over the same period (105%), assuming 70% LTV and 20% MIP. If the same premises is bought today, while prices may have risen by another 5%, the total initial cash outlay will have increased by 85% (maximum) under the new measures.

The lowering of the stress DSR cap, on the other hand, does help lower gearing of these first-time homebuyers, in particular those on a longer mortgage tenure, thus protecting these cash-strapped buyers from overstretching themselves with longer mortgage terms. From Graph 2 we can see that for a mortgage tenure lower than 18 years, the stress test has no impact as the borrowing ability of the buyer is capped by the 40% income cap on the original mortgage rates (assumed to be 2.15%). The stress test prevails for a mortgage tenure longer than 18 years, capping the loan amount at a range of six to eight-and-a-half years of income for a mortgage tenure of between 19 and 40 years.

The impact of the new measures is again focused on residential, as most commercial mortgages were with LTV below 30% even before this latest round of measures, with strict stress tests on DSR already. A recent example saw a buyer wanting to apply for a mortgage on a Grade A office premises in a decentralised area with a purchase price of around HK$60 million, with a HK$150,000 monthly rental income (around 3% yield). The bank granted a loan amount of around HK$20 million (30% LTV) with a 3% mortgage rate and 15-year tenure, meaning the monthly instalment was around HK$140,000 per month. The bank required the purchaser to provide a steady income proof of around HK$350,000 per month for such a mortgage deal to go through, which already represented a 40% income cap for the normal rate and 50% income cap for the stress test rate (normal rate + 3%).

While widespread anticipation of the latest policy is expected to impact volume rather than price, we believe the actual impact of such a policy is much more profound and has yet to be reflected.

Actual impact 1: More pressure on residential land supply?

The lowering of banks' as well as MIP's LTV would only shrink the pool of potential buyers (due to insufficient down payment) in the secondary market. For primary launches, developers can offer second mortgages to top up the decreased LTV (subject to the passing of stress tests). Therefore, cash-strapped buyers would flock to the primary market, increasing demand for first-hand properties.

As the amount of primary launches is dependent on developers' pipelines, of which a majority comes from government land sales and MTR projects, increasing demand for first-hand properties would ultimately exert more pressure on the government to provide more land supply for residential developers. This is something which is increasingly harder to come by, with over half of the 29 residential land plots earmarked for sale this year not yet zoned as residential, and fewer MTR/URA projects that can be launched.

In fact, a top-down strategy to focus on providing as much residential land supply as possible from the current government regime has already suppressed the government's position as the sole land supplier, making it a price taker in land sales over the past few years. The extra pressure created by the latest measures would only amplify such an impact and further undermine the government's ability to negotiate land prices / land premiums with developers in future land sales.

Actual impact 2: Shoebox apartments to become even more popular?

With the down payment ratio increased, first-time homebuyers can only afford smaller lump sums and that gives developers further incentives to build smaller, 'shoebox' apartments to tie in with buyers' deteriorating financial abilities. Almost all recent primary launches have devoted a portion of units to studio flats and one-bedroom units of 200 to 300 sq ft. On paper, more units will be supplied from the same amount of land (which may or may not be the government's intention) and more first time homebuyers can buy their own homes, albeit with smaller unit sizes.

Actual impact 3: Money lenders' party time?

As the LTV for the small lump sum apartments is lowered, more first-time homebuyers, if not purchasing primary projects, may switch to 'money lenders' (the less-regulated financiers) for second mortgages to avoid the strict LTV and stress test requirements from banks. Such 'off-radar' financing may in turn increase the risk in the entire financial / banking system, working against the HKMA's original intention.

Actual impact 4: Wealth disparity to widen?

The measures may also widen the wealth disparity as purchasers with equity (stored in a prior property) could easily outmuscle their first-time counterparts to access bank financing for the below HK$7 million market, meaning their wealth can accumulate at a much faster rate if the property market continues its current rally.

With a portion of first-time homebuyers being forced to stay put (again, this may or may not be the government's intention), they become a core tenant group to existing landlords, which would further decrease incentives for these landlords to sell off their investment properties – meaning even less secondary stock will be available for sale in the foreseeable future. Secondary prices would become more resilient to market downturns (e.g. interest rate hikes), with first-time homebuyers needing to wait even longer and therefore completing a vicious circle.

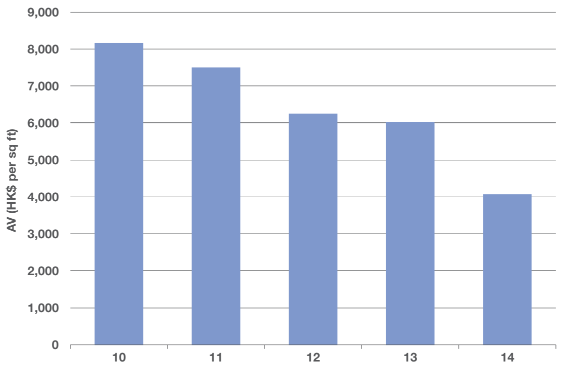
Is there a way out?

Of course these 'actual impacts' are only hypothetical and may not happen at all. Nevertheless, from the introduction of the Special Stamp Duty (SSD) at the end of 2010, when the then Chief Executive targeted bringing residential prices down by 30%, to the latest measures which aim to deter less affluent homebuyers from the mortgage market, we can see a clear shift in the government's agenda in launching these different measures: from simply trying to curb price growth to suppressing property purchasing and waiting for a market correction (to be caused by interest rate hikes, a hard landing of the Mainland economy, another black swan event in the global economy, etc.).

Given the 'effectiveness' of the previous rounds of measures, with residential prices rising by 70% from Q4/2010 to Q4/2014, and the record high transaction value achieved in the primary market in 2014, it remains to be seen if the most recent round of measures will achieve their intended aims, or if any of the anticipated 'actual impact' materialises. With most major economies around the globe (except the U.S.) stepping up their own versions of Quantitative Easing, and with upcoming supply to be normalised rather than substantially increased, the 'waiting game' prompted by the latest policies may be much longer than the government has anticipated.

GRAPH 4

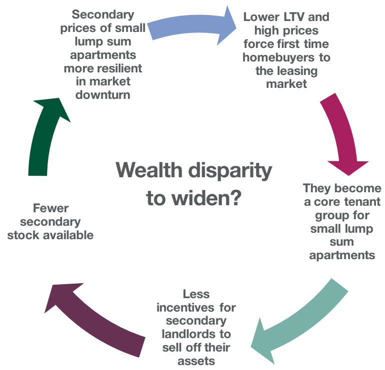
Land price trend, 2010–2014



Source: Lands Department, Savills Research & Consultancy

GRAPH 5

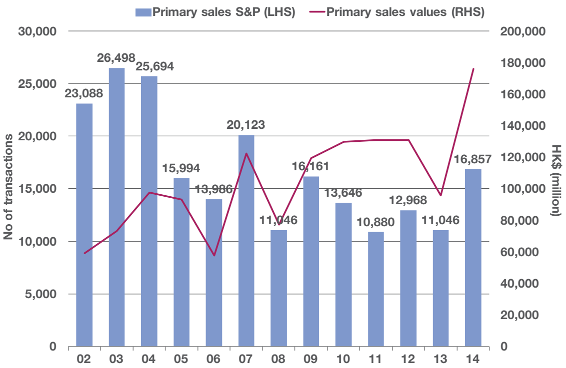
Vicious circle for wealth disparity



Source: Savills Research & Consultancy

GRAPH 6

Primary value and volumes, 2002–2014



Source: Rating and Valuation Department, Savills Research & Consultancy

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