

The Future of Hong Kong's Residential Market: Polarisation and Segmentation

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Abstract

The objective of this paper is to analyse the possible future changes in Hong Kong's private residential property market. We begin by introducing some background information of Hong Kong's residential market. We then go on to present two possible structural changes in the private residential property market. First, the price differentials between luxury and mass residential properties are anticipated to widen. Second, the price differentials between new and old residential properties are also expected to be more segmented, as the speed of building obsolescence will accelerate due to technological advancement and modification of building control regulations.

Keywords: residential property market, price differentials

Introduction

Hong Kong is a densely populated city, a large number of very similar high-density developments located in a very small urban area. It is a common belief that the performances of the all-private residential properties are very similar, irrespective of their physical characteristics and locations. This might have been the case in the past. However, recently, there seems to be evidence that the residential markets are becoming more segmented (Chau and Lam, 1997). This paper analyses the potential diverging trends in Hong Kong's residential market and examines the implications of such diverging trends.

The local residential units have been officially categorised as five classes according to the size of the units (Rating and Valuation Department, 2001). Table 1 shows the classification of housing units in the private housing sector. Class A units are often referred to as small or mass residential units. They constitute approximately 35 percent of the total number of private residential properties in 2000 (Figure 1). Demand for Class A unit is mainly from end-users who are first-time homebuyers or from the lower income groups. There is very little investment demand for small units, resulting in a relatively inactive rental market. Investors are less willing to purchase small units for four reasons. First, the rentals of small residential units were subjected to rent control until recently (Chau, 1997). Second, leasing smaller units entails a higher risk as tenants of such units are usually individuals from the lower income group and the default risk is relatively higher. On the other hand, tenants of larger units are usually institutions or large company. The default risk of these tenants is comparatively lower. Third, larger units are often located in traditional prestigious residential areas with a pleasant environment that is very much favoured by the higher income expatriate working in Hong Kong. The rental demand for larger units is therefore higher making them a more attractive investment than

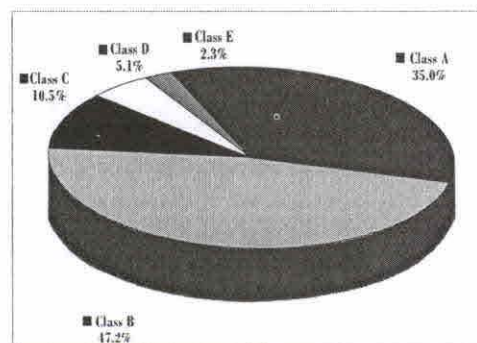
small units. Fourth, the search costs (such as the costs of inspection of unit and collecting information on the nearby environment) for small and large units are similar in absolute terms; therefore the search costs of a small unit relative to its value are higher.

Table 1. Classification of Private Residential Properties by Size (usable floor area)

Housing Class	Size
Class A	<40m ²
Class B	40-69.9m ²
Class C	70-99.9m ²
Class D	100-159.9m ²
Class E	≥160m ²

Source: Rating and Valuation Department. Property Review. Government of the Hong Kong Special Administrative Region, various issues.

Figure 1: Distribution of Private Housing Stock as at the end of 2000



Note: Total number of units 1,026,125

Class D and E units are often referred to as large or luxury units in Hong Kong. They are limited in supply and constitute only approximately 7.4 per cent of the total stock of housing units. Demand for large units is from both the investors and owner-occupiers. Compared with the small units, the proportion of owner-occupier is much smaller for large units. Official figures reveal that the average proportions of newly completed rental-occupied units for Class D and E are 41 and 70 per cent respectively, which are significantly higher than that of Class A units (21 per cent) during the period 1990 - 2000 (see Table 2).

The rental market for large units is much more active than for small units since most employees cannot afford to purchase larger units. Even after the crash in the stock and property market in 1997, the price of a large unit in good location by the mid-1998 was still higher than US\$1,000 per square foot, which was beyond the reach of an average household in Hong Kong.

Compared with the small units, the price appreciation is higher for large units but this sub-sector of the market is more volatile (see Table 3). This is, however, not unique to Hong Kong. Carson and Kiel (1990) have shown that there are significant differences in price appreciation between cities, physical characteristics and even owners' characteristics. In particular, their study suggests that larger houses experience

higher rates of appreciation than smaller ones. In a related study, Smith and Tesarek (1993) have found that during a long boom period in Houston (1970-1985), the real average unit price increased by 27 per cent for high quality houses while the rise in prices for low quality units was only 14 per cent. During the downturn (1985 - 1987), the decline was larger for the higher quality units.

Due to the domination of owner-occupiers, the small unit sub-sector is also characterised by lower vacancy rates. The higher vacancy rates for large units are also a result of higher proportion of short-term investment and speculative activities in this sub-sector. Table 4 shows the vacancy rates of the mass and large units for the period 1990-2000. The vacancy rate of small units was consistently lower than that of large units.

Table 2. Mode of Occupation for New Domestic Units after Completion (% of total)

Year	Small Units		Large Units	
	Class A	Class D	Class E	
	Owner occupied	Renter occupied	Owner occupied	Renter occupied
1990	78.5%	21.5%	52.0%	47.9%
1991	84.4%	15.5%	52.2%	47.8%
1992	83.0%	17.0%	51.8%	48.0%
1993	78.5%	21.5%	59.3%	40.7%
1994	74.9%	25.0%	52.3%	47.7%
1995	74.5%	25.4%	49.9%	50.1%
1996	72.4%	27.6%	69.5%	30.5%
1997	80.2%	19.8%	68.4%	31.6%
1998	83.3%	16.7%	54.9%	45.1%
1999	74.9%	25.1%	67.9%	32.1%
2000	86.0%	14.0%	74.9%	25.1%
Average	79.1%	20.8%	59.4%	40.6%
				30.1%
				69.9%

Source: Rating and Valuation Department, Property Review, Government of Hong Kong Special Administrative Region, various issues

Table 3. Average Price Appreciation and Risks 1980:Q1 - 1997:Q4

	Small Units (Class A)	Large Units (Class D/E)
Capital Return (p.a)	11.5%	12.7%
Price Volatility (Std dev)	15.8%	23.9%

Source: Figures compiled from the price indices constructed by the Rating and Valuation Department, Government of the Hong Kong Special Administrative Region.

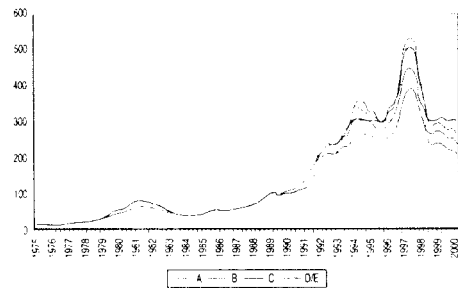
Table 4. Vacancy Rates of the Mass and Luxury Residential Units (% of total)

Year	Small Units		Large Units	
	Class A	Class D	Class E	
1990	2.0%	6.0%	6.5%	
1991	1.9%	4.8%	8.0%	
1992	2.8%	4.5%	4.5%	
1993	2.6%	3.2%	5.3%	
1994	3.0%	6.4%	2.5%	
1995	2.4%	6.3%	3.3%	
1996	2.4%	5.1%	4.2%	
1997	2.4%	4.8%	4.9%	
1998	2.4%	7.2%	8.4%	
1999	4.2%	6.0%	6.1%	
2000	3.8%	8.1%	6.1%	

Source: Rating and Valuation Department, *Property Review*, Government of Hong Kong Special Administrative Region, various issues

Market Conditions

Figure 2 exhibits the price trends of the five categories of the private residential properties in Hong Kong for the period 1975:Q1 -2000:Q2. The prices first peaked in 1980, bottomed out in 1984, and have been rising since then, except for brief corrections in 1989, 1993, 1995 and severe downturns in 1997 and 1998. Despite the anti-speculative measures adopted by the government in the mid-1994, property prices have been generally on the upward trend until the second half of 1997². With rampant speculation, prices of residential properties skyrocketed to new highs in the mid-1997, more than 30 per cent over the fourth quarter of 1996. Demand for residential property remained strong. Some 115,700 housing units were transacted. New residential developments were over-subscribed. On the other hand, rental levels only rose marginally, resulting in a fall in residential yield from 3.5 - 4.5 per cent to 2 - 3 per cent (Chesterton Petty, 1999). Housing affordability therefore deteriorated significantly and price escalations posed the threat of creating an overheated economy.

Figure 2. Price Index of the Residential Market Sub sector

On 8 October 1997, the Chief Executive announced three targets to stabilise the “property market: (i) increasing housing production to at least 85,000 units by 1999/2000; (ii) achieving home-ownership rate of 70 percent by 2007; and (iii) reducing average waiting time of being offered a public housing unit to 3.5 years by 2004. Meanwhile, starting 1 July 1997, the restriction on new land supply of 50 hectares imposed under the Annex III of the Sino-British Joint Declaration was lifted. The government therefore planned to increase land supply significantly to speed up housing production. Although the public did not expect the new administration to adopt restrictive measures to regulate the property market, the extent of further escalation in property prices was limited. Indeed, the immediate effect of the announcement was a reduction in transaction volume, from 22,700 units in June 1997 to 15,300 units in July 1997. However, the decline in property prices was mild, and recovery took place towards the end of the third quarter.

Following the Asian financial turmoil in mid-1997, Hong Kong property market, as a whole, witnessed a slump. Interest rates were high and the lending policy of the retail banking sector was tight. As for the luxury residential property sector, investors/speculators actively participated in the stock market. Due to the losses on the stock market, together with the tight credit constraint, many had to liquidate their property holdings.

During the first three quarters of 1998, the residential property market was sluggish, especially for the second hand market, due to the economic depression and volatile external environment. Some 80,000 transactions were recorded in 1998, a decline of 47 per cent over 1997. With respect to capital depreciation, capital values for luxury residential property dropped by 40 per cent. The economic downturn also led many sellers to the leasing market as a way of retaining some form of cash flow until there was a signal of market improvement. Generally, the residential property price index dropped from 433 in the third quarter of 1997 to 253 in the fourth quarter of 1998, with an accumulated decline of 41.6 per cent. At the end of 1998, prices of large flats in popular developments in urban areas were 37.3 per cent lower than they were a year earlier. Prices of small to medium-sized units in urban areas fell 36.1 per cent during the same period. In popular developments in the New Territories, prices of large flats fell 35.3 per cent during the year while those of small to medium-sized flats fell by 35.1 per cent (SCMP, March 10, 1999).

To speed up sale, competition for buyers urged local developers to offer new flats at close to cost or even below prices in the secondary market during 1998/1999. As housing supply (including the unsold units in 1998) amounted to 40,000 units in 1999, together with 25,000-30,000 new completions offered to the market at the second half of 2000, it has been a general belief that the excess supply of residential property would depress any rise in prices in 2000. Compounding the situation was that there were 60,000 vacant units of residential properties. Indeed, buyers are not likely to enter the property market until there are some indications that the market has reached its trough. The situation suggests that after the Asian financial crisis, property has no longer been viewed as an investment hedging against inflation. This would effectively reduce speculative demand and transaction volumes for residential property.

Competition among banks for mortgage business intensified recently. Banks in Hong Kong have never offered mortgages to buyers of new private developments at rates below costs. On 2 April 1999, at the sale of Cheung Kong (Holdings) Laguna Verde flats in Hunghom, some banks offered mortgages at costs significantly below the prime rate. Chekiang First Bank offered buyers a mortgage rate as low as 7.75 per cent for the first six months of the mortgage loan, which was 1 per cent below the best lending rate of 8.75 per cent. Loan war among banks continued in the second half of 1999. The price war in the home loan market flared again in August 1999, with one of the leading banks - Hang Seng Bank Ltd. raising the level of cash-rebate incentives for new mortgage borrowers to 0.75 per cent of the loan from the previous 0.5 per cent (SCMP, August 28, 1999).

In the first half of the new millennium, economic conditions slightly improved. Real GDP growth reached a rate of 14.3 per cent in the first quarter. Pressure on deflation alleviated as the composite Consumer Price Index (CPI) declined by 4.5 per cent in June when compared to a 6.1 percent drop in September 1999. The employment rate also decreased from 6.2 per cent in October 1999 to 5 per cent in June 2000. In mid-February 2000, average prices of small-to-medium sized residential properties rose 4 per cent over the fourth quarter of 1999 (at \$3,950 per square foot).

In April 2000, the Rating and Valuation Department announced that the completion of private residential property exceeded the annual target of 35,000 private units set by the Chief Executive in October 1997. Overall vacancy rate was 5.4 per cent in 1999. Annual completion is estimated to be 25,790, 27,756 and 29,653 units for the fiscal years 2000-2002. These negative sentiments, together with the volatility of the US Nasdaq Index before the end of the first quarter, and a poor government land auction of a mass residential

site in West Kowloon Reclamation area sold at 30 per cent below market price expectation in April, caused property prices to fall by 6-8 per cent to between HK\$3,360 and HK\$4,370 in the second quarter of 2000 (Vigers GVA Worldwide, 2000a). On the other hand, luxury property prices were not seriously affected by the poor sentiment in the mass residential market. Average prices for luxury residential property rose by more than 3 per cent to HK\$8,000 per square foot in the first six months. The rise in prices was a result of limited supply, which was comprised of less than 10 per cent of the total annual residential property supply.

On 30 June 2000, the Chief Executive of the Hong Kong SAR Government announced the suspension of the annual target of 85,000 residential units with a view to stimulating the property market. The Home Ownership Scheme (HOS)¹ projects originally scheduled for disposal for the remaining of 2000 were also suspended. Moreover, the supply of HOS units will be cut by 16,000 units in the next four years. Meanwhile, economic conditions slightly improved, with the unemployment rate falling from 6 per cent a year ago to 4.5 per cent in December 2000. Market sentiment heated up immediately after these announcements and major developers resumed to raise the selling prices of residential developments. During the second half of 2000, average prices of small-to-medium sized residential properties rose by 3 per cent to between HK\$3,260 per square foot to HK\$4,270 per square foot. Demand for luxury residential properties from end-users and investors were also increased. At the sale of a major luxury residential project "The Leighton Hill", all 544 units were sold within weeks, with some sold for prices as high as HK\$14,000 per square foot. By the end of 2000, average luxury residential property prices rose to HK\$8,200 per square foot (Vigers GVA Worldwide, 2000b).

In the first quarter of 2001, average prices of small-to-medium sized residential properties did not change much relative to the end of

2000. As local interest rates were cut three times, bringing the best lending rate and mortgage rate down to 8 per cent and 5.75 per cent, homes were more affordable. In February, the Government issued a package of measures with a view to reviving the private residential market. First, the monthly income ceiling for families applying to purchase HOS units was lowered from HK\$31,000 to HK\$25,000, with the objective of driving more families back to the private property market. Second, the Government limited future residential property supply by restricting land supply for residential development. As a result, only 10 lots of land, with the total site area of 5.13 hectares and the capacity of providing 1,000 units will be put for auction in 2001/2002. Third, all anti-speculative measures were lifted for a 6-month trial period.

The immediate effect was the improved market sentiment, as the general public believed that the Government was trying to revive the private residential market. Mass residential property prices in prime areas rose slightly by less than 10 per cent in February 2001 as buyers were still cautious. However, when the sentiment cooled down, the prices actually fell by 3 per cent between HK\$3,160 and HK\$4,170 per square foot at the end of the first quarter, when compared with the end of 2000 (Vigers GVA Worldwide, 2001). The positive effect of government intervention was a 130 per cent surge in transaction volume to 11,412 cases recorded in March when compared with the previous month. On the other hand, despite the fact that investment for luxury residential properties was active during the first quarter of 2001, its capital value remained more or less unchanged when compared with the end of 2000, at an average of HK\$8,200 per square foot (Vigers OVA Worldwide, 2001).

Future Trends in the Housing Market

Given the current market conditions and governmental housing policies, we anticipate that two phenomena will emerge in the private

residential property market in the future. First, the price (\$/floor area) differentials between luxury and mass residential properties will widen in the future. Second, the prices of new and old residential properties will also diverge, as the speed of obsolescence of buildings will accelerate due to technological advancement and future change in building control regulations.

a. Increasing price difference between small and large units

- *Polarisation of Income Distribution*

Income distribution will continue to polarise due to the continuing restructuring of the economy resulting from the economic reform in Mainland China. Since the early 1990s, the manufacturing industry in Hong Kong has been contracting in terms of labour employment and income generation. The labour force of the manufacturing sector grew from 591,659 persons in the first quarter of 1975 to 942,819 persons in the second quarter of 1981 and thereafter fell to 245,457 persons in the fourth quarter of 1998. During the same period, the income share of the manufacturing sector as a percentage of GDP reached its peak at 28.3 per cent in 1979 and then dropped to only 8 per cent in 1998 (Census and Statistics Department, 2000). These two indicators suggest that given the rising production costs and the "Open Door Policy" of China, many local industrialists have relocated their routine production lines to the Southern part of Mainland China so as to take the advantages of cheap labour and factory premises.

Recently, negotiations have been carried out to determine whether China is allowed to join the World Trade Organisation (WTO). For China, one of the benefits of joining the WTO is the

entitlement to Most-Favored-Nation (MFN) treatment by other WTO members. This will reduce uncertainties in trading such as those arising from the annual renewal of China's normal trading right status with the US. According to the agreement between China and US, US has agreed to phase out the quota on Chinese exports of textiles and garments during the next 5 -6 years. In other words, China will be treated like other signatories to the Agreement of Textiles and Garment (which is a multi-lateral agreement to phase out the Multi-Fiber Agreement by 2005).

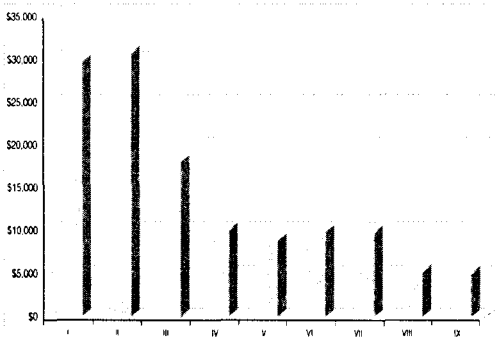
Local industrialists who relocated their production lines to China have benefited from the open door policy of Mainland China. With China joining WTO, many of them will find that their products are even more accessible to international markets. On the other hand, the lower income group in Hong Kong, whose productive skills can be easily replaced by cheap labour in the Mainland, will have difficulty in adjusting to the economic transformation.

The current economic reform and development in China, which require a lot of specialists and financing, will create numerous job opportunities for local professionals in legal, financial and information technology fields, such as lawyers, accountants, and computer engineers. In order to compete with other Asian countries, Hong Kong, as an international financial centre, is anticipated to transform into a knowledge-based economy with high demand for specialised skills and knowledge, especially if China joins the WTO.

This restructuring of Hong Kong's economy is likely to continue in the future. The result is that the income growth for the lower income group will be slower compared with that of

the higher income groups. Figure 2 reveals the income distribution by occupation in the first quarter of 2001. The monthly earning of a professional is 5.6 times that of a worker in elementary occupations category, and 6.2 times that of a worker in other categories. In the future, it is expected that such income spreads between professionals and ordinary workers will continue to widen.

Figure 2. Median Monthly Earnings by Occupation (HK\$)



Notes: I: Managers and Administrators; II: Professionals; III: Associate Professionals; IV: Clerks; V: Service Workers and Shop Sales Workers; VI: Crafts and Related Workers; VII: Plant and Machine Operators, and Assemblers; VIII: Elementary Occupations; IX: Others

- *Limited Supply of Luxury Units*

The supply of luxury units is relatively fixed (at least in the short run) due to the limited supply of “prestigious locations”. Luxury units are not simply large residential units in any location. They have to be located in expensive prestigious residential area in order to meet market demand. Therefore, large units tend to concentrate in prestigious areas. The formation of prestigious location is a rather complicated issue that involves sorting of different income groups and evolves slowly over time. This slow process makes the supply of luxury unit much more inelastic than that of mass residential unit. Official

figures suggest that the average annual completion of Class A unit is 4 times of Class D unit, and 12.6 times of Class E unit during the period 1991-2000. Furthermore, as shown in Figure 1, the total housing stock of Class A unit is approximately 7 times of that of Class D unit and 15 times of that of Class E units, which suggests that the supply of large units has increased (relative to small unit) recently.

- *Change in land supply policy*

The supply of residential units as a whole is becoming more elastic due to a change in the land supply policy after the mid-1997. Before the return of the sovereign of Hong Kong to China, the new land supply was constrained by the Annex III of the Sino-British Joint Declaration. Under the agreement, the maximum bound of new land sale by the Hong Kong Government was restricted to 50 hectares of land in a single year during the transition period between 27 May 1985 - 30 June 1997. This had contributed to rapid escalation of property prices before mid-1997 and resulted in serious housing problems and Hong Kong losing its competitiveness in the region.

After the hand over on 1 July 1997, the land supply constraint was removed and we expect that the government will increase new land supply to stabilise the property market in the long run. The relaxation of this constraint will make supply of mass residential units more elastic since supply of land for luxury residential development cannot be easily increased. On the other hand, it is relatively easier for the government to increase the supply of land for mass residential development by increasing plot ratios of land lots or invest to

increase the amount of developable land in the rural New Territories. Wong et al. (1998) point out that for the period 1975 - 1985, the average plot ratio was 3.35 while the figure was 4.27 for the period between 1985-1994. There was a 27 per cent increase in average plot ratio after the Sino - British Joint Declaration. The significant increase in plot ratio was likely an attempt to offset the impact of restrictive land sale imposed by the Joint Declaration, since the development densities of the 50 hectares of new land supplied to the private sector were not specified.

The increased supply of land and future economic growth imply that there will be increasing pressure of upgrading the living standards, including increase in living space per person. This filtering up process involves selling of smaller units and buying of larger units. The demand for larger units relative to that of smaller units will increase.

- *Privatisation of Public Housing*

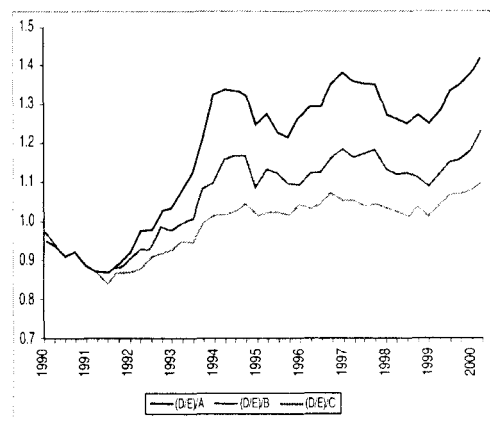
Besides the private sector, the public sector also plays an important role in providing housing accommodation to Hong Kong people. At present, more than 40 per cent of Hong Kong's population are living in public housing rental units and subsidised housing units which are sold to eligible household at a substantial discount (45 - 55 per cent of market prices). Public housing units, which are provided to the lower income groups, are generally smaller and have lower quality. Through the provision of small residential units, the government is competing with the private sector in the mass residential market. On 8 December 1997, the Hong Kong Housing Authority proposed a Tenants Purchase Scheme (TPS) to sell public housing units to sitting tenants. The

first batch of public rental estates which included Cheung On Estate, Heng On Estate, Kin Seng Estate, Wan Tau Tong Estate (in the New Territories), Fung Tak Estate (in Kowloon) and Wah Kwai Estate (in Hong Kong Island), was sold in early 1998. A total of 19,807 public rental units were sold by March 1999 (Hong Kong Housing Authority, 1999). Until now, this TPS is still in practice. The policy of privatising public housing will result in an increased supply of small units in the market place, thereby curbing the growth of the price of small housing units.

- *Implications*

The above analysis suggests that the price differentials (unit price measured in terms of HK\$/GFA) between luxury residential unit (large units in expensive locations) and mass housing (small units) are anticipated to widen in the future. This trend can be crudely measured by the ratio of price index of Class D/E (>100m²) unit to Class A (<40m²) unit. Figure 4 exhibits the price of luxury residential property as a ratio of the price of mass residential property for the period 1975:Q1 - 2000:Q2.

Figure 4. Price of Class D/E units as ratio of Price of other Class units



The figure shows that there has been an increasing trend in the ratio of price of large to small unit in recent years. The trend is more obvious for Class D and E units to that of Class A units. This trend is likely to continue in the future.

For investors, this means that the investment return on large units will outperform the market. Unfortunately, it is not possible to sell property short in the residential market, otherwise short selling small units and holding large units at the same time will be a perfect arbitrage strategy. A close substitute to this strategy is to hold stocks of the listed property companies that are known to concentrate on developing luxury residential units and short-sell the stocks of the listed property companies that are known to concentrate on developing mass residential development. However, the obvious risk of this strategy is that developers may change the focus of their business.

As the price of luxury residential property is expected to rise more rapidly than that of mass residential units, developers are advised to increase the portion of large units in their development strategy. Moreover, as “prestigious locations” for residential development are very scarce in Hong Kong, developers should try to “create” prestigious locations by adopting various marketing techniques.

b. Shorter economic life of residential property

Although economic development has grown substantially for the past 30 years, the current building regulations have not

changed much since the 1960's. Development control regulations need to be revised and amended in order to keep up with the ever-changing environmental management policy and business environment. In recent years, there is an increasing demand for more environmental friendly “green buildings”. Furthermore, the high land price in Hong Kong together with the undated development density control result in developers' maximisation of gross floor area and minimisation of circulation space. The result is that building designs are similar for different developments.

The government is now reviewing the building and development control regulations. We anticipate that there will be relaxation of various design constraints imposed by building and development controls. With the current pace of technological advancement and the changes in building and development control regulations, developers will be able to produce housing units with more innovative designs, which are more environmental friendly and more habitable in the future. Older units with design subject to old regulations and constraints will become less popular and their values will decline relative to newer units.

In the future, shorter economic life of product is anticipated due to rapid technological progress and change in taste and preferences. Older products become obsolete when new models of products are put to the market. Excellent examples are personal computers and mobile phones. Although this process is more noticeable for hi-tech products, it is equally applicable to residential units. Despite the fact that this process evolves very slowly in the housing market, we can still observe at least two examples of housing attributes that become obsolete over time. First, pre-war residential building units without flushing toilet and

lift are disappearing over the past twenty years. Second, large estate-type development has been popular since the 1980's. Nowadays, "standalone" residential buildings in Hong Kong are much less popular and are often sold at a discount to comparable units in large estate-type developments. In the future, it is expected that the speed of obsolescence of older residential buildings will increase, thus enlarging the price gap between older and newer units.

- *Implications*

Given that the economic life of properties is decreasing in the future, property investors should take this into account in the cash flow projection of property investment. The risk of investing in older units will also increase. For the developers, development is no longer just a timing problem. Product design, which is very much ignored by developers, is also an important element in the future. We expect that more resources

will be invested in the design of housing units. In the future, housing units will be less "homogeneous".

Conclusions

While speculating into the distant future is difficult, there are often hints and evidence that allow us to make bold assumptions and predict future changes. We have predicted that two phenomena will emerge in the private residential property market in the coming future. First, the price differentials between luxury and mass residential properties will widen. This is due to polarisation of economic growth with uneven income distribution, limited supply of prestigious locations, increased land supply, and privatisation of public housing. Second, due to the technological progress and the modification of building and development control regulations, the economic life of housing units will decrease. The result is that the price gap between new and old residential properties will enlarge in the future. Both predictions have important implication for property investors and developers.

Notes

1. A Task Force on Land and Property Prices was set up to control the rapidly rising property prices in the mid-1994, with the result of collectively achieving the immediate objectives of curbing rampant housing speculation and depressing property prices. During the second half of 1994, average property prices around the territory dropped by 6.8 per cent, with the greatest falls experienced in Kowloon (9.4 per cent), followed by the New Territories (6.3 per cent) and Hong Kong Island (3.3 per cent). For a description of the anti-speculative measures, please see Ho (2000).
2. For a detailed description of the Hong Kong real estate market for the period 1980 to the mid-1997, please see Chau and Ho (2000).
3. In April 1954, the Hong Kong Housing Authority (HKHA) was set up by the government to provide

cheap and low-quality rental units for those incapable of housing themselves. Since then, Hong Kong has experienced dynamic socio-economic and demographic changes. Growing economic affluence has led to aspiration for home ownership. The Home Ownership Scheme (HOS) was drawn up by the government in 1976, and was the first plan featuring public sector apartment for sale. It is the government's intention to sell apartments to better-off tenants of public rental housing and low-middle class of the general public whose household income is too low to afford a housing unit in the private sector.

4. Due to the linked exchange rate system adopted by the Hong Kong Government on October 17, 1983, the Hong Kong dollar was pegged to US dollar (US\$1=HK\$7.8). In order to keep this system operative, an increase in US interest rates is usually met by an increase in local rates. Otherwise, investors/speculators will excessively sell Hong Kong dollar and buy US dollar so that US dollar will relatively appreciate.

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