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REAL ESTATE PRICE INFLATION: LESSONS FROM HONG KONG

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by

Richard Cullen[1]

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1.0 INTRODUCTION

In cities across the developed-world, especially in jurisdictions popular with Chinese immigrants, there have been deep concerns expressed about rapid, residential real estate price inflation. It is argued that such inflation is putting home ownership beyond the reach of increasing numbers of younger, local residents seeking to buy their first home.

The media in Melbourne and Sydney, in Australia, for example, carry almost daily stories on this theme. It would seem, though, that the global "leader" in this regard may be Vancouver, in Canada. A few weeks ago, in early May, it was reported that the benchmark price for a house in the Vancouver Region was C$1.41 million (around HK$8.35 million) – up 30.1% in one year. (In fact, Vancouver's problems with excess offshore-sourced demand date back around thirty years to the time of the first major, Hong Kong Chinese immigration wave.)

The primary purpose of this essay is to review the ways in which behavior-modifying fiscal measures – in particular Stamp Duty (or any like impost) – can be deployed to help bring this problem of excessive home-price inflation under greater control. It is

2 This TLRP Tax Comment is an extended version of a short article dealing with similar issues published in the *South China Morning Post,* June 1, 2016 entitled: "Vancouver should look to Hong Kong for lessons in cooling property prices", available at: http://www.scmp.com/comment/insight-opinion/article/1959996/vancouver-should-look-hong-kong-lessons-cooling-property (accessed June 2, 2016)..

important to note, too, that such measures do not bring immediate relief – it takes some time before they begin to reshape behaviour.

Although the lessons offered by Hong Kong potentially have quite wide application, the principal comparative focus in this essay is on Vancouver, in view of the stand-out nature of the price inflation problem in that city.

The essay also, more briefly, reviews certain related issues which are associated with this public policy challenge. Included, as well, is a short discussion on why the recent innovative use of Stamp Duties in the HKSAR remains compliant with the Basic Law of the HKSAR (BL).

Part 2 of the essay, directly below, considers some basis supply and demand issues which apply. Part 3 mainly reviews certain public policy measures adopted in Hong Kong over the last 20 years aimed at restraining home-price inflation. Part 4 discusses several related matters. Concluding remarks are set out in Part 5.

2.0 SUPPLY AND DEMAND

In all three cities noted above – and in most all cities feeling this pressure (including Hong Kong) – there is a fundamental, underlying problem of demand exceeding supply. Limits on land supply, planning controls (and related complexities) and building cost increases explain much of the supply-side problem.

In all such cities, immigration is driving populations up, year after year, intensifying the demand effect. These cities are attractive in a number of ways, often in terms of providing good, value-for-money educational opportunities.

Further significant demand pressure has arisen from the low-interest-rate era which has now prevailed for most of the last decade. In 2008, Lehman Brothers Holdings, a major financial services firm in the US, filed for bankruptcy tipping the world decisively into what has become known at the Global Financial Crisis (GFC). The US financial services industry had collectively, in the years before, done more than anyone elsewhere to undermine the basic foundations of high level – and mass – financing. Many other financial institutions, especially across Europe, were willingly drawn in, however, when it all still seemed like a "good idea". The fallout from the GFC was immense (and is still being felt).

A pivotal response to help prevent this disaster from turning into an even greater catastrophe was the rapid lowering of interest rates to near-zero - plus the massive, effective, "printing of money" - by the US Central Bank, the Federal Reserve. These measures were controversial and they have provoked much debate. Our concern here is not with the wisdom of these policy-responses, however. The fact is that these policies helped drive down interest rates around the World and, at the same time, drive liquidity up, through the money-printing policy known as "Quantitative Easing". Not surprisingly, much of this freshly available, low interest funding was diverted towards real estate investment – especially in those places around the globe seen to be both safe and attractive.

When one adds into this mix a cohort of buyers who are especially "cashed-up", which, today, means Mainland Chinese above all, the notable affordability problems noted are amplified. As it happens, these Chinese buyers are often strongly focused on long-term educational opportunities, they value "safe-haven" investing and they are also used to assisting one another with real estate purchases.

3.0 RESTRAINING PRICE INFLATION

Some key supply and demand realities have been sketched out in Part 2. Even from this brief overview, one can see how complex the overall position became – and remains.

There is no "magic wand" fix for this set of problems. Hong Kong has, however, done more than most, in an effective way, to bring the problem under a level of control. There is much that Vancouver (and other like-affected cities) could learn from the HKSAR.

Hong Kong has been, in a sense, driven to deploy more innovative measures than other comparable jurisdictions due to the "hard-link" between the HK Dollar and the US Dollar. This Linked Exchange Rate System has been in place since 1983. Because of this system, interest rates in the HKSAR are essentially locked-in to US Federal Reserve interest rate policy. Thus, for more than 30 years, Hong Kong Governments have had no access to the most common public policy tool for dampening excessive speculation, raising interest rates.

Hong Kong moved over 20 years ago, in 1994, to impose Stamp Duty on each and every "flipping" transaction, involving residential real estate, which may take place before final completion. Prior to these measures being introduced in (British) Hong Kong, one could have multiple re-sales between the signing of the initial Sale and Purchase Agreement and the final Completion and Registration of Title (Conveyance on Sale). Stamp Duty, pre-1994, normally was payable only at the time of the final transaction.

More recently, Hong Kong has acted to hose-down excessive speculative activity in the residential real estate market relying on a creative use of Stamp Duties. First we had Special Stamp Duty (SSD) which took effect in 2010 which now normally imposes very hefty duties of up to 20% on any, deemed, too rapid, resale of a relevant property. Next, from 2012, we introduced Buyer's Stamp Duty (BSD) where, broadly, a non-permanent resident of the HKSAR who purchases property in Hong Kong has to pay an additional duty of 15%. Finally, from 2013, we introduced Double Stamp Duty (DSD) where any person who already owns a relevant property in the HKSAR at the time of purchase of a second (or third etc) property essentially has to pay double the regular amount of Stamp Duty.[3]

A significant affordability problem remains in Hong Kong for young first home buyers but the acceleration of that problem has been stopped and, now, in fact, residential property prices have retreated by 10% -15%.[4] It is clear that the combination of SSD, BSD and DSD has played a significant part in this outcome.

This policy approach has also reduced the "property-bubble" aspect of price inflation in Hong Kong without, so far, triggering a price collapse such as occurred so severely after the last British Hong Kong property-bubble began to burst around late 1997.

As noted above, Vancouver has seen periods of very high real estate price inflation for several decades (interspersed with notable price falls). A significant amount of

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3 All of these innovative uses of Stamp Duty in the HKSAR are very thoroughly reviewed and critically analyzed in: Chen, Jianlin "The Yet-to-be Effective But Effective Tax: Hong Kong's Buyer's Stamp Duty as A Critical Case Study of Legislation by Press Release, (2014) 10 *University of Pennsylvania East Asia Law Review*,1. See also: Chen, Jianlin "Tools for Immediate Regulatory Tax Implementation: Subsidiary Legislation vs Legislation by Press Release" 2015 *Singapore Journal of Legal Studies*, 1, where like-focussed Stamp Duty changes in Singapore are subjected to similar scrutiny. .

4 Li, Sandy, "Has the real estate bubble burst? Hong Kong flat prices return to early 2014 levels, experts say the drop will continue", *South China Morning Post,* February 2, 2016, at: http://www.scmp.com/property/hong-kong-china/article/1908528/has-real-estate-bubble-burst-hong-kong-flat-prices-return (accessed June 2, 2016).

this inflation was also driven by migration-purchases, for example when mass migration from Hong Kong to Vancouver accelerated notably after June 4, 1989.[5]

The Provincial Government in British Columbia (BC), where Vancouver is located, imposes a Property Transfer Tax (PTT) on real estate transactions. In terms of structure and operation, it is the equivalent of the Stamp Duty we pay on real estate transactions in Hong Kong. It applies at a rising rate from 1% - 3% depending on the market price of each transaction.

All of the Hong Kong measures noted above could be applied in Vancouver (using the PTT system) with a realistic expectation that a measure of control could be achieved. At the same time one could expect to see a significant swelling in public revenues, as has happened in Hong Kong.

BC still has no fully-fledged "anti-flipping" provisions within its PTT – measures designed to impose PTT on every single intermediate transaction between an initial Sale and Purchase Agreement – although it is belatedly moving to impose some quite limited restrictions (so limited, it is hard to see them having any cooling effect at all).[6]

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5 See, further: Helsey, Robert and Sommerville, Tsur, "Housing in Vancouver: Booms Busts and Bubbles" (2005) Spring/Summer *Viewpoints*, at: http://www.sauder.ubc.ca/Faculty/People/Faculty_Members/~/media/Files/Faculty%20Research/Publications/Helsley-Paper-BoomsBustsBubbles.ashx (accessed May 30, 2016).

6 Morrow, Fiona, "'Shadow Flipping' loophole to be closed, says B.C. Premier Christy Clarke, *CBC News*, March 18, 2016, at: http://www.cbc.ca/news/canada/british-columbia/christy-clark-affordable-housing-1.3497586 (accessed May 30, 2016).

As it happens, the Annual Property Tax applied in BC (equivalent to "Rates" imposed in Hong Kong and Australia) is also comparatively low.[7] This may be a further factor helping to fuel the high rate of real estate price inflation in Vancouver.[8]

4.0 RELATED MATTERS

4.1 Non-Resident Investment Restrictions

After Australia experienced a wave of (non-resident) Japanese buying of residential real estate in the 1980s, the Federal Government placed strict limits on what non-residents could buy (typically, only new properties under certain firm conditions).[9] Canada (like Hong Kong) has not imposed restrictions such as these, however. These Australian measures have worked over the last several decades, to curb the impact on local price inflation of non-resident investment in residential real estate in Australia.

They have been less effective over the last decade, approximately, however as mass migration, not least from Mainland China, has risen significantly. Chinese students have been highly prominent within the very great expansion of onshore, international tertiary students studying in Australia. Academic migration has frequently been able to be converted to permanent migration as Australia has sought to meet the demand for all manner of new professionals within an economy increasingly service and higher-technology based.

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7 "Canada's Highest, Lowest Property Taxes" *Huffington Post, Canada*, September 27, 2014, at: http://www.huffingtonpost.ca/2014/09/27/property-taxes-canada_n_5890090.html (accessed May 30, 2016).

8 See, Lane, Edward, "Vancouver's 'freak show' property market", *BBC World Service – Business Daily*, at: http://www.bbc.com/news/business-36369108 (accessed May 30, 2016).

9 See, further: *Foreign Investors- Buying a Property as a Foreigner or Temporary Resident is Australia*, at: http://www.australia-migration.com/page/Foreign_Investors_Buying_property_as_a_foreigner_or_Temporary_Resident_in_Australia/178 (accessed June 2, 2016).

4.2 Similar Singapore Sanctions[10]

Singapore first introduced a Stamp-Duty-based, behavior modification provision (similar to one later used in the HKSAR) in 1996, known as Seller's Stamp Duty (Seller'sSD), during a 1990s rapid lift in real estate values. As in Hong Kong, the Asian Financial Crisis (the commencement of which was signalled by collapse of the Thai Baht in July, 1997) sent real estate prices rather swiftly into reverse in Singapore (by 1998) and the new Seller'sSD was quickly suspended (and later repealed).[11]

Seller'sSD was reintroduced in Singapore with effect from February, 2010, as the real estate market once again entered a highly "exuberant" phase. As with SSD in the HKSAR, it imposes duties (of up to 16% since January, 2011) on any (deemed) too rapid, resale of a relevant property.

More recently, Singapore has introduced Additional Buyer's Stamp Duty (ABSD) with effect from late 2011. ABSD was further enhanced in 2013 with an impost of 15% of market value being imposed on defined foreign buyers.

As in Hong Kong, these measures have played a significant role in, first, halting what were rapid prices rises (peaking in 2013) followed by a retreat in prices of close to 10% by 2016 (which may be extended).[12]

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10 See, further, re Singapore's deployment of these Stamp Duties: Chen, Jianlin "Tools for Immediate Regulatory Tax Implementation: Subsidiary Legislation vs Legislation by Press Release" 2015 *Singapore Journal of Legal Studies*, 1.

11 See, Webb, David, "SSD, the Basic Law and a lesson from Singapore", January 30, 2011, *Webb-site Reports,* at: https://webb-site.com/articles/ssd2.asp (accessed June 2, 2016).

12 See: Mahrotri, Thakur, "Singapore Home Prices Have Longest Drop in Almost 2 Decades" *Bloomberg News*, at: http://www.bloomberg.com/news/articles/2016-04-01/singapore-home-prices-have-longest-slide-in-almost-two-decades (accessed May 30, 2016): and "Singapore home price drop in 2016 may prompt lifting or tweaking of curbs: Property Consultants" *The Straits Times*, January 13, 2016, at: http://www.straitstimes.com/business/property/singapore-

One point of comparison worth noting is that Hong Kong has long imposed the obligation to pay real estate Stamp Duty jointly and severally on buyers and sellers. From a revenue point of view this makes sense: it produces a degree of "self-enforcement" as each seller, normally, will share with the Stamp Duty Office a desire to see that each (related) buyer pays the Stamp Duty involved. BSD is an exception to this rule, however, as only the Buyer is liable in the HKSAR to pay BSD. In Singapore, the liability to pay falls on either the seller (Seller'sSD) or the buyer (ABSD). This helps explain why SSD in the HKSAR, which is most similar to Seller'sSD in Singapore, is called "Special (*not Seller's*) Stamp Duty".

4.4 New Stamp Duties and the Basic Law

Some commentators have wondered to what extent some or all of SSD, BSD and DSD may fail to comply with provisions in the BL stipulating the protection of Property Rights (Articles 6 and 105) in certain circumstances. Such concerns can be related, too, to the power to tax, generally, in the HKSAR and how that power may be constrained, not just by Article 105, but also by the exhortation in Article 108, a key tax-empowering provision in the BL, that the HKSAR should adhere "to the low tax policy previously pursued". [13]

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home-price-drop-in-2016-might-prompt-lifting-or-tweaking-of-curbs (accessed May 30, 2016)..

13 See, for example: Webb, David: "SSD, The Basic Law and a Lesson from Singapore", January 30, 2011, *Webb-site Reports*, at: https://webb-site.com/articles/ssd2.asp (accessed June 2, 2016); and "BSD and SSD 2.0 Submissions to LegCo Bills Committee on Stamp Duty (Amendment) Bill 2012", February 5-12, 2013, *Webb-site Reports*, at . https://webb-site.com/articles/stamp2012.asp (accessed June 2, 2016). See, also, Webb, David: "HK's Stamp Duty Addiction, March 2, 2010, *Webb-site Reports*, at: https://webb-site.com/articles/stampout.asp (accessed June 2, 2016).

Arguments made include that some (or all) of the new Stamp Duties may not be examples of “legitimate taxation” (drawing on an expression used by Rogers J in a Court of Appeal judgment in 2004).[14]

I support the view that the general power to tax authorized by the BL (see Articles, 73, 107 and 108) operates as an express exception to the reach of the Articles protecting property rights in the HKSAR (Articles 6 and, especially, 105).[15] In this regard, it is noteworthy that neither of the provisions stipulating a protection of property rights is contained within Chapter III of the BL “Fundamental Rights and Duties of the Residents”. The Court of Final Appeal (CFA) has found that these Chapter III rights should be given a “generous” interpretation. Other parts of the BL which would include Article 105, are meant to be applied in a (less expansive) “purposive” way.[16]

I have previously argued that it is questionable if the tax authorizing (and framing) provisions, such as Article 107 and 108 would actually be justiciable – that is, that a court would ever agree that a dispute involving these provisions, primarily, could give

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14 *Weson Investmens Limited v Commissioner of Taxation* (CACV 262/2005) at: http://legalref.judiciary.gov.hk/lrs/common/ju/ju_frame.jsp?DIS=55824&currpage=T (accessed May 30, 2016).

15 See, Jones, Oliver, “Right to Property” in (Chan and Lim (eds.)) *Law of the Hong Kong Constitution* (2nd Edition.) (Sweet & Maxwell, Hong Kong, 2011) Chapter 31.

16 *Ng Ka Ling and Others v Director of Immigration* [1999] 1 HKLRD 315. See, also: Chen, Albert H. Y. and Lo, P. Y., “The Basic Law Jurisprudence of the Court of Final Appeal” in (Young, Simon and Ghai, Yash (eds)), *Hong Kong’s Court of Final Appeal* (Cambridge UNversity Press, Cambridge, 2013) Chapter 14 (available at: https://books.google.com.hk/books?id=P5N2AgAAQBAJ&pg=PT573&lpg=PT573&dq=CFA+BL+generous+and+purposive&source=bl&ots=R3G_Lfs6qw&sig=EdmqtUKXlpjPhnfvHqh9hda0EPY&hl=en&sa=X&ved=0ahUKEwigr4ae24jNAhWFJqYKHaj5CVEQ6AEIKzAD#v=onepage&q=CFA%20BL%20generous%20and%20purposive&f=false (accessed June 2, 2016).

rise to matter on which a court could properly rule. In such a dispute questions arise, inter alia, related to standing and the (US-influenced) "political question" doctrine.[17]

Finally, a radical but CFA approved, valid option remains in the case of any doubt arising from a court decision questioning the constitutionality any of the new Stamp Duty provisions (or a taxing provision similar thereto). The HKSAR Government could seek an Interpretation from the Standing Committee of the National People's Congress (SCNPC) in Beijing, under Article 158 (of the BL) to establish a final ruling on the issue of fiscal validity under the BL.[18]

5.0 CONCLUDING REFLECTIONS

There is some a resemblance, operationally, between SSD, especially, and Capital Gains Tax (CGT). A CGT typically imposes tax on profits arising from the sale of any (non-exempted) capital assets within a given jurisdiction (with the sale of real estate assets, typically, figuring prominently).[19] A CGT is, however, fundamentally, a revenue raising tax. Moreover, putting aside the dense political challenges involved in introducing a CGT, everywhere a modern, comprehesive CGT has been

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17 Cullen, Richard, Arner Douglas, Hsu, Berry, Yang, Xiaonon and Wong, Antonietta, "Fiscal Policy and Financial System" in (Chan and Lim (eds.)) *Law of the Hong Kong Constitution* (Sweet & Maxwell, Hong Kong, 2011) (2nd Edition) Chapter 12.

18 See, *Lau Kong Yung and Others v Director of Immigration* [1999] 3 HKLRD 778, where the CFA confirmed that Article 158 of the BL confers a plenary power on the SCNPC, which covers all Articles in the BL and which may be exercised in the absence of litigation. See, also, Chen and Lo, op. cit. note 16.

19 See on the "natural" design complexity of a typical CGT: Adam, Stuart, "Capital Gains Tax" (20018) at: http://www.ifs.org.uk/budgets/gb2008/08chap10.pdf (accessed June 2, 2016). This Chapter takes 26 pages to provide a review of the development and density of the UK CGT. SSD is, of course, more harsh than a CGT in that it imposes an obligation to pay Stamp Duty on stipulated transactions based on the value of the real estate regardless of whether a gain or loss has resulted from a given sale.

introduced has required highly complex drafting, due to the intrinsic technical necessities.[20]

The behaviour-modifying impact of any given CGT will, at best, be far more indirect (and limited) than the impact we have witnessed using SSD, BSD and DSD. As taxes go, these new Stamp Duties are far more “nimble” than a CGT. They can be imposed using a relatively simple and widely experienced framework. They can be imposed swiftly (especially relying on “legislation by press release” methods, where the impost is announced to apply from a particular date – with legislation (or regulations) to follow later).[21] Similarly, they can be reduced or “switched off” swiftly. They are also powerfully, “self-enforcing”: proper title such as one needs to secure a mortgage (or later, re-sell) can only be registered after all Stamp Duties have been paid.

Measures such as these new HKSAR Stamp Duties take time to engender behaviour modification. In the case of the HKSAR, it was 4-5 years after the introduction of SSD and 2-3 years after the introduction of BSD and DSD that price falls really set in. Prior to those falls, however, the acceleration rate of price increases was diminishing. Of course, other factors also influenced these changes. But the pattern of new Stamp Duty introduction being followed by a stalling of price increases and then a real decline is plain. Moreover, this clear pattern has been repeated in Singapore.

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[20] Ibid. It should be noted that the option remains to apply a comparatively simple CGT to a single clear class of assets – for example to defined residential real estate. Such an approach can secure targeted revenue raising, though, for the reasons already given, such a tax is appreciably less likely to engender behaviour modification than the deployment of targeted Stamp Duties. (I am grateful to Stefano Mariani for explaining the possible use of CGT, in this way, in a recent discussion).

[21] Chen, op cit. note 3.

It is true that Stamp Duties are “friction-making” taxes: they impose additional, immediate transaction costs compared to a market where imposts on transactions are minimized (or removed). These measures do have certain unavoidable consequences – and a good case can be made that these consequences, in themselves, are undesirable. But to scorn, too readily, the use of such policy measures is yet another case, I believe, of “making the perfect an enemy of the good”.

Hong Kong has a long and remarkably successful fiscal history where we have often not followed the conventional wisdom on Tax Policy. We have tried, tested and retained what works. SSD, BSD and DSD come with flaws and wrinkles. Overall, however, they have proved themselves comparatively well as effective, “least bad options”.

Hong Kong still has a serious housing affordability problem, of course. Now, though, this problem is, above all, a product of the continuing excess of local demand over supply.

We should return, before closing to Canada. Might such measures as have been used in the HKSAR yet come to be applied in Vancouver in order to curb the serious public policy problems reviewed in this essay? Do not hold your breath: those doing very well from the prevailing system have long been keen financial supporters of the main Political Parties in BC. This could this explain why there is has been so much hand-wringing over the problem in Vancouver across the last several decades - but so little action – despite the regular changes of government between Conservative and Left-Liberal parties dating back to 1972.

One final, crucial, land-tax-related benefit we enjoy in the HKSAR deserves to be noted. A particularly fine bequest from British Hong Kong policy-making (implemented from 1842) is the fact that our Government retains a core proprietary interest in *all* material land across Hong Kong because of our leasehold system of land disposition. This means that, at least when there is strong or excessive growth in real estate values, the public interest is still supported in the sense that any such rising values are shared publicly through that retained government proprietary interest. In Vancouver, and virtually the entire Developed World, Governments have long-ago disposed of all land absolutely (in "fee simple") rather than by using a long-term, renewable Government leasehold system. This is a great pity. For a full discussion of how this came to be in Hong Kong and how it has worked, overall, to Hong Kong's significant benefit, see a recent TLRP Tax Comment: "Land Revenue and the Chinese Dream, at: http://www.aiifl.com/wp-content/uploads/file/TLRP-TaxComments-No_2.pdf.