

20 June 1994

The Right Honourable Christopher Patten
Governor of Hong Kong
Government House
Hong Kong

Dear Sir,

Review of Home Financing Scheme

We have been invited by the Administration to advise, under clause 1(e) of our Terms of Reference, on its proposals to revise the rates and conditions of the Home Financing Scheme.

BACKGROUND

2. The Home Financing Scheme (HFS) was introduced on 1 October 1990 by the Government with the dual objective of encouraging home ownership for senior civil servants and reducing the Government's long-term expenditure on the provision of housing benefits to its employees. With the introduction of the HFS, this becomes the only form of housing benefit for local officers remunerated at MPS 34 and above appointed after 1 October 1990. Those appointed before this date have been given an option, until 30 September 1994, to decide whether to join the HFS, or retain their existing housing benefit, including Private Tenancy Allowance (PTA), Non-Departmental Quarters (NDQ), Home Purchase Allowance or Housing Loan, as appropriate.

Appendix J (Cont'd)

3. On joining the HFS, an officer receives a monthly Home Financing Allowance (HFA) according to his salary point for a maximum period of 10 years to assist him towards mortgage repayment. An officer may choose to use the HFA to rent accommodation initially for up to two years before purchasing the property. In this case, his 10 year entitlement for the HFA to cover mortgage repayment will be correspondingly reduced. An officer may also apply for a downpayment loan (DPL). The maximum amount of the loan is 20% of the purchase price of his property or 18 months' salary, whichever is the less. The DPL is repayable over 10 years and interest is charged at a concessionary rate.

4. Overseas officers appointed before 1 October 1990 are eligible for either PTA or NDQ irrespective of their salaries, or if they are on MPS 34 or above and choose to purchase a residential property in Hong Kong, assistance under the HFS. Those appointed on or after that date are provided with an Accommodation Allowance (AA) for renting accommodation only.

5. Local officers below MPS 34, on the other hand, may apply for an allowance under the Home Purchase Scheme (HPS) to purchase their own home, subject to an annual quota. The Home Purchase Allowance is payable for a maximum of 10 years and an officer may also apply for a DPL under the scheme.

6. Since the introduction of the HFS in October 1990, the HFA rates have not been revised, while PTA and AA rates have been adjusted annually. The HFA rates have thus lagged behind. The widening gap between HFA and PTA rates and the sharp increase in property prices in the past three years have led to a reduction in the number of senior civil servants willing to give up PTA or NDQ to join the HFS. To ensure that the HFS continues to meet the objective of reducing long-term Government expenditure on PTA and NDQ, the Administration, having reviewed the rates and the conditions of the scheme, sought our preliminary views in December 1993. Our observations on the Administration's initial proposals were subsequently conveyed to the Administration in February 1994. The Administration has since carried out staff consultation and, in the light of feedback obtained, come up with a revised package of proposals. These proposals are now presented to us for our formal advice.

THE ADMINISTRATION'S PROPOSALS

7. The Administration's revised package of proposals includes -

- (a) the Home Financing Allowance (HFA) rates to be increased by 35%;

- (b) the maximum downpayment loan to be increased from 20% of property price or 18 months of salary (whichever is the less) to 30% of property price or 24 months of salary (whichever is the less);
- (c) the HFA rates to be adjusted annually according to property price movements, but capped by the rate of inflation as measured by the Consumer Price Index (A) [CPI(A)];
- (d) the provision whereby existing HFA recipients may draw the revised rates of HFA upon a change of property to be abolished;
- (e) the requirement to plough back all sale proceeds into the second property upon a change of property to be abolished;
- (f) the requirement to sell the existing property when an officer moves into another property to be abolished;
- (g) the initial two-year renting period under existing arrangements to be retained and that this be extended to cover the entire normal probationary period if it exceeds two years; and
- (h) the option period for eligible officers appointed before 1 October 1990 to decide whether to join the HFS to be extended to 30 September 1995.

COMMISSION'S VIEWS AND RECOMMENDATIONS

Proposed increase in HFA rates

8. We note the Administration has maintained that the HFA rates be increased by 35% as originally proposed. In upholding this proposal, the Administration acknowledges our earlier reservation about the validity of the basis for calculating the proposed increase. This is because the proposed 35% increase, based on the cumulative increase of PTA rates between 1990 and 1993, reflects rental rather than property price movements in the corresponding period and that this basis for the proposed increase is out of step with the Administration's other proposal that property price movements, capped by the rate of inflation as measured by CPI(A), should be used as the basis for the annual adjustment of HFA rates in future.

9. The Administration accepts that the proposed 35% increase for the HFA rates is not entirely satisfactory and that our reservation is shared by the majority of staff associations consulted. However, having regard to all relevant factors, the Administration is of the view that any increase based simply on property price movements in the past three years is neither publicly defensible nor practicable in public finance terms. It is also of the view that the 35% increase

Appendix J (Cont'd)

is the minimum necessary to induce officers currently living in NDQs or drawing PTA to join the HFS, thereby achieving the Government's objective of reducing public expenditure on civil service housing benefits.

10. In the circumstances, while we continue to have reservation about the validity of the proposed increase, we can appreciate the Administration's position and the difficulty involved in increasing the HFA rates beyond the 35% as proposed. We agree, albeit with great reluctance, that the Administration's proposal to increase the HFA rates by 35% be accepted.

11. In our earlier advice to the Administration, we expressed one other concern and that was that the proposed increase of 35% for the HFS rates would create a serious staff relations problem with junior civil servants covered by the Home Purchase Scheme (HPS) for which a much lower level of rate increase of 8.7% has been implemented from 1 January 1994. In response, the Administration has intimated that the HFS and HPS are different schemes with different bases and objectives. While the HFS is a condition of service for officers remunerated at MPS 34 and above, the HPS is a concessionary benefit for officers remunerated below MPS 34. The Administration emphasises that as the HFS is a more economical form of civil service housing benefit vis-a-vis NDQs and PTA, a higher rate of increase leading to a greater use of the HFS would be in the public interest.

12. Notwithstanding the Administration's explanation, we remain firmly of the view that serious presentational and staff relations difficulty may ensue, if the considerable differential between the increased rates for the HFS and those for the HPS cannot be explained with conviction.

Increase in maximum downpayment loan

13. The Administration proposes to increase the maximum downpayment loan from 20% of property price or 18 months of salary (whichever is the less) to 30% of property price or 24 months of salary (whichever is the less), in order to assist eligible officers in meeting downpayment following the reduction by banks of the mortgage ceiling from 90% to 70% of the assessed value of residential property. We support this proposal which we understand is generally welcomed by staff.

Future revision of HFA rates

14. The Administration proposes that in future the HFA rates be adjusted annually according to property price movements, but capped by the rate of inflation as measured by CPI(A). The Administration points out that in many staff submissions, it has been proposed that the annual adjustment should strictly follow the property price movements and not be capped at all. The Administration, has not, however, accepted these suggestions on grounds that, given the volatile state of the property market, it is impracticable from a financial and public point of view to allow future HFA rates to follow the market.

15. We share the Administration's concern and agree that given the huge financial commitment otherwise involved and the volatility of the property market, it would be prudent and necessary to impose a limit on the annual increase of the HFA rates as proposed. However, capping the annual increase by CPI(A), which reflects the inflation rate for households with a lower average monthly expenditure, may not be appropriate in the case of HFS which is only available to officers remunerated at MPS 34 and above. A different index, one which measures the inflation rate for the higher income groups, to which the HFA recipients belong, will, in the circumstances, be more appropriate. We appreciate that this may result in different rates of inflation being used in revising the HFA rates on the one hand and the HPA rates on the other. For reasons of equity, however, we think that the Administration should give this matter serious consideration.

Cessation of trading-up provision

16. The trading-up provision under the existing HFA scheme permits an officer to draw the revised (and higher) HFA rate applicable to his salary point, provided he disposes of his first property and ploughs back all the sale proceeds into the second property. The Administration proposes to remove this provision since the substantial increase now proposed for the HFA rates may induce some existing recipients to make use of this provision to acquire another property at considerable cost to the Government. We support the Administration's proposal and agree that the limited Government financial resources available should be directed towards officers who have yet to acquire their own homes.

17. We understand from the Administration that most staff submissions are of the view that the Administration's proposal, if implemented, will constitute a unilateral variation of conditions of service with adverse consequences on the Government's credibility and the morale of the civil servants. Indeed we note that by upholding its original proposal, the Administration recognises the risk of legal

Appendix J (Cont'd)

challenge, although legal advice to the Administration is that conditions of service may be varied by the Government on reasonable and public interest grounds and after the due process of staff consultation has been effected.

Simplification of administration of the HFS

18. The Administration proposes to simplify the administration of the HFS by abolishing the requirements to plough back all sale proceeds into the second property upon a change of property, and to sell the existing property when an officer moves into another property. We understand that these requirements can and do create hardship for staff at times and we see, therefore, no objection to the Administration's proposal which was well received by staff during the consultation period.

Abolition of renting period under HFS

19. An eligible officer may at present use his allowance to rent accommodation for a maximum of two years on joining the HFS. This provision was originally intended to enable PTA recipients, whose tenancies had not expired, to join the HFS as soon as possible after its introduction. Under its initial proposal, the Administration intended to remove this provision as staff had since had four years to terminate their tenancies and consider when to join the scheme.

20. In the light of staff submissions, however, the Administration has decided to retain this provision having regard to the fact that, given the volatile property market, it may be difficult for an officer newly appointed or reaching the requisite salary point to make a decision on a mortgage commitment immediately. The Administration further proposes to extend this renting period to cover the entire normal probationary period of an officer if this exceeds two years and before they are eligible for the downpayment loan on confirmation to the permanent and pensionable establishment.

21. On account of the above considerations, we accept that the Administration's position is reasonable and we support its decision not to proceed with its original proposal to abolish the renting period under the HFS.

Option period to be extended to 30 September 1995

22. As pointed out in paragraph 2 above, eligible officers appointed before 1 October 1990 may opt to join the HFS or retain their existing housing benefit. This option has to be exercised before 30 September 1994. In the light of staff

comments, the Administration has decided to extend the option period by one more year to 30 September 1995, so as to enable more officers to join the HFS and to avoid a sudden impact on the property market by officers wishing to make use of the scheme before the original deadline of 30 September 1994. We support the Administration's decision.

Capping of adjustments to PTA and AA rates by CPI(A)

23. At present, PTA and AA rates are revised annually on the basis of rental movements. To maintain similar levels of increase for the various housing benefit schemes, the Administration initially proposed that, similar to the arrangement for revising HFA and HPA rates, the annual increase of the PTA and AA rates should also be capped by the rate of inflation as measured by CPI(A). We supported this proposal in our earlier advice to the Administration.

24. The Administration has now decided not to pursue this proposal in the light of staff objections that the proposed capping will result in a lowering of the standard of accommodation for participants of the two schemes, particularly those AA recipients who are overseas officers appointed after 1 October 1990 on agreement and have no alternative form of housing benefit.

25. Having regard to staff concerns and the fact that the present review is intended to deal primarily with the HFS, the Administration has decided that the PTA and AA schemes should be excluded from the current exercise. We do not dispute this, but would point out that this variation in treatment may, over the years, reduce the relative attraction of the HFS vis-a-vis NDQs and PTA.

Synchronisation of commencement dates of revised rates

26. During our deliberations on the Administration's initial proposals, we noted that different dates were adopted for the annual adjustment of allowances under the various housing benefit schemes. We suggested that the Administration should consider synchronising the dates of these annual adjustments in future. This would ensure that, as far as practicable, the indicators used in calculating the new rates covered the same period. We are pleased to note that the Administration has accepted our suggestion and will be looking into the practicability of effecting the necessary change.

Appendix J (Cont'd)

CONCLUSION

27. In conclusion, we support the Administration's revised package of proposals for the Home Financing Scheme as detailed in paragraph 7 above. In coming to this conclusion, we appreciate the financial constraints confronted by the Administration in making improvements to the Home Financing Scheme. This notwithstanding, we remain seriously concerned about the potential staff relations problems arising from the huge differential between the rate of increase (35%) proposed for this scheme and that (8.7%) already approved for the Home Purchase Scheme. We urge that this issue be given due consideration by the Administration again when it is in a position to conduct another review.

Yours faithfully,

(Sidney Gordon)

Chairman

For and on behalf of
Members of the Standing Commission