Some interesting trends of Hong Kong commodity housing

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This article discusses some interesting trends of Hong Kong's commodity housing, which are revealed by a recent study on ten representative residential developments along the rail network. It looks at a number of aspects including internal architectural design, overall estate layout and financial performance such as rental investment return.

Selected estates

The following four generations of representative Hong Kong commodity housing have been selected for the study (numbers in brackets are the years of completion):

- G1 (1981-1986) – Telford Garden and Heng Fa Chuen
- G2 (1998-1999) – Tung Chung Crescent and Tierra Verde
- G3 (2004-2006) – Residence Oasis and Metro Town
- G4 (2009-2011) – The Palazzo, LOHAS Park, Lake Silver and Festival City

The selected estates are large private estates developed by renowned private developers. The projects contain the typical characteristics of estates built in the concerned eras.

Aspects of study

The following four categories of estate characteristics have been studied:

- C1 (efficiency-related) – Bay window depth and area efficiency
- C2 (internal living quality) – Sizes of bedrooms and balconies/utility platforms
- C3 (external living quality) – Wind shield effect due to block layout
- C4 (financial aspects) – Management fees, investment return and price trend

The above characteristics are the chief concerns of users and investors. Item C3 is also a major concern of green groups and political parties.

Bay window depth

Bay windows mean windows with projected window sills. It is a design feature commonly

adopted by property developers in Hong Kong because bay window areas can be exempted from Gross Floor Area (GFA) calculation. However, to the users, the inclusion of bay windows reduces area efficiency, i.e. the carpet area would become smaller. An analysis of the ten estates regarding bay window depth has been made. The result is shown in Fig. 1. It can be seen that the later the year of completion, the deeper the window sill.

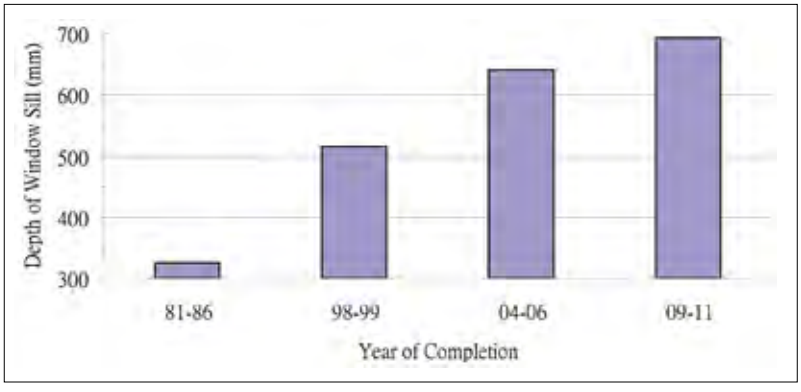

Fig. 1 – Trend of bay window depth

Area efficiency

Gross floor area is the total area (including apportioned public areas) that is still commonly used by the market to calculate the price of a flat unit. Saleable floor area is the nominal flat area (including wall thickness) that is really sold to and occupied by the buyer. Area efficiency is the saleable floor area divided by the gross floor area. It represents the value that the buyer gets back for every dollar he or she has paid. An analysis of area efficiency for the ten estates has been made. The result of analysis is shown in Fig. 2. It can be seen that the later the year of completion, the lower the area efficiency.

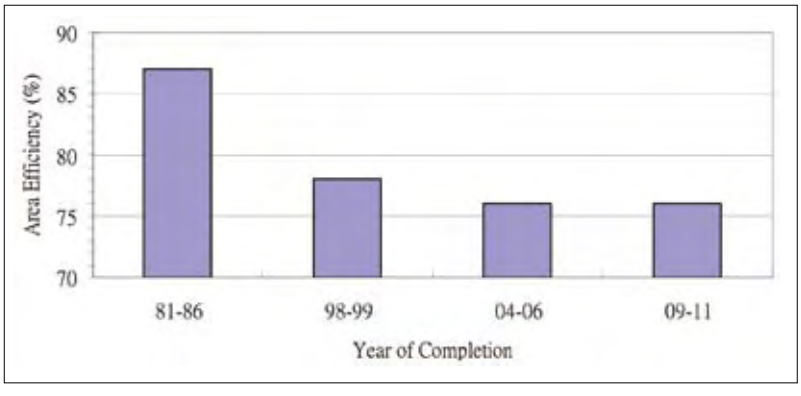

Fig. 2 – Trend of area efficiency

The above phenomenon is attributable to GFA exemption policy. In the beginning, bay windows could be exempted. Then later, club houses also began to be exempted. As long as certain features are exempted, property developers will try to build the maximum areas of such features that are still within the exemption limits, so that they can make full use of the potential of the land to earn the greatest amount of profit. However, there are differential treatments on the reporting of GFA. To the Building Authority, the developer reports a GFA of say 900 sq ft for a flat, taking into account that certain features are exempted from calculation. For the same flat, to the buyer, the developer claims a GFA of 1000 sq ft as all features (no matter exempted in statutory terms or not) are counted. Because such GFA is still commonly used by the market to calculate flat price, this is disadvantageous to the buyer.

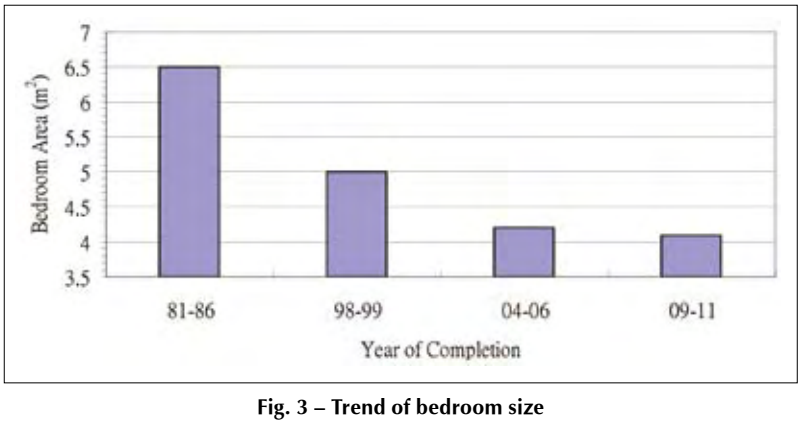

Fig. 3 – Trend of bedroom size

Bedroom size

The area of the second or third bedroom (i.e. excluding the master bedroom) in the flat design of each estate has been analyzed. The result is shown in Fig. 3. It can be seen that the later the year of completion, the smaller the bedroom. Besides, the bedroom size appears to converge to about 4.1 sq m in the later generations.

Balcony / utility platform size

The area of balcony or utility platform in the flat design of each estate has been analyzed. The

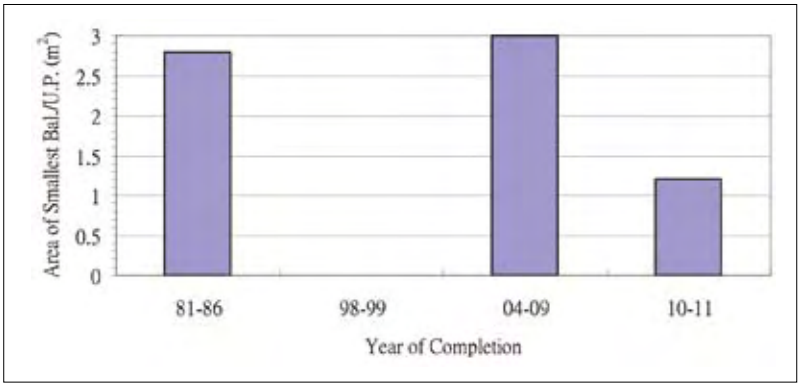

Fig. 4 – Trend of balcony / utility platform size

result is shown in Fig. 4. In the figure, no area is shown in the 98-99 generation because that generation of estates featured bay windows alone, without the provision of balconies. Later in 2004, balconies were again provided due to the introduction of GFA exemption policy. From the overall chart, it can be seen that in or before 2009, the balcony or utility platform size was close to 3 sq m. However, after 2009, the size has significantly dropped to 1.2 sq m. This area is mainly for the utility platform as the Building Authority has recently required utility platforms to be separated from balconies. Such a small area of utility platform is quite unusable.

It can be seen that the newer the estates, the lower the sizes of bedrooms and balcony/ utility platforms. For the bedroom size, a commonly used size in recent estates is 2m x 2m. This is the smallest room size that can accommodate a bed and a small wardrobe. A probable reason is that the developers wish to provide the greatest number of bedrooms inside each flat, at the expense of reducing the size of each room. Flats with three bedrooms can be sold at a higher price than flats with two only. Regarding the size of utility platform, the developers build utility platforms with size exactly equal to the exemption limit. As the exemption limit is small, the utility platforms so built are also small. A dilemma is: while the developers design flats to earn the maximum profit, in doing so, they are making the flats less useful. With such a small bedroom, the occupant cannot place much furniture in it. Also, with such a small utility platform, it is impossible to hang the clothes of the whole family in it.

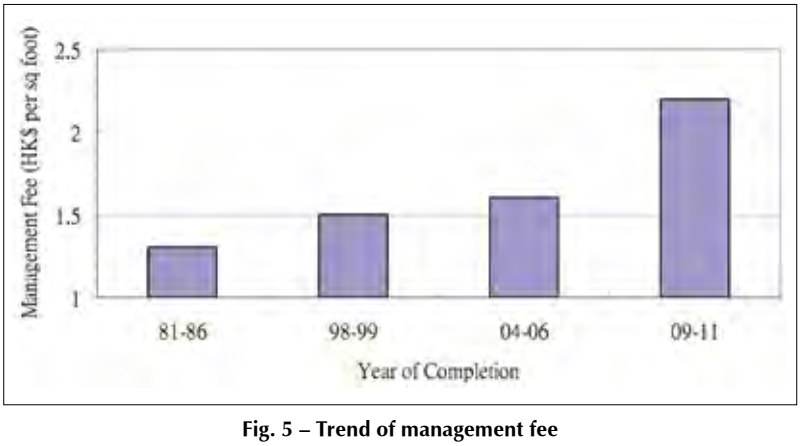

Fig. 5 – Trend of management fee

Wind shield effect

The tower layout of each estate has been analyzed. The general trend is summarized as follows:

- 1981-1986 – Scattered
- 1998-2011 – Lined up / Partially lined up

The newer the estates, the more likely the residential towers are lined up to form a wind shield. The probable reason is: the wall-crescent form of block layout is more favorable in terms of visual impression. Any void between towers will adversely affect the visual continuity of blocks and will lower the potential splendid design of the whole development. It appears that given any high class, large-scale residential estate, the architect and developer would prefer a lined-up block layout to give a grander appearance. Green groups and political parties have repeatedly pointed out that high-rise buildings in a wall pattern could cause valley or heat-island effects. Although the effects would more be on the neighborhood, the health of the residents in the estate itself would also be affected. So, there is a tradeoff between the grand appearance of the development and the heat-island effect brought by it. The society's value is seen to be changing as the voices of green groups are becoming louder.

Management fee

The level of management fee of each estate at a reference month of April 2011 has been analyzed. The result is shown in Fig. 5. It can be seen that the later the year of completion, the higher the management fee.

Investment return

The investment return, i.e. net return from rental income, minus management fee and government rates and rent at the reference month of April 2011, of each estate has been analyzed. The result is shown in Fig. 6. It should be emphasized that the total acquisition

cost in this case has included stamp duty (and also commission if the flat is only available on the secondary market). It can be seen that the later the year of completion, the lower the investment return. Although commission fee has not been included in the calculation of acquisition cost in the new estates completed in 09-11, their investment return is still low compared to the first three generations.

It can be seen that the newer the estates, the poorer the financial performance. A higher management fee is charged for all the newer estates. The reason is that the management style of Hong Kong's property management has changed. In the 1980s, the management function was just like a watchman, but in the 2000s the function is upgraded to hotel-style management. This means that new estates are provided with luxury club houses and highly delicate management services. However, this brings about a new problem. As the management fee has risen to over $2 per sq ft, it is beginning to erode the rental income, which could be around $16 per sq ft depending on locations. The net rental investment return hits a record low of 2.4% for the last generation of estates. Before March 2011, the mortgage interest rate (HIBOR + 0.7%) was at a very low level of 0.9%. An investment return of 2.4% was still acceptable. However, after that date, the interest rate has gradually risen. For example in June 2011, it rose to HIBOR + 2%, i.e. 2.2%. There was not enough margin between the investment return and the average cost of capital. So, investing in such estates would become too risky. If the interest rate further increases in future, there is a possibility that the flat owners would suffer a loss if they rely on rental income to cover interest expense.

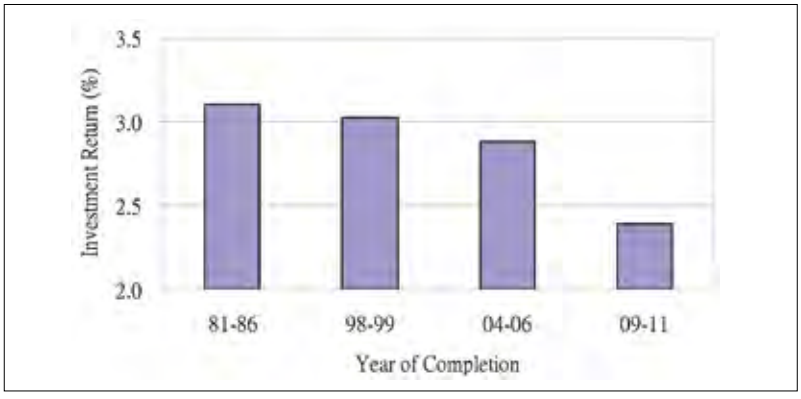

Fig. 6 – Trend of investment return

Price trend

The price rise during a 4-year period (Jan 07 to Dec 10) for the first three generations of estates has been analyzed. The result is shown in Fig. 7. It can be seen that the later the year of completion, the lower the price growth.

It is found that the 4-year price rise for the first two generations of estates was higher than the third. One possible explanation is that recently the property developers have adopted an aggressive pricing strategy, i.e. they price their new flats at a level that is far (e.g. 20%) above second-hand flats in the same district due to reasons such as trendy materials and luxury club houses. This makes the first sale prices of new flats very high. Another possible explanation is that the older generations of estates have a higher area efficiency, which is a feature attracting potential buyers in the second-hand market. This makes their prices grow faster than the newer generations. Of course, there are other factors such as location of estates that come into play, but the effect of this is outside the scope of this study.

Conclusion

From an analysis of the four generations of Hong Kong's commodity housing, it can be seen that the later the year of completion, the more likely some user or investor need-mismatch problems would occur. Examples include over-sized bay windows, poor area efficiency, small bedrooms, wind shield effect, high management fees and low investment return. With the increasing supply of land in the coming years, it is expected that competition in the commodity housing market will become much stronger. Coupled with the fact that the Building Authority has imposed more stringent sustainable building design requirements to combat the so-called "inflated" flats, it is time for property developers to re-think how to fine-tune their design and re-position their products.

Fig. 7 – Price rise for the first 3 generations of estates