

ASYMMETRIC INFORMATION IN THE HONG KONG FORWARD PROPERTY MARKET

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ABSTRACT. Use of forward contracts for pre-selling uncompleted properties is becoming popular in many countries. However, there have been limited researches investigating the risks arising from asymmetric information specific to buying a presale property and the critical factors required for the development of an effective forward property market. Hong Kong is one of the largest forward property markets in the world and it has been getting mature after half-a-century long development. This paper therefore aims to study the asymmetric information problem found in the forward property markets in different areas and explores the set of factors that are critical to the development of a forward property market by referencing the development of the Hong Kong forward property market.

KEYWORDS: Asymmetric information; Forward property market; Presale properties

1. INTRODUCTION

For the past two decades, developers in big cities like Hong Kong, Singapore and Malaysia have been involved in building large housing estates to meet the growing demand for residential properties. The increasing popularity of self-contained condominium particularly in North America, Canada and the U.K. in recent years, with provisions of better management such as central managed garden, swimming pool and self-sustained recreational facilities, has created a competitive edge in the forward property markets. Since financing for these large-scale real estate projects is a major issue faced by developers in exchange for

the significant profits they can generate, there has been an increasing use of forward contracts for presale of uncompleted properties at planning or construction stage by developers to release their financial burden and to enhance the value of their real estate assets (Leung and Hui, 2007; Lindholm et al., 2006). This kind of financing means is also commonly adopted in developing countries. For example, the pre-contract sale law is being used in Morocco which allows developers to get prepayments from buyers before completion of the construction works (AbanaReview, 2004). However, the finance for condominium construction in Moldova and other Eastern European countries is yet to explore (ECE, 2002).

For developers, pre-selling uncompleted properties can, on one hand, help secure the upfront capital for the construction; on the other hand, they can transfer the market risk of the project during the construction period through passing the equitable ownership of the presale properties to the buyers (Chau et al., 2003; Lai et al., 2004). For the buyers, although they have more choices in acquiring a property with the features that they desire in the forward property market, they have to bear the risks arising from the asymmetric information problem specific to a forward property market. Once a forward property contract is signed, the buyer becomes the principal of the uncompleted property and has to rely on the specialist knowledge of the agent, i.e. the developer, to finish the construction work. But this principal-agent relationship has an inherent asymmetric information problem that the agent knows more about the situation than the principal. Because of the lack of knowledge and technical expertise in the construction work, the principal cannot be sure whether his best interests are served by his agent of up-keeping the quality work after the agent has collected the money (Farrell, 2003). As Holstrom (1979) stated, the “actions taken by agents are not directly observable and therefore complete monitoring is not generally possible.” It is not uncommon that when the presale buyers collected their properties upon completion, problems such as inaccurate size of the properties, mismatch of fittings and finishes were found.

The problem of default in the middle of construction was also serious in some countries (Esha, 2003; Kalifa, 2005). Figure 1 shows the risks transferred from the developer to the buyer in a presale of an uncompleted property which include both the market risk and the capital financing risk during the construction period, and also the additional risks that the buyer have to bear which arise from the asymmetric information problem embedded in a forward property market.

Despite many failures of pre-selling uncompleted properties in different places, there have been limited researches studying the problems specific to forward property markets. As a purchase of a presale property, very often, takes a substantial amount of the life-time saving of the prospective buyer, the study on the asymmetric information problem embedded in presale property markets and the means to correct the imperfect information problem deserve serious attention. Hong Kong has been a pioneer in using forward contracts to pre-sell large-scale housing developments since the Fifties and hence many lessons can be learnt from it. By referencing the development of the forward property market in Hong Kong, the study identifies the set of factors that are critical for the development of a forward property market. The following section reviews the risks arising from asymmetric information problem in pre-selling uncompleted properties in different countries. Section three examines the development of the forward property market in Hong Kong and the

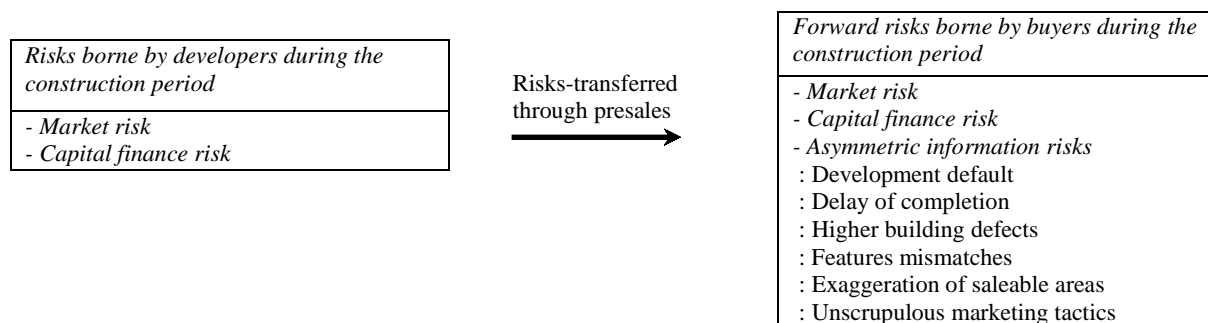


Figure 1. Forward risks embedded in presale properties

measures taken to correct the imperfect information problem. Section four draws the set of factors that are critical for the development of a forward property market.

2. REVIEW OF FORWARD PROPERTY MARKETS

Many countries have their own presale systems of uncompleted properties. In the U.S., a presale¹ of off-plan uncompleted properties commonly represents a pre-construction sale programme carried out by a condominium (condo) developer who is required to sell a certain percentage of the flats before a lender will commit to financing construction of the project. The lending threshold on the number of flats pre-sold to the total number of flats could be as high as 40%. On the other hand, the buyer is able to secure an uncompleted property by placing a deposit, usually at 5%, and will either pay the remainder upon completion of the project, known as 5:95 system; or according to the development schedule, known as progress payment method². This kind of mixed practice is also applied in Canada and Australia, just the deposit required in Australia is 10%, and thus it is called 10:90 concept (Buang, 2006).

When the deposit is submitted, the developer usually ask the buyer to get pre-approval for a mortgage loan to secure the finance of

the purchase. Many mortgage companies will not allow the buyer to close his purchase unless sales of 50% to as high as 70% of the flats of the project have been placed in order to insulate the lender from the risk that the project cannot be completed. But the downside is that a number of presale projects have been abandoned as a result of the developers not being able to secure the required presale threshold and so as the financing. Despite the rules, records showed that with the condo-boom in recent years, many lending companies were willing to take the risk by relaxing the presale threshold requirement in order to get a competitive edge in lending business in the forward property markets (Tribune, 2005).

Mixed practice of presales similar to that of Australia is also adopted in Greece and Dubai. Usually, 10% deposit is required and the remainder is paid either on completion or in multiple stages during the progress of the construction. If progress payment method is used, a discount on the purchase price is usually offered, and the completion of each stage must be certified in writing by the Architect before payments are made. The terms contained in the forward contracts include the timetable for the property's completion; stage payment dates; the completion date and penalties for non-completion; guarantees for building work; details of the builder's insurance policy³; and a copy of the plans and drawings. The floor plan and technical specifications signed by both parties are also attached to the forward contract to ensure that the size and standard of construction are adhered to. The contract also requires to withhold at least 5% of the purchase price for six months upon completion as retention money in case the builder fails to correct any defects (Homesgofast, 2006).

In Mainland China, the presale system is used as a means to secure the upfront capital

¹ A presale is different from a custom sale of an uncompleted property. In a custom sale, the buyer owns the land and hires the builder to build the property. In a presale, the builder owns the land, obtains the construction finance, builds the house and then conveys the completed property to the buyer (Tribune, 2005).

² Following is a progress payment schedule of a 30-floor condo presold in Dubai (Homesgofast, 2006):

- Deposit (within 7 days of purchase) : 10%
- 1st instalment (within 30 days) : 10%
- 2nd instalment (within 90 days) : 10%
- 3rd instalment (Podium ready) : 10%
- 4th instalment (10th Floor ready) : 10%
- 5th instalment (20th floor ready) : 15%
- 6th instalment (structure ready) : 15%
- 7th instalment (handover) : 20%

³ The builder/developer is required to obtain an insurance policy, or a 'termination' guarantee, to protect the construction works in the event that he goes bust before completing the property (Justlanded, 2006).

for financing the entire construction project, and thus it requires the buyers to pay 100% upfront far in advance of completion. As such, it poses a very high risk to the buyers. If presales of the project are not as good as expected and cannot meet the total financing cost, the project will very likely be defaulted and the buyers stand to lose all their money put into the presales. According to the record of Liaison Office of China, up to June 2004, there were 240 defaulted property sites left unresolved just within the Guangtung Province. Some of the housing estates were even repeatedly sold or mortgaged due to absence of proper regulation. The problem was so severed that in the Real Estate Financial Report 2004, the People's Bank of China questioned whether the current presale policy should be continued or replaced by a system in which developers may only sell completed projects (Kalifa, 2005).

The case in Malaysia is not much better under the "Sell-then-Build" Scheme in which progress payment method is adopted. It has been the objective of the Malaysian Government to promote real estate products as a popular investment instrument. However, 526 housing projects in West Malaysia were abandoned from 1966 to 2001. Just in 2004, the government was working hard to revive 97 abandoned housing schemes affecting more than 30,000 buyers (The Star, 2004). Besides defaults, the problems of "housing scam", late completion and building defects were so severe that there were strong calls for the reversal of the "Build-then-Sell" method. In June 2006, the government came to a decision to introduce the 10:90 system, in parallel with the progress payment method, which allows buyers to pay 10% first and the rest upon completion of the property with issue of the permanent certificate of fitness. It is believed that with the use of 10:90 system, buyers would be insulated from the fallout should the developer abandon the project. However, there had been heated debates on whether the new system would shrink the construction works so as the overall economy of the country (Property Times, 2006).

Apart from defaults in the middle of construction, the presale properties in China also suffer from poor built quality. The poor quality derived not only from substandard building materials but also decoration mismatches with what had been promised in the presale promotions (Yang, 2001). Similar problems were also found in other countries like Singapore, Taiwan, Canada and the U.K. (Ong, 1997; Li, 1998; Cullum, 2005). In Taiwan, most housing complaints came from presale deals which accounted for 65% of the total housing complaints (Hua et al., 2001; Li, 1998). The three main types of complaints included poor quality building work (30.6%), shrinkage of housing space (11.9%) and incorrect housing information (21.2%). These problems are also common in western countries like the U.S. and U.K. and, therefore, Braxtan (2006) reminded potential buyers to include the inspection contingency clause in the presale contracts.

In the U.K., a building missive was published by a Glasgow solicitor in 1986 to expose the problems contained in presales of uncompleted properties (SCC, 2006), quoted:

"I hereby offer to purchase from you whatever type of house in whatever location and using whatever standard and specification of materials you see fit and I undertake to pay over the full purchase price within twenty-four hours of you intimating to me that the house is ready whether it is, in fact, ready or not and whether or not it has been passed as completed by the Local Authority. ..."

Notwithstanding how ironic the above missive sounded, according to the findings of the Baker Review in 2004 and the report prepared by the National Consumer Council (NCC) (Cullum, 2005), not much has been changed and there has been a lack of adequate consumer protection in buying presale properties in the U.K. The forward property contracts used are often unclear and included wide-ranging exclusions of liability. The problems include late completion of project, pressure on buyers to accept incomplete properties; late after-build service and inadequate means of redress. More

important, the issue of snagging, resulted from the disparity between the actual and the expected specifications on the fittings and finishes, is seen to be a major problem. Attempts have been made by The Law Society to propose a standard Builders' Missive with the aim at "bringing the standards of all up to the level of the few and promoting a fairer, more even-handed standard missive in the industry". However, according to the report prepared by the Scottish Consumer Council (SCC) in 2006, little progress had been noted.

Unscrupulous sales tactics in conducting presales in some areas also cause concerns. Surveys conducted in Hong Kong revealed that developers used grey areas for not adhering to the requirements stipulated in the presale guidelines. For example, presales were conducted through the so-called "reserved unit registration" in which no price list was provided to allow buyers to compare prices of different flats. There were all sorts of confusing pretexts to promote sales, such as 'priority sales' and 'tied-sales', 'handshaking price' and 'sincerity price', etc. (Lai, 2006). Some developers had selectively released the transaction information in order to ramp up prices by cre-

ating an impression that the market was in dire demand (HKSAR, 2005; Apple Daily, 2006). Similar problems through so-called "soft launch", i.e. presales of uncompleted properties by invitation, were also found in Singapore. Previously, only 30% of a new development in Singapore could be sold through soft launches. However, following the heated market since 1996, some developers had sold all their flats through soft launch on the quiet, without going public (Sim, 2006). Furthermore, Gwin and Ong (2000) found that builders in Singapore might have minimized costs by putting "less than efficient effort" in constructing pre-sold properties. As a result, more building defects were found upon completion of these houses.

Table 1 categorised the presale problems commonly found and showed a comparison of the presale payment methods used in different countries. Some interesting insights can be drawn in regard to the operation of the different presale mechanisms.

As shown in Table 1, most countries, like the U.S., U.K. and Malaysia, adopt 10(5)/90(95) system in parallel with progress payment method for pre-selling uncompleted properties.

Table 1. Presale payment methods and problems in different forward property markets

Forward property markets	Hong Kong, Singapore	Taiwan	China	Malaysia	Canada, US, UK, Australia	Morocco, Dubai	Greece
Payment methods							
100% in advance	√	√	√	n/a	n/a	n/a	n/a
Progress payment	√	√	√	√	√	√	√
10(5)/90(95)	√	√	n/a	√	√	√	√
Retention money	X	n/a	X	√	X	n/a	√
Presale property problems							
Development default	X	√	√	√	√	n/a	n/a
Delay of completion	√	√	√	√	√	n/a	√
Building defects	√	√	√	√	√	n/a	n/a
Features mismatch	√	√	√	√	√	n/a	n/a
Exaggeration of saleable areas	√	√	√	√	√	n/a	n/a
Unscrupulous marketing tactics	√	√	√	√	n/a	n/a	n/a

Note: "√" = yes, X = no, n/a = information not available

Despite the use of 10(5)/90(95) payment method, defaults are still found in these areas. Furthermore, in Canada, U.S. and U.K., a number of potential projects were forced to cease even before their start when the developers were not able to secure the presale threshold, and the deposits had to be returned to the presale buyers. Whereas in places like Singapore and Hong Kong in which full settlement of the payment at the time of purchase is common, the default rate was close to zero for the last two decades. It poses the question on whether the use of a more prudent payment method like 10(5)/90(95) system can really enhance the efficiency of forward property markets, or whether there are other factors to dictate.

In regard to the other presale problems, they can be found in all places to some extent no matter which payment method is adopted. For example, many delays of completion were due to disputes between the developers and the government/contractors in fulfilling their responsibilities rather than force majeure reasons. Mismatches of fittings and finishes were often found in the completed properties because the quality and the decoration had been overstated in the presale brochures. The method for measuring the net usable floor area had not been specified in presales that the actual internal floor size of the flats turned out to be much smaller than what the buyers had expected, so-called "shrunk flat". Despite the problems found, forward property markets are still in place and works particularly active in certain areas like Hong Kong, Singapore and China. As such, what are the factors at force behind in activating the forward property presale mechanisms?

According to Gardner (2003), investment decisions are analogue to a game in which players are placed in a rule-governed situation with defined outcomes, characterized by strategic interdependence between the game players. The importance of information available to the players in a game makes a big difference to its outcomes. If the information is biased to

some players, then the game would be unfair to those who do not possess the information. To correct the imperfect information problem in the games played in forward property markets where information is asymmetric, different means have been introduced by governmental sectors to clean up the markets in an attempt to deter the mal-practices of developers (Holmstrom, 1979; Ong, 1999). The forward property market in Hong Kong started since the Fifties and, to a certain extent, has managed to play a significant role in the economy for the past five decades. To facilitate a smooth operation, the Hong Kong government has initiated rules and regulations to deter the presale problems and to make the game played at a level-playing field for all players. As such, by referencing the development of the forward property market in Hong Kong, an attempt is made to explore the set of factors which are critical to the development of a forward property market.

3. THE HONG KONG FORWARD PROPERTY MARKET

The demand for residential property in Hong Kong has always been high despite the up-and-down cyclical movements in between years. Property prices shot up by seven folds from 1986 to the Asian Financial Crisis in 1997 (Hui and Lui, 2002). To cope with the surging demand for property with limited land supply, developers have concentrated on constructing high-rise buildings and large-scale housing estates. They adopt "production-based" strategies focusing on timing and maximizing quantity of property developments rather than on quality of production (Tang and Liu, 2001). With regard to financing for huge investments, developers have increasingly secured a substantial amount of upfront capital through the use of forward contracts to pre-sell uncompleted properties.

As shown in Table 2, the presales of uncompleted properties accounts for a large proportion of the Agreement for Sale and Purchase (ASP) transacted in the first-hand market from

1993 to 2005, ranging from 25% to as high as 78%. Figure 2 shows the number of properties pre-sold compared to the property price index in the territory from 1993 to 2005. It can be

seen that the number of ASPs transacted in the forward market was trending along the property price index in general, the higher the property prices, the higher demand for presales.

Table 2. Number of forward ASPs to total number of ASPs in the first-hand market

Year	Total no. of ASP	ASP on uncompleted properties	% of uncompleted properties sales to total ASP
1993	23375	18191	78%
1994	10778	6525	60%
1995	4704	3440	73%
1996	9109	4975	55%
1997	15500	12082	78%
1998	23384	17534	75%
1999	22121	11093	50%
2000	18151	5849	32%
2001	18539	8493	46%
2002	16541	9926	60%
2003	19047	7529	40%
2004	18566	4691	25%
2005	13495	8772	65%

Source: Data are extracted from the Economic and Property Research Centre (EPRC)

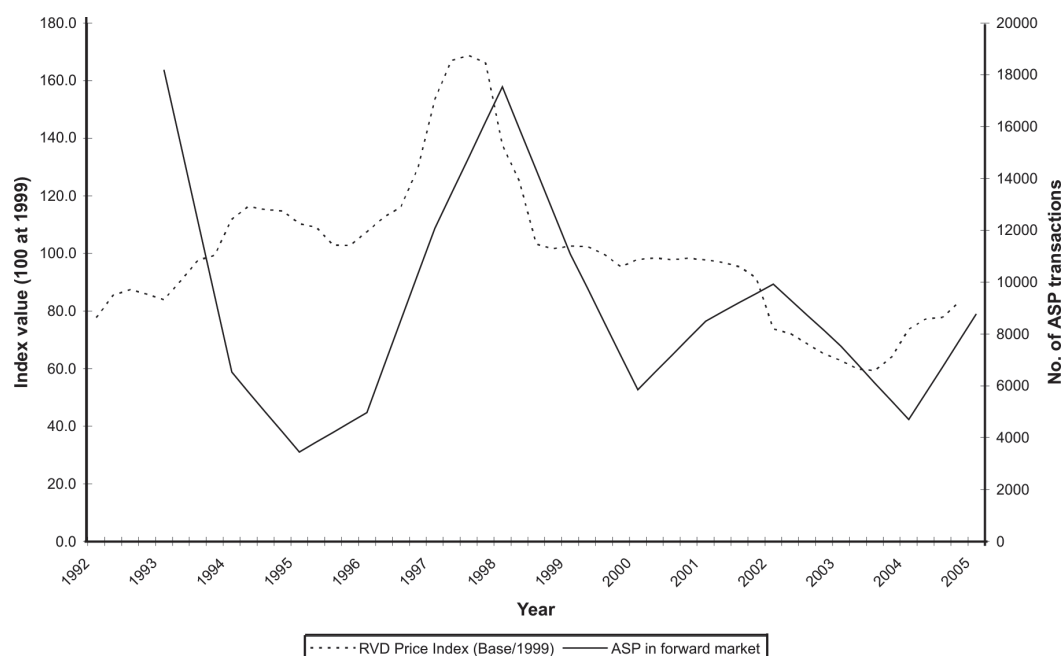


Figure 2. Forward ASP transactions and the spot property price index 1993–2005

Source: Hong Kong Property Reviews (HKPR) 1995–2005

3.1. Consent scheme and the three-pronged approach

The formal presales of uncompleted residential properties in Hong Kong was first recorded in 1954 covering a housing estate of over a hundred blocks of 3-floor buildings. It also signaled the start of co-ownership of multi-storey properties and, for the first time, allowed buyers to pay by installment on a purchase of property. However, in the early 1960s, a number of developers collapsed because of cashflow problems, this had deterred the interest of potential buyers in purchasing presale properties. As a result of the Peony House fiasco in 1960 of which the buyers had to pay an excess of 30% over the original purchase price in order to complete the construction after the developer fled, the government in 1961 made a review on the conveyancing practice in the forward property market and the Consent Scheme was introduced to guide the presales for protecting the buyers. The Consent Scheme⁴ is implemented through the use of restrictions placed on the developers under the government lease, of which the developers must meet in order to obtain the consent of the Director of Lands for presales of the uncompleted properties (CM, 1999, 2001a, 2001b, 2002a, 2002b, 2002c; LC Paper, 2000a, 2000b, 2000c, 2002, 2003, 2004, 2006).

Apart from the use of administrative measures under the Consent Scheme, self-regulatory measures are also taken by the Real Estate Developers' Association of Hong Kong (REDA) with the aim to build up the reputation of the developers in the industry as a

whole in order to mitigate the agency costs incurred by some non-performed unscrupulous developers. The self-regulatory measures are used to guide the developers in the presales to enhance the transparency of the presales and the accuracy of sales information released to the public (Appendix 1). Furthermore, the Consumer Council (CC) and the Estate Agent Authority (EAA) also play a part to undertake activities to enhance consumer protection. For example, a pamphlet has been published by CC and EAA to be inserted in presales brochures to remind prospective buyers of the issues that they need to pay attention to (Appendix 2). Furthermore, awareness-raising and educational measures are undertaken by CC to teach buyers on how to take appropriate action on their own behalf to safeguard their rights. The government believes that this three-pronged approach, i.e. the REDA, CC and EAA, together with the administrative measures stipulated in the Consent Scheme can on one hand protect consumers' interest and would not fetter the market operation on the other.

3.2. Measures to deter presale property problems

Through the use of the hard administrative scheme and the soft self-regulatory three-pronged system, a number of measures have been taken to deter the presale property problems, and they are discussed as follows:

To deter developer's default risk on the development project

In order to ensure that the development is adequately financed, documentation like guarantee from banks/associated company to show the developer's financial ability to complete the development are required. Furthermore, to protect the payments that the buyers made, the solicitor of the developer will hold the money as stakeholders in an escrow account and is entitled to release only the amount certified by the architect as having been expended

⁴ The Consent Scheme can be applied only to developments under government lease of which the government has been given the control over the development. For those redeveloped land of which no such consent is required in the lease, the Law Society has issued a statutory declaration form and a standard form of Agreement for Sale and Purchase with the mandatory clauses similar to those that are used for the Consent Scheme for use of redevelopment projects, known as Non-consent Scheme.

on the building. Since the measures introduced in the Consent Scheme, presale buyers have received effective protection against unscrupulous developers from defaults of construction.

To deter delay on completion

As stipulated in the Consent Scheme, if the developer fails to complete the construction on/ before the date specified other than force majeure reasons, the buyer has the right to rescind the agreement or receive the interest loss on the payment made and other necessary expenses if no extension of the construction has been approved. So far, the enforcement of the measures has been effective with the commitment of the parties concerned. For example, the CC took the initiative to help the buyers claim compensation from a developer on the delayed delivery of the properties. At the end, the developer agreed to compensate to avoid a lawsuit (Next Magazine, 2005).

To deter higher building defects

A warranty clause must be made by the developer in the ASP to ensure that “the building work is done in a good and workmanlike manner that the materials used are good and proper, and that the property will be reasonably fit for human habitation or for the purpose for which it is built.” A liability warranty of one year will be issued and the developer shall remedy any defects to the completed property as soon as “reasonably practicable” upon receipt of a written notice of the buyer within the year. In practice, developers would undertake the rectification works but in a very slow manner which often caused inconvenience to the buyers.

To deter exaggeration of saleable areas

It is mandatory that the “saleable floor area” together with the “gross floor area” must be specified in the presales brochures, and compensation must be rendered to the buyer if the saleable area of the completed property differs from that is stated in the forward contract. The “saleable area” refers to the floor area con-

tained within the enclosing walls of a residential property measured up to the external edge of the enclosing wall or the centre line of a separating wall between two adjoining units. Whereas, the “gross floor area” is an apportioned share of the total domestic gross floor area of the development (LC Papers, 2000a and 2000b). However, the methods of apportionment and the main components of common areas to be included in the calculations so as the ancillary facilities like the utility platforms detached to the flat have not been standardized.

Twenty years ago, developers adopted the standard used by the Buildings Department in calculating the saleable areas of buildings which contained neither podium and parking lot nor the ancillary facilities. But now, developers counts whatever they can find to “inflate” the saleable areas in order to make more room for sales because of the lack of standardized methods for measuring floor areas. The “net internal floor area” that can be used by buyers in recently-built properties is only around 60% of the “gross floor area” claimed⁵. A consultation paper prepared by the government in 2000 (LC Paper, 2000c) recommended that the “internal floor area”, the common areas and the ancillary facilities that are included in calculating the “gross” and “saleable” areas, should all be indicated in the sales brochures, but the recommendations were turned down with the objection of REDA.

To deter features mismatch upon completion

It is stipulated in the Consent Scheme that the ASP should contain a description of the fittings and finishes, for example, the door panels, the type of kitchenware and bathing facilities. However, the descriptions made there are usually vague and subject to change. Many

⁵ For example, a flat which was claimed to have a gross area of 1078ft² with saleable area of 857ft², the usable floor area inside the flat was found 640ft², only about 60% of the “gross” area (Next Magazine, 2006).

developments have been disguised as up-market estates in the sample flats and presales brochures. But they turn out to be no difference from ordinary residential flats without the luxurious internal fittings/decoration inside and outside, nor the communal/recreational facilities prescribed in the presales. To obviate disputes over the state of the completed properties, the consultation paper (LC Paper, 2000c) recommended that developers should keep the relevant sales brochures, miniature models and photographs depicting the interior of the sample properties as evidence to facilitate proof in court if necessary. However, the recommendations were also turned down because REDA considered them impractical.

To deter unscrupulous marketing / sales tactics

To enable prospective buyers to get hold of adequate and accurate information when considering a purchase, the REDA, at the request of the government, set up a self-regulatory system in June 2001 which requires its members to comply with the guidelines issued when pre-selling uncompleted flats. The guidelines require developers to include in sales brochures a variety of information with the aims at enhancing the transparency of the market. However, incidences showed that developers kept

using grey areas for not adhering to the requirements stipulated. For example, two leading developers in recent presales breached the internal guidelines by withholding price lists from potential buyers. Another developer was even alleged to have demanded HK\$50,000 from potential buyers before a price list was given (Apple Daily, 2006). As a result, the government urged REDA to step up its efforts to ensure compliance with the guidelines, but no further disciplinary action was taken on the developers.

4. CRITICAL FACTORS FOR DEVELOPMENT OF THE FORWARD PROPERTY MARKET

The operation mechanism of the forward property market in Hong Kong, through the use of the administrative measures contained in the Consent Scheme and the three-pronged system, has been considered effective in boosting up the economy, yet presale problems are still commonly found in the market. Based on the review of the measures taken in correcting the imperfection information problem and in deterring the presale property problems as discussed above, insights can be drawn on the factors which are critical for enhancing the development of the forward property market as shown in Figure 3.

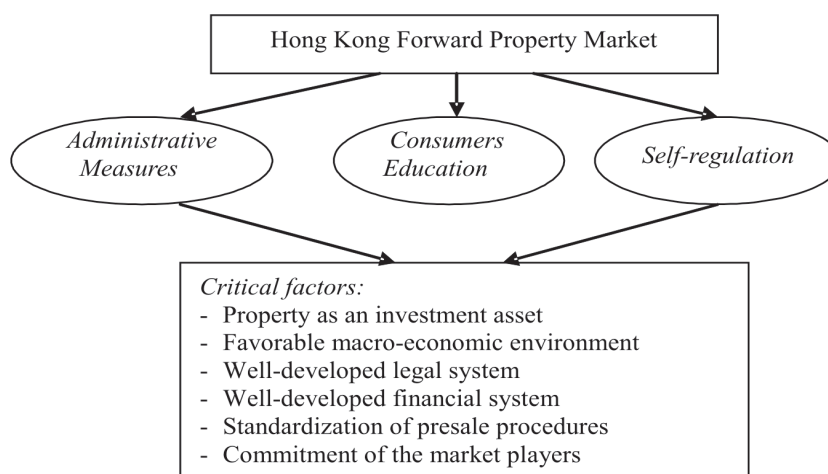


Figure 3. Critical factors for an effective presale mechanism of forward property market

Property as an investment asset

Property in Hong Kong has been considered a safe investment which generates reliable incomes accompanied with capital growth, and thus it has been a popular investment alternative with high transaction volume. Furthermore, the business tactics of developers, on one hand, focusing on large-scale self-contained condo projects maximizing floor area which are favoured by buyers and, on the other, get access to low-cost finance through presales, have earned them generous profits. These have made presales of uncompleted properties, as substitutes of spot properties, popular in Hong Kong.

A favourable macro-economic environment

A number of macro-economic factors have exacerbated the strong demand for properties in Hong Kong in the past two decades, despite the up-and-down cyclical movements over the years. These included the continued population growth from around 4 million in 1980 to nearly 7 million in 2006 caused by the influx of immigrants, the foreign capital influx and the home-ownership policy promoted by the government. More important, the negative interest rates resulted from the linked exchange system coupled with the boom economy in Hong Kong in the 1980s and early 1990s had exacerbated the already surging demand for property. Despite the Asian Economic Turmoil in 1997, there has been a robust recovery of the economy in years from 2004 to 2006 because of the strong trade and financial industry growth. The economy picks up again with an impressive increase in GDP of 7.3% in 2005, and so as the sales of spot properties and the presales of uncompleted properties.

Transparency of the forward property market

Transparency of the forward property market is of utmost importance to facilitate effective valuation of presale property investments. The mandatory disclosure of information required in the Consent Scheme and the voluntary self-regulatory measures taken by the

REDA, to a certain extent, allow presale properties to be traded effectively. Investors' awareness of the forward risks relating to their affordability is also enhanced through educational activities taken by CC and EAA. The measures, to a certain extent, create a favourable environment for investment decisions.

A well-developed legal system

Hong Kong offers a sound legal system with a corruption-free environment in protecting property investors' interests. They include the strong foreclosure laws, the availability of recourse lending and the tight underwriting standards relating to transacting presale properties. Apart from the Consent Scheme guiding the arrangement of the ASPs, the formation of equitable mortgage also standardise the procedure for financing a purchase of a presale property. There are also strong and efficient regulatory bodies like the Lands Department to oversee the various conditions stipulated in the Consent Scheme, which the developer and his solicitor must comply. These criteria and conditions are refined from time to time in response to the prevailing social and economic environment.

A well-developed financial system

Hong Kong has a well-established financial system to support the building project finance through, for example, issue of debts, bonds and/or securitization of investment assets. To ensure that the developer must be able to meet the construction expenses, two methods of financing the outstanding construction costs are accepted by the government, they are building mortgage and/or bank undertaking. Both methods must be undertaken by either a licensed bank or registered deposit taking company to guarantee completion of the development. For the buyers, equitable mortgage has been popularly used for financing a purchase of a presale property.

Standardization of presale procedures

The procedure on transacting presale prop-

erties and the practice on conducting the presales have been standardized through the set up of the Consent Scheme and the self-regulatory guidelines taken by REDA to safeguard the rights of the buyers. As such, the operation of the forward property market has been streamlined and confusion could be, to a certain extent, avoided. The standardized ASPs for pre-selling uncompleted properties and the formation of the sample equitable mortgage contract have also facilitated the financing matters relating to presales.

Commitment of the market players

Commitment of the government to protect presale property buyers is of utmost importance for the success of the forward property market. Apart from the administrative measures, the government meet regularly with REDA, CC and EAA to monitor the presale mechanism and solicits views from the public. However, the guidelines set by REDA and EAA are on voluntary basis only with no legal binding. Incidences showed that developers were not committed to adhering to the guidelines and disseminating misleading information for boosting the sales. Also, the consultant paper prepared in 2000 made a number of recommendations to address the inadequacy of protection for presale property buyers. Despite the urge of the public, many of the recommendations such as the use of "internal floor area" that can be used by buyers and the keeping of sample flats for future reference were turned down largely due to the objection of REDA. Furthermore, measures being used in other places, such as the use of retention money to enhance developers in correcting defects and the sales brochures to be attached to the ASP to prove the subject commodity for sale, should also be considered.

5. CONCLUSION

There has been an increasing use of forward contracts to pre-sell uncompleted units of large-scale housing projects by developers to release

their financial burden. However, numerous problems have been found using this financing means because of the asymmetric information problem embedded in the forward property market. They include default of the project in the mid-way of construction, snagging problems and others. By referencing the development of the forward property market in Hong Kong for the past five decades and the various government initiatives in monitoring the operation of the market, the set of factors which can enhance the development of an effective forward property market has been identified as follows:

- property market as an investment asset,
- a favourable macro-economic environment,
- transparency of the forward property market,
- a well-developed legal system,
- a well-developed financial system,
- standardization of presale procedures,
- commitment of the government.

The operation mechanism adopted in Hong Kong which includes both administrative measures and self-regulatory system has provided, to a certain extent, protection to presale property buyers against unscrupulous developers. It also lays down the important references for the development of a forward property market, despite the rooms for improvement. Yet, further research are needed to investigate how the monitoring system can be enhanced and whether similar mechanism for pre-selling uncompleted properties can be applied in different places where socio-cultural and economic environment are different.

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SANTRAUKA

ASIMETRINĖ INFORMACIJA HONKONGO IŠANKSTINĖJE (DAR NEPASTATYTO) TURTO RINKOJE

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Išankstinės sutartys, pardavinėjant plotą neužbaigtuose pastatuose, populiarėja daugelyje šalių. Tačiau nėra daug tyrimų, kuriais siekiama išnagrinėti riziką, kylančią dėl asimetrinės informacijos, būdingos turtą perkant išankstinio pardavimo metu, ir kritinius veiksnius, kurie padėtų efektyviai plėtoti dar nepastatyto turto rinką. Honkongas – viena iš didžiausių dar nepastatyto turto rinkų pasaulyje. Ji pradėjo bręsti po pusę amžiaus trukusios raidos. Todėl šiame darbe siekiama išnagrinėti asimetrinės informacijos problemą, aptinkamą dar nepastatyto turto rinkose įvairiose srityse. Straipsnyje, pateikiant pavyzdžių iš Honkongo dar nepastatyto turto rinkos plėtos, tyrinėjama grupė veiksmų, kurių vaidmuo yra lemiamas tokios rinkos plėtroje.

APPENDIX 1

Real Estate Developers' Association of Hong Kong - Guidelines for Sales Descriptions of Uncompleted Residential Properties

To enhance the transparency of the private sale mechanism, the following guidelines, which have been revised on 25 August 2006, are to be adopted by all members of REDA.

1. Sales brochures should be made available to prospective purchasers at least 24 hours before the private sale.

2. Sales brochures should contain essential information in respect of the property offered for sale, including but not limited to the following:

- floor area and floor plan,
- prominent fittings and finishes,
- location plan and drawn to scale,
- disposition plan,
- salient conditions of the Government lease,
- salient provisions of the draft the Deed of Mutual Covenant (DMC),
- obligations for slope maintenance if any,
- anticipated completion date,
- management fee details.

3. A copy of the draft the DMC and the Government lease should be provided at the sales office for free inspection by prospective purchasers.

4. An enquiry counter should be set up at the sales office and a hotline be made available to provide information relating to the property being offered for sale.

5. Leaflets on useful information for flat purchasers published by the Consumer Council and/or the Estate Agents Authority should be made available at the sales office.

6. Reasonable steps should be taken to inform purchasers of subsequent materials changes with regard to the information provided in the sales brochures.

7. The price list and the list of flats on offer should be made available at the sales office to prospective purchasers and also through estate agents (if engaged).

8. The price list of the flats to be offered in first launch (which should not be less than 20 flats or 20% of the total number of flats on offer at the first batch, whichever is the higher) should be provided to potential purchasers at least 24 hours before such flats are put up for sale.

9. For subsequent batches, an up-to-date price list should be made available and posted at the sales office immediately prior to the time when such flats are put up for sale.

10. Members are free to decide on whether or not to make public the results of their sales. If they choose to publicize, any information provided must be as accurate as possible.

11. Members should ensure that their sales activities are conducted in an orderly manner.

12. Members should specify in their promotional materials the name of any estate agency engaged by them.

13. Clear instructions on sales arrangements must be provided to the engaged estate agency.

14. Appropriate action should be taken against any estate agent (if estate agency is engaged) who is found to have adopted unprofessional sales practices.

15. Random check on the compliance with these Guidelines by members will be conducted by the REDA Secretariat.

APPENDIX 2**Notes to Purchasers of Uncompleted Properties Issued by Consumer Council and Estate Agents Authority (2006)****1. Before the purchase of uncompleted properties:**

- remember that buying uncompleted flats is different from acquiring completed ones,
- calculate the total expenses of the purchase, such as solicitors' fees, mortgage charges, insurance fees and stamp duty,
- select the appropriate payment method; calculate the amount of the mortgage loan to ensure it is within your repayment ability,
- visit the development site and get to know the surroundings of the property, and check town planning proposals and decisions which may affect the property,
- study the Sales Brochure carefully for details, the expected completion date, management fees and find out the salient terms of the Government Lease, terms of the Deed of Mutual Covenant (DMC), etc.
- have the right to request to read the Government Lease and the DMC free of charge,
- check recent transaction prices of comparable properties for comparison,
- ensure that any important matters explained or guaranteed to you by the developers staff or other persons are written into both the provisional and formal agreements for sale and purchase as part of the contractual terms; or a separate written agreement.

2. Before the appointment of an estate agent to look for a property:

- find out whether the estate agent will act on your behalf only, if the agent also acts for the developer, he may not be able to protect your interests in the event of a conflict,
- find out whether any commission is payable to the agent and the amount,
- note that only licensed estate agents or salespersons may accept your appointment. If

in doubt, call the Estate Agents Authority on 3102 0838 to make enquiries,

- note that some developers handle sales themselves and you can decide whether to appoint an estate agent.

3. Before the purchase of an uncompleted flat:

- seek confirmation from the developer whether a 'Consent to Sell' has been issued,
- note that the developer and estate agent are not allowed to receive any deposit or 'reservation fee' before the developer has obtained the "Consent to Sell",
- the deposit should be made payable to the stakeholder solicitor of the development,
- understand that your deposit of up to 5% of the property price may be forfeited if you withdraw from the Provisional Agreement for Sale and Purchase.

4. Before engaging a solicitor:

- consider engaging your own solicitor to protect your interests, if the solicitor also acts for the developer, he may not be able to protect your interests in the event of a conflict,
- compare the charges of different solicitors.