RESIDENTIAL RESEARCH

Knight Frank

ASIA-PACIFIC RESIDENTIAL REVIEW

April 2013

INTRODUCTION

A NEW WAVE OF COOLING MEASURES IN ASIA

"Residential prices have continued to go up, standing 61%, 52% and 108% above the post Lehman troughs in China, Singapore and Hong Kong respectively. "

Nicholas Holt
Asia Pacific, Head of Research

As housing markets continue to see significant price inflation, China, Hong Kong and Singapore introduce yet more lending restrictions, additional taxes and regulations. How will the markets react and just how far could policy makers continue to go? Nicholas Holt looks into the numbers and provides the context.

Given policy maker's records over recent years, few were overly surprised about the new rounds of government intervention in China, Singapore and Hong Kong. Residential prices have continued to go up, standing 61%, 52% and 108% above the post Lehman troughs in China, Singapore and Hong Kong respectively.

In this edition of the Asia Pacific Residential Review, we look in more depth at the cooling measures that have been brought in across the region over the last few years (pages 4-11), examining the type of policy used and the impact they have had on both the mainstream and prime residential markets.

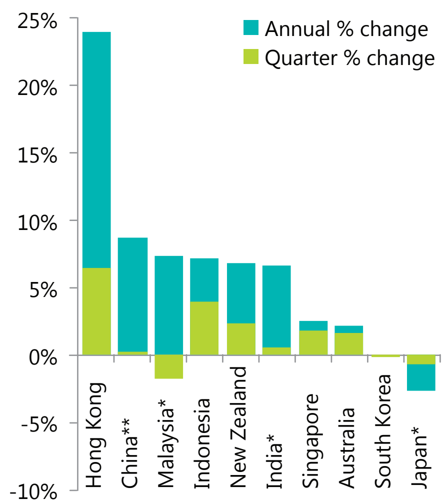
The picture that emerges is one of a post-crisis Asia that has seen its property markets rebound so strongly (driven by numerous factors), that it has motivated governments to intervene. Issues of affordability for first time buyers have been brought into sharp focus, while the price increases have caused concern to many who have not forgotten what happened when an external trigger sets in motion a serious correction (as it did in 1997/8 – see page 14).

Interestingly, while in the west, there is to some extent a more laissez-faire approach to housing markets, we have also seen policy makers intervene, but for different reasons. As we are seeing in the US, a pick-up in the housing markets can lead a wider economic recovery through the wealth and multiplier effects. This reasoning is also being applied in the UK, where the recent budget demonstrates how the government's hopes of an economic recovery lies in the housing market.

These wider considerations and impacts are one reason why we continue to carefully monitor the markets in Asia Pacific, examining the key indicators and risks while analysing what measures policy makers are taking.

It is our view that while a number of markets in Asia Pacific are likely to correct over 2013, the fact that government intervention has occurred to such a large extent over that last few years, has taken some risk out of the market, while at the same time arming policy makers with the option to lift measures to reinflate demand if necessary.

Figure 1
Global House Price Index Q4 2012



*Data from Q3 2012
**Based on Beijing and Shanghai

Source: Knight Frank Research

VOLUMES START TO DROP IN HONG KONG, AS COOLING MEASURES AND A RISE IN INTEREST RATES DAMPENS DEMAND

In **Hong Kong**, the doubling of stamp duty for property over HKD 2 million to up to 8.5% has finally put the brakes on volumes transacted in the local market. The HKMA's decision to order banks to increase the amount of capital they hold against new residential mortgages led to an increase in interest rates of around 0.25% by the major banks. Mainstream prices increased 23.6% in 2012.

Singapore meanwhile has seen the seventh round of cooling measures, with rumours continually circling of an eighth. Cooling measures were also introduced in to the non-residential sphere for the first time, with an exit stamp duty introduced on industrial property sold within four years from the date of purchase. The recent budget has also set out an increase in property tax for high-end residential real estate, set to be phased in over 2014-15.

China has sent out a strong signal, as power was officially passed to the new president, with a set of "five rules" including a capital gains tax of 20% required by local authorities to be fully implemented. Many buyers were looking to exit before these measures are enforced, most notably in Shanghai, which saw an increase in volumes transacted in March.

Malaysia has continued to see the market remain quiet in light of the impending elections. Malaysian interest in property abroad continues, notably with SP Setia's Battersea Power Station development selling successfully in the local market.

In **India**, the market has remained fairly soft, with the relatively subdued economic performance continuing to reduce volumes. Prices however increased in 18 of the 20 markets monitored, giving a non-weighted price increase of 6.5% across India in 2012.

In **Indonesia**, Jakarta's property boom continued with some of the largest price increases across the region in recent months. Developers and investors continue to enter the market, remaining bullish on the back of solid fundamentals.

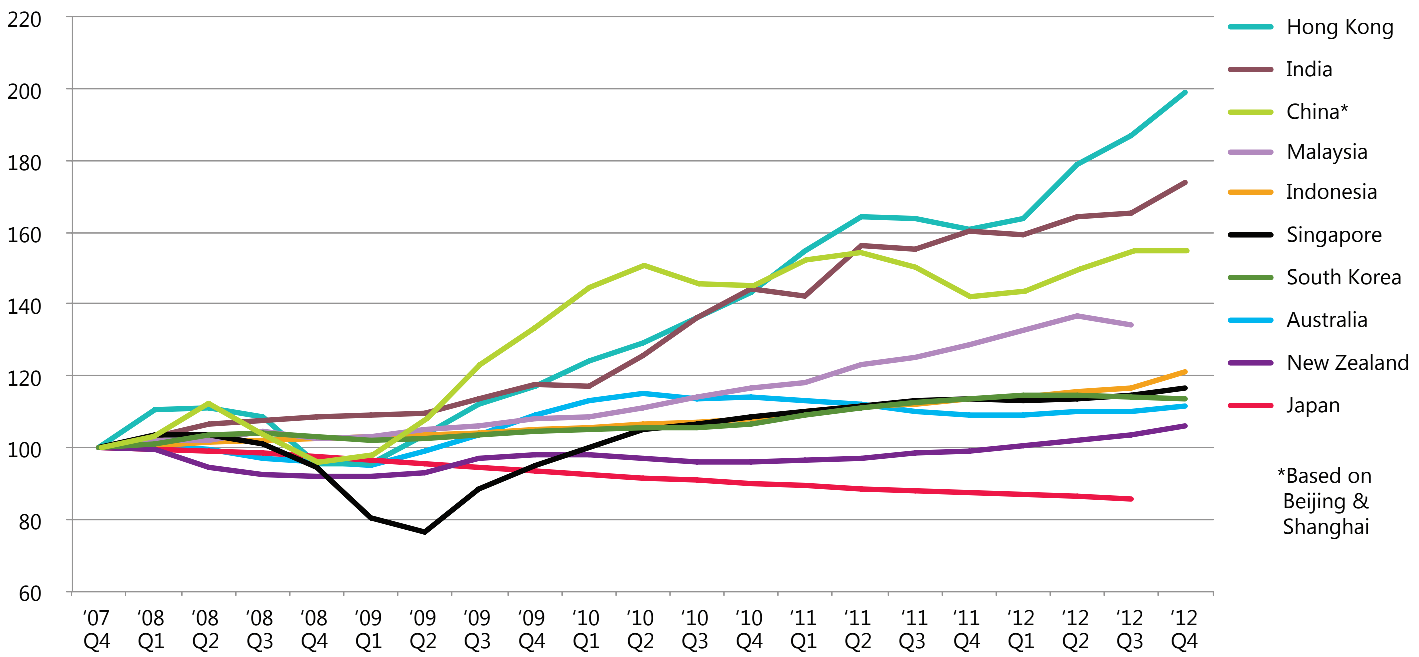
The **Vietnamese** government has proposed a package to invest VND30 trillion (nearly US$1.5 bn) into its flagging real estate market. The package will incorporate a preferential fixed interest rate of 6% for certain borrowers for 3 years.

Australia, in the midst of the longest lead up to an election ever, continued to see property markets stagnate. Hopes of a recovery in activity have however been buoyed by increases in auction clearance rates and private treaty sales in key cities.

In **New Zealand**, a 6.7% price increase across the country, with much larger increases in Auckland and Christchurch has started to cause concerns. Policy makers have started a consultation period on the possibility of using various tools to cool the market down.

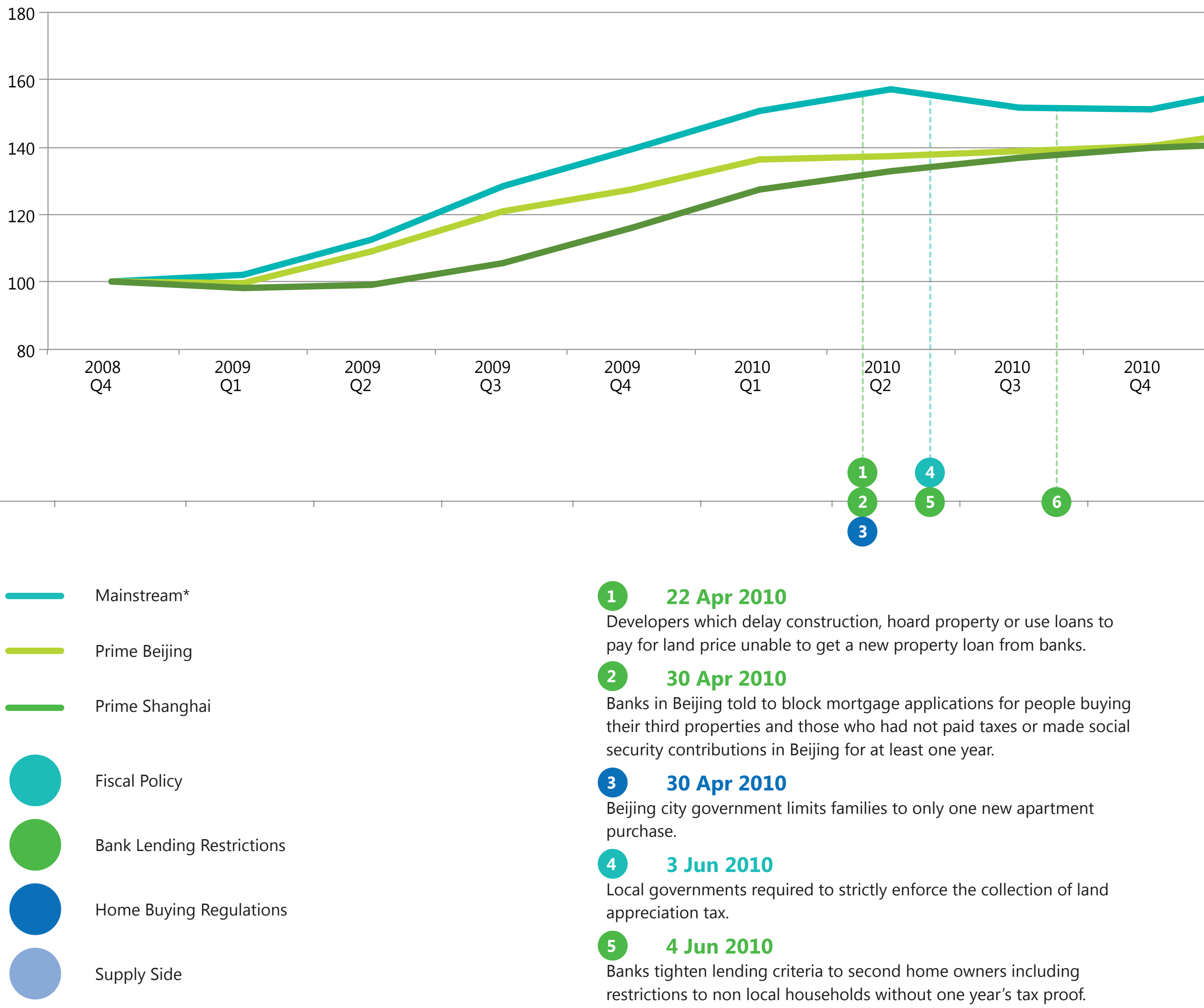
Finally, the Bank of **Japan's** recent ground-breaking new expansionary monetary policies which aim to end Japan's two decade deflationary spiral, could have significant repercussions for the property market.

Figure 2
Global House Price Index (Q4 2007 = 100)



Source: Knight Frank Research

CHINA
COOLING MEASURES TIMELI



*Based on Beijing & Shanghai

1 22 Apr 2010
Developers which delay construction, hoard property or use loans to pay for land price unable to get a new property loan from banks.

2 30 Apr 2010
Banks in Beijing told to block mortgage applications for people buying their third properties and those who had not paid taxes or made social security contributions in Beijing for at least one year.

3 30 Apr 2010
Beijing city government limits families to only one new apartment purchase.

4 3 Jun 2010
Local governments required to strictly enforce the collection of land appreciation tax.

5 4 Jun 2010
Banks tighten lending criteria to second home owners including restrictions to non local households without one year's tax proof.

6 29 Sep 2010
Banks prohibit lending to buyers who already had two homes and the down-payment ratio of first-home purchases rise to at least 30%.

Source: Knight Frank Research

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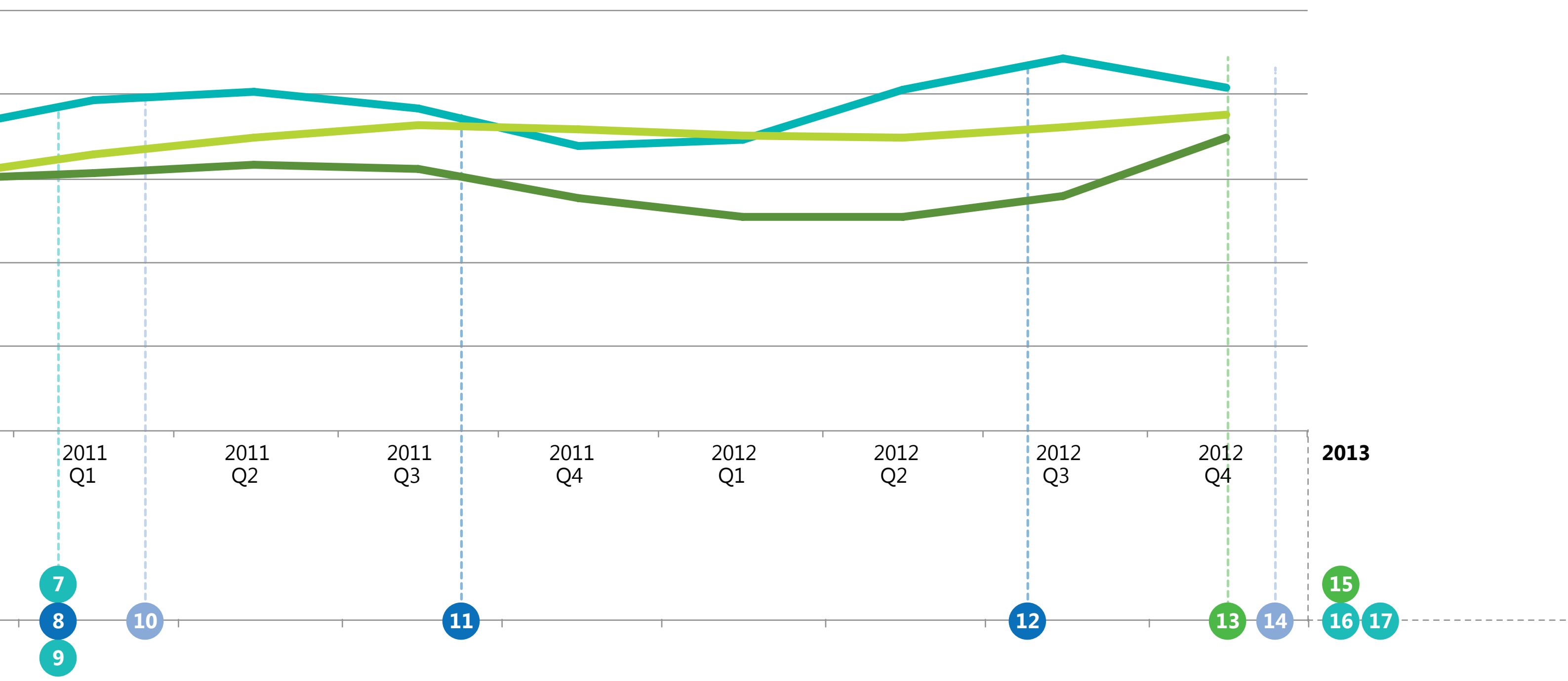


7 **26 Jan 2011**
Minimum down-payment ratio for second-home purchases rise to 60% from 50%.

8 **26 Jan 2011**
Local governments required to cap the number of apartments residents can purchase.

9 **28 Jan 2011**
Trial property tax launched in Chongqing and Shanghai.

10 **14 Mar 2011**
36 million public affordable housing units to be built 2011-2015.

11 **Aug – Sep, 2011**
Home purchase restrictions extend to some second and third-tier cities such as Taizhou and Quzhou in the Zhejiang province.

12 **13 Jul 2012**
Central government issues an emergency notice urging local governments to correct loosening in property control policies.

13 **2 Nov 2012**
People's Bank of China promise its future property loan policies will aim at suppressing speculative and investment demand in the real estate market.

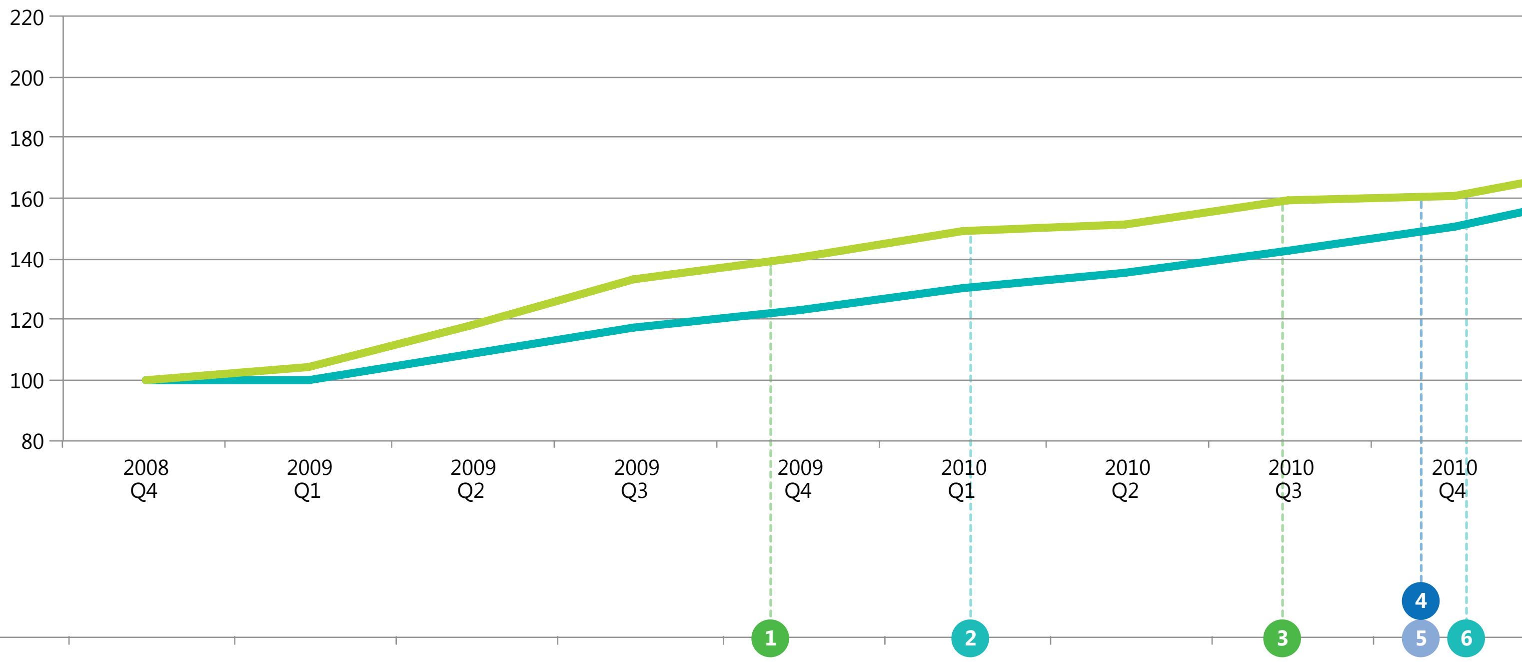
14 **4 Dec 2012**
CCP Politburo announce property market controls will be strengthened and social housing supply secured in 2013.

15 **1 Mar 2013**
China tells its central bank to raise down-payment requirements and interest rates for second-home mortgages in cities with "excessively fast" price gains as authorities step up efforts to cool the property market.

16 **8 Mar 2013**
Central government announce "Five Rules" of property tightening, including the 20% capital gain tax. Detailed terms determined by local governments.

17 **Mar 2013**
Local governments announce detailed policies in the spirit of State Council's "Five Rules", but they are in general benign with no drastic measures. Most Tier-2 cities silent on 20% capital gain tax.

HONG KONG COOLING MEASURES TIMELI



Mainstream

Prime

Fiscal Policy

Bank Lending Restrictions

Home Buying Regulations

Supply Side

1 23 Oct 2009
HKMA lowers LTV ratio to 60% for residential mortgages on properties valued at $20 million or more.

2 04 Feb 2010
Stamp duty on transactions of properties valued more than HK$20 million increased to 4.25%. Deferred stamp duty payment on such transactions no longer allowed.

3 13 Aug 2010
Disallowed confirmor transactions of first-hand uncompleted flats, maximum LTV ratio lowers, require banks to stress-test mortgage applicants.

4 13 Oct 2010
Introduce My Home Purchase Plan.

5 13 Oct 2010
Increase land and housing supply.

6 20 Nov 2010
Introduce Special Stamp Duty (SSD) on all residential property transactions.

Source: Knight Frank Research

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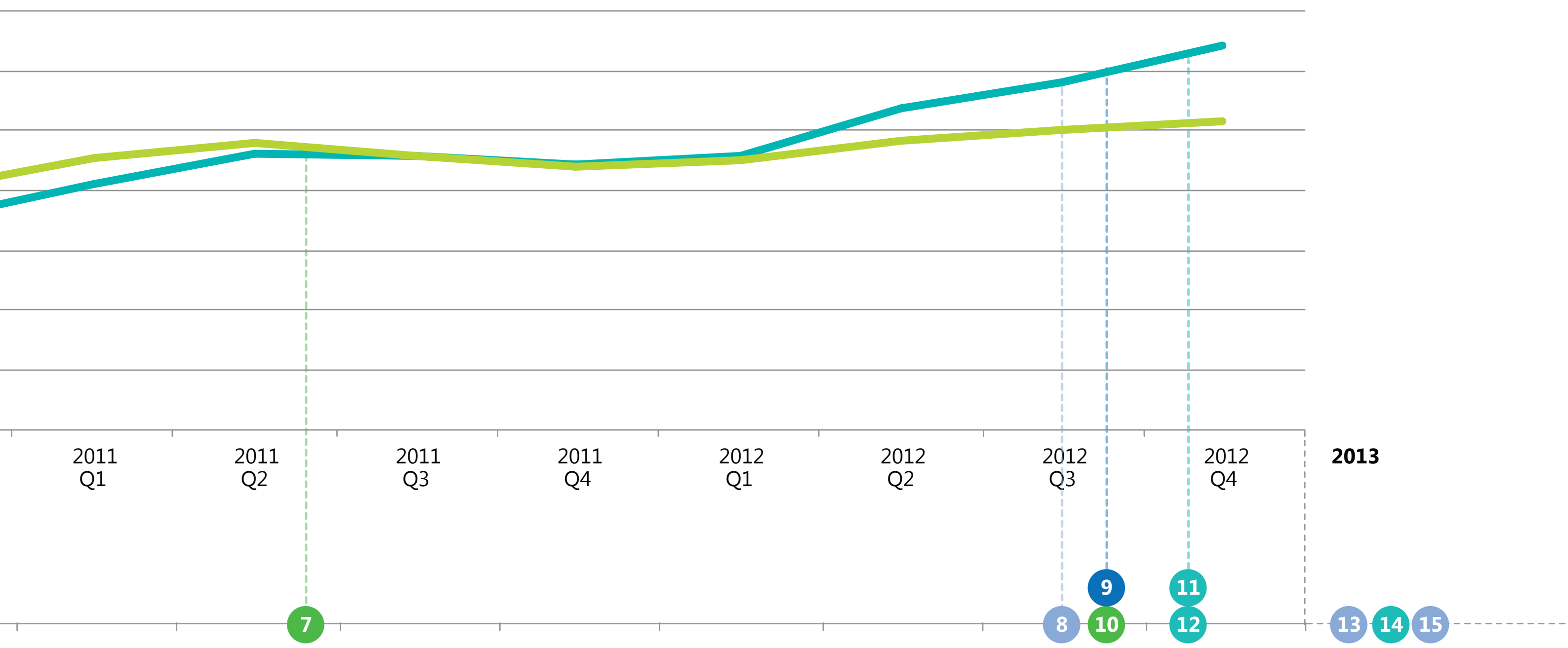


7 — 10 Jun 2011
HKMA lowers LTV ratios for residential mortgages on properties valued at $7 million or above. Lower LTV ratios apply to overseas buyers.

8 — 30 Aug 2012
Hong Kong's government says it will speed up the approval of permits for private project sales and began selling some public units originally intended for rent.

9 — 06 Sep 2012
Hong Kong restricts buyers of apartments on selected sites, planning to sell to local residents only as the government attempts to cool housing prices.

10 — 14 Sep 2012
HKMA says it will limit the maximum terms on all new mortgages to 30 years. It also lowers the cap on mortgage payments for investment properties to 40% of buyer's monthly income, from 50%.

11 — 29 Oct 2012
Introduce a new Buyer's Stamp Duty (BSD). Non-permanent residents as well as both local and foreign companies to pay an additional 15% BSD for buying homes in Hong Kong.

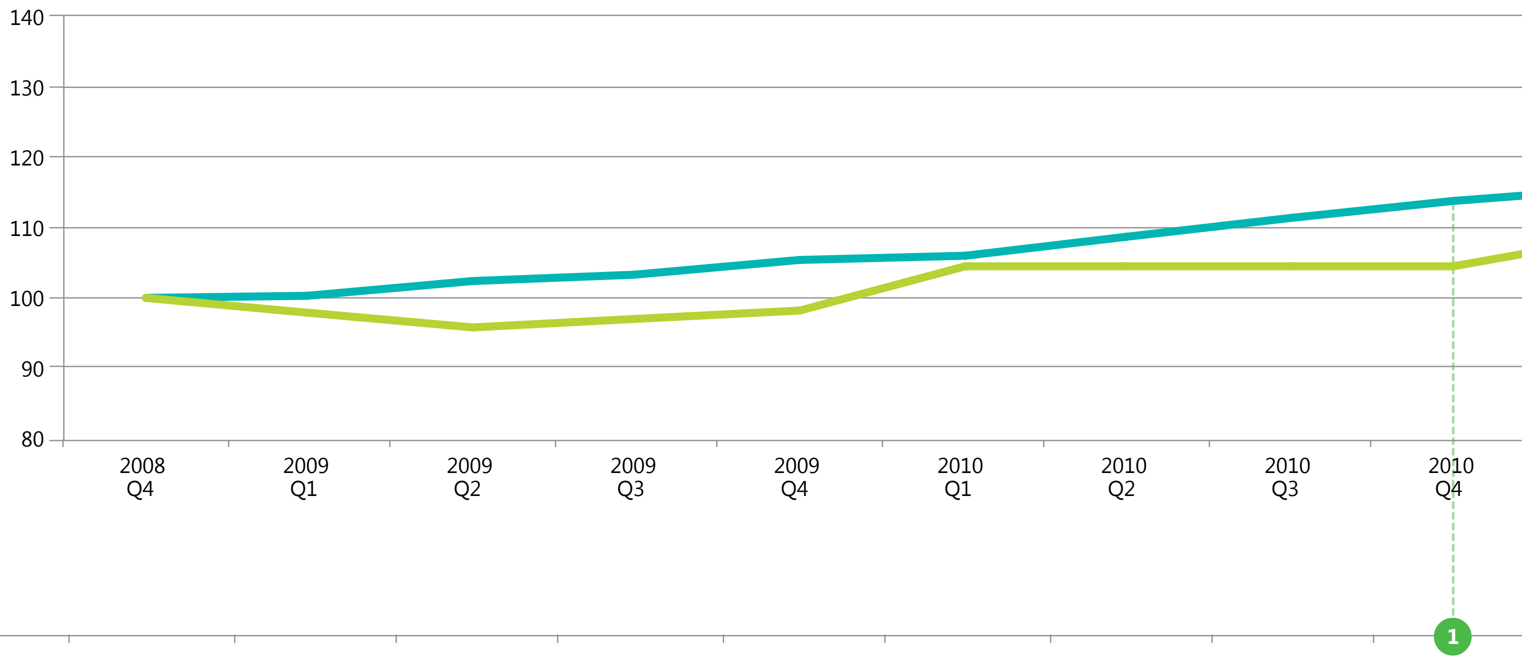
12 — 29 Oct 2012
SSD extends for another three years and the rates rise.

13 — 16 Jan 2013
Hong Kong will build a land reserve and speed up public-housing construction, Chief Executive Leung Chun-ying says.

14 — 22 Feb 2013
Hong Kong doubles the stamp duty on all property deals over HK$2 million, including residential, commercial, industrial properties and car parks, to as much as 8.5%. HKMA also requires banks to lower the maximum mortgage loan-to-value ratio on commercial properties by 10%.

15 — 1 Mar 2013
The government announces to scrap the application list system. Instead, it will release a schedule for land sales every quarter starting from April.

MALAYSIA
COOLING MEASURES TIMELI



Mainstream

Prime

Fiscal Policy

Bank Lending Restrictions

Home Buying Regulations

1 Nov 2010
The Central Bank of Malaysia implements the 70% LTV which is applicable to the third house financing facility taken out by a borrower.

2 01 Apr 2011
The Central Bank of Malaysia raises the Statutory Reserve Requirement (SRR) from 1% to 2% to manage liquidity but maintains the Overnight Policy Rate (OPR) at 2.75%.

3 16 May 2011
The Central Bank of Malaysia raises the Statutory Reserve Requirement (SRR) from 2% to 3% and the Overnight Policy Rate (OPR) from 2.75% to 3%.

4 16 Jul 2011
The Central Bank of Malaysia again raises the Statutory Reserve Requirement (SRR) from 3% to 4%.

Source: Knight Frank Research

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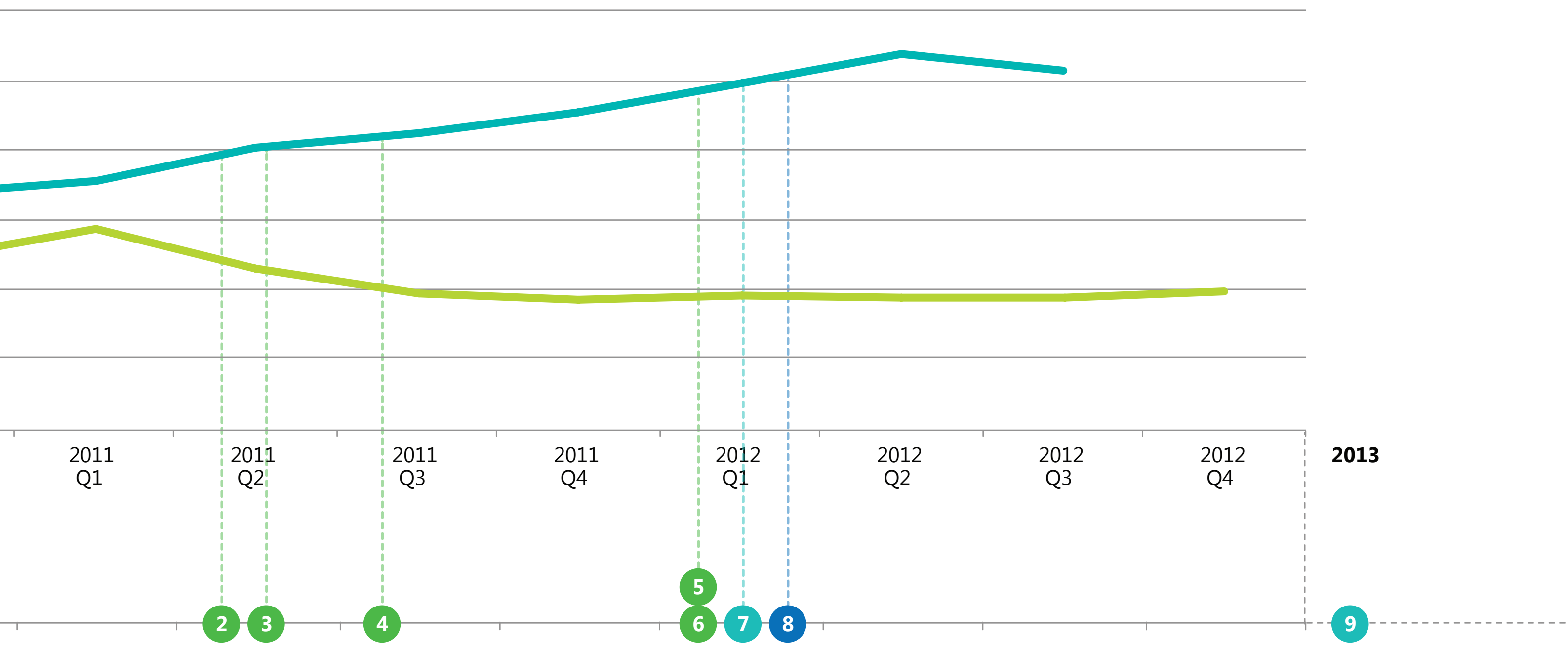


5 **01 Jan 2012**
Guidelines released to further tighten lending that require financial institutions to make assessments of a borrower's ability to afford financing facilities based on a prudent debt service ratio as inputs to their credit decisions (to be based on net income).

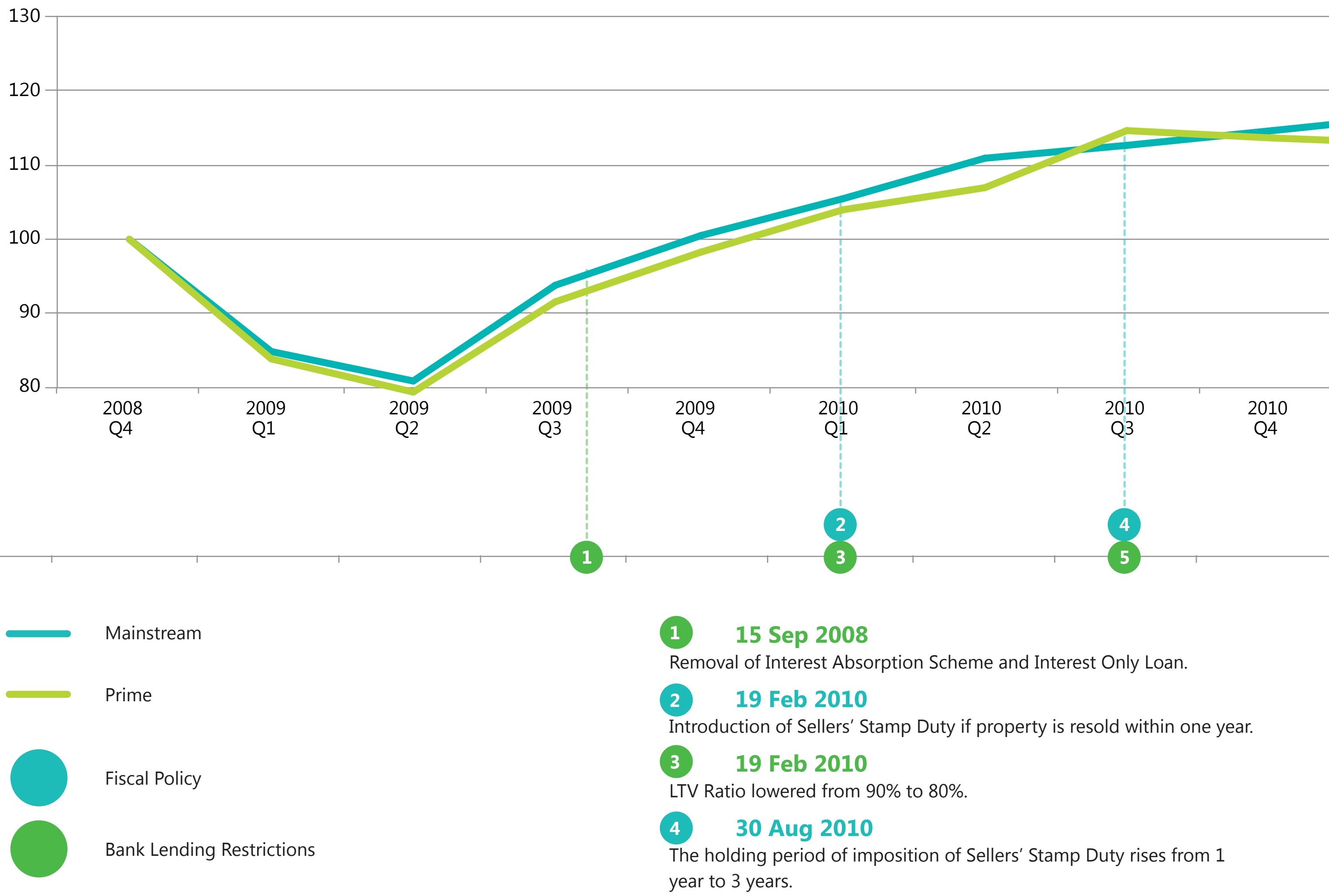
6 **01 Jan 2012**
Financial institutions must make appropriate enquiries into a prospective borrower's income after statutory deductions for tax and EPF, and consider all debt obligations, in assessing affordability.

7 **01 Jan 2012**
Real Property Gains Tax (RPGT) falls to 10% from 5% for properties held and disposed of within two years.

8 **01 Jan 2012**
Budget 2012 proposes to increase the maximum price ceiling for houses under the My First Home (MFH) scheme to RM400,000. This improved scheme is available to house buyers through the joint loans of both husband and wife beginning January 2012.

9 **01 Jan 2013**
RGPT falls to 15% from 10% for properties disposed of less than 2 years after purchase. RPGT for houses sold 2-5 years after purchase rise to 10% from 5%.

SINGAPORE COOLING MEASURES TIMELI



In 2013...

- The government also introduced measures on public housing to control leasing and ownership of HDB flats by Permanent Residents.
- New development guidelines for executive condominiums cap maximum strata floor area of EC units at 160 sq m and restrict sales of new dualkey EC units to multi-generational families only.
- Private enclosed space (PES) and private roof terraces will be counted as gross floor area (GFA) under the 10% bonus GFA, similar to the treatment for balconies.

1 **15 Sep 2008**
Removal of Interest Absorption Scheme and Interest Only Loan.

2 **19 Feb 2010**
Introduction of Sellers' Stamp Duty if property is resold within one year.

3 **19 Feb 2010**
LTV Ratio lowered from 90% to 80%.

4 **30 Aug 2010**
The holding period of imposition of Sellers' Stamp Duty rises from 1 year to 3 years.

5 **30 Aug 2010**
Property buyers who already have one or more outstanding housing loans at the time of new housing purchase have to pay 10% of valuation limit instead of 5% and the LTV limit decreases from 80% to 70%.

6 **14 Jan 2010**
The holding period of imposition of Sellers' Stamp Duty will rises from 3 years to 4 years.

7 **14 Jan 2011**
SSD rates rise to 16%, 12%, 8% and 4% of consideration for residential properties which are bought on or after 14 January 2011, and are sold in the first, second, third and fourth year of purchase respectively.

Source: Knight Frank Research

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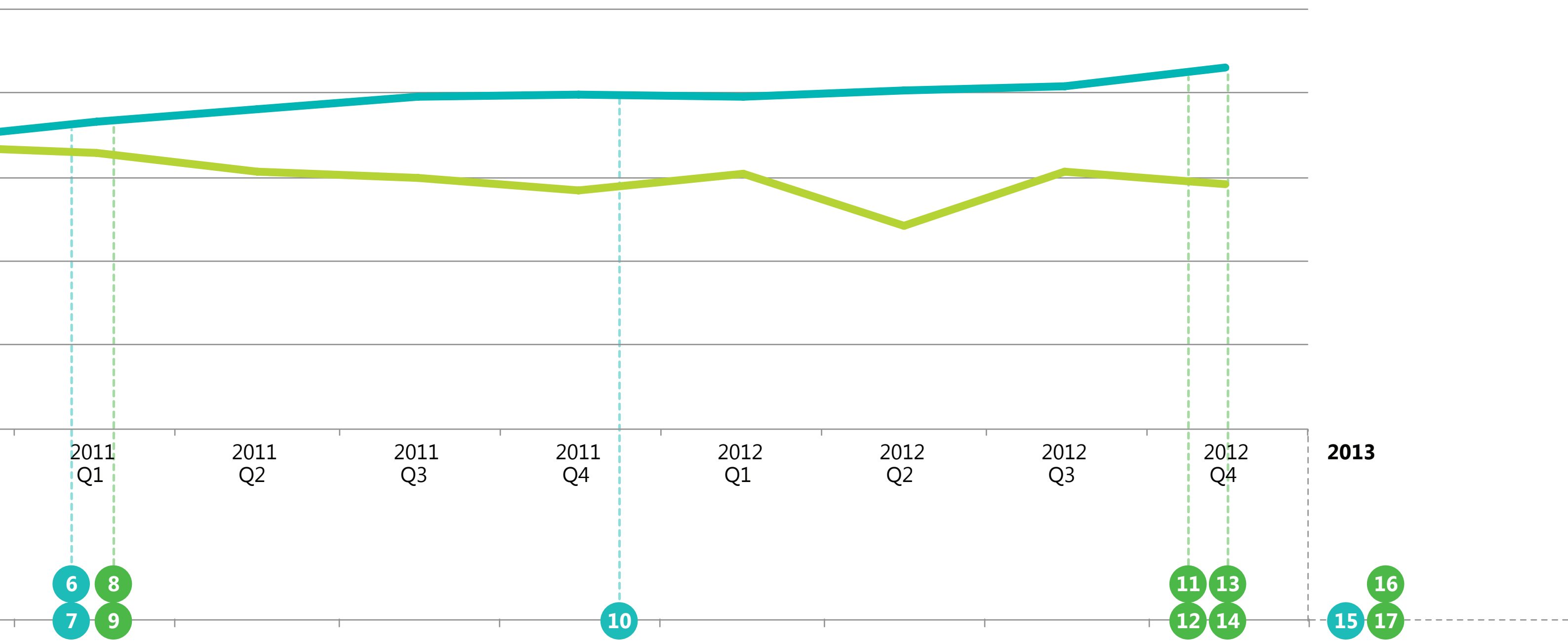


8 **14 Jan 2011**
LTV limit falls to 50% on housing loans granted by financial institutions regulated by MAS for property purchasers who are not individuals.

9 **14 Jan 2011**
LTV limit falls on housing loans granted by financial institutions regulated by MAS from 70% to 60% for property purchasers who are individuals with one or more outstanding loans at the time of the new housing purchase.

10 **7 Dec 2011**
Foreigners and non-individuals (corporate entities) buying any residential property pay an ABSD of 10%; b) Permanent Residents (PRs) owning one and buying the second and subsequent residential property pay an ABSD of 3%; c) Singapore Citizens (Singaporeans) owning two and buying the third and subsequent residential property pay an ABSD of 3%.

11 **6 Oct 2012**
Absolute limit of 35 years imposed on the tenure of all loans for residential property.

12 **6 Oct 2012**
LTV ratio lowers for new residential property loans to borrowers who are individuals, if: the tenure exceeds 30 years; or the loan period extends beyond retirement age of 65 years. For these loans, the LTV limit is: 40% for a borrower with one or more outstanding residential property loans and 60% for a borrower with no outstanding residential property loans.

13 **6 Oct 2012**
Lower the LTV ratio for residential property loans to non-individual borrowers from 50% to 40% the loan period extends beyond the retirement age of 65 years.

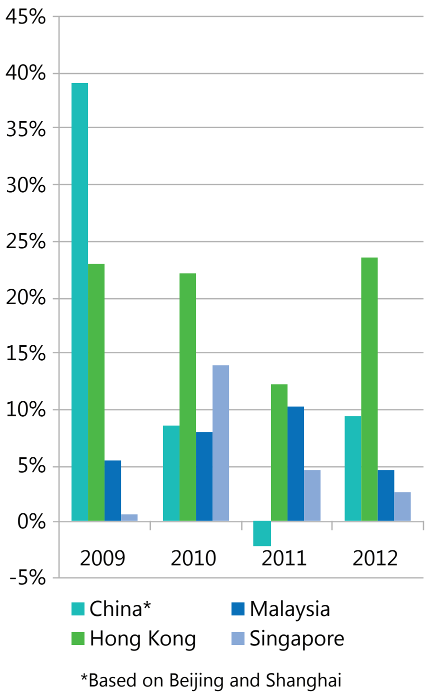
14 **6 Oct 2012**
For new residential property loans to borrowers who are individuals, if: the tenure exceeds 30 years; or the loan period extends beyond the retirement age of 65 years. For these loans, the LTV limit will be: 40% for a borrower with one or more outstanding residential property loans, 60% for a borrower with no outstanding residential property loan.

15 **11 Jan 2013**
ABSD rates increase between 5 – 7% across the board.

16 **11 Jan 2013**
LTV limits on housing loans granted by financial institutions tighten for individuals who already have at least one outstanding loan, as well as to non-individuals such as companies.

17 **11 Jan 2013**
The minimum cash down payment for individuals applying for a second or subsequent housing loan will also be raised from 10% to 25%.

Figure 5
Annual Price Growth in Mainstream Markets



Source: Knight Frank Research

Government Intervention in Other Countries

Indonesia: July 1, 2012 70% LTV Cap introduced for properties over 70 sqm.

New Zealand: March, 2013 Reserve Bank of New Zealand looking to introduce new economic tools to control rising prices.

Analysis

The aims of the interventions are broadly the same across all of the key markets; control price inflation, reduce the role of speculators and help support first time buyers. The tools being used are a mixture of fiscal policy, supply side intervention, home buyers regulations and financing restrictions.

If we start by looking at annual price growth in the major markets, we can see that in Malaysia, prices have flattened considerably over the last 12 months, perhaps also due to the "wait and see" attitude in light of the upcoming election. In China, Singapore and Hong Kong, the success of the cooling measures in actually reducing price inflation is more mixed. Singapore has seen a reduction in annual price growth, but not perhaps the reduction policy makers expected after the 5th round of cooling measures. China saw prices drop in 2011, but they rebounded in 2012. Hong Kong stands out as continuing to see strong price inflation, buoyed by the low interest rates (the HKD is pegged to the USD) and tight supply.

In terms of other tangible results, there is no doubt that the cooling measures have been effective in reducing speculation, simply by pricing them out by extra taxes and limiting finance options. The pick-up in equity markets over the last quarter has also seen some of these "arbitrage investors" move out of the residential sector.

The protectionist measures introduced into Singapore and Hong Kong have led to a reduction of purchases by foreign buyers. Singapore saw a drop of 23.5% in 2012 from 2011 (for PR and non-PR). Hong Kong has seen the proportion of mainland Chinese buyers drop from around 30% in October 2012 to only 9.4% in January 2013 (in the Hong Kong luxury market).

Financing restrictions are aimed not only at restricting speculative demand, but also reducing banking sectors' exposure to the property market. The increasing capital requirements that many banks are having to adhere to is also reducing exposure to property. Again policy makers are aware, with lessons from the 2007/08 US sub-prime crash, that in the case of a significant price correction, an overexposed banking sector could cause much more serious problems.

Ultimately however, in order to understand the sustainability of the price rises in these markets, we have to look at what have been driving factors. In Hong Kong and Singapore's case, it is low interest rates (negative real interest rates) and tight supply. Singapore will see a significant amount of new supply come to the market over the next two to three years, while in Hong Kong supply will remain tight over the same period. As the respective currencies are pegged to the USD, interest rates are likely to remain low until 2015.

In China, it is increasing incomes, historic levels of urbanisation, smaller family units and the lack of alternative investment options which are essentially driving the market. None of these are drivers are likely to change in the medium term.

UNINTENDED CONSEQUENCES?

International buyers weigh up their options
Property investors in cooling markets are increasingly looking overseas, to markets that are not impacted by restrictions and are open to foreign buyers. The UK has seen a large influx in interest from markets impacted by cooling measures, with Asian buyers making up nearly half of all purchasers in the new build market (see International Residential Investment in London). Similarly Thailand, the Philippines, Australia, New Zealand, the US and Canada have all seen an uptick of interest from Asian buyers.

Movement to commercial real estate
The qualities of prime commercial real estate, especially in this time of economic uncertainty has proved attractive for investors as they search for a safe haven, as well as yield and capital appreciation. With the cooling measures impacting residential markets, we have seen increasing numbers of buyers moving into the office, retail, industrial and hotel markets. The first signs of government intervention in the commercial markets have begun however, with the Singaporean government introducing a sales stamp duty in industrial property to reduce speculation.

With the cooling measures impacting residential markets, we have seen increasing numbers of buyers moving into the office, retail, industrial and hotel markets. The first signs of government intervention in the commercial markets have begun however, with the Singaporean government introducing a sales stamp duty in industrial property to reduce speculation.

ASIAN GOVERNMENT INTERVENTION IN PROPERTY MARKETS IS NOTHING NEW

A glance back to the 1990s....

Policy makers in Asia do not have short memories, and recall very clearly what happened to the housing markets before and after the Asian Financial Crisis of 1997/98.

The Asian crisis triggered significant asset price drops as the region saw GDP contract significantly in 1998. Leading up to the crisis, from the mid-1990s, housing markets across the region saw significant price rises with policy makers stepping in to attempt to cool markets off.

The Singaporean government who have held a tight grip on land, development levels and financing, introduced anti-speculative measures such as capital gains tax for properties, loan to value caps of 80% and an increase in stamp duties. Indeed the punitive capital gains taxes (which included a 100% capital gains tax if sold within the first year of purchase) were only removed in 2001.

In Hong Kong, the long-term regulatory policy of loan to value ratios of 70% was introduced in the early 1990s, and in January 1997 a maximum LTV ratio of 60% was adopted for "luxury" properties with a value of more than HK$12 million.

In Malaysia, rapid price increases encouraged the government to intervene in 1995, introducing measures to curb speculation including an extra levy and minimum price for foreign buyers and a 30% real estate gains tax.

Elsewhere, notably South Korean policy makers, who have also traditionally intervened in the market, introduced anti-speculative measures as price inflation reached uncomfortable levels.

CONCLUSION

Government intervention in the property markets is not a sudden new phenomenon, but rather a number of policy tools; some which have been used on an ongoing basis, and others when deemed necessary. The importance of a balanced housing market to the health of an economy is such that policy makers, to varying extents, have always found it necessary to intervene by exercising some element of control over market participants, along with two key factors of production; land and finance.

The measures that we have witnessed over the last three years are a result of significant price rises that have brought into focus issues of affordability and the risk of potential asset bubbles. The measures are temporary, and we have seen that as quickly as the cooling measures can be implemented, they can also be removed. This should offer some reassurance to market participants; that if prices begin to correct too alarmingly, many of the measures can be removed, potentially unleashing new segments of demand which would help stabilise the market.

Policy makers however have sent a very strong signal – stable and sustainable growth is what they desire, and while a large element of the huge price increases we have seen across the region have been fuelled by genuine solid fundamentals; economic growth, urbanisation, a move towards nuclear family units - the concern is that historically low interest rates and speculative activity have been fuelling prices beyond this "sustainable" barrier.

While every market is different, we believe that prices will soften in Singapore by an average of 5% and Hong Kong by 10%. In China over the next 12 months, there is likely to continue to be price appreciation in Tier 1 cities, while we could see drops in some of the Tier two and three cities. Finally, Malaysia is likely to see a rebound in activity following the upcoming election.

The various policies have not targeted first time buyers, but have targeted multiple home owners and speculative (or arbitrage investors) who look to "flip" property. Paradoxically the continued price increases we see in certain markets, actually show strong first time and upgrader buyer demand, a positive sign in terms of the health of the market, with the more unstable speculative segment of demand already being restricted. This is certainly the case in many parts of China.

We believe that the latest measures will however have an impact on volumes and pricing. While every market is different, we believe that prices will soften in Singapore by an average of 5% and Hong Kong by no more than 10% over the next 12 months. In China, there is likely to continue to be price appreciation in Tier 1 cities, while we could see drops in some of the Tier two and three cities. Finally, Malaysia is likely to see a rebound in activity following the upcoming election.

Is there a risk of further intervention? If prices keep rising - quite possibly. The reaction of the latest rounds of cooling measures has yet to be fully absorbed and analysed, with past experience telling us that it takes a few months to draw significant conclusions. Given the severity of the last wave of cooling measures on these markets however, it is quite likely that there may not be any further need.

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Prime Global Cities Index Q4 2012

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