

**Legislative Council
Panel on Public Service**

Review of Mechanism for Adjusting Housing Allowances

PURPOSE

This paper sets out the Administration's proposals to revise the mechanisms for adjusting the Home Financing Allowance (HFA), the Home Purchase Allowance (HPA), the Rent Allowance (RA), the Private Tenancy Allowance (PTA) and the Accommodation Allowance (AA).

BACKGROUND

2. The rates of these allowances are adjusted annually on 1 April according to established mechanisms approved by the Finance Committee.
3. The rates of HFA/HPA/RA are adjusted according to movements of property prices in the past 12 months ending 31 December as measured by the annual Private Domestic-Price Indices compiled by the Rating and Valuation Department, but capped by the increase in Consumer Price Index (A) [CPI(A)]. The mechanism has been in place since 1994. It is silent, at least formally, on whether and if so how adjustments of allowances should be made in case the property prices move downwards, or where there is deflation. Because of this deficiency, we had to seek special approval from the Finance Committee to reduce the rates of allowance in April 1999 and April 2000. We see a need to review the mechanism to see whether it meets present day circumstances.
4. As regards the rates of PTA/AA, they are adjusted annually according to changes in rental indices in selected areas in the third and the fourth quarters of the previous year compiled by the Rating and Valuation Department.
5. Before the last review in 1991, the rates of PTA were adjusted according to rental movements in the third quarter of the previous year. In 1991, the Finance Committee endorsed the inclusion of rental movements in the fourth quarter to provide more up-to-date indication of rental levels. In 1992, Finance Committee agreed to adjust the rates of AA using the same mechanism. In conjunction with the review of HFA/HPA/RA, the opportunity has also been taken to consider whether it is more appropriate to use full-year rental movements to adjust the rates of PTA/AA.

PROPOSALS

(a) HFA/HPA/RA

6. We consider the rates of allowances should continue to be adjusted according to property price movements and that the increase in rates should continue to be capped to contain government's cost on grounds of prudent management of public funds. However, we also note that at present, the rates which were capped in previous adjustments form the bases for subsequent upward or downward adjustments. As such, there is a cumulative capping effect over the years. This situation is not appropriate and should be removed. Accordingly, we have developed a new mechanism.

7. Under the proposed new mechanism, adjustments (both upwards and downwards) will be made according to the rates of allowance, the annual Private Domestic-Price Indices and the Composite CPI¹ of a base year. In other words, the capping effect of upward adjustments in the intervening years since the base year will not affect the current adjustment. The proposed formula is illustrated as follows:

Revised rates

= Rates in Base year x $\frac{\text{annual Private Domestic-Price Indices in the past 12 months ending 31 December}}{\text{annual Private Domestic-Price Indices in Base Year}}$

but any increases will be capped by:

$\frac{\text{Composite CPI in the past 12 months ending 31 December}}{\text{Composite CPI in Base Year}}$

The rates of allowance are adjusted according to property price movements but any increases in rates are capped by the increase in Composite CPI to contain cost. As such, no upward adjustment will be made in a rising property market if the change in Composite CPI is negative. Besides, the rates will be reduced according to property price movements when the property price decreases irrespective of whether the change in Composite CPI is positive or negative. The annual Private Domestic-Price Indices and the Composite CPI in 1999 and the current rates (effective from April 2000 and reflect the property prices in 1999) will be used as the bases for future adjustments. This set of figures will be the most up-to-date available if the proposed mechanism is to be used with effect from the next adjustment due on 1 April 2001.

8. The proposed mechanism is based on the existing mechanism with the bases for comparison modified as set out in paragraph 7 above. In addition, CPI(A) will be replaced by the Composite CPI as the cap for increase in rates for reasons set out in the footnote below, and adjustments to be made under different scenarios are clearly set out in the proposed mechanism. With the removal of the cumulative effect, this should allow for more rational adjustments to housing allowances.

¹ Composite CPI is based on expenditure of households with an average monthly expenditure of \$4,500 to \$68,700 while CPI(A) is based on an average monthly expenditure of \$4,500 to \$18,000 (both at 1999 price level). Composite CPI reflects better the expenditure pattern of our allowance recipients and hence it is proposed to replace CPI(A) by Composite CPI as the cap for upward adjustment.

(b) PTA/AA

9. We consider the PTA and AA should continue to be adjusted according to the changes in rental indices. However, it is more appropriate to adjust the rates based on the full-year rental movements so that any seasonal fluctuations in the year could be evened out, especially since there are participants joining these schemes all year round. The revised review period will be the same as that for adjusting other housing allowances.

10. As a related issue, the Rating and Valuation Department will re-base all rental indices from those of 1989 to more updated figures of 1999. Nevertheless, the Rating and Valuation Department has confirmed that this change will not affect the percentage change of rental indices and hence the basis for adjustment of the allowances.

FINANCIAL IMPLICATION

(a) HFA/HPA/RA

11. There will be no additional financial implications under most circumstances as treatment under both the existing and the proposed mechanisms is the same, i.e. when property prices decrease, when the increase in property prices is smaller than the increase in CPI(A), or when the property prices increase under deflation. There may be financial implication only when the increase in property prices is greater than the corresponding increase in CPI(A). If there is any additional expenditure in future, the amount involved can be absorbed in the existing provisions.

(b) PTA/AA

12. The difference between the full-year figures and those for the corresponding third and the fourth quarters varies at different point in time and no consistent pattern can be established. Based on figures in the past 3 years, there will be no financial implication for implementing the proposed mechanism. If there is any additional expenditure in future for implementing the proposed mechanism, the amount involved will not be significant and can be absorbed in the existing provisions.

CONSULTATION

13. We have consulted the four central consultative councils on these proposals. The Staff Sides accept that the new mechanism is a reasonable way to update the adjustment of these allowances. There is a request from the Police Force Council for the Administration to consider reviewing the base year used for adjusting HFA/HPA/RA every three to five years. We see no need to review the base year for adjusting these allowances. This is because the change of base year will not affect the percentage change in the property prices indices which is the basis for adjusting the allowances.

14. We have also consulted the Standing Commission on Civil Service Salaries and Conditions of Service, the Standing Committee on Directorate Salaries and Conditions of Service and the Standing Committee on Disciplined Services Salaries and Conditions of Service. They support the proposed mechanisms.

WAY FORWARD

15. We intend to seek approval for the new mechanisms from the Finance Committee on 9 March 2001 with a view to implementing these proposals with effect from the next adjustment due on 1 April 2001. In line with the current practice, we shall also seek the Finance Committee's approval to delegate to the Secretary for the Treasury the authority to revise the rates according to the proposed mechanisms in future.