

## PRICING REACTION UNDER AREA INFLATION: NEW INSTITUTIONAL ECONOMICS PERSPECTIVES

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### Abstract

Information asymmetry exists between the presale and completion stage in the housing market. In Hong Kong, some developments account for over 50% variance in terms of effective floor area sold between these two markets. That is the “Area Inflation”. What is the pricing effect due to this unexpected area variance?

As the institution in Hong Kong allowed, there is no legitimate definition of area for flat selling before 2012. Even after 2012, the legitimate definition can not reflect the real area that the buyer can really enjoy. In presale market, buyers could not inspect the premises because they are still under construction. Pricing due to decrease in area expectation will be reflected in the second hand market, where buyers are legitimate to inspect the properties.

Hong Kong’s housing market has provided ample market transaction records which could enable scholars conducting empirical tests. Empirical studies, comprising mass developments located in Hong Kong Island, comprising 42,232 transacted data from 2003 to 2013, were carried out to measure the pricing reaction. It was found that every 1% decrease in area expectation will cause property prices to drop by 0.38% reflected in the second hand market relatively. The mean value for the decrease in expectation is 26%. If a property price is HK\$10 Million (US\$1.28 Million), there would be approximately HK\$1 Million (US\$128,000) reduction in real price. It accounts almost 10% price reduction.

The housing market is imperfect and the information cost is induced and could be measured. Although it illustrates that there is a price reduction in every area variance comparatively to different developments, presale market is still of high demand regardless of the area variance. Land is the single most valuable natural resource in Hong Kong, while the Hong Kong Government acted as the sole land owner. Its policies control the land supply and price, which lead to market failure. Previous measures lead to severe unbalancing limited supply, and high demand from not only the local, but mainly from the mainland. Hong Kong housing market is a speculative investment market, and hence, the whole housing market still boom sharply regardless of the area variance.

In order to lower the transaction cost and enhance the housing market transparency, government tried to ease the lemon problem by imposing new institution on the property sales in first hand market. Are they working? What are the effects?

The change of rules has enabled a natural experiment for empirical test. By using a panel data of housing projects carried by selected developers in Hong Kong, this study will measure the pricing reaction due to the introduction of regulatory controls.

**Keywords:** Hong Kong, Housing Market and Price

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