COMMENTARY

The unintended consequences of property cooling policies

A study on China's Housing Purchase Restriction policy shows investors misallocating capital after property market curbs were implemented, resulting in significant trading losses

By Qian Wenlan

RESIDENTIAL real estate is a highly coveted prize. Over the years, the slew of property curbs rolled out by the Singapore government to cool overly bullish demand bears testament to its tremendous popularity – and also to the exceptional resilience of both the asset and its buyers.

Despite numerous disincentives, homebuyers return in sufficient numbers, together with a hefty debt appetite, to trigger yet another round of property curbs. The latest set of property cooling measures was introduced in April last year.

But what drives demand against such odds? As Qian, Tu, Wu and Xu (2022) highlighted in a working paper titled *Unintended consequences of demand-side housing policies: Evidence from household reallocation of capital*, a possible explanation lies in the tendency for households to extrapolate from the historical performance of residential real estate without paying heed to obvious market shifts.

It is only a matter of time before such unfounded optimism will lead to sobering outcomes, as reality eventually sets in.

While demand-side property cooling regulations may be effective in achieving their intended objectives, capital reallocation following policy implementation could generate negative outcomes, as our study discovered.

Research findings suggest that policymakers may need to adopt a wider perspective beyond the immediate property market, and also explore ways to manage inelastic household expectations that appear to be oblivious to market signals.

Inefficient allocation in the capital market can create distortions in the sector as well. As money stubbornly flows into real estate stocks in spite of negative signals, developers may be lulled by the additional liquidity to further expand amid a market that is already contracting. Possible consequences include supply overhang, downward pressure on prices, and subsequently a compromised ability to repay debt and equity holders.

Capital reallocation

Our 2022 study observed how households reallocated capital into the stock market following the implementation of the Housing Purchase Restriction (HPR) policy in China.

In the wake of it, housing demand plummeted, and market analysts promptly downgraded their assessments of listed real estate developers.

Residential buildings in Shanghai. Policymakers may need to adopt a wider perspective beyond the immediate property market.
PHOTO: BLOOMBERG

Yet, as if in defiance, findings showed that investors affected by the HPR exhibited a tendency to channel their money to real estate stocks. In an attempt to use property stocks as an alternative for betting on housing price growth, those investors eventually experienced significant trading losses.

Following the Global Financial Crisis, the Chinese government issued a series of stimulus policies for the housing market, which included the historically lowest mortgage interest rate, higher credit accessibility for developers and lower tax rates for housing transactions.

Amid an expansionary fiscal and monetary environment, house prices increased by over 40 per cent countrywide between December 2008 and March 2010, and almost doubled during the same period in top cities such as Beijing and Shanghai.

To curb spiralling prices, the Chinese government in April 2010 announced the HPR.

Though policy details varied by city, in general, all the HPR cities imposed restrictions for two groups of homebuyers, with the explicit target of curbing investment demand. First, the HPR policy barred non-local residents from any home purchase in the city. Specifically, a person was qualified for home purchase only if he or she had local household registration, or had lived in the city for an extended period (five years or longer for most cities).

Second, local residents were also prohibited from purchasing multiple homes in the city. In most HPR cities, such as Beijing, Shanghai and Shenzhen, a local resident could not purchase additional dwelling units if he or she already owned two units in the city.

The staggered implementation of HPR measures across geographically dispersed cities in China over a period of nearly two years allowed us to work with the premise that if investors showed similar behaviours across different times, locations and economic environments, then there is evidence to suggest that the HPR is causing such behaviours. (*see footnote)

What we observed was that there was a large and significant increase in stock market participation following the HPR, after controlling for time and location fixed effects.

Compared with four weeks before policy implementation, the weekly number of new stock accounts opened by the group being studied increased by nearly 60 per cent during the four weeks following the HPR.

In contrast, stock account opening behaviour and cash inflows remain unchanged for investors who were not subject to the same market curbs.

The behaviours observed furnished good evidence that capital – which would otherwise have been used for property purchases – was reallocated into the stock market. The researchers estimated that about 58.3 per cent of households' housing investment capital, amounting to about 33 billion yuan (S$6.2 billion), was channelled to the stock market after the HPR.

The observed pattern was prevalent across a wide spectrum of investor demographics: the post-HPR propensity to invest in real estate stocks was equally strong across different age groups, by gender or by wealth.

The researchers found a strong effect for more experienced investors with a longer account history compared to less experienced investors.

In other words, the trading behaviours did not arise from a subgroup of investors who lacked financial sophistication or literacy. Instead, the findings were consistent with the hypothesis that affected households do not adjust their expectations downwards on future house prices, but chose to use the stock market as an indirect way of betting on real estate.

The consequences of unrealistic optimism

Following the HPR implementation, the investors studied experienced a decline in their stock portfolio performance over the next year compared to the year before the policy. The average monthly cumulated abnormal return (CAR) was significantly lower – by 0.55 percentage point – than that in the pre-HPR period.

Notably, this decrease was even more pronounced for their real estate stock holdings. The average monthly CAR for real estate stocks in the affected investors' portfolio in the post-HPR period was 0.72 percentage point lower than the pre-HPR period, and such a loss was significantly higher than that of their non-real estate stock holdings.

What the research suggests is that well-intended demand-side regulations could generate negative outcomes, as our study discovered.

Policymakers may need to adopt a wider perspective beyond the immediate property market, and also explore how to manage inelastic household expectations.

The writer is Ng Teng Fong chair professor in real estate and professor of finance and real estate at NUS Business School

The 2022 working paper was authored by Prof Qian, along with Tu Hong, professor at Apec Study Center of China at Nankai University; Wu Jing, professor at the Department of Construction Management, Tsinghua University; and Xu Weibiao, senior lecturer at the Singapore University of Social Science.

Footnote: Individual-level stock investor account and trading activity data was obtained from a leading stock brokerage company that had 150 branches in the 45 HPR cities, and accounted for between 2 and 4 per cent of market share in the country. Before April 2015, each individual investor could, by law, only hold one stock account in mainland China – the data therefore captured the entire stock holdings of sampled individuals involved in the study. To further corroborate their findings, the researchers created a falsification group. This group consisted of non-local investors residing in HPR cities who had previously migrated from non-HPR cities. While disallowed from buying property in their current HPR city, unlike the treatment group, these investors had the option to invest in property within their hometown cities.