

## **On the Impact of Bank Valuation on Property Prices and Expectations**

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### **ABSTRACTS**

*Banks are the mother of the foundation of all industries. As we all know, the banking sector has a significant impact on the operations of the industrial, commercial, and even real estate sectors. Among them, banks play a crucial role as a reference point in determining building prices. In particular, the makeup of the real estate cycle has an essential influence. In this research paper, we want to discuss the dilemma problem in the bank valuation of the asset, which may in turn hinder the bank's bad debt value. In addition, we suggested using a more moderate method to estimate the property price in the longer run approach, in order to solve the volatility of the real asset price valuation.*

**Keywords:** bank valuation, real asset price valuation, property prices, bad debts, dilemma valuation of the asset.

### **Introduction**

In Hong Kong's financial ecosystem, the primary lending activity involves real estate developers and property purchasers securing mortgage loans. These credit arrangements constitute the principal revenue-generating segment for Hong Kong's banking institutions, underpinning a significant portion of their interest income. The reliance on real estate-backed lending reflects the region's highly developed property market, where such loans facilitate property transactions and influence the broader economic cycle. Additionally, the credit risk management and regulatory frameworks surrounding these loans are critical components of the islands' financial stability and monetary policy implementation.

To comprehensively understand how banks assess the valuation of real estate, it is imperative to first examine the fundamental operating principles that underpin the banking institution itself, thereby enabling a more nuanced analysis of the underlying rationale. Primarily, a bank functions as a financial intermediary that depends heavily on the attraction and retention of client

deposits to sustain its liquidity and operational capacity. These deposits, provided by individuals and entities, constitute the primary liability on the bank's balance sheet and serve as the foundational source of funding.

In addition to the fundamental objective of maximizing profit and optimizing return on equity, banking institutions may engage in proactive and aggressive financial strategies. For instance, they might implement loan rebate programs (cash rebate)—such as offering interest rate concessions or partial fee waivers in order to enhance their competitive positioning in the marketplace. These tactics are often aimed at attracting a larger client base, thereby increasing the volume of borrowing activities, which can subsequently lead to higher interest income streams and improved overall profitability. Such strategic maneuvers are reflective of banks' broader pursuit of market share expansion and revenue maximization within the framework of risk-return trade-offs.

### **Hong Kong's financial ecosystem**

In Hong Kong's financial ecosystem, the primary lending activity usually involves real estate developers and property purchasers securing mortgage loans. These credit arrangements constitute the principal revenue-generating segment for Hong Kong's banking institutions, underpinning a significant portion of their interest income. The reliance on real estate-backed lending reflects the region's highly developed property market, where such loans facilitate property transactions and influence the broader economic cycle. Additionally, the credit risk management and regulatory frameworks surrounding these loans are critical components of the islands' financial stability and monetary policy implementation.

Furthermore, banks often operate under regulatory frameworks that impose reserve requirements and capitalize standards, influencing their asset-liability management. To optimize profitability, banks may engage in deposit reallocation strategies, including offering competitive interest rates or incentivizing certain deposit types, to influence liquidity profiles and remaining resilient against potential defaults or economic fluctuations.

"Financial institutions, including banks, are also mandated to adhere to regulatory requirements such as minimum reserve or deposit ratio thresholds, which mandate maintaining a certain proportion of customer deposits as reserves. Additionally, they face credit risk exposure due to potential property asset loan defaults, known as non-performing or bad debts. Their operational activities are further constrained by various regulatory restrictions on deposit-taking and lending practices, designed to ensure financial stability, liquidity, and prudent risk management." Therefore, banks conduct risk assessments on assets and lenders to assess their repayment capabilities before making loans.

With knowledge and persistence, banks will begin their lending process by assessing the quality of risk assets. For example, when valuing properties in expensive areas, banks tend to consider the supply and demand of the location. Simply put, these three key factors are location, location, and location. Additionally, valuation depends on transportation accessibility and market rental demand. Since rental income is the primary source of profit from property ownership, property appreciation is a way to increase asset value significantly. It's important to understand that a property's value generally correlates with its rental income. For instance, if rental income decreases, the valuation of properties held by banks will typically decline rapidly. Of course, this is just a general overview of how banks operate. To gain a deeper understanding, one would need to examine their internal evaluation and reporting mechanisms, though these internal criteria are often considered confidential by the banking industry and are not readily disclosed [1][2].

**Discussion:**

This research article begins by analyzing the impact of ancient books on the banking industry's influence on property prices from various perspectives in a new way. The goal is to show how these books value can alter expectations of real asset prices and, consequently, distort the real estate cycle.

For example, consider HSBC (HK) Bank's valuation of Kingswood Villas as an analysis, focusing on 2018, 2019, 2020, 2021-2022. These five-year periods represent the period of the real estate cycle, and the peaks have been continuous since 2018 to 2021. During this five-year period, most of the property mortgages in the area were borrowed from HSBC or the Bank of China. According to HSBC (HK) statistics, HSBC (HK) is the leader in the HK property borrowing market, and Bank of China ranks second in the property borrowing market.

Also, according to the report [1,2], HSBC (HK) has the property leading lending rank in this area (King Wu), which was close to 60%. So, HSBC (HK) has a decisive influence on property valuation in the area. As a leading bank, any change in HSBC's valuation can cause other banks to adjust their property valuations in the area (Kingwood).

Table 1: Illustrating the valuation trend contextually based on HSBC’s (HK) known valuation and market conditions for Kingwood Villas from 2018 to 2022s for Kingswood Villas from 2018 to 2022 [3]:

Year	Market Context	Estimated Valuation Trend	Notes
2018	Stable to slight initial decline	Stable to slight decrease (0-2%)	Early signs of market cooling
2019	Market uncertainty, protests	Decrease approx. 3-4%	Social Situation unrest causes valuation cuts
2020	Pandemic impact	Continued decrease	Market affected by Pandemic uncertainties
2021-2022	Market recovery uncertain	Continued decrease	Possible cautious approach in valuations

Therefore, the valuation of financial institutions plays a critical role in shaping the dynamics of real estate asset pricing. This relationship hinges on the premise that perceptions of banking sector stability and profitability directly impact capital availability and risk premiums, which in turn influence the valuation benchmarks used in property market transactions. Consequently, fluctuations in bank valuations can lead to significant adjustments in the overall cost structure and market sentiment within the real estate sector, thereby exerting a substantial effect on property price formations.

In the context of anticipated building costs and the broader real estate cycle, financial institutions' valuation metrics frequently serve as leading indicators. These valuations systematically reflect market sentiment and expectations about future property value trajectories, thereby exerting a significant influence on asset pricing dynamics within the property sector. Consequently, bank valuations are intricately linked to, and often indicative of, the projected fluctuations in property market values, making them a pivotal component in the forward-looking assessment of real estate investments.

As an intermediary in property evaluation, banks not only have the responsibility to follow prudent lending practices to protect their survival, but also to accurately estimate the property's true value. Keep in mind that the property's value often influences the amount borrowed, and the quality of the assets also impacts the bank's overall health.

If a financial institution devalue non-performing assets (NPAs), it can lead to significant repercussions on its balance sheet, including reduced profitability, increased provisioning requirements, and potential erosion of capital adequacy and debt ratios. This can also undermine depositor confidence and disrupt operational stability.

The banks should apply advanced property valuation techniques, such as long-run discounted cash flow analysis or comparable long-run sales methods. Instead of a short-run analysis and valuation approach. Ould focus on long-run application, instead of the short-run period.

Long-run valuation may harmonize the property value volatility. Long run valuation practices may minimize market volatility and minimize distortions within the property development pipeline, thereby minimize the impact of the overall property market in Hong Kong and the bad debt that may occur from their loans.

Suppose the bank uses a short-run valuation approach. In that case, this may cause a mismatch in valuation, which may hinder the asset value by “seafood price”, thereby affecting the broader macroeconomic environment and real estate cycle dynamics.

Therefore, the historical financial records maintained by the banking institution pertaining to the valuation and formation of real estate prices—along with the embedded long-run valuation data—will subsequently to smooth down and harmonize the adjustments. This evolution reflects the dynamic nature of market data and the importance of updating the average to accurately incorporate these foundational shifts.

They cannot deny that property valuation not only influences the size of mortgage loans but also impacts the actual operation and even housing price expectations. If banks take the initiative to adjust the mortgage amount, such as increasing or decreasing it, we can also expect building prices to rise or fall in the future.

People can't help but wonder whether the rise in property prices causes the increase in property valuations or if rising property valuations lead to higher property prices. Which one comes first, and who starts it? Based on general practical experience, banks usually lag behind in property valuations. However, during certain times, such as when property prices fall, banks' valuations tend to decline more quickly than property prices. People often jokingly refer to banks as institutions that "shut up their umbrellas when it rains." This is true. In many cases, banks will

lower their loan limits to minimize their lending risks. However, this will in turn cause further panic and property price devaluation when they start to devalue the property prices. This will in turn lead to bad debt that may eventually hinder the bank's assets. When the loan valuation drops, the property loans previously issued by the bank can become insolvent, and "negative assets" can lead to bad debts for the bank.

This is the dilemma valuation contradiction of the bank found in the research of this article. On one hand, low property valuations can effectively reduce bank risks; on the other hand, from another perspective, the current low asset price valuation has created a certain risk of bad debts of banking industry due to the early property loans in the early years. For example, the peak valuations in 2018, 2019, 2020, 2021, and even 2022 are the low valuations banks are now facing, which ends up shooting themselves in the foot.

Although the current borrowing risk for the bank has been reduced, the bank's previous borrowings have led to impairment of the balance sheet, "negative assets," and "insolvency." Therefore, for the bank, it is not only a negative value but also suffers a huge loss.

This kind of asset valuation contradiction often harms the bank's revenue and even operations. What's more, the deterioration of assets shakes the confidence of depositors and threatens the stability of the bank.

**Suggestion:**

In view of this, this article recommends stabilizing the real estate cycle as the goal, and not determining property value based on a few transactions.

- (1) A stable long run Property Value evaluation mechanism must be established (with the year as the anchor for evaluation)
- (2) Do not determine the value of a Property Value based on individual small amount of transactions
- (3) Use multiple quantitative average property transactions as an anchor
- (4) Increase the quantitative nature of property evaluation and reflect stable evaluation value (long run State)

These suggestions may seem simple, but they are very useful because current property valuations are mostly driven by a few small transactions and lack the basis of multiple quantitative transactions. It is easy to cause manipulation, causing property prices to rise and fall sharply; and individual transactions that are manipulated can cause the real estate cycle to rise and fall

sharply, based on the biases of the property price expectation. Therefore, establishing an average annual value anchor and using a large number of long transactions as the evaluation benchmark will be more objective.

This is not only conducive to the development of the real estate market, but also conducive to the operation of the bank. It will not cause the bank to collapse due to a sharp deterioration of the balance sheet in the short term.

**In conclusion:**

Banks serve as the backbone of all industries, significantly impacting the operations of the industrial, commercial, and real estate sectors. They are especially vital as key reference points for determining property prices, with the real estate cycle playing an influential role. This paper explores the challenges in bank asset valuation, which can affect the assessment of bad debts. Furthermore, we advocate for a more balanced, long-term approach to estimating property prices to mitigate the volatility inherent in real asset valuation.

**References**

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[3] <https://www.hsbc.com.hk/zh-hk/mortgages/tools/property-valuation>