

**For Discussion
on 3 June 2002**

Legislative Council Panel on Housing

An Update on the Finance and Regulatory Work of the Estate Agents Authority

Introduction

This paper updates Members on the finance and regulatory work of the Estate Agents Authority (EAA), and to report on the progress of the review of the Estate Agents Practice (General Duties and Hong Kong Residential Properties) Regulation (the “Practice Regulation”).

Background

2. The Estate Agents Ordinance (the “EAO”) aims to improve the standard of service provided by estate agents and protect consumers involved in property transactions. The EAA was set up on 1 November 1997 to regulate the trade through, inter alia, the implementation of a licensing system under the Estate Agents (Licensing) Regulation (the “Licensing Regulation”) and a practice regulatory framework under the Practice Regulation.

The Finance of the EAA

3. The EAA is an independent and self-financed statutory body and it derives its income mainly from licence fees collected from licensed estate agents. Its statements of accounts and auditor’s report are furnished to the Secretary for Housing for tabling before the Legislative Council annually.

The Licence Renewal Exercise

4. The EAA has completed an exercise on the renewal of licences which expired at the end of 2001. This was the first licensing renewal exercise immediately after the end of the three-year licensing transitional period and the introduction of flexible licensing arrangement approved by the Legislative Council in October 2001. Statistics of the EAA indicate that, at the beginning of 2002, there were 13,771 licensed individuals and 2,821 licensed shops. These figures

represented a decrease in the total number of licensees by 14% when compared with figures as at the end of 2001, and by 34% when compared with the licensee population at its peak in 1999. By May 2002 the number of individual licensees showed a moderate pick-up and there were 10,243 licensed estate agents and 4,522 licensed salespersons. The number of licensed shops, however, continued to drop to 2,655. The total number of licensees has indicated a drop of 31% compared with the peak in 1999. Also, the ratio between estate agents (whose licences cost more) and salespersons has also changed considerably from 6.14 to 1 at the beginning of 2000 to 2.27 to 1 in May 2002. It is anticipated that this ratio will further change under the flexible licensing arrangement, with more licensees opting for the salesperson's licence which costs less. The decrease in the number of practitioners and the drop in the proportion of estate agents both have direct impact on the income of the EAA.

The EAA budgets and licence fees

5. Under the existing mode of funding, the income of the EAA is entirely dependent on the size of the licensee population. However, estate agency has been well known for being an industry with very high mobility among the practitioners. While the fee-based income does not provide for long-term financial stability as licensee numbers are difficult to predict, frequent fluctuations in fee levels are also unacceptable to the licensees. To address this issue a feasibility study on ad valorem levies on property transactions as an alternative mode of funding has been conducted. The report has yet to be deliberated by the EAA, after which it will be presented to the government for consideration, and full consultation with the trade and the authorities will be made before a final decision is taken on this matter.

6. Since its inception, the EAA has pursued a policy of economy and prudent financial management. From 2000/01 to 2002/03, savings in overall expenditure are estimated to be 7.3% which exceed the target of 5% over three years in the Government's Enhanced Productivity Programme. The present staff establishment has been trimmed by 16% compared with 2000/01. The Authority will continue to save on expenditure vigorously as long as its statutory functions are not compromised.

7. The EAA has twice reduced the licence fees, by 20% in 2000 and 30% in 2002. The reduction in fee levels, together with attrition in the licensee population, will bring about a projected 33% drop in licence fee income in 2003/04. The Authority will also, for the first time, be running an annual operating deficit of about \$9 million from 2002/03.

8. The purchase of office premises might be one of the possible means to cut

cost in the long term. By acquiring its own premises, the EAA is expected to be able to make a net saving of about \$3 million per annum. The expiry of the tenancy of the EAA offices in October 2003 will be an opportune time for the Authority to consider this option, to take advantage of low property prices and interest rates. Full consultation with the trade and the authorities will be made in due course.

9. After funds have been set aside for capital projects including the capital expenditure for the possible acquisition of office premises referred to above, the cumulative surplus already fell below a benchmark equivalent to 12 months' expenditure of the EAA. It will fall below the 6-month mark by 2004/05, and will be entirely depleted by 2007/08. Details of EAA's budgets and projected income and expenditure from 2002/03 to 2006/07 are in Appendix A.

Regulatory work of the EAA

10. During the year 2001, the enforcement and complaints units of the Authority handled a total of 1,470 complaints and reported cases of non-compliance, involving 2,286 allegations. Consequent upon inquiry hearings, 35 licensees had their licences revoked or suspended, while another 56 had conditions attached to their licences. 44 of the complaints were referred to the Police, the ICAC and other enforcement authorities, of which 18 had by now been convicted. The Authority also conducted 1,391 inspections of agency shops and first sale sites (Appendix B).

Review of the Practice Regulation

11. The Practice Regulation came into effect in November 1999. Over the two and a half years of implementation, a number of areas where the Practice Regulation may be improved upon have been identified. A working group on the review of the Practice Regulation was formed in late 2001 with a membership comprising not only members of the EAA from the trade, but also two representatives of the trade associations. The working group has discussed a number of issues in depth, including the following:

- (a) The standard documents prescribed in the Practice Regulation are legally binding instruments by which the relationship between an estate agent and his client is defined, and through which the interests of both parties are protected. On the proviso that the legal effect of the documents is not compromised, the working group discussed various ways and means to streamline and simplify the documents.

- (b) The working group considers several suggestions with regard to the mode and timing for the provision of property information. These include the provision of information by stages and the acquisition of property information from sources other than those presently prescribed.
- (c) The working group considers the need to strengthen the role of managers in the supervision of the conduct and behaviour of estate agents under their employ, in order to improve the overall standard of service in the trade.
- (d) The working group also considers a number of measures to enhance consumer protection in the course of property transactions including stake-holding of deposit money, proper authorisation to sell, and bank consent for the leasing of mortgaged properties.
- (e) The working group also considers ways and means to enable the EAA to handle unethical conduct of practitioners more equitably and effectively.

12. The EAA Board will further deliberate on the review of the Practice Regulation as briefly described above, and the results will be presented to the government for further consideration.

Structure of the EAA

13. The EAO provides for a structure of the EAA with membership representing a good balance of different interests in the community. In accordance with the provisions concerning the composition of the EAA in the EAO, apart from the Chairman and Vice-chairman, there are altogether 18 members appointed in three categories : five from the estate agents trade, four from people related to the estate agents sector and nine from others in the community. Where and when necessary, the EAA has co-opted additional trade members to its standing committees (e.g. the Training Committee and the Practice Committee) and working groups.

Estate Agents Authority
Projected Income and Expenditure in connection with 2002/03

Budget
(HK\$M)

| | <u>2002/3</u> | <u>2003/4</u> | <u>2004/5</u> | <u>2005/6</u> | <u>2006/7</u> |
|-----------------------------------|----------------|----------------|----------------|----------------|----------------|
| <u>Income</u> | | | | | |
| Licence fees | 32.761 | 32.018 | 32.018 | 32.018 | 32.018 |
| Examination fee | 2.140 | 2.140 | 2.140 | 2.140 | 2.140 |
| Interest income | 2.337 | 1.937 | 1.937 | 1.937 | 1.937 |
| Total income | <u>37.238</u> | <u>36.095</u> | <u>36.095</u> | <u>36.095</u> | <u>36.095</u> |
| <u>Expenditure</u> | | | | | |
| Operating expenditure | 40.831 | 39.131 | 37.431 | 37.431 | 37.431 |
| Provision | 5.421 | 5.421 | 5.421 | 5.421 | 5.421 |
| Total expenditure | <u>46.252</u> | <u>44.552</u> | <u>42.852</u> | <u>42.852</u> | <u>42.852</u> |
| Current year deficit | <u>(9.014)</u> | <u>(8.457)</u> | <u>(6.757)</u> | <u>(6.757)</u> | <u>(6.757)</u> |
| <u>Cumulative fund c/f</u> | <u>35.536</u> | <u>27.080</u> | <u>20.323</u> | <u>13.566</u> | <u>6.809</u> |

Budget assumptions

1. The licensee population as at the beginning of 2002, assumed unchanged, is used as basis for the projection of licence fee for the years covered in these forecasts. The licence fee for 2002/03 is slightly higher than that of the subsequent years because income of that year still contains a small amount of licence fees paid according to the old scale, ie, before the fee reduction of 30% which commenced January 2002.
2. For examination fees, it is assumed that there are 4,000 candidates per annum.
3. Interest income of 2002/03 is used as the basis for projection of subsequent years. An interest rate of 2% p.a. on the average cash balances is assumed.
4. With regard to expenditure, the budgeted expenditure of 2002/03 is used as the basis for projection. On this the following points are to be noted:
 - a) The EAA, despite the fact that it is at the startup phase of its development, will have achieved an overall saving of 7.3% in expenditure in three years, from 2000/01 to 2002/03, vis-à-vis the targeted 5% saving over three years under the Enhanced Productivity Programme of the government.
 - b) Assume the acquisition of the EAA's own office premises in 2003/04 upon expiry of leases of present premises, there will be a decrease in expenditure as savings on rentals, by \$1.7 million (being rental cost for six months as the leases will expire in early October 2003) in 2003/04, and by \$3.4 million per annum in subsequent years. This is offset by a loss of interest income of about \$0.4 million per annum from 2003/04 to give a net saving of about \$3 million per annum.
 - c) In these forecasts there is no provision for expenditure on new activities or the introduction of new legislation.

5. The purchase of EAA's own office premises will be financed with appropriation from the Capital Project Development Fund. No depreciation is assumed on the leasehold property and its improvement, in accordance with exemption per the Statement of Standard Accounting Practice No. 17 ("Property, plant and equipment") issued by the Hong Kong Society of Accountants.

6. An appropriation of \$1.5 million for the Litigation Equalisation Reserve is included in the annual total expenditure in all the years covered in these forecasts.

7. The EAA still owes the government a setting-up loan of \$28 million at an annual interest of 5%.

Inspection and Complaints for the Year 2001**Complaints and Reported Cases of Non-Compliance**

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| Cases | 1,470 |
|-------|-------|

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|--------------------|-------|
| No. of allegations | 2,286 |
|--------------------|-------|

Inspection of agency shops and first sale sites

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| Agency shops | 1,141 |
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| First sale sites | 250 |
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Actions Taken

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| Revocation of licence | 9 |
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| Suspension of licence | 26 |
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| Attachment of conditions | 56 |
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| Fine | 9 |
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| Reprimand | 12 |
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| Warning letters | 206 |
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| Advice letters | 1,271 |
|----------------|-------|

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| Referral to other bodies (Police, ICAC etc.) | 44 |
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