

**For discussion on
2 February 2004**

**LEGISLATIVE COUNCIL
PANEL ON HOUSING AND
PANEL ON PLANNING, LANDS AND WORKS**

**System for Pre-sale of Residential Properties :
Review of the Consent Scheme**

PURPOSE

This paper sets out the outcome of the review of Lands Department's Consent Scheme for the sale of uncompleted properties and the proposed improvement measures.

BACKGROUND

2. In May 2003, two residential projects in Tuen Mun either failed to complete as scheduled (i.e. Villa Pinada) or construction was suspended (i.e. the Aegean). Some units of these developments had been sold to purchasers under the Consent Scheme ("the Scheme"). As a result of the above incidents, the purchasers' interests were at risk.

3. On 18 June 2003, the Administration briefed the joint meeting of the LegCo Panel on Housing and Panel on Planning, Lands and Works on the arrangements for the pre-sale of uncompleted properties under the Scheme. The meeting also discussed possible measures to prevent default cases in future in the wake of the Villa Pinada and the Aegean cases. At the meeting, the Administration undertook to review the Scheme with an aim to improve the situation.

4. In the past six years (1998 – 2003), the Legal Advisory and Conveyancing Office (LACO) of the Lands Department (Lands D) approved 243 consents for pre-sale of uncompleted flats. Except for the Villa Pinada and the Aegean cases, there were no major problems with the Scheme. For reference, a brief on the operation of the Scheme is at **Annex A**.

5. Under the present Scheme, a developer has to demonstrate that it has adequate financial ability to complete a development before Lands D gives consent to the pre-sale of uncompleted properties. The Scheme includes provisions requiring purchasers' monies to be put in a stakeholder account. The monies can mainly be released from the stakeholder account for meeting the construction cost of the development. Currently, the earliest time that a developer can sell uncompleted flats under the Scheme is 20 months before the estimated completion of the properties.

REVIEW OF THE CONSENT SCHEME

6. In June 2003, Lands D convened a Working Group ('WG') comprising representatives from relevant professional/trade bodies, and the Consumer Council to review the operation of the Scheme and to identify areas where improved protection to purchasers could be made. The terms of reference and membership of the WG are at **Annex B**.

7. The views of the relevant professional and trade organizations have been considered in detail by the WG. These organizations include the Law Society of Hong Kong ("Law Society"), the Hong Kong Institute of Architects ("HKIA"), the Hong Kong Association of Banks ("HKAB") and the Real Estate Developers Association of Hong Kong ("REDA"). Views and suggestions of other members have also been taken into account in the WG's deliberations.

RECOMMENDATIONS OF THE WORKING GROUP

8. The WG has suggested a number of improvement measures to the operation of the Scheme. They are set out in the ensuing paragraphs.

I. Safeguarding Purchasers' Legal Ownership

9. Property developments are financed mainly by building mortgage or bank undertaking. For the building mortgage cases, the development provides security to the mortgagee bank who has priority over flat buyers in the properties. To protect the legal ownership of flat buyers, the Working Group has proposed that :

- (a) a building mortgage will in future include an undertaking that if a buyer has paid up the full purchase price of a unit, the mortgagee bank concerned will unconditionally release that unit upon completion of the development if the entire sale proceeds have been paid into the stakeholder account opened with the mortgagee bank for the development;
- (b) the lease conditions, relating to the form and requirements for a building mortgage and the consent letter, will be amended to require that –
 - (i) the developer's solicitor firm must open and keep the stakeholder account for purchasers' payments with the mortgagee bank; and
 - (ii) the purchasers' payments (including preliminary deposits) must be made directly to the stakeholder account.

10. For property developments covered by bank undertaking, it should be noted that this form of financing is only available to developers who are considered to have good commercial standing by the banks. The banks concerned do not have any legal rights over the flats under the bank undertaking cases. Together with the general measures proposed to reduce the risks of conflict of interest and a specific proposal to introduce periodic reporting by the AP and solicitor into the proper management of the stakeholder account as described in paragraph 13(b) below, the WG considered that no change is necessary for the time being. However, the WG will continue to monitor the situation and liaise with the trade and relevant bodies if there is scope for further improvements.

II. Disclosure of Conflict of Interest

11. To reduce the risks of conflict of interests among the developer, the AP, the solicitor and the superstructure contractor, the WG has proposed the following measures regarding the disclosure of personal and financial relationships between the concerned parties :

- (a) the names of the developer company and its holding company (if any); the AP (and his firm); the solicitor firm representing the developer; and the mortgagee bank (if any) must be clearly disclosed in all sales brochures, printed media and other advertising where practical. This arrangement has already been introduced, as an interim measure, since July 2003;
- (b) when applying for consent, the AP and the solicitor will be required to confirm to LACO whether there is any conflict of interest –

(i) As regards personal relationships

- Whether the AP/solicitor is directly related to a director/secretary/officer of the developer, its holding company or the superstructure contractor.
- The WG has considered the disclosure requirements of various organizations and concluded that disclosure of relationships between family members should be contained in relevant sales material. LACO will issue detailed guidelines on implementation.

(ii) As regards financial relationships

Where the developer, the developer's holding company or superstructure contractor is –

- a private company, the AP/solicitor holds more than 10% of the shares;
- a listed company, the AP/solicitor holds more than 1% of the shares; or
- in the case of either a private or listed company, where the AP/solicitor is a director, company secretary or other officer of the developer or its holding company or the superstructure contractor,

these relationships must be clearly disclosed in sales brochures and printed media or other advertising where practical.

- (c) Disclosure in the sales brochure and advertising material is also required if the AP firm and/or the superstructure contractor is a subsidiary or in the same group of companies as the developer company, its holding company, or the superstructure contractor.

12. The Law Society and HKIA will consider drawing up more precise guidelines for solicitors and APs on the circumstances and level of disclosure where appropriate.

III. Improved Management of the Stakeholder Account

13. To ensure proper management of the stakeholder account by the solicitor, the WG has proposed the following main measures –

- (a) Under the building mortgage arrangement, a Tripartite Stakeholders' Agreement (“the Agreement”) will be entered into between the solicitor, the mortgagee bank and the developer. The Agreement will require :
- The stakeholder account to be opened in the name of the solicitor with the mortgagee bank and for the specific property development.
 - Written consent of the mortgagee bank will be required for any drawdown of the stakeholder account for any purpose.
 - The solicitor will make periodic returns to the mortgagee bank with details of units sold, full payment cases, proceeds received and paid into the stakeholder account and amounts paid out to the developer or contractors.

- (b) For bank undertaking cases (only available to developers with good commercial standing), a third party Financier joins in the Agreement for Sales and Purchase (ASP) to guarantee the full construction costs. The flat buyers' interests will not be encumbered by any form of bank security on the property development. Together with the checks and balances on the stakeholder account and periodic reports by the AP and solicitor on the property development, the present arrangements will continue.
- (c) A monthly updated report relating to the total costs of construction, the amount expended and incurred for construction costs will be made available to purchasers by the solicitor or the developer on payment of a fee.
- (d) The solicitor's monthly report to the developer on the receipt and payment of purchasers' money in the stakeholder account will be copied to LACO and the mortgagee bank for reference.

IV. Clarifying the Professional Role of AP

14. To facilitate APs in discharging their professional duties, the WG considered that AP's role be further defined with the following improvement measures –

- (a) A standard form of AP certificate will be adopted requiring, among other things, the AP to :
 - (i) confirm that he is registered with the Building Authority ("BA") for the project;
 - (ii) declare any conflict of interest;
 - (iii) undertake to inform the bank, stakeholder solicitor and LACO of any change of registered AP other than his temporary absence (provided that there is no change of AP firm). Certificate issued by the temporary AP for drawing down money from stakeholder account

will only be accepted with LACO's approval. The temporary AP must disclose any conflict of interest;

- (iv) confirm that the professional consultants fees have been endorsed in writing by the developer;
 - (v) certify that he has obtained adequate supporting evidence that the expended costs to date have been paid to the contractors, suppliers and consultants; and
 - (vi) identify the contractor registered with the BA for the superstructure work, other main contractors and suppliers, as appropriate.
- (b) Where the AP is an employee of the developer, its holding company or the superstructure contractor, either: -
- (i) a certificate by an independent AP will be required; or
 - (ii) if the AP issues the certificate himself, it must be supported by the certificate of an independent QS.
- (c) Professional consultant fees shall not be paid out of the stakeholder funds, except if the amount is disclosed in the AP certificate.

V. Other measures recommended by the WG

15. The WG has also reviewed other aspects of the Scheme and has made the following recommendations :

(a) Separate legal representation

The terms of the Consent Scheme will require the prominent display (in sales brochures and the Preliminary Agreement for Sale and Purchase (ASP)) of a bilingual notice to purchasers of their right to separate legal representation.

(b) Cost overrun

Developers will be required to notify the AP of any cost overrun of 10% or more of the total construction costs. The AP will notify LACO, the mortgagee bank and the stakeholder solicitor of the amount of overrun and the revised total construction cost. LACO will require the developer to confirm within six weeks that it has adequate finance to complete the development. AP will not certify any payment out of the stakeholder account in respect of the cost overrun until LACO is satisfied that the developer has adequate finance to complete the development.

(c) Additional solicitors for handling the sale of flats

Where any additional solicitors or solicitors firm are nominated to handle sales and purchase of units after the consent has been issued, the application should be made by the original solicitor firm who applied to LACO for the consent. The requirement of making a statutory declaration, opening a stakeholder account with the mortgagee bank and complying with the conflict of interest requirement will also apply.

(d) Minor Defects

To give better protection to buyers, a checklist of minor defects will be required under the ASP. The idea of allowing inspection of flats by buyers prior to execution of Assignment is not considered practical.

(e) Consumer education

LACO will further liaise with the Consumer Council, the Law Society and REDA on the production of an explanatory pamphlet for purchasers on relevant aspects of buying uncompleted properties.

MONITORING OF CONSENT SCHEME

16. The various checks and balances, as discussed above, provide the basis for improved monitoring of the operation of the Consent Scheme. Improved monitoring will be achieved by :

- (a) the mortgagee bank under the Tripartite Stakeholder's Agreement and regular returns to the mortgagee bank by the solicitor;
- (b) a quarterly updated AP Certificate submitted to LACO up to practical completion of the development;
- (c) the stakeholder solicitor making its monthly reports to the developer with copies to the mortgagee bank and LACO confirming the progress of sales, details of payments, full payment cases and release of funds for construction costs.

THE GUANGZHOU PRACTICE

17. Members of the Working Group visited the Land Resource and Housing Management Bureau of Guangzhou in September 2003 to understand their practices and regulatory framework relating to the sale of uncompleted properties. A note on the Guangzhou experience is at **Annex C**.

PROGRESS RELATING TO THE VILLA PINADA AND THE AEGEAN CASES

18. According to the Receivers of the above two developments, the flats in Villa Pinada have been completed and are in the process of assignment to the flat purchasers (starting from December 2003). The Receivers have also arranged financing to complete the construction of the Aegean. Construction work was resumed in December 2003 and would take one year to complete.

IMPLEMENTATION OF IMPROVEMENT MEASURES

19. LACO is working on the implementation details of the proposed improvement measures as discussed above. Subject to Members' further views, implementation of these improvement measures can commence as from February 2004. LACO will continue to monitor the situation and to liaise with the relevant professions, trades and organizations as and when further refinements to the Scheme are identified.

Lands Department
Housing, Planning and Lands Bureau
January 2004

Brief on Lands Department's Consent Scheme

The Lands Department's Consent Scheme ("the Scheme") was introduced in 1961. The Scheme is administered by the Legal Advisory and Conveyancing Office (LACO) of Lands Department (Lands D). The Scheme is designed to regulate the sale of uncompleted flats whilst giving protection to purchasers. Under the Scheme, the developer has to demonstrate that it has adequate financial ability to complete the development. A standard form of sale and purchase agreement is used setting out the rights and obligations of the developer and the flat buyer. The purchase of uncompleted flats can then be registered in the Land Registry. The Scheme also includes provisions requiring purchase monies to be put in a stakeholder account and their release for meeting the construction cost of the development. Through these arrangements, the interests of flat purchasers are protected.

2. Since its introduction over 40 years ago, the Scheme has been running smoothly on the whole. Pre-sale of flats under the Scheme remains to be welcome by both flat buyers and developers apparently because of mutual benefits. On the one hand, pre-sale of flats allows developers to receive money in advance of flat completion and this helps finance their property development. On the other, the pre-sale arrangement enables the buyers to buy flats at a price level attractive to them. This may also help them secure properties they desire in terms of location, size etc.

Operation of the Consent Scheme

3. Currently, the earliest time that a developer can sell flats under Lands D's Consent Scheme is 20 months before the estimated completion of the flats. Lands D's consent can be issued if the following main requirements are complied with by the developer :

- (a) all formation and foundation works have been completed and the developer has obtained the consent of the Building Authority to commence building works on the superstructure;
- (b) submission of certificates from the Authorized Person (AP) as to :

- (i) the total amount of construction costs of the proposed development;
 - (ii) how much has already been spent;
 - (iii) the outstanding balance and expected completion date etc; and
- (c) submission of a certificate from a mortgagee bank stating the amount drawn under a building mortgage and the remaining undrawn amount available which must be sufficient to cover the balance of construction costs certified by the AP. Alternatively, a bank undertaking for the outstanding balance of construction costs can be submitted.

Interim Improvement Measures

4. In June 2003, Administration undertook a review of the Scheme. Pending the implementation of the review recommendations, several interim improvement measures have been introduced since July 2003 as follows :

- (a) the listing, in the sales brochure, the names of the developers and parent company (if applicable), the Authorized Person and his firm, and the mortgagee bank;
- (b) developer is to obtain the approval of LACO for addition or deletion of solicitors;
- (c) developer is to inform flat buyers if the construction cannot be completed according to the original schedule; and
- (d) mortgagee's and solicitor's approval to release of funds.

Working Group on the Review of the Consent Scheme

Terms of Reference

To consider and review appropriate measures under the Consent Scheme for regulating the sale of uncompleted flats and protection of purchasers' interests and to monitor the future operation of the Consent Scheme.

Membership

Representatives of :

Lands Department (Chairman)

The Hong Kong Real Estate Developers Association

The Hong Kong Association of Banks

Consumer Council

The Law Society of Hong Kong

The Hong Kong Institute of Architects

The Hong Kong Institute of Surveyors

The Hong Kong Institute of Real Estate
Administrators

In attendance

Independent Commission Against Corruption

Housing, Planning and Lands Bureau

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The Guangzhou practice of regulating the sale of uncompleted flats

The following are the regulatory arrangements employed by the Guangzhou authority. For multi-storey buildings, consent for pre-sale of flats will only be given if :

- (a) a minimum of 25% of the total construction costs have been spent; and
- (b) two-thirds of the superstructure has been completed.

2. Before withdrawing any money from the stakeholder bank account, the developer has to submit to the Land Resource and Housing Management Bureau (the Bureau) a report on the work progress supported by the construction contracts. The Bureau will consider the report and carry out a site inspection before issuing a certificate confirming that the developer may withdraw money from the account. The Bureau levies 0.2% of the amount in the stakeholder account as a service charge. The various professionals do not have any official part to play in this system. The developer prepares the reports on the project, including the work progress.

3. Under the Guangzhou system, for buildings not exceeding seven storeys, the superstructure work has to be completed to rooftop level before consent to sell will be given.

4. No pre-sale consent will be approved in respect of land which is subject to a mortgage i.e. the units to be put on sale must be released from any mortgage before the pre-sale consent is issued. In addition, the developer has to obtain the consent of all purchasers before he may apply to vary any details relating to the buildings as set out in his application e.g. to amend the building plans. On completion, the Government will inspect and check the construction work (including the supply of fire safety services, utilities and the provision of fittings and finishes) before issuing a completion certificate.