

HUNGHOM PENINSULA PRIVATE SECTOR PARTICIPATION SCHEME FLATS

PURPOSE

This paper sets out the background and outcome of the negotiation between the Housing Authority (HA) and the Government and the developer of the Hunghom Peninsula Private Sector Participation Scheme (PSPS) project over the disposal of the flats concerned.

BACKGROUND

Private Sector Participation Scheme

2. To provide an additional source of subsidized ownership housing, the Government introduced the PSPS in 1977 to supplement the Home Ownership Scheme (HOS) by inviting participation of private developers. PSPS developments were different from other HOS developments in that the developer owns the entire property instead of the HA.

3. Under the PSPS, private developers were invited to tender for housing sites on which they were required to build flats conforming to certain specifications stipulated by the Government. Like other Government land sales, the land title of a PSPS site was vested in the developer. The developer held legal title to the land lot, owned the residential units, the car parking spaces and commercial facilities it built under the same lease. The obligations of the contracting parties were stipulated in the Conditions of Sale for the housing site. Under the Conditions of Sale for PSPS projects, the HA was named to nominate eligible purchasers to purchase the flats from the developer concerned within a specified period. In the event that flats were unsold at the end of the specified period, the HA was obliged to purchase the flats at the guaranteed purchase price.

Hunghom Peninsula PSPS Project

4. The Hunghom Peninsula PSPS project, comprising 2,470 flats, 494 car parking spaces and shopping facilities, was completed in November 2002. The total gross floor area of the flats is about 144,300m² and their total saleable floor area is 123,500m². The guaranteed purchase price is \$15,500 per square meter and the total guaranteed purchase price (which is calculated on the saleable floor area) for all the 2,470 residential units is about \$1,914 million.

5. Under the subject PSPS Land Grant, the HA should nominate eligible home purchasers to purchase the flats within a period of 20 months from the date of the Consent to Sell, which was issued in November 2002.

POLICY CONSIDERATIONS

6. The subdued demand for and oversupply of private residential flats since 1997 have dampened the confidence of the public and investors in the property market. This had called into question the Government's role in the property market, particularly its provision of subsidized flats for sale under the Home Ownership Scheme at a time when private-sector flats have become increasingly plentiful and affordable to home buyers. In view of the changed circumstances, there was an increasing public demand for the Government to undertake a timely and comprehensive review in order to realign our housing policies and programmes.

7. In November 2002, the Government announced in its housing policy statement that, among other things, it would recommend to the HA that, except for a small number of unsold and returned flats which would be sold to Green Form Applicants, the production and sale of HOS would cease indefinitely from 2003 onwards. Government would also recommend the HA to terminate the PSPS and seek HA's agreement to halt the production and sale of HOS flats and PSPS flats starting from 2003. This sent a clear message to the market that the Government was determined to withdraw from its role as property developer and minimize its intervention in the market. It was also stated that the Government would dispose of the surplus HOS and PSPS flats by market-friendly means. In end November

2002, the HA discussed the policy statement in-depth and endorsed, among other things, the recommendation to halt the production and sale of HOS flats and terminate the PSPS.

8. The Statement also underlined the importance of maintaining a stable environment to enable the sustained and healthy development of the property market on a level playing field. The public have in general considered that the Statement is in the right direction and that a clear and consistent housing policy is instrumental in maintaining public confidence in the market.

9. Following the re-positioning of the housing policy, the Government and the HA explored several possible options to dispose of the surplus HOS flats as well as the PSPS flats with due regard to the difference in ownership of these two kinds of flats. As a result, the HA endorsed a number of possible options to dispose of the surplus HOS and PSPS flats including Government's negotiating with the developers of the Hunghom Peninsula and Kingsford Terrace PSPS projects for lease modification to enable the developers to sell the flats in the open market. A detailed chronology of events is at Annex A. Progress on disposal of surplus HOS flats is at Annex B.

OPTIONS EXPLORED

10. Against the overriding policy objective stated above, the Administration has explored different options to dispose of the PSPS flats. One of the options explored was for the HA to purchase all the flats from the developer. Disposal of the flats as HOS flats was a non-starter as it ran contrary to our policy direction and would adversely affect the property market which was then hardest hit by the oversupply situation.

11. The option of the HA disposing and changing the use of these flats without first obtaining the developer's agreement is simply not possible. As explained above, the developer holds legal title of the land and owns the entire property. Disposal of the flats through other means necessitates modifications to the lease, which requires pre-requisite agreement of the developer. In view of this uncertainty and with the developer's commercial and car park facilities still remaining in the development, the developer's

agreement would be unlikely without protracted negotiations. The Government and the HA would in any event be faced with the prospect of settling the developer's claims for compensation due to loss in income as a result of the alleged delay in sale of the flats concerned.

12. We have explored the option for the HA to purchase these flats for conversion into public rental housing. This was not adopted because the flats are not suitable for conversion. Apart from its prime location, the development comprises flats which are excessive in size and of a high provision standard than the existing public rental units. About 60% of the flats are of three-bedroom and with gross floor area of above 60m². Moreover, as explained above, modification of the lease and Conditions of Sale would have been required, which needs the pre-requisite agreement of the developer.

13. We have in particular examined the possibility of the HA nominating a single purchaser to take up all the flats from the developer so that the single purchaser can in turn dispose of them in the private market. The legal advice from our solicitors and external Senior Counsel is that this could be considered as providing housing to the general public and as such the HA could be challenged for acting outside its authority and powers under the Housing Ordinance. Besides, this option is also outside the terms of the Conditions of Sale and may be subject to claims by the developer. Although it would be possible for the HA to remedy this situation by seeking a modification of the lease conditions, this would require the agreement of the developer. Other than the above legal implications and lease constraints, it could be perceived as market intervention through selling of flats in the private residential market and ran contrary to the Government's re-positioned policy.

NEGOTIATION WITH THE DEVELOPER

14. After thorough consideration of the feasibility of various options, we considered that allowing the developer to sell the flats in the open market subject to payment of a lease modification premium is in line with the housing policy. The Government therefore commenced preliminary negotiations with the developer in January 2003. However both sides were unable to reach any agreement. The Government adopted

the increase in value of the lot that the lease modification would bring about as its position in the negotiation but failed to reach agreement due to the huge difference between positions of the parties on the premium. Negotiations were broken off in March 2003.

DEVELOPER'S LITIGATION AGAINST THE GOVERNMENT AND THE HA

15. In July 2003, the developer initiated litigation against the Government and the HA, alleging breaches of terms of Land Grant and claiming damages. Legal advice is that if the developer's claim succeeded, the HA would have to pay the damages as awarded by the Court on top of the guaranteed purchase price.

16. In light of the pending court case, the Government re-considered its strategy. After taking into account the various policy, legal and financial considerations and re-considered various options, the Government had decided that the best way would be to settle the dispute with the developer, failing which the HA would probably face a potential huge cash outlay of \$1,914 million in return for the flats which cannot be disposed through rational means plus facing a claim for damages. A negotiation team comprising representatives from the Lands Department, Housing Department and Department of Justice was then formed to re-open negotiation with the developer by way of mediation with a view to settling the matter. The purpose of the mediation is to reach an amicable out-of-court settlement and a reasonable and mutually agreed sum for the lease modification discharging HA's contractual obligations in purchasing the flats and settling the dispute on the alleged damages. The mediation was concluded in December 2003 with the modification premium agreed, before an independent mediator, who is accredited by the Hong Kong International Arbitration Centre.

OUTCOME OF THE NEGOTIATION

17. The Government has reached an agreement with the developer to modify the Conditions of Sale to allow the 2,470 flats to be sold in the open market. The developer has agreed to give up its right to receive the payment of a guaranteed purchase price at \$1,914 million from the HA for

the 2,470 flats held under the PSPS conditions and will, in addition, pay a premium of \$864 million to the Government for the lease modification to allow it to dispose of the flats in the open market. The Conditions of Sale restrict the development on the lot to a residential gross floor area of 144,300m². The modification will not change this. Any redevelopment would have to be in accordance with the Master Layout Plans approved for development of the lot as a PSPS development.

ASSESSMENT OF FINANCIAL IMPLICATIONS

18. Throughout the process, the Government has examined carefully the financial implications of the various options. To prevent possible claims from the developer, the HA could have purchased the PSPS flats. But apart from the various policy and legal considerations described above, this proposal would require the HA to pay an upfront cash amounting to about \$1,914 million. This would be extremely detrimental to the critical financial situation of the HA. Besides, additional costs on rates, management fees, maintenance costs and so on would also be incurred for holding onto the flats upon completion, pending a decision on the timing for sale of the flats taking into account the then adverse market conditions.

19. Taking into account the various restrictions under the PSPS Land Grant, the imminence of the deadline for the HA to nominate purchasers due in July 2004, and the ongoing litigation brought by the developer against the Government and the HA, the Government considers that the outcome of the mediation is the best possible deal under the circumstances. If we had not clinched a deal, the Government would forego \$864 million, the HA would have to pay \$1,914 million and be left with 2,470 flats which simply could not be disposed in a rational manner.

20. As regards the developer's claims for damages arising from the alleged delay in nomination of purchasers by the HA, it was not possible to resolve these claims during the mediation. The Government and the HA hold a very different view from the developer in respect of liability for damages and the quantum of damages. We consider that the developer does not have a good case. We will contest the claim most vigorously in court, if necessary. The conclusion of the modification would, however, effectively put a cap on the amount of damages that the Government and the HA might

have to pay in the event of their being found liable in the litigation. All parties concerned have left the door open for further negotiation on these claims and will continue to attempt to reach an agreement. Otherwise, these claims will have to be decided by the Court.

WAY FORWARD

Kingsford Terrace PSPS Project in Ngau Chi Wan

21. Kingsford Terrace is the last project under the PSPS. All the restrictions described above remain valid and so constrains our freedom of action. However, the market conditions have recently improved. In the light of the opinions expressed in the community over the disposal of the flats of the Hunghom Peninsula PSPS project, the Administration will re-visit the overall approach as well as taking into account the latest property market situation. The Administration will keep this Panel informed of major development and outcome of the negotiation, if any, with the developer concerned in due course.

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Housing, Planning and Lands Bureau
February 2004

Annex A

Hunghom Peninsula Chronology of Events

Date	Major Events
24.9.1999	Land lease was granted to the developer at a tender price of \$583M.
22.10.1999	The developer commenced construction.
6.12.2001	Lease modification for change of provision of pedestrian passage between LandsD and the developer executed.
6.8.2002	Construction completed. BD issued the Occupation Permit.
13.11.2002	SHPL announced the Statement on Housing Policy. The measures announced included ceasing the production and sale of Home Ownership Scheme flats and terminating PSPS.
November 2002	Government considered the disposal arrangements for Hunghom Peninsula and agreed that negotiations should proceed with the developer to allow them to sell the flats in the private property market subject to payment of an agreed premium.
20.11.2002	With LandsD's issue of Consent to Sell to the developer, the 20-months prescribed period for the HA to nominate purchasers for the completed PSPS flats commenced.
21.11.2002	LandsD issued the Certificate of Compliance.
28.11.2002	HA agreed to halt production and sale of HOS/ PSPS flats.
14.1.2003	At LegCo Housing Panel meeting, SHPL advised that the Government was discussing with the PSPS developers with a view to working out details of lease modification to enable them to sell the flats in the open market.
January to March 2003	Government carried out initial negotiation with the developer.
23.1.2003	HA held a brain-storming session on the possible disposal options of the surplus HOS/ PSPS flats.
6.3.2003	HA's Strategic Policy Committee (SPC) approved the disposal arrangement of

	the surplus HOS/PSPS flats and was informed that negotiation with the developer was underway.
18.3.2003	At LegCo Housing Panel Meeting, Members were advised that negotiation between Government and the developers of the two PSPS projects at Hunghom Peninsula and Kingsford Terrace were underway for lease modification to enable them to sell the flats in the open market.
End March 2003	Negotiation with the developer halted since both sides were unable to reach any agreement upon encountering difficulties.
25.7.2003	The developer initiated litigation by issuing a Writ of Summons.
August to October 2003	Government revisited various possible disposal options and decided that further negotiation with the developer through mediation should proceed.
3.11.2003	At the LegCo Housing Panel meeting, Members were informed of the updated progress in the disposal of surplus HOS / PSPS flats.
8 to 23.12.2003	LandsD, HD and Department of Justice conducted Mediation with the developer with the facilitation of an independent mediator accredited by HKIAC.
26.1.2004	Government formalized preliminary agreement on lease modification with the developer.
February 2004	Completion of lease modification process.

Disposal of Surplus HOS flats

We consulted Members in March and November 2003 on proposed disposal arrangements for some 10 000 surplus HOS flats in seven unsold HOS developments, a list of which is attached. At the November meeting, Members passed a motion urging the Government to consider converting the surplus HOS flats (except PSPS flats and those to be converted into departmental quarters and guesthouses) to public rental housing as soon as possible. We supported Members' suggestion. As a start, action is in hand to seek the Housing Authority's approval to transfer about 3 000 flats to public rental housing. We are identifying suitable flats for such purpose.

Meanwhile, we are actively pursuing other disposal options. On the proposed conversion of some flats into guesthouses or similar uses, we invited expression of interest in October 2003. A total of eight proposals had been received. Our assessment of the proposals revealed that most of the interested parties are small set-ups without the specialised knowledge and experience in guesthouse operations. The financial backup for some of them is also doubtful. We would solicit more views from the participants of the related industry before concluding the exercise. We have also proposed to use some 4 300 flats for re-provisioning the existing quarters for the disciplined services. Our discussion with the relevant Government bureaux and departments on detailed administrative and financial arrangements are still in progress. Concerns including financial arrangements and technical issues have come up during the discussion but we are optimistic that they will be smoothed out.

We will expedite follow-up works along these directions and keep Members abreast of progress.

Unsold HOS projects completed or under construction

Unsold HOS Projects	No. of flats	Status
King Hin Court (Ngau Chi Wan)	344	Completed
Yau Mei Court (Yau Tong)	3 872	Completed
Ko Cheung Court (Yau Tong)	2 800	Completed
Kwai Chung Phase 7	800	Completed
Tung Tao Court (Aldrich Bay)	1 216	Completed
Kwai Yung Court (Kwai Chung)	512	Scheduled for completion in March 2004
Lam Tin Phase 6	720	Scheduled for completion in April 2004
Total :	10 264	