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Panel on Housing

Divestment of Housing Authority's Retail and Car-parking Facilities

Background brief

Purpose

This paper gives the background information on the divestment of retail and car-parking (RC) facilities of the Housing Authority (HA) and summarizes the discussion of the Panel on Housing (the Panel) on the issue.

Reasons for the divestment

2. HA currently holds approximately one million square meters of retail facilities and some 100 000 car-parking spaces, amounting to some 11% and 16% of the market respectively. Divestment of HA's RC facilities was first mooted in 2000, with the objective of enabling HA to focus its resources on its core function as the provider of public housing in Hong Kong. This objective was in line with the direction provided in the Report on the Review of the Institutional Framework for Public Housing published in June 2002, where it recommended that HA should progressively divest its non-core assets, i.e. the commercial portfolio (RC facilities).

3. In July 2002 HA appointed a consultant to assess the feasibility of the divestment, recommend the divestment strategy and formulate an implementation proposal. Based on the findings of the consultancy study, the Administration put forward a divestment proposal to the Chief Executive in Council for consideration on 15 July 2003. The Chief Executive in Council ordered that the HA's agreement be sought to divest its RC facilities and that the net proceeds from the divestment should entirely go to HA. On 24 July 2003 HA agreed in principle to divest its RC facilities.

4. The reasons for the divestment, according to the Administration, are two-fold. First, it would enable HA to focus its resources on its core functions as a provider of subsidized public housing. Second, with the cessation of

production and sale of Home Ownership Scheme flats indefinitely, HA lacks a recurrent source of income. HA's cash balance is forecast to decrease from \$22 billion at the beginning of 2003/04 to minus \$5.5 billion by the end of 2005/06. Proceeds from the divestment will help to meet HA's funding requirements in the short term.

Details of the divestment

5. HA agreed to adopt the following broad strategy to take forward the divestment:

- (a) A Real Estate Investment Trust (REIT)¹ structure will be established;
- (b) A new company to manage the REIT will be set up. This company will be beneficially owned by unit-holders of the REIT and held in trust by the REIT's trustees;
- (c) Initially, the HA will assign the cash flow of the RC facilities to the new company and sign a sale and purchase agreement with it in respect of the RC facilities. On this basis the new company will make an initial public offering (IPO) on the Stock Exchange of Hong Kong, which, tentatively, is set in 2004/05;
- (d) At a later stage when preparation of relevant land leases are completed, the HA will transfer the legal title of the RC facilities to the new company; and
- (e) The new company will pay to the HA for the sale of the RC facilities by two installments: a major proportion of the sale amount will be paid immediately after the IPO and the balance will be paid upon the completion of transfer of legal titles.

6. HA also decided that other than a small proportion of the RC facilities which may be unsuitable for divestment because of their poor location, small scale, old age or obsolescent condition, all the RC facilities will be divested in one go.

¹ According to the Securities and Futures Commission (SFC) of Hong Kong, a REIT is "a collective investment scheme constituted as a trust that invests primarily in real estate with the aim to provide returns to holders derived from the rental income of the real estate. Funds obtained by a REIT from the sale of units in the REIT are used in accordance with the constitutive documents to maintain, manage and acquire real estate within its portfolio."

Members' concern

7. After the HA had agreed in principle to divest its RC facilities, the Administration briefed the Panel on the details of the divestment on various occasions. The major concerns of members are summarized below.

Impact on staff of the Housing Department

8. Members are concerned about the job security of staff, in particular contract staff in the Housing Department. The divestment would affect some 650 civil servants, ranging from professionals to front-line officers, currently managing or maintaining the RC facilities. The Administration introduces a voluntary exit scheme (VES) for those who wish to leave the civil service. The VES covers only the 646 departmental grade posts being identified to be surplus to requirement arising from the divestment. Any civil servants working in the Housing Department who are in the same ranks as these 646 posts are eligible to apply, provided that they have more than five years' active service prior to normal retirement and are not subject to disciplinary proceedings. The benefits under the VES include, inter alia, immediate payment of pension benefits irrespective of whether or not the officer concerned has attained the normal retirement age, but subject to completion of the stipulated minimum qualifying length of service.

9. The Administration expects that some of the existing staff may be required to support the new company during the initial stage through secondment or service contracts. Staff may also be recruited by the new company given their operational knowledge and experience. Members however remain concerned that the introduction of VES and redeployment of surplus staff may not resolve the problem. They urge the Administration to sort out measures to mitigate impact on the contract staff.

Impact on commercial tenants

10. Of equal concern to members of the Panel is the impact of the divestment on stakeholders, such as commercial tenants and service providers. On 5 July 2004 the Panel listened to the views of 10 deputations coming from the retail, catering, and medical sectors. Their main concerns include rent increase, security of tenancy and continuity of letting/contracting policies, payment of stamp duty, and changes in trade mix and policies on name change and fire insurance, etc. The major concerns and suggestions raised by commercial tenants are set out in **Appendix I**. Members consider it important that the new company should maintain dialogue with the commercial tenants to see how their concerns could be addressed and the Administration should play an active role in the process.

Operation and structure of the new company

11. Members express concerns about the operation and structure of the new company as follows:

- (a) There is a possibility of monopoly or oligarchy of the RC facilities by a limited number of big corporations which have sufficient financial strength to buy up all the shares of the new company;
- (b) If HA does not retain any share in the new company, it would not have any role to play in its management to ensure continuity of tenancy policy;
- (c) The new company should have a proper corporate structure to ensure that it would not be controlled by a few persons and the terms of its board of directors would not be extended indefinitely; and
- (d) After divestment, the RC facilities would be operated fully on a commercial basis. The new company would be more ready to increase rents and the burden of which would eventually be passed onto consumers in terms of higher prices for goods and services.

12. There is also concern that the rental income from the RC facilities is a major source of recurrent cash flow to the HA and without which, the HA would incur deficit in the long run.

13. A chronology of relevant events and the relevant papers with their hyperlinks are in **Appendices II and III** respectively.

**Major concerns and suggestions raised by commercial tenants
on divestment of retail and car-parking facilities
of the Housing Authority**

1. Rental policy

- 1.1 Rental increase by MgtCo for pursuit of higher profits?
- 1.2 Possibility of rent review on a three-year cycle, in accordance with Consumer Price Index (CPI) movements?

2. Various tenancy terms

- 2.1 Continue with the existing arrangement, including those for -
 - (a) air-conditioning charges;
 - (b) management fees (of which the rent is inclusive);
 - (c) rent deposit (ie generally two-months' rent, in cash and / or bank guarantee);
 - (d) exemption from stamp duty payment;
 - (e) area of letting being expressed in Internal Floor Area, instead of Gross Floor Area;
 - (f) negotiation mechanism on rental levels; and
 - (g) termination of tenancy
- 2.2 As a comfort to sitting commercial tenants -
 - (a) Will they be eligible (or enjoy priority) for tenancy renewal?
[Note : Some groups have asked for tenancy renewal up to 9 years.]
 - (b) Alternatively, will the tenancy period for these tenants be extended (say, to 5 years)?
 - (c) Will MgtCo be prohibited from exercising "early termination" provision against these tenants?

- 2.3 Any one-off and unconditional waiver for the so-called "conspired sub-letting"?
- 2.4 Any ex-gratia payment (and, for those let on premium tender, return of premium) to those opting to move out, or those with tenancies not renewed by MgtCo?
- 2.5 Insurance against damage to the premises (by fire and other perils such as typhoon and flood) continues to be provided at the cost of the landlord?
- 2.6 Arrangement for commercial tenants benefited from the 2001 Rent Assessment Exercise, bearing in mind that the lower rent assessed under the exercise will expire by end of October 2004?
- 2.7 Arrangement for rent relief measures such as "rent adjustment" for new estates with slow population intake?

3. Trade mix

- 3.1 Continue with the existing trade mix to avoid unhealthy competition?
- 3.2 Prospect for MgtCo to minimize vacancy rate by compromising the original trade mix?

4. Interests of small tenants / social responsibility of MgtCo

- 4.1 How to protect the interest of small tenants?
- 4.2 How to avoid monopoly / oligarchy of RC facilities by individual operators (especially those of big names)?
- 4.3 More fundamentally, how to avoid MgtCo being "taken over" by large corporations?
- 4.4 Given MgtCo's priority to financial returns, how to ensure its social responsibility (e.g. provision of healthcare services) and commitments to the tenants?
- 4.5 Will MgtCo sell off RC properties under its portfolio, as they have an incentive to do so in respect of those with low return rate?
- 4.6 Will HA retain a certain degree of control over the operation of MgtCo after divestment?

5. Maintenance / repair cost

- 5.1 Will the MgtCo take up the cost of maintenance / repair services?
- 5.2 Will the MgtCo cut the budget for maintenance / repair services for these properties given their low return rate?

6. Communication channels with tenants

- 6.1 Any channel for commercial tenants to monitor the transitional arrangement?
- 6.2 Any consultation / communication mechanism between the MgtCo management and the commercial tenants?
- 6.3 Any appeal mechanism on MgtCo's decision in future? Any mechanism to monitor its policy (e.g. rental policy) and operation?
- 6.4 Will commercial tenants be represented on MgtCo's board of directors?

7. Operational management

- 7.1 Small tenants against a wider use of the single-operator system, but this is advocated by the existing "single operators".
- 7.2 Continue with the existing policy of out-sourcing carpark management to outside companies?
- 7.3 Ability for MgtCo to take up at once the management of a massive portfolio of RC facilities?
- 7.4 Will estate common areas and prohibited zones be clearly carved out to minimize potential management problems after divestment?
- 7.5 Important to ensure a smooth transfer of existing contracts or financial instruments (e.g. letter of guarantee) to MgtCo.

8. Others

- 8.1 Given all the adverse implications of the divestment project on the commercial tenants, will HA defer / call off the project?
- 8.2 Provision of clinic services according to population ratio?

- 8.3 Possible to exclude clinics from divestment, having regard to their social service nature?
- 8.4 Possible for commercial tenants to subscribe for REIT units on a pre-emptive basis?
- 8.5 Possible for sitting tenants to buy their own shops?
- 8.6 Compensation arrangement for redevelopment?

Source: Annex B to LC Paper No. CB(1) 2291/03-04(08) provided by the Administration

Council Business Division 1
Legislative Council Secretariat
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Divestment of Housing Authority's Retail and Car-parking Facilities

Chronology of events

Date	Event
15 July 2003	The Chief Executive in Council approved the divestment plan
24 July 2003	HA approved the divestment plan
31 October 2003	HA announced appointment of Global-Coordinator and advisers to assist in the divestment plan
3 November 2003	Meeting of the Panel on Housing to discuss divestment of HA's RC facilities
1 December 2003	Meeting of the Panel on Housing to discuss divestment of HA's RC facilities
9 December 2003	HA's Supervisory Group on Divestment met with commercial tenants
December 2003	The Administration met with staff unions and staff of the Commercial Properties Sub-division to exchange views
21 April 2004	HA appointed Chief Executive Officer and Chief Financial Officer of the Management Company
21 April 2004	The Administration announced the voluntary exit scheme for Housing Department staff affected by the divestment plan
3 May 2004	Meeting of the Panel on Housing to discuss the progress of divestment of HA's RC facilities
5 July 2004	Meeting of the Panel on Housing to listen to views of deputations on the divestment

Divestment of the Housing Authority's Retail and Car-parking Facilities

List of references

Council/Committee	Date of meeting	Paper
Housing Panel	14 January 2003	LC Paper No. CB(1)941/02-03 http://www.legco.gov.hk/yr02-03/english/panels/hg/minutes/hg030114.pdf
Council Meeting	2 April 2003	Hansard http://www.legco.gov.hk/yr02-03/english/counmtg/hansard/cm0402ti-translate-e.pdf
Housing Panel	3 November 2003	File Ref: HD(CR)/(CS) Div/DV/3 http://www.legco.gov.hk/yr03-04/english/panels/hg/papers/hg1103cb1-hplb-e.pdf LC Paper No. CB(1)190/03-04(04) http://www.legco.gov.hk/yr03-04/english/panels/hg/papers/hg1103cb1-190-4e.pdf LC Paper No. CB(1)190/03-04(05) http://www.legco.gov.hk/yr03-04/english/panels/hg/papers/hg1103cb1-190-5e.pdf LC Paper No. CB(1)438/03-04(03) http://www.legco.gov.hk/yr03-04/english/panels/hg/papers/hg1201cb1-438-3e.pdf LC Paper No. CB(1)439/03-04 http://www.legco.gov.hk/yr03-04/english/panels/hg/minutes/hg031103.pdf

Council/Committee	Date of meeting	Paper
Housing Panel	1 December 2003	LC Paper No. CB(1)438/03-04(03) http://www.legco.gov.hk/yr03-04/english/panels/hg/papers/hg1201cb1-438-3e.pdf LC Paper No. CB(1)668/03-04 http://www.legco.gov.hk/yr03-04/english/panels/hg/minutes/hg031201.pdf
Housing Panel	3 May 2004	LC Paper No. CB(1)1638/03-04(03) http://www.legco.gov.hk/yr03-04/english/panels/hg/papers/hg0503cb1-1638-3e.pdf LC Paper No. CB(1)2030/03-04 http://www.legco.gov.hk/yr03-04/english/panels/hg/minutes/hg040503.pdf
Establishment Committee	16 June 2004	EC(2004-05)9 http://www.legco.gov.hk/yr03-04/english/fc/esc/papers/e04-09e.pdf
Housing Panel	5 July 2004	LC Paper No. CB(1)2291/03-04(08) http://www.legco.gov.hk/yr03-04/english/panels/hg/papers/hg0705cb1-2291-8e.pdf LC Paper No. CB(1) 2503/03-04 http://www.legco.gov.hk/yr03-04/english/panels/hg/minutes/hg040705.pdf