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16 May 2008

Ms Miranda Hon
Clerk, Public Accounts Committee
Legislative Council
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Ms Hon,

**The Director of Audit's Report on the
results of value for money audits (Report No. 50)**

Chapter 2: Commercialisation and utilisation of government properties

Thank you for your letter dated 8 May 2008 requesting the Audit Commission (Audit) to provide additional information. The following additional information may facilitate the Public Accounts Committee's consideration of the subject:

- (a) as stated in paragraph 1.2 of the Audit Report, the Government Property Agency (GPA)'s objectives in respect of the utilisation and commercialisation of government properties are to ensure that all government accommodation is fully utilised with maximum efficiency and value for money, and to introduce appropriate commercial activities in suitable government accommodation so as to maximise the return to the Government for its capital investment. Audit noted that, the GPA, by relocating the Student Financial Assistance Agency (SFAA) to the Trade and Industry Department (TID) Tower, might not have fully utilised the TID Tower with maximum efficiency and value for money, and had not explored appropriate commercialisation opportunities in the TID Tower so as to maximise the return to the Government. The reasons are as follows:
 - (i) the TID Tower was acquired by the Government in 1990. At the time of acquisition, the ground, the mezzanine, the first and the second floors (i.e. the lower floors) were fitted out as a shopping arcade and leased to retail shops. The Administration finally considered that it was justified to convert the shopping arcade (except the ground floor) to office accommodation for the TID because of the special circumstances mentioned

in paragraph 2.8 of the Audit Report. However, following the scheduled phase-out of textiles quotas by 2005, the special circumstances of the TID no longer existed and the TID was able to deliver surplus areas to the GPA. In view of the change in circumstances, the GPA should review whether the continuous use of the lower floors as office accommodation was justified when surplus areas were released by the TID. To achieve maximum value for money, the GPA should evaluate whether it would be more economical to relocate the SFAA to other available surplus government accommodation or less costly leased office accommodation at that time; and

- (ii) as it is the GPA's objective to introduce appropriate commercial activities in suitable government accommodation so as to maximise the return to the Government, Audit considers that the GPA should explore the commercialisation opportunities of the TID Tower. As stated in paragraph 2.13 of the Audit Report, the basements, the ground, the mezzanine, the first and the second floors of the TID Tower have valuable commercial potential for use as a shopping arcade. To maximise the return to the Government, the GPA should evaluate the costs and benefits of converting the lower floors for retail use.

Similar to the case of the Queensway Plaza, Audit considers that the GPA should not follow Accommodation Circular No. 1/97 mechanically in warranted cases and should not follow the principle of minimising the leased accommodation if substantial benefits can be obtained. Audit therefore stated in paragraph 2.22(a) of the Audit Report that the GPA should have conducted a cost-benefit analysis of converting all or portions of the lower floors to retail use before allocating the surplus areas to the SFAA in 2007;

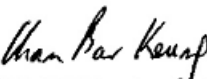
- (b) Audit has reservations on the results of the GPA's preliminary assessment because it is not a comprehensive analysis. The preliminary assessment was based on the mezzanine floor, as an example, rather than the lower three floors. Audit also has reservations on the following assumptions (based on internal floor area) used in the preliminary assessment:

- (i) **Rental income of \$800 per square metre per month.** It is too conservative to use the rental income of \$800 per square metre per month to assess the viability of converting the lower three floors to retail use. In September 2006, the GPA assessed the financial implications of relocating government offices in the TID Tower to a proposed new government office building around 2013 and selling the TID Tower to a new owner who would convert the offices on a number of floors to shops. According to the data furnished to Audit on 22 April 2008, the GPA, in 2006, estimated that the rental income of the converted shops in the basements, on the mezzanine floor, and the first to the third floors was \$1,300 per square metre per month. The rental income of the offices on the 4th to the 19th floors was \$255 per square metre per month. Audit has noted that the 2007-08 average rateable value of the shops on:

- the ground floor of the TID Tower (formerly the Argyle Centre Tower II) was \$1,800 per square metre per month; and
 - the first to the third floors of the Argyle Centre Tower I was \$2,700 per square metre per month; and
- (ii) **Rental expenses of \$420 per square metre per month.** The estimated rental expenses were based on the rents of the Langham Place and the Pioneer Centre in February 2008. The GPA assumed that alternative offices of similar quality in the locality should be provided for all the offices, including the SFAA, on the lower floors of the TID Tower. Audit notes that the Headquarters of the SFAA is located in the Cheung Sha Wan Government Offices. The rental value of the TID Tower is higher than that of the Cheung Sha Wan Government Offices;
- (c) the current shopping environment of the TID Tower is mentioned in paragraph 2.27 of the Audit Report. Audit considers that the rental value of a shopping arcade may be increased by improving the pedestrian flow and allowing the shops to operate in the evenings, on weekends and public holidays. To improve the pedestrian flow, the GPA may explore the feasibility of re-opening the footbridge to the Argyle Centre Tower I, connecting the elevated pedestrian walkway over Mong Kok Road to the TID Tower, and even providing direct access to the Mass Transit Railway station through the basement of the TID Tower; and
- (d) it may not be appropriate to draw a direct comparison between rents of the ground floor shops in the TID Tower with those of similar shops in the same area. According to the tender assessment reports prepared by the GPA in 1990, the monthly rents obtained through open tenders for the shops were mostly higher than the corresponding Rating and Valuation Department's rental valuations of ground floor shops at nearby developments at that time (see Appendix C of the Audit Report). In this connection, Audit noted that, in 2007-08, the average rateable values of the ground floor shops per square metre per month (based on internal floor area) were \$1,800 for the TID Tower and \$4,300 for the Argyle Centre Tower I.

A Chinese translation of this letter will be forwarded to you shortly.

Yours sincerely,


(CHAN Bar-keung)
for Director of Audit

Government Property Administrator
Secretary for Financial Services and the Treasury
Director-General of Trade and Industry