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24 May 2011

Clerk to Public Accounts Committee
Legislative Council
8 Jackson Road, Central
Hong Kong
(Attention : Ms Macy NG)

Dear Ms Ng,

**The Director of Audit's Report on the
results of value for money audits (Report No. 56)**

**Hong Kong Housing Authority:
Management of commercial properties (Chapter 7)**

I refer to your respective letters of 17 and 18 May 2011 on the captioned matters. I hereby provide the information as requested detailed in the two aforementioned letters as follows –

- (a) The Hong Kong Housing Authority's standard tenancy agreements for shops and for food premises/restaurants respectively; and
- (b) information provided by the Administration in response to the Clerk to the Public Accounts Committee's letter of 17 May 2011.

Our reply in Chinese will follow shortly.

Yours sincerely,


(Vincent TANG)
for Director of Housing

c.c.

Secretary for Financial Services and the Treasury (Fax No.: 2147 5239)
Director of Audit (Fax No.: 2583 9063)

***Note by Clerk, PAC:** *The Hong Kong Housing Authority's standard tenancy agreements for shops and for food premises/restaurants not attached.*

The Public Accounts Committee

Information provided by the Administration in response to the Clerk to the Public Accounts Committee's letter of 17 May 2011

We note that the reference to “notional” Government rent chargeable cited by the Director of Audit in his report covers the period from 1 July 2008 up to 14 July 2010, whereas questions (a) to (c) below relate to the time before this relevant period. We have nevertheless set out as far as possible information in response to questions (a) to (c) for the Public Accounts Committee's reference. We have also set out in the following paragraphs our response to the remaining questions.

(a) when the then Secretary for Housing, Planning and Lands (“SHPL”) attended the Executive Council (“ExCo”) meeting during which the ExCo made the decision of transferring the beneficial ownership for the remaining 104 properties to The Link REIT without a definite timeline for the transfer of legal titles, which Government official had provided advice to the SHPL and what advice had been given. Please provide the Committee with a copy of the relevant brief for the SHPL for attending the ExCo meeting;

2. At the meeting of the Executive Council (ExCo) held on 15 July 2003, the Chief Executive (CE) in Council considered the Administration's proposal pertaining to the divestment of Hong Kong Housing Authority (HA)'s Retail and Car-parking (RC) Facilities and ordered that HA's agreement in principle be sought to divest its RC facilities. Details were reported and set out in the Legislative Council (LegCo) Brief on “Divestment of HA's RC facilities” issued to the LegCo in July 2003 [LegCo Brief File Ref HD(CR)/(CS)Div/DV/3] (copy is at **Enclosure A**). According to the LegCo brief, the issue on land lease and Government rent (paragraphs 13 to 14) were specifically addressed. ExCo was aware of the fact that new leases of land are normally granted subject to payment of Government rent, and that after the Government leases are granted, The Link Real Estate Investment Trust (The Link REIT) will need to pay Government rent in respect of the RC facilities.

Enclosure A

3. For the said ExCo meeting, the then Secretary for Housing, Planning and Lands (SHPL) attended as an official member of ExCo. In general, senior Government officials attending ExCo for the discussion item under their purview may receive briefs, should they find it necessary and appropriate, prepared by subject officers in the concerned policy bureaux and departments. However, in this case, we have carried out a search through the relevant subject files available in our office but cannot source or locate any briefing materials prepared for the then SHPL for his attendance at the said ExCo meeting.

(b) a copy of the engagement letter for the legal adviser engaged by the Administration for the divestment exercise, if any; and

(c) whether the legal adviser engaged by the Administration had assessed and advised the Administration on the risks and potential financial implications of the delay in transfer of legal titles of the divested properties; if the legal adviser had, what were the Administration's considerations and ways to address the risks (please also provide a copy the relevant legal advice to the Committee); if the legal adviser had not, whether the Administration would consider seeking remedy from the legal adviser for failing to provide such advice and protect its interests;

4. For the divestment exercise, the Hong Kong Housing Authority sought external legal advice but, as far as we can determine, the policy bureaux and Government departments involved, relied upon the Government's own internal legal advisors for matters relevant to their particular interest.

5. As pointed out in our response to question (d) below, and as reflected in the LegCo brief, ExCo acknowledged that the Link would only be charged Government rent once the leases were completed.

(d) whether the overall valuation of the divested properties had reflected the financial implications of a possible delay in charging Government rent arising from the late completion of the process of transfer of legal titles; if it had, please provide the Committee with information on the valuation and highlight the relevant parts;

6. New leases of land are normally granted subject to payment of Government rent. After the leases are granted and the legal titles to the RC properties are transferred to The Link REIT, The Link REIT will need to pay Government rent in respect of such RC properties. This was clearly explained in paragraph 14 of the LegCo Brief on “Divestment of HA’s RC facilities” issued to the LegCo in July 2003 as attached at **Enclosure A**.

7. The valuation of the RC properties covered was clearly intended to ensure that a fair market price was set for all of the properties in question. This was clearly explained in Annex A to the LegCo Brief. Separately, it is clear from the ‘Manager’s Discussion and Analysis of Future Operations’ section of the Offer Circular that The Link REIT would be required to pay Government rent for List 1 properties upon divestment and that at a later stage for List 2 properties upon the issue of Government leases and the legal titles to the RC properties be transferred to The Link REIT. This shows that this was a factor fully taken into account in the divestment exercise. Indeed, the fact that the leases would be put in place over a number of years following divestment was also stated in the documents. In particular, the fact that the intention was originally to complete this exercise in 2008 was clearly set out on page 93 of the Offer Circular (an extract from the said Offer Circular is at **Enclosure B**).

Enclosure B

(e) whether the Administration had negotiated with The Link REIT for compensating the Government for not being able to charge the Government rent due to the late completion of the process of transfer; if it had not, whether it would consider doing so; and

8. Given the fact that the obligation to pay the Government rent

only arises when the Government lease concerned is granted, The Link REIT is not obliged to pay the Government rent for those properties with no Government leases and the legal title to the properties yet to be transferred to The Link REIT. There is thus no legal basis for the Government to recover from The Link REIT the alleged “notional” Government rent chargeable in respect of the properties for the period during which the Government leases were yet to be granted.

(f) the reasons for the late completion of the transfer of legal titles of each of the 54 divested properties mentioned in paragraph 6.13 of the Audit Report.

Enclosure C 9. Our responses are set out in **Enclosure C**.

Housing Department
23 May 2011

***Note by Clerk, PAC: Enclosures A and B not attached.**

Legislative Council
Public Accounts Committee
Transfer of Legal Titles for the Divested Properties

PURPOSE

This paper provides background to and information on the need to revise the target date for completion of the transfer of legal title for the divested properties.

BACKGROUND

2. The land on which most of the public housing estates are situated, including retail and carparking facilities within the estates, is vested in the Hong Kong Housing Authority (HA) by the Government under a vesting order. To complete the transfer of legal title of the divested properties to The Link Real Estate Investment Trust (The Link REIT), it would first be necessary for the HA to obtain land leases from the Government and to enter into relevant deeds of mutual covenant (DMCs) for those properties. Owing to the large number of properties under the divestment portfolio, when The Link REIT was listed in November 2005, it was only possible to transfer to The Link REIT both the legal titles and beneficial ownership for 76 out of the 180 properties sold to The Link REIT. For the remaining 104 properties, only beneficial ownership was transferred at that time. Accordingly, agreements were entered into between the Government and the HA (Government Agreement), and between the HA and The Link Properties Limited (PropCo) (Property Agreement) to provide for, inter alia, the transfer of legal title to the remaining properties to The Link REIT subsequent to its listing.

3. In the Offering Circular, there is a statement of intention indicating that ‘it is intended that the process (for transfer of legal title to the remaining properties) will be completed by the middle of 2008.’ The material terms of the Government Annex A Agreement and the Property Agreement are summarized at pages 192 to 196 of the Offering Circular, and it is stated at page 192 of the Offering Circular that these agreements pertaining to the acquisition of properties are available for physical Annex B inspection at the office of Linklaters. Also, at page 45 of the Offering Circular, it is stated that there is no exact timeline for transferring the legal title to the remaining

properties, and there is no specified recourse against the Government in the event it fails to comply in a timely manner with the Government Agreement.

REASONS FOR NOT MEETING THE ORIGINAL TARGET DATE

4. The procurement of leases and DMCs after the sale of beneficial interest of the divested properties is an unprecedented task. The work involved in the procurement process was much more complex and onerous than could be anticipated at the time of planning and of divestment. During the procurement process, new requirements and restrictions were imposed by various Government departments. There was also a host of other unforeseen issues seriously affecting the progress. In the light of these circumstances, it was thus necessary to revisit and revise the original target completion date for the transfer of legal titles. The details are set out in the following paragraphs.

Certification of Gross Floor Area (GFA) under Lease

5. New procedures and requirements on certification of GFA under lease were introduced by the Lands Department (LandsD) in end 2005, shortly after the listing. Pending finalization and issue of the new procedures and requirements by the LandsD, progress of the programme was seriously affected until end 2006. Moreover, these changes resulted in considerably longer processing time for individual leases, which in turn significantly affected the overall programme.

Planning Issues

6. New planning requirements regarding carving out of free standing Government, Institution and Community (GIC) facilities from lease boundaries and building height restrictions ^{Note 1} were raised by Planning Department (PlanD) in early 2007. The Housing Department (HD) made repeated representations to PlanD for not applying the new planning requirements to the remaining properties, in particular in relation to those leases of which approval in principle had already been granted by LandsD. However, PlanD considered that no exceptions could be

^{Note 1} Building height restrictions stipulate the maximum building height of a development upon redevelopment, and aims to address the rising public concern on excessive building heights and bulk of new developments.

allowed. Significant additional liaison work was thus required with relevant Government departments on the determination of the revised boundary and on granting of appropriate rights and easements, including for those leases on which approval in principle had been granted by LandsD. More specifically, the imposition of building height restrictions entailed a revision of the Master Lease document ^{Note 2}, and additional efforts in taking de-facto measurements on-site for determining the building heights for stipulation in the respective leases, in preparing the roof-top structures list, and in finalizing the relevant legal documentation. The lease finalization work was inevitably deferred as a result. Subsequent preparatory works for DMC and title transfer were also seriously affected.

DMC Issues

7. The assignment programme had been further affected by revisions to the Model DMC ^{Note 3} required by the Legal Advisory and Conveyancing Office (LACO) of LandsD to align with the new DMC requirements. There were also changes necessitated by the legislative amendments then introduced.

8. Promulgated in April 2006, LACO Circular Memorandum No. 56 (LACO CM56) set out various new guidelines for drafting of DMC with a view to incorporating the Government's initiative on building safety. In view of the scope and complexity of the new requirements, HD appointed a legal consultant in May 2006 to revise the then Model DMC for complying with the new guidelines. As substantial revisions were involved, it had taken over six months for the legal consultant to complete the work and to secure the final approval from LACO. During the period, repeated requests were made to LACO for granting waiver to HA, in particular in relation to the new guideline No. 36 which set out a new requirement for submitting a maintenance manual ^{Note 4} for major works and installations (for both divested and HA retained portion) within one month of the date of the DMC.

^{Note 2} Master Lease for divested properties was the form of Government lease as approved by the Government for the public rental housing (PRH) estates with divested properties. Individual leases were prepared based on the Master Lease, with necessary modifications to suit the particular circumstances of each estate.

^{Note 3} Model DMC was the form of deed of mutual covenant approved by the Government for the PRH estates with divested properties. The Model DMC only served as a general framework based on which individual DMCs were prepared with necessary modifications to suit the particular circumstances of each property.

^{Note 4} Under the new guideline, a developer must compile for the reference of the owners a maintenance manual for all the major works and installations in the development. The maintenance manual must include all as-built record plans of the building and services installations, all warranties and guarantees provided by the contractors, recommended maintenance strategy and procedures, and checklist for routine maintenance inspection etc.

However, after lengthy negotiations, LACO decided that no exemption could be granted to the HA, but agreed to allow extension of time for deposit of the maintenance manual.

9. Further revision of the Model DMC was necessitated by the enactment of the Building Management (Amendment) Ordinance on 1 August 2007. The HD engaged a legal consultant in September 2007 to review the Model DMC to ensure its consistency with the new requirements under the statute. All the remaining DMC cases had to be premised on the revised model and had to be re-submitted to LandsD for approval. This further lengthened the title transfer programme.

Other Complications

10. The situation was further aggravated by unexpected complications which arose from time to time during the processing of individual leases, for example,

- Presence of structures with historical values within the site.
- Requirement to demolish structures or transplant trees erected over the Drainage Reserve Area.
- Requirement to protect highway structures and to build in appropriate lease clauses.
- Reservation of land stratum for new railway lines to pass through.
- Inclusion of slopes within lot boundaries for maintenance.
- Resolution of projecting structures from the lot over Government land or private lot.
- Resolution of encroachment over adjoining lot or vice versa.

11. Such complications required additional negotiations with relevant Government departments and parties, re-submission to LandsD for approval and/or preparation of complex legal documentation.

ACTIONS TAKEN BY HA

12. The issues as set out in paragraphs 5 to 9 were raised by various Government departments, and inevitably would take time to resolve to the satisfaction of all departments concerned. As set out in the paragraphs above, the

new requirements introduced then were put in place to address various public concerns and for the sake of protecting the overall interests of the parties concerned. In the light of these circumstances which could not be anticipated at the time of planning and of divestment, the HA had taken every possible measure to overcome these difficulties and expedite the procurement task, including engagement of temporary staff on HA contract terms for secondment to the Government Property Agency and LandsD to work on the lease and DMC procurement project, frequent liaison and day to day telephone contacts were carried out with the Government departments and parties concerned to resolve the outstanding problems as soon as possible.

13. Based on the then new requirements and special circumstances as set out in paragraphs 5 to 10, and in the light of experience gained in working with the Government departments and parties concerned to resolve the relevant issues, the HA considered that realistically, the completion of the whole procurement exercise could only be by July 2010. In its report to the Legislative Council (LegCo) Panel on Housing in March 2008 and to the Establishment Subcommittee under the Finance Committee of the LegCo in May 2008, the Administration reported that the target completion date of the whole project had to be revised to July 2010 in view of the statutory requirements and complexities unforeseen at the planning and divestment stages but encountered during the course of the lease and DMC procurement exercise. This revised target date was subsequently publicized through a public announcement made by The Link Management Limited (The Link). The HD further advised the LegCo Panel on Housing on the progress of the lease procurement exercise at its meetings of September 2009 and April 2010 respectively.

14. The HA met the revised target date and completed the whole procurement exercise in July 2010. The Link made a public announcement on the completion of the conveyance of legal title in August 2010. The revised timetable for the transfer of legal title has no adverse financial implications to the HA from the angle of property sale since the purchase price was fully received by the HA at the time of listing. As regards land lease and Government rent, these issues were raised and considered at the time of planning, including the fact that new leases of land are normally granted subject to payment of Government rent, and that after the leases are granted, The Link REIT will need to pay Government rent in respect of the retail and Annex C carparking facilities.

15. The lease procurement exercise did not depend solely on the work of the HA, but also on the Government (including all relevant Government departments) as set out in the Government Agreement and the Property Agreement. During the whole exercise and in accordance with the Government Agreement and Property Agreement, both the HA/HD and the relevant Government departments had respectively strived to expedite the process and complete the exercise within the revised target timeframe. With the concerted efforts of all involved, the revised timetable of July 2010 was met. The Government rent foregone is, hence, as pointed out by the Director of Audit, only a notional figure.

16. That said and although the HA does not have further plans to divest HA's commercial facilities, we will conduct a post-implementation review on the divestment exercise as recommended by the Director of Audit in order to gain from the experience.

Housing Department
May 2011

***Note by Clerk, PAC: Annexes A, B and C not attached.**