

**For discussion on
18 June 2003**

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

Pre-sale of Residential Flats and the Consent Scheme

PURPOSE

This paper sets out the existing system for the pre-sale of uncompleted residential flats under the Lands Department's Consent Scheme (the Scheme), and discusses possible measures to prevent default in residential property developments taking into account the experience of two recent cases of Villa Pinada and The Aegean.

BACKGROUND

2. Sale of residential flats before their completion started in Hong Kong in the late 1950s. However, at that time, such arrangements were in breach of the lease conditions which prohibited alienation before compliance with the building covenant in the lease. This put flat buyers in a disadvantageous position as their purchase could not be registered in the Land Office, and their purchase monies were not kept in a stakeholder's account subject to any controls such as to be released for construction cost only. Hence flat buyers' interests were not protected if the residential project failed. For this reason, the Scheme was introduced by Government in 1961. The Scheme, with refinements over the years to meet prevailing market conditions, has been in operation since.

Objective of the Consent Scheme

3. The Scheme, as introduced in 1961, was designed to regulate the sale of uncompleted flats and to give some 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 to be 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's account and their release for meeting the construction cost of the development. Through these arrangements, the interests of flat purchasers are protected. The Scheme is administered by the Legal Advisory and Conveyancing Office (LACO) of Lands Department (Lands D).

4. Since its introduction, the Scheme has been running smoothly on the whole. Pre-sale of flats under the Scheme has proven to be of mutual advantage to flat buyers and developers and has facilitated the overall development of the property market. 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 hand, 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.

5. In the past five years, from 1998 to 2002, LACO approved 215 consents for pre-sale of uncompleted flats. Other than the Villa Pinada and The Aegean cases, there were no major problems with these consent cases.

Operation of the Consent Scheme

6. 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 Guarantee for the outstanding balance of construction costs can be submitted.

Role of the various parties in the Consent Scheme

7. The following are the role of the main parties involved in the Scheme:

- (a) Legal Advisory and Conveyancing Office (LACO) of Lands D
 - To ensure that relevant documents have been submitted by different professionals, i.e. Solicitors and APs, and Banks, before consent is issued. Solicitors have to provide a Statutory Declaration showing, among other things, a draft Agreement for Sale and Purchase (ASP) in a standard form as required by LACO, AP's

Certificates, and Mortgagee's Certificate or Bank Undertaking issued by the mortgagee bank.

- LACO treats the AP's Certificates as evidence of the construction works undertaken, and the Bank's statements to indicate the developer has sufficient funding to complete the project.
- These organizations and professionals are relied upon to comply with their professional codes of conduct. The onus is on these bodies and professionals to uphold their professional integrity in providing true and accurate information to LACO. They are expected to update the information provided to LACO when any of the circumstances has changed.

(b) Solicitors

- Solicitors have to undertake in a Statutory Declaration sworn by a partner of the Solicitor firm to release sale proceeds from stakeholder's accounts held by them only when the AP certifies that the amount is spent on the construction of the development or in repayment of amounts drawn down under the building mortgage.
- Although solicitors are allowed by law to represent both the developer and purchasers in the Scheme, they are expected to provide the same degree of care when advising flat purchasers and must cease to act for any party where conflict of interest arises.
- Solicitors are regulated by the Law Society of Hong Kong for their professional conduct.

(c) Authorized Persons (APs)

- APs, regulated by their own professional bodies, are expected to provide certificates regarding the total

construction costs, stage of work reached, outstanding costs to complete the development, construction costs spent etc. based on their professional evaluation.

- AP's certificates form the basis on which the Solicitors rely for the release of stakeholder's money as well as the evidence required by LACO as proof of developer's ability to complete the project.

(d) Banks

- Where a Bank is a mortgagee under a Building Mortgage, it is obliged to provide the financing agreed for outstanding construction cost, unless there has been default in which case the financing facilities will be cancelled.
- It is also a standard term of the land grant that the Bank is obliged to release a particular residential unit from the Building Mortgage when it receives the total purchase price of the flat.
- If the financing is by way of Bank Guarantee, then the Bank would undertake to provide money for construction if the developer fails to complete.
- Banks are regulated by the Hong Kong Monetary Authority.

VILLA PINADA (茵翠豪庭) & THE AEGEAN (愛琴灣)

8. The developers of Villa Pinada and The Aegean were subsidiaries of a listed company. On 16 May 2003, the two developer companies were placed in the receivership of Ernst & Young Transactions Limited (安永企業財務服務有限公司) (the Receivers) appointed by the

Bank of China and Liu Chong Hing Bank respectively.

9. On 28 May 2003, the Managing Director and an officer of the holding company (who are also directors of both developers) were arrested by the Commercial Crime Bureau of the Police on charges of “conspiracy to defraud”. The Court has adjourned the case for hearing on 1 August 2003.

10. Pending the outcome of the court hearing, the Administration is also concerned about purchasers’ right of ownership and their obligation to continue with the repayment of mortgages whilst the developments are in receivership. In this connection, the Administration has met representatives of the flat purchasers and the Receivers to discuss the situation.

Position of flat purchasers of Villa Pinada and The Aegean

11. The Receivers issued two statements, one on Villa Pinada and the other on The Aegean, on 26 May 2003 and 10 June 2003. Copies are at **Annexes A and B** respectively.

12. As the solicitor’s firm for The Aegean have not yet provided adequate explanations in response to LACO’s enquiries, the consent for this development has been cancelled in order to prevent any further pre-sales until the future of the development is clarified. If the developer or any party entitled to sell the development wants to put the remaining flats on sale before completion, a fresh application to LACO for pre-sale consent will be required.

Other Developments

13. LACO has also written to the developers of the 44 developments that are currently covered by the Scheme and 17 developments for which applications are being processed now. These developers have been asked to provide updates on the documents submitted in support of their application for pre-sale consent.

Areas of concern as highlighted in the Villa Pinada/The Aegean cases

14. Whilst investigation by the Police is underway and court hearing of the Villa Pinada and The Aegean cases has yet to commence, the Administration has begun a preliminary review of the Scheme and held discussions with the relevant professional bodies to ascertain their views. The Administration believes that the Scheme is generally sound. It also recognizes the continued need to maintain a proper balance between the interests of developers and flats buyers in the sale and purchase of uncompleted flats.

15. The Scheme has put in place a mechanism to regulate the sale of uncompleted flats and to protect the interests of the flat purchasers. It requires the developer to engage different professionals, and upon their exercise of proper professional conduct, to ensure that the construction works of the development are on schedule, and that sale proceeds are held in an independent stakeholder's account to finance construction cost and to repay the building mortgage.

16. Despite the fact that the Scheme has been operating effectively, the Villa Pinada and The Aegean incident reveals some areas of concerns. The main concern is how to ensure purchasers get title to the units. Other issues raised include conflict of interest of the parties concerned, and proper disbursement of money held in the stakeholder's account.

Legal ownership

17. Generally, a building mortgagee bank has priority over purchasers in pre-sale transactions. There is a standard provision in the land grant to require the mortgagee bank under the building mortgage to release the unit from its security to enable ownership to be assigned to flat buyers upon full receipt of the purchase price (usually by the bank, but in the case of The Aegean, by the stakeholder). Problems arise if the purchasers have paid full purchase price to the developer's solicitor as stakeholder, but the bank has not received the sale proceeds. To address flat purchasers' main concern about their legal ownership of the unit, we

intend to include a provision in the standard ASP or other aspects of the Scheme to the effect that flat buyers would be entitled to full legal ownership of their flats after completion, once they have paid up the purchase price. The Administration will continue to examine with the relevant bodies on this suggestion and any other safeguards for flat purchasers to ensure their title of ownership under the Scheme.

Other issues

(i) Conflict of interest

18. As discussed in paragraph 7(c) above, the AP's Certificates form the basis for the solicitors to release money from the stakeholder's account.

19. Currently, an officer or a shareholder of a development company is not prohibited from acting simultaneously as the AP of the company's projects, or acting as the Solicitor holding the stakeholder's account. Under such circumstances, there may be scope for fraud to take place if the parties manipulate the release of money from the stakeholder's account. In this regard, one possible solution is to require, under the Scheme, the concerned parties to declare any interest in the company involved in the development project. The Administration will further consult the relevant professional bodies on this suggestion, together with other possible measures to minimize the risk of fraud in the existing system.

(ii) Release of money held in the stakeholder's account

20. Currently, the sale proceeds paid by flat purchasers are held by the developer's solicitor in an independent stakeholder's account. Solicitors are expected to exercise due care in the release of the sale proceeds in the stakeholder's account in accordance with the Scheme. However, problems still arose as shown in the case of Villa Pinada and The Aegean. To provide additional safeguard, it has been suggested that an independent trust company should be appointed as stakeholder to hold the sale proceeds as a trustee. The Administration will further consult the relevant professional bodies on this suggestion.

WAY FORWARD

21. Subject to the outcome of the investigations and court hearing on the Villa Pinada and The Aegean cases, the Administration will continue to consult the relevant professional bodies and concerned parties on the Scheme with a view to further refining the system and to address the concerns identified in the two cases at issue. The Administration has also suggested ICAC to undertake a study on the prevention of fraud and possible corrupt practices in the operation of the Scheme. ICAC is receptive to the idea and will consider to undertake a study at an appropriate time in future. The Administration will also work with the Consumer Council on further promotion of consumer rights in the purchase of flats.

Housing, Planning and Lands Bureau
June 2003

Hong Kong – 26 May, 2003

ISSUED

Arrangement for Completion of Sales and Purchase Agreements
and Outstanding Works for Villa Pinada

This is to announce that the Receivers of True Gold Investments Limited, Mr. Stephen Liu Yiu Keung and Mr. Yeo Boon Ann, Managing Directors of Ernst & Young Transactions Ltd., would use their best efforts to arrange for early completion of the outstanding works and completion of the sale and purchase agreements with purchasers who had paid money consideration to acquire the property.

The Receivers are now working with their legal advisers and the contractors for the arrangements. Further announcement on the progress will be released later.

Please contact Ernst & Young Transactions Ltd. on 2846 9646 or 2846 9045 for further information.

完成茵翠豪庭餘下工程及物業買賣合約安排

True Gold Investments Ltd. 接管人安永企業財務有限公司董事總經理廖耀強及楊文安發表：現正盡快安排完成茵翠豪庭餘下的工程及跟已償付真金白銀的茵翠豪庭業主完成物業買賣合約。接管人現階段正跟律師及建築商商討安排相關事項。如有進一步發展，將於日後公佈。

如有任何查詢，歡迎跟安永企業財務有限公司查詢熱線聯絡：

電話：(852) 2846 9646/ 2846 9045

Hong Kong – 10 June 2003

ISSUED

**Arrangement for Completion of Sales and Purchase Agreements
and Outstanding Works for The Aegean**

This is to announce that the Receivers of Profit Nation Development Limited, Mr. Stephen Liu Yiu Keung and Mr. Yeo Boon Ann, Managing Directors of Ernst & Young Transactions Ltd., would use their best efforts to arrange for early completion of the outstanding works and completion of the sale and purchase agreements with the purchasers of the Aegean who had paid money consideration to acquire the property.

The Receivers are now working with their legal advisers and the contractors for the arrangements. Further announcement on the progress will be released later.

Please contact Ernst & Young Transactions Ltd. on 2846 9646 or 2846 9045 for further information.

完成愛琴灣餘下工程及物業買賣合約安排

盈明發展有限公司接管人安永企業財務有限公司董事總經理廖耀強及楊文安發表：現正盡快安排完成愛琴灣餘下的工程及跟已償付真金白銀的愛琴灣業主完成物業買賣合約。接管人現階段正跟律師及建築商商討安排相關事項。如有進一步發展，將於日後公佈。

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