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16 February 2005

Ms Miranda Hon
Clerk to PAC
Legislative Council Secretariat
Legislative Council Building
8 Jackson Road
Central
Hong Kong
[Fax: 2537 1204]

Dear Ms Hon,

The Director of Audit's Report on the results of value for money audits (Report No. 43)

Chapter 6: Grant of land at Discovery Bay and Yi Long Wan

Please refer to the Director of Audit's letter to you dated 1 February 2005 copied to me and others. While the concern of the Director of Audit is appreciated, it is incumbent on me to make sure that the issues involved are understood in the proper context. I write therefore to set the record straight and to facilitate consideration by the Public Accounts Committee in perspective.

2. To set the scene, I wish to set out the basic considerations underlying the handling of the Discovery Bay case in the seventies and eighties –

(i) Since the subject land grant contained an MLP clause to enable the Administration to exercise detailed control over the implementation of the development within the approved parameters stipulated in the lease conditions, premium would not be charged on each and every occasion when amendments to the MLP were made, unless such changes would require lease modification and/or there was an increase in the total permitted GFA (for revenue generating purposes). This practice adopted for cases under similar situations in that period was also adopted in this case.

(ii) How the premium for the land transaction concerned was calculated was explained in my letter dated 25 January 2005, namely the **highest land use value among any of the permissible mix** as specified in the MLP was adopted. This means that Government was able to capture the highest revenue income at the outset without any downside risk due to fluctuations in the property market. On the part of the developer, the certainty in his financial commitment under the land transaction plus the flexibility of being able to make more timely decisions in response to changes in market conditions would arguably be essential for a project of this magnitude and nature.

(iii) On the above basis, as explained in my letter dated 25 January, 2005, this has obviated the need for further premium assessment when changes in the development mix were subsequently made to the MLP as long as the total permitted (revenue-generating) GFA was not exceeded.

3. I would now offer my more specific response to the Director of Audit's comments, as follows:

Audit's Comments	Our Response
(a) ***the reply to Question (j) on p.3 of the Acting Director of Lands' letter***	Our response as provided, is factual to the best of our knowledge. It should be

dated 8 January 2005 in which he states that, "It was the normal practice not to charge premium for changes to MLPs which did not require a modification of the lease in 1970s and 80s as long as there was no increase in total GFA." (i) ***"Normal practice" not substantiated.*** As far as could be ascertained from the Lands D's records, the acting Director of Lands' statement was not substantiated in either the Lands Administration Office Instructions or the Revenue Assessment Manual. Audit is not aware of any approval from the Executive Council (ExCo) for such "normal practice";	appreciated that most land administrative practices evolve over time in the light of experience and changes in circumstances and the Lands Department did not come into existence until 1982. Our understanding of the practice prevailing two to three decades ago should not be negated simply by the Director of Audit being unable to locate any written material to substantiate our statement.
(ii) ***Increase in total GFA and change in user mix.*** Audit would like to recapitulate the increase in **total GFA** and changes in user mix (mentioned in Note 3 in para 2.8, para 2.10 and Table 3 in para 4.16 of the Audit Report), as follows (see footnote on the next page):	It has to be re-emphasized that, despite the changes to the GFA in various MLPs up to MLP 5.5, the revenue – generating GFA did not exceed the permitted maximum of 608,510m^2 as determined by the Land Policy Meeting (LPM) held on 25 May 1987. Copies of the paper and the minutes of the LPM have been forwarded to the PAC at its second hearing on 13 December 2004.

(iii) it is also relevant to point out that, while the then Secretary for the New Territories was delegated with the authority to approve changes to MLPs (para 2.9 of the Audit Report refers), Audit is not aware that he had been given any **explicit** authority of not charging premium if there was enhancement in value arising from changes in lease conditions;	Please see paragraph 2 above. The last paragraph of my letter dated 25 January 2005 is relevant.
(iv) ***Changes to MLP.*** According to Director of Lands' statement in the Public Accounts Committee (PAC) hearing held on 13 December 2004, the MLPs and the lease conditions of the Discovery Bay site had equal standing and effect (line 36 on page 17, and lines 5 to 7 on page 71 of the PAC Verbatim Report dated 13 December 2004 refer). Therefore, any modification of the MLP (such as the increase in the total GFA and the significant change in user mix in MLP 4.0 over MLP 3.5) would in substance	Please see paragraph 2 above. My letter dated 25 January 2005 is also relevant.

	tantamount to a modification of the lease conditions;	
(v)	***Deletion of public golf course and cable car system constituted lease modifications.*** The provision of the public golf course and the cable car system was a mandatory requirement stipulated in **Special Condition 5(b) of the lease** of the Discovery Bay development (paras 3.2, 3.6 Note 17, 3.16 and 3.20 of the Audit Report refer). Moreover, because of the importance attached to the public golf course proposal, the developer's responsibility to maintain the public golf course was more particularly referred to in **Special Condition 54(c)** of the lease (para 3.6 and Note 17 of the Audit Report refers). In the circumstances, the deletion of: - the public golf course in MLP 5.0 in February 1982 (by the then Secretary for City and New Territories Administration – para 3.7 of the Audit Report	The deletion was dealt with by way of consent given under the MLP clause set out in SC 6 of the Conditions of Exchange which reads as follows : - "*.....the whole of the Lot shall be developed or redeveloped to the satisfaction of the Secretary in conformity and in accordance with the Master Layout Plan approved and signed by the Secretary who shall retain a copy thereof, and no alterations whatsoever shall be made by the Grantee to the Master Layout Plan or to the development or any redevelopment without the prior consent in writing of the Secretary,.....*" The then Registrar General in 1983 had advised that there would be no need to modify the lease insofar as the deletion of the non-membership golf course and the cable car system were concerned. A copy of the advice has been forwarded to the PAC at its second hearing on 13 December 2004.

	refers); and - the cable car system in MLP 5.1 in February 1985 (by the Director of Lands – paras 3.16 and 3.20 of the Audit Report refer). constituted **modifications of the lease conditions**.	
	(vi) To conclude, as mentioned in para 4.21 of the Audit Report, the Government might have suffered losses in revenue. The Lands D had not assessed the implications, financial or otherwise, of the deletion of the facilities, and the reasons for not assessing and/or charging premium for the changes in those MLPs were not documented (paras 3.20 and 4.17 of the Audit Report refer)	As explained in my letter dated 25 January 2005 we do not consider that there might have been loss in revenue as suggested and the need to calculate such figures does not arise.
(b)	**The Director of Lands' letter dated 25 January 2005.** (i) According to Section 7 of Land Administration Policy on Modification and Administrative Fees (amended on 1 April 1984), as a general rule for lease	S. 7 of LAP remains a valid rule for general application for assessing premium arising from lease modifications. The case in question is not inconsistent with s. 7 of LAP. As explained in my letter dated 25 January 2005 and set out above we do not concur with the Director of Audit's views that a series of further premiums should have been collected for changes in

	modification, "Premium will normally be required representing the difference in value between the lot as formerly restricted and as modified ..... The general principle relating to the assessment of modification premia is that the lessee must pay for any enhancement in the value of the lot deriving from the modification"; (ii) in other words, premium assessment should be done by comparing the current land values under the modified lease conditions (and/or MLP) and the original lease conditions; (iii) having regard to the general rule in (b)(i) above, the unit land cost (accommodation value) and the valuation benchmark (i.e. ground floor shop value) adopted at the date of execution of the lease conditions are not relevant to the premium assessment of a lease modification at a later date (para 3 of the Director of Lands' letter dated 25 January 2005 refers);	the development mix, even though the revenue-generating GFA has not been exceeded and the types of uses are not beyond what were allowed in the conditions of exchange executed in 1976. Such suggestion fails to take account of the established facts of this case that the developer had already paid for such flexibility at the time of the original grant.

(iv) in view of this, Audit does not concur with the Director of Lands' views that "adopting the highest use value among the mix in calculating the land premium to be paid by the developer upfront for the grant ... had obviated the need for further premium assessment when changes in the development mix were subsequently made to the MLP as long as the total permitted GFA was not exceeded"; and (v) furthermore, as explained in para a(ii) above, there had been an increase in total GFA and **changes in user mix** since the change from MLP 3.5 to MLP 4.0. Audit therefore also does not concur with the Director of Lands' view quoted in (b)(iv) above and his conclusion that he does "not consider it appropriate to compute the premium for each of the changes made to the MLP prior to 7 June 1994."	

In conclusion, we strongly disagree with the views held by the Director of Audit in his letter of 1 February 2005 especially that "the Government might have suffered losses in revenue", having regard to the manner that the original premium was calculated. The Director of Audit's suggestion that a series of further premiums should have been collected for changes in the development mix up to 608,510m^2 (revenue-generating GFA) would constitute double charging since the facts established indicate that the developer, at the time of the original grant, had already paid for the flexibility of varying the development mix subsequently reflected in successive MLPs.

I should be grateful if the above comments would be taken into account in preparing and publishing the PAC's final report.

Yours sincerely,

(Patrick Lau)
Director of Lands

c.c. Secretary for Housing, Planning and Lands
Secretary for Financial Services and the Treasury
(Attn: Mr Manfred Wong)
Director of Audit