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We strive to achieve excellence in land administration.

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Please quote our reference in your reply

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Clerk, Public Accounts Committee
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong
(Attn : Mr. Anthony CHU)

By Fax & Email
(Fax No. 2543 9197)

16 June 2017

Dear Mr. CHU,

Public Accounts Committee

Consideration of Chapter 1 of the Director of Audit's Report No. 68

Government's support and monitoring of charities

Thank you for your letter of 29 May 2017. Our responses to sections (a) to (f) of your letter are set out below.

Section (a)

In connection with the land administration policy of granting sites for private treaty grant ("PTG") of 1959 and 1981 as set out in paragraphs 3.2 and 3.3 of the Audit Report (all paragraphs hereinafter referred to paragraph number in Chapter 1 of the Audit Report):

- (i) **Please elaborate the policy intent of the 1959 and 1981 land administrative policy on PTG;**

In the absence of file records going back to the 1950s, LandsD has tried to deduce the policy intent of the 1959 Executive Council (ExCo) Memorandum by making reference to the contents of the

paper. We note that the Memorandum was presented as an information paper, one that set out in general the context under which different types of PTGs subject to nil/nominal, concessionary and full market premium respectively would be applicable and the general land administration arrangements. As such, the paper did not, and was not meant to, prescribe the standard terms and conditions for inclusion into the relevant types of PTGs.

As far as PTGs granted at nil premium for non-profit-making purposes are concerned, the principle conveyed by the 1959 Memorandum was that it would be important for the facilities/services operating from the PTG site to be run to the satisfaction of the appropriate Head of Department; and that any profit derived from the permitted facilities/services under the PTG should not be distributed, but ploughed back to facilities/services serving worthy causes on site or off site, according to the policy intention for the case in question.

As regards the 1981 ExCo Memorandum, we consider that it is mainly applicable to circumstances where the grantee of a PTG for social service purposes at nil or concessionary premia wishes to enter into partnership with a private developer to redevelop the sites, and where the private developer would be allowed to share the profit from a “commercial”, income-generating element to be included in the redevelopment. The policy intent of the policy framework set out therein is to facilitate early redevelopment by allowing the partnership, and to capitalise on the commercial element to finance the redevelopment and support the maintenance and running of the social services activities.

(ii) How were the 1959 and 1981 policy directives applied to and implemented in the land leases of the 14 sites highlighted in the Audit Report (paragraph 3.7 refers)?

The land leases for the 14 sites were executed at different points in time, having regard to different circumstances as well as considerations prevailing then.

Amongst the 14 sites highlighted in the Audit Report, Cases A, B and E with lease terms commencing between 1840s to 1880s held under virtually unrestricted leases are not PTGs (the lots concerned were bought or were likely to be bought by the lessees in the market). As such, both the 1959 Memorandum and 1981 Memorandum should not be relevant. Cases C, D and K with lease terms/original lease term commencing between 1920s to early 1950s are subject to very broad user restriction allowing much liberty for the lessees, and no

relevant information have been located so far about the existence or otherwise of specific policy intentions governing the three cases. In the circumstances, LandsD is not in a position to deduce whether the 1959 Memorandum is relevant.

For the remaining 8 cases (Cases F, G, H, I, J, L, M and N) where the leases specifically permitted the running of hostel/dormitories, one or more of the following requirements have been stipulated in their lease conditions:-

- (a) the permitted use(s) or operation should be run on a non-profit-making basis;
- (b) the operation shall be conducted in all respects to the satisfaction of a certain head of department (usually the relevant monitoring department);
- (c) submission of accounts;
- (d) no distribution of profit.

For details, please refer to table attached at **Annex I**. LandsD considers that (a) and (d) are different formulations supporting the principle conveyed in the 1959 Memorandum, i.e. that any profit derived from the permitted facilities/services under the PTG on nil/nominal premium should not be distributed, but ploughed back to facilities/services serving worthy causes on site or off site, according to the policy intention for the case in question. (b) and (c), where included, are also consistent with the principle of ensuring adequate control by the relevant government department(s).

Since Case N involves the inclusion of the “commercial” elements of public vehicle parks and telephone exchange on full market value premium to facilitate the redevelopment of Grantee N’s Headquarters, the 1981 Memorandum is relevant and was indeed mentioned in the relevant ExCo submission on the redevelopment project in Case N.

- (iii) while the “no distribution of profits is allowed” was clearly stipulated in the land policy paper presented to the Executive Council (“ExCo”) in 1959 (R68/1/GEN2), why was this clause not specifically spelt out in the land leases granted by way of PTG (land lease of grantee M was the only lease that contains this clause) highlighted in the Audit Report? How could the Lands Department (“LandsD”) effectively monitor compliance by the non-government organizations (“NGO”) in the cases of the remaining 13 leases? Please group the provisions in each land lease of these 13 sites by which LandsD could exercise effective**

***Note by Clerk, PAC: Please refer to Appendix 12 of this Report for R68/1/GEN2.**

monitoring and enforcement of the “no distribution of profits” requirement?

- (iv) According to Table 5 regarding the lease conditions of 11 sites with hotels/serviced residence operation, submission of audited accounts were not required in leases C, D, K, F, G, I and L. How could the relevant supporting bureaux/departments (“B/Ds”) effectively monitor the distribution of profits derived from hotel operations were used to purposes acceptable to the Government? What remedial actions could be taken to address the problems?**

We believe these sections (iii) and (iv) are not applicable to Cases A, B, C, D, E and K, given the background of those cases as explained in our response to section (a)(ii) above

Although the leases for the remaining 7 cases, i.e. Case F, G, H, I, J, L and N, do not carry a specific clause on “non-distribution of profits”, 4 out of the 7 cases, i.e. Cases F, G, J and L, carry a clause requiring the operation concerned to be run on a non-profit-making basis. We consider that such a clause is another formulation of the “no profit distribution” requirement. For the remaining 3 cases, Cases H and N carry a clause requiring submission of accounts while the remaining Case I carries a clause requiring the operation to be run to the satisfaction of Government; these clauses will give room for the Government to make enquiries and monitor compliance with the spirit of “no distribution of profits”.

Likewise, for those leases which do not contain a “submission of audited accounts” requirement, LandsD considers that the requirement for demonstration of operation on a “non-profit-making” basis and/or the requirement for operation to be run to Government’s satisfaction will give room for the Government to make enquiries regarding the financial accounts where it is considered that such enquiries would help the checking of compliance with the stated “non-profit-making” requirement and/or the “to Government’s satisfaction” requirement. Meanwhile, we understand that some charitable organisations would in any case submit their accounts to the relevant policy bureaux/departments in other contexts outside the lease.

The above notwithstanding, we agree that the inclusion of specific clauses on “submission of audited account” and “no distribution of profit” into the PTGs concerned would give greater clarity about the obligations under lease and facilitate Government’s compliance checking. Looking forward, for the 11 PTGs named in the Audit report (excluding the 3 virtually unrestricted leases), where the opportunities arise (such as when lease modification application and

lease renewal are received), LandsD would recommend to the concerned sponsoring bureaux/departments the imposition of “submission of audited account” and “no distribution of profit” requirements and request for justifications if the recommendation is not accepted. The same arrangement will apply to the processing of new PTGs.

Section (b)

whether guidelines/circulars have been issued to B/Ds on factors to consider when processing NGOs’ applications for sites to be granted at nil or concessionary premium. If yes, copy of guidelines/circulars. If not, how would B/Ds submit the applications to ExCo so that ExCo could consider and compare the relative merits of different applications;

Given the diversified circumstances under which PTGs are considered (including, for example, variations in the policy objectives, nature of the proposed facilities/services on site and background of the grantees), it may not be practical to draw up an exhaustive set of factors applicable to all cases. The Protocol issued in 2014 set out the general guidelines for B/Ds in considering matters concerning PTGs. A copy of the Protocol has been sent to you via my letter dated 25 May 2017. We believe the Protocol, supplemented by the usual practice of researching into relevant precedents by both the sponsoring B/Ds and LandsD, would facilitate consideration of potential cases.

Section (c)

will LandsD include the “no-profit-distribution requirement” and ‘submission of audited accounts requirement’ in future land leases for sites granted to NGOs at nil or concessionary premium. If yes, when such practice start. If no, the reason why not;

Please refer to our response under sections (a)(iii) and (iv) above, specifically the last paragraph therein.

Section (d)

will LandsD consider specifying definitions on “hotel” and “hostel” in order to make such differentiation in future land leases for hotel operation on sites granted to NGOs at nil or concessionary premium;

Generally, for land leases granted at nil or concessionary premium, LandsD supports greater precision in setting out the uses permissible to reflect the policy intention and minimise ambiguity, and in so doing to address modern day expectations. In this regard, when processing new proposals for PTGs or lease modifications/land exchanges involving the provision of hotels or hostels in recent years, LandsD has been mindful of

the desirability of stipulating specifications such as the mode of operation, target clientele, basis of fee to be charged etc. in the relevant leases or service agreements associated with the leases. As mentioned in the opening statement made by the Director of Lands at the PAC hearing on 6 May 2017, the PTGs under Home Affairs Bureau's Youth Hostel Scheme is a typical example of how "hostel" has been elaborated under the leases concerned. Another relevant example mentioned at the PAC hearing on 27 May 2017 is the in-situ land exchange for the redevelopment of The Mariner's Club under processing, where it is Government's clear policy intention to include provisions in the lease to clearly distinguish the club portion providing accommodation for seafarers from the hotel portion to be run as a commercial hotel and for which full market value premium would be chargeable.

Section (e)

the Protocol on the delineation of responsibilities on monitoring private treaty grants among the LandsD and relevant supporting B/Ds was issued in 2014. What measures have been/will be taken to remind supporting B/Ds of their responsibilities, in particular about monitoring and enforcement of lease conditions throughout lease term? Has LandsD provided assistance to supporting B/Ds to formulate guidelines or a mechanism on monitoring and enforcing the lease conditions under their respective purview? If yes, details of assistance offered by LandsD. If no, reasons why not;

The 2014 Protocol itself serves as an important reminder for bureaux/departments supporting the provision of facilities/services on PTGs. According to LandsD's prevailing practice, we would, after execution of the PTG, inform in writing all the concerned government departments/bureau including the supporting B/Ds so that they are aware of their respective monitoring role under lease.

While relevant bureaux/departments should have a good understanding of the types of facilities/services under their purview, e.g. Education Bureau overseeing education facilities, Food and Health Bureau/Department of Health overseeing medical facilities, Social Welfare Department overseeing welfare facilities, etc., it is possible that they may not have stock taken cases on the basis of the leases concerned and the specific provisions therein, particularly for leases executed years ago. To this end, LandsD will assist by taking stock of PTGs on nil or concessionary premia and key provisions therein by phases, taking into account resources available. The information will be shared with the relevant bureaux/departments. However, we would defer to the supporting B/Ds to set up their own guidelines for monitoring so as to achieve their policy intention in supporting the land grant on case by case basis. But if any established breach of lease is identified by the responsible B/Ds, LandsD

will follow up with appropriate lease enforcement action at their directive in the capacity of land agent of Government being the landlord.

Where it is revealed that the monitoring role for individual lease conditions could not be attributed to a specific bureau/department due to the existence of grey areas, e.g. the hotel/hostel as an incoming-generating facility supports community/welfare services under the purview of different bureaux, LandsD will co-ordinate internally to arrive at a consensus and take a proactive role on monitoring if necessary, as what we are doing for the hotel/hostel operation under Lease M.

Section (f)

with reference to Case 1 in paragraph 3.14 on Lease M (paragraph 3.11 to 3.13 also refer), please provide the following:

- (i) a copy of Lease M;**

Copy of Lease M is attached.

- (ii) the operating agreement between Grantee M and the operator in relation to the development and operation of the hotel;**

LandsD requested Grantee M in August 2014 to provide the operating agreement but Grantee M expressed difficulties due to confidentiality with what was said to be a private contract between Grantee M and the hotel operator. As part of our follow up action on the Audit report, we made the request again in May 2017 and have recently urged Grantee M to make its best endeavours to overcome the concern with confidentiality by measures such as seeking the consent of the other party for disclosure, disclosing the agreement with sensitive information redacted or providing a summary of the provisions. We will continue to follow up accordingly.

- (iii) based on what justifications/ considerations the Administration approved to grant the site to Grantee M by way of contemporaneous surrender of the site by Charity M bearing in mind that Grantee M was not a charity under section 88 of the Inland Revenue Ordinance (Cap. 112). Which bureau/department gave the policy support for the grant of site to Grantee M;**

As revealed from the relevant file records available so far, the surrender lots namely Inland Lot No. 2616 and Inland Lot No. 3646 were owned by Charity M for an institute for promoting the welfare of the Forces under lease. With the diminished usage of the Sailors and Soldiers Home originally built on the lots, application was received in 1979 for lease modification by way of a land exchange to facilitate redevelopment of then existing property, which already

***Note by Clerk, PAC: Copy of Lease M not attached.**

included hostel used mainly by tourists and servicemen and various welfare and education services run by Charity M, into a new facility comprising hostel with domestic staff quarters and ancillary office, church, and social welfare uses.

The proposed lease modification was subsequently withdrawn by the Charity M and they re-applied in 1985 for lease modification for redevelopment along similar lines. LandsD approved the lease modification by way of land exchange in 1986 in view of Director of Social Welfare's support towards social welfare facilities and Director of Home Affairs' earlier no objection on similar redevelopment scheme provided that the multi-purpose centre would be running on a non-profit making basis. Upon the request of Charity M to facilitate the use of a limited liability company as an instrument for their redevelopment and having considered the fact that Grantee M is controlled by Charity M and that appropriate controls i.e. "submission of account" clause and operation shall be to the satisfaction of Government, were imposed under lease, LandsD acceded to Charity M's request to grant the site to Grantee M instead of Charity M.

- (iv) LandsD had not requested Grantee M to submit accounts until August 2013 in response to a complaint received in April 2011, although the submission of accounts conditions was clearly stipulated in the land lease. Why was that so?**

The complaint received in April 2011 was related to the operation of a hotel on site and the suspicion that the running of a hotel on profit-making basis would be in breach of the PTG stipulating "hostel" as a permissible use, amongst others. In order to address the complainant's concern, LandsD focused initially on the alleged lease breach of the user restriction, seeking legal advice and liaising with relevant bureaux/departments to ascertain the policy intention.

While Lease M carries a clause on the submission of accounts to LandsD, the clause specifies that the grantee should submit the annual accounts "if so required". Until recent years, LandsD had been taking the view that the decision as to whether such submissions would be required should be taken by the bureaux/departments with policy responsibilities over the facilities on site, and when that decision was taken LandsD would follow up accordingly by exercising its authority under the lease to require the accounts as the government's land agent. When following up on complaints concerning the case in recent years, LandsD has come to realise that the responsibility over that "submission of account" clause is not as clear cut as expected when the hostel as an incoming-generating facility on site supports community/welfare services both

on site and off site under the purview of different bureaux. LandsD has therefore taken a more proactive role since 2013 by requesting audited accounts for the hostel from Grantee M in accordance to Special Condition No. (13) of the lease conditions, noting also that the development was renovated in 2012 and re-opened in May 2013.

- (v) **LandsD only took action to review the accounts of Grantee M in August 2013, more than two years after the receipt of a complaint in April 2011. Why did it take so long for LandsD to take relevant action?**

Please refer to our response to section (f)(iv) above.

- (vi) **Follow-up actions that have been taken by LandsD in relating to Lease M since August 2013, including papers/documents/agreement/audit accounts obtained and still pending reply from Grantee as well as actions that will be taken and the implementation timetable;**

LandsD requested Grantee M to submit audited accounts for the hostel on the lot annually since 2013 and has so far received the annual audited accounts for 2013 up to 2015. LandsD has also received certifications by a Certified Public Accountant (CPA) acting as Charity M's independent auditor that the Hostel income for 2013 to 2015 has been applied by Charity M towards improvement and/or extension of charitable services provided by Charity M. (Note: The certifications for 2014 and 2015 were recently received after the last PAC hearing on 27 May 2017.) Meanwhile, Lands D is awaiting the submission of audited account for 2016 and the provision of similar certification by an independent auditor regarding the ploughing back of Hostel income to Charity M for the year 2016.

In addition, to further strengthen Government's monitoring over the ploughing back of hostel income, LandsD has recently requested Charity M and Grantee M to expand the certification by the independent auditors to include a breakdown of the hostel income ploughed back by categories of uses, e.g. education, welfare, church activities etc. Our intention is to share the information with the relevant bureaux to facilitate their monitoring of uses and relevant subventions under their purview.

- (vii) **\$16 million of hostel/hotel operation income was earned and the same amount was paid to Charity M in Grantee M's audited accounts for the year ended March 2013 (paragraph 4 of Case 1). Has LandsD ensured that the \$16 million is used in compliance with the condition that there shall be no distribution of profit**

derived from the facilities (paragraph 3.13(c)). If yes, details of action taken/to be taken and the updated progress. If no, which department is responsible for monitoring such compliance. Whether further actions would be taken to require Charity M to submit relevant information for the years following 2013;

Lands D had taken a proactive role and for actions taken by LandsD, please refer to our response to section (f)(vi) above.

- (viii) according to the Protocol on delineation of responsibilities on PTGs issued by LandsD, which B/Ds should take up the responsibility for monitoring the submission of accounts and scrutiny and ensure non-distribution of profit (paragraph 3.6(b) refers) on the hotel facilities operated by Grantee M? If LandsD should take up such role, what measures will be taken to enhance such role in enforcing the relevant requirements in respect of the hotel operation?**

We trust our responses to sections (f)(iv) and (vi) above have also addressed the questions raised under section (f)(viii).

- (ix) according to paragraph 7 of Case 1, LandsD did not have the expertise or knowledge to scrutinize the accounts submitted or determine whether the profit had been used in a manner and for purposes acceptable to the Government. What measures had been taken by LandsD to address the situation? What lessons could be drawn from this case?**

While LandsD does not possess the expertise or experience in scrutinising financial accounts, we hope the measures set out in the earlier sections (including the requirement for certification by independent auditors, request for the provision of breakdown, the sharing of breakdown with relevant bureaux/departments) would facilitate the monitoring of the principle of “no profit making”.

For new cases of PTGs on nil or concessionary premia, LandsD will ensure that responsibilities over the scrutiny of accounts are internally agreed and grey areas are removed before the leases are finalised, in order to facilitate the monitoring for compliance of no-distribution of profit requirement.

Yours sincerely,



(Ms Sophia CHIANG)
for Director of Lands

c.c. Secretary for Financial Services and the Treasury (fax no. 2537 3210)
Commissioner of Inland Revenue (fax no. 2877 1082)
Secretary for Home Affairs (fax no. 2591 5536)
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Secretary for Education (fax no. 2810 7235)
Director of Audit (fax no. 2583 9063)

Secretary for Development (fax no. 2147 3691)

- enclosed also the incoming letter of 29.5.2017 from the Clerk, PAC

Lease	Lease Condition			
	(a) The permitted use(s) or operation should be run on a non-profit-making basis	(b) The operation shall be conducted to the satisfaction of a certain head of department (usually the relevant monitoring department)	(c) Submission of accounts	(d) No distribution of profit
Virtually unrestricted lease				
A	No	No	No	No
B	No	No	No	No
E	No	No	No	No
Leases with broad user restriction				
C	No	No	No	No
D	No	No	No	No
K	No	No	No	No
Leases specifically permitted the running of hostel/dormitories				
F	Yes	Yes	No	No
G	Yes	Yes	No	No
H	No	Yes	Yes	No
I	No	Yes	No	No
J	Yes	Yes	Yes	No
L	Yes	Yes	No*	No
M	Yes	Yes	Yes	Yes
N	No	No**	Yes	No

*The grantee is required to submit audited accounts for the nursery and educational facilities under the lease.

**The grantee is required to establish a Management Committee.