

CHAPTER 9

**THE GOVERNMENT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION**

CAPITAL WORKS RESERVE FUND

GOVERNMENT SECRETARIAT

Planning, Environment and Lands Bureau

GOVERNMENT DEPARTMENT

Lands Department

**The Government's
administration of sale of land by tender**

**Audit Commission
Hong Kong
11 October 1999**

THE GOVERNMENT'S ADMINISTRATION OF SALE OF LAND BY TENDER

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THE GOVERNMENT'S ADMINISTRATION OF SALE OF LAND BY TENDER

Summary and key findings

A. **Introduction.** Land is one of Hong Kong's most valuable assets. The Government's general preference for the sale of land is by auction. The sale of land by tender may be more appropriate in cases where the Government imposes special requirements on the development of a lot, the lot is exceptional in size or value, or the value of the lot is difficult to determine. In 1998-99, revenue from the sale of land by tender was \$11,054 million (paras. 1.1 and 1.2).

B. **Audit review.** Audit has recently conducted a review to evaluate how effective the Government has been in administering the sale of land by tender and to ascertain whether there is room for improvement. The audit findings are summarised in paragraphs C to D below (para. 1.3).

C. **Purchasers' failure to complete land sale contract.** In the sale of land by tender for the Kowloon Bay and the Ap Lei Chau sites, the Purchasers, which were companies with no substantial assets, defaulted to complete the land sale transaction after the tenders had been awarded to them. Under the terms of the Tender Notice, the Government could require a purchaser to procure from its parent company or associated company a written guarantee whereby such company unconditionally and irrevocably guarantees the due and punctual completion of the development of the site. However, the Lands Department (Lands D) had not obtained such guarantees from the Purchasers' parent or associated companies. As a result, the Government could not recover its losses arising from the Purchasers' failure to complete the sales from their parent or associated companies. For the Kowloon Bay site, the Government suffered a loss of about \$248.4 million due to the drop in the tender price in the resale of the site. For the Ap Lei Chau site, which had not yet been resold as at August 1999, Audit estimated that the Government could suffer a loss of some \$162.9 million if it is to be resold as a Private Sector Participation Scheme site under the original arrangement. In Audit's view, the Government should have obtained from the successful tenderer a parent or associated company guarantee or a bank guarantee on the award of the tender. Audit also noted that the Purchaser of the Kowloon Bay site had not submitted in its tender statements giving evidence of its financial and technical ability, contrary to the requirement of the Tender Notice. Such a requirement is essential to enable the Lands D to vet the financial and technical capability of the prospective tenderers prior to the award of the tender (paras. 2.2, 2.4, 2.5 and 2.24 to 2.26).

D. **Sale of the Ma On Shan site by tender for hotel use.** In July 1995, the Administration agreed to zone two sites specifically for hotel use as a trial scheme to encourage the building of new hotels. While this was considered as a change in the land disposal policy, the Executive Council (ExCo) had not been informed of such a change in policy and the financial implications. The estimated revenue forgone arising from the zoning of the Ma On Shan site specifically for hotel use amounted to some \$644 million. Prior to the award of the tender of the Ma On Shan site in

March 1998, the market sentiments and outlook for the hotel industry had changed dramatically from those forecasted in 1995. However, the Chief Secretary for Administration's Committee was not informed of such significant changes in the hotel industry. Audit also noted that in the sale of land by tender, a reserve price is usually not set. However, in the sale of land by public auction, reserve prices are set for the lots to be sold. The lots will be withdrawn from auction if the reserve price is not reached. Audit considers that the setting of a reserve price in the sale of land by tender is necessary in order to protect the Government's interest (paras. 3.5 to 3.8, 3.33 to 3.37 and 3.42 to 3.46).

E. **Audit recommendations.** Audit has made the following main recommendations:

- (a) the Director of Lands should, upon the award of a land sale tender, require the successful tenderer to procure a bank guarantee or a written parent or associated company guarantee for a sum equivalent to the balance of the tender price, so as to adequately protect the Government's interest in case of default by the purchaser (first inset of para. 2.27);
- (b) if a successful tenderer chooses to provide a written parent or associated company guarantee, the Director of Lands should thoroughly vet the financial statements of the guarantor to ensure that the guarantor has adequate means to fulfil its obligations under the guarantee (second inset of para. 2.27);
- (c) the Administration should inform ExCo of proposals for rezoning sites specifically for a particular type of development, such as for hotels, and the financial implications (first inset of para. 3.38);
- (d) the Administration should always seek ExCo's endorsement for any significant changes in the land disposal policy, such as the introduction of specific zoning of sites for hotel use (second inset of para. 3.38); and
- (e) the Director of Lands should consider always setting a reserve price for the sale of land by tender and ensure that full justifications are documented in exceptional circumstances where the setting of a reserve price is considered unnecessary (para. 3.47).

F. **Response from the Administration.** The Secretary for Planning, Environment and Lands has generally agreed with the audit recommendations (para. 3.39). The Director of Lands has agreed that there is scope to improve the current system on tender procedures (para. 2.29) and has agreed with the audit recommendation that the Government should consider always setting a reserve price for the sale of land by tender (para. 3.48). The Secretary for the Treasury has supported the audit recommendations from the angle of revenue and resources protection (paras. 2.28 and 3.49).

PART 1: INTRODUCTION

Background

1.1 Land with its limited supply is one of Hong Kong's most valuable assets. It is therefore essential that the Government utilises the land resources efficiently by optimising the use of land. The Government's general preference for the sale of land is by auction because it is simple, transparent and perceived to be more competitive. However, the sale of land by tender may be more appropriate in cases where the Government imposes special requirements on the development of a lot, the lot is exceptional in size or value, or the value of the lot is difficult to determine.

1.2 The terms and conditions for the sale of land are set out in the Conditions of Sale which may cover, among other things, conditions relating to the development, the minimum gross floor area (GFA —Note 1) and user requirements. Tenderers are usually allowed four weeks from the date of gazetting to submit their tenders. A longer period may be allowed when it is considered appropriate. The Government usually awards the tender one or two months after the tender closing date. In 1998-99, revenue from the sale of land by tender was \$11,054 million.

Audit review

1.3 An audit review has recently been carried out:

- to evaluate how effective the Government has been in administering the sale of land by tender; and
- to ascertain whether there is room for improvement in the administration of sale of land by tender.

Audit has sought expert advice from a consultant (hereinafter referred to as the Audit Consultant) specialised in land valuation, development and disposal to assist in this audit review.

Note 1: *The GFA of a building is the area contained within the external walls of the building measured at each floor level (including any floor below the level of the ground), together with the area of each balcony of the building. The GFA should be calculated from the overall dimensions of the balcony (including the thickness of the sides thereof), and the thickness of the external walls of the building.*

PART 2: PURCHASERS' FAILURE TO COMPLETE LAND SALE CONTRACT

2.1 This part examines two cases of sale of land by tender where the purchasers subsequently defaulted to complete the land sale contract.

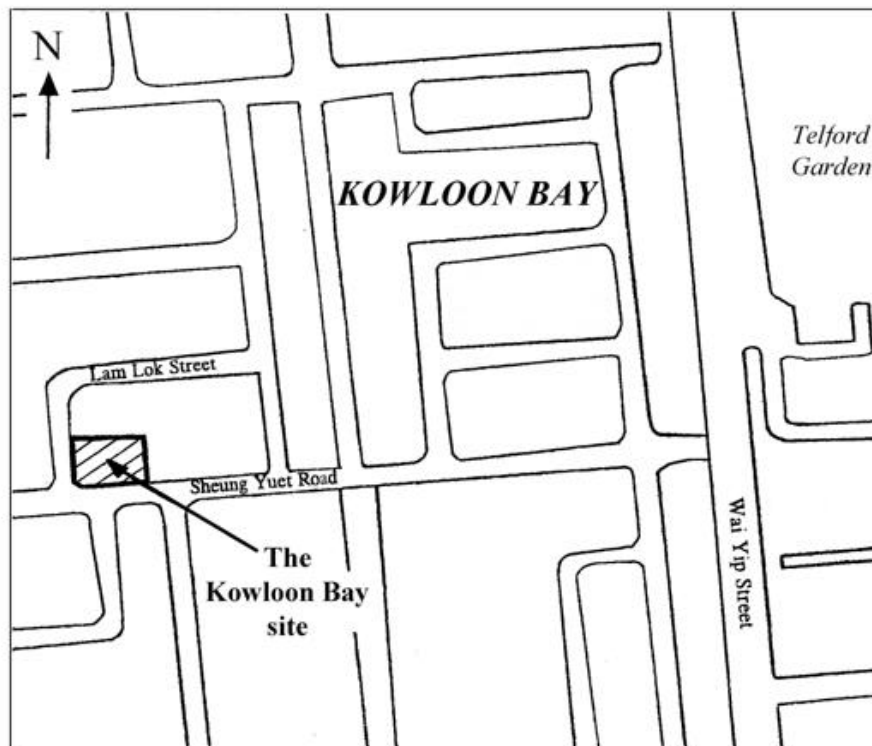
Background

2.2 In an audit of the sale of land by tenders in 1997-98 and 1998-99, Audit noted that there were two cases where the purchasers subsequently defaulted to complete the land sale contract. According to a clause in the Tender Notice, the Government could require a purchaser's parent company or associated company to guarantee the completion of development of the site and to indemnify the Government against all losses arising from the purchaser's failure to complete the sale contract. However, the Lands Department (Lands D) had not invoked the clause to require such a guarantee. As the defaulting purchasers of the two sites were companies with no substantial assets, the Government could not recover its losses arising from the purchasers' failure to complete the sale contracts. The two cases involve:

- *a site in Kowloon Bay*. This site (hereinafter referred to as the Kowloon Bay site) is situated at the junction of Lam Lok Street and Sheung Yuet Road in Kowloon Bay. It is for Industrial/Office use. Figure 1 below shows its location; and

Figure 1

Location of the Kowloon Bay site

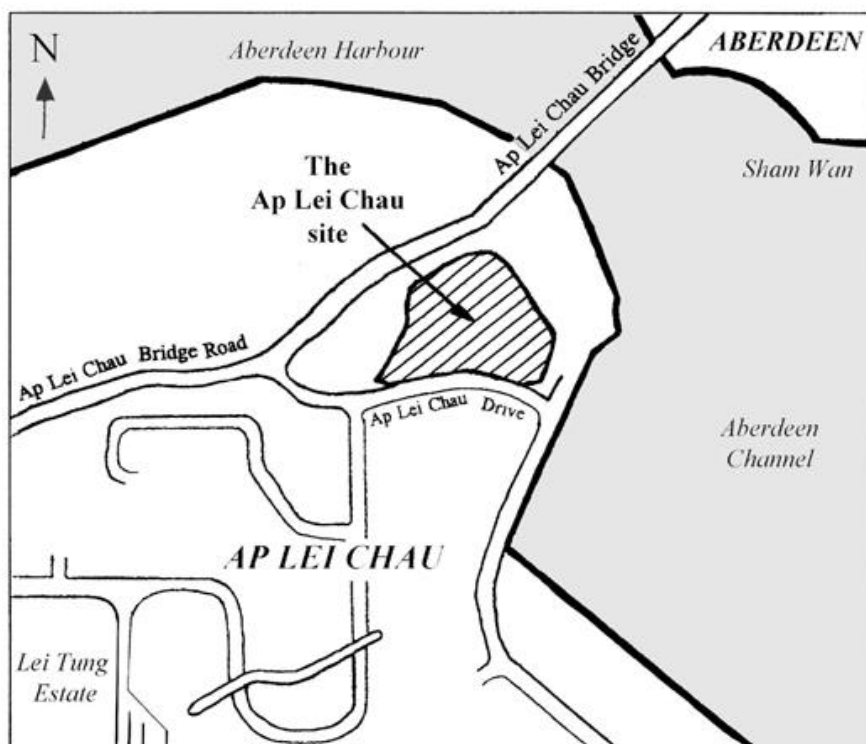


Source: Lands D's records

- *a site in Ap Lei Chau.* This site (hereinafter referred to as the Ap Lei Chau site) is situated at Ap Lei Chau Drive. The site was for a Private Sector Participation Scheme (PSPS —Note 2) development mainly for domestic premises. Figure 2 below shows its location.

Figure 2

Location of the Ap Lei Chau site



Source: Lands D's records

2.3 A chronology of the key events relating to the sale by tender of the Kowloon Bay site is at Appendix A, and that of the Ap Lei Chau site is at Appendix B. Table 1 below summarises the tender results:

Note 2: *The PSPS was introduced in 1978 as a supplement to the Home Ownership Scheme (HOS) which was designed to enable public housing tenants and lower-middle income families to acquire their own homes at affordable prices. The intention of the PSPS is to engage the expertise and resources of private sector developers in the production of HOS-equivalent flats. Under the PSPS, the Government sells land by tenders to private developers. The Conditions of Sale specify the standard of the completed PSPS flats and require the successful tenderer to build flats for sale to the HOS target group.*

Table 1

Tender results of the Kowloon Bay and the Ap Lei Chau sites

	Kowloon Bay site	Ap Lei Chau site
Site area	1,889 square metres	9,301 square metres
Date of award of tender	31 October 1997	21 November 1997
Successful purchaser	The highest tenderer, (Purchaser A)	The highest tenderer, (Purchaser B)
Tender price	\$290 million	\$351 million
Deposit paid by the purchaser	\$20 million	\$35.1 million
Due date for payment of the balance of the tender price	28 November 1997	19 December 1997
Date of cancellation of the sale by the Government	2 December 1997	19 January 1998
Date of resale of the site	19 June 1998	(Note 2)
Resale price	\$46.8 million	(Note 3)
Estimated loss	\$248.4 million (Note 1)	\$162.9 million (Note 4)

Source: Lands D's records

Note 1: The losses included the drop in land price arising from the resale of the site and the related interest charges (see paragraph 2.9 below).

Note 2: The exact date has not yet been announced but is expected to be in late 1999.

Note 3: To date, the site has not yet been resold (see Note 10 in paragraph 2.23 below). Assuming that the site would be resold as a site solely for PSPS purpose, Audit estimated that the resale price could amount to some \$200 million. This was calculated based on the estimated price of a PSPS site in Hung Hom Bay made by the Lands D in mid-1999.

Note 4: This is estimated as follows:

	\$ million
<i>Original tender price</i>	351.0
<i>Add: Interest forgone for the period 20 January 1998 (date following cancellation of sale) to 27 April 1999 (date of abandonment of claim)</i>	47.0
<i>Less: Estimated resale price of this site (see Note 3 above)</i>	(200.0)
<i>Less: Deposit paid by Purchaser B, which was forfeited</i>	(35.1)
Total	<u>162.9</u>

Tender provision concerning the financial and technical ability of purchasers and the parent company guarantee

2.4 The Tender Notice for the sale of both the Kowloon Bay and the Ap Lei Chau sites stipulated the following:

- ***Financial and technical ability of purchasers.*** “Tenders must be accompanied by a statement or statements giving evidence of the tenderer’s financial and technical ability to carry into effect and discharge all the obligations of the Purchaser under the Conditions of Sale”; and

- ***Parent or associated company guarantee.*** “If required by the Government, the Purchaser shall procure from its parent or other associated company ...a written guarantee whereby such company unconditionally and irrevocably guarantees the due and punctual completion of the development of the lot in accordance with the Conditions of Sale and indemnifies the Government against all losses, damages, costs and expenses which may be incurred by it by reason of or arising out of any breach or non-performance of the Purchaser’s obligations under the Conditions of Sale. The guarantee shall be subject to the laws of the Hong Kong Special Administrative Region in a form to be approved by the Director of Lands and shall be delivered to him on or before completion of the sale and purchase of the lot.” (Note 3)

Actions taken in respect of Tender Notice requirements

2.5 Table 2 below shows the actions taken by the Lands D in respect of the requirements of the Tender Notice.

Note 3: *In a PSPS Tender, the Tender Notice also stipulated that “If a Purchaser has a parent or associated company incorporated outside of the Hong Kong Special Administrative Region and if required by the Government the Purchaser shall procure..a performance bond or bank guarantee satisfactory to the Government, to be obtained by its parent or associated company.”*

Table 2

Actions taken in respect of Tender Notice requirements

	Kowloon Bay site	Ap Lei Chau site
Financial and technical ability of purchasers	Purchaser A only submitted a copy of the 1996-97 annual report of Company A. It stated in the Form of Tender that Company A was its parent company. It did not submit a statement giving evidence of the tenderer's financial and technical ability.	The PSPS Tender Board (Note 4) was informed that Purchaser B had complied with the tender requirement that the purchaser should accompany its tender with statements giving evidence of its financial and technical ability.
Parent or associated company guarantee	No written guarantee was obtained from Purchaser A's parent or associated company.	No written guarantee was submitted notwithstanding that Purchaser B was invited by the Lands D to note that it would be required to produce a company guarantee, a performance bond or a bank guarantee.

Source: Lands D's records

Cancellation of the sale of the Kowloon Bay site

2.6 *Request for deferring the due date of payment of the balance of the tender price.* In early November 1997, shortly after the award of the tender, Purchaser A requested the Lands D to defer the execution of the Conditions of Sale and the due date of payment of the balance of the tender price. Purchaser A said that it needed more time to arrange financing with its bank due to a sudden change in the bank's lending policy. The Land Administration Meeting (LAM —Note 5)

Note 4: *The PSPS Tender Board is chaired by the Secretary for Housing and its members include the Secretary for the Treasury, the Director of Housing, the Director of Lands, the Director of Architectural Services, the Director of Planning and Chairmen of the Home Ownership Committee and the Building Committee of the Housing Authority. Its main function is to consider tender submissions, select the successful tenderer or decide on alternate actions in the event that no suitable tenderer is selected.*

Note 5: *The LAM is chaired by the Deputy Director (General) of the Lands D. Its members include the Deputy Director (Specialist), the Assistant Director (as appropriate), the Assistant Director (Legal) and the Senior Estate Surveyor (Technical Information). Its terms of reference are to consider specific issues affecting individual land transactions.*

approved Purchaser A's request, and deferred the date of execution of the Conditions of Sale to 4 December 1997 and the date of payment of the balance of the tender price to 18 December 1997, subject to the payment of interest at 2% above the Best Lending Rate. However, in November 1997, Purchaser A stated that it did not agree to pay any interest. It requested the Lands D to further defer the execution date and the payment due date to the end of March 1998. The LAM rejected Purchaser A's request. The Legal Advisory and Conveyancing Office (LACO) of the Lands D advised that the final date of payment of the balance of the tender price should be the original date of 28 November 1997 because Purchaser A's counter offer had not been accepted. If Purchaser A did not pay the balance of the tender price on 28 November 1997, the Government would cancel the sale and forfeit Purchaser A's deposit.

2.7 Cancellation of the sale. Following Purchaser A's failure to pay the balance of the tender price on 28 November 1997, in December 1997, the Lands D informed Purchaser A that the Government had decided to cancel the sale and had forfeited the tender deposit of \$20 million. In accordance with General Condition 3 of the Conditions of Sale (see Appendix C for details), the Government would reserve the right to recover all losses and expenses as a result of resale of the site (Note 6) from Purchaser A.

2.8 Liability of Purchaser A's parent company. In January 1998, the District Lands Officer/Kowloon East of the Lands D sought the LACO's advice about the extent of liability of Purchaser A's parent company on the losses as a result of resale of the site. In response, the LACO advised that:

- so long as the parent company was not connected legally to the tender by either signing on it as the principal or by being required to lodge a corporate guarantee or other security, the tenderer was a separate legal entity from its parent company. Any provision of the parent company's particulars could only be taken as for general information; and
- in this case the tenderer was Purchaser A. There was no such guarantee, security or legal involvement on the part of the parent company. The parent company, therefore, had no liability for Purchaser A's failure to complete the sale contract.

2.9 Recovery of losses from Purchaser A. In April 1998, the Lands D arranged the resale of the Kowloon Bay site by tender. In June 1998, the site was sold to the highest tenderer, Purchaser C, at a tender price of \$46.8 million. In July 1998, the Lands D issued a demand note

Note 6: *Such losses included interest on the balance of the tender price, the drop in land price and related interest charges.*

for \$245.7 million (Note 7) to Purchaser A to recover the losses arising from the resale. However, Purchaser A did not settle the demand note by the due date of 12 August 1998. Another demand note of \$248.4 million, which included the interest for the overdue period, was sent to Purchaser A for settlement by 17 September 1998. The Lands D informed Purchaser A that if the demand note was not settled by that date, the Government would take legal action to recover the losses. However, Purchaser A did not settle the demand note.

No legal action taken to recover the losses from Purchaser A

2.10 **Company and land searches conducted by the Lands D revealed that Purchaser A was a limited company formed in 1997. It had a nominal capital of \$10,000 and had no landed property in Hong Kong.** The Lands D considered that any recovery of the losses through litigation was unlikely. The Department of Justice advised the Lands D that:

- in general it might not be worthwhile to institute legal proceedings against newly-formed shelf companies (Note 8) with only a nominal share capital and with no landed properties or other properties; and
- in a sale and purchase transaction, unless the defaulting purchaser's shelf company had furnished a parent company guarantee or other bank guarantee, it was difficult to obtain other forms of remedy apart from the forfeiture of the deposit already paid.

2.11 In February 1999, the LAM decided that no legal action should be taken. With regard to the question of whether a parent company guarantee should in future be obtained for the sale of land by tender, the LAM considered that such a guarantee should not be required at that time because:

- it could be counter-productive and damaging to confidence in the then delicate property market; and

Note 7: *The Lands D assessed this sum of \$245.7 million, as follows:*

	<i>\$ million</i>
<i>Difference between the original tender price (\$290 million) and the tender price (\$46.8 million) of the resale</i>	243.2
<i>Add: Interest on the unpaid balance of the original tender price from 28 November 1997 to 16 July 1998</i>	20.4
<i>Add: Interest on the difference between the original tender price and the tender price of the resale from 16 July 1998 to 12 August 1998</i>	2.1
<i>Less: Deposit paid by Purchaser A, which was forfeited</i>	<u>(20.0)</u>
<i>Total</i>	<u><u>245.7</u></u>

Note 8: *The term "shelf company" is used to describe those ready-made companies set up by secretarial or accountancy firms.*

- the purpose of a deposit was to “cover the default scenario”. However, in this case, the losses in excess of the deposit sum were primarily due to the delay in effecting the prompt resale of a site.

Subsequent to Audit’s enquiry, the Lands D is now seeking the Secretary for the Treasury’s approval to write off the amount of \$248.4 million.

Lands D deleted tender clause concerning tenderers’ financial and technical ability

2.12 In December 1997, the Lands D decided that, under normal circumstances, the requirement for prospective tenderers to submit their tenders with statements of their financial and technical ability (see the first inset of paragraph 2.4 above) should be discontinued. The Lands D’s reasons were as follows:

- it was not the usual practice of the Lands D to verify information submitted in such statements;
- the content of the statements submitted by tenderers was not normally a factor in the Lands D’s tender recommendation to the Central Tender Board (CTB –Note 9);
- the Lands D’s only concern was whether the tender price was acceptable and whether it would be paid; and
- it was consistent with the auction practice.

In January 1998, the clause requiring the submission of statements of financial and technical ability was deleted from the Tender Notice. However, for the sale of PSPS sites, the clause still remains as one of the requirements specified in the PSPS Tender Notice.

Sale of the Ap Lei Chau site by tender

2.13 *Sale of the site as a PSPS development.* The Ap Lei Chau site was sold by tender for a PSPS development. Tenders were assessed on a weighted scoring system. Purchaser B submitted the highest bid for the tender and scored the highest points. In October 1997, the PSPS Tender Board agreed to award the tender to Purchaser B at the tender price of \$351 million.

Note 9: *The CTB is chaired by the Secretary for the Treasury. Its members consist of the Director of Government Supplies, the Secretary for Works or his representative, a member of the Department of Justice and a Deputy Secretary for the Treasury. The CTB is responsible for making recommendations to the Secretary for the Treasury on the acceptance of tenders.*

Request for deferring the payment of the balance of the tender price

2.14 On 21 November 1997, the Lands D informed Purchaser B that its tender at the tender price of \$351 million was accepted. The Lands D also informed Purchaser B that it would be required to submit a guarantee, a performance bond or a bank guarantee in accordance with the provisions of the Tender Notice.

2.15 On the same date (i.e. 21 November 1997), the CTB received a letter dated 13 November 1997 from Purchaser B. Purchaser B informed the CTB that its banks were reluctant to provide financing for the project in view of the severe financial crisis in Hong Kong. Purchaser B suggested that the Conditions of Sale should be amended so that it could withhold the unpaid balance of the tender price until the PSPS units were ready for sale, or the banks' lending rates returned to normal.

2.16 On 26 November 1997, the LAM rejected Purchaser B's request. The Lands D gave Purchaser B a counter offer that it should pay the balance of the tender price by 19 January 1998, subject to payment of interest at 2% above the Best Lending Rate. In December 1997, Purchaser B reiterated that it had difficulty obtaining financing from its banks. It requested an extension of another two months to 19 March 1998 and agreed to pay interest for the extended period. However, the Lands D did not accept its request and advised Purchaser B that it had to pay the balance of the tender price by 19 January 1998 and the interest by 18 December 1997. If Purchaser B failed to comply with the requirements, the Government would have to cancel the sale and forfeit the deposit. On 19 December 1997, Purchaser B paid the Government \$3.2 million being interest on the balance of the tender price for the extension period 19 December 1997 to 19 January 1998.

2.17 *Cancellation of the sale.* In January 1998, Purchaser B informed the Lands D it could no longer fulfil the contract due to the change of circumstances and extraneous causes beyond its control. Purchaser B contended that the contract had been terminated by frustration and the parties concerned should be discharged from the contract. It requested a refund of the deposit and the interest paid. As Purchaser B had not paid the balance of the tender price by the due date, on 19 January 1998, the Lands D informed Purchaser B that the sale was cancelled and that the deposit and the interest paid had been forfeited. Purchaser B would be liable to the Government for any losses thus arising. The Lands D did not accept Purchaser B's contention that the contract had been frustrated.

2.18 *Liaison with the second highest tenderer.* Meanwhile, in order to minimise delay to the development programme of the site, the Lands D approached Purchaser D, the second highest tenderer, to ascertain whether it would accept the award of the tender in case of default by Purchaser B. At an informal meeting, Purchaser D informed the Lands D that it would only accept the award of the tender if the tender premium of \$243 million was reduced to \$72 million. The Lands D considered that such a reduction was unacceptable.

Concerns of the Independent Commission Against Corruption

2.19 When news of Purchaser B's failure to complete the sale was announced, the Director of Corruption Prevention of the Independent Commission Against Corruption (ICAC) raised with the Lands D the following questions:

- what actions the Lands D had taken to safeguard the Government's interest apart from the forfeiture of deposit;
- whether it was a normal requirement to ask the successful tenderer to provide the Government with a written guarantee from its parent company for the due completion of the development; and
- what was the arrangement for the parent company guarantee for the Ap Lei Chau site.

2.20 The Lands D replied that no written guarantee had been obtained from Purchaser B's parent company. In view of this, the ICAC suggested to the Lands D that:

- in future sale of land by tender, the Lands D should consider making it a standard requirement for the purchaser, if it was a subsidiary company, to procure a written guarantee from its parent company. This would indemnify the Government against any loss arising from the non-completion of the sale; and
- if the purchaser was allowed to defer the date of execution of the Conditions of Sale, apart from charging an interest on the balance of the premium, the requirement for the written guarantee should be imposed as a condition for the deferment.

No legal action taken to recover the amount due from Purchaser B

2.21 **Company and land searches conducted by the Lands D revealed that Purchaser B was a limited company established in 1997. It had a paid-up capital of only \$100 and had no landed property in Hong Kong.** Regarding Purchaser B's failure to complete the sale of the Ap Lei Chau site, the LACO advised that:

- as Purchaser B had no assets, any judgement obtained by means of legal proceedings would likely be unenforceable;
- Purchaser B could avoid its liability to the Government by disposing of its assets (if any) prior to the Government obtaining an injunction or judgement. The institution of legal proceedings would not prevent Purchaser B from disposing of its assets; and
- it was possible to require the submission of a parent company guarantee before the award of a tender.

2.22 In May 1998, the LAM decided that no legal action should be taken to recover any losses in connection with Purchaser B's default to complete the sale. In order to safeguard the Government's interest, the LAM considered that the amount of deposit for PSPS tenders should be increased. However, in March 1999, the PSPS Tender Board decided that the amount of deposit (i.e. 10% of the tender price) should remain unchanged for PSPS tenders because the successful

tenderer would be required to provide a parent company guarantee within two weeks of award of the tender.

2.23 ***Abandonment of claim for losses from Purchaser B.*** In January 1999, the Lands D sought the Secretary for the Treasury's approval for abandoning the claim for losses from Purchaser B. Further legal advice was also sought. The Department of Justice concurred with the LACO's views. The Department of Justice also suggested that in future the Lands D should consider requiring the purchaser to give a larger amount of deposit or a bank/parent company guarantee. In March 1999, in reply to enquiries from the Finance Bureau, the Lands D said that:

- **in order to prevent the occurrence of a similar default, in March 1999, the PSPS Tender Board approved the recommendation that the successful tenderer should be required to provide a parent company guarantee within 14 days from the award of the tender. The requirement would be imposed on future PSPS tenders; and**
- the Lands D did not provide an estimated loss because the Ap Lei Chau site was no longer intended for resale as a PSPS site (Note 10).

In April 1999, the Secretary for the Treasury approved the Lands D's request to abandon the claim for losses from Purchaser B.

Audit observations on the purchasers' failure to complete the land sale contract

Parent company guarantee clause not invoked

2.24 Audit observed that the purchasers of the Kowloon Bay and the Ap Lei Chau sites who had defaulted were newly-formed shelf companies with no landed property in Hong Kong. **Purchaser A, with a nominal capital of only \$10,000, was awarded the tender of the Kowloon Bay site at the tender price of \$290 million. Purchaser B, with a paid-up capital of only \$100, was awarded the tender of the Ap Lei Chau site at the tender price of \$351 million. According to the Tender Notices for the sale of the sites, the Government had the right to obtain a guarantee from the Purchasers' parent or associated company. However, the Lands D had not obtained such a guarantee when the tender was awarded to the Purchasers.** Notwithstanding that the Conditions of Sale of both the Kowloon Bay and the Ap Lei Chau sites empowered the Government to recover all losses arising from the Purchasers' failure to complete the sale, the Government could not do so because the two Purchasers did not have any substantial assets. **In the event, the Government suffered a loss of \$248.4 million due mainly to the drop in land price upon the resale of the Kowloon Bay site. As regards the Ap Lei Chau site, Audit estimated that the total loss due to the drop in land price and interest forgone was \$162.9 million (see Table 1 in paragraph 2.3 above). Audit supports the views of the ICAC and the Department of Justice that a parent or associated company guarantee or a bank**

Note 10: *The Ap Lei Chau site was considered as a site more suitable for the first mixed development pilot scheme. Under this scheme, the purchaser is required, upon completion of the development, to make available to the Government, free of cost, 30% of the saleable area for sale as home ownership flats to eligible purchasers nominated by the Hong Kong Housing Society.*

guarantee should be obtained from successful tenderers in order to indemnify the Government against any losses arising from the breach or non-performance of the tenderers' obligations under the Conditions of Sale.

2.25 Audit noted that the Lands D has learned a lesson from the sale of the Ap Lei Chau site. In future PSPS tenders, the successful tenderer will be required to provide a parent company guarantee within 14 days from the award of the tender. **However, for non-PSPS land sale tenders, the Lands D has not yet decided whether a similar requirement should be imposed by invoking the clause in the Tender Notice which requires a purchaser to procure from its parent or associated company a written guarantee.**

Tenderers' financial and technical ability

2.26 Audit observed that Purchaser A had not submitted statements giving evidence of its financial and technical ability in its tender, contrary to the requirement specified in the Tender Notice. In the absence of such statements, the Lands D could not assess the tenderers' financial position and technical ability. **Audit considers that it is unsatisfactory that the financial and technical ability clause was deleted from the Tender Notice of non-PSPS land sale tenders. Such a requirement is essential to enable the Lands D to vet the financial and technical capability of prospective tenderers prior to the award of the tender. Furthermore, this clause will protect the Government's interest.** This is also consistent with the current requirement of the PSPS land sale Tender Notice for tenderers to submit statements giving evidence of their financial and technical ability to complete the PSPS development.

Audit recommendations on tender requirements

2.27 **Audit has recommended that the Director of Lands should:**

- **upon the award of a land sale tender, require the successful tenderer to procure a bank guarantee or a written parent or associated company guarantee for a sum equivalent to the balance of the tender price, so as to adequately protect the Government's interest in case of default by the purchaser;**
- **if a successful tenderer chooses to provide a written parent or associated company guarantee, thoroughly vet the financial statements of the guarantor to ensure that the guarantor has adequate means to fulfil its obligations under the guarantee;**
- **in the Tender Notice for the land sale of sites, reinstate the financial and technical clause which gives the Government the right to require purchasers to submit evidence of their ability to discharge their obligations under the Conditions of Sale; and**
- **strictly enforce the requirement of the Tender Notice for purchasers to submit evidence of their financial and technical ability. Full justifications should be documented for cases where such a requirement is waived.**

Response from the Administration

2.28 The **Secretary for the Treasury** supports the audit recommendation that, from the angle of revenue and resources protection, the Director of Lands should, upon the award of a land sale tender, require the successful tenderer to procure a bank guarantee or a written parent or associated company guarantee for a sum equivalent to the balance of the tender price. She has said that the amount of losses in case of purchasers' default could be huge as demonstrated by the sales of the Kowloon Bay site and the Ap Lei Chau site.

2.29 The **Director of Lands** agrees that there is scope to improve the current system on tender procedures. He considers that the two cases of the Kowloon Bay and the Ap Lei Chau sites are "casualties" of the Asian financial crisis in 1997. He has said that:

- (a) he agrees with the audit recommendation that the financial statements of the guarantor should be thoroughly vetted in cases where such a requirement is contained in the Tender Conditions;
- (b) he agrees with the audit recommendation that the requirement of the Tender Notice should be strictly enforced. To award tenders which do not comply with the requirement of the Tender Notice may inevitably run the risk of legal challenges from other unsuccessful tenderers;
- (c) inclusion of the requirement for bank guarantees, parent or associated company guarantees will be made in appropriate cases having regard to the existing guidelines. For PSPS cases, the standard Tender Conditions now contain a requirement that such guarantees must be submitted within 14 days from the award of the tender. However, the requirement for submission of bank guarantees or parent or associated company guarantees is not considered essential in each and every non-PSPS land sale. Unlike PSPS cases where the Government is committed to achieving a set target on the provision of assisted housing, for the majority of non-PSPS cases, the requirement for a deposit is to ensure that the Government is not dealing with "men of straw". If the successful tenderer defaults, the Government will forfeit the deposit and this should be a sufficient deterrent. Under a steady market condition, the deposit should be able to cover the shortfall;
- (d) the more stringent financial requirements that the Government tries to impose in the tender documents, the more the likelihood such requirement will reduce the number of potential bidders willing to participate in the tender. Apart from the fact that such requirement could have an adverse effect on prices, this practice could also easily lead to the misunderstanding that the tender procedures are geared towards favouring the major developers;

- (e) in cases where sites for certain special purposes are put up for tender in pursuance of certain specific policy objectives, submission by tenderers giving evidence of their financial and technical capability to discharge the obligations under the Conditions of Sale will normally be specified. Indeed, subject to the CTB's approval to be sought on such cases, such factors are taken into consideration in tender evaluation on the basis of an approved scoring system. Hence, the requirement for submission of statements giving evidence of tenderers' financial and technical ability is not considered necessary in all land sale cases; and

- (f) the Ap Lei Chau site was included in the 1998-99 Land Sale Programme for PSPS development. However, following the Government's announcement in June 1998 of the special relief measures to help revive the economy, land sale by auction and tender for the remainder of the 1998-99 financial year was suspended. The site has now been included in the 1999-2000 Land Sale Programme for sale as a mixed development project with tender invitation scheduled for October 1999. The estimated resale price of \$200 million (see Note 3 of Table 1 in paragraph 2.3 above) for the site is hypothetical as the site will no longer be disposed of for PSPS development.

2.30 Concerning the audit recommendations on tender requirements, the **Secretary for Justice** has said that:

- care should be taken with the wording of a bank guarantee, parent or associated company guarantee; and

- the Government may need to scrutinise, during the life of a guarantee, that the guarantor giving the guarantee has adequate assets.

PART 3: SALE OF THE MA ON SHAN SITE BY TENDER FOR HOTEL USE

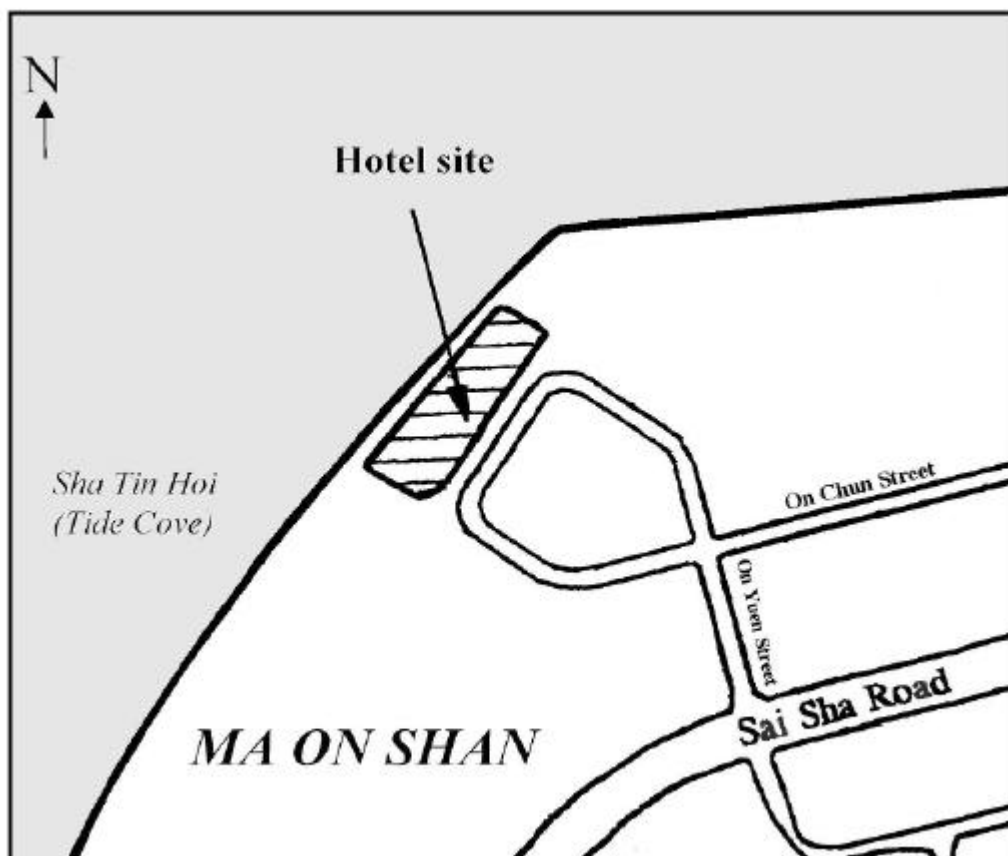
3.1 This part examines the sale of a site by tender in Ma On Shan which was specifically zoned for hotel use.

Background

3.2 As mentioned in paragraph 1.1 above, the sale of land by tender is usually chosen as the means of land disposal where the Government imposes special user requirements on the development of a lot to achieve a particular planning objective. The audit revealed that there were lessons to be learnt in the sale of a site situated at Ma On Shan Town Centre Area 100 which was specifically zoned for a hotel. Figure 3 below shows the location of this site. A chronology of key events relating to the rezoning and sale of the Ma On Shan site by tender is at Appendix D.

Figure 3

Location of the Ma On Shan site



Source: Lands D's records

Hotel industry appealed for more incentives

3.3 In 1995, a consultancy study known as the Visitor and Tourism Study for Hong Kong (hereinafter referred to as the VTS) commissioned by the Hong Kong Tourist Association (HKTA) and managed by the Planning Department (Plan D) was completed. The VTS estimated that there would be a shortage of 16,500 hotel rooms in Hong Kong by 2004. At the same time, another consultancy study commissioned by a group of hotel owners in Hong Kong also concluded that there would be a shortage of hotel rooms, and some 14,000 hotel rooms would be required over the next ten years. As a lead time of three to four years was required to build a hotel, the earliest date for the new additional hotels to be available would be in 1998-99.

3.4 *Reasons for the shortage of hotel accommodation.* In Hong Kong, hotels and offices may be built on land which has been zoned “Commercial (C)” or “Commercial/Residential (C/R)”. A developer has the right to decide on the type of property to be built in order to give him the highest return on his investment. Prior to September 1995, some developers redeveloped or converted existing hotels to commercial/office use because this would give them a higher return. There was not much incentive for new hotel development. According to the VTS, the higher returns of other types of property development were one of the reasons for the anticipated shortage of hotel rooms.

3.5 The VTS suggested that the plot ratio for hotel development should be increased to the same level as that for non-domestic development. However, this measure alone was insufficient to encourage the building of new hotels in the short and medium term. The introduction of “prescriptive land zoning for hotels” was therefore needed as a complementary course of action. Hence, the VTS recommended, among other things, that the Government should:

- increase the plot ratio for hotel development to the same level as that for non-domestic development; and
- zone sites specifically for hotel development in suitable locations.

Zoning sites specifically for hotel development

3.6 *Concern over the loss in revenue due to zoning of hotel sites.* In July 1995, the Chief Secretary for Administration’s Committee (CSC) considered the VTS report submitted by the Economic Services Bureau (ESB). According to CSC Discussion Paper No. 20/95 of July 1995, the Planning, Environment and Lands Bureau (PELB) and the Lands D did not favour a change in the existing land disposal policy. Under the land disposal policy at that time, sites for hotel use were usually included within a general “Commercial (C)” zone in the Outline Zoning Plans (OZPs — Note 11), or included in large scale projects in Comprehensive Development Areas, the development of which was subject to approval by the Town Planning Board (TPB). The PELB and

Note 11: *OZPs are statutory plans prepared and published by the Town Planning Board under the provisions of the Town Planning Ordinance (Cap. 131). OZPs show the proposed land uses and major road systems of individual planning scheme areas. Areas covered by OZPs are zoned for such uses as residential, commercial, industrial, open space, government, institution and community uses, green belt, or other specified purposes.*

the Lands D expressed reservations about the proposal of zoning sites for hotel development. **The Government Economist shared their views. He said that “it would distort the market mechanism and sales of designated hotel sites would fetch lower prices than that where a wider choice of developments is permitted, thereby providing a subsidy and a resultant loss in government revenue”.** The Secretary for the Treasury supported a more cautious approach and doubted if the growth in the number of visitors could be sustained in the long run.

3.7 ***Measures recommended.*** According to CSC Discussion Paper No. 20/95, the following measures were recommended to the CSC:

- the Building Authority’s current practice notes and the Building (Planning) Regulations should be amended to allow hotel sites to have the same plot ratios as sites for non-domestic use; and
- a Task Force under the Plan D should be set up to make recommendation to the TPB for the designation of up to six suitable sites specifically for hotel development under the OZPs.

3.8 ***The CSC’s decision.*** At the CSC’s meeting of 17 July 1995, the Chief Secretary for Administration said that there was no disagreement on the proposal to increase the plot ratios for hotels. However, with regard to the proposal of zoning specific sites for hotel development, she said that:

- the Government should press ahead with the increase in the plot ratios as a first step;
- she agreed with the Secretary for the Treasury and the Secretary for Planning, Environment and Lands that the Government should move cautiously and should not interfere with the market unnecessarily;
- she agreed reluctantly to the recommendation of testing the market with one or two sites earmarked specifically for hotel development; and
- before the Government took a firm decision, the ESB was requested to provide the CSC with the number and details of the sites identified.

3.9 In September 1995, the Building Authority issued a Practice Note for Authorized Persons and Registered Structural Engineers (PNAP) 111 (Note 12). **The Building Authority**

Note 12: *In August 1996, the Building Authority revised PNAP 111 (which is currently in force). The main revision is that the Building Authority accepts that for better functioning of hotels, exemptions may be justifiable for such facilities as suitably designed setting-down and picking-up areas for hotel users and back-of-the-house facilities, which are special and essential for hotel operations.*

announced that for bona fide hotel proposals, it would favourably consider applications to modify the site coverage and plot ratio limits in the Building (Planning) Regulations up to non-domestic standards. Since August 1996, back-of-the-house facilities (Note 13) have also been excluded from the plot ratio calculation as an additional incentive to the hotel industry.

3.10 *ExCo informed of the Government's effort to help the hotel industry.* The Executive Council (ExCo) had been informed of the Government's effort to help the hotel industry. In 1969, ExCo was informed that, to alleviate the shortage of hotels and to encourage tourism, the Building Authority would grant concessions for the construction of bona fide hotels. As a concession, the Building Authority would disregard basements in hotel developments for the purpose of calculating the plot ratio (Note 14) of the whole building. **In July 1998, ExCo was also informed of the measures mentioned in paragraph 3.9 above to help the hotel industry.**

Trial scheme of zoning two sites for hotel use

3.11 Meanwhile, in August 1995, the ESB informed the CSC that six sites had been identified as suitable for zoning for hotel development. Among the six sites, the ESB recommended two sites as a test case. After zoning, these two sites would be included in the land sales programme and the response from the market would be closely monitored. The CSC agreed with the ESB's proposed sites, which were:

- *Site No. NE4 in Sha Tin Area 14.* The site is situated at Yuen Chau Kok in Sha Tin (hereinafter referred to as the Yuen Chau Kok site); and
- *Site No. TW4B in Tsuen Wan.* The site is situated at the junction of Yeung Uk Road and Ma Tau Pa Road in Tsuen Wan (hereinafter referred to as the Tsuen Wan site). The Tsuen Wan site was originally zoned "Commercial" on the Tsuen Wan OZP No. S/TW/6 in October 1993. In August 1996, the TPB rezoned the site from "Commercial" to "Other Specified Uses" and annotated "Hotel" in the draft Tsuen Wan OZP No. S/TW/7, which was exhibited for public inspection under section 5 of the Town Planning Ordinance (Cap. 131). During the public inspection period, no objection was received.

Note 13: *Back-of-the-house areas accommodate facilities which are unique and integral to the normal operation of a hotel. The omission or under-provision of such facilities would result in poorer quality of life for hotel guests. Acceptable facilities include workshops, storage areas and facilities for the welfare of hotel staff. Unacceptable facilities include shops, restaurants, cinemas and any commercial use (other than hotel use) to which the general public has access.*

Note 14: *Under the Building (Planning) Regulations, the plot ratio of a building is obtained by dividing the GFA of the building by the area of the site on which the building is erected. In September 1995, the grant of basement concessions ceased.*

Replacement of the Yuen Chau Kok site by the Ma On Shan site

3.12 In November 1995, the Committee on Planning and Land Development (CPLD — Note 15) considered the draft Yuen Chau Kok Layout Plan. The CPLD considered that the Yuen Chau Kok site was more suitable for public housing development than for hotel development and decided that an alternative hotel site in Sha Tin should be identified. The Plan D then identified an alternative site, the Ma On Shan site, which had been reserved for use as a marine police base. As the site was zoned “Government/Institution/Community” on the draft Ma On Shan OZP, the site had to be rezoned. The Plan D also recommended that the Lands D should include the site in the 1996-97 Land Sales Programme.

Rezoning the Ma On Shan site specifically for hotel use

3.13 *Rezoning of the Ma On Shan site.* In June 1996, the CPLD agreed to rezone the Ma On Shan site for hotel use and to increase the plot ratio of the site from five to seven. Table 3 below summarises the key features relating to the site:

Table 3

Key features relating to the Ma On Shan site

	Key features
Site location	The site was near the waterfront, close to a public transport terminus, the proposed rail station and adjacent to shopping centres and the Ma On Shan town centre.
Site restriction	There was a marble rock cavern layer below the site. The higher cost of development would be reflected in the premium offered.
Number of hotel rooms	A 930-room hotel could be built as the plot ratio had been increased from 5 to 7.
Gazette date and objection received	In July 1996, the TPB approved the rezoning of the site and the amended OZP was gazetted on 23 August 1996. One objection was received. The TPB decided not to amend the draft OZP. The objection was submitted to the Chief Executive in Council for decision.

Source: Lands D's records

Note 15: *The CPLD is chaired by the Secretary for Planning, Environment and Lands and is responsible for monitoring the general progress of physical development of the territory, considering and approving detailed planning briefs, layouts and development plans, and dealing with specific land policies.*

3.14 **Further justifications requested by ExCo.** At a meeting held on 29 September 1997, the Lands and Works Subcommittee of ExCo considered the draft Ma On Shan OZP No. S/MOS/4A and the objection (Note 16) raised. The ExCo Subcommittee expressed reservations about the viability and suitability of the proposed designation of the Ma On Shan site for hotel development. Nevertheless, the ExCo Subcommittee agreed that the draft OZP should be approved, subject to further justifications to be sought from the HKTA.

3.15 **HKTA's justifications.** In September 1997, the HKTA provided the following justifications for zoning the site for hotel development:

- the Sha Tin area including Ma On Shan had been identified as one of the new tourism nodes. The HKTA saw great potential of developing the Sha Tin area into an internationally renowned tourist area focusing on sports and recreation. The HKTA therefore supported the designation of sites for hotel development in the area, which would provide the needed accommodation for visitors;
- the HKTA was examining the feasibility of developing an international aquatic centre in the area to provide enhanced facility for aquatic based events, competitions and recreational activities. One of the potential sites identified was Whitehead near Ma On Shan;
- the proposed hotel site was centrally located, close to transportation network and the Ma On Shan town centre. It would also serve the local residents; and
- the site was designated as "Other Specified Uses" and annotated "Hotel" on the draft OZP, with hotel as the permitted use. This was in line with the recommendations of the VTS. A site with specific designation for hotel development would support the hotel industry by relating the land cost directly to hotel projects, rather than to commercial or residential uses.

3.16 **ExCo's decision.** After taking into account the justifications given by the HKTA, in October 1997, ExCo advised and the Chief Executive ordered that the draft Ma On Shan OZP should be approved pursuant to the Town Planning Ordinance.

Note 16: *The objection was based on the grounds of incompatibility of hotel use with surrounding residential areas, blockage of seaview, adverse traffic impact and other problems associated with commercial facilities in the proposed hotel development.*

Application for permission for commercial use under section 16 of the Town Planning Ordinance

3.17 In April 1997, the Lands D applied to the TPB to seek permission under section 16 of the Town Planning Ordinance (Note 17) for commercial uses within the proposed hotel development. Table 4 below shows some salient features of the Lands D's application:

Table 4

Salient features of the application for permission for commercial use of the Ma On Shan site

Salient features

Purpose	To seek permission for commercial uses within the hotel development.
Maximum GFA	56,000 square metres (i.e. a plot ratio of 7) including the GFA for other uses.
GFA for other uses	16,000 square metres for other uses such as banks, retail shops and places of entertainment (i.e. a plot ratio of 2).
Justifications for GFA for other uses	Though a large site, the location as a tourist area was untested and was far from popular tourist districts. Entertainment facilities and shops should be provided within the hotel area as extra incentives to developers.

Source: Lands D's records

3.18 The Plan D raised no objection to the application because the proposed commercial uses within the hotel development were generally compatible with the hotel use and the land uses in the vicinity. Following the Chief Executive in Council's approval of the draft Ma On Shan OZP, in November 1997, the TPB approved the Lands D's application.

Sale of the Ma On Shan site by tender

3.19 In December 1997, in response to the Secretary for Planning, Environment and Lands' enquiry, the Director of Lands said that the Ma On Shan site would be sold by tender because:

Note 17: *This refers to the application to the TPB for permission of such uses as specified in the set of notes attached to each OZP for which the TPB's permission must be sought.*

- hotel sites were usually disposed of by way of tender;
- the Ma On Shan site was not in a prime location and enthusiastic bidding was not expected in view of the recent decline in tourism; and
- in view of the then state of the property market, the Lands D had no wish to see possible withdrawal of the site in the auction room as this would surely attract much public attention and have undesirable repercussions.

3.20 ***Tender price of the Ma On Shan site.*** In November 1997, the Lands D estimated that, for the purpose of determining the tender deposit, the sale price of the site would be **\$1,056 million**. Therefore, the Lands D set the tender deposit at \$50 million. In January 1998, tenders for the sale of the Ma On Shan site were invited. In February 1998, the Lands D received only two tenders. **Purchaser E submitted the highest tender of \$120 million, which was equivalent to an accommodation value (Note 18) of \$2,150 per square metre.**

Proposal to withdraw the site and rezoning it for residential use

3.21 ***Lands D proposed to withdraw the site from tendering.*** In February 1998, the Director of Lands requested the Secretary for Planning, Environment and Lands to consider withdrawing the site from tendering with a view to rezoning it for residential use. The Director of Lands said that:

- the outlook for the tourist industry and market sentiment in respect of hotels had changed quite dramatically since the completion of the VTS and the CSC's decision in July 1995 to offer two "pilot" sites for hotel use;
- according to the draft final report of a HKTA Study on Hotel Demand and Supply in Hong Kong, which had been circulated towards the end of 1997, there would only be an average hotel occupancy rate of about 70% across the board, taking into account the expected new hotel developments. In certain classes of hotel, there would be excess capacity. Furthermore, there had been a dramatic drop in the number of tourists in the second half of 1997; and
- **rezoning the site to allow for residential development (at a plot ratio of five) would bring about some 500 flats, and would yield a land premium five times that of the highest tender price.**

3.22 In February 1998, the Secretary for Planning, Environment and Lands requested the Director of Planning to assess the impact on the area if the Ma On Shan site was changed to residential use. He said that he had not yet made up his mind on the Director of Lands' proposal,

Note 18: *The accommodation value is the sale price per square metre (or per square foot) of the GFA of a building.*

and requested the Director of Planning to provide an objective assessment. He said that he would take the following into account when deciding on the matter:

- ***Credibility of the Government.*** Recently, the Government had argued strongly that there was a need for more hotel sites, and that the Ma On Shan site was suitable for the purpose. The Government had overruled the objection to the hotel zoning there;
- ***Commitment to tenderers.*** The tenderers submitted tenders on the understanding that they would operate a hotel there. The Government had to assume that they would wish to do so. The Government would need very strong reasons to reject the tenders; and
- ***Wrong message to the market.*** The question of whether the Government was sending the wrong message to the market that it was taking too short-term a view on the need for hotels should be considered. Also, he had to consider how demand in the long term should be met.

3.23 ***Director of Planning's views.*** The Director of Planning agreed with the Secretary for Planning, Environment and Lands' views. He did not agree that the Ma On Shan site should be rezoned from hotel use to residential use. Although there would not be major, insurmountable technical problems which might prohibit the rezoning to residential use, he considered it appropriate to retain the site for hotel use because of the following reasons:

- ***Suitability of the site.*** The site was considered suitable for hotel development. The long-term benefit of providing hotel facilities at suitable locations to sustain and foster the tourist industry should not be hampered by the short-term demand and supply situation;
- ***Credibility of the TPB.*** During the public inspection period of the draft Ma On Shan OZP, an objection to the hotel zoning was received. The TPB considered that the site was suitable for hotel use and finally decided not to uphold the objection. Rezoning the site to residential use within such a short period of time would probably render the TPB vulnerable to criticisms and would damage its credibility, bearing in mind the local residents' concern of this development;
- ***Credibility of the Government.*** The draft Ma On Shan OZP was approved by the Chief Executive in Council, after taking into account the objection (see paragraphs 3.14 to 3.16 above). To vary the Government's stance and the decision of ExCo within such a short period of time on the basis of purely economic concern due to a temporary gloomy market situation would likely put the credibility of the Government at risk; and
- ***Criticism from the hotel association and the HKTA.*** The Government might be strongly criticised by the hotel association and the HKTA. They might criticise the Government for not keeping a land bank of one or two sites for hotel use while there were numerous sites for housing.

Withdrawal of the site not accepted

3.24 In February 1998, the Secretary for Planning, Environment and Lands asked the Director of Lands to proceed with the tendering procedures and to submit the tender recommendation to the CTB for consideration. He said that:

- considerable efforts and arguments were put forward by the Government and the TPB for zoning the site for hotel use. This was supported by the HKTA. All these arguments were taken into account by ExCo in approving the rezoning of the site and over-ruling the objection. The Government's credibility would be very much affected if it suddenly changed course at this moment;
- the impact of a change in zoning on traffic and infrastructure of the district had not been fully assessed;
- the Government's refusal to accept the tender or withdrawal of the site from tendering, on the argument that the site could be better used for residential purposes, was unlikely to be well received by the tenderers or the public; and
- the Government had all the time insisted that it did not operate a high land price policy and that prices of land were determined through market forces. It might not be tenable for the Government to argue that it had to withdraw the site because the tender prices were too low, particularly in the then economic situation. The Government should trust that the tenders had been submitted in good faith.

Tender submission to the CTB

3.25 In March 1998, the Director of Lands submitted the tender report to the CTB. The Director of Lands advised the CTB that, having regard to the location of the Ma On Shan site, the less than promising tourist industry outlook and the prevailing condition of the economy at that time, the tender sum of \$120 million was "not unreasonable". He also said that:

- the price offered by the purchaser was equivalent to a price of \$1.78 million per hotel room. Although this appeared on the low side when compared with other hotel transactions, it could not be said that the price was not the then current value of the site; and
- the following factors had undoubtedly contributed to the low price offered:
 - (i) the tourist industry was at a low ebb. Statistics published by the HKTA showed that the number of tourists had peaked in 1996 at 11.7 million, but fell by 11% to 10.4 million in 1997. There were indications that an increasing proportion of visitors would choose to stay in private lodgings and for a shorter period. This affected the occupancy rate of hotels, which fell from 88% in 1996 (for all categories of hotels) to 76% in 1997;

- (ii) in October 1997, the HKTA projected a significant increase of 44% in hotel rooms in the next three years. From 1997 to 2000, the number of hotels would increase from 88 to 127, and the number of hotel rooms would increase from 34,205 to 49,366; and
- (iii) the possibility of high construction costs due to the presence of cavernous marble.

Award of the tender

3.26 At a meeting of the CTB held in March 1998, the Director of Government Supplies suggested that, having regard to the Director of Lands' tender analysis and the less than promising tourist industry outlook, it might be more appropriate to consider the site for other purposes. He asked whether the Government should irrevocably commit to the use of the site for hotel purpose. The Chairman of the CTB said that the question of whether the site should continue to be sold for hotel purposes was a matter for the PELB and the ESB to decide. In the light of the Lands D's analysis, he considered that the sale price of \$1.78 million per hotel room was not unreasonable in the then economic climate. The CTB then recommended acceptance of Purchaser E's tender at the tender price of \$120 million. In March 1998, the Lands D informed Purchaser E that its tender was accepted.

Supply and demand of hotel rooms in the coming years

3.27 *Consultancy study to update hotel demand and supply.* Since the completion of the VTS in 1995, several measures had been implemented to encourage the private sector to develop more new hotels. By early 1997, it became apparent that a large number of new hotel projects were under planning. In May 1997, the HKTA appointed a consultant to carry out a study on the demand and supply of hotels. In November 1997, the consultant of the HKTA said that an occupancy rate of 75% or above would be acceptable to hotel developers worldwide. A representative of an association of developers said that while an occupancy rate of 70% would be acceptable internationally, developers would only accept an occupancy rate in excess of 80% in pursuing hotel development in Hong Kong.

3.28 *No shortage of hotel rooms envisaged by the HKTA.* Shortly after the sale of the Ma On Shan site, the Office of the Chief Executive enquired about the shortage of hotel rooms in Hong Kong. In April 1998, the Secretary for Economic Services responded that:

- according to the HKTA, there were 33,877 rooms at the end of February 1998. **Based on confirmed hotel projects, the HKTA forecasted that there would be 48,400 hotel rooms at the end of 2002, i.e. an increase of 43%; and**
- the HKTA forecasted that the hotel occupancy rate would be 72% in 2002. **The HKTA did not envisage any shortage of hotel rooms before 2002.**

3.29 Having been informed that there would be no shortage of hotel rooms, in April 1998, the Director of Lands said that the sale of land restricted for hotel development should be reviewed.

He said that the Lands D ‘has been against this policy from the very beginning as we were of the view that land should be sold for non-industrial purposes (including hotel) and we (the Government) should leave it to the market to decide whether to build hotels or offices.’ He urged the Secretary for Planning, Environment and Lands and the Director of Planning to reconsider his views.

3.30 *Untimely sale of the Ma On Shan site.* In reply, the Secretary for Planning, Environment and Lands said that he was seeking the Secretary for Economic Services’ view for deferring the sale of the hotel site in Tsuen Wan (see the second inset of paragraph 3.11 above). In April 1998, the Plan D said that as a result of modifying the plot ratio limits for hotels up to non-domestic standards, there had been a rush for hotel proposals, including many planning applications and rezoning requests in the peripheral areas. However, there was no guarantee that all such proposals would eventually materialise. **The Plan D considered that the sale of the Ma On Shan site was rather untimely. Apart from the recent drop in overseas visitors to Hong Kong, the market conditions in the property sector were also not favourable. Such market conditions could not have been anticipated in the VTS completed in 1995.** The timing for the sale of the Tsuen Wan site should be reviewed. However, from the planning point of view, the Plan D felt that there was still a case for zoning other sites for hotel use.

3.31 In May 1998, the consultancy study commissioned by the HKTA was completed (see paragraph 3.27 above). The main findings of the study were as follows:

- hotel development decisions were driven not only by tourism-related factors, but also by underlying real estate considerations. The revisions to PNAP No. 111 in 1995 and 1996 had led to increasing interest in hotel development;
- **the occupancy rate would drop from 72% in 1998 to 69% in 2001. The occupancy rate was expected to pick up after 2002, reaching 73% by 2004 and 80% by 2006; and**
- **the overall projection of supply and demand of hotel rooms did not indicate a need for immediate or further government actions.** However, for Hong Kong to remain competitive and to satisfy the increasing demand for Class A hotels in the central business districts, the introduction of incentives such as specifically zoned sites for hotel use might be advisable.

3.32 *Sale of the Tsuen Wan site deferred.* The Director of Planning supported the recommendations of the consultancy study. The Secretary for Planning, Environment and Lands said that there seemed to be a case for reserving sites in the OZPs exclusively for hotel use. Nevertheless, he intended to defer the sale of the Tsuen Wan site so that the Government could keep its options open. If the market would remain gloomy, the Government could consider rezoning the site for residential development. The Secretary for Economic Services had no objection to an adjustment to the timing of the sale of the Tsuen Wan site. The Tsuen Wan site has been included

in the “Reserve List of Sites Available for Application (Note 19) —Sale by way of Tender (April 1999 to March 2000)”.

Audit observations on the sale of the Ma On Shan site by tender

ExCo not informed of the trial scheme and the change in land disposal policy

3.33 In August 1995, the CSC agreed to zone two sites specifically for hotel use as a trial scheme. In March 1998, one of the two sites, the Ma On Shan site, was sold for \$120 million. **Audit noted that, in October 1997, ExCo was informed that, in the context of seeking ExCo’s decision in respect of the draft Ma On Shan OZP, the Ma On Shan site had been proposed to be designated for hotel development. However, ExCo had not been informed of the trial scheme, the change in the land disposal policy and the financial implications. Audit considers that this is unsatisfactory because:**

- according to CSC Discussion Paper No. 20/95 of July 1995, zoning sites specifically for hotel use was considered as a change in the existing land disposal policy (see paragraph 3.6 above). The Lands D had expressed its views against this policy because “land should be sold for non-industrial purposes (including hotel) and (the Government) should leave it to the market to decide whether to build hotels or offices”(see paragraph 3.29 above);
- the Government Economist had expressed concern (see paragraph 3.6 above) which was valid in view of the low price tender for the Ma On Shan site; and
- the implementation of the trial scheme would have significant financial implications. The Lands D had pointed out that a change of zoning of the Ma On Shan site to allow residential development would achieve a premium of some five times (on a conservative estimate) that of the top tender. **In this connection, Audit Consultant estimated that the site could have been sold at a price of \$764 million (close of the tender on 6 February 1998) if it had been allowed to be developed for residential purposes. Therefore, the estimated revenue forgone arising from restricting the land use to hotel would amount to some \$644 million (i.e. \$764 million less \$120 million —see Appendix E for details).**

Note 19: *Under the system of the Reserve List of Sites Available for Application, a developer interested in any sites may apply to the Government for the purchase of the land by offering a minimum price. If the Government considers that the offer is acceptable, the applicant will be required to sign an undertaking to bid for the site at the minimum price and pay a deposit. The applicant will be notified of the sale date and the site will be gazetted for sale. If the applicant is successful in acquiring the site, the deposit will be used to off-set the purchase price. If the applicant is unsuccessful, the deposit will be refunded. If the bids do not reach the minimum price or if the applicant fails to submit a bid, then the deposit will be forfeited.*

The CSC not informed of the downturn in the hotel industry

3.34 Pursuant to the findings of the 1995 VTS that there would be a shortage of 16,500 hotel rooms by 2004, in July 1995, the CSC agreed to sell two sites restricted for hotel use on a trial basis. **However, the financial implications of the possible loss in revenue in zoning sites specifically for hotel developments were not assessed. Audit considers that such information was essential for, and should have been submitted to, the CSC so that it could make an informed decision about the change in the existing land disposal policy.**

3.35 Prior to the award of the tender for the Ma On Shan site in March 1998, the market sentiment and outlook for the hotel industry had changed significantly, when compared with the forecast in the 1995 VTS. This was because:

- **the number of tourists had decreased from the peak of 11.7 million in 1996 by 1.3 million (11%) to 10.4 million in 1997;**
- **the occupancy rate of hotels had fallen from 88% in 1996 to 76% in 1997;**
- the number of hotel rooms would be increased from 34,205 by 44% to 49,366 from 1997 to 2000; and
- the forecasted average hotel occupancy rate for the next few years was 70%. This was below the occupancy rate of 80% which developers in Hong Kong considered worthwhile for hotel development (see paragraph 3.27 above).

However, the CSC was not informed of such significant changes in the hotel industry, particularly the significant drop in the number of tourists and the increase in the supply of hotel rooms.

3.36 In February 1998, in his submission to the Secretary for Planning, Environment and Lands for considering the withdrawal of the Ma On Shan site from tendering after receipt of the low tender price of \$120 million (Note 20), the Director of Lands also confirmed that the outlook for the tourist industry had changed dramatically since the CSC's July 1995 decision to offer the two pilot hotel sites (see the first inset of paragraph 3.21 above). **Audit therefore considers that the sale of the Ma On Shan site should have been referred back to the CSC, together with an options analysis, for its reconsideration so as to determine whether it was really appropriate to award the tender at that time.** Furthermore, Audit also observed that the Yuen Chau Kok site, which was originally approved by the CSC in August 1995 as one of the two sites for zoning specifically for hotel development, was replaced by the Ma On Shan site. However, the change of the site had not been referred back to the CSC for endorsement. Audit considers that the CSC should have been informed of such a change.

Note 20: *According to the Audit Consultant's assessment, as at the tender closing date, hotel development on the site might incur high costs because of the particular site conditions.*

3.37 *Other possible alternative options of providing the same hotel GFA not considered.* Under the Conditions of Sale of the Ma On Shan site, the minimum hotel GFA to be built was 17,600 square metres. The Secretary for Planning, Environment and Lands did not accept the Lands D's suggestion of reverting the whole Ma On Shan site into a residential zone. **However, the Government had not considered other possible options (for example, a comprehensive development of residential and hotel premises) of achieving the Government's objectives of providing the same hotel GFA while getting a higher financial return on the sale of the site.**

Audit recommendations on the sale of the Ma On Shan site by tender

3.38 **Audit has recommended that:**

- **the Administration should inform ExCo of proposals for rezoning sites specifically for a particular type of development, such as for hotels, and the financial implications;**
- **the Administration should always seek ExCo's endorsement for any significant changes in the land disposal policy, such as the introduction of specific zoning of sites for hotel use;**
- **if there are significant changes in the circumstances in which the CSC's decision has been made (such as the changes in the hotel and tourism industry since the CSC's 1995 decision to offer two pilot hotel sites for sale), the responsible policy bureau should make another submission to the CSC for a new direction;**
- **having regard to the change in economic circumstances and market conditions of the hotel industry, the Administration should reassess the need:**
 - (i) **for selling the Tsuen Wan site (see the second inset of paragraph 3.11) as scheduled; and**
 - (ii) **for zoning specifically the other four sites (see paragraphs 3.11 and 3.30 above) identified as potential sites for hotel use; and**
- **the Administration should consider other possible options which will achieve the objectives of providing sufficient hotel GFA and of maximising the Government's revenue.**

Response from the Administration

3.39 The Secretary for Planning, Environment and Lands generally agrees with all the audit recommendations. He has said that:

- (a) it is the responsibility of the relevant policy bureau to inform the CSC of any significant changes in the market sentiment and outlook for a particular industry and to seek the CSC's views on the appropriate strategy for the development of a particular industry;
- (b) the Tsuen Wan site has been put on the Reserve List for 1999-2000 for sale under the Application System. Its sale will be subject to developers' application and offer of an acceptable minimum price. If no application for its sale is received in 1999-2000, the Government will review the proposed use of the site in consultation with the relevant policy bureaux and departments;
- (c) in the context of the submission of the draft Ma On Shan OZP (No. S/MOS/4A) and the draft Tsuen Wan OZP (No. S/TW/10A) to ExCo in October 1997 and September 1999 respectively, ExCo had been informed that the Ma On Shan site and the Tsuen Wan site were zoned specifically for hotel use to help relieve the anticipated shortage of hotel rooms;
- (d) the Government's objective was to zone sites specifically for hotel use with a view to facilitating the hotel/tourist industry. If the Ma On Shan site was considered not appropriate for hotel use, another site would have been identified; and
- (e) residential sites generally attract a higher price. However, zoning of sites for different uses is to achieve the planning objective of providing sufficient land to cater for the various social and economic needs of our community.

3.40 The **Secretary for Economic Services** has said that:

- (a) the VTS and the consultancy study commissioned by a group of hotel owners in Hong Kong pointed to the need for measures to reduce the economic differentials between commercial and hotel developments to ensure that market forces were encouraged to stimulate sufficient investment in hotels;
- (b) as the policy bureau responsible for inbound tourism, the ESB, with the support of the Plan D, put forward the recommendation made by the VTS for the designation of sites specifically for hotel development as one of the measures to address the problem;
- (c) the decision to test the proposal of hotel-specific zoning with two sites was made having balanced various factors in question, including revenue implications arising therefrom and the need to ensure that the tourism industry continues its significant socio-economic contributions to Hong Kong; and
- (d) the question of hotel-specific zoning should be looked at with a long-term view in mind. The market circumstances at the time could be regarded as unprecedented, and it is really a matter for debate whether a scheme intended for addressing long-term industry development needs should be affected by short-term market fluctuation.

3.41 The **Director of Planning** has said that:

- (a) financial implication is one of the considerations in determining whether a site should be zoned specifically for hotel use. Other relevant considerations, such as the contribution of the hotel industry to tourism and the forecast of supply and demand for hotel rooms, should also be taken into account. The Government should not let the short-term financial implications or short-term fluctuation in market conditions override the long-term benefit of providing sufficient hotel rooms at suitable locations to cater for the sustained growth of the tourist industry;
- (b) ExCo is informed of all zoning amendments when OZPs are submitted to it for approval in accordance with the provisions of the Town Planning Ordinance. When the draft Ma On Shan OZP No. S/MOS/4A was submitted to ExCo for approval, details of the Ma On Shan hotel site had been incorporated in the ExCo Memorandum. Indeed, the Lands and Works Subcommittee of ExCo had raised questions on the viability and suitability of the hotel site and had asked for further justifications from the HKTA;
- (c) regarding the audit recommendation that the Administration should reassess the need to zone specifically the other four sites for hotel use, only two of the sites, which are in Hung Hom Bay, are still designated for hotel/service apartment development. The third site (in Sha Tin) will be rezoned for PSPS development. The fourth site, which is in the Central Reclamation, is no longer available as a result of a complete replanning of the whole reclamation area; and
- (d) the various options of encouraging investment in hotels and of achieving the objective of providing sufficient hotel GFA have been considered in detail in the VTS. The Government will continue to liaise closely with the HKTA and other relevant bodies/departments to explore the practicability of such options.

Setting of a reserve price

3.42 In the sale of land by tender, the Director of Lands is required to set up an internal valuation panel to analyse the bids received, work out a fair market value of the site and make recommendations to the CTB on whether the tender should be awarded. The Secretary for the Treasury will, on the advice of the members of the CTB, decide whether a tender should be accepted. However, the Government is not obliged to accept the highest or any tender.

3.43 In the sale of land by public auction, reserve prices are set for the lots to be sold. Prior to the auction date, a committee (Note 21) of the Lands D will meet to determine the starting prices and the reserve prices of the lots to be sold. If the reserve price is not reached at the auction, the lots will be withdrawn.

Note 21: *The committee is chaired by the Deputy Director (Specialist). Its members include the Assistant Director (Valuation), the Assistant Director (Regional), the Chief Estate Surveyor (Valuation) and the Senior Estate Surveyor (Valuation) (Secretary) of the Lands D.*

3.44 Audit observed that no reserve price had been set for the sale of land by tender, such as the sale of the Ma On Shan site, the Kowloon Bay site and the Ap Lei Chau site. However, for the sale of two other sites (the Leighton Hill and the Aldrich Bay sites in April and May 1998 respectively), a reserve price for each site was set in a Valuation Conference (Note 22) held on the closing dates of the tenders.

3.45 In April 1998, in response to the Secretary for Planning, Environment and Lands' enquiry about the fixing of a minimum price, the Director of Lands said that they would continue with the practice of not setting a reserve price for lots which they would, in normal circumstances, have put out to tender. As for the Leighton Hill and the Aldrich Bay sites, reserve prices had been set because the two sites would normally be sold by auction.

Audit observations and recommendation on the setting of a reserve price

3.46 **Audit considers that similar to the practice of the sale of land by auction, the setting of a reserve price in the sale of land by tender is necessary in order to protect the Government's interest.** The Government could consider withdrawing a site if the highest tender price is below the reserve price, as the Government does not bind itself to accept the highest or any tender. It is also the normal practice in the private sector for the seller to set a reserve price. Furthermore, the setting of a reserve price will serve as a good benchmark for subsequent tender analyses. **As mentioned in paragraph 3.44 above, there was inconsistency in the practice of setting a reserve price in the sale of land by tender. The Government set reserve prices for the Leighton Hill site and the Aldrich Bay site but did not do so for other sites, such as the Ma On Shan site, the Kowloon Bay site and the Ap Lei Chau site.**

3.47 **Audit has recommended that the Director of Lands should:**

- **consider always setting a reserve price for the sale of land by tender so as to determine the minimum price acceptable to the Government; and**
- **ensure that full justifications are documented in exceptional circumstances where the setting of a reserve price is considered unnecessary.**

Note 22: *The Valuation Conference was chaired by the Director of Lands. Its members included the Deputy Director (Specialist), the Assistant Director (Valuation) and other responsible officers from the Valuation Section of the Lands D.*

Response from the Administration

3.48 The **Director of Lands** has said that he agrees with the audit recommendation that the Government should consider always setting a reserve price for the sale of land by tender. In fact, the Lands D has been implementing the procedure since the resumption of land sales in April 1999.

3.49 The **Secretary for the Treasury** supports the audit recommendation that a minimum price should be set in all cases of sale of land by tender.

Chronology of key events

The Kowloon Bay site

- February 1997 The District Lands Conference approved the sale of the Kowloon Bay site by tender.
- September 1997 Nine tenders were received upon the tender closing date for the Kowloon Bay site.
- October 1997 Upon the recommendation of the CTB, the Secretary for the Treasury approved the acceptance of the offer from Purchaser A in the sum of \$290 million.
- October 1997 The Director of Lands informed Purchaser A that its tender was accepted and that the deposit of \$20 million had been applied in part payment of the tender price.
- November 1997 Purchaser A requested the District Lands Officer/Kowloon East to postpone execution of the Conditions of Sale and the payment of the balance of the tender price due to difficulty in obtaining bank financing.
- November 1997 At the LAM, members approved the postponement of the execution of the Conditions of Sale and the payment of the balance of the tender price, subject to the payment of interest at 2% above the Best Lending Rate.
- December 1997 The District Lands Officer/Kowloon East informed Purchaser A that the Government had decided to cancel the sale. The Government also reserved the rights to recover all losses and expenses arising out of non-performance of Purchaser A's obligations under the Conditions of Sale.
- January 1998 The LACO considered that there was no legal involvement on the part of the Purchaser A's parent company. Therefore, the parent company had no liability in respect of Purchaser A's failure to complete the sale.

May 1998	Seven tenders were received upon re-tendering of the Kowloon Bay site.
June 1998	Upon the recommendation of the CTB, the Secretary for the Treasury approved the acceptance of the offer from Purchaser C in the sum of \$46.8 million.
July 1998	Purchaser C settled the balance of the tender price.
July 1998	The District Lands Officer/Kowloon East requested Purchaser A to pay the deficiency between the original tender price and the re-tender price and the related interest.
August 1998	The LACO doubted that anything would be achieved by the institution of legal proceedings against Purchaser A as it had a nominal share capital and no landed property in Hong Kong.
November 1998	The Department of Justice considered that in general it might not be worthwhile to institute legal proceedings against newly-formed shelf companies with only a nominal share capital and no landed properties or other properties.
November 1998	The LACO said that no company guarantee or security of any kind had been furnished by Purchaser A's parent company.
February 1999	The LAM agreed that no legal action should be instituted against Purchaser A to recover the liquidated damages suffered by the Government.

Chronology of key events

The Ap Lei Chau site

- August 1996 The District Lands Conference approved the sale by tender of the Ap Lei Chau site for a PSPS development.
- August 1997 Five tenders were received for the tender of the Ap Lei Chau site.
- October 1997 The PSPS Tender Board agreed to award the tender to Purchaser B, the highest tenderer, at a tender price of \$351 million.
- November 1997 Purchaser B suggested to amend Condition 3 of the General Conditions of Sale to provide an option for the balance of the tender price to be withheld by the Purchaser until the units were sold or the local lending rates returned to normal.
- November 1997 The Director of Lands informed Purchaser B that its tender at a tender price of \$351 million in respect of the subject site was accepted.
- November 1997 The Director of Lands informed Purchaser B that the execution of the land grant and payment of the balance of the tender price would be postponed by one month, subject to the payment of interest at 2% above the Best Lending Rate.
- December 1997 The Director of Lands informed Purchaser B that payment of the outstanding amount of the tender price had to be made no later than 19 January 1998 and that the interest on this sum had to be paid by 18 December 1997.
- January 1998 The Director of Lands advised Purchaser B that the sale was cancelled and that the deposit and interest paid were forfeited as it failed to pay the balance of the tender price on the due date.

January 1998	The PSPS Tender Board agreed that the site should be re-tendered.
February 1998	The ICAC advised the Director of Lands that consideration should be given to making it a standard requirement for the purchaser, if it was a subsidiary, to procure a written guarantee from its parent company for the due completion of the development.
March 1998	The LACO (Headquarters) considered that Purchaser B could be sued. However, as Purchaser B had no assets, any judgement obtained would be unenforceable.
May 1998	The LAM agreed that the Government could not effectively pursue any legal action against Purchaser B.
January 1999	The Director of Lands sought the Secretary for the Treasury's authorization to abandon the claim for losses from Purchaser B.
April 1999	The Department of Justice opined that in general it might not be worthwhile to institute legal proceedings against newly-formed shelf companies with only a nominal share capital and with no landed properties or other properties.
April 1999	Approval was given by the Secretary for the Treasury to abandon the claim for losses.

General Condition 3 of the Conditions of Sale of the Kowloon Bay site

General Condition 3 states that:

- “— if the purchaser shall fail to pay the balance of premium, the Government may either enforce or cancel the sale;

- on cancellation, the sum forwarded by the defaulting Purchaser with his tender as a deposit and in part payment of the premium tendered by him shall be wholly forfeited to the Government;

- the Government shall be at liberty to resell the lot at such time and place and in such manner as the Government shall deem fit. All losses and expenses attending a resale or attempted resale shall be made good and paid by the defaulting Purchaser and be recoverable by the Government as liquidated damages. Such losses and expenses include:
 - (i) interest equivalent to two per cent per annum above the Best Lending Rate (hereinafter referred to as “the Agreed Rate”) on the balance of the said premium for the period from the latest date upon which such balance should have been paid up to and including the date upon which the balance of the premium upon a resale is paid;

 - (ii) any deficiency which may result on a resale; and

 - (iii) interest at the Agreed Rate on any such deficiency for the period from the date upon which the balance of the premium upon a resale is paid up to and including the date of payment of the deficiency; and

- any increase of price on a resale shall belong to the Government.”

Chronology of key events

The Ma On Shan site

- September 1969 ExCo was informed that to alleviate the shortage of hotels and to encourage tourism, the Building Authority would grant basement concessions for the construction of bona fide hotels.
- August 1995 The CSC agreed to the recommendation to earmark two sites specifically for hotel development to test the market.
- June 1996 The CPLD agreed to rezone the Ma On Shan site for hotel use.
- August 1997 The Director of Lands asked the Director of Planning to give serious consideration to rezoning the Ma On Shan site for residential rather than hotel development.
- September 1997 The Director of Planning said that such a proposal might arouse criticisms from the public as the site was publicly known for hotel use.
- September 1997 At the meeting of the Lands and Works Subcommittee of ExCo, members expressed reservations on the viability and suitability of the proposed designation of the site for hotel use. However, members agreed that the draft OZP should be approved subject to further justifications for the proposed zoning.
- October 1997 Upon further information submitted by the Plan D and the HKTA, the Chief Executive in Council approved the draft Ma On Shan OZP.
- November 1997 The TPB approved the Lands D's application for permission to include commercial uses in the proposed hotel development.

- December 1997 The Secretary for Planning, Environment and Lands agreed that the Ma On Shan site should be sold by tender.
- February 1998 Two tenders were received in respect of the Ma On Shan site on the tender closing date.
- February 1998 The Director of Lands proposed not to award the tender. He suggested that the zoning of the site should be changed to residential because the market sentiment and outlook for the tourist industry had changed quite dramatically.
- February 1998 The Director of Planning did not agree with the Director of Lands' proposal to rezone the site from hotel use to residential use.
- February 1998 The Secretary for Planning, Environment and Lands concluded that the Director of Lands should submit the tender to the CTB.
- March 1998 The CTB said that the use of the site was not for the CTB to consider. The CTB recommended acceptance of the offer from Purchaser E at \$120 million.
- March 1998 The Director of Lands informed Purchaser E that its tender was accepted.
- March 1998 The Conditions of Sale of the Ma On Shan site were executed and possession of site was given to the grantee.

Appendix E
(paragraph 3.33 refers)

**Audit Consultant's estimate of
the market value of the Ma On Shan site if
it would be developed for residential purposes**

GENERAL INFORMATION

Site area	8,000m ²	Class of site	C
Site coverage entitlement	30.00%	Proposed number of storeys	13
Plot ratio entitlement	5	Interest rate	10.25%
Maximum building height	44.1m	Developer's profit	20.00%
Maximum Gross Floor Area (GFA)	40,000m ²	Professional fees	6.00%
Development period	36 months	Marketing costs	1.00%

VALUATION AS AT 6 FEBRUARY 1998

Development proposal

Use	GFA (m ²)	Car park (no.)	Unit value	Gross Development Value
Residential	29,100	—	\$59,000/m ²	\$1,716.9 million
Private car parking spaces	—	265	\$500,000/no.	\$132.5 million

Gross Development Value **\$1,849.4 million**

Less: development costs **\$620.6 million**

Residual for land value & associated costs, etc. **\$1,228.8 million**

Land value		1.0
Interest on land value	@ 10.25% for development period (36 months)	0.3401
Developer's profit	@ 20% on land value and interest	0.2680
		1.6081

Residual land value (\$1,228.8 million ÷ 1.6081) **\$764 million**

Acronyms and abbreviations

CPLD	Committee on Planning and Land Development
CSC	The Chief Secretary for Administration's Committee
CTB	Central Tender Board
ExCo	Executive Council
ESB	The Economic Services Bureau
GFA	gross floor area
HKTA	Hong Kong Tourist Association
ICAC	Independent Commission Against Corruption
LACO	Legal Advisory and Conveyancing Office
LAM	Land Administration Meeting
Lands D	Lands Department
OZP	Outline Zoning Plan
PELB	The Planning, Environment and Lands Bureau
Plan D	Planning Department
PNAP	Practice Note for Authorized Persons and Registered Structural Engineers
PSPS	Private Sector Participation Scheme
TPB	Town Planning Board
VTS	Visitor and Tourism Study for Hong Kong