

Report No. 47 of the Director of Audit — Chapter 2

ADMINISTRATION OF SHORT TERM TENANCIES

Summary

1. The Lands Department (Lands D) is responsible for managing unleased government land and land held under short term tenancies (STTs). In 2005-06, the Lands D raised \$967 million rental income from the STTs. The Audit Commission (Audit) conducted a review of the Lands D's administration of STTs and found that there were areas for improvement.

Administration of rent arrears

2. ***Need to comply with Standing Accounting Instructions (SAI).*** Audit examination of the Lands D's annual returns of arrears of revenue for the past six years (1999-2000 to 2004-05) revealed that four significant STT rent arrears had not been included in the returns. While the rent arrears in these four cases were not formalised by demand notes, they should have been included in the Lands D's annual returns of arrears of revenue in accordance with SAI 1020. *Audit has recommended that the Director of Lands should comply with SAI 1020 when preparing annual returns of arrears of revenue by including in the returns debts or charges not formalised by demand notes.*

3. ***Need to take prompt action on long outstanding STT rents.*** Audit test check revealed that the Lands D had not taken action to write off four long outstanding STT rent arrears cases despite there were indications that recovery action would not be fruitful. *Audit has recommended that the Director of Lands should conduct a review of the long outstanding cases of rent arrears and take timely write-off action if the Lands D is satisfied that recovery action would be futile.*

4. ***Need to expedite action to implement approved measures.*** The Lands D's rent arrears increased significantly from \$42 million as at 31 March 2004 to \$163 million as at 31 March 2005. The increase was mainly due to rent arrears from five car-park STT cases. Audit examination of these five cases revealed that: (a) once a tenant had commenced legal proceedings against the Government, the Lands D had difficulties in recovering the rent

arrears; and (b) the Lands D had difficulties in repossessing the sites even after the termination of the tenancies because of the ongoing legal proceedings.

5. In 2005, the Lands D carried out a review of the car-park STTs and decided to introduce new measures for managing these STTs. However, up to mid-September 2006, there were still some outstanding measures to be implemented, such as requiring a personal guarantee from a shareholder or a director of the company concerned, adding a new clause in the STT agreement permitting the Government to set off the rent arrears by the deposits held for all other STTs of the same tenant, and requiring a special deposit to ensure the due performance of the tenancy conditions by a tenant where substantial upgrading works are required of the tenant. *Audit has recommended that the Director of Lands should expedite implementation of the outstanding measures for improving the administration of STTs.*

6. ***Need for financial vetting of major car-park STT tenants.*** The financial capability of the major car-park STT tenants to successfully carry out their car-park operations warrants the Lands D's attention because: (a) there could be a significant disruption to the supply of parking spaces if they discontinue their business; and (b) a large amount of government revenue is at stake if they do not pay the STT rents. However, unlike some other government departments, the Lands D does not check whether the tenderers holding a large number of STTs have adequate financial resources to successfully carry out the car-park operations. *Audit has recommended that the Director of Lands should consider introducing procedures for vetting the financial position of major car-park STT tenants before awarding them new car-park STTs.*

7. ***Need for additional control over settlement arrangement.*** Audit noted that the Lands D had not issued internal guidelines on the level of authority that the District Lands Offices (DLOs) should seek before accepting a tenant's settlement proposal or making a counter-offer. This resulted in inconsistent practices among different DLOs. According to Financial Circular No. 6/2000, the authority to write off a loss in excess of \$500,000 is vested with the Secretary for Financial Services and the Treasury. Audit noted in one case that the Lands D had not consulted the Financial Services and the Treasury Bureau before making a counter-offer to the tenant which would involve the waiving of a claim of over \$500,000.

8. *Audit has recommended that the Director of Lands should: (a) prescribe the circumstances under which the DLOs should seek the approval of a Lands D Deputy Director or Land Administration Meeting (LAM) before making a counter-offer to a tenant's settlement proposal; and (b) ensure that the Secretary for Financial Services and the Treasury is consulted before making a counter-offer to a tenant's settlement proposal involving write-off or waiver of revenue of over \$500,000.*

Monitoring of tenants' performance

9. ***Need for timely dissemination of LAM decision.*** The Lands D has laid down a requirement that STT tenders from tenants with tenancy breach records (identified tenants) should be submitted to LAM for review. However, Audit found that, in three cases, the Lands D had not informed the DLOs in time of the latest LAM decisions concerning the identified tenants, and that the DLOs granted three STTs to two identified tenants and a related party without referring the tenders to LAM for review. *Audit has recommended that the Director of Lands should: (a) disseminate LAM decisions to the DLOs on a timely basis; and (b) adopt more efficient methods to disseminate LAM decisions to the DLOs.*

10. ***Need to conduct timely performance reviews.*** In September 2003, LAM decided to adopt a three-month review cycle for the identified tenants. Since then, the Lands D had conducted nine performance reviews. Audit found that there were delays of 28 to 85 days in conducting four of the reviews. *Audit has recommended that the Director of Lands should require the Lands D staff to comply with the three-monthly review requirement stipulated by LAM.*

Enforcement action on unauthorised use of sites for car-park purposes

11. ***Need for guidelines to ensure more effective and consistent enforcement actions.*** Between 2000 and 2002, the Lands D let out three sites by STTs, namely Case 5-1 for the provision of an amusement park, Case 5-2 for constructing and operating a petrol-filling station, and Case 5-3 for operating a plant nursery. In all the three STTs, the Lands D found that the tenants had breached the tenancy conditions by using the sites as fee-paying car parks. Audit examination revealed that, upon finding the tenancy breaches, the DLOs concerned took 19 months in Case 5-1, and 35 months in Case 5-2 to issue notices to terminate the STTs, while the DLO in Case 5-3 only took one month for the action. *Audit has recommended that the Director of Lands should: (a) issue guidelines to DLOs stipulating the types and timing of enforcement actions DLOs should take against tenants in breach of tenancy conditions; and (b) closely monitor DLOs' performance to ensure that they take prompt and effective enforcement actions.*

12. ***Need for more flexible site inspection arrangements.*** Audit examination revealed that the site inspections carried out outside office hours in Case 5-1 were more effective than those carried out during office hours in Case 5-2, for obtaining evidence of the unauthorised use of the sites for car-park purposes. *Audit has recommended that the Director of Lands should issue guidelines requiring DLO staff to conduct site inspections outside office hours, if warranted.*

13. ***Need for proper control over release of rental deposit.*** Audit noted that the Lands D had refunded the deposit in Case 5-2 in full to the tenant without deducting from it the loss of rental income as a result of forfeiture of the STT. *Audit has recommended that the Director of Lands should: (a) remind DLO staff to deduct outstanding debts due to the Government before making a refund of rental deposit to a tenant; and (b) take action to recover the loss of rental income from the tenant of Case 5-2 if the Government is entitled to do so.*

Enforcement action on unauthorised use of site for residential purposes

14. In 1976, a site in Sha Tin was granted by an STT (STT 1) to Company L for the purpose of facilitating the construction of power lines nearby. Subsequently, the site was let mainly for storage purposes through three STTs: (a) STT 2 (in 1979) to Company M; and (b) STT 3 (in 1994) and STT 4 (in 2000) to Tenant A, who had also been the actual user of the site during STT 2. The Lands D found that: (a) during seven site inspections (in respect of STT 2 to STT 4), the tenant had breached the tenancy conditions by using the site for residential purposes; and (b) during six site inspections (in respect of STT 3), the tenant had occupied the adjoining government land without approval.

15. ***Need to take effective enforcement action.*** Audit examination of the enforcement action taken by the Lands D against the STTs in respect of the Sha Tin site revealed that: (a) on one occasion, the Lands D did not issue a warning letter to the tenant upon finding that he had used the site for residential purposes; (b) on three occasions, the Lands D did not request the Housing Department to clear the car-port structure which was found occupying the adjoining government land without approval; (c) on three occasions, the Lands D did not promptly carry out a follow-up inspection after finding that the tenant had breached the tenancy conditions or had occupied government land without approval; (d) on three occasions, the Lands D did not seek advice from the Buildings Department upon finding building structures within the STT premises which might require the Buildings Department's approvals; and (e) except on one occasion, the Lands D did not require the tenant to demolish domestic fixtures found within the STT premises. *Audit has recommended that the Director of Lands should take effective enforcement action against: (a) an STT tenant in breach of tenancy conditions; and (b) unauthorised occupation of government land, such as clearing the occupied site.*

16. ***Need to clarify the Lands Administration Office Instructions.*** According to the Lands Administration Office Instructions, a contentious case should be submitted to the District Lands Conference (DLC) for making a recommendation. In June 1993, the DLO/Shan Tin approved an application for a tenancy transfer (by terminating STT 2 and granting STT 3) to Tenant A who had been the actual user of the STT site. The DLO/Shan Tin did not consider the granting of STT 3 as a contentious case. *Audit has recommended*

that the Director of Lands should clarify the circumstances under which an STT case should be regarded as contentious, requiring a submission to the DLC.

17. ***Need to strengthen STT administration.*** Audit noted that, when granting STT 3 to the tenant in January 1994, the Lands D had not implemented additional measures to ensure that the tenant would not use the site for residential purposes. The Lands D only carried out routine inspections and issued warnings when the site was found being used for residential purposes. Audit examination also revealed that the Lands D's copy of the STT 3 agreement had not been signed by the Government's representative. *Audit has recommended that the Director of Lands should: (a) for an STT tenant who has a past record of tenancy breaches, implement additional measures to deter him from committing similar breaches; (b) for recurring tenancy breaches, consider taking more stringent enforcement action (such as terminating the tenancy) against the tenant; and (c) remind Lands D staff that all STT agreements must be signed by the Government's representative.*

18. ***Lands D's follow-up action.*** In August 2006, the Lands D sought legal advice on the action that the Government could take in respect of the breaches of tenancy conditions of the STTs of the Sha Tin site. *Audit has recommended that the Director of Lands should: (a) take appropriate action based on the legal advice; and (b) conduct a check of other STTs with a view to finding out unauthorised use of the sites and take appropriate action as soon as possible.*

Other enforcement action

19. ***Need to remind staff of the proper handling of Notice-to-quit.*** The purpose of serving a Notice-to-quit is to terminate the tenancy upon its expiry and to demand possession of the site. Audit noted in two cases that the tenants took legal action to challenge the validity of the Notices-to-quit issued by the Lands D, resulting in delays in repossessing the STT sites. Audit found that the issue of the Notice-to-quit in these two cases had not complied with the Lands D's guidelines. *Audit has recommended that the Director of Lands should remind DLO staff handling Notices-to-quit that they should: (a) comply with legal advice in computing the required notice period of a Notice-to-quit; and (b) check that, before issuing an STT rent demand note, the rental period stated in the demand note should not cover any period after the expiry date of a related Notice-to-quit which has been issued.*

20. ***Need to clarify the basis of calculating mesne profits.*** The Government may make a claim for damages (mesne profits) when a tenant remained in possession of an STT site after the expiry of the tenancy against the Government's will. While the Lands D had issued guidelines on handling mesne profits, these guidelines did not state the basis of

calculating such profits. Audit noted in a case that the DLO's calculation of the mesne profits was not consistent with LAM decisions. *Audit has recommended that the Director of Lands should issue guidelines to DLOs to clarify the basis of calculating mesne profits.*

21. ***Need to share tenants' information.*** Apart from the Lands D, the Housing Department, the Government Property Agency and the Leisure and Cultural Services Department also let out properties and sites under their management on a short-term basis. Audit noted that there were no arrangements for sharing information on tenancy breaches among the Lands D and other relevant government departments. *Audit has recommended that the Director of Lands should liaise with relevant government departments to devise suitable arrangements for sharing tenants' information.*

Response from the Administration

22. The Administration has accepted the audit recommendations.

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