

# **CHAPTER 1**

## **Government Property Agency**

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| <p><b>Administration of leased-out<br/>non-domestic government properties</b></p> |
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**Audit Commission  
Hong Kong  
25 October 2007**

*This audit review was carried out under a set of guidelines tabled in the Provisional Legislative Council by the Chairman of the Public Accounts Committee on 11 February 1998. The guidelines were agreed between the Public Accounts Committee and the Director of Audit and accepted by the Government of the Hong Kong Special Administrative Region.*

Report No. 49 of the Director of Audit contains 12 Chapters which are available on our website at <http://www.aud.gov.hk>.

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# ADMINISTRATION OF LEASED-OUT NON-DOMESTIC GOVERNMENT PROPERTIES

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## **PART 1: INTRODUCTION**

1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

### **Background**

1.2 The Government Property Agency (GPA — Note 1) was established in April 1990 to administer and manage efficiently and cost-effectively all government-owned and leased properties. One of its responsibilities is to optimise the utilisation of all surplus government properties with potential for alternative government use or commercialisation. Once a surplus government property is available, the GPA will try to identify alternative government users. Failing this, the GPA will assess the commercial viability of the premises and dispose of those with commercial potential, either through commercial letting or by sale. For premises suitable for commercial letting, the GPA leases out the surplus non-domestic government properties and undertakes tenancy management related work. Surplus government properties suitable for commercial use are leased out at commercial rent. Properties which are considered unsuitable for commercial use may be leased out to voluntary non-government organisations (NGOs) at nominal rent.

1.3 As at 31 March 2007, the GPA administered 1,041 tenancies in respect of non-domestic government properties as follows:

- (a) 557 commercial tenancies (i.e. properties leased out to commercial organisations); and
- (b) 484 NGO tenancies (i.e. properties leased out to voluntary NGOs).

1.4 The rental income from commercial tenancies was \$365 million in 2006-07. Premises let by commercial tenancies include:

- (a) retail outlets (e.g. shops, banks, cafés, kiosks and restaurants);
- (b) space for automatic teller machines and automatic vending machines;

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**Note 1:** *In April 1990, the GPA took over the responsibility for dealing with various aspects of government property matters from the Government Secretariat, the then Buildings and Lands Department, and the Rating and Valuation Department.*

- (c) advertising space in government buildings or premises;
- (d) car parking spaces in government office buildings after office hours, or in government-owned properties;
- (e) government canteens;
- (f) bus regulator's offices and ferry operator's offices; and
- (g) locations for radio base and transmission stations.

1.5 An organisation chart of the GPA is shown in Appendix A. In the GPA, the Site Utilisation Division (SUD) is responsible for administering all commercial and NGO tenancies (with the exception of tenancies of radio base and transmission stations, which are administered by the Property Management Division — PMD). Departmental guidelines are issued through the GPA Manual, Office Instructions and Technical Circulars.

1.6 The GPA uses the following procedures to lease out surplus non-domestic government properties:

- (a) **Open tender.** Properties that are likely to be of general commercial interest are leased out by open tender; and
- (b) **Direct negotiation.** From time to time, the GPA receives requests from commercial operators or other bodies to lease a particular government property for commercial or other use without using open tender. Letting through direct negotiation is undertaken only in exceptional circumstances. Such circumstances include cases where:
  - (i) there is a policy support for the provision of a particular or specified accommodation for a particular service or activity (e.g. use for non-profit-making activities by charitable/non-profit-making organisations with policy support of a policy bureau);
  - (ii) the intended use of the property would be of interest to a single bidder (e.g. bus regulator's offices). A restricted tender exercise may be considered in accordance with the conditions specified in the Stores and Procurement Regulations; and
  - (iii) open public tendering would not be in the public interest.

In all cases, the approval of the Secretary for Financial Services and the Treasury must be obtained before commencement of negotiations.



## **Audit review**

1.7 The Audit Commission (Audit) has carried out a review to examine the economy, efficiency and effectiveness of the GPA in the administration of leased-out non-domestic government properties. The review has focused on the following areas:

- (a) rent in arrears (PART 2);
- (b) enforcement of tender conditions and site inspections (PART 3); and
- (c) collection of management fees and security deposits (PART 4).

1.8 In carrying out the audit review, Audit examined the records and interviewed the staff of the GPA. Audit has found that there are areas where improvements can be made. Audit has made a number of recommendations to address the issues.

## **Acknowledgement**

1.9 Audit would like to acknowledge with gratitude the full cooperation of the staff of the GPA during the course of the audit review.

## **PART 2: RENT IN ARREARS**

2.1 This PART examines the administration of rent in arrears in respect of leased-out non-domestic government properties by the GPA, and suggests measures for improvement.

### **Responsibilities of Controlling Officers**

2.2 According to Standing Accounting Instruction (SAI) 800, Controlling Officers must regularly review the procedures and the activities within their jurisdiction which give rise to revenue due to the Government and satisfy themselves that:

- (a) demand notes for the collection of revenue are issued promptly; and
- (b) if payment is not received within a reasonable time, appropriate follow-up actions are taken to recover the arrears. Such actions include the issue of reminders and taking legal action as appropriate.

### ***Annual return of arrears of revenue***

2.3 SAI 1020 and Treasury Circular Memorandum (TCM) No. 7/2006 state that:

#### ***SAI 1020***

- (a) Controlling Officers are required to produce each year a statement (i.e. annual return of arrears of revenue) of all debts and charges which were due to the Government but were not paid by the last day of the financial year (i.e. 31 March);
- (b) the return should also show which of the debts and charges were still outstanding three months after the financial year end (i.e. 30 June);
- (c) in determining whether a debt or charge is due and payable, it should be noted that:
  - (i) if a demand note has been raised, the due date of the debt or charge is the date specified in the demand note; and
  - (ii) in all other cases, a debt or charge is normally due as it arises, even though it has not been formalised by way of a demand note;

- (d) all debts and charges should be included in the return unless they are cancelled or written off;
- (e) accounts under dispute should be regarded as arrears but shown separately in the return; and

***TCM No. 7/2006***

- (f) the return should include debts and charges:
  - (i) covered by demand notes issued under the General Demand Note System (GDNS);
  - (ii) covered by demand notes issued outside the GDNS; and
  - (iii) not covered by any demand notes (e.g. by letter).

***The GPA's annual return of arrears of revenue***

2.4 For the purpose of preparing the annual return of arrears of revenue, Controlling Officers are required to report the arrears under individual Revenue Heads. The GPA has reported rent in arrears (Note 2) under Revenue Head 7 (Properties and investments) of the General Revenue Account (Note 3). Revenue collected by the GPA under Revenue Head 7 in 2006-07 is shown in Figure 1.

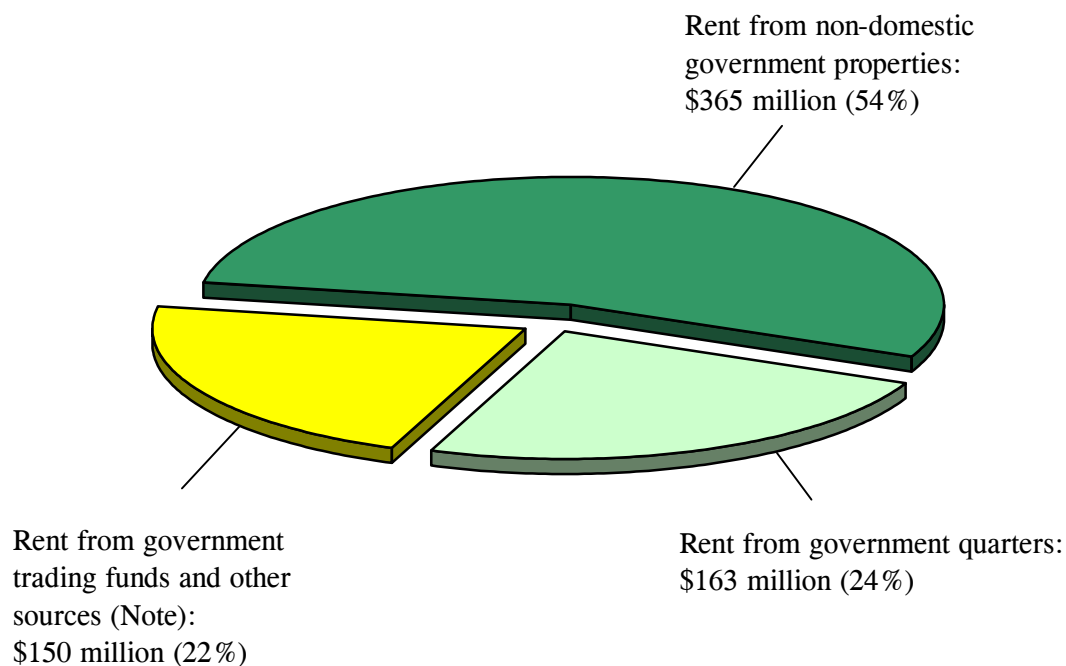
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**Note 2:** *In this report, unless otherwise specified, rent in arrears refers to outstanding commercial tenancies rent and accrued interest for late payments, and amounts due to the Government.*

**Note 3:** *Revenue Head 7 includes the GPA's other revenue items (such as rent from government quarters, government trading funds and overseas properties).*

**Figure 1**

**Revenue collected by the GPA under Revenue Head 7  
(2006-07)**



*Source: GPA records*

*Note: The government trading funds are the Companies Registry Trading Fund, the Electrical and Mechanical Services Trading Fund, the Land Registry Trading Fund, the Office of the Telecommunications Authority Trading Fund and the Post Office Trading Fund. Other sources include rent from overseas properties and car parking spaces of \$7 million (1%).*

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## Audit observations

### *Need to comply with Treasury requirements*

2.5 Audit review of the annual return of arrears of revenue for 2005-06 indicated that the return had not been properly prepared in accordance with SAI 1020 and TCM No. 7/2006. The GPA did not include all the outstanding claims not covered by demand notes in its return of arrears of revenue for 2005-06. Outstanding claims such as commercial tenancies rent and accrued interest for late payments, mesne profits, judgement debts, damages for rental loss and reinstatement costs for the premises, for which demand notes had not been issued, were not included in the return.

2.6 In May 2007, in response to audit enquiries, the GPA informed Audit that owing to a misunderstanding of the information sought in TCM No. 7/2006, only debts to be recovered by instalments were included under “debts and charges raised other than in the form of a demand note” in the return of arrears of revenue for 2005-06. The GPA would ensure compliance with SAI 1020 and the relevant TCM in preparing the 2006-07 return of arrears of revenue.

2.7 The inclusion of debts or charges not covered by demand notes in the GPA’s 2006-07 return of arrears of revenue significantly increased the amount of arrears of revenue from \$52 million as at 31 March 2006 to \$132 million as at 31 March 2007. Debts or charges not covered by demand notes accounted for 66% of the total arrears of revenue as at 31 March 2007.

2.8 The objectives of SAI 1020 are to help enhance control and accountability of outstanding debts and charges due to the Government and improve monitoring of the recovery of debts. **Accurate and complete financial data are essential for control and management information purposes. The GPA needs to comply with SAI 1020 and the relevant TCM by including all outstanding debts or charges in its annual return of arrears of revenue.**

### *Need to take prompt action on long outstanding rent in arrears*

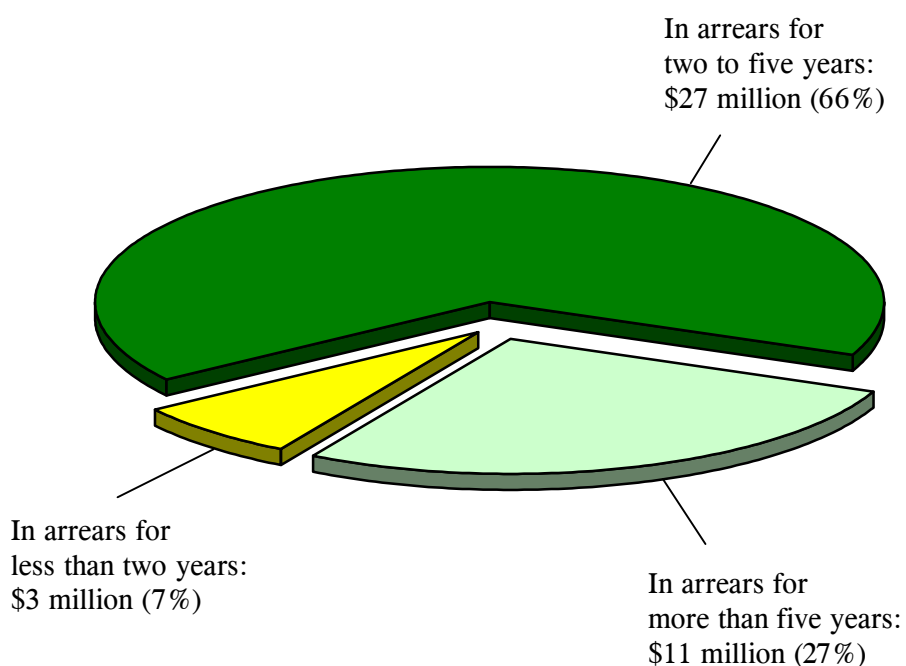
2.9 Under the GDNS, as at 31 March 2007, the total rent in arrears was \$41 million (Note 4), of which rent in arrears totalling \$11 million was overdue for more than five years. Details are shown in Figure 2.

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**Note 4:** *This amount was based on data in the GDNS (i.e. excluding the amounts covered by demand notes issued outside the GDNS, and the amounts not covered by any demand notes).*

**Figure 2**

**Rent in arrears under the GDNS  
(31 March 2007)**



*Source: Audit analysis of GPA demand notes issued under the GDNS*

*Remarks: Amounts (i.e. commercial tenancies rent and accrued interest for late payments, mesne profits, judgement debts, damages for rental loss and reinstatement costs for the premises) in arrears for more than two years, including amounts not covered by demand notes issued under the GDNS, were \$107 million (89%) as at 31 March 2007.*

2.10 Audit test check of eight major rent-in-arrears cases (i.e. outstanding rent of more than \$1 million as at 31 March 2006) revealed that the recovery actions for two long outstanding cases (i.e. Case 1 and Case 2) would unlikely be fruitful. However, up to 30 June 2007, action to write off the amounts involved including rent in arrears for these two cases was still in progress. Details are shown in Table 1 and Table 2.

**Table 1****Recovery actions for the long outstanding rent in Case 1  
(up to 30 June 2007)**

**Periods of outstanding rent:** August 1998 to February 1999, January 2000, and May 2000 to January 2001

**Amount involved including rent in arrears:** \$5.2 million

**Particulars:**

- (a) In March 2004, the Department of Justice (D of J) advised the GPA that:
  - (i) the liquidator had been released in May 2003 and there was no further dividend available for distribution; and
  - (ii) the GPA might wish to write off the judgement debts and interest if there was no prospect of recovery by other means.
- (b) In July 2004, the GPA requested the D of J to provide the documents showing the judgement debts and interest due to the GPA. There was an inadvertent delay in responding to the GPA's request.
- (c) In January 2007, the D of J forwarded to the GPA copies of documents (including the writ of summons issued on 24 October 2000, the final and interlocutory judgement dated 4 May 2001 and the winding-up order dated 17 July 2002).
- (d) In June 2007, the D of J provided the GPA with a detailed breakdown of the judgement debts and interest.

*Source: GPA records*

**Table 2**  
**Recovery actions for the long outstanding rent in Case 2**  
**(up to 30 June 2007)**

**Period of outstanding rent:** January to December 2003

**Amount involved including rent in arrears:** \$4.4 million

**Particulars:**

- (a) In March 2004, the D of J informed the GPA that the winding-up petition would be issued in a few days. The D of J also advised the GPA that:
  - (i) the tenant was a small trading company with no assets and it was unlikely that there would be any dividend to creditors;
  - (ii) it could take a long time for the liquidator to confirm whether there would be any dividend payable to the creditors;
  - (iii) in the circumstances, the most likely outcome was that the debt would have to be written off; and
  - (iv) the GPA might wish to consider at what point it would begin taking steps to write off the debt.
- (b) In September 2004, the D of J advised the GPA that a winding-up order against the tenant had been filed in August 2004.
- (c) In May 2005, the D of J advised the GPA that there was no further action for the D of J in regard to the winding-up proceedings. In December 2005, the D of J advised the GPA that provisional liquidators were appointed.
- (d) In March 2006, the D of J advised the GPA that the liquidator had indicated that the possibility of any dividend available for distribution to general creditors was remote.
- (e) On 4 April 2006, the GPA informed the D of J that it would:
  - (i) propose to write off the debt as soon as possible if the D of J had no other views; and
  - (ii) proceed to write off the debt accordingly if it did not hear from the D of J within two weeks.
- (f) In June 2006, the GPA requested the D of J to give a reply to its memo dated 4 April 2006.
- (g) In August 2006, the D of J advised the GPA that according to the liquidator, the liquidation would be concluded by the end of 2006 and that the GPA might consider writing off the debt after conclusion of the liquidation.

*Source: GPA records*



2.11 In September 2007, in response to audit enquiries, the GPA informed Audit that:

- (a) in Case 1, notwithstanding that the liquidator had confirmed that no dividend was available for distribution, the GPA could not commence write-off actions until after the receipt of the relevant documents, such as a detailed breakdown of the judgement debts from the D of J. On 29 January 2007, the D of J provided the judgement and relevant documents to the GPA. On 14 June 2007, the D of J provided the GPA with a detailed breakdown of the judgement debts and interest. With the detailed breakdown, the GPA was in a position to complete the write-off submission which would be ready soon; and
- (b) in Case 2, the GPA accepted the D of J's advice and waited for the conclusion of the liquidation. In response to the GPA's enquiries, the D of J advised that the liquidation was still in progress. All along, the GPA had been taking proper follow-up action in accordance with the advice of the D of J.

### **Audit recommendations**

2.12 **Audit has recommended that the Government Property Administrator should:**

- (a) **comply with SAI 1020 and the relevant TCM when preparing the annual return of arrears of revenue by ensuring that all outstanding debts or charges not covered by demand notes are included in the return;**
- (b) **in consultation with the Director of Accounting Services, issue departmental guidelines on the circumstances under which outstanding debts or charges are required to be included in the annual return of arrears of revenue; and**
- (c) **continue to review the long outstanding cases of rent in arrears and take timely write-off action.**

### **Response from the Administration**

2.13 The **Government Property Administrator** accepts the audit recommendations. He has said that:

- (a) the GPA has compiled the annual return of arrears of revenue for 2006-07 in accordance with SAI 1020 and the relevant TCM by including debts or charges not covered by demand notes in the return. The GPA will continue to comply with SAI 1020 and the relevant TCM when preparing the annual return of arrears of revenue;

- (b) the GPA, in consultation with the Treasury, has issued departmental guidelines on reporting outstanding debts and charges in the annual return of arrears of revenue;
- (c) although not all outstanding debts and charges were included in compiling the annual return of arrears of revenue for 2005-06, the GPA had been closely monitoring the arrears cases and followed up all the outstanding claims, including those not reported in the annual return of arrears of revenue for 2005-06. On the other hand, the GPA has been preparing quarterly reports on major arrears cases since September 2004 as part of the GPA's management information system for divisions to closely monitor the progress of arrears cases and for the senior management's information and periodic review of progress on arrears cases in accordance with SAI 1025; and
- (d) the GPA will continue to take follow-up actions on rent-in-arrears cases and closely monitor their progress. It is the GPA's established practice to review all outstanding cases of rent in arrears regularly and take timely action to write off the amount for cases where all exhaustive actions have been taken and concluded. In future, the GPA will work closely with the D of J in ensuring the early completion of action on write-off cases.

2.14 The **Director of Administration and Development, Department of Justice** has said that:

- (a) in Case 1, due to an inadvertent delay, the judgement was provided to the GPA in January 2007. The D of J is investigating the circumstances leading to the delay and would ensure that its internal system will be tight enough to prevent recurrence of incidents of similar nature; and
- (b) the D of J acts for the GPA to take the necessary actions to recover the rent in arrears and advises the GPA on the merits of individual cases. The advice of the D of J on the likelihood of recovery is one but may not be the only consideration to be taken into account by the GPA. It is for the GPA to determine if and when it is appropriate to write off any outstanding rent in arrears. As in Case 2, the GPA could have proceeded to write off the debt when it did not hear from the D of J within two weeks of 4 April 2006 (see (e)(ii) of Table 2 in para. 2.10).

## Measures to improve the recovery of rent in arrears

### *Procedures for recovering rent in arrears*

2.15 Prior to October 2003, the SUD did not have any documented procedures for the recovery of rent in arrears. According to the arrears control procedures of October 2003, the SUD would terminate tenancy on the 90th day after the due date for the payment of rent and refer the case to the D of J for legal action. In July 2005, the procedures for recovering rent in arrears, based on the procedures of the Acquisition, Allocation and Disposal Division (Note 5), were issued to the GPA staff and these procedures were included in the SUD Office Instructions in October 2005 as follows:

- (a) ***Issue of first reminder.*** On the 16th day after the due date, the case officer issues the first reminder to the tenant, asking for payment within 7 days;
- (b) ***Issue of second reminder.*** On the 35th day after the due date, the second reminder is issued;
- (c) ***Issue of warning letters.*** On the 48th day after the due date, a warning letter is issued to the tenant. The tenant is warned that if he does not make payment within 7 days, the GPA will repossess the property;
- (d) ***Referral for legal action.*** On the 60th day after the due date, the case officer refers the case to an appointed solicitor or the D of J for legal action;
- (e) ***Termination of tenancy.*** On the 90th day after the due date, the tenancy should be terminated by the appointed solicitor or the D of J;
- (f) ***Institution of court proceedings to recover possession of premises.*** If the tenant has not delivered up vacant possession of the premises after the termination of the tenancy, the appointed solicitor or the D of J will be instructed to institute court proceedings to recover possession (see para. 2.16); and
- (g) ***Write-off of debt.*** After reasonable actions have been taken and there is no prospect of recovery of the arrears, the GPA may write off the debt in accordance with Financial Circular No. 6/2000.

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**Note 5:** *The Acquisition, Allocation and Disposal Division is responsible for, among other things, the disposal of surplus government quarters by leasing or sale.*

2.16 The time frame for key recovery actions after the first due date for the payment of outstanding rent is summarised in Table 3.

**Table 3**

**Time frame for key recovery actions**

| <b>Action</b>                       | <b>Time specified in the<br/>SUD Office Instructions<br/>(Days)</b> |
|-------------------------------------|---|
| Referring the case for legal action | 60  |
| Termination of tenancy              | 90  |
| Filing of writ of summons           | 120   |
| Recovering possession of premises   | 180   |

*Source: GPA records*

2.17 According to the GPA, the time frame after termination of tenancy is only indicative for the staff to plan ahead for the recovery of possession of premises. The actual time for recovery depends on the time taken by the legal proceedings, which is out of the control of the GPA. However, in some cases, actions may not be completed within the time specified. For example, where a court order after a hearing is required before possession can be recovered, it will be unreasonable to expect a recovery of the possession of premises within 60 days from the filing of the writ.

**Audit observations**

2.18 Audit checked the eight major rent-in-arrears cases mentioned in paragraph 2.10. The tenancies of these eight major cases were terminated and the GPA recovered possession of the premises before March 2004. The results of an audit analysis of the time taken by the GPA in recovering rent in arrears in these eight major cases are summarised in Table 4.

Table 4

## Time taken in recovering rent in arrears

| Action                              | Range of actual time taken<br>(Days) |
|-------------------------------------|--------------------------------------|
| Referring the case for legal action | 65 to 355                            |
| Termination of tenancy              | 77 to 765                            |
| Filing of writ of summons           | 133 to 815                           |
| Recovering possession of premises   | 122 to 997                           |

*Source: Audit analysis of GPA records*

Details of the eight major cases are shown in Appendix B. The long time taken by the GPA in recovering rent in arrears for these eight major cases was unsatisfactory. **Audit considers that the GPA needs to monitor closely the efficiency and effectiveness of the recovery of rent in arrears, after the issue of the procedures for recovering rent in arrears in July 2005 (see para. 2.15).**

*Need to take early repossession of government properties*

2.19 According to the standard tenancy agreement of the GPA, in case rent or any part of it is in arrears and unpaid for 21 days, it shall be lawful for the landlord at any time thereafter to re-enter upon the premises and the tenancy shall be terminated. Hence, at the earliest, the GPA may initiate actions to recover possession of leased-out government property 21 days after rent is overdue.

2.20 In September 2007, in response to audit enquiries, the GPA informed Audit that:

- (a) the standard condition provided the Government with the legal right to terminate the tenancy with immediate effect;
- (b) according to the SUD Office Instruction (see para. 2.15), if a tenant failed to settle rent in arrears after 60 days, the case would be referred to the appointed solicitor or the D of J for legal action. The tenant would be expected to settle the outstanding rent upon receipt of the demand letter issued by the appointed solicitor or the D of J; and

- (c) if the tenant failed to make payment after 90 days, the tenancy would be terminated. As it was the practice of the GPA to demand a deposit equivalent to three-months' rent, the rental loss to the Government should be adequately covered by the deposit even if the tenant failed to fully settle the arrears.

2.21 Before the issue of the procedures for recovering rent in arrears in July 2005, the GPA took 122 to 997 days (see Table 4) to recover possession of government properties. **In Audit's view, the amount of rent in arrears may be reduced if the GPA takes action to recover possession of a government property earlier. The GPA needs to recover possession of leased-out government properties as early as possible in warranted cases.**

*Need to consider negotiating for early termination of tenancy*

2.22 Audit noted that in Case 3 (see Appendix B), in June 2002, the tenant proposed to have an early termination of the tenancy. The GPA informed the tenant that there was no provision under the agreement to do so and rejected this proposal. When the GPA informed the D of J on 5 July 2002 that the tenant had asked for an early termination of the tenancy on 31 July 2002, the D of J advised the GPA that:

- (a) a tenancy agreement could always be dissolved by mutual agreement notwithstanding that there was no provision in the agreement itself;
- (b) dissolving the tenancy agreement would not prejudice the GPA's right to recover outstanding rent in arrears and other charges;
- (c) if the GPA chose to terminate the tenancy by mutual agreement, the GPA could find a new tenant and let the property out again as soon as possible to mitigate loss of rental income; and
- (d) the GPA might claim loss of rental income for the remaining term of the tenancy.

2.23 On 13 July 2002, the GPA informed the D of J that it had tried to contact the tenant by phone and left a voice mail but no response was received from the tenant, and the on-site property management team observed that there was no evidence of any moving out action being taken by the tenant. The GPA considered that the tenant did not show any interest in negotiation or vacating the premises, and requested the D of J to initiate legal action. Termination notice was served by the D of J on 17 July 2002. The tenant refused to deliver up vacant possession of the premises and made a counter-claim against the Government. In March 2003, the tenant delivered up vacant possession of the premises by returning the keys to the GPA. In early April 2003, the GPA advertised in the newspapers to invite interested parties to submit applications for leasing the premises up to 31 December 2003. No application was received.

2.24 In Audit's view, to mitigate loss of rental income, the GPA needs to consider negotiating with the tenant who proposes to have an early termination of the tenancy in warranted cases. As negotiations may lead to accepting a sum smaller than the amount of unpaid rent for the remaining period of a fixed tenancy, there is a need for the GPA, in consultation with the Financial Services and the Treasury Bureau (FSTB), to issue instructions to advise GPA staff the circumstances under which they may negotiate with the tenant for early termination of the tenancy.

*Need to conduct cost and benefit analysis*

2.25 Audit noted that winding-up proceedings had been instituted against the defaulting tenants in all the eight major rent-in-arrears cases. However, up to 30 June 2007, the GPA did not receive any dividend from these winding-up proceedings.

2.26 Audit test check of the eight major arrears cases revealed that the institution of winding-up proceedings against the defaulting tenants for recovering rent in arrears was not cost-effective. Details are as follows:

- (a) **Case 2.** In March 2004, the D of J advised the GPA that as the tenant was a small trading company with no assets, it was unlikely that there would be any dividend payable to the creditors. The D of J also advised the GPA that it could take a long time for the liquidator to confirm whether there would be any dividend payable to the creditors. The GPA instructed the D of J to proceed with the winding-up proceedings and a winding-up order was filed in August 2004. As at 30 June 2007, the GPA was still awaiting the advice from the liquidator; and
- (b) **Case 3.** The tenant was a company registered outside Hong Kong. In June 2004, the D of J advised the GPA that the next step was to put the tenant into liquidation. In March 2005, an overseas law firm was appointed by the D of J to commence winding-up proceedings against the tenant. In December 2005, the D of J informed the GPA that the law firm had advised that it was not cost-effective to pursue the winding-up proceedings. The D of J suggested the GPA write off the debt because there was no information that the tenant had any assets. In April 2006, the GPA sought approval from the FSTB to write off the outstanding debt due by the tenant. In July 2006, the FSTB approved the write-off of \$2.8 million.

2.27 Where the chances of recovering debts from a defaulting tenant are slim (e.g. the defaulting tenants do not have any assets similar to Cases 2 and 3), it may not be worthwhile for the GPA to institute winding-up proceedings. In Audit's view, similar to Case 3, the GPA should consider following the D of J's advice and be

**selective in instituting winding-up proceedings against defaulting tenants. To facilitate making an informed decision on whether to take further legal actions, the GPA needs to conduct a cost and benefit analysis before instituting winding-up proceedings against the defaulting tenants.**

*Need to safeguard the Government's interest*

2.28 According to the standard tenancy agreement of the GPA, a tenant is required to deposit with the GPA on execution of the agreement a sum equivalent to three months' rent as security for the due payment of rent, rates and other charges, and the due performance and observance by the tenant of the conditions in the agreement. In case the GPA exercises its right to recover possession of the property by reason of default, on the part of the tenant, in payment of rent and rates, or in performance or observance of the conditions in the agreement, the deposit shall be forfeited.

2.29 **Prior to the issue of the procedures for recovering rent in arrears in July 2005, the GPA took 77 to 765 days (see Table 4) to terminate the tenancies in the default cases. In Audit's view, the GPA needs to consider reviewing the level of security deposit required for cases with a high risk of default.**

2.30 Audit noted that, at a meeting held in April 2007 between the GPA and the D of J concerning recovery of rent in arrears, the D of J suggested the GPA consider obtaining personal guarantee from the directors of the corporation tenants in appropriate cases.

**Audit recommendations**

2.31 **Audit has recommended that the Government Property Administrator should consider:**

- (a) **recovering possession of leased-out government properties as early as possible in warranted cases;**
- (b) **negotiating with defaulting tenants for early termination of tenancy in warranted cases and, in consultation with the Secretary for Financial Services and the Treasury, issuing instructions to advise GPA staff the circumstances under which they may do so;**
- (c) **conducting cost and benefit analysis before instituting winding-up proceedings against defaulting tenants;**



- (d) **reviewing the level of security deposit required for cases with a high risk of default; and**
- (e) **obtaining personal guarantee from the directors of corporation tenants.**

### **Response from the Administration**

2.32 The **Government Property Administrator** generally accepts the audit recommendations. He has said that:

- (a) it is always the GPA's aim to recover possession of leased-out premises from defaulting tenants as early as possible. The GPA has implemented tightened procedures with a view to bringing early legal action against defaulting tenants in respect of rent in arrears and recovering possession;
- (b) in very exceptional circumstances, the GPA will consider, in consultation with the FSTB, financial proposals on early termination put up by a tenant. However, such cases can only be considered on an individual basis. The GPA considers that as a matter of principle, negotiating early termination of tenancy with the tenant is against the spirit of contract and will instil an unwarranted expectation among tenants of government properties that they are not required to fulfil the obligations of the terms and conditions of tenancy agreements;
- (c) he will continue to seek the advice of the D of J regarding whether it is worth pursuing winding-up proceedings. In pursuing winding-up action, the GPA has been acting in compliance with Accounting Circular No. 1/2005, which stipulates that Controlling Officers should consider writing off the arrears only after all exhaustive actions to recover the arrears have failed. In practical terms, he finds it extremely difficult to conduct a cost and benefit analysis before instituting winding-up proceedings against defaulting tenants. This is because the debtors' assets available for the Government's recovery action are unknown before instituting winding-up proceedings;
- (d) the GPA will continue to appraise the situation regularly to see if there is any category of cases that warrants higher deposits. It is the GPA's practice to impose a higher level of deposit on a case-by-case basis. There are currently no defaulting cases falling within the same category which warrants the imposition of higher deposit for all cases falling within any particular category; and
- (e) the GPA accepts the audit recommendation to consider obtaining personal guarantee from the directors of corporation tenants in appropriate cases, but considers that personal guarantee may not be applicable to all corporation tenants (such as banks or listed companies).

### **PART 3: ENFORCEMENT OF TENDER CONDITIONS AND SITE INSPECTIONS**

3.1 This PART examines the enforcement of tender conditions and site inspections of commercial and NGO tenancies in respect of leased-out non-domestic government properties by the GPA, and suggests measures for improvement.

#### **Tender conditions**

3.2 According to the standard tender notice of the GPA, within seven days of being called upon by the GPA, a successful tenderer shall sign or execute the tenancy agreement and pay to the Government the first month's rent due under the tenancy agreement. Subject to the due signing or execution of the tenancy agreement and to the payment of the first month's rent, possession of the premises is given to the successful tenderer within three months of the date on which the tenancy agreement is signed or executed.

#### **Audit observations**

##### *Payment of the first month's rent by cheque*

3.3 Audit found that, in Case 4 (see para. 3.4), the successful tenderer was allowed to take possession of the government premises before the cheque for the payment of the first month's rent was cleared.

3.4 **Case 4.** On 27 March 2006, Company A, the successful tenderer, returned to the GPA the executed tenancy agreement together with a copy of the receipted demand note for the first month's rent. On 28 March 2006, the GPA gave possession of the premises to Company A. The cheque issued by Company A was dishonoured. The case officer was informed that the dishonoured cheque was made good on 3 April 2006 (**i.e. one week after giving possession of the premises to Company A**). A chronology of the key events of this case is shown in Appendix C.

3.5 **In Audit's view, the GPA needs to ensure that the cheque for the payment of the first month's rent is cleared before giving possession of government premises to the successful tenderer.**

*Need to review the processing and checking procedures*

3.6 Audit noted that in Case 4, it had taken almost four months to secure the proper signing or execution of the tenancy agreement by the tenant. The Legal Advisory Division advised the case officer on 12 April 2006 that the tenancy agreement had not been properly executed by Company A. After a number of submissions and clarifications by Company A, the tenancy agreement was duly executed on 18 July 2006.

3.7 In September 2007, in response to audit enquiries, the GPA informed Audit that it was not unusual for successful tenderers to take a couple of rounds to comply with the legal formalities in full and very often the legal irregularities found were very minor (e.g. copies of documents provided had not been certified and signatures were put in the wrong places). Whilst these irregularities might be minor, they took time to be rectified.

3.8 From the management point of view, the GPA needs to advise the successful tenderer, in advance, the proper procedures for signing and executing tenancy agreement and the documents required to be submitted together with the signed tenancy agreement. **Audit considers that the GPA needs to critically review the processing procedures in order to avoid irregularities in the execution of tenancy agreements by the successful tenderers.**

**Audit recommendations**

3.9 **Audit has recommended that the Government Property Administrator should:**

- (a) **ensure that the cheque for the payment of the first month's rent is cleared before giving possession of government premises to the successful tenderer; and**
- (b) **critically review the procedures in processing tenancy agreements and provide the successful tenderers with checklists and guidelines to expedite the due signing or execution of tenancy agreements.**

**Response from the Administration**

3.10 The **Government Property Administrator** accepts the audit recommendations. He has said that:

- (a) in all tender cases, the GPA will not give possession of government premises until after the cheque for the payment of the first month's rent is cleared; and

- (b) although it is incumbent upon the successful tenderer to complete his part of the tenancy agreement for its proper execution, simple guidelines have already been set out in the covering letter sent to him. The GPA is prepared to consider providing more detailed checklists and guidelines to expedite the due signing or execution of tenancy agreement by the successful tenderer.

### **Sharing of tenants' information**

3.11 Apart from the GPA, the Housing Department, the Lands Department (Lands D) and the Leisure and Cultural Services Department (LCSD) also let out properties and sites under their management on a short-term basis. For example, the LCSD lets out car-park facilities within sports compounds and the Lands D lets out government sites.

3.12 Audit examination revealed that the directors and shareholders of an ex-tenant were also the directors and shareholders of the company holding Tenancy H (see Appendix B). Furthermore, one of the directors of these two companies was also the director of a company with unsatisfactory performance in a number of short-term tenancies (STTs) reported in Chapter 2 "Administration of short term tenancies" of Report No. 47 of the Director of Audit.

### **Audit observations**

#### ***Need to develop a system for monitoring tenants' performance***

3.13 In the GPA's tender notice, the GPA has provided for the disclosure of tenderers' information to other government departments, as follows:

*"The information collected by means of this Form will be used and may be disclosed to other government departments for the purpose of processing this tender."*

According to the GPA, the above provision is only applicable for processing the related tender, and the provision does not allow the GPA to disclose the tenderer's information to other government departments for other purposes.

3.14 The GPA has not adopted any system for monitoring the tenants' performance. Audit notes that in the Lands D's tender notice, the tenderers are informed that their performance as the Government's tenants will be considered in the award of tenders, as follows:

*“The Government will consider the past or current performance of the tenderers as tenants of the Government both in examining any tender submitted and in deciding whether to award the tender.”*

3.15 Audit notes that in the administration of STTs, the Lands D has since 2002 introduced measures for monitoring tenants’ performance. For example, for STT tenants with records of tenancy breaches, the Lands D would consider whether new STTs would be awarded to them on a case-by-case basis. The Lands D would apply the assessment procedure to tenders from companies with substantially the same directors or shareholders as the tenants. The Lands D would conduct company searches. If the tenderers were limited companies, the Lands D would require them to submit details of their directors and shareholders.

3.16 In view of repeated breaches of tenancy conditions by a number of companies (see para. 3.12), it may be worthwhile to share tenants’ information among relevant government departments. By doing so:

- (a) the departments could take into consideration the tenants’ unsatisfactory past performance in other government tenancies in assessing their tenders; and
- (b) tenants may be prompted to perform well in all tenancies granted by relevant government departments.

3.17 **Audit considers that the GPA needs to develop a system for monitoring the performance of tenants. The GPA needs to liaise with relevant government departments with a view to making arrangements for sharing of tenants’ information among them.**

### **Audit recommendations**

3.18 **Audit has recommended that the Government Property Administrator should:**

- (a) **develop a system for monitoring the performance of tenants; and**
- (b) **in consultation with the Director of Administration and Development, Department of Justice, liaise with relevant government departments with a view to making arrangements for sharing of tenants’ information among them.**

## Response from the Administration

3.19 The **Government Property Administrator** agrees that a system of monitoring the performance of tenants may assist the Government in screening out undesirable tenants. He has said that:

- (a) the GPA considers that the application of such a system has to be carefully appraised and will examine how to develop such a system and its application; and
- (b) subject to the advice given by the D of J, the GPA has no objection to introducing suitable arrangements for sharing tenants' information with relevant government departments. In response to the Lands D's enquiry in September 2006 to take on board the audit recommendation (i.e. Chapter 2 "Administration of short term tenancies" of Report No. 47 of the Director of Audit) of sharing information amongst departments, the GPA has already informed the Lands D of its willingness to take part in the discussion.

## Site inspections

3.20 Site inspections are conducted to ensure that there is no breach of or failure on the tenants' part to observe any of the tenancy terms and conditions. In September 2004, the Independent Commission Against Corruption, in the Assignment Report "Leasing out Government Properties" on the GPA, made the following recommendations on site inspections:

- (a) an inspection checklist should be designed for use by GPA officers so that site inspections could be properly documented;
- (b) site inspections should be based on risk management so that tenants with poor compliance records would be inspected more frequently. Alternatively, the GPA should consider setting up an ad hoc independent team to conduct site inspections on all these premises periodically; and
- (c) the GPA should provide a summary of tenancy conditions to the property management agents (PMAs — Note 6) to facilitate their site inspections and enforcement.

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**Note 6:** *Since 2001, the GPA has devolved its day-to-day property management functions of government joint-user buildings and government wholly-owned staff quarters to PMAs through the award of property management contracts.*

### *Routine site inspections*

3.21 Before November 2005, site inspections were not conducted by the GPA on a routine basis and there was no proper documentation. In November 2005, the SUD promulgated office instructions on conducting routine site inspection of leased-out government properties. For leased-out government properties not managed by the PMAs, the GPA should arrange in-house staff to conduct at least one routine site inspection of these properties at an interval of two years and complete an inspection checklist after the inspection. The inspection checklist specifies that the following major items should be checked during routine site inspections:

- (a) subletting and change to permitted use and boundary of the premises;
- (b) change to the name of the shop;
- (c) unauthorised structural alteration to the premises;
- (d) obstruction to common area or nuisance caused by the tenant; and
- (e) breach of other tenancy conditions.

3.22 For leased-out government properties managed by the PMAs, the PMAs are required to record any obvious breach of the tenancy conditions during their daily inspections of the common areas of the buildings concerned and report the details to the SUD within three working days. To facilitate the PMAs to carry out internal inspection work, the GPA provides a summary of tenancy conditions with a plan delineating the boundary of the concerned property to the PMAs. The PMAs need to submit a return at an interval of two years to the SUD on their site inspection findings.

3.23 The GPA conducts routine site inspections of premises to ensure their proper use by the NGOs. The GPA Manual requires the GPA staff to review NGO tenancies annually with sponsoring policy bureaux or departments to ensure that the continual occupation of the premises by the NGOs for the approved purposes is warranted.

### *Non-routine site inspections*

3.24 The SUD conducts non-routine site inspections either by its staff or through the PMAs:

- (a) before commercial letting of government properties for deciding on the appropriate trade;

- (b) upon handing-over of the premises to the successful tenderer;
- (c) when considering locking up the premises, if there is no prospect of commercial use. The physical condition of the building and the requirements for restoring it to usable condition would be surveyed; and
- (d) upon receiving complaints from the public or referrals from other government departments and the PMAs in relation to the operation of the tenancies, Notices-to-quit, requests for early termination/extension/renewal of tenancy and proposed change of use, and reprovisioning requests of NGOs.

According to the GPA, inspections before letting or pre-tender site inspections are conducted 9 to 12 months before expiry of the existing tenancies which are normally of a term of three years. Since May 2007, pre-tender site inspections have been treated as routine site inspections. In addition to identifying issues which may affect the next tender and assessing the business potential for the next tender, the inspectors take note of the performance of the current tenant including whether there is any change in user, subletting, structural alteration/additions, and repair and maintenance.

### ***Inspection arrangement***

3.25 The SUD has three teams of technical officers. One team (comprising one Senior Survey Officer, two Survey Officers and one Valuation Officer) is responsible for, among other things, site inspection for NGO and commercial tenancies granted by direct negotiation. The other two teams (comprising one Senior Survey Officer, one Senior Valuation Officer and five Survey Officers) are responsible for, among other things, site inspection for commercial tenancies leased out by tender.

### **Audit observations**

#### ***Number of routine site inspections conducted***

3.26 The GPA keeps proper control records of routine site inspection for NGO tenancies but does not keep similar records of routine site inspections of non-domestic government properties leased out by tender. In May 2007, in response to audit enquiries, the GPA provided the information shown in Table 5 to Audit.



Table 5

**Routine site inspections  
(November 2005 to March 2007)**

|   | Commercial tenancies | NGO tenancies | Total      |
|---|----------------------|---------------|------------|
| (A) Number of inspections conducted by the GPA                          | 24                   | 53            | 77         |
| (B) Number of inspections conducted by PMAs                             | 0                    | 0             | 0          |
| (C) Total   | <b>24</b>            | <b>53</b>     | <b>77</b>  |
| (D) Number of tenancies as at 31 March 2007                             | <b>270</b> (Note)    | <b>484</b>    | <b>754</b> |
| (E) Percentage of tenancies inspected<br>$\frac{(C)}{(D)} \times 100\%$ | <b>9%</b>            | <b>11%</b>    | <b>10%</b> |

Source: GPA records

Note: The commercial tenancies excluded 52 tenancies of canteens managed by other government departments and tenancies administered by the PMD.

3.27 According to the GPA, up to 31 August 2007, the total number of site inspections conducted for all tenancies (including pre-tender site inspections conducted since May 2007) was 146 (i.e. 19% of the total 754 tenancies). The number of site inspections conducted for tendered commercial tenancies was 61 (i.e. 58% of the total 106 tendered commercial tenancies).

***Need to ensure compliance with the Office Instructions***

3.28 According to the SUD Office Instructions promulgated in November 2005, at least one routine site inspection of every leased-out government property should be conducted in every two years. However, during the 17-month period from November 2005 to March 2007, the percentage of the number of routine site inspections to the number of tenancies was only 10% (i.e. 9% for commercial tenancies and 11% for NGO tenancies). **Audit considers that the GPA needs to maintain proper control records of routine site inspections and take action to ensure compliance with the SUD Office Instructions (i.e. conducting at least one routine site inspection of every leased-out government property at an interval of two years).**

*Need to monitor the progress of routine site inspections*

3.29 The progress in achieving the targeted frequency of routine site inspections had been far from satisfactory. According to the GPA records, all the 77 routine site inspections were conducted by the team responsible for NGO tenancies and commercial tenancies granted by direct negotiation. No routine site inspection had been conducted by the other two teams and the PMAs up to 31 March 2007. **Audit considers that the GPA needs to introduce a control mechanism to closely monitor the progress and clear the backlog of routine site inspections.**

*Need to document non-routine site inspections*

3.30 The GPA does not keep proper control records of non-routine site inspections of leased-out non-domestic government properties under the circumstances mentioned in paragraph 3.24. In June 2007, the GPA informed Audit that, based on the number of tenders processed by the SUD during the period from November 2005 to March 2007, the SUD had conducted at least 76 pre-tender non-routine site inspections during the same period. However, records of these 76 pre-tender non-routine site inspections could not be produced for audit examination. **Audit considers that the GPA needs to maintain proper control records of non-routine site inspections, and prepare inspection reports for control purpose and for taking appropriate follow-up action.**

**Audit recommendations**

3.31 **Audit has recommended that the Government Property Administrator should:**

- (a) **draw up site inspection programmes and deploy adequate staff resources to ensure compliance with the SUD Office Instructions of conducting at least one routine site inspection of every leased-out government property at an interval of two years;**
- (b) **introduce a control mechanism to closely monitor the progress and clear the backlog of routine site inspections;**
- (c) **maintain proper control records of routine and non-routine site inspections;  
and**
- (d) **prepare inspection reports for all non-routine site inspections for control purpose and for taking appropriate follow-up action.**

## Response from the Administration

3.32 The **Government Property Administrator** accepts the audit recommendations. He has said that:

- (a) the GPA will complete site inspections of all tendered commercial tenancies by November 2007 in compliance with the SUD Office Instructions. In respect of the non-tender cases, the GPA will draw up an inspection programme having regard to the staff resources available;
- (b) since 30 August 2007, a register has been introduced to record the number of routine and non-routine site inspections to monitor the progress of site inspections;
- (c) formal handover receipt showing the conditions of the premises signed by the tenant will continue to be recorded in minute form in individual files;
- (d) investigation report will continue to be prepared in minute form stating clearly the findings of the site inspection and seeking approval before locking up unusable premises;
- (e) investigation report will continue to be prepared in minute form recording the findings of investigations into complaints or referrals from other government departments or the PMAs to facilitate a decision on the follow-up actions; and
- (f) with the newly introduced register together with the findings recorded on file, the GPA considers that there are sufficient records for control purpose and as evidence for taking appropriate follow-up action.

## **PART 4: COLLECTION OF MANAGEMENT FEES AND SECURITY DEPOSITS**

4.1 This PART examines the collection of management fees and security deposits from tenants of leased-out non-domestic government properties by the GPA, and suggests measures for improvement.

### **Management fees**

4.2 According to the standard tenancy agreement of the GPA, tenants are required to pay management fees based on their tenancy areas. Management fees are charged to recover the costs incurred by the Government to meet the expenses for managing and maintaining the common areas and facilities of government properties. In April 2007, the GPA collected management fees from the tenants of 93 commercial tenancies and 38 NGO tenancies in respect of non-domestic government properties (Note 7). The amount of management fees collected by the GPA was \$10.4 million in 2006-07.

### ***Internal review of management fees***

4.3 In January 2005, the GPA completed an internal review of the control mechanism on the determination and review of management fees for leased-out government properties. The review found that there was a lack of a common and coordinated approach to determining and reviewing management fees. In March 2005, the GPA set up a working group (Note 8) with the following terms of reference:

- (a) to devise a common and coordinated approach to the setting and review of management fees; and
- (b) to consider and advise on issues relating to the determination and review of management fees.

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**Note 7:** *Management fees are not applicable to radio base and transmission stations, advertising sites, car parks and bus regulator's offices because tenants do not use the common facilities of the buildings/properties.*

**Note 8:** *The Deputy Government Property Administrator is the Chairman of the working group and representatives of the functional divisions of the GPA are members of the working group.*

4.4 In November 2005, a sub-working group reported to the working group that it had assessed management fees on five government quarters buildings and four government joint-user buildings on the basis of full-cost recovery. It found that the assessed management fees of the government joint-user buildings, computed under the full-cost recovery approach, were higher than the management fees imposed. The sub-working group invited the working group to consider:

- (a) whether the determination of management fees should proceed on the basis of full-cost recovery; and
- (b) whether other options, such as market comparable approach and Standard Accommodation Cost Table (Note 9) rate approach, should be adopted to assess management fees.

4.5 In May 2007, in response to audit enquiries, the GPA informed Audit that it had studied the review report of the sub-working group on management fees. The GPA considered that:

- (a) management fees represented only part of the tenants' financial obligation under tenancy agreements;
- (b) it was inappropriate to isolate management fee from the tenancy for consideration on its own. It was necessary to consider related factors that were connected with each other under the tenancy;
- (c) while emphasis had been tilted towards the costing side, some views in the report might be prone to further debate. For example, in a case of leased-out premises situated at the basement level next to the ramp leading to the car-park entrance (i.e. Tenancy Q in Appendix D), the tenant was during day-to-day operation receiving a minimal level of common services and facilities of the building. It was inappropriate to apportion the costs of managing and maintaining the common areas for charging management fee on the leased-out premises situated at the basement level; and

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**Note 9:** *The Standard Accommodation Cost Tables, issued by the Director of Accounting Services, set out the standard accommodation rates for bureaux and departments to calculate the accommodation costs for government-owned premises.*

- (d) it was premature to draw a conclusion on the proposals of the review report. The GPA had instructed the members of the working group to revisit the subject matter in greater breadth and depth aiming at a fair, reasonable, cost-effective and sustainable approach, having regard to relevant factors including cost-recovery principle, marketability of the property portfolio and trade practice for leasing of properties.

4.6 Audit noted that, up to 31 July 2007, the working group had not made a decision on the internal review of management fees. In September 2007, in response to further audit enquiries, the GPA informed Audit that:

- (a) the setting and review of management fees for lettings in government-owned properties managed by the GPA followed the established practices. The lack of a common approach to the charging of management fees over the past decade was historical. Coupled with the various forms of lettings (e.g. commercial, radio base stations and NGO) and different origins (e.g. some lettings were inherited from other departments when the GPA was formed in 1990) handled by three different functional divisions within the GPA, the many types of government properties involved, the review of management fees was essentially complex and delicate, calling for careful and thorough deliberations; and
- (b) the apparent lack of dedicated management input to the review was partly due to other more pressing commitments. Moreover, while the proposed rationalisation exercise was not expected to result in any gain or loss in revenue, the review was a resource intensive exercise for members of the working group who had already been loaded with other competing priorities. Therefore, the GPA did not give a high priority to the review.

#### *Cost components and review cycle*

4.7 It is stated in the GPA Manual (issued in January 2007) that the PMD, in consultation with the Architectural Services Department and the Electrical and Mechanical Services Department, is responsible for advising on management fees in respect of government properties. According to the GPA Manual, the following cost components should be used for assessing management fees:

- (a) building maintenance expenses;
- (b) electrical and mechanical operation and maintenance expenses;
- (c) electricity charges;

- (d) building management expenses; and
- (e) administrative overheads.

In addition, the SUD is required to review management fees annually.

## **Audit observations**

### *Undercharging of management fees*

4.8 Audit test check of management fee assessments on the tenants of four major government joint-user buildings in Wanchai (i.e. the Wanchai Tower, the Immigration Tower and the Revenue Tower in respect of commercial tenancies, and the Southorn Centre in respect of NGO tenancies) revealed that:

- (a) GPA administrative overheads had not been included as a cost component for assessing management fees for all tenancies, notwithstanding that administrative overheads was a cost component specified in the GPA Manual; and
- (b) while the GPA included the costs of building maintenance, electrical and mechanical maintenance and electricity for the common area in its management fee assessment for the Revenue Tower, such costs were not included in the management fee assessments for some tenancies in the Immigration Tower and the Wanchai Tower. Details are shown in Appendix D. This indicated that management fees on some tenants of the Immigration Tower and the Wanchai Tower had been undercharged.

4.9 In September 2007, in response to audit enquiries, the GPA informed Audit that:

- (a) as commercial tenancies were granted by the GPA to private tenants by open tender and only the highest conforming offer was accepted, there was no question of loss of revenue to the Government. When submitting the tendered sum, the tenderers had considered all the items of expenses including the amount of management fee set out in the tender document in their entirety. If the management fee was set at a relatively high level, the amount of rent offered would be reduced, and vice versa. The overall revenue received by the Government remained the same;
- (b) the existing PMA cost covered a full range of building management services some of which did not bring direct benefit to the leased-out properties. As far as management of the leased-out premises was concerned, administrative overheads could be deemed to be reflected in the PMA cost;

- (c) the GPA was leasing out many types of government properties ranging from office unit, shop, car park to storeroom, automatic teller machines site, bus regulator's office, radio base and transmission station, advertising station and standalone building. Given the different occupation modes and use of each type of property within the same building, individual tenants were actually enjoying different levels of property management services and common facilities of the building. It was unfair to require a tenant to share the cost for certain services which brought no benefit to its occupation of the property; and
- (d) the 'cost component' approach based on full-cost recovery was only one of the options considered and was not final. The GPA would explore other rationalisation options (e.g. the 'market comparable' approach).

### *Review of management fees*

4.10 **Audit notes that, according to the tender notice, management fees may be revised from time to time by the landlord in accordance with the clause of the tenancy agreement. In November 2005, the sub-working group submitted its report. Audit considers that the working group for the review of management fees needs to expedite action to finalise its review. The GPA also needs to include all the cost components stated in its Manual in assessing management fees on tenants of government joint-user buildings and rectify the problem of undercharging of management fees as soon as possible.**

### **Audit recommendations**

4.11 **Audit has *recommended* that the Government Property Administrator should:**

- (a) **urge the working group responsible for reviewing the management fees to expedite action to finalise the review;**
- (b) **take into account all relevant cost components, including GPA administrative overheads on the PMAs, in the assessments of management fees; and**
- (c) **review all management fee assessments to ensure that there is no undercharging of management fees.**



## Response from the Administration

4.12 The **Government Property Administrator** accepts the audit recommendations. He has said that:

- (a) the working group is currently revisiting the subject matter and the GPA will endeavour to focus its effort on the subject with a view to identifying and developing a viable and cost-effective option as soon as possible;
- (b) the administrative overheads as described in the GPA Manual are not clear and need further elaboration. This aspect of the Manual is also under review and will be fine-tuned to reflect the actual situation of leased-out properties; and
- (c) the GPA agrees that in principle there should be no undercharging of management fees. However, the GPA must have regard to the trade practice in setting management fees for commercial tenancies.

## Security deposits

4.13 As mentioned in paragraph 2.28, security deposits are collected to safeguard the Government's interest in case of default by tenants. It is important to ensure that the amount of security deposits is adequate for the intended purposes.

## Audit observations

### *Need to adjust the amount of security deposits*

4.14 Audit reviewed the level of security deposits of the commercial tenancies in respect of non-domestic government properties. Audit found that, in a number of cases, the amount of security deposits was less than the monthly rent or three months' rent. Details are shown in Appendix E.

4.15 The seven cases in Appendix E show that the shortfall of the amount of security deposits is \$1.4 million, based on the security deposits of three months' rent. Audit noted that, in six out of the seven cases, the security deposits had not been increased correspondingly upon revising the monthly rent. **Audit considers that the GPA needs to adjust the amount of security deposits upon the revision of the monthly rent in order to safeguard the Government's interests.**

### **Audit recommendation**

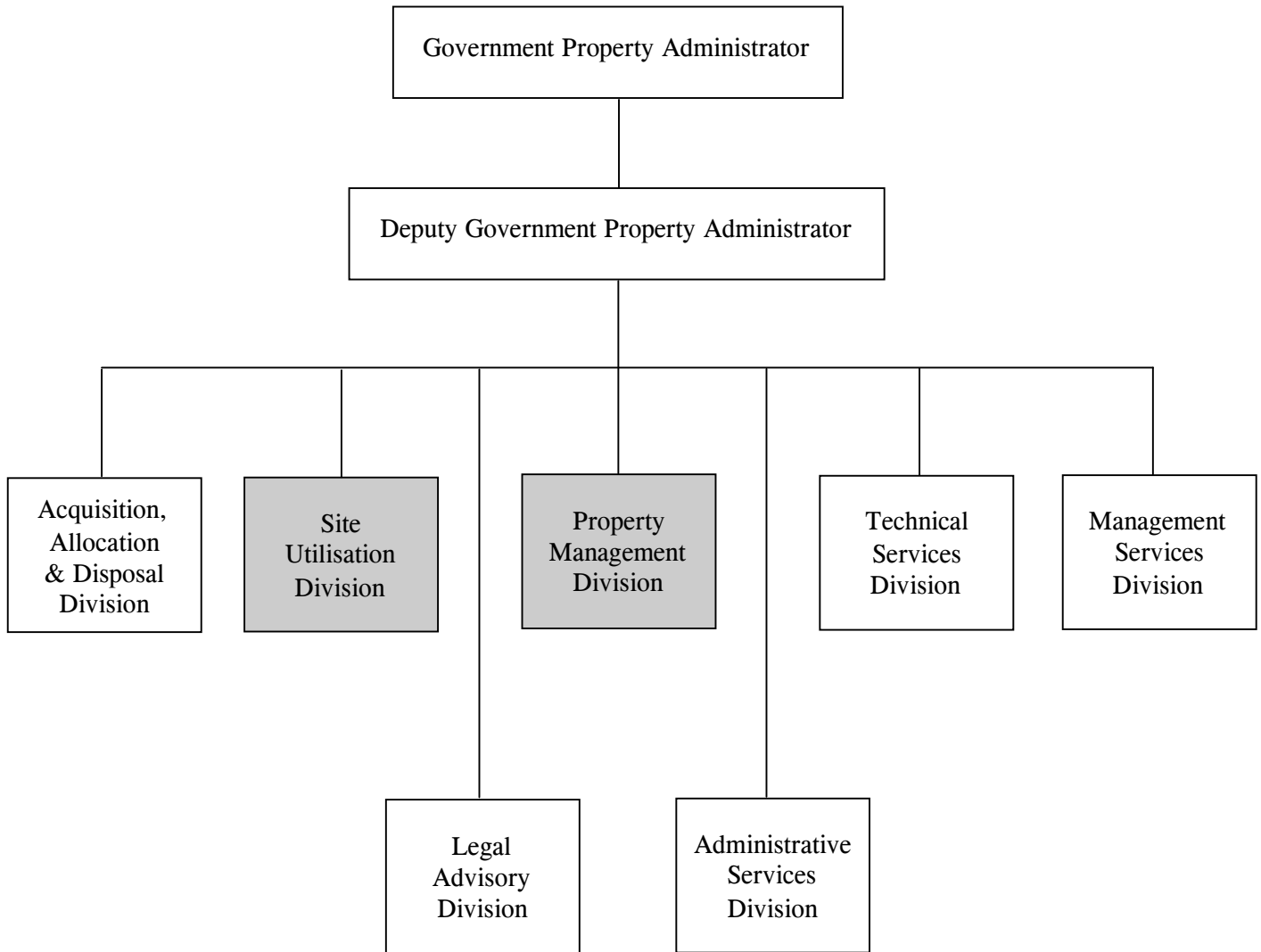
4.16 **Audit has *recommended* that the Government Property Administrator should adjust the amount of security deposits of commercial tenancies in respect of non-domestic government properties upon the revision of the monthly rent.**


### **Response from the Administration**

4.17 The **Government Property Administrator** agrees with the audit recommendation that the level of the security deposits should be adjusted upon the variation of the monthly rent in order to protect the Government's interests. He has said that:

- (a) Tenancy X of Appendix E had already expired and the new tenancy agreement of the same premises had already imposed a deposit equivalent to three months' rent; and
- (b) for the remaining cases, the GPA will adjust the security deposits as recommended upon the next round of revision of the monthly rent.

**Organisation chart of the Government Property Agency**



Legend:  Divisions responsible for administering all commercial and NGO tenancies

Source: GPA records

**Analysis of time taken to recover rent in arrears**

| Tenancy reference<br>(Note 1) | Period of outstanding rent   | Amount involved including rent in arrears as at 31.3.2006<br>(Note 2)<br>(\$ million) | Time taken for referring the case for legal action | Time taken for termination of tenancy | Time taken for filing of writ of summons | Time taken for recovering possession of premises |
|-------------------------------|------------------------------|---|--|---------------------------------------|--|--|
|                               |                              |   | (Days – Note 3)                                    |                                       |  |  |
| A                             | 8/1998 – 1/2001<br>(Note 4)  | 5.2   | <b>355</b>   | <b>765</b>                            | <b>815</b>                               | 902  |
| B                             | 1/2003 – 12/2003             | 4.4   | 79   | 364                                   | 397                                      | 364  |
| C                             | 5/2002 – 3/2003              | 2.5   | <b>65</b>  | <b>77</b>                             | 138                                      | 309  |
| D                             | 2/2001 – 10/2003             | 8.2   | 97   | 228                                   | 264                                      | <b>997</b>                                       |
| E                             | 9/2001 – 12/2002             | 18.9  | 137  | 189                                   | 220                                      | 468  |
| F                             | 7/2002 – 10/2002             | 54.1  | 80   | 122                                   | <b>133</b>                               | <b>122</b>                                       |
| G                             | 11/2002 – 12/2003            | 8.7   | 81   | 140                                   | 175                                      | 457  |
| H                             | 4/2003 – 12/2003<br>(Note 5) | 2.7   | 123  | 274                                   | 442                                      | 275  |
|                               | <b>Total</b>                 | <b><u>104.7</u></b>   |  |                                       |  |  |
|                               |                              | <b>Range</b>  | <b>65 to 355</b>                                   | <b>77 to 765</b>                      | <b>133 to 815</b>                        | <b>122 to 997</b>                                |

*Source: Audit analysis of GPA records*

*Note 1: Tenancies A, B and C refer to Case 1, Case 2 and Case 3 respectively.*

*Note 2: These amounts include the outstanding claims not covered by demand notes.*

*Note 3: Days refer to the number of days after the first due date for the payment of outstanding rent.*

*Note 4: The periods of rent in arrears were August 1998 to February 1999, January 2000 and May 2000 to January 2001.*

*Note 5: The periods of rent in arrears were April, June and August to December 2003.*

**Chronology of key events of Case 4**

|                    |  |
|--------------------|--|
| 14 March 2006      | The Government Logistics Department Tender Board approved the letting of the government premises to Company A.   |
| 17 March 2006      | The GPA forwarded the tenancy agreement and a demand note to Company A.  |
| 27 March 2006      | Company A forwarded to the GPA the executed tenancy agreement and a copy of the receipted demand note for the first month's rent. The Treasury subsequently found that the cheque issued by Company A was a dishonoured cheque.  |
| 28 March 2006      | Company A acknowledged possession of the premises by providing the GPA with a signed possession certificate. The tenancy's commencement date was 29 March 2006.  |
| 3 April 2006       | The case officer sought advice from the Legal Advisory Division on whether the tenancy agreement had been properly executed by Company A.<br><br>Company A made good the cheque.   |
| 12 April 2006      | The case officer was advised by the Legal Advisory Division that the tenancy agreement had not been properly executed by Company A.  |
| 19 April 2006      | The GPA advised Company A that the tenancy agreement could not be executed and requested Company A to provide the necessary documents within 2 weeks.  |
| 26 April 2006      | The Finance Section sought advice from the case officer of this case if interest should be charged against the late payment for the period between the due date and 3 April 2006, and be reflected in the rental demand notes for the subsequent months.   |
| 24 May 2006        | The GPA received the executed tenancy agreement from Company A.  |
| June and July 2006 | Company A rectified all deficiencies (e.g. the signatory of the tenancy agreement was not the person authorised by Company A's board resolution and one of the directors present at the board meeting was not included in the Annual Returns submitted to the Companies Registry) identified by the GPA. |
| 18 July 2006       | The tenancy agreement was duly executed.   |

*Source: GPA records*

**Cost components used in assessment of management fees**

| Tenancy reference            | Location          | Cost component      |                      |                                     |                             |                              |
|------------------------------|-------------------|---------------------|----------------------|-------------------------------------|-----------------------------|------------------------------|
|                              |                   | Building management | Building maintenance | Electrical & mechanical maintenance | Electricity for common area | GPA administrative overheads |
| <b>Commercial tenancies:</b> |                   |                     |                      |                                     |                             |                              |
| I                            | Immigration Tower | Yes                 | Yes                  | Yes                                 | Yes                         | No                           |
| J                            | Immigration Tower | Yes                 | No                   | No                                  | No                          | No                           |
| K                            | Immigration Tower | Yes                 | No                   | No                                  | No                          | No                           |
| L                            | Immigration Tower | Yes                 | Yes                  | Yes                                 | Yes                         | No                           |
| M                            | Revenue Tower     | Yes                 | Yes                  | Yes                                 | Yes                         | No                           |
| N                            | Revenue Tower     | Yes                 | Yes                  | Yes                                 | Yes                         | No                           |
| O                            | Revenue Tower     | Yes                 | Yes                  | Yes                                 | Yes                         | No                           |
| P                            | Wanchai Tower     | Yes                 | No                   | No                                  | No                          | No                           |
| Q                            | Wanchai Tower     | Yes                 | No                   | No                                  | No                          | No                           |
| <b>NGO tenancies:</b>        |                   |                     |                      |                                     |                             |                              |
| 11 NGO tenancies             | Southern Centre   | Yes                 | Yes                  | Yes                                 | Yes                         | No                           |

Source: GPA records

**Appendix E**  
(paras. 4.14, 4.15  
and 4.17(a) refer)

**Cases of insufficient security deposits**

| <b>Tenancy<br/>reference</b> | <b>Security deposits<br/>(Note 1)</b> | <b>Monthly rent</b>   | <b>Shortfall<br/>(Notes 2 and 3)</b> |                     |
|------------------------------|---------------------------------------|-----------------------|--------------------------------------|---------------------|
|                              | (\$)                                  | (\$)                  | (\$)                                 | (Percentage)        |
| R                            | 11,400                                | 12,780                | 26,940                               | 70.3%               |
| S                            | 10,200                                | 13,330                | 29,790                               | 74.5%               |
| T                            | 33,000                                | 36,500                | 76,500                               | 69.9%               |
| U                            | 12,300                                | 41,400                | 111,900                              | 90.1%               |
| V                            | 94,500                                | 159,000               | 382,500                              | 80.2%               |
| W                            | 114,150                               | 215,400               | 532,050                              | 82.3%               |
| X                            | 150,000                               | 130,000               | 240,000                              | 61.5%               |
| <b>Total</b>                 | <b><u>425,550</u></b>                 | <b><u>608,410</u></b> | <b><u>1,399,680</u></b>              | <b><u>76.7%</u></b> |

*Source: Audit analysis of GPA records*

*Note 1: All security deposits collected by the GPA are equivalent to the amount of three months' rent at the commencement of tenancy.*

*Note 2: The shortfall of the amount of security deposits is equal to the amount of three months' rent minus the amount of security deposits.*

*Note 3: The percentage of shortfall of the amount of security deposits is equal to:*

$$\frac{\text{Shortfall of the amount of security deposits}}{\text{Amount of three months' rent}} \times 100\%$$

**Acronyms and abbreviations**

|         |  |
|---------|--|
| Audit   | Audit Commission                           |
| D of J  | Department of Justice                      |
| FSTB    | Financial Services and the Treasury Bureau |
| GDNS    | General Demand Note System                 |
| GPA     | Government Property Agency                 |
| Lands D | Lands Department                           |
| LCSD    | Leisure and Cultural Services Department   |
| NGO     | Non-government organisation                |
| PMA     | Property management agent                  |
| PMD     | Property Management Division               |
| SAI     | Standing Accounting Instruction            |
| STT     | Short-term tenancy                         |
| SUD     | Site Utilisation Division                  |
| TCM     | Treasury Circular Memorandum               |