

Report No. 49 of the Director of Audit — Chapter 1

ADMINISTRATION OF LEASED-OUT NON-DOMESTIC GOVERNMENT PROPERTIES

Summary

1. The Government Property Agency (GPA) is responsible for, among other things, optimising the utilisation of all surplus government properties with potential for alternative government use or commercialisation. Surplus non-domestic 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. As at 31 March 2007, the GPA administered 557 commercial tenancies and 484 NGO tenancies of non-domestic government properties. The rental income from commercial tenancies was \$365 million in 2006-07.

Rent in arrears

2. *Compliance with Treasury requirements.* 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 Standing Accounting Instruction (SAI) 1020 and Treasury Circular Memorandum (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. *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; and (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.*

3. *Need to take prompt action on long outstanding rent in arrears.* Audit test check of eight major rent-in-arrears cases revealed that the recovery actions for two long outstanding cases would unlikely be fruitful. *Audit has recommended that the Government Property Administrator should continue to review the long outstanding cases of rent in arrears and take timely write-off action.*

4. ***Measures to improve the recovery of rent in arrears.*** The long time taken by the GPA in recovering rent in arrears, totalling \$104.7 million as at 31 March 2006, for the eight major cases was unsatisfactory. Audit analysis of these eight cases revealed that: (a) the GPA took 77 to 765 days to terminate the tenancies, and 122 to 997 days to recover possession of government properties; (b) the GPA rejected the proposal of a tenant to have an early termination of the tenancy; and (c) the institution of winding-up proceedings against the defaulting tenants for recovering rent in arrears was not cost-effective and, up to 30 June 2007, the GPA did not receive any dividend from these winding-up proceedings. *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.*

Enforcement of tender conditions and site inspections

5. ***Payment of the first month's rent by cheque.*** Audit found that, in one case, 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. *Audit has recommended that the Government Property Administrator should 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.*

6. ***Need to review the processing and checking procedures.*** Audit noted that, in the case mentioned in paragraph 5, it had taken almost four months to secure the proper signing or execution of the tenancy agreement by the tenant. 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 has recommended that the Government Property Administrator should 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.*

7. ***System for monitoring tenants' performance.*** Apart from the GPA, the Housing Department, the Lands Department and the Leisure and Cultural Services Department also let out properties and sites under their management on a short-term basis. Audit notes that the GPA has not adopted any system for monitoring the tenants' performance. The GPA needs to liaise with relevant government departments for sharing of

tenants' information among them. *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.*

8. **Site inspections.** 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 November 2005, the Site Utilisation Division (SUD) promulgated office instructions on conducting routine site inspection of leased-out government properties. For leased-out government properties not managed by the property management agents (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 SUD conducts non-routine site inspections either by its staff or through the PMAs.

9. **Compliance with the Office Instructions and monitoring of the progress of routine site inspections.** The GPA target was that at least one routine site inspection should be carried out in every two years. Audit noted that, 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%. *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; and (b) introduce a control mechanism to closely monitor the progress and clear the backlog of routine site inspections.*

10. **Documentation of site inspections.** Audit noted that the GPA did not keep proper control records of: (a) routine site inspections of non-domestic government properties leased out by tender; and (b) non-routine site inspections of leased-out non-domestic government properties. Furthermore, records of pre-tender non-routine site inspections could not be produced for audit examination. *Audit has recommended that the Government Property Administrator should: (a) maintain proper control records of routine and non-routine site inspections; and (b) prepare inspection reports for all non-routine site inspections for control purpose and for taking appropriate follow-up action.*

Collection of management fees and security deposits

11. **Internal review of management fees.** In January 2005, the GPA 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 to devise a common

and coordinated approach to the setting and review of management fees, and to consider and advise on issues relating to the determination and review of management fees. In November 2005, a sub-working group reported to the working group that the assessed management fees of four government joint-user buildings, computed under the full-cost recovery approach, were higher than the management fees imposed. Audit noted that, up to 31 July 2007, the working group had not made a decision on the internal review of management fees. *Audit has recommended that the Government Property Administrator should urge the working group responsible for reviewing the management fees to expedite action to finalise the review.*

12. ***Undercharging of management fees.*** Audit test check of management fee assessments on the tenants of four major government joint-user buildings in Wanchai 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 assessment of management fee 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. *Audit has recommended that the Government Property Administrator should: (a) take into account all relevant cost components, including GPA administrative overheads on the PMAs, in the assessments of management fees; and (b) review all management fee assessments to ensure that there is no undercharging of management fees.*

13. ***Need to adjust the amount of security deposits.*** Audit reviewed the level of security deposits of the commercial tenancies in respect of non-domestic government properties. Audit found that, in six out of seven cases selected for audit examination, the security deposits had not been increased correspondingly upon increasing the monthly rent. *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

14. The Administration generally agrees with the audit recommendations.

November 2007