Resuming Land Sales by Application List Good for the Market

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The Government's announcement of resuming land sales heralds the comeback of land market in Hong Kong. It should be considered as a welcoming move as it signifies the Government's intention to embrace free market principle in the land market.

A market-led land sales mechanism

We have seen two land sale moratoriums since the property crash in 1997. The first one was imposed in June 1998 for a period of nine months. The current one commenced in November 2002.

The Application List system was introduced to the market in April 1999 after the end of the first moratorium. Interested developers must first make an application for a lot in the Application List to the Government with an offer price and initial deposit. If the offer is accepted, the lot is then put into an open auction.

The system is generally regarded as a market-led, fair and transparent land sale mechanism

Debunk market myth

Government land sales by auction and tender in recent years have not been the major source of residential land supply. According to the estimates made by the Lands Department, the number of private flats that can be produced through auction and tender sites was 2,515 for the fiscal year 2002/03 and 2,130 for 2001/02, accounting for about 12% and 8% of the estimated total flat production for the respective years.

The majority of residential units supply came from lease modifications/land exchanges and private treaty grants. For example, the MTRC development projects are disposed through private treaty grant. It is estimated that about 20,000 private residential units were generated from the MTRC projects in the past five years.

Notwithstanding this, land auction plays an important role in giving land prices information to the market and driving sentiment in property market. The response of developers and the transaction prices have been widely taken by the market as indications for future property price movement.

With the Application List system in place, instances that would have damaging knock-on effects on the market, such as lower-than-expected auction prices or site withdrawals due to lack of interest, are less likely to happen.

Supply Picture beyond 2005

The property market is still hampered by supply overhang. According to a recent study by the Government, a total of 79,000 units will be up for sale in next three years, which means about 26,000 units each year.

However, some analysts have raised the concern that tight supply would be creeping back in few years time due to a series of ongoing efforts by the Government and private sector in curbing supply.

1. The temporary suspension of land sales this year has effectively delayed new projects.

2. Lease modification, one major source of land supply, has been sluggish in last two years which means supply from developers' land banks would be limited.

3. The Government indicated there would be a more coordinated approach in the sale of development portfolios from the two railway corporations, a potential of 50,000 new units from these projects would be delayed.

As recently reported in the press, some developers have rescheduled the development and sale timing of some of their projects to later dates - which could be interpreted as moves to take advantage of the perceived supply gap in several years' time.

As a result, the actual new supply could be lower than what the market anticipates.

Benefits of re-opening of the land sale market

Resuming the Application List system will bring back the land market. The land sale transactions will provide an avenue for the market and the Government to gauge the underlying market strengths. With the availability of land transaction comparables, it would help facilitate land premium negotiation and settlement between developers and the Government.

Number of Private Flats Produced by Types of Land Transactions 1998/99-2002/03

	1998/1999	1999/2000	2000/2001	2001/2002	2002/2003
Auctions and Tenders (incl. PSPS)	12,826	7,101	16,334	2,130	2,515
Private Treaty Grant (incl. assisted housing)	7,556	15,896	5,779	15,686	8,715
Modification/Exchange	1,679	16,738	7,537	7,769	10,072
Total	22,061	39,735	29,650	25,585	21,302
% of auctions and tenders	58%	18%	55%	8%	12%

For developers, they will have the opportunity to re-invest the sales proceeds from projects completed back to the local property market. If insufficient real estate investment opportunities were available in Hong Kong, developers would shift their investment focus more from Hong Kong to other countries.

A rise in property development activities would bring back demand in the construction industry and other associated businesses.

The Government also stands to gain. The sale of two lots in the application list last year had brought in a land revenue of HK$2.2bn, or 60% of the total land premium received by the Government in the year. Resuming land sales could bring in much-needed revenues to alleviate the widening fiscal deficits that have been plaguing the Government.

Impact on property market likely to be modest

The overall impact of resuming Application List on the market can be expected modest. First, the Government has a full control on what sites - including their types and developable floor area - are to be put into the list and thus the future supply.

Second, the requirement of an acceptable offer and deposit received from an interested developer under the procedure for the Application List system gives the Government flexibility. If the offer is not attractive, the Government can withhold the land sale without creating any negative impacts on the market. The Government has reiterated many times that she would not sell the land cheaply.

And finally, would it not be a good market signal if there were an overwhelming response for land application as developers are voting with their money and investing in the property market?

A Vision for education development in the land surveying profession in Hong Kong

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The trend in Hong Kong, and indeed globally, is for professionals to continuously upgrade their capacities. A first degree is an indispensable step for a professional. Beyond that, it is now common to continue seeking other professional degrees or to move higher towards Master's and PhD degrees. There is a need to facilitate the burgeoning demand of in-service professionals and technicians to expand their knowledge base and upgrade their academic qualifications, albeit within better tailored schedules and more affordable forms of tuition.

The overall trend in education is towards greater openness, so that a wider variety of entry qualifications are now accepted for courses. For example, it is now a government policy that an associate degree qualifies a student to enter the second year of a degree course. Land surveying is no exception to this trend.

Manpower supply and demand

University plays a major role in producing a stream of professionally educated people. At a time of weakness in the economy, many senior professionals cannot avoid the feeling that educational institutes are producing more fresh graduates that the market can absorb. On one hand, although the land surveying sector is not an exception to the general trend, land surveying graduates, in salary terms[1], are doing better than all other construction and real estate professionals. On the other, due to technological development and improvement in the traditional surveying and mapping fields, competition has become intense. There is a strong need for better forecasting, and in that regard, for a long term surveying and mapping policy, so that reasonable predictions of the demand for surveying personnel can be made.

Pragmatic skills and syllabus

Feedback from graduates and professionals indicate that there is room for improvement in local practical knowledge and skills. Specifically, there are requests for more engineering and cadastral surveying training in the land surveying sector and GIS applications in the geomatic sector. Some advanced surveying elements in geodesy, adjustment and photogrammetry may be covered at the introductory stage, with in-depth studies being left until later, at the Master's level. The main theme of the syllabus improvement is the fortification of industrial pragmatic skills so as to conform to the PolyU aim of preferred graduates. In preparation for a reform of the syllabus, a survey on the needs and skills of land surveying graduates should be carried out through the appropriate government and industrial sector - HKIS.

Full modular structure

Currently there is a full-time degree and a part-time degree for the land surveying industry. There is an overall demand for upgrading from the practitioners who do not possess a degree. A part-time degree is now a viable route, but it requires a considerable amount of tuition. The industry is also concerned that there may be an oversupply of professional land surveyors through the part-time mode.

With the recent development of the local university enrollment system, the advanced standing status applicants represent an increasing portion of the yearly in-take. 'Advanced standing status' is an umbrella term for university applicants holding qualifications other than Form 7 matriculation. The intake in the part-time program comprises mostly advanced standing applicants.

The current land surveying degree program takes 85% of its quota from Form 7 graduates (JUPUS[2]) and 15% from other sources such as applicants from abroad and higher diploma students with excellent results as advanced standing applicants. The authors propose a full modular land surveying degree course structure such that one program would take in 70% F7 students and 30% from other sources including advanced standings, instead of the current two separate degree programs. In this design, a small portion of modules would be provided in the evening, so that a normal day time student could finish the program in three years while a self-paced student would take longer. The total number of graduates in this design is less than the sum of the existing two. Further, it accepts professionals and technicians into a versatile educational path, and there is a good mix of F7 graduates and experienced surveyors, creating more information exchange and promoting a healthy competitive spirit.

Modular scheme for CPD requirements

Professional bodies need to organize CPD (continuous professional development) events for members. The events could be short courses, seminars and technical visits. Indeed, there is sometimes pressure on professional bodies to organize CPD events. The PolyU could offer some modules for these events. For example, a surveyor who wishes to study the recent developments in GPS may come to study the subject "Global Positioning System". After passing this subject, he/she is issued with a certificate. This certificate may be submitted to a professional body to meet the CPD requirements for membership and may also be used for credit transfer if he/she wishes to get a degree later on.

Land Survey degree and GIS degree

The full modular scheme can be further developed into two professional streams - a land survey degree and a GIS degree. At this early stage in the design, it can be stated that the first two years are similar while the third year is subject to separate treatment. To suit such a development, it would be desirable for the Land Surveying Division of HKIS to accept candidates specializing in one acknowledged field, instead of the current minimum requirement of two specialist fields.

Note:

1 Information from the PolyU Student Affairs Office, the income for 2000, 2001 and 2002; LSGI degree graduates earn an average salary of $11,433, $12,810 and $11,219 respectively.

2 JUPUS stands for Joint University Programmes Admissions System

The Challenge of Privatization of the Housing Authority's Assets

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Background

The Housing Authority (HA) is a major government organisation and the largest property developer in Hong Kong. Over 50% of the population are living in public housing provided by the HA. Up to now, the HA has accumulated a huge cash reserve with a current total of HK$28 billion. This huge reserve has accumulated mainly from two sources. One main source is the profit from the disposal of HOS/ PSPS properties. The other source is the rental income from commercial facilities owned by the HA. Historically, the income from these two sources was used to subsidize the expenditures in public housing. Since these two sources provide a strong income stream, the Government does not need to inject cash into the HA but only to grant lands for development. Basically, the HA can enjoy a high level of financial independence.

In terms of having a low amount of government cash subsidy, the HA was very successful in providing housing solutions to over half of Hong Kong's citizens. However, the HA's self-sustained financial ability is now facing a big challenge.

Last November, the Secretary for Housing, Planning and Lands announced the Statement on Housing Policy. The Statement clarified the role of the Government in the property market and confirmed that the thrust of the Government's subsidized housing policy should be to assist low-income families that cannot afford private rental housing. On this basis, a number of other measures, directly related to the work of the HA were also announced, including the cessation of the production of HOS flats and the suspension of the sale of HOS and Tenants Purchase Scheme flats.

For this reason alone, the HA projected that in the absence of other replacement income sources to fund its capital expenditure on the production of public rental housing flats, the HA will incur an annual net cash flow deficit. The HA's cash balance is forecast to decrease from HK$28 billion, at the moment, to minus $5.5 billion by March 2006.

In addition, the HA is embarrassed by losing in the first lawsuit requesting the HA to bring the rent to a level whereby the Median Rent-to-Income Ratio (MRIR) of all public housing estates does not exceed 10%, as required by Section 16 (1A) of the Housing Ordinance Cap 283. The HA has decided to appeal. However, to deal with the huge political pressure from the tenants, the HA undertook, in the event of an unsuccessful appeal, to refund to the applicants and all families affected by the Order of Mandamus, the difference between the rents at the existing levels and the rent that they should have been paying together with interest. Should the appeal be unsuccessful, it is possible that the HA will become a negative asset to the SAR Government and require government direct funding thereafter. Under the current government's current situation of having a huge fiscal deficit, this financial burden from the HA is a real problem.

Divestment of Assets

Under these backdrops, the HA has announced a series of measures including cutting 3,500 staff in the coming 4 years, the adoption of "functional and cost-effective" designs to reduce 25% building costs, and the divestment of the HA's retail and car-parking (RC) facilities. While the cutting of staff and costs in the former two measures are long-term, the last measure of the divestment of assets will produce immediate proceeds to help the HA's funding requirements in the short term and allow the HA to pursue various longer term cost-saving initiatives to improve its financial position.

The HA currently holds approximately one million square metres of retail facilities and 100,000 car parking spaces, equivalent to about 11% and 16% of the respective total stock in Hong Kong. While most of these facilities are not within prime retail districts, like Mongkok, Tsim Sha Tsui and Causeway Bay, these facilities are either nearby or within densely populated public housing estates. The demand for these facilities is very strong and the income stream is, therefore, quite secure.

In July, the HA unveiled an approved plan to divest itself of its RC facilities. Under this plan, the HA will transfer ownership and management of the RC facilities to a new company, which will be listed on the Stock Exchange of Hong Kong through an Initial Public Offering (IPO) in 2004/ 2005. After the IPO, the HA will not hold any shares in this new company. After the divestment of RC facilities, the HA can reduce 700 staff. The proceeds from the divestment will help the HA to tide itself over its serious financial difficulties until 2007. This would provide a window for the HA to pursue a range of cost-saving initiatives in order to achieve financial sustainability in the longer term.

Worth over HK$37 Billion

UBS Warburg, the financial advisor of the HA, estimated that the sale proceeds from the IPO will be over HK$20 billion. UBS Warburg gets this figure by discounting the projected cash flows and using a discount rate from 10%-14%. However, the Valuation & Advisory Services of CB Richard Ellis believes that this estimation is too conservative. According to CB Richard Ellis' estimation, the facilities currently provide an annual net cash flow of over HK$2.5 billion. The appropriate discount rate should refer to the forecast dividend yield of the "Fortune REIT", i.e. about 6.7%. The "Fortune REIT" is a real estates investment trust successfully raised by Cheung Kong Group recently for five Hong Kong secondary shopping facilities. The nature of these assets is similar to the RC facilities owned by the HA. Using the same rate on the net operating income of the HA's RC facilities, the asset value is over HK$37 billion. This is further confirmed by the P/E ratios being over 15 for many listed property companies in Hong Kong. A P/E of 15 represents a return on equity (RoE) of 6.67%.

Moreover, compared with the "Fortune REIT", the future net cash flows of the RC facilities seem to have more room for improvements and make the IPO more attractive to potential investors. In fact, the RC facilities are not fully utilized under the HA control. The total income for the last two years was HK$4.77 billion (2002/03) and HK$5.14 billion (2001/02) but the expenditures are as high as HK$2.25 billion and HK$2.36 billion respectively (excluding depreciation provision). Even though the HA have tried to operate the RC facilities according to commercial principles, the operating costs still take away over 45% of the total revenue. CB Richard Ellis regards this percentage as an expensive cost pattern and believes that an acceptable percentage should be around 20-30%. The privatization of the HA's RC facilities is likely to allow an improvement of operating efficiency and gives growth potential of net operating cash flows from the assets.

Challenges

However, the HA still has to overcome a lot of complicated issues. The most crucial one is disposal timing. The market is currently reaching the lowest point of the interest rate cycle and this period is the most suitable for launching an IPO. It is anticipated that this low interest rate period will not last forever, especially when Hong Kong's interest rate level has to follow the US interest rate. If the HA cannot seize the days, it is possible that the interest rate will start hiking again and the sale proceeds generated from the IPO will be less than expected.

Another challenge is the potential political resistance from the existing tenants. Many tenants of the RC facilities fear that the new company will increase the rent after the takeover of the portfolio. This may make the tenants join together to form a political force to defer the divestment process.

In addition, the in-house staffs are resistant. It is unavoidable that existing civil servants will have to be laid off in order to implement the divestment scheme. The new company definitely needs the existing HA staff participation to ensure a proper transition period but the new company may not be able to afford to take over all the HA staff at the current high remuneration package. The retrenchment problems are always more difficult to handle in the public sector than in the private sector. Huge ex-gratia compensation to existing affected staff is anticipated. Even after that, the transition period from public to private management is still full of conflicts and resistance from the affected staff/ staff unions.

A further challenge is the need for an improvement of return to attract investors. Mr Leung Chin-man, Director of Housing, disclosed that the HA was now targeting a reduction of the operating expenses for the RC facilities to about 20% of the total income.

The title documents bottleneck creates uncertainties to the HA's divestment plan. Currently, the HA does not have the transferable title of the RC facilities. The HA's RC facilities are built on lands that do not have government leases. The lands are generally vested in the HA by the Government. The HA has to acquire the government lease for the purpose of the divestment. Since these facilities are generally a part of a public housing estate, the Government cannot grant leases for the facilities in isolation. As a result, land leases together with the necessary Deed of Mutual

Covenant in respect of some 130 rental estates will have to be produced. In addition, all the HA's properties are currently exempted from the Buildings Ordinance control. After the divestment, such exemption will no longer apply to the RC facilities. For the purpose of divestment, the HA has to compile plans and records of the RC facilities to facilitate future building control. The HA has to identify and arrange for the implementation of consequential works, if any, to demonstrate that the standards set down in the Buildings Ordinance and other allied statutory building requirements are met. The processing of these documents and modification works is estimated to take a few years to complete, subject to sufficient resources being made available to the relevant government departments. Before the documents are ready, the legal title of the RC facilities cannot be transferred to the new company.

To overcome the title documents bottleneck, the HA is now envisaging a broad strategy to take forward the divestment. This strategy is basically to assign the cash flows of the RC facilities to the new company first. Then, the new company, on this basis, will make an IPO on the Stock Exchange of Hong Kong. At later stages, when the relevant title documents are ready, the HA will transfer the legal title of the RC facilities to the new company. During these processes, the HA will receive the sales proceeds from the new company in two installments: a majority portion of the proceeds payment, immediately after the IPO, and the balance payment upon assignment of the legal title.

Conclusion

The HA divestment of its RC facilities is a positive move towards the long-term strategy of the privatization of government assets. The divestment is not only a short-term solution to the HA's financial problem but also brings efficiency enhancement to the utilization of the RC facilities. The HA may also seek this opportunity to further cut the bulky organizational structure of the Housing Department. Despite these advantages, the divestment is full of challenges. The disposal timing, the tenants resistance, the in-house staff resistance, the ability to increase cash flows from the RC facilities, as well as the title documents bottleneck are challenging problems that the HA is required to solve.

Residential Properties Rebound
Is It for Real?

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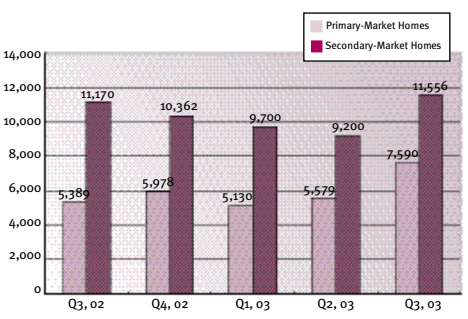
This is a question everybody is asking at the moment. Some believe it is. Some think otherwise. First, let us look at the statistics.

Chart 1 Quarterly Overview of Residential Transactions

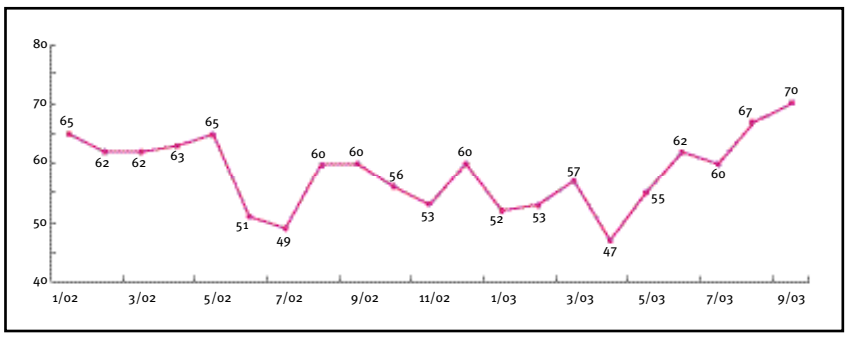


From Chart 1 above, in the third quarter of 2003, both primary and secondary home sales have recorded substantial increases, 36% and 25.6% respectively, over the previous quarter. In fact, the number of residential transactions reached the highest level in a year.

There are other favourable signs as well.

Firstly, the percentage of sales versus rental transactions in residential units has been on the rise since the SARS days. Chart 2 below shows the trend of residential sales transactions as a percentage of total (including letting) transactions.

Chart 2 Residential Sales Transactions as a Percentage of Total Transactions

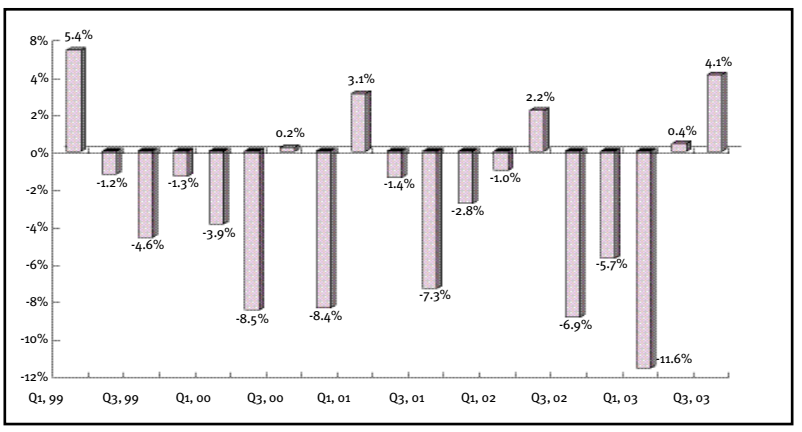


Compared with a sale to letting ratio of 47% versus 53% in April, the corresponding figures changed to 70% and 30% in September. This was clearly a sign of improving buying sentiment.

Secondly, facing a buoyant market, developers have started to reduce discounts over prices and other benefits, such as abolition of second mortgage offered by developers to purchasers. Some have even raised their list prices.

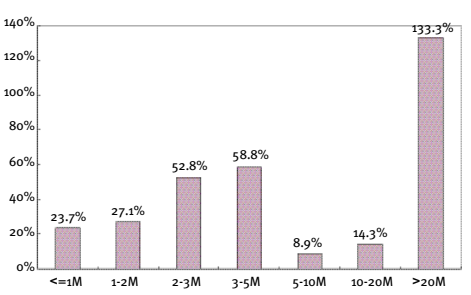
Thirdly, there are signs that the secondary residential property prices might have already hit the bottom. As seen from Chart 3 below, the average secondary home price rose 4.1% (from HK$1,941 psf. to HK$2,020 psf.) in the third quarter of 2003, the biggest increase since 1999.

Chart 3 Average Price Trend in the Secondary Residential Market



Amid the euphoria of signs of recovery in the residential market perhaps the most striking is that of the higher-end homes.

Chart 4 Percentage Increase in Residential Property Sales in Different Price Ranges over the Second Quarter of 2003

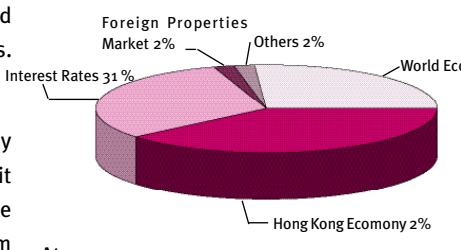


Sources: Land Registry & Midland Realty's Research Department

In Chart 4 above, it can be seen that the luxury properties have recorded the highest percentage increase in the volume of transactions over the previous quarter, the second of 2003. Traditionally luxury properties, especially those in Hong Kong Island, are most sought after by investors. It is usually in this sector that the rebound has been the most obvious and significant.

Apart from end-users, luxury homes are also investors' favourites. Their investment decisions usually depend on the following factors: -

Chart 5 Factors Affecting Investment Decisions



At present the performance of the above factors all turn in favour of investing in properties. Interest rates, both saving and prime, are at an all-time low. Hong Kong's bank savings have accumulated to HK$3,700 billion. It is tempting to invest a certain amount of this reserve into properties in Hong Kong, as properties elsewhere in London and New York are expected to either top out or show a lower rate of increase in value. A weak US dollar, against which the Hong Kong dollar is pegged, can help draw more capital influx, boosting investment. On top of these, Hong Kong has been enjoying an export growth in recent years.

While the consumer market may not have revived, the pent-up demand for investment, particularly luxury properties, is now silently in work.

From surveys conducted by Midland Realty in 2002 and 2003 by taking telephone interviews with 2,176 purchasers who intended to purchase properties over $7m, it is obvious that the buying sentiment has significantly improved. More investors are now in favour of investing in luxury properties.

Chart 6 Expectations on Price Trend of Luxury Properties

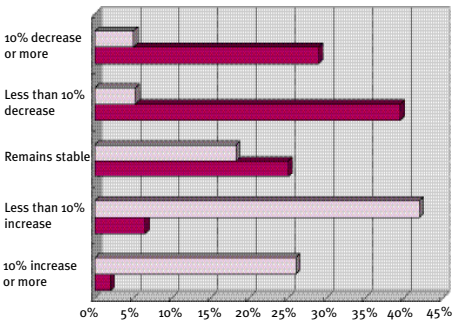


Chart 7 Investors' Preferences

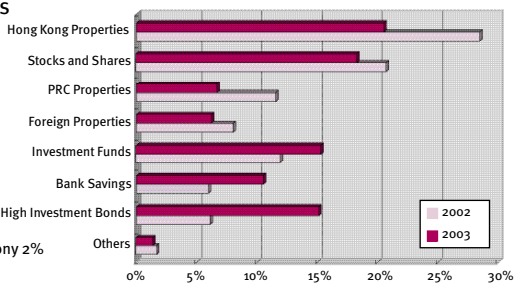


Chart 7 above illustrates investors' preferences in various alternative investment opportunities. It shows clearly that Hong Kong property have become the most sought after among them.

The question of course, is whether the momentum can sustain. Judging by the above, it looks like it will.

The Land (Compulsory Sale for Redevelopment) Ordinance? An Alternative?

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The Land (Compulsory Sale for Redevelopment) Ordinance, Cap 545 (hereinafter referred to as "the Ordinance") came into the legal regime in 1998. It was enacted to enable a majority owner of the undivided shares in a lot to make an application to the Lands Tribunal for an order for the sale of all of the undivided shares in the lot for the purposes of the redevelopment of the lot.

Prior to that, it had always been the market phenomenon that redevelopment of multi-ownership buildings was hindered or stultified by one or more minority owners who held out his/their interest, for one reason or another, so that ownership of all undivided shares could not be obtained despite the building was already in the end of its economic or physical life.

Then, whereas this new statutory framework has come into force, a majority owner who owns 90%[1] or more of a lot or lots can apply to the Lands Tribunal to compel sale of all the undivided shares in the lot or lots by public auction.

Nevertheless, it appears that the Lands Tribunal has only given an order for sale in one case; *Bond Star Development Limited v. Capital Well Limited*, LDCS 2000 of 2001[2], despite that the Ordinance has been in place for more than 5 years.

In most of the other cases, the parties all consented before the tribunal made any ruling to grant the necessary orders. Has the Ordinance achieved its objective?

In the past, although a majority owner might have tried his best to acquire most of the undivided shares of a lot and have expended considerable time and money, one of the most common reasons that the majority owner could not redevelop a lot was that one or more of the minority owners often made use of their delicate bargaining position to demand a huge sum of money as the "last unit premium".

In Bond Star Development Limited v. Capital Well Limited afore-mentioned, there were 5 properties, which comprised 6 contiguous building lots forming a rectangular-shaped site. The developer in question already acquired all save a half share of one of the six floors of the building in the middle.

Based on the provisions of Part 1 of Schedule 1 of the Ordinance, inter alia, not taking into account the redevelopment potential of the lot, this outstanding half share was assessed at less than $600,000 but the owner of which was asking for $15,000,000. In support of this $15,000,000, the half-share owner was suggesting that he should be entitled to at least the corresponding equal and undivided shares of the redevelopment value of the lot plus the marriage value of the merged sites.

Obviously, the Lands Tribunal disapproved the latter approach and remarked that such a minority owner should not be entitled to reap all the marriage value arising from a site amalgamation.

The Lands Tribunal posed the question as follows: "if all these merging of interests would put the owners of the neighbouring interests in exactly the same position as before, why should they be bothered to acquire the interest of (the subject lot) in the first place?"

At this juncture, while I am agreeing with the Lands Tribunal in the present case, it might be interesting to compare the Lands Tribunal's remark with the finding of a differently constituted Lands Tribunal much earlier in *Kwok Lee Sau-sang & Siu Kit-ho v. Director of Lands & Survey* (1977) HKLTLR 105.

Then, the Lands Tribunal observed that the maximum value for a single site would be the open market value as a Class 'A' site having no merger potential, plus the developer's profit reasonably expected on the redevelopment of such a Class 'A' site. The developer would then be in a position to extricate himself without loss even if the anticipated merger does not proceed. The earlier Lands Tribunal further explained:

"a developer, bearing in mind the amalgamated site potential set out above, would be prepared to purchase such a site only upon a 'no loss basis'. By this it is meant that he would only purchase the site at a price which would leave him, even if he were unable to collect one or more adjoining sites for amalgamation, without a loss after a redevelopment of the subject site upon a single site basis. In other words he would be prepared to risk his profit from a single site development and the fact that his capital would be immobilized for a period of about 18 months against the substantially greater profit which he would be able to realize if he were able to purchase one or more of the adjoining lots."

This may further limit the share of marriage value that a single interest might achieve in the open market in circumstances,

In any event, the enactment of the Ordinance has probably changed the situation so that the owner who owns the last unit in a lot is no longer expected to get the "last unit premium".

Failing negotiation with the minority owner(s) for the last unit, the majority owner may apply to the Lands Tribunal for an order of sale whereby the proceeds and expenses of the sale would follow the ratio of the values of the various units of the lot based on their existing use.

Nevertheless, the Lands Tribunal in this Bond Star Development case admitted that "there may still be instances that a majority owner agrees to pay a certain premium above the proportionate share of the assessed market value of the lot, which could form the subject matter of an application under the Ordinance, since the procedure of the Ordinance will certainly take some time."

One of the hurdles might be, for instance, the majority owner has to demonstrate to the satisfaction of the Lands Tribunal that he has taken reasonable steps to acquire all the undivided shares in the lot on terms that are not less than fair and reasonable. The minority owner might also dispute the value of any property as assessed in the application, thereby prolonging the hearing of application.

In this regard, there appears to be an alternative means by which an owner, not necessarily a majority owner, can obtain an order for sale of a piece of property under co-ownership.

Under the Partition Ordinance, Cap. 352, the Court of First Instance or the District Court as the case may be may make an order for sale of the property where it appears that a partition of the property would not be beneficial to all the persons interested by reason of:-

(a) the nature of the land to which the proceedings relate;

(b) the number of the persons interested or presumptively interested.....

In my experience, on most occasions when the Partition Ordinance applied to rid shackles of co-ownership were in respect of buildings that were considered unsafe and required to be demolished by the Building Authority.

In such circumstances, it would be quite obvious that the pursuit of partition of the property would not be beneficial to all of the persons interested in it. One good example can be found in *Golden Bay Investment Limited & Another v. Cheung Kam Moon and Others*, HCMP Nos. 554, 555, 556 & 557 of 1990; CACV Nos. 160 & 161 of 1992).

But unlike that under the Land (Compulsory Sale for Redevelopment) Ordinance, person(s) who has an interest, not necessarily a majority interest, can institute proceedings under the Partition Ordinance for a sale.

The other most notable difference is that in the Golden Bay Investment case, the Court of Appeal approved the distribution of the proceeds of sale in accordance with the equal and undivided shares in the land (instead of proportionate values of the various units of the lot prior to the demolition).

The Court of Appeal came to this conclusion obviously based on the fact that the buildings erected thereon were gone so that all that remained were equal undivided shares in the land. This is in stark contrast to the provision in the Land (Compulsory Sale for Redevelopment) Ordinance, which states otherwise.

This latter difference however would have significant impacts on the apportionment of sales proceeds for ownership of the ground floor interest, which, prior to the demolition of the buildings, might have commanded a value more than tenfold of that on the upper floors.

And this was particularly the case concerning similar applications regarding the lots at Nos. 138, 140 & 144 Sai Yeung Choi Street, which were then sold by public auction in July 1997.

For the same reason, it appears that it would be more beneficial for the former minority owners of Garley Building at Nathan Road, which was damaged by fire in 1996, to pursue a sale of the lot under the Partition Ordinance instead of under the Land (Compulsory Sale for Redevelopment) Ordinance.

Note:

1 The Chief Executive in Council may specify a lower percentage (subject to a minimum of 80%) by notice in the Government Gazette.

2 An appeal by the minority owner to the Court of Appeal, being CACV No. 458 of 2002, was recently dismissed.

The Proliferation of Claims Are Notice Provisions to Blame?

John B MOLLOY

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This month I was fortunate to attend an international conference organized by the Society of Construction Law. The speakers were all extremely experienced and knowledgeable in the field of construction law, and the majority were Queen's Counsel from London.

Notice provisions were a topic of some debate at the conference, and a number of speakers noted that contracts were increasingly containing complicated and exacting requirements for contractors to serve notice and submit detailed particulars within set time frames, should they consider themselves entitled to claims for extensions of time or additional payment. It was further noted that many contracts are now also making it clear that compliance with such requirements is a condition precedent to the contractor's rights to claim.

Whilst such provisions are traditionally met with protests from contractors, employers defend such requirements on the basis that they are intended to ensure that potential claims are brought to the employer's attention at an early stage when action can be taken to resolve the problem and can be dealt with by the contract administrator when events are still fresh in all parties minds.

The speakers at the conference were however extremely skeptical about this reasoning, and my experience certainly supports their skepticism. I have never seen an employer receive a notice of claim for an extension of time or additional payment and then take positive action to deal with the problem to avoid or reduce the effects of the potential claim (save for contracts with provisions for delay recovery measures). Nor does provision of notice and particulars ensure that the matter is dealt with in a timely manner, as all too often the contract administrator files the notice and particulars and then waits until the end of the project before deciding what extension of time or additional payment he considers is due to the contractor.

The real reason for inclusion of complicated notice and detailed particulars requirements, and compliance with such provisions a condition precedent, is to discourage the contractor from making claims. The speakers at the conference were all in agreement that this was the employer's intention by including such provisions in their contracts.

Why employers would want to do this is uncertain. On the one hand they include clauses in contracts that encourage the contractor to claim additional time and additional money if certain circumstances occur, whilst on the other hand they make it increasingly difficult for a contractor to make such claims by including complicated and strict provisions concerning notice and submission of detailed particulars. The employer's message is unclear.

But do such provisions discourage contractors from making claims? The general view at the conference was that they have the opposite effect in that they cause a proliferation of claims because contractors, wary of falling foul of the condition precedent nature of the notice and requirements for detailed particulars, adopt a safe approach and notify every single event that could possibly lead to a claim for an extension of time and additional payment no matter how slight the possibility. Standard letters are drawn up by lawyers with blanks to be filled in by the contractor whenever an event occurs and consequently the contract administrator can be bombarded with notices and particulars on a daily basis.

The result of this does not only cultivate an adversarial attitude from day one of the project but also a state of affairs where any advantage of requiring notice is lost because the contract administrator cannot easily identify the potentially serious problems from the minor problems because of the volume of paperwork.

Not surprisingly clauses making the provision of notice and detailed particulars within a strict time limit a condition precedent to a claim for an extension of time or additional payment have been the subject of a number of challenges by contractors in the courts in the last few years, and I have discussed some of these cases in previous articles.

The challenges to such clauses are generally made in the situation where the contractor has been delayed by acts of the employer and then is denied an extension of time because he failed to provide notice within the time limits set out in the contract. The argument traditionally raised by the contractor in such circumstances, is that where the employer has caused an act of prevention and delayed completion he cannot take liquidated damages for that delay. If no extension of time is possible due to the failure of the contractor to serve notice within the time limits of the contract, then the contractor argument is that time must be at large.

These arguments, or arguments of a similar nature have met with mixed reaction from the courts. They were rejected in the Australian case of *Turner Corporation v. Austotel Pty Ltd* (1994) and the United Kingdom case of *City Inn Limited v. Shepherd Construction Ltd* (2001) but accepted in the Australian case of *Gaymark Investments Pty Ltd v. Walter Construction Group Ltd* (1999).

The uncertainty introduced by these arguments and the differing findings by the courts have led employers to include a provision to protect themselves in the event that the employer causes a delay but the contractor fails to comply with the condition precedent notice. These provisions give the contract administrator the power to grant an extension of time notwithstanding the contractor's failure to serve notice, or even make a claim at all.

A local example of this type of clause can be seen in the Disney Conditions of Contract where Clause 49.9 provides:

"Notwithstanding any other provision of the Contract, the Project Manager may in his complete discretion, for any reason and at any time, whether before, on or after the issue of a Completion Certificate, determine and grant an extension of time to any Key Date."

The intention is of course that the contract administrator will exercise this discretion where the employer causes delay, to avoid any prevention arguments but that he will not exercise his discretion for other delays where the contractor has simply failed to give notice within the required time limits.

However, even clauses such as the above have now been the subject of court scrutiny in the recent case Australian case of *Peninsula Balmain Pty Ltd v Abigroup Contractors Pty Ltd* [2002] NSW CA 211. In this case the contract contained a clause very similar to the one above, that provided:

"Notwithstanding that the contractor is not entitled to an extension of time [due to failure to satisfy the condition precedent notice requirements] the Superintendent may at any time and from time to time before the issues of the final certificate by notice in writing to the contractor extend the time for practical completion for any reason."

Various problems arose under the contract with the result that the contract was terminated and a variety of issues were put before the court. One of the decisions made by the court was that the extended date for practical completion should have been 5 June 1999. This was an odd decision because the contract administrator had only extended time to 29 April 1999 and no further extension of time had ever been sought by the contractor.

The court had in effect decided that the contractor was entitled to a further extension of time, notwithstanding the fact that it had not claimed such time, and that the contract administrator should have granted such time pursuant to the clause set out above.

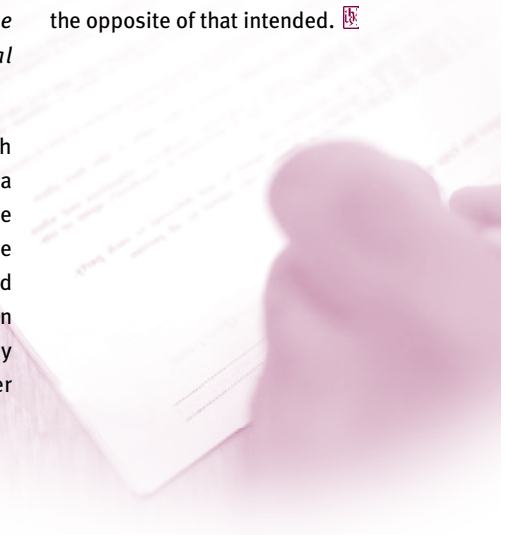
The employer appealed the decision. They argued that the clause was inserted for the benefit of the employer only and that the contract administrator had no duty to exercise his power in favour of the contractor. The employer further argued that there was in any event no occasion for the contract administrator to exercise the discretionary power when no claim had been made by the contractor.

The court of appeal disagreed with the employer and upheld the previous decision. The court considered that the power was one which was capable of being exercised for the benefit of both the employer and the contractor and that the contract administrator is obliged to act honestly and impartially in deciding whether to exercise this power.

It must be pointed out that the court was influenced in its decision by the fact that the contract also contained a provision expressly stating that the superintendent was obliged to act honestly and fairly in the exercise of his contractual duties (the Disney Conditions contain a similar clause). However such an obligation may also be implied in other contracts unless there is an express statement to the contrary.

I understand that the employers' reaction to this judgment is to amend any such clause to make it clear that the discretion can only be exercised in the employers' favour, which seems to reinforce the argument that the employers' real intention with condition precedent notice provisions is to discourage contractors' claims.

Nonetheless, as stated earlier in this article, evidence suggests that the more stringent the notice provisions the greater the proliferation of claims, so the effect of the clauses is exactly the opposite of that intended.



Confidentiality in Arbitration

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Most large projects in Hong Kong which go awry and end up in arbitration are likely to involve disputes or differences which cross a number of subcontract tiers. Therefore, documents relevant to one arbitration (e.g. main contractor v. employer) may also be relevant to a subsequent arbitration for the next link down the subcontracting chain (e.g. subcontractor v. main contractor). This situation arose recently in an arbitration in which BERA were providing expert advice. However, when specific discovery and inspection of certain documents arising out of the earlier arbitration were requested by our instructing solicitors the response from the other party was *"No, you can't have them... they're confidential!"*

So what then is the legal position in such circumstances?

Some Definitions

Disclosure or discovery of documents
- the process by which the parties in an arbitration provide a list to each other of all material documents to the disputes in their possession, custody or power.

Specific discovery
- where a party is obliged to disclose specifically identified documents or categories of documents.

Inspection of documents
- the process by which disclosed documents are physically inspected by the other party and copies made thereof.

The general rule is that any document in the possession, custody or power of a party, which is relevant to the disputed issues, is discoverable. A relevant document was defined in *Compagnie Financiere at Commerciale du Pacifique v. Peruvian Guano Co* (1882) 11 QBD 55 as "a document which it is reasonable to suppose contains information which may enable a party either to advance his case or to damage that of his opponent, or which may fairly lead him to a train of enquiry having either of these consequences".

Some Examples of Relevant Documents

Subcontracts often limit the subcontractor's rights to additional payment, for claims that originate from an excusable compensable event under the main contract, to the amount, which the main contractor is able to recover from the employer.

In such circumstances, any documents referring to the amount of such claims compromised or agreed in any settlement agreement between the main contractor and employer would be relevant to a dispute between the subcontractor and main contractor.

If the subcontractor had claims against a main contractor for the main contractor's default caused by another subcontractor then the injured subcontractor may be entitled to have disclosure of the following:

(i) any relevant documentation between the main contractor and the employer (and its consultants) concerning such default; and

(ii) any relevant documentation between the main contractor and the other subcontractor who caused the default.

However, the general rule of disclosure changes for documents generated in the actual arbitration proceedings.

Obligation of Confidentiality

Arbitration is a private means of dispute resolution and privacy is obviously one of its major attractions. Matters are determined behind close doors, *"strangers"* are excluded from the proceedings and the awards and/or outcome are not made public knowledge. Arising from this privacy there is an implied obligation of confidentiality imposed upon both parties and the tribunal not to disclose material generated during the proceedings. This might include, but not be limited to, the pleadings, written submissions, witness statements, expert reports and arbitrator's awards.

This is the general rule of confidentiality.

There are however exceptions to this general rule which were considered by the Court of Appeal in the English case of *Ali Shipping v. Shipyard Tragir* [1999] 1 WLR 314 at p.326 to 327.

Consent

The first exception is where the party who originally produced the material gives either express or implied consent to disclosure.

Order of the Court or Leave of the Court

The second exception is where a court orders, or gives leave for, the disclosure of the documents having taken into account the confidential nature of the documents and the fact that they were produced for a private arbitration.

In so doing, a court must consider whether the use of the material is **reasonably necessary** for the protection or enforcement of the parties rights in the second arbitration. Factors of consideration for this test of "reasonable necessity" might include:-

- the nature and purpose of the proceedings for which the information is required;
- the powers and procedures of the tribunal;
- the evidential significance of the documents;
- whether the information sought can be obtained from elsewhere; and
- the practicality and expense of obtaining the information from elsewhere.

The documents sought for disclosure must, therefore, be more than simply helpful or persuasive in advancing a party's case in the subsequent arbitration.

Potter LJ in Ali Shipping said the doctrine of confidentiality *"rests upon the assumption that the parties have a legitimate interest in privacy which the court will protect, an exception based on the subsequent need to protect inconsistent interest of one party is properly formulated in terms of reasonable necessity rather than mere convenience or advantage"*.

A court, therefore, takes a pragmatic view that the party with the documents will be prejudiced unless it can be shown by the other party that the documents are reasonably necessary for establishing its case. The motives of the party with the documents for not consenting to disclosure are of no consequence.

Interests of Justice

The third exception is in the interests of justice. If a factual or expert witness expressed himself in a materially different way when acting for a different side in a subsequent arbitration, it would be in the public interest to disclose the proofs of the witness as well as transcripts and notes of evidence given in the earlier arbitration.

Conclusion

If the parties to the first arbitration consent to the release of documents for use in the second arbitration they are free to do so. If not, the starting point is to assume an implied obligation of confidence whereby the use of documents generated in the course of the first arbitration remains strictly confidential. That is unless it can be shown that the documents fall within one of the recognized exceptions. Unless such recognised exceptions are established a court will uphold the confidentiality of such documents.

For further information please contact *bera@netvigator.com*

Land Compensation and Hope value

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From this edition onwards, we will feature some of the key court cases that relate to land and buildings. As a start, I would like to share with you two important cases on land compensation.

LAND COMPENSATION AND HOPE VALUE

1. Yin Shuen Enterprises Ltd v. Director of Lands
2. Nam Chun Investment Co Ltd v. Director of Lands
   [2001] HKLT 40, [2002] HKCA 21, [2003] HKCFA 5

INTRODUCTION

These two cases raise an important issue of principle in regard to the assessment of compensation payable on the resumption of land under the Lands Resumption Ordinance (Cap 124) (the Ordinance).

The question to be decided is whether the compensation should be:-

1. Existing use value or
2. Value of the land reflecting its development potential i.e. hope value.

BACKGROUND

These two cases involve three pieces of land in Yuen Long and Fanling/Sheung Shui, which were resumed by the Government in 1999 under the Ordinance. The land was subject to similar Block Crown Leases, which restricted the use to agriculture and prohibited the erection of buildings except for those ancillary to agricultural purposes.

The piece of land in Fanling/Sheung Shui owned by Yin Shuen Enterprises Ltd was re-zoned for high-density residential use and was designated for public housing development before resumption. The two lots in Yuen Long owned by Nam Chun Investment Co Ltd were also re-zoned and resumed for similar use and purpose.

Both claimants turned down an offer of compensation and took the case to the Lands Tribunal arguing that the lots entailed considerable potential for residential development, which should be taken into account in determining the dimension of the compensation.

Since similar issues were raised in these two cases, they were heard together in the Court of Appeal and the Court of Final Appeal.

The Lands Tribunal ruled in favour of both claimants and the decision was upheld by the Court of Appeal. However, this was later reversed by the Court of Final Appeal.

JUDGEMENTS

Lands Tribunal

In both cases, the applicants' valuers in their valuation reports collated and analyzed sales comparables of agricultural land in the near vicinity of the lots. However, the comparables were challenged by the Government's valuer on the ground that the prices paid contained a large element of what he described as "hope value", that is to say the amount which a purchaser is prepared to pay in excess of the existing use value of the land in the hope or expectation of obtaining a modification of the terms of the lease to permit development.

He contended that the comparables in question should be disregarded because s.12(c) of the Ordinance excludes this element of the value of the land from compensation.

Under s.12(c), no account was to be taken of any value which the land might have by reason of the probability, or expectancy, of obtaining any "licence, permission, lease, or permit whatsoever" to which the claimant was not entitled as of right.

In each case the Tribunal rejected this contention and based its assessment on the claimant's comparables, which it found to be perfectly acceptable. It made no finding as to whether the prices included an element of "hope value" and made no adjustment to reflect it, taking the view that the claimant was entitled to compensation which fully reflected the development potential of the land even if it could not be realised without first obtaining a modification of the terms of the lease.

The Director of Lands appealed.

The Court of Appeal

The Court of Appeal dismissed both appeals. It laid repeated emphasis on the fact that the claimants were entitled to compensation for the intrinsic value of their land with all its natural attributes, which made it suitable for development.

It held that s.12(c) did not affect this principle because it merely excluded compensation in respect of any expected or probable interest in the land which the claimant did not own at the date of resumption but might have expected to obtain in future if the land had not been resumed. The section did not depart from the principles, which governed the assessment of compensation in England or other common law jurisdictions. This did not mean that no regard should be paid to the terms of the lease. But the claimants' comparables were held under similar leases and were subject to similar restrictions.

They were, therefore, directly comparable, and full account has been taken in the prices paid of the prospect of obtaining a modification of the restrictions and of being required to pay a premium for their modification.

The Director of Lands appealed again.

The Court of Final Appeal

After taking into consideration the legal and factual context in which s.12(c) was enacted, the court held that the statutory language was decisive.

Any component, which would reflect the speculative element in the value of the land referable to the prospect of obtaining a modification of a lease, would be excluded from the compensation. Insofar as the intrinsic value of land included its development potential, if this could not be realized without a modification of the lease, the prospect of obtaining such a modification fell squarely within s.12(c).

Therefore, the appeals were allowed and the cases were remitted to the Lands Tribunal to reconsider the assessment of compensation.