



# REITS Benefits

## The rewards and challenges for Hong Kong to develop a REITS market



The Hong Kong Securities and Futures Commission is expected to release a consultation paper on establishing Real estate investment trusts (REITS) in Hong Kong very soon. While the new initiative is not part of the government's package of property market-boosting measures, REITS are likely to enhance Hong Kong's economy and its ambition to become Asia's international financial centre in the long term.

Hong Kong has fallen far behind its chief regional rival Singapore in terms of developing a market for REITS. More troubling, Singapore-listed CapitaLand and Keppel Land recently announced they would set up S-REITS worth about US\$200 million each to invest in Mainland projects.

One must wonder if Hong Kong is losing the race for the coveted role of regional financial centre because it has always boasted about being the Mainland's key financial gateway to the world.

Also, in a media conference last month Singapore's Land Working Group on the Economic Review Committee promoted the city-state as the major regional centre for listing and managing REITS.

The panel recommended that REITS be allowed to raise debt levels to 35% and suggested that tax benefits for REITS be extended to foreigners who pay taxes in Singapore.

Hong Kong has long aspired to become the international finance centre of Asia. It has Asia's second-largest stock market behind Japan and the strength of its market has created a critical mass of the world's top financial services firms.

The factors that make Hong Kong an effective international finance centre include efficient risk management, prudent regulations, premier financial infrastructure, and a high degree of integrity and transparency.

However, the range of products traded and the quality of financial services and products are also extremely important. REITS would significantly expand Hong Kong's range of products because they are likely to be focused geographically (that is, towards China, Hong Kong and Greater China) as well as across property sectors such as retail, office, industrial as well as development.

The Asian financial crisis should have taught the region that the high domestic savings of its investors should be mobilised more efficiently and effectively for better returns through long-term bond markets.

As a result, Asian borrowers should be able to avoid the maturity and currency mismatches that partially contributed to the crisis.

The debt market in Hong Kong will become more mature through the institutionalisation of savings through the Mandatory Provident Fund (MPF) scheme and the securitisation of bank assets such as mortgages through the creation of the Hong Kong Mortgage Corporation.

In addition, the Hong Kong Stock Exchange has already demonstrated its important role in assisting both state-owned and private enterprises in China to raise international capital. So the establishment of its own REIT market is a natural progression for Hong Kong.

Given the lack of capital gains and dividend taxes in the SAR, a REIT structure offers no significant taxation advantages relative to property companies.

Moreover, Hong Kong already has one of the world's most sophisticated public real estate markets. Because of this, many critics believe that there is no need to develop a REIT market.

In addition, the Hong Kong banking system is so liquid that most property companies do not need the access to capital offered by a REIT market.

At present, while a premier property company such as Sun Hung Kai Properties can easily obtain bank financing at less than 100 basis point premium over hibor (Hong Kong interbank offer rate), lesser quality real-estate companies also have no significant problems in assessing bank financing.

There are two major differences between a typical Hong Kong property company and a United States-style REIT.

First, while a US-style REIT must pay out at least 95% of its taxable income as dividends to its shareholders, a typical Hong Kong property company's dividend policy is discretionary, which makes the company more of a growth asset than an income investment.

Second, while a US-style REIT generally focuses on a niche area in the real estate industry - a specific property type or geographical area - a typical Hong Kong real estate company's focus can be as diverse as telecommunications or infrastructure, or even other listed securities.

Developing a REIT market in Hong Kong does not necessarily help property developers/investors as they do not need the capital (their costs of capital is already low) and REITS compete against them for investor capital.

As a result, Hong Kong property developers/investors are unlikely to embrace the REIT format initially.

Given the lack of taxation incentives in Hong Kong, the significant benefit of a REIT format is access to capital and lower cost of capital.

Despite this, Hong Kong needs a REIT market because, firstly, REITS would enable small investors to invest in large-scale commercial real estate that offers higher yields than Hong Kong property companies. Also, REITS would convert many illiquid real estate projects into liquid investments simply because there are not many buyers with strong balance sheets in the Hong Kong market at present.

The MPF is likely to be a prospective investor in REITS. Since pension funds are mainly

liabilities managers, real estate represents an attractive and appropriate investment. The increasing interest shown in real estate by US and European pension funds should prompt MPF managers to increase their real estate allocation.

Moreover, Hong Kong's rapidly ageing population means that its investment portfolio is likely to become more income, rather than growth, focused. At the end of October last year, the net asset values of approved constituent funds of MPF schemes amounted to almost HK\$31 billion. This amount is set to continue to increase.

Another major concern for a REIT market is the availability of investment-grade commercial real estate projects in Hong Kong, as most are held by listed property developers/investors for the long term.

Nonetheless, other non-real estate companies have many such properties that can be securitised.

Many non-real estate companies in Hong Kong own their offices and retail outlets, as well as their production facilities.

By committing their capital to the ownership and operation of real estate, rather than deploying this capital to their core operating businesses, they drain capital from their core area of expertise.

These operating companies will improve the return on their capital and enhance shareholder value by disposing of their real estate holdings.

Capital markets were very forgiving of operating companies that misused their capital, especially when Hong Kong was experiencing a property bull market.

However, both product and corporate life cycles have been greatly reduced by rapidly

changing customer preferences, technologies, global competition, and merger and acquisition activity.

Consequently, the ownership of corporate real estate has become detrimental to shareholder value.

Today, the most successful firms will be those that correctly and rapidly deploy their capital to exploit these changing opportunities.

REITS will enable these non-real estate companies to dispose of their corporate real estate and the general economy will benefit.

Send your comments to [nicholas.wong@ap.joneslanglasalle.com](mailto:nicholas.wong@ap.joneslanglasalle.com) 

The Hong Kong Securities and Futures Commission has just released a consultation paper on the Draft Code on REITS ([www.hksfc.org](http://www.hksfc.org)). The public consultation will end on 9 April 2003.

# REITS

## Beat Stocks In Recent Years



**Y**our humble author has been reviewing some information on the REITS (Real Estate Investment Trusts) recently and found that they have performed on the whole quite well in recent years. Not to mention that they generally give a better return than bank deposits, they also outgun the stock markets in the last several years. Here are a few observations:

- The information has been based on figures published by the National Association of Real Estate Investment Trusts (NAREIT) and are compared to the indexes of S&P 500 and NASDAQ.
- The REITS generally reflect the relatively better performance of the USA real estate market in recent years, in particular the residential sector, notwithstanding certain cities or market sectors are having difficulties currently.
- For someone who had started investing some 15 to 20 years ago, stocks, both S&P 500 and NASDAQ, would have given the investor a better return overall than what the REITS would.
- For someone who had started 10 years or so ago, REITS would tie with S&P 500 (actually by a tiny edge over) S&P 500, but would beat NASDAQ.

e) For someone who had only begun to invest in the last 5 years, REITS would definitely beat both S&P 500 and NASDAQ in terms of return, and it is not an issue of which one of them has a better or higher return, but which one of them offers a positive return while the rest give a negative return.

f) Even on the REITS alone, someone who had started to invest in them 3 years ago would have beaten someone who had just begun to invest in them last year. The annual return for the former is around 16% while the (annual) return to the latter is only 7%.

Using very basic figures, there is little correlation between the REITS and S&P 500 or NASDAQ. As such, investors concerned with risks or are risk-adverse may consider creating an investment portfolio with both REITS and S&P / NASDAQ components as a way to reduce some of the risks involved.

This leads to a possibility for Hong Kong which is currently considering the set up of REITS or some variants of it. Traditionally, and before 1997, both the Hong Kong stock and real estate markets seemed to go hand in hand, i.e. they went up and down more or less together. This was not a surprise given that publicly listed real estate companies made up more than half the capitalization. Today, this pattern might have altered somewhat e.g. while the stock market since the Asian Financial Crisis in 1998 has been moving up and down (at one point even exceeding the 1997 peak index), real estate prices have been on a steady downward trend. Instead of capital appreciation potential, investors now regard Hong Kong real estate as rental income properties. As such, there may be a scope for using real estate / REITS to balance out the volatility of stocks or other asset types.

Please refer to the table below for the annualized returns.

Years Invested	REITS	S&P 500	NASDAQ
1	6.77%	-16.51%	-23.40%
3	15.93%	-11.13%	-23.75%
5	3.21%	0.97%	-1.57%
10	10.32%	10.14%	8.52%
15	9.18%	12.48%	11.09%
20	9.33%	13.16%	9.70%

*Notes: The article and/or content contained herein are for general reference only and are not meant to substitute for proper professional advice and/or due diligence. The author(s) and Zeppelin, including its staff, associates, consultants, executives and the like do not accept any responsibility or liability for losses, damages, claims and the like arising out of the use or reference to the content contained herein.*

# SO DIFFERENT - Where the Creativity Rules

*SOHO China CEO Mr Pan Shiyi always sings a different song in the Beijing property market, and as always, his songs are riveting to the mass audiences but irksome to his rivals. Reported by Jim Yip.*

The Beijing property market is an ugly battlefield for developers. In 2002 there were over 600 pre-sale projects on the market, all vying the same pool of buyers. With 25% of the total sales last year taken up by 10 biggest projects, it means most of the projects are starving of buyers. Many developers, after stacking up huge losses, die on the sales pitch.

But one stands out from the pack. SOHO China's Jianwai China project raked in RMB 2.4bn in sales and topped in sales revenue amongst all projects last year. "The key to our success is our creativity. We don't follow others and loath to copy what others are doing. Ingenuity has been the hallmark for all of our projects," said Mr Pan Shiyi, SOHO China's CEO, with big smiles on his face. SOHO China ranked No. 1 in sales revenue in Beijing property market for 2001 and 2002.

Despite the brutal market competition and a rising concern for a looming bubble in Beijing luxurious property sector, Mr Pan these days has never felt more relaxed and upbeat - at least this was what he showed in his recent talk to over one hundred Hong Kong surveyors in a CPD event organised by the HKIS General Practice Division.

"As a developer, we need to be a smart thinker, analyse the market trend wisely; we use our heart to sense what the market wants, what designs our buyers love; and we design and build it with passion," Mr Pan disclosing more of his winning recipes.

Easier said than done. But SOHO China's past impeccable track records are testaments to his words. The company has achieved huge success by being creative. With his ideas so innovative and always rebellious against

traditions, he has re-written the codes for developers. His irked competitors have nicknamed him the "Naughty Boy" in the Beijing property.

## Design Driven

He was the first developer to provide furnished kitchens and bathrooms in apartments sold for local residents at a time when most of these apartments were completed in a state of not more than a bare shell. In a city once deeply obsessed with painting the buildings in grey colour, his development with colour-painted walls provoked a public outcry. But very soon Beijing citizens began to embrace this new

visual delight. Today, Beijing's cityscape is no longer dull, more buildings have been painted in bright colours, some even more fanciful.

SOHO China is the most innovative property developer in building design. Internet has broadened communication and dramatically changed the world and work environment. Mr Pan believes it would also signal a revolution on living space. A new design concept - Small Office Home Office (SOHO), which allows residents to live and work at home - has become popular in US. He pioneered this design concept in his SOHO New Town apartments in Beijing. His bet reaped handsome profits, as buyers thronged to the sales pitch to snap up the split-level apartments.

The project Commune by the Great Wall has won him many awards and media limelight. The hotel development of 11 avant-garde villas and one clubhouse near the Great Wall designed by 12 young and well-known Asian



Mr Pan Shiyi, SOHO China CEO, speaking in a CPD on 10 February 2003



The split-level apartment in SOHO Jianwai project



One of the villas in the Commune by the Great Wall -- Suitecase designed by Hong Kong architect Gary Cheung

architects was the first Chinese architectural project invited to la Biennale di Venezia. A Biennale prize was awarded to his wife Zhang Xin, also a CEO in SOHO China. She was hailed as the patron of China's most visionary architectural commission by the Biennale's international jury.

Although the project has yet to win any real money for him, he has been seen swift in cashing in the media frenzy to market his SOHO developments.

## A Market Rebellion

When his competitors dished out a standard commission rate 2% on property sales to the sales agents, he topped it up to 7% to attract the best people joining his sales team. To motivate the sales team, he devised an incentive scheme called "The Last One Out" in which any sales agent who finished last at the end of each review period would be fired.

"While we motivate them to deliver results, we also impose strict control on the ethics of our sales staff. We do not tolerate any misrepresentation," he said.

He dropped a bombshell to his competitors when he offered buyers a Refund Guarantee scheme in his pre-sale development. Under this scheme buyers can for whatever reasons

ask for their money back from the developer - a move akin to a suicide claimed by his rivals.

The innovative scheme, giving wary homebuyers a protection, enraged all of his competitors who feared they would be forced to give similar incentive in their developments.

China capital market for developers is still very primitive, bank borrowings or listing shares in the stock exchange are not the common tools for local developers to tap financing. Developers still heavily rely on pre-sale incomes to fund projects. The refund policy no doubt would hamper the developers' cashflow and threaten their competitiveness.

Bracing for more criticisms, Mr Pan refined the scheme and made an even better offer to his buyers: full deposit refund plus an interest return.

## No Property Bubble Yet

Mr Pan is sanguine towards the Beijing property market outlook. "Beijing is embarking on a great building boom. We are only at the beginning of this cycle."

"The harbingers of a property bubble such as spiraling up property prices and runaway transaction volumes are not clearly seen in the Beijing property market," he says.

He told that the market has greatly underestimated the allure of owning properties in the capital of China amongst Chinese citizens. In his SOHO New Town project, they had attracted buyers from all over the country as well as from overseas, some from inner-Mongolian regions.

"The rapid urbanisation happening in many of

China's cities is the main driver for property development. Compared with the developed countries where 60% of the population live in the cities, our rate is still very low, only 30%. We still have plenty of room to grow," he said.

But he expressed concern for the present land market in Beijing, especially on the phenomenon in which a lot of developers from other regions, attracted by the latest property craze in Beijing, have come to the Beijing property market and aggressively bought up large pieces of land at inflated prices.



Over 100 members turned up in this CPD

"As the Government has now issued a new policy that any land left vacant for more than two years will be forfeited, they will find the going is getting tough for them.'

"Our winning strategy has never been built on land bank, but creativity," he added.

One thing is certain - he will still play the maverick role and bring many surprises to the Beijing property for many years to come. 🇭🇰

# Tenants Must ACT

The end of security of tenure spells out the new game plan for residential tenants in tenancy negotiation



Jim YIP

MRICS, MHKIS

Senior Manager, Valuation Advisory Services, Jones Lang LaSalle

The Government is reviewing the provision of security of tenure under Part IV of the Landlord and Tenant (Consolidation) Ordinance (LTO). In its public consultation paper, it states that the aim of the review is to "set out a number of possible approaches to remove certain security of tenure provisions in the LTO and reduce intervention by the Government where appropriate."

## Security of Tenure

Under the existing LTO, landlords must grant an automatic tenancy renewal right to tenants so long as the tenants pay the market rent and fulfill the tenancy covenants. This restrictive clause has deterred owners from leasing out vacant properties and potential investors from buying investment properties, a critic says.

One of the most important reasons that drives for this review is the marked change in the private rental market in recent years. The flat supply has risen significantly, rentals have become more affordable and the queue for public housing has been cut from 9 years to 2.6 years, indicting that the original ground for statutory protection is no longer valid. Against the backdrop of acute shortage of rental flats and rocketing rentals in the early 70s, the Government put in the security

of tenure clause in LTO to protect tenants from the risk of being evicted by unscrupulous landlords.

"Set aside the consideration of market factors, free market mechanism is an important principle in Hong Kong economy. Government intervention in the private rental market should be kept to a minimal," says **Mr CK LAU**, convenor for the Local Affairs Committee, General Practice Division, HKIS. "The proposed change would bring the practice for residential tenancies in line with the commercial tenancies." Mr Lau and his team have reviewed the consultation paper and submitted their comments to the Government, which has extended its public consultation to 22 March 2003.

Previously, the Government has lifted the rental control through expiry of Part 1 and Part 2 under LTO in 1998. The removal of security of tenure in residential tenancies will be another significant retreat for the Government from meddling in the private rental market.

Amid several options laid down in the consultation paper, the Government expressed its preference for this option: removal of the security of tenure for new tenancies while giving a grace period to existing tenancies.

The implications of the law change will be profound on existing residential letting practice. One example: in the new regime after the removal of the security of tenure, the current rental determination mechanism through the Lands Tribunal under sections 119C and 119N of LTO would become redundant

and unnecessary, as landlords and tenants would have full liberty to negotiate the terms of their tenancy agreement.

But the impacts on existing tenants will be more acute. Many exiting tenants have relied on the statutory protection to stay on the leased premises year after year. How will they respond and negotiate the tenancy renewal with the landlord who will have full power to recover possession for whatsoever reasons?

Negotiating an option to renew - a term commonly found in commercial tenancies as a tenant's defence for tenure security - is the way forward. Unfortunately, the option to renew term is virtually non-existent in most of the existing residential tenancies. They are not necessary at the moment as such protection has been entrusted to tenants under the existing LTO provision.

In view of the imminent change in LTO, insisting on inserting an option to renew clause in all tenancies, new or renewed, is a good strategy for tenants to protect future occupation interest in the premises. Another alternative is to negotiate a longer lease term, if tenants intend to occupy the premises for more than 2 years.

In drafting the option to renew term, it is important to specify clearly the mechanism of determining the new rent in the event that both parties cannot reach an agreement, by expert witness or arbitration or by a pre-agreed adjustment rate.

## Minimum Notice Requirement

In the same consultation paper, the Government also considers to remove or shorten the minimum notice requirement imposed on the commercial landlords. Under Part V of LTO, non-domestic tenancies could

not be terminated at the end of the tenancy, unless a Notice to Quit (NTQ) is served by landlords to tenants not less than 6 months before the expiry date.

To gauge the likely impacts, we have interviewed two market practitioners, both from Jones Lang LaSalle: **Jeremy Sheldon**, Head of Tenant Representation, and **Eric Lee**, Head of Property Management.

Jeremy expressed his reservation on the removal of NTQ. "Frankly, the NTQ allows tenants to be reminded to get themselves into a position to negotiate a fair deal with enough time to move potentially. I still think it has a great deal of validity," he says.

He also adds that the current 6-month notice is appropriate. "If it is shortened to 4 months, it is just too short. Given that a rent review mechanism usually starts 3-6 months ahead of the expiry and should be finished 2 months before the expiry date."

If the security of tenure is removed in the new LTO, the current statutory guideline on notice requirement for residential tenancies will also have to be changed. How will that be changed? It is still unknown yet.

Eric favours a shorter notice period for residential tenancies. "The current 6-month's notice is not totally fair to the landlords as the duty of lease management should not only rest on landlords, the tenants should also share the price of being ill-informed or failing to plan in advance," he says.

Whatever the outcome, tenants will have to shoulder more responsibilities to protect their property interests in future.

Send your comments to  
[jim.yip@ap.joneslanglasalle.com](mailto:jim.yip@ap.joneslanglasalle.com) 

# Default of Contractors

## The Position under the Hong Kong Government Forms



**John B MOLLOY**

LLB (Hons), BSc (Hons), FHKIS, FRICS,  
FInstCES, MCI Arb, RPS(QS)

Managing Director, James R Knowles  
(Hong Kong) Limited

This is the third and final instalment of my articles on default of contractors and sub-contractors and, in particular, termination provisions. Whilst this may seem a gloomy topic to be writing about at the beginning of a new year it is nonetheless a matter of importance and one that surveyors need to be careful of, because wrongful termination can lead to very serious consequences.

Following examination last month of the Hong Kong Private Form, I will look this month at the termination provisions in the Hong Kong Government forms of contract. The provisions are basically the same in the Building, Civil Engineering and Electrical and Mechanical versions of that form of contract, and are contained in Clause 81.

This clause, which is similar to the RICS form in many respects sets out a number of grounds which entitle the employer to determine the employment of the contractor under the contract, and then continue the works to completion, either by the employer himself, or by the use of another contractor. The grounds are:

### Insolvency

Unlike the Private form this clause does not provide for automatic determination, but requires a notice of determination to be served. However, as with the Private form, whilst this provision is valid against the contractor, it may well not be valid against a

trustee or liquidator as it infringes basic rules of bankruptcy.

### The Contractor has assignment without consent.

In the House of Lords decision in *St Martins Property Corporation Ltd and Another v. Sir Robert McAlpine and Sons Ltd (1993) 63 BLR1*, it was held that this prohibition on assignment also included assignment of the payments due under the contract. Therefore, if a Contractor comes to an arrangement with his bank whereby he assigns the payments due under the contract, then this would be an assignment, which requires the prior written approval of the Architect.

### The Contractor has abandoned the Contract.

A straightforward ground which would also be a repudiatory breach at common law.

### The Contractor has without reasonable excuse failed to commence the Works in accordance with Clause 47.

A seldom used ground but one criticised by contractors who maintain that their obligation is to complete on time, and that they should be free to start whenever they consider it appropriate to achieve such aim.

### The Contractor has suspended the progress of the Works for 14 days after receiving from the Architect notice in writing to proceed.

A similar ground to the Private form, but one which firstly requires a written notice to proceed from the Architect, and subsequently a failure to do so for fourteen days.

It should be noted that a number of these grounds require a written notice from the Architect. This is because of the nature of the second notice - see my comments below.

### The Contractor has failed to comply with an order from the Architect given in accordance with Clause 46.

Clause 46 concerns the removal of works not carried out in accordance with the contract, and this clause is therefore the same as that of the Private form.

### Despite previous warning by the Architect in writing the Contractor is failing to proceed with the Works with due diligence or is persistently in breach of any of his obligations under the Contract.

This clause is probably the most commonly used ground for determination, but is also the one most difficult to prove. The second half of the clause is a wide-ranging and very useful provision, surprisingly so when it is considered that no prior notice is required to determine under this ground.

### The Contractor has sub-let the Works.

### The Contractor has to the detriment of good workmanship or in defiance of the Architect's instruction to the contrary sub-let any part of the Works.

These two clauses may seem, at first glance, very harsh grounds for determination. However, it must be remembered that the Employer may well have entered into the contract because of the specific identity of the Contractor, either because he was pre-qualified, or because he had satisfied certain criteria to be on an approved list. It would make a nonsense of such provisions if the Contractor having won the contract could then simply sub-let the Works or an important part of the works to another entirely inappropriate contractor without the Employer being able to take action to prevent.



It should be noted that unlike the Private form there is no provision that determination under the above grounds should not be made unreasonably or vexatiously, simply that such grounds exist.

The Clause then specifies the procedure to be adopted in the event that the Contractor's default falls into one of the above grounds. Points to note are as follows:

**Seven days notice in writing** - The procedure is different from the Private form in that if one of the above grounds exists then the Employer (not the Architect) may serve a notice of determination giving the Contractor seven days notice. The important point to note is that this is not a notice giving the Contractor seven days to remedy the default, but seven days notice to leave the site. Accordingly after seven days the Contractor's employment is determined no matter what steps he may take to remedy his default. This may seem a very harsh approach, but it should be remembered that most (but not all) of the grounds for determination detailed above, require prior written warnings from the Architect.

**The Employer may use ..... the Constructional Plant, temporary buildings and materials ..... the Employer may at any time sell ..... and apply the proceeds of sale in or towards the satisfaction of any sum due or which may become due to the Employer from the Contractor under the contract.** This first part of this clause is similar in wording to the Private form, but the latter and most important part gives the Employer the additional and extremely valuable power to sell the plant and equipment and apply the proceeds in satisfaction of any sum due. The two provisions, are good against the Contractor himself or the liquidator, but are not good against any third party owners of the plant such as plant hire companies.

Clause 81(2) is a peculiar clause. The clause requires the Surveyor, as soon as possible after re-entry to ascertain the quantity of work

completed to date, and ascertain and record the quantity of unused materials and constructional plant and temporary buildings. Whilst the latter part of the clause is sensible, the purpose of the first part, i.e. the ascertainment of the works completed to date, is not entirely clear. The procedures for ascertaining the financial standings of the Employer and the Contractor for the purposes of settling matters between them are set out in Clause 81(4) and (5), and this exercise involves a comparison of the actual cost of completing the works with the theoretical cost of completing them had the Contractor's employment not been determined. Accordingly whilst a record of the works completed to date may assist the Employer in providing, for example, evidence that the Contractor had not proceeded with due diligence, such figures will not ultimately be used in the calculation of the final account.

Clause 81(3) provides that **the Employer may require the Contractor to assign to the Employer and if so required the Contractor shall forthwith assign to the Employer the benefit of any agreement** (with sub-contractors). This is a useful and sensible provision for both employers wishing the works to continue without unnecessary delay and sub-contractors who are happy to continue working for a solvent employer.

The principal problem however, is that unlike the Private form there is no provision for the Employer to pay sub-contractors directly for works carried out prior to determination of the contract, and deduct such sums from sums due. The absence of this power is a serious omission, which is extremely unfair to sub-contractors and, in turn, thus hinders an Employer seeking to avoid delay.

The only exception to the Employer's lack of rights to make direct payment to sub-contractors for works carried out prior to determination, concerns nominated sub-contractors. GCC Clause 69(3)(b) provides such a right but only where those works have

already been certified, and the Contractor has failed to pay. Where works have been completed but not certified at the date of determination the Employer still has no means of making direct payment.

Clauses 81(3) and (4) provide the procedures regulating the accounts between the parties, and the combined provisions are very similar to those of the Private form.

The clauses allow the Employer damages in the form of the excess cost of completing by another contractor compared with the notional cost of completion had the contract not been determined, plus any direct loss or damage suffered by the Employer as a result of the determination.

Unlike the Private form the clause expressly states that **damages for delay** are to be included in the expenses incurred by the Contractor, but again most authorities consider that this will include liquidated damages up to the date of determination, but thereafter the Employer will have to prove his actual damage (i.e. general damages).

Like the RICS form the clause suffers from the major defect that it seems necessary for an Employer to wait until the completion of the work before he can claim damages, by which time it may well be too late to secure any money.

Hopefully the year of the Goat will prove a happier one for the construction industry in Hong Kong, but if contractors do default on their performance I hope that the points made in this and the last two articles will prove of use to surveyors advising their clients. 🙏

# Luxury Property - The Outperformer



## General

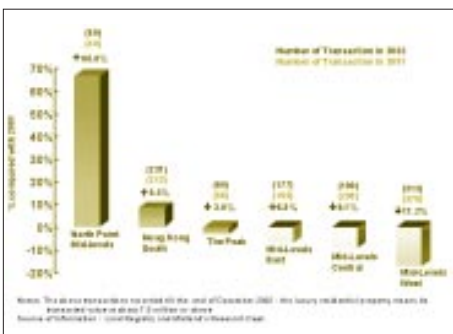
In a property market characterized by falling demand and prices, the luxurious properties, particularly those in Hong Kong Island, have done remarkably well.

By luxurious properties they are defined here as those with a transaction price of HK\$7 million or above.

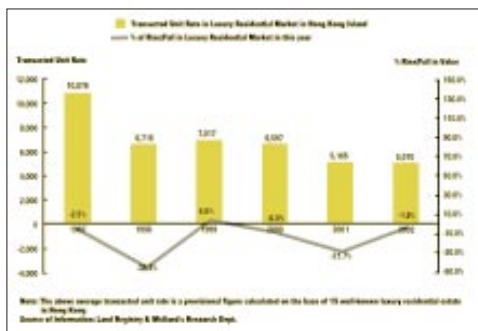
## Number of Transactions in 2002

Actually, the total number of transactions of luxurious properties in Hong Kong Island has maintained the same level, 377 in 2002 as compared with 379 in 2001. Transactions in the second hand market alone, however, have registered a fall. But its 5.3% drop still compares favourably with the 5.7% drop suffered by the whole of the second hand market.

Across Hong Kong, North Point Mid-Levels fared best. Transactions rose from 48 in 2001 to 80 in 2002 (a 66.6% increase), largely due to the launch of Sky Horizon in Cloud View Road. The other areas, however, showed mixed results, with an increase in Hong Kong South and the Peak but a decrease in Mid-Levels, as shown in the following chart.



Perhaps more significantly, those with a HK\$10 million price tag or more fared even better. All over Hong Kong Island, annual transactions in the HK\$10-20 million bracket rose 12.8%, from 384 to 433. Next, the HK\$20-50 million bracket rose 7.8%, from 102 to 110. Those over HK\$50 million recorded one transaction more, from 15 to 16. Among them, the most luxurious sector, detached houses, showed a marked increase. The number of houses sold in 2002 amounted to 93, notable examples of which included No. 8 Tai Tam Road, No. 16 Peak Road and No. 24 Shouson Hill Road, compared with 81 in the previous year.



## Price

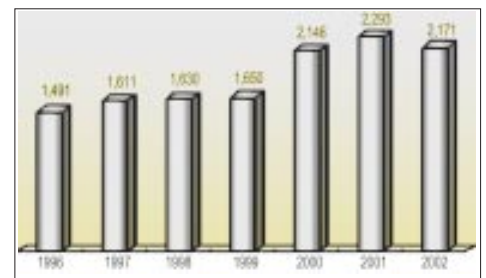
From statistics there are signs that the price of luxurious properties in Hong Kong Island might have bottomed out. Since 1997 their average unit price fell from an all-time high of HK\$10,876 to HK\$5,070 in 2002. Undoubtedly it has fallen over 50%, but then which sector hasn't? The important sign is that the percentage drop in 2002 has been significantly reduced, as shown in the following chart.

## Remarks

In retrospect, perhaps it is not surprising that the luxurious properties in Hong Kong Island

have out-performed the other sectors in terms of price levels. And the trend is it will continue in the coming years. There are reasons to substantiate this thinking.

1. Unlike West Kowloon and the New Territories, the supply of flats in Hong Kong Island, particularly luxurious properties, are limited.
2. Luxurious properties in Hong Kong Island have traditionally been a popular choice for those who wish to "upgrade" their living environment. This is due probably to a more established network of infrastructure, amenities, shopping, office setting and schools.
3. More importantly, the number of foreign companies, traditionally showing strong demand for luxurious properties in Hong Kong Island, has shown no sign of a significant retreat. Their number from 1996 to 2002 is as follows;



In addition, the following factors may well be welcoming signs to the luxurious property market as a whole:

1. Import/export and trading have improved over the past year. In 2002 handling of containers has increased 4.6%, ranking the SAR's Container Terminal the busiest in the world for 10 years running.
2. The number of tourists visiting Hong Kong In the first 10 months of 2002 totaled 13,330,000, showing a 20% increase.
3. The SAR's GDP in the third quarter of 2002 showed a real increase of 3.3% over that of 2001.

## Conclusion

The luxurious properties in Hong Kong Island should enjoy a relatively buoyant market. An increase of 20% in transaction volume in 2003 shouldn't be considered as too optimistic, with price and rental levels more stable than those of the other sectors.

# As-built Programmes - Part 1: *Composition*



## Introduction

Claims on construction contracts invariably involve an analysis of what happened, when it happened, why it happened and who caused it to happen. Obvious! However, there are no contractual rules to follow which say how this is to be done and there are many different situations from the simple to the complex.

Part of the what, when, why and who analysis can be carried out by the preparation of an as-built programme which is then compared to the planned intentions before an event occurred which caused the delays and / or disruption under investigation.

As-built programmes are, on the whole, neither a contractual requirement nor routinely developed by contractors or contract administrators. Furthermore, as-built programmes do not, contrary to popular belief, identify criticality, critical paths, or directly demonstrate cause-and-effect. However, if compiled correctly, an as-built programme can assist analysts to identify where programme delay(s) occurred, pinpoint the areas for further investigation and indicate the probable extent of such delay(s). Just as important, an as-built programme will also identify activities that were not prolonged and did not cause further delay to follow-on works.

Though certain Hong Kong's standard forms of contract (ACP, MTRC, KCRC and Swire Properties Ltd) require the composition of as-built data whilst the project is being progressed, the majority of contractors or contract administrators do not routinely, or

effectively, prepare as-built programmes until the need for delay analysis comes to the fore.

Production of an accurate and detailed as-built programme should be one of the first steps in delay analysis (including dispute resolution) for construction projects where time and/or programme issues are disputed. If the disputing parties are first able to agree the actual timing of key activities and events, then resolution of the dispute by the parties directly involved, or by an outside adjudicator / arbitrator, will become that much easier.

Once compiled, comparison of an as-built programme with the as-planned (or contract) programme for the same works often leads an analyst to ask more questions than it provides answers. Good presentation of as-built data is vital if the analyst is to draw meaningful conclusions. Therefore, contractual and/or commercial personnel should have a clear understanding as to how as-built data should be researched, compiled and presented, together with knowledge of how to read an as-built programme.

## The Format of an As-built Programme

An as-built programme, in its simplest form, is a list of activities against which the actual timing of the activities is recorded. An as-built programme can take on many forms. A few varieties and the circumstances whereupon they may be adopted, are listed in *Figure 1*.

## Activity Selection for the As-built Programme

The as-built programme should include a sufficient level of detail to reflect the original perceived extent of works and refer to all instances whereupon significant changes and/or events occurred. Large projects of about \$500 million can be reasonably

represented by 1,000 activities, though once consolidated far fewer activities are often required to identify the effects of a change and/or event.

So which activities should one select? The best place to start is the as-planned, or contract programme. The as-planned programme will provide an activity list relating to the contract scope of works which should then be modified by the following:-

- addition of activities to reflect all the significant events that materially affected progress of the works, such as instructions by the contract administrator (e.g. activities to instruct, assimilate, co-ordinate, procure, manufacture, deliver, install and test and commission);

- failure of crucial plant and the resultant effects upon activity sequences;

- defect rectification;

- removal of activities through consolidation in respect of non-contentious works or works which progressed according to programme.

The resultant list of activities will likely be more detailed than the as-planned programme, especially in critical areas under investigation, though less detailed in most other areas not subject to investigation.

Beware! It is easy to get carried away with the perceived level of detail required. Remember, over-complicated as-built programmes could confuse the average reader.

## Establishing Actual Start and Finish Dates

Formulation of the as-planned programme is a purely theoretical process carried out before the work is constructed. The commonly

adopted finish-to-start relationship link between two activities is easy to comprehend in the as-planned scenario. However, in actuality, it is common to find a successor activity commencing before completion of the predecessor activity. This is often contrary to the planned logic.

For instance, consider two activities representing the construction of reinforced concrete works for the 3rd and 4th floors of a typical office building. The as-planned

programme illustrates completion of the 3rd floor prior to commencement of the 4th floor. When viewed on a macro scale such programming logic is easy to comprehend.

Now consider the as-built scenario. When was the 3rd floor actually completed? Pouring the concrete? Or perhaps, when the formwork was struck? Or, maybe once the slab had been post-tensioned? Maybe a portion of the slab was found to be defective and had to be replaced prior to loading above specified

levels. Alternatively, perhaps the construction sequence was changed and a small portion of the 3rd floor slab was cast at a later date.

Now consider the actual commencement of the 4th floor. Is overall commencement to be taken as the commencement of reinforcement fixing, or the earlier activity of erecting falsework and formwork? A guide is to consider the core, or primary resources and the uses and movements thereof.

Such instances are not uncommon whilst considering as-built data. Taken literally, the as-built programme of an activity sequence originally inter-related with finish-to-start relationships may well be compiled of many overlapping sub activities and present a far more complicated picture than did the as-planned programme. Ascertaining the critical construction sequence through the as-built data may become difficult.

When deciding actual start and finish dates and the activity relationships it is essential to be consistent and to focus on when the core works that best fit the original activity description occurred. Peripheral issues, though related to the main activity, can largely be ignored, especially if they confuse the overall picture. If necessary, activities actually executed over long periods, or intermittently, may be sub-divided or mini-networks formed and the original activity retained as a hammock. However, remember not to introduce too many new activities which do not impact upon the basis for the analysis.

Wherever possible, reference should be made to the events that preceded or succeeded major components of work. Such events include:-

- possession of portions of the site;
- receipt of approvals and consents from the Building Authority;
- approval of concrete mix designs;
- awards of nominated sub-contracts;
- delivery of key materials, plant and equipment;

Forms	Features	Use
Bar Chart / Gantt Chart	<ul style="list-style-type: none"> <li>• A series of activity descriptions represented by horizontal bars.</li> <li>• The position and length of the bars correspond to the timescale at the head of the chart.</li> <li>• The order in which the bars are placed provides an indication of the sequence and structure of works.</li> <li>• Links can be drawn between the bars to provide an indication of how the activities were inter-related.</li> </ul>	<ul style="list-style-type: none"> <li>• Bar charts are the most common form of as-built programme.</li> <li>• Bar charts are easy to understand and straight forward making them suitable for recording as built progress on most projects.</li> </ul>
Table Format	<ul style="list-style-type: none"> <li>• A table listing activities, corresponding as-built dates and productivity outputs.</li> </ul>	<ul style="list-style-type: none"> <li>• Production rates for construction plant e.g. bored piling equipment and tunnel boring machines.</li> </ul>
Logic Precedence Diagram	<ul style="list-style-type: none"> <li>• A series of activities represented by boxes, between which lines are drawn to indicate inter-activity relationships.</li> </ul>	<ul style="list-style-type: none"> <li>• Methodology of complex projects.</li> <li>• Understanding construction sequences and changes brought about by delaying events.</li> </ul>
Linear Programme	<ul style="list-style-type: none"> <li>• A series of lines and shaded blocks positioned in relation to a timescale (y-axis) and chainage (x-axis).</li> </ul>	<ul style="list-style-type: none"> <li>• Projects which involve repetitive activities, e.g. trades through a high rise building.</li> <li>• Linear projects e.g. railway works.</li> </ul>

Figure 1 - Forms of As-built Programmes

concrete pours and dates;

important instructions; and

statutory submissions, inspections and approvals.

## Sources of Useful Data

Where possible, as-built programmes should be prepared from data that has already been produced, accepted, reviewed or agreed between the parties. The reason for this is simple. If a meaningful as-built programme is to be prepared then both parties involved should agree the content.

Specifically, the best sources of data are formally prepared site diaries, drafted by either the contract administrator or the contractor and countersigned by the other. Incidental records of progress by statutory authorities (i.e. BD, FSD & WSD) and non-partisan bodies (i.e. CLP) are also very useful. Thereafter, contractor's monthly progress reports (if un-contested), official site photographs, signed-off works record sheets and formal correspondence are excellent sources of as-built data. Remember, a contract where there are good records stands a far better chance of being settled amicably than one that has not.

## Qualification of Data

How many times have you examined an as-built programme only to be left pondering exactly what constituted the start or finish of an activity, the activity relationships or be able to find exactly where such data was obtained from?

Once as-built dates have been established it is advisable to provide an audit trail similar to *Figure 2*, particularly if the data is likely to be subject to scrutiny by others.

The easiest way to compile as-built data is in a table format, possibly using a computer based spreadsheet. Entering, searching, organising and filtering data is far easier and quicker in a spreadsheet than if recorded by hand or input directly into programming software. Any amount of notes, comments

### Activity title: R.C. works for 3rd floor

As-built Start	
Date:	2 January 1998
Start of activity:	Erection of falsework / scaffolding at GL 1 -3 / A - C
Source of data:	ER's site diary

As-built Finish	
Date:	9 January 1998
Finish of activity:	The day of placing concrete to the slab pour at GL 5 - 6 / G - H
Source of data:	Contractor's monthly progress report, Appendix B 'Schedule of concrete pours'

Figure 2 - The Audit Trail

and second opinions may be added and filed within a spreadsheet. Further, numerical analysis such as comparing the as-planned and as-built programmes or productivity rates is often easier within a spreadsheet.

## Reading the As-built Programme

Upon completion of an as-built data bank of actual progress, the analyst can commence the task of trying to identify the as-built construction sequences and activity relationships to identify, where delay(s) first began to occur, the causes of delay(s) and perhaps what measures were undertaken to reduce or minimise delay(s).

As-built programmes do not, ordinarily, contain inter-activity linkage and, therefore, do not directly indicate criticality or critical paths. However, from an as-built programme it is possible to produce a networked version from which criticality can be ascertained and what-if or but-for analyses conducted.

## The Mansion / Dog Kennel Syndrome

The investigators of as-built data, particularly in what-if or but-for analyses, should beware of what the writer terms the mansion / dog

kennel syndrome. This is where float was created on none critical activities (the dog kennel) due to delays on critical work (the mansion). In such circumstances, the non-critical activity (the dog kennel) was allowed to slide even though there was no activity link to the critical work (the mansion). A what-if or but-for analyses should recognise this slide and revert it otherwise such analyses will result in the dog kennel becoming critical, when in fact, it was construction of the mansion where the critical delays occurred and which should be the focus of the investigation.

## The Next Article in this Series

The next article in this series on as-built programmes will cover net-working as-built programmes and analysis thereof.

For further information contact [bera@netvigator.com](mailto:bera@netvigator.com) 

# CD ROM TENDERING

## - Could it be done better?

John CHIANG

FKIS, MRICS

Group Operations Director, Icflox  
International Limited (www.icfox.com)

### INTRODUCTION

In this article, I explore the latest development in CD ROM Tendering, or as some may term it, "electronic dissemination of tender documents and electronic submission of tender returns on removable media" (collectively referred to here as "CD ROM Tendering"), currently deployed by the Works Bureau and by one Consultant Quantity Surveying firm in Hong Kong.

Unlike my previous articles on the subject, I have, for a change, interviewed the following to obtain from them first hand comments on the pros and cons in the prevailing CD ROM Tendering approaches:

1. **Case Study 'A'** - A Chartered Quantity Surveyor who has dealt with several Works Bureau's tenders using CD ROM Tendering in the capacity of a tenderer.
2. **Case Study 'B'** - A director of a leading Consultant Quantity Surveying practice who has instigated the dispatch of tender documents both in hard copy and as electronic files (i.e. via CD-ROM).

### BACKGROUND

Before rushing off to unveil the findings from the interviews, maybe I should take you back in time to look at the first generation of CD ROM Tendering in Hong Kong.

Back in 1988, CD ROM Tendering was not around and we had Floppy Disc Tendering ("FDT") - obviously CDs were not invented at that time. Subsequently, FDT was really only used on the MTRC Airport Railway projects.

Although there is a difference in terminology describing the two tendering media, there are

actually a lot of similarities between FDT and the most recently developed CD ROM Tendering, so far as users' requirements are concerned:

1. **Integrity of Bills of Quantities ("BoQ")** - "Checksum" verifications were adopted in FDT to authenticate the integrity of the returned BoQ.
2. **Change Management** - Merging of addenda was enabled in FDT by incorporating the changes without overwriting items not affected by them. Summary report of changes resulting from addenda can also be generated in FDT.
3. **Electronic Submission** - FDT relied on diskettes as the media for transferring data between the initiator and the tenderer. These were the steps:

- Create tables for storing the required information to be transferred to remote site.
- Dump the tables onto diskettes using "bytestream" (i.e. interpret the data from multiple files as a sequence of bytes).
- When the remote site receives the diskettes, it reads the data from the diskettes and restores the tables.
- Merge the data from the tables with the existing tables.

Meanwhile FDT carried out the following functions in conjunction with the data files:

- Rate/Amount Entry
- Computation of Extensions, Page Totals, Collection, Bill Summaries and Final Summary
- Adjustment of rates/amount by percentage.

- Priced BoQ Printing

It would seem to be essential that an evaluation on the current practice of CD ROM Tendering be conducted, to compare with those projects that pioneered FDT over a decade ago, to decide if CD ROM Tendering is actually moving the process ahead.

### TWB TECHNICAL CIRCULAR (WORKS) NO. 39/2002

In preparing the questions to ask in my interviews, I have revisited the TWB Technical Circular. And, having gone through the circular, a series of points are highlighted:

1. **Format of Submission Allowed** (*ETWB TCW No. 39/2002* refers; same circular also referred to in the following unless otherwise stated).

- Form of Tender - In hard copy format only. (*clause 22a*)
- BoQ or Schedule of Rates ("SoR") - For hard copy, **only** on the format provided by the Works Department. (*clause 22b*)
- BoQ or SoR - For electronic files, in an **Editable File\*** Format, i.e. the Excel 97 format. (*Appendix 6 - clause 10 of the Appendix to the General Conditions of Tender.*)

\* "Editable File" means an electronic file, which is stored in file formats that are editable using mainstream computer applications for office automation and computer-aided drafting. (*Appendix 6 - clause 1(a) of the Appendix to the General Conditions of Tender.*)

2. **Tender Evaluation** (*clauses 28 & 32*)

- No alteration to the electronic files of the tender returns is allowed.

- The original set of the tenderers' electronic files shall not be used as far as possible.
- Works Departments should verify whether any alteration has been made to the original text in the BoQ and/or SoR.

### 3. Data Format

- Cells that are not intended for data entry by tenderers should be locked and protected from being updated. (*Appendix 1 - clause 3.4.2*)
- Tenderers shall not modify cells that are locked and protected, failing which shall constitute a qualified tender. (*Appendix 6 - clause 11 of the Appendix to the General Conditions of Tender.*)

### 4. Integrity of Submitted BoQ/SoR

- If a tenderer fails to [price the BoQ/SoR on the hard copy supplied by the Employer], any extra cost incurred by the Employer in checking whether the printed descriptions or figures of the tender are identical to those in the hard copy supplied by the Employer is recoverable by the Employer as a debt. (*Appendix 5 - GCT Clause 3(4)*)
- The electronic files of BoQ may contain simple arithmetic for automatic calculation of the totals and sub-totals. (*Appendix 6 - clause 13 of the Appendix to the General Conditions of Tender.*)

## THE QUESTIONS

With the above in mind I have set out the following questions for the interviews:

#### 1. Format of Submission Allowed

- What comments do you have on the mandatory rule of only accepting a hard copy format of the Form of Tender?
- What are the necessary security features you would be looking for in supporting the submission of a soft copy of the Form of Tender?
- Could you share your expectation and/or experience in pricing and submitting your BoQ/SoR only on the hard copy supplied by the Employer?

- Have you either submitted or supported the return of an electronic file of a BoQ/SoR? If not, why not?

#### 2. Tender Evaluation

- What protection to a submitted priced BoQ/SoR would you consider essential?
- What comments do you have on the requirement that "Works Departments should verify whether any alteration has been made to the original text in the BoQ and/or SoR"?

#### 3. Data Format

- What are your comments in the cell protection technology being applied to BoQ/SoR in Excel format?
- Have you experienced the pricing and/or submission of a priced BoQ/SoR in a format other than Excel?
- What are your views on the Conditions of Tender clause stipulating, "Tenderers shall not modify cells that are locked and protected, failing which shall constitute a qualified tender"?

#### 4. Integrity of Submitted BoQ/SoR

- What comments do you have on the statement "The electronic files of BoQ may contain simple arithmetic for automatic calculation of the totals and sub-totals"?
- What are your comments and/or expectations on other currently available technologies in the encryption of the BoQ/SoR to be submitted?

## MODES OF TENDER RETURN IN BOTH CASES

Neither of the parties being interviewed has personal experience of the submission of tender documents in electronic files, despite the fact that, in both of the cases, their adopted system supported the return of electronic files. This will become the subject of separate exploration, in due course.

Since the basic mode of tender return as electronic files in Case Study 'A' has already been covered previously, it is not necessary to repeat it here. As for the reasons for not going all the way through with an electronic submission, I will leave it to the readers to deduce after reading the replies from the interviewees.

In Case Study 'B', tenderers can encrypt the priced BoQ and burn it onto a CD-ROM for submission. The reason it has not yet been implemented, as was explained by the interviewee, was that they wanted to take things one step at a time. They reckon that they should allow ample time for the tenderers to get through the learning curve at their own pace before moving onwards. The interviewee then remarked that they have now aroused the interest of a lot of tenderers in using the system where they were snubbed initially.

## THE INTERVIEW

**Case Study 'A'** - The Chartered Quantity Surveyor who has handled several Works Bureau's CD ROM Tendering in the capacity of a tenderer.

#### 1. Format of Submission Allowed

**Q.** What comments do you have on the mandatory rule of only accepting a hard copy format of the Form of Tender?

**A.** "It did not bother me at all as I have been submitting my BoQs in hard copy anyway. However, had I gone for electronic file submissions, I would expect that the Form of Tender should also be available in an electronic format. Better still, I hope the Tender Sum inserted in the General Summary could be automatically carried forward to the Form of Tender."

**Q.** What are the necessary security features you would look for in supporting the submission of a soft copy of the Form of Tender?

**A.** "Come to think of it and knowing how the Government works, I would expect that all the text prepared by the Works Department are protected from alterations by mistake on our part. Along this line, I would equally expect that all my inserted data be protected from alterations by the Works Department. Signing the whole Form of Tender with my digital certificate is a MUST." 