

**Memorandum for the Commercial Properties Committee of
the Hong Kong Housing Authority**

**Single-operator Letting Arrangements
for Housing Authority's Markets**

PURPOSE

To inform Members of the recent development in the operation of Single Operator Markets (SOMs) and to seek Members' approval to enhance the letting arrangements and monitoring mechanism for SOMs.

BACKGROUND

2. The single-operator letting arrangement was first introduced in 1988 and has been adopted in all Housing Authority (HA)'s new markets from 1997 onwards under the endorsed policy. At present, there are 22 markets under HA and six of them are SOMs^{Note 1}.

3. The tenancies for Ching Long and Hung Fuk Markets were terminated in late 2016 respectively as a result of default in rent payment and early surrender. Tender exercises were subsequently arranged for re-letting of the two markets. There were also complaints from stall operators of Shui Chuen O Market against low patronage and unsatisfactory business operation of the market. In this connection, there have been public calls for HA to discontinue the single-operator letting arrangement. We consider it opportune to undertake a review of the current arrangements for SOMs in the light of recent operations of these markets.

Note 1 Including Ching Long, Hung Fuk, Kwai Chung, Lei Muk Shue, Shui Chuen O and Tin Yan Markets.

CURRENT DEVELOPMENT

Ching Long Market

4. Due to default in rent payment by the SOM tenant of Ching Long Market, HA issued notice-to-quit (NTQ) in August 2016 and finally confirmed the termination of the tenancy in November 2016. Having regard to the need to ensure a smooth transition and provision of continued market services to residents, the following actions had been taken –

- (a) Tender for re-letting of the market was arranged shortly after the serving of NTQ, with provisions requiring the new tenant to offer to let the stalls to the existing operators first and at licence fees and terms to be agreed between themselves;
- (b) During the interim period and prior to commencement of the new tenancy, the Department mobilized its property management team to provide cleansing, security and minor maintenance services to facilitate continued operation of the market ^{Note 2}; and
- (c) Briefings on the above arrangements had been given to the stall operators as well as the local Councillors and the Estate Management Advisory Committee (EMAC) of the estates concerned.

5. A new SOM tenant was recruited with tenancy commenced on 1 December 2016. According to our observations, the change-over of SOM tenancy has been smooth as a result of the implementation of the above transitional arrangements.

Note 2 As there was no contractual relationship between HA and the stall operators, the latter was not demanded to pay any charges to HA during the interim period.

Hung Fuk Market

6. The tenant of Hung Fuk Market indicated difficulty to run the market due to poor business. Early termination of the tenancy was accepted by the Department in November 2016 with payment of four months' rent by the tenant according to established policy. We arranged a tender exercise to re-let the market by inviting the eligible operators on the SOM Client List. In the tender assessment based on the two-envelope system, the same SOM tenant obtained the highest combined score and was awarded a new tenancy for Hung Fuk Market. Similar to the re-letting of Ching Long Market, the SOM tenant was required to offer to let the stalls to the existing operators first and the new SOM tenancy commenced on 1 February 2017.

Shui Chuen O Market

7. As endorsed vide Paper No. CPC 67/2001, a rent adjustment scheme would apply to assist the commercial tenants, including the SOM tenant, of new estates with slow intake and the monthly adjustment would be calculated based on the number of flats let as a percentage of the number of flats scheduled for intake ^{Note 3}. Due to slow intake of flats in Shui Chuen O Estate, the Department has been granting rent rebate to its commercial tenants in the estate accordingly. Since commencement of the SOM tenancy in March 2016, the SOM tenant has been granted a monthly rent rebate at 80% of the rent stated

Note 3 Details of the rent adjustment scheme for slow population intake are as follows –

<u>Flats already let as percentage of flats scheduled for intake</u>	<u>Rent payable as percentage of rent stated in tenancy agreement</u>
above 90%	100%
above 80% up to 90%	85%
above 70% up to 80%	70%
above 60% up to 70%	60%
above 40% up to 60%	40%
above 20% up to 40%	20%
up to 20%	10%

under the tenancy up to June 2016 ^{Note 4}, 60% from July 2016 to January 2017 and 40% since February 2017. In accordance with the established requirements, the SOM tenant has in turn refunded the rent rebates obtained from HA to the stall operators proportionally based on the internal floor area (IFA) of individual stalls. In addition, the SOM tenant had also given a concession of three months' rent free to the stall operators, albeit this was not a requirement under its tenancy with HA.

8. Notwithstanding the above rent concessions, there have been complaints from the stall operators on the low footfall to the market and business loss of their operations. The Department and the SOM tenant would continue to carry out enhanced promotion activities to boost the patronage and sales of the market. It is anticipated that the business environment will improve when the remaining phases of Shui Chuen O Estate are gradually completed.

PROPOSED ENHANCEMENTS

9. Since the implementation of the single-operator letting arrangement in all HA's new markets in 1997, a comprehensive review had been conducted in 2002 vide Paper No. CPC 9/2002, putting in place a series of measures ^{Note 5} to enhance the protection to stall operators and better monitor the performance of the SOM tenants. We consider that the single-operator management mode had been operating effectively and should continue to be adopted in HA's new markets. However, in view of the recent demands and concerns in the

Note 4 The SOM tenant of Shui Chuen O Market was granted a three-month rent free period from 21 March 2016 to 20 June 2016 under its tenancy with HA and has been granted rent rebates under the rent adjustment scheme starting from 21 June 2016.

Note 5 Including the tightening up of conditions under tenancy agreements to ensure that the premises are operated as a traditional market with focus on specified essential market trades, impose restrictions on the fees and charges to be levied on the stall operators, and avoid excessive dominance by any one operator; improvement in management responsiveness; adoption of a combined scoring system in assessing tenders for letting of the market; and the setting up of a performance appraisal system.

community on the SOM letting arrangements and learning from the experience in the recent SOM operations, we have conducted a review of the current arrangements and are proposing some enhancements to improve the effectiveness of SOM operations and address related concerns in the ensuing paragraphs.

Interim Arrangements for Change in SOM Tenant

10. In case of change of SOM tenant in future, we shall follow the arrangements for Ching Long and Hung Fuk Markets and require the new SOM tenant to offer to let the stalls to the existing operators first at licence fees and terms to be agreed between themselves. In cases where a new tenancy could not be arranged to tie in with the termination of the existing tenancy, the interim arrangements adopted for the case of Ching Long Market will be followed. To enhance transparency, we shall keep the stall operators and relevant stakeholders informed of the related arrangements.

Early Surrender of Tenancies

11. There are currently no restrictions to bar those tenants from leasing HA's commercial premises after early surrender of tenancies. Arising from the case of Hung Fuk Market, there were concerns on allowing the outgoing tenant to participate in the tender for re-letting of the premises following early surrender. To address such concerns, we *propose* that in future, upon early surrender of the tenancy, the same tenant would not be invited to bid again for the premises in question upon its re-letting. Such one-off suspending arrangement would apply to all commercial tenancies, including SOMs, in the event the tenant pursues early surrender of its tenancy.

Rent Rebate for Slow Population Intake

12. To assist commercial tenants, we consider that the current rent adjustment scheme for slow population intake in new estates should be maintained. In addition, the requirement for the SOM tenants to refund the rent rebate amount to individual stall operators proportionally based on the IFA

of individual stalls should continue to be adopted^{Note 6}. At present, SOM tenants would enjoy a three-month rent free period under its tenancy with HA. As SOM tenants do not receive any rent rebate during the rent free period, no rebate will be granted to the stall operators. Such arrangement had created much confusion to others and as a result, there were complaints arising from misunderstanding that the SOM tenant had not complied with the requirement of refunding the rent rebate amount to the stall operators during the rent free period. In view of the situation, we *propose* that the SOM tenant would be required to grant individual stall operators a concession equivalent to the rent rebate amount under the current rent adjustment scheme during the three-month period when no rent is payable to HA by the SOM tenant. However, during the licence fee free period for stall operators, the SOM tenant is not required to refund the rent rebate amount granted by HA or grant the concession equivalent to the rent rebate amount under the rent adjustment scheme to the stall operators concerned.

Measures to Enhance Protection for Stall Operators

13. The following measures are *proposed* to enhance the protection for stall operators –

(a) ***Standard Licence Fee Free Period***

Currently, SOM tenants are granted a three-month rent free period to facilitate their business start-ups and fitting-out works. Some SOM tenants would grant licence fee free periods from 14 days up to a month to individual stall operators depending on the type of trades and their agreement of licence terms. To enhance uniformity and to avoid possible complaints, we consider it appropriate to make it a standard requirement for the SOM tenants to grant licence fee free period to stall operators as follows –

Note 6 Some stall operators are of the view that the rent rebate amount should be refunded to the stall operators in proportion to the licence fees paid by the stall operators. As the licence fees are negotiated between the SOM tenant and the stall operators on commercial basis and may vary depending on the location and trade of individual stalls, we consider that the IFA of individual stalls provide a more objective basis for apportionment.

Licence Term	Licence Fee Free Period
12 months or more	Not less than one month
3 months to less than 12 months	Not less than 14 days

(b) ***Amount of Deposits to be Collected from Stall Operators***

According to the tenancy agreement, SOM tenants are required to pay a deposit equivalent to three months' rent to HA. In turn, SOM tenants are allowed to collect a deposit amount of not more than three months' licence fees from the stall operators. As a relief measure to the stall operators, SOM tenants will only be allowed to collect a deposit of not more than two months' licence fees from their stall operators in future. This is in line with their counterparts in leasing markets stalls with HA.

(c) ***Amount of Management Fees***

Under the current tenancy terms, the amount of management fees as set out by the SOM tenants in the leasing proposal may be collected and annual adjustments should accord with the movement in the Nominal Wage Index published by the Census and Statistics Department. As a further measure to protect the stall operators, the maximum amount of management fees to be charged upon initial letting on a per square metre IFA basis will be capped by the prevailing average management fees charged by the existing SOM tenants of HA's markets ^{Note 7}.

(d) ***Standard Terms under the Licence between the SOM Tenant and the Stall Operators***

Under the current tenancy terms, SOM tenant shall not collect any fees other than licence fees, air-conditioning charges, rates and management fees from the stall operators. Recent disputes arose in the Shui Chuen O case as the SOM tenant did not list out each item of charges clearly and also included clauses requiring payment of

Note 7 Currently at \$267/m² per month on average.

administrative fees in the licence agreement, although the tenant had no intention of imposing such administrative fees on the stall operators. For clarity, the SOM tenant should be required to separately list out each of the four permitted items of charges and must not include any other item of charges in the licences signed with the stall operators to avoid any disputes. The SOM tenant should also specify the standard licence fee free period and the amount of deposit to be collected from stall operators in the licence agreement.

Measures to Enhance Monitoring of the SOM Tenants

14. The following measures are *proposed* to enhance the monitoring of the SOM tenants –

(a) ***Performance Evaluation for Tender Invitation and Assessment***

At present, performance of SOM tenants is assessed on a bi-monthly basis. For renewal of tenancies, the SOM tenant must have achieved an average performance score of at least 60% over the last twelve months and a score of over 60% in the last two performance reports. For new lettings, we consider that those SOM tenants managing HA's markets with average performance scores less than 60% over the past six months should not be invited to participate in the tender exercise.

Under the existing arrangement for assessment of the leasing proposals, separate scores will be allotted on the basis of bidders' past performance^{Note 8} in managing markets and the rentals proposed. These two aspects carry equal weight and the bidder with the highest combined score will be awarded the new tenancy.

Note 8 According to Paper No. CPC 9/2002, bidders with no performance record will be awarded a score equivalent to the median obtained by bidders with performance records, but capped at 69 points, which is equivalent to the maximum score awarded for an acceptable standard.

(b) ***Direct Operation of Stalls by SOM Tenants***

The direct operation of stalls by the SOM tenant has always been criticized by the public as monopolizing individual trades and leading to high prices of goods. There is no evidence that direct operation of stalls by SOM tenants would push up the prices. Furthermore, it may sometimes be necessary for the SOM tenant to directly operate the stalls in order to reduce the vacancy rate and ensure the effective operation of the market or to meet the tenancy requirement of providing certain proportion of food and miscellaneous trades. In order to strike a balance between maintaining flexibility for SOM operation and addressing public concerns, we suggest restricting the scale of direct operation by the SOM tenant to an area of not more than 20% of the total IFA of the market stalls.

(c) ***Promotion Fee***

To ensure that the SOM tenant will carry out regular promotional activities to enhance shopping ambience and boost patronage to the market, we would upon new letting or tenancy renewal impose a requirement for the SOM tenants to maintain an annual promotion fee of not less than 2% of their annual rent payable to HA for promotional activities ^{Note 9}. They will be required to provide documentary proof certified by qualified accountants to substantiate such spending for promotional activities.

(d) ***Publicizing the Letting of Market Stalls***

To enhance dissemination of information, SOM tenants would be required to publicly advertise lettings of the market stalls, such as placing newspaper advertisements, issue of public notice, etc. whenever vacancy arises.

Note 9 The annual promotion fee as specified under current tenancies of the six SOMs range from \$100,000 to \$500,000.

(e) ***Communication with SOM Tenants and Stakeholders***

To enhance the communication, local management staff will arrange regular meetings with the SOM tenants on daily management and their performance. Moreover, SOM tenants would be required to keep close liaison with other stakeholders including the stall operators and local dignitaries on management issues, promotional programme, etc. for the market. The SOM tenant may also be invited to attend meetings with EMAC or local Councillors on need basis to listen to their views on the operation and service improvement of the market.

FINANCIAL, STAFFING AND INFORMATION TECHNOLOGY (IT) IMPLICATIONS

15. The proposed enhancement measures would increase operating costs of the SOM tenants and may be reflected in their rental bids. It is not possible to estimate the amount as this would depend on the business potential of the markets concerned and the tenderers' commercial decision.

16. There is no additional staffing implication as the workload arising from the implementation of the above enhanced measures will be absorbed by the existing staff. There is no IT implication.

PUBLIC REACTION/PUBLICITY

17. We believe that the public will generally welcome the enhancements. We shall continue to closely monitor the performance and effectiveness of the SOMs and explain HA's policy in continuing to adopt such letting arrangement for new HA's markets.

DECLASSIFICATION

18. We *propose* that this paper be declassified after Members' endorsement of the proposed enhancements. The paper will be made available to the public at the HA Homepage, Housing Department's library and through the Departmental Access to Information Officer if it is declassified.

RECOMMENDATIONS

19. Members are invited to note –

- (a) the current development of Ching Long, Hung Fuk and Shui Chuen O Markets (paragraphs 4 to 8); and
- (b) the interim arrangements for change in SOM tenant (paragraph 10);

and to approve the following recommendations –

- (c) The outgoing tenant of commercial premises, including SOMs, will not be invited to participate in the tender for re-letting of the premises concerned following early surrender of tenancy (paragraph 11);
- (d) During the three-month rent free period provided by HA, the SOM tenant will be required to grant individual stall operators, except during the licence fee free period for the stall operators, a concession equivalent to the rent rebate amount under the rent adjustment scheme applied to new estates with slow population intake (paragraph 12);
- (e) Measures will be implemented to enhance protection for stall operators through setting the standard licence fee free period, capping the amount of deposits to be collected from stall operators as well as the amount of management fees to be charged upon

initial letting, and setting out the standard licence terms between the SOM tenant and stall operators (paragraph 13);

- (f) Measures will be implemented to enhance monitoring of the SOM tenants through setting the threshold performance score as a pre-requisite for tender invitation, restricting the extent of direct operation of stalls by the SOM tenant, requiring a minimum annual promotion fee and that letting of vacant stalls should be publicized, and enhancement of communication with SOM tenants and stakeholders (paragraph 14); and
- (g) This paper will be declassified after the meeting (paragraph 18).

DISCUSSION

20. At the meeting to be held on 27 March 2017, Members will be invited to endorse the recommendations as set out in paragraph 19 above.

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