

# Mannequin Marvel

Watching the shop girls putting the latest fashion wear on the mannequins at the shop window display changed my perception in retailing when I was young. Then in the mid-80s I became mesmerized by the water fountain show at the Shatin New Town Plaza. Today, I would most probably spend hours queuing up for a table at the gourmet place of the mall.

Thanks to the shopping center managers' ever changing appetite for new retail concepts, our shopping scenes have been fast evolving. It is true to say that the shopping experience has never been more fun, entertaining and exciting.

In our opening article for this month's theme Retail Tales, Stephen Chung discusses some of the emerging trends in the US retailing landscape and provides his thoughts on how these would be evolved in Greater China.

Renovation has become a buzzword for shopping malls. It seems that with each renovation the mall can resurrect the falling trend in visiting shoppers. But, as Victor Ng discussed in his article, this is not necessarily the case. He examines the key driving forces for shopping mall renovation in market downturns.

Although the threat that the "Virtual Mall" concept would wipe out all shopping malls in future has not materialized, we cannot yet write it off completely. The threat, like SARS virus, has mutated into a different form. Another feature article tells how the growing emergence of e-commerce could jeopardize the future of turnover rent.

As always, shopping mall management is all about imagination and innovation. Over the years we have seen many examples in which shopping mall owners harnessed each crisis for their own advantage and rejuvenated the malls.

So next time when you see the mannequins changing into new clothes, you shouldn't be too surprised to see there has yet been another round of a host of new and exciting changes inside the mall.

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# Unleashing the Real Power

## Proposal for the Review of the Land (Compulsory Sale for Redevelopment) Ordinance



The Government Practice and Local Affairs Panel of the General Practice Division

### Introduction

Since the enactment of the Land (Compulsory Sale for Redevelopment) Ordinance ("the Ordinance") on 7 June 1999, four cases have been reportedly filed to the Lands Tribunal under the Ordinance (statistics from the Judiciary website), with two granting the order of sale.

The Hong Kong Institute of Surveyors ("HKIS") considers that the Ordinance has helped facilitate redevelopment of the urban area by private sector though on a small and piecemeal scale.

Before the enactment of the Ordinance, the HKIS had expressed the concern that the Ordinance would not be able to cater for many old blocks, though with strong redevelopment merits, due to the very restrictive criteria for application laid down in the Ordinance.

With the familiarity and experience gained by the public and the industry in the past few years, the HKIS believes it is high time to review the Ordinance and relax certain provisions so that the Ordinance can be more effective in facilitating urban renewal projects.

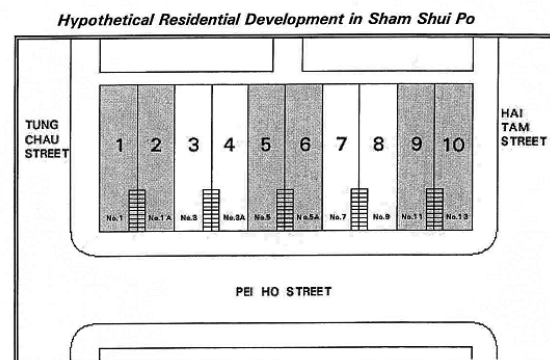
This proposal will focus on three main areas:

- ▶ To reconsider relaxation of the application criteria to include lots or a scheme and whether such conditions of relaxation be specified by the Chief Executive (pursuant to Section 3(5) and (6) of the Ordinance).
- ▶ To specify more grounds for the redevelopment justifications for which the Secretary for Housing, Planning and Lands has the power to make regulation (pursuant to Section 4(2)(a)(ii)).
- ▶ To clarify certain ambiguous clauses as highlighted in the judgments, for example the wording of "existing development" (pursuant to Section 4(2)(a)(i)).

### A Application criteria

#### 1 Existing Provisions of the Ordinance

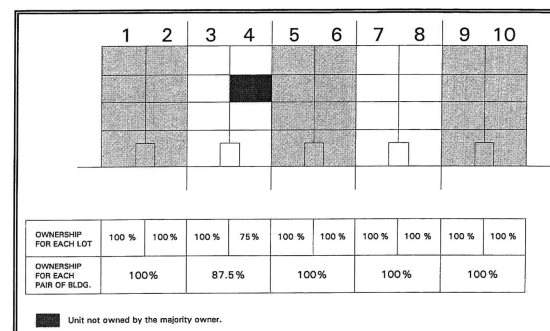
The Ordinance applies to a lot forming the subject of a Government Lease or a section of a lot (the "Lot"). The majority owner (as explained below) can apply to the Lands Tribunal for an order to sell all the undivided shares in the Lot for the purposes of redevelopment of the Lot. The majority owner is defined as the owner or owners who own more than 90% of the undivided shares in the Lot, or in the case of two buildings standing on two Lots connected by a common staircase, the majority



owner can own 90% of the undivided shares in the two Lots. This very narrow application creates a lot of difficulty and substantially restricts the application of the Ordinance.

#### 2 A Hypothetical Example

*Ownership Pattern of Residential Development in Sham Shui Po*



In our previous submission on the Urban Renewal Authority Bill in 1999, we used a hypothetical case to illustrate how this narrow definition could not help in otherwise desirable redevelopment projects. We would like to reiterate the example below.

A street block at the junction of Tung Chau Street, Hai Tam Street and Pei Ho Street which consists of a row of ten buildings all 4 storey in height and each pair of buildings is connected by a common staircase. The plan of this street block is shown below. The numbering of these buildings are quite complicated and we have therefore referred to them as buildings no. 1 to 10:-

There are altogether 40 interests for the whole block. If the developer owns 39 of the 40 interests, the Ordinance will not be able to help in the overall redevelopment of the block. The diagram below shows the ownership pattern.

If the developer fails to obtain one of the units, his ownership in the Lot will only be 75%. If we take a pair of Lots, the developer's interests will only be seven-eighths or 87.5%. This still falls 2.5% short of the 90% threshold stipulated in the Ordinance. The provision in the Ordinance cannot therefore apply.

#### 3 Ownership Threshold Can be Lowered to 80%

The Chief Executive in Council may specify that the percentage of ownership of the majority owner to be lower than the 90% in respect of a Lot or a class of Lots, provided that the percentage specified is not lower than 80% (Section 3(5) and (6)). This can be a useful provision and may help to resolve the problem described above. So far, the Chief Executive has not made any specifications on that.

#### 4 The HKIS Proposal - The Redevelopment "Scheme" Concept

The HKIS proposes that the government consider again the Ordinance be amended so that for cases as illustrated in the above

hypothetical example can be included in the application criteria.

In addition to the above suggestion, the HKIS also recommends that the concept of a 'Scheme' be introduced.

In the example quoted above, buildings numbered 1-4 will not be part of the redevelopment project of buildings numbered 5-10, consisting of six lots with a total site area of about 600 sq. m. In spite of the fact that the developer owns all except one unit in buildings numbered 1-4, these four lots cannot be amalgamated to form part of the redevelopment scheme. The result of this is what is commonly known as a "pencil development".

When the developer eventually acquires the outstanding unit in building number 4, there will be another even smaller "pencil development" on numbers 1-4. If the site is going to be redeveloped as two towers, the efficiency ratio for both towers will be reduced, as each will have to have staircases and a lift core. From a broader perspective, this is not desirable as resources will be used to erect common areas in buildings which are not living space.

The HKIS proposes to replace the definition of "Lot" with "Scheme" (the "Scheme"). The Scheme can consist of as many buildings as the majority owner proposes but the extent of the Scheme will have to be approved by a tribunal which may or may not be the Lands Tribunal. Whilst the majority owner is free to propose the boundary of the Scheme, he will have to demonstrate to the Tribunal the planning gain and the public benefit of his proposal.

In the example quoted above, one would have thought that the Tribunal would see merit in approving the limit of the Scheme to cover the whole block of ten buildings.

## **B The Secretary to make regulations on the conditions of justifications for redevelopment**

The Lands Tribunal shall not make an order of sale unless it is satisfied with the justifications for redevelopment under Section 4(2)(a), which reads:

- (2) *The Tribunal shall not make an order for sale unless, after hearing the objections, if any, of the minority owners of the lot the subject of the application under section 3 (1) concerned, the Tribunal is satisfied that-*
- (a) *the redevelopment of the lot is justified (and whether or not the majority owner proposes to or is capable of undertaking the redevelopment) -*
- (i) *due to the age or state of repair of the existing development on the lot; or*
- (ii) *on one or more grounds, if any, specified in regulations made under section 12;*

In some situations the reasons that render the building ripe for redevelopment may not just be confined to the age of building or state of repair. It could be that the existing use of the building is no longer compatible with the current zoning use stipulated in the relevant Outline Zoning Plan, or its use would cause an ongoing environmental nuisance to the nearby areas. The HKIS considers these are valid justifications for redevelopment and their redevelopments are in the best interests of the public. In order to stimulate redevelopment in these types of properties, the HKIS suggests the government to make use of its power under the Ordinance to include appropriate conditions for redevelopment justifications.

## **C Clarifications of certain provisions in existing Ordinance**

In *Bond Star Development Ltd. v Capital Well Ltd* (2002), Judge Wong noted that the wording of "**the age or state of repair of the existing development on the lot of existing development**" in Section 4(2)(a)(i) would be ambiguous in situations where the building formerly erected on the lot has been demolished. Moreover, the Ordinance is silent as to the basis of valuation of the property on the lot in this situation.

Judge Wong tackled this problem with the assistance of other provisions of the Ordinance including the Preamble, Section 2 (the section on interpretation of the term "redevelopment") and Section 3(3)(c)(i)(B) (the section on the affixing of notice in case "where there is no building on the lot") and held that the Ordinance applies to the situation where there is no building on the lot.


To avoid ambiguity in interpretation of the Ordinance and in the light of the comment made by Judge Wong, the HKIS suggests that the Ordinance should be revised to cater for such situation.

## **Conclusion**

With more than 4 years experience gained since its enactment, the public in general has become more familiar with the application of the Ordinance and the operation of the Order for Sale. The HKIS proposes for a relaxation of the application criteria in the Ordinance in order to promote more private sector participation in urban regeneration.

The current criteria have not been able to foster what would be otherwise more desirable redevelopment projects. The merit of urban regeneration goes beyond removal of urban eyesore. Aesthetics design; environmental improvements and amenity facilities - factors critical in assessing the redevelopment merit -

cannot be ignored. The HKIS calls for endorsement of the "Scheme" concept in the Ordinance in order to encourage more socially desirable redevelopment projects.

The above proposal will involve legislative change. The outcome and timing for such change is uncertain and could take a long time. To avoid undue delay and speed up urban redevelopment, the HKIS recommends the government make use of the current built-in flexibility under Section 3 (5) and (6) of the Ordinance in which the Chief Executive has the power to lower the current 90% ratio to not less than 80%. We recommend the ratio be relaxed to 80% to increase the practical scope of the Ordinance. Send your comments to [chunkong.lau@ap.jones.lasalle.com](mailto:chunkong.lau@ap.jones.lasalle.com). 

## The JO Forum 3 - A Thought-Provoking Session




Reported by Kelvin NG

Although the theme in the JO Forum was valuation concerns on three case studies, i.e. government rents on NT, industrial lease modification and URA resumption compensation, our three presenters gave excellent presentations that demonstrated they possessed a high level of analytical skills beyond mere elaboration of valuation models. They put their case concerns into perspective and gave a detailed account why these problems could arise through discussions on the legal framework, planning considerations, land lease conditions and the land administration mechanism. Moreover, with the help of our two moderators, they engaged the audience into a heated debate and put forward some innovative proposals in solving their problems.

After the forum our young speakers all reported that they enjoyed the thrill of public speaking which has boosted their confidence in the coming APC. The JO Forum has got the stage for you - join the forum as our next speaker, take home our special souvenir and achieve new breakthroughs in your life. For details of the JO Forum, please contact forum organiser [jimyip@hkis.org.hk](mailto:jimyip@hkis.org.hk)



Special thanks to our three student speakers (from left to right) Sam Chiu, Raymond Ho and C Y Jim, and our two moderators Rock Tsang and Tony Wan 

## CONGRATULATIONS TO THE FOLLOWING WHO WERE ELECTED AS HKIS MEMBERS ON 22 MAY 2003

### FELLOWS (2)

#### GP DIVISION

CHOU CHE HUI JEFFREY

#### QS DIVISION

LEE YU MENG

### MEMBERS (11)

#### BS DIVISION

CHAN BING WING HENRY

CHEUNG WOOD MAN

HUNG KAM YING

LEE LEE

SHIU KWAI KING JOE

SZETO HAU YAN ESTHER

YEUNG HO CHUEN

#### GP DIVISION

LEE CHUN LUNG GABRIEL

#### LS DIVISION

TAM HOI CHEUNG SIMON

#### QS DIVISION

GOURLAY, CATRIONA HUME

RIDLEY, TIMOTHY JAMES

### RESIGNATIONS (11)

CHAN FEI PANG

CHENG SECK FAT PETER

CHIU SZE NGA CECILIA

DALE, JAMES PHILIP

LEE CHEUK WAI ANTONY

LEUNG CHI WAI

LEUNG CHUN KWONG

LUK YIN FONG

SEYMOUR-JONES, TREVOR JOHN

TSANG KWAI YU

WAI KING HANG HOWARD

### OBITUARY

Mr WONG Yuen Tat, Student B, Quantity Surveying Division, student since 2002, passed away on 2 March 2003.



# USA Shopping Centers: *Fun, Food and Family?*



**Stephen CHUNG**

Executive Director, Zeppelin Real Estate Analysis Limited

Shopping Centers have been part of North American life since the 1950s and they include the neighborhood strip plazas all the way to the super regional malls. In recent years other specialty types have sprung up as well, such as power centers, festival centers etc. in part reflecting perhaps the change in retail behaviors, and business structure and competition. To the technical minded, the following description from the International Council of Shopping Centers reads:

**SHOPPING CENTER** = A group of retail and other commercial establishments that is planned, developed, owned, and managed as a single property. On-site parking is provided. The center's size and orientation are generally determined by the market characteristics of the trade area served by the center. The main two configurations are malls and strip centers. Malls are typically enclosed retail complexes with climate-controlled walkways connecting the stores. Most regional and super regional shopping centers tend to be of such design. Strip centers are usually open-air with open canopies and the layout can be a straight line, L-shaped or U-shaped plan.

Basically, there are 8 primary types of shopping centers, and they are categorized mainly according to their scales, trade-capture areas, the significance of anchor tenants (i.e. stores which draws traffic, people and business), and the like. The following provides a rough guide:

- 1) **NEIGHBORHOOD CENTERS** = tend to have 30,000 - 150,000 ft<sup>2</sup> of floor area on 3 to 15 acre sites. There is usually 1 supermarket anchor occupying around 1/3 of the floor space. The concept is convenience for nearby neighborhoods within a 3-mile radius.
- 2) **COMMUNITY CENTERS** = tend to have 100,000 - 350,000 ft<sup>2</sup> of floor area on 10 - 40 acre sites. Anchors are usually drug stores, home improvements stores, and the like and may constitute around 1/2 the floor space. The concept is general merchandizing and convenience serving households within a 6-mile radius.
- 3) **REGIONAL CENTERS** = tend to have around 400,000 - 800,000 ft<sup>2</sup> of floor area on 40 - 100 acre sites. Anchors are likely to be department stores, fashion stores etc. and these may use up 50 - 70% of the floor space. The concept is general merchandizing and fashion serving households within a 15-mile radius.

- 4) **SUPER REGIONAL CENTERS** = tend to have over 800,000 ft<sup>2</sup> of floor area on 60 - 120 acre sites. Anchors are similar to the regional centers albeit plenty more and these too occupy up to 70% of the floor space. The concept is similar to regional centers offering much variety and serving households within a 25-mile radius.
- 5) **FASHION / SPECIALTY CENTERS** = tend to have 80,000 - 250,000 ft<sup>2</sup> of floor area on 5 - 25 acre sites. The focus is on higher boutique grade fashion serving neighborhoods within a 15-mile radius.
- 6) **POWER CENTERS** = tend to have 250,000 - 600,000 ft<sup>2</sup> of floor area on 25 - 80 acre sites. The anchors may number 3 or more and are so-called category killers (i.e. they offer the best possible range of certain product items and/or best possible prices for them) etc. warehouse stores, home improvement stores etc. are common. These anchors usually occupy 3/4 or more of the floor space and the concept relates to having category-dominant anchors. They usually serve households within a 10-mile radius.
- 7) **THEME / FESTIVAL CENTERS** = tend to have 80,000 - 250,000 ft<sup>2</sup> of floor area on 5 - 20 acre sites. The concept is usually leisure/ tourism / retail service focused and there may not be any significant anchors, although restaurants and entertainment stores are likely to dominate. Also, the trade area served is less identifiable as people may come from other cities or countries.
- 8) **OUTLET CENTERS** = tend to have 50,000 - 400,000 ft<sup>2</sup> of floor area on 10 - 50 acre sites. These are the manufacturers' outlet stores and they may attract people from within a 75-mile radius.

Please note the above are rough guidelines only and there may be various hybrids i.e. a mingling of two or more of the above categories. Also, not all retail property types are included herein as the focus here is on shopping centers.


In view of the increased influence and use of the web-internet, and the observably increased impatience that people have for mundane tasks, your humble author would like to do a few speculations i.e. intuitive guesses:

- a) **FUN, FOOD, AND FAMILY** = save for perhaps the most basic relatively tiny neighborhood strip centers, shopping centers by and large have long since ceased to be places where you go just for the sake of buying things (or getting services) you need (or do not need). Unless the goods and retail items themselves are so exotic that they already induce much joy / happiness / excitement / satisfaction in the buying process (for the consumers), shopping centers are likely to do themselves favors if they can instill some

of these ingredients into the centers i.e. the shopping (including just looking and strolling around) process itself has to be a joyful, happy, satisfactory or even exciting event. Fun here implies entertainment and excitement, food here implies more than just filling bellies and quenching thirst, and family implies giving reasons for people, relatives and friends included, to socialize / mingle / congregate or just hang around together. As online ordering becomes more common, competitive (in pricing), and convenient, giving reasons for people to actually leave their homes and drive to shop will involve quite a bit of imagination, marketing skills, and persistence. Those who fail to do so will have empty shopping centers.

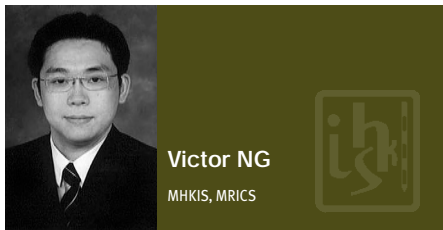
- b) **SHOPPING PARKS** = we already have office parks i.e. office buildings or compounds, many owned or used by one single corporation, set in a suburban environment plus some landscaping and outdoor features. One idea is that the people who work there can enjoy the outdoors / sun / fresh air etc. during lunch hours or even during meetings. Hence, shopping centers may well consider incorporating some form of garden or park concept in their overall design i.e. shoppers not only shop there but can do a round of coffee or picnic in the park (instead of having to drive another 20 miles getting from one location to another). This also beats just having tarmac parking areas.
- c) **CHINA AND CARS** = private family car sales are said to be on a growth path in China, especially in the more affluent major cities. As such, private family cars may become a relatively common household item someday if not now, meaning families, at least some of them, will have a larger freedom to choose where they shop, seek entertainment, or eat (out). In turn, this enhances the possibility that collectively shopping centers, especially ones that originate from the North American / USA model (which is very much a car-based model), or at least some hybrid forms of them, may have a bright future in China.

Summing up, divest in no fun North American / USA shopping centers, consider new formats for shopping-retail properties, and study the prospects of shopping centers for some of the probable car-intense China cities.

The above is of a macro view and individual circumstances may vary. Seeking proper consultation and latest market information are required for a more concerted analysis and decision-making process. 

# Mall Changes its *Face* to Draw More *Faces*

*The driving forces for mall upgrades in downturns*



Victor NG  
MHKIS, MRICS

Prior to the financial downfall in 1997, the Hong Kong economy was buoyant, but somewhat overheated. Retail, property, information technology, as well as other business sectors were enjoying their era of high-growth.

Retail sales were booming and virtually all retailers recorded a thriving trade. "Renovation" at that time might be a distant thought, especially for those landlords of bustling shopping centres.

Over time, as economic conditions have changed, so have the business mind. Since the economy slide in 1997, more and more landlords of shopping malls have started to think about ways to survive and what else they could do in response to the falling economy and consumer confidence.

Renovation of shopping malls becomes one of their options or even a critical decision to make.

The following table shows some shopping mall renovation projects undertaken by different developers in recent years:

Shopping Mall	District	Developer	Renovation period
1 Prince's Building	Central	HongKong Land	1998 -1999
2 Cityplaza	Island East	Swire	1998 - 2001
3 Tuen Mun Town Plaza	Tuen Mun	Sino	1998 - 2004
4 Paradise Mall	Chai Wan	MTRC	2000 - 2001
5 New World Centre	Tsim Sha Tsui	New World	2000 - 2001
6 Metroplaza	Kwai Fong	SHKP	2001 - 2002
7 Ocean Terminal	Tsim Sha Tsui	Wharf	2001 -2002
8 Alexandra House	Central	HongKong Land	2002 - 2003
9 Citylink Plaza	Shatin	KCRC	2003
10 Caroline Centre	Causeway Bay	Hysan	2003
11 China Hong Kong City	Tsim Sha Tsui	Sino	2003 - 2004
12 New Town Plaza	Shatin	SHKP	2003 - 2004

The renovation projects listed above could have been triggered by any or all of the three possible expectations listed below: -

- 1 To increase the sales, thus the rental income of the malls;
- 2 To maintain a good return of developer's investment in the long run by maintaining or enhancing its value; and
- 3 To sustain and enhance customer's experience in view of evolving market demand and trends.

In order to turn these expectations into a success, several driving forces were needed for a renovation in the current gloomy period and they will be discussed as follows:-

### ► Re-tenanting

Being the crux in shopping mall management, tenant mix makes the mall unique from its rivals and creates a synergetic effect on its overall sales performance.

However, it never comes perfect and needs to be fine-tuned continually in response to market changes. During the present stagnant market with weak consumer confidence, more and more tenants are asking their landlords for rental abatement, some of them may even ask for early termination because of the failure in sustaining the rental payment with the diminishing income.

With increase in vacancies and decline in unit rental chargeable, renovation indeed provides the landlord a timely opportunity for re-tenanting and repositioning the shopping mall in the market with a fresh tenant mix.

Cityplaza serves as a good example by incorporating a modernized 7-screen cinema and a Japanese merchandiser as its new anchors to give a fresh look at the southern part of the mall. With the introduction of festive booths besides the cinema, the enhanced variety of goods has proved successful in drawing new shoppers.

On top of these additions, Cityplaza have made a series of noticeable changes to its pre-tenant mix, which repositions and upgrades itself to another new market segment.

Citylink Plaza is another mall that will undergo the re-tenanting process by renovating the existing retail space and the office space after the relocation of governmental offices to the nearby government office buildings.

### ► Rejuvenation

There are 2 major ways to improve the sales performance of the retailers, hence increasing the rental income to the landlord. One is to encourage shoppers to spend more; another way is to attract additional shoppers.

In the current sluggish economy, thematic design seems to be a trend for some malls, especially for those located at the decentralized areas, to generate market niche and thus stimulate more consumers' desire to visit the mall.



There are some good examples, such as Metroplaza with the theme of four seasons, China Hong Kong City designed in Continental European style and Paradise Mall added with Treasure Land and European elements.

### ► Enhancement of Traffic Flow

During the renovation, some inefficient designs in the existing shopfront and shops layout will inevitably be altered in order to facilitate a better traffic flow, bringing shoppers to every corner of the mall and hence increasing the average unit rental chargeable.

For instance, in Caroline Centre, the landlord will construct a new lift access from the carpark to every retail floor. In New Town Plaza, 2 additional escalators will be built to divert the shopper's flow to the relatively quiet retail space of the upper floors.

Owing to the lower traffic during a quiet market, it is opportune to carry out substantial alteration and improvement works in the mall, which can cause fewer

nuisances to the shoppers.

Moreover, landlords can have the flexibility to use vacant spaces for tenants' temporary relocation.

### ► Maximization of Lettable Area

Apart from drawing new shoppers and increasing their expenditures in the mall, renovation can also bring in additional rental revenue from expansion or maximization of the unused or underused lettable area of the shopping mall.

In difficult times, every dollar counts. It is the reason that drives the owner of Caroline Centre to utilize its unused plot ratio by converting its roof-top to a well-furnished open cafe. Alexandra House, after renovation, will add one more retail floor of about 10,000 sf.


### ► Lower Construction Cost

Since 1997, the average construction cost for a shopping centre has declined by more than 20% as shown in the following graph.

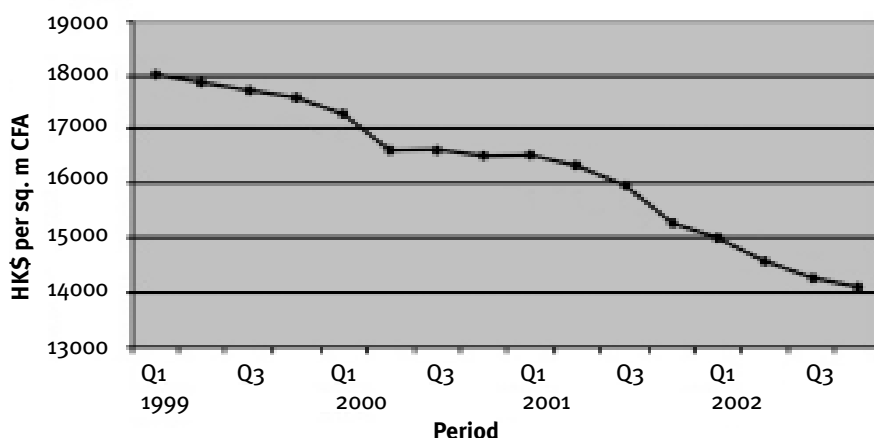
With the current much-reduced cost for renovation and the landlord's hope for a rise in rental when the economy recovers, more renovation projects for shopping malls become financially sound and economically feasible.

This may well explain the phenomena of a spate of shopping malls being renovated in recent years.

Most of the developers hold their large-scale shopping malls for long-term investment. Therefore, the short-term economic downfall should not affect their commitment to upkeep their malls to take advantage of every new opportunity.

Renovation, in the current sombre times, does provide an opportunity to maintain and enhance the value of shopping malls. However, there is an equal opportunity for a renovation project to succeed or to fail. A comprehensive analysis and careful planning are therefore keys for a successful renovation of shopping malls. 

**Average Construction Cost for Shopping Centre (High Quality)**



Source: Tender Price Indices & Cost Trends - A Quarterly Publication by Levett & Bailey



# E-lusive Retail Rents

*Could the growing emergence of e-commerce "turn-over" the future of percentage sales rent clause?*



**Jim YIP**

Senior Manager, Valuation Advisory Services, Jones Lang LaSalle

2003 April proved a wicked month for retailers and retail property owners as they were deeply affected by the SARS contagion.

In the fight against SARS, one more battlefield, perhaps, has opened up for the property owners - to ward off the pressure to cut rent while to roll out alternative measures to contain casualties within their tenant portfolios.

The reason for landlords being reluctant to give in to rental concessions can be understandable, as they also suffer as badly as the retail operators in this SARS outbreak.

A common practice in shopping mall leasing is for the landlord to get part of the rental income in the form of turnover rent, i.e. tenants pay rent at a pre-agreed % of gross sales achieved by the store each month. With retail sales dwindling fast, turnover rent is also drying up, sabotaging landlords' income.

However, hopeful signs of an end to this economic malaise have emerged on the back of recent anecdotal evidence that the number of cases of infection was going down by the day and the number of visitors to shopping malls during the Easter and May 1 holidays was reported to have resumed back to the pre-crisis level.

We have seen nothing as deadly a threat to the vibrancy of retail properties as the SARS virus in recent memory.

Before SARS, the biggest threat was the emergence of the "Virtual Mall" retail concept that came at the height of the internet boom three years ago, which threatened to cannibalize shopping malls.

As far as we know, this has never happened.

Ironically, the internet bubble bust wiped out many online retail upstarts, which were more hype than reality, but not a single shopping mall.

While the idea of "virtual mall" did not take off, e-commerce has been growing fast globally. Many large retailers have basically embraced the "brick and mortar" retailing concept and run a virtual shop at the cyberspace.

It is not known during the SARS-strike period whether retailers have experienced a big jump in online sales as consumers, shying away from visiting shopping malls, could make use of online stores to make their purchase.

In the US it is now widely held amongst retailers and developers that e-commerce marketplace does not necessarily lead to the demise of the shopping mall and it could, on the contrary, trigger more demand for retail space as retailers could use the physical store presence as ongoing marketing to boost online sales.

In fact, it is observed that retailers who reap most of the benefits from the Net are those who succeed at integrating online sales and physical shopfronts.

On the other hand, mall operators are focusing more on their efforts to convert their malls into entertainment and lifestyle centers to boost the shopping experience in order to capture more shopper's flow.

A mall's trade mix will become ever more important in attracting customers and prompting spending on the spot.

While the e-commerce is not going to replace the function of shopping malls, traditional mall operators are increasingly put on a high alert for its implications on their mall management strategy.

They will certainly keep asking themselves three questions:

**1 Will shoppers cut their visits or length of stay in the mall?**

Since it is convenient to use e-commerce to do utility and price comparison shopping, shoppers may the visit shopping mall less frequently.

**2 Will retailers take up less space per shop?**

Because retail tenants become product showcase platforms, rather than a point of purchase and product stock houses, tenant space may become smaller.

**3 Will e-commerce cause a cannibalization of in-store sales?**

If more merchandising activities are taking place through the online shop, rather than at the physical shops, sales per sq.ft. will be reduced, which could severely impair the landlord's total rental income.

Traditionally, retail property landlords charged retailers a turnover rent in addition to a base rent.

The advantage of which is to enable landlords to participate in the retailer's thriving business due to their successful operation in the mall. It also rewards landlords for their ongoing efforts to enhance the attraction of the mall.

The mechanism of turnover rent works like this: the rental will be based on a certain percentage of the gross sales revenue of the retailer.

For example, a retailer with high mark-up such as a high-end boutique might pay a percentage between 10-15% while a fast-food retailer with a lower mark-up might pay only 8-10%.

If e-commerce becomes a dominant trend in retail sales in the future and begin to consistently lower gross store sales below levels where turnover rents would kick in, no doubt landlords will have to revisit the provision of such clause in the tenancy agreement.

One implication of, which may force the landlord to slash the turnover rent clause and instead charge a higher unit rent.

With that, it could mean the rental levels for high street shops and prominent shop units in the mall will be higher in future.

In 2000, Jones Lang LaSalle (UK) moved to propose a wired lease structure to tackle the siphoning of gross store sales to online shops. Such lease takes the form of a % rent based on retailer's sales generated through the shopping mall site and a % of sale made through the centre's internet sales, thus capturing rent from multi-channel retailing.

But it is yet to see how the wired lease structure would evolve to capture the internet sales that are not done in the store, which by far is the biggest component of online sales.

Given the evolving nature of the e-commerce trend, it is difficult at this stage to gauge the full implication on retail properties and thus define an appropriate strategy in response. Nevertheless, the situation requires regular monitoring and review.

The growing emergence of e-commerce has underscored one important principle in shopping mall management: the shopping mall should be viewed more as a flexible business enterprise adapting to and in competition with many other product delivery and entertainment systems, rather than as a relatively unchanging real estate. Send your comments to [jim.yip@ap.joneslanglasalle.com](mailto:jim.yip@ap.joneslanglasalle.com).



# Assessment of Current Retail Rentals

## While Market Comparisons Do Not Yet Reflect SARS



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In our model, the monthly rentals of the shops range from \$20 to \$200. The variance in the rental values is due to a combination of the following reasons:

- Location of shop units:** some trades are eager to have prime locations with good exposure. These trades can afford higher rental payments by virtue of their bigger profit margins and/or higher sales turnover.
- Size of shop unit:** commercial users such as restaurants, fitness centres and karaoke parlours can take up sizeable space but can only pay low rents. The factor of bulk discount on

### Introduction

The outbreak of severe acute respiratory syndrome (SARS) has not only reduced the number of tourists visiting Hong Kong, but also weakened local consumer sentiment. Shop tenants are requesting landlords to reduce their property rentals.

The effects of SARS on the retail sector vary between different trades and locations. Retail tenants find SARS is creating a very uncertain future and are generally not willing to lease new shops. The landlords, on the other hand, are adopting a wait-and-see attitude and do not want to cut their asking rentals substantially. New shop leasing activity is therefore quiet at present.

For assessment of a shop rental as at today's value, updated market comparisons may not be available, or the transactions found may show contradicting figures. A study of the retailers' operating results by using the income approach is an alternative to the traditional direct comparison method.

### Retail business before SARS

Before the SARS crisis, the Hong Kong economy was already facing the problem of a high unemployment rate. The retail market in some prime locations, however, was previously well-supported by an increasing number of visitors to Hong Kong. According to the Hong Kong Tourism Board (HKTB), a total of

16.57 million people visited Hong Kong in 2002, representing an increase of 20.7% over the level recorded in 2001. Arrivals from Mainland China increased remarkably by 53.4% year-on-year to 6.8 million, representing over 40% of all visitors to the territory.

Nevertheless, the World Health Organisation has classified Hong Kong as one of the SARS infected areas and recommends people planning to travel to Hong Kong to consider postponing all but essential travel. The Airport Authority recorded a 68.9% drop in the number of passengers using Chek Lap Kok International Airport in April. Following the numerous infection cases in Mainland China, Mainland tourist arrivals have also fallen, to 75% to 80% below the peak of last year. The impact of SARS on those traders specialising in retailing to visitors is much greater than those shops targeting mainly local citizens.

To illustrate the impact of SARS on retail market rentals, a model has been established to reflect the situation of a hypothetical shopping mall. It is assumed the mall concerned is a regional shopping centre serving mainly local Hong Kong customers. It is also assumed that the shopping mall is held under a single ownership and the leasing manager has carefully considered a balanced trade mix which generates the best return to the property owners under normal market situations.

The trades which are commonly found in a large-scale shopping mall have been selected for the illustration. The operating conditions of the selected trades, before the outbreak of SARS, are shown in Table 1.

Trade	Profit Margin (per turnover)	Monthly Rental (per Lettable Area - \$/sf)	Rental as Percentage of Turnover
Jewellery/ watch/ accessories	20%	\$200	20%
Brand fashion	10%	\$150	10-15%
Gift shop	15%	\$100	15%
High street fashion	15%	\$100	10-15%
Children's toys	10%	\$60	15%
Beauty shop	20%	\$40	10%
Furniture/ home fittings	10%	\$40	10%
Electrical appliances	10%	\$40	7%
Music/ books	10%	\$40	7%
Restaurant - Speciality	20%	\$40	10-15%
Restaurant - Fast food	10%	\$30	10-15%
Restaurant - Chinese	10%	\$25	10-15%
Supermarket/ chemist chain	8%	\$28	5-6%
Fitness centre	10%	\$20	15%
Karaoke parlour	10%	\$20	15%

#### Notes:

- The profit margins and percentage of turnover for rental payment vary from company to company and are determined by the companies' policies and the operating results of individual firms;
- The monthly rental rate represents the pattern of different trades in a typical regional shopping mall. The actual rents depend on floor level, location, frontage, sizes, layout, etc. of the shop units concerned;
- All the figures above are approximate, for illustration only. They reflect the relationship between rental values and sale turnover of some trades in a typical regional shopping mall.

Source: CB Richard Ellis

Table 1: Operation of various trades before SARS

Trades	Estimated Change in Turnover	Change In Cost other than rent	Revised Profit/ (Loss) Margin	Required % rental reduction to break even
Karaoke parlour	-60% to -70%	-20%	(106%)	>(100%)
Restaurant - Speciality	-50% to -60%	-20%	(42%)	>(100%)
Restaurant - Chinese	-50%	-20%	(44%)	>(100%)
High street fashion	-30% to -50%	-15%	(20%)	(98%)
Brand fashion	-30% to -50%	-25%	(13%)	(38%)
Jewellery/ watch/ accessories	-30% to -50%	-20%	(7%)	(20%)
Restaurant - Fast food	-30% to -40%	-15%	(18%)	(92%)
Fitness centre	-20%	-10%	(1%)	(7%)
Furniture/ home fittings	-15% to -20%	-8%	0%	(5%)
Electrical appliances	-10% to -20%	-8%	3%	--
Gift shop	-10% to -20%	-5%	5%	--
Beauty shop	-5% to -10%	-5%	18%	--
Children's toys	0% to +5%	+1%	11%	--
Supermarket/ chemist chain	+5%	+3%	10%	--
Music/ books	+5% to -10%	+5%	12%	--

Note: Revised profit/(loss) margins above are based on the new turnover after the spread of SARS on condition that the passing rentals remain unchanged.

Table 2: Current situation, with no rental concessions

the unit size in this retail sector is more sensitive than other types of properties.

- Protection from direct competition:** the landlord would prefer to create monopolies on certain trades, such as supermarkets and speciality restaurants, within the shopping mall. Higher rental incomes are obtainable from these kinds of trades when there are no direct competitors within the same shopping mall.

### Retail business during SARS

Based on our observations and discussions with some retailers, we have estimated the immediate effects of SARS on the same traders, as shown in Table 2.

The entertainment sector was the hardest hit in the SARS crisis as people believed that the risk of infection was higher if people were crowded in confined areas, such as a karaoke room. For the same reason, fewer people visited restaurants and shops. Instead, people chose to stay at home or went to the countryside.



Trades	1st Month	2nd Month	3rd Month	4th Month	5th Month	6th Month	Rent Upon Recovery	Average of 36-month Term	Change from Pre-SARS Rent
Karaoke parlour	\$0	\$0	\$0	\$0	\$0	\$4	\$20	\$17	-16.1%
Restaurant - Speciality	\$0	\$0	\$0	\$0	\$0	\$24	\$40	\$34	-15.0%
High street fashion	\$0	\$0	\$0	\$0	\$4	\$69	\$100	\$85	-14.6%
Restaurant - Chinese	\$0	\$0	\$0	\$0	\$0	\$17	\$25	\$21	-14.8%
Restaurant - Fast food	\$0	\$0	\$0	\$0	\$4	\$22	\$30	\$26	-14.3%
Jewellery/ watch/ accessories	\$0	\$0	\$30	\$60	\$90	\$167	\$200	\$176	-11.9%
Brand fashion	\$0	\$0	\$30	\$51	\$71	\$127	\$150	\$133	-11.5%
Electrical appliances	\$0	\$0	\$0	\$20	\$27	\$33	\$40	\$36	-11.1%
Furniture/ home fittings	\$0	\$0	\$0	\$21	\$28	\$34	\$40	\$36	-10.9%
Fitness centre	\$1	\$3	\$5	\$7	\$15	\$18	\$20	\$18	-10.0%
Gift shop	\$10	\$19	\$29	\$69	\$79	\$90	\$100	\$92	-8.4%
Beauty shop	\$30	\$32	\$33	\$35	\$37	\$38	\$40	\$39	-2.4%
Children's toys	\$66	\$65	\$64	\$63	\$62	\$61	\$60	\$61	+1.0%
Supermarket/ chemist chain	\$34	\$33	\$31	\$30	\$28	\$27	\$28	\$28	+1.4%
Music/ books	\$55	\$52	\$50	\$47	\$45	\$42	\$40	\$41	+3.6%

Note: Figures in dollars are in terms of per sq.ft. in lettable area

Table 4: Effect on market rentals when the expected recovery period is 6 months

Only a few trades had no drop in sales under the attack of SARS. Some of them even showed an improvement. Supermarkets, chemist chain stores and medicine shops were benefiting in the crisis as people were eating out less but buying more food, surgical face masks and anti-bacterial agents from these shops. Moreover, sales of some in-home entertainment items such as CD/VCD/DVD and children's toys have also increased marginally.

With the fall-off in sales, some operating expenses could be lowered: first, by a direct reduction in the cost of goods sold, and second, by the implementation of strict cost saving plans. Owing to the presence of historical set-up costs as well as fixed overheads, the total fall in expenses was always smaller than the drop in revenues. Reduced turnover resulted in narrower profit margins or greater business losses. The reduced sales revenue of restaurants sometimes could not even cover their daily operating expenditure. This explained why a number of restaurants temporarily closed their businesses.

### Assessment of New Market Rents

Because of the lack of updated market transactions during the SARS crisis, time adjustments need to be made by using an income approach. In our analysis, we have made the following assumptions:

- ▶ Tenants are restricted to use the shops for the trades specified by the landlord;
- ▶ The pre-SARS trade mix balance remains the optimal one in view of the short recovery period, which is generally expected by the market to be six months;
- ▶ Revenues of all trades must cover all their variable running costs including but not limited to management fees, air conditioning charges and rates;
- ▶ Lease terms are all assumed to be 3 years subject to fixed rents, with options to renew for a further 3 years;

- ▶ No discounted cash-flow analysis is employed to assess the equivalent fixed rent owing to the prevailing low interest rate and short lease terms;
- ▶ The fall (/improvement in certain trades) in turnover will be recovered gradually in phases within the recovery period; and
- ▶ The impact of SARS is totally discharged by the end of the recovery period. Turnover and required profit margins will all return to the pre-SARS levels.

We then employed an income approach to assess the residual amounts affordable for property rentals month-by-month. The market rent of each trade is calculated as the average of the residual amounts over a 36-month term.

During the early stages of the recovery period, the turnover of some trades cannot support their business costs. No residual amount is therefore available for the rental payment. The residual amounts of the selected trades for the 1st month are tabulated in Table 3.

In view of the uncertainty created by SARS, new retail tenants face a higher risk on their investments. We have factored in the additional risk by increasing the profit margin, up to 15%; depending on the effect on turnover due to SARS, the ratio of variable and fixed costs of the business, the amount of investment involved, etc. of different trades. Most trades will gain no profit in the coming month and no residual amount will be contributed to the rental. Similar calculations were made for the remaining months of the recovery period in Table 4. The rentals will return to the pre-SARS levels afterwards.

This shows the rentals of spacious retail units dropping some 15% from the pre-SARS levels in general. The reduction in other small to medium sized units depends on the type of trade. A landlord may reduce the drop in rental by adjusting the trade mix and leasing to those businesses with less impact

from SARS. As boutiques and accessories are dominant in a typical shopping mall, the overall rental drop should be close to that of these trades and in the region of 10%.

### Conclusion

Since 4 May 2003, the number of daily new infections has been reduced to single digits. The spread of SARS seems to be under control but its development is still uncertain due to the easy transmission of the virus and the infection cases in our neighbouring provinces/countries. The expected recovery period is ever-changing. We have conducted a sensitivity analysis on retail market rentals (of general shops not located within tourist areas) against the expected market recovery period. The conclusions are as follows:

Shop Sizes	Expected Recovery Period/ Change in Market Rent		
	Optimistic scenarios (3 Months)	Base scenarios (6 Months)	Pessimistic scenarios (9 Months)
Large sized shops (such as Chinese restaurants)	-8%	-15%	-24%
Small to medium sized shops	-6%	-10%	-18%

# Discounted Cashflow Model - Estimation of the Remaining Useful Life in Real Estate



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Among three traditional valuation approaches, income approach, market approach and cost approach, income approach is the common one to be adopted in the valuation of investment assets. The principle of this approach is that:

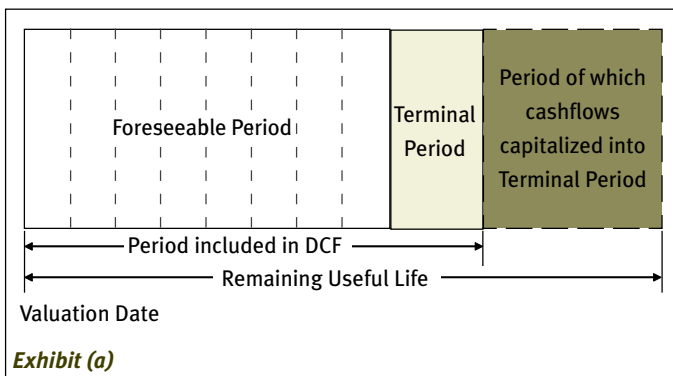
*"the value of an asset is the present value of the expected returns. Specifically, you expect an asset to provide a stream of returns during the period of time that you own it. To convert this stream of returns to value for the security you must discount this stream at your required rate of return. This process of valuation requires estimate of (1) remaining life of the property, (2) the stream of expected returns, and (3) the required rate of return on the investment. Value today always equals future cashflow discounted at the opportunity of cost of capital."*

Two conventional methods of income approach are capitalization method, and term and reversion method. The capitalization method is a simpler one which a single stream of income is capitalized by an appropriate rate of return. The term and reversion method is more complex in that the two different incomes, fixed (term) and projected (reversion), are estimated and capitalized by their respective rates of return. However, Discount Cashflow (DCF) method, a model which is commonly employed by business analysts, accountants and real estate appraisers in US, becomes popular in Hong Kong, especially after REITS market is developed.

Compared with the two conventional approaches, DCF pays more attention to cashflow forecast, which is not dominated by one or two streams of

income but a series of foreseeable inflow and outflow of cash. The series of cashflow are placed in a regular time framework showing how they influence the valuation with respect to time.

But when a DCF model skeleton begins to be constructed, the first question, very often, is how long are the cashflow forecasts and when will it end. The first and fundamental idea always comes from the client's instruction. It may be fixed by the usual habit of the client or the common practice of this exercise such as "to prepare a 10-year cashflow model with yearly interval" or "to prepare the market value by constructing a 20 year cashflow model with bi-yearly interval." To be more proactive, valuers are expected to provide professional advice to let the client tailor his instruction to fit what he needs. This article aims



at bringing up some discussions about this question.

A DCF model basically comprises two components. The first one is the "reasonable foreseeable period" which cashflow, including incomes and expenditures, can be estimated by a reasonable degree of certainty and some events that can have impact on the cashflow are identified. This period is segregated into constant pieces of time (for some cases it may not) to present a picture of cashflow with respect to time. Let us call it "Foreseeable Period". The second is the terminal period immediately following Foreseeable Period. In usual practice, this period is usually the same as one piece of time interval in Foreseeable Period and a single stream of cashflow is converted to a terminal value by a capitalization rate. Let us call it "Terminal Period". The entire period, including Foreseeable Period, Terminal Period and the period after Terminal Period of which the

cashflows are capitalized into Terminal Period, is called "Remaining Useful Life".

## Remaining Useful Life Estimation

Remaining Useful Life Estimation is an important topic in valuing intangible assets. Life of an intangible asset is often created by human beings and its life span is governed by various laws and statutes. For example, patents and copyrights are well protected by ordinances and registration laws. In other cases their lives will discontinue when their function is substituted by other more advanced intangible assets. Examples include computer softwares and cassette tapes. Therefore, their life spans are easily interfered by human power and can vary from several months to many years.

Lives of tangible assets, such as real estate, on the other hand, are usually governed by nature and their life spans are deteriorated by wear and tear and physical retirement. Lives are comparatively longer than intangible assets and it is easily overlooked that it will come to an end.

In determining Remaining Useful Life, legal, contractual, physical and economical determinants play important roles to real estate while intangible assets, in addition to these four, include also judicial, technological, functional and analytical ones. More discussions will be put on the first four determinants.

**Legal determinant** - It is set by law, statute, ordinance, or administrative ruling. The most common example is a freehold property where the remaining useful life is perpetuity while a leasehold property, like in Hong Kong, the remaining useful life of which is laid down by land grants.

**Contractual determinant** - It is set by a contract, agreement, license, or franchise. To a certain extent, it may mix up with legal determinant when a contract is signed with the government.

**Physical determinant** - It is set by the amount of wear and tear on the asset. For real estate, a longer physical life is sustained by proper management and maintenance.

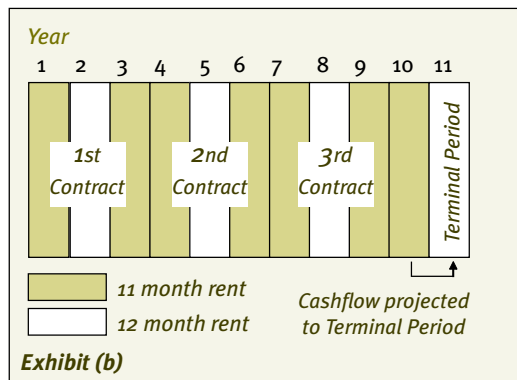
**Economical determinant** - It is influenced by the ability of the asset to provide a fair rate of return to the owner or the user. If the asset can no longer generate an adequate amount of economic income (either through operation or through lease) to justify its continued use, it has reached the end of its economic life. Nevertheless, the economic life is very difficult to estimate as it is subject to external demand and competition with other similar products.

Very often, the shortest life estimated from various determinants is the life conclusion to be used in DCF. But similar to most general rules, this rule should not be applied without the consideration of professional judgement and common sense. The reasonableness and degree of certainty of each life determinant should also be taken into account.

## Foreseeable Period Estimation

Foreseeable Period is the stage prior to the achievement of a stabilized level of income (growth and sustainable profit margin). The level will usually be reached with future operation of assets that is not expected to deviate from normal operations except as a result of normal growth.

To illustrate, assume that a hotel starts operation

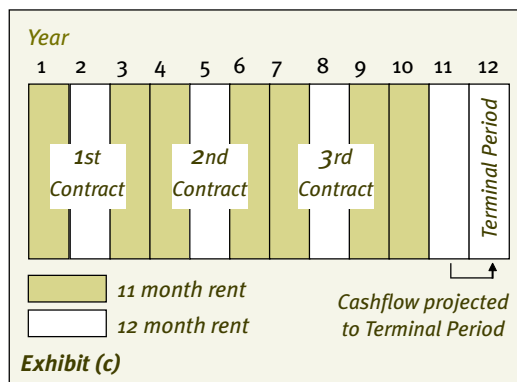


earning capability is no longer impinged by these two events. Another example is a multi-phase real estate development. If the last phase of development is expected to be finished after 20 years from valuation date, Foreseeable Period is required to be prolonged until when the income of the last phase is reflected in the DCF. Therefore, there is no distinctive answer to the length of Foreseeable Period but it depends on when a stabilized cashflow is reached. Sometimes, 3 or 4 years is acceptable while others may be over 20 years.

## Terminal Period Estimation

It is a common perception that Terminal Period is the extension of one constant time piece from Foreseeable Period in order to capitalize this single stream of cashflow to find out the terminal value. However, sometimes it may not cover the whole operation cycle of cashflow which can be repeated beyond Foreseeable Period and inflated by a constant growth rate.

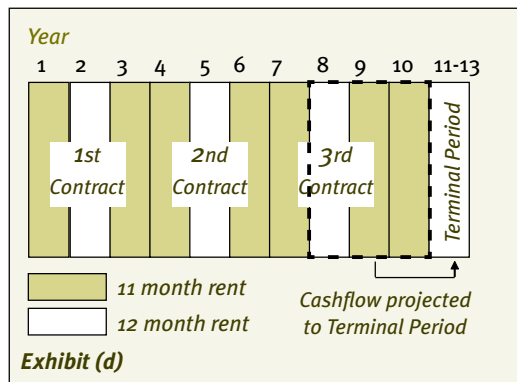
Every income generation asset, no matter whether it is tangible or intangible, a real estate or a retailer, has its operation cycle of which inflow and outflow of cash is repetitive in a fixed time segment. The operation cycle of a shopping arcade receiving turnover rent is similar to a retail business enterprise, which peak seasons (during Christmas and before Chinese New Year) and non-peak seasons (after Chinese New Year) of consumer habit are repetitive each year.



in 2003. In general, Foreseeable Period consists of time segments from the date of valuation to a point when a stabilized level of cashflow is reached. It may probably be two to three years when the hotel has experienced sufficient exposure to the market, gained stable customer support, built-up reputation and achieved smooth operation. However, two special and confirmed events which can exert substantial financial impact to the cashflow, the opening of Disneyland in 2005 and 2008 Beijing Olympic Games, will extend the Foreseeable Period up to 2008 or more until the

If the constant time pieces of Foreseeable Period are half yearly and the Terminal Period follows the same suit, the Terminal Period may cover fragments of cashflow in a operation cycle and result in incorrect terminal value when it is inflated by the growth rate.

Another example is an office with a fixed three-year term and two months rent free are provided in the first month and last month in the lease term. It is assumed that another three-year contract with the same terms follows after the previous one expires. A 10-year cashflow model with yearly interval is then constructed. From Exhibit (b), the Terminal cashflow is understated since it takes reference to the last year of Foreseeable Period which is a 11-month rental year and represents that all future years will have an 11-month rental income each year. If a 11-year cashflow model is constructed (illustrated in Exhibit (c)), it represents that all future years will have a 12-month rental income each year, therefore the terminal value is magnified.



To rectify such problem, the Terminal Period of 3 years with a 3-year growth rate, see Exhibit


(d), or a yearly effective rent is adopted. However, the latter one, strictly speaking, may not be appropriate as it assumes that the rent in a fixed term still grows yearly but it does not in reality.

## Point To Note

Different assets have their time spans of Foreseeable Period and Terminal Period in Remaining Useful Life. From a valuation point of view, special attention is needed for the value ratio being concluded from these two periods, i.e. the ratio between the summation of discounted values in Foreseeable Period and the discounted value in Terminal Period. Usually the shorter the Foreseeable Period, the more the value of Terminal Period, or vice versa. As mentioned earlier, there is no definite rule regulating that an equal or one-third between these two periods is optimal. Nevertheless, if any one of them possesses a substantial weighting to the final value, full justification to each factor in that period should be given because of their extreme sensitivity to the entire valuation of the asset.

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## About ASA

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# Precast = PROFIT

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## Why precast

To promote the construction of green and innovative buildings, the Buildings Department, Lands Department and the Planning Department jointly issued a practice note in February last year for exempting the gross floor area (GFA) of a list of green features, among which non-structural prefabricated external walls drew marked attention. The policy is generally welcome by private developers as the exempted GFA, although subject to premium assessment in some cases, will prima facie increase the profit amounts of development projects. Precast concrete construction has been applied to the Housing Authority's projects for many years as it is considered cheaper, better in quality control and less in material wastage when compared to in-situ concrete construction. Yet why has it not shared the same prevalence in the private sector? What are the limitations?

## Limitations for use in Hong Kong

**WORKING SPACE** One of the determinants of the use of precast construction is the availability of site working space. Precast concrete construction needs ample site space for loading/unloading, storage and manoeuvring of the precast units on site. Unlike public housing estates projects where spacious sites with sufficient working space are available, confined and congested sites in private developments are commonplace in Hong Kong. This may have ruled out the possibility of using precast construction from the outset.

**INFLEXIBILITY IN DESIGN** Precast construction requires lead-time for statutory submission, approval and consent, manufacture and delivery. Further time will be needed if mock-ups are required for testing aesthetic, water tightness or buildability. After the units are manufactured, changes in design may involve substantial abortive works and detrimental effects on programme. The inflexibility is particularly unfavourable to Hong Kong's property market situation where changes are fast and drastic. In

view of the possible changes in design to adapt to the latest market condition, developers tend to take a conservative approach when considering the use of precast construction in their developments.

**EXTENDED DESIGN PERIOD** In view of the difficulty for later design changes, longer design period is usually required for design incorporating precast elements than in-situ construction. In a programme conscious project, longer design period may mean longer development period and higher finance charges, increasing total development cost.

**EXTENDED CONCRETE CYCLE** Experience shows that the use of precast units may increase concrete cycle from the normal 4 days to 5 or 6 days due to the extended time for vertical transportation of precast units from ground level to designated floors, which is largely determined by the weights and sizes of the precast panels and loading capacity of hoists/cranes available. (On the other hand, the period of concrete cycle could be kept down by careful design of the panel sizes to cope with the loading capacity of the lifting plant). In addition, initial learning time for getting used to the site operation could be longer than in the case of the traditional in-situ construction.

**CONSTRUCTION COST** For the use of precast elements to be cost advantageous, there should be an adequate number of repetitive units so that factory equipment could be utilized to its full capacity. As a rough indication, the number would be in the range of 50, which means for each non-identical building block, the number of typical floors should be about 50 to justify for the use of the precast elements in terms of cost. That is to say, precast concrete construction is more cost effective for high-rise developments than low and medium rise.

## Added advantages of Precast Concrete Construction

Notwithstanding the limitations mentioned above, there are a number of added advantages of using precast concrete elements:

**INCREASE IN FLOOR AREA** Additional floor area due to the GFA exemption for a high rise

development project may amount to 2%, depending on the extent of the prefabricated elements used in external walls. 2% in a 50-storey high-rise building may translate into an additional floor, which no developer could risk missing.

**CORPORATE IMAGE ENHANCEMENT** Precast concrete construction is viewed as a "green process of construction" and help enhance the positive image of the developer advocating the use of the construction method in their development sites. A good image is advantageous to the long-term establishment of the company and could be an effective marketing tool for promoting business.

**CONSTRUCTION COST** An on-going project shows that the construction cost of using precast concrete elements is about 2% higher than that of using in-situ concrete. However, it is generally held that as the use of precast concrete is gaining increasing popularity, more suppliers and contractors will be joining the market to keep price competitive. In the long run, the private sector will enjoy the same economic advantages contributed by precast concrete construction as the public sector.

**DECREASE IN WET TRADES** Although the use of precast construction may increase the concrete cycle period, the amount of wet trades, especially for external walls, could be minimized significantly because finishes could be integrated into the precast panels during factory production. Given good site planning and management, overall construction period may be reduced.

## Technical Considerations

The following are some technical issues in connection with the use of precast concrete construction that are worth considering:

**PREMIUM ASSESSMENT** The Lands Department takes the view that for the purpose of lease interpretation, non-structural prefabricated external walls fall within the category of curtain wall systems. For existing lease conditions that contain the special condition for "Determination of GFA with curtain wall system" issued since April 1999, no premium will be required for the exempted GFA in relation to the prefabricated external wall. On the other hand, a lease

modification at premium to permit the construction of the additional GFA (if permitted GFA under the lease is exceeded) will be necessary for leases that do not contain that special condition. These leases were normally in existence before April 1999 when GFA exemption was not granted by the Buildings Department for curtain wall systems. Additional premium, if any, should be taken into consideration for deciding whether precast concrete external walls should be incorporated into the design of development project. (Interested readers can refer to Practice Notes 6/2002 and APSS 3/99 issued by the Lands Administration Office for more details)

**QUALITY CONTROL IN FACTORY YARD** In light of the cheap labour and land costs in the Pearl River Delta area, most of the precast concrete suppliers have set up their fabrication yards there. Since quality control and supervision of factory production is just as important as the site construction process, a resident quality control engineer could be appointed by the developer to oversee the factory production process.

**DEFECT RECTIFICATION OF PRECAST ELEMENTS** Precast units are difficult to rectify after they have been fixed into position since dismantling may be difficult for the interlock of panels. An effective system should be set up and implemented in the factory yard and on site for detecting any defects that may be present in the precast elements before they are finally installed.

**WATER-TIGHTNESS** Vertical joints between precast elements of external walls may cause a concern of water-tightness, especially for high-rise buildings during rainy seasons in Hong Kong. The commonly adopted types of joints are the fully grouted joints and the open drain joints, which have to be carefully designed and tested before being incorporated into buildings.

**EXPERTISE REQUIRED OF BUILDING PROFESSIONALS** Since precast construction in private developments has only become popular recently, building professionals in general might not have the hands-on experience in handling the construction method. Technical knowledge is required of architects in the aspects of construction sequence, water-tightness and fire proofing properties of precast elements, their effect on the façade of building and GFA implication. A structural engineer would take the lead in the statutory submission in relation to the precast elements, which forms part of the structural plans. They should be familiar with the structural and connection details, the design principles and the effect of the precast elements

on the integrity and continuity of the whole building. The building services engineer should be conversant with the arrangement of various buildings services to adapt the use of precast concrete elements. Construction management personnel should be capable of advising on buildability, site logistics, methodologies, defects diagnosis and rectification.

**CONTRACTUAL ARRANGEMENT** Similar to curtain wall system, design responsibilities usually rest with the supplier of precast concrete elements on the basis of the design intent produced by the architect. Due to the lead-time required, nominated supply contract could be adopted to get early involvement of the precast concrete supplier. The disadvantage is the split of the supply and installation to different parties so that it would be sometimes difficult to define liabilities between the two parties. If programme allows, both the supply and installation could be incorporated into the main contract as domestic supplier and sub-contractor respectively.

## Outlook

Purchasers today tend to favour large composite developments of multi-residential blocks with retail and recreational facilities. Developers would cope with the market by pursuing massive sites where pre-fabrication construction would be facilitated. At present, the use of precast concrete in most of the on-going private developments focus on the non-structural external walls like façade panels and balconies because of the GFA exemption. Some developers have been exploring the application of precast structural elements and the complete precast bath and kitchen units. The increased environmental awareness, coupled with the increased suitability of site conditions, will lead to the more widespread use of the pre-fabrication method.

However, whether the trend of using precast concrete will persist is dependant upon a number of factors and above all, feedback from the ultimate users, i.e. flat owners, is of paramount importance. Waterproofing, maintenance, aesthetic appearance, implications for interior decoration, etc. are their major concern. Positive feedback promotes sales and will boost the use of precast construction whilst negative feedback will surely defeat confidence in further use.

As said before, precast concrete suppliers are making use of the low land and labour costs in Mainland China. While we are expecting a drop in the construction cost for the long run, the surplus labour condition as a result of the shifting of labour forces from the building sites in Hong Kong to the factory yards in Mainland China is

not surprising. As the use of precast concrete construction becomes prevalent, the surplus of construction labours in the trades of concreting, formwork fixing and reinforcement fixing is expected to come. The situation is similar to the move of the manufacturing industry from Hong Kong to China in the past decades. In order not to be dispensed with, construction labourers should be prepared to take the challenge by arming themselves with the skills of the site installation methods and making themselves acquainted with the site planning and management in the area of precast concrete construction.

On one hand we are expecting construction sites to become tidier and safer and construction costs cheaper; but on the other hand the construction industry will be facing considerable challenge, which would have a far-reaching effect on the industry. If it can be handled properly, there may be a good chance to make way for a better future for the society as a whole.

## Acknowledgements

The author is thankful to the following practitioners for their valuable opinions:

- (1) Mr Kenneth Ng, Senior Project Manager of Swire Properties Ltd
- (2) Mr Tony Siu, Director of WCWP International Ltd
- (3) Mr K L Lam, Director of P & T Architects and Engineer Ltd 



# The *Sailor's* Return



**John B MOLLOY**

LLB(Hons), BSc(Hons), FHKIS, FRICS,  
MCI Arb, RPS(QS)  
Managing Director, James R Knowles (Hong  
Kong) Limited

In 1809 a seaman named Stilk signed on for a voyage from London to the Baltic and back at an agreed wage of £5 per month. As part of the agreement the crew undertook to 'do all that they could under all emergencies of the voyage'.

The ship sailed safely to Cronstadt in Russia, but whilst they were in port two of the crew deserted. The ship's captain tried in vain to find replacements for the two deserters, firstly in Cronstadt and secondly at the next port of call which was Gottenburgh in southwest Sweden.

Having failed to find any replacements, and with the majority of the return voyage still to be completed the captain promised the rest of the crew that he would divide the deserters' wages among the remaining crew if they worked the ship back to London.

The ship duly arrived safely back in London. However, when the crew demanded their share of the deserters' wages the captain refused, and Mr Stilk brought an action against him for his share.

These are the simple facts of what has become to be the most important case of *Stilk v Myrick* (1809) 2 Camp 317: 170 ER 1168.

For the defendant it was argued that the promise made by the captain was not enforceable because it was contrary to public policy. If such promises were valid they argued it would open the way to exorbitant demands.

For the plaintiff it was argued that the agreement was valid. It was an agreement made on shore and was not one made with reference to any danger or emergency (which was covered by the undertaking). Why it was argued, should the seamen be deprived of a benefit offered voluntarily?

Lord Ellenborough agreed with the defendant that the promise was unenforceable, but not because of "public policy" reasons. It was his decision that the agreement was unenforceable because there was no consideration, and without consideration a promise (unless made under seal) could not form a binding contract. Before they sailed, the crew had undertaken to do all they could under all emergencies of the voyage, and this was the basis upon which they had sold their services. If the crew had been entitled to leave at Cronstadt, or the master had capriciously discharged the two deserters, it might have been different, but desertion is an 'emergency' as much as death and the remaining crew were bound to perform.

The case is well known and often cited as authority for the proposition that the promise to perform, or performance of, an existing contractual duty cannot be consideration for a promise made by the person to whom the duty is already owed. The only question was whether the remaining crew were contractually bound to act as they did in working the ship to Gottenburgh and then to London. The Court held that they were.

I had cause to consider this case recently when drafting a supplementary agreement between a contractor and an employer in respect of an agreement to accelerate the works. The question to be addressed was whether the proposed supplementary agreement was supported by consideration or whether it was simply an agreement to carry out what the contractor was already contractually obliged to do and no more.

Well in my case, the contractor was being required to do more than he was contractually obliged to do, in that he was being required to complete the works in a shorter period of time than the contract provided for, and this was therefore clearly valuable consideration.

However the matter is not always clear, and the highly contentious construction case of *Williams v Roffey Bros and Nicholls (Contractors) Ltd* [1991] 1 QB 1 is an example where, in some cases, the performance of an existing contractual obligation can be taken as consideration in a new agreement, thus departing from the principle set out in *Stilk v Myrick*.

Roffey were a firm of builders contracted to renovate a block of flats called Twynholm Mansions in Lillie Road in London. Their own contract contained a liquidated damages clause in the event of late completion, and so it was clearly in Roffey's interests to ensure that the works were finished on time.

Roffey engaged Williams as a sub-contractor to carry out the carpentry work in the refurbishment, including works to the roof structure for the sum of £20,000. As work progressed Williams fell further and further behind schedule. It was apparent that Williams' poor progress was caused firstly because their contract sum was far too low to be able to carry out the works and they had fallen into financial problems. In this respect the quantity surveyor conservatively assessed that a more realistic contract sum would have been £24,000. Secondly, Williams were failing to properly supervise the works, although this was in reality probably also resultant from Williams' financial problems.

In an attempt to secure timely completion Roffey negotiated a new deal with Williams whereby it was agreed that Williams would be paid an additional £575 per flat upon timely completion. However, when the next building was completed Roffey refused to pay.



Williams brought an action against them and in defence, Roffey claimed that the new agreement with Williams was void, as there was no sufficient consideration from Williams. Roffey relied upon *Stilk v Myrick* and in particular on the point that the promise to perform an existing contractual duty cannot be consideration for a promise made by the person to whom the duty is already owed.

However, surprisingly the Court, whilst expressly stating that the principle in *Stilk v Myrick* was still good law, distinguished the situation before them from that case and held that in this case there was valid consideration and therefore that the agreement to pay Williams an additional £575 per completed flat was valid and binding.

Glidewell LJ held as follows:

*"..the present state of the law on this subject can be expressed in the following proposition: (i) if A has entered into a contract with B to do work for or to supply goods or services to B, in return for payment by B and (ii) at some state before A has completely performed his obligations under the contract B has reason to doubt whether A will, or will be able to, complete his side of the bargain and (iii) B thereupon promises A an additional payment in return for A's promise to perform his contractual obligations on time and (iv) as a result of giving his promise B obtains in practice a benefit or obviates a disbenefit and (v) B's promise is not given as a result of economic duress or fraud on the part of A, then (vi) the benefit to B is capable of being consideration for B's promise, so that the promise will be legally binding."*

In this case the court considered that the promise of Williams served to obviate a disbenefit to Roffey, i.e. the liability to pay liquidated damages to the employer, and therefore constituted valid consideration.

With the greatest respect to the court, I failed to see the distinction between the facts of this case and that of *Stilk v Myrick*. Williams were contractually obliged to complete on time by way of their original agreement. By coming to a subsequent agreement to similarly complete on time it appears to me that they were doing no more than they were already contractually required to do. Roffey received no additional benefit, nor in reality did it obviate a disbenefit because they could simply have passed any liquidated damages through to Williams.

The decision in this case appears to leave the door open to unscrupulous sub-contractors putting pressure on main contractors to pay them more money for catching up delays of their own making, which can not be a desirable situation. 📄

# Contractor Owned Plant Operating Costs - Part III



This final article, of a three part series, considers plant operating costs and their relationship to owning costs. The article considers operating costs during a period of delay and disruption involving a Caterpillar 330L hydraulic excavator purchased in 1996 by DIG Ltd.

The obvious costs of operating DIG Ltd's excavator are fuel, oils and lubricants but there are also a whole range of parts which have to be serviced or replaced at given times if the production capabilities of the item of plant are to be preserved. Such parts like air filters, brake pads, tyres, tracks, undercarriage and even engines come into the category of either wear and tear or maintenance.

## Fuel

We will start with the easiest - fuel. Where fuel consumption is recorded for individual items of plant these records should, obviously, form the basis of any claim. However, more often than not, plant is refuelled directly from a fuel tanker and whilst fuel consumption for the project site is monitored, consumption for individual items of plant is usually not. In such circumstances, fuel consumption data taken from the manufacturer's literature may assist in an apportionment of project fuel costs.

The Caterpillar Performance Handbook (1995) refers to fuel consumption in terms of three engine load factors - "High", "Medium" and "Low" (see Figure 1).

DIG Ltd's excavator is costed at a low load factor to reflect the lower intensity of working that occurred as progress was delayed and disrupted i.e.

$$\text{HK\$2.00/litre} \times 16 \text{ litres/p.h} = \text{HK\$32.00/p.h}$$

## Consumables

Ideally, records should be maintained to establish

Load Factor	Description	Litres/p.h
High	Steady digging in hard material	32-36
Medium	Steady digging with frequent periods of idling	22-28
Low	Light easy work with considerable idling	16-22

Figure 1 Hourly fuel consumption table - 330L hydraulic excavator

the actual cost of operating each item of plant. This was certainly the case for some of the large joint venture concerns that worked on the Airport Core Projects. However, in BERA's experience, maintaining actual cost records for each item of plant seldom occurs with local Hong Kong contractors.

In the absence of detailed contemporary records, reasonable plant operating costs may be assessed based on the actual costs of such consumables and the manufacturer's recommendations for replacements (see Figure 2) if the company follows such recommendations.

## Undercarriage and Repair Reserve

Some of the costs of wear and tear of operating the excavator may not be paid during the period of delay and disruption. However, such costs would be incurred, as the relevant part subject to wear and tear would be partly worn during the use of the excavator on site. Take, for example, the tracks of the excavator, which wear out with use (similar to tyres on wheeled vehicles) according to:-

- ▶ **ground conditions** - high impact and abrasiveness will accelerate track wear;
- ▶ **operational practices** - tight turns, high speed driving, track slippage, etc., will all increase track wear; and
- ▶ **maintenance** - good maintenance will minimize the effects of track wear and extend the track life.

If the tracks were new at the start of the period of delay and disruption, then there may have been no replacement or repairs by the end of the period. Nevertheless, the tracks would have been worn and such wear would be related to the amount of use.

Therefore, when ascertaining the excavator's operating costs, accruals should be made for wear on the tracks even though such tracks were not replaced, or repaired, during the period of delay and disruption. Similar comments would apply to any other machine parts, which wear out with use and require replacement at some time or other.

Consider the obverse, if the period of delay and disruption was, say, a month and during that month the tracks failed, and had to be replaced, then the cost of replacing the tracks could hardly be called a contract cost to the delayed and disrupted project.

Hence, a cost reserve or sinking fund should be established to allow for such wear and tear to be paid for when replacements are needed.

The Caterpillar Performance Handbook includes formulae and tables based on cost studies for excavators working in a variety of applications and working conditions to estimate the hourly cost of wear and tear, including undercarriage and repair reserve. These are calculated on a straight-line graph basis. This means that repair and replacement costs, which are initially low, and then rise gradually, are averaged out over the period of the useful plant life of the excavator. Hence, extra funds are reserved when the excavator is new to cover future costs.

According to the Caterpillar Performance Handbook, one significant factor of repair costs is whether the repair is performed before or after catastrophic failure. Repair before a major part fails can be one third of the cost of an after-failure repair. Repairing a major part just prior to failure achieves optimum cost per hour.

The undercarriage and repair reserve are calculated at the two extremes of operating conditions ("high" and "low") using the recommendations made by Caterpillar (see Figure 3) to show the sensitivity of such costs to different applications and working conditions.

## Summary

The owning and operating costs for the excavator are collected in Figure 4 and 15% is added to cover DIG Ltd's head office overheads and profit.

In Figure 5, the above cost assessment is compared to actual external hire rate agreements for Caterpillar hydraulic 330L excavators on the airport in or around 1997. There is a close similarity when the cost of fuel is added to the basic hire rates.

<b>Filters</b>			
<b>Part</b>	<b>Cost/Item HK\$</b>	<b>No. Changes Per 2000 p.h's</b>	<b>Total Cost HK\$</b>
Hydraulic tank element	498.86	1	498.86
Fuel filter	47.31	4	189.24
Oil filter	77.09	8	616.72
Pump line filter	344.29	1	344.29
Element-air (out)	529.13	2	1,058.26
Element-air (in)	489.20	1	489.20
Total Cost			3,196.57
Hourly Cost		/2,000 p.h's	1.60
<b>Lubricants</b>			
0.334 litres/p.h x HK\$12/litre			4.00
<b>Grease</b>			
$\frac{926 \text{ No. fittings}}{2000 \text{ p.h's}} \times \frac{\text{HK\$20.60/kg}}{100 \text{ No. fittings}}$			0.10
<b>Labour</b>			
0.01m.h/p.h x HK\$100/m.h			1.00
Hourly cost of consumable (rounded up)			<u>HK\$6.70/p.h</u>

Figure 2 Consumables

<b>UNDERCARRIAGE (DATA TAKEN FROM 1995 HANDBOOK)</b>	<b>High HK\$ /p.h</b>	<b>Low HK\$ /p.h</b>	<b>Average</b>
US\$ Basic hourly undercarriage cost for labour and parts x exchange rate conversion x 70% parts x condition multiplier High: US\$4.40/p.h x HK\$7.75/US\$1.00 x 70% parts x 1.7 multiplier Low: US\$4.40/p.h x HK\$7.75/US\$1.00 x 70% parts x 0.4 multiplier <i>(The condition multiplier is taken from the Caterpillar Performance Handbook and accounts for the combined effects on the excavator's plant life of a variety of working, environmental, operational and maintenance considerations.)</i>	41	10	
<b>Labour</b> High: 0.06m.h/ p.h x HK\$100/m.h Low: 0.01m.h/ p.h x HK\$100/m.h	6	1	
Hourly cost of undercarriage repair	47	11	
Hourly cost of undercarriage repair (average)			<u>29</u>
<b>REPAIRS / PARTS (DATA TAKEN FROM 1998 HANDBOOK)</b>			
<b>Parts</b> US\$ basic hourly repair cost for labour and parts x exchange rate conversion x 50% parts High: US\$10.00/p.h x HK\$7.75/US\$1.00 x 50% parts Low: US\$5.00/p.h x HK\$7.75/US\$1.00 x 50% parts	39	19	
<b>Labour</b> High: 0.13m.h/ p.h x HK\$100/m.h Low: 0.06m.h/ p.h x HK\$100/m.h	13	6	
Hourly cost of repairs / parts	52	25	
Hourly cost of repairs / parts (average)			<u>39</u>

Figure 3 Undercarriage and repair reserve

330L Excavator (at end of 1996)	HK\$/p.h.
<b>Owning Costs</b>	
Depreciation (see part I of this series)	108.19
Insurance (see part I of this series)	5.56
Finance (see part I of this series)	16.55
Capital lock-up (see part II of this series)	23.02
Inflation costing (see part II of this series)	8.65
<b>Operating Costs</b>	
Fuel	32.00
Consumables	6.70
Undercarriage reserve (average)	29.00
Repair / parts reserve (average)	39.00
Hourly cost	268.67
x 8.0 hours operation per day*	x 8
Subtotal daily cost (excl. operator)	2,149.36
Cost of operator	750.00
Subtotal daily cost (incl. operator)	2,899.36
Add 15% overheads and profit	434.91
Total daily cost (8 hrs/day)	3,334.27
(*Airport effective working hours i.e. 8:00 to 18:00 = 10 hours less 1 hour lunch, 1/2 hour to and from ferry and 1/2 hour tea break)	

Figure 4- Owning and operating costs

However, it should be apparent from this article that operating costs, like owning costs, are sensitive to wide variances. There is again plenty of room for "exercising judgement". Moreover, this particular assessment relies heavily on data from the Caterpillar Performance Handbook. Similar detailed information is not published by manufacturers of other plant used in Hong Kong such as Komatsu and Kato.

This is a problem as most companies will simply not have (or not keep) enough historical data to

calculate their own repair sinking funds or reserves. Remember, for a new model of dump truck this could mean looking ahead and calculating the total repair costs for some 15 years for a piece of plant which may be new and untested.

Accordingly, BERA reiterate the advice of the first article that a prudent assessment of the cost of plant should never lose sight of the market rental rate to, at the very least, establish a reality check on any assumptions made in the cost assessment.

	HK\$ Per Day (incl. Fuel)
Assessment	3,334
Hire agreement No.1	3,136
Hire agreement No.2	3,179*
Hire agreement No.3	3,685*
(*Rate includes an allowance for fuel, which was not included under the hire terms).	

Figure 5 - Comparison of excavator cost and external hire charges in 1997

## The Way Forward

Most contractors in Hong Kong operate on a capital purchase and residual value basis with owning and operating costs being collected in a company cost centre and not separately allocated to contracts. Nevertheless, the best advice to give to contractors is that they internally charge their contracts for the use of company owned plant at pre-assessed hourly, weekly or monthly rates. Better still, retain the plant in a subsidiary company and hire it out to the contracting arm of the business. The obvious advantage being that the costs are fixed contemporaneously.

## A Final Thought for Readers

In the case of **B Sunley & Co Ltd v Cunard White Star Ltd** referred to in Part I of this series of articles (Surveyors Times, April 2003), the Court of Appeal in England allowed depreciation for a tractor and scraper deployed to carry out levelling work in the Channel Island of Guernsey. The plant arrived too late at the port for shipment to Guernsey and had to be carried on another shipment one week later. There was no evidence of any loss of profit on the Guernsey contract. The Court of Appeal held among other things that:

*"The depreciation would on a pure sinking fund basis be £29 but we cannot believe that a machine exposed to such working strains in use that it will only last three years depreciates as much when idle as it does when working, and we therefore think that £20 for the week is as much as ought to be allowed for depreciation..."*

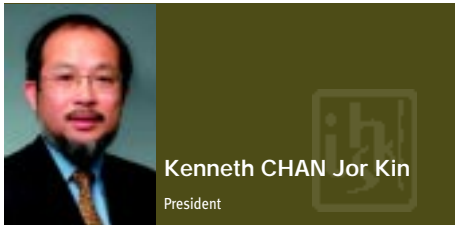
The court therefore allowed a lower rate of depreciation for idle time to that of working time. However, if depreciation of plant is related to plant hours being clocked-up, there is no depreciation when plant is standing. In this case, the tractor and scraper was standing for only one week and had exactly the same plant life and earning potential at the end of that week as it had at the beginning of the week.

The question, for readers to consider is therefore, did the Court of Appeal get it wrong when it awarded Sunley damages for depreciation of the tractor and scraper?

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



# In the Aftermath of SARS



Kenneth CHAN Jor Kin  
President

I had a very busy schedule in April and May. Some actions were taken following the effect of SARS on Hong Kong. I would just like to take this opportunity to highlight some of the events for members' information.

## Interview – Sing Tao Daily

Sing Tao Daily reporter, Ms CHEUNG Ka Wing interviewed me on 7 April 2003 covering subjects such as the effect of SARS on the property market, the government's offer to investors for residency in Hong Kong, our proposal for the government to conduct systematic boundary surveys to old scheduled NT lots, etc. The result of the interview was published on 24 April 2003, more than two weeks from the interview itself. It was a time when the developer was proposing an improved design to their residential units. I have said this long before. I talked about the short-term effect of SARS on property transactions. I predicted that buyers would be looking for better designs in residential buildings. Environmental hygiene and

healthiness would be of particular concern. These would affect the marketability of older units. I said it was important for the government to stage a campaign to re-establish the confidence of the international/global community in Hong Kong.

## Forum on Facility and Drainage Improvement due to SARS and Press Conference

This was a joint function organised by HKIS and HKIFM (Hong Kong Institute of Facility Management) on 25 April 2003 at Wei Hing Theatre, City University of Hong Kong. The theatre was fully packed with about 300 professionals, property management personnel, students, etc. The Deputy Director of Buildings was one of the guests to speak and answer questions raised by attendees.

The government was urged to introduce mandatory inspection and maintenance of buildings including the drainage system as a matter of high priority. The Building Surveying Division of HKIS will be producing a layman's guide to healthy living environment and drainage hygiene.

## Press Conference – Launch of the CPS AP Charity Trust

The Coalition of Professional Services officially launched the 'Coalition of Professional Services

Atypical Pneumonia (CPS AP) Charity Trust' on 6 May 2003. Appeal for donations to the Trust was also officially invited. Donations received would be used to provide financial assistance to medical staff in their fight against AP and members of the public, including members of the professions, who have been afflicted with AP. The donations would also be utilized to fund research and community actions to mitigate environmental risks that could lead to re-occurrence of AP or other community diseases. Members are urged to donate to the Trust if they have not already done so.

## Press Briefing – Launch of E-learning Package on Professional Ethics

A joint press briefing was organised with ICAC on 9 May 2003. The e-learning package on professional ethics was introduced to the media. I also announced the launch of Au Chung's calligraphic and artistic interpretation of the Nine Core Values. The first one being 'Act with Integrity – 正直不阿'.

I was surprised to see that the Oriental Daily and Apple Daily were making the most positive appropriate and accurate report of the press briefing. Sing Tao Daily had missed the shot and emphasised too much on bribery and the negative side of the matter. This was a reflection on the mentality and standard of the reporters in the press.



Deputy Director of Buildings speaking at the Forum



Expression of opinion by one of attendees

## Cable TV

I was interviewed on the drainage problems in buildings in Hong Kong by Cable TV on 6 May 2003. The interview was broadcast on 13 May 2003. My message was that the maintenance of drainage systems in many existing buildings was neglected. Adding



to the problem was unauthorised alterations leading to the omission of traps. This in effect took away the defense against foul air getting into bathrooms.

### **Asia TV**

On 9 May 2003, Raymond CHAN and I attended a studio recording for a programme to be aired on "Afternoon Tea" on 12 May 2003. The topic covered common drainage system in Hong Kong, authorised and incorrect alteration, repair and maintenance. Raymond arranged a real life mock up of a typical drainage system with translucent 'U' and bottle traps to demonstrate the function of the traps through the retention of water seals.

### **Forum on Saving our Treasure – Developing a Mechanism to Preserve Hong Kong's Historical Buildings**

I attended the forum organised by the Conservancy Association on 10 May 2003 at the Breakthrough Centre. My reflection on the forum could be summarized as follows:

- ▶ Hong Kong was lacking a clear policy on conservation. The whole community should be involved in forging a Community-wide

Holistic Conservation/ Preservation Policy.

- ▶ The agent in implementing the policy should be critically looked at. The HAD didn't seem to be an appropriate authority. Too much emphasis was placed on preserving the cultural heritage. The URA had been experimenting with the revitalization and rehabilitation concept and it would seem appropriate for it to be vested with the authority and responsibility of implementing the territory-wide conservation/ preservation policy of the Built Environment.

I have asked Francis LAM, chairman of the Environment and Sustainable Development Committee to look into this matter and produce a position paper of the Institute.

### **Talks on Drainage Problems for the Regions**

Talks on drainage problems were organised by HAD for owners in the four regions. The Institute provided two speakers for two of the talks on 13 and 14 May 2003 at New Territory East and Hong Kong Island respectively. I spoke at the Hong

Kong Island occasion at the Causeway Bay Community Hall. The meeting was well attended. Owners involved in IO were given a very good and practical lesson on domestic drainage system and maintenance. They were really concerned.

### **Joint Meeting of Panel on Housing and Panel on Planning, Lands & Works, LegCo**

Raymond CHAN and I represented the Institute to present our views on the 'Design of sewerage system of residential buildings in Hong Kong to prevent future recurrence of outbreak of infection diseases including Atypical Pneumonia' to the joint meeting of the Panel on Housing and Panel on Planning, Lands & Works on 16 May 2003. Apart from a written submission in English, I verbally presented our views in Cantonese on four major issues for the attention of the meeting. They were repair and maintenance, unauthorised alterations, lack of comprehensive guidelines of best practices and inadequate access for inspection and maintenance. ㄣ



This month we have our first guest Christine Loh sharing her writing experiences. Ms Loh, a law graduate, was a former legislative councillor (1992-97, 1998-2000). In 2000, she founded Hong Kong's first independent non-profit think tank, the Civic Exchange and is its current CEO. Ms Loh writes extensively about public affairs and has published both locally and internationally. Most of her writings can be found at her homepage: <http://www.christineloh.bizland.com>

# Basic Skills for Life



Christine LOH

**M**y primary school English teacher remains the only person I've ever met who could make me cringe and feel useless for failing to live up to her high expectations. Mrs Davis was a fierce lady who seemed dissatisfied with our class all the time. We were petrified of her. I especially dreaded the moment in class when she handed back our homework. She would snarl at those of us who hadn't done well enough.

One of our most difficult homework assignments was to read and then summarize long stories. When Mrs Davis handed me back my summary, it was the first time in two years that her lips appeared to be upturned. "Well done," she said to me. I thought a miracle had occurred - Mrs Davis could actually be satisfied with something.

I didn't realize at the time that what we were learning were the skills needed to produce a good précis. Now that I do, I am grateful to Mrs Davis for having introduced these skills to me at a young age. Producing a précis involves reading comprehension, judgement and use of language. Doing it well requires very high literacy skills. First, you have to understand the original text. Then you have to be able to grasp the essential message of the text, distil it into your own words and convey it to someone else, succinctly, accurately and preferably in an interesting way.

As adults and in the professional world, we attend many meetings and events. We need to read and digest a considerable amount of information. The ability to frame a problem or a piece of information in a few words, whether orally or in writing, is a basic life skill. I have great admiration for people who can do this well as it actually helps to clarify issues. People who


have these kinds of skills are usually successful in their careers because they can distinguish the wood from the trees.

I studied law at university. Lawyers tend to use words carefully to avoid misunderstanding. Although I never practised law, my legal training made me aware of using words and organising sentences with the aim of being as accurate as possible. Framing issues effectively is important not only for enhancing clarity but also in articulating controversial or highly charged topics in a neutral way. Of course, there are many different reasons for communicating and sometimes we want to be provocative and combative. Again, being able to state the issue well by using the appropriate language for this purpose requires considerable skill.

Literacy skills are basic communication skills. Almost all information, even simple facts or figures, needs to be explained in words. Communicating well also requires context. The ability to speak to and write for different types of audiences can be enhanced greatly by training in the humanities. It bothers me that many schools in Hong Kong do not provide young people with a solid foundation in subjects such as history, literature, philosophy and languages. Our primary and secondary education system should provide students with the skills to speak, listen, read and write effectively in today's knowledge based society.

My last year at university made me realize how important it is to communicate well. I shared a house with a number of students, one of whom was a physics PhD candidate. He was a brilliant person who taught me many things, including how to play bridge and drink warm, dark English beer. To my surprise, he asked me to read and edit his thesis because he said I could write well and he couldn't. Although the numbers and squiggles were incomprehensible to me, I found that I was able to offer some advice on how he could improve the explanatory part of his thesis. It is wrong to assume that people in fields such as science, engineering, surveying or business do not need strong literacy skills. The fact is that

both personally and professionally, we all need to be able to use language well in order to express ourselves and communicate with others.

Now that I run a public policy think tank, I am writing and editing more than ever. I have never thought of myself as a writer, but I spend an enormous amount of time writing all sorts of things from emails to short e-newsletters to long research papers. I also spend a considerable amount of time editing other people's work. On some level, I am probably still trying to please Mrs Davis by doing my homework better! 

# When **Asia** Meets **China** in the New Millennium

Written by Chi Lo

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Since China's entry to the World Trade Organization in 2001, more and more China-focused books are placed at eye-catching booths in every bookstore. Some see China as a catalyst to effect changes in Asia whilst others see China as a threat, hurting the regional economies. Since the Asian financial crisis in 1997/8, Asia's economic challenges have yet to receive thorough analysis and discussion. In particular, there has been no systematic discussion about China's influence on the dynamics of economic transformation of Asia.

Recently, I discovered this 200-page book, "When Asia Meets China in the New Millennium", which attempts to tackle head-on the nagging issues of Asia's post-bubble economic challenges under the shadow of China. It takes an analytical approach, complemented by real-life business and market events, to discuss the role of China in driving regional development into a new economic paradigm of prolonged price erosion, profit squeeze and constrained demand growth. The author argues with conviction that the bubble days of the 1990s were gone, and that only tough economic restructuring can revive Asia's growth stamina.

The book's stunning conclusion of a potential deflationary environment for Asia in the new millennium should serve as a wake-up call to those complacent businesses and politicians that "cheating on reform", as the author puts it, won't lead to a return of economic prosperity. The detailed treatment of the economic decline of Japan, Hong Kong and Taiwan, which used to have strong economic fundamentals, underscores the risk that even the "economic tigers" could lose their stripes in the face of China if complacency sets in.

Many discussions in the book are controversial. But they are argued with strong analytical and data back-up that make re-thinking of many conventional views necessarily. This book should be able to unlock our understanding of the interacting forces between Asian economies and China and the global economy. It should also stimulate us to think what lies ahead

in the new economic paradigm. The following is a synopsis of the chapters.

The four "tiger" economies including Hong Kong, Taiwan, South Korea and Singapore, were long admired as the most dynamic economies in Asia. Their remarkable economic performance in the 1980/1990s was attributed to export-orientated and pro-market economic policies, and macroeconomic stability. The tigers' economic models followed closely that of Japan's. If these models were so successful, Chapter 1 asks why the eruption of a financial crisis in July 1997 brought such devastating impact on Northeast Asia? Most have linked the Asian crisis to a currency crisis that caused investor panic. But Chapter 1 reveals the other missing pieces, such as moral hazard (which means someone's selfishness hurt public interests) and structural failures in the regional financial sectors.

We may have heard about reforms in various Asian countries, but why is the post-crisis economic recovery so short-lived? Chapter 2 analyses how Asia "cheats" on reforms. Basically, some crisis-hit countries' financial systems were politically driven, i.e. their financial decisions were based on political connections without reference to commercial criteria and prudent risk assessment. Vested interests have put up strong resistance to reform after the Asian crisis. Many Asian corporations have cheated on their restructuring efforts with little incentive to cut domestic debt, as the author argued with evidence. This process has short-circuited the economic recovery process, according to the book's analysis.

Chapter 3 examines how China shapes the new paradigm of rising competition, weak pricing power, and slow economic growth. Asia's export-orientated business model relied heavily on strong US consumer demand back in 1990s. This excessive demand is now gone. The global economy is plagued by over-capacity, as the author opined, which resulted from its excessive investment backed by a huge debt build-up in the 1990s. Then, there is prolonged global competition. All these forces are exerting long-term downward pressures on prices, nominal growth and corporate earnings. China's rise as a dominant manufacturer for cheap products with rising quality will only intensify these inherent deflationary forces in the new economic paradigm. The competitive stress from China will force out many low-efficiency manufacturers eventually. It is time for Asian countries to look for new directions guided

by their comparative advantages in order to survive the China challenge.

Whilst there are concerns that China's entry to the WTO will swallow lots of foreign investment and trade from the other Asian countries, the author argues that China's growth would do otherwise. The China factor could even speed up Asia's internal reforms to help the region to attract foreign investment. Chapter 4 argues that foreign investment and international trade flows were not zero-sum games; that foreign investment and trade would flow to both China and the rest of Asia, depending on their relative reform efforts to improve economic efficiency.

Chapter 5 contrasts the economic emergence of China with a declining Japan, currently the largest economy in Asia and the world's second largest after the US. The author argues that the economic divergence between Japan and China in recent years was a result of their different reform attitudes - Japan's denial and China's embracement of reform. While it remains to be seen if China has pursued a better policy mix in handling growth and reform, as the author argues she had, the case presented in the book is strong enough to focus our thinking on future policy directions of both China and Japan.

The author made two case studies on China's pressures on Hong Kong and Taiwan in Chapters 6 and 7. After the financial crisis, the Hong Kong SAR government had not started to explore economic integration with China until quite recently when the Hong Kong economy suffered another severe economic blow in 2001/02. Facing persistent deflation and high unemployment, Hong Kong's economy had suffered from "liquidity trap" symptoms, as the book argued. The trouble lied in falling price expectations, which deterred private spending and prompted companies to cut costs and employment. The weak job outlook hurt consumption further, forcing companies to cut jobs again and risking a deflationary spiral. As Hong Kong lost its traditional role as a middleman between China and the rest of the world after China's entry into the WTO, it needed to re-position itself to regain economic vigor. But the author saw the lack of leadership as a major factor dragging Hong Kong's feet.


The final chapter extends the scope of the analysis to the global problems of excessive debt and over-capacity. It argues that these problems would be linked to Asia's growth challenges in the coming years. The bottom line from the Chapter is that Asia needs to uproot its old export-orientated model and replace it with a high value-added production model. In the meantime, China also needs to rectify her long-standing weaknesses, such as an inadequate legal system, corruption, lack of transparency, and an insufficient social security system in order to face the forthcoming global challenges.

This book is unique in its context, very comprehensive, insightful and provocative in its discussions. Each chapter is written with its own theme. But all the chapter-themes are linked to form the overall theme of the new economic paradigm under China's economic shadow. It would be an interesting read for members who want to understand the complex relationships between Asia, China and the global economy in this millennium.

#### After words

If you want to learn more about the modern China, these two articles should not be missed:-

The November 11 2002 issue of TIME magazine on 'China's Next Cultural Revolution' instigates an analysis on the organic changes that are evolving in China from the rise of middle class to the more self-centered lifestyles, from religion to the minorities. (<http://www.time.com/time/search/article/0,8599,386985,00.html>).

The December 9 2002 issue of BusinessWeek on 'Greater China - how leaders from the mainland, Hong Kong, and Taiwan (missed Macao) are creating an integrated powerhouse', which evaluates the respective business roles of these cities being played in the forthcoming emergence of Greater China. ([http://www.businessweek.com/magazine/content/02\\_49/b3811007.htm](http://www.businessweek.com/magazine/content/02_49/b3811007.htm)). 

# The Wrath of

# SARS



**Ronald Y F CHEUNG**

BSc(Hons), MHKIS, MRICS, RPS(GP)

Director of Midland Surveyors Limited

**F**or the second month running, only one thing was on everybody's mind.

Everyone was talking about SARS, behind a face mask, naturally. Every social activity was severely curtailed by SARS, even HKIS' CPD events were cancelled. Needless to say, every business was adversely affected. The property market was no exception.

April 2003 was the only month for a long time in which there was no new development offered for sale. In the first two weeks, first hand flats had attracted an average of only 100 buyers each week, a sharp drop from those before SARS broke out.

When you think the first-hand market was poor, wait until you saw the second-hand market. In the first two weeks, there were no viewing of flats in Amoy Gardens and the neighbouring Telford Gardens. In fact, many large residential estates recorded less than ten transactions, some had none at all.

To attract visitors, let alone buyers, some vendors adopted various incentives. Some offered a cash gift of HK\$100 to any agent who could bring along

a visitor to view their flats. Some raised their commission to 3% of the transaction price. Such benefits notwithstanding, second-hand transactions remained few and far between. As a result, estate agents suffered a disastrous month. Some, reportedly, lost 90% of their business.

In response to the poor market, the Government Property Agency also reduced the rents for their flats in Baguio Villa and Mount Nicholson by 8% and 5% respectively. This was the first time that rent in Baguio Villa had fallen below the HK\$10 mark.

The case of retail properties was no better. Rental transactions severely dropped. In Tsim Sha Tsui, due to a sharp decline in tourism, only two rental renewals took place. The number of rental transactions for shops in the previous two months was as follows:

	March 2003	April 2003	
Hong Kong Island	39	28	28% down
Kowloon	42	18	57% down
New Territories	36	33	8% down

All, however, was not lost. A happy turnaround happened during the Easter Holidays. Fearing possible quarantine after arrival in a foreign city, Hong Kong people stayed in town and spent their money in Hong Kong. Retail and dining picked up, so did viewing of flats. A 50% increase in transactions resulted in the second half of April. Among developments recently put

up for sale, the Seaview Crescent in Tung Chung and Hampton Place in West Kowloon achieved more satisfactory sales.

As it turned out, the total number of transactions in April amounted to a surprisingly encouraging figure of 6,382, higher than that in March. The following table provides the breakdown:

From the table below, a few observations can be drawn up:

- 1 People now care more about their living environment. Their preference might have shifted from being close to work to nearness to green areas. Flats in the New Territories may move up the ladder of their choice. This is particularly evident in the large number of transactions in the New Territories in the past two months and especially an increase of 136% in April from March.
- 2 The absolute amount for a flat does mean a lot to most buyers. In times of economic difficulties they may only afford flats in the New Territories with lower unit prices.
- 3 There are always people who would seize the opportunity to buy properties at low prices for a quick profit or higher yield, an example of which is Amoy Gardens which have aroused interest among these type of investors.

Amid all the gloom in times of SARS, hopefully a ray of light has dawned. ☺

	March 2003		April 2003	
	No. of Transactions	Amount (\$billion)	Number of Transactions Lump Sum	Amount (\$billion)
Land Registry Figures	5,800	14.290	6,382	12.846
First-Hand Residential Transaction Figures	H.K. 431 KLN. 601 N.T. 815 Total 1,847	2.893 2.824 1.649 7.366	208 446 1,924 2,578	1.300 1.892 3.186 6.378
Second-Hand Residential Transaction Figures	H.K. 687 KLN. 883 N.T. 1,289 Total 2,859	1.770 0.996 1.491 4.257	707 912 1,369 2,988	1.629 1.056 1.619 4.304
Others (Include shops and carparks)	1,094	2.667	816	2.164

Source: Land Registry



## The Dong Population (侗族) in Guizhou -

# The Sustainable Communities?



In the steep mountainous regions of the mid-western part of China lives the minority ethnic group - Dong population. What struck me, as a first time visitor was their simplistic way of living relying on Mother Nature? They live and eat out of the land. Year round cultivations offering sufficient rice and vegetables with some poultries have sustained their lives for decades. Their ancestor carved out farmlands following the contours of the mountains. Their architecture and music were stunning. The Drum Tower, Drama Stage and Wind & Rain Bridge were the focus of daily living of the population.

During late February this year, I had the opportunity of joining a fact-finding tour of eco-tourism in the mid-western provinces of the Mainland. We, including Professor Patrick S S Lau of Professional Green Building Council, were escorted in jeeps to the main concentration of Dong population at Lai Ping Prefecture via narrow unfinished roads constructed through the contours of the steep mountains of the region. A six-hour drive from the nearest airport at Guilin was very tiring. The view of this scenic mountainous area was stunning and stays very much natural and not touched by modern civilization.

Frequent exchange amongst villages was the way of life. Visitors were welcomed by a group of young female singers in traditional costumes and head jewels at the entrance gate to the village.

Even before setting foot inside the village, the first thing I noticed was the music. We were greeted with gate-barring songs - one of a small repertory of tunes that, despite the name, was not meant to exclude strangers from passing the village entrance as much as it was to introduce the ways of the people inside.

After some welcoming songs, visitors were presented with bowls of rice wine. Visitors could drink as much or as little as they liked. But when they stretched out their hands to hold the bowls then they would have to drink up what was in the bowls. There was a second and third round until everyone was happy. The visitors were then led into the town hall - Drum Tower where female and male singers chanted a few more songs and ended



with dancing by all those present. One had to chant along a few of the familiar lyrics that one could voluntarily pick up by listening to the repetitive chanting.

We stayed for the night in the wooden guesthouse constructed as part of a museum of Dong culture with donations from the Norwegian government.

After having a delicious breakfast of the local produce, we were driven again along bumpy, muddy, unfinished roads to another settlement where we were greeted as real VIPs. Virtually the whole village was out lined up along the village pathways to greet us. First of all, the beautiful young ladies and smart men were at the main entrance to perform the gate-barring ritual. A few rounds of rice wine got the visitors excited and in mood for the long possession.

Immediately after passing the gate, girls in their colourful costume and headwear were the first in line. As we moved on, the age of the greeters also moved up. At the end of the long lines were the elders of the village.

This was a true reflection of the hospitality of the population under the call of the village head who was also the clan head.


Our last stop was a visit to the office of the County Government where ways to preserve the rich culture of the Dong population were discussed. The plan was to build an eco-cultural hotel at Zhao Xing Village and training facilities to preserve the heritage in view of youngsters who were fleeing the village to seek better jobs and lives in the cities. A consortium from Hong Kong had offered to help the County Government to raise funds, supervise the construction of the various facilities and help manage them for the people there.



### Notes on Dong Music

Like most cultures, solo singing plays an important part, particularly in love songs and narrative ballads. Apart from solos that reveal the desires of an ardent suitor, love songs are sometimes sung as dialogue (dui chang) between man and woman. The Dong has ballads accompanied on pipa (guitar like instrument), ox-bone fiddle, or bamboo flute. Most often, the singer accompanies himself or herself on the pipa, telling an episode of Dong history, or a story with a moral. But for people as sociable as the Dong, group singing is truly an inevitability.

Group songs also break into a number of subdivisions, from "drum tower" da ge, mostly love songs that are boisterous for men and lyrical for women (and, as the name implies, authentically sung in a drum tower, where the "visiting" female singers are pitted against "local" males) to "sound imitation" de ge, which utilizes word painting as well as textless imitations of birds or insects.

For more information on this topic, one can visit: [www.ffmm.com/cd](http://www.ffmm.com/cd). 



The Drum Tower is the Town Hall of the local population

Girls in colourful decorated costumes and silver



Gate-barring ritual at Di Men Village



Gate-barring ritual at Tung An Village



Zhao Xing Village - the largest settlement of the Dong population in the region



The Drama Stage was once the focal point in daily living and festive celebration



Elders of the village gathered at the Drum Tower



The whole village at Di Men was out to welcome visitors



# SC Liu - Shining Pearl



We can have several epithets to describe Mr Liu Sing Cheong (SC): an astute surveyor who learned the tricks of the trade in property industry in the early years of his career and reaped a windfall from making good use of them; an acclaimed entrepreneur who founded the largest property consultancy (Pearl River - Hang Cheong Real Estate Consultancy) and subsequently one of the largest property agencies (My TopHome Company Ltd) in Guangzhou and a popular property website (www.mytophome.com); and a property professor, who serves as a visiting professor in two local universities in addition to being a visiting professional fellow to Cambridge International Land Institute, Cambridge University.

His success story has not gone unheard. A documentary about his entrepreneurship was filmed by the Radio Television Hong Kong last year. In November 2001, the Business Week Online ran an interesting article of his property agency and website in Guangzhou. Moreover, the City University of Hong Kong published a management book titled "Innovation Management Cases in Hong Kong", which included SC's company as well as other leading companies like Peninsular Hotel, V-tech and Johnson Electric etc as a showcase on innovation of Hong Kong-based companies and entrepreneurs.

He represents a shining example of trailblazing Hong Kong professionals in the Pearl River Delta.

Recently he was named one of the winners of the Outstanding Hong Kong Polytechnic University Alumni Award 2003 and appointed as Chairman of the RICS Asia Pacific Board.

*Can you tell us about the early development experience of your practice in Guangzhou?*

**SC:** Through an exchange program organised by the former Hong Kong Polytechnic, I met my present partner in the early 90s. We set up Pearl River - Hang Cheong in 1993, one of the first professional property consultancy firms in the market. Back then the Guangzhou property market was still at the embryonic stage. We had some tough times. We lost money in the first five years of operation.

But I never thought of giving up, as I had a hunch that if we held on, we should have a promising future. At that time I clearly saw our business growing each year and activities in the real estate market were increasing with fast-rising economy and investment flows - but we just didn't know when we could translate the opportunities into profits for us. It turned out that my hunch was right. We have achieved quite encouraging results in the past five years. Moreover, we successfully ventured into other business areas such as property related IT consultancy and established My TopHome which operates one of the largest property agencies in Guangzhou and the most popular real estate website in China.

*How did you manage to get financial support to sustain the business through the difficult periods?*

**SC:** Before I moved to Guangzhou, I ran a boutique agency specializing in investment properties in Hong Kong. Thanks to the unprecedented property boom during the 90s, we made a bit of money and used the profit to support the new venture in Guangzhou.



In the commercial world not many shareholders would tolerate a company losing money 5 years in row. The reason that Pearl River - Hang Cheong could still exist at that time was that I really wanted to try something different from what I had used to do in Hong Kong.

In hindsight, I would think our commitment and investment in staff training and company infrastructure were the major reasons that we had not been able to make a profit earlier. But thanks to the investment, we have amassed a talented workforce that helped us capitalize on the opportunity and build up the organisation.

Right now, more than half of our businesses are from repeat clients and although we are based in Guangzhou, and at the moment we only have one other office outside Guangzhou, we work on a substantial number of assignments that are related to markets outside the Guangdong region.

*You have mentioned that the success is largely due to your staff and efforts on staff training, what are the training resources Pearl River - Hang Cheong has provided to them?*

**SC:** To start with, training was a necessity when we started 10 years ago. There was not even a single real estate related course run by any university in Guangzhou. We

were literally forced to train our colleagues in-house. Gradually it has become our tradition. On a more practical note, we run training programs every week and we invite staff who have recently done interesting projects and external speakers to share their experience. For example, recently we had a plant manager from Honda Guangzhou to talk about quality control. We had also invited an architect to speak on the design elements for a quality development from an architect's perspective. We foster a company culture that each senior must take responsibility for looking after his subordinates on job skills enhancement. From time to time we sponsor our staff to attend courses organised by universities in Hong Kong and Guangzhou. Had it not been the SARS incident, 4 of our staff would have been flying out to Sydney on a property market study tour.

*Do you not worry that your highly trained staff would be poached by competitors? How do you retain them?*

**SC:** I am very proud of our record on this - most of our staff hired in the early years are still with the company. Before I became my own boss, I had worked for large corporations such as Swire Properties, Hsin Cheong Group and Way Foong Properties (a subsidiary of HSBC) for many years. I know providing a fulfilling working environment is important in retaining good staff. Talented and ambitious people don't just look for short-term remuneration. While we pull a lot of resources into staff training, we also focus in building our company infrastructure, brand name and market position so that we are a company that our colleagues are proud to work for. Externally we promote our company as a professional company that cares about all our stakeholders; internally, we have both on-line and off-line devices to enable us to share and enlarge experience and knowledge. Improving productivity is the key issue in our minds. Besides I personally take an interest in staff development. Most of the week I have lunch and dinner with them and discuss issues of mutual interests, business related or not.

*How do you see the PRC property market? Do you agree it has now become a bubble?*

**SC:** My view is that the PRC property market may not experience a wild property bubble like we had in Hong Kong, simply because any momentum of price inflation would be quickly dented by a large supply. The governments at all levels have been spending very heavily on infrastructures, and the completion of a new road could in theory open up large strips of development land - you can take a look at the vast land reserve along the new highway from Guangzhou to Pan-yu, for instance.

Based on analysis purely from an economic point of view, there are two types of land economy: the island type - examples are Japan, Hong Kong (that is before 1997) and Taiwan, property markets of this type tend to be unstable and highly volatile; and the continental type - examples are United States and Continental Europe, property price movements in these countries are in the long run quite gentle. I think the PRC property market exhibits characteristics of the continental-type.

*Do you think there are any opportunities for property developers in the PRC market?*

**SC:** Housing demand aligns with the socio-economic trends. The structural reform in housing market in the past few years has fueled a strong housing demand amongst local residents. With good projects, good project team and prudent financial management, developers can still make a living out of property developments despite the already crowded market.

The chance to earn super-profits like what Hong Kong developers had experienced before the 1997 property



SC Liu at the presentation of the Outstanding Poly U Alumni Award

crash is unlikely to happen here. Property development in PRC is akin to an industrial operation, which thrives on smart management and innovation.

*What are the prospects you would see in the Hong Kong property market?*

**SC:** I am not as sanguine as one property analyst who said earlier this year property prices would go up by 40% in 2003. Citing a historic high affordability ratio is misleading, particularly in this time of market. It is fundamentally wrong if it is used to gauge the actual housing demand. Why? The affordability ratio would be meaningless for people who are out of a job or who are worrying about job security, and property owners with negative equities.

*What is your opinion of the "85,000" housing policy announced in 1997?*

**SC:** During the period 1994-1997, the property market had already shown many typical symptoms of a property bubble - property prices soaring to dizzy heights against the backdrop of rising vacancy, flattening rent and paltry yields. After all, the total number of households is less than the total number of housing stock. More than half of our population live in subsidized housing of one kind or another. Quite clearly we were not lacking flats to meet genuine housing demand, we were only lacking flats for speculation. It was not a lack-of-supply problem in the housing market. The property market would definitely fall even without the "85,000" housing policy. But the "85,000" housing policy had aggravated the fall in property prices and more importantly, caused substantial wastage (overbuilt) in the subsidised housing sector at the expense of taxpayers in the aftermath of the burst of property bubble.

*The office sector, which was not affected by a policy similar to the "85,000" housing policy in residential sector, had also seen a price collapse. Some people cited this observation to argue that the "85,000" housing policy had nothing to do with the problem in residential market. What is your view?*

**SC:** This argument doesn't hold water and it is another misguided statement. For the office sector, true, it had not fared better than the housing sector, but its demise was mainly due to a falling demand and not oversupply. If a person dies of starvation, would you reach a conclusion that taking cyanide is not fatal?

*Your market opinions seem to be different from the mainstream.*

**SC:** Thanks to my training in property and property market knowledge is surveyors' expertise. As a surveyor we should have our own views and give well-reasoned advice to the government and the public. If we are only acting as a mouthpiece of vested interests and a believer in what simply are property myths rather than facts, we earn no public respect.



## SC Liu's Profile

### Education

1977	Higher Diploma in Surveying, the former Hong Kong Polytechnic
1994	MBA, Hong Kong University of Science and Technology
1981	Chartered surveyor

### Professional Qualifications

Fellow of the Hong Kong Institute of Surveyors
Fellow of the Royal Institution of Chartered Surveyors

### Career

1977	Assistant Surveyor, Swire Properties Ltd
1983-87	Worked for Hsin Cheong Group, Knight Frank and Way Foong Properties
1988	Managing Director of Hang Cheong Real Estate Consultants Co Ltd (HK)
1993	Managing Director, Pearl River - Hang Cheong Real Estate Consultants Co Ltd and Chairman, Guangzhou MyTopHome Co Ltd (2000)

### Public and Institute Services:

Recipient of the Outstanding Poly U Alumni Award 2003
Honorary Fellow of the Hong Kong University of Science and Technology 2001
Honorary Professor at the University of Hong Kong
Adjunct Professor at the Hong Kong Polytechnic University
Director, R and D Corporation Ltd, the Hong Kong University of Science and Technology
Member, Corporate Advisory Board of School of Business and Management, the Hong Kong University of Science and Technology
Visiting Professional Fellow to the Cambridge International Land Institute, Cambridge University
Member of the Hong Kong Housing Authority
Junior Vice President of the Hong Kong Institute of Surveyors
Chairman of the Royal Institution of Chartered Surveyors Asia Pacific Board

*What advice would you give on the property market at this time?*

**SC:** Our interest rate is currently at a low level, because our currency is linked to US dollars and interest rate movement is largely affected by the Fed. The current US interest rates are the lowest in four decades. But the interest rate would not stay low forever, there may be one more cut in the interest rate before it swings back and rises again. Given that the US trade deficit has swollen to over 5% of the GDP, not to mention the bulging federal and state budget deficits, the scenario for a weakening dollar and a tightening monetary measure in the coming future is not unlikely.

I am concerned that if the mortgage rate rises up again in the near future, back to the level where we used to see in the 90s. i.e. at 8% - 9%, more existing owners may not be able to service the mortgages, which would bode financial disasters to the mortgagees, banks and the economy. We may at this stage need to consider whether we should develop a contingency plan, for example, in the form of a massive debt-restructuring master program, to mitigate the risks.

*What are the reasons for accepting the RICS post?*

**SC:** Hong Kong has been playing a "bridge" role between China and the rest of the World. To play that role well, it is important to ensure the traffic is two-ways. The force of globalization has seen the interactions between China and the rest of the world growing. This provides tremendous opportunities for Hong Kong professionals. Property industry is one key growth sector in the PRC. I believe, as a Hong Kong surveyor, we can have a lot to contribute in what will be a vital future for us. The new RICS post has thrown a challenge to me to strengthen the tie amongst property

professionals in the region and our counterparts in the other parts of the world.

*Do you have any advice for young surveyors?*

**SC:** Work for something that interests you, whether it has anything to do with surveying or not. Do your best, and with a bit of luck and patience, you will be there. Being adventurous is fun, as you are all young, your opportunity costs are low. Also it is important you do not burden yourself with too many unnecessary worries.

## Epilogue

Never been encountered before, this interview ended with a question from our interviewee – "What do you think about this interview?" SC looked intently at me, his eyes begging for an answer. His avuncular demeanor suggests that he is the sort of man who likes to listen to others and values for ideas. Perhaps, he has been accustomed to getting feedback after each lunch meeting with his colleagues.

Why does he want feedback from us? Before this interview, my knowledge of him was only limited to last year's documentary and the impression from which was somewhat puzzling. He is well-off, or at least he lives in a house somewhere around the peak – I can even name the development he lives from the quick shot in the documentary, thanks to my property instinct. And yet in the film he talked about the hardship, loneliness and struggles of opening his practice in Guangzhou. He was obviously in a better position than many others and could afford to lead a different life.

Why should he bother to go through the pains? The answers only came after this two-hour long interview. [E]