

## CHAPTER 2

# Hong Kong's System of Management of Multi-Storey Buildings in Private Ownership

In this chapter, we:

- (1) give an outline of the main components of Hong Kong's system of building management ('the system');
- (2) indicate practical implications of the system's piece-meal development; and
- (3) address some of the effects produced by adopting a system based on private agreements.

## PART 1

### SUMMARY OF THE MAIN COMPONENTS OF THE SYSTEM

#### EVOLUTION

Hong Kong's current system of management of multi-storey buildings in private ownership did not begin with a specific act of legislation. It has emerged in a piece-meal fashion over a period of more than 50 years from the mid-1950s. In that time, it has changed from a simple system predominantly concerned with the legal arrangements necessary to transfer ownership of units in a building into a complex one for dealing with the diverse problems associated with managing a building. Charting this process is difficult because the changes have been gradual and irregular. For practical purposes, we can identify certain broad periods during which significant developments took place.

#### *Phase 1: mid-1950s to 1961*

This was a period of rapid expansion, during which developers and landowners took every opportunity to exploit their property rights.<sup>1</sup> Once building plans were approved, there was little regulation over what happened to the land thereafter. The main concern in the 1950s was how to allocate ownership and use rights to purchasers of units in the building.

This was primarily a question of conveyancing, not building management. For flats to be marketable, it was necessary to answer questions such as:

- (1) 'What interest would purchasers have in the land and buildings?'
- (2) 'How should the building be divided up?' and
- (3) 'What rights would the participants have over the various parts of the building?'

<sup>1</sup> See Sihombing & Wilkinson (5th ed, 2007), op cit, pp 291-92.

The legal arrangements of the present system were established in the course of answering these questions.

(a) The ownership interest: tenancy in undivided shares

Where a sole owner intends to erect a multi-storey building on a lot of land for the purpose of selling flats in the building, he must subdivide the lot. Subdivision in Hong Kong means notionally dividing the land into a certain number of undivided shares. The division is notional because it does not correspond to any physical division of the land or of the undivided shares. As a matter of law, the shares attach to the whole of the land, not to any particular part of the land or building. It is legally impossible in Hong Kong to purchase ownership of a flat in a multi-storey building without also buying shares.<sup>2</sup> This is because the property right (or ownership interest) of a co-owner in a multi-storey building is the right to an undivided share in the land and buildings.<sup>3</sup> There is no separate ownership of an individual unit. Rights of ownership attach to the shares, not to the flat, so to acquire those rights, the purchaser must make sure that he or she buys shares, not simply a flat. Incidental to ownership of the shares comes the right to exclusive possession of the flat, hence lawyers call this right an incident of ownership of the shares.

This is difficult to grasp since in practical terms it is flats in a building that are advertised for sale, not shares in the land. Nevertheless, it is the outcome of adopting the common law system<sup>4</sup> of co-ownership known as the tenancy in undivided shares or tenancy in common, rather than a system of strata title or other forms of landholding. Strata title refers to a system in which an owner obtains separate ownership of a flat with owners having reciprocal rights over property which is enjoyed in common.<sup>5</sup> In England, owners of flats may form a company which owns the land, with owners having shares in the company or a lease of flats from the company. There appears to be no written record of why Hong Kong adopted the concept of tenancy in common. Nield suggests<sup>6</sup> that although there are some examples in England of what is termed 'flying freeholds' under which the rights of ownership are divided horizontally, English law has always had difficulty with the concept of owning a piece of airspace.

A tenancy in undivided shares means that the whole of the land and buildings are held by all the owners in common, rather than by any single owner. The term 'tenancy' here does not refer to the relationship of landlord and tenant, but to the fact that the land is held from another. At common law, tenants in common could own land on a freehold or leasehold tenure. However, in Hong Kong, as seen in chapter 1, privately owned land is nearly always held on a long lease from the government. The term 'undivided' refers to the fact that the property in which the shares subsist, that is, the whole of the land and buildings erected on the land, has not been physically divided up and distributed amongst the co-owners.<sup>7</sup> This reflects the essential characteristic of a tenancy in common, the 'unity of possession'. Unity of possession means that each co-owner has the right to possession of the land and buildings erected on the land in common with all other owners. There is no separate ownership of the land, building or units. Each co-owner is entitled to possess the whole of the property comprised in the development. No single co-owner has

2 Although it is possible to lease the flat, that would not make the tenant a co-owner.

3 *Jumbo King Ltd v Faithful Properties* [1999] 3 HKLRD 757; [1999] 4 HKC 707; *Kung Ming Tak Tong Co Ltd v Park Solid Enterprises Ltd* FACV 1/2008 (8 Sept 08).

4 Common law is used here in two senses. Firstly, to indicate the laws which emerged in one particular society, England and Wales, and which apply in Hong Kong, in contrast to other systems of law, such as Roman law or Chinese law. Secondly, to refer to rules of law made by judges in the course of resolving disputes, as distinct from legislation. Cf Peter Wesley-Smith (1994), *op cit*, pp 3-5.

5 As, for example, in Singapore, New South Wales and Canada.

6 S Nield, *Hong Kong Land Law* (Longman, 2nd ed, 1997), p 10.

7 Megarry & Wade, *The Law of Real Property* (6th ed, 2000), p 480.

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the right to point to a part of the land and say to the other co-owners, 'This is mine, you have no right to enjoy it.'

As regards the surface of the land, a tenancy in common is thus not like a cake which has been sliced up into pieces. The division is notional only. A co-owner cannot identify his slice, and prevent other co-owners from claiming it as theirs, or appropriate the whole cake. A better culinary analogy is with a pot of soup. The shares become identifiable only when the soup is poured out into bowls, but this does not happen unless the land is sold as a whole or is compulsorily acquired.<sup>8</sup>

In the meantime, the owners must be able to claim a stake in the development. This is reflected in the term 'shares', which refers to the separate and distinct interest which belongs exclusively to each co-owner. Shares represent the co-owners' stake in the property.

The abstract concept of undivided shares is considered more fully in Parts 2 and 3 of this chapter. In chapter 4, we look at how the community of co-owners is established on the first sale of shares in a development.

#### (b) Division of the development: exclusive use areas and common parts

The combination of common ownership of land and buildings and the right to exclusive possession of a flat implies a division in reality of the development into areas for the owners' exclusive use, occupation and enjoyment, and areas to be shared by all owners. If there were no such division, it would be difficult for a co-owner to assert exclusive rights over any part of the land.

The two classes of use are:

- (1) exclusive use areas, such as flats and car parking spaces;<sup>9</sup> and
- (2) common use areas, often called the common parts, which can be physically enjoyed, such as gardens, yards, swimming pools and tennis courts.

Common areas will also include:

- (1) common parts or facilities which are not capable of physical use or occupation, such as machine rooms, pump rooms, pipes and wiring ducts; and
- (2) common access areas which are set aside for the purpose of entry to and egress from the areas of exclusive use, such as entrances and passageways, driveways, staircases and landing.<sup>10</sup>

The building plans and DMC, if any, should indicate the physical parts of the building intended for separate possession or use. Clear delineation of classes of use, and precise specification of rights and duties in relation to such uses, enhances certainty and helps to avoid disagreements between the participants. However, poorly drawn plans and/or inadequate definition in the DMC are common causes of complaint, particularly in respect of older buildings.<sup>11</sup>

Exclusive use areas and common parts are mutually exclusive. However, it does not follow that they are physically separate from each other. For example, an area which is reserved for exclusive use may contain a structure which is a common part, either within the definition in the DMC or under the BMO. The most obvious example is a flat roof which contains machine rooms for lifts, water tanks, or meters which are installed for the benefit of the whole building as part of its amenities. Where an owner exercises a right,

<sup>8</sup> Although a tenancy in common implies that co-owners share property, it is distinct from common property, which is a form of landholding in which all owners have the same interest.

<sup>9</sup> *The Incorporated Owners of Viking Garden v Golden Brains & Anor* [1991] 1 HKC 353.

<sup>10</sup> Cf *Chau Sau-heung v Chue Jen Investment Co Ltd* Civil App 60/1988.

<sup>11</sup> See, for example, Hunter J's comments in *Incorporated Owners of Golden Crown Court v David Hsiung & Ors* HCA No 4322 of 1986.

arising under the assignment or conferred by the DMC, to erect structures on a common use area, disputes may arise about whether those structures form part of the common areas. This is a question of construction of each DMC or of the BMO or both.

(c) Rights over the various parts

In principle, each owner will have rights and obligations in respect of the property which is designated as within his sole possession and control, while all the owners are collectively subject to the general liabilities of property owners. However, the nature and scope of those rights will depend upon the assignment, the DMC (if any) and the general law. In addition to the grant or reservation of exclusive possession, the assignment may also include ancillary rights which are enjoyed together with the property. For example, owners need to be able to get to and from their units and car parking spaces. For this purpose, they will be given, expressly or impliedly, a right to use means of access such as lifts, entrance halls, staircases and landings, and other passages intended for common use. In addition, the purchaser will also acquire other rights and privileges which appertain or belong to the property, such as easements exercisable over the land of another. Such rights will pass automatically, unless a contrary intention is expressed in the assignment.<sup>12</sup>

The subdivision of the lot into shares does not necessarily correspond to the user classes. This lack of correspondence between the ownership interest and the physical asset is in sharp contrast to condominium and strata title systems, and has contributed to the problem of identifying owners' rights and obligations. Thus, as we will see in Part 2, a person may own undivided shares and yet have no right to exclusive possession of any particular part of the building. Alternatively, a person may have a licence to enjoy an exclusive use area, but have no shares in the land and thus no proprietary right which can be sold to another.

It is also necessary to distinguish between the right to use and the right to exclusive possession of a part of the building. Thus, the right to pass and re-pass over a corridor forming part of the common areas does not confer any right to exclusive possession of the corridor, only a right in common with others to use the corridor.<sup>13</sup>

Phase 2: December 1961 onwards — the 'Consent Scheme'

Since the 1950s and the rapid expansion of construction in Hong Kong, developers have been eager to sell units even before the development is finished. Binding agreements for sale invariably involve payment of a deposit and the money from such deposits and from other periodic advance payments of the price is obviously advantageous to a developer, adding generally to financial stability and specifically to the funds required to finish the development. Purchasers may be interested in buying flats (often at a discount) in an uncompleted development, either for the purposes of speculation where there is a market for sub-sales, agreeing to re-sell the units before completion of the construction, or simply to guarantee a home in an area where housing is in short supply.

However, there are risks in signing a binding agreement to purchase an unfinished unit. The most obvious is the risk that the development will not be completed, for example, due to the developer going into liquidation and ceasing to be able to obtain funds to complete the construction. The purchaser then has no security or preference and can only share as an ordinary creditor in any proceeds arising out of the liquidation. Moreover, the purchaser would be liable in damages for breach of contract himself if he had entered a binding agreement to sub-sell the property. The purchaser is also at risk of a decline in the value of the property.

12 By virtue of the Conveyancing and Property Ordinance (Cap 219), s 16.

13 *Welltech Investment Ltd v Easy Fair Industries Ltd* HCA A 5853/1994.

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In addition to these risks, the parties do not bargain on an equal footing. In a seller's market, there is little the purchaser can do to negotiate terms in the agreement. Unless controlled, the developer may insert clauses which are excessively favourable to it and unfavourable to the purchaser.

For these reasons, and because there were a number of cases in the late 1950s where the developer failed to complete the construction, the government introduced protection for purchasers of flats in uncompleted developments under the Land Authority Consent Scheme in 1961. The scheme operates through a condition, found in the government grant of the land to the developer, that the developer may not sell any part of the land (which would include flats in buildings on it) without the prior written consent of the Director of Lands. The scheme lays down the terms upon which that consent will be given.

The current purposes of the 'Consent Scheme', as it is widely known, are:

- (1) to allow for the entry into agreements for sale and purchase of flats in uncompleted developments, ensuring that arrangements are in place for the completion of the construction of those flats;
- (2) to provide for fair practice in the sale and purchase of uncompleted units in developments; and
- (3) to give effect to government policy in promoting a healthy property market.

As seen in Chapter 1, the Legal Advisory and Conveyancing Office ('LACO') administers the Consent Scheme on behalf of the Director of Lands.

The scheme applies to sales of residential and non-residential units in private developments and of residential units in subsidised housing projects. The procedures and criteria for each are different. The requirements for approval and consent to sale of units are specified from time to time in circular memoranda ('LACO CM'), which set out a series of pre-conditions to be satisfied before the Director will give consent.<sup>14</sup> The criteria are not exhaustive and the Director may require other or varied conditions, particularly in relation to complex developments.

Broadly speaking, the criteria and conditions for residential units in private developments concern:

- (1) the developer's financial position, designed to ensure that the developer has the ability to meet all outstanding construction costs;
- (2) the developer's investment in the project, designed to show that he has a significant stake in completing the project;<sup>15</sup>
- (3) development progress, so that consent will not be given unless the project has reached a certain stage of development;<sup>16</sup>
- (4) location of proposed sales office, to ensure that it is large enough to avoid queues in the streets;

<sup>14</sup> The latest circular in respect of residential units in private developments is LACO CM 56 (2006). This presents all current instructions still in force in a single memorandum. There are standard forms of statutory declaration and prescribed terms for the sale and purchase agreement. The circular applies to uncompleted private residential developments (excluding the Private Sector Participation Scheme ('PSPS'), and Sandwich Class Housing Scheme and Flat for Sale Scheme).

<sup>15</sup> This is supplied by the developer's purchase of the land and payment of the cost of foundation work.

<sup>16</sup> Currently, this means that foundation and piling works have been completed, the Building Authority has given consent to commence building works on the superstructure under the Buildings Ordinance s 14, and the authorised person's certified estimated date of compliance does not exceed three months from the expiry date of the current building covenant.