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# The Issue of Subdivided Units in Hong Kong: Licensing as a Solution?

*Kai-Tai Wallace Chung\**

*In response to widespread concerns over the safety and living conditions of ‘subdivided units’ (SDUs), the Hong Kong government has vowed to tackle the existence of illegally SDUs and to assess whether licensing is a feasible solution for regulating SDUs in residential buildings. To determine this, I examine the sources of the SDU problem as well as the licensing experience with bedspace apartments. Drawing from economic analysis, I argue that licensing is not a viable solution because: (1) there is an insufficient supply of affordable alternative housing for displaced SDU households; and (2) it fails to address the primary factor attracting flat owners to procure illegal flat subdivision, that is, the lack of enforcement action by authorities.*

*Instead, I propose that alongside the long-term goal of increasing housing supply over a ten-year period, the government should adopt a short-term three-pronged approach. Under this proposal, the government should: (1) strengthen enforcement action against illegally subdivided flats; (2) offer incentives to owners of illegally subdivided flats to conduct proper removal and/or rectification of unauthorised building works; and (3) impose a system of rental control and housing tenure to safeguard the interests of SDU households.*

## I. INTRODUCTION

The general public and the Hong Kong Special Administrative Region (HKSAR) government (Government) have been very concerned with the safety and living conditions of ‘subdivided units’ (SDUs).<sup>1</sup> This was prompted, in part, by the occurrence of several tragic incidents involving SDUs, such as the Ma Tau Wai Road fire in June 2011<sup>2</sup> and the Fa Yuen Street fire in November 2011.<sup>3</sup> These incidents brought to light the building and environmental safety risks commonly associated with improper flat subdivision, which continue to exist due to issues such as housing unaffordability<sup>4</sup> and lack of government enforcement.<sup>5</sup> In 2013, the Long Term Housing Strategy (LTHS) Steering Committee (Steering Committee) commissioned a survey (2013 Survey), which estimated that

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<sup>1</sup> Subdivided units (SDUs) are defined by the Buildings Department as a domestic unit formed by subdivision of a flat into two or more individual rooms not present in the original approved plan of a building, although this Paper will adopt a narrower definition. See n 8.

<sup>2</sup> Hong Kong Special Administrative Region (HKSAR) Government, ‘Information Note: Subdivided Flats in Hong Kong’ (Information Note 2013) (IN22/12-13) fn 1.

<sup>3</sup> Policy 21 Limited, ‘Report on Survey on Subdivided Units in Hong Kong’ (2013 Survey) (June 2013) [1.1.3]; Office of the Chief Executive (Chief Executive), ‘The 2014 Policy Address’ (January 2014) [147]; T Chan, ‘Mong Kok fumes spread “in absence of fire-resistant lobbies”’ *South China Morning Post* (Hong Kong, 14 Mar 2013) <<http://www.scmp.com/news/hong-kong/article/1190046/mong-kok-fumes-spread-absence-fire-resistant-lobbies>> accessed 28 February 2014.

<sup>4</sup> See text to n 64.

<sup>5</sup> See text to n 87.

171,300 persons were living in 66,900 SDUs in Hong Kong.<sup>6</sup> In the 2014 Policy Address, the Chief Executive of the HKSAR firmly supported enhancing law enforcement action to eradicate and tackle SDUs that have breached fire safety and building laws, and expressed that the government will need to carefully assess the feasibility of regulating SDUs in residential buildings by licensing.<sup>7</sup>

In this Paper, I provide an overview of the issues concerning SDUs and assess whether licensing is a viable solution to regulate their safety and living conditions. In Parts II and III, I define what a SDU is and highlight the safety and hygienic issues commonly associated with them. This helps to illustrate the seriousness of the problem and explain the widespread concern surrounding illegally SDUs. In Part IV, I identify the reasons for the creation and continued existence of (illegally) SDUs and refer briefly to an economic analysis of criminal law to explain the dynamics of individual choices. With reference to this economic model in Part V, I explain why the licensing scheme used in regulating bedspace apartments (BSAs) cannot be applied to the regulation of SDUs. In Part VI, I propose a short-term solution to the issue of SDUs that avoids the problems encountered by the initially discussed licensing scheme. I then conclude with a summary of my arguments in Part VII.

## II. DEFINING SUBDIVIDED UNITS

Although there is at present no statutory definition of a SDU, the Buildings Department (BD) regards it as a domestic unit, formed by ‘the subdivision of a flat as shown on the original approved plan of a building into two or more individual rooms’.<sup>8</sup> These subdivisions often involve building works such as the removal or erection of non-structural partition walls, installation of new toilets and kitchens, alteration of internal drains, thickening of floor screedings to accommodate said drain pipes, or addition of door or ventilation openings.<sup>9</sup> It should be noted that SDUs are not illegal if their

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<sup>6</sup> Policy 21 Limited (n 3) [10]-[11]. A task force (composed of the representatives of the Building Department, Census and Statistics Department, Rating and Valuation Department, and Transport and Housing Bureau) monitored the progress of the 2013 Survey. The survey involved a stratified random sample of about 18,600 buildings aged 25 and above, with the stratification factors being building age, rateable value and spatial characteristics (eg, proximity to Mass Transit Railway stations). A total of 1,860 buildings, which were distributed throughout all districts in Hong Kong, were fully or partially enumerated during the period from 31 January to 30 April 2013. A ratio estimation method was used to derive estimates of the number of quarters with SDUs and the number of SDUs, using independent estimates on the stratification factors mentioned. See Policy 21 Limited (n 3) [2.1]-[2.6].

<sup>7</sup> Chief Executive (n 3) [148]. Enforcement action usually involves the issuance of orders for the removal or rectification of unauthorized building works within 60 days, non-compliance of which is an offence liable upon conviction to a fine or imprisonment; see Buildings Ordinance (Cap 123) (BO), ss 24-24AA, 40.

<sup>8</sup> Buildings Department, ‘Frequently Asked Questions – Subdivision of a flat (Subdivided units)’ <[http://www.bd.gov.hk/english/services/index\\_faql.html](http://www.bd.gov.hk/english/services/index_faql.html)> accessed 28 February 2014.

<sup>9</sup> Ibid.

associated subdivision works do not violate any relevant legislation, such as the Buildings Ordinance (Cap 123)(BO) and its subsidiary legislation,<sup>10</sup> or the Fire Safety (Buildings) Ordinance (Cap 572) (FSBO). Building works carried out in contravention of the BO are called unauthorised building works (UBWs) and are subject to enforcement action.<sup>11</sup>

On the other hand, the working definition employed in the 2013 Survey stated that a ‘SDU is formed by the subdivision of individual living quarters into two or more units for rental purposes to more than one household.’<sup>12</sup> Here, a domestic household is regarded as consisting of an individual or ‘a group of persons who live together and make common provision for essentials for living.’<sup>13</sup> Further, this definition is applicable only to units found in permanent private domestic or composite buildings, and excludes those in non-domestic and industrial buildings.<sup>14</sup> This SDU definition reflects the community’s shared understanding that most flats are subdivided by homeowners for the purpose of sale or rental to multiple non-related parties.<sup>15</sup> although subdivision may occur for other purposes, as is implied by the absence of the sale or rental element in the BD definition. The 2013 Survey definition also reflects the data collection methodology employed in the survey for assessing the number of SDUs in a building by partial reference to the number of visible mail boxes in a sampled building, since enumerators may not know the original plans of or have access to a particular flat.<sup>16</sup>

With reference to the two SDU definitions above, this Paper will adopt the one employed in the 2013 Survey for two reasons. First, concern over the safety of SDUs is mostly associated with rental units.<sup>17</sup> Although SDUs may be created for purposes other than for rental or sale, the number and effect of these units is likely to be small.<sup>18</sup> Second, this Paper will make repeated references to the 2013 Survey, so adopting the same definition will ensure that the statistics contained therein will be more applicable to the present analysis.

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<sup>10</sup> Policy 21 Limited (n 3) [1.1.1].

<sup>11</sup> HKSAR Government (n 2) [2.3].

<sup>12</sup> Policy 21 Limited (n 3) [3.1.10]. ‘Household’ refers to a domestic household.

<sup>13</sup> *Ibid* [3.1.9] fn 21.

<sup>14</sup> *Ibid* [2.1.2].

<sup>15</sup> Government Information Centre, ‘Press Releases - LCQ11: Subdivided flats, bedspace apartments and cubicle apartments’ (24 October 2012) <<http://www.info.gov.hk/gia/general/201210/24/P201210240386.htm>> accessed 28 February 2014.

<sup>16</sup> Policy 21 Limited (n 3) [3.1.7]. While SDUs may contain UBWs (and thus be illegal), subdivided flat owners may nonetheless provide mailboxes to SDU tenants, even at risk of the flat being identified as containing UBWs and subject to enforcement action.

<sup>17</sup> *Ibid* [5.1.1].

<sup>18</sup> See *ibid* [4.1.3], where 100 per cent of surveyed households living in SDU were tenants.

Hence, for the remainder of this Paper, and unless otherwise stated, a SDU shall refer to a domestic unit that is located in a permanent private domestic or composite building, and formed by the subdivision of individual living quarters into two or more units for rental purposes to more than one household. Reference to an illegally SDU refers to a SDU which contains UBWs.

### **III. ISSUES WITH SUBDIVIDED UNITS**

Subdivided units commonly involve UBWs, which may adversely affect building safety and environmental hygiene.<sup>19</sup> These illegally subdivided flats may pose health and safety risks to not only its inhabitants but also to those of surrounding flats,<sup>20</sup> so that the number of persons affected could potentially exceed the estimated 171,300.<sup>21</sup> Thus, the existence of improperly created SDUs merits much attention.

#### **A. Building Safety**

##### *1. Structural Integrity*

As already mentioned, UBWs frequently involve the removal and/or erection of non-structural partition walls and thickening of floor screedings, which may add additional stress on the floor slabs, beams and columns of the building.<sup>22</sup> Adding openings for new doors or drain pipes on structural walls may also weaken the building's integrity, and improperly completed drainage works may lead to water seepage, corrosion of steel reinforcements and concrete spalling at the ceiling of the flat below.<sup>23</sup>

In January 2010, a five-storey tenement building at 45J Ma Tau Wai Road collapsed, claiming four lives and seriously injuring two residents.<sup>24</sup> The building, completed in 1955, contained SDUs on all its upper floors<sup>25</sup> and disturbance on one of the building's concrete structural columns by

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<sup>19</sup> Buildings Department (n 8) [1].

<sup>20</sup> See text to n 22.

<sup>21</sup> Policy 21 Limited (n 3) [10]-[11].

<sup>22</sup> *Ibid.*

<sup>23</sup> *Ibid.*

<sup>24</sup> Subcommittee on Building Safety and Related Issues (SBSRI), 'Measures To Enhance Building Safety in Hong Kong' (LC Paper CB(1)681/10-11(01), December 2010) [2].

<sup>25</sup> Buildings Department, 'Report on the Collapse of the Building at 45J Ma Tau Wai Road To Kwa Wan, Kowloon - KIL 8627 on 29 January 2010' (LC Paper CB(1)1716/09-10(01), April 2010), [6].

‘external’ forces was concluded to be the likely cause of the collapse.<sup>26</sup> Subsequently, the government reported that most buildings in Hong Kong, like the one at 45J Ma Tau Wai Road, are reinforced concrete structures designed to have a serviceable life of around 50 years.<sup>27</sup> As at December 2010, approximately 4,000 buildings in Hong Kong were aged 50 years or above, with the number increasing by 500 buildings annually, and 25 per cent of these have maintenance and repair problems.<sup>28</sup> Furthermore, the Urban Renewal Authority reported that 20 per cent of 7,000 buildings aged 30 years or above are in various degrees of dilapidation.<sup>29</sup> This means that even by excluding the number of buildings aged 30 to 49 years that are in various degree of dilapidation (which account for at least 400 buildings), approximately 1,500 buildings aged 50 years or above will have maintenance and repair problems by December 2014.

Because UBWs may damage a building’s structural integrity, older buildings designed to have a serviceable life of 50 years are likely more susceptible to the dangers associated with such works. With SDUs being more prevalent in older buildings (eg, 25 years or above),<sup>30</sup> UBWs associated with flat subdivision are thus likely to adversely affect the structural integrity of many domestic buildings in Hong Kong and endanger the lives of many residents.

## 2. Fire Safety

Aside from a building’s structural integrity, UBWs may also compromise the fire safety of residents by obstructing emergency escape routes and removing fire-resisting measures during the alteration process.<sup>31</sup>

In June 2011, a No 3 alarm fire engulfed an 8-storey composite building at 111 Ma Tau Wai Road, which led to four deaths and 19 injuries.<sup>32</sup> Obstructed escape routes and locked emergency exits may have contributed to the large number of casualties.<sup>33</sup> The Buildings Department later

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<sup>26</sup> Ibid [16].

<sup>27</sup> SBSRI (n 24) [2].

<sup>28</sup> Ibid.

<sup>29</sup> Ibid.

<sup>30</sup> Policy 21 Limited (n 3) [2.1.1].

<sup>31</sup> HKSAR Government (n 2) [1.1].

<sup>32</sup> M Cheung, C Lo and J Lo, ‘Survivors desperate to move out’ *South China Morning Post* (Hong Kong, 17 June 2011) <<http://www.scmp.com/article/970825/survivors-desperate-move-out>> accessed 28 February 2014.

<sup>33</sup> Ibid.

discovered that the emergency escape routes from most of the 12 flats that were subdivided (of a total of 14 flats) had been blocked by partition walls which were UBWs.<sup>34</sup>

Later that year, a No 4 alarm fire at a building on Fa Yuen Street claimed nine lives and injured 34.<sup>35</sup> Evidence at an inquest suggested that the removal of two fire-resistant lobbies might have sped up the spread of smoke, which was the predominant cause of the deaths.<sup>36</sup> Furthermore, seven of 12 subdivided flats in the building had no access to the rear staircase due to UBWs, which posed a higher risk to the tenants.<sup>37</sup>

These two incidents suggest that improperly carried out flat subdivisions may adversely affect the fire safety of buildings. Although the source of the above fires may not be related to UBWs, some evidence suggests that SDUs may be subject to a higher risk of electrical fires. A survey conducted by the Hong Kong Association for Democracy and People's Livelihood in 2013 revealed that of 83.8 per cent of 120 respondents living in SDUs did not have separate electricity meters installed.<sup>38</sup> These tenants are subject to a greater risk of fire due to prolonged and/or concurrent use of electronics, which may be fatal when coupled with impeded means of escape caused by UBWs. The situation is even more alarming when considering that approximately 171,300 people may be exposed to such risks.<sup>39</sup>

## **B. Environmental Hygiene**

UBWs associated with flat subdivision may also affect the environmental hygiene in the building and/or its contained flats. Water seepage caused by improper drainage works increases indoor dampness, which can promote the growth and spread of fungi, bacteria, allergens and other toxins, all of which may have adverse effects on the health of inhabitants.<sup>40</sup> Excess moisture may also result in increased chemical emissions from building materials and floor covers, and attract cockroaches and rodents capable of transmitting infectious diseases.<sup>41</sup> Furthermore, illegally SDU may not

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<sup>34</sup> Bills Committee on Buildings Legislation (Amendment) Bill 2011, 'Administration's Response to Follow-up Issues of the Meeting held on 12 January 2012' (LC Paper No CB(2)1033/11-12(01), February 2012), [12].

<sup>35</sup> Chan (n 3).

<sup>36</sup> Ibid.

<sup>37</sup> Ibid.

<sup>38</sup> HKSAR Government (n 2) [4.22].

<sup>39</sup> Policy 21 (n 3) [10-11].

<sup>40</sup> World Health Organization (WHO), *WHO Guidelines for Indoor Air Quality - Dampness and Mould* (WHO, Copenhagen 2009) [2.2].

<sup>41</sup> Ibid.

provide adequate natural lighting and ventilation, which may exacerbate existing levels of moisture and increase the concentrations of potentially harmful indoor pollutants.<sup>42</sup>

The 2013 Survey reported that 30.3 per cent of households living in SDUs were worried about the conditions of their current residence (eg, in relation to water seepage and hygienic conditions) and 11.5 per cent of householders encountered health problems.<sup>43</sup> Although these statistics alone are inconclusive, they suggest that UBWs associated with SDUs may augment hygienic risks and endanger the health and safety of their occupants and those in nearby flats, which may also contain SDUs.

#### **IV. SOURCE OF THE PROBLEM**

Given the aforementioned risks, one must wonder—why would so many households in Hong Kong choose to reside in SDUs? Moreover, why is there such a substantial number of (illegally) SDUs in the first place?

##### **A. Reasons For Rental Choice**

As to the former question, one possible conclusion is the lack of public unawareness on the risks and living conditions of SDUs. However, this is unlikely to be the case following the extensive media coverage of various tragic incidents involving SDUs—especially after the Fa Yuen Street fire in 2011.<sup>44</sup> The general public is aware that many old buildings have poor hygienic condition and lack fire safety facilities, and that SDUs may be associated with various safety risks.<sup>45</sup>

Instead, the more likely reason is the lower rental costs of SDUs as compared with other types of available accommodation. According to the 2013 Survey, 59.4 per cent of surveyed households ranked the price of rental as the most important factor affecting their housing choice, followed by the location of the flat (20.5 per cent) and nearby transportation (12 per cent).<sup>46</sup> The Steering Committee attributed the general increase in rental prices to a severe supply-demand imbalance for both public

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<sup>42</sup> Ibid.

<sup>43</sup> Policy 21 Limited (n 3) [4.5.1].

<sup>44</sup> Policy 21 Limited (n 3) [1.1.3].

<sup>45</sup> Ibid.

<sup>46</sup> Ibid [4.6.8].



and private housing, together with deteriorating affordability and changing demographics.<sup>47</sup> The ultimate effect is that both housing prices and rents are reaching levels beyond what the general public can afford, and many low-income families are thus inadequately housed,<sup>48</sup> which includes those living in SDUs.<sup>49</sup>

### *1. The Supply-Demand Imbalance*

According to Dwan, Sawicki and Wong,<sup>50</sup> several factors underlie the severe imbalance between the supply and demand for housing in Hong Kong.

First, the existing lands allocated and available for residential development is severely lacking when compared with its total population.<sup>51</sup> At the end of 2013, the estimated population of 7.2 million<sup>52</sup> in Hong Kong is distributed amongst the 76 square kilometres of land allocated for residential use.<sup>53</sup> Thus, the resulting population density is approximately 95,000 persons per square kilometre, which may illustrate the insufficiency of land available to meet the great housing demands.

Second, the Government, which is the absolute owner of land in Hong Kong, has limited the allocation of undeveloped land due to policy and other reasons, such as the Government's practise of auctioning land parcels only when it deems necessary and its over-reliance on land sale revenue for its fiscal health.<sup>54</sup> By restricting land supply, land can be auctioned at a higher value.<sup>55</sup> Although 738 square kilometres of land are undeveloped as at January 2013,<sup>56</sup> one academic believes that the lack of government resources for identifying and developing residential sites is the root of the housing

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<sup>47</sup> Long Term Housing Strategy (LTHS) Steering Committee, 'LTHS Consultation Document September 2013' (September 2014) [2.13].

<sup>48</sup> LTHS Steering Committee, Report on Public Consultation (February 2014) iii.

<sup>49</sup> Ibid [3.7]

<sup>50</sup> D Dwan, M Kawicki and J Wong, 'Subdivided Housing Issues of Hong Kong – Causes and Solutions' (Worcester Polytechnic Institute 2013) [4.1].

<sup>51</sup> Ibid [4.1.1].

<sup>52</sup> Census and Statistics Department, 'Population' <<http://www.censtatd.gov.hk/hkstat/sub/so20.jsp>> accessed 18 Mar 2014.

<sup>53</sup> Planning Department, 'Land Utilization in Hong Kong 2012' <[http://www.pland.gov.hk/pland\\_en/info\\_serv/statistic/landu.html](http://www.pland.gov.hk/pland_en/info_serv/statistic/landu.html)> accessed 19 Mar 2014.

<sup>54</sup> Dwan, Sawicki and Wong (n 50) [4.1.2].

<sup>55</sup> P Hui, 'Hong Kong Faces Renewed Pressure Over Its Housing' *Wall Street Journal* (Hong Kong, 20 July 2011) <<http://online.wsj.com/news/articles/SB10001424052702303661904576452982242744572>> accessed 17 Mar 2014.

<sup>56</sup> Planning Department (n 53).

problem.<sup>57</sup> This theory is generally consistent with the Steering Committee's position that the Government should continue to streamline the application and approval processes for land supply and housing development, and secure sufficient manpower resources in the construction industry to combat the insufficient supply of housing.<sup>58</sup>

Third, the supply of public housing, and in particular of PRH, is heavily outweighed by its demand.<sup>59</sup> Although PRH is recognised as the primary housing solution for households currently living in SDUs,<sup>60</sup> there are approximately 229,000 eligible applicants on the PRH waiting list as at the end of the 2012-13 period.<sup>61</sup> Within the same period, only 16,000 waitlisted applicants were allocated PRH flats.<sup>62</sup> These numbers reinforce the notion of a severe supply-demand imbalance.

Furthermore, statistics show that approximately half of all SDU households are on the waiting list for PRH, while the remaining half was either ineligible to apply or—to a much smaller extent—unfamiliar with the process.<sup>63</sup> Thus, SDUs may remain a viable housing option for those who: (i) have applied and are awaiting PRH allocation, or (ii) are ineligible for PRH and cannot afford other alternative forms of private accommodation.

## *2. Deteriorating Affordability*

The cost of private housing has increased to beyond an affordable level due to a combination of factors. Aside from an inadequate housing supply, global abundant liquidity and a low interest rate environment fuelled the property price surge, which was incommensurate with the rise in household income.<sup>64</sup> Between December 2008 and December 2012, residential property prices increased drastically by 117 per cent,<sup>65</sup> while the affordability ratio<sup>66</sup> deteriorated from 31.7 to 46.9 per cent.<sup>67</sup> Just as flat prices became unaffordable to the public, so too did rental prices in the private housing

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<sup>57</sup> Hui (n 55) (per professor Francis Lui).

<sup>58</sup> LTHS Steering Committee (n 48) [5.6].

<sup>59</sup> Dwan, Sawicki and Wong (n 50) [4.1.3].

<sup>60</sup> LTHS Steering Committee (n 48) [3.7].

<sup>61</sup> Hong Kong Housing Authority, 'Housing in Figures 2013' (2013).

<sup>62</sup> *Ibid.*

<sup>63</sup> Policy 21 Limited (n 3) [4.6.6], [4.6.7].

<sup>64</sup> LTHS Steering Committee (n 47) [2.13].

<sup>65</sup> *Ibid* [2.10].

<sup>66</sup> Calculated as the ratio of mortgage payment for a 45 square metre flat to median income of households (excluding those living in public housing), for a tenure of 20 years at the prevailing mortgage rate, with down payment being 30 per cent of the purchase price of the flat. If the affordability ratio rises, it means affordability deteriorates, and vice versa.

<sup>67</sup> LTHS Steering Committee (n 47) [2.13(b)].

market.<sup>68</sup> This in turn caused people to seek more affordable alternative housing options such as SDUs.

## **B. The Proliferation of Subdivided Units**

### *1. Why Are Illegally Subdivided Units Created?*

The severe imbalance between the supply and demand of housing caused people to seek alternative housing options that were more affordable than the traditional whole-flat rental. These circumstances likely gave rise to the proliferation of SDUs in general, as opportunistic homeowners realised that flat subdivision may yield significantly more rental income as compared with that of a non-subdivided flat.<sup>69</sup> For example, a non-subdivided 900 square foot apartment in Sham Shui Po, which would normally be rented for less than HKD9,000 per month, can be subdivided into nine 100-square foot units with rental income totalling HKD35,000 per month, which is four times its undivided value.<sup>70</sup> This hypothesis is generally consistent with the assumption taken in the 2013 Survey that SDUs are more likely to be found in older buildings, which typically have larger floor areas, lower rateable rental values and therefore higher profit margins on conversion.<sup>71</sup>

The same rationale can be used to explain the widespread existence of illegally SDUs. Simply put, flat owners wish to maximise profits and minimise costs. As flat subdivision often involves minor building works, such as the addition or removal of non-structural partition walls and the installation of new toilets and drainage systems,<sup>72</sup> owners may find it difficult to justify the time and costs involved in complying with the statutory requirements in the BO,<sup>73</sup> if the current law and enforcement lacks sufficient deterrent effect. Thus, many owners employ lesser-charging but unqualified contractors or workers to carry out the internal alteration and flat subdivision works<sup>74</sup> in

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<sup>68</sup> Ibid.

<sup>69</sup> J Chiu, 'How subdivision of flats yields higher profits' *South China Morning Post* (Hong Kong 19 Aug 2012) <<http://www.scmp.com/business/money/money-news/article/1018096/how-subdivision-flats-yields-higher-profits>> accessed 15 Mar 2014.

<sup>70</sup> Ibid.

<sup>71</sup> Policy 21 Limited (n 3) [2.1.1].

<sup>72</sup> Ibid [1.1.2].

<sup>73</sup> M Wong, 'Domestic Sub-divided Units in Urban Areas in Hong Kong: A Study of Policy Problems and Solutions' (Postgraduate Thesis, The University of Hong Kong 2012) 35.

<sup>74</sup> Subcommittee on Building Safety and Related Issues, 'Enforcement against Unauthorised Alteration Works Inside Private Premises' (LC Paper No CB(1)2605/09-10(01), July 2010) [11]. These subdivided flat owners are presumed to know the legal consequences of their actions, since (1) the Government has publicly advertised the need for proper flat subdivision and (2) unqualified contractors would likely have informed flat owners seeking their assistance of the proper procedure for flat subdivision. On the Government's publicity efforts, see Legislative

contravention of the statutory requirements, and are thus subject to criminal liability.<sup>75</sup> The resulting improper designs, substandard workmanship and use of improper materials undermine the durability and safety of the works, which could lead to overloading, water seepage or hampered means of escape in the event of a fire or accident.<sup>76</sup>

This hypothesis can also be justified from an economic standpoint, which suggests that individuals rationally choose amongst their total available opportunities to achieve the greatest satisfaction of their individual preferences.<sup>77</sup> While criminal punishment (or threat thereof) seeks to reduce the attractiveness of criminal opportunities from amongst the opportunities available to the individual,<sup>78</sup> a subdivided flat owner<sup>79</sup> whose preferences are economically driven would engage in crime if either her criminal opportunities are sufficiently remunerative as compared with her non-criminal opportunities, or if she has a sufficiently low distaste for criminal activity.<sup>80</sup> Such considerations involve weighing, eg, the attractiveness of the potential rental income available from illegally subdivided flats (along with its associated criminal sanctions) as against the attractiveness of the potential rental income available from properly subdivided flats (without criminal sanctions). Thus, a rational flat owner will engage in illegal flat subdivision if its remuneration exceeds its criminal liabilities. Given the example of the Sham Shui Po flat above,<sup>81</sup> the bar may be quite high. Therefore, the better question to ask is whether the criminal sanctions (or costs) arising from illegal flat subdivision can sufficiently deter the rational flat owner from choosing criminal opportunities over non-criminal ones.

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Council Panel on Housing, 'Measures to Deal with Subdivided Flats' (LC Paper No CB(1)367/12-13(03), December 2012) [11].

<sup>75</sup> Even though prior approval from the Buildings Department is unnecessary for certain building works identified as minor works under the Buildings Ordinance, it must be conducted by prescribed building professionals. See BO s 4A(2).

<sup>76</sup> *Ibid* [4], [11].

<sup>77</sup> KG Dau-Schmidt, 'An economic Analysis of the Criminal Law as a Preference-Shaping Policy' (1990) 1 *Duke Law Journal* 1, 3.

<sup>78</sup> GS Becker, 'Crime and Punishment: An Economic Approach' (1968) 76:2 *Journal of Political Economy* 169, 179, 191.

<sup>79</sup> A subdivided flat owner who seeks to carry out UBWs is presumed to be rational and fully aware of her potential opportunities and their consequences.

<sup>80</sup> Dau-Schmidt (n 77) 5.

<sup>81</sup> See text to n 70.

## 2. Why Do Illegally Subdivided Units Continue to Exist?

Arguably, illegally SDUs continue to exist due to the lack of law enforcement action.<sup>82</sup> This theory assumes (correctly) that a potentially effective legal framework is already in place to encourage proper flat subdivision.

Under the current legal regime, building works commonly associated with flat subdivision are now subject to a simplified approval process in order to encourage public compliance with building safety standards.<sup>83</sup> Subdivision works that are not performed by qualified contractors and that fail to meet the statutory standards are nonetheless subject to enforcement action, such as the issuance of removal orders.<sup>84</sup> Flat owners who fail to comply with these orders are liable on conviction to a fine of HKD200,000 and imprisonment for one year,<sup>85</sup> which represent the (apprehension) costs of illegal flat subdivision. In 2011, the Government strengthened enforcement by launching a large-scale operation, which aimed to inspect and rectify UBWs in 150 buildings per year, with the number of targeted buildings increased to 200 per year since April 2012.<sup>86</sup> Thus, the law facilitates proper flat subdivision and failure to comply with the statutory requirements is subject to enforcement action, which can result in fairly substantial penalties.

While the Government has been active in inspecting and locating illegally SDUs, enforcement in terms of prosecution has been lacking. From 2007 to September 2012, the Buildings Department issued a total of 527 removal orders pertaining to UBWs in subdivided flats. However, of these only 166 orders<sup>87</sup> (or 31.5 per cent) have been complied with and only 41 non-complied orders (or 11.4

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<sup>82</sup> Note that the expected cost of crime to an offender will be the cost associated with the activity (eg, transaction costs of procuring UBWs, cost of being apprehended, fine, etc) multiplied by the probability that the apprehension by authorities will take place. Therefore, the lack of law enforcement contributes to the probability of apprehension and, thus, to the cost of procuring flat subdivision involving UBWs. See L Phillips and H Votey, 'Economic Analysis of the Deterrent Effect of Law Enforcement on Criminal Activity, An' (1973) 63:3 *Journal of Criminal Law and Criminology* 330, 332.

<sup>83</sup> Subcommittee on Building Safety and Related Issues, 'Measures to Enhance Building Safety in Hong Kong' (LC Paper No CB(1)681/10-11(01), December 2010) [9(i)].

<sup>84</sup> HKSAR Government (n 2) [2.3].

<sup>85</sup> BO, s 40(2C).

<sup>86</sup> Director of Buildings, 'Controlling Officer's Reply to Initial Written Question' (Reply Serial No DEVB(PL)079, February 2012) 2.

<sup>87</sup> Secretary for Development, 'LCQ11 – Subdivided Flats, Bedspace Apartments and Cubicle Apartments' (October 2012) Annex 1 <<http://www.info.gov.hk/gia/general/201210/24/P201210240386.htm>> accessed 28 February 2014.

per cent) have been followed by prosecution action.<sup>88</sup> This suggests that current enforcement action, being the cost reflecting the probability of prosecution, is inadequate in eliciting compliance with building safety requirements from subdivided flat owners. This lack of enforcement is arguably a material cause in the continued existence of illegally SDUs, since the legal machinery and enforcement procedures necessary for regulating UBWs are already in place. The subdivided flat owner is not deterred from procuring UBWs since the potential rental profit derived from illegally SDUs greatly outweighs the risk of prosecution action by the authorities.<sup>89</sup> After all, the effectiveness of a law is largely dependent upon its enforcement.

Therefore, illegally SDUs may continue to exist as long as the potential benefits of illegal flat subdivision remain high due to the severe supply-demand imbalance of residential flats, while its costs of engaging in the activity remain low due to lack of government enforcement. Logically, flat owners should be less likely to engage in illegal flat subdivision if the benefits of the criminal activity decrease, such as where an adequate supply affordable housing is provided, or if the costs of the activity increase, such as where the Government strengthens prosecution action.

## V. LICENSING AS A POSSIBLE SOLUTION?

Following completion of the public consultation on Hong Kong's LTHS in December 2013, the Steering Committee published the Report on Public Consultation (2014 Report), which addressed issues relating to the rent and living conditions of SDUs.<sup>90</sup> It expressed that while PRH should be the primary housing solution for eligible SDU households in the long term, the safety conditions of SDUs in the meantime should 'under no circumstances be compromised', and the Government should consider the feasibility of introducing a licencing or landlord registration system for SDUs in domestic buildings.<sup>91</sup> This proposal attracted mixed responses from the public, ranging from cautious approval of the concept in general to outright rejection.<sup>92</sup> Thus, the Government declared that it

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<sup>88</sup> Ibid.

<sup>89</sup> This lack of enforcement action is arguably due to the lack of resources available for rehousing current SDU tenants who may be displaced by enforcement action. The Hong Kong Institute of Surveyors (HKIS) acknowledges that it is neither practical nor realistic to eradicate SDUs, as they satisfy the present housing need of society at large and, in particular, those of low-income families. See The HKIS, 'Re: HKIS Views to 2014 Policy Address and 2014-15 Budget' *The Hong Kong Institute of Surveyors* (10 December 2013) <<http://www.hkis.org.hk/ufiles/2014PA.pdf>> accessed 28 February 2014. See also text to n 133-137.

<sup>90</sup> LTHS Steering Committee (n 48).

<sup>91</sup> Ibid [6.15]-[6.17].

<sup>92</sup> Ibid [6.18].

needs to consider carefully whether licensing should be used to regulate SDUs in residential buildings.<sup>93</sup> However, such considerations have yet to be made.

This Paper will now examine whether a licensing scheme can effectively regulate the safety conditions of SDUs, while catering to the needs of SDU tenants.<sup>94</sup> In particular, I will examine the existing BSAs licensing scheme in Hong Kong and analyse whether its experiences can be used to predict the likely consequences and feasibility of implementing a similar scheme for SDUs in the present circumstances. Since BSAs (commonly known as ‘caged homes’) are similar to subdivided flats in many respects, it is a suitable model of comparison for the purposes of the Paper.

## **A. The Bedspace Apartments Licensing Scheme**

### *1. Definition and Characteristics of Bedspace Apartments*

Under section 2 of the Bedspace Apartments Ordinance (Cap 447) (BSAO), a BSA is ‘any flat ... in which there are 12 or more bedspaces used or intended to be used as sleeping accommodation under rental agreements’.<sup>95</sup> A ‘bedspace’ means ‘any floor space, bed, bunk or sleeping facility of any other type ... used or intended to be used as sleeping accommodation for one person’.<sup>96</sup> BSAs are similar to subdivided flats in that both types of individual living quarters are located in permanent residential buildings and rented to multiple parties for domestic use. Much like SDU households, some people (especially single persons) choose to live in BSAs because of their lower rental and proximity to work.<sup>97</sup> While BSAs are distinct from subdivided flats, there may be some overlap, since an estimated 0.2 per cent of SDU households live in premises also falling within the definition of a ‘BSA’.<sup>98</sup> However, the two types of dwellings are mutually exclusively for the most part and the vast majority of subdivided flats are not regulated by the BSAO.

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<sup>93</sup> Chief Executive (n 3) [148].

<sup>94</sup> The needs of SDU tenants include the availability of affordable alternative accommodation should they become displaced.

<sup>95</sup> BSAO, s 2.

<sup>96</sup> *Ibid.*

<sup>97</sup> Home Affairs Department Audit Commission (Audit Commission), ‘Licensing of bedspace apartments and provision of singleton hostels’ (February 2000) [1.1]; Policy 21 Limited (n 3) [4.6.8].

<sup>98</sup> Policy 21 Limited (n 3) [4.1.4].

Like subdivided flats, many BSAs were found in dilapidated tenement blocks in densely populated urban areas where living conditions and building safety were generally poor.<sup>99</sup> Overcrowding in BSAs can pose fire safety, hygiene and other problems for both tenants and the community,<sup>100</sup> as demonstrated by the Sham Shui Po incident in December 1990, in which a fire from a BSA caused seven deaths and 50 injuries.<sup>101</sup> As a result, the Government introduced a statutory licensing scheme in January 1991 to reduce overcrowding, and improve building and fire safety as well as sanitation standards in BSAs.<sup>102</sup>

## *2. Enactment of the Bedspace Apartments Ordinance*

The BSAO was enacted in April 1994 ‘to provide for the regulation, supervision and safety of bedspace apartments’.<sup>103</sup> The legislation, which came into operation on 8 July 1994, granted a four-year grace period to enable BSA operators to: register their BSAs with the relevant authorities, perform the works necessary for complying with various safety and sanitation requirements, and apply for licences for operating their BSAs.<sup>104</sup> After this exemption period, a person who operates a BSA in contravention of the BSAO commits an offence liable on conviction to imprisonment for two years, an initial fine of HKD100,000 and a further fine of HKD20,000 for each day the offence continues.<sup>105</sup>

At the time of enactment, the Government anticipated that some BSA lodgers may be displaced in implementing the licensing scheme.<sup>106</sup> Some BSA operators, who are unable or unwilling to meet the requisite safety standards of the BSAO, were anticipated either to reduce the number of bedspaces so as to fall outside the legal definition of a BSA, or cease operation.<sup>107</sup> To ensure that no displaced lodgers would be rendered homeless as a result, the Government sought to provide sufficient alternative accommodation mostly in the form of government-operated singleton hostels or PRH.<sup>108</sup>

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<sup>99</sup> Audit Commission (n 97) [1.1].

<sup>100</sup> Ibid [1.2].

<sup>101</sup> Ibid.

<sup>102</sup> Ibid.

<sup>103</sup> BSAO, Long title.

<sup>104</sup> Audit Commission (n 97) [1.4].

<sup>105</sup> Ibid [1.6]. See also BSAO, s 5(1).

<sup>106</sup> Audit Commission (n 97) [1.3].

<sup>107</sup> Ibid [3.1].

<sup>108</sup> Ibid.



### *3. Effect of Enforcement Action*

Contrary to the Government's expectations,<sup>109</sup> the number of BSA lodgers decreased drastically after the BSA licensing scheme was fully implemented in 1998. Prior to implementation, a Government survey in 1991 indicated there were approximately 4,000 BSA lodgers in Hong Kong.<sup>110</sup> In 1996—two years after the BSAO came into force—the number of BSA lodgers declined to about 2,800.<sup>111</sup>

Likewise, the number of BSAs decreased greatly after implementation of the BSAO. In 1990, there were approximately 180 BSAs in Hong Kong.<sup>112</sup> By July 1998, only 99 BSAs were registered, of which the Licensing Authority (LA) expected: 43 to be issued full licences, 30 to be issued conditional licences, and 26 to be refused licences as they were subject to high risks.<sup>113</sup> However, by the same time in 1999, the distribution of the previously registered BSAs was as follows: 58 were deleted from the BSA register; 36 were issued full licences; three were issued conditional licences; and two were not issued licences.<sup>114</sup> In addition, the LA identified eight other premises as illegal BSAs.<sup>115</sup> Of the BSAs removed from the register, the primary reasons were either that the BSAs had ceased to operate or that they had been modified so as not to come under regulation by the BSAO.<sup>116</sup>

While BSA lodgers were displaced due to enforcement actions in connection with the BSAO, the Government managed to rehouse at least 1,703 displaced BSA lodgers from the period of April 1994 (when the BSAO was enacted) to September 1999.<sup>117</sup> This number represents a fairly substantial proportion of the total number of BSA lodgers displaced during that time.<sup>118</sup> In addition, the Government was at the time acquiring or constructing new singleton hostels, which would provide for additional accommodation for displaced lodgers.<sup>119</sup>

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<sup>109</sup> Ibid [2.3].

<sup>110</sup> Ibid [4.1].

<sup>111</sup> Ibid [4.3], [4.7].

<sup>112</sup> City and New Territories Administration, 'Report on the Survey on Bedspace Apartments (BAs) and Tenants' (Hong Kong February 1991) [4].

<sup>113</sup> Audit Commission (n 97) [2.3].

<sup>114</sup> Ibid [2.4].

<sup>115</sup> Ibid.

<sup>116</sup> Ibid [2.4].

<sup>117</sup> Ibid [3.2].

<sup>118</sup> From an initial number of 4,000 BSA lodgers, and assuming that lodgers from the 39 licensed BSAs (each with at least 12 occupied bedspaces on average) were not displaced, and that some BSA lodgers may have remained in situ in BSAs no longer governed by the BSAO, then at most 3,532 lodgers were displaced during that period. Thus, 1703 lodgers is approximately 48 per cent of the estimated total number of lodgers displaced from implementing the BSA licensing scheme.

<sup>119</sup> Audit Commission (n 97) [3.4]-[3.5].

The (partial) success in regulating BSAs by licensing lies in the Government's willingness to enforce the BSAO as against non-complying BSO operators. In economic terms, the Government increased the 'cost' of operating illegal BSAs establishments so as to outweigh the total benefits an individual derives from operating illegal BSAs. The Government may have been ready and willing to take such actions because it was confident that the amount of alternative affordable housing available would be sufficient to rehouse any BSA lodgers displaced by enforcement actions.<sup>120</sup>

### **B. Reflections On The Licensing of Bedspace Apartments**

The experience from regulating BSAs suggests that implementing a licensing scheme for SDUs may adversely affect the number of SDUs available to the community as a means of more-affordable private housing. Like BSA operators in the past,<sup>121</sup> subdivided flat owners may choose to cease operations rather than to comply with the building safety and other requirements under the licensing scheme.<sup>122</sup> The Secretary for Transport and Housing accepts that any such regulation would be regarded as an increase in costs in the eyes of current subdivided flat owners and SDU households may be affected as a result.<sup>123</sup> This notion is supported by the response of one owner of a block of subdivided flats, which house dozens of Kwun Tong residents.<sup>124</sup> He expressed that he may cease to rent out SDUs if the licensing scheme was too burdensome or requires substantial monetary investment, and opt instead to run homes for the elderly or hostels, which may be subject to fewer or less stringent requirements.<sup>125</sup> Even if a subdivided flat owner complies with the requirements under the licensing scheme, any monetary costs she incurs may be passed onto her tenants by increasing rents,<sup>126</sup> especially in the current market where the demand for flats greatly outstrips its supply.<sup>127</sup>

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<sup>120</sup> See text to n 117-119.

<sup>121</sup> Ibid.

<sup>122</sup> If the Government patrols and strictly enforces a statutory licensing scheme (or any regulatory scheme, eg, the Buildings Ordinance) concerning the operation and safety of SDUs, illegally subdivided flats are unlikely to operate 'underground'. This is because the Government is currently capable of identifying illegally SDUs even without the self-reporting of illegally subdivided flat owners, as demonstrated by the issuance of removal orders and the successful completion of the 2013 Survey.

<sup>123</sup> S Lau and O Wong, 'Regulation plan mooted for Hong Kong's subdivided flats' *South China Morning Post* (Hong Kong 4 Sept 2013) <<http://www.scmp.com/news/hong-kong/article/1302746/regulation-plan-mooted-hong-kongs-subdivided-flats>> accessed 5 April 2014.

<sup>124</sup> Ibid.

<sup>125</sup> Ibid.

<sup>126</sup> LTHS Steering Committee (n 48) [3.8].

<sup>127</sup> LTHS Steering Committee (n 47) [2.13].

Furthermore, some BSA operators chose to decrease the number of contained bedspaces to less than 12 in order to avoid regulation by the BSAO.<sup>128</sup> This is possible because the BSAO was introduced primarily to address the issue of overcrowding in BSAs,<sup>129</sup> so those premises that are not ‘overcrowded’ (ie, composed of less than 12 bedspaces) are not subject to regulation. Consequently, some ‘BSA’ lodgers remained unaffected by enforcement action pursuant to the BSAO, and were not displaced and forced to seek alternative accommodation. This reduced the demand on the Government to provide temporary or interim housing to BSA lodgers who were displaced by enforcement of the BSAO.

However, the licensing of SDUs is intended to address flat owners’ unwillingness to rectify or remove UBWs, which are the primary causes of health and safety risks in subdivided flats.<sup>130</sup> If SDUs were subject to regulation and enforcement action, some subdivided flat owners may choose to stop operating SDUs and convert the flat for other uses instead.<sup>131</sup> Unlike for BSAs, the definition of an illegally subdivided flat or unit is less likely to contain a legal ‘loophole’. The presence or absence of UBWs determines whether a subdivided flat is legal or illegal.<sup>132</sup> Thus, enforcement of any licensing scheme (or even of the current legal regime under the BO) may lead to displacement of SDU households to a greater extent than that of BSA lodgers. In this respect, it may even be argued that a licensing scheme would serve little purpose for the goal of strengthening enforcement and compelling compliance with building codes, which are already established by statute.

As previously mentioned, flat owners should be less willing to engage in illegal flat subdivision if the costs of the activity (ie, likelihood of prosecution) outweigh its benefits. Implementing a licensing scheme without strengthening enforcement action would not improve the current situation. On the other hand, should the Government wish to ‘step up’ enforcement against illegally SDUs, it needs to ensure that an adequate quantity of affordable alternative accommodation is available for potentially displaced SDU tenants. The number of households (69,900) currently living in SDUs is much greater than that of BSA lodgers (4,000) in the past. As a result, even displacement of a small

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<sup>128</sup> Audit Commission (n 97) [2.4].

<sup>129</sup> Ibid [1.2].

<sup>130</sup> Buildings Department (n 8) [1]; HKSAR Government (n 2) [1.1].

<sup>131</sup> Lau and Wong (n 123). Under economic theory, an individual will choose the opportunity which best satisfies her individual preferences. If the operation of illegally SDUs is no longer the most preferred option for the flat owner because the costs outweigh the benefits, the flat owner may choose to prefer other opportunities, which need not involve the operation of legally SDUs.

<sup>132</sup> Policy 21 Limited (n 3) [1.1.1].

proportion of SDU households may affect the welfare of numerous tenants and place a substantial burden on Government resources.

According to a Legislative Council report on Housing, SDU tenants who become homeless as a result of Government law enforcement actions (ie, pursuant to the Buildings Ordinance) would be provided with three months' temporary accommodation at the Po Tin Transit Centre in Tuen Mun, after which they can be rehoused to Interim Housing (IH) *if* they pass the 'homeless' test *and* are eligible for PRH.<sup>133</sup> Two problems arise from this arrangement. First, 39.7 per cent of SDU households (or 27,750 households) are ineligible for public housing.<sup>134</sup> If taken to the extreme, this might mean that 27,750 SDU households may be forced to seek more (expensive) alternative accommodation within three months of a government enforcement action.<sup>135</sup> Second, the number of available IH flats is insufficient to accommodate the total possible number of SDU tenants eligible for public housing who might be displaced by enforcement action. There are currently three IH estates available to provide a total of about 4,600 flats;<sup>136</sup> whereas, the total number of potentially displaced SDU households who might qualify for admission into IH is 48.3 per cent (or 33,762 households).<sup>137</sup> Whether a SDU household is eligible or ineligible for public housing, the Government is at risk of having insufficient resources to accommodate all SDU households who might be affected by implementing (and strictly enforcing) a licensing scheme for subdivided flats.

Therefore, if the Government wishes to strengthen enforcement (and especially prosecution) to rectify or remove UBWs in illegally subdivided flats, it must ensure it has sufficient resources to provide accommodation to SDU households who may be displaced by the enforcement actions. Failure to do so may have adverse effects on the welfare of SDU households, even if a licensing system is imposed.

## VI. OTHER POTENTIAL SOLUTIONS

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<sup>133</sup> Legislative Council Panel on Housing (n 74) [12].

<sup>134</sup> Policy 21 Limited (n 3) Table 48. Calculation is based on the sum of all percentages of households declared to be ineligible for public Housing, together with the total number of SDU households (69,900).

<sup>135</sup> However, the Author recognises that not all SDU households who are ineligible for PRH will be simultaneously displaced, even if all of their subdivided flat landlords cease to rent out their SDUs.

<sup>136</sup> Panel on Housing, Background brief on 'Policy on Interim Housing and the latest planning for the Long Bin Interim Housing estate' (LC Paper No CB(1)840/13-14(04), February 2014) [3].

<sup>137</sup> Policy 21 Limited (n 3) Table 48. Calculation is based on the sum of all percentages of households declared to be on the waiting list or to have accepted offers for public housing, together with the total number of SDU households (69,900).

Regulating the safety of SDUs by licensing may do little to improve the overall living conditions of tenants of illegally SDUs, because a solution that aims blindly at ensuring the legality of all SDUs at the expense of the displaced tenant's wellbeing is simply unrealistic. Furthermore, implementing a licensing scheme by itself, without also providing an adequate supply of affordable alternative accommodation or other supporting schemes, will prevent the Government from achieving its dual goals of ensuring that the safety conditions of SDUs will not be compromised,<sup>138</sup> and that no one who is displaced by Government enforcement action would be rendered homeless.<sup>139</sup>

As part of its LTHS, the Government recognised the need to increase housing supply and proposed to provide 470,000 residential units in the coming ten years, of which 60 per cent will be public housing.<sup>140</sup> This solution is in some respects similar to Singapore's public housing policy, which is generally recognised as one of the most successful examples of affordable housing production in the world.<sup>141</sup> While there is widespread support for adopting this approach in Hong Kong,<sup>142</sup> it is a gradual process<sup>143</sup> which requires much time and resource to achieve. Meanwhile, SDU households are continually subject to safety risks, which may grow alongside the age of the building in which they are found.<sup>144</sup> Rather than exploring the feasibility of a licensing scheme, the Government should explore measures catered to the goal of improving the safety conditions of SDUs in the short-term.

Under economic analysis, a subdivided flat owner should be less willing to engage in illegal flat subdivision if the costs of the activity outweigh its benefits.<sup>145</sup> However, we concluded earlier that strict enforcement of regulatory laws by government authorities might even deter rational flat owners from operating *legally* subdivided flats.<sup>146</sup> Therefore, the ideal solution to the current problem should strike an appropriate balance between costs and benefits, so that the net benefit of operating legally SDUs should be greater than that of operating illegally SDUs. To achieve this, the Government can enhance prosecution action against illegally SDUs to the extent that it would outweigh its associated benefits, and thereby deter the rational individual from engaging in illegal flat subdivision. At the

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<sup>138</sup> LTHS Steering Committee (n 48) [6.15]-[6.17].

<sup>139</sup> *Ibid* [6.16].

<sup>140</sup> Chief Executive (n 3) [142].

<sup>141</sup> J Lin, 'The Development of Affordable Housing – A Case Study in Guangzhou City, China' (Postgraduate Thesis, KTH Architecture and the Built Environment 2011) [3.4].

<sup>142</sup> LTHS Steering Committee (n 47) [6.1(b)].

<sup>143</sup> Chief Executive (n 3) [143].

<sup>144</sup> Recall that most SDUs are found in older residential buildings, which have a serviceable life of around 50 years, and that are subject to various states of dilapidation. See Buildings Department (n 25) [6].

<sup>145</sup> See n 131.

<sup>146</sup> *Ibid*.

same time, the Government can offer incentives to owners of illegally subdivided flats by partially subsidising the works pursuant to their rectification or removal orders if they are done through Government-prescribed building professionals. The Government can also pursue some form of rental control combined with housing tenure in order to prevent subdivided flat owners from passing the costs of rectification or removal works onto their SDU tenants, or from terminating their leasehold tenancies after expiry in favour of new tenancies at higher rents.<sup>147</sup>

In the event that a person fails to comply with a Building Authority (BA) order to rectify the UBWs in a subdivided flat, the Government should (as it is so entitled under s 24A(3) of the BO) carry out, or cause to be carried out, such work as may be necessary to ensure that the order will be complied with. Any costs the Government incurs from such works can then be recovered from the person upon whom the order was served.<sup>148</sup> However, Government subsidies should not be available in such cases, so that the subdivided flat owner has incentive to willingly comply with the BA order and take advantage of the decreased costs (and thereby increased net benefit) of operating legally SDUs. This scheme could potentially ensure that any rectification/removal works are properly done, subdivided flats will be free from UBWs, and SDU tenants will not be adversely affected by any Government enforcement action.

## VII. CONCLUSION

The general public and the Government have been very concerned with the living conditions of SDUs.<sup>149</sup> This is hardly surprising, given that tragic events have taken place in recent years<sup>150</sup> and an estimated 171,000 persons may be subject to building safety and environmental hygiene risks.<sup>151</sup> The severe supply-demand imbalance of traditional private residential flats<sup>152</sup> and their deteriorating affordability<sup>153</sup> have caused the rents of such flats to become unaffordable.<sup>154</sup> This attracted opportunistic flat owners to create (illegally) SDUs,<sup>155</sup> the occurrence of which can be explained by

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<sup>147</sup> See Institute of Law Research and Reform, 'Residential Tenancies Project: Rental Control Security of Tenure' (Edmonton November 1975) 1. Various forms of rent control exist and the Government must carefully consider which form is most appropriate to the circumstances of Hong Kong.

<sup>148</sup> BO, s 24A(4).

<sup>149</sup> Policy 21 Limited (n 3) [1.1.3]; Chief Executive (n 3) [147].

<sup>150</sup> Chan (n 3).

<sup>151</sup> Policy 21 Limited (n 3) [10]-[11].

<sup>152</sup> Dwan, Sawicki and Wong (n 50) [4.1].

<sup>153</sup> LTHS Steering Committee (n 47) [2.13(b)].

<sup>154</sup> Ibid [2.4].

<sup>155</sup> Chiu (n 69).

economic analysis,<sup>156</sup> with reference to the lack of enforcement action against illegally SDUs by Government authorities. Because of their lower costs, many households are forced to inhabit SDUs, which typically have cheaper rents and also poorer living conditions.<sup>157</sup> It was against this backdrop that the LTHS Subcommittee suggested,<sup>158</sup> and the Government accepted, that the feasibility of a licensing system for SDUs should be explored.<sup>159</sup>

After considering the experience of the licensing system under the BSAO, I suggested that a licensing scheme for SDUs should not be implemented because: (1) SDU households might be displaced by government enforcement actions, should a licensing scheme be introduced; and (2) the Government has insufficient resources<sup>160</sup> to accommodate the potentially substantial number of tenants who may be displaced by such actions,<sup>161</sup> so that a large amount of persons will be forced to seek alternative accommodations which may be more expensive and potentially unaffordable. Furthermore, any licensing scheme may prove redundant since (illegal) flat subdivisions are already governed by existing legislation,<sup>162</sup> and further codification may not address the enforcement issues at hand.

In contrast to the Government's solution of increasing housing supply in the coming ten years,<sup>163</sup> I proposed that a short-term scheme be employed to address the safety conditions of SDUs. Under this proposal, the Government should adopt a three-pronged approach of: (1) strengthening enforcement action against illegally subdivided flats; (2) offering incentives to flat owners of illegally subdivided flats to conduct proper removal and/or rectification works; and (3) imposing a system of rental control and housing tenure to safeguard the interests of SDU tenants.<sup>164</sup> If successfully implemented, this scheme may potentially ensure the safety and hygiene condition of SDUs and protect SDU tenants from the adverse effects of enforcement action.

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<sup>156</sup> Dau-Schmidt (n 77) 3.

<sup>157</sup> Ibid [3.15].

<sup>158</sup> Ibid [6.17].

<sup>159</sup> Chief Executive (n 3) [148].

<sup>160</sup> Panel on Housing (n 136) [3].

<sup>161</sup> Policy 21 Limited (n 3) Table 48.

<sup>162</sup> Ibid [1.1.1].

<sup>163</sup> Chief Executive (n 3) [142].

<sup>164</sup> See text to n 145-147.