

## DATA CENTRES

### Hong Kong Land Supply and Entitlement Issues

#### Greenfield Sites, Converted Industrial Buildings and Rock Cavern Developments

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##### Introduction

The Government has recognised the vital role of the data centre industry in Hong Kong and has over the past few years introduced a number of policy changes aimed at facilitating the development of data centres. This paper considers some of the issues around data centre development and the ongoing challenges for the industry. Following a brief overview of Hong Kong's development system, we discuss potential greenfield sites, existing industrial sites, Hong Kong Science and Technology Park sites and issues around rock cavern development.

##### Background to development control in Hong Kong

Hong Kong's land development control system has three main limbs and a land owner/user must comply with all three sets of requirements:

- Land Grants

Land is granted in Hong Kong by way of lease from the Government. Most Government leases contain a use restriction and other building obligations and restrictions, including those relating to height and density.

- Town Planning Zoning

Outline zoning plans set out the determined use for an area and sometimes the maximum permitted height and density. Some uses are always permitted without specific consent; some require planning permission; and some are never permitted in that area without rezoning. The outline zoning plan is usually, but not always, consistent with the permitted use under the land grant.

Usually IT&T industries, including data centres, are always permitted in areas

zoned as Commercial, Industrial, Other Uses (Business), Other Uses (Mixed), Other Uses (Industrial Estates) and Residential (Group E). In Comprehensive Development Areas, permission from the Town Planning Board is required for data centre use.

The remit of the Town Planning Board is to prepare outline zoning plans for approval by the Chief Executive in Council. It also considers applications for planning permission. The Town Planning Board has no enforcement powers in respect of outline zoning plan compliance.

- Buildings Authority

Implementation and enforcement of the outline zoning plan is the responsibility of the Buildings Authority under the Buildings Ordinance. Building approval is usually not granted if the submitted general building plans do not comply with the relevant outline zoning plan, although this is not invariably the case.

The Building Planning Regulations, which are implemented by the Buildings Authority, also contain the maximum permitted height and density limits, but these are only applied when the outline zoning plan or land grant do not contain lower limits.

The Buildings Authority issues an occupation permit which shows the initial authorised use. Generally it does not issue a new occupation permit, even where there has been a permitted material change of use.

##### Site acquisition

###### Greenfield Sites

In Hong Kong, most property is available for grant by Government on a competitive tender basis. The Government includes sites in the Land Sale Programme that it expects will be

available for sale in the coming 12 months and it announces in advance the actual sites up for sale in the coming quarter.

The Government has increased land supply, notably for residential sites, but for commercial sites there are major land supply challenges. There are only 2 commercial sites in the current Land Sales Programme (to March 2018) and those are "commercial/hotel".

Further, commercial properties are available for a number of competing uses, for example, Business, Commercial, Office and Hotel. As bidding takes place on a competitive pricing basis, it may mean that a successful bid for a data centre use is unlikely.

### Converted Industrial sites

Land supply is somewhat easier in old industrial building space. Data centres are often located in retrofitted industrial buildings where the Government lease only permits industrial use. In this case, a waiver or modification is needed to allow data centre use. There are currently two broad processes that apply in certain circumstances. These processes are discretionary, meaning the Director of Lands does not have to grant the waiver or modification:

- [Partial conversion by waiver](#) (Practice Notes No.3 /2012, No.3/2012A and No.3/201B)

These measures came into operation in June 2012. Until further notice is issued by the Government, owners of the relevant part of an industrial building, located in an Industrial, Commercial or Other Use (Business) zone may apply for a special waiver from the Lands Department for changing parts of an eligible industrial building to data centre use. No waiver fee is payable.

Under these measures, the use cannot conflict with the deed of mutual covenant (DMC). If the building is multi-owned, all the owners will be subject to a mutual co-ownership agreement - the DMC. It is therefore necessary to consider whether a data centre use is acceptable, and practically feasible, under the DMC. For example, the permitted use may not allow the data centre use – often the DMC for older buildings will only allow the original use permitted under the occupation permit. Likewise, there may not be sufficient rights through the risers and the common mechanical and electrical areas in the building to install upgraded infrastructure, and structural alterations and changes to the exterior may be prohibited. The

manager or owners' committee may be able to consent to the necessary works or rights, but this needs to be closely considered.

The following rules also apply to any such application:

- The building must not be less than 15 years old calculated from the date of the occupation permit.
- The waiver lasts for the lifetime of the building or until the expiry of the current land grant, whichever is earlier, and the relevant part of the building cannot be used otherwise than for the newly permitted use without further consent from the Government.
- The conversion works must be completed within three years after the granting of the waiver.
- [Development of industrial lots for high-tier data centres through lease modification](#) (Practice Notes No. 3/2012, 3/2012A and 3/2012B)

Until further notice is issued by the Government, owners of industrial lots may apply for a land grant modification to allow the development of a high-tier data centre. There is no expressed limitation as to the zone in which the building is to be situated but as a general matter the outline zoning plan must always be complied with.

The application may be made for development up to or less than the maximum permitted density under either the land grant, outline zoning plan or Building Planning Regulations. However, the proposed development should not be less than 40% of the applicable maximum density or a plot ratio of 2.5 (whichever is higher). Not more than 30% of the total floor area can be used as offices. The premium is assessed on the basis of a high-tier data centre use and proposed development intensity (less the current value).

- [Previous policies](#)

Up until 31 March 2016, it was also possible to make similar applications for a waiver in respect of wholesale conversions and lease modifications for the redevelopment of industrial buildings in non-industrial zones.

## HKSTP sites

Some developers may be interested in taking land from the Hong Kong Science and Technology Parks Corporation and several companies already have. These sites are subject to many restrictions in the standard form documentation which was drafted about 40 years ago and has been scarcely up-dated. We comment here on the main alienation restrictions.

The Corporation encourages the land on the old industrial estates to be used for data centre use particularly at Tseung Kwan O. However, the standard alienation clause imposes challenges for certain types of data centre end use:

“Not to assign, mortgage...underlet or part with the possession .... or otherwise dispose of the said premises or any part thereof ... or enter into any agreement so to do nor to permit any other party by way of a licence or otherwise to occupy the said premises or any part thereof.”

Accordingly the lessee cannot sub-lease or licence space to a third party. Licences to associated companies are carved out, but otherwise no-one other than the named lessee can occupy the premises.

Hosting, managed and outsourcing services are therefore acceptable within this restriction, but co-location services would not be permitted.

There is a further carve out allowing the lessee to assign to a third party if it has first offered the site back to the Corporation at an annually diminishing price based on the depreciated assets and leasehold interest. If the offer to surrender is rejected, the Corporation can impose such fee as it decides in order to consent to an assignment. Clearly, this affects the end-game for investors. The sale of the asset itself is unlikely.

This may be an area that the Corporation and the Government should consider further in order to make more land properly available for co-location data centre use.

## Underground Cavern Sites

Rock cavern development (RCD) may allow an additional supply of land but it is not without challenges. A detailed feasibility study has been completed by Arup for the Government. The following section gives an overview of some of the legal (rather than practical) issues that will need to be addressed - the extent of ownership interests; required easements and covenants; amendments to standard land grant covenants; liabilities and

environmental issues. From a legal perspective, certain sites will be easier to develop than others.

- **Ownership**

Under the common law system in Hong Kong, it is possible to own different strata of land, including surface and sub-surface. The basic position is that, unless express provision is made otherwise, a land owner owns the surface of his land and everything below down to “the centre of the earth” and everything above “to the heavens”.

Ownership of the sub-surface can be stratified into different levels by means of separate land grants from the Government. This is not uncommon, for example, sub-strata will often be reserved from a land grant for an MTRC line. Strata-titled multi-storey buildings in Hong Kong have an entirely different structure comprising one land grant from the Government that is held in undivided shares as tenants in common.

In selecting appropriate sites for RCD, one basic consideration is whether the surface is unleased or leased. Where the surface is unleased and it is envisaged that different sub-strata and surface land uses will be carried out by different persons in the future, it is likely that the sub-strata and surface spaces would be held under different grants. Where the surface land is already leased (for example if there is a building on the surface), then unless there was a relevant sub-strata reservation, resumption of the sub-strata space may be necessary, leaving the surface use intact. Is resumption for data centre use possible under current legislation?

- Under the Land Resumption Ordinance, land may be resumed for a public purpose. This is widely defined as being any purpose deemed to be a public purpose by the Chief Executive in Council. It is unclear whether data centre use would qualify, at least without dispute. Arguably, the freeing up of limited land supply is itself a public purpose, and the fact that the land is necessary for data centre use, which is in the nature of a utility, is relevant. Whether the resumed land is ultimately owned and operated by a public, quasi-public or private entity is not the key issue. It may be, however, that the Land Resumption Ordinance would require some statutory modification to clarify its scope.

- Resumption for underground purposes could raise the spectre of 'blight' on the surface or neighbouring properties. Currently there is no right to claim compensation for blight, but a consultative document on the Comprehensive Review of the Town Planning Ordinance in 1991 made certain recommendations which have not been implemented. This may re-open the debate. There may also be issues of derogation from grant.
- Older Government leases reserve ownership of various mines and minerals and contain a right of access to obtain them. Such provisions may be deemed to be included in new grants. Minerals are also reserved to the Government under the Mines Ordinance. However, neither of these includes a right of occupation, and accordingly it is unlikely that caverns can be developed pursuant to these powers.
- **Demarcation of levels of strata**  
If only one surface lot and one sub-strata lot is envisaged, it is possible to have a simple surface/sub-strata demarcation by reference to a measurement +/- PD, applied at varying depths or over multiple levels of sub-strata.  
Sub-strata and surface lots, both horizontally and vertically, will probably require a buffer zone between them. Ownership and control of the intervening space is relevant as it may affect the development rights granted, and also liability.  
A right of support only exists at common law for the land in its natural state. This means that where there are adjacent developments, express easements are required for the various owners. In addition, the sub-strata owner will require a restrictive covenant not to have the integrity of his structures compromised by the surface owner. This is only achievable, without statutory intervention, if the surface land has not yet been granted.
- **Covenants**  
The standard covenants in land grants will need adaptation. For example, some of the financing restrictions contained in recent land grants may well be unacceptable to the industry such as restrictions on a mortgagee's ability to exercise its power of sale without the consent of Director of Lands, which is entirely discretionary. Such provisions are not usual and are likely to cause real issues.

There is also a need to avoid the co-location restrictions in HKSTP leases.

- **Liability**

Liability is a major issue. Loss, damage and nuisance may emanate from either the sub-strata or surface lots in a variety of ways, for example, development works or on-going use could cause vibration, water seepage or toxicity. Liability may be tort based (eg. nuisance); contract based (eg. land grant); or statutory based (eg. pollution control legislation). Damages may be substantial and an injunction preventing use would have significant repercussions.

For RCD to be viable, the Government will need to consider both how to protect itself and the protections that future users will seek.

- **Environmental Issues**

Underground uses may raise a number of serious environmental problems:

- Lowering of local groundwater tables through pumping
- Discharges from facilities, including into underground water systems
- Disposal of excavated material, especially if it is contaminated
- Destruction of buried heritage sites

The scope of the Environmental Impact Assessment Ordinance and other pollution control ordinances will need consideration and possibly enhanced regulation introduced through technical memoranda.

RCD offers interesting possibilities for data centre use, but there are several legal implications to work through (in addition to numerous practical ones). Clearly, some sites will be much more suitable than others.

## Summary

In summary, land for data centre development and use is likely to be limited for the foreseeable future, at a time when data storage is increasing exponentially. The Government has taken measures to facilitate the data centre industry but how effective they are over the long term remains a real question.

Corporate real estate, leasing and data centre advice forms one of the core elements of Cordells' practice. For full details of these services please see our website: [www.cordells.com.hk](http://www.cordells.com.hk)

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