**LAND SUPPLY – WHY AND HOW WE NEED TO UNLOCK THE PRIVATE SECTOR'S LAND BANKS TO HELP MEET CURRENT HOUSING NEED**

## Introduction: Why

The latest statistics from Lands Department reveal that in the first half of 2016 there were no lease modification/land exchange cases concluded.

2. In June 2015 the Development Bureau statistics revealed that the number of flats generated by land exchanges and lease modifications had fallen from a high of 4,070 units in 2011/12 to 700 in 2012/13 and as low as 90 in 2013/14 rising only slightly to 90 in 2014/15. Coming at a time when the Government is actively seeking to increase housing supply, these figures surely demonstrate that there is something fundamentally wrong with the present system that needs to be addressed as a matter of urgency if the objective of producing 20,000 units per annum is to be any where near being met.

3. There would appear to be a correlation between the decline in this source of land supply and the timing of Government's decision in early 2013 to resume a regular programme of land sales by tender. A review of the tenders received for eight residential sites prior to 2013 reveals that for the best sites, on average, ten bids were received for each site whereas over the past fifteen months, an average of fifteen bids was received for twelve similar sites. Perhaps more significant is the interest shown in the post 2013 sites by major developers such as Henderson Land, Sun Hung Kai Properties and New World that hold large land banks. This would indicate that these developers have become totally frustrated by the time and cost of going through all the planning procedures followed by the land exchange/lease modification process, including premium negotiation, preferring to bid in tenders whilst their land banks sit idle! It is generally accepted that the prices achieved at Government land sales are usually the highest so the fact that developers with land banks are prepared to go down this route would indicate that the premiums for land exchanges/lease modifications are, by comparison, unreasonably high. For example, New World in its latest Annual Report reviews the seventeen major projects it has undertaken in the past five years and only six of those used its land bank.

4. Government in its desire to meet the projected shortfall in its own land supply has spent the last year looking at alternative sites such as GI/C, Green Belt and even Country Park land. Many of these sites are clearly unsuitable and even if they were suitable, would only produce relatively low numbers of flats. The whole process has generated a lot of (justified) negative responses from the community culminating in the threat of judicial reviews which, as predicted, look set to frustrate, delay or remove from the list, certain sites which have been put forward for tender in the last quarter of 2015.

5. So it seems clear that at least in the short term, the Government is not going to be able to supply sufficient suitable land itself. What it is capable of doing, however, is facilitating and expediting the development of land currently being held by developers but presently standing idle. A review of the latest annual reports of the three companies holding the largest land banks reveals the following figures: Henderson Land has 44.5 million sq. ft.of agricultural land; Sun Hung Kai over 30 million sq. ft. and New World 18.2 million sq. ft. This land is typically situated along existing or planned railway lines and is surely more suitable for development than any Green Belt or Country Park land!

6. It is recognized that all developers will seek to manage and optimize their respective land banks in step with market conditions and attuned to their development plans and needs. The very fact that these developers are prepared to pay top dollar for new Government sites rather than use their land banks and pay the premiums currently being levied by the Lands Department would indicate that they consider the current methodologies and premium levels to be unreasonable, hence their reluctance to utilise their land banks.

**The Detail: How**

7. The basic principle behind the policy is to charge premiums of 100% of the increase in value and that is sound land economics. The increase is assessed by valuing the site in question under the existing lease conditions (the "before" value) and under the proposed conditions (the "after" value) with the premium being the difference. However, certain of the assumptions the Lands Department makes in assessing these values mean that premiums well in excess of the increase in value are often asked. And that departure from the basic principle and, indeed, common sense, means that developers find premiums unacceptable. All this means that the lease modification process takes much longer than it ought as appeal after appeal on premium is lodged. The assumptions in question are : -

A. The value of NT agricultural land;

B. The adoption of cleared site value in the before situation, even when under the existing lease conditions, the site is not a redevelopment proposition, i.e., its value lies in the land and buildings. As a corollary of this, there is a need for taking into account the costs of and time needed for obtaining vacant possession and completing demolition in the after value.

C. The refusal to take into account certain costs which are essential to complete the development under the so-called "costs contingent on development" policy.

8. A. **The value of NT agricultural land**

(i) For many decades now the Government has compensated owners of agricultural land in the NT when their land is to be resumed for a public purpose at a figure described as *Ex-gratia* compensation which is adjusted every six months to reflect underlying market values. This *Ex-gratia* figure is broken down into 4 zones with Zone A being the highest for the most valuable land and Zone D being used for more remote locations. The Zone A rate is enhanced by 20% in respect of resumptions for New Town Development Area's which would include the planned NDA's in the NWNT. In October 2006 the Zone A rate was $467 per sq. ft rising steadily to $969.6 per sq. ft in October 2013 in line with rising market trends. The rate as at October 2015 is $1112.40/sq. ft.

(ii) Although this compensation figure is described as being *ex-gratia,* landowners have for many years used it as a benchmark for assessing what they consider to be the true value of their land. It makes no difference to them if the land is being bought by the Government or by a developer, their attitude is that they should not sell their land for a figure any less than what the Government would pay for it. So it is now true to say that these regularly updated *ex-gratia* figures have now become the equivalent to the open market value for such land as is ripe for development and should therefore be adopted as the basis when assessing 'before' values.

(iii) It can be further argued that when land is being surrendered to the Government as part of a land exchange the very act of surrendering the land before the re-grant of the new site is equivalent to a resumption, the only difference being that it is being done on a voluntary basis. Both events achieve the same objective – the implementation of the planning intention.

(iv) The following two cases are relevant to the points being raised in this paper: the Court of Final Appeal's judgment in *Director of Lands v Yin Shuen Enterprises Ltd* (2003) 6 HKCFAR 1 clarified and confirmed that compensation is not payable for any element of market value attributable to the expectancy or probability of Government granting a modification, new grant or any other licence, permission or permit in respect of the existing resumed land. This decision effectively overruled the earlier decision in *Suen Sun Yau Alias Sun Ting Shu v D.B.L. CLR no. 5 of 1988* which both acknowledged and allowed purchasers hope value over and above the agricultural value where it could be shown there was that potential. However the more recent decision in the case of Secretary for Transport and Delight World Ltd (2006) 9 HKCFAR,720, is

more significant because the Court of Final Appeal upheld the Lands Tribunal and Court of Appeal's decisions to award compensation for agricultural land resumed on the basis of a *Melhado* use without taking the need for a s.16 permission into account and even though the land at all material times lay unused, is a most useful and important guide as to how agricultural land should now be assessed in a 'before' situation. *Melhado* uses can be described as those non-agricultural uses of agricultural land, which do not need any building structures, such as open storage, storage of containers, vehicle parking and the like which will clearly enhance the value of the land beyond pure agricultural value, probably close to, if not in excess of, the prevailing *ex-gratia* figures.

(v) Using the exgratia rates in assessing the value of NT agricultural land as a before value would provide a simple, realistic and in most cases indisputable basis and would essentially eliminate this area of assessment from argument.

B. **The adoption of cleared site value when the actual value lies in land and buildings**

(i) In most cases where there is an existing building on the lot, the lot only becomes a redevelopment proposition with the benefit of the modified lease terms. Under the existing lease conditions, the value lies in the land and buildings. Notwithstanding this, the Lands Department always assess both the before and after values on a cleared site value basis. This results in the premium exceeding the increase in value that the lease modification confers. The land and buildings value, sometimes called the existing use value (EUV), is what the developer had to pay for the lot and, should the lease modifications not proceed, what he can sell it for.

(ii) The Lands Department insists that in assessing both before and after value on a cleared site basis it is acting consistently, (see letter from the Director of Lands to the SCMP, October 2013, copy at Appendix) but this contradicts the reality of the situation. Consider the following two examples :

(a) A lot subject to an industrial user clause built to the maximum PR of 15 but which is zoned for residential. Clearly without the lease modification, the lot is not a redevelopment proposition as no-one would demolish such a building only to build another, but in assessing the premium Lands Department will only allow the site value.

(b) A lot in, say, Deep Water Bay, restricted to a single private residence of 5000 sf with a beautiful single residence built to the maximum on it, but

zoned for more intensive residential development with multiple units. The value of the lot unmodified is clearly the EUV with land and buildings. That is what was paid for it and what, if the modification application were to fail to come to fruition, what the applicant could sell it for, but again, in the premium assessment, only the site value for a single residence is allowed.

(iii) In both these cases, which are typical, the currently adopted assumptions result in significant over assessments of the increase in value and therefore the premium.

(iv) At the same time, with the recognition of the need to adopt the land and buildings EUV as the before value, it is necessary to reflect the presence of the buildings in the after value and allow for the time and cost for obtaining vacant possession and the costs of demolition.

(v) It is also relevant to point out that in assessing development values and value increases under Notice of Application to the Lands Tribunal for an Order for Sale under the Land (Compulsory Sale for Redevelopment) Ordinance, Cap 545, the contributions and complications to value arising from the presence of existing buildings are always recognized.

C. **"Cost contingent on development"**

(i) This policy requires the Lands Department to not take account of certain development costs in assessing the after value. In their valuation, which adopts the "residual" method whereby the value of the finished development is assessed and from that deducted the costs of achieving it with allowances for the timing of the costs ("deferment") and developers' profit, the Lands Department will not allow costs deemed to fall under this heading, despite that fact that these costs have to be incurred and that if the lot were to be put tender or auction, the prices bid would automatically take them into account. The policy inevitably results in the premium being increased beyond the actual increase in value conferred by the lease modification by the amount of the disallowed costs. This is indisputable.

(ii) However, the Lands Department attempts to justify this departure from the fundamentally sound principle of charging 100% of the increase in value by saying, for example, in relation to the disallowing of the costs of demolishing and rebuilding an existing transport interchange, "Think about the scenario in

which the public transport interchange should have continued in public use for years if not for the development project initiated by the lot owner. Its replacement or reprovisioning using public funds in the form of allowing the costs in the premium may not be justifiable. Similarly, public funds should not be used for the provision of public facilities offered by a developer merely to secure planning permission". (Letter by Director of Lands to SCMP, October 2013 copy at Appendix)

(iii) This argument is misconceived in the following ways :

(a) Redevelopment projects all originate from Outline Zoning Plans which set out what the Government wants to see developed. The objective of lease modifications is to facilitate the implementation of those planning objectives. The "initiative" for development projects is the Government's and in making applications for lease modifications, developers are simply responding to the Government's initiatives. If these initiatives, as they often do, involve, the demolition and rebuilding of public facilities, failure to take account of these costs means that the after value exceeds the true value by the amount of the disallowed costs;

(b) The allowance of an essential development cost in a valuation is no way a use of public funds. It is simply one of the steps necessary in arriving at the true value. Not allowing such a cost should make the premium unacceptable to the developer;;

(c) It is only the one-on-one relationship between the Government and the developers in lease modifications that enables the Lands Department to attempt to implement this self defeating policy as, if a lot requiring, for example, the demolition and reconstruction of a transport interchange were put to auction or tender, the costs of that would automatically be taken into account in the bids.

**Conclusion**

9. Unless and until these departures from the basic principle of charging the actual increase in value are rectified, developers will continue to prefer the simple method of buying Government land at tender, leaving the well suited for development land in their land banks virtually untouched. Such applications for lease modifications as may be lodged will continue to

attract whole series of appeals on premium thus slowing down the lease modification process. Furthermore, with the current aberrant assumptions in many cases resulting in premiums in excess of the increase in value conferred by a modification, will continue to decline particularly as the current arbitration avenue does not allow the arbitrators sitting to question these assumptions...

**Recommendation**

10. Given the entrenched position of the Administration with its huge reluctance to consider change it is now recommended that the Chief Executive/ Secretary for Development appoint a neutral Committee of Inquiry to thoroughly examine the points we have made above, to consider submissions and representations from relevant parties and stakeholders including, but not exclusively, both Government and the developers and to set out its conclusions and recommendations as to the way forward. We suggest, because of the complexity of the issues involved that this is not a suitable subject for 'public consultation' and that such a Committee be chaired by a suitably neutral senior academic from the surveying discipline or a Barrister/Judge with strong experience and exposure to the real estate world, together with one, at most two, senior representative from each of the HKIS and RICS HK Branch.

Roger Nissim Adjunct Professor of HKU

John Corrigall Retired ex Deputy Director of Lands

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