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Executive Summary

If a valuation is required prior to acquisition of a property, the appropriate basis of valuation will normally be market value as it intends to represent the transaction price. This rationale is in line with the Hong Kong Basic Law as compensation shall correspond to the real value of the property concerned at the time. However, in the latest Hong Kong court judgment, the court did not properly address the common law position that all potentialities of the land have to be included in assessing compensation.

In a court decision, it was recognized that under s.12(c) of the Lands Resumption Ordinance any values that due to “expectancy or probability of the grant or renewal or continuance, by the Government or by any person, of any license, permission, lease or permit whatsoever” have to be disregarded. Its immediate effect has prevent the assessment of market value of the resumed property by taking similar transaction sales in the private land market if they are suspected of containing any element of hope value.

In terms of law, the disputes of s.12(c) appear to have been settled by the court. However, its settlement is not in conformity with the present land development pattern and process in Hong Kong. Introduced in the beginning of 1920’s, s.12(c) of the Lands Resumption Ordinance is one of the important rules for determining compensation in Hong Kong. This is a very restrictive provision and has led to many criticisms as the compensation payable under this rule will be substantially less than the market value of other properties with similar attributes. Many affected land owners are of the view that it opposes the general compensation principle of

equivalence and principle of equity.

It is understandable that this provision was formed several decades ago when the Hong Kong Government was responsible for all the cost of infrastructures. At that time, Hong Kong did not have a proper town planning control system and sophisticated land administration systems. At that time, it was not uncommon for people to pay speculative prices when there were rumors of resumption in the hope that they could ripe the price differences. This had created heavy financial burden to the government. However, time has changed. The Court of Appeal had already pointed out that the circumstances in Hong Kong eighty years ago when s.12(c) was introduced were clearly very different from those prevailing now as we have a comprehensive town planning system and a recognized lease modification system.

In a closer look on the issue of the expectation of the continuation or renewal of a terminable interest in land, it is of the view that s.12(c) of the Lands Resumption Ordinance is highly restrictive in comparing with other common law regions. The current provision is in favor of the government (acquiring authority) and the dispossessed owners are put in an inferior position. In contrast, in other countries such as Australia, the majority of compensation laws explicitly require the courts to consider the likelihood of the continuation or renewal of the interest and the courts generally adopt a generous approach in favor of the claimant to ensure a just result.

This report presents a longitudinal study of the rules and principles which govern the matters of compensation in land resumptions in Hong Kong and explores the impacts of s.12 (c) of Lands Resumption Ordinance (Cap. 124) on compensation assessment in the light of the changing social and economic circumstances. As a reasonable

compensation system, it should reflect the changes in development that had taken place over the years in three aspects namely, land premia, planning concept and provision of infrastructural facilities.

Harmony is important to any society and unfair land acquisition compensation has already led to disputes that are causing social disruptions in China. This research wants to point out that based on the equity principles and the current land development pattern and practices, it may be the right time to revisit its application and the purpose that it serves. Furthermore, based on the experience of other regions, it is more equitable to take the value of comparable sites which were similarly restricted would better reflect the common law principles that the applicants are entitled to have the value of their land assessed on the basis which included recognition of the attributes which the land had. It would probably result in the most satisfactory way of assessing the various factors which need to be assessed where the land has unrealized potentialities. Finally, if the Hong Kong SAR government is prepared to make changes to the compensation law, the Australian statute laws that mandate courts to consider the likelihood of the continuation or renewal of the interest acquired and the generous approach adopted by Australian courts can be a valuable experience to borrow.

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CHAPTER ONE

Overview

In Hong Kong, Article 7 of the Basic Law of Hong Kong vests all land in the state. In terms of the article, the Hong Kong Government is responsible for its management which includes the lease or grant of land to individuals for “use and development”. Furthermore, as stated in Article 6 of the Basic Law, the Hong Kong Special Administrative Region ‘shall protect the right of private ownership of property in accordance with law’. Article 105 also provides that any person whose property is compulsorily acquired has a right to compensation according to the property’s “real value”.

“The Hong Kong Special Administrative Region shall, in accordance with law, protect the right of individuals and legal persons to the acquisition, use, disposal and inheritance of property and their right to compensation for lawful deprivation of their property.

Such compensation shall correspond to the real value of the property concerned at the time and shall be freely convertible and paid without undue delay.”

However, s.12(c) of the Lands Resumption Ordinance (Cap. 124), excludes compensation “in respect of any expectancy or probability of the grant or renewal or continuance, by the Government or by any person, of any license, permission, lease or permit whatsoever”. Unlike the current position in Hong Kong, land compensation laws in other common law regions are quite different and more considerate in this

regard. For example, in Australia, there are several compensation statutes that mandate the courts to consider the likelihood of the continuation or renewal of the acquired leasehold interest and the likely terms and conditions on which any continuation or renewal would be granted.

In view of the Government's capital investments in infrastructural facilities in the past decades and the substantial amendments made to the Town Planning Ordinance in 1990 and 1991, the general planning concept for NT had been changed. Therefore, the intention of this research is to investigate the impacts on the compensation assessment in the light of recent legal developments of s.12(c) of the Lands Resumption Ordinance and relied on the analysis of the historical background of compensations for compulsory acquisition / resumption of landed property in Hong Kong and the recent legal development, including court judgments and tribunal decisions, on the application and interpretation of s12(c) locally and overseas

Research Problem

The research problem is rooted from a number of court appeals in Hong Kong regarding the compensation assessment of land resumption that a piece of land which is considered to be suitable and has significant potential for residential development and is either in a Comprehensive Development Area or is zoned for residential use but is held under a Government lease on terms which do not permit building was compensated in less than the market value of similar properties due to s.12(c) of the Lands Resumption Ordinance. The argument started up when some affected landowners had submitted their claims by using market comparables with "similar

attributes” that subject to the restrictions in the lease. The Government argued that the comparables were being inflated by the element of “hope value” as the purchasers were willing to pay such prices in the hope of obtaining a modification of the terms of the lease to permit development and these comparables did not represent the true market value and compensation assessments were required by s.12(c) of the Lands Resumption Ordinance to disregard this portion of value. This has led to the issues that whether the current legal position is fair to the affected landowners as they have actually received less from the government than in the market.

Research Question

Market value assumes an unconditional sale and the quantum of hope value will be determined by the probability, costs and timescale of obtaining planning permission and lease modifications. The question is whether s.12(c) of the Lands Resumption Ordinance that governs the land compensation assessment by the Lands Tribunal should be reformed or restructured so as to reflect the changing social and economic contexts in Hong Kong.

Research Objectives

The following items will be investigated in this paper:-

- (1) To provide an overview of the historical background of compensations for compulsory acquisition / resumption of landed property in Hong Kong.

- (2) To provide an overview on the compensation provisions under various legislations that confers the power of compulsory acquisition / resumption in Hong Kong.
- (3) To provide an overview on the existing compensation system in Hong Kong, including a comparison between the compensation provided under different mechanisms and Section 12(c).
- (4) To provide a review of the provision of s12(c) of the Lands Resumption Ordinance, including the relevance and application on compensation assessments in the legislations of (2) above.
- (5) To review the recent legal development, including court judgments and tribunal decisions, on the application and interpretation of s12(c).
- (6) To investigate the impacts on compensation assessment in the light of recent legal developments of s12(c) of Lands Resumption Ordinance.
- (7) To investigate and recommend practical means to alleviate the impacts of (5).

This research paper recognizes the evolution of any statutory provision must be understood in its social, economic and historical context. Therefore, an outline on the development of the land compensation laws in Hong Kong together with an economic analysis on the nature of the government intervention will be provided. This paper produce a concise study on the land compensation laws in Australia so as to provide more information for the judgment in the fairness of s.12(c) of the Lands Resumption Ordinance to the society as a whole when comparing with other common law regions.

This research is organized in three parts. The first is an introduction of the research together with the development of s.12(c) in its historical context. Chapter 1 outlines the objectives and scopes of the research. Chapter 2 presents the historical development of section 12(c) of the Lands Resumption Ordinance. Chapter 3 introduces the rules for determining compensation and the existing compensation system in Hong Kong.

The research's second part is an analytical in nature as it attempts to sketch an overview on the relationship between development potential and its compensation. Chapter 4 sets out the development potential and its compensation upon Resumption. Chapter 5 presents an economic framework to reveal the nature of s12(c) of the Lands Resumption Ordinance and provides recommendations for policy implementation purposes. Chapter 6 introduces the compensation assessment experiences in Australia.

The research's third and last part focuses on the findings and making recommendations on the impact of s.12(c) of the Lands Resumption Ordinance in Hong Kong. Chapter 7 summarizes all the findings with recommendations that the government would be able to apply them to policies and development decisions. It is argue that s.12(c) of the Lands Resumption Ordinance must be understood by its historical and economic context and follows the change of the society and establishment of town planning system in Hong Kong, its existence has to be revealed by relevant authorities.

CHAPTER TWO

Historical Background of Section 12 (c) of the Lands Resumption Ordinance

Historical Development of Land Tenure System in Hong Kong

The tenure system in Hong Kong is very much related to its historical context as a British colony. The Hong Kong Island, Kowloon and the New Territories were successively ceded to British Government in different stages and in different terms. In general the British Government granted leases on Hong Kong Island and Kowloon for 75 years, with a right of renewal for 75 years. Later some older leases in the longer settled areas for 999 years and 99 years were granted.

In the New Territories, leases were never granted for periods longer than 99 years from 1 July 1989, less the last three days. However, for a period of time, some New Territories grants were for shorter duration of 75 years with a right of renewal for 24 years less three days but later leases were generally for the residue of 99 years less the last three days from 1 July 1898. When the New Territories (Renewable Crown Leases) Ordinance (Cap 125) came into force, those leases in the New Territories were granted for a term of 75 years, together with a right of renewal for a further 24 years less three days. Rights to land in the New Territories are generally dealt with by the New Territories Ordinance (Cap 97).

Major Ordinances Governing Land Resumption in Hong Kong

Despite its laissez-faire tradition and its rule of laws in protecting property rights, Hong Kong has not been spared the necessity to acquire private property. Indeed, the large increase in population since the Second World War and subsequent spectacular development has made the compulsory resumption of large areas of private land inevitable. However, there is an important procedural difference between the compulsory acquisition of Hong Kong and in many other countries. Where land is largely freehold, a Government requires compulsory powers to purchase private land. However, with the only exception of the St. John's Cathedral Church in Central, all land in Hong Kong is held formerly from the Crown or now from the HKSAR Government and it will only dispose land by way of lease, license or lesser title. In other words, the HKSAR Government still owns the land. The HKSAR Government does not therefore need the compulsory powers to purchase the freehold interests. It merely resumes the lessee's interest. This is how the term "land resumption" is derived and specially applied to the land acquisition exercises in Hong Kong.

The legislative approach of land resumption in Hong Kong has usually been to enact separate ordinances for different subjects when need arises, such as public health, creation of new towns, road construction, railway construction, reclamation and other various public purposes. It is by these ordinances that the HKSAR Government is conferred with the statutory power to resume compulsorily private interests in land. These ordinances contain detailed provisions governing the purposes and procedures under which the resumption powers could be exercised.

In Hong Kong, many ordinances like the Mass Transit Railway (Land resumption and Related Provisions) Ordinance (Cap. 276), the Roads (Works, Use and Compensation) Ordinance (Cap. 370), Railways Ordinance (Cap. 519) and the Foreshore and Sea-bed (reclamations) Ordinance (Cap. 127) are relevant in connection with the power to resume land. However, it is commonly recognized that the main power in land resumption in Hong Kong is Land Resumption Ordinance (Cap. 124) on the ground that all the compensation claims in relation to land resumption arisen from the abovementioned ordinances were still made under the provisions laid down in the Lands Resumption Ordinance. In this research paper, we have only focused on this Ordinance.

The Evolution of Lands Resumption Ordinance in Hong Kong

In early days, land resumption were ordered mainly for public health reasons such as malaria epidemics and bubonic plague such as in the resumption in the Happy Valley rice fields and Tai Ping Shan carried out in 1845 and 1894 respectively. After the enactment of the Crown Lands Resumption Ordinance in early nineteen, resumption ordered for public works purposes increased gradually with the pace of development of Hong Kong as a whole. This Ordinance is not only the first but also the most significant statute that governs the land resumption exercise in Hong Kong. Where the Government requires resumption of land for public purposes, it principally does so under this Ordinance.

Historically, the Lands Resumption Ordinance is based on the English 1845 Act (the Lands Clauses Consolidation Act), the law cases decided by the courts in England during the 19th century and by amendments made after 1889, and the important rules

introduced in England by Section 2 of the Acquisition of Land (Assessment of Compensation) Act 1919. This phenomenon is not surprising as Hong Kong has been a British colony over the past century. Hong Kong, like other English colonies, most notably Australia before the federation in 1901, is subject to sovereignty of the Crown which owned all land and granted leases of it. Therefore, as mentioned earlier, the Crown merely “resumes” the land.

The former Lands Resumption Ordinance was subsequently repealed by the new Crown Lands Resumption Ordinance in 1900 where for the first time the statutory principles for assessment of compensation were set out. In 1974, an important amendment was made to section 10 which expressly created different heads under which compensation may be awarded. Section 10 makes the Government separately liable to pay compensation in the following ways: for the land resumed; for the value of any easement or other right resumed; for the amount of loss or damage suffered due to severance; and for business disturbance. In 1984, section 10 was widened to recognize a claim for domestic and other non-business disturbance.

Another 1984 change was the reference to the value of the land sold on the open market was expanded to mean the value if sold “by a willing seller”. The willing seller assumption had been implicit in the legislation since the former value to the owner criterion was replaced in 1921 by open market value. The 1984 amendment makes it clear that in determining land value, any special value of the resumed land to the owner is to be disregarded. Although there has been a series of amendments before it reached its present form, the Ordinance remains a relatively short and simple statute. The original simplicity has largely been preserved, because its provisions are supported by a substantial body of common law principles.

Enactment History and the Rationales of Section 12(c) of Lands Resumption Ordinance

There are many principles and rules in determining compensation under the Lands Resumption Ordinance. In this research paper, we have focused on the provision of s.12(c) and its application in the compensation assessment. In Lands Resumption Ordinance, s.12(c) reads:

“no compensation shall be given in respect of any expectancy or probability of the grant or renewal or continuance, by the Government or by any person, of any license, permission, lease or permit whatsoever: (Amended 29 of 1998 s. 105)

Provided that this paragraph shall not apply to any case in which the grant or renewal or continuance of any licence, permission, lease or permit could have been enforced as of right if the land in question had not been resumed; and”

Before going into details of its impact, the enactment history of s.12(c) is important in finding out the basic rationale in introducing such section in the Lands Resumption Ordinance. Two scenarios, namely legal and factual context will be investigated separately as follow.

The legal context in which Section 12(c) was enacted

Section 12(c) was introduced by amendment in 1922, when in other respects the law of Hong Kong in relation to compensation for compulsory acquisition was generally

the same as the law of England and, for that matter, elsewhere in the Commonwealth. The relevant principles of English law can be summarized as follows:

The value of the land is the value to the claimant, not its value to the acquiring authority: see Re Lucas and Chesterfield Gas and Water Board [1909] 1 KB 16 at p.29 per Fletcher Moulton LJ; Re South Eastern Railway Co. and London County Council's Contract [1915] 2 Ch 252 at p.258-9 per Eve J.

Although it is common practice to speak of the value of the land, the property taken, and therefore the subject of compensation, is not the physical land itself but the claimant's estate and interest in the land. That is why the sitting tenant is entitled to compensation for his lease, but not to the chance of obtaining its renewal: this is the true ratio of Lynch v. The Corporation of the City of Glasgow.

The subject land must be valued not only by reference to its present use but also by reference to any potential use to which it may lawfully be put: see Horn v. Sunderland Corporation [1941] 2 KB 26, where agricultural land suitable for development was valued as building land; Raja Vyricherla Narayana Gajapatiraju v. Revenue Divisional Officer, Vizagapatam [1939] AC 302; and Maori Trustee v. Ministry of Works [1959] AC 1, where undivided land suitable for subdivision was to be valued for what it was at the date of taking, that is to say as undivided land, but taking into account its suitability for subdivision.

Where land is subject to restrictions which affect its value, the claimant is not entitled to be paid the unrestricted value of the land. While, however, the existence of the restrictions must be taken into account, so too must the possibility of obtaining a

discharge or modification of the restrictions: see Corrie v. MacDermott [1914] AC 1056. In such a case the costs as well as the risks and delays involved in obtaining any necessary consent must also be taken into account: see Maori Trustee v. Ministry of Works.

In the absence of s.12(c), therefore, compensation for the subject lands would be based in the first instance on their value subject to the restrictions in the relevant lease. Two further considerations are particularly relevant in Hong Kong regarding this point. First, the user covenants in the Government leases are absolute. They are not qualified by any requirement that the Government's consent is not to be unreasonably withheld; and the statute law of Hong Kong does not subject user covenants in leases to any such requirement. Secondly, in deciding whether to grant or withhold its consent to a modification of the terms of a lease, the Government does not exercise a public law function but acts in its private capacity as a landlord: see Hang Wah Chong Investment Co. Ltd v. Attorney-General [1981] HKLR 336 (PC). It thus has an absolute right if it chooses to demand a premium, however large, for granting a modification of the terms of the lease, or to withhold its consent altogether, however unreasonably: see Viscount Tredegar v. Harwood [1929] AC 72.

The factual context in which Section 12(c) was enacted

In 1922, the New Territories were intensely rural. Most of the land was devoted to agriculture and occupied by smallholders. In fact, however, the legislation in question was prompted, not by conditions in the New Territories, but by the explosive growth of Kowloon, which was experiencing a speculative boom in land prices. The Government was responsible for infrastructure and urban development and when

there were rumors of resumption, many people would pay speculative prices in the expectation that the Government would resume their land.

At that time the sale and disposal of land in Hong Kong was ordered by the Governor under the authority of Letters Patent from the Crown, and the conditions which might be imposed on the grant of land or of a change of use were not limited in any way by statute. There was no town planning legislation before 1939. The Government of Hong Kong exercised control over land development through its rights as ground landlord of almost all land in what was then a Crown Colony. Land was almost universally demised either as agricultural land or building land, and different rents were charged accordingly. It was not the normal practice of the Government to charge a premium for the modification of the terms of a lease, but it had the legal right to do so. It is not clear whether it was accustomed to charge an increased rent, but this would have been an appropriate course for it to take.

The above was the background to the introduction of s.12(c) in 1922.

Explanatory Memorandum

In accordance with the normal practice in Hong Kong, there was attached to the Bill an Explanatory Memorandum which explained the objects and reasons for the Bill. Such a document has always been admissible, not for the purpose of construing the words of the statute, but as evidence of the mischief which it was the object of the proposed statute to remedy: see *Elson-Vernon Knitters Ltd v. Sino-Indo-American Spinners Ltd* [1972] HKLR 468; *Westminster City Council v. National Asylum Support Service* [2002] 4 All ER 654. As Lord Steyn explained in that case at p.657:

“..... there is no need to establish an ambiguity before taking into account the objective circumstances to which the language relates. Insofar as the Explanatory Notes cast light on the objective setting or contextual scene of the statute, and the mischief at which it is aimed, such materials are therefore always admissible aids to construction. They may be admitted for what logical value they have. If used for this purpose the recent reservations in dicta in the House of Lords about the use of Hansard materials in aid of construction are not engaged: see R v Secretary of State for the Environment, Transport and the Regions, ex parte Spath Holme Ltd [2001] 2 AC 349, 407; Robinson v. Secretary of State for Northern Ireland [2002] UKHL 32, The Times, 26 July 2002, in particular per Lord Hoffmann, at paragraph 40. On this basis the constitutional arguments which I put forward extra-judicially are also not engaged: “Pepper v Hart: A Re-Examination” (2001) 21 Oxford Journal of Legal Studies 59.”

Such evidence is admissible for a limited purpose only, to enable the Court to understand the factual context in which the statute was enacted and the mischief at which it was aimed. This is not the same as treating the statements of the executive about the meaning and effect of the statutory language as reflecting the will of the legislature. Within the permissible limits, however, the admissible evidence is not confined to the Explanatory Memorandum of Objects and Reasons, but must logically extend to explanations given by Ministers when introducing the Bill.

The Explanatory Memorandum attached to the Bill in 1922 reads:

“1. The object of this Ordinance is to make it clear that in resumptions under the Crown Lands Resumptions Ordinances no compensation is to be awarded in respect of mere expectancies or probabilities. For example, the owner of agricultural land

held under a Crown lease which prohibits the erection of buildings except with the license of the Crown is not to receive any compensation with respect to the possibility that such a license might at some time have been obtained if the land had not been resumed. This principle is not new as it is in force under the Lands Clauses Consolidation Acts in England, and it seems only reasonable that the community should not have to pay for a mere possibility of this kind which the claimant could never have enforced.

2. The reason for the amendment of Ordinance No. 14 of 1921 on this point is that the Ordinance laid down as a general rule that the basis of compensation should be the market value of the land, and it appears to be the case that speculators, in the case of agricultural land for instance, are often prepared to pay more than the value of the land for agricultural purposes in the hope that they may be allowed to convert it into building land. The claimants in such a case would no doubt argue that the speculator's price formed or was evidence of a market price above the real value of the land as agricultural land. This position is all the more likely to arise in a district which is about to be developed by the Government for building purposes, and if the above argument were to prevail the result would be that the community would have to pay a very much increased price for the land, although this increased price was based solely on the mere possibility of conversion which the Government have absolute discretion to refuse. The effect would be to make development more expensive and to raise the rents on the developed property, and it might even have the effect of checking development altogether in a particular district.

3. The intention of this bill, therefore, is to provide that the rule of taking the market price as the basis of compensation is to be subject to the further rule that no

compensation is to be given in respect of such mere probabilities.

4. For convenience, the whole of section 2 of Ordinance No. 14 of 1921 is to be repealed and re-enacted but practically the only part of the substituted section which is new is paragraph (c).”

When introducing the Bill into the Legislative Council, the Attorney-General repeated the foregoing and added:

“What happens, very often, is that speculators in the case of agricultural land are prepared to pay a good deal more than the value of the land for agricultural purposes in the hope that they, or the purchasers from them, may be allowed to convert that land into building land. The operation of these speculators, of course, creates a fictitious market price, and when land is resumed the arbitrators are asked to give compensation on the basis of that fictitious market price. That happens particularly in the case where the Government is about to lay out and develop land for building purposes I only wish to add that this principle of not receiving compensation for a mere probability or expectancy is not a principle invented here but is already in force in England under the Lands Clauses Consolidation Acts.”

Two points about these passages should be noted. First, the Government was concerned with the fact that purchasers, not intending or being able to develop the land themselves, were willing to pay speculative prices in the expectation that the Government would resume the land and develop it as building land free from any restrictions in the lease. The remedy was to exclude the speculative element from the assessment of compensation. Secondly, contrary to what the Legislative Council was told, s.12(c) had no direct counterpart in the English statutes. It seems likely that the

reference was to Lynch v. The Corporation of the City of Glasgow, where the subject of compensation was limited to the interest taken and it did not exclude compensation for chances which affected the value of that interest. Insofar as the new s.12(c) excluded compensation for the possibility of obtaining a modification of the terms of the lease under which the subject land was held, it went further than contemporary English law. On the other hand, it was consistent with the principle that the value of the land was the value to the claimant, in whose hands its user was restricted, and not its value to the acquiring or resuming authority, in whose hands its user was unrestricted. If s.12(c) was limited to the principle lay down in Lynch v. The Corporation of the City of Glasgow, then it was not only unnecessary but failed to remedy the mischief at which it was aimed.

Relevancy of Section 12(c) in modern society of Hong Kong

There is no doubt that social and economic circumstances have changed dramatically since 1922 when s.12(c) was enacted. Zoning is determined by an independent body, the Town Planning Board. The mischief envisaged by s.12(c) no longer exists as people do not now speculate on the likelihood that the Government will resume the land. In fact, with reference to the *Hong Kong Lawyer* published in December 2005, the following statement showing that Lands Department also held a view to repeal s.12(c):

“The Hung Yee Kuk, a representative body which represents the interests and views of the indigenous villagers of the New Territories, held a number of meetings with the Lands Department regarding abolition of Section 12(c) in the early 80’s. On a number of occasions, the representatives of the Lands Department, including the Director of Lands in 1982, admitted that

Section 12(c) was unfair to the land owners as it did not award them the real value of the lands resumed. Indeed, on a number of occasions, the representatives of the Lands Department have indicated their agreement to repeal Section 12(c).”

Furthermore, property development is nowadays usually left to private developers, who seek any necessary modification of the terms of their lease, rather than undertaken by the Government after resumption. It was evident in a table, sourced from “accrual-based consolidated financial statements of the Government from the year of 2003 to 2006”, as shown in Chapter 7. As illustrated in the aforesaid table, about half of total land premium received by the Government was attributed to the category of “Modification of existing leases, exchanges and extensions.” for the past few years and such contribution is expected to go on still in the coming future.

Since the 1950’s the Government has charged premiums for granting modification of the terms of a government lease, and its policy for many years has been to charge the full value of the difference between the value of the land subject to the restricted use and the value of the land after modification. Whether it always succeeds is, of course, another matter; but the result is that purchasers no longer speculate on the likelihood that the Government will resume the land; instead they speculate on the Government charging a premium which does not fully reflect the value of the modification in the rising market. In reality, the developers would choose the right timing to agree land premium so as to take advantage of the market conditions. The speculation is not relying on the Government being behind the market, but just expecting the market will rise beyond the prevailing level so as to realize the maximum profit in the bull market.

The Government's right to charge the full value of the modification has not been and could not be challenged. Its policy is informed by the philosophy which formerly underlay the ownership of land in Hong Kong. While it remained a Crown Colony, land in Hong Kong was regarded as belonging to the Crown which parted with its ownership only for the duration of the lease and for the user specified in the lease. Subject thereto, it remained the undisposed property of the Crown. In granting a modification of the user covenants in the lease, therefore, the Crown in effect made a further disposal of the land for which it was entitled to charge full value. In the case of a Crown lease, at least, no distinction in principle was seen between a tenant's hope of obtaining a renewal of his lease and his hope of obtaining a modification of the terms of the lease. In England, by contrast, where the vast majority of leases are granted by private landlords, user covenants are generally qualified so that the landlord cannot unreasonably refuse his consent to a change of use or make it conditional on the payment of a premium. But even where the landlord can unreasonably withhold his consent, the right to make more beneficial use of the land during the currency of the term cannot be said to belong wholly to the landlord or wholly to the tenant, for the tenant cannot exercise the right without the consent of the landlord and the landlord cannot exercise it while the lease subsists.

CHAPTER THREE

Rules for Determining Compensation and the Existing Compensation System in Hong Kong

As discussed in previous chapter, Hong Kong has adopted a leasehold land tenure system established by the British government immediately after the Treaty of Nanking in 1843. Under the leasehold tenure system, all land in Hong Kong (with the only exception of the St. John Cathedral Church in Central) is held from the government by the ways of lease, license or lesser title. Therefore, when private land is acquired for public purposes, the government needs to resume the lessee's interests.

Statutory compensation vs ex-gratia compensation

Under the leasehold tenure system, landowners or occupiers are entitled to the payment of compensation if their land is resumed or adversely affected by the actions of government. Hong Kong's land compensation policy is underpinned by a dual system in which statutory compensation and ex-gratia compensation intermingled with each other in forming the basis of compensation assessment. Statutory compensation refers to compensation assessed in accordance with the principles and rules as laid down by the respective ordinances under which the legal interest is extinguished or affected. Statutory compensation normally arises under the following Ordinances:

- ❑ Lands Resumption Ordinance (Cap. 124)
- ❑ Land Acquisition (Possessory Title) Ordinance (Cap. 130)
- ❑ Town Planning Ordinance (Cap. 131)
- ❑ Railways Ordinance (Cap. 519)
- ❑ Water Pollution Control Ordinance (Cap. 358)
- ❑ Roads (Works, Use and Compensation) Ordinance (Cap. 370)
- ❑ Sewage Tunnels (Statutory Easements) Ordinance (Cap. 438)
- ❑ Land Drainage Ordinance (Cap. 446)
- ❑ Marine Parks Ordinance (Cap. 476)
- ❑ Urban Renewal Authority Ordinance (Cap. 563)
- ❑ Foreshore and Sea-bed (Reclamations) Ordinance (Cap. 127)
- ❑ Country Park Ordinance (Cap. 208)
- ❑ Hong Kong Airport (Control of Obstructions) Ordinance (Cap.301)

Running in parallel with the system of statutory compensation there is another system administratively developed by the government under the name of “ex-gratia compensation”, which is paid to affected owners for administrative convenience in lieu of statutory compensation. The primary purpose of the ex-gratia compensation system is to soften the conflicts that may happen during the resumption process. For this purpose, it is the general practice of the Government to make compensation offers based on ex-gratia rates in full and final settlement of all claims arising out of the relevant Ordinances.

Land owners or occupiers have a right to accept or reject the ex-gratia compensation offered by the government. However, if an owner or occupier refuses to accept the ex-gratia compensation offered by the government and intends to make a claim in

accordance with the perspective ordinance, the ex-gratia offer is deemed to be immediately withdrawn prior to the hearing of Lands Tribunal. Thereafter, a re-assessment for compensation should be made on statutory basis.

Definition of open market value in Hong Kong and other regions

Article 6 of the Basic Law provides that the right of private ownership of property shall be protected in accordance with law. Article 105 deals with compensation for lawful deprivation of property and provides that compensation shall correspond to the “real value” of the property. Furthermore, under the existing Lands Resumption Ordinance, the owner shall receive compensation for the market value of the land. s.12 (d) of the Ordinance states that ‘the value of the land resumed shall be taken to be the amount which the land if sold by a willing seller in the open market might be expected to realize.’ Therefore, it is important to examine the meaning of market value in Hong Kong and other regions.

Hong Kong Institute of Surveyors (HKIS)’s Definition

According to HKIS, market value is defined as follows:

Market value is the estimated amount for which a property should exchange on the date of valuation between willing buyers and a willing seller in an arm’s-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

Definition of Appraisal Institute (USA) & Appraisal Institute of Canada

According to the Appraisal Institute (USA) & Appraisal Institute of Canada, open market value is defined as follows:

The most probable price which a property should bring in competitive and the open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specific date and the passing of title from seller to buyer under conditions whereby:

- Buyers and sellers are typically motivated;*
- Both parties are well informed and well advised, and acting in what they considered their best interests;*
- A reasonable time is allowed for exposure in the open market*
- Payment is made in terms of cash or in terms of financial arrangements comparable thereto;*
- The price represents the normal consideration for property sold unaffected by special creative financing or sales concessions granted by anyone associated with the sale.*

The International Assets Valuation Standards Committee (IAVSC) Definition

In the early 1990s, the International Assets Valuation Standards Committee (IAVSC) defines open market value as:

The amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing, wherein the parties had each acted knowledgeably prudently and without compulsion.

Drawing upon the above definitions, key assumptions and underlying principles for the definition of open market value include:

- Willing buyers and sellers
- Competitive market
- The importance of the date of valuation
- Highest and best use of the property

Land compensation policy for Urban Area

Land compensation policy for urban area (i.e. Hong Kong Island and New Kowloon) provides different compensation packages for the following types of lot:

- New Grant Lots
- Old Schedule Agricultural Lots
- Old Schedule Building Lots

New Grant Lots

New Grant Lots refer generally to those where land were not granted under the Block

Crown Lease system. Statutory compensation for owners of New Grant Lots has been well governed by the provisions of the ordinance under which the land is resumed. When the land is resumed, the affected owners are entitled to compensation assessed on the basis of open market value as at the date of resumption (i.e. the date on which the land is reverted to the government).

In addition to the statutory compensation, an ex-gratia allowance known as "Home Purchase Allowance (HPA)" is payable to owners of domestic properties. The HPA is principally designated to permit the owner of residential accommodation resumed to purchase a replacement residence of similar size in the locality of the property is resumed.

The HPA policy was firstly introduced in 1980 for the resumption project in Sai Lau Kok of Tsuen Wan, and has been reviewed several times over the past two decades. The current practice is that the HPA is payable to make up the difference between the amount of statutory compensation (assessed on the basis of existing use) and the cost of a replacement residence of 7 years old in a comparable quality building situated in a similar locality in terms of characteristics and accessibility. This allowance applies to all resumption exercises carried out under any Ordinance and proof of purchase is not required. It is worth noting that the HPA for owners of a tenanted flat was named separately as the Supplementary Allowance (SA) from 2001 to make it clear that it is a supplement to the open market value of the resumed flat.

Apart from the HPA/SA, it is the common policy that occupiers of resumed properties are offered with ex-gratia compensation which would be in lieu of the statutory disturbance compensation that the occupiers are entitled under Ordinance. For

domestic and industrial premises, the assessments are based on the standard rates divided into groups by locations. For commercial properties, the assessments of ex-gratia compensation are linked up with the rateable value of the property concerned.

Old Schedule Agricultural Lot

According to the current policy, ex-gratia compensation for land resumed within old schedule agricultural lots in urban area is assessed as the same as the rate for agricultural within the New Town Development Area (Zone A) in New Territories.

Old Schedule Building Lot

The ex-gratia compensation policy for old schedule building lots was firstly introduced in 1973. The assessment of the rate of ex-gratia allowance was based on the value of the right to an exchange of a piece of building land with a 6-storey commercial/residential tenement building of 18 meters in height with shops on the ground floor and domestic tenements on the upper floors. The ex-gratia allowances for old schedule building lots in urban area over the past year are shown as follows:

Year	Unit Rate (per sq. ft.)
1973	\$300
1978	\$600
1983	\$850
1985	\$900
1986	\$1,000
1987	\$1,300
1988	\$2,000
1989	\$2,150

1991	\$2,700
1992	\$4,500
1999	\$4,800

Land compensation policy in the New Territories (N.T.)

Land compensation policy for N.T. was developed from a set of different mechanism in which compensation packages vary between two basic types of the lot (i.e. agricultural lots and building lots). The evolution of land compensation policy in the N.T. can be traced back to the early 1960s when the system of Land Exchange Entitlements (Letters A and B) was introduced.

Land Exchange Entitlements

After the Second World War, large scale land resumption was carried out in the N.T. for new town development. The Government intended to compensate land owners with equivalent land by way of exchange instead of cash compensation so as to ease the immediate financial impacts caused by compensation. However, the rapid rate of development created difficulties in identifying sufficient land for exchange. As a result, a land exchange entitlement system known as "Letters A or B" system in respect of land acquisition emerged in 1960.

Under this system, Letters A were issued where land owners agreed to surrender their land voluntarily while Letters B were issued where the resumption process had commenced. Letters A and B were virtually identical in terms of their entitlement and handling. Both Letters A and B were to offer the land owner with an option of a cash

payment at a standard rate or an entitlement to a future grant of land, at an unspecified date in any urban development area in the N.T at a specific rate (i.e. 2 square feet of new building land for every 5 square feet of agricultural land surrendered, or 1 square foot of new building land for every square foot of old building land surrendered). Moreover, all Letters A/B were allowed to be freely assigned in the private market.

In the late 1970s, with the continuously rapid growth in new town development, the Government found that it was unlikely to identify sufficient land to redeem all existing letters, and hence devised a substitute to gradually replace the Land Exchange Entitlements system. In 1979, a new compensation package combining land exchange with cash payment¹ was offered at a more favorable rate in order to induce landowners to forego their exchange entitlements. In 1983, the Government decided to abolish the Land Exchange Entitlements System. Owners of both agricultural and building land were thereafter compensated fully in cash. In 1996, the New Territories Land Exchange Entitlements (Redemption) Ordinance (Cap. 195) was enacted to redeem all outstanding Letters A/B and to extinguish all rights against the Government under a land exchange entitlement.

Zonal Compensation System

In 1978, the government had adopted the suggestion of a Working Group under the chairmanship of Sir Y.K. Kan to consider those landowners whose land fell outside the N.T. Layout Areas where the Land Exchange Entitlements were not readily

¹ The new compensation package offered: (1) an exchange rate of 5:2 (for agricultural land) and 1:1 for (building land) exchange entitlement up to half of the land surrendered; and (2) a cash offer of \$27 per sq.ft for agricultural land) and \$55 per sq. ft. plus compensation assessed by valuation (for building land) for the remaining land and any of the first half in which an exchange entitlement was not requested.

applied, the Government decided to make a new deal available for resumption outside the N.T. Layout Areas. Having considered that land in different parts varied greatly in value (mainly due to the differences in their actual value and the value attributable to expectations of modifications and government permissions etc.), all land was divided into seven zones with reference to the potential use of land on the basis of its location and proximity to developed areas. In order to avoid heavy land exchange commitments, all compensation outside the layout area was paid in form of cash only.

In response to the complaints from landowners about the existing seven-zone system which had weighted too much in favor of the areas near new town development, the Government rationalized the seven zones into four in 1985. Moreover, it was decided that the zonal boundaries would be reviewed on an annual basis. This four-zone system has been working satisfactorily and adopted up to the present. The basic rates applicable to both the agricultural land building are reviewed twice with reference to the prevailing property market conditions and published to take effect on the 1st April and 1st October every year. The ex-gratia compensation rates for four zones are shown as follows:

Zones	Definition	Compensation Rate for Agricultural Land	Compensation Rate for Building Land
A	New Town Development Areas (namely areas with the New Town boundaries as shown on gazetted outline zoning plans for new towns), and those areas that are affected by essential projects with territory wide significance of the New Territories	120% of Basic Rate	Valuation plus 120% of Basic Rate
B	Areas which may be brought under urban development in the near future, either by extensions to the adjoining layout areas or by reason of their know potential for urban development.	75% of Basic Rate	Valuation plus 75% of Basic Rate
C	Areas in which no urban development is planned and which are unlikely to be affected by later extension to layout areas, but where resumptions are required sometimes for purposes directly connected with urban layout development and sometimes for local improvement scheme.	50% of Basic Rate	Valuation plus 50% of Basic Rate
D	Areas are not included into other zones.	30% of Basic Rate	Valuation plus 30% of Basic Rate

Land compensation policy for urban renewal projects

The current principles and policies adopted by the Urban Renewal Authority (URA) for making statutory and ex-gratia compensations to owners affected by urban renewal projects are made in accordance with the Urban Renewal Authority

Ordinance (URAO) (other than projects previously announced by the former Land Development Corporation in January 1998). They can be generally classified as follows:

Domestic properties

- The URA offers an owner-occupier of domestic property the market value (valued on vacant possession basis) of his property plus an ex-gratia allowance (HPA).
- An owner-occupier is entitled to receive HPA for no more than three properties in a redevelopment project.
- Properties used as sole residence by an owner's "immediate family members" will be treated as being occupied by the owner himself for the purpose of ascertainment of his eligibility to HPA. "Immediate family members" of an owner means parents, children, dependent brothers and sisters, grandparents, grandchildren, stepparents, spouse's parents and spouse's stepparents.
- An owner who does not reside in his property as his sole residence or leaves it vacant will be offered the market value (valued on vacant possession basis) of his property plus Supplementary Allowance (SA). SA is based on a percentage of the HPA.
- An owner who lets his property out will be offered market value (valued on vacant possession basis) of his property and a Supplementary Allowance.

- An owner of tenanted or vacant properties is entitled to receive SA for no more than two properties.

- If a property is owned by joint owners (whether as joint tenants or tenants in common) / a company, each joint owner / shareholder of that company will be subject to the same principles applicable to individual owners. The HPA and SA will be calculated pro rata to the shares of each joint owner and the shareholdings of each shareholder in the company.

- The URA offers an incidental cost allowance to owners of domestic properties to assist payment of removal expenses and expenditure relating to the purchase of a replacement property. The actual amount of this allowance shall be determined and announced by the URA as and when an offer to purchase is made for each individual project.

- If an owner of sub-divided flat elects not to receive the HPA, he may be offered re-housing.

- The HPA is payable to an owner-occupier of non-domestic property which has been issued with an occupation permit other than for domestic use but nevertheless has been used for domestic purpose for a long time provided that such use is not prohibited under the Government lease of the property.

Non-domestic Properties other than Industrial Use

- An owner of non-domestic property (other than Industrial Properties) will receive the market value of his property (valued on vacant possession basis).
- The URA will also pay the owner an allowance. The allowance for tenanted or vacant non-domestic property (other than Industrial Properties) is 10% of its market value (valued on vacant possession basis) or one time of its Rateable Value, whichever is higher.
- The allowance for owner-occupied non-domestic property (other than Industrial Properties) is 35% of its market value (valued on vacant possession basis) or 4 times its Rateable Value, whichever is higher.
- An owner-occupier may claim for business loss, as an alternative to the above allowance, if he so chooses. "Owner-occupier" here means an owner who occupies his property for his own business.

Other General Rules

- An owner of tenanted or vacant rooftop property will be offered the market value of the property on an open roof basis (disregarding any illegal structure or any rent passing). The URA will also pay the owner an allowance at 10% of the said market value.

- An owner-occupier of a rooftop property will be offered the market value of the property on an open roof basis (disregarding any illegal structure). If the owner-occupier meets the normal Hong Kong Housing Authority and Hong Kong Housing Society eligibility criteria, he may elect for re-housing. However, if he does not elect for re-housing, the URA will also pay the owner an allowance at 10% of the said market value.

- A building in single ownership is valued either on its existing use value plus ex-gratia allowances for shops and HPA/SA and incidental cost allowance for domestic units in case of multiple ownerships or on its redevelopment value (assuming redevelopment of the building on its own) plus an ex-gratia allowance of 5%, whichever is higher.

- A vacant site is valued on its redevelopment value basis (assuming redevelopment of the building on its own). The URA will also pay the owner 5% of the redevelopment value as ex-gratia allowance.

Conclusion

Hong Kong has different land compensation mechanisms and they were designed many years ago to suit the situations at that particular period of time so as to provide a balance on the equitable compensation of private interest and public interests. In the context of Hong Kong, the statutory power of the Government to resume compulsorily private land interests are conferred by numerous ordinances and their subsidiary legislations, which have been enacted separately for different headings such as public health, creation of new towns, road construction, railway construction

and reclamation. Among all these legislations, Lands Resumption Ordinance (Cap. 124) is widely recognized as a landmark statute as it laid down the foundation rules and principles of compensation assessment for all land resumptions including those arisen from other Ordinances. However, with decades of development, the planning system and the land administration system in Hong Kong have already evolved to a more advanced and transparent stage. Land speculation activities in the past are no longer a profitable activity and the existence of s.12(c) will only understate the market values in the private market which in turn will infringe the private interests of land owners in Hong Kong.

CHAPTER FOUR

Development Potential and its Compensation upon Resumption

The recent debate or more correctly the dispute on whether planning benefit and development potential form part of the 'real value' or intrinsic value of land upon resumption by Government in Hong Kong was started when Yin Shuen Enterprises Ltd. referred its case to the Lands Tribunal for determination in 2000.

Upon compulsory acquisition, or land resumption, as is the case in Hong Kong, landowners have been understood to receive compensation for the loss of land with development potential or value. For instance, "the special adaptability for some purpose or other is the basis of the market value of all land". In *Lucas and Chesterfield Gas and Water Board* (1909) 1 KB 16, Fletcher Moulton LJ went on to state:

.....that where the special value exists only for the particular purchaser who has obtained powers of compulsory purchase it cannot be taken into consideration in fixing the price, because to do otherwise would be to allow the existence of the scheme to enhance the value of the lands to be purchased under it. But where the special value exists also for other possible purchasers, so that there is, so to speak, a market, real though limited, in which the special value goes towards fixing the market price the owner is entitled to have this element of value taken into consideration.....

Thus, possible purchasers include those interested not merely in the land in its existing state but also in its potentialities. *Kwok Lee Sau-sang v. Director of Lands and Survey* (1977) HKLTLR 105 is one of a number of cases, where the Lands Tribunal held that an owner is entitled to recover higher compensation for loss of development value where, on the evidence, that potential has been established.

Similarly, “if it is shown that a property has an added value on the open market because of the likelihood that it will be incorporated into a scheme of redevelopment then this added value must be taken into account when compensation is being assessed. However, before such a value can be attributed to the property the likelihood of redevelopment must be shown”².

The *Yin Shuen* case³

This case concerned the application for compensation for a plot of land in Sheung Shui measured about 1,236.9 square meters which was resumed by the Hong Kong Special Administrative Region Government (hereinafter referred to as “the Government”) for the development of public housing on 27th January, 1999. The Applicant, the owner of the land on the date of resumption, lodged a claim for a sum of HK\$10,120,000 as compensation calculated at the price of HK\$8,184 per square meter. More particularly, the valuation approach adopted by the Applicant's expert was comparing the subject lot - a piece of agricultural land within a "residential" zone - with another piece of agricultural land with similar zoning. The Applicant also drew

² *Cheung Lai-wan v Director of Lands and Survey* (1977) HKLTLR 14

³ *Yin Shuen Enterprises Limited v. Director of Lands*, LDLR 5 of 2000

attention to an earlier judgment of the Lands Tribunal⁴ in which the use of certain comparables with development potential was allowed to be used for valuation. At page 41 of the judgment, the judge said:

"The market reality is that purchasers are prepared to buy agricultural land with non-agricultural potential and accept the risk of obtaining the necessary change of user. Mr. MacNaughton agreed that this commonly, occurred in the market. It was for this very reason that he rejected Mr. Chan's six comparables of agricultural land, because they included an element over and above their value for agricultural use because of the purchaser's hope that he could obtain a change of user. On the evidence I am satisfied that Lot 22, because of its size and location, was suitable for residential use. I appreciate any purchaser would require to obtain Crown approval for any change of use; probably have to pay a premium; and comply with other conditions. However, I am equally satisfied that a purchaser, fully aware of those risks, would be willing to pay above bare agricultural land market value for the land with that potentiality. Where land is compulsorily resumed, the owner is entitled to the present value of the land, including the advantage of those potentialities." (emphasis added)

The Respondent disagreed. It challenged the comparable relied on by the Applicant carried a hope value in developing that piece of agricultural land into building land in future because the purchaser of that land, a subsidiary company of a developer, was in the process of amalgamating lands in the vicinity and had already submitted a rezoning request to the Town Planning Board to have its land rezoned as "Residential (B)". Instead, the Respondent chose comparables all either zoned "green belt" or

⁴ *Suen Sun-yau v Director of Buildings and Lands* [1991] HKDCLR 33

"agricultural" on the relevant Outline Zoning Plans. This approach adopted by the Respondent's expert was that zoning of the subject lot should be disregarded altogether for the subject lot was held under Block Crown Lease with stipulations prohibiting its being developed into building land unless approval from the relevant authorities could be obtained. Section 12(c) of the Lands Resumption Ordinance excluded compensation to be awarded under such circumstance. To this, the Applicant rebutted that if zoning of the subject property was to be disregarded because of section 12(c) of the Lands Resumption Ordinance, section 12(aa) which was added in 1973 would be rendered meaningless. It was because section 12(aa) - a provision which precluded the Tribunal from considering certain negative zoning under s.4 of the Town Planning Ordinance in the process of calculating compensation, had deliberately omitted mentioning section 4(b) of that ordinance. Section 4(b) provided for "zones or districts set apart for use for residential, commercial, industrial or other specified uses". Hence, by necessary implication, argued the Applicant, section 12(aa) of the Lands Resumption Ordinance required the Tribunal to consider those zoning when assessing compensation for a piece of resumed land so zoned.

The Lands Tribunal agreed with the Applicant and awarded compensation to the Applicant assessed at \$7,592,000.

This case was then immediately followed by *Dragon House Investment Limited v. Secretary for Transport*, LDMR 31 of 2000 and *Nam Chun Investment Company Limited v. Director of Lands*, LDLR 3 of 2000 on similar issue. The whole saga began as shown in the table below:

Date of Judgments	Yin Shuen Enterprises Ltd.	Dragon House Investment Ltd.	Nan Chun Investment Co. Ltd.	Tang Chiu Leung Tso	View Point Development Ltd.	Busy Firm Investment Ltd.
14 Feb. 2001	Lands Tribunal					
25 May 2001		Lands Tribunal				
19 June 2001			Lands Tribunal			
14 September 2001				Lands Tribunal		
15 Jan. 2002	██████████ ██████████		██████████ ██████████			
7 Nov. 2002					Lands Tribunal	
21 Nov. 2002						Lands Tribunal
17 Jan. 2003	Court of Final Appeal		Court of Final Appeal			
21 Oct.2003			Lands Tribunal			
24 Dec.2003		██████████ ██████████		██████████ ██████████	██████████ ██████████	██████████ ██████████
4 Mar. 2005			██████████ ██████████			
21 Nov.2005		Court of Final Appeal	Court of Final Appeal			

The Government, dissatisfied with the judgments of the Lands Tribunal, appealed to the Court of Appeal, which upheld the decision of the Lands Tribunal by way of a judgment dated 15 January 2002. The Government further appealed to the Court of Final Appeal, who pursuant to their judgment dated 17 January 2003, remitted the matter back to the Lands Tribunal for reassessment.

The *Nam Chun* case

On appeal to the Court of Appeal and to the Court of Final Appeal, the *Yin Shuen* case and the *Nam Chun* case were heard together because of similarity of the issues.

The Applicant in the *Nam Chun* case also owned a few blocks of agricultural land zoned residential in Hung Shui Kiu, Yuen Long but resumed for public housing development. Again, the Lands Tribunal was convinced that the lots were suitable for being developed into some kind of building lots in the future and agreed that lands sharing similar attributes with the resumed lands, including the residential zoning, were good comparables, though they were all subject to the same non-building covenant contained in the government lease. The latter means the landowner was not allowed to build on his land without paying a premium to the Government for modifying the government lease.

Thus, the Government challenged the Applicant's comparables as "special purchaser's bids with the expectancy of approval of a land exchange by the Government" and/or carrying an element of "hope value" which is precluded by section 12(c). Disapproving the Government's challenge, however, the Lands Tribunal awarded

compensation to the Applicant assessed at \$57.5 million as opposed to approximately \$10 million offered by Government.

The Government appealed to the Court of Appeal, which upheld the decision of the Lands Tribunal by way of a judgment dated 15 January 2002. The Government further appealed to the Court of Final Appeal.

The 1st Court of Final Appeal decision⁵ (hereinafter referred to as the *Yin Shuen* judgment)

In the Court of Final Appeal's decision, Mr. Justice Bokhary PJ delivered a short but important judgment and Lord Millet NPJ delivered the leading judgment.

Mr. Justice Bokhary PJ held that section 12(c) of the Lands Resumption Ordinance merely excludes a speculative element which sometimes inflates land prices and that such exclusion is consistent with art. 105 of the Basic Law which requires the Government to compensate the claimant for the 'real value' of the property resumed.

Lord Millet NPJ nevertheless concentrated on the question: whether the compensation payable on resumption should reflect a price in excess of the value of the land subject to the restrictions if the evidence shows that purchasers are willing to pay such a price in the hope or expectation of obtaining a modification of the terms of the lease. This question turns on the meaning and effect of s.12(c) of the Lands Resumption Ordinance. His Lordship commented that although the open market value of land is "in general" the measure of fair compensation, it is not universally so. Sometimes a departure from the open market value may be justified. The open market value

⁵ *Director of Lands v. Yin Shuen Enterprises Limited and Nam Chun Investment Company Limited* [2003] 6 HKCFAR 1; [2003] 2 HKC 490

proviso, i.e. Section 12(d), is subject to exceptions, in particular to sections 12(b) and 12(c) which describe particular circumstances in which the legislature considered that the resuming authority ought not to be required to pay the open market value of the subject land. His Lordship also agreed that in a free market, purchasers may be prepared to pay a higher price than would otherwise be justified. The question in the present case is whether section 12(c) has the effect of excluding the speculative element in that value from the computation. In the absence of this special provision, regard would rightly have to be paid not only to the likelihood or otherwise of the Government granting a modification of the terms of the lease, without which the development potential of the lands could not be realized, but also to the costs of obtaining such modification, including the payment of any premium which the Government might demand as the price of modification.

In this regard, Lord Millet noted land held under a Block Crown (or Government) Lease 'demised for agricultural or garden' is subject to a restrictive user covenant which is absolute and not qualified by any requirement that the Government's consent is not to be unreasonably withheld. In addition, in deciding whether to grant or withhold its consent to a modification of the terms of a lease, the Government has an absolute right if it chooses to demand a premium, however large, for granting a modification or to withhold its consent altogether. Not only is this user covenant not found in any of the Commonwealth countries but this particular section 12(c) is unique to Hong Kong. As Lord Millet noted in para. 17 of the *Yin Shuen* judgment:

“Section 12(c) must be understood in its legal and factual context. It has no counterpart in the English legislation.”

Referring to the factual context in which section 12(c) was enacted, Lord Millet noted the Government was concerned with the fact that purchasers, not intending or being able to develop the land themselves, were willing to pay speculative prices in the expectation that the Government would resume the land and develop it as building land free from any restrictions in the lease. The remedy was to exclude the speculative element from the assessment of compensation. Reference was also made to *Lynch v. The Corporation of the City of Glasgow* (1904) 5F 1174 (Court of Session) where the principle was laid down that the subject of compensation was limited to the interest taken. It did not exclude compensation for chances which affected the value of that interest. Insofar as the new section 12(c) excludes compensation for the possibility of obtaining a modification of the terms of the lease under which the subject land was held, it goes further than contemporary English law. On the other hand, it is consistent with the principle that the value of the land is the value to the claimant, in whose hands its user is restricted, and not its value to the acquiring or resuming authority, in whose hands its user is unrestricted. Moreover, if the new section 12(c) was limited to enacting the principle in *Lynch v. The Corporation of the City of Glasgow*, then it was not only unnecessary but failed to remedy the mischief at which it was aimed.

The factual background is no longer the same as it was in 1922. Urban development is nowadays usually left to private developers, who seek any necessary modification of the terms of their lease, rather than undertaken by the Government after resumption. Lord Millet explained further that the Government's right to charge the full value of the modification has not been and could not be challenged. Land in Hong Kong belongs to the Government, which parts with its ownership only for the duration of the lease and for the user specified in the lease. Subject thereto, it remains the undisposed property of the Government. In granting a modification of the user

covenants in the lease, therefore, the Government in effect made a further disposal of the land for which it is entitled to charge full value. This view was shared by Power P while giving the judgment of the Lands Tribunal in *Ching Chun-Kau v. Director of Lands and Survey* [1978] HKLTLR 190:

"It seems that section 12(c) was drafted locally to meet local conditions and it is a fair inference from a study of the judgments in *Lynch v. Glasgow Corporation* that this case in some part provided the inspiration for the phraseology of section 12(c).

Section 12(c) clearly went much further than the principle laid down in *Lynch v. Glasgow Corporation* which dealt only with the renewal of a lease. Section 12(c) goes much further as it deals with 'any licence, permission, lease or permit whatsoever' which may be issued 'by the Crown or by any other person'."

Comparing like with like, therefore, Lord Millet held if the prices paid by purchasers on the claimants' comparables contained such a speculative element for which the Government ought not to be required to pay on resumption, they could not be taken at face value. "It does not follow that they must be disregarded altogether; but they cannot stand without adjustment."

Regarding art. 105 of the Basic Law which requires compensation to correspond to the 'real value' of the property concerned, Lord Millet observed open market value of a property may not always reflect its real value because in a imperfect market purchasers are prepared to pay a speculative price which exceeds the true value of the property and reflects an element for which the resuming authority ought not to be required to pay. Secondly, compensation is only required to be paid for "the property

concerned", that is to say for the interest acquired. In the present case, that means for the land for the duration of the Government lease and subject to the user restrictions in the lease. The right to exploit the development potential of the land by using it as building land was not disposed of by the Government and remains the property of the Government for which it ought not to be required to pay.

Thus, the Court of Final Appeal allowed the Respondent's appeal on the ground that the evidence of hope value by the expert had been wrongly excluded as irrelevant and immaterial. It discharged the assessments and remitted both cases to the Lands Tribunal to reconsider the assessment of the compensation on a full evaluation of all the evidence and in the light of this judgment.

The *Nam Chun* rehearing

After the Government won the appeal, *Yin Shuen* decided not to press on with the re-assessment, perhaps because the claim amount involved in that case was relatively small. *Nam Chun* proceeded and the rehearing before the Lands Tribunal took place in July 2003 before a differently constituted panel. *Nam Chun*'s expert valuer prepared a fresh valuation report wherein he proposed that the difference in price (the hope value) between comparables of residential and agricultural zonings should be split 50/50 between the Government and the Applicant.

However, just a couple of weeks before the resumed hearing started, *Nam Chun*'s expert filed another replacement report on the ground that he had been advised by his legal advisers that he had misunderstood the *Yin Shuen* judgment.

In his opening at the re-assessment hearing, Leading Counsel for *Nam Chun* made a distinction between ‘zoning benefit’ and ‘speculative element’ and submitted to the Lands Tribunal that, on a closer reading of the *Yin Shuen* judgment, the Court of Final Appeal had not held that their comparables, all with residential zoning, could not be used. In para. 54 of the *Yin Shuen* judgment, the Court of Final Appeal said:

“In the present case the Government valuer asserted that the prices paid by purchasers on the claimants' comparables contained such an element and should be disregarded for this reason. His evidence has not been accepted or rejected, but rather ruled to be irrelevant. It is not irrelevant, but highly material. If correct, then the claimants' comparables cannot be taken at face value. It does not follow that they must be disregarded altogether; but they cannot stand without adjustment.”

The Tribunal’s task, therefore (so *Nam Chun* submitted), should be to ascertain if the Government’s expert’s contention was in fact correct, and if it was, to identify, quantify and exclude this speculative element. According to the Applicant, zoning or planning benefit (arising from the piece of land being zoned ‘residential’ on the Outline Zoning Plan) was an ‘intrinsic attribute’ of the land which could not and should not be ignored in the assessment of compensation.

To the above submission by *Nam Chun*, the presiding officer of the Lands Tribunal totally agreed. He ruled:

“What is to be disregarded is that part of the inflated price which is attributable to speculating on the Government removing the restrictions to build. The ultimate question is whether the price is inflated.”

As the Government 's valuer could not identify this speculative element (which was confined as something other than the zoning or planning benefit), the presiding officer accepted the same comparables advanced by *Nam Chun*, and returned the same award as that made in the first round hearing. It is interesting to note that the Member of the Tribunal expressed his reservation on the view of the presiding officer which has been rare in Hong Kong.

The Government thereupon appealed on the ground that the Tribunal had misunderstood the *Yin Shuen* judgment. Meanwhile, appeals concerning four other claimants (*View Point*, *Busy Firm*, *Dragon House*, and *Tang Chiu Leung Tso*) raising the same question of law, namely the proper interpretation of the *Yin Shuen* judgment was ruled by the Court of Appeal⁶. This time, the Court of Appeal held that in the context, the 'speculative element' mentioned in the *Yin Shuen* judgment could only have been referable to the 'non-agricultural potential', 'an element over and above their value for agricultural use' and 'the purchaser's hope that he could obtain a change of user'. As a result, the Court of Appeal unanimously held that the Lands Tribunal in the rehearing had misunderstood the *Yin Shuen* judgment and allowed the Government's appeal.

The 2nd Court of Final Appeal decision⁷ (hereinafter referred to as the *Dragon House* judgment)

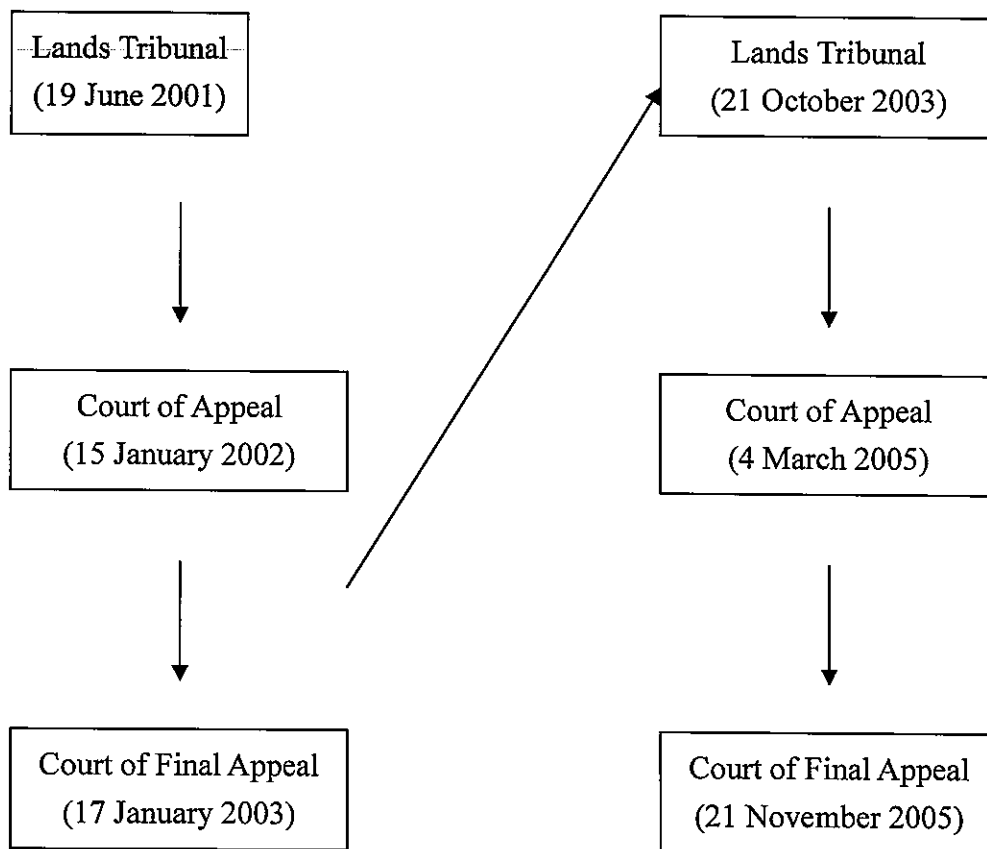
Dragon House and *Nam Chun* then further appealed to the Court of Final Appeal,

⁶ *View Point Development Limited and Others v. Secretary for Transport* [2004] 2 HKC 52

⁷ *Dragon House Investment Ltd. v. Secretary for Transport and Nam Chun Investment Company Limited v. Director of Lands* [2005] 4 HKLRD 480; [2005] 8 HKCFAR 668

contending that the Court of Appeal had been wrong in their interpretation of the *Yin Shuen* judgment. Thus, for the first time, the same issue or the same case reached the Court of Final Appeal the second time in the judicial history of Hong Kong.

Nam Chun Investment Company Limited. v. Director of Lands



In its second judgment, the Court of Final Appeal again with Lord Millet leading the judgment noted in particular the claimants did not contend that the *Yin Shuen* judgment was wrong in any respect. They however relied on a number of isolated passages in the *Yin Shuen* judgment taken out of context in support of their argument.

The Court of Final Appeal reminded of its first judgment that where land is subject to restrictions which affect its value, the claimant is not entitled to be paid the unrestricted value of the land. For this reason, where the existence of the restrictions

must be taken into account, so too must the possibility of obtaining a discharge or modification of the restrictions. Thus, where the resumed land is held under a Government lease, no account may be taken of any element in the open market value which reflects the prospect of a modification of the terms of the lease. In this context the expression "a speculative price" can only mean a price in excess of the value of the land subject to the restrictions in the lease and which reflects the purchaser's assessment of the chances of obtaining a modification of the terms of the lease.

In the *Yin Shuen* judgment, the Court of Final Appeal remarked that "...the claimants' comparables cannot be taken at face value. It does not follow that they must be disregarded altogether; but they cannot stand without adjustment." In this context, the necessary "adjustment" can only mean the substitution of the value of the land for the restricted use permitted by the lease for the open market value obtained by the use of the comparables. Insofar as the claimants relied on comparables which reflected a price in excess of the value of the land subject to the restrictions, therefore, the excess must be disregarded.

The claimants also argued zoning is a present, accrued feature of the land, like its physical features such as its infrastructure which make it suitable for development and must be taken into account in any proper valuation. Here, the Court of Final Appeal responded by saying that "Zoning does not have an independent value of its own, and zoning for residential purposes is of value only if it can be realized by developing the land for such purposes."

The syllogism is as follows:

“

- (i) zoning for a use which is not permitted by the lease has no value capable of being realised unless the terms of the lease are modified;
- (ii) in assessing the compensation to be paid on resumption no account may be taken of the prospect of obtaining such a modification; and
- (iii) therefore no value may be attributed to zoning which can only be realised by obtaining a modification.”

Following from the above, the Court of Final Appeal considered the comparables provided by the Government’s valuer which were not zoned for residential development were good evidence of the value of the land subject to the restrictions in the lease and would usually be the best evidence of the value of comparable land whose development potential is to be disregarded.

The Court of Final Appeal also approved the methodology to apply section 12(c) in *Watford Construction Co. Ltd. v. Secretary for the New Territories* [1978] HKLTLR 253. In that case, the Lands Tribunal held that in order to apply section 12(c), it was not necessary to employ a two-stage approach by first ascertaining the open market value of the land and then quantifying and deducting the expectancy or probability factor. Giving the judgment of the Tribunal, Power P said at p. 260:

“This may, in certain cases, be a proper and useful approach but the Tribunal can see nothing in s.12 that would prevent it from approaching the valuation of land

restricted to agricultural use by using the sales of comparable land which is similarly restricted. Indeed, in the present case, the Tribunal is satisfied not only that this is a proper and permitted approach under s.12 but also that it is the approach to the problem of valuation most likely to result in a correct valuation."

In that regard, in the view of the Court of Final Appeal, unless there is no alternative, the two-stage approach should be discarded. The object of the inquiry is to ascertain the value of the subject land without taking into account the prospect of obtaining a modification of the terms of the lease to permit development.

Implication of the *Yin Shuen* or *Dragon House* judgments

Following the *Yin Shuen* judgment or the subsequent *Dragon House* judgment, there was outcry in the market the judgments were unfair or injustice had been done to the owner of agricultural lots. Some had such a thought because lots owners will be deprived of the 'hope value' for modification or development that had previously been paid to them as this is now expressly to be disregarded by the Court of Final Appeal.

However, let's forget for the meantime the ruling by the Court of Final Appeal (para. 57 of the *Yin Shuen* judgment) that

"The right to exploit the development potential of the land by using it as building land was not disposed of by the Crown and remains the property of the Government for which it ought not to be required to pay" (emphasis added).

The Court of Final Appeal was only tasked to interpret a statutory provision which is applicable upon resumption. As stated in para. 5 of the *Yin Shuen* judgment:

“The question is whether the compensation payable on resumption should reflect a price in excess of the value of the land subject to the restrictions if the evidence shows that purchasers are willing to pay such a price in the hope or expectation of obtaining a modification of the terms of the lease” (emphasis added).

The Court of Final Appeal was not entrusted to pronounce a rule in the free market; and in fact, its judgment can have no intervention in the open market. *“The market reality is that purchasers are prepared to buy agricultural land with non-agricultural potential and accept the risk of obtaining the necessary change of user.”* Furthermore, as remarked by Member Lam of the Lands Tribunal in the *Nam Chun* rehearing (at para. 26-28):

“26. Back to the formula for calculating premium, I considered that it is well known to all developers. The formula has made it very clear that the premium is derived by subtracting the agricultural land value from the building land value. I noted the advice of the two parties that this formula is contained in a policy practice note open to the public. I am of the view that there should not be any controversies as to whether the value of zoning, if any, should go to the developer or government. *By this formula, it is quite clear that it belongs to the government (if there is such value), as it is a lease modification where only the agricultural user stipulated in the lease would be taken into account. The zoning element is not part of the formula and no value has been given for it so that such value needs to be added to or subtracted from any other values involved. It is relevant to the lease*

modification only because firstly, the user in the lease after modification must be the same as the zoning, and secondly, with the benefit of a land use zoning permitting building development, the government is obliged to process the developer's lease modification application. That being the case, I concluded that the amount paid by a developer in excess of the auction land price is not paid because of the zoning but something meaningful to the developer himself.

27. On the valuation side, I considered that both the government and the developer do not tend to diverge significantly on the agricultural land value but do in the building land value. I understood that the government is bounded by the rule of assessing the building land value prevailing around the time of lease modification. The government is so bounded because she does not need to be lucrative but fair. The developer, whilst accepts such rule applicable in lease modification, in reality, bases on his assessed future market price (for finished units) in deciding whether the premium calculated by government should be accepted or not. I disagreed to Mr. Lau's opinion that if the market will go down, the developer will be charged a lower premium. I viewed that this argument is untrue because the government do not bother with the market position two or three years later but around the time of lease modification. So long as the prevailing market is not falling, the premium charged will not be less. Contrary to this stance, the developer needs to assess the future market two to three years later when the development is about to complete. The developer's assessment on the future market is absolutely a kind of speculation for he has a chance of getting it either right or wrong. This speculation has an impact on the level of premium acceptable to the developer. If the developer considers that the market will soar two or three years later, he will simply forget government's calculation and pay a bit more than the agricultural

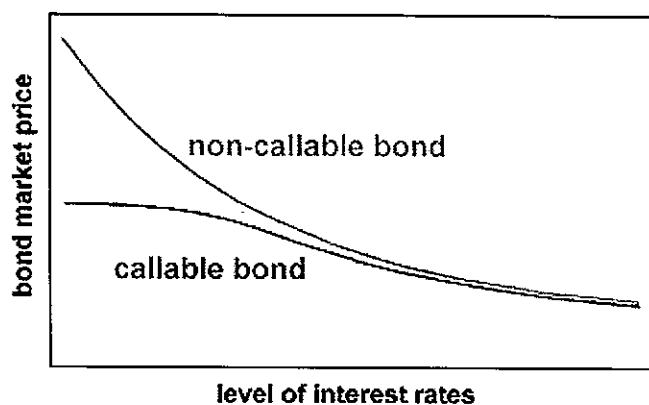
land value so long his assessed profit margin is great enough to cover the extra sum payable. If the market will slump, the developer will stop making lease modification applications and cease buying the agricultural land at a price above the agricultural land value. This phenomenon explains as to why in the period where the property market booms, developers will rush to put in applications for lease modification but in the case of a decline, developers will refrain at all from applying (refer to statistics released publicly by the Lands Department for the last few years).

28. The property market started to slump since late 1998. In early 1999 when the resumption in question took place, it was not the consensus that a major re-shuffle of the market to such an extent as we all have seen today would have undergone. The consensus appeared that it would resume thriving very soon. I was of the view that an extra sum above the agricultural land value was paid for buying the subject agricultural land in anticipation of a greater profit margin that would be resulted from a thriving market two or three years later.”

In light of this observation, it is quite obvious that the market will function as normal as before and purchasers will continue to buy agricultural land with non-agricultural potential and pay a speculative price in the hope of obtaining a modification of the terms of the lease.

Thus, the consequence raises another dilemma: suppose an owner of a piece of agricultural land in the New Territories (*Nam Chun*, for instance) with his neighbors selling their land in the open market at \$12,000 per sq. meter. The land being sold in the neighborhood is all similar, possessing more or less the same attributes as the owner's land. They are all subject to the restriction in the Government lease that does

not permit building but are all zoned residential anyway. Would it be fair if the Government, as the grantor of the lease, resumes the owner's land at \$2,200 per sq. meter instead of \$12,000 per sq. meter? Firstly, the Court of Final Appeal in the *Yin Shuen* judgment made reference to *Hang Wah Chong Investment Co. Ltd v. Attorney-General* [1981] HKLR 336 (PC) and held that in deciding whether to grant or withhold its consent to a modification of the terms of a lease, the Government does not exercise a public law function but acts in its private capacity as landlord. This phenomenon appears to be comparable to a callable bond issued in the investment market where the issuer has the option to redeem the bond prior to its maturity at a predetermined call price. The issuer would never be required to pay any speculative element over and above the call price, based on the hope or expectation that the bond will not be called.



There is also another fear that, following *Yin Shuen* or *Dragon House* judgments, will the Government in Hong Kong depart from the compensation principle established by those Commonwealth authorities such as *Raja Vyricherla Narayana Gajapatiraju v. Revenue Divisional Officer, Vizagapatam* [1939] AC 302 (which is commonly known as the Indian or Raja's case) that land resumed will be valued by reference to the development potential.

Although in the *Dragon House* judgment, terms like ‘hope value’ and ‘development potential’ had been used interchangeably, the Government never sought to challenge the principle that value of the land resumed should be given for development potential. What the Government sought to exclude by reference to section 12(c) is only that part of the hope value or development potential which cannot be realized without a lease modification. Save the effect of section 12(c), owners of land or property in the urban area, as well as owners of building or house land in the New Territories, will upon resumption continue to be compensated for any development value which their property or land may possess.

The implication of section 12(aa)

Under section 12(aa) of the Lands Resumption Ordinance, in assessing compensation, the Lands Tribunal is expressly prohibited from taking into account the fact that the land lies within zonings like “Government, Institution and Community”, “Comprehensive Development Area”, country parks and so on. It appears that section 12(aa) does not prohibit the Lands Tribunal from taking into account the residential zoning, which somehow contradicts the *Yin Shuen* or *Dragon House* judgments.

As the Court of Appeal in *View Point* noted Section 12(aa) was enacted by way of amendment in 1973. The mischief at which it was directed appears from the observations made by Mr Robson when he moved the second reading of the bill:

"... the purpose of this bill is to ensure that land owners whose land is resumed under the Crown Lands Resumption Ordinance are awarded appropriate compensation in cases where the land in question is subject to restrictions imposed by an Outline Zoning Plan."

In his speech in support of the motion, Mr Bray observed:

"... when the bill was published it gave rise to considerable anxiety in the country as it was thought that the bill emphasized that compensation for agricultural land must be assessed without regard to the development potential of that land. The bill has no bearing on this vexed problem..."

At the resumption of debate on second reading, Mr Szeto remarked that:

"... [W]hile the chief aim of these Outline Zoning Plans is the improvement of the areas by increasing their present deficient provision in open space and sites for Government and community facilities, it has inevitably, as the law stands, given rise to anxiety and hardship of property owners whose land is affected. ...

... No one likes to see his land changed out of his control from residential or commercial use to that for public open space, since the latter has no commercial value. A grievance exists as the law stands when the Compensation Board can have regard only to the future permitted use of the land. In view of the large number of resumptions that are to be effected in the immediate future, it is important, Sir, to remove this sense of grievance, and the bill therefore has my support."

As Judge Cruden explained in his book *Land Compensation and Valuation Law in Hong Kong, 2nd Ed.* at page 80, section 12(aa) prevents the Town Planning Ordinance from being used to rezone or otherwise blight land so as to reduce the compensation payable on a later resumption.

Although it might be inferred from the exclusion of section 4(1)(b) of the Town Planning Ordinance from section 12(aa) that it is permissible to take into account the fact that the lots lay within or are affected by any area, zone or district set apart for use for residential, commercial, industrial or other specified users, its relevance for compensation purposes would depend on the use (existing or potential) to which the land could be put. Where the potential use is non-residential, zoning has little relevance. It would not enhance the value of the land for non-residential use. In the view of the Court of Appeal, it is for this reason that section 12(aa) is of no assistance to the applicant's case. What falls to be excluded by section 12(c) cannot be re-introduced and taken into consideration via section 12(aa). In this regard, the Court of Appeal appeared to have set aside its original view expressed in *Director of Lands v. Yin Shuen Enterprises Ltd. and Nam Chun Investment Company Ltd.*, CACV 376 & 1636 of 2001.

Secretary for Transport v. Delight World Limited, FACV 19 of 2005

This application of section 12(aa) of the Lands Resumption Ordinance is more recently reviewed by the Court of Final Appeal in *Secretary for Transport v. Delight World Limited*, FACV 19 of 2005. In this case, a piece of agricultural land subject to the same covenant prohibiting building was zoned agricultural and was resumed. The Court of Final Appeal, after reviewing the purpose of the enactment of this provision, agreed that the purpose of section 12(aa) is to prevent resumption compensation from being reduced by zoning. This does not involve any clash between section 12(aa) and Section 12(c) of the Lands Resumption Ordinance.

Conclusion

Although in terms of law, the issue on Section 12(c) appears to have been settled, maybe time is ripe that its application or the purpose it serves is due for review. The Court of Appeal had in its original decision in *Director of Lands v. Yin Shuen Enterprises Ltd. and Nam Chun Investment Company Ltd.*, CACV 376 & 1636 of 2001 pointed out that the circumstances in Hong Kong 80 years ago when section 12(c) was introduced were clearly very different from those prevailing now. 80 years ago there was no town planning and no Town Planning Ordinance. There was, apparently, no recognised system of premiums payable for removal of restrictions in Crown leases. Indeed, the New Territories was undoubtedly a very different place from that which it is now. It was then clearly intensely rural.

The practical reality in the present cases is that although the lots of land were restricted to agricultural use under the terms of the original Crown lease, their future use as agricultural land was by no means assured. It appears that the land could have been used for open storage but that, eventually, it was more likely to be used for housing. In this context, attention should be drawn to the now formalized process for applying for exchange of land and for modification of lease conditions. By taking the value of comparable sites which were similarly restricted would better reflect the common law principles that the applicants are entitled to have the value of their land assessed on the basis which included recognition of the attributes which the land had. It would probably result in the most satisfactory way of assessing the various factors which need to be assessed where the land has unrealized potentialities.

CHAPTER FIVE

Economics of Compensations in Land Takings

It is prima facie unfair when there are two adjoining pieces of land of same conditions and characteristics, but one is sold in private market at market price, while the other is taken by government at the same time but at a lower price, as illustrated in the previous chapter. The government of Hong Kong contends that 'hope value' is not compensated in accordance with the Basic Law and the Land Resumption Ordinance:

- *Article 105 of the Basic Law of Hong Kong: "Compensation is only required to be paid for "the property concerned "i.e. for the land for the duration of the Government lease and subject to the user restrictions in the lease."*
- *S.12(c) of Lands Resumption Ordinance: "no compensation shall be given in respect of any expectancy or probability of the grant or renewal or continuance, by the Government or by any person, of any licence, permission, lease or permit whatsoever."*

Basically, land value is simply divided into existing land use value (V1) and potential land use value, which is interpreted as the 'hope value' (V2). Since almost all land in Hong Kong are leasehold and any changes of use or tenure requires land lease modification or re-grant, which incurs land premium payment in commensurate with the full hope value, thus it is argued that there is no point in compensating the 'hope value' in land takings, as put forward by the Government of Hong Kong in the court

cases reported in Chapter 4. However, it is over-simplistic to consider land value to be composed of just these two components of value. There are at least four other components of value intrinsically ingrained in land (as shown in Figure 4.1), viz.

1. Consumer surplus (attachment value) (V3)
2. Value of contiguity (V4)
3. Value of option to apply for change of land use (V5)
4. Value of option to apply for lease re-grant / renewal (V6)

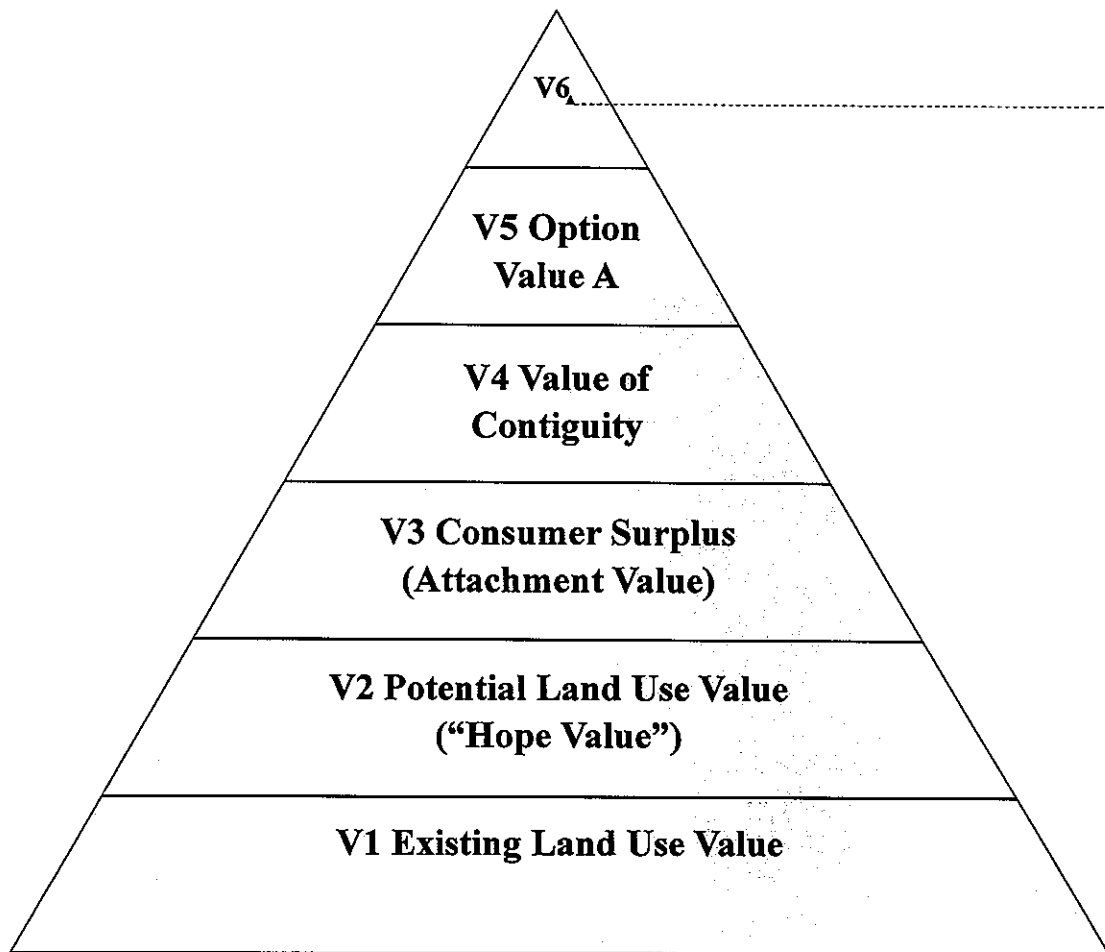


Figure 4.1 Components of Land Value

We contend that, even if the “hope value” is not compensated, the other four components shall be compensable, and there are evidence that they have been compensated both in public and private land acquisitions. Unfortunately, all the arguments and interpretations in the previous court cases concentrated on the first two components of land value only, without taking into account of the remaining three.

Values to be Compensated Other Than Existing and Potential Land Use

The importance of compensating property value cannot be over-emphasized as Coleman (1994) “believes that duties of compensation are essential to the establishment of a framework within which individuals can formulate meaningful projects and plans and rationally invest in their implementation.” and Gaus (1994) included right to [be] compensated as one of the rights of property rights.

Epstein (2003, p.318), one of the renowned economists on property rights, reviewed the US court cases on forced transfer of property and contended that compensation allowed for future use values (Laitos, 1998 §17.03[c]); because “the owner is entitled to receive what a willing buyer would pay in cash to a willing seller at the time of the taking.” (*United States v. 564.54 Acres of Land*, 441 U.S. 506 (1979)). Recognizing the uniqueness of the land administration system of Hong Kong, Epstein’s argument may not be directly applicable in Hong Kong context, yet there have been numerous studies and evidence on compensating consumer surplus (V3) and options values (V5, V6).

Consumer Surplus

For example, Evans (2004, p.90) posited that owner will usually NOT SELL unless some COMPENSATION is received for the loss of the CONSUMER SURPLUS.” This argument has been discussed at length since the classical economists, from Adam Smith ([1776] 1910) to Alfred Marshall (1890) to Karl Marx ([1894] 1962) - as what they called a good’s ‘use value’ and its ‘exchange value’. Then Harvey (1973) re-introduced the concept of consumer surplus into land price study. This consumer surplus has also been confirmed empirically by Dynarski (1986) who found attachment value (consumer surplus) in house owners in the US; and by GB Commission on the 3rd London Airport (1970) where they also found consumer surplus on compensation required. Other empirical evidence includes Imrie et al. (1997). Epstein (2004) further divided the consumer surplus in compensation into five elements, viz. subjective value, goodwill, consequential damages, collateral losses, and expectations. For example, it is a common practice in commercial property sales that goodwill value is included in the transaction price. These attachment values have nothing to do with the potential land use value (V2). In other words, the compensation of these attachment values shall not be banned by the Land Resumption Ordinance.

Whether these consumer surpluses shall be compensated or not in eminent domain in the US were not conclusive. A very early court case: *Monongahela Navigator Co. v. United States*, 148 U.S. 312 (1893) p.326, excluded this consumer surplus in the compensation by arguing that “... the compensation must be a full and perfect equivalent for the property taken. And this just compensation, ..., is for the property, and not to the owner.” Similarly, in *Kimball Laundry Co. v. United States* (1949, p.5),

the court held that "...the liability of all property to condemnation for the common good, loss to the owner of nontransferable values deriving from his unique need for property or idiosyncratic attachment to it, ..., is properly treated as part of the burden of common citizenship." However, another cases, *Olson v. United States*, 292 U.S. 246 (1934, p.255), supported consumer surplus argument as the judge held that the object of compensation is to put the owner of condemned property "in as good a position pecuniarily as if his property had not been taken." Furthermore, the seminal book on compensation, Blackstone (1765, Book 1, p.135) also posited that the objective for compensation is "giving him a full indemnification and equivalent of the injury thereby sustained." Furthermore, Epstein (2004, p.319) argued that The *Kimball Laundry* decision "involved the temporary condemnation of the owner's laundry facilities that resulted in the dissipation of his goodwill", which shall be compensated. These arguments are in line with the Hong Kong scenario that "the subject of compensation, is not the physical land itself but the claimant's estate and interest in the land" (*Lynch v. The Corporation of the City of Glasgow*). Unfortunately, the claimant's attachment value has not been considered in the previous court cases.

Value of Contiguity

Munch (1976) demonstrated that the use of compulsory powers would enable the completed development to be larger and be built more quickly. Imrie and Thomas (1997) investigated the acquisition of land in Cardiff and found that compulsory purchase expedited the implementation stage to just 2 years time. But this expedition is achieved at the expense of the original owners of the land. Why these profits are not shared with the original owners? There are numerous evidences of compensating this value of contiguity to owners worldwide, although under different names of account.

For example, owner occupiers in the UK are compensated with not only the market price of their house but also 10% more in compensation for moving, business property owners can receive compensation for disturbance as well. Similarly, owner occupiers in Hong Kong receive the market price of their house plus an ex-gratia allowance, i.e. the Home Purchase Allowance (HPA), when the housing properties are taken by the Urban Renewal Authority⁸. Other Resumption Authority in Hong Kong, such as the Railway Corporations do compensate for business disturbance and costs of moving. In accordance with the previous courts' judgements, it is concrete clear that this value of contiguity can be compensable and has nothing to do with section 12(c) of the Land Resumption Ordinance, Laws of Hong Kong as it does not involve any permission of lease modification.

Options Value to Apply for Land Use Change

It has to emphasize that the actual potential development value (hope value) is different from the value of the right to exercise the application of the potential change (i.e. option value). Unfortunately, all the previous discussions and court cases decisions have not taken this option value into account. Probably, the two values are mixed up as one single value. While the prosperity of the warrant markets nowadays vividly reflects that the value of the right to buy (call option) or to sell (put option) an asset is different from the value of the asset itself.

Goodchild and Munton (1985, p.111) opined that the value of a piece of land depended on the probability of obtaining planning permission / land lease

⁸ The amount of HPA payable to individual owners is the difference between the value of a notional replacement flat (based on a *seven year old* flat of a size similar to the resumed flat and in the same locality) and the open market value of the resumed flat.

modification. Thus, the rights to apply for planning permission and lease modification are valuable. It is a real option for an owner because it is a rights, but not obligation, to exercise the option to apply for the change in the future. The values of these options are not only theoretically justified by real options model, but they are also empirically tested in real life situations. For example, Evans (2004, p111) reported a real case of selling this option value to apply for planning permission for the University of Reading in the UK. This case illustrated clearly that such an option is valuable and different from the 'hope value'. In the late 1980s, an oil company paid the University £5,000 for an option to buy a piece of farmland with frontage onto a main road on which they planned to build a petrol filling station. The developer then applied for planning permission, and paid all the costs of doing so. Finally, planning permission was not obtained, but the University received the £5,000 and still owned the land. This case implies that the value of the option to apply for planning permission belongs to the land owner, even if the planning application is finally not permitted (i.e. the rights is not exercised). Such rights to apply for change of land use have been discussed in Gau (1994), Spector (1992) and Norman (1987).

Options Value to Apply for Renewal / Re-grant

Similarly, the owners shall also own the right to apply for renewal or regrant of land lease. It is different from the value of the renewed or regranted lease. For example, Wang (2005) found empirically options value of renewal clause in commercial real estate leases in Hong Kong. She estimated the value of the option-to-renew at market rent in private leases of office premises. The analogy is that the government sells an option to the lease holder at the time of lease grant for renewal or re-grant. It is unfair to forfeit this option value at the time of land takings. However, this idea was not

supported in a very old case in the US. *United States v. Petty Motors* (1946) held that “renewal right only counts as a mere expectation for which no compensation is required when the government condemns the landlord’s interest.” Yet, there have been no decisions on the ownership and compensability of this option value in Hong Kong.

Land Premium

The government’s argument that land premium payable for lease modification includes all capital gains due to the modification, thus including all value of contiguity and options value. This idea has been strongly criticized in the UK and in Hong Kong. It traced back to the failure of the Town and Country Planning Act, UK in 1947 when 100% betterment levy was imposed, which was a tax on a change in its capital value (equivalent to the premium of lease modification). The levy came into force in 1948, but was to freeze the land market. The levy was repealed when the Conservative Party won the election in 1951, and Evans (2004, pp.225-227) put forward a theory to explain why such levy would bring the market to a virtually standstill. The problem of 100% betterment levy was raised by the then Home Secretary, Herbert Morrison as reported in Cullingworth (1975, 212). In the writing to Lewis Silkin, the minister responsible for the Act, Herbert Morrison wrote:

“Whilst we leave the actual land in private ownership we take away the incentive which the owner has to develop or allow development by taking away the increased value which at present he gets as a result of development. Thus we are in danger of getting ... private ownership without the incentives which a system of private ownership needs to operate.”

HKIS (2003) also argued similarly on the premium of lease modification mechanism in Hong Kong. The logic is that if premium is a real 100% levy, there shall have no modification application, because there is no incentive to do so. The endless applications of lease modifications rejected the argument that land premium payable includes all capital gains including value of contiguity and options value.

Lastly, the argument of land premium payable covers all options value and value of contiguity is unfair as owners have no information about the land premium payable until modification application is made. In other words, there is no sufficient information for owners to make rational decisions of applying lease modifications or not. As Coleman (1994, p.125) believed that “by requiring compensation for takings, each potential taker (or forced transferer) is put in the position of determining whether he will benefit sufficiently by harming another to make it worth his while to do so. In order for someone rationally to decide, he will **need sufficient information about his benefit schedule** and the damage schedule of his victim.”

Conclusions in Economics Context

The rights to claim consumer surplus, value of contiguity and options value when land is resumed are supported with both theoretical and empirical evidence. The refusal to compensate all these losses would not only cause unfairness, but also result in market inefficiency. For example, Epstein (2004, p.320) warned that “the inequitable treatment leads to profound allocative distortions. The lower prices stipulated by the government **lead to an excessive level of takings**, which in turn increase the size of government relative to what it should be, and thereby alters for the worse the balance between public and private control.” It is concluded that “compensation should leave

the owner indifferent between the property once possessed and the compensation tendered thereafter for its use. Following Blackstone, the level of compensation should be beefed up to cover subjective value and consequential damages ...”

Previous chapters have discussed in details about the interpretations of the existing land use value (V1) and the potential development value (V2). However, the other four components of land value, viz. attachment value, value of contiguity, option value to change land use, and the option value to renew, are totally ignored in all the previous discussions and court cases. This complete categorization of land value components can help solve future arguments on land value compensation. It also helps delineate the exact exclusion of compensation vested in section 12(c) of the Land Resumption Ordinance.

CHAPTER SIX

Compensation principles in Australia

Overview of land tenure system in Australia

Australia has 6 States (New South Wales, Victoria, Queensland, West Australia, South Australia and Tasmania) and 2 Territories (Northern Territory and Australian Capital Territory). Australian Capital Territory is the only jurisdiction in the country that has an exclusive leasehold land tenure system. Land is generally disposed of by the government on 99-year leases. Subject to the payment of a fee, lessees will be granted a new lease towards the end of the lease term if the land is not required by either the Territory or Commonwealth for public purposes (ACT Planning and Land Authority, 2005). Under ss. 171 & 172 of Land (Planning and Environment) Act 1991 (ACT), if the term of a further lease (residential and leases other than residential or rural) is not longer than the term of the existing lease, the fee payable must not be more than the cost of granting the lease.

While freehold land tenure system prevails in other jurisdictions, the States and Territory governments may also dispose of surplus Crown land by long leases or perpetual leases. In New South Wales, perpetual lease holders have a right under the Crown Lands (Continued Tenures) Act 1989 to convert perpetual leases into freehold titles subject to the payment of a purchase price. Nevertheless leasehold land titles represent a small proportion of all land titles in Australia.

Overview of Australian compensation principles

In Australia, compensation for compulsory land acquisition is not based on common law. The compensation principles are written in the statutes and are continuously being fine-tuned by court rulings. Gobbo J commented in *Kozaris v Roads Corporation* [1991] 1 VR 237 at 239 that “compensation for compulsory land acquisition is a matter of statutory entitlement and does not rest on common law ..., case law has provided considerable scope for development of the law where the statute sometimes uses concepts and not precise rules in addressing the question of compensation.” In *Konowalow v Minister for Works* (1960) 8 LGRA 75 at 77, Virtue J ruled that “the right to claim compensation and the heads under which it can be claimed depend exclusively upon the terms of the relevant statutory provisions.”

Although it is generally accepted that dispossessed landowners are entitled to compensation, the term ‘compensation’ is not defined in any compensation law enacted by the Commonwealth or State/Territory governments. In the absence of a statutory definition for compensation, Australian courts have from time to time to study the purpose of compensation. For example, in *Nelungaloo Pty Ltd v Commonwealth* (1948) 75 CLR at 571, the High Court ruled that compensation “prima facie means recompense for loss, and when owner is to receive compensation for being deprived of real or personal property his pecuniary loss must be ascertained by determining the value to him of the property take from him. As the object is to find the money equivalent for the loss or, in other words, the pecuniary value to the owner contained in the asset, it cannot be less than the money value into which he might have converted his property had the law not deprived him of it”.

Australian courts will also look at court rulings from the UK and other common law countries or jurisdictions for the meaning of compensation if necessary. For example, the rulings in *Horn v Sunderland Corporation* [1941] 2 KB 26 are frequently referred to by Australian courts. In this case, Scott LJ held that a dispossessed person is entitled to compensation and to be put, “as far as money can do it, in the same position as if his land had not been taken from him. In other words, he gains the right to receive a money payment not less than the loss imposed on him in the public interest, but, on the other, no greater”.

Section 51(xxxi) of Australian Constitution provides that the Commonwealth may only acquire property on ‘just terms’ (Brown, 2004). However, the meaning of ‘just term’ is not defined in the Constitution or any other legislation.

In regard to the general principle of compensation, it is based on the principle of ‘**value to the owner**’: *Minister Administering the Heritage Act 1977 v Haddad* (1988) 67 LGRA 438 at 444 – 445, *Housing Commission of NSW v Falconer* [1981] 1 NSWLR 547 at 572, *Yarn Traders Pty Ltd v Melbourne and Metropolitan Board of Works* [1970] VR 427 at 431, etc.

This principle acknowledges that compensation is more than the market value of the land taken. In *Turner v Minister for Public Instruction* (1956) 95 CLR 245 at 264, Dixon CJ commented that “[c]ompensation should be the full monetary equivalent of the value to [the owner] of the land. All else is subsidiary to this end.” Beaumont J in *Leppington Pastoral Co Pty Ltd v Commonwealth* (1997) 94 LGERA 68 at 88 pointed out that “[i]n this country, the land acquisition statutes have not only retained the English concept of the market value of land, but also have gone further: our

legislation provides for other factors to be taken into account which an ordinary seller of land would not be able to obtain from an ordinary buyer; so that it is well understood here that the dispossessed owner may be entitled to a claim for 'disturbance' or a 'solatium' over and over the ordinary sale price of land."

The 'value to the owner' principle has been incorporated in the various compensation statutes in Australia. There are 9 compensation statutes in Australia and the relevant compensation principles are provided in:

1. Lands Acquisition Act 1989 (Commonwealth): ss. 55 -58;
2. Land Acquisition (Just Terms Compensation) Act 1991 (NSW): ss. 55 - 61;
3. Land Acquisition and Compensation Act 1986 (VIC): ss. 40 - 45;
4. Acquisition of Land Act 1976 (QLD): s. 20;
5. Lands Acquisition Act 1994 (ACT): ss. 45 -52.
6. Land Administration Act 1997 (WA): s. 241;
7. Land Acquisition Act 1969 (SA): s. 25;
8. Land Acquisition Act 1993 (TAS): ss. 27 - 33; and
9. Lands Acquisition Act 1978 (NT): Sch. 2.

In regard to which compensation statute is to be used for a particular land acquisition case, it depends on the background of the acquiring authority. If the authority is a Commonwealth government agency, then the Commonwealth compensation statute applies. If it is a State or Territory government agency, then the respective State or Territory compensation statute applies.

The heads of compensation under the principle of 'value to the owner' are known as

'matters' for consideration in these statutes. While the relevant 'matters' are described differently in the statutes, they generally include the following items:

1. Market value of the interest taken;
2. Special value due to ownership or use of the land taken;
3. Severance loss to retained land;
4. Disturbance loss or consequential loss;
5. Solatium; and
6. Disregard any increase or decrease of the property value due to the purpose of the acquisition.

Item 6 actually contains 2 'matters' for consideration. Any 'increase' of the property value due to the purpose of the acquisition means 'betterment' or 'value enhancement' due to the authority's scheme. If the acquired land enjoys betterment or value enhancement due to the authority's scheme, it has to be deducted from the compensation. In contrast, any 'decrease' of the property value due to the purpose of the acquisition is otherwise known as 'injurious affection' by the courts and text books. It is a head of compensation claim arising from a partial land acquisition.

Similar to compensation statutes in other common law countries or jurisdictions, Australian statutes allow compensation for market value of the land taken, severance and injurious affection value losses to any retained land and consequential losses. In addition, there is compensation for special value loss and solatium as well. These 2 heads of compensation may not be available in other countries and jurisdictions.

The special value of land is the additional financial advantage above market value.

Special value is described differently in the compensation statutes. It was explained by Callinan J in *Boland v Yates Property Corp Pty Ltd* (1999) 74 ALJR 209 at 269 as “the value to the owner over and above [the land’s] market value. It arises in circumstances in which there is a conjunction of some special factor relating to the land and a capacity on the part of the owner exclusively or perhaps almost exclusively to exploit it. ... There will in practice be few cases in which a property does have a special value for a particular owner. Obviously neither sentiment nor a long attachment to it will suffice. The special quality must be a quality that has an economic significance to the owner. A possible case would be one in which, for example, a blacksmith operates a forge in the vicinity of a racetrack on land zoned for residential purposes as a protected non-conforming use, the right to which might be lost on a transfer of ownership or an interruption of the protected use. Such a property will have a special value for its blacksmith owner, and perhaps another blacksmith who might be able to comply with the relevant requirements to enable him to continue the use but no one else.”

Solatum is not a compensation for sentiment or attachment to the land. It is a sum of money to make up for the disruption, nuisance and inconvenience suffered by the dispossessed owner who has to relocate due to the land acquisition. The Shorter Oxford Dictionary defines it as “a sum of money paid over and above the actual damages as solace for injured feelings”. In general, it is compensation to residential owners who have to relocate from their principal place of residence due to the land acquisition. The amount of solatium payment differs under the various compensation statutes. For example, under s. 61 of Lands Acquisition Act 1989 (Commonwealth), the amount is \$10,000 adjusted annually according to CPI. Under s. 60 of Land Acquisition (Just Terms Compensation) Act 1991 (NSW), the amount is a maximum

of \$15,000 or such higher amount notified by the Minister. In Victoria, s. 44(1) of Land Acquisition and Compensation Act 1986 provides that solatium payment could be up to 10% of the market value of the land taken.

In Australia, courts generally adopt a liberal approach to assess compensation. In *Commissioner of Succession Duties (SA) v Executor Trustee & Agency Co of SA Ltd* (1947) 74 CLR 358, it was held that compensation should be “resolved in favour of a more liberal estimate”. This principle was reaffirmed in a number of court cases including *McBarron v Roads & Traffic Authority NSW* (1995) 87 LGERA 238 at 244 – 245. In this case, Talbot J expressed that “it is appropriate to seek to do justice by adopting a generous approach in favour of the resumee that just compensation is paid so far as the Act allows. Therefore any discretion should be exercised in favour of the claimant where practicable in order to achieve a just result.”

The principle of ‘value to the owner’ is the foundation in Australian compensation law. Does compensation under this principle achieve a just result? Section 55(1) of Lands Acquisition Act 1989 (Commonwealth) and s. 45(1) of Lands Acquisition Act 1994 (ACT) have the same words and stipulate that:

“The amount of compensation to which a person is entitled under this Part in respect of the acquisition of an interest in land is such amount as, having regard to all relevant matters, will justly compensate the person for the acquisition.”

Section 3(1)(b) of Land Acquisition (Just Terms Compensation) Act 1991 (NSW) provides that the objective of the Act is:

“to ensure compensation on just terms for the owners of land that is acquired by an authority of the State when the land is not available for public sale”.

However, ‘just term’ is not defined in the relevant Acts. Presumably if the prescribed ‘matters’ under the relevant Acts have been considered in the course of assessing the compensation, a dispossessed landowner is deemed to have been given ‘just term’ compensation. The ‘value to the owner’ compensation principle together with the generous approach adopted by the courts form the mechanism to ensure ‘just’ compensation in Australia.

Compensation principles in Australian Capital Territory (ACT)

As mentioned above, ACT is the only jurisdiction in Australia that has an exclusive leasehold land tenure system. Compensation for compulsory land acquisition follows the principle of ‘value to the owner’ and is governed by the Lands Acquisition Act 1994 (ACT). Although ACT has a leasehold land tenure system, compensation is also based on the principle of ‘**value to the owner**’. It is not surprising to find that the contents of this Act are virtually the same as the Lands Acquisition Act 1989 (Commonwealth) for political and geographical reasons. The general compensation principles are provided in section 45 of the Act as follows:

45 Amount of compensation—general principles

- (1) The amount of compensation to which a person is entitled under this part in respect of the acquisition of an interest in land is such amount as, having

regard to all relevant matters, will justly compensate the person for the acquisition.

(2) In assessing the amount of compensation to which the person is entitled, regard shall be had to all relevant matters, including—

(a) except in a case to which paragraph (b) applies—

- (i) the market value of the interest on the day of the acquisition; and
- (ii) the value, on the day of the acquisition, of any financial advantage, additional to market value, to the person incidental to the person's ownership of the interest; and
- (iii) any reduction in the market value of any other interest in land held by the person that is caused by the severance by the acquisition of the acquired interest from the other interest; and
- (iv) where the acquisition has the effect of severing the acquired interest from another interest—any increase or decrease in the market value of the interest still held by the person resulting from the nature of, or the carrying out of, the purpose for which the acquired interest was acquired; and

(b) if—

- (i) the interest acquired from the person did not previously exist as such in relation to the land; and
- (ii) the person's interest in the land was diminished, but not extinguished, by the acquisition; and

the loss suffered by the person because of the diminution of the person's interest in the land; and

- (c) any loss, injury or damage suffered, or expense reasonably incurred, by the person that was, having regard to all relevant considerations, including any circumstances peculiar to the person, suffered or incurred by the person as a direct, natural and reasonable consequence of—
 - (i) the acquisition of the interest; or
 - (ii) the making or giving of the pre-acquisition declaration or certificate under section 21 in relation to the acquisition of the interest;other than any such loss, injury, damage or expense in respect of which compensation is payable under part 7; and
- (d) subject to section 50, if the interest is limited as to time or may be terminated by another person—the likelihood of the continuation or renewal of the interest and the likely terms and conditions on which any continuation or renewal would be granted; and
- (e) any legal or other professional costs reasonably incurred by the person in relation to the acquisition, including the costs of—
 - (i) obtaining advice in relation to the acquisition, the entitlement of the person to compensation or the amount of compensation; and
 - (ii) executing, producing or surrendering such documents, and making out and providing such abstracts and attested copies, as the chief executive or a person authorised under the *Government Solicitor Act 1989*, section 5 (4) requires.

In summary, under s. 45 of the Act, a dispossessed landowner is entitled to claim:

1. market value of the interest taken (s. 45(2)(a)(i))

2. special value (s.45(2)(a)(ii))
3. severance loss (s.45(2)(a)(iii))
4. injurious affection loss (s.45(2)(a)(iv))
5. consequential loss (s.45(c),(e))

Solatium is separately provided in s. 51 under which a person whose has to relocate because his principal place of residence has been compulsorily acquired is entitled to claim a payment of \$15,000 indexed at CPI.

It is interesting to note that there are few major court decisions in land acquisition compensation from ACT. It may be due to that major decisions had already been made by courts in the more populous States over the years.

Compensation principles relating to the potential or future values of acquired land

Australian compensation statutes require the payment of market value for the land taken. In accessing the market value of the acquired land, the full potential, present and future, of the land has to be considered. In a Queensland case *Daandine Pastoral Co Pty Ltd v The Crown* (1950) 11 The Valuer 266 at 273, it was held that “[t]he property is to be considered with all its advantages, present and future, in the hands of the owner, and compensation is to be assessed in such a way to give the property its greatest value”.

Sometimes, the compensation will depend on the grant, renewal or continuance of a

licence or permit etc. In Hong Kong, this issue is covered by s.12(c) of Lands Resumption Ordinance (Chapter 124). This section states that “no compensation shall be given in respect of any expectancy or probability of the grant or renewal or continuance, by the Government or by any person, of any licence, permission, lease or permit whatsoever: Provided that this paragraph shall not apply to any case in which the grant or renewal or continuance of any licence, permission, lease or permit could have been enforced as of right if the land in question had not been resumed.”

In Australia, the compensation statues have different descriptions in respect of this matter. A summary is provided in the following table:

Statute	Provisions
Lands Acquisition Act 1989 (Commonwealth)	<p data-bbox="651 327 1366 741">“In assessing the amount of compensation to which the person is entitled, regard shall be had to all relevant matters, including: ... (d) if the interest is limited as to time or may be terminated by another person—the likelihood of the continuation or renewal of the interest and the likely terms and conditions on which any continuation or renewal would be granted” (s. 55(2)(d))</p> <p data-bbox="651 842 1366 1178">“In determining the amount of compensation to which the person is entitled in respect of the acquisition of the interest: (b) it shall be assumed that the land was subject only to such limitations and restrictions as would have been likely if there had been no proposal to limit or restrict the use of the land to use for the purpose permitted by the planning instrument” (s. 59(2)(b))</p>
Land Acquisition (Just Terms Compensation) Act 1991 (NSW)	No specific provisions
Land Acquisition and Compensation Act 1986 (VIC)	<p data-bbox="651 1480 1366 1738">“If the claimant's interest in the acquired land was liable to expire or to be determined, the assessment of compensation payable under this Part in respect of that interest must take account of any reasonable prospect of renewal or continuation of the interest.” (s. 41(6))</p> <p data-bbox="651 1827 1366 1975">“regard may be had to the actual zoning of the land in which the acquired interest subsists and, where relevant, to the actual zoning boundary” (s. 43(1A)(c))</p>

Acquisition of Land Act 1976 (QLD)	No specific provisions
Lands Acquisition Act 1994 (ACT)	<p>“In assessing the amount of compensation to which the person is entitled, regard shall be had to all relevant matters, including— ... (d) subject to section 50, if the interest is limited as to time or may be terminated by another person—the likelihood of the continuation or renewal of the interest and the likely terms and conditions on which any continuation or renewal would be granted” (s. 45(2)(d))</p> <p>“it shall be assumed that the land was subject only to such limitations and restrictions as would have been likely if there had been no proposal to limit or restrict the use of the land to use for the purpose permitted by the planning instrument” (s. 49(2)(b))</p> <p>”In assessing compensation, there shall be disregarded— ... (e) in the case of an acquisition of land the subject of a rural lease that was granted for a term less than 21 years—the possibility of a further lease being granted in respect of the land under the <i>Land (Planning and Environment) Act 1991</i>” (s. 50(1)(e))</p>
Land Administration Act 1997 (WA)	No specific provisions
Land Acquisition Act 1969 (SA)	“The compensation payable under this Act in respect of the acquisition of land shall be determined according to

	<p>the following principles: ... (d) where the claimant's interest in the subject land was liable to expire or be determined, any reasonable prospect of renewal or continuation of the interest must be taken into account" (s. 25(1)(d))</p>
<p>Land Acquisition Act 1993 (TAS)</p>	<p>"it is to be assumed that the land was, on that day, zoned or reserved in such manner as would have been likely if there had been no proposal or requirement for public use." (s. 29(1)(b))</p> <p>"Each of the following matters is to be disregarded in the determination of compensation in respect of subject land: ... (d) any expectation by a claimant who was a lessee of the subject land that the claimant's lease would be renewed, other than an expectation which is based on an option of renewal in the lease contract" (s. 33(1)(d))</p>
<p>Lands Acquisition Act 1978 (NT)</p>	<p>"If, at the date of acquisition, the interest of the claimant in the land was –</p> <p style="padding-left: 40px;">(a) due to expire; or</p> <p style="padding-left: 40px;">(b) liable to be determined,</p> <p>the Tribunal shall take into account any reasonable prospect of renewal or continuation of the interest, and the likely terms and conditions of that renewal." (Sch. 2, rule 6)</p>

Apart from statutes in NSW, Queensland and Western Australia, all other statutes have provisions in connection with the grant, renewal or continuance of the interest of the land acquired. In jurisdictions where there are no prescribed rules, the courts resort to

rely on the general principle of ‘value to the owner’ to determine the appropriate compensation.

The tabled statutory rules cover 2 main areas– lease term and zoning in respect of the acquired land. The grant, renewal or continuance of lease term, and permission to put land to the next best use will greatly affect the potential or adaptability of the land and hence the amount of compensation. It is thus necessary to examine and estimate the probability of getting the necessary permissions.

In Hong Kong, courts are required by s. 12(c) of the Lands Resumption Ordinance to disregard “any expectancy or probability of the grant or renewal or continuance, by the Government or by any person, of any license, permission, lease or permit whatsoever”. In Australia, the situation is different. The provisions under several compensation statutes, i.e. s. 55(2)(d) of Lands Acquisition Act 1989 (Commonwealth); s. 43(1A) of Land Acquisition and Compensation Act 1986 (VIC); s. 25(1)(d) of Land Acquisition Act 1969 (SA); and Sch. 2, rule 6 of Lands Acquisition Act 1978 (NT), mandate the courts to consider the likelihood of the continuation or renewal of the acquired interest and the likely terms and conditions on which any continuation or renewal would be granted.

In ACT where there is a leasehold land tenure system, the position is not much different. Section 45(2)(d) of Land Acquisition Act 1994 (ACT) requires compensation to be assessed with regard to “the likelihood of the continuation or renewal of the interest and the likely terms and conditions on which any continuation or renewal would be granted”. However, there is one exception to this rule. Where the acquired land is subject to a rural lease that was granted for a term less than 21

years, s. 50(1)(e) of the Act requires compensation to be assessed with no regard to “the possibility of a further lease being granted in respect of the land”. A probable reason for this provision is that land in ACT is generally granted for a lease term of 99 years. Land subject to a rural lease for a term less than 21 years is land that will be required for a public use in the foreseeable future. Hence the lease term granted is less than 21 years and there is no intention for the lease term to be renewed or extended.

In the absence of statutory requirement for considering the expectancy or probability of the grant or renewal or continuance the interest, the courts will assume they have the authority to consider the likelihood of the continuation or renewal of the interest unless it is explicitly prohibited by law.

In *Robert Reid & Co v Minister for Public Works* (1902) 2 SR (NSW) 405, it was held that the court was entitled to consider the expectancy of leases being renewed. This decision was refined in *The Minister v New South Wales Aerated Water and Confectionery Co Ltd* (1916) 22 CLR 56 that the value of the claimant’s unexpired lease term could not be increased by the expectation that the lease term would be extended unless it could be established that there was a right to an extension.

In considering the expectancy of continuation or renewal of a lease, the courts have to consider all relevant facts and evidence before them. It is necessary to identify the levels of probability. In *Beard v Director of Housing (Tas)* [1961] Tas SR 141 at 149 Burbury CJ used the metaphor ‘there is a difference between an anticipated and a realized potential, between the unhatched egg and the chicken’ to illustrate the main points.

In general, lessees under fixed term tenancy are required to prove the right to extend or renew the lease. However, lessees under periodic tenancy or holding of indefinite duration have been held to sustain claims for compensation (Brown, 2004). In *Unimin Pty Ltd v Commonwealth* (1977) 18 ACTR 1, the claimant had partly written and partly oral agreements with the landowner to extract sand, topsoil and granite from the land prior to the compulsory land acquisition. It was agreed by the parties that the agreements could be terminated at any time by giving one month written notice to the other. The extraction activities carried on for almost 3 years before the land was acquired. In allowing the compensation claim, Connor J at 19 – 20 ruled that “[i]t is highly probable that the plaintiffs would have been permitted to carry on their operation ... “and it was appropriate to value the claimant’s rights on the basis that they would have subsisted during the commercial life of the deposits but to make some deduction for the risk that they have been terminated sooner.”

In contrary to the above, the statute may restrict the courts from having such consideration. As mentioned earlier, under 50(1)(e) of Land Acquisition Act 1994 (ACT) requires that no regard shall be had for “the subject of a rural lease that was granted for a term less than 21 years—the possibility of a further lease being granted in respect of the land”. Another restrictive provision can be found in s. 33(1)(d) of Land Acquisition Act 1993 (TAS). Under this provision, courts are required to disregard “any expectation by a claimant who was a lessee of the subject land that the claimant's lease would be renewed, other than an expectation which is based on an option of renewal in the lease contract”. These two provisions are the most restrictive written rules in Australia that come close to the one in Hong Kong. It is apparent that there is no consensus on this issue in Australia.

In Hong Kong, subject to the zoning provision, the land use clause in a crown/government lease may be changed by way of a lease modification. There is an implication on compensation when land with potential for lease modification is acquired. In Australia, lease modification has never been a big issue as the majority of land is freehold and land use is mainly governed by zoning. There is no known reported court case between grantees and the government on lease modification in Australia. This may be due to that there are few lease modification disputes, and such disputes, if arise, are privately settled out of court.

In regard to zoning considerations, only the Commonwealth, Victoria, ACT, and Tasmania statutes have relevant provision. In general, these statutes require that in the course of assessing compensation, the land acquired shall be deemed to be subject to its existing zoning as if there had been no proposal or requirement for public use. In jurisdictions where there are no specific statutory provisions, courts may follow precedents. In *Housing Commission (NSW) v San Sebastian Pty Ltd* (1978) 140 CLR 196, it was held that if the zoning or rezoning of the required land was a step prior to acquisition, such zoning or rezoning could be ignored in compensation assessment. In other words, the existing zoning of the land is to be used to ascertain the land value.

Regarding zoning restrictions, it was held in *Pringle v The Minister* (1967) 14 LGRA 280 at 283 that land subject to zoning restrictions must not be valued on the basis that the compulsory land acquisition has nullified the restrictions. In general, land is to be valued with all its restrictions. Regarding the probability of getting planning permission to put the land to other more profitable use, Australian compensation statutes do not restrict the courts from taking this matter into consideration. It was held in *Royal Sydney Golf Club v Federal Commissioner of Taxation* (1957) 97 CLR

379 that the prospect of a relaxation of the restrictions under a planning scheme may also be properly taken into consideration.

Under the liberal approach, courts will consider the remote probability that the restrictions on land use may be relaxed or removed. In *Nardone v SA Land Commission* (1978) 20 SASR 168, it was held that in cases where the likelihood of zoning restrictions being relaxed or removed is slender, it is appropriate to value the land in the first instance with all its restrictions and to make some allowance, however slight, in favour of the landowner for the remote possibility that they will be eased removed. In *Liverpool City Council v Commonwealth of Australia* (1993) 81 LGERA 405, 32 hectares of public roads owned by the Liverpool City Council were compulsorily acquired by the Commonwealth in connection with an airport proposal. Wilcox J ruled that there was a remote probability that some of the roads could be closed and rezoned for residential purpose in the distant future if there was no compulsory acquisition and awarded a compensation based on a 'best guess' that 10% of the roads would be so converted.

Conclusions

Compensation in Australia is based on the principle of 'value to the owner' which comprises the following 'matters' or heads of claim:

1. Market value of the interest taken;
2. Special value due to ownership or use of the land taken;
3. Severance loss to retained land;
4. Disturbance loss or consequential loss;

5. Solatium; and

6. Disregard any increase or decrease of the property value due the purpose of the acquisition.

Presumably if compensation is assessed with these 6 matters in mind, it will satisfy the 'value to the owner' principle and the 'just terms' compensation requirement in the Australian Constitution.

Section 50(1)(e) of Land Acquisition Act 1994 (ACT) and s.33(1)(d) of Land Acquisition Act 1993 (TAS) are the only provisions that are similar to s. 12(c) of Lands Resumption Ordinance (Chapter 124) in Hong Kong. The Commonwealth and other States and Territory statutes either explicitly or implicitly allow courts to consider the likelihood that the claimants may get the necessary grant, renew or continuance of the relevant permits or lease term. Generally Australian courts adopt a generous approach in favour of the claimant to ensure a just result.

Australia and Hong Kong have similar source of compensation laws. In regard to the issue of the likelihood of the continuation or renewal of a terminable interest in land, s.12(c) of the Lands Resumption Ordinance is highly restrictive. The provision is in favour of the government (acquiring authority) and the dispossessed owners are put in an inferior position. In contrast, the majority of Australian compensation laws explicitly require the courts to consider the likelihood of the continuation or renewal of the interest. What is more, courts generally adopt a generous approach in favour of the claimant to ensure a just result.

Hong Kong is a well developed city which is ranked high in the world. However, the

provision of s. 12(c) of the Lands Resumption Ordinance has left a lot to be desired. While compensation for land acquisition should not be excessive, it should be assessed in a compassionate manner in favour of the dispossessed owners. Harmony is important to any society; even China is targeting at achieving this goal. Unfair land acquisition compensation has already led to disputes that are causing social disruptions in China. Hong Kong is in a good position to take the lead in making good its compensation law and set a good example for China. If the Hong Kong SAR government is prepared to make changes to the compensation law, the Australian statute laws that mandate courts to consider the likelihood of the continuation or renewal of the interest acquired and the generous approach adopted by Australian courts can be a valuable experience to borrow.

CHAPTER SEVEN

Conclusions and Policy Implications

The market value of a piece of land is determined by many factors. In hypothetical term, two pieces of agricultural land, similar in all material aspects, would have different market values if their zonings are different. Thus, the land that was zoned 'residential' would fetch a higher price in the market than one that was zoned 'agricultural'. However, under s12(c) of the Lands Resumption Ordinance (Cap 124), the court is not allowed to use comparables of agricultural land with residential zoning, even though their comparables are more similar. This is because under Section 12(c) of the Lands Resumption Ordinance has barred this possibility and provides that:

"no compensation shall be given in respect of any expectancy or probability of the grant or renewal or continuance, by the Government or by any person, of any license, permission, lease or permit whatsoever:

Provided that this paragraph shall not apply to any case in which the grant or renewal or continuance of any license, permission, lease or permit could have been enforced as of right if the land in question had not been resumed..."

The rationale of this contention is that under the agricultural land lease, erection of buildings is not allowed and the development of the land requires the Government for a lease modification with a premium. The government is of the view that the higher prices transacted in the market for agricultural land zoned 'residential' contained or

reflected an additional value over and above their value limited for agricultural (or non-building) use, based on the hope or expectation of obtaining a modification of the terms of the lease. This 'hope value' is caught by s12(c) and was excluded.

The general conclusion reached by this study is that, it is time to review the function of s.12(c) as it has not been able to adequately cope with social and economic changes and development under which the concept of "hope value" has embodied changing substances. The above conclusion is underpinned by the following important observations.

First, any discussion on the function or value of s12(c) in regulating compensation assessment would be meaningless if it is not to be carried out in conjunction with the factual context in which it was enacted. The purpose of the introduction of s12(c) was to make it clear that no compensation should be awarded for any value in respect of mere expectations or probabilities in resumptions under the Crown Land Resumption Ordinance. At that time, many purchasers, not intending or being able to develop the land themselves, were preparing to pay speculative prices for agricultural land in the expectation that the government would resume the land and developed it for public purposes. The operation of these speculators had created fictitious market transaction prices so as to achieve higher compensation from the government.

This was allowed to happen due to the historical background that sale and disposal of land in Hong Kong was ordered by the Governor under the authority of Letters Patent from the Crown, and the conditions which might be imposed on the grant of land or of a change of use were not limited in any way by statute. Lacking town planning legislation before 1939, the Government exercised control over land development

entirely through its rights as ground landlord. Land was almost universally demised either as agricultural land or building land, and different rents were charged accordingly. Under such circumstances, land owners speculated that their agricultural land would be resumed by the Government, especially when the Government had indicated the planning intention for new town development in the New Territories (NT). The substance of so-called "hope value" was thus underlined by purely speculative elements in connection with resumption.

The speculative nature of "hope value" was further justified by the factual contexts at that time, under which it was not the normal practice of the Government to charge a premium for the modification of the terms of a lease even it had the legal right to do so. Given this, it was not unreasonable that the hope of obtaining lease renewal or lease modification permission was merely a hope. Against such backgrounds, the importance of s12(c) should be recognized as it played a significant role in preventing that a very much increased price for the land, which was solely based on the mere speculation of resumption or use conversion that the Government had absolute discretion to refuse, was to be paid at taxpayers' expenses.

Second, the factual background for land control policies in Hong Kong has changed substantially after 1922. Planning legislations come into existence in 1939. Nowadays, urban development has been increasingly left to private developers rather than undertaken by the government after resumption. It is the Government policy, to permit modify old lease conditions which severely restrict the development permitted on a lot, in order to allow redevelopment complying with the applicable town planning requirements. Since the 1950's, granting modification of terms of a land lease has been subject to full premiums reflecting the difference between the value of

the land under the restricted use and value of the land after modification. In other words, the amount of premium is the enhancement in current land value as at the date of assessment after the government modifies the lease conditions (Wong, 1998)⁹.

	2003 (\$million)	2004 (\$million)	2005 (\$million)	2006 (\$million)
Modification of existing leases, exchanges and extensions	4,424 (38.66%)	2,860 (52.95%)	10,280 (32.10%)	14,074 (47.77%)
Sales by public auction and tender	3,732 (32.62%)	878 (16.26%)	20,714 (64.67%)	10,666 (36.20%)
Private treaty grants	3,058 (26.72%)	1,432 (26.51%)	809 (2.53%)	4,460 (15.14%)
Fees received in respect of short-term waivers	228 (2%)	231 (4.28%)	226 (0.71%)	265 (0.90%)
Total Land Premia	11,442 (100%)	5,401 (100%)	32,029 (100%)	29,465 (100%)

Source: Accrual-based consolidated financial statements of the Government from the year of 2003 to 2006

⁹ Wong, K.C. (1998), "Statutory valuation", in Poon, N.T., Chan, H.W. (Eds), *Real Estate Development in Hong Kong*, Pace Publishing Limited, Hong Kong, .

	2003 (\$million)	2004 (\$million)	2005 (\$million)	2006 (\$million)
Total Government Revenue	209,097 (100%)	275,469 (100%)	271,838 (100%)	324,353 (100%)
Total Land Premia	11,442 (5.47%)	5,401 (1.96%)	32,029 (11.78%)	29,465 (9.08%)
Modification of existing leases, exchanges and extensions	4,424 (2.12%)	2,860 (1.00%)	10,280 (3.78%)	14,074 (4.34%)

Source: Accrual-based consolidated financial statements of the Government from the year of 2003 to 2006

It is understandable that s12 (c) is to disregard that part of the inflated price which is attributable to speculating on the Government removing the restrictions to build. However, the ultimate question is whether the price is inflated. The introduction of statutory Outline Zoning Plans and its extension in recent decades to cover almost all land of Hong Kong further reduced the uncertainties to land development. Under such circumstances, land purchasers no longer speculate on the likelihood of resumption. Instead, what they speculate on is the real development value of the land in the future and a modification premium which may not reflect the value of the modification. According to the statistical figures and the normal practice of the Government, the lease modification and exchange have shared a significant portion of the Government revenues. Moreover, it is the existing land policies that lease modification will be in line with town planning intention as far as possible. Thus, the market transaction prices have already reflected the situation and little will be contributed to the inflated price that speculates on the removal of the restrictions to build.

Third, the adoption of ex-gratia zonal compensation system (EZCS) for land resumption in the NT has indeed recognized some elements of the development potential of each zone irrespective of the land lease restrictions. On reflection, this indicates that there are some inconsistencies in recognizing the development potential of different sites and inequitable treatment to different land owners. As stated in the Report of the Working Group on New Territories Urban Land Acquisition that "... the system must provide for the owner of private lands to enjoy a reasonable share of the development profits of the new areas for which they were required to surrender their lands..."

Finally, from the viewpoints of economics, the rights to claim consumer surplus, value of contiguity and options value when land is resumed are supported with both theoretical and empirical evidence. Given that the value of a piece of land depended on the probability of obtaining planning permission / land lease modification Goodchild and Munton (1985, p.111), the rights to apply for planning permission and lease modification to make change in the future is a real option but not obligation. Such rights should be compensated as one of the property rights. The refusal to compensate all these rights would not only cause unfairness, but also result in market inefficiency. Therefore, it is evident from the experience of some Commonwealth countries such as Australian that courts adopt a generous approach based on the principle of 'value to the owner' in favour of the claimant to ensure a just assessment result. The Commonwealth and other States and Territory statutes either explicitly or implicitly allow courts to consider the likelihood that the claimants may get the necessary grant, renew or continuance of the relevant permits or lease teams.

For Hong Kong's sustainable urban development, a fair compensation system is essential to the establishment of a framework in which private developers can formulate meaningful projects and plans and rationally invest in their implementation. Actually, the presence of s.12(c) will hinder the incentives of development by the private developers and it is not the original intention of s.12(c) to impose inequitable treatment of the hope of land owner for real land development on their land. As Epstein (2004) suggests, the lower prices stipulated by the government lead to an excessive level of takings, which in turn alters for the worse the balance between

public and private control.

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