

Review of the Rationale of Government Land Premium Assessment Procedures and Policy

Executive Summary

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by

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1) General Review of the Land Premium Mechanism in Hong Kong

Introduction of the study

This study is to examine the ways our government can recruit the **maximize benefits** from the land economy via a more innovative use of the current land premium assessment system when lease modifications arise.

Being the sole land owner in Hong Kong, the government is more than a public authority. She is also a land supplier in the commercial sense.

To be as flexible as a commercial landlord, the public authority will not only stimulate market interests in urban land development and re-development, it will also enhance other socio-economic benefits. In the following, we will put forward our rationale for such argument.

General Policy for Lease Modification

Modifications of Government Lease conditions are normally permissible subject to the submission of a request or an application to the Lands Department, and payment of land premium assessed in accordance with some “prescribed method” as required by the Lands Department.

General Policy for Premium Assessment

As a general principle, assessment of modification premia is that the lessee **must pay for any enhancement in the value** of the land derived from the modification of Government Lease.

Sometimes empirical premium is charged on a standard figure reviewed periodically by Valuation Section of the Lands Department.

Basis of Premium Assessment

The general governing policy relating to the assessment of modification premium is that it shall be equal to the difference between the value of the land under the conditions before modification and its value after the conditions are modified.

The general Government policy is that for modifications and exchanges, the general principle is current value at the date of assessment, namely it is a moving "target" if the Government (or sometimes on the request of the Government Lessee) keeps on reviewing the valuation.

Particular Premium Concession Policy

We have found that from time to time, the Government in fact, like many private landlords, has on many different occasions offered concession to many different people. The following are some examples:

1. Half Premium Policy before 1st July 1973
2. Private Treaty Grant Policy

2) **Main Issues for Discussion**

a. “Before and After” value basis for assessment

The basic notion in this “Before and After” assessment principle is that the owner of the land is required to pay for any enhancement/betterment in land value arising from lease modifications and change of use applications allowed by the authority.

The method of valuation will normally be a direct comparison of the “before value” and “after value” of the land.

The land premium amount can be viewed not as an amount the developer owes the public, but as an amount the developer helps creating in the process of redevelopment. This becomes an incentive for developers to participate in the lease modification and redevelopment process in the first place.

The core problem lies with the definition of “before value” in practical terms. The “before value” is not necessarily the same as existing use value as the latter may sometime exceed the former due to various reasons.

Under normal market conditions, the “before value” in practical terms as far as the applicant is concerned will exceed the sum of the theoretical existing use values of all property units on the site. The main reason for this discrepancy is the holding up by the owners of these strata-titled property units, especially the last few ones when the intention of redevelopment is almost public information.

b. Market impact of the existing mechanism

According to various economic and social studies, the current land premium assessment mechanism does pose as a burden on urban land development (and redevelopment) process, among other cost items, that development costs are increased unnecessarily.

We find that , partly due to this increasing costs on redevelopment, there was a decreasing trend in the number of successful lease modification / extension/exchange cases in the recent years.

c. International experiences

The American System

In the US, application for rezoning is not uncommon and the procedure is relatively straightforward. Applicants normally apply through a specialist

lawyer who would accompany the applicant through various open hearings. As far as the public authority is concerned, there is only a certain administrative fee (normally at standard rate) payable.

Similar to the situation in Hong Kong where the modification will result in enhancement which cannot be assessed by normal valuation methods, empirical premium plus normal administrative fee will be charged. Apart from that, there is no compensation payment to the government similar to the land premium situation in Hong Kong, or to a third party.

The Australian system , in Canberra

In the ACT (Australian Capital Territory, ie. Canberra) leasehold system, a developer/owner/land user must pay a 'Change of Use Charge' to the ACT Government when trying to vary a provision in the Crown Lease and that change increases the value of the lease.

The Australian practice in assessing the land premium payable, however, is set at the 75% level of the 'added value' (not taking the lease's potential for higher use into account in the 'before value').

If the lease belongs to the Commissioner for Housing, there is a further 25% discount so that developers only pay 50% of the premium amount.

It is only when lease is a concessional lease (granted for less than market value) or for the purposes of the Regulations is considered to be a recently commenced lease, that a 100% premium is payable.

Recently there was a proposal to vary the amount for all payments of CUC to 100%. This proposal was defeated in Assembly.

3) The Way Forward

a. Maximize government revenues by stimulating the real estate economy by market forces

With a revived and growing interest in the land market arising from the incentive mechanism proposed above, economic activities in the real estate and construction sectors will be intensified leading, via multiplier effects, to more positive economic consequences.

In the simplest analogy, it is not impossible to expect an increase in future property values leading to increase in the estimation of the “after value” in the land premium assessment process. This increase in the premium amount will offset the discount given under the proposed concessionary premium mechanism to a certain extent.

A win-win situation is not therefore unreasonable.

b Create a positive incentive scheme from the land premium mechanism and stimulate renewal projects by the private sector

Being the sole landlord in an active but compact market economy, the government must perceive the whole system with a market perspective.

The whole land conversion process is a partnership with the government supplying land and the private sector providing the investment to build and market the products.

This “market view” from the public sector is no different from any private landlord, for example in the case domestic property, who would not discourage his tenant to maintain or even upgrade the property by increasing the rent to reflect the improvements done by the tenant.

We propose a number of options for the government to further examine which will build this “market factor” into the mechanism to various degrees :

- i) “Before value” allowing for actual costs (or considering the actual existing use value of the subject property)
- ii) Profit sharing option
- iii) Premium incentive concession

c. Streamlining the Administrative Procedure for Transparency

Purposes

We need a need to improve the transparency of the system. A more liberal approach of opening up of the process of premium assessment would be to allow any premium figure decided by the committee to be subject to an independent third party appeal panel. This independent appeal panel may comprise with certain number of surveying professionals practicing in the private sector and public sector (who has no relation with the Lands Department).

4) Conclusion

We need to reiterate here again that this report is not arguing for a financial concession on what the government is already entitled to gain as public revenue.

The report, as we stated in the beginning, argues that a market-oriented land management policy will help the public sector to achieve more land income by stimulating more interest in land redevelopment arising from a more reasonable set of land premium assessment standards.

For such allowance to be made in a reasonable way, we suggest a simple fixed discount on the premium amount assessed under the current system. This prevents an overhaul of the administrative system in the Lands Department, and hence saves time and money. This is a simple and straight forward

proposal that leaves little room to personal and subjective discretion, thus provides maximum transparency.

We do not regard allowances to be made to all cases of lease modifications as necessary. To justify the value of “public interest”, an action timetable providing the inner area redevelopment first priority of financial incentives, then applied to other categories of lease modification projects, seems inevitable.

We believe that this is an issue worth pursuing by the public authority given the current state of the real estate sector and the overall economy.

Given that the government is not selling land by auction anymore, small to medium developers may find it hard to survive without a viable market environment for them to continue with their existing activities.

The multiplier effect arising from a re-activated urban redevelopment market can be assessed by examining the potential gains by various sectors directly and indirectly related to the construction industry, based on data government has already possessed. We therefore it is not an impossible task for the government in the political and social context.