

# Urban Redevelopment – Compulsory Purchase in Hong Kong

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**Key Words:** Redevelopment of urban area, Compulsory purchase; statutory valuation; existing use value; apportionment of property value;

## OVERVIEW

The problem of urban decay and redevelopment is one of the hot topics which prompt much discussion in the public over the last decades. Good maintenance planning and proper upkeep of the building stock would be a way to arrest building deterioration in the territories. For buildings which are determined to be physical obsolescence, demolition for redevelopment in generating new urban fabric may be a good way for tackling the problem. The enactment of the Land (Compulsory Sale for Redevelopment) Ordinance (hereafter referred to as “LCSRO”) (Cap. 545) in Hong Kong played a key role in facilitating private sector’s redevelopment efforts.

## 1. INTRODUCTION

As part of the Government’s urban renewal strategy promulgated in the 1996 policy statement “Urban Renewal in Hong Kong”, the Hong Kong Government has enacted the Ordinance to facilitate owners of buildings in multiple ownership<sup>1</sup> to redevelop their lots. Under the Ordinance, persons who have acquired a specified majority of the undivided shares in a lot (not less than 80%) may make an application to the Lands Tribunal for an order for the sale of all of the undivided shares in the lot for the purpose of redevelopment. The Lands Tribunal will make such an order if it is satisfied that redevelopment is justified and that the majority owner making the proposal has taken reasonable steps to acquire all the shares of the lot. In determining any application, the Lands Tribunal shall first hear and determine any dispute on the assessed value of any property under the application. If the Tribunal agrees to make an order, it will approve the reserve price for the auction of the lot. This is to ensure transparency and protection of the minority owners. The reserve price will take into account the redevelopment value of the lot. Any person, including the minority owners, is free to bid at the auction of the lot.

This paper aims to explain the operation mechanism of the LCSRO in Hong Kong and the valuations for the compulsory purchase.

## 2. BACKGROUND

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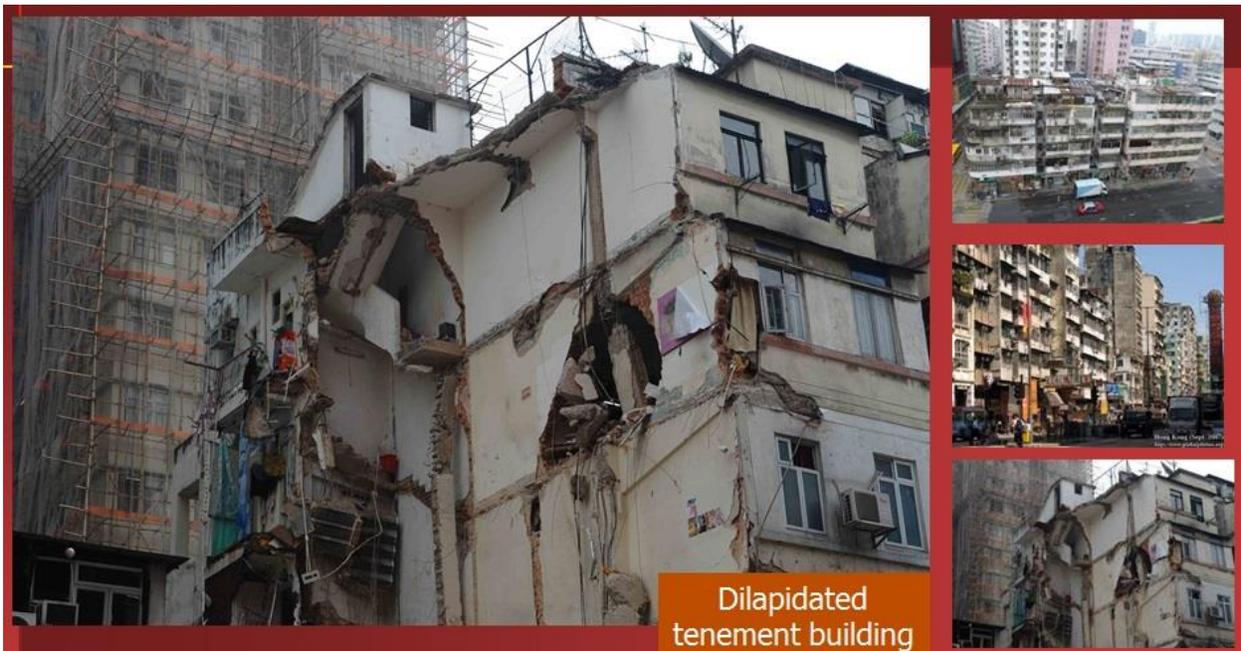
<sup>1</sup> In Hong Kong, owners of individual flat or apartment in a building hold certain amount of undivided share of the lot of land where the building is situated. This may be somewhat similar to strata-title ownership in other countries while the difference is that all land in Hong Kong is all held under leasehold.

The problem of urban decay and redevelopment is always one of the hot topics which prompt much discussion in the public over the last decades. Good maintenance planning and proper upkeep of the building stock would be a way to arrest building deterioration in old urban center. For buildings which are determined to be physical obsolescence, demolition for redevelopment in generating new urban fabric may be a good way for tackling the problem. The enactment of the Land (Compulsory Sale for Redevelopment) Ordinance (hereafter referred to as “LCSRO”) (Cap. 545) in Hong Kong played a key role in facilitating private sector’s redevelopment efforts.





Post war  
tenement building



Dilapidated  
tenement building

Since the LCSRO came into operation, the Lands Tribunal has received a large number of applications for compulsory sale of properties with a view for redevelopment. The Lands Tribunal requires applications to adduce sufficient evidence to satisfy that redevelopment is

justified due to the age or state of repair of the existing development on the lots or otherwise the Lands Tribunal decided not to make a compulsory sale order.

Since 2010, the application threshold for compulsory sale is lowered from 90% to 80% for the following three classes of lot :-

1. a lot with units each of which accounts for more than 10% of the undivided shares in the lot;
2. a lot with each of the buildings erected thereon aged 50 years or more before the date of the application; and
3. a lot that is not located within an industrial zone and each of the buildings erected thereon is an industrial building aged 30 years or more before the date of the application.

The lowered compulsory sale rule will facilitate redevelopment of private dilapidated buildings by preventing a minority owner from seeking a wholly unreasonable price for the interest in question.

Under the LCSRO, an application by a majority owner to the Lands Tribunal for compulsory sale of land shall be accompanied by a valuation report prepared not earlier than 3 months before the date on which the application is made. The report shall set out the assessed market value of each property on the subject lot, and the assessment shall meet the relevant requirements specified in the LSCRO. The valuation report will form the basis for pro rata apportionment of future sale proceeds to each majority owner and each minority owner in accordance with the existing use values of their respective properties as assessed in the report.

If the Lands Tribunal decides to grant a compulsory sale order after hearing the case, it will approve a reserve price which has "taken into account the redevelopment potential of the lot", and appoint a trustee to sell the lot by public auction (unless all owners of the lot have agreed to seek the Lands Tribunal's approval under the LSCRO for selling the lot by other means). A reserve price which has "taken into account the redevelopment potential of the lot" will be higher than the total existing use values of all properties on the lot as the former reflects the value derived from, among others, a better utilisation of the plot ratio of the lot. When handling compulsory sale cases, the Lands Tribunal judge always sits with an experienced surveyor who will offer professional advice on the cases in the capacity of a Lands Tribunal member.

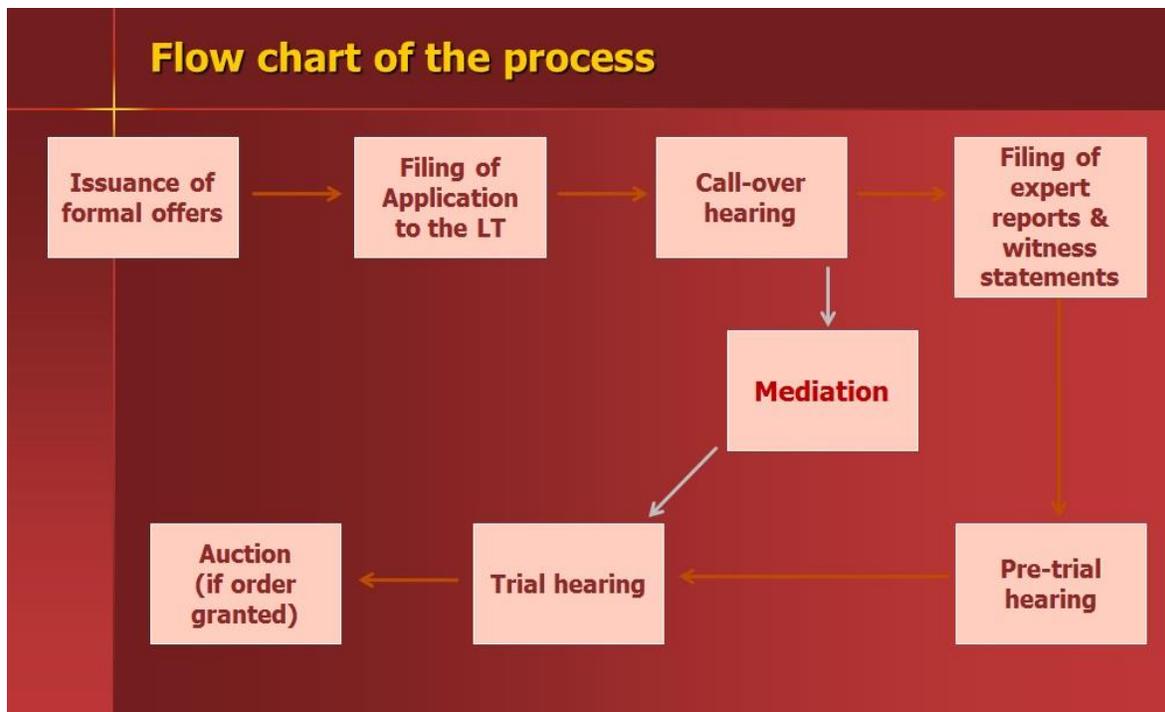
After the lot has been sold, sale proceeds will be apportioned on a pro rata basis in accordance with the values of the respective properties of each majority owner and each minority owner of the lot as assessed in the above-mentioned valuation report (that is, in accordance with the ratio between the existing use values of the respective properties of the majority and the minority owners).

From statistics of early cases where the Lands Tribunal have granted compulsory sale orders and the subject lots have been successfully sold by public auction, the transaction prices were on average 2.6 times the existing use values ("EUV") of the lots. In other words, the proceeds apportioned to each minority owner after public auction were 2.6 times the then prevailing market value of their respective properties. The provision under the LCSRO empowers for the Lands Tribunal to approve the auction reserve price can ensure that the minority owners are reasonably compensated. However, the "2.6 times" is only an average figure based on early cases when the LCSRO was first enacted. The gap between the EUV and the apportioned sale proceed has gradually narrow down to less 0.5 times nowadays. Obviously, developers has raised much in the initial acquisition price in order to secure minimum 80% rate. Besides, the redevelopment value of land lots varies from site to site and also affect the difference ratio.

### **3. THE OPERATION OF THE LCSRO**

#### **3.1 Application to Lands Tribunal**

Under section 3(1) of the LCSRO, a person or persons who owns or own, otherwise than as a mortgagee, not less than 90% (or 80% in cases where the new compulsory sale rule applies) of the undivided shares in a lot (the "Majority Owner") may make an application to the Lands Tribunal for an order to sell all the undivided shares in the lot for the purposes of redevelopment. Under the LCSRO, a Majority Owner may make an application in respect of more than one lot if the conditions set out in the LCSRO are satisfied. In calculating the percentage of undivided shares owned by a person or persons in a lot, any undivided shares assigned solely to the common parts of the lot shall be disregarded.



The application must be accompanied by a valuation report, which must be prepared not earlier than three months before the date of the application, setting out the assessed market value of each property on the lot, on a vacant possession basis, ignoring the possibility of being made the subject of a compulsory order and the redevelopment potential of the property or the lot. It does not address the value of the projected redevelopment. The purpose of the valuation report is to provide the basis of apportionment of sale proceeds between the Majority Owner and any other person or persons who owns or own shares in the lot (the “Minority Owner”).

After the making of the application, the Majority Owner shall (1) serve a copy of the application on each Minority Owner, unless the Tribunal directs otherwise; (2) cause a copy of the application to be registered against the lot in the Land Registry; (3) cause a bilingual notice to be affixed upon a conspicuous part of the building on the lot (or upon a conspicuous part of the lot if there is no building on the lot); and (4) cause a notice to be published in not less than one Chinese language newspaper and in not less than one English language newspaper circulating generally in Hong Kong.

### 3.2 Consideration of the Lands Tribunal

The Lands Tribunal, upon receipt of an application for compulsory sale, shall first hear and determine any dispute over the value of any property as assessed in the valuation report and in cases where the Minority Owner cannot be found, shall satisfy itself that the value of the property of the Minority Owner as assessed in the valuation report is fair and reasonable

(including when compared with that of the Majority Owner). The Lands Tribunal may make such adjustments as is necessary in the valuation report in the light of the evidence available. Then, the Lands Tribunal will decide whether or not a compulsory order for sale should be made. The LSCRO provides that the Lands Tribunal shall not make an order unless, after hearing the objections of the Minority Owner, it is satisfied that:-

1. the redevelopment of the lot is justified due to the age or state of repair of the existing development on the lot; and
2. the Majority Owner has taken reasonable steps to acquire all the undivided shares in the lot (including, in cases where a Minority Owner whose whereabouts is known, negotiating for the purchase of the shares owned by the Minority Owner on terms that are fair and reasonable).

It was held in the higher court that in assessing the reasonableness of an offer, the Lands Tribunal is not required to take into account factors such as the “strategic position” of the lot (due to the fact that the lot is in the middle of the row of lots intended to be redeveloped) and the “marriage value” of redeveloping the entire row of lots (as opposed to embarking upon two smaller redevelopments separated by an undeveloped lot) which may make it disproportionately valuable. It merely needs to be satisfied that, on the evidence available, the offer falls within a range of a fair and reasonable compensation for the interest in question.

If the Lands Tribunal makes an order for sale, it will appoint sale trustees to conduct the sale and authorize the trustees to charge such remuneration for their services as the Lands Tribunal thinks fit. The Lands Tribunal may also order that compensation be paid to existing tenants whose leases were entered into before the date on which the order for sale was made and give such other directions as it thinks fit. Upon the grant of the order for sale, the Majority Owner shall cause:-

1. a copy of the order to be served on each Minority Owner, unless the Lands Tribunal directs otherwise;
2. a copy of the order to be served on the Director of Lands; and
3. a notice to be published in not less than one Chinese language newspaper and in not less than one English language newspaper circulating generally in Hong Kong stating :-
  - sufficient particulars of the lot for identification;
  - that the Lands Tribunal has made an order for sale of all the undivided shares in the lot for the purpose of redevelopment; and
  - that the lot will be sold by auction or other means.

### **3.3 Compulsory Sale**

Unless all the parties agree in writing to some other means of sale approved by the Lands Tribunal, the lot must be sold by public auction. The Lands Tribunal is empowered to give directions relating to the sale. The general public will be given notice of the auction by way of an advertisement published in not less than one Chinese language newspaper and in not less than one English language newspaper circulating generally in Hong Kong at least 3 weeks immediately preceding the date of the auction stating, among other things, the date, time and place of the auction.

It is required by law that the lot shall be sold to the highest bidder (who could be the Majority Owner or Minority Owner or a third party) subject to a reserved price approved by the Lands Tribunal which takes into account the redevelopment potential of the lot. If the lot is not sold within 3 months immediately following the date on which the order is made or within such further period of 3 months as the Lands Tribunal may specify in directions, the order shall be deemed to be of no effect as if it had been cancelled by the Lands Tribunal. The costs of the auction shall be borne by the Majority Owner solely. The Majority Owner and the Minority Owner may, at any time before there is a purchaser, agree in writing that they do not want the lot to be sold. In such cases, the order for sale shall be deemed to be of no effect as if it had been cancelled by the Lands Tribunal.

### 3.4 Apportionment of Sale Proceeds

The proceeds of sale as well as the expenses of the auction (or other means of sale) shall be apportioned between the Majority Owner and Minority Owner on a pro rata basis in accordance with the values of the respective properties of each Majority Owner and each Minority Owner as assessed in the valuation report subject to any adjustments that may have been made by the Lands Tribunal. The apportioned proceeds will then be distributed by the trustee to the respective Majority Owner and Minority Owner after

- (1) deducting the expenses of the auction (or other means of sale) and legal costs on assignment of the lot;
- (2) discharging any liability due to the Government and encumbrance affecting the lot; and
- (3) paying off any compensation due to existing tenants (if so ordered by the Lands Tribunal).

**Aggregated EUV of the building:**

= Sum of all the individual EUV

**Apportionment of Interest :**

Apportioned interest in Land of each individual unit

$$= \frac{\text{EUV}}{\text{Aggregated EUV}} \times 100\%$$

#### **4. ASSISTANCE TO MINORITY OWNERS**

In order to provide support to minority owners before the commencement of legal proceedings under the LSCRO, a Mediation Scheme for compulsory sale cases has been launched. In order to assist owners, primary minority owners, involved in or contemplating applications for compulsory sale for redevelopment, the HKSAR provides financial support to the Pilot Mediation Scheme (the mediation scheme) to facilitate the owners to undertake mediation on a voluntary basis. The Pilot Scheme is independently administered by a Joint Mediation Helpline Office (JMHO).

This scheme aims to facilitate parties involved in or contemplating compulsory sale applications under the LSCRO to undertake mediation on a voluntary basis. The Government will provide financial support for the pilot scheme, including its setup and operating costs, as well as the financial assistance to be provided to eligible elderly minority owners in paying mediator fees. If both parties, namely, the majority owners and the minority owners, who are or who will be involved in compulsory sale applications, are willing to join the mediation scheme, mediators of the mediation scheme will in an unbiased and confidential manner, help both parties discuss and negotiate on a balanced footing, with a view to reaching consensus.

## **BIOGRAPHICAL NOTES**

Mr. Edward AU MHKIS FRICS MCIREAA is a senior General Practice Surveyor with extensive experience in land administration, planning and development of property in Hong Kong. He is currently the Senior Vice President of Hong Kong Institution of Surveyors (2014-2015), Chairman of the Hong Kong Surveyor Registration Board (2014-2015), WAVO Vice President (2012 to present). He is the Chairman of HKIS GPD Education Committee responsible for APC examination and training of probationers of the HKIS and he has also actively participated in difference committees and panels of the surveying profession.

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