Rating Valuation of Special Properties : The Hong Kong Experience

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Rates and Rateable Value

Rates

- A tax on occupation of properties
- Assessed and collected under the Rating Ordinance (Cap 116)
- Calculated as a percentage of the "Rateable Value"
- The percentage is 5% for the Financial Year 2014/15

Rateable Value

- Assume the property is vacant and to let in the open market as at the "Valuation Reference Date"
- An estimate of the annual rental value

Valuation Reference Date

- A date designated by the Chief Executive of HKSAR. The rateable value assessed by the Commissioner is ascertained by reference to the rental level at that date
- For 2014/15 General Revaluation, the designated Valuation Reference Date is 1 October 2013

Plant and Machinery - Section 8 of Rating Ordinance (Cap 116)

Rateable

All machinery (including lifts) used as adjunct to the tenement

Not rateable

Machinery for the purpose of manufacturing operations or trade process

Plant (Section 8A of Rating Ordinance)

- cables
- ducts
- pipelines
- railway lines
- tramway lines
- oil tanks
- settings and supports for plant or machinery

Methods of Valuation

- Rental Comparison Method
- Receipts and Expenditure Method (R&E or Profits Method)
- Contractor's Method (Cost Method)

Receipts and Expenditure (R & E) Method

- The R & E Method aims to identify
  - The return to the hypothetical tenant in running the business (tenant's share)
  - The return (i.e. rent) to the hypothetical landlord
- The R & E Method may not be applicable where the occupation of a property is not occupied for profit motive
- The profit and loss account provided by the actual operator may not be relevant in assessing the rateable value of the property concerned

Characteristics of properties valued by R & E Method

- Seldom let in the open market
- Rental evidence not available
- Special properties, usually possess some monopoly elements
- Occupied with a profits motive
- Rent relates to the gross receipts or profits

Examples of Special Properties valued by the R & E Approach

- Electricity Supply and Distribution System
- Gas Supply System
- Hotels
- Tunnels
- Railways System
- Theme Parks

R & E Method

Reasonableness of the actual revenue and expenses

Factors to be considered

- Compare with trading accounts in similar properties
- Compare with accounts of past years
- Statistical figures of the relevant market
- Views or expectations of actual operators on the business environment

Tenant's Share

Return on tenant's investment, including

- Interest on tenant's capital
- Tenant's remuneration
- Compensation for risk

Calculation of amount of Tenant's Share

- Tenant's Capital x %
- Gross Receipts x %
- Divisible Balance x %
- Spot figure, depending on the nature of business, risks, scale of capital invested, etc.

R & E Method – Hotels

- Collect and analyse the profit and loss accounts
- Assess the rateable value of each hotel
- Deduce the average rateable value per room for each hotel
- Compare the average rateable value per room of each hotel of similar class in similar location (location, size, facilities etc.)
- Make appropriate adjustments if considered not reasonable
- Apply the average rateable value per room in valuing those hotels without reasonable accounts

R & E Method – Theme Park

- Income and Expenses Analysis
  - Collect revenue and expenses from the theme park operator
  - Estimate the anticipated annual revenue, expenses and tenant's share of the hypothetical tenant as at the Valuation Reference Date
- Assess the reasonable rent that the hypothetical tenant would pay
- Compare with the rateable values of other theme parks

R & E Method – Cross-Harbour Tunnel

Case: The Cross-Harbour Tunnel Limited v. Commissioner of Rating and Valuation (RA 3 of 1978)

The Hunghom Cross-Harbour Tunnel

Rateable Portion

- The tunnel structure
  - A facility on the seabed that makes it possible for drivers to drive their own vehicles from one side of the harbour to the other
  - Not a trade process

Rateable Plant and Machinery

- Ventilation System
  - Part of the structure, used as adjunct to the tenement, not a trade process
- Water Mains and Pipes
  - Embedded in the walls of the tunnel

Tenant's Share

- Needs to compare with the hypothetical Landlord's return on his huge capital investment
- Considers whether the hypothetical tenant can cover interest on tenant's capital, remuneration and compensation for risk

Contractor's Method (Cost Method)

- Built on the hypothesis that, the hypothetical tenant has an alternative to purchase the land and build a similar property for occupation by himself

The Concept

- Assuming the rent is equal to the annual interest the hypothetical tenant pays by borrowing money or the opportunity cost he foregoes by using his own capital to buy the land and construct the alternative building
- The annual rent will not be greater than the interest or opportunity cost, or else the hypothetical tenant will build the building for himself

Why

- No rental evidence available for similar properties
- R & E method not applicable, e.g. no profit, etc.

Examples of properties valued by the Method

- Oil depots
- Recreation clubs
- Golf Courses
- Pumphouses and pipelines

5 Stages in the Cost Method

1) Estimate the construction costs of the building, plant and machinery as at the "Valuation Reference Date"
2) Adjust to reflect the conditions of existing property (including allowance for age and depreciation)
3) Estimate the land value
4) Apply decapitalisation rate to arrive at the rental value
5) Stand back and look

Cost Method – Recreation Properties

Case : Royal Hong Kong Yacht Club v. Commissioner of Rating and Valuation (RA 38 of 1985)

- Private recreation club, located on the north shore of Hong Kong Island
- Facilities include open car park, berths, club house building and swimming pool

Ownership Benefits

- Rental Income
- Title ownership
- Security of tenure and permanence of use
- Assets in support of business
- Enjoys capital appreciation
- Right to dispose of property
- Security for financing the purchase of plant
- Freedom to alter, add or demolish property; or change of use
- No uncertainties in budgeting for rental increase

Cost Method – Oil Depot

Case : Mobil Hong Kong Limited v. Commissioner of Rating and Valuation (RA 244 of 1991)

- Oil Depot for storage and distribution of petroleum products
- With ancillary parking and a large pier for marine access
- No direct profit derived from the occupation of the oil depot
- Valued by rental comparison method and cost approach

Cost Approach - Case : Mobil Hong Kong Ltd

Points to note in the case

1. ***Ownership Risks***
2. ***Both Landlord's and Tenant's Viewpoints to be Considered***
3. ***Credit Rating of a Particular Ratepayer to be Ignored***

Conclusion

Last Step

Consider the hypothetical tenant's ability to pay rent

Bear in mind

The objective of rating valuation is to find out a reasonable rateable value of a property

It is vital to adopt the appropriate method(s) of valuation