GENERAL

These notes are for general guidance purpose only. The purpose of the written assessment is to test the candidate’s knowledge in the respective areas and the ability to present his answer logically and sensibly in accordance with his own assumptions.

QUESTION 1, a compulsory question

The candidates should cover in their answer the following major aspects:

(a) the proposed form of development, which has a direct bearing on the site value;

(b) some explanation of the gross development value(s) adopted (which is related to the type/class of the development assumed);

(c) explain, where necessary, the adoption of other valuation components;

(d) some comments on the asking price are required

The asking price, though may not be acceptable to many potential buyers, serves as a rough indication of price expected. If the candidate’s advice on the site value shows a wide difference without good reasons, such answer may be viewed with doubt, whether it is sound advice or not. Reasonable assumptions also count.
QUESTION 2

(a) The major benefits of annual revaluations are to provide a more equitable basis for distributing the rates liability among ratepayers according to the up-to-date rental levels of different properties. The changes in the rental levels over time can vary significantly among different categories of property and in different locations. Hence a more frequent revaluation can better achieve the fair distribution of rates liability.

(b) There is no correct answer, or correct value. The candidate should state reasonable assumptions, and the assessor can then assess whether the answer is logical based on the assumptions stated. Comparables can be analysed on a Reduced Zone A (RZA) or Internal Floor Area (IFA) basis. The following points should be covered:

- It is necessary to ascertain the rental value as at 1 October 2004, the designated valuation reference date for the 2005/06 General Revaluation.
- Assumption with regard to the headroom of the comparables should be made, whether they have built in cocklofts, and also trading potential of all comparables. With regard to the rents available, assumptions must be made on whether they are inclusive or exclusive of rates and management charges, to bring them in line with the rating basis excluding rates and management charges. Rating basis also assumes that Government rent is payable by the landlord.
- Given the difference in depth, it will be useful to use the zoning method. The conventional zoning is 7 m depth, and halving back for each zone. The reduced zone A floor areas are: subject shop 43 m², first comparable 37.6 m², 2nd comparable 36 m², and last comparable 15 m².
- Using the first comparable, downward adjustment for time is essential. If IFA devaluation is used instead of the RZA method, slight adjustment for difference in frontage is desirable.
- Using the second comparable, the following adjustments are necessary: upward adjustment for time, and further upward adjustment for size if IFA analysis is used.
- Using the third comparable, the following adjustments are necessary: downward adjustment for no return frontage, further adjustment for size, and slight upward adjustment for time is acceptable.
If assumption is made that all comparables have same clear headroom as the subject shop, and that none of them have built-in cocklofts, it is acceptable to ascribe a slight value to the timber cockloft of the subject shop. The cockloft is rateable, although it can be argued that the headroom of 1.5 m is too low to be of substantial value or use, save for storage, and the rents of comparables probably reflecting in some way the potential to erect cocklofts.

A possible rateable value for the subject shop is around $22,000 per month, but the figure depends on the assumptions made by the candidate.

QUESTION 3

(a) As professional building managers, it was incumbent upon your company to ascertain for itself from the DMC and from the various assignments which are the common parts of the building. For instance, relying on the Deed of Mutual Covenant itself may not be satisfactory because the Deed of Mutual Covenant could have been no substitute for what was actually assigned (See the judgment of Keith JA in Wong Lai Kai v. The Incorporated Owners of Lok Fu Building, Yuen Long (2000) 3 HKC 633. Also, by virtue of section 2 of the Building Management Ordinance (Cap. 344), excluded from the definition of the “common parts” are “such parts as have been specified or designated in an instrument registered in the Land Registry as being for the exclusive use, occupation or enjoyment of an owner. If the canopy is a common part of the building, the building manager should have a duty to take it under control and management by virtue of the Deed of Mutual Covenant or Building Management Ordinance. Your company could not have discharged its duties as building managers without ascertaining for itself from the DMC and from the various assignments which are the common parts of the building. Your company are under a duty to ensure that the canopy, a common part of the building, was properly maintained and kept in good repair so that it would not collapse and injure pedestrians below. (See Lily Tse Lai Yin and Others v. The Incorporated Owners of Albert House and Others, HCPI 828 of 1997)

(b) Notwithstanding what might be said in the Deed of Mutual Covenant, section 34I of the Building Management Ordinance prevails in case of any consistency. The clear wording of section 34I prohibits any one to convert the common areas to his
private use. The only exception is that he has obtained the approval of owners committee. The meeting of owners cannot be stretched to mean owners committee. Therefore, the paper resolution was not approval by the owners’ committee within the meaning of section 34I. Theoretically, a meeting of all the owners has greater power or authority to deal with the affairs of the building than an owners’ committee but the fact remains that the statutory mechanism has not been employed. (See Gallium Development Limited and Others v. Winning Properties Management Limited, CACV 186 of 2003 and CACV 400 of 2003). Then if the canopy remains common area, the building manager will be liable for the collapse.

(c) As the owners have not been incorporated, there exists no owners’ committee for the building. Therefore, unless the Deed of Mutual Covenant has provision otherwise, the conversion of common areas to private use must be by way of re-designation which is tantamount to rewriting the Deed of Mutual Covenant. This requires the approval of all owners instead of mere 77%. If the approval of all owners has been obtained to convert the common area to private use, your company as building manager only for the common areas will not be responsible for the collapse. (See Wong Lai Kai v. The Incorporated Owners of Lok Fu Building, Yuen Long, supra)

Section 34I of the Building Management Ordinance reads as follows:

(1) No person may-
   (a) convert any part of the common parts of a building to his own use unless such conversion is approved by a resolution of the owners' committee (if any);
   (b) use or permit to be used the common parts of a building in such a manner as-
       (i) unreasonably to interfere with the use and enjoyment of those parts by any owner or occupier of the building; or
       (ii) to cause a nuisance or hazard to any person lawfully in the building.
(2) Any person who contravenes subsection (1) shall be deemed to be in breach of an obligation imposed on him by the deed of mutual covenant in respect of the building.
QUESTION 4

(a) In *Director of Buildings and Lands v. Shun Fung Ironworks Limited* (1995) 2 AC 111, the Privy Council elucidated three conditions which must be satisfied:

(i) There must be a causal connection between the resumption or acquisition and the loss in question;

(ii) There is a need to distinguish between adverse consequences which trigger a claim for compensation and those which do not. The loss should not be too remote.

(iii) The loss must be not one that a reasonable person would have avoided or reduced.

Provided a claim for compensation satisfies the criteria mentioned above, there should be no distinction between post-scheme and pre-resumption losses.

(b) In this part, the candidate is not required to cite the name of any court case in support of his/her answer though quoting the principle involved may be helpful.

(i) Incorrect. This involves giving the concept of causal connection an extended meaning, wide enough to embrace all such losses. To qualify for compensation a loss suffered post-resumption must satisfy the three conditions of being causally connected, not too remote, and not a loss which a reasonable person would have avoided. A loss sustained post-scheme and pre-resumption will not fail for lack of causal connection by reason only that the loss arose before resumption, provided it arose in anticipation of resumption and because of the threat which resumption presented. However, the less certain the prospect of resumption, the greater will be the burden of showing that he acted reasonably in running down his business and that the losses were caused by the prospect of resumption. Therefore, loss of business that suffers based on mere rumour might not be compensatable. Of course, if the resumption does not become fruitful, no compensation will ever be payable.

(ii) Incorrect. One of the conditions for compensation is that the loss must have been incurred reasonably. The age of the Claimant must be taken into account when assessing whether or not that Applicant was reasonable in terminating instead of relocating his business. However, depending on the circumstances of the case, if a reasonable person of such age of the Claimant would have continued to trade normally the landowner cannot
claim compensation for losses incurred by his refusal to accept any more orders. He cannot simply let his business run down, and then seek to recover compensation for his losses. (See *Yip Kui trading as Tai Wo Trading Company v. Secretary for Transport*, LDMR 52 of 2000, affirmed by the Court of Appeal in CACV 379 of 2002.)

(iii) Incorrect. “…. compensation can only be awarded in respect of loss or damage which has been suffered or expenses which have been incurred.” “It may be that quantification of that loss would depend upon an assessment of future loss or expenses which would be incurred but any claim for compensation must be founded upon actual loss and not upon some hypothetical basis of expenses that might be incurred if the applicant were to do something which he has not done and has no intention of doing.” (See *Yip Kui trading as Tai Wo Trading Company v. Secretary for Transport*, CACV 379 of 2002. followed by *Hongda Containers Limited v. Secretary for Transport*, CACV 269 of 2003)

(iv) Correct. In Part II of the Schedule to that Ordinance, the first heading in respect of matters for which compensation may be claimed is the resumption of land under the Roads (Works, Use and Compensation) Ordinance. The basis of compensation is "As if the claim were made under the Lands Resumption Ordinance (Cap. 124) for land resumed under that Ordinance." Hence, reference to the “disturbance payments” not included as a basis of compensation under the Lands Resumption Ordinance is irrelevant. (See *Yip Kui trading as Tai Wo Trading Company v. Secretary for Transport*, CACV 379 of 2002.)

**QUESTION 5**

(a)

1. The calculation for the domestic plot ratio is wrong. The formula under the Building (Planning) Regulations does not apply to that specified in the Notes in the Outline Zoning Plans. In the captioned case, the domestic plot ratio should be just 7.5.

\[
\begin{align*}
\text{GFA for G/F} & = 270 \text{ s.m. (a)} & \text{90\% for G/F site coverage} \\
\text{Domestic plot ratio remained} & = 7.5 \\
& \text{2,250} \\
\text{GFA for 1/F to 23/F} & = \text{s.m. (b)} & \text{(two 474 s.f.(G) units on each floor)} \\
\text{Total GFA} & = 2520 \text{ s.m. (a)+(b)}
\end{align*}
\]
2. The assistant has overstated the interest cost by adding “interest for 9 months at 5%” before the building cost is discounted for half the construction period. In effect, the assistant has accounted for the whole construction cost upfront without any discounting.

3. On the other hand, by taking the marketing cost and developer’s profit at a percentage of GDV, he should have discounted them for the whole of 18 months instead of half of it. Discounting for just half the construction period is an averaging exercise to take into account that the expenses/cost would be incurred from the beginning of the construction to completion.

4. The assistant has double counted the developer’s profit by firstly allowing 10% on GDV and then further reduced the residual value by 15% on land cost. He should have allowed either a percentage on GDV or a percentage on Cost but not both without good justification.

(b) The developer’s profit in a residual valuation is in fact a factor risk; if risk is high, it should be higher or if risk is low, it should be lower. It also depends on how conservative or aggressive when you decide on the Gross Development Value which on many occasions is the present value. If the market is trending upwards, therefore, in a competitive market, the developers might be willing to accept less “initial profit” in anticipation of growth. In this regard, one may consider the developer is buying an option for development and the purchase price is just the option premium that he has little chance to lose anyway (See Investment Valuation: Tools and Techniques for Determining the Value of Any Asset, Second Edition Wiley 2002 by Aswath Damodaran or The Surveyor Times December 2003 “Lease Modification – with an Option to Delay” by Lawrence Pang). Indeed, if there exists a hope value or speculation that is so rife that the developer’s profit may be even reduced to zero. (See the “No Loss Basis” as expounded by the Lands tribunal in Kwok Lee Sau-sang & Another v. Director of Lands & Survey (1977) HKLTLR 105).
QUESTION 6

(a) In valuation of bonds, both the current and future cash flows are relatively certain. Whereas in the valuation of business enterprises, maybe only the current cash flow is certain but the medium or long-term cash flows are highly uncertain and subject to risk. As a result, the value of a business undertaking is highly influenced by the short-term result or projection.

Also, in the valuation of bonds, the risk-free rate may be adopted as the discount rate or the risk-premium will be relatively mild. But in the valuation of businesses, the risk premium will generally be very high but unfortunately difficult to measure.

(b) (i) It is argued that the IRR is not a realistic measure of return because the method implies that a project’s annual cash flows must be capable of reinvestment to earn the project’s IRR. This will particularly the case when the IRR method fails to distinguish the size of the project and the life of the investment. In the latter case, the Net Present Value method is preferable. (ii) Multiple IRRs may be obtained if there are occasional negative capital outlay in the investment time frame. (iii) The IRR is a measure of percentage return on capital which has taken no account of the cost of the capital or the project’s risk. For instance, the IRR fails to take account the extent of leverage or the risk involved. Hence, the spread between IRR and the cost of capital makes no sense in business valuation. This assertion can be illustrated by the table of calculation (which is not required to be produced by the candidate) as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>IRR-COC</th>
<th>Capital</th>
<th>Economic Profit</th>
<th>Discount Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2.14 2.36</td>
</tr>
</tbody>
</table>

which, after adding back the original investment of $90 Million, fails to correspond to $114.67 Million in part (c) below.

(c) (i) ROE = 9.9/90 =11%

(ii) If you assume the cash flows in the remaining 9 years will remain constant at
$19.9 million (i.e. $9.9 million net income adding back depreciation $10 million), you will get:

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash Flow</th>
<th>Discount Factor</th>
<th>Net Present Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td>2.14</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td>2.36</td>
<td></td>
</tr>
</tbody>
</table>

Unfortunately, there is no ground to assume that the cash flows in the project will remain constant, i.e. not subject to risk and competition. Therefore, unless you are satisfied that the discount rate of 10% adequately compensate for the risk and uncertainty of obtaining the cash flow in question, there is no ground to arrive at a Net Present Value of $114.6 or thereabout.

**QUESTION 7**

1. Candidates shall suggest one of possible themes or combination for the shopping mall that should be made sensible (at least practical in North Point) and, most important, maximize its rental return. Therefore, the trade(s) to be introduced definitely affect(s) at large the rental return. Here below are some examples:-

<table>
<thead>
<tr>
<th>Full marks with bonus (high rental expected)</th>
<th>Low to medium quality fashion mall, toys city, computer center, mobile &amp; its accessories, fitness and body care center, featured food center, gold and jewelry trading or exhibition center, other creative ideas, etc.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full marks (low rental expected)</td>
<td>Mega book stores, household applicants, furniture houses, school or teaching center, etc.</td>
</tr>
<tr>
<td>No marks (not supported by locality facilities)</td>
<td>Branded products center, branded fashion mall etc.</td>
</tr>
</tbody>
</table>

As the question itself requires a proposal format, a full account of why the theme(s) is/are suggested shall be given.

2. There is no specific answer to this section but the candidates shall show the knowledge of knowing what is the anchor tenant. It is the tenant with whom the
marketer shall proactively negotiate in early stage before leasing campaign starts. They are normally introduced to fix the theme of a shopping mall and acts as a tool to uplift the rental of the rest.

3. Long rent-free period, substantial rental discount for years, low turnover rent plus a nominal basic rent, step-up rental scheme, low management fee, etc.

4. The candidates shall
   a. Identify target tenants,
   b. Work out how to approach them effectively,
   c. Advise how to attract them to move in
   d. Suggest possible marketing activities such as sample show room, mail shots, press conference, press advertisements, etc.

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