

Introduction to Hong Kong SAR Real Estate System Fundamentals of Land Holdings, Ownership and Use

Land Holdings and Registration Systems

Land holdings

All land in Hong Kong is owned by the People's Republic of China as State property and is managed by the Government of the Hong Kong Special Administrative Region (Government) under the Basic Law of Hong Kong.

Land identified as suitable for private development is sold by the Government through public tender. Government can make land available through direct grant although this is only in limited circumstances for special purposes and subject to approval by the Executive Council.

The right to develop, occupy and use land is generally granted by way of lease from the Government. The present practice is that land is granted by Conditions of Grant which are, in effect, an agreement for lease subject to certain conditions. After the grantee has fulfilled these conditions (normally when a building has been completed) and a certificate of compliance has been issued by the Government, the lease is deemed to have been granted by statute. Although some leases in the past were granted for longer terms of up to 999 years, the usual lease term granted now is 50 years. The Government also grants short term tenancies, usually up to 5 years.

This system of land holdings is protected under the Basic Law until 2047.

Registration

There is presently a deeds registration system governed by the Land Registration Ordinance. Under this system, deeds and other documents relating to property transactions are generally recorded on the land register, although there are some exceptions.

Registration does not confer validity on a document nor does it guarantee the legal ownership of the property or a mortgagee's

interest. Registration establishes priority for dealings with an interest in a property in accordance with the date on which documents are registered, provided they are registered within 30 days of their completion. This is an imperfect system, for a search of the register on a particular day will not show all documents that may have priority.

The Government proposes to introduce a title registration system, whereby the Government will indemnify a person who loses an ownership interest in land (but not a mortgagee interest) in certain limited circumstances and subject to a cap on liability. This legislation was passed in 2005 but has still not been implemented.

Ownership

Restrictions

Any legal entity, whether an individual, a corporation or otherwise, and whether local or overseas, can own or lease property in Hong Kong. The ownership structure should be considered in the context of tax or stamp duty implications – see further below.

Multi-Storey Buildings

Multi-storey buildings are the most common form of property in Hong Kong. The rights and obligations of owners in a multi-storey building are generally governed by a deed of mutual covenant that binds all the owners of the building, and additionally by the Building Management Ordinance. Ownership in these buildings is in the form of undivided shares in the whole building with the exclusive right to use a specified part.

Planning and Environmental Protection

Planning

The Town Planning Board formed under the Town Planning Ordinance is responsible for

town planning policy. The Town Planning Board is not, strictly speaking, a government body although it is briefed by the Town Planning Department of the Government and is chaired by a Government official. The Board approves outline zoning plans which regulate the use, size, height, plot ratio and mix of developments permitted in various areas throughout Hong Kong. Similar restrictions are often also imposed under Government leases.

Environment

The Environmental Protection Department of the Government enforces environmental legislation such as the Air Pollution Control Ordinance, Noise Control Ordinance, Waste Disposal Ordinance, Water Pollution Control Ordinance and Dumping at Sea Ordinance.

The Environmental Impact Assessment Ordinance requires the commissioning, and Government approval, of an environmental impact assessment report in connection with certain designated projects, typically large scale projects.

Resumption

The Government and various other statutory bodies may resume privately owned property if it is in the public interest. This is mostly for public works projects such as road or urban renewal by drainage works.

In order to encourage the private sector, the Land (Compulsory Sale for Redevelopment) Ordinance was passed in 1999 enabling owners of 90% or more of a property (or 80% of the owners in the case of properties older than 50 years) to apply to the Lands Tribunal for an order to sell the property for redevelopment.

The Urban Renewal Authority's function is to implement an urban renewal strategy, principally aimed at improving or replacing older and decaying urban areas. The Authority has statutory powers to resume land on payment of compensation to give effect to its urban renewal programmes. It can resume land by paying an amount awarded by the Lands Tribunal, but it also operates a system of ex-gratia payments set at advantageous rates. Most properties are resumed by way of agreement under the ex-gratia scheme.

Currency, Tax and Other Payments

Currency controls

The Hong Kong dollar is freely convertible and is presently pegged to US dollar. There are no

exchange controls preventing the remittance of funds into or out of Hong Kong.

Capital Gains Tax

Hong Kong does not have a capital gains tax. However capital gains on property in the nature of trading gains are subject to Profits Tax on those gains.

Profits Tax

Persons, including corporations and partnerships carrying on business in Hong Kong, are chargeable to tax on all profits (excluding profits from the sale of capital assets unless in the nature of trading gains) derived from that business. There is no distinction between residents and non-residents. The current rate of Profits Tax is 15% for unincorporated businesses and 16.5% for corporations.

Rental income derived in the course of a business is therefore subject to Profits Tax after deducting actual expenses.

Certain depreciation allowances are available. These are relatively nominal in the case of commercial buildings but can be significant for industrial buildings, particularly those which contain plant and machinery.

Profits which are remitted by corporations in the form of dividends are not subject to any withholding or other tax.

Property Tax

Property Tax is charged on rental income received by the owners of land and buildings. If Property Tax is charged then this is deducted from the amount of Profits Tax assessed. Again, certain expenses are deductible. The current maximum rate of Property Tax is 15%.

Special incentives

Hong Kong does not have tax or other incentives for property investment.

Government rent and rates

Government rent is generally an annual rate of 3% of the rateable value of the property although there are some buildings held under old Government leases where the rent is nominal.

Rates are levied quarterly at 5% of the rateable value of the property. Broadly speaking, rateable values are assessed by reference to the property's annual market rent. In the case of leased properties, the tenant usually pays the rates.

Stamp duty

Stamp duty is payable on certain chargeable documents relating to property sale

transactions at variable rates depending upon the value of the transaction. The buyer usually agrees to pay the stamp duty although the statutory obligation to pay is on both the seller and the buyer.

The Government has introduced several rounds of additional stamp duty measures with the intent of cooling the property market:

- **Special Stamp Duty (SSD)** – payable on any residential property acquired, either by an individual or a company (regardless of where it is incorporated), and resold within 24 months if the property was acquired between 20 November 2010 and 26 October 2012. The Government had extended this period to 36 months if the property was acquired on or after 27 October 2012. SSD is assessed at rates varying from 5% to 20% depending on the period the property was held for and is payable in addition to the basic stamp duty. There are certain exemptions.
- **Buyer's Stamp Duty (BSD)** – BSD comprises an additional duty on any acquisition on or after 27 October 2012 of residential property by any person (including a company) except a Hong Kong Permanent Resident (HKPR). BSD is to be charged at a flat rate of 15% on residential properties, on top of the existing stamp duty and the SSD, if applicable. There are certain exemptions.
- **Ad Valorem Stamp Duty (AVSD)** – payable on the acquisition on or after 23 February 2013 of all residential property and non-residential property. There are different rates of AVSD. A rate of 15% will apply to all acquisitions of any residential property unless an exemption applies. The main exemption is where a residential property is acquired by a HKPR acting on his own behalf who does not own any other residential property in Hong Kong at the time of acquisition. Here ad valorem stamp duty at the previous rates, now known as Scale 2, is payable. Ad valorem stamp duty at Scale 1 rates applies to all commercial property acquisitions.

The Government has indicated that the measures are not permanent, and may be reviewed in the future when the Government feels that it has achieved its objectives. The Government has also warned that there may be further intervention if deemed necessary.

Stamp duty on the sale of shares is 0.1% for each of the buyer and seller.

Conveyancing Procedures

Title

In order to establish title to a property, it is necessary to check all title documents affecting it. There are many issues of varying materiality that are a common cause of questions and delays and which can affect a property's liquidity. Title insurance is available in Hong Kong and provides protection against many defects in title commonly found.

Buying Procedure

A purchase normally involves the following stages:

- Negotiating the principal terms either directly or through an estate agent.
- Signing a binding provisional agreement for sale and paying a deposit of 3-5% of the price. If the property is subject to a mortgage, the deposit is paid to the seller's solicitors as stakeholders; otherwise it is usually released to the seller although there is some risk in this. Provisional agreements are usually binding but not specifically enforceable, so that either party can withdraw from the transaction but with the loss of an amount equal to the provisional deposit.
- Signing a formal agreement for sale within 14 days after the provisional agreement and paying a further deposit to make up the total deposit to 10%. Again, payment will be made either to the seller or his solicitors as stakeholders depending on whether the property is subject to a mortgage. At this stage, the agreement will usually be specifically enforceable.
- Investigating the title by the buyer's lawyer after exchanging the formal agreement for sale and raising and replying to questions on the title (requisitions).
- Completion, which is usually effected by a solicitor's undertaking rather than in a formal face to face completion meeting.

The buyer's lawyer usually acts for the buyer's mortgagee as well.

Payments

The buyer usually pays the following:

- Its own legal costs for dealing with the purchase
- Stamp duty
- Estate agent's commission (negotiable but usually no more than 1% of the purchase price)
- Land registration and search fees

- Company registration and search fees
- Insolvency search fees

Mortgages

Subject to production of satisfactory proof of income, mortgages are generally available. There are loan to value and debt servicing ratios imposed by the HKMA. For example a self-use residential property has a LTV ratio of 60% for a property value of up to HK\$10m and 50% for a value above that amount. The debt servicing ratios apply where the borrower already has an outstanding mortgage loan-see www.hkma.gov.hk.

Mortgage financing is usually secured by a first legal charge over the property. In more complex loan, there may also be:

- Assignment of Rental
- Assignment of Insurances
- Assignment of Sale Proceeds
- Charge over Shares (if a company owns the property)

In order to protect the interests of the lender, the security documents will need to be registered at the Land Registry and, for a company owner charging its property or shares, at the Companies Registry.

Insurance

Typically, as from the date of signing of the provisional agreement, the risk in the property transfers to the buyer, although the agreement can provide otherwise. It is important for the buyer to have arranged adequate insurance cover for the property from the date it is signed. If the preliminary agreement is not specifically enforceable, the risk is limited to loss of the initial deposit prior to signing the formal agreement. In this case it is usual only to insure on the signing of the formal agreement.

Leasing

Commercial Lease terms

Leases typically contain the following terms:

- Term of 2-3 years for smaller lettings, 6-12 years for larger ones
- Option to renew or break the term may be granted for larger lettings
- Tenant pays 2-3 months' rent, management charges, air-conditioning charges and rates as a security deposit (and sometimes 4-6 months' for retail premises)

- Rent review every 3 years generally to current net effective rental levels - special care needed
- Tenant pays rates, but not Government rent or payments of a capital or non-recurring nature
- No assignment
- Limited sub-letting rights, if any
- Changes of corporate control can trigger landlord's rights to recover the premises
- Tenant does internal repairs, landlord does external and structural repairs
- Tenant insures public liability
- Wide tenant's indemnities to the landlord – special care needed

These terms are negotiable although some landlords are more flexible than others.

Stamp duty

Leases are subject to stamp duty at a rate of between 0.25% and 1% of the average yearly rent, depending on the length of the term. Stamp duty on leases is usually shared between landlord and tenant.

For more information on commercial leasing, please refer to our "Briefing Note – An Overview of Hong Kong Leasing Law and Practice (Commercial Premises)".

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Legal Notices

This Note does not constitute legal advice and you should not take, or refrain from taking, any action as a result of it. No responsibility can be taken for losses arising out of any such action or inaction. Always seek advice from a solicitor in respect of any legal issue which you may have.

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