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[online version](http://www.charltonslaw.com/streamlined-property-valuation-requirements/)

# Streamlined Property Valuation Requirements Effective 1 January 2012

## Introduction

New streamlined requirements for property valuation disclosure in listing applicants’ prospectuses and issuers’ circulars came into effect on 1 January 2012 with the implementation of the Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) (Amendment) Notice 2011 (the **Class Exemption Notice**) and amendments to the Main Board and Growth Enterprise Market (**GEM**) Listing Rules. The new requirements implement the proposals set out in the Securities and Futures Commission (**SFC**) and the Stock Exchange of Hong Kong (**SEHK** or the **Exchange**) joint consultation conclusions (**Consultation Conclusions**) published in October 2011.

As a result of the changes, less onerous property valuation requirements apply to listing applicants and issuers, especially for property interests that are not related to property development and investment activities. The aim was to facilitate the disclosure of more focused and relevant information in prospectuses and circulars and to reduce the cost burden on listing applicants and issuers.

The purpose of this newsletter is to provide a summary of the new requirements. References to the Listing Rules refer to the Main Board Listing Rules, but the amendments apply to the GEM Listing Rules as well.

## A. The General Disclosure Obligation For Listing Applicants (“Applicants”) And Issuers

Both the Companies Ordinance[[1]](#footnote-25) and the Listing Rules[[2]](#footnote-26) contain a general disclosure obligation which requires a prospectus, listing document or circular to include sufficient particulars and information necessary to enable an investor to make an informed decision. The general disclosure obligation may require greater disclosure than is required under the Class Exemption Notice and Listing Rules.

### Disclosure of Material Property Interests

Listing documents and circulars are now specifically required to include descriptive information on material properties (including leased properties), irrespective of whether property valuation reports are required (Listing Rule 5.10).

### Materiality

According to the FAQs, materiality should be considered taking into account all relevant facts and circumstances of the applicant. They provide, by way of guidance only, the following non-exhaustive list of factors that may suggest materiality:

* if the property interest (individually or in aggregate) is used for a reportable segment of the applicant and contributes a significant portion of revenue;
* if there are any encumbrances on the property or its use that may, at any time, directly or indirectly impact the operations of the applicant’s reportable segment;
* if there are any defects relating to the property or its operations that may have major impact on the applicant’s business or operations, e.g. breach of environmental regulations or title defects; or
* if there is re-development potential for the property that may affect the applicant’s financial position.

### Information to be Disclosed

According to the note to Rule 5.10, appropriate information for disclosure in relation to material properties may include:

* a general description of the property’s location (rather than only its address) and some market analysis (in relation to properties held for sale or investment);
* the property’s use and approximate area;
* restrictions on the property’s use;
* an indication of how the property is held (e.g. owned or leased) and if leased, the remaining term of the lease;
* details of encumbrances, liens, pledges and mortgages against the property;
* environmental issues involving the property;
* detail of investigations, notices, pending litigation, breaches of law or title defects;
* future plans for construction, renovation, improvement or development of the property and the estimated costs of such;
* plans to dispose of, or change the use of, the property; and
* any other information considered material for investors.

## B. Specific Valuation Requirements For Listing Applicants

For listing applicants, different valuation requirements are set for the “property interests” of “property activities” and those of “non-property activities”.

### 1. Key Definitions

#### Definition of Property Activities

The definition of property activities is:

“holding (directly or indirectly) and/or development of properties for letting or retention as investments, or the purchase or development of properties for subsequent sale, or for subsequent letting or retention as investments. It does not include holding of properties for own use.”

Any property interest which is outside the definition of “property activities” is classified as “non-property activities”. The date for classification of property interests as property activities or non-property activities is the date of the listing document (Note to Rule 5.01(2)).

The FAQs clarify that a listing applicant may be engaged in both property and non-property activities, in which case it should consider the use of each property. For example, if a property is for letting or sale, it would be categorised into property activity. The FAQs also clarify that “Holding (directly or indirectly)” includes property interests recognised in the applicant’s consolidated balance sheet.

#### Definition of “Property Interests”

“Property” is defined as land and/or buildings that are completed or under construction. A “building” includes fittings and fixtures (including plumbing, electrical instalments, ventilation systems, escalators and other general improvements) but not equipment and machinery used for production.

#### Guidance on What Constitutes a Single Property Interest

A note to Listing Rule 5.01(3) provides the following non-exhaustive list of what should be treated as a single property interest:

* one or more units in the same building or complex;
* one or more properties located at the same address or lot number;
* one or more properties comprising an integrated facility;
* one or more properties, structures or facilities (or phases of such) comprising a property development project;
* one or more properties held for investment in one complex;
* one or more properties, structures of facilities located contiguously to each other or on adjoining lots and used for the same or similar operational/business purposes; or
* a project or phases of development publicly presented as one whole project or forming a single operating entity.

### 2. Property Valuation Requirements For Property Activities

Applicants are required to obtain property valuation reports and disclose valuation information for all property interests of their property activities, except those with a carrying amount below 1% of the applicant’s total assets (Main Board Rule 5.01A(a)). “Carrying amount" in the case of an applicant means the amount at which an asset is recognised in the group’s most recent audited consolidated balance sheet as disclosed in the prospectus after deducting any accumulated depreciation (amortisation) and accumulated impairment losses. "Total assets", for an applicant, means the total fixed assets, including intangible assets, plus the total current and non-current assets, as shown in the latest audited consolidated financial statements in the accountants' report. If a property interest was acquired after the latest audit, the acquisition cost of that property interest will be used in applying the exemption instead of the carrying amount. The total assets used to calculate the 1% threshold should however be the total assets as shown in the latest audited accounts of the applicant.

The carrying amount of a property interest used to calculate the 1% should be the amount as reported in the applicant’s consolidated balance sheet and not the effective value based on the applicant’s percentage holding in the subsidiary (or the entity that is consolidated into the balance sheet). Thus if a 80% owned subsidiary of an applicant holds a property interest with a carrying amount of HK$200 million, the carrying amount will be HK$200 million and not HK$160 million.

#### Exemption from Valuation Disclosure

The above exemption from valuation for individual property interests with a carrying amount below 1% of the listing applicant’s total assets is subject to a cap. The total carrying amount of property interests that do not require valuation must not exceed 10% of the applicant's total assets.

An applicant should therefore identify the carrying amount for each property interest and add up from the lowest values until the 10% limit is reached. Property interests comprising the lowest 10% are exempt from valuation. The FAQs clarify that if there are two properties with similar carrying amounts that cross the 10% limit at the same time, the applicant may choose to value either property but should take into account the general disclosure obligation in doing so.

In relation to operating leases, while these are treated as property interests, they will not require valuation since under current accounting standards, rental payments under operating leases from a lessee’s point of view are generally recognised as expenses and the carrying amount in the balance sheet is zero. If the operating lease is a material property interest, disclosure of relevant information must be disclosed under Listing Rule 5.10. If the operating lease is not a material property interest, it must be disclosed in the overview section.

#### Requirements for Non-exempt Property Interests

Full text valuation reports for valued property interests are required to be disclosed in the listing document, except where summary disclosure is allowed.

#### Summary Disclosure of Valuation Reports

Summary disclosure of valuation reports for property interests valued at below 5% of the applicant’s total valued property interests is permitted, although detailed valuation reports must be made available for inspection by the public.

Summary disclosure is required to be in the form set out in new Appendix 26 (GEM Appendix 19) to the Listing Rules. The new Main Board Rule 5.01B(a)(ii) (GEM Rule 8.01B(a)(ii)) states that the summary form may be varied depending on the circumstances of the applicant. In any case, it should include relevant information for investors to make an informed decision.

#### Overview of Property Interests Not Valued

Property interests for which valuation reports are not required and for which the applicant does not voluntarily disclose valuation information should be described in an overview in the listing document. If a property interest is exempt from the valuation requirements, but the applicant has valued and disclosed the valuation information voluntarily, that information may be included in the overview as well at the applicant’s discretion provided that this is clearly stated.

The overview should provide relevant information such as the number, approximate size range, uses, how the property interests are held (owned or leased) and the geographic location.

### 3. Property Valuation Requirements For Non-Property Activities

Property interests of an applicant’s non-property activities are normally owned and occupied for own use.

#### Valuation Reports for each Property Interest with a Carrying Amount of 15% or more of Total Assets

An applicant is required to obtain a property valuation report for each property interest of its non-property activities which has a carrying amount of 15% or more of its total assets as shown in the accountants’ report included in its listing document. The full text of such valuation reports must be included in applicants’ listing documents.

Applicants must also include in their listing documents a statement that, other than the property interests in the valuation reports, no single property forming part of its non-property activities has a carrying amount of 15% or more of total assets.

#### Overview of Property Interests not Valued

Listing applicants must also include an overview of all property interests for which valuation reports are not required and the applicant does not voluntarily disclose valuation in their listing documents. The requirements described above for the overview section in relation to the property interests of an applicant’s property activities, apply equally to that for the property interests of its non-property activities.

### 4. Property Interests Ancillary To Mining Activities

Valuation is not required for property interests which are ancillary to mining activities if the prospectus includes a valuation that encompasses the natural resources and the ancillary property interests as a business or as an operating entity (New Rule 5.01C). The valuation must be conducted by a Competent Evaluator (as defined in Chapter 18).

The Exchange notes in the Consultation Conclusions that there are apparently two general methods of valuation of natural resources, being:

* business or project valuation which normally includes valuation of the resources and the ancillary properties; and
* valuation of natural resources or licences only.

The Exchange states that the value of natural resources will depend also on its ancillary properties and infrastructures for operations, and that a valuation of natural resources alone may not give meaningful information. Mining activities should therefore be viewed as an operating entity. It goes on to say that separate valuation of ancillary properties will not be required if a mine has been valued as a business or an operating entity (including ancillary properties). However, if only the resources or licences have been valued, a separate valuation of ancillary properties will still be required.

It is however still necessary to include an overview of property interests ancillary to mining activities for which a property valuation is not required.

### 5. Application Of Class Exemption Notice To Prospectuses For Unlisted Companies

The Class Exemption Notice also applies to prospectuses of unlisted companies as well as to those of applicants.

## C. Specific Valuation Requirements For Issuers

The Listing Rules retain the requirement for a property valuation and information on the property to be included in a shareholders’ circular for an acquisition or disposal of any property interest, or of a company whose assets consist solely or mainly of property, where any of the percentage ratios is 25% or above (i.e. a major transaction or above) (Listing Rule 5.02). In the case of issuers, no distinction is made between the property interests of property activities and non-property activities.

### 1. New Exemption For Acquisition Or Disposal Of An Interest In A Company Listed On The Exchange

Valuation of property interests is no longer required where an issuer acquires or disposes of an interest in a company which is listed on the Exchange (New Rule 5.02A(c)). Instead, the circular must include an overview of the listed company’s property interests covering the number, approximate size range, uses, how the property interests are held (owned or leased) and the geographic location. This exemption does not however apply if the relevant transaction is a connected transaction under Chapter 14A.

### 2. Acquisition Or Disposal Of An Interest In An Unlisted Company

On an acquisition or disposal of an interest in an unlisted property company constituting a major transaction or above, the issuer must include a property valuation and information on the property in the circular to shareholders.

#### Exemption from Valuation for Property Interests with a Carrying Amount Below 1% of the Issuer’s Total Assets

Property valuations are not, however, required for individual property interests with a carrying amount of less than 1% of the issuer’s total assets. The exemption is subject to a cap: the total carrying amount of property interests not valued must not exceed 10% of the issuer’s total assets. “Carrying amount” means the amount at which an asset is recognised in the issuer’s latest published audited consolidated accounts or latest published interim report (if more recent) after deducting any accumulated depreciation (amortisation) and accumulated impairment losses. “Total assets” has the meaning given in Chapter 14.

#### Requirements for Non-exempt Property Interests

Full text valuation reports for valued property interests are required to be disclosed in the shareholders’ circular, except where summary disclosure is allowed.

#### Summary Disclosure of Valuation Reports

Summary disclosure of valuation reports is allowed for property interests valued at below 5% of the total property interests that are required to be valued, although detailed valuation reports in compliance with the Listing Rules must be made available for inspection by the public.

Summary disclosure is required to be in the form set out in new Appendix 26 (GEM Appendix 19) to the Listing Rules. The new Main Board Rule 5.02B(b)(ii) (GEM Rule 8.02B(b)(ii)) states that the summary form may be varied depending on the circumstances of the applicant. In any case, it should include relevant information for investors to make an informed decision.

#### Overview of Property Interests Not Valued

An overview of property interests not covered by a property valuation report must be disclosed in the shareholders’ circular.

#### Property Interests Ancillary to Mining Activities

On an acquisition or disposal of an unlisted company, valuations of property interests ancillary to mining activities are not required if the circular to shareholders includes a valuation by a Competent Evaluator (as defined in Chapter 18) that encompasses the natural resources and the ancillary property interests as a business or as an operating entity (Rule 5.02A(d)). Property interests ancillary to mining activities for which valuations are not required, will however need to be covered in the overview section.

### 3. Very Substantial Acquisitions

Previously, for a very substantial acquisition (i.e. where any of the percentage ratios is 100% or more), the issuer was also required to include in the shareholders’ circular a valuation report on the enlarged group’s property assets (including properties being acquired as well as existing properties). Under the amended Listing Rules, a valuation of the issuer’s existing properties is no longer required.

### 4. Connected Transactions

There has been no change to the valuation requirements for connected transactions under Chapter 14A. In particular, disclosure of valuation reports in the shareholders’ circular is still required where the connected transaction involves an acquisition or disposal of an interest in a company listed on the Exchange.

## D. Further Information

The [Class Exemption Notice](http://www.gld.gov.hk/egazette/pdf/20111542/es220111542143.pdf) ([see archive](es220111542143.pdf)) can be found on the website of the Government Logistics Department.

The following documents, available on the Exchange’s website, can be viewed by clicking on the following links:

The [Consultation Conclusions](http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201012cc.pdf) ([see archive](cp201012cc.pdf))

The [consultation paper](http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201012.pdf) ([see archive](cp201012.pdf)) on the proposals

[Amendments to the Main Board Listing Rules](http://www.hkex.com.hk/eng/rulesreg/listrules/mbrulesup/Documents/mb103.pdf) ([see archive](mb103.pdf))

[Amendments to the GEM Listing Rules](http://www.hkex.com.hk/eng/rulesreg/listrules/gemrulesup/Documents/gem41.pdf) ([see archive](gem41.pdf))

A [set of FAQs](http://www.hkex.com.hk/eng/rulesreg/listrules/listrulesfaq/Documents/FAQ_15.pdf) ([see archive](FAQ_15.pdf))

[Charltons’ newsletter](/newsletters/hklaw/en/2011/108/nl-hklaw-20110121-108.html) on the consultation paper

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1. Paragraph 3 to the Third Schedule to the Companies Ordinance [↑](#footnote-ref-25)
2. For applicants, see Main Board Rule 11.07; for issuers, see Main Board Rule 14.63(2)(a) [↑](#footnote-ref-26)