

# Valuation of Real Estate that is Bound by Site Leasehold and Subject to Regulation by the Ground Lease Act

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**Key words:** Site leasehold, valuation, The Ground Lease Act

## SUMMARY

The paper presents an approach to valuation of real estate that is bound by site leasehold, which is also subject to regulation by the Ground Lease Act of December 20<sup>th</sup> 1996 number 106.

Site leasehold is the right of long-term use of land for housing purposes, both private and commercial. The term may be unlimited, but is normally a period of 80 – 100 years.

With the leaseholder as the owner of the buildings, the market is abnormal, because in reality, the leaseholder is the only purchaser. Estimating a value of real estate bound by site leasehold brings the appraiser certain challenges with lack of comparable objects.

## SUMMARY

Artikkelen inneholder en tilnærming av temaet verdsetting av eiendom som er gjenstand for tomtefeste, og som i tillegg er underlagt bestemmelsene i lov om tomtefeste 20. desember 1996 nr. 106.

Tomtefeste er rett til leie av grunn til hus som festeren har eller får på tomta, hvor formålet blant annet kan være til bolig, fritidshus eller forretningsbygg. Leieforholdet er normalt av langvarig karakter, og kan også være evigvarende.

Markedet for en festetomt er atypisk, da tomten er bebygd, og fester av tomta som samtidig er eier av påstående bygninger, vil være eneste aktuelle kjøper. Bortfestede tomter er ikke fritt omsettelige, og mangel på sammenlignbare objekter i markedet gjør verdsettingen til en særskilt utfordring.

# **Valuation of Real Estate that is Bound by Site Leasehold and Subject to Regulation by The Ground Lease Act**

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## **1. INTRODUCTION**

Site leasehold is lease of land, opposite to lease of a building. Mainly, the presentation will focus on valuation of sites for private housing and cabins, as leaseholders of such properties among other things is given stronger rights in relation to redemption through the Ground Lease Act. Lease of land for agricultural purpose is outside the applicability of the Ground Lease Act, and will not be discussed.

There are several interesting problems brought up concerned with valuation of leasehold sites and legislation and law court practice. This presentation can only touch a few of them, and on a basic level. Basic facts about site leasehold and central statutory provisions, which presume valuation of leasehold sites, will be referred shortly.

Further on, a practical approach to valuation of the most common types of objects will be presented, and some final reflections will roundup the presentation.

## **2. SITE LEASEHOLD**

### **2.1 The site leasehold institute**

Site leasehold was introduced in Norway in the Middle age, mainly after pattern from cities in Germany and England. This kind of agreement dealing with lease of land for housing purposes was already widespread in Europe a thousand years ago.

In 1988, the number of leasehold sites in Norway was estimated to 250 000, whereas about 100 000 was used for housing and approximately 90 000 were leased to cabin purposes. A subsequent estimate in 1996 has shown as many as 350 000 registered leasehold sites. The increasing is both a result of improved statistic material and of an actual establishing of new agreements.

The large number of leasehold sites gives many Norwegians some kind of relation to site leasehold. Most of them as leaseholders, and many of the leasehold contracts has large private or public authorities as property owners.

## **2.2 The Ground Lease Act - purpose and application**

The Ground Lease Act of December 20<sup>th</sup> 1996 nr.106 § 1 gives the definition on Site leasehold, which is lease of real estate for buildings that the leaseholder has, or will get on the site. In addition, the lease agreement must also give a right to long-term use.

Even if a building is raised on the site, pure lease of land is not within the scope of the act. This can be illustrated if a property owner A leases a site to B. B sublets the site to C, and C raise a building. The Ground Lease Act comes to application for the agreement between B and C, but not for the agreement between A and B.

## **2.3 Leaseholders disposal**

Within the purpose according to the contract, and as long as nothing different is agreed upon, a leaseholder achieves the entire disposal of the leasehold site through his contract on housing or cabin purposes. This follows by the Ground Lease Act § 16.

In other words, the limitations in the leaseholders' disposal are at the legislative level. The leaseholder has no access to undertake a judicial act connected with the property, for instance selling it. This fact does not obstacle the leaseholder from mortgaging in case of building loans etc. A mortgage on a leased property includes buildings and other constructions that the leaseholder has placed on the site, as stated in the Ground Lease Act §18.

Most lease agreements for housing purposes contain a provision on long-term use, often 50 – 100 years. According to the Ground Lease Act § 7, new and prolonged contracts are valid until leaseholder terminates the agreement, or redemption of the leasehold site is accomplished.

## **2.4 The Ground Lease Act in relation to market price**

### **2.4.1 Rental adjustment**

According to the majority of lease contracts, the contract parties have entered an agreement in rental adjustment after a given period, for example after every 10, 20 or 25 years. Through the regulations, the owner should be able to maintain his yield based on the property as a tied-up capital.

The Ground Lease Act § 15 establishes a right for the parties to demand a rental adjustment according to changes in the national price index since the last time an adjustment was carried out, eventually since entering the agreement. If the contract, without doubt, state an adjustment calculated in another way than according to changes in the national price index, there will be access to make a rental adjustment on the basis of the contract. There are certain conditions for such an adjustment; an agreement for housing and cabin purposes between leaseholder and property owner must have been signed before January 1<sup>st</sup>, 2002, and can only be carried out once. This is stated in the second part of §15.

Basically, agreements in other purposes than housing follow the same main rule on rental adjustment but there are no restrictions concerned to when the agreement was established or the number of possible value adjustments, according to the contract.

In all cases where leaseholder and property owner have agreed on a rental adjustment according to a market value, and the Ground Lease Act allows it, there is a need to obtain a valuation price.

The calculation of the leasing rental is based on two components; estate valuation and leasing interest rate. The interest rate reflects the owners' demand of yield, based on an alternate placement of capital, equivalent to the market value of the property at the time of regulation.

#### 2.4.2 Redemption

Leaseholder in an agreement for housing purposes has, through the Ground Lease Act § 32, a right to buy, or redeem his site, for the first time 30 years after the time of agreement, and then every second year. Redemption must be demanded in writing, and within a year before the end of the redemption period.

The requirements for redemption is stated in the Ground Lease Act §37, first part., where the main rule is that the redemption amount shall be 30 times the annual leasing fee, after regulation at the time of redemption. As an exception, both the leaseholder and the owner can demand that the redemption price is set to 40% of the estate value at the time of redemption, if certain requirements are fulfilled. In the Supremes Court's "Rettstidende" 2007, page 1308, it is stated that the exception rule in some cases may be in conflict with the Constitution §105, concerning the owner's right of full compensation when relinquishing land.

In cases where there without doubt is stated in the agreement that the regulation of the leasing fee shall be done in other ways than according to changes in the national price index, there is a need to obtain a valuation price even in case of redemption.

### **3. VALUATION**

#### **3.1 General reflections**

Site leasehold first became a subject of special legislation in 1975, but leasehold has almost continuously been under price regulation since World War II. Until 2002, the price regulations stated that the letter could not demand a annual fee of more than 1 NOK per square meter, or 1000 NOK per decaire. On January 1<sup>st</sup>, 2002, when the law of 1996 was introduced, the price regulations were set aside, and from this time on the valuation of leasehold property have been of current interest.

The challenge when valuating leasehold sites is the lack of available market prices for sites where an agreement since long is established, and already is built on. Disagreement between the site leaseholder and the property owner on what the actual market price would have been

if the site could have been sold independent of the building will often arise. There is no open market for trading leasehold sites, because normally there will be only one actual purchaser; the owner of the buildings on the site.

Normally, the disagreements are solved by hiring a valuation expert to set the real estate value for the current site. The comparison will often be poor, because leasehold sites hardly ever are sold independent of the buildings on top of it.

In agreements of leasehold, the ground is the object of valuation. This is opposite to the more normal forms of valuation, where the object is the site with its buildings. In valuation, the currently existing buildings shall not be a part of the value, which means that the state of current buildings is not of any concern in valuation of the site.

### **3.2 Different types of valuation objects**

#### **3.2.1 Single sites – area based leasehold**

In valuation of single sites, the price can be settled per square meter, or as a total for the whole site.

A leasehold site shall be valued as being without buildings and not under leasehold. Even though leasehold sites are not under free circulation, it is stated that, in lack of a better basis, the correct basis is the market value of the site without buildings. The site value must be corrected based on how the site has been built up, and other investments concerned to infrastructure. Such corrections shall be done based on the actual investments that the leaseholder has made. Public infrastructure and other public relations shall nevertheless be given concern, and this value rise goes to the property owner.

On regulation of leasing fee, there shall not be given any concern to potential for dividing the site into several new sites. This means that the site value shall be set related to the buildings that are on the site at the time of regulation.

#### **3.2.2 Single site – point based leasehold**

Most sites for housing are connected to a given area, but it is not unusual that agreements on leasehold of sites for cabins are established as point based leasehold. A large amount of the pointbased leaseholds are in outlying fields, often a hundred meters from the closest neighbour cabin, and up to several kilometres from a road. It is a limited need to mark exact site borders, and surveying has been difficult until the introduction of GPS. The sites have been registered in the estate registry as individual objects, with a geometric representation of a point.

On basis of the Ground Lease Act §16 and the preliminary work, the site is supposed to, if no other limitations are referred to, be about one decare, based on an appropriate approach under the conditions at the site.

Valuation of such leasehold is based on the marked value for a site of one decares. Many cabins that were raised in the mountains and in outlying fields before the introduction of the current Planning and Building Act would not have been allowed built today. In such areas there are no sites for sale, and the market value for a leasehold site must be calculated based on comparative areas.

There are examples of trade of mountain cabins, where the sites has had a good placement concerned to view and closeness to water, and where there has been very high prices for cabins that has been likely to be torn down at the time of trade. Such cases show that the value of the site position in these examples has come to the seller of the buildings, but it is also a signal of high site values.

### 3.2.3 Site areas –differentiated prices

Sites within one large area may be of varying size. The basis is that each site shall be given individual valuation, but very often a template based technique is used, to save time and resources. The valuator often divides the area into zones with different valuation based on the condition of the sites.

The valuation is often based on a normal site being 1000 square meters. The central value of the site is the possibility to raise buildings, and a discount is likely to be given for area above 1000 square meters. For instance, a price reduction of 30% for the area between 1000 square meters and 60% for the area above 1500 square meters.

### 3.2.4 Site areas for further leasehold

Sometimes an actor, often the local authorities (municipalities) are leasing a large area, and subletting sites within the area further on to the inhabitants, for housing. Within the area there will be smaller areas regulated for developing, roads, playgrounds and recreation. The level of utilization should be considered in the valuation process, and a technique with net and gross area is used, with individual valuation for each area type. In valuations, the ratio between the net area and other areas will create the basis for such a distribution, likely to be 70/30. In advance, some valutors make a reduction of 5% for the administrative expenses of the municipalities.

Concerning the cost of preparing infrastructure, such as public roads, water and draining, separate treatment of the municipality as leaseholder and as preparer of infrastructure for the inhabitants has to be done.

### 3.2.5 Sites with a high level of utilization

For sites with a high level of utilization, such as apartment buildings, there are good reasons for setting a higher site value than for sites with one-family houses. The valuation may also be connected to the permitted level of utilization.

### 3.2.6 Sites with preservation regulations or other special regulations

If the utilization of a site is restricted by for instance preservation by the Cultural Heritage Act, or if limitations caused by the terrain reduce the possibility to utilize the site for the given purpose, this will be given concern as far as it is considered to inflect the site value.

### 3.2.7 Sites for public or common use purpose

Many sites from the share of leasehold agreements that are not connected to housing or cabins are used for public or common useful purposes.

The question in such cases is how sites used for schools or nursing homes should be valued. This is often an area-demanding usage, and creates no income for the leaseholder. Within the rules for expropriation, it is stated through court practice that compensation should be measured out based on the regulation purpose. There are two exceptions from this rule, one of them concerned to measuring out compensation in cases with acquisition of area regulated for public purposes. In such cases, the expected alternating usage shall be the basis, in other words the purpose that it is likely to believe that the site would be used for, if the given regulation had not been there.

When valuating sites that are bound to such purposes, it is natural to look at the rules for expropriation, because the leasehold agreement ties the parties for a long time, and the leaseholder has the same actual disposal as an owner. In reality this indicate that if a site is leased for a nursing home, and it lies within a housing area, the market price will be calculated based on the site value for housing in the area.

If the leasehold agreement opens for regulation of annual rental, based on the site value at the time of regulation, this rule can be used for all upcoming regulations. This is opposite to cases with equivalent agreements for housing and cabins.

## **4. FINAL REFLECTIONS**

The two parties in leasehold have opposite interests, and there will always be a possibility for disagreements on how to set the correct market value for a leasehold site.

Over the last years, the Ground Lease Act has been given much concern, not only from leaseholders and property owners, but also politically. Several changes in the act have been carried out after January 1<sup>st</sup>, 2002. The changes have given the leaseholders stronger rights, and regulation of leasehold rentals and redemption has been the subject for many lawsuits.

As long as the letter has access to make adjustments of the leasehold rentals based on the site value, the valuation of leasehold sites will be a subject of discussions.

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