



MANAGEMENT
DISCUSSION
AND ANALYSIS

The problem of urban decay in Hong Kong remains daunting. According to a study conducted in 2017, about 10,000 of our buildings were over 50 years old and more than a third of those were in deteriorating or poor condition.

By 2046, the number of building blocks over 50 years old would approach 28,000, with the possibility of a parallel increase in dilapidation if no action is taken.

Moreover, the development potential of many of these high-density old buildings have already reached their limits without much room for plot ratio gains after redevelopment. To address the redevelopment dilemma and tackle the problem in urban decay, the URA takes the initiatives to carry out urban renewal in a more holistic and visionary approach including district-based planning and strategic studies.

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Current Position

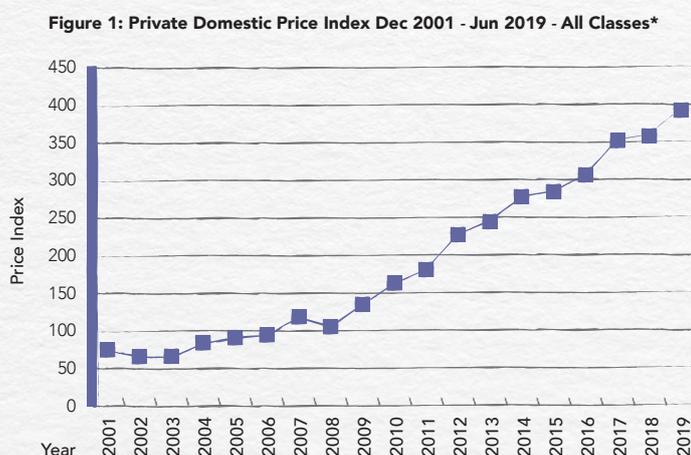
Since its establishment in 2001 and up until 30 June 2019, the URA had commenced and implemented 62 projects comprising 59 redevelopment projects, two preservation projects and one revitalisation project. A further of six redevelopment projects were undertaken in association with the Hong Kong Housing Society (HKHS). Of these 68 projects, 24 have been completed and the remaining are at various stages of implementation. The URA's notable achievements can be measured through the scale of urban decay that has been successfully addressed, the consequent benefits to the affected people, the contributions to new flat supply and the new facilities created for communities, as highlighted below:



At the time of its establishment, the URA also took over 10 projects which were under implementation by its predecessor, the Land Development Corporation. All of these have now been completed.

Challenges and Opportunities

The property market is now in the 16th year of an upward trend, which began in 2003 and has seen prices for all classes of accommodation in the private domestic market rise about six-fold (see Figure 1). This price increase poses a growing risk to the value of the URA's acquired building stock in the event of a market downturn. The risk is further compounded as the URA is obliged to bear higher development costs by acquiring properties under the "7-year rule" and is subject to ex-gratia payments markedly higher than those incurred by private sector developers. The URA is also obliged to commence acquisition as soon as possible after authorisation by the Secretary for Development or approval by Executive Council. This exacerbates the risk of "buy high, sell low" as URA does not have the flexibility to slow the acquisition process under unfavourable market conditions. The URA mitigates this risk by targeting the clearance and tender of projects which can help reduce the value and market exposure of properties under development. The URA has cleared and tendered one and three



*HKSAR Government, Rating & Valuation Department, Hong Kong Property Review Monthly Supplement, August 2019.

projects respectively during the year to 30 June 2019. Construction costs, meanwhile, though largely steady in the last few years, remain high (see Figure 2).

Meanwhile, the URA has kept in view the effectiveness of the Demand-led Pilot Scheme, which began after the Urban Renewal Strategy was issued in 2011 in an effort to harness the collective willingness of owners to help initiate urban renewal themselves. The refinements in 2014 were not conducive to the scheme's overall objectives and the scheme is now being reviewed holistically under the strategic Yau Mong District Study (YMDS) with a view to creating a greater planning impact by adopting a planning-led approach without compromising owners' demands.

In response to an invitation from the Government, the URA has identified two clusters of suitable Civil Servants' Co-operative Building Society (CBS) Scheme sites as pilot projects for implementation, subject to the approval of the Financial Secretary, in order to release their redevelopment potential and increase housing supply. The experience gained from these two pilot projects will help to establish an efficient policy and procedure for the implementation of future CBS projects.

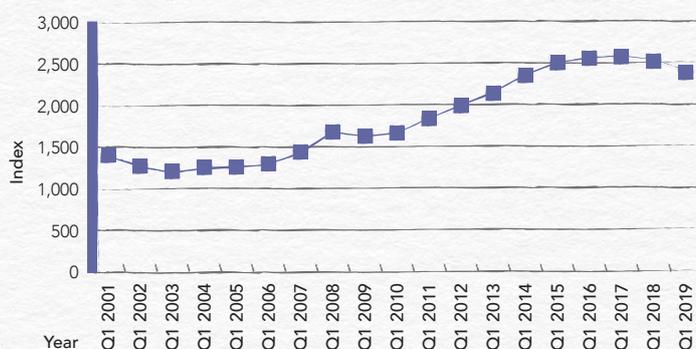
District-based Approach

By commencing a grouping of six projects in To Kwa Wan, the URA has taken a monumental step toward optimising the potential from larger clusters of dilapidated buildings in need of redevelopment. This can achieve more meaningful urban renewal benefits through the creation of a more community-friendly environment with a refined urban grid and appropriate land usage. It is important that this district-based approach ushers in alternative development outcomes which provide a tangible reflection of people-first urban renewal, designed with the community in mind. The Operating Review of this report introduces the district-based approach and provides details of these To Kwa Wan projects and their related planning and social gains.

To optimise the planning benefits from our redevelopment projects, the URA is now promulgating a shift in its urban renewal focus from the traditional project-led approach to a more holistic planning-led approach to urban renewal. Based on this approach, district-based and integrated "5R" projects can only be properly designed after comprehensive planning strategies for the sites and the surrounding areas have been carried out.

The URA commenced the YMDS in 2017. Previous urban renewal studies have sought to identify isolated redevelopment and other opportunities under the "4Rs". The brief to the YMDS, however, is an altogether new paradigm aimed at achieving holistic urban renewal by exploring new Institutional and Implementation strategies integrating the "5Rs" with a temporal progression. Upon the completion of the study, the YMDS will formulate feasible and financially sustainable projects as part of a wider set of district-based renewal strategies under the "5R" initiatives which can be readily replicated in other older districts.

Figure 2: Quarterly Construction Tender Price Index 2001-2019*



*Rider Levett Bucknall, Quarterly Construction Cost Update, June 2019

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Rehabilitation

Rehabilitation is one of the two URA's core businesses targets, with the other being redevelopment. The URA has become the primary agent in Hong Kong for building rehabilitation after taking over the Hong Kong Housing Society (HKHS) responsibilities under the Integrated Building Maintenance Assistance Scheme (IBMAS) in July 2015. As a rule, it should always be the owners' responsibility to ensure timely repair and maintenance of their buildings. However, frequent lack of financial means, technical support, organisation and awareness among owners are persistent hurdles to proper rehabilitation. To confront these obstacles, the URA has supplemented its rehabilitation efforts through various loan and subsidy schemes. Three new schemes, namely Operation Building Bright 2.0, Fire Safety Improvement Works Subsidy Scheme and Lift Modernisation Subsidy Scheme, were introduced in 2018/19 to tackle building safety hazards and enhance fire and lift safety standards. In addition, various building assistance and subsidy schemes have been consolidated into the IBMAS for an easy one-stop application procedure which helps owners take advantage of various building assistance and subsidy schemes. The financial assistance, technical advice and coordination services provided by the URA under these schemes have been well received, judging by the enthusiastic response and commendations received from Owners' Corporations.

New Building Rehabilitation Strategy Study

Noting the increasing pace of building deterioration and the substantial cost of maintenance and repair, the New Building Rehabilitation Strategy Study was launched in 2017. This is aimed at developing strategies to maximise benefits of building rehabilitation in the urban renewal process by improving the condition of buildings and extending their effective lifetime, thus reducing the number of buildings requiring immediate redevelopment. To create a mindset of preventive maintenance amongst owners, raising rehabilitation awareness for buildings under 30 years old has been proposed as the first step to prolong the service life of buildings. Owners and other stakeholders can turn to the newly-formed Building Rehabilitation Platform as an all-in-one information centre. This platform provides building owners and Owners' Corporations with comprehensive building rehabilitation information and technical support, including practice notes and guidelines, and standardised documents. The URA will continue updating the information contained in the Platform, including the provision of cost references and list of service providers.

Preservation and Revitalisation

The URA is mandated under Section 5 of the URS to preserve buildings, sites and structures of historical, cultural or architectural value. There are 10 such projects now in the URA's portfolio which contain buildings for preservation or revitalisation. Three of these projects at Prince Edward Road West, Shanghai Street/Argyle Street and Mallory Street are dedicated preservation or revitalisation projects, whereas preserved buildings form part of a larger redevelopment project site in seven other projects.

The Shanghai Street/Argyle Street preservation project is at a vital stage. The construction of new building blocks to be integrated with the preserved shophouse cluster have been completed, and the fitting-out works are in progress. Another initiative involving a historic building at an important stage is the Central Market revitalisation project, which commenced in 2009 as tasked by the Government under the "Conserving Central" initiative in the 2009/10 Policy Address. The main revitalisation works of this project commenced in November 2018 with the first phase to be tentatively completed in early 2021 for the public's early enjoyment.

There was a new beginning for the Mallory Street revitalisation project in 2018/19 as it has renamed to "7 Mallory Street". The URA took over the management and operation of the project in August 2018 and will continue to collaborate with a wider spectrum of art, cultural and community organisations.

Human Resources

To better equip the URA with sufficient manpower to take up the challenges, there was a slight increase in the actual headcount in 2018/19 compared to the previous year. To nurture a leadership pipeline, the URA Future Leaders Programme has been implemented to develop promising General Managers and Senior Managers. Core Career Ladders which provide clear and transparent career paths for URA staff were also introduced in 2018/19. At the same time, in order to attract, motivate and retain young qualified professionals with satisfactory performance, combined establishment was introduced to allow more upward move for these professional staff.

To equip the workforce with the proper mind-set, knowledge and skills required to apply innovation and technology in their work, training programmes in 2018/19 focussed on building our staffs' ability to apply the latest technology into their work; broadening their horizon and exposure via visits and talks delivered by external experts; and further enhancing their skills through various Big Data, Artificial Intelligence (AI), BIM and GIS workshops.

At the organisation level, and to support the urban renewal directions, divisional reviews were carried out leading towards better alignment and organisational effectiveness. To promote a culture of continuous improvement, Staff Suggestion Scheme and Work Improvement Team initiatives have been sustained to help our staff develop and apply their innovative ideas into tasks, in order to improve work procedures and to enhance efficiency.

Outlook

Hong Kong's rapidly ageing building stock remains the key challenge. Implementing urban renewal in a sustainable manner is the overarching goal of the holistic approach adopted by the URA. Through the strategically important YMDS and New Building Rehabilitation Strategy Study, the URA has taken a forward-looking vision towards devising ways to address the rising tide of urban decay. Although the URA currently enjoys a strong cash position, the financial ground has inevitably shifted beneath us with high acquisition costs, relatively high construction costs and cautious outlook on future property market. The URA has taken a critical look at various means to continue to chart our way forward. The objective remains to deliver a sustainable and holistic urban renewal programme that meets the needs and expectations of the community in changing economic and market conditions.

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Financial Review

(I) Review of 2018/19 Results

(a) Revenue

The revenue for the year ended 31 March 2019 was \$3,423 million, which comprised upfront payments from tendered projects, share of surplus from joint development projects and proceeds from sale of flats at Kai Tak. The amount was lower than the revenue of \$13,868 million in 2017/18 by \$10,445 million.

The upfront payments in 2018/19 of \$2,833 million were significantly lower than that of 2017/18 as there were only two projects tendered during the year, namely Tung Chau Street/Kweilin Street and Castle Peak Road/Un Chau Street with a total site area of 3,540 m², compared to three tendered projects in 2017/18 with a total site area of 4,755 m² and including a commercial/office/hotel development in Central area which brought in an upfront payment of \$10 billion.

The share of sales proceeds from joint development projects of \$445 million in 2018/19 (2017/18: \$1,128 million) was revenue from projects where the sales proceeds exceeded the thresholds stipulated in the development agreements. The decrease in the share of sales proceeds reflected that the majority of the residential units of the projects had been sold in prior years, and only a small number of unsold flats were left for proceeds sharing upon sale.

The revenue from sale of properties of \$144 million mainly related to the proceeds of \$139 million from sale of 14 residential flats at Kai Tak (2017/18: \$157 million for 18 flats) and these flats were sold at prevailing market price.

(b) Other income

Of the \$536 million (2017/18: \$451 million) in other income for 2018/19, \$436 million (2017/18: \$320 million) was interest income from bank deposits and fixed income investment products, with an average yield of 2.31% p.a. (2017/18: 1.60% p.a.). The higher average yield reflected the increase in interest rates in the money market during the year. Other income also included rental income from certain properties retained by the URA.

(c) Administrative expenses

Administrative expenses for 2018/19 of \$449 million (2017/18: \$423 million) mainly covered staff costs, accommodation costs and office expenses. Cost control measures were implemented whenever possible to minimise administrative expenses.

To cope with the expansion of urban renewal activities, including the increased level of rehabilitation works arising from the new subsidy schemes, including the Operation Building Bright 2.0, the Fire Safety Improvement Works Subsidy Scheme and the Lift Modernisation Subsidy Scheme, the staffing level was increased from 501 at 31 March 2018 to 517 at 31 March 2019. Of the 517 staff, 15 (31 March 2018: 15) were employed on contracts of less than three years.

(d) Write back of provision for impairment on properties and committed projects

Based on the accounting policy detailed in Notes 2(h) and 2(n) to the financial statements, write back of provision for impairment on properties and committed projects of \$841 million was made in 2018/19 in view of rising property prices during the year.

(e) Surplus for the year

For the year 2018/19, the URA recorded a net surplus of \$2,330 million, showing a decrease of \$9,708 million as compared to \$12,038 million for 2017/18. Major contributions to the 2018/19 net surplus were (a) the surplus from tendered projects, (b) the share of surplus sales proceeds from various joint development projects, and (c) the write back of provision for impairment on properties and committed projects on various projects previously made as a result of the rising property prices during the year.

(II) Financial Position at 31 March 2019

(a) Properties under development

Properties under development before provision for impairment of \$29,609 million as at 31 March 2019 (31 March 2018: \$25,769 million) reached record high level. This sum represented the acquisition and development costs of 18 projects under various states of implementation.

The aforesaid value was off-set against the cumulative provision for impairment totalling \$1,181 million (31 March 2018: \$1,980 million), resulting in a net value of \$28,428 million (31 March 2018: \$23,789 million). The increase in the net value was mainly due to continued acquisition of Kowloon City projects during 2018/19 and the write back of provision for impairment. It was off-set by certain projects being tendered during the year.

(b) Total liquidity

As at 31 March 2019, the URA's total liquidity, including cash, bank deposits and debt securities investments, was \$18,107 million (31 March 2018: \$21,221 million).

The URA placed the surplus cash on deposits with a number of financial institutions, and also invested in fixed income products of the required credit rating in accordance with the investment guidelines as approved by the Financial Secretary with capital preservation as the priority.

The liquidity position, off-set by the borrowings of \$2,793 million (31 March 2018: \$2,791 million) mentioned in paragraph II (c) below, resulted in the net liquidity position including the securities holdings at 31 March 2019 of \$15,314 million (31 March 2018: \$18,430 million).

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(c) Debt securities issued

The URA is rated AA+ by Standard & Poor's Rating Services. As at 31 March 2019, the outstanding debt securities issued by the URA was \$2,793 million under the US\$1,000 million Medium Term Note (MTN) Programme.

(d) Net asset value

The URA's net asset value as at 31 March 2019 was \$46,974 million (31 March 2018: \$44,644 million), representing the Government's capital injection of \$10,000 million (31 March 2018: \$10,000 million) and an accumulated surplus of \$36,974 million (31 March 2018: \$34,644 million).

The financial highlights of the past ten years are summarised on page 113 of this Annual Report.

(III) Capital Injection and Tax Exemption

Following approval by the Finance Committee of the Legislative Council on 21 June 2002, the Government injected \$10,000 million of equity capital into the URA in five tranches of \$2,000 million each over a five-year period from 2002/03 to 2006/07. The Government continues to exempt the URA from taxation.

(IV) Waiver of Land Premia by the Government

The Government waives the land premia for redevelopment sites granted to the URA. For 2018/19, the land premia waived by the Government on three land grants amounted to \$190 million. Since May 2001, a total of 43 land grants have been waived in respect of all the tendered projects with aggregate land premia totalling \$19,678 million.

Without this waiver, the URA's net surplus for 2018/19 of \$2,330 million for the year would have been lowered by \$190 million to \$2,140 million; its accumulated surplus as at 31 March 2019 would have been lowered by \$19,678 million to \$17,296 million; and its net asset value as at 31 March 2019 would have been decreased to \$27,296 million.

(V) Financial Resources, Liquidity and Commitments

As at 31 March 2019, the URA's net liquidity position totaled \$15,314 million. At the same date, the URA's outstanding commitments to the commenced projects, together with the construction cost on projects based on the valuation carried out by the URA's in-house professionals, were estimated at \$9,134 million.

In addition to the US\$1,000 million MTN Programme mentioned in paragraph II (c) above, the URA also maintained uncommitted credit facilities with major banks in Hong Kong. The external funding and credit facilities ensured the URA would have sufficient financial resources to carry out its urban renewal programme as planned.

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Individual projects, with various development potentials, are tendered out at different times during property market cycles. Subject to the market conditions prevailing at the time of tender submission, the upfront payments may be higher or lower than the URA's acquisition costs. As at 31 March 2019, the total costs of properties under development, excluding provision for impairment, was \$29,609 million. The value of properties under development is exposed to the risk of property price fluctuation. Should the projected future value of the properties under development is lower than its actual/estimated acquisition and clearance costs, impairment loss will be recognised in the URA's books.

It is estimated that a total cash outlay of about \$34,000 million, excluding operational overheads, will be required in the coming five years to meet both of the URA's currently outstanding commitments and its forthcoming cash outlay for the implementation of the projects. This amount covers the URA's work in redevelopment, rehabilitation, preservation and revitalisation.

The URA will continue to review its businesses with an aim to maintaining a highly prudent financial position and having due regard for commercial principles in its operations so that the urban renewal programme could be sustainable in the long term.