Management Discussion and Analysis

(I) Review of 2010/11 Results

(a) Revenues

Revenues for the year ended 31 March 2011, comprising mainly upfront payments from tendered projects and share of surpluses from jointly controlled development projects, amounted to $3.6 billion. Compared to the last financial year's revenue of $9.7 billion, this represents a decline of $6.1 billion or 63%. The aggregate value of upfront amounts concluded by the URA in 2010/11 was much lower than 2009/10 as the two redevelopment project sites tendered and awarded during the year, namely Yu Lok Lane / Centre Street and Fuk Tsun Street / Pine Street, with 2,710 m^2 in total area, were fewer in number and smaller in size than the three sites tendered and awarded in 2009/10 with total area of 15,892 m^2. The upfront amounts concluded in 2009/10 also represented the highest aggregate value recorded in any financial year since the establishment of URA in 2001. Also included in the revenues were shares of sales proceeds totalling $1.5 billion (2009/10: $0.2 billion) from certain jointly controlled development projects with the proceeds exceeding certain thresholds stipulated in the development agreements which were set years ago when property market values were relatively much lower. The development agreements of Island Crest in Sai Ying Pun, Florient Rise in Tai Kok Tsui and Vision City in Tsuen Wan were executed in 2005, 2004 and 2002 respectively.

(b) Other net income

Of the $72 million included as other net income for the year (2009/10: $80 million), $49 million (2009/10: $25 million) was interest income earned from bank deposits, with an average yield of 0.90% p.a. (2009/10: 0.45% p.a.). There were also gains of $12 million (2009/10: $29 million), principally achieved from funds managed by the investment manager with a gross yield of 1.61% p.a. against the reported one-year benchmark return of 1.58% for 2010/11.

(c) Administrative expenses

Administrative expenses mainly covered staff costs, accommodation costs and depreciation charges. Administrative expenses before depreciation for the financial year increased to $269 million (2009/10: $246 million) largely due to the headcount growth required to meet the workload of the URA's planned projects and new initiatives. The depreciation charge for office capital expenditure was $20 million for the financial year 2010/11 (2009/10: $20 million).

To cope with the expansion of urban renewal activities, including the increased levels of rehabilitation works arising from Operation Building Bright which will be implemented over a number of years, the staffing level as at 31 March 2011 increased by 28 to 423 (31 March 2010: 395), of which 97 staff (31 March 2010: 55) were employed on contracts of less than three years in duration.

(d) Provision for Urban Renewal Trust Fund (URTF)

Under the new Urban Renewal Strategy (URS), the URA is committed to providing $0.5 billion funding as an endowment for the establishment of the URTF. This was recorded as a liability consequent to the promulgation of the new URS on 24 February 2011 and charged as a provision in the current year's account. The new URS also requires the URA to provide additional funding in the future to the URTF.

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

The URA's properties and committed projects are valued by in-house professionals at the end of each financial year. Based on its accounting policy detailed in Notes 2(g) and 2(n) to its financial statements, a net write back of the provision for loss aggregating $0.3 billion was made in this financial year. The said amount reflected the reduction in the provision for loss for various projects resulting from the increases in their respective assessed development values as compared with those at 31 March 2010, offset against the additional provision required for some projects due to changes in development plans and approaches to them.

As a note of interest, acquisition offers were issued to owners of interests in the Ma Tau Wai Road project in May 2011. URA intends to develop this project directly by itself to provide small flats to the housing market. It is currently anticipated that a provision for loss would be made for this project in 2011/12.

(f) Operating surplus for the year

For the year ended 31 March 2011, the URA recorded a net operating surplus of $2.2 billion mainly attributable to the surplus from the two tendered projects and the share of surplus sales proceeds from various joint venture projects. This represents a decline of $4.8 billion or 69% compared to the $7.0 billion net operating surplus reported in 2009/10. This significant reduction mainly resulted from the smaller sizes of the projects awarded in 2010/11 by comparison with 2009/10 as mentioned in paragraph (I)(a) above.

The Masterpiece and K11 Mall is the only URA project under the Owner Participation Scheme. Sale of its residential units and operation of its hotel and retail mall all commenced in 2009/10. Subject to the finalisation of the account and fulfilment of certain conditions, it is envisaged that the URA will likely share a certain surplus from this project which will be accounted for in the ensuing 2011/12 financial year.

(II) Financial Position at 31 March 2011

(a) Properties under development

The value of "Properties under development" as at 31 March 2011 was at a historically high level of $15.9 billion (2009/10: $14.1 billion), representing the acquisition costs for projects for redevelopment or preservation purposes at various stages of implementation, comprising two projects under acquisition; six projects pending completion of resumption process; one project with over 90% ownership of interests acquired pending reversion to the Government; and five projects with ownership reverted to the Government pending final clearance. The aforesaid cost was set off against the cumulative provision for loss on nine projects of $5.2 billion (2009/10: $4.7 billion for 10 projects) giving rise to a net cost of $10.7 billion (2009/10: $9.5 billion). The increase in the net cost reflects mainly the higher number of projects now being implemented and the generally higher levels of acceptance of offers for acquisition of properties in these projects. During 2010/11, the URA commenced acquisition of two redevelopment projects, one located in Sham Shui Po and the other in Ma Tau Kok.

(b) Cash and bank balances

As at 31 March 2011, the URA's cash and bank balances and the fair value of the funds managed by the investment manager totalled $7.1 billion (2009/10: $5.7 billion). The improvement in bank balances of $1.4 billion from last year was substantially due to the receipts, in 2010/11, of the balances of the upfront payments of the projects tendered in 2009/10, coupled with the lower acquisition acceptances to its revised offers.

The URA placed its surplus cash on short-term deposits with a number of financial institutions and invested in HK$ bonds of the required credit rating in accordance with the URA's investment guidelines, which have been approved by the Financial Secretary with capital conservation as the priority. The investment manager who manages a portion of the surplus funds also follows the same guidelines.

Off-set by the borrowings of $1.5 billion mentioned in paragraph (II)(c) below, the net cash position including the fair value of the financial assets at 31 March 2011 was $5.6 billion (31 March 2010: $4.2 billion).

(c) Debt securities issued

In December 2010, in conjunction with the upgrading of the Government's rating, the URA's rating was also adjusted by Standard & Poor's (S&P) from its previous rating of AA+ to AAA. The ratings were reassessed and reaffirmed in February 2011, with URA's standalone credit rating reconfirmed at AA+.

As at 31 March 2011, the debt securities issued by the URA was $1.5 billion. In May 2011, the URA issued three-year fixed rate notes with an annual coupon of 1.45% for a total principal amount of HK$0.2 billion under its US$1 billion Medium Term Note (MTN) Programme.

(d) Net assets value

The URA's net assets value as at 31 March 2011 was $19.2 billion, representing the Government's capital injection of $10 billion and an accumulated surplus from operations of $9.2 billion.

The financial highlights of the past ten years are summarized on page 83 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 billion of equity capital into the URA in five tranches of $2 billion over a five-year period from 2002/03 to 2006/07. The Government has exempted the URA from taxation.

(IV) Waiver of Land Premia by the Government

Under the Urban Renewal Strategy (URS), the Government waives the land premia for redevelopment sites granted to the URA. For 2010/11, the land premia waived by the Government on two land grants amounted to $0.9 billion. Since May 2001, a total of 16 land grants, including the two made in 2010/11 have been waived in respect of all the tendered projects with aggregate land premia totalling $5.4 billion.

Without this waiver, the URA's net operating surplus for 2010/11 of $2.2 billion for the year would have been lowered by $0.9 billion to $1.3 billion; its accumulated surplus since May 2001 would have been lowered by $5.4 billion to $3.8 billion; and its net assets value as at 31 March 2011 would have been decreased to $13.8 billion.

(V) Financial Resources, Liquidity and Commitments

As at 31 March 2011, the URA's net cash position including the fair value of the funds managed by the investment manager totalled $5.6 billion as mentioned in paragraph (II)(b) above. At the same date, the URA's accruals and estimated outstanding commitments to the commenced projects based on the valuation carried out by the URA's in-house professionals stood at $12.8 billion.

In addition to the US$1 billion MTN Programme mentioned in paragraph (II)(c) above, the URA maintained a total of $2.0 billion and $0.8 billion in committed and uncommitted bank facilities as at 31 March 2011. Securing some external funding in advance and certain credit facilities has ensured that the URA will have sufficient financial resources to carry out its urban renewal programme as planned.

When implementing its urban renewal programme, the URA is necessarily exposed to financial risks arising from property market fluctuations. Individual projects with various development potentials are launched for tendering process at different times during property cycles after their site clearance. Subject to the market conditions prevailing at their respective times of tender submission, their upfront payment receivables may be higher or lower than the URA's acquisition costs. As at 31 March 2011, the total costs of properties under development was $15.9 billion. Taken together with its outstanding commitments, the URA's exposure to the property market was at a historically high level.

The URA estimates in its latest Corporate Plan that in the five years from 1 April 2011, a total cash outlay of about $20 billion, excluding operational overheads, will be required to meet the costs of both its currently outstanding commitments and its forthcoming expenditure on implementation of the projects contained in the Plan. This expenditure covers the full range of the URA's work principally in redevelopment and preservation, but excludes any demand-led redevelopment projects, of which the cash flow requirement cannot be estimated before their inclusion into the Plan.

To ensure that its urban renewal programme is sustainable for the longer term, the URA is tasked to maintain a very prudent financial position and have due regard for commercial principles in its operations.