Review of Financial Results and Positions

(I) Review of 2009/10 Results

(a) Revenues

Revenues for the 2009/10 financial year amounted to $9.7 billion against $1.4 billion attained in the previous financial year. The upfront payments for the three tendered redevelopment projects, namely, Lee Tung Street / McGregor Street, Kwun Tong Town Centre – Yue Wah Street Site and Lai Chi Kok Road / Kweilin Street / Yee Kuk Street, which were recognised during the year, were higher than the URA had expected due to the favourable property market conditions prevailing at the times of the tendering of the said development projects. The aggregate value of upfront amounts concluded by the URA in 2009/10 was the highest recorded in any financial year since the URA was established in 2001. The total site area of the projects awarded during the year was 15,892 m^2 versus the 5,004 m^2 for three projects in 2008/09.

(b) Other net income

Of the $80 million included under other net income for the year (2008/09: $286 million), $25 million (2008/09: $226 million) relates to interest income earned from bank deposits, with an average yield of 0.45% p.a. (2008/09: 2.43% p.a.), which represents a decline of 81% from 2008/09 to 2009/10, but compares favourably with the decline of 93% in average 1-month HIBOR in the same period. There were also gains of $29 million (2008/09: $30 million), principally achieved from funds managed by the investment manager, with a net yield of 3.04% p.a., against the reported one-year benchmark return for 2009/10 of 2.46%. The decrease in other income was mainly attributable to the lower deposit interest rate offered by banks and declining bank balances referred to in paragraph (II)(b) below.

(c) Administrative expenses

Administrative expenses mainly comprised staff costs, accommodation costs and depreciation. Administrative expenses before depreciation for the financial year increased to $246 million (2008/09: $219 million), largely due to the expansion required to meet the workload of the URA's planned projects and new initiatives. The depreciation charge increased to $20 million for the financial year 2009/10 (2008/09: $16 million), owing to the capital expenditure needed to upgrade office equipment and the establishment of the Urban Renewal Exploration Centre.

To cope with the increased scale of urban renewal activities, including increased levels of activities in rehabilitation, revitalisation and preservation during the year, the staffing level as at 31 March 2010 increased by 37 to 395 (3/2009: 358) of which 55 staff (3/2009: 19) were employed on contracts of less than three years in duration.

(d) Operation Building Bright

Under an agreement entered into with the Government in May 2009, the URA undertook to implement the Operation Building Bright (OBB) initiative for buildings within the URA's Scheme Areas and contributed $150 million to URA's portion of the OBB Fund, with the remaining amount of about $350 million to be borne and payable by the Government into that Fund in a number of instalments over a period of two years. Subsequently, under a Supplementary agreement made in September 2009, the Government increased its contribution to the OBB Fund operated by the URA to about $850 million.

By 31 March 2010, the URA's portion of the OBB Fund had received $150 million from the URA plus $175 million from the Government. Following the payment schedule of the building works, grants totalling $15 million were approved and provided for in the financial statements of the OBB Fund at 31 March 2010.

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

The URA's properties and committed projects were valued by in-house professionals at 31 March 2010. 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 of $0.5 billion in aggregate was made in this financial year. The said amount was largely due to the write back of the provision for loss for the Kwun Tong Town Centre project and Sai Yee Street project because of their higher assessed values than last year, resulting from the improved property market conditions, net of the provision for loss made for two pre-war shophouse preservation projects. The loss of $5.3 billion provided for in 2008/09 had consisted of provision of $4 billion for the Kwun Tong Town Centre project and $1.3 billion for other projects.

(f) Operating surplus for the year

The URA recorded a net operating surplus of $6.9 billion as at 31 March 2010. This compares favourably with the $4.5 billion net operating deficit reported as at 31 March 2009. This improvement in operating result was mainly attributable to the surplus from the three tendered projects mentioned in (I)(a) above. The good tender results of these three projects were attributable to the favourable property market conditions prevailing throughout the year. The operating deficit reported last year included the substantial loss provision made for the Kwun Tong Town Centre project mentioned in paragraph (I)(e) above. Before the write back of or provision for impairment on properties and committed projects, there was a surplus of $6.4 billion for the financial year against $0.8 billion reported in the previous year.

(II) Financial Position at 31 March 2010

(a) Properties under development

The value of “Properties under development” as at 31 March 2010 was at a historically high level of $13.9 billion (2008/09: $8.1 billion), representing the acquisition costs for projects for redevelopment or preservation purposes which were at various stages of implementation: four projects under acquisition; three projects with ownership of interests over 80% pending resumption process; and five projects with ownership reverted to the Government pending final clearance. Such cost is set against the cumulative provision for loss on 10 projects of $4.7 billion (2008/09: $3.0 billion for 10 projects) resulting in a net cost of $9.2 billion (2008/09: $5.1 billion). The increase in the net cost was mainly due to the increase in the number of projects now being implemented, and the generally higher levels of acceptance of offers for acquisition of properties affected by these projects. During 2009/10, the URA commenced acquisition of three projects, including two projects to preserve pre-war shophouses and one redevelopment project in Tai Kok Tsui.

(b) Cash and bank balances

As at 31 March 2010, the URA’s cash and bank balances and the fair value of the funds managed by the investment manager totalled $5.7 billion (2008/09: $7.7 billion). The decline of $2.0 billion in bank balances was mainly due to additional property acquisition requirements during the year, coupled with the arrangement stipulated in the relevant development agreements, in order to enhance the attractiveness of the large tenders, that certain portions of the upfront payment receipts of the tendered projects concerned will only be received in the 2010/11 and 2011/12 financial years.

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

(c) Debt securities issued

In December 2008, the URA obtained a corporate credit rating of AA+ from Standard & Poor's Ratings Agency. In July 2009, the URA established a Medium Term Note Programme of US$1 billion which enables it to access debt capital market funding, and allows for future issuance from time to time. In the same month, it also issued its first HK$1.5 billion bond under the Programme. The bond issue carries a three year maturity, with an annual coupon of 2.08% and is rated AA+ by Standard & Poor's.

(d) Net assets value

The URA's net assets value as at 31 March 2010 was $16.7 billion, representing the Government's capital injection of $10 billion and an accumulated surplus from operations of $6.7 billion.

The financial highlights of the past few years are summarized on page 97 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 2009/10, the Government waiver amounted to $3.2 billion for three land grants. A total of 14 land grants, including the three made in 2009/10, with aggregate land premia totalling $4.5 billion, have been waived since May 2001.

Without this waiver, URA's net operating surplus for 2009/10 of $6.9 billion for the year would have been lowered by $3.2 billion to $3.7 billion; its accumulated surplus since May 2001 would have been lowered by $4.5 billion to $2.2 billion; and its net assets value as at 31 March 2010 would have been decreased to $12.2 billion.

(V) Financial Resources, Liquidity and Commitments

As mentioned in para II (b), as at 31 March 2010, the URA's cash and bank balances and the fair value of the funds managed by the investment manager totalled $5.7 billion. At the same date, the URA's accruals and estimated outstanding commitments in respect of projects under acquisition and resumption stood at $11.7 billion.

Besides the establishment of the Medium Term Note Programme as mentioned in (II)(c) above, the URA also maintained committed term credit facilities with several major financial institutions. Securing these two sources of external funding in advance has ensured that sufficient financial resources will be in place for the URA to enable it 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. As individual projects are cleared and launched at different times during property cycles and depend on the market conditions prevailing at the time of tender, the upfront payment from a project may be higher or lower than URA's acquisition costs. As at 31 March 2010, the total costs of properties under development was $13.9 billion. Taken together with its outstanding commitments, URA's exposure to the property market was at a historically high level.

The URA estimates in its 2010 to 2015 Corporate Plan that a total expenditure of about $16 billion, excluding operational overheads, will be required by the URA to meet the costs of both its currently outstanding and its forthcoming expenditure commitments on implementation of the projects contained in the Plan, which covers the five years from 1 April 2010. This expenditure covers the full range of the URA's 4Rs work in redevelopment, preservation, rehabilitation and revitalisation. The Kwun Tong Town Centre project, the largest project ever undertaken by the URA, requires an exceedingly large outlay for the acquisition of almost all of the 1,657 property interests, following issue of acquisition offers for all of the properties on 29 December 2008. It covers 5.3 hectares containing five Development Areas and is expected to take about 13 years until 2021 to complete. Moreover, it will be some years before such cost can be recouped through the awards of joint venture development contracts for the project. As at 31 March 2010, over 80% of property interests had been acquired. The tender for Development Area 1 Yue Wah Street Site was awarded during the year. Property acquisition was not required as only a bus terminal was situated at the site. URA's decision to develop Development Areas 2 and 3 concurrently will advance the completion date by one and a half years.

In addition to redevelopment, the URA is now implementing an extensive programme of preservation of pre-war shophouses and other buildings and features, as well as stepping up the scales of its building rehabilitation and street and open space revitalisation work. As a result, the URA has committed to deploy significant human and financial resources over the next five years to implement the programmes for these three growing and worthwhile but non-revenue generating works.

During the year, the URA has continued to provide proactive support to the Development Bureau in the conduct of the two-year review of the current URS by the Government. The review was now at the final stage. The directions identified by its Steering Committee are expected to be finalised by the end of 2010. Based on the Steering Committee's Review of the URS's latest directions, there are expected to be some changes from the current URS. The URA will adhere to the updated URS in preparing its next five year Corporate Plan for 2011 to 2016 and its 2011/12 Business Plan, to ensure alignment of these Plans with the URS.

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

(VI) Internal Control

The URA keeps its financial and administrative systems and procedures under constant review and updates and improves on them whenever appropriate. Apart from statutory audit, the URA's Internal Audit Department conducts regular reviews of activities undertaken by the URA. During the year, in line with its established annual procedure, the URA conducted its annual organization-wide review of internal control and risk management covering all the Divisions and Departments. Where appropriate, treatment plans were formulated and implemented to address significant operating risks and to enhance the URA's internal control framework on an ongoing basis. In addition, the URA continued to seek the advice of the Independent Commission Against Corruption's Corruption Prevention Department whenever necessary on various policies and procedures in order to minimize the risks of any abuse or misinterpretation of them.