

Management Discussion and Analysis

Review of Financial Results and Positions

(I) Review of 2009 Results

(a) Revenues

Revenues for the financial year amounted to \$1,413 million. Compared to the last financial year's revenue of \$5,266 million, this represents a decrease of \$3,853 million. Although upfront payments for the three redevelopment projects namely Pine Street / Anchor Street, Baker Court and Macpherson Indoor Stadium were recognised during the year versus two projects in the previous year, the receipts were much lower due to the market conditions prevailing at the times of awarding the development agreements being worse in 2008/09 than in 2007/08 and the much smaller sizes of the projects awarded in 2008/09. The total site area of the projects awarded during the year was 5,004 square metres whereas in 2007/08, it was 22,495 square metres. There were also fewer properties sold by and less sizable shares of surpluses from our joint venture partners during the 2008/09 financial year. In the 2007/08 financial year, sizeable shares of surpluses from certain jointly controlled development projects, including the Vision City project were received.

(b) Other net income

Of the \$286 million in other net income for the year (2007/08: \$404 million), \$226 million (2007/08: \$377 million) relates to interest income earned from bank balances, with an average yield of 2.43% p.a. (2007/08: 4.11% p.a.), and \$30 million is the gain reported from funds managed by the investment manager, with a net yield of 3.65% p.a.. URA placed its surplus cash as short-term deposits with a number of financial institutions in accordance with the Authority's approved investment guidelines. An investment manager was appointed in May 2008 to manage a portion of the URA's surplus funds. The decrease in other income as compared to 2007/08 was mainly due to the lower deposit interest rate and bank balances mentioned in paragraph (II)(b) below.

(c) Administrative expenses

Administrative expenses comprised mainly staff costs, accommodation costs and depreciation. Administrative expenses for the financial year increased to \$235 million (2007/08: \$198 million) for expansion required to meet the workload of our planned projects.

The URA continued to maintain prudent financial management, to contain growth in headcount and to undertake cost-reduction measures whenever possible. Nevertheless, to cope with the increased scale of urban renewal activities, such as the commencement of acquisition of four projects, including the Kwun Tong Town Centre project, and increased activities in rehabilitation, revitalisation and preservation during the year, it was necessary to expand the URA's headcount which resulted in a surge in annual administrative expenses. The staffing level increased from 275 as at 31 March 2008 to 358 as at 31 March 2009.

(d) Provision for impairment on properties and committed projects

The URA's properties and committed projects were valued by in-house professionals at 31 March 2009 and based on our accounting policy, there was a need to make a provision for loss in this financial year of \$5,337 million (2007/08: \$1,034 million) in aggregate. The provision for loss for the year mainly comprises losses on the Kwun Tong Town Centre project of \$4,032 million and \$1,305 million on other projects. The provision for loss made in the previous year was mainly for the Sai Yee Street project.

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(e) Operating deficit for the year

The URA recorded a net operating deficit of \$4,524 million for the year. This compares unfavourably to the \$2,078 million net operating surplus reported last year. This was mainly due to the reduction in upfront payment income and share of surplus from jointly controlled development projects recognised during the year mentioned in paragraph (l)(a) above and the substantial loss provision of \$4,032 million made for the Kwun Tong Town Centre project mentioned in paragraph (l)(d) above. Before the provision for impairment on properties and committed projects, there was a surplus of \$813 million against \$3,112 million reported in the previous year.

(II) Financial Position at 31 March 2009

(a) Properties under development

The value of "Properties under development" as at 31 March 2009 was \$8.1 billion (2007/08: \$4.7 billion) representing the acquisition costs for projects for redevelopment or preservation purpose which were at various stages of implementation. This is set against the cumulative provision for loss on projects of \$3 billion (2007/08: \$0.2 billion) resulting in a net cost of \$5.1 billion (2007/08: \$4.5 billion). The increase in the balance was mainly due to the increase in the number of projects up to 13 now being implemented from 12 in 2007/08 and generally higher acceptance levels. The URA commenced acquisition of four projects, including the Kwun Tong Town Centre project, during 2008/09, and issued acquisition offers to 2,168 owners in aggregate.

(b) Cash and bank balances

As at 31 March 2009, the URA's cash and bank balances and the fair value of the funds managed by the investment manager totalled \$7.7 billion (2007/08: \$10.9 billion). The \$3.2 billion decrease in bank balances from last year was mainly due to the increase in the amount spent for property acquisitions during the year.

The URA placed its surplus cash as short-term deposits with a number of financial institutions and it had no borrowings in this financial year. An investment manager also managed a portion of the URA's surplus funds in accordance with our approved investment guidelines.

(c) Net assets value

The URA's net assets value as at 31 March 2009 was \$9.9 billion, representing the Government capital injection of \$10 billion offset by an accumulated deficit from operations of \$0.1 billion. The accumulated deficit was mainly a result of the substantial provision for loss made for the Kwun Tong Town Centre project, although surpluses were earned in previous years mainly because of the improved condition of the property market. When established in May 2001, the URA started with a deficit of \$2.2 billion after taking over from its predecessor, the LDC. Therefore, URA has made an accounting profit of \$2.1 billion in the eight years since 2001, thereby reducing its deficit to \$0.1 billion. This has been achieved partly because of the waiver of premia by the Government on the Land granted to URA.

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(III) Capital Injection, Land Premium Waiver 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 waives the land premia for redevelopment sites granted to URA and has also exempted the URA from taxation.

(IV) Financial Resources, Liquidity and Commitments

As mentioned in paragraph (II)(b), as at 31 March 2009, the URA's cash and bank balances and the fair value of the funds managed by the investment manager totalled \$7.7 billion. At the same date, the URA's accruals and estimated outstanding commitments in respect of projects under acquisition and resumption stood at \$17 billion.

When implementing its urban renewal programme, the URA is necessarily exposed to financial risks arising from property market fluctuations. Due to the timing difference and other factors, the upfront payment receipt from a project may be higher or lower than URA's acquisition costs. As at 31 March 2009, the total costs of properties under development was \$8.1 billion. Taken together with its commitments, URA's exposure to the property market was at a high historically level. Its financial position is also affected by the outcomes of individual projects cleared and launched at different times of property cycles.

The URA estimates, in its 2009 to 2014 Corporate Plan, that a total expenditure of about \$20.2 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 this Plan, which covers the five years from 1 April 2009. This expenditure covers the full range of the URA's 4Rs work in redevelopment, preservation, rehabilitation and revitalisation. Among the redevelopment projects are several major ex-LDC projects, including the Kwun Tong Town Centre project, which is the largest project ever undertaken by the URA. It, therefore, requires an exceedingly large outlay of about \$12 billion for the acquisition of all of the almost 1,657 property interests in it, following issue of acquisition offers for all of these properties on 29 December 2008. Moreover, it will be some years before such cost can be recouped through the awards of joint venture development contracts for this project. In recent years, acquisition costs for URA's various projects have increased significantly, bringing with them increased development risks for the URA. In addition, the URA has recently launched an extensive new programme of preservation of pre-war shophouses at an estimated cost of about \$1.3 billion, as well as stepping up the scales of its building rehabilitation and street and open space revitalisation work. Therefore, the URA envisaged in its approved Corporate Plan that the URA would have to seek external financing in order to implement its 4Rs Plans in the years to come.

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

In December 2008, the URA obtained a corporate credit rating of AA+ from Standard & Poor's Ratings Agency. In July 2009, committed term credit facilities with several major financial institutions were put in place. In the same month, the URA also put together a Medium Term Note Programme which allows it to access debt capital market funding. 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+ Standard & Poor's. Securing these two sources of external financing in advance has ensured that sufficient funding will be in place for the URA to enable it to carry out the urban renewal programme as planned.

control and risk management covering all its Divisions and Departments. Where appropriate, treatment plans formulated to address significant operating risks were implemented to enhance the URA's internal control framework on an on-going basis. In addition, the URA continued to seek the advice of the Independent Commission Against Corruption's Corruption Prevention Department whenever necessary with respect to various policies and procedures in order to minimize the risks of any abuse or misinterpretation of them.

The financial highlights of the past few years are summarized on page 95 of this Annual Report.

(V) Internal Control

The URA keeps its financial and administrative systems and procedures under constant review and updates and improves 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, the URA conducted its annual organisation-wide review of internal