Management Discussion and Analysis

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A brief look back

The URA was established in May 2001, taking over the work of the Land Development Corporation (LDC). Until 31 March 2015, the URA has commenced 57 redevelopment projects and three preservation and revitalisation projects under the URA Ordinance, as well as taken over the implementation of ten on-going projects of the former LDC. Nine of these projects are now fully complete and a further nine are nearing completion with construction now finished and flat sales underway. Excluding those projects which have been terminated, the remaining projects are at various stages of implementation.

URA projects are mainly those that are unattractive to private developers as well as often meeting stiff resistance from a few occupiers and concern groups, resulting in a protracted period between launch and implementation. In spite of these difficulties the URA has made notable achievements and commitments which can be appreciated and measured through the extent of dilapidation being tackled, the number of people benefiting or being rehoused and - different

URA

Run down urban area improved
15.2 hectares

Population benefiting from projects
24,000

New commercial gross floor area
376,000 m^2

Dilapidated buildings redeveloped
650 buildings

New domestic gross floor area
830,000 m^2

New Government, Institutional and Community floor space
53,000 m^2

Rehoused / compensated households
10,000

New flats
15,000

New open space
26,000 m^2

from private developers - the new facilities being created for the public good.

The problem of urban decay remains daunting, and when set in the context of Hong Kong's urban decay problem where over 6,000 buildings are now over 50 years old and about 42% are in deteriorating or poor condition, we still have a mountain to climb.

Following the issue of the Urban Renewal Strategy (URS) in early 2011, the URA introduced new initiatives to its repertoire notably the Facilitating Services (Pilot Scheme) and the Demand-led (Pilot Scheme). Considerable effort has been devoted to these two schemes which seek to harness the collective willingness of owners to help initiate urban renewal themselves. Thus far, the overall impact of these initiatives has been somewhat limited. For example, although nine Demand-led projects have been launched and implemented, they occupy relatively small sites and offer limited scope for planning or community gains.

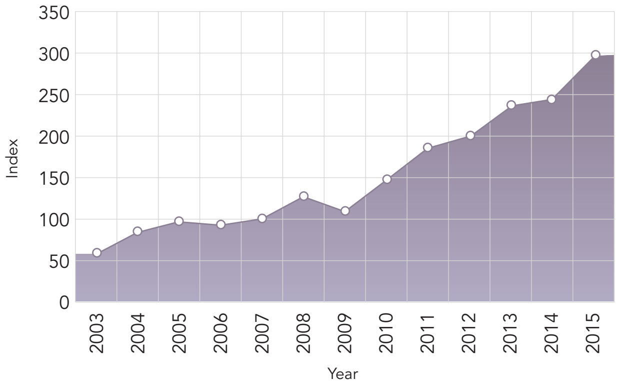
Project Challenges

Section 5 of the URS sets out the main objectives of urban renewal for the URA and other stakeholders to implement. In order to accomplish as many of the laid down objectives as possible, the URA needs to find ways and means to break through a labyrinth of obstacles, in particular the implementation of those sizeable sites in old urban districts in need of redevelopment, which can offer more tangible urban renewal benefits through replanning with much improved layouts and suitable land use. To go forward for a sustainable urban renewal programe, we need to overcome many challenges such as the limited plot ratio gain, the high acquisition costs under the seven-year-old rule and the strong resistance from some existing occupiers.

At the same time, in recent cases the accommodation value of our projects at acquisition has been around $9,000 per square foot, whereas at tender they have realised only $6,000 per square foot, as developers have displayed caution in bidding for URA site tenders.

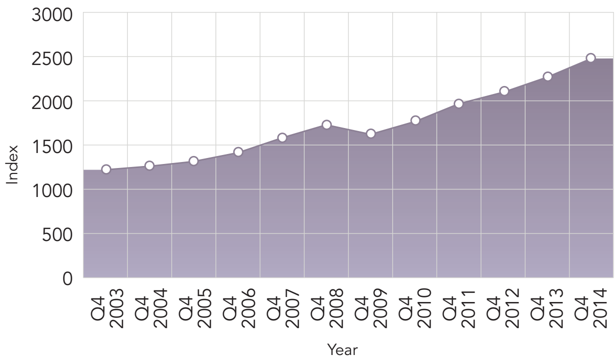
The property market is now in the twelfth year of an upward trend starting from 2003 since when prices for all classes of accommodation in the private domestic market have risen around fivefold (see Figure 1). This rise poses a growing risk to the value of the URA's acquired stock of holdings in the event of a market downturn, a risk which may be exacerbated by a possible increase in interest rates later this year. Meanwhile, construction costs, as reflected in tender prices, have roughly doubled over the same period and continue to rise (see Figure 2).

*Figure 1: Private Domestic Price Index April 2003 - April 2015 - All Classes**



*HKSAR Government, Rating & Valuation Department, Hong Kong Property Review Monthly Supplement, June 2015.

*Figure 2: Quarterly Construction Tender Price Index 2003 - 2014**



*Rider Levett Bucknall, Hong Kong Report, Quarterly Construction Cost Update, March 2015.

Acquisition

Consolidation was the theme of the URA's work in 2014/15 during which slightly fewer projects were commenced and our focus was more on a conscientious effort to unjam the backlog of projects in need of clearance for subsequent tender or construction by the URA. In all, seven projects were cleared, notably the Hai Tan Street/Kweilin Street & Pei Ho Street project with a site area of over 7,500 square metres and well over 700 households.

Although two projects at Fuk Wing Street and Pak Tai Street/San Shan Road were both cleared several months ahead of schedule, in other cases the acquisition process can be a long and drawn out affair. Projects such as Nga Tsin Wai Village, Staunton Street/Wing Lee Street, Peel Street/Graham Street, Kwun Tong Town Centre and Hai Tan Street/Kweilin Street & Pei Ho Street have all endured extended acquisition stages. The clearance of Nga Tsin Wai Village and Kwun Tong Town Centre both remain as thorns in our side after seven years of effort. The URA is looking to apply measures to help diminish negative sentiment and speed up acquisition. For example, the social service teams which are appointed independently of the URA can be promoted as trusted agents to handle the concerns of affected residents and shop operators.

Rehabilitation

Under the URS issued in 2011, rehabilitation became a core URA business together with redevelopment. As a rule, it should always be the owners' responsibility to ensure timely repair and maintenance to their buildings. There are however several reasons why this ideal cannot be met in practice. For example, where an Owner's Corporation for a building is lacking, there are no means to organise repairs and maintenance. Many older buildings are occupied by low-income elderly residents who may not be aware of their responsibilities and are unable to afford the cost of repairs.

The URA has been a partner to the Government's Operation Building Bright (OBB) programme for which it has contributed significant staff resources and assisted in the rehabilitation of around 1,260 buildings. The OBB programme is now winding down after six years of effort, however, at the same time the URA's services under the Integrated Building Maintenance Assistance Scheme (IBMAS) have since July 2015 extended to cover the whole territory of Hong Kong.

In the light of this widening responsibility in rehabilitation and the drive towards sustainability, the URA Board reviewed the URA's strategy for promoting building rehabilitation in 2014. The subsequent refinements to the strategy include more emphasis on directing assistance towards aged buildings most in need of repair, empowering the community in rehabilitation through promotion and education, as well as integrating and enhancing IBMAS and the financial subsidy package. The URA will actively monitor the effectiveness of the refined IBMAS in helping owners in building rehabilitation.

Preservation and Revitalisation

Section 5 of the URS sets out the Authority's mandate in *'preserving buildings, sites and structures of historical, cultural or architectural value.'* Apart from the Western Market which is a scheduled monument, the URA has implemented ten projects under the URA Ordinance 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 the preserved buildings form part of a larger redevelopment project site in the seven other projects. Whilst the Mallory Street revitalisation project has been completed, two preservation projects are meanwhile at vital stages. Acquired units in the Prince Edward Road West preservation project have been renovated and leased out for various uses including social enterprises. We have however been unable to acquire a number of units and the issue in hand is the way forward for the project. For the Shanghai Street/Argyle Street preservation project, the delicate operation to reconfigure and retain the shophouse cluster has just commenced.

Another initiative involving a historic building at an important stage is the Central Oasis revitalisation project of the Central Market building which commenced in 2009. Since then, the estimated $500 million cost has ballooned. Efforts are now devoted to review the design and create a less costly, yet still popular, destination.

Human Resources

To ensure our human capital possesses the right set of critical capabilities for success, the core competencies for senior management were revamped in the year. The core competencies reflect the critical attributes required for employees to perform well and were built into recruitment, selection, leadership development, performance management and succession management.

A comprehensive training needs analysis was carried out to identify the critical knowledge, skills and attitude essential to outstanding job performance. The training needs as identified were built into the new training curriculum for all levels of employees to equip them with the right attributes.

The succession management process was kick-started to address the leadership succession issues URA is facing. The four most critical jobs were reviewed and profiled using the new competencies. Internal nominated candidates were assessed and the need to recruit from outside was also confirmed and executed.

Looking ahead, the core competencies review will be implemented for all levels. Succession management will continue to roll out to all critical positions within a clear structure of succession planning. The continuous improvement culture will be cultivated through the upcoming introduction of Work Improvement Teams.

Outlook

The URA's operating environment is one of continuous change in the financial world, the community at large and our mandate. In the months ahead, whilst commencing new redevelopment projects, several projects are scheduled for clearance and tendering to joint venture partners. Our attention will be focused on overcoming the various constraints to our endeavours, meanwhile we will examine closely the effects of the recently introduced and refined Demand-led Project Scheme, Facilitating Services and rehabilitation strategies.

Financial Review

(I) Review of 2014/15 Results

(a) Revenues

The revenue for the year ended 31 March 2015 was $9,904 million which comprised of upfront payments from tendered projects, URA's share of sales proceeds from jointly controlled development projects and sale of properties. The amount represents an increase of $8,735 million compared to the revenue of $1,169 million in 2013/14. The revenue in 2014/15 was higher than those in 2013/14 as it included upfront payment from five tendered projects and sales proceeds from jointly controlled development projects whereas the revenue in 2013/14 had no tendered project revenue and included only sales proceeds from jointly controlled development projects.

The share of sales proceeds from jointly controlled development projects of $736 million in 2014/15 (2013/14: $1,169 million) were revenues from projects where the sales proceeds exceeded the thresholds stipulated in the development agreements. The projects contributed to the surplus during the year included Park Metropolitan in Kwun Tong with development agreement executed in 2009, Citywalk in Tsuen Wan with the development agreement executed in 2002, The Zenith / One Wanchai in Wan Chai with the development agreements executed in 1996. The sales proceeds also included the sale of some properties totaled $131 million.

(b) Other net income

Of the $195 million (2013/14: $127 million) in other net income for the year, $158 million (2013/14: $117 million) was interest income from the investment portfolio managed in house, which included bank deposits and fixed income products, with an average yield of 1.72% p.a. (2013/14: 1.55% p.a.) Other net income included rental income from certain properties retained by the URA.

(c) Administrative expenses

Administrative expenses mainly covered staff costs, accommodation costs and depreciation charges. Administrative expenses before depreciation for the year 2014/15 was $404 million (2013/14: $367 million), with the increase largely due to salary adjustments and staff promotions. The depreciation charge for office capital expenditure and properties for own use was $45 million (2013/14: $34 million) for the year.

The staffing level was reduced from 564 in 31 March 2014 to 561 in 31 March 2015. Of the 561 staff, 22 (31 March 2014: 55) were employed on contracts of less than three years.

(d) Provision for / write back of 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 the accounting policy detailed in Notes 2(g) and 2(n) to the financial statements, provision for loss for a project, if necessary, is made during the year. Provision for loss of $703 million was made in 2014/15, the amount of which included new provision of $691 million on three redevelopment projects (five in 2013/14) plus net provision of $12 million on the other previously provided projects. Of the three redevelopment projects, two are located in Sham Shui Po and one is located in Kowloon City. The provisions were necessary mainly due to the high acquisition costs together with rising construction costs have resulted in lower estimated upfront payments from tenderers.

(e) Surplus for the year

The URA recorded a net surplus of $1,076 million for the year 2014/15, reflecting an increase of $3,346 million compared to the $2,270 million net deficit for the year 2013/14. The 2014/15 revenue included both upfront payments from tendered projects and surplus from jointly controlled development projects with a loss provision of $703 million as provisions for loss on some projects were postponed to 2015/16. In comparison, the revenue in 2013/14 included only surplus from jointly controlled development projects while a loss provision of $3,010 million was necessary resulting in an operating deficit of $2,270 million. Before the provision for impairment on properties and committed projects, the surplus in 2014/15 was $1,779 million in comparison with $740 million reported in 2013/14.

(II) Financial Position at 31 March 2015

(a) Properties under development

Properties under development as at 31 March 2015 was at $21.0 billion (31 March 2014: $27.7 billion) representing the acquisition and development costs for projects. This sum comprised of five projects under acquisition; five projects pending completion of resumption process; six projects with ownership reverted to the Government pending final clearance; and three projects with site cleared and pending tender. The aforesaid value was off-set against the cumulative provision for loss totalling $4.7 billion (31 March 2014: $6.2 billion), resulting in a net value of $16.3 billion (31 March 2014: $21.5 billion). The decrease in the net value was mainly due to certain projects being tendered during the year.

In accordance with the Urban Renewal Strategy (URS), the URA launched the Flat-for-Flat (FFF) scheme for redevelopment projects commenced after 24 February 2011 to provide domestic owner-occupiers affected by the URA's development projects an additional option after cash compensation. The Government has provided URA with a site at Kai Tak to develop about 500 small to medium sized flats under the FFF scheme. As at 31 March 2015, land premium and construction cost totalling $2.0 billion for Kai Tak development were also recorded as "Properties under development".

(b) Cash and bank balances

As at 31 March 2015, the URA's cash and bank balances and the fair value of the funds managed by the investment manager and in-house totaled $12.6 billion (31 March 2014: $8.0 billion).

The URA placed the surplus cash on short-term deposits with a number of financial institutions. The URA also invested in HK$ and RMB bonds of the required credit rating in accordance with the 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 adheres to the same guidelines.

The cash position, off-set by the borrowings of $4.6 billion (31 March 2014: $4.8 billion) mentioned in paragraph II (c) below, resulted in the net cash position including the fair value of the financial assets at 31 March 2015 of $8.0 billion (31 March 2014: $3.2 billion).

(c) Debt securities issued

The URA is rated AAA by Standard & Poor's (S&P). This rating was reaffirmed after an annual review in February 2015. As at 31 March 2015, the outstanding debt securities issued by the URA was $4.6 billion under the US$1 billion Medium Term Note (MTN) Programme.

(d) Net assets value

The URA's net assets value as at 31 March 2015 was $25.0 billion (31 March 2014: $23.9 billion), representing the Government's capital injection of $10 billion (31 March 2014: $10 billion) and an accumulated surplus of $15.0 billion (31 March 2014: $13.9 billion).

The financial highlights of the past ten years are summarized on page 91 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 capital into the URA in five tranches of $2 billion each 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

The Government waives the land premia for redevelopment sites granted to the URA. For 2014/15, the land premia waived by the Government on five land grants amounted to $7.8 billion. Since May 2001, a total of 26 land grants have been waived in respect of all the tendered projects with aggregate land premia totalling $14.3 billion.

Without this waiver, the URA's net surplus for 2014/15 of $1.1 billion for the year would have been lowered by $7.8 billion to a deficit of $6.7 billion; its accumulated surplus as at 31 March 2015 would have been lowered by $14.3 billion to $0.7 billion; and its net assets value as at 31 March 2015 would have been decreased to $10.7 billion.

(V) Financial Resources, Liquidity and Commitments

As at 31 March 2015, the URA's net cash position including the fair value of the funds managed by the investment manager and funds managed in-house, totaled $8.0 billion. At the same date, the URA's accruals and estimated outstanding commitments to the commenced projects, together with the construction cost for Kai Tak Site based on the valuation carried out by the URA's in-house professionals, stood at $13.3 billion.

In addition to the US$1 billion MTN Programme mentioned in paragraph II (c) above, the URA maintained $1.0 billion and $0.7 billion in committed and uncommitted bank facilities as at 31 March 2015. Securing the external funding and the credit facilities ensured the URA would 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 tendered out at different times during property cycles after the site clearance. 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 2015, the total costs of properties under development was $21.0 billion.

The URA estimates, in its latest Corporate Plan that from 1 April 2015, a total cash outlay of about $29.0 billion, excluding operational overheads, will be required in the next five years to meet the costs of both its currently outstanding commitments and its forthcoming expenditure for the implementation of the projects in the Plan. This expenditure covers the URA's work in redevelopment, rehabilitation, preservation and revitalisation. It should be noted that the expenditure may vary subject to the level of interest shown in the various initiatives, including the demand-led redevelopments, the FFF initiatives, the expanded programme of building rehabilitation and other additional initiatives which may be added subsequent to the preparation of the Plan.

The URA continues to review its operating programme with the aim to maintain a highly prudent financial position and have due regard for commercial principles in its operations so that the urban renewal programme may be sustainable in the long term.