MANAGEMENT DISCUSSION AND ANALYSIS

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CURRENT POSITION

Up until 30 June 2016, the URA has implemented 59 redevelopment projects, two preservation and one revitalisation projects on top of 10 on-going projects that it took over from its predecessor the Land Development Corporation (LDC). Of these projects twelve are now completed and the remaining projects are under planning, acquisition or construction.

At this time, urban renewal in Hong Kong faces a dilemma. The sobering truth is that over 9,000 buildings are now over 50 years old and over a third of these are in deteriorating or poor condition. Increasingly though, many of these aging buildings have already used up all or the bulk of their development potential with little or no room for plot ratio gains, hence they are not attractive to private developers. As a result, URA projects confront not only development risks but also potential resistance from occupiers and concern groups which can lengthen the project programme. The record of these 59 URA projects shown below is nevertheless noteworthy as witnessed by the scale of urban decay being addressed and the consequent benefits afforded to people in projects who are rehoused and the facilities created for new communities and the public good.

Run down urban area improved 17.1 hectares	Population benefiting from projects 27,000	New commercial gross floor area 400,000 m^2
Dilapidated buildings redeveloped 710 buildings	New domestic gross floor area 950,000 m^2	New GIC floor space 54,000 m^2
Rehoused / compensated households 12,000	New flats 18,000	New open space 26,000 m^2

Note: the above figures exclude the 10 projects taken over from the LDC

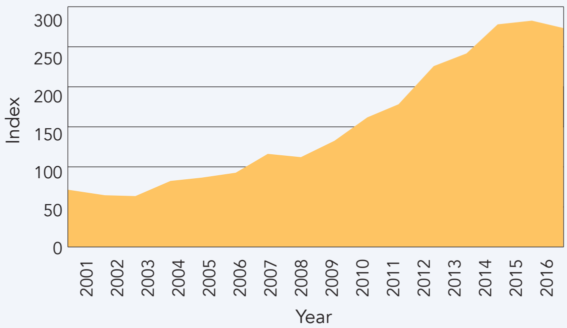
CHALLENGES AND OPPORTUNITIES

A key concern during the year was the risk posed to the value of the URA's properties under development in the event of a property market downturn. The URA mitigated this risk by targeting the clearance and tender of five projects under each of these two project stages.

Ultimately, we were able to exceed our target by clearing altogether eight projects. Two of these cleared projects namely Nga Tsin Wai Village and Peel Street/Graham Street project had been painstakingly for the past several years. We also met our tender target of five projects. These tenders helped reduce the value and market exposure of properties under development. Such actions were timely as in the context of a slowing economy the multi-fold increase in the property market is now showing signs of reversal (see Figure 1). In fact, developers have already shown caution over the past few years in bidding for URA sites as the accommodation value of our projects at acquisition, where the 'seven year rule' under the Home Purchase Allowance is applied, remains around $9,000 per square foot whereas at tender they have realised only $6,000 per square foot. Construction costs meanwhile, have still continued their upward march in 2015/16, albeit at a slower pace (see Figure 2).

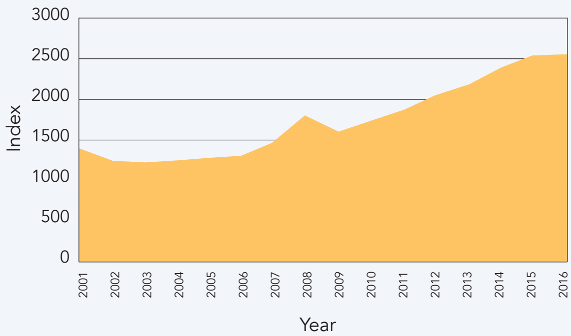
Over the year, we have been watching the effects of the recently refined strategies for the Facilitating Services (Pilot Scheme) and the Demand-led (Pilot Scheme) which were first initiated following the issue of the Urban Renewal Strategy in 2011 and designed to harness the collective willingness of owners to help initiate urban renewal themselves. The impact of these initiatives remains modest bearing in mind the efforts applied.

Figure 1: Private Domestic Price Index May 2001 - May 2016 - All Classes*



*HKSAR Government, Rating & Valuation Department, Hong Kong Property Review Monthly Supplement, June 2016.

Figure 2: Quarterly Construction Tender Price Index 2001 - 2016*



*Rider Levett Bucknall Quarterly Construction Cost Update, June 2016.

District-Based Approach

Now and in the coming years, the URA is seeking to optimise the potential from larger clusters of dilapidated buildings in need of redevelopment which can achieve more meaningful benefits from urban renewal with planning for a more community-friendly environment with a refined urban grid and appropriate land use. The Operating Review of this report introduces the District-based approach and details several projects in To Kwa Wan which have recently been commenced under its scope.

It is important that the District-based approach brings with it alternative development outcomes which give a tangible expression to people-first urban renewal by designing with the community in mind. Priority is given to pedestrian circulation and walkability with the creation of new streets whilst retaining parts of the original urban fabric and street shop fronts in the neighborhood to maintain the vibrancy of local streets. The provision of a communal underground car park in one of the project sites serving the local community avoids car park entrances at individual developments further enhancing the local street vibrancy. Circulation is improved by opening new north-south linkages to expand accessibility within the area and to the new Ma Tau Wai MTR station.

REHABILITATION

The URA has a widening responsibility for rehabilitation as one of its core businesses together with redevelopment. While the Government's Operation Building Bright (OBB) to which the URA contributed significant staff and resources has been winding down, the URA's services under the Integrated Building Maintenance Assistance Scheme (IBMAS) have since July 2015 been made available throughout Hong Kong. Whilst recognising that owners are responsible for the maintenance and repair of their building, the frequent lack of financial means, organisation and awareness by owners are persistent hurdles to rehabilitation. The URA is confronting these obstacles by exploring alternatives to pursue urban renewal more effectively and efficiently.

Enhanced Rehabilitation By "Retrofit"

For those buildings with little scope for any further increase in plot ratio and gross floor area and which encounter particular difficulties in accessing current rehabilitation schemes, one way forward is to instigate rehabilitation more proactively. Owners would be engaged to ascertain their needs and the consent of the Owners' Corporation (OC) would be sought to identify and make suitable improvements. Such improvements could address structural matters, barrier free access including the retrofitting of lifts, facade treatments fire services, energy efficiency and greening.

Facilitating Rehabilitation Through "Smart Tender"

The "Smart Tender" Building Rehabilitation Facilitating Services (Pilot Scheme) is another potentially effective measure which aims to provide technical services to the OCs of private buildings and reduce the risk of tender rigging at the works procurement stage. Launched in May 2016, the Pilot Scheme is an initiative introduced in response to the Chief Executive's Policy Address this year. It seeks to help building owners procure contractors independently to carry out rehabilitation works and the URA is already receiving applications.

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.'* The URA has implemented ten projects under the URAO which contain buildings for preservation or revitalisation. Three of these projects are dedicated preservation or revitalisation projects whereas the preserved buildings form part of a larger redevelopment project site in the seven other projects. Two preservation projects are being actively implemented. Acquired units in the Prince Edward Road West preservation project have been renovated and leased out for various uses including social enterprises. We are working to clarify how to proceed with this project where the acquisition of certain interests is problematic. For the Shanghai Street/Argyle Street preservation project, new building works to be integrated with the retained shophouse cluster are underway.

The Central Market revitalisation which commenced in 2009 is another initiative involving a historic building. A simplified version of the revitalisation scheme has been approved by the Board at a significantly reduced cost. The project is now moving towards implementation under the watchful eye of an Ad-hoc committee set up by the Board.

HUMAN RESOURCES

Arising from a training needs analysis conducted previously together with a new training curriculum, staff training hours per employee increased by 19% compared with the previous year. Furthermore, a 'One Team One Goal' teambuilding workshop for managerial staff shared the URA's aligned vision, mission and strategic priorities.

Having set the core competencies for senior management in the previous year, it was the turn of managers and below in 2015/16. The core competencies reflect the critical attributes required for employees to perform well and these competencies were built into recruitment, selection, leadership development, performance management and succession management.

To attract, motivate and retain competent staff, a consultant conducted a comprehensive remuneration review for all jobs in the Authority and a new grading structure was recommended and approved to be implemented.

To contain our manpower cost which was growing with our headcount increase in the past three years, efforts were made at containment through a recruitment freeze. A headcount reduction of 7.7% was achieved in the year.

In the coming year, to cater for the changing operating environment and new core competencies, a new series of management training programmes for staff at different levels with be launched. In addition, building on a successful earlier pilot run, Work Improvement Teams will be launched across the whole organisation to promote a continuous improvement culture within the Authority. The recruitment freeze will continue in the coming year to contain manpower cost.

OUTLOOK

With the recent launch of a number of sizeable projects under the District-based approach, more projects for commencement in the pipeline, as well as several projects programmed for clearance and tender to joint venture partners, it will be another industrious year ahead. We will of course encounter hindrances and obstacles to be overcome in our work whilst responding to changes in our operating environment, the economy and wider community. As we take new directions and an innovative approach in delivering urban renewal, we will still keep a close eye on the application and results of our committed policy initiatives.

FINANCIAL REVIEW

(I) REVIEW OF 2015/16 RESULTS

(a) Revenue

The revenue for the year ended 31 March 2016 was $7,422 million which comprised of upfront payments from tendered projects and share of surplus from jointly controlled development projects. The amount is lower than the revenue of $9,904 million in 2014/15 by $2,482 million. Although six redevelopment projects were tendered during the year, the total site area was 4,926 m^2, compared with the total site area of 30,862 m^2 from the five redevelopment projects tendered in 2014/15 hence resulted in the lower upfront payments for the year.

The share of sales proceeds from jointly controlled development projects of $4,450 million in 2015/16 (2014/15: $736 million) were revenue from projects where the sales proceeds exceeded the thresholds stipulated in the development agreements. The projects contributed to the surplus during the year mainly included projects with development agreements executed in prior years.

(b) Other income

Of the $158 million (2014/15: $195 million) in other income for the year, $149 million (2014/15: $158 million) was interest income from the investment portfolio managed in house, which included bank deposits and fixed income products, with an average yield of 1.35% p.a. (2014/15: 1.72% p.a.). Other income included rental income from certain properties retained by the URA and gains on the investment portfolio net off by the foreign exchange loss.

(c) Administrative and operating expenses

Administrative and operating expenses mainly covered staff costs, accommodation costs and depreciation charges. Administrative expenses before depreciation for the year 2015/16 was $400 million (2014/15: $405 million), with the decrease largely resulting from cost control measures undertaken whenever possible. The depreciation charge for office capital expenditure and properties for own use was $50 million (2014/15: $44 million) for the year.

The staffing level was reduced from 561 in 31 March 2015 to 521 in 31 March 2016 resulting from recruitment freeze to enhance cost effectiveness and efficiency of manpower investment and to ensure the growing staff cost be contained. Of the 521 staff, 16 (31 March 2015: 22) were employed on contracts of less than three years.

(d) Provision for impairment on properties and committed projects

Based on the accounting policy detailed in Notes 2(g) and 2(m) to the financial statements, provision for loss for a project, if necessary, is made during the year. Provision for loss of $764 million was made in 2015/16, the amount of which included new provision of $790 million on two demand-led projects offset by net write back of provision of $26 million on the other previously provided projects. Of the two demand-led projects, one is located in Kwun Tong and the other one is located in Tai Kok Tsui. The provisions were necessary mainly due to the high acquisition costs, the limited plot ratio gain and the increase in construction costs which result in lower estimated upfront payments expected on the projects.

(e) Surplus for the year

For the year 2015/16, the URA recorded a net surplus of $4,451 million, reflecting an increase of $3,375 million compared to the $1,076 million net surplus for the year 2014/15. The 2015/16 revenue included both upfront payments from tendered projects and surplus from joint development projects with a loss provision of $764 million as provisions for loss mainly on two demand-led projects for the year. Before the provision for impairment on properties and committed projects, the surplus in 2015/16 was $5,215 million in comparison with $1,779 million reported in 2014/15.

(II) FINANCIAL POSITION AT 31 MARCH 2016

(a) Properties under development

Properties under development as at 31 March 2016 was at $20,199 million (31 March 2015: $20,984 million), representing the acquisition and development costs for projects. This sum comprised of thirteen projects under various states of implementation. The aforesaid value was off-set against the cumulative provision for loss totalling $4,765 million (31 March 2015: $4,695 million), resulting in a net value of $15,434 million (31 March 2015: $16,289 million). The decrease in the net value was mainly due to certain projects being tendered during the year.

During the year, upon the completion of Kai Tak Development, land premium and construction costs totalling $2,418 million was transferred from "properties under development" to "properties held for sale". In response to the Chief Executive's 2015 Policy Address requesting the URA to help increase the supply of subsidised sale flats (SSF), the URA identified 338 units in the Kai Tak Development for the SSF scheme. The sales process started in January 2016 and the purchasers are expected to complete the purchase by August 2016.

(b) Cash and bank balances

As at 31 March 2016, the URA's cash and bank balances and the fair value of the funds managed by the investment manager and in-house totaled $13,856 million (31 March 2015: $12,626 million).

The URA placed the surplus cash on short-term deposits with a number of financial institutions. The URA also invested in bonds of the required credit rating in accordance with the investment guidelines as approved by the Financial Secretary with capital conservation as the priority. The investment manager who manages a portion of the surplus funds also adhered to the same guidelines.

The cash position, off-set by the borrowings of $3,285 million (31 March 2015: $4,582 million) mentioned in paragraph II (c) below, resulted in the net cash position including the fair value of the financial assets at 31 March 2016 of $10,571 million (31 March 2015: $8,044 million).

(c) Debt securities issued

The URA is rated AAA by Standard & Poor's. As at 31 March 2016, the outstanding debt securities issued by the URA was $3,285 million under the US$1,000 million Medium Term Note (MTN) Programme.

(d) Net assets value

The URA's net assets value as at 31 March 2016 was $29,464 million (31 March 2015: $25,013 million), representing the Government's capital injection of $10,000 million (31 March 2015: $10,000 million) and an accumulated surplus of $19,464 million (31 March 2015: $15,013 million).

The financial highlights of the past ten years are summarized on page 107 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 2015/16, the land premia waived by the Government on seven land grants amounted to $940 million. Since May 2001, a total of 33 land grants have been waived in respect of all the tendered projects with aggregate land premia totalling $15,231 million.

Without this waiver, the URA's net surplus for 2015/16 of $4,451 million for the year would have been lowered by $940 million to $3,511 million; its accumulated surplus as at 31 March 2016 would have been lowered by $15,231 million to $4,233 million; and its net assets value as at 31 March 2016 would have been decreased to $14,233 million.

(V) FINANCIAL RESOURCES, LIQUIDITY AND COMMITMENTS

As at 31 March 2016, the URA's net cash position, including the fair value of the funds managed by the investment manager and in-house totaled $10,571 million. At the same date, the URA's accruals and estimated 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, stood at $9,971 million.

In addition to the US$1,000 million MTN Programme mentioned in paragraph II (c) above, the URA maintained $360 million and $700 million in committed and uncommitted bank facilities as at 31 March 2016. 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 2016, the total costs of properties under development was $20,199 million.

The URA estimates a total cash outlay of about $34,000 million, 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. 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 Flat-for-Flat arrangements, the expanded programme of building rehabilitation and other additional initiatives.

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