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Block A
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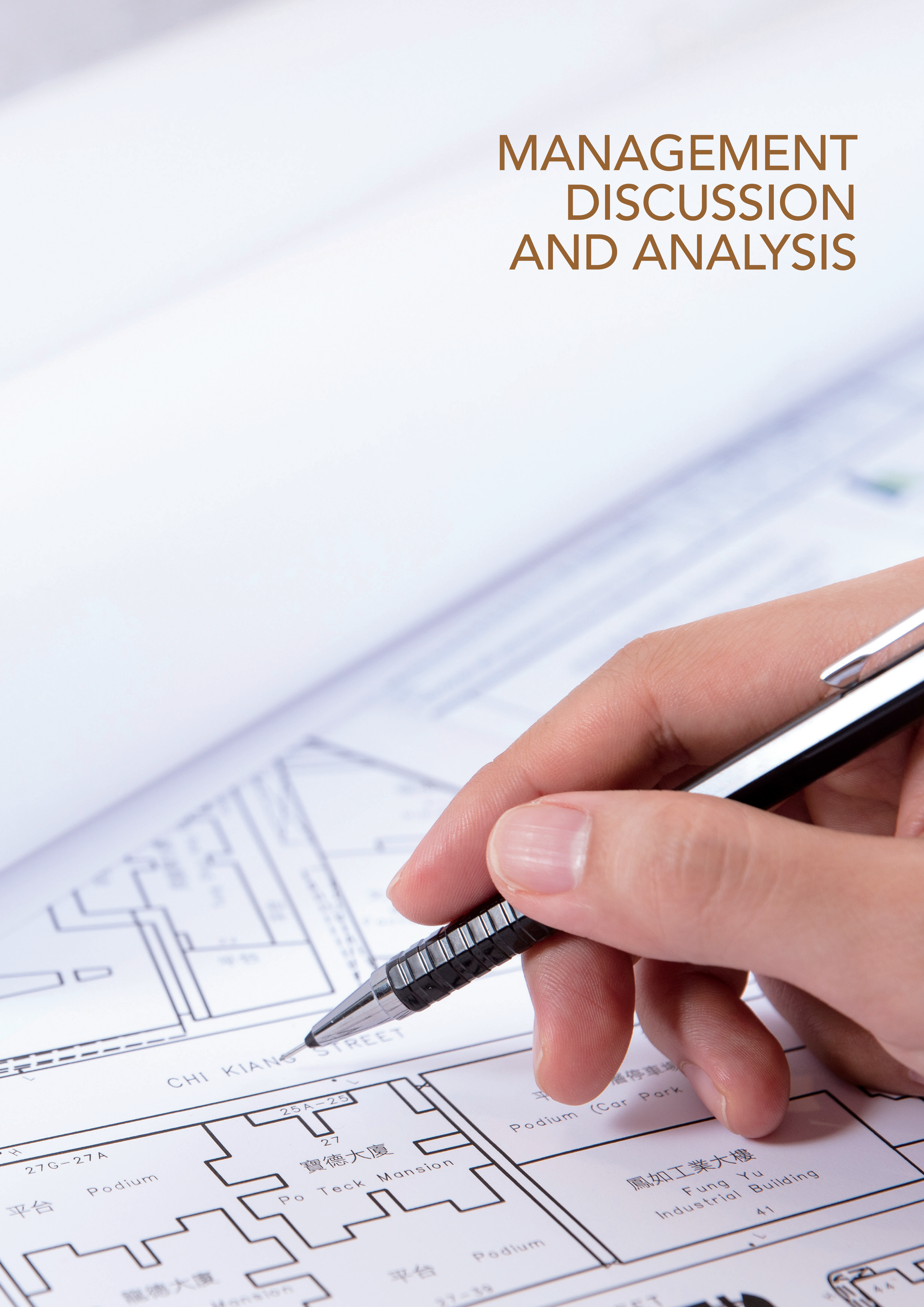
TAK STREET
宏豐大廈

MANAGEMENT DISCUSSION AND ANALYSIS



Our Onerous Task

A survey conducted in 2015 concluded that over 9,000 buildings in Hong Kong were more than 50 years old, one third of which were in either deteriorating or poor condition. By 2040, some 23,000 buildings are projected to reach 50 years, with the daunting possibility of a parallel increase in dilapidation. Increasingly, many of these ageing 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 who can be more selective. To cap it all, URA projects confront not only development risks but also potential resistance from occupiers and concern groups which can lengthen the project programme.

Current Position

By 30 June 2017, the URA has commenced and implemented 60 redevelopment projects (including six Hong Kong Housing Society projects) and three preservation and revitalisation projects on top of 10 projects that it took over from its predecessor the Land Development Corporation (LDC). Of these projects 14 are now completed and the remainder are under planning, acquisition or construction. The track record of these commenced and implemented projects highlighted below bears mentioning considering the extent of dilapidation being addressed and the resulting benefits to the people in projects who are rehoused, the facilities delivered to new communities and the public good.

Challenges and Opportunities

A perennial concern has been the risk posed to the value of the URA's properties under development in the event of a property market downturn. The URA has endeavoured to mitigate this risk and cleared and tendered respectively three and four projects over the year including up to 30 June 2017.

These tenders helped reduce the value and market exposure of properties under development. Such actions are fitting at a time when the property market is at an all time high (see Figure 1) and yet housing supply is rising with some 96,000 units becoming available in the next three to four years. This new housing supply, together with an upturn in interest rates, could affect market sentiment negatively. The risks are compounded by the disparity over the past several years between the accommodation value (AV) of our projects at acquisition when the 'seven-year rule' under the Home Purchase Allowance is applied, and at project tender where the respective average AVs are $8,600 and $6,800 per square foot. Construction costs meanwhile, though largely 'treading water' in the last two years remain high (see Figure 2).

Run-down urban area improved 17.4 hectares	People benefiting from projects 28,000	New commercial gross floor area 406,000 m²
Dilapidated buildings redeveloped 715 buildings	New domestic gross floor area 960,000 m²	New GIC floor space 53,000 m²
Rehoused/compensated households 12,300	New flats 18,300	New open space 26,000 m²

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

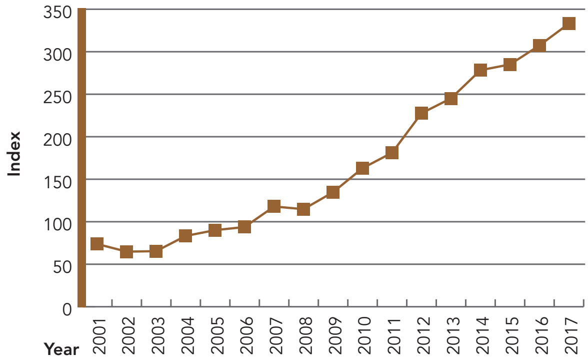
Meanwhile, we have kept in view the effect of the refined strategies for the Facilitating Services (Pilot Scheme) and the Demand-led (Pilot Scheme). These schemes began after the Urban Renewal Strategy was issued in 2011 and were designed to harness the collective willingness of owners to help initiate urban renewal themselves. The refinements have however not led to greater impacts. Facilitating services are now also being directed towards building owners in the Civil Servants' Co-operative Building Society Scheme and the Demand-led (Pilot Scheme) is to be reviewed further under the Yau Mong District Study (YMDS) described below.

District-based Approach

By commencing a grouping of several projects in To Kwa Wan, the URA has taken steps 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 these To Kwa Wan projects and their related planning and social gains and the Corporate Sustainability chapter explains the new people-oriented 'Project Engagement' Programme directed at affected residents.

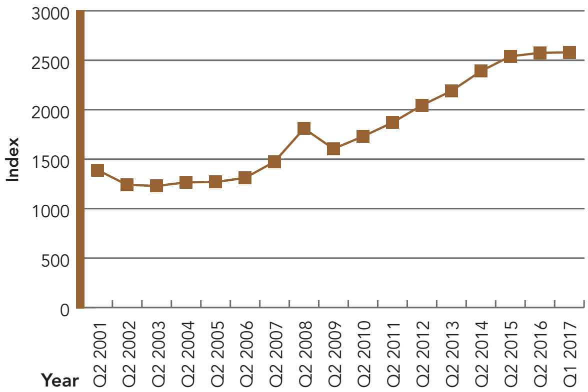
Recently, the URA has embarked on the YMDS. Previous urban renewal studies have sought to identify redevelopment and other opportunities under the 4Rs, however the brief to the YMDS is of an altogether more holistic order. It expands upon the district-based approach which is now proving its mettle in To Kwa Wan. It embraces the fifth 'R' of retrofitting as a new dimension of building rehabilitation. It will dissect the often elusive opportunities to optimise development potential such as through plot ratio transfer and it will not shirk from examining the constraints of the prevailing legislative and institutional framework. The YMDS will certainly propose implementable projects but as part of a wider set of new institutional and implementation strategies for district-based financially sustainable urban renewal under the 5R initiatives that can be readily applied elsewhere in Hong Kong's older districts.

Figure 1: Private Domestic Price Index May 2001 - April 2017 - All Classes*



**HKSAR Government, Rating & Valuation Department, Hong Kong Property Review Monthly Supplement, July 2017*

Figure 2: Quarterly Construction Tender Price Index 2001 - 2017*



**Rider Levett Bucknall, Quarterly Construction Cost Update, June 2017*

Rehabilitation

The URA's responsibility for rehabilitation has widened as one of its core businesses together with redevelopment. The URA's services are now more devoted to the Integrated Building Maintenance Assistance Scheme (IBMAS) which since July 2015 has been made available throughout Hong Kong. Owners are responsible for the maintenance and repair of their buildings, however 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.

Facilitating Rehabilitation through 'Smart Tender'

The 'Smart Tender' Building Rehabilitation Facilitating Services (the Scheme) is already proving effective in providing technical support to the Owners' Corporations of private buildings and reducing the risk of tender rigging at the works procurement stage. Launched in 2016 in response to the Chief Executive's Policy Address in that year, the Scheme seeks to help building owners reduce the risk of tender rigging at the works procurement stage for which over 79 applications have been received up until 30 June 2017.

New Strategy on Building Rehabilitation Study

Just as the YMDS is a holistic approach to district-based urban renewal, the New Strategy on Building Rehabilitation (NSBR) study is examining an all-embracing approach to rehabilitation seeking to reduce the number of buildings in varied and poor condition which will need redevelopment in future. Raising rehabilitation awareness even for young buildings under 30 years old is proposed to create a new mindset for preventive maintenance amongst owners. Owners and other stakeholders can turn to a new Building Rehabilitation Platform as an all-in-one web-based information centre which is targeted to be launched in early 2018. For older buildings, standards for rehabilitation and retrofitting are proposed so as to prolong building lifespan covering the five essential elements of building structure, the external facade, fire services, energy efficiency and barrier free facilities.

Preservation and Revitalisation

Section 5 of the URS spells out the URA's mandate in '*preserving buildings, sites and structures of historical, cultural or architectural value*.' The URA has implemented ten projects 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. At the Prince Edward Road West preservation project, acquired units in the project have been renovated and leased out for various uses including social enterprises. 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 as tasked by the Government under the "*Conserving Central*" initiative in the 2009/10 Policy Address, is another historic building initiative. A simplified version of the revitalisation scheme has been approved by the Board at a significantly reduced cost. An ad-hoc committee set up by the Board is overseeing the revitalisation with building works scheduled to kick-off by the third quarter of 2017.

In YMDS, a district-based approach for preservation and revitalisation will also be adopted by identifying local characteristics and cultures that need to be preserved and revitalised in an early planning stage.

Human Resources

With an operating environment that is continuously changing, the URA needs new core competencies and training to match. The necessary related management training programmes for staff at different levels have been launched. Additionally, with the introduction of new technologies in our work, as a first step, the training curriculum has been expanded to include Building Information Modelling (BIM) for senior executives and operational staff.

At the organisation level and to support the urban renewal directions, divisional reviews were carried out leading towards better alignment and organisational effectiveness. Also, to promote a continuous improvement culture and building on a successful earlier pilot run, Work Improvement Teams (WIT) were launched across the whole organisation within the URA. Eight such WITs were formed to improve work procedures and to enhance efficiency, with projected savings in man-hours and resources.

To contain our manpower costs, a recruitment freeze has continued for a second year achieving a further headcount reduction of 2.1%. This freeze will be retained in the coming year. Nevertheless, to nurture the leadership pipeline supply, five graduate trainees were recruited in the year. At the same time, to ensure competitive remuneration is offered to attract, motivate and retain the right staff to support our mission, a new grading structure with fewer levels was implemented effective from 1 April 2016.

To understand our strengths and areas for improvement and to build a highly motivated workforce, an Employee Engagement Survey was conducted. The URA's employee engagement score of 60% turned out to be 11% higher than the Hong Kong public sector and 4% higher than the Hong Kong total. Improvement actions would be implemented at both corporate and divisional levels for a better workplace for our staff.

Outlook

The URA's operating environment is in continuous flux in the financial world, the wider community and in our mandate and in the coming year we will doubtless encounter various constraints. Whilst continuing with our ongoing work in 4Rs with recently identified projects, we will develop a holistic approach in urban renewal through Yau Mong District Study and other major studies to take urban regeneration to a new level.

Financial Review

(I) Review of 2016/17 Results

(a) Revenue

The revenue for the year ended 31 March 2017 was $5,035 million which comprised of upfront payments from tendered projects, share of surplus from joint development projects and proceeds from sale of flats at Kai Tak. The amount is lower than the revenue of $7,422 million in 2015/16 by $2,387 million. Three projects, namely Pine Street/Oak Street, Kowloon Road/Kiu Yam Street and Peel Street/Graham Street (Site A), were tendered during the year. The total site area was 2,202 m^2 as compared with total site area of 4,926 m^2 from the six redevelopment projects tendered in 2015/16 hence resulted in the lower upfront payments for the year.

The share of sales proceeds from joint development projects of $1,249 million in 2016/17 (2015/16: $4,450 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 are projects with development agreements executed in prior years.

Proceeds of $1,763 million from sales of residential flats at Kai Tak was recognized in 2016/17. These flats were sold under Subsidised Sale Flat Scheme at 86% of the market value assessed by the URA.

(b) Other income

Of the $290 million (2015/16: $158 million) in other income for the year, $244 million (2015/16: $149 million) was interest income from bank deposits and fixed income investment products, with an average yield of 1.38% p.a. (2015/16: 1.35% p.a.). Other income included rental income from certain properties retained by the URA.

(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 2016/17 was $400 million (2015/16: $400 million). Cost control measures were implemented whenever possible to minimize administrative expenses. The depreciation charge for office capital expenditure and properties for own use was $45 million (2015/16: $50 million) for the year.

The staffing level was reduced from 521 at 31 March 2016 to 516 at 31 March 2017 resulting from recruitment freeze to enhance cost effectiveness and efficiency of manpower investment. Of the 516 staff, 15 (31 March 2016: 16) were employed on contracts of less than three years.

(d) Write back of 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, write back of provision for impairment on properties and committed projects of $831 million was made in 2016/17. It is primarily due to rising property prices during the year.

(e) Surplus for the year

For the year 2016/17, the URA recorded a net surplus of $3,142 million, reflecting a decrease of $1,309 million compared to the $4,451 million net surplus for the year 2015/16. The 2016/17 revenue included upfront payments from tendered projects, surplus from joint development projects and proceeds from sale of flats at Kai Tak. Before the write back of provision for impairment on properties and committed projects of $831 million, the surplus in 2016/17 was $2,311 million in comparison with $5,215 million reported in 2015/16.

(II) Financial Position at 31 March 2017

(a) Properties under development

Properties under development as at 31 March 2017 was $19,087 million (31 March 2016: $20,199 million), representing the acquisition and development costs for projects. This sum comprised of eleven projects under various states of implementation. The aforesaid value was off-set against the cumulative provision for impairment totalling $3,305 million (31 March 2016: $4,765 million), resulting in a net value of $15,782 million (31 March 2016: $15,434 million). The increase in the net value was mainly due to the write back of provision for impairment net off by certain projects being tendered during the year.

(b) Cash and bank balances

As at 31 March 2017, the URA's cash and bank balances and securities holdings totaled $19,741 million (31 March 2016: $13,856 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 cash position, off-set by the borrowings of $3,288 million (31 March 2016: $3,285 million) mentioned in paragraph II (c) below, resulted in the net cash position, including the securities holdings, at 31 March 2017 of $16,453 million (31 March 2016: $10,571 million).

(c) Debt securities issued

The URA is rated AAA by Standard & Poor's. As at 31 March 2017, the outstanding debt securities issued by the URA was $3,288 million under the US$1,000 million Medium Term Note (MTN) Programme.

(d) Net asset value

The URA's net asset value as at 31 March 2017 was $32,606 million (31 March 2016: $29,464 million), representing the Government's capital injection of $10,000 million (31 March 2016: $10,000 million) and an accumulated surplus of $22,606 million (31 March 2016: $19,464 million).

The financial highlights of the past ten 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 $10,000 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 2016/17, the land premia waived by the Government on three land grants amounted to $180 million. Since May 2001, a total of 36 land grants have been waived in respect of all the tendered projects with aggregate land premia totalling $15,411 million.

Without this waiver, the URA's net surplus for 2016/17 of $3,142 million for the year would have been lowered by $180 million to $2,962 million; its accumulated surplus as at 31 March 2017 would have been lowered by $15,411 million to $7,195 million; and its net asset value as at 31 March 2017 would have been decreased to $17,195 million.

(V) Financial Resources, Liquidity and Commitments

As at 31 March 2017, the URA's net cash position, including the securities holdings, totaled $16,453 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 $8,496 million.

In addition to the US$1,000 million MTN Programme mentioned in paragraph II (c) above, the URA maintained $700 million in uncommitted bank facilities as at 31 March 2017. 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 2017, the total costs of properties under development, excluding provision for impairment, was $19,087 million.

The URA estimates a total cash outlay of about $35,000 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.