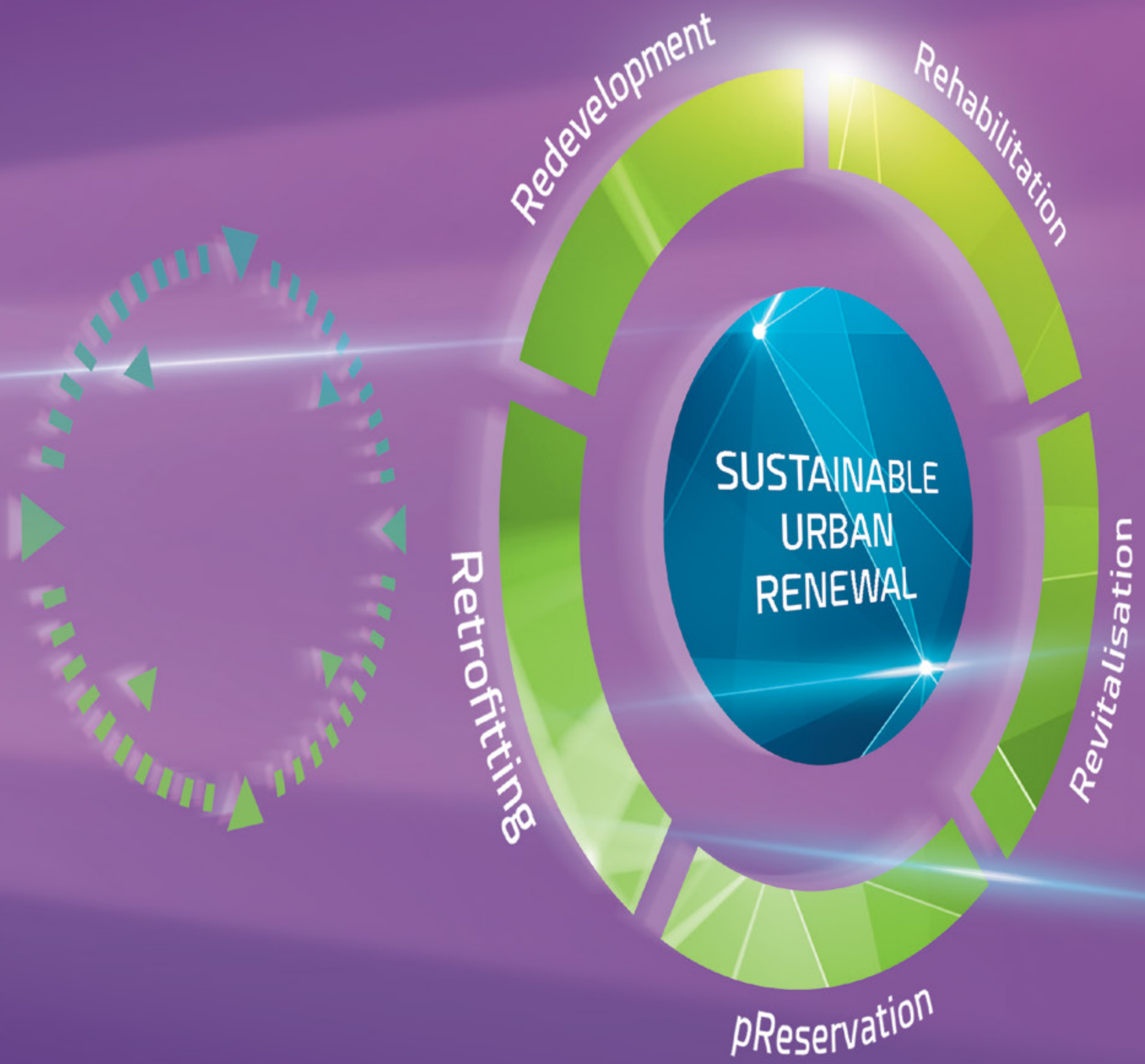
MANAGEMENT DISCUSSION AND ANALYSIS

Looking ahead, URA will make good and full use of its available resources to speed up urban renewal through our strategies and plans, while at the same time, take on the task of supporting the Government in addressing the provision of adequate affordable housing to the public.



The past year has been one of the most difficult for URA during its 20-year history and it has been challenging to just carry on business as usual. With some of our redevelopment projects inevitably delayed, we now need to make up for lost time to keep up with the pace of urban renewal.

On a more positive note, the eventful year has seen some softening of property prices and construction costs. However, unlike developers in the commercial sector, we do not have the luxury or flexibility to "buy low, sell high" by taking full advantage of the market cycle, owing to the statutory procedures and schedules the URA has to adhere to. Faced with volatility, we have to exercise extra caution in our business decisions requiring us to devise forward-looking project plans, comprehensive mitigating measures, and prudent financial and risk management to ensure that our business operation and financial position remain robust and urban renewal work can be sustained in the long run.

Two Core Businesses – Redevelopment & Rehabilitation

Performance Review of Redevelopment

The URA has weathered an unprecedented operating environment in 2019/20. In spite of the challenges arising from public health crisis, the URA managed to commence two redevelopment projects in May 2020 albeit with a three-month delay from their original schedules to mitigate the infection risk of COVID-19. This demonstrated our persistent effort to maintain a steady pace of urban renewal while exercising vigilance and flexibility in our planning.

Since its establishment in 2001 and up until 30 June 2020, the URA has commenced and implemented a total of 64 projects comprising of 61 redevelopment projects, two preservation projects and one revitalisation project. A further of six redevelopment projects were undertaken in association with the Hong Kong Housing Society. Of these 70 projects, 26 were completed and the remaining are at various stages of implementation.

The URA's notable achievements can be measured through the scale of urban decay that has been successfully addressed, the consequent benefits to the affected people, the contributions to new flat supply and the new facilities created for communities, as highlighted below:

Urban area improved	Dilapidated buildings redeveloped or to be redeveloped	Rehoused/compensated households	Residents benefitting from projects
20.8 hectares	1,495 building blocks	14,250	32,600
New domestic gross floor area	New flats	New commercial gross floor area	New GIC floor space
1,178,000 square metres	23,200	438,000 square metres	56,000 square metres

The URA has also completed 10 projects which were taken over for implementation from its predecessor, the Land Development Corporation. Adding this to the count, a population of around 46,000 previously living in dilapidated housing condition has been benefitted with improved living environment.

Challenges and Opportunities

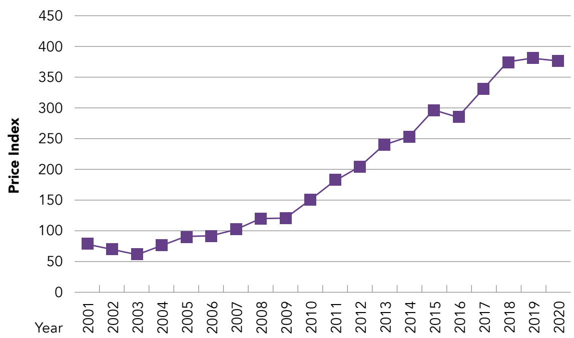
Following the Sino-US trade war, the local social movements and the subsequent outbreak of COVID-19 in early 2020 which abruptly disrupted the city's economy, have negatively impacted the residential property market with consecutive price drops for a few months. Meanwhile, the retail property market has taken a direct hit, as the risks continue to surge affecting market sentiments. Street shop vacancy rates soar to a record high in traditional retail districts. All these have alerted the URA to carry out its projects with extra caution and exercise prudence in its financial arrangement to be able to weather the volatilities. Maintaining a cautious outlook would be conducive to the URA's ultimate objective of taking forward urban renewal in a sustainable manner for the city's long term development.

Notwithstanding the drop in recent months, the property market has followed a largely upward path since 2003, and has seen an about six-fold surge in prices for all classes of accommodation in the private domestic market (see Figure 1). With the blooming property market, the URA has been acquiring its building stock at soaring prices, making it more vulnerable to market downturn.

The URA is obliged to bear higher development costs by acquiring properties under the "7-year rule" and is subject to ex-gratia payments markedly higher than those incurred by private sector developers. The URA is also obliged to commence acquisition as soon as possible after authorisation by the Secretary for Development or approval by the Executive Council. This practice exacerbates the risk of "buy high, sell low" since the URA lacks flexibility to slow down acquisition process in view of unfavourable market condition. To mitigate the risk, the URA is exploring ways to optimise the implementation schedule of different projects such that property acquisition of one project which requires significant cash outflow, could tie in with tender award of another, providing cash inflow, to ease the pressure on cash shortage.

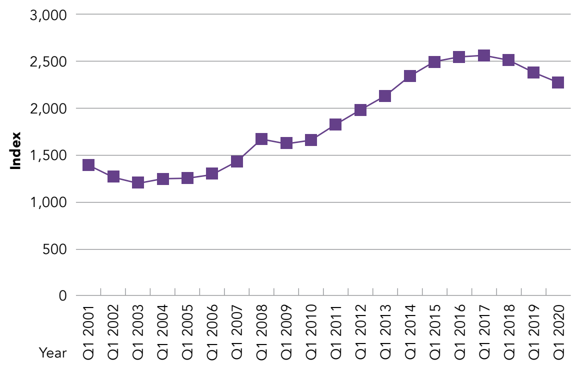
Meanwhile, construction costs though have dropped slightly in recent two years, remained at the higher end of the cost range compared with historical years, making it another financial burden to urban renewal (see Figure 2).

Figure 1:
Private Domestic Price Index
2001-2020 (up to June) - All Classes*



** HKSAR Government, Rating & Valuation Department, Hong Kong Property Review Monthly Supplement, August 2020.*

Figure 2:
Quarterly Construction Tender Price Index
2001-2020*



** Rider Levett Bucknall, Quarterly Construction Cost Update, June 2020*

On top of our existing urban renewal works, the URA has taken up a number of new initiatives under the 2019 Policy Address, among others, to actively provide more Starter Homes (SH) or other types of subsidised sale flats in its redevelopment projects, and to provide advisory and project management support to assist NGOs in developing transitional housing. While the URA would deploy resources in response to the Government's housing initiatives in particular to develop SH projects, it is also important for the URA to achieve a balance between sustainable development of its core businesses in urban renewal and the provision of SH flats which would cause cash flow issue to the URA.

Rehabilitation

In view of the increasing pace of building deterioration and the substantial cost of maintenance and repair, the importance of rehabilitation and preventive maintenance cannot be underestimated. Rehabilitation as one of the two URA's core businesses is a linchpin of URA's efforts to tackle the problem of urban decay in Hong Kong. Through proper maintenance, the service life of buildings can be extended thus reducing the pressure on redevelopment, and thereby relieving the financial burden on URA. While repairing and maintaining one's building has always been the responsibility of building owners, the lack of awareness, financial means and technical support to organise building rehabilitation works among owners has become a major obstacle towards proper and regular maintenance.

The URA has pressed on with our rehabilitation efforts to help building owners overcome these hurdles. The Building Rehabilitation Platform, launched in March 2019 as an all-in-one information platform, aims to provide professional and comprehensive information together with technical support on building rehabilitation to building owners as described in page 39 of the Operating Review Chapter.

Holistic Urban Renewal Approach

Planning-led. The URA has strived to pursue a holistic approach to optimise the planning benefits from our urban renewal efforts, by shifting its approach from the traditional project-based to planning-led. Two important strategic studies, namely Yau Mong District Study (YMDS) and Study on New Strategy on Building Rehabilitation (NSBR), were envisaged to establish new integrated business directions and executions embracing redevelopment, rehabilitation, preservation, revitalisation and retrofitting. The Preliminary Project Feasibility Studies (PPFSs) would further embrace a forward-looking and holistic long-term urban renewal planning mind-set, identifying 5R urban renewal projects with replanning and restructuring opportunities for building up a project reserve.

In addition to new strategies and project planning, the URA has kept in view the effectiveness of the Demand-led Pilot Scheme in an effort to harness the collective willingness of owners to help initiate urban renewal in both redevelopment and rehabilitation. The refinement to the scheme's overall objectives and framework is being reviewed under the purview of the YMDS, with a view to creating a greater planning impact by adopting a planning-led approach incorporating owners' needs at large while formulating urban renewal projects with bigger planning gain to the community or neighbourhood.

Integrated and District-based. The district-based model was piloted through the implementation of a group of six projects in To Kwa Wan since 2015 in a bid to take forward redevelopment in a more holistic approach, bringing greater planning gain and community benefits through replanning and restructuring of a larger cluster of dilapidated buildings. The creation of a more community-friendly environment with a refined urban grid and optimised land use are the main focuses of these redevelopment projects under the district-based approach. The shift in our fundamental planning paradigm brings in enhanced development outcomes designed with the larger community in mind, echoing the principle of people-first in urban renewal.

The YMDS and PPFSs are means to build up "planning reserves" comprising a wider set of integrated and district-based 5R renewal strategies.

The Operating Review of this report provides the latest status of key initiatives under the district-based approach along with their related planning and social gains.

Human Resources

To cope with the strategic move and new initiatives under the Policy Address, there was a slight increase in the actual headcount in 2019/20 compared with the previous year. To nurture a leadership pipeline, following the launch of the Future Leaders Programme in 2018/19 for General Managers and Senior Managers, a Manager Development Programme targeting middle management and selected promising managers was launched in this year. In addition, the Divisional Career Ladders were introduced for different divisions to help staff plan their own career development while a Successor Identification Model is being developed to identify successors for key positions using data analytics.

To equip the workforce with the proper mind-set, knowledge and skills required to apply innovation and technology in their work, training programmes in 2019/20 continued to focus on building our staff members' ability to apply the latest technology into their work; broadening their horizon and exposure via visits and talks delivered by external experts; and advancing their skills through various Big Data, Artificial Intelligence (AI), BIM and GIS workshops.

Outlook

At the URA, we are committed to implementing urban renewal in a sustainable and forward-looking manner to support the development of Hong Kong in the long run. While Hong Kong's rapidly ageing building stock remains a daunting task and challenge to overcome in the short run, the URA will press on to pursue the overarching goal of the holistic approach embracing its 5Rs to maximise benefits of urban renewal. Findings of the YMDS and NSBR will underpin the future direction and implementation of our urban renewal works. Going forward, the URA will endeavour to maximise planning gain through our 5R urban renewal projects, while promoting maintenance and improvement of the ageing building blocks through various financial subsidies and technical support to building owners. Moreover, the URA will continue to support the Government in supplying more affordable housing for the general public as promulgated in the 2019 Policy Address.

Although the URA currently enjoys a strong cash position, we will continue to uphold the core principle of prudent financial management, especially given the recent downturn of the economy and the uncertain outlook of the future property market, while balancing the enduring risks of high acquisition and construction costs. In the coming year, the URA will continue to stride towards a sustainable and holistic urban renewal programme that meets the needs and expectations of the community at large.

Financial Review

(I) Review of 2019/20 Results

(a) Revenue

The revenue for the year ended 31 March 2020 was $2,107 million, which comprised upfront payment from a tendered project, share of surplus from joint development projects and proceeds from flat sale. The amount was lower than the revenue of $3,423 million in 2018/19 by $1,316 million.

The upfront payment in 2019/20 of $883 million was lower than that of 2018/19 of $2,833 million as there was only one project tendered during the year, namely Hang On Street with site area of 865 m^2, compared to two tendered projects in 2018/19 with a total site area of 3,540 m^2.

The share of surplus from joint development projects of $1,185 million in 2019/20 (2018/19: $445 million) was revenue from projects where the sales proceeds exceeded the thresholds stipulated in the development agreements.

The revenue from sale of properties of $39 million in 2019/20 mainly related to the proceeds from sale of residential flats under the Flat-for-Flat Scheme where the flats were sold at prevailing market price at the time of acquisition offer issuance.

(b) Other income

Of the $479 million (2018/19: $536 million) in other income for 2019/20, $396 million (2018/19: $436 million) was interest income from bank deposits and fixed income investment products, with an average yield of 2.61% p.a. (2018/19: 2.31% p.a.). The higher average yield reflected the increase in interest rates in the money market during the year. Other income also included rental income from certain properties retained by the URA.

(c) Administrative expenses

Administrative expenses for 2019/20 of $515 million mainly covered staff costs, accommodation costs and office expenses. Cost control measures were implemented whenever possible to minimise administrative expenses.

To cope with the expansion of urban renewal activities, including the increased level of rehabilitation works arising from the new subsidy schemes, such as the Operation Building Bright 2.0, the Fire Safety Improvement Works Subsidy Scheme and the Lift Modernisation Subsidy Scheme, the staffing level was increased from 517 at 31 March 2019 to 557 at 31 March 2020. Of the 557 staff, 27 (31 March 2019: 15) 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(h) and 2(n) to the financial statements, provision for impairment on properties and committed projects of $1,025 million was made in 2019/20 in view of weakened property market during the year.

(e) Surplus for the year

For the year 2019/20, the URA recorded a net surplus of $118 million, showing a decrease of $2,212 million as compared to $2,330 million for 2018/19. Major contributions to the 2019/20 net surplus were (a) surplus from a tendered project, and (b) share of surplus sales proceeds from various joint development projects, partially off-set by (c) provision for impairment on properties and committed projects as a result of the weakened property market during the year.

The higher net surplus in 2018/19 was largely attributable to (a) upfront payments from two tendered projects and (b) the write back of provision for impairment on properties and committed projects of $841 million, as compared to one tendered project only and additional provision for impairment made in 2019/20.

(II) Financial Position at 31 March 2020

(a) Properties under development

Properties under development before provision for impairment of $33,494 million as at 31 March 2020 (31 March 2019: $29,609 million) reached record high level. This sum represented the acquisition and development costs of 16 projects under various states of implementation.

The aforesaid value was off-set against the cumulative provision for impairment totalling $1,221 million (31 March 2019: $1,181 million), resulting in a net value of $32,273 million (31 March 2019: $28,428 million). The increase in the net value was mainly due to continued acquisition of Kowloon City projects during 2019/20. It was off-set by Hang On Street Project already tendered and certain projects which construction works were completed during the year.

(b) Total liquidity

As at 31 March 2020, the URA's total liquidity, including cash, bank deposits and debt securities investments, was $11,067 million (31 March 2019: $18,107 million).

The URA placed the surplus cash on deposits with a number of financial institutions, and also invested in fixed income products of the required credit rating in accordance with the investment guidelines as approved by the Financial Secretary with capital preservation as the priority.

The liquidity position, off-set by the borrowings of $1,796 million (31 March 2019: $2,793 million) mentioned in paragraph II (c) below, resulted in the net liquidity position including the securities holdings at 31 March 2020 of $9,271 million (31 March 2019: $15,314 million).

(c) Debt securities issued

The URA is rated AA+ by Standard & Poor's Rating Services. As at 31 March 2020, the outstanding debt securities issued by the URA was $1,796 million under the Medium Term Note (MTN) Programme.

(d) Net asset value

The URA's net asset value as at 31 March 2020 was $47,092 million (31 March 2019: $46,974 million), representing the Government's capital injection of $10,000 million (31 March 2019: $10,000 million) and an accumulated surplus of $37,092 million (31 March 2019: $36,974 million).

The financial summary of the past ten years is described on page 103 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 2019/20, the land premia waived by the Government on a land grant amounted to $4 million. Since May 2001, a total of 44 land grants have been waived in respect of all the tendered projects with aggregate land premia totalling $19,682 million.

Without this waiver, the URA's net surplus for 2019/20 of $118 million for the year would have been lowered by $4 million to $114 million; its accumulated surplus as at 31 March 2020 would have been lowered by $19,682 million to $17,410 million; and its net asset value as at 31 March 2020 would have been decreased to $27,410 million.

(V) Financial Resources, Liquidity and Commitments

As at 31 March 2020, the URA's net liquidity position totaled $9,271 million. At the same date, the URA's 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, were estimated at $7,470 million.

In addition to the MTN Programme mentioned in paragraph II (c) above, the URA also maintained uncommitted credit facilities with major banks in Hong Kong. The external funding and credit facilities ensured the URA would have sufficient financial resources to carry out its urban renewal programme as planned.

Individual projects, with various development potentials, are tendered out at different times during property market cycles. 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 2020, the total costs of properties under development, excluding provision for impairment, was $33,494 million. The value of properties under development is exposed to the risk of property price fluctuation. Should the projected future value of the properties under development is lower than its actual/estimated acquisition and clearance costs, impairment loss will be recognised in the URA's books.

It is estimated that a total cash outlay of about $60,000 million, excluding operational overheads, will be required in the coming five years to meet both of the URA's currently outstanding commitments and its forthcoming cash outlay for the implementation of the projects. This amount covers the URA's work in redevelopment, rehabilitation, preservation, revitalisation and retrofitting.

The URA will continue to review its businesses with an aim to maintaining a highly prudent financial position and having due regard for commercial principles in its operations so that the urban renewal programme could be sustainable in the long term.