



MANAGEMENT DISCUSSION AND ANALYSIS

#opportunities #challenges #rainwater #dewdrops #plants

Plants thrive on rainwater after stormy weather, while economic headwinds will present the URA with opportunities to review its long term business model.

Rainstorms can bring havoc, yet also provide essential life support to plant growth.



Similarly, economic headwinds present the URA with not just stiff challenges but also an opportunity to critically review its business model and existing regulatory regime, looking well beyond its corporate planning cycles.

The recent downturn of the property market, with inflationary pressure persisting on construction costs, is overshadowing URA's financial prospects. The major financial resources of URA to carry out urban renewal works largely relies on upfront payments received from tendering of its projects for joint development with private developers. However, the source is highly susceptible to property market fluctuations, the overall economic environment, as well as interest rate movements, posing unavoidable risks to the financial stability of the URA to bring forward urban renewal works in the long run. In addition, this has been further aggravated by the established practice of acquiring property interests from owners under the 'seven-year-old flat' acquisition mechanism, a premium over prevailing market value.

Adding to the challenge is the low awareness of the importance of building rehabilitation among property owners, which has caused many dilapidated and irreparable buildings to require demolition and redevelopment when they reach the age of 50.

It is therefore a matter of urgency that we should review the resources for urban renewal and adopt an innovative approach, which includes using new planning tools to increase land development potential, strengthen our land and financial reserves, and introduce new preventive measures to prolong the service life of buildings, thereby alleviating the pressure on redevelopment.

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Challenges

Weak Prospects for Global Economic Recovery

The Hong Kong economy has shown signs of recovery recently, with growth in its gross domestic product in the first quarter of 2023, marking the end of four consecutive quarters of contraction. This can be attributed to an increase in local economic activities and an improved labour market, driven by the generally stable pandemic situation and the reopening of the Mainland border.

However, the external macro environment has deteriorated as a result of ongoing geo-political tensions. These have been compounded by multiple other factors, including rising inflation and a series of interest rate hikes that began in 2022, which have brought downside risks to the global economy.

As an open economy, Hong Kong has not been immune to these global economic challenges. Its adherence to the Hong Kong - US dollar peg saw a reverse in the low-interest-rate environment in the second half of 2022, which had a dampening effect on the local property market. The residential property market has undergone a marked correction as a result. Both the number of property transactions and flat prices have plummeted, reversing the long-term trend of high property prices in Hong Kong, and leading to a deeper fall in the land value, resulting in a less-than-expected revenue return of the URA from tendering of development projects.

Continuing Urban Decay

Our efforts to regenerate the ageing-built environment are a race against time, as the pace of urban decay has continued to outstrip the implementation of redevelopment projects.

As of June 2023, Hong Kong had about 12,400 residential buildings aged 50 years or more, and this number is expected to increase to around 26,000 in the next 20 years. Badly-maintained buildings quickly deteriorate, and their lower structural integrity and serviceability undermine public safety and liveability. Property owners' neglect of maintenance works has aggravated the problem of ageing buildings, and the situation has been further complicated by the problem of units in many old districts having been sub-divided, creating grave challenges for the building structures and sewage systems, deteriorating building conditions further.

Additionally, because most of the older building clusters were built with excessive development intensity, which mean the gross floor area of these existing buildings is higher than that is permissible under the current Outline Zoning Plan and hence have low redevelopment potential, these sites are unfavourable for private developers to pursue redevelopment. This situation has become a stumbling block to private market participation and has brought about an increasing reliance on the URA alone to take on the daunting task of urban renewal at these sites.

Insufficient Financial Reserves for Acquisitions

The URA's redevelopment projects involve hefty acquisition costs because its acquisition policy, referencing with that of Government's land resumption offer formulated 22 years ago, on owner-occupied domestic properties is calculated based on the value of a notional seven-year-old-replacement flat situated in the same locality. The mechanism was previously viable during the early years when the property market was experiencing an upward trend, which allowed the revenue generated from the new development to surpass the expenditure incurred for acquiring property interests of the old buildings under redevelopment.

However, the decline in home prices in recent years has led to a deeper fall in the land value, resulting in a less-than-expected revenue return of the URA from tendering of development projects. Should this unfavourable market situation continue, it would adversely affect the scale and pace of redevelopments by the URA in the years to come, and the long-term sustainability of urban renewal.

As a matter of fact, the existing mechanism of using public resources to help private property owners of dilapidated buildings buy better replacement units represents a significant social and economic burden that is compromising the sustainability of the urban renewal process. In this connection, the URA believes that it is an opportune time to encourage a thorough discussion about variable options in order to maintain both financial stability and land provision for the sake of taking forward sustainable urban renewal development.

Owner-initiated Rehabilitation Hurdles

Owners are responsible for the proper management and maintenance of their buildings. The New Strategy on Building Rehabilitation (NSBR), a study conducted by the URA and completed in 2020, however revealed three main obstacles that were hindering building owners from undertaking building rehabilitation projects: (i) insufficient professional knowledge in hiring consultants/contractors, (ii) inadequate financial resources, and (iii) insufficient organisational capabilities. Although the URA has made progress in promoting building rehabilitation, in partnership with various government departments and stakeholders, including professional institutions and practitioners, weakness of current regulation and lack of public awareness have impeded the implementation of building rehabilitation initiatives.

Opportunities

The URA cannot tackle the daunting challenges of urban regeneration alone, given the scale and intensity of urban decay. Also essential for urban renewal sustainability is the concerted effort by the Government, the private market and building owners.

Holistic Planning for Greater Community Benefits

As the primary agent of urban renewal in Hong Kong, the URA has utilised strategic studies and data analysis to implement a more holistic and forward looking 'planning-led' and 'district-based' approach, with the aim of maximising the planning and community benefits of urban renewal projects to address Hong Kong's current and future needs. Instead of implementing piecemeal redevelopment projects, we have increasingly focused our resources on large-scale redevelopment that can bring greater benefits for the wider community. A particular focus has been on renewing old buildings that have less appeal for private market participants due to their low development potential.

Under this approach, the URA commenced two Development Schemes at Ming Lun Street/Ma Tau Kok Road (KC-018) and To Kwa Wan Road/Ma Tau Kok Road (KC-019) in October 2022. KC-018, also known as 'Five Streets', covers a large cluster of buildings in disrepair, which together occupy the maximum plot ratio allowed by the planning permit. Proceeding with redevelopment under such circumstances would create a heavy financial burden on the URA, as the expenditure of the hefty acquisition cost would outgrow the revenue from the new development.

In view of the above, the URA has taken into account the planning intentions of the current Kai Tak Outline Zoning Plan, in which some industrial buildings in the To Kwa Wan area will be transformed into composite developments upon redevelopment. By incorporating 'Five Streets', the two industrial buildings (KC-019) and the adjoining underused streets in the holistic planning, the two projects were implemented with a view to optimise land resources in the district, thereby increasing the feasibility of implementing the redevelopment of 'Five Streets'. In the meantime, the redevelopment will bring greater planning benefits to the community by improving the connectivity of To Kwa Wan with the Kai Tak Development Area and creating a vibrant harbourfront for public enjoyment.

Additionally, the URA has been making efforts to adopt new approaches to seek innovative and flexible solutions to enhance land use efficiency and redevelopment potential. New urban renewal opportunities were identified by applying new planning tools and planning-led approaches to maximise land use and enhance development potential. For instance, the URA adopted the 'planning-led' urban renewal model, together with the Integrated Approach, to formulate a holistic plan for the Nga Tsin Wai Road/Carpenter Road redevelopment project. Part of the Carpenter Road Park in the project's northern site will be designated for reprovisioning community facilities, including the Kowloon City Market and the adjoining facilities, by building a new government complex under a 'Single Site, Multiple Uses' approach. Meanwhile, a low-rise commercial building will be built in the project's eastern site to support the business activities of the proposed Gateway Square. With the transfer of plot ratio, the residue gross floor area of the eastern site will be transferred to the main site (the land where the existing Kowloon City Market sits), unleashing further potential of the land for redevelopment.

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Government Facilitation to Expedite the Renewal Process

In 2022, the URA submitted a proposal to the Development Bureau (DEVB) in which it recommended streamlining the mechanisms and processes of different development procedures in order to compress the project delivery cycles for both the URA and private sector redevelopment projects.

The URA's recommendations have won Government support. For instance, the Lands Department implemented an 'advance land grant' policy in the Starter Homes Project for the redevelopment of Tai Hang Sai Estate. Under this policy, the Lands Department will grant the land in advance to the URA once only a few households and businesses remain to be relocated in a project. This enables the project to be tendered out earlier where applicable, and design, site investigation, demolition and construction to be commenced ahead of time.

Promoting Private Sector Participation

The URA commenced the Yau Mong District Study (YMDS) in 2017 with the aim to devise a district-based urban renewal plan for the study area, which covered the Yau Ma Tei and Mong Kok districts with an area of about 212 hectares, comprising more than 3,300 buildings, and to explore new planning mechanisms to facilitate implementation. Through a holistic district-based approach to urban renewal, the main objective is to map out a blueprint for restructuring and regenerating the old districts to enhance land use efficiency and optimise redevelopment potential. With a view to incentivising market participation, new urban renewal strategies involving both URA and the private sector as well as institutional and implementation mechanisms are formulated.

The Government has endorsed the recommendations of the YMDS in 2021, including the application of new planning tools. In line with this, the URA supported the Planning Department's submission of amendments on the Mong Kok Outline Zoning Plan to the Town Planning Board (TPB) in order to increase the gross floor area within the infrastructural limits and planning capacity. These amendments involve relaxing the plot ratio for the commercial spine along Nathan Road, and allowing for interchangeability of domestic and non-domestic plot ratios to cater for market changes. The amended plan was approved by the Chief Executive in Council in June 2023. Similar amendments to the Yau Ma Tei Outline Zoning Plan have been submitted to the TPB and are currently under public consultation.

In July 2023, the TPB promulgated new Guidelines for the Application for Transfer of Plot Ratio (TPR). This scheme is proposed to unleash and transfer development potential from sites of low redevelopment potential to more sizeable sites at more strategic and accessible locations suitable for higher development intensity, while providing improvements to the living environment and planning gains to the local community. This will speed up urban regeneration in the Yau Ma Tei and Mong Kok districts where redevelopment momentum has been slow whereas the number of old and dilapidated buildings has been on the rise.

Fostering a Culture of Preventive Maintenance

When property owners and other stakeholders conduct building rehabilitation and preventive maintenance to extend the life of their buildings, the need for redevelopment is reduced, thereby creating a 'window period' in which redevelopment efforts can be focused on the severely dilapidated buildings in old urban areas.

Given this, the URA is putting extra efforts into encouraging building owners to proactively carry out repair and maintenance works in order to maintain the structural integrity and serviceability of their buildings and internal units. To this end, the URA opened Hong Kong's first Building Rehabilitation Resource Centre, located at its 'eResidence' project in Hung Hom, to the public in July 2023. Using innovative interactive displays, the Centre provides visitors with comprehensive information on building rehabilitation. It also offers online consultation and application services to help property owners apply for various building rehabilitation subsidy schemes on the spot. These services are encouraging more building owners to carry out essential maintenance and repairs.

We also plan to test preventive maintenance measures in the next Starter Homes project, eResidence Tower Three, for which applications are set to open in September 2023. The project's Deed of Mutual Covenant will include guidelines and regulations requiring owners to establish a regular maintenance plan for the building, and to set aside reserve funds for future maintenance work.

In addition, the URA has been working with various stakeholders, including the Property Management Services Authority and other property management institutions, to facilitate the future implementation of preventive maintenance and to promote regular contributions to the maintenance fund. A set of templates will be developed and published, designed to help building owners formulate their own maintenance manuals and plans. By strengthening our promotional efforts in these ways, we aim to help building owners become more confident and competent in carrying out preventive maintenance.

We will also continue to enhance the content of our Building Rehabilitation Platform website. This provides building owners with a wider range of useful information, including standard sample documents and data on market reference rates for related work items, all designed to help owners select suitable service providers for their building inspection and repair needs.

Forging Ahead

Urban decay is a complex problem, and requires a holistic and sustainable approach to address it. Given Hong Kong's substantial number of deteriorating buildings, its high property prices and fluctuating economic environment, it is imperative that alternative solutions are explored that will enable the URA to build up the financial and land reserves necessary for it to carry out urban renewal work in an effective and sustainable manner.

The Government has been a consistent source of various forms of financial support for the URA, which have ensured it has had the resources to fulfil its urban renewal mission. These have included an initial HK\$10 billion capital injection upon the URA's establishment, and a waiver of land premium payable for its redevelopment projects. In recent years, the URA has also collaborated with Government departments to consolidate out-of-date community facilities sites into URA's project to increase the overall development potential of redevelopment projects and improve their financial viability, while reprovisioning and upgrading those facilities upon redevelopment.

In addition, approval has been obtained from the Financial Secretary to raise the URA's borrowing limit from HK\$6 billion to HK\$25 billion in order to cope with the anticipated cash shortfall in the next few years arising from the implementation of several large redevelopment projects. The URA is committed to maximising the flexibility of its financial resources in order to enhance its project reserves and enable timely adjustments in response to market fluctuations, in order to mitigate potential financial risks.

We expect to see new land supply gradually become available over the next 10 years, as the Government expedites the construction of the Kau Yi Chau artificial island. This will provide about 1,000 hectares for between 190,000 and 210,000 housing units. We will explore with the Government how to use this new land supply to provide decanting space for households affected by urban renewal and enable larger-scale urban redevelopment projects, as an alternative urban-renewal solution with existing land resources.

Meanwhile, the URA will continue to identify land with restructuring and replanning potential in different districts. We will adopt the new planning tools proposed by the YMDS, along with the 'vertical city' planning concept, to formulate a more effective urban renewal plan for other old districts. We also plan to accelerate the preparation work for new redevelopment projects and related technical feasibility studies, and mobilise resources for these projects in a timely manner, depending on the availability of financial reserves and the property market situation.

On another front, we will be making significant efforts to encourage property owners to fulfil their responsibilities in all aspects of building maintenance, and assist them in the internal and external maintenance of their units, to prolong the service lives of older buildings. By doing this, we will be working to shift the urban renewal model from relying redevelopment as the only way forward to a more holistic, comprehensive and sustainable model, thus paving the way for a new era of urban renewal.

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Financial Review

(I) Review of 2022/23 Results

(a) Revenue

The revenue for the year ended 31 March 2023 was HK\$5,513 million, which comprised upfront payments from three tendered projects, share of surplus from joint development projects and proceeds from flat sale. The amount was lower than the revenue of HK\$22,653 million in 2021/22 by HK\$17,140 million.

The total upfront payments in 2022/23 of HK\$4,841 million were significantly lower than that in 2021/22 of HK\$20,900 million as a result of property market downturn in the second half of 2022/23. Upfront payments from the three project tenders awarded during the year, namely (a) Sung Hing Lane / Kwai Heung Street; (b) Wing Kwong Street / Sung On Street; and (c) Queen's Road West / In Ku Lane, with a total site area of 6,182 m², were significantly lower than the expected amounts. Moreover, the tender for the joint venture development of Development Areas 4 & 5 of the Kwun Tong Town Centre Project (K7) was not awarded due to poor market response. Comparatively, four tenders involving seven redevelopment projects with a total site area of 18,044 m² were awarded in 2021/22.

The share of surplus from joint development projects of HK\$476 million in 2022/23 (2021/22: HK\$1,362 million), largely contributed by SSP/1/003-005 Seaside Sonata and K7 Area 2&3 Grand Central, was revenue from projects where the sales proceeds exceeded the thresholds stipulated in the development agreements.

The revenue from sale of properties of HK\$196 million in 2022/23 (2021/22: HK\$391 million) mainly related to the sale of 10 flat-for-flat residential units at Kai Tak.

(b) Other Income

Of the HK\$575 million (2021/22: HK\$253 million) in other income for 2022/23, HK\$518 million (2021/22: HK\$84 million) were interest income from bank deposits and fixed income investments, with an overall yield of 2.06% p.a. (2021/22: 0.66% p.a.). The higher yield reflected the sustained interest rate hikes since July 2022.

Other income also included rental income, net of rental relief, of HK\$130 million (2021/22: HK\$141 million) from certain properties retained by the URA, and unrealised exchange loss of HK\$76 million (2021/22: exchange gain of HK\$25 million) relating to Renminbi deposits due to the fluctuation of exchange rate.

(c) Administrative Expenses

Administrative expenses for 2022/23 of HK\$637 million (2021/22: HK\$623 million) mainly covered staff costs, outsourcing service charges, accommodation costs and office expenses. Cost control measures were implemented whenever possible to minimise administrative expenses.

(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 HK\$3,036 million was made in 2022/23, mainly arising from (a) decrease in the assessed land value of the committed projects, reflecting unfavourable results in the URA's project tenders and the Government's land sales in recent months; and (b) the changes in the development plan and estimated costs for certain projects.

(e) Result for the Year

For the year 2022/23, the URA recorded an operating deficit of HK\$494 million. After inclusion of the provision for impairment on properties and committed projects, the net deficit was HK\$3,530 million, compared to a net surplus of HK\$6,568 million for 2021/22. The unfavourable performance for 2022/23 was mainly attributable to property market downturn, which led to (a) lower upfront payments from the three project tenders awarded in the year as mentioned in paragraph (l)(a) above, and (b) substantial provision for impairment made for committed projects.

(II) Financial Position at 31 March 2023

(a) Properties under Development

Properties under development before provision for impairment was HK\$25,249 million as at 31 March 2023 (31 March 2022: HK\$22,501 million). This sum represented the acquisition and development costs of eight projects under various states of implementation, out of which Kowloon City Projects, Kwun Tong Town Centre Project and the Civil Servants' Co-operative Building Society (CBS) project at Shing Tak Street accounted for 81% of the total value.

The aforesaid value was off-set against the cumulative provision for impairment totalling HK\$4,053 million (31 March 2022: HK\$654 million), resulting in a net value of HK\$21,196 million (31 March 2022: HK\$21,847 million). The decrease in the net value was mainly due to (i) the removal of the development costs of the projects tendered out in 2022/23 as mentioned in paragraph (l)(a) above and (ii) the large provision for impairment on committed projects made for the year as explained in paragraph (l)(e) above, after offsetting the costs incurred for property acquisitions for the remaining Kowloon City Projects.

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(b) Total Liquidity

As at 31 March 2023, the URA's total liquidity, including cash, bank deposits and debt securities investments, was HK\$23,623 million (31 March 2022: HK\$26,943 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 HK\$799 million (31 March 2022: HK\$1,098 million) mentioned in paragraph II (c) below, resulted in the net liquidity position including the securities holdings as at 31 March 2023 of HK\$22,825 million (31 March 2022: HK\$25,845 million).

(c) Debt Securities Issued

The URA is rated AA+ by Standard & Poor's Rating Services. As at 31 March 2023, the outstanding debt securities issued by the URA under the Medium Term Note (MTN) Programme was HK\$799 million.

(d) Net Asset Value

The URA's net asset value as at 31 March 2023 was HK\$50,280 million (31 March 2022: HK\$53,810 million), representing the Government's capital injection of HK\$10,000 million (31 March 2022: HK\$10,000 million) and an accumulated surplus of HK\$40,280 million (31 March 2022: HK\$43,810 million).

The financial summary of the past ten years is described on page 123 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 HK\$10,000 million of equity capital into the URA in five tranches of HK\$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. A total of 54 land grants have been waived in respect of all the tendered projects with aggregate land premia totalling HK\$22,942 million up to 31 March 2023.

Without this waiver, the URA's accumulated surplus as at 31 March 2023 would have been lowered by HK\$22,942 million to HK\$17,338 million; and its net asset value as at 31 March 2023 would have been decreased to HK\$27,338 million.

(V) Financial Resources, Liquidity and Commitments

As at 31 March 2023, the URA's net liquidity position totaled HK\$22,825 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 HK\$4,470 million.

In addition to the MTN Programme mentioned in paragraph II(c) above, the URA also maintained uncommitted bank credit facilities 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 2023, the total costs of properties under development, excluding provision for impairment, was HK\$25,249 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 HK\$78,000 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 works in redevelopment, rehabilitation, preservation, revitalisation and retrofitting. In addition to current liquidity, the projected cash outlay will be met by future upfront payments from project tenders, share of surplus sales proceeds from joint development projects and proceeds from sale of properties in the corresponding period. Should funding be required for URA's urban renewal works, financing will be sought via bank loans and/or bond issuance as appropriate.

Despite improved Hong Kong economy in the first half of 2023, local property and financial markets, impacted by external environment factors including global inflation, interest rate hikes, trade disputes and geopolitical tensions, remain volatile. Facing the uncertainties and challenges, the URA will continue to manage its businesses in an agile manner and monitor its financial position closely, with an aim to accomplish its urban renewal missions while maintaining long-term sustainability.