# Management Discussion & Analysis

## (I) Review of 2012/13 Results

### (a) Revenues

Revenues for the year ended 31 March 2013, comprising mainly upfront payments from tendered projects and share of surpluses from jointly controlled development projects, amounted to $5.3 billion. This represents an increase of $1.6 billion compared to the last financial year's revenue of $3.7 billion. The aggregate value of upfront amounts concluded by the URA in 2012/13 was much higher than 2011/12 as the three redevelopment project sites tendered and awarded during the year, namely Peel Street / Graham Street, Pak Tai Street / Mok Cheong Street and Sai Yee Street, with 4,940 $m^2$ in total area, were more in number and larger in size than the one site tendered and awarded in 2011/12 with total area of only 931 $m^2$. Also included in the $5.3 billion revenues were shares of sales proceeds totaling $0.6 billion (2011/12: $3.2 billion) from certain jointly controlled development projects with the proceeds exceeding certain thresholds stipulated in the development agreements. The thresholds were set years ago when the URA arranged the relevant revenue tendering exercises in a market where property market values were relatively lower. The projects contributed to the surplus during the year included Lime Stardom in Tai Kok Tsui, Island Crest in Sai Ying Pun, Florient Rise in Tai Kok Tsui, Vision City in Tsuen Wan and The Zenith / One Wanchai in Wan Chai, with development agreements executed in 2007, 2005, 2004 and 2002 respectively, and The Zenith / One Wanchai project which was executed in 1996 by the Land Development Corporation, the predecessor of the URA.

### (b) Other net income

Of the $183 million (2011/12: $190 million) included as other net income for the year, $144 million (2011/12: $153 million) was interest income earned from the investment portfolio managed in-house which included bank deposits and fixed income products, with an average yield of 1.72% p.a. (2011/12: 1.68% p.a.). There were also gains of $20 million (2011/12: $12 million), principally from funds managed by the investment manager with a gross yield of 1.47% p.a. (2011/12: 1.27% p.a.).

### (c) Administrative expenses

Administrative expenses mainly covered staff costs, accommodation costs and depreciation charges. Administrative expenses before depreciation for the financial year was $316 million (2011/12: $278 million). The increase was largely due to the headcount growth required to meet the workload of the URA's planned projects and activities. The depreciation charge for office capital expenditure was $21 million (2011/12: $19 million) for the financial year 2012/13.

To cope with the expansion of the urban renewal activities, the staffing level was increased by 49 from 449 in 31 March 2012 to 498 in 31 March 2013. Of the 498 staff, 82 (31 March 2012: 96) were employed on contracts of less than three years in duration. It is expected that the headcount will increase further to cope with the planned expansion in future years of the building rehabilitation works including the expanded geographical coverage. The URA will progressively take over the rehabilitation work from the Hong Kong Housing Society by assuming its responsibilities in

Kowloon, Tsuen Wan and Kwai Tsing Districts in 2013, and then the whole territory by 2015.

**(d) Urban Renewal Trust Fund (URTF)**

In 2011/12, the URA contributed $0.5 billion funding as an endowment for the establishment of the URTF, one of the initiatives under the new Urban Renewal Strategy (URS).

**(e) Write back of / provision for impairment on properties and committed projects**

The URA's properties and committed projects are valued by in-house professionals at the end of each financial year. Based on its accounting policy detailed in Notes 2(g) and 2(n) to its financial statements, a net write back of provision for loss aggregating $1.7 billion was made in this financial year. The said amount was largely due to the write back of the provision for loss for the Kwun Tong Town Centre project resulting from the modification of assumptions made to certain Government/Institution and Community's (GIC's) and the project's overall development plan during the year, in addition to the increase in the assessed development values as compared with those in the previous year. The write back was offset by the provision for loss made for Kowloon City Road / Sheung Heung Road project and the provision for loss on three demand-led projects which started acquisition during the year.

**(f) Operating surplus for the year**

For the year ended 31 March 2013, the URA recorded a net operating surplus of $4.4 billion being increased in revenues as explained in paragraph (I) (a) above less expenditure, reflecting an increase of $1.8 billion or 69% compared to the $2.6 billion net operating surplus reported in 2011/12.

## (II) Financial Position at 31 March 2013

**(a) Properties under development**

The value of "Properties under development" as at 31 March 2013 was at a historically high level of $22.4 billion (31 March 2012: $19.2 billion), representing the acquisition costs for projects for redevelopment or preservation purposes at various stages of implementation, comprising five projects under acquisition; five projects pending completion of resumption process; two projects with over 90% ownership of interests acquired pending reversion to the Government; and seven projects with ownership reverted to the Government pending final clearance. The aforesaid cost was set off against the cumulative provision for loss on 15 projects of $3.3 billion (31 March 2012: $5.6 billion for nine projects) giving rise to a net cost of $19.1 billion (2011/12: $13.6 billion). The increase in the net cost reflects mainly the higher number of projects now being implemented, the overall higher levels of acceptance of offers and higher acquisition costs for acquisition of properties in these projects. During 2012/13, the URA commenced acquisition of five redevelopment projects, three located in Sham Shui Po, one located in Tai Kok Tsui and another one in Kowloon City. Among these five projects, three of them are demand-led projects.

In accordance with the URS, the URA launched the Flat-for-Flat (FFF) Scheme to provide domestic owner-occupiers affected by the URA's redevelopment projects commenced after 24 February 2011 as an alternative option to cash compensation. The Government has provided a site at Kai Tak for the URA to develop about 500 small to medium sized flats for the FFF Scheme. As at 31 March 2013, land premium and construction cost totalling $1.5 billion for Kai Tak development were also recorded as "Properties under development".

**(b) Cash and bank balances**

As at 31 March 2013, the URA's cash and bank balances and the fair value of the funds managed by the investment manager totaled $9.4 billion (31 March 2012: $10.6 billion).

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

Off-set by the borrowings of $3.3 billion (31 March 2012: $1.7 billion) mentioned in paragraph II (c) below, the net cash position including the fair value of the financial assets at 31 March 2013 was $6.1 billion (31 March 2012: $8.9 billion).

**(c) Debt securities issued**

In December 2010, in conjunction with the upgrading of the Government of HKSAR's rating, the URA's rating was also upgraded by Standard & Poor's (S&P) to AAA from AA+. This rating was reaffirmed after an annual review in February 2013.

As at 31 March 2013, the debt securities issued by the URA was $3.3 billion. In May 2013, additional debt securities totaling $0.6 billion were issued under its US$1 billion Medium Term Note (MTN) Programme.

**(d) Net assets value**

The URA's net assets value as at 31 March 2013 was $26.2 billion (31 March 2012: $21.8 billion), representing the Government's capital injection of $10 billion (31 March 2012: $10 billion) and an accumulated surplus from operations of $16.2 billion (31 March 2012: $11.8 billion).

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 billion of equity capital into the URA in five tranches of $2 billion over a five-year period from 2002/03 to 2006/07. The Government has exempted the URA from taxation.

## (IV) Waiver of Land Premia by the Government

Under the URS, the Government waives the land premia for redevelopment sites granted to the URA. In 2012/13, the land premia waived by the Government on four land grants amounted to $1.0 billion. Since May 2001, a total of 21 land grants, including land premia under the four land grants made in 2012/13 have been waived in respect of all the tendered projects with aggregate land premia totalling $6.5 billion.

Without this waiver, the URA's net operating surplus for 2012/13 of $4.4 billion for the year would have been lowered by $1.0 billion to $3.4 billion; its accumulated surplus since May 2001 would have been lowered by $6.5 billion to $9.7 billion; and its net assets value as at 31 March 2013 would have been decreased to $19.7 billion.

## (V) Financial Resources, Liquidity and Commitments

As at 31 March 2013, the URA's net cash position including the fair value of the funds managed by the investment manager totaled $6.1 billion as mentioned in paragraph II (b) above. At the same date, the URA's accruals and estimated outstanding commitments to the commenced projects based on the valuation carried out by the URA's in-house professionals stood at $14.3 billion.

In addition to the US$1 billion MTN Programme mentioned in paragraph II (c) above, the URA maintained a total of $1.0 billion and $0.7 billion in committed and uncommitted bank facilities as at 31 March 2013. Securing the external funding and the credit facilities ensured that the URA will 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 launched for tender 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 2013, the total costs of properties under development was $22.4 billion. Taken together with the outstanding commitments, the URA's exposure to the property market was at a historically high level.

The URA estimates in its latest Corporate Plan that from 1 April 2013, a total cash outlay of about $26.0 billion, excluding operational overheads, will be required in the next five years to meet the costs of both its currently outstanding commitments and its forthcoming expenditure on implementation of the projects contained in the Plan. This expenditure covers the URA's work in redevelopment, rehabilitation, preservation and revitalisation. It should be noted that while the Corporate Plan has been drawn up taking into full account of the new initiatives under the URS promulgated in February 2011, expenditure may nevertheless vary subject to the levels of interest shown in these initiatives, including in particular, demand-led redevelopment, flat for flat scheme, the expanded programme of building rehabilitation and other additional initiatives which may be added subsequent to the preparation of the Plan.

To ensure that its urban renewal programme is sustainable for the longer term, the URA is tasked to maintain a highly prudent financial position and have due regard for commercial principles in its operations.