For discussion **FCR(2002-03)24**
on 21 June 2002

ITEM FOR FINANCE COMMITTEE

CAPITAL INVESTMENT FUND
NEW HEAD "URBAN RENEWAL AUTHORITY"

Members are invited to approve a new commitment of $10 billion under the Capital Investment Fund for injection as equity into the Urban Renewal Authority to enable the Authority to implement the urban renewal programme.

PROBLEM

The Urban Renewal Authority (URA) does not have sufficient funds of its own to implement the urban renewal programme.

PROPOSAL

2. The Secretary for Planning and Lands proposes that Members approve a commitment of $10 billion under the Capital Investment Fund for injection as equity into the URA for the implementation of the urban renewal programme.

JUSTIFICATION

(A) Need for Government Support

3. The URA is set up to undertake projects in areas where urgent redevelopment is required in view of the dilapidated state of buildings and the poor living conditions of residents. A considerable number of these projects have limited redevelopment potential. The land assembly cost of some projects is likely to exceed the value of the sites after redevelopment. Many projects are also of little interest to private developers on their own due to land assembly difficulties.

/4. .....

4. In accordance with the transitional provisions under the Urban Renewal Authority Ordinance (URAO), the URA has taken over all the assets and liabilities of the Land Development Corporation (LDC), including the on-going projects. Mainly due to the losses from one on-going project taken over from the LDC, the URA has not started in a strong financial position. The URA estimates that the total deficit for the ten on-going projects of the LDC would amount to around $1.7 billion upon their completion.

5. To take forward the urban renewal programme, the URA needs to raise finances through joint venture partnership with private developers and bank borrowings. It also requires financial support from the Government.

6. We have assessed the extent of government financial support required by the URA to jumpstart the urban renewal programme against the targets of its approved five-year Corporate Plan (CP) for 2002 to 2007 and its approved annual Business Plan (BP) for 2002-03. In this process, we have taken into account the following considerations –

(a) the objective that the urban renewal programme should be self-financing in the long run;

(b) the projected financial needs of the URA to carry out its redevelopment, rehabilitation and preservation work; and

(c) the Government's fiscal position.

The programme of work and the associated financial projections in URA's CP and
Encl. the BP are summarised at the Enclosure.

(B) Government Financial Support

7. As part of the Government's financial support package for the URA, urban renewal sites for new projects set out in the URA's CPs and BPs to be approved by the Financial Secretary (FS) from time to time may, in principle, be granted to the URA at nominal premium, subject to URA satisfying FS of the need therefor. Similarly, land required to meet URA's rehousing needs as identified in the approved CPs and BPs may, in principle, be made available at nominal premium, subject to URA satisfying FS of the need therefor. The land premium foregone by the Government will be reflected in the accounts of the URA.

/8. .....

8. To address URA's immediate financial needs and to enable it to launch the urban renewal programme on a sound financial footing, we propose that a commitment of $10 billion under the Capital Investment Fund be approved for injection as equity by the Government into the URA.

(C) Implications of Government Financial Support

9. The proposed injection of equity together with the nominal land premium concessions for urban renewal and rehousing sites to be granted to the URA, constitute a significant contribution by the Government to the urban renewal programme. This sizable subsidy for renewing Hong Kong's urban fabric underlines the Government's strong commitment to improving the living conditions in the older urban areas and the environment for the whole community.

10. The tangible support from the Government, in the form of the proposed injection of equity and the availability of land grants at nominal premium, will enable URA to raise the balance of funds required for taking forward the urban renewal programme through borrowings at competitive rates and joint ventures with developers where appropriate. The URA estimates that, with the Government's financial support and the finances that it intends to raise in the market, it will achieve a break even position with a cash balance of $10 billion and no liabilities by 2014-15, the end of the implementation period of all the projects in its first CP. This is in line with our objective that the urban renewal programme should be self-financing in the long run.

FINANCIAL IMPLICATIONS

11. Subject to Members' approval of the $10 billion commitment, we propose that equity be injected into the URA in phases over the five financial years from 2002-03 to 2006-07.

MONITORING MECHANISM

12. The financial forecasts in the CP have been arrived at based on the various assumptions adopted by the URA. (Please see paragraph 3 of the Enclosure.) Factors such as movements in the property market, interest rate changes, construction cost fluctuations and the actual implementation mode of individual projects would all have a significant bearing on the outturn of the financial projections and indeed the financial viability of the programme. Factors like interest rate and property market movements are in turn influenced by macro economic conditions. The Government will keep under close review the performance of the URA in delivering the urban renewal programme and its financial position in the annual examination of URA's CP and BP.

/**ECONOMIC** .....

ECONOMIC IMPLICATIONS

13. Urban redevelopment will present considerable business and employment opportunities to the building and construction industry, the related trades and the associated professions. The redevelopment projects, when carried out in collaboration with private sector developers, will bring about considerable business opportunities for the real estate development sector. The projected expenditure will add to overall demand in the economy, thus contributing to the Gross Domestic Product. The improved district planning will add to the value of the redeveloped and existing properties in the concerned areas as a whole. The new premises, when completed, will constitute better housing stock complemented with better community facilities.

ENVIRONMENTAL IMPLICATIONS

14. Urban redevelopment will ameliorate the problem of obsolete and incompatible land uses. It will bring about better local transport networks and district facilities, and improve the quality of the living environment through the provision of public open space and government/ institution/ community facilities in the built-up urban areas. This will be to the overall benefit of the community.

BACKGROUND INFORMATION

15. Hong Kong faces an urban decay problem. In 2001, there were about 9 300 private buildings in the Metro Area[1] which were 30 years old and above. In ten years' time, this number will increase by half as much again to some 14 000 buildings.

16. The URAO was enacted in July 2000. The URA was established in May 2001 to undertake an urban renewal programme comprising 200 projects identified in the Government's Urban Renewal Strategy and 25 uncompleted projects of the LDC.

17. Under the URAO, urban renewal includes the redevelopment of dilapidated buildings, promoting the rehabilitation of older buildings and the preservation of buildings of historical, cultural or architectural interest. The main policy objective is to improve the environment of the older urban areas and the living conditions of the residents therein. The Government's Urban Renewal Strategy sets out the following targets for the urban renewal programme –

/(a) .....

---

[1] The Metro Area covers Hong Kong Island, Kowloon, Tsuen Wan and Kwai Tsing.

(a) redevelopment of some 2 000 ageing or dilapidated buildings;

(b) improvement of the environmental quality of 67 hectares of old and run-down urban areas;

(c) rehousing some 27 000 tenant households;

(d) provision of around 60 000 m^2 of open space;

(e) provision of about 90 000 m^2 of floor space for use as community/welfare facilities; and

(f) provision of seven new schools.

18. We consulted the Legislative Council Panel on Planning, Lands and Works on 31 May 2002. Members in general supported the proposed injection of equity .

19. Some Members were concerned about the amount of development costs to be reimbursed by the URA to the Housing Authority (HA) for providing casual vacancies to rehouse tenants affected by URA projects. We explained that the rehousing costs according to the current reimbursement formula had already been taken into account in the Government's proposed financial support package for the URA. Under the current institutional framework, it would be up to the URA and HA, as statutory bodies, to work out a mutually agreeable arrangement in the spirit of co-operation. If there was room and justification for reviewing the issue in the future, we would do so.

20. Some Members asked if the compensation offered by the URA could be increased. We explained that the URA's acquisition offers followed the basis outlined by the Secretary for Planning and Lands at the Finance Committee meeting held in March 2001.

\-------------------------------------

Planning and Lands Bureau
June 2002

Urban Renewal Authority
First Corporate Plan and Financial Projections

Under the Urban Renewal Authority Ordinance (URAO), before the start of each financial year, the Urban Renewal Authority (URA) is required to submit to the Financial Secretary (FS) for approval a draft corporate plan (CP) setting out its proposed programme of projects for the next five years and a draft business plan (BP) setting out the projects to be implemented in the next year. In order to kick-start the urban renewal programme as early as possible to meet the community's expectation, FS gave approval to the URA in January 2002 for the implementation of three uncompleted projects of the Land Development Corporation (LDC) as "early launch" projects prior to the submission of its first draft CP and BP. Subsequently, the URA submitted its draft CP and draft BP covering the periods 1 April 2002 to 31 March 2007 and 1 April 2002 to 31 March 2003 respectively to FS for approval on 18 March 2002. The two draft plans were approved by FS on 28 March 2002.

2. The approved CP comprises 42 projects, including all of the 25 uncompleted projects of the LDC and 17 projects identified in the Government's Urban Renewal Strategy. These projects will affect over 6 200 property interests and about 10 400 tenant households. They cover a total area of around 13.5 hectares, with up to 18 000 flats to be built. Together, the 42 projects will produce around 1 000 000 m^2 of domestic gross floor area (GFA) and 220 000 m^2 of non-domestic GFA. In addition, about 13 400 m^2 of public open space and about 39 200 m^2 of floor space for use as Government/ Institution/ Community (GIC) facilities will be provided. Such GIC facilities include residential care homes for the elderly, schools, an indoor stadium and youth centre, a community performance hall, a hostel for the mentally handicapped, markets, public toilets and refuse collection points.

3. The URA has made a number of assumptions in the financial projections in its CP. Subject to the various assumptions, the URA expects the 42 projects in the CP to be financially viable as a whole. This is in line with our policy that the urban renewal programme should be self-financing in the long run. The major assumptions are as follows –

/(a) .....

(a) nominal premium will be payable in respect of urban renewal sites[1] and land for the URA's rehousing purposes;

(b) a total of $10 billion will be injected into the URA by the Government, to be drawn down in five equal tranches from 2002-03 to 2006-07;

(c) a 50:50 joint venture approach with developers is adopted as a proxy[2], whereby it is assumed that the developers would contribute half of the land value of the assembled site at the start of the development stage and share the development costs and profits with the URA equally;

(d) no assumption of future inflation/deflation in the cashflow forecast. The acquisition costs of the 42 projects and gross development value (GDV) of these projects are based on valuation figures as at September 2001; and

(e) the interest rates on bank loans and cash surplus are 6% per annum and 4% per annum respectively[3].

4. On the basis of the above assumptions, the URA estimates that the GDV of the 42 projects will be about $53.2 billion and the total development cost over the development period will amount to about $37.9 billion, broken down as follows –

Acquisition	$17.7 billion
Cash compensation and rehousing	$3.4 billion
Construction	<u>$16.8 billion</u>
	<u>$37.9 billion</u>

In addition, a sum of $0.4 billion is earmarked for rehabilitation, revitalisation and heritage preservation works.

/5. .....

1 Except for one project which does not involve compensation for owners and rehousing.

2 There are three implementation modes for URA projects, namely sole development by the URA, joint venture with private developers, and land sale after site assembly. The URA will decide on the exact implementation mode for each project having regard to the characteristics of the project and other relevant factors such as the prevailing market condition.

3 The URA's forecast of the interest rate at which it could raise funds from the market and the interest rate on bank deposits is based on the prevailing market conditions at the time when the CP was prepared and the assumptions in (a) to (d) above.

5. In addition to the Government's financial support, the URA will have to borrow from the market to finance its projects. At the peak of the development period of its first CP in 2009-10, this borrowing is estimated at $9.6 billion.

6. Under the scenario of the 50:50 joint venture approach as described in paragraph 3(c) above, the financial implications of the 42 projects to the URA are as follows –

Revenue	
50% of land value	$10.5 billion
50% of GDV	$26.6 billion
Total revenue	*$37.1 billion*
Cost	
Full acquisition cost	$17.7 billion
Full cash compensation and rehousing cost	$3.4 billion
50% of construction cost	$8.4 billion
Rehabilitation, revitalisation and heritage preservation cost	$0.4 billion
Overheads (Staff cost, accommodation etc.)	$3.1 billion
Corporate interest expenses	$2.4 billion
Total cost	*$35.4 billion*
Total revenue	$37.1 billion
Less: Total costs	$35.4 billion
Surplus	$1.7 billion

7. Taking into account the deficit of $1.7 billion inherited by the URA in the ten on-going projects of the LDC, the URA estimates that it will achieve a break even position with a cash balance of $10 billion and no liabilities by 2014-15, the end of the development period of all the projects in the first CP.

8. If there is no injection of equity from the Government and based on the 50:50 joint venture approach, the URA estimates that only nine out of the 42 projects would be financially viable. With the $10 billion injection over a five-year period, interest expenses would be reduced so that a total of 15 projects would become financially viable.

9. The financial assessments will be affected by a number of factors, including fluctuations in the interest rate, movements in the property prices, changes in construction costs and the implementation mode for the projects. A series of sensitivity tests have been conducted by the URA on these factors and their results are at the Appendix.

Table 1: Sensitivity Test on Fluctuations in the Interest Rate

($ billion)	Base Case	Decrease by 1 percentage-point	Increase by 1 percentage-point	Increase by 2 percentage-point	Increase by 3 percentage-point
Interest rate on bank loans Interest rate on cash surplus	6% per annum 4% per annum	5% per annum 3% per annum	7% per annum 5% per annum	8% per annum 6% per annum	9% per annum 7% per annum
Revenue: 50% of land value 50% of gross development value Total revenue	 10.5 26.6 37.1	 10.5 26.6 37.1	 10.5 26.6 37.1	 10.5 26.6 37.1	 10.5 26.6 37.1
Cost: Full acquisition cost Full cash compensation and rehousing cost 50% of construction cost Rehabilitation, revitalisation and heritage preservation cost Overheads (Staff cost, accommodation etc.) Corporate interest expenses Total cost	 17.7 3.4 8.4 0.4 3.1 2.4 35.4	 17.7 3.4 8.4 0.4 3.1 *2.0* 35.0	 17.7 3.4 8.4 0.4 3.1 *3.0* 36.0	 17.7 3.4 8.4 0.4 3.1 *3.7* 36.7	 17.7 3.4 8.4 0.4 3.1 *4.5* 37.5
Project surplus/deficit (Total revenue minus Total cost)	**1.7**	**2.1**	**1.1**	**0.4**	**-0.4**
Deficit of the ten on-going LDC projects	-1.7	-1.7	-1.7	-1.7	-1.7
Surplus/Deficit of the URA	**0.0**	**0.4**	**-0.6**	**-1.3**	**-2.1**

Table 2: Sensitivity Test on Movements in Property Prices

($ billion)	Base Case	Increase by 10%	Decrease by 10%
Gross development value	53.2	58.4	47.8
Land value	21.0	23.1	18.9
Acquisition cost	17.7	19.4	15.9
Revenue			
50% of land value	10.5	*11.5*	*9.4*
50% of gross development value	26.6	*29.2*	*23.9*
Total revenue	37.1	40.7	33.3
Cost			
Full acquisition cost	17.7	*19.4*	*15.9*
Full cash compensation and rehousing cost	3.4	3.4	3.4
50% of construction cost	8.4	8.4	8.4
Rehabilitation, revitalisation and heritage preservation cost	0.4	0.4	0.4
Overheads (Staff cost, accommodation etc.)	3.1	3.1	3.1
Corporate interest expenses	2.4	*2.5*	*2.3*
Total cost	35.4	37.2	33.5
Project surplus/deficit (Total revenue minus Total cost)	**1.7**	**3.5**	**-0.2**
Deficit of the ten on-going LDC projects	-1.7	-1.7	-1.7
Surplus/Deficit of the URA	**0.0**	**1.8**	**-1.9**

Table 3: Sensitivity Test on Changes in Construction Costs

($ billion)	Base Case	Decrease by 10%	Increase by 10%
Construction Cost	16.8	15.1	18.4
Revenue 50% of land value 50% of gross development value Total revenue	 10.5 26.6 37.1	 10.5 26.6 37.1	 10.5 26.6 37.1
Cost Full acquisition cost Full cash compensation and rehousing cost 50% of construction cost Rehabilitation, revitalisation and heritage preservation cost Overheads (Staff cost, accommodation etc.) Corporate interest expenses Total cost	 17.7 3.4 8.4 0.4 3.1 2.4 35.4	 17.7 3.4 *7.6* 0.4 3.1 *2.2* 34.4	 17.7 3.4 *9.2* 0.4 3.1 *2.6* 36.4
Project surplus/deficit (Total revenue minus Total cost)	**1.7**	**2.7**	**0.7**
Deficit of the ten on-going LDC projects	-1.7	-1.7	-1.7
Surplus/Deficit of the URA	**0.0**	**1.0**	**-1.0**

Table 4: Sensitivity Test on the Implementation Mode for the Projects

($ billion)	Base Case	30 (URA):70 (private) joint venture	Land Sale
Gross development value	50%	30%	0%
Land value	50%	70%	100%
Construction cost	50%	30%	0%
Revenue:			
Land value	10.5	*14.7*	*21.0*
Gross development value	26.6	*15.9*	*0.0*
Total revenue	37.1	30.6	21.0
Cost:			
Full acquisition cost	17.7	17.7	17.7
Full cash compensation and rehousing cost	3.4	3.4	3.4
Construction cost	8.4	*5.0*	*0.0*
Rehabilitation, revitalisation and heritage preservation cost	0.4	0.4	0.4
Overheads (Staff cost, accommodation etc.)	3.1	3.1	*2.5*
Corporate interest expenses	2.4	*1.1*	*0.6*
Total cost	35.4	30.7	24.6
Project surplus (Total revenue minus Total cost)	**1.7**	**-0.1**	**-3.6**
Deficit of the ten on-going LDC projects	-1.7	-1.7	-1.7
Surplus after deficit of the on-going LDC projects	**0.0**	**-1.8**	**-5.3**