

From the Office of *Tony T N Chan*

29th September 2006

Committee on Rail Merger Bill
Legislative Council Building
8 Jackson Road,
Central,
Hong Kong.
Attn.: Ms. Sarah Yuen, Clerk to Bills Committee

Dear Sirs,

Comment on the Rail Merger Bill

I am an estate surveyor. I have 26 years of experience in valuation of land and buildings gained through my past and current employments in the Lands Department of the Hong Kong Government and surveying firms in the private sector. I do care for the community and readily respond to the media interviews from time to time on topics which concern my profession.

With reference to the Clerk to your Committee's letter dated 18 August 2006 addressed to me on this subject, I have the following submission.

I. Concur with the Methodology of the Surveyor appointed by the Government

In principle, I support the proposed merger of the two railway companies. I concur that there will be corporate synergy effect which would be brought about by the merger. Through the website of the LegCo Bills Committee, I have been able to read into the relevant documents on this subject including a paper from the Environment, Transport and Works Bureau CB (1)2198/05-06 (2) and its appendices. I have gone through the content on the Property Package issues in particular the paragraphs on the basis and methodology adopted by the professional surveyor appointed by the Government on the valuation of the development rights of the 8 KCRC sites. As most of the assumptions as described in (III) below (part of which being commercially sensitive information) involved in the assessment of the development rights are not provided in the said papers, I cannot go further into commenting on whether the total consideration of \$4.91 Billion is reasonable or not. However, I do concur with the methodology adopted by the surveyor appointed by the Government.

II. Clarification on the Press Article on the Assessment of Development Rights

In connection with this subject, I have responded to interviews by the media in July. In regard to an article in Ming Pao on 3rd July 2006 (see a copy of the extract attached in Appendix I), I would wish to take this opportunity to make clarifications as below.

From the Office of Tony T N Chan

I recall that it was a very urgent telephone call and the reporter requested that I made an evaluation of the development rights of the 8 KCRC sites. I refused to do so because the salient information and assumptions were not available. Later, the reporter called again and changed his questions on two sites, namely:

- (a) Tai Wai Station
- (b) West Kowloon Station (Site C and Site D)

In referring to (a) Tai Wai Station, the reporter asked me to comment on the unit sale price of the commercial portion of that project. In replying, I said that considering the 667,000 s.f. size and the locational advantage of the regional potential as a future focal point of the East Rail, Ma On Shan Line and the future Shatin-Central Line, I was of the opinion that the unit rate could be in the range of \$10,000 to \$12,000 per s.f. In the said article, it was projected that the *expected proceed* from the commercial portion of Tai Wai Station project could be revised upward from the estimated \$4.805 Billion to \$6.674 Billion - \$8.008 Billion, i.e. a difference of a maximum of \$3.203 Billion.

On the face of it, the said article could give a wrong impression that the consideration for the development right could be under-estimated by up to \$3.203 Billion. I wish to hereby clarify that the consideration for the development right should be based on the present value of the expected **net profit** that could be realised by KCRC instead of the "*expected proceed*". For property development projects, the **net profit** is derived by deducting the development costs (including land value, building cost, professional fees, taxes and cost of borrowing etc.) from the Gross Development Value. Furthermore, since KCRC projects follow the tender procedure in selecting developer partner, a fraction of the net profit will need to be deducted to account for the share payable to the developer partner according to the sharing ratio in the submission made by the highest tenderer, see Appendix II for details. The present value (see explanation in para. III (6) and para. (6) of Appendix III hereof) of the residual amount of net profit payable to KCRC is what should actually constitute the consideration for the development right.

In the same telephone interview, the said reporter made a similar request concerning the market unit rate of new residential flat regarding (b) West Kowloon Station (Site C and Site D). I responded accordingly and likewise, that was concerning the proceed from that development.

III. Uncertain Factors which affect the Assessment of the Development Rights

There are a number of other factors which could affect the assessment of the development rights of the 8 sites including:

- (1) The fluctuation of the property market
- (2) The Town Planning Board's decision on the mode and scale of development (for example, the recent concern on the "Shielding Effect" by high tower blocks could bring about changes in the scale of development which could affect the net development profit)

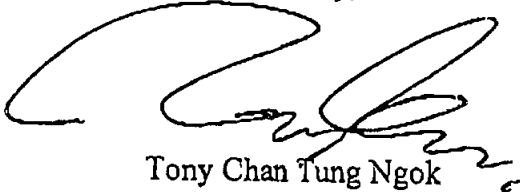
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- (3) The premium to be assessed and paid to the Lands Department (the premium for 6 sites not yet known)
- (4) The Sharing Ratio of profit between KCRC and the developer partner (commercially sensitive information)
- (5) Development Schedule and Expected Completion Date
- (6) The Discount Rate(s) adopted to bring the valuation into Present Day Value (reflects development risk)

Most of these factors are uncertain and assumptions will have to be made, refer to Appendix III for details.

I hope that the above submission will be useful to you. I will not attend your committee's meeting on 28th October 2006.

Yours faithfully,



Tony Chan Tung Ngok

c.c. Secretary for the Environment, Transport and Works
Secretary for Financial Services and the Treasury

Encl.: Appendix I - Copy of Extract of an article in Ming Pao dated 3rd July 2006
Appendix II - Table on the assessment of KCRC's share of development profit
Appendix III Major Assumptions which affect the assessment of the development rights

Appendix II

Table on the Assessment of KCRC's share of development profit

Development Profit of each of the site	A(pv)
Less	
Developer Partner's share	B
KCRC's share of profit	C = A(pv) - B

Since there are 8 sites, each site will have its calculation and generates its sum of profit for KCRC's share.

Total consideration for the development rights = C1+C2+C3+C4+ C5+C6+C7+C8

Note:

(C): The KCRC sites now follow the tender procedure in choosing developer partner. The tenderer will submit a profit sharing ratio. The ratio is commercially sensitive information.

A(pv): Present Value of each project's development profit

Appendix III**Major Assumptions which affect the Assessment of the Development Rights of the KCRC sites**

- (1) **The fluctuation of the property market**
The Hong Kong property market has undergone dramatic fluctuations in the past ten years. It is difficult for anyone to precisely predict the future trend of the property market in particular for those development projects with a long development schedule.
- (2) **The Town Planning Board's decision on the mode and scale of development**
The KCRC sites are at a planning stage. The Town Planning Board's decision on the mode and scale of development could affect the development profit. For example, the recent concern on the "Shielding Effect" by high tower blocks could bring about changes in the scale of development which could affect the net development profit.
- (3) **The premium to be assessed and paid to the Lands Department (the premium for 6 sites not yet known)**
Land premium is a major cost item in property development.
For 6 of the 8 KCRC sites, the land premium is not yet known. According to what happened in the past, the rail companies did appeal on the premium assessments and what will be the premium are assumptions to be made for the purpose of assessing the development profit.
- (4) **The Sharing Ratio of profit between KCRC and the developer partner (commercially sensitive information)**
For KCRC projects (whether they have been tendered or not at this stage), the profit sharing ratio belongs to commercially sensitive information which could not be released to the public. However, the assumption of how much this sharing ratio should be will essentially affect the slice of KCRC's share of profit and hence the assessment of the development right.
- (5) **Development Schedule and Expected Completion Date**
When will the 8 projects be implemented and when will they be completed affect the interest payments and the risk taken by the developer. Some of the sites do not even have a land lot number which says for itself the preliminary status of the sites. These time schedule and target completion dates are important assumptions.
- (6) **The Discount Rate(s) adopted to bring the valuation into Present Day Value (reflects development risk)**
As per (5), the 8 projects will be implemented according to different schedules and the conversion of future profits into present day values, discount rate(s) will have to be assumed.