

**Joint Meeting of the Panel on Planning, Lands and Works and
the Panel on Financial Affairs on 24 May 2005**

Concerns raised and Information requested at the Meeting

Response by the Government

Q(a): Subsidy in the form of land grants to commercially operated bodies, such as the two railway corporations and the Airport Authority, is undesirable because the actual amount could not be ascertained. The arrangement of land grants by private treaties also lacks transparency and accountability to enable effective public scrutiny. The administration is requested to review and replace subsidy by land grants with direct capital injection;

A(a): Regarding the two railway corporations, the Administration has explained its stance in a paper submitted to the Bills Committee on Mass Transit Railway Bill in November 1999. A copy of the paper is at **Annex A** for reference.

A railway project is considered not financially viable, if the present value of all its revenues net of its capital and operating expenditures over the franchise period falls short of the capital expenditures. This shortfall is known as the funding gap. The grant of land to the two railway corporations if necessary to close any funding gap of rail projects had been found beneficial in enabling the two railway corporations to build and operate railways with reasonable returns and serve the traveling public.

The sustainability of railways built and operated commercially would in turn affect the roll-out of railways for Hong Kong with minimal Government participation and costs.

The rail-and-property model also has the operational benefit of optimizing the interface between the railway part and property part of a rail project. This is because, on the basis that it would automatically be involved in the property developments along the stations of its railway projects, the railway corporation concerned would provide suitable property enabling works needed when it constructs its railways. If the above-station sites were to be sold separately for property development, additional costs would likely be incurred because of the extra efforts required to address the interface between the property development works and the railway operation.

Property development rights are considered on a case-by-case basis having regard to the justifications on individual merits and are not automatic. It is not a form of subsidy to the railway corporations. A subsidy consists of either Government expenditure or revenue forgone. The grant of property development rights to the railway corporations does not come into any of these categories as premium at full market value is charged for the land.

It is important to note that the Government cannot bridge the funding gap of a railway project by an equity injection. An equity injection would increase the cost of capital and hence the rate of return required by the railway corporation from its projects. Where there is a funding gap, an equity injection will only lead to an even larger funding gap. A more viable

alternative is a capital grant which is, in essence, a cash subsidy to the railway corporation from which the Government will not see anything in return. For future projects where a funding gap exists, the Government will certainly consider on a case-by-case basis the merits of capital grants or other forms of financing instead of, or in addition to, the grant of property development rights.

As for the Airport Authority (AA), the Airport Island was granted to AA in 1995 for the development of the Hong Kong International Airport (HKIA) for a term up to 2047 under a legally binding land grant. The land grant contains stringent controls over land use so that only airport support and airport-related developments are permitted on the Airport Island. AA has paid for the land by bearing the land formation costs of over \$10 billion, which are normally the responsibility of the Government. The land grant is not a subsidy to AA.

Q(b): Whether the profits generated from property developments of the two railway corporations have ever been used to subsidize rail fares. If so, the amounts and how they are calculated;

A(b): The grant of property development rights is one of the options for closing the funding gap of railway projects which are not financially viable. The grant of property development rights is intended to bring to the shareholders commercial returns commensurate with the risks involved in investing in a new railway project which would otherwise be non-viable and not to be pursued. It is not intended to subsidize the rail fares for a particular project.

In accordance with their respective Ordinances, the two railway corporations conduct their business according to prudent commercial principles. In setting rail fares, the railway corporations would have to give due consideration to various factors such as the prevailing economic condition, operating environment, public affordability, market competition etc.

Q(c): Whether there are any criteria for land grants by private treaties. If so, what are they;

A(c): Most land available for commercial, industrial or residential development is sold by public auction or tender. Apart from this, we also grant land by PTG to private or non-governmental organizations for specified use in justified circumstances, to comply with approved Government policies and to meet Hong Kong's economic, social and community needs. All such direct land grants have to be subject to stringent policy scrutiny and are thoroughly considered to be justified in the public interest, with specific approval granted by the Executive Council (ExCo) or by delegated authority exercised in accordance with the approval criteria set by ExCo, on a case by case basis.

PTGs are normally for a specific purpose with the land use specified in the grant. Premium payable varies from nominal, concessionary to full market value depending on the nature of the use. Examples of the different categories of PTGs classified by premium charged are as follows –

(a) nominal premium

- (i) education purpose: schools, tertiary institutions;
- (ii) welfare purpose : social welfare, residential care homes for the elderly;
- (iii) health use: clinics, hospitals;
- (iv) housing purpose: e.g. public rental housing by the Housing Authority.

(b) concessionary premium

- (i) charitable uses such as churches, temples;
- (ii) housing purpose: assisted housing (e.g. rental estates built by the Housing Society).

(c) full market premium

- (i) public utilities purpose;

- (ii) special industrial purposes; and
- (iii) housing purpose: e.g. property development by the railway corporations.

Other than the above-mentioned categories, there are a small number of PTG cases, where the relevant bureau / department will consider the merits of each case for submission to ExCo for approval, with regard to certain policy considerations, such as whether the development proposal for PTGs complies with approved Government policies or assists to meet pre-determined policy objectives; the assessed economic or other benefits of the proposal, the strategic importance or otherwise of the proposal; whether it is the right timing to make the proposed PTGs; and the ability of the applicant in financing the implementation of the proposal etc.

To sum up, the number of PTG cases is not many, and these cases are approved only under rather special circumstances on individual merits. Development must conform to the current town plans at the time of grant or subsequent permissions granted or amendments of the relevant town plans by the Town Planning Board. Development must represent full use of the site having regard to the purpose of the grant. Grantees must demonstrate their financial capability to implement their projects. Unequivocal policy support from the relevant bureaux / departments must be secured before the application for land under PTGs can be processed. All PTGs have to be submitted to ExCo for approval or to the delegated authority for approval in accordance with the approved criteria set by ExCo. Restrictions as

appropriate are included in the Conditions of Grant. The policy of granting land by private treaty is long established, and has worked well. It has proven to be effective in ensuring the timely and optimal development of our land resources to keep pace with our social and economic development, for the purpose of meeting economic, social and community needs in a timely and appropriate manner.

Q(d): To achieve better regulation of the property market, the disposal of Government land should rest with the Secretary for Housing, Planning and Lands and other bureaux should not have the authority to approve private land grants;

A(d): Apart from public auction or tender, all other form of long-term land disposal must be covered by policy approved by the Executive Council, either on a case-by-case basis or on a “blanket approval” basis. Other bureaux do not have authority to approve PTGs. The Director of Lands, to whom certain powers to execute land grants have been delegated, would ensure that all PTGs are consistent with the relevant approved government policies.

Q(e): Information on the mechanism for assessing land premium in private treaty grants and how transparency and impartiality of the mechanism could be enhanced;

A(e): Premium for lease modifications and land exchanges are assessed by qualified professional valuers in the LandsD. The approach adopted for

assessing enhancement in land value conferred by the change in the lease conditions accords with the policy reaffirmed by the Executive Council in July 1997. In arriving at the enhancement, the difference between the land value under the existing lease conditions and the land value under the modified lease conditions is assessed. Stringent guidelines on the policies, procedures and justifications have also been issued by LandsD for its staff to ensure that each and every case will be handled in a fair, reasonable and consistent manner. After the concerned application is approved, premium will be assessed by a Valuation Conference/Valuation Committee. The procedures are set out in a practice note issued by LandsD to the trade on 17 February 2006 (see **Annex B**).

Under the current system, the Audit Commission will conduct audit on land sale proceeds from time to time, and the Public Accounts Committee will also closely monitor. Furthermore, the ICAC and the Ombudsman also have a check and balance and monitoring role to play.

Q(f): Lands granted by private treaties for specific uses must be monitored to ensure that they are put to the designated uses. In the event that the lands are not put to the designated uses after the land grant for a certain period of time, the Administration should enforce the lease conditions and recover the lands;

A(f): Where the cessation or diminution clause in the PTG has been demonstrably breached and the relevant policy justifications for the PTG remain valid, the Administration will seek to re-enter the lot if the grantee refuses to purge the

breach.

Q(g): Information on the status of land grants by private treaties;

A(g): The Administration has briefed Members of the Legislative Council Panel on Planning, Lands and Works on 28 March 2006 on the information on the status of land grants by private treaties.

Q(h): Information on land falling within the following categories:

- (i) Lands granted by private treaties for non-profit making purposes where nominal or concessionary premium have been charged but the lands are restricted to use by certain categories of persons, not complying with the relevant lease conditions; and**
- (ii) Lands granted by private treaties were exchanged for another sites which were subsequently sold for profits.**

Q(h): (i) We are not aware of any PTG cases where the land concerned was granted for non-profit making purposes at nominal/concessionary premium and the use of the land was restricted to use by certain categories of persons, in breach of the lease conditions.

- (ii) We are not aware of any PTG cases where the land concerned was exchanged for another site which was subsequently sold for profits.

Q(i): Information on the review on enforcement of the cessation of user clause in private treaty grants.

A(i): The Administration briefed the Legislative Council Panel on Planning, Lands and Works on 28 March 2006 on the outcome of the review of lease modification to permit change of use for sites previously granted by private treaty.

Economic Development and Labour Bureau

Environment, Transport and Works Bureau

Financial Services and the Treasury Bureau

Housing, Planning and Lands Bureau

April 2006

Bills Committee on Mass Transit Railway Bill

Property Development Rights

PURPOSE

This paper is submitted in response to the request made by Members of the Bills Committee on the Mass Transit Railway Bill, at its meeting on 11 November 1999, that the Administration should provide further information on the existing policy on granting property development rights, where appropriate, to MTRC in connection with its railway projects. Members have also asked the Administration to explain why this policy, which also applies to KCRC, should continue to apply to MTRC after privatization.

BACKGROUND AND ARGUMENT

Integration of Railway and Property Development

2. For planning, safety and technical reasons, the Government considers it generally necessary to make property development, where appropriate, above railway stations and depots, and on land adjacent to the railway, an integral part of the railway development. The MTRC has been designing and constructing above station property for 25 years. The current arrangement presents the most effective use of resources.

3. With the Corporation held responsible for the entire station site, the above-station or depot development can be most optimally planned and utilized. Master plans are drawn up well in advance of the commencement of works. The necessary infrastructure to support the development and any property enabling works, such as foundations,

utilities trenches and internal roads, which are intricately integrated with the railway station structures, are done at the most appropriate time in the most efficient way. This coordinated approach would ensure that a comprehensive development is accomplished.

4. The integration of property and station developments also ensures that safety and operational aspects of the railway are safeguarded. With one organization managing the development and the railway, responsibilities are clearly defined and any incidents at the property development having an effect on the railway can be properly managed.

5. These important planning, construction and operational considerations will be as valid after privatization as at present. We should maintain the successful formula which has served the community well for a quarter of a century.

Property Development Right is not a Subsidy

6. It is important to note that property development right is not a form of subsidy to MTRC. A subsidy consists of either Government expenditure or revenue foregone. The grant of property rights to MTRC, on the other hand, does not come into any of these categories as full market premium for the land is charged.

7. The profits made by the Corporation from the property development arise from a sharing of profit between MTRC and the developers. When above-station developments are put out to tender by MTRC, developers agree to offer a share of their profit to the Corporation.

This profit share is highly sensitive to market conditions. MTRC is required to bear a development as well as financial risk in the process.

Open Tender for Property Development Rights

8. There have been suggestions that :-

- (a) as the property development rights are not awarded through open tender, the Government is not receiving the full market value of those rights; and
- (b) the Government should consider putting the property development rights to open tender and injecting the cash generated from the tender bid into MTRC in the form of either a loan or equity.

9. As demonstrated above, the Government receives the full market value of these rights although they are not awarded through open tender. The team of professional valuers in the Lands Department regularly assesses land premium for various types of land transactions and imposes these assessments on developers. The grant of the land to MTRC for property development is subject to the same process. In assessing the full market premium payable by MTRC for the property development rights, appropriate valuation techniques is used, including taking reference from recent open market sales prices of comparable properties. In addition, the potential interface problem between the railway corporation and an independent developer could have a depressing effect on tender bids if those rights were put to open tender. For example, the independent

developer may factor into his cost additional expenditure relating to coordination with and possible claims from the railway corporation. There is therefore no guarantee that open tender will fetch a price over and above that which the Government could obtain from the Corporation.

10. In respect of the suggestion in para 8(b), open tender under such circumstances will not necessarily result in a higher premium for the development right being achieved than through valuation conducted by the Lands Department, for the reasons explained above. Furthermore, the MTRC's share of profits generated by such developers have all along assisted it to finance and operate the railway system on a commercially prudent basis without requirement for Government subsidy. Were Government to set aside the proceeds from the tender of property development rights and earmark them for the specific purpose of MTRC railway projects, the MTRC would bear an additional financial burden if it is expected to repay such loan or achieve a return on such equity at commercial rates. Any rates at less than commercial levels would entail a Government subsidy.

11. Without specific legislative provision, such an approach would also amount to hypothecation of General Revenue, contrary to the Public Finance Ordinance.

CONCLUSION

12. Historically, MTRC has played a useful role in the property developments over its railway stations and depots and has established new communities along the railway footprint. It undertakes planning for the

property developments, building a substantial part of the foundations and providing other common infrastructure. The property developments also help provide early patronage to the railway system. We believe MTRC should be allowed to continue its role in integrating railway and property developments after privatization. The existing policy of granting property development rights, where appropriate, on top of stations and depots, and on land adjacent to the railway will continue. The current policy of charging MTRC the full market value of the land granted for such property developments will remain unchanged.

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Transport Bureau
17 November 1999



Lands Administration Office

Lands Department

Practice Note

Issue No. 1/2006

Premium Assessment Procedure Relating to Lease Modification Transactions⁽¹⁾

Pursuant to discussions at the Land Sub-committee Meeting of the Land & Building Advisory Committee (LBAC) regarding measures to streamline and enhance the transparency of the premium assessment procedure in lease modification transactions, the Department has, in consultation with Hong Kong Institute of Surveyors (HKIS), reviewed its current procedure and has put in place a number of new practices.

2. This Practice Note (PN) sets out the revised premium assessment procedure is as follows : -

(i) Initiation of Premium Assessment

Generally speaking, the acceptance by the applicant of the offer of provisional basic terms (PBTO) and conditions for the proposed lease modification transaction issued by the District Lands Office (DLO) concerned together with the draft Special Conditions as approved by the District Lands Conference will trigger the premium assessment procedure.

(Note: For cases such as those requiring the completion of statutory procedure as a condition for execution of the lease modification document, the actual timing of the premium assessment will be adjusted to take into account the progress of the statutory process involved).

To facilitate preparation of the premium assessment, applicants or their agents are invited to submit to the DLO concerned such information as they consider relevant to the premium assessment as soon as possible after their formal acceptance of the PBTO. The finalised premium assessment will then be submitted to the Valuation Section in LandsD/HQ for action under (ii) and (iii) below.

⁽¹⁾ The reference to lease modification transactions includes lease modifications to be effected by way of land exchanges.

(ii) Vetting of the Premium Assessment Submission

Upon receipt of a submission from the DLO, the Valuation Section will notify the applicants/agents and vet all submissions before referring them to the Valuation Committee (V. Com.)/Valuation Conference (V. Conf.) for consideration. During this period, applicants/agents may submit additional information and/or clarifications they consider relevant to the premium assessment direct to Valuation Section. It is important that this be done without delaying the referral of the premium assessment to V. Com./V. Conf. No negotiation on the premium assessment would be permitted.

(iii) Consideration of the Premium Assessment

Depending on the amount of the premium involved, the assessment will be referred to and decided by either V. Com. or V. Conf. V. Conf. will also consider appeals to assessments previously approved by V. Com.

(iv) Communication of the Premium Assessment and the Issue of Binding Basic Terms Offer

The premium will be communicated to the applicant by the DLO concerned by way of a binding basic terms offer. If the applicant disagrees with the amount of the premium, he or she may appeal against it. However, any revised assessment to be carried out will be at value current at the time of re-assessment, which could be the same as, or higher or lower than, the premium originally offered.

(v) Consideration of Appeal against Premium Assessment

On receipt of an appeal against the premium assessment, the DLO concerned will submit the case to the Appeal Team of the Valuation Section. Prior to submission of the premium appeal to V. Conf., the case officer in the Appeal Team will communicate with the applicant/agent on a non-committal and without prejudice basis. The case officer will exchange views with the applicant/agent on matters relevant to the premium assessment, including the basis of valuation, gross development values, construction costs of the development, comparables and relevant transaction evidence etc. Normally, at the final stage of this process, the case officer will also enquire if the agent has received any instruction from his/her clients as regards the latest counter-offer of premium for the proposed lease modification transaction for incorporation into a submission to V. Conf.

(vi) Attendance at Valuation Conference

The applicant/agent will be invited to attend the meeting of the V. Conf. to consider his/her premium appeal. The case officer will present the case to Members of V. Conf. in the presence of the applicant/agent who will then have the opportunity to elaborate on any arguments which he/she may have already put forward in any written submissions in support of a revised assessment. Deliberation of the case by Members of the V. Conf. will take place after the applicant/agent has left the meeting.

(vii) Issue of Revised Offer on Premium Assessment

After a decision has been made by V. Conf. on the premium appeal and a binding offer of the revised premium assessment has been issued, the case officer may, upon request of the agent, advise him/her of the major parameters adopted by V. Conf. in the premium assessment, which are substantially different from those put forward by the agent including any major arguments/comparables contained in the agent submission that have not been accepted by V. Conf. The purpose of the above is to facilitate the consideration of the revised assessment by the agent clients.

3. A flow chart highlighting the key steps referred to above is attached.

(Patrick L. C. LAU)
Director of Lands
17 February 2006

**Flow Chart
(Premium Assessment Procedure Relating to Lease Modification Transactions)**

