Letterhead of Standard & Poor's

CB(1)565/99-00(01)

3 December 1999

Hon Mrs. Miriam Lau Kin-yee
Chairman, Bills Committee
c/o Miss Irene Man
for Clerk to Bills Committee
Legislative Council
The People's Republic of China
Hong Kong Special Administrative Region
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Mrs. Lau,

Thank you for the opportunity to comment on the Mass Transit Railway Bill.

Standard & Poor's has had a long relationship with the MTR, and has rated the company for well over a decade.

Standard & Poor's is a global organization, which assigns credit ratings to companies, governments and others, and to debt securities which they issue. Standard & Poor's is respected internationally for its financial analysis and for its independent, unbiased and expert opinions. Debt rated by Standard & Poor's amounts to over US$10trillion. For more information on Standard & Poor's please refer to our public web site at http://www.standardandpoors.com/ratings

The 'A+' local currency credit rating assigned to Mass Transit Railway Corp. (MTRC) reflects not only MTRC's solid operational record and adequate financial profile, but also its ownership by and strong support from the government of Hong Kong.

As the backbone of Hong Kong's public transport network, MTRC has historically enjoyed strong government support since its inception, as illustrated by substantial direct equity contributions, lucrative property development rights along railway lines, and a supportive policy environment, including autonomy in relation to fare setting. The current rating assumes MTRC's basic commercial framework and fare autonomy will likely be preserved over the long term.

MTRC has substantial capital programs, including the Tseung Kwan O extension and improvements to existing systems. The company has substantial financing needs for capital expenditures and refinancing. This capital expenditure and refinancing program will occur against the background of the economic downturn in Hong Kong, which has placed pressure on fare revenues and will also negatively affect revenues from property rentals and development. The economic viability of the Airport Railway remains uncertain, as current patronage is below original forecasts.

MTRC is expected to maintain an adequate financial profile despite continued substantial capital expenditures. Railway earnings are expected to be supplemented substantially in the years ahead by contributions from property development along the Airport Railway and the proposed Tseung Kwan O Extension, as well as the increased patronage these developments will generate.

The recently announced partial privatization of MTRC may be positive as it will likely endorse and reinforce the company's commercial principles. As MTRC is wholly owned by the government of Hong Kong its rating reflects not only its solid operating record and adequate financial performance, but also its ownership by and strong support from the government. This support has been evidenced by the government's equity injections--particularly to fund the Airport Railway--and the property development rights it has granted. Management has the autonomy to manage MTRC according to commercial principles, including fare-setting autonomy. Changes in credit status could occur, depending on the regulatory structure which is developed, as the government reassesses its relationship with an enterprise that also has private shareholders. The introduction of private shareholders could impact the government's flexibility in dealing with the company. The government, MTRC, and the Legislative Council will need to agree on a suitable regulatory framework that will reflect the interests of the public and of private shareholders. The extent to which a new regulatory system, and more broadly the relationship with government, will be supportive of MTRC compared with existing arrangements, has yet to be clarified.

The privatization process will be monitored closely to assess the rating implications. Specifically Standard & Poor's will monitor developments with fare setting arrangements, support for MTRC's commercial viability, and the continuance of generally supportive arrangements for a company engaged in a capital intensive business in which commercial outcomes are often difficult to predict.

I trust this letter will assist you with assessing the credit implications of the privatization process.

Yours Sincerely

Paul Coughlin
Managing Director
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