CB(1)1530/99-00

Enclosure 1 to FCR(97-98)97

Draft Project Agreement
for the
Financing, Design, Construction and Operation of West Rail
between
The Government of the Hong Kong Special Administrative Region
and
The Kowloon-Canton Railway Corporation

Clause by Clause Explanation

Extract from Provisional Legislative Council Brief
by Transport Bureau dated 24.3.1998

PROJECT AGREEMENT

5. The Project Agreement sets out how the TKE project will be undertaken, and the respective obligations of Government and MTRC in respect of the financing, design, construction and operation of the TKE. The major terms and conditions of the Agreement are set out below.

(A) Financial Arrangements and Property Development

6. MTRC's assessment is that the extended railway alignment will involve an additional cost of $5.5 billion in Money of the Day (MOD) prices, hence increasing the total project cost of the TKE to $30.5 billion. This sum does not include the costs to be incurred in later years to construct and operate stations in Pak Shing Kok and Area 86, which are stations additional to the original scheme. MTRC plans to construct the additional stations when justified by population build-up.

7. MTRC does not require any equity injection from Government, and proposes to finance the project from its own resources and commercial borrowings. MTRC however requests property development rights at the stations at Tiu Keng Leng, Tseung Kwan O Town Centre, Hang Hau, and the depot in Area 86. Some of the proposed developments are directly above the stations/depot, whilst some are located on adjacent land.

8. In line with the prevailing practice, we consider it appropriate to let MTRC undertake property developments along TKE so as to ensure the timely delivery of housing supply, and better integration between the housing developments and the railway stations. Apart from these reasons, MTRC needs the property development rights to generate extra profits to help achieve a reasonable return on the project. The estimated Internal Rate of Return for the project, taking into account property development revenues, is 8.5%. We and MTRC have also agreed that any property development profits in excess of what is required for MTRC to achieve the projected return (currently estimated at $5.2 billion in 1998 prices) should be passed back to Government in full by way of dividends.

Part III - Property Developments

5. This section sets out the arrangements for dealing with property development rights along the East Rail, the Light Rail and West Rail.

> **Clause 6** provides that Government shall use reasonable endeavours to enable the Corporation to undertake, at its own cost, proposed commercial or residential property developments at locations along the East Rail and the Light Rail subject to basic terms and conditions set out in the Project Agreement and the approval of the Chief Executive in Council or the Director of Lands under delegated authority, as appropriate. This Clause also sets out Government's understanding that the Corporation intends to apply accrued property development profits in respect of the East Rail and the Light Rail property developments to the extent reflected in the Financial Projections annexed to the Project Agreement as an appendix in and towards the financing of West Rail.
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> **Clause 7** provides that property developments to be undertaken above or adjacent to West Rail stations, West Rail depot, facilities or railway premises shall be in such manner and upon such terms as may be agreed between Government and the Corporation.
>
> **Clause 8** specifies that property developments to be undertaken by the Corporation at locations along the East Rail, the Light Rail and West Rail shall be granted by private treaty and subject to the conditions set out therein.
>
> **Clause 9** provides that the private treaty grants to be issued in respect of the property development sites to the Corporation will provide that the Corporation manages and maintains the completed developments subject to a deed of mutual covenant incorporating a management agreement to be approved by the Director of Lands and subject to the Building Management Ordinance (Cap.344 of the Laws of Hong Kong).

Extract from Item for Finance Committee
<u>for discussion on 27.2.1998 - FCR(97-98)97</u>

Property Development

12. For WR financing purposes, KCRC will continue to be allowed to make use of the development potential along its East Rail and Light Rail alignments so that profits can be applied towards meeting project costs. In respect of property developments along WR, KCRC will be allowed to undertake these developments so as to ensure the timely delivery of housing supply, better integration with the neighbourhood and smooth interface with railway operations. However, as these developments will go beyond the time frame for the WR project, profits in their respect will not be generated in time to help finance the construction of WR. As such and because KCRC can achieve a reasonable project IRR without the stream of profits from WR developments, KCRC will not require the profits to finance the project nor to improve the project return.

13. As to whether KCRC should be allowed to keep the WR property development profits, KCRC has, in fact, made adequate provision in its current and future financial plans, both to service WR debt and to meet the cost of keeping its railway networks efficient, modern and competitive. Therefore, no WR property development profits have been factored into the cash flow projections of WR, as there is no need to do so. KCRC, as a prudent railway operator, must also pay regard to the basic financial principle that capital revenue, due to its one-off nature, should not be applied to meet recurrent operating expenditures. KCRC also accepts that such resources as it does not immediately require should be channelled to the General Revenue for other public purposes.

14. We and KCRC have therefore agreed that it should pass on the net WR property development profits (i.e. exclusive of KCRC's contingent expenses and, if necessary, any additional development-related costs) to Government directly as soon as they are realised, rather than treating them as windfall profits, for which no specific use has been identified. KCRC's preliminary estimates are that West Rail properties could have a development potential of 46 million square feet, and could yield net profits to Government of up to $20 billion from 2004 onwards. KCRC will nevertheless retain an interest in the completed developments, e.g. retail podia, carparks, etc. Government and KCRC are currently in discussion on the principles and mechanisms for giving effect to this arrangement to ensure that it is equitable and will optimise the developments in question. For example, as an incentive for KCRC to maximise profits from such developments, Government may allow KCRC to retain a part of the profits for financing future capital expenditure. That said, KCRC will in future depend heavily on Government equity for the capital financing of other new railway projects and extensions. We will assess these on their individual merits with KCRC, and revert to this Committee for any funding approvals that may be required, as the need arises.

Annex B

Land Matters Related to the Tseung Kwan O Extension

Nature	Form of land grant	Broad terms
Land for operation of TKE	Running lines lease	• Nil premium, in line with past practice. • A term of 50 years, in accordance with existing land policy. • MTRC to pay Government rent at 3% of the rateable value from time to time.
Land for depot	Private treaty grant	• Premium based on the full industrial value of the site as at the date of grant of such site subject to a minimum plot ratio of 1 or the cost of making the site available, whichever is greater. • A term of 50 years. • MTRC to pay Government rent at 3% of the rateable value from time to time.
Property development rights	Private treaty grant	• Full market value premium on the non-railway premises. • A term of 50 years. • Payments of Government rent at 3% of the rateable value from time to time. • As the development at Tiu Keng Leng station and in Area 86 will be phased, we have no objection in principle to MTRC's proposal that premium for the later phases should be assessed and charged when the development is ready to proceed based on the then prevailing market conditions. This is in line with the approach adopted for the Airport Railway Hong Kong and Kowloon stations.

Commercial activities inside stations		MTRC intends to carry out commercial activities inside stations. The Corporation proposes that no premium should be charged if such activities do not occupy 100 m^2 of usable floor area per unit. Normally, a premium should be payable for profit-making activities. However, we have no objection to MTRC's proposals since we do allow MTRC to issue tenancies and licences within existing station premises at nominal premium provided that the activities are of small scale. There is nonetheless no justification for larger commercial enterprises to be exempt from premium. These arrangements have been reflected in the Project Agreement.