

LCQ6: MTR property development

Following is a question by the Hon Paul Chan Mo-po and a reply by the Secretary for Transport and Housing, Ms Eva Cheng, in the Legislative Council today (April 25):

Question:

In order to support the adoption of railways as the backbone of Hong Kong's transport system, the Government gives the MTR Corporation Limited (MTRCL) various items of support, including granting to MTRCL the property development rights on top of the stations along the railway. However, MTRCL's Fare Adjustment Mechanism does not take into account the series of MTRCL's benefits arising from property development rights. In this connection, will the Government inform this Council:

(a) of the real estate projects the property development rights of which were obtained by the Mass Transit Railway Corporation (MTRC) before the rail merger; in respect of each of the projects, the land premium paid by MTRC; the amount of grant provided to MTRC by the Government based on estimates to bridge the funding gap when it granted the property development rights to MTRC; the actual revenue received by MTRC after completing the development; the difference between such revenue and the funding gap bridged by the government grant which was calculated based on estimates; the respective annual rentals and other revenues for the year ended December 31, 2011 and the 15 years before that year derived by MTRC from the properties in those real estate projects which were not sold but were partly or wholly kept by MTRC for rent or business operation purposes; the respective amounts of the fair value or valuation of these properties from the dates of completion to the end of each of the years; and set out the aforesaid information of each project in table form;

(b) when MTRC merged with the Kowloon-Canton Railway Corporation (KCRC) to form MTRCL in 2007, whether the Government had sold to MTRCL all property development rights on top of the stations along the Kowloon-Canton Railway; if not, how the property development rights not sold to MTRCL were dealt with in that year; if so, list the locations and the details and scales of development of such projects in table form; of the price (including the land premium per square foot of floor space and

the total amount of land premium) paid by MTRCL for each project; the respective actual revenues (after deducting the aforesaid price paid to KCRC or the Government) derived by MTRCL from the completed projects; in each of the undeveloped projects, the difference between the current estimated land premium per square foot of floor space and that paid by MTRCL to KCRC or the Government at that time; set out in table form the aforesaid related information in respect of the developed and undeveloped parts of those projects which are under development but are not fully completed; and

(c) of the details (including whether the funding gaps for the projects were subsidised with the returns from property development (e.g. the South Island Line) or the projects were constructed with government funding (e.g. the West Island Line)) of the funding arrangement for each railway project confirmed for construction after the rail merger; of the respective amounts of land premium received or to be received from MTRCL and the funding gap subsidised or to be subsidised in respect of the projects the property development rights of which were granted by the Government, with a breakdown in table form by project?

Reply:

President,

Railway development projects involve substantial capital investment. Despite their benefits conducive to the development of our society, these projects are usually non-viable financially or with low financial viability. Overseas experience shows that most projects require government direct funding or other supports to take forward. Hong Kong is no exception.

The Rail-plus-Property development model (R+P model) is one of the approaches adopted by the Government to provide financial support to new railway development projects. In the past decades, this approach has been used to implement a number of railway projects with success. It enables speedy implementation of the projects to meet the transport demand of the public. This arrangement optimises the use of public resources in the absence of competition with other public works projects for resource allocation. It also smoothes the interface between stations, depots and topside developments to ensure timely completion of the railway works while avoiding the need to carry out property development works within the railway areas in future which may affect railway operation.

My reply to the three parts of the question is as follows:

(a) Before the public listing of the then Mass Transit Railway Corporation (MTRC) (currently named as the MTR Corporation Limited (MTRCL)) in 2000, the Government was the sole shareholder and wholly owned the company. When developing the Kwun Tong Line, Tsuen Wan Line, Island Line, Airport Railway and Tseung Kwan O Extension, the Government granted property development rights to the company to finance the corresponding railways under the R+P model. Not only to satisfy the transport demand, the Government has other crucial consideration in adopting such an arrangement. With the R+P model, the railway development spearheads the growth of local communities along the rail lines. The model also empowers the company to raise funds from the market for the railway and property developments. Since its listing, the MTRCL has not implemented any railway project under the R+P model in the decade ending 2010. Those financed under this model in 2011 are elaborated in part (c) of my reply.

The sales proceeds, rental income and property value generated by the property development projects between 1970s and 2000, when the company went public, were considered, settled, and reflected in the market value and share price of the company at that time. The information was published in detail in the Initial Public Offer (IPO) prospectus of the MTRCL in 2000. Most of the information requested by Hon Chan has also been included in the IPO prospectus. We also attached the relevant pages of the prospectus at Annex 1 for reference.

Under the R+P model, the Government and the railway company share the risks and benefits. In spite of the government funding via the grant of property development rights, the MTRCL has to arrange on its own the necessary funding beforehand to settle the construction costs of the railways, the operation expense and fixed asset replacement costs during the operation period, and later to pay the expenses on property development and land premium. As property developments above stations or depots cannot start until the completion of the railway projects, it is estimated that such developments can only be completed for sale about ten odd years after the commencement of railway construction. As a result, the MTRCL has to bear long-term risks in financing the railway projects, fluctuations in the property market as well as the operation responsibilities of the railways while the Government is spared.

(b) The financial terms negotiated between the MTRCL and the Government for the rail merger include, inter alia, the property package for acquisition of property and other commercial interests. The property package covers the purchase from the MTRCL the property development rights in respect of six property sites held by the then Kowloon-Canton Railway Corporation (KCRC), plus two property sites along Kowloon Southern Link held by Government at that time. According to the financial terms of the rail merger, the MTRCL paid the KCRC \$4.91 billion for the development rights over these eight sites. The professional property valuation consultant commissioned by the Government at that time had confirmed that the pricing of the development rights over these eight property development sites was fair and reasonable.

The information of these eight sites including their location, current development scope, content, land premia paid by MTRCL to the Government as well as land premium per square foot are set out in Annex 2. Out of the eight property sites, flat sales of three developments comprising Ho Tung Lau (i.e. The Palazzo), Wu Kai Sha Station (i.e. Lake Silver) and Tai Wai Maintenance Centre (i.e. Festival City) are almost completed with some flats remain unsold. Construction works are being carried out by respective developers on another three sites comprising Che Kung Temple Station (i.e. The Riverpark), and Site C and Site D of Kowloon Southern Link's Austin Station. Land grant applications for the remaining two sites, i.e. Tai Wai Station and Tin Shui Wai Light Rail Tin Wing Stop, are underway.

In addition, under the above-mentioned property package, the MTRCL has replaced the KCRC as the agent of the Government after the merger for developing the property sites along the West Rail Line. In other words, the property development rights for the sites concerned have not been sold to the MTRCL. Under the relevant arrangements, the MTRCL only acts as the agent of West Rail property development projects and receives an agent's fee equivalent to 0.75% of the gross return on sales from these projects.

The post-merger property development profits of the MTRCL are presented in its annual reports. Relevant information is detailed in Annex 3 and briefly set out as follows:

Year 2008	\$3.91 billion
Year 2009	\$3.03 billion
Year 2010	\$3.26 billion

Year 2011 \$4.23 billion

(c) Since the merger, we have implemented five new railway projects under the Operating Agreement signed with the MTRCL in 2007. They are the West Island Line (WIL); Guangzhou-Shenzhen-Hong Kong Express Rail Link (Hong Kong Section) (XRL); South Island Line (East) (SIL(E)) and Kwun Tong Line Extension (KTE) which are under construction; and the Shatin to Central Link (SCL) of which the construction is scheduled to commence in mid-2012.

Among these projects, the WIL is funded by a capital grant. The Legislative Council (LegCo) has approved a provision of \$12.7 billion for the MTRCL to bridge the funding gap. Financial support by means of granting property development rights is not involved.

Both the XRL and the SCL are implemented under the concession approach. The Government seeks funding for the construction of both projects directly from the LegCo under the appropriate public works programmes. Thus, the grant of property development rights to the MTRCL is not involved in these projects either.

The SIL(E) and the KTE are implemented under the R+P model. After a detailed assessment conducted by an independent consultant commissioned by the Government, it confirmed that the capital cost of the SIL(E) is \$12.4 billion while that of the KTE is \$5.3 billion. The independent consultant considered that both projects were financially non-viable, and that funding support from the Government was required to bridge the funding gaps of \$9.9 billion and \$3.3 billion respectively. In May 2011, the Executive Council approved granting to the MTRCL the property development rights for the ex-Wong Chuk Hang Estate site and ex-Valley Road Estate Phase 1 site as the funding support for developing the two railway projects.

We have commissioned an independent consultant to assess the development costs of the two property developments, and engaged another two independent surveying companies to help assess their property values. Based on their assessments, the funding assistance to be offered by the property developments may barely bridge the estimated funding gap in the light of the increases in development costs and implementation of the latest planning parameters.

The topside property developments of the two sites will not be able to commence until the stations and depot concerned have completed in 2015. The

Lands Department (LD) will assess the land premium payable by the MTRCL according to established procedures only after it has received the company's application for land grant. After granting the land to the MTRCL, the LD will publish the relevant information, including the land premium payable by the company, on its website.

Thank you.

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