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[English Translation]

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(Attn.: Ms Sharon CHUNG)
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11 April 2017

Dear Ms CHUNG,

**Public Works Subcommittee
Meeting on 5 April 2017**

**63TR – Shatin to Central Link –
Construction of Railway Works – Advance Works
56TR – South Island Line (East) – Essential Public Infrastructure Works**

Supplementary Information

Following the Public Works Subcommittee (“PWSC”) meeting on 5 April 2017, Hon CHU Hoi-dick wrote separately to the Chairman of the PWSC on the same day with regard to the funding applications for **63TR** – Shatin to Central Link (“SCL”) – advance works and **56TR** – South Island Line (East) (“SIL(E)”) – essential public infrastructure works. In the letter, he expressed his views on the topside developments at Ho Man Tin Station and Wong Chuk Hang Depot, and requested the Government to provide supplementary information.

Matters relating to the SCL, the Kwun Tong Line Extension (“KTE”) and the SIL(E) were discussed in detail at different meetings of the Legislative Council

(“LegCo”) in the past. The background information of these railway projects, including the financial arrangements for the KTE and the SIL(E), the apportionment of the construction cost of Ho Man Tin Station between the SCL and the KTE projects, and the reasons for the implementation of the essential public infrastructure works (“EPIW”) for the SIL(E), is summarised below.

Financial arrangements for the KTE and the SIL(E)

The KTE and the SIL(E), being the extensions of the Kwun Tong Line and the Island Line respectively, are “ownership” projects under the terms of the Operating Agreement signed in 2007 between the Government and the MTR Corporation Limited (“MTRCL”) upon implementation of the rail merger. Under the ownership approach, the MTRCL will be responsible for the financing, design, construction and operation of these two railway projects and will own the railways.

The construction costs of the railways are so enormous that the KTE and the SIL(E) projects are not considered financially viable based on their fare and non-fare revenues alone. The Government therefore has to provide funding support¹ to the MTRCL to bridge the funding gaps of the projects.

To implement the KTE and SIL(E) projects, the Government granted the property development rights under the “Rail-plus-Property Model” to bridge the funding gaps of the projects that the land to be granted to the MTRCL should not be in principle more than what is required to bridge the funding gaps. In this connection, the Government decided in 2011 to grant the topside property development rights at Ho Man Tin Station and Wong Chuk Hang Depot for the implementation of the KTE and the SIL(E) projects respectively.

Where a new railway project is implemented under the “Rail-plus-Property Model”, the MTRCL is required to pay full market premium (on a green field basis²) for the property development. At the same time, the MTRCL, being granted the property development rights, will have to bear all the risks arising from market fluctuations and rail operations, and the Government will no longer be held responsible for the risks. This model also brings other operational benefits, such as ensuring smooth interface between works for the station/depot and the topside developments, and facilitating the scheduling of works to allow the simultaneous implementation of various works. Such arrangement not only ensures the smooth implementation of the railway projects, but also avoids the need to

¹ A railway project is considered not financially viable if the present value of all its revenues net of expenditures falls short of the expected return on capital, which in the case of the MTRCL is its weighted average cost of capital plus 1% to 3%. This shortfall is known as the funding gap.

² Land premium is assessed based on green field site principle by which the “full market value” ignoring the presence of the railway shall be the amount payable by the MTRCL to the Government.

carry out the topside property development works within the railway areas in future which may affect railway operation.

When reporting the financial arrangements for the KTE and the SIL(E) projects to the LegCo in 2011, we stated that we had examined carefully how the topside sites at Ho Man Tin Station and Wong Chuk Hang Depot should be used under the “Rail-plus-Property Model” to ensure that the funding support provided by the Government for the KTE and the SIL(E) projects was reasonable. Our aim was to enable the two railway projects to be smoothly implemented and public resources used properly without undermining the prudent commercial principles for rail operation. To achieve this, we adopted two measures at that time. First, when considering how the MTRCL should be allowed to develop the aforesaid sites, we took into account relevant planning considerations to ensure that any development should be compatible with the surrounding land uses and public expectation. Second, independent checking consultants (“ICCs”) were commissioned to help check the project costs and funding gaps of the projects and to estimate whether the profits of the property developments were sufficient to bridge the funding gaps. The outcome of the estimation could serve as a useful basis for assessing whether the funding support provided by the Government was reasonable.

The then ICCs estimated that the construction costs of the KTE and the SIL(E) would be \$5.3 billion (in December 2009 prices) and \$12.4 billion (in December 2009 prices) respectively, i.e. \$5.9 billion and \$13.5 billion when converted to money-of-the-day prices.

We are cautious that the land to be granted to the MTRCL should not be more than the land required to bridge the funding gaps. In this regard, apart from ICCs’ assessments, two independent surveying firms were also engaged to provide property valuation for each development. Based on the property valuation provided by the ICCs and the two independent surveying firms at the time, as well as the aforesaid estimated construction costs of \$5.3 billion (in December 2009 prices) and \$12.4 billion (in December 2009 prices), the funding gaps in the implementation of the KTE and the SIL(E) were estimated at about \$3.3 billion and \$9.9 billion respectively³. Having regard to the assessments of the ICCs, the Government decided to grant the topside property development rights at Ho Man Tin Station and Wong Chuk Hang Depot to bridge the funding gaps of the KTE and the SIL(E) projects respectively.

The financial arrangements for implementing the KTE and the SIL(E) projects under the “Rail-plus-Property Model” were discussed at the special meeting of the LegCo Subcommittee on Matters Relating to Railways on 17 June 2011. Members may visit the LegCo website for the two LegCo Briefs discussed on that day.

³ All estimates regarding funding gaps are in net present value at December 2010.

As mentioned above, after being granted the property development rights, the MTRCL has to arrange on its own the necessary funding to settle the construction costs (including the additional expenditure arising from delay and modification of works) of the KTE and the SIL(E) projects. Therefore, even though the construction costs of the KTE and the SIL(E) projects have increased to \$7.2 billion (in MOD prices) and \$16.9 billion (in MOD prices), the Government does not have to bear the additional expenditure.

Apportionment of the construction cost of Ho Man Tin Station between the SCL and the KTE projects

As we mentioned in the discussion paper (LC Paper No. PWSC(2010-11)34) submitted to the PWSC in January 2011, the advance railway works for the SCL include the expansion of the existing Admiralty Station and the construction of Ho Man Tin Station to accommodate SCL railway facilities. Ho Man Tin Station is thus an integrated station serving passengers of both the SCL and the KTE in future. The construction cost of Ho Man Tin Station is apportioned between the SCL and the KTE projects at a ratio of about 74:26 in accordance with the estimated patronage at peak hours at the station. As such, part of the additional expenditure on Ho Man Tin Station is shared by the KTE project according to the above ratio.

Reasons for the implementation of the EPIW for the SIL(E)

As we mentioned in the discussion paper (LC Paper No. PWSC(2010-11)33) submitted to the PWSC in January 2011, to tie in with the commissioning of the SIL(E), the Government entrusted the MTRCL with the EPIW, including the construction and enhancement of pedestrian and transport links to facilitate the public travelling to and from MTR stations, so that the consequential social and economic benefits of the new railway line can be fully realised. Although such EPIW were implemented in parallel with the railway works, they did not fall under the SIL(E) project.

Regarding the question raised by Hon CHU Hoi-dick enquiring how the Government concluded that the revenue from the topside development at Ho Man Tin Station is part of the revenue of the KTE, according to the LegCo Brief on the financial arrangement for the KTE in 2011, granting the topside property development right at Ho Man Tin Station to the MTRCL is only to bridge the funding gap of the KTE project for the purpose of budgeting. Therefore, the Government still has to bear the cost of the portion of Ho Man Tin Station for the SCL in accordance with the aforesaid ratio of 74:26.

As for the issue of whether the profits of the topside development at Wong

Chung Hang Station can be used to bear the cost of the EPIW of the SIL(E), according to the LegCo Brief on the financial arrangement for the SIL(E) in 2011, granting the topside property development right at Wong Chuk Hang Depot to the MTRCL is only to bridge the funding gap of the SIL(E) project for the purpose of budgeting. To facilitate the public travelling to and from stations of the SIL(E), the Government entrusted the MTRCL with the EPIW, which are to be implemented in parallel. Such EPIW are government works rather than SIL(E) works. Hence, in respect of financial arrangement, the profits of the topside development at Wong Chuk Hang Station are not related to the cost of the EPIW of the SIL(E).

Yours sincerely,

[Chinese version signed]

(LEUNG Sai-ho)

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