

THE HONG KONG HOUSING AUTHORITY

Memorandum for the Housing Authority

Housing Authority's Revised Budgets 1998/99

Proposed Budgets 1999/2000

and

Financial Forecasts 2000/01 to 2002/03

PURPOSE

To seek Members' approval of the 1998/99 Revised Budgets and 1999/2000 Proposed Budgets of the Authority prior to their submission to the Chief Executive for formal approval and for Members to note the Financial Forecasts for 2000/01 to 2002/03.

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BACKGROUND

3. The Authority is a large organisation providing subsidised housing to half of Hong Kong's population comprising 664,000 rental units, 245,000 Home Ownership Scheme (HOS) flats, 997,000 + sq. m. commercial space, 76,000 + parking spaces, 400,000 + sq. m. factory space etc. While the Authority's expenditure is not part of the Government's expenditure and general revenue, it represents an important element of public sector spending and averages (net of payments to Hong Kong Government) about **12.5% of public sector expenditure**. Based on the Authority's revised 1998/99 budgets and the Government's approved 1998/99 budgets, the following figures give a reasonable indication of the Authority's finances compared to the Government's -

	HA		HKG	% HA to HKG
	\$Bn		\$Bn	
(a) Operating Income	36.7)		
(b) Net Investment Income	2.7)	192.7	20.4
(c) Operating Expenditure	21.3		182.5	11.7
(d) Average Funds Managed	29.3		N/A	-
(e) Capital Budget	23.9		34.1	70.0

BUDGET PROCESS

4. As an essential element of the Management Enhancement Programme (MEP), an overhaul and re-structuring of the budget cycle was made in 1997. This has resulted in the introduction of a new business planning process of which the annual budgets and forecasts form an integral part. Under this new business planning process, each Business Director is required to produce a business plan which includes the key budget and forecast proposals and to submit the plan to the respective Business Committee for endorsement. The new strategic business planning and budget cycle is summarised at Section V of the Budgets and Forecasts Proposal. To interface with the business planning process, a strategic plan has been developed for the Authority. The strategic plan and the individual business plans will be consolidated together with extracts from the approved budgets to form the Authority's Corporate Plan which was endorsed in the Strategic Planning Committee at its meeting on 14 January 1999.

5. The Budgets and Forecasts Proposal for 1998/99 to 2002/03 attached has been prepared in line with the new financial management framework and business planning process. The annual business plans including the Operating Accounts, Capital and Cash Budgets and the Financial Forecasts of the Authority have been examined and endorsed by Finance Committee before their submission to the Authority for approval.

BUDGETARY BASES, ASSUMPTIONS AND PRINCIPLES

6. In keeping with previous exercises, the budgets and forecasts are based on the June 1998 PHDP and only approved policies as at 31 July 1998 have been factored into the budgets and forecasts.

7. For the purpose of preparation of the business budgets and forecasts, the bases and assumptions which affect all businesses and other general or cross business parameters were approved by the Finance Committee vide FC Paper No. 45/98. Those business specific bases and assumptions adopted in the business budgets and forecasts and approved by the respective Business Committees are summarised at Section III of the Budgets and Forecasts Proposal.

8. In addition to the bases and assumptions as mentioned at paragraph 7, the budgets and forecasts proposed in this paper were prepared with reference to the following principles -

(a) **Revenue policy**

The philosophy as stated in the Long Term Housing Strategy, i.e. to ensure that adequate housing at affordable price or rent is available to all households, continues to be followed. With regard to the public rental housing, Members' attention is drawn to S.4 of the Housing Ordinance which stipulates that revenue accruing from its estates shall be sufficient to meet the recurrent expenditure on its estates.

(b) **Total cash flow surplus/deficit**

The Authority aims to maintain adequate funds to sustain its capital programmes and recurrent operations. The Authority is financially autonomous and the Government has agreed that available funds currently in excess of the short-term requirements should be placed in the Development Fund as part of HA's finances to accelerate the provision of public housing.

(c) **Total expenditure growth**

The Authority will continue to adopt prudent financial policies to make the best use of its funds and to strive to get better value for money in respect of the services which the Authority provides or which are contracted out.

Members are also requested to note the financial objectives of the core businesses as set out in the paragraphs 19, 23 and 27.

ENHANCED PRODUCTIVITY PROGRAMME

9. In response to the Enhanced Productivity Programme (EPP) announced by the Chief Executive in his October Policy Address, the Department is fully committed to this programme and in fact, through the Management Enhancement Programme (MEP), the Department has various BPR, outsourcing and similar initiatives to enhance efficiency and productivity which have already been incorporated into the business plans. These will form the main thrust of our EPP initiatives and it is fully expected that the target of 5% by 2002/03 will not only be achieved but will be well exceeded.

REVISED BUDGETS 1998/99 AND PROPOSED BUDGETS 1999/2000

A. Consolidated Budgets for the Authority

Consolidated Operating Account

10. The consolidated operating results for the 1998/99 Revised Budget and 1999/2000 Proposed Budget are set out at Table 1 below -

Table 1 - Summary of Operating Surplus/(Deficit) (\$M)				
	Public Rental Housing	Commercial Properties	Home Ownership	Consolidated Operating Surplus
1997/98 (Actual)	(1,690)	2,645	11,602	12,557
1998/99 (Approved Budget)	(1,835)	3,339	19,410	20,914
1998/99 (Revised Budget)	(2,251)	2,306	15,306	15,361
1999/2000 (Proposed Budget)	(1,592)	1,755	10,161	10,324

Cash Budget

11. The budgeted cash flows and closing cash balances are summarised below -

Table 2 - Summary of Cash Flow (\$M)					
	Net Cash Inflow/ (Outflow) in the year	Closing Cash Balance	<u>Analysis of Cash Balance</u>		
			HCWF⁽¹⁾	DF⁽²⁾	WC⁽³⁾
1997/98 (Actual)	3,074	32,117	14,276	8,605	9,236
1998/99 (Approved Budget)	(3,940)	27,180	16,402	3,614	7,164
1998/99 (Revised Budget)	(5,734)	26,383	15,697	3,111	7,575
1999/2000 (Proposed Budget)	(4,552)	21,831	15,518	-	6,313
Notes :					
(1) Housing Capital Works Fund					
(2) Development Fund					
(3) Working Capital					

12. The Authority's cash position is forecast to continue to be strong throughout the budgets and forecasts period although it is expected to see a fall in the funds balance by \$7.6Bn from the current level of \$34Bn at 31 December 1998 to 26.4Bn as at 31 March 1999 and then fall again by \$4.6Bn to \$21.8Bn as at 31 March 2000. These declines are mainly as a result of the increase in construction payments due to the peak production period.

Capital Expenditure (HCWF)

13. The capital budgets are summarised at **Table 3** below -

Table 3 - Summary of Capital Expenditure (\$M)				
	Actual 1997/98	Approved Budget 1998/99	Revised Budget 1998/99	Proposed Budget 1999/2000
(A) Construction Expenditure	12,948	22,321	20,842	24,975
(B) Improvement Works	652	1,083	729	842
(C) Purchase of Computer Assets & Equipment	56	203	195	144
(D) Direct Costs and Overheads charged to Construction Projects & Improvement Works	1,534	2,116	2,164	2,512

Total	15,190	25,723	23,930	28,473
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14. The Authority's proposed capital budget for 1999/2000 represents an increase of \$4,543M (19%) compared to the 1998/99 Revised Budget. This is mainly due to an increase in the average number of rental and HOS flats under construction, as explained in the building business review in paragraphs 30 to 32.

Development Fund

15. This is a separate account used to finance the development of housing and housing-related projects, infrastructure and community facilities. In accordance with the 1994 Supplemental Agreement to the 1988 Financial Arrangements with the Government, the amount held in this account is the excess, if any, of the Authority's total cash balance above the amounts required for the Housing Capital Works Fund plus normal working capital requirements.

16. The budgets for the Development Fund are summarized at **Table 4** below -

Table 4 - Estimated Balance of the Development Fund (\$M)		
	Transfers to/(from) the Fund	Closing Balance
1997/98 (Actual)	(2,426)	8,605
1998/99 (Approved Budget)	(4,931)	3,614
1998/99 (Revised Budget)	(5,455)	3,111
1999/2000 (Proposed Budget)	(3,079)	-

17. The closing balance of the Development Fund is expected to fall to zero as at 31 March 2000 due to net cash deficit of \$5,734M and \$4,552M in 1998/99 and 1999/2000 respectively. The detailed Budgets/Forecasts for the Development Fund are set out at Section 2.6 of the Budgets and Forecasts Proposal.

B. Budgets For Core Businesses

Public Rental Housing

18. The business is responsible for the allocation, management and maintenance of the domestic rental properties of the Authority.

19. **The financial objective of the business is to develop and manage each domestic rental estate i.e. excluding all commercial operations, at a return to generate sufficient funds to meet the operating expenses, including depreciation, over its economic life.** This financial objective has been closely followed in the preparation of the 1999/2000 Business Plan (Paper No. RHC 87/98) for the rental housing business.

20. The financial performance of the business for the budget periods is summarised below -

Table 5 - Rental Housing Operating Account (\$M)				
	Actual 1997/98	Approved Budget 1998/99	Revised Budget 1998/99	Proposed Budget 1999/2000
Income	9,583	11,540	9,181	10,632
Expenditure	11,273	13,375	11,432	12,224
Operating Deficit	(1,690)	(1,835)	(2,251)	(1,592)

21. The 1998/99 Revised Budget is substantially affected by the economic environment. Various economic relief policies including rent freeze and waiver, and the Triennial Rent Review have been implemented. As a result, the operating deficit for the 1998/99 Revised Budget is increased to \$2,251M which is \$416M higher than the Approved Budget. The 1999/2000 estimated deficit is forecast to reduce to \$1,592M as a result of various measures to contain costs and an increase in rental levels.

Commercial Properties

22. The business is responsible for the management and operation of the commercial properties of the Authority. The portfolio of properties can be broadly categorized into retail premises, car parking spaces, flatted factory premises and welfare/community premises.

23. **The financial objective of the business is to develop and manage each commercial property, on full commercial principles, with a view to achieving a specific return.**

24. The financial performance of the business for the budget periods is summarised below -

Table 6 - Commercial Operating Account (\$M)				
	Actual 1997/98	Approved Budget 1998/99	Revised Budget 1998/99	Proposed Budget 1999/2000
Income	5,267	5,995	4,917	5,121
Expenditure	2,622	2,656	2,611	3,366
Operating Surplus	2,645	3,339	2,306	1,755

25. The income for the 1998/99 Revised Budget is reduced by \$1,078M compared to the Approved Budget as a result of the reduced income from letting of retail and factory premises due to the rent freeze and rent re-assessment, and reduced car parking charges. Accordingly, the operating surplus is also reduced by \$1,033M. In anticipation of a stable rental income for the letting of commercial premises for 1999/2000, the rental income is estimated to increase by 4% but this will be offset by an increase of \$755M in expenditure, mainly due to an increase of \$212.8M in Government Non-Reimbursable and \$178.7M increase in maintenance and improvements.

Home Ownership

26. The business is responsible for the development, monitoring and review of measures to assist the lower-middle income families to become home owners through the Home Ownership Scheme/Private Sector Participation Scheme (HOS/PSPS), Home Purchase Loan Scheme (HPLS), Secondary Market Scheme (SMS), Mortgage Subsidy Scheme (MSS), and the Tenants Purchase Scheme (TPS) as briefly described in the Home Ownership Business Plan (Paper No. HOC 69/98).

27. The **financial objectives** of home ownership operations are summarised as follows -

- **To develop HOS estate as cost effectively as possible and to maximize the return to sustain the construction development programmes, HPLS and other initiatives.**

- **To make use of private sector resources to develop PSPS estates as cost effectively as possible and to maximize the return to sustain the construction development programmes, HPLS and other initiatives.**
- **To maximize the use of HPLS in increasing the home ownership rate commensurate with levels affordable to the Authority.**

28. The financial performance of the business for the budget periods is summarised below -

Table 7 - Home Ownership Operating Account (\$M)				
	Actual 1997/98	Approved Budget 1998/99	Revised Budget 1998/99	Proposed Budget 1999/2000
Income	18,271	22,692	22,588	27,781
Expenditure	6,669	3,282	7,282	17,620
Operating Surplus	11,602	19,410	15,306	10,161

29. Income for the 1998/99 Revised Budget of \$22,588M is close to that of the 1998/99 Approved Budget. This is mainly due to the lower PSPS proceeds in 1998/99, which are offset by the non-budgeted sales proceeds of the Tenant Purchase Scheme (TPS) flats. The reason for the large variances in expenditure between the 1998/99 Approved and Revised Budgets and the Proposed 1999/2000 Budget is the production mix i.e. the large increase for 1999/2000 is due to a much higher number of HOS units (17,290 for 1999/2000 as compared to 3,994 for 1998/99). The increase in land costs payable to Government from \$1,554.2M per the Revised 1998/99 Budget to \$3,872.3M for 1999/2000 is also due to the larger HOS production as well as \$707M for TPS.

Building

30. The business is responsible for the provision of professional services for the planning, design, project management and contract administration for the construction and improvement of public housing developments.

31. The types of construction expenditure for the budget periods is summarised below -

Table 8 - Construction Expenditure (\$M)				
	Actual 1997/98	Approved Budget 1998/99	Revised Budget 1998/99	Proposed Budget 1999/2000
Housing Authority Projects	12,581	22,187	20,652	24,588
Government Non-Reimbursable Direct Costs and Overheads	253	59	69	267
Government Funded Projects	1,348	2,027	1,947	2,275
Total	114	75	120	120
	14,296	24,348	22,788	27,250

32. The 1998/99 Revised Budget of \$22,788M is 6.4% below the Approved Budget. The Proposed Budget for 1999/2000 represents 19.6% increase over the 1998/99 Revised Budget and is attributable to a higher level of flat production projected in the coming 2 years, with the major increase in expenditure being for rental housing and HOS projects of \$727M and \$3,203M respectively.

C. Budgets For Other Services

Agency and Management Services

33. The scope of the services includes the following -

(a) **Agency Functions**

In accordance with paragraph 4.1 of the 1988 Financial Arrangements, the Authority is responsible for the Government, on an agency basis and with funds provided by the Government, squatter control, improvements to squatter areas and the clearance of squatters from land required for development.

(b) **Agency Management Services**

The Authority manages property on behalf of other parties and charges a management fee for the services rendered. This covers the management of TPS estates, completed Home Ownership Courts and two Government Officers Housing Schemes.

(c) **Supervision of Government Reimbursable Projects**

The Authority provides supervision of Government projects, which includes the building of schools or community building in new estates, additions, alterations, improvements and external maintenance of Government building in rental estates. As a standard practice, the Authority pays the contractors first and subsequently obtains reimbursement from the Government including full cost of supervision services.

The total level of expenditure for 1998/99 Revised Budget is \$147M and is fully recoverable.

Administration and Support Services

34. It includes the services provided by Finance and Accounting Branch, Corporate Services Branch, Corporate Strategy Unit and Director's Office.

35. All directly attributable supporting services and departmental administration expenses are allocated to the businesses/activities to which they relate. The remaining non-directly attributable costs are allocated in accordance with the agreed bases.

FINANCIAL FORECASTS 2000/01 TO 2002/03

36. The financial forecasts for 2000/01 to 2002/03 are summarised at Section II of the Budgets and Forecasts Proposal for members' information only.

37. The five year summary of the operating results and cash position is set out at Table 9 below -

Table 9 - Summary of Operating Results and Cash Position (\$M)					
	Public Rental Housing	Commercial Properties	Home Ownership	Consolidated Operating Surplus	Cash Balance
1998/99 (Revised Budget)	(2,251)	2,306	15,306	15,361	26,383
1999/2000 (Proposed Budget)	(1,592)	1,755	10,161	10,324	21,831
2000/01 (Forecast)	(700)	2,068	11,508	12,876	22,845
2001/02 (Forecast)	(684)	2,266	24,546	26,128	43,363
2002/03 (Forecast)	(971)	2,366	13,483	14,878	52,427

SENSITIVITY ANALYSES AND OTHER FACTORS

38. The results of our sensitivity analyses are summarised at Section IV of the Budgets and Forecasts Proposal. These analyses illustrate the impact on the Authority's overall operating surplus and cash flow with variations in major budget bases and assumptions. As the impact of such changes would be cumulative, the Authority should be able to detect an early warning of a potentially serious deterioration of funds.

39. The analyses cover the following changes -

- **increase in construction cost**
- **reduction in property market prices**
- **increase in HOS/PSPS discount rate**
- **increase in HPLS quota**

CONSULTATION

40. The Authority's 1998/99 Revised Budgets, 1999/2000 Proposed Budgets and Financial Forecast for 2000/01 to 2002/03 were endorsed at the FC meeting on 7 January 1999, after detailed examination and discussion. The Budgets and Forecasts of the four core businesses have also been discussed and endorsed (as part of the Business Plans) in the following business committee meetings -

Committee	Paper No.	Date
Home Ownership	HOC 69/98	12 November 1998
Building	BC 150/98	19 November 1998
Rental Housing	RHC 87/98	25 November 1998
Commercial Properties	CPC 62/98	26 November 1998

PUBLICITY

41. The Department briefed the media on the salient points of the budgets on 7 January 1999 while the FC meeting was in progress and a press conference was held after the FC meeting.

DISCUSSION

42. This paper is issued for discussion at the next meeting of the Housing Authority to be held on 28 January 1999. Members are invited to **approve** the Authority's Revised Budgets for 1998/99 and Proposed Budgets for 1999/2000 at Section I and to **note** the Financial Forecasts for 2000/2001 to 2002/03 at Section II of the Budgets and Forecasts Proposal.

43. Following the Authority's approval, the 1998/99 Revised Budgets and 1999/2000 Proposed Budgets will be submitted to the Chief Executive for formal approval in accordance with Section 4(3) of the Housing Ordinance.

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