THE HONG KONG HOUSING AUTHORITY

Memorandum for the Housing Authority

Housing Authority's Revised Operating Account
Capital and Cash Budgets (1997/98)
Proposed Budgets (1998/99)
and
Financial Forecasts 1999/2000 to 2001/02

PURPOSE

To seek Members' approval to the 1997/98 Revised Budgets and 1998/99 Proposed Budgets of the Authority's businesses prior to their submission to the Chief Executive for formal approval and for Members to note the Financial Forecasts for 1999/2000 to 2001/02.

CONTENTS

2. The contents of the paper are summarised below for Members' reference.

BACKGROUND

3. The Authority is a large organisation providing subsidised housing to half of Hong Kong's population i.e. over 665,000 rental units, 224,000 Home Ownership Scheme (HOS) flats, 994,000+ sq. m. commercial space, 74,000+ parking spaces, 410,000+ sq. m. factory space etc. While the Authority's expenditure is not part of the Government's expenditure and general revenue, it is still an important element of public sector spending - it averages (net of payments to Hong Kong Government) about **12.7% of public sector expenditure and 2.3% of GDP.** Based on the Authority's revised 1997/98 budgets and the Government's approved 1997/98 budgets, the following figures give a reasonable indicator of the Authority's finances compared to the Government's -

		HA $Bn		HKG $Bn	% HA to HKG
(a)	Operating Income	36.0	)		
			)		
(b)	Net Investment Income	2.1	)	177.8	21.4
(c)	Operating Expenditure	22.8		159.4	14.3
(d)	Funds Managed	31.1		N/A	-
(e)	Capital Budget	20.4		35.7	57.1

NEW BUDGET PROCESS

4. At the Finance Committee (FC) Meeting held on 6 March 1997, Members agreed a set of financial objectives for the Housing Authority, which were structured around the Authority's core operating businesses - Public Rental Housing, Commercial Properties, Home Ownership, Building and cross-business supporting services - Finance and Accounting, and Corporate Services. To implement these financial objectives, Members also agreed on certain changes to the Financial Management Framework, and that a re-alignment of Committees' responsibilities and of departmental responsibilities would be needed (Paper No. FC 12/97). The Department has since re-organized its structure along the business line concept, effective from 15 April 1997. Each of the four core businesses (Development plus the three core operating businesses) is headed by a Business Director who reports to the corresponding Business Committee for all areas of the business operations.

5. The Authority also agreed that as part of the reform of the Management Enhancement Programme (MEP), it was necessary for the Authority and its Committees to re-align their responsibilities and terms of reference (TOR). The changes were approved by the Authority vide Paper Nos. HA 61/97 and HA 65/97. The TOR of the FC were also revised whereby FC was given a more strategic role in the financial affairs of the Authority and asked to provide advice to the Authority on the overall financial effects of the proposals of the business committees in line with the financial policies set by FC and the financial objectives of each business. A copy of the chart showing the new business planning process and budget cycle, together with the financial objectives as endorsed by FC at its 6 March 1997 meeting, is attached at **Annex A** for Members' reference.

6. As an essential element of the MEP, an overhaul and re-structuring of the budget cycle has been made. This has resulted in the introduction of a new business planning process of which the annual budget and forecast 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. To interface with the business planning process, the Head of the Corporate Strategy Unit is required to develop a strategic plan for the Authority. The strategic plan and the individual business plans are then consolidated to form the Authority's 'Corporate Plan'. This plan will be endorsed by the Strategic Planning Committee and approved by the Authority.

7. This budgets and forecasts included in this paper have 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 FC before their submission to the Authority for approval.

BUDGETARY BASES, ASSUMPTIONS AND PRINCIPLES

8. Members are also advised that these budgets and forecasts have been prepared during a major transitional period. In keeping with previous exercises, only approved policies as at 30 June have been factored into the budgets and forecasts; however various scenarios have been compiled to reflect the likely impact of new policies to be implemented shortly (paragraphs 62 and 63 refer).

9. The major bases and assumptions used in the 1998/99 Proposed Budget and the Financial Forecasts for 1999/2000 to 2001/02 are set out below -

(a) No amounts have been included in the budget for any new major policy initiatives or changes to existing policies i.e. the budgets are prepared upon the approved policies as at 30 June 1997, which are currently in force.

(b) All items of income and expenditure are initially set at price bases as at June 1997. Price adjustments are then made for the years 1998/99 to 2001/02 in accordance with the assumed rates of increase as set out at **Annex B**.

(c) In line with previous practice for HOS projects already sold, the date of issue of completion certificate or the latest project completion date provided by architect have been used for income recognition. Whereas for HOS projects not yet sold, the project completion dates (per June 1997 PHDP) plus 3 months have been used for HOS income recognition.

(d) As the implementation date of the Housing (Amendment) Ordinance 1997 has yet to be determined by the Secretary for Housing, the existing practice of biennial rent review of the public rental housing has been adopted in the budget and forecasts. The percentage increases for domestic rents to be adopted for the budget and forecasts are at **Annex B(i)**.

(e) Although the forecast of flat production for the period 1997/98 to 2001/02 is based on the June 1997 PHDP, there are minimal differences with the CE pledges (the financial consequences of the minor differences are not significant).

(f) Land formation costs payable to the Government will continue to be calculated and paid at 35% of the development costs of Home Ownership Scheme flats less the actual site formation costs incurred by HA (if any) on the domestic portion.

10. In addition to the bases and assumptions as set out at paragraph 9, there are a number of principles against which the budgets and forecasts should be referenced -

(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 strictly 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.

It is considered that the budgets proposed in this paper are consistent with the above principles.

OVERALL BUDGETS AND FORECASTS FOR THE AUTHORITY

A. Consolidated Operating Account Budget

11. The consolidated operating account budget covers the Authority's core operating businesses viz. Public Rental Housing, Commercial Properties and Home Ownership but does not cover capital projects, agency functions, agency services, supervision of Government reimbursable projects and funds management. The operating results of the Authority for the 1997/98 Revised Budget and 1998/99 Proposed Budget are set out at **Annex C(i)**.

12. **The 1998/99 operating surplus of $20,914M is made up of an estimated surplus of $3,339M from Commercial Properties and $19,410M from Home Ownership operations offset by a deficit of $1,835M on Public Rental Housing.** Analyses of the operating accounts for 1997/98 Approved Budget, 1997/98 Revised Budget and 1998/99 Proposed Budget are given in **Annexes C(iii), C(vi) and C(ix).**

13. A substantial increase in the Authority's consolidated operating surplus for 1998/99 over 1996/97 and 1997/98 is forecast. This mainly arises from the increase in surplus in Home Ownership operations as shown in **Table 1** below. A brief review of the Home Ownership business is set out at paragraphs 42 - 49.

Table 1 - Summary of Operating Surplus/(Deficit)

	Public Rental Housing $M	Commercial Properties $M	Home Ownership $M	Consolidated Operating Surplus $M
1996/97 (Actual)	(660)	2,379	11,350	13,069
1997/98 (Approved Budget)	(1,781)	2,440	5,182	5,841
1997/98 (Revised Budget)	(2,170)	2,663	12,681	13,174
1998/99 (Proposed Budget)	(1,835)	3,339	19,410	20,914
1999/2000 (Forecast)	(1,314)	3,343	13,257	15,286
2000/2001 (Forecast)	(1,170)	3,763	36,110	38,703
2001/2002 (Forecast)	(781)	4,261	44,898	48,378

Note : The main reason for the increase in the 1997/98 Public Rental Housing deficit is due to the introduction of the Maintenance Fund.

14. The Five-year Operating Forecasts at **Table 1** indicate that **Public Rental Housing** is expected to continue to incur **deficits** which will diminish over the forecast period although if the Housing (Amendment) Ordinance 1997 is enacted, these deficits will be increased as shown in the sensitivity analyses (**Annexes H(iv) and H(v)**). However, it is estimated that the Authority will be able to generate an overall operating surplus from its three operating businesses (before appropriations) in each of the forecast years.

15. A review of the operations of businesses is given at paragraphs 28-56 while reviews of funds management operations and agency services are covered at paragraphs 57 - 61.

B. **Consolidated Appropriation Account Budget**

16. The surpluses and deficits arising from the Operating Accounts together with the surplus from the Funds Management Account are transferred to the Consolidated Appropriation Account. The interest and dividend payments to the Government are also charged to this account. The net surpluses are used to finance the Authority's ongoing construction programme and projects under the Development Fund.

17. The Consolidated Appropriation Account at **Annex D(i)** shows that the Authority is expected to generate a surplus of income over expenditure in each year, principally as a result of the surpluses generated from HOS sales. **The surpluses generated from HOS sales are primarily used by the Authority to finance its ongoing construction programmes with any excess being transferred to and used for housing and housing-related projects under the ambit of the Development Fund. However, Members should note that if the full value of HOS land of $121.7Bn for the five-year period from 1997/98 to 2001/02 had to be paid in cash to the Government, the Authority would incur a substantial negative cash flow.**

18. Part of the Authority's cash balances will be separately accounted for in the Housing Capital Works Fund and the Development Fund as set out in paragraphs 23-27.

C. Cash Budgets

19. The Authority's cash position continues to be strong and the Authority expects this to continue in 1998/99 and throughout the forecast period although it is expected to see a fall in its funds balance of **$3.9Bn in 1998/99**. The Authority is therefore budgeting for a cash balance of **$27.2Bn** as at **31 March 1999** as compared to **$31.1Bn** at **31 March 1998**.

20. Detailed forecasts of cash flow are at **Annexes E(i) to E(iii)** but the major items which will have impact on the cash balance are -

	$Bn		
Income			
Rental Income	+2.1	)	Difference between
HOS Receipts	+1.1	)	1997/98 Revised
	+3.2	)	Budget and
Expenditure		)	1998/99 Proposed
Recurrent Expenditure	+1.1	)	Budget
Construction payments	+7.5	)	
HOS Land Costs	+0.7	)	
Dividend Payable to Government	+0.2	)	
HPLS payments	-0.6	)	
	+8.9		

21. The Authority's cash budgets are influenced by a number of factors, in particular, the size and progress of the construction programme and the number and sale price of HOS units. **The Authority's total receipts are expected to increase by $3.2Bn or 8.3% from the 1997/98 Revised Budget of $38.8Bn to $42.0Bn in 1998/99**. This increase is mainly due to increase in rental and HOS sales income. **The Authority's total payments** (recurrent and capital) including HOS land formation costs, interest on loan capital, dividend and repayment of loan capital **are expected to increase by $9.2Bn or 25.1% from the 1997/98 Revised Budget of $36.7Bn to $45.9Bn in 1998/99**.

22. The cash flow projections for the five-year forecast period are given at **Annex E(iii)**. The projected cash flows and closing cash balances are summarised below -

Table 2 - Summary of Cash Flow

	Cash Inflow/ (Outflow) in the year $M	Closing Cash Balance $M	Analysis of Cash Balance HCWF* $M	DF* $M	WC* $M
1996/97 (Actual)	2,867	29,043	10,090	11,205	7,748
1997/98 (Revised Budget)	2,077	31,120	14,276	8,580	8,264
1998/99 (Proposed Budget)	(3,940)	27,180	16,402	3,614	7,164
1999/2000 (Forecast)	(309)	26,871	16,247	535	10,089
2000/2001 (Forecast)	27,991	54,862	14,758	27,333	12,771
2001/02 (Forecast)	40,084	94,946	15,441	64,727	14,778
Five-year Total	65,903				

* Notes :

HCWF = Housing Capital Works Fund; DF = Development Fund;
WC = Working Capital

D. Capital Budgets

23. The Authority's proposed **capital budget** for 1998/99 is **$25.7Bn** as compared to the 1997/98 revised budget of $17.7Bn (+45%). The bulk of this expenditure will be spent on construction works ($22.3Bn), the balance for major improvement works ($1.1Bn), direct costs and overheads for construction and improvement works ($2.1Bn) and the purchase of computer assets and equipment ($0.2Bn). The increase of $8.0Bn or 45% is mainly due to a 60% increase in the average number of rental and HOS flats under construction, as explained in the building business review in paragraphs 50-56, the number will rise from 95,322 for 1997/98 to 152,139 for 1998/99.

24. The five year capital expenditure forecasts are given at **Annexes F(i) to F(iv)** and are summarised below -

Table 2 - Summary of Capital Expenditure for 1997/98 to 2001/02 (Note 1)

	1997/98 Approved Budget	1997/98 Revised Budget (a)	1998/99 Proposed Budget (b)	1999/00 Forecast (c)	2000/01 Forecast (d)	2001/02 Forecast (e)	Total (a) to (e)
	$M	$M	$M	$M	$M	$M	$M
(A) Construction Expenditure	13,998	14,765	22,321	26,239	25,689	22,478	111,492
(B) Improvement Works	644	932	1,083	1,178	1,145	973	5,311
(C) Purchase of Computer Assets & Equipment	210	136	203	229	256	289	1,113
(D) Direct Costs and Overheads charged to Construction Projects & Improvement Works	2,057	1,843	2,116	2,439	2,662	2,872	11,932
Total	16,909	17,676	25,723	30,085	29,752	26,612	129,848

Note : The 1997/98 Revised Budget and 1998/99 Proposed Budget are submitted for approval while the Forecasts for 1999/2000 to 2001/02 are for indication only.

E. Development Fund

25. 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.

26. Based on the agreed formula with the Government and the present budget proposals, the balance of the Development Fund over the forecast period is estimated as follows -

Table 4 - Estimated Balance of the Development Fund

	Transfers to/(from) the Fund $M	**Closing Balance $M**
1997/98 (Revised Budget)	(2,426)	8,580
1998/99 (Proposed Budget)	(4,931)	3,614
1999/2000 (Forecast)	(3,046)	535
2000/01 (Forecast)	26,811	27,333
2001/02 (Forecast)	37,394	64,727

27. Based on the budgets and forecasts in this paper, the closing balance of the Development Fund is expected to fall to $535M as at 31 March 2000 due to the net cash deficits of $3,940M and $309M in 1998/99 and 1999/2000 respectively. The detailed Budgets/Forecasts for the Development Fund are set out at **Annexes G(i) to G(ii)**.

BUDGETS AND FORECASTS FOR CORE BUSINESSES

A. Public Rental Housing

28. Rental housing (Domestic) is one of the four core businesses of the Authority. In 1998/99, it accounts for approximately 29% and 69% of the Authority's total operating income and expenditure respectively. The business encompasses the Authority's rental estates, THA's, cottage areas, interim housing and transit centres. Broadly speaking, the business can be divided into the following main segments -

- Estate Management Services
- Maintenance and Improvement Services
- Community and Social Services
- Application and Allocation of Rental Domestic Units
- Operations and Redevelopment Services
- Services across Business Branches and Departments

29. **The financial objective of the rental housing operation 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 1998/99 Business Plan (Paper No. RHC 8/97) for the rental housing business.

30. Because of the social role of public rental housing, the business is heavily subsidised by the community. The accumulated operating deficit over the 5-year period from 1997/98 is estimated to total $7,271M. In addition, **the estimated value of land to be provided free by the Government over the period is $96.6Bn** (paragraph 56 refers). This operating deficit and value of land represents a huge subsidy to Rental Housing. However, the financial position of the business is expected to improve slightly as summarised below-

5-Year Domestic Operating Account Forecasts ($M)

Year	**1997/98 Revised Budget**	**1998/99 Proposed Budget**	**1999/2000 Forecast**	**2000/01 Forecast**	**2001/02 Forecast**	**Total**
Income	10,077	11,540	13,110	15,478	17,800	68,005
Expenditure	12,248	13,375	14,424	16,648	18,581	75,276
Operating Deficit	(2,171)	(1,835)	(1,314)	(1,170)	(781)	(7,271)

31. The 1997/98 Revised Budget, 1998/99 Proposed Budget and Financial Forecasts for 1999/2000 to 2001/02 of the business are at **Annexes C(iii) to C(iv)**.

32. For the year 1997/98, there is only a marginal difference between the approved budget income of $10,039M and the revised budget income of $10,077M. The total expenditure is, however, estimated to increase by $429M from $11,819M to $12,248M. This is mainly attributable to the increase in maintenance and improvements expenditure by $495M as a result of the provision required for the Maintenance Fund, and the increase in administration and supporting services expenses by $229M. These increases, however, are partly offset by a decrease in rates of $375M.

33. Total income is expected to increase by 14.5% from $10,077M in 1997/98 to $11,540M in 1998/99. Effective control measures will be exercised to contain the total expenditure at $13,375M. Although the operating deficit which amounts to $1,835M is still a cause of concern, it is budgeted to reduce to 15.9% of total income, as compared to 21.5% for 1997/98.

34. The Management Branch has adhered to the Department's policy of capping staff growth. The 8.7% increase in personal emoluments for 1998/99 is the result of the anticipated annual salary adjustment plus a minimal growth of head-count.

35. The income and expenditure for each rental estate group is shown in **Annex C(v)**. Although the deficit of Group A estates is the highest among all properties, this is only 12% of its $11,211M income. This is understandable as Group A estates account for the majority of the total property stock in 1998/99 and most of them are relatively new and hence require relatively less maintenance provision. Due to stringent financial control, the deficit situation of Group A estates is steadily improving to just around 1.5% of income by the end of 2001/02 (excluding the financial implications arising from the Housing (Amendment) Ordinance 1997 which will become operative on a date to be appointed by the Secretary for Housing).

36. Group B estates and Interim Housing, on the other hand, are a cause of concern over the longer run, as indicated by the increasing amount of deficit and also deficit as a percentage of income. In 1998/99, the deficit of Group B estates is 110% of its income and will reach 278% by 2001/02.

B. Commercial Properties

37. Commercial Properties accounts for about 15% and 14% of the Authority's total operating income and expenditure respectively in 1998/99. The business encompasses the management of a wide range of commercial facilities including commercial complexes, carparks, factories as well as non-domestic premises such as welfare, community and other premises.

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

39. As illustrated below, income from Commercial Properties for 1997/98 is budgeted at $5,340M and the surplus at $2,928M. For 1998/99, total income is projected at $5,995M less operating expenditure of $2,593M leaving an operating surplus of $3,402M. Income is forecast to grow steadily at a rate of around 12% per annum during the forecast period and will generate an operating surplus of $4,266M in 2001/02.

5-Year Commercial Operating Account Forecasts ($M)

Year	1997/98 Revised Budget	1998/99 Proposed Budget	1999/2000 Forecast	2000/01 Forecast	2001/02 Forecast	Total
Income	5,340	5,995	6,538	7,405	8,303	33,581
Expenditure (*)	2,412	2,593	3,057	3,569	4,037	15,668
Operating Surplus	2,928	3,402	3,481	3,836	4,266	17,913

Note * - Government Projects (non-reimbursable) Funded by the Authority are not included.

40. The 1997/98 Revised Budget, 1998/99 Proposed Budget and Financial Forecasts for 1999/2000 to 2001/02 of the business are at **Annexes C(vi) to C(viii)**.

41. The 1998/99 Proposed Budget surplus of $3,339M as shown in **Annex C(viii)**, comprises a surplus of $2,164M from commercial complexes, $929M from carparks, $122M from factories, $187M from welfare, community and other premises, and $63M of Government non-reimbursable projects expenditure funded by the Authority. While the operating surplus is projected to increase by 16% in 1998/99, the year 1999/2000 will see a growth of just 2% resulting from a large increase in depreciation, arising from the new stock coming on stream and improvement schemes to be completed in the year.

C. **Home Ownership**

42. It is the objective of the business to develop, monitor and review various measures to assist the lower-middle income families to become home owners through three subsidized schemes namely, Home Ownership Scheme (HOS), Private Sector Participation Scheme (PSPS) and Home Purchase Loan Scheme (HPLS) as briefly described in the Home Ownership Business Plan (Paper No. HOC 74/97).

43. The **financial objectives** of home ownership operations are summarised as follows:

- **To develop HOS estates 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.**

44. The home ownership business is the major source of revenue for the Authority to sustain its development programmes and other initiatives. In the 1998/99 Proposed Budget, the business accounts for about 56% and 17% of the Authority's total operating income and expenditure respectively and contributes a surplus of $19,410M before appropriations.

45. As summarised below, the 1997/98 Revised Budget indicates that the total home ownership income will be $20,558M, an increase of $3,936M over 1996/97. The increase is mainly due to more HOS flats being completed in 1997/98. The surplus budgeted for 1997/98 is $12,682M.

5-Year Home Ownership Operating Account Forecasts ($M)

Year	1997/98 Revised Budget	1998/99 Proposed Budget	1999/2000 Forecast	2000/01 Forecast	2001/02 Forecast	Total
Income	20,558	22,692	25,826	58,074	72,820	199,970
Expenditure	7,876	3,282	12,568	21,965	27,922	73,613
Operating Surplus	12,682	19,410	13,258	36,109	44,898	126,357

46. The 1997/98 Revised Budget, 1998/99 Proposed Budget and Financial Forecasts for 1999/2000 to 2001/02 of the business are at **Annexes C(ix) to C(xi)**.

47. The 1998/99 Proposed Budget at **Annex C(ix)** shows that the recurrent expenditure of $298M accounts for 1.3% of the total income. The surplus for the year comprises $5,623M for HOS, $13,863M for PSPS and expenditure of $76M for HPLS.

48. It is estimated that each project to be completed in 1998/99 is able to generate a satisfactory operating surplus.

49. The Authority assumes the responsibility for the contingent liability arising from mortgage default guarantees for HOS and for flats unsold or sold at a price below the guaranteed price. The contingent liabilities relating to mortgagee default guarantees and price guarantee as at 31 March 1997 amounted to $64,103M.

D. **Building**

50. The Development and Building business is also one of the core businesses of the Authority. The scope of the business is to provide professional services for the planning, design, project management and contract administration for the construction and improvement of public housing development.

51. Whilst there are no specific financial objectives for the Development and Building business, **the financial objectives at paragraphs 29, 38 and 43, together with the overall objective 'to manage effectively and safeguard the Authority's assets to maximise their economic life and their contribution to the Authority's mission, vision and targets', need to be taken into account when planning and developing all new projects and assets**.

52. The business objectives are to lift production from current levels to an annual production of no less than 50,000 flats a year from 1999 onwards. Further improvements will be made to the business operations in terms of efficiency, cost-effectiveness, quality control, financial management and sensitivity to customer requirements. Technical support will also be provided to formulation of various feasibility studies for mixed development projects being pursued by the Authority.

53. The 1997/98 Revised Budget is $16,532M which slightly exceeds the original approved budget by $553M (about 3.5%). The upward adjustment is mainly due to an increase in tender price inflation. The proposed 1998/99 budget for construction expenditure including direct costs and overheads is $24,348M, an increase of 47% when compared with the 1997/98 Revised Budget. The increase in budget is mainly due to a 60% increase in the average number of rental and HOS flats under construction i.e. from 95,322 flats in 1997/98 to 152,139 flats in 1998/99. Construction expenditure, as shown below, will be maintained at a high level throughout the forecast period of 1999/2000 to 2001/02.

5-Year Construction Expenditure Forecasts ($M)

Year	**1997/98 Revised Budget**	**1998/99 Proposed Budget**	**1999/2000 Forecast**	**2000/01 Forecast**	**2001/02 Forecast**	**Total**
Housing Authority Projects	14,449	22,187	26,036	25,547	22,398	110,617
Government Projects Funded by HA	241	59	128	68	5	501
Direct Costs and Overheads	1,767	2,027	2,336	2,549	2,749	11,428
Government Funded Projects	75	75	75	75	75	375
Total	16,532	24,348	28,575	28,239	25,227	122,921

54. The 1997/98 Revised Budget, 1998/99 Proposed Budget and Financial Forecasts for 1999/2000 to 2001/02 of the business are at **Annex F(iv)**.

55. **The Authority finances its construction programme entirely from its own financial resources**. The Authority's total production of public housing flats is expected to increase by 1% from 34,185 in 1997/98 (21,633 Rental, 144 Interim Housing, 12,408 HOS) to 34,598 in 1998/99 (16,528 Rental, 840 Interim Housing, 17,230 HOS).

56. The land required by the Authority for its construction programme is provided by the Government on concessionary terms. While the land for public rental housing and commercial properties is provided free by the Government, the Authority is required to pay land formation costs for Home Ownership flats, which are calculated at 35% of the development costs of Home Ownership flats less the actual site formation cost incurred by the Authority (if any) for the domestic portion. **The values of land subsidized by the Government over the 5-year period from 1997/98 to 2001/02 amount to $244.6Bn in total** and are summarised below. These values are based on the historical market values as at the date of completion.

5-Year Land Value Forecasts ($M)

Year	1997/98 Revised Budget	1998/99 Proposed Budget	1999/2000 Forecast	2000/01 Forecast	2001/02 Forecast	Total
Public Rental Housing	16,317	12,467	19,263	39,264	9,256	96,567
Commercial Properties	3,072	2,524	6,032	9,855	4,812	26,295
Home Ownership	19,442	5,824	21,212	32,181	43,080	121,739
Total	38,831	20,815	46,507	81,300	57,148	244,601

BUDGETS AND FORECASTS FOR OTHER BUSINESSES

A. Funds Management

57. The Authority’s funds are managed by the Finance and Accounting Branch and the services rendered include the following -

- ensure sufficient funds are available to meet operational requirements;
- carry out daily investment activities for in-house funds in accordance with guidelines;
- conduct market analyses for the purpose of formulating appropriate investment strategies; and
- monitor the performance of Fund Managers.

58. The budgets and forecasts for investment income generated from the funds management activities are shown at **Annex D(ii)**. It is assumed that the surplus funds will generate an investment income at a rate of 6.6% p.a. throughout the forecast period. Investment income is credited to the Funds Management Account with the net income remaining in this Account being transferred to the Consolidated Appropriation Account.

B. Agency and Management Services

59. 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 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 buildings in new estates, additions, alterations, improvements and external maintenance of Government buildings 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.

60. **The financial objective of agency services is to deliver, as cost effectively as possible and within the funds made available, the agreed level and quality of agency services.**

61. The 1997/98 Revised Budget, 1998/99 Proposed Budget and Financial Forecasts for 1999/2000 to 2001/02 of the business are at **Annex D(iii)**.

SENSITIVITY ANALYSES AND OTHER FACTORS

62. The results of our sensitivity analyses are summarised at **Annex H** These analyses are based on assumptions which are, to a large extent, arbitrary. However, the analyses do illustrate that fluctuations in property market prices and construction cost would have a **dramatic** impact on the Authority's overall operating surplus/deficit and the cash flow forecasts, should any one or more of these scenarios materialise. Of particular concern are the possibilities of drop in flat selling prices due to changes in property market and of further increase in capital expenditure as a result of labour shortages and/or contractor capacities. Members will have noted the forecast falls in the Authority's cash balances over the next two years (approximately $4.3 Billion). With the recent trend in flat selling prices and contract prices, further price falls and cost escalations could substantially erode the Authority's cash balances. However, 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.

63. **While the financial implications arising from the proposed Long Term Housing Strategy and Tenants Purchase Scheme (TPS) have not been included in the budgets and forecasts, scenario analyses for the TPS are at Annexes H(vii) and (viii).** Members will be advised of the full financial implications in due course when the relevant policies and details are approved.

CONSULTATION

64. The Authority's 1997/98 Revised Budgets, 1998/99 Proposed Budgets and Financial Forecasts for the years 1999/2000 to 2001/02 were endorsed at the FC meeting on 16 January 1998, after detailed examination and discussion.

PUBLICITY

65. The Department had briefed the media the salient points of the budgets on 16 January 1998 while the FC meeting was in progress and a press conference was held after the FC meeting. At the briefings it was stressed that a strong financial position is needed in order to deliver the ambitious public housing programme over the coming years.

DISCUSSION

66. This paper is issued for discussion at the next meeting of the Housing Authority to be held on 22 January 1998. Members are invited to -

(α) approve the Authority's Revised Budget for 1997/98, Proposed Budget for 1998/99 in respect of -

(ι) Consolidated Operating Account Budgets (Annex C);

(ιι) Consolidated Appropriation Account Budgets (Annex D);

(ιιι) Consolidated Cash Budgets (Annex E);

(ιϖ) Capital Expenditure Budgets (Annex F); and

(ϖ) Development Fund Budgets (Annex G).

(b) note the Financial Forecasts for 1999/2000 to 2001/02.

67. Following the Authority's approval, the 1997/98 Revised Budgets and 1998/99 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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Date : 17 January 1998