UCLG Committee on Local Finance and Development

HONG KONG

HONG KONG — SALE OF PUBLIC LAND OR EQUIVALENT

LAND VALUE CAPTURE

Use of land use rights to fund transport infrastructure

DESCRIPTION

Funding for construction and metro system operated by a mechanism called "Rail + Property" (R + P). In line with the strategic planning of the territory, the government of Hong Kong MTRC sells the rights to use land around the future network for a price set up "before the metro." The size of this property is determined by the "funding gap" difference between the potential of self-financing of the line (50 years) and its cost. MTRC used this in many different forms, sometimes combined, with previously approved developers. He may ask the developers an initial payment (upfront), a previously established share of the profits and / or payment "in kind" with commercial real estate that will increase its heritage and bring back perennial rental income. Developers consistently support full development costs. When the financial potential of available land to be built is insufficient (especially when the sites are already developed), the Government may grant additional subsidies (which will be reimbursed if the funding gap is lower than expected).

LEVEL OF GOVERNMENT INVOLVED

Hong Kong government

INSTITUTIONAL AND FINANCIAL FRAMEWORK

- HK was a British colony until 1997, then a Chinese territory, retaining most of its past governance functions. It is managed by an executive appointed by the Chinese government and a legislative council composed of MPs appointed by the Chinese government and representatives of organized society (unions, real estate, lawyers, ...) as well as elected members. The use of the land-use rights was established as the main financing tool for the Government of Hong Kong in early colonial times, because the British wanted to make it a free port with very low taxes on one hand, and because the government owned the entire urban territory on the other.
- MTRC and URA were created by the Hong Kong government in charge respectively of the construction and operation of the subway and of urban renewal / densification policies in older areas. Mass Transit Railway Corporation (MTR) was established in 1975 to build and manage the Hong Kong subway system. Initially a 100% public company, about 23% of its shares were sold to the Hong Kong Stock Exchange in 2000 (but the government keeps full control of the MTRC (including "special resolutions" requiring a majority of 75%)), and merged with the Kowloon - Canton Railway Corporation in 2007.

EVOLUTION

With time and the professionalization of MTRC in real estate and business planning, development operations have become increasingly large (in terms of floor and built area, and financial amounts), complex, mixed use and integrated with the metro stations and surrounding territories. The latest operations were developed in close collaboration with communities and residents near developed areas, enabling a better balance between financial and social objectives.

OUTCOMES

- MTRC currently manages 10 subway lines (218 km / 84 stations) + a city rail network of 68 stations and the Airport Express, with 4.12 million passengers / day in 2012 (modal share of 46.4% of franchised public transport). This network was built almost without public subsidies. The first generation of subway lines (type Mass Rapid Transit) was built in Hong Kong in the 1980s and then the second generation, the last sections, were completed in the mid 2000s, and were financed according to the Rail + Property model (R + P). Since 2009 five new lines are under construction (three new lines and two extensions). The Hong Kong government uses P + R model to finance a new line and extension of an old line, yet it also mobilizes most common financing tools for the financing of other projects.
- A new line is funded under the "concession" model, and the fast train project (linking Hong Kong to Shenzhen) is also funded by this mechanism. However, the extension of the "island" line located on the island of Hong Kong is financed directly from public funds. The government has been forced to diversify its sources of funding (in the sense of not only using the R + P model) due to lack of land (which could possibly be valued according to the technical and financial requirements of MTRC) and also because of the "strategic" nature of some projects (like the line from Hong Kong to mainland China).
- MTRC is extremely lucrative (profits reached USD869 million in 2012, with revenues representing 185% of expenditures). Its revenues related to the operation of the metro represent only 34% of total revenues between 2000 and 2012, against 38% associated with development operations, 15% from commercial activities related to metro stations and 13% of rental income and "management business. "

STAKEHOLDERS INVOLVED

The Hong Kong government has been able, through this mechanism, to produce both an extensive and efficient subway network and appropriate urbanization, typically TOD, almost without public spending (and on the contrary, annually receiving substantial dividends). Development operations have represented opportunities for developers, with a reduced risk due to the coherent planning and controlled provisioning of land to be developped, but also by the participation of MTRC in operations, which allows to avoid or mitigate the risk associated with buying the land. Citizens benefit from an efficient and relatively cheap transport network, but for those who are not yet owners of their house, the mechanisms involved a huge increase in property prices, among the highest in the world.

PUBLIC MANAGEMENT AND ACCOUNTABILITY

- MTRC is a public company part of whose capital was put on sale at the Hong Kong Stock Exchange, in part to enhance its transparency. Because of its public-private nature (general interest vs. profit maximization), conflicts of interest may exist concerning the delimitation lines and allocation of land to be developped. To remedy to this, a Legislative Council Committee has been examining until 2007 if the new projects of subway lines were appropriate, with a reasonable price and an acceptable quality of service, and analyzed the associated financing proposals. Since the main operator, the MTRC, has made its IPO, then with the 2007 merger of the MTRC and KCRC (company that operated some urban rail lines in the "New Territories"), it suffered many criticisms falling into two aspects: economic and social.
- These criticisms are aimed particularly to the MTRC mixing genres (both a private operator of a public service and an urban property developer) and the ambiguous role of the government (which is both main shareholder of the MTRC, to 73%, but also the public transit authority preparing the pricing policy on the network).

ANALYSIS AND ASSESSMENT OF THE TOOL

- This system optimizes revenue generation by the MTRC, combining significant capture of the capital property gain (by high densification around the stations (building density between 4 and 10) and capital participation in development operations, beyond the mere sale of building land), part of which translates into sustainable income (rental business park). This densification, which is seen as key to success (a minimum of building density of 4 is often mentioned), also helps encourage the use of the subway, and thus also optimize revenue from ticketing. It relies on privileged access to land at prices that do not incorporate the anticipation of public investment (and on a staged and cautious sale of land within the territory by the government to allow its valuation). Coherent planning that guides the densification around stations while retaining the flexibility to adapt to market changes is fundamental.
- This system has greatly benefited from the expertise in real estate development and urban planning operations built by MTRC over time, enabling it to optimize its development and financial operations. The gradual increasing size and complexity of operations over 30 years has been instrumental in building this expertise. The confidence of partners and developers and a stable institutional and legal environment are fundamental, and clear and transparent rules for sharing risks, costs and profits help build that trust with developers, but also with the public opinion.
- Finally, MTRC is relatively protected from fluctuations in the property market because it is the developers that support all transaction costs. However, this model related to land valuation involves risk of negligence on the quality of public space and connection with the environment to optimize financial income, as well as focusing on the « high-end real estate », more cost effective and yet generator of social exclusion, and participation in the increase in overall prices in the territory. The participation of representatives of local stakeholders around reduces this risk (but also the incomes of operations!).
- In addition, "R + P" model is only possible for the subway lines around which the land is available and recoverable in sufficient quantity, and minimizing political guidance (on the course or programs) likely to reduce significantly the profitability of the operation. The extension of the "island" line on the island, financed directly from public funds, and the Hong Kong Shenzhen line, which takes the form of a concession, are two illustrations of current limits.

Sources : Suzuki et. al. (2015), Peterson (2013), Murakami (2012)