Chapter 2 – Management of Government Assets

(A) Overview

2.1 In anticipation of the hefty requirements in public spending, the Working Group recommended in the March 2014 Report that the Government should consider managing its asset portfolio in a more proactive manner, and use the financial return to help reduce the fiscal pressures in the coming decades. The Working Group stressed that one-off revenue from asset disposal could not resolve a structural deficit problem. It could only serve as one of the alternatives to tide over short-term financial difficulties.

2.2 At the request of the Financial Secretary in July 2014, the Working Group has reviewed the nature and governance structure of the Government's investments in its fixed and financial assets. Investments held by the Hong Kong Housing Authority, the Hong Kong Link 2004 Limited and the Exchange Fund, though reflected in the accrual-based consolidated financial statements, are beyond the Terms of Reference of the Working Group.

2.3 The fixed assets of the Government were estimated to cost \$240.1 billion as at end March 2014. The analysis to follow covers –

(a) the management of government buildings (estimated to cost \$89.7 billion), including non-departmental quarters which would become surplus, and

(b) the management of four government utilities (the assets of which are estimated to cost \$105 billion).

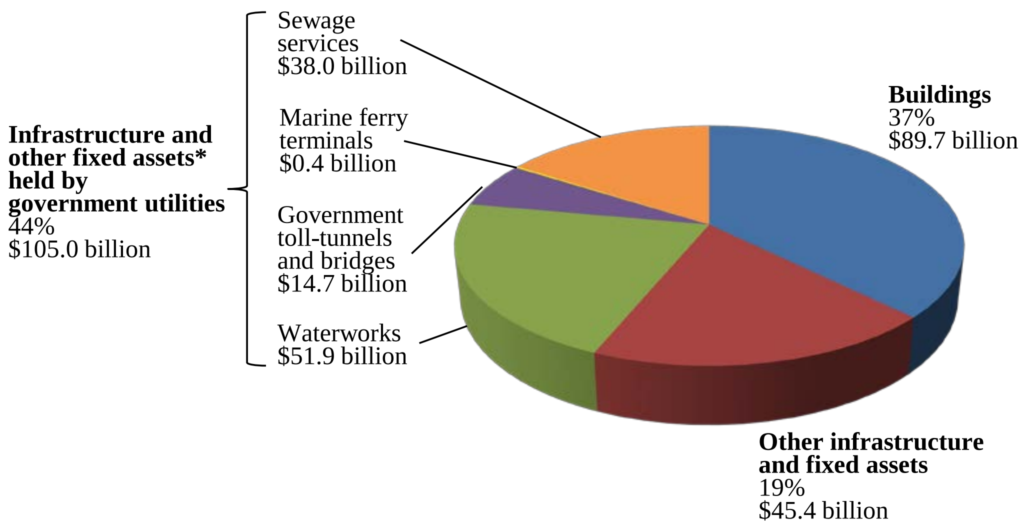
2.4 The financial assets of the Government were estimated to cost \$1,332.6 billion as at end March 2014. The analysis covers the management of government business enterprises (GBEs) (estimated to cost \$300.2 billion), nine outside the Government and five within (as Trading Funds). The rest of the financial assets are the fiscal reserves held with the Exchange Fund and cash, loans and advances, etc.

(B) Management of the Government's Fixed Assets

Fixed Assets

2.5 The fixed assets of the Government include the buildings held by the Government; the infrastructure and fixed assets held by four "government utilities" for the purpose of delivering water, sewage, ferry embarkation, and other services relating to the use of toll tunnel and toll bridges; and other infrastructure and fixed assets including capital works / projects in progress, computer assets and other plant and equipment. A breakdown of the Government's fixed assets is set out below –

Chart 2.1 – Government's fixed assets#
($240.1 billion as at 31 March 2014)



\# The above does not include the buildings under the ownership and management of the Hong Kong Housing Authority. These buildings comprised mainly the housing estates for 748 605 public rental housing units and other facilities such as retail facilities and welfare facilities. These are outside the Terms of Reference of the Working Group.

* "Other fixed assets" include computer assets, other plant and equipment and capital works / projects in progress.

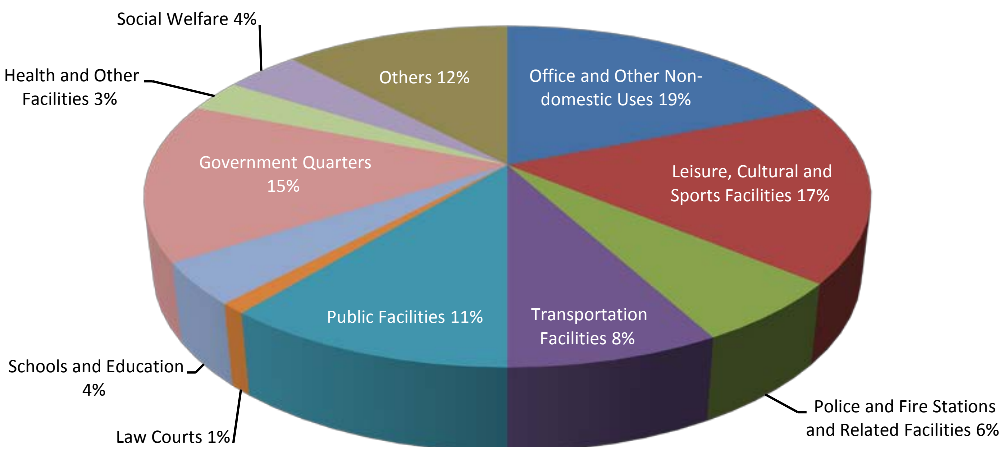
Government Buildings ($89.7 billion)

2.6 The Working Group has considered whether and how the current policy and strategy of managing government buildings can be suitably adjusted to maximise financial returns for the Government.

2.7 Government buildings are primarily used to support government operation and the delivery of public services. Under the current policy, government operations are accommodated in government-owned buildings as far as possible to provide security of tenure and minimise the Government's rental expenditure.

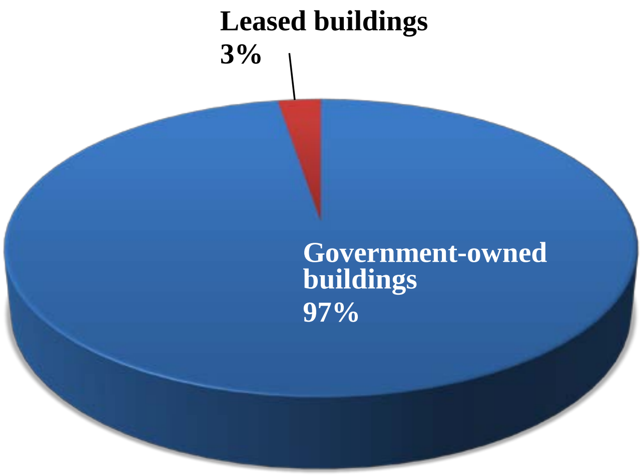
2.8 At present, there are a total of about 7 200 government-owned buildings, with an aggregate floor area of over 10 860 000 m^2. They include office buildings, leisure and cultural facilities, transportation facilities, health and welfare facilities, police and fire stations, law courts, schools as well as government quarters. Government quarters comprise mainly disciplined services quarters for eligible married junior disciplined services staff, and non-departmental quarters (NDQs) for senior civil servants who joined the service before 1 October 1990.

Chart 2.2 – Use of Government-owned Buildings by floor area



2.9 When the accommodation / operational needs of individual bureaux or departments cannot be met by government-owned buildings, the Government will lease buildings in the private market for the purpose. The Government will nevertheless delease rented accommodation and relocate the concerned government operation to government-owned buildings as circumstances permit. As at end 2013, the Government leased a total floor area of around 290 000 m^2.

Chart 2.3 – Percentage of Government-owned and Leased buildings by floor area



2.10 To help optimise site utilisation and generate revenue, the Government will consider ways of maximising the utilisation and revenue-generating potential of government-owned accommodation and government sites if suitable opportunities arise. They include commercialisation, redevelopment and disposal.

2.11 **Commercialisation.** Where appropriate, the Government will explore the feasibility and viability of commercialising any available space in government-owned buildings which is surplus to the Government's operational requirements. This will help exploit the potential of the buildings in full and generate revenue. Examples of commercial tenancies in government-owned buildings include shopping spaces, advertising spaces, car parks, automatic tellers and vending machines.

2.12 **Redevelopment.** The Government regularly reviews the site utilisation of government-owned buildings. Where cases of under-utilisation are identified, the Government will explore the possibility of reprovisioning the concerned government operation and work with the relevant bureaux / departments to release the site for redevelopment. This will help optimise the use of land resources and may generate revenue. Two recent examples of under-utilised sites released for redevelopment are the site at 650 Cheung Sha Wan Road where previously a building with government quarters, a post office and storage space stood; and the multi-storey carpark building site at 15 Middle Road in Tsim Sha Tsui. The Cheung Sha Wan Road site was sold for commercial / office development at a price of $1,002 million in April 2014 whereas the Middle Road site was sold for "Commercial / Office / Hotel" uses at a price of $4,688 million in September 2014.

2.13 **Disposal.** When government-owned buildings have become surplus to operational requirements and alternative gainful uses cannot be identified, the Government may dispose of them to generate revenue. In 2014, the following surplus government-owned buildings have been disposed of, generating revenue at a total of $400 million –

Table 2.1 – Disposal of surplus government-owned buildings

2014	Buildings	Revenue generated
June	Sale of three NDQs by open tender	$88 million
August	Sale of nine NDQs by public auction	$281 million
November	En bloc sale of 11 units at Man Yee Fisherman Village by public auction	$31 million

Alternatively, the Government may demolish the surplus buildings and return the site to Lands Department for development purposes.

2.14 The Working Group noted the broad portfolio of government buildings and discussed possible ways of managing some high-value government buildings as assets to provide a source of upfront cash if so required. Options discussed include –

(a) raising funds through using government buildings as underlying assets to support the **issue of bonds**. Proceeds from the bond issuance can be used for investment to generate income, and the investment income can be used partly for payment of interest to the bond holders. The legal ownership of the buildings will remain with the Government in the process and the security of tenure for government operations will not be affected; and / or

(b) securing an upfront cash flow through using government buildings under a **sale-and-lease-back** arrangement. The Government will have to give up ownership of the buildings as well as the security of tenure and pay rentals on a recurrent basis subject to market rental fluctuations; and / or

(c) forming a **real estate investment trust** by using income-generating government buildings which will operate as a portfolio of income-producing real estate, and to deploy the stream of income so generated for purchase and sale as liquid securities in the market. Instead of the existing arrangement of disposal by sale, these buildings can be retained as investment in the medium term and for possible capital appreciation over time. Only the income stream will be securitised and ownership of the buildings may remain with the Government in the process. But the buildings will be held for investment purpose, rather than serving government operational needs.

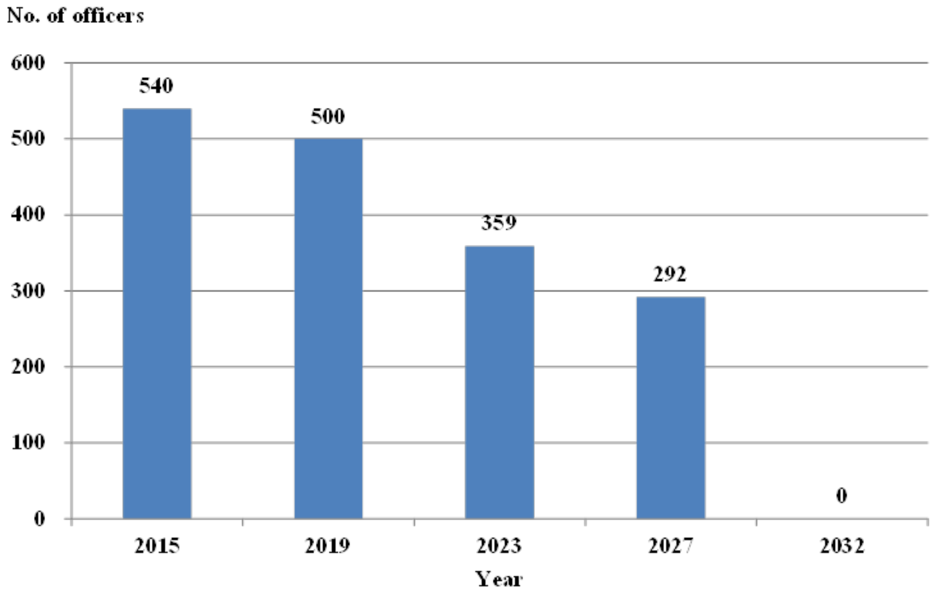
Recommendation – Government Buildings

2.15 The Working Group does not see any immediate fiscal need to pursue the above options and is concerned that option (c) above may not be consistent with the role of Government. The Working Group **recommends** that options (a) and (b) above be explored if the Government is under imminent cash flow pressure.

Surplus Non-departmental Quarters

2.16 The Working Group noted that a large number of surplus government-owned residential buildings would become available as the demand for NDQs provided for senior civil servants who joined the service before 1 October 1990 gradually phases out in the next two decades upon the retirement of eligible officers.

Chart 2.4 – Projected demand for NDQs



2.17 To address the issue of surplus NDQs, the Government introduced a rolling five-year NDQ disposal programme in 1996. The programme sets out sites anticipated for disposal in the coming five financial years so as to give ample advance notice to the affected NDQ occupants. The programme is reviewed annually by a working group convened by the Civil Service Bureau with representatives from the relevant bureaux and departments.

2.18 Noting that most of these surplus NDQs are situated in prime locations (e.g. Tai Hang Road, the Peak and Mid-levels) and have no direct impact on the delivery of public services, the Working Group agreed that surplus NDQs could be a significant source of revenue for the Government and considered how their returns could be maximised.

2.19 As at November 2014, there were 14 government-built NDQ sites (with 631 units) and 220 NDQ units in private developments, making up a total of 851 NDQ units.

2.20 **Government-built NDQ sites.** Under the existing government policy, government-built NDQ sites earmarked for disposal under the NDQ disposal programme are normally disposed of by land sale when all the units at the site are vacated. Some of the NDQ sites mentioned in paragraph 2.19 above have already been included in the NDQ disposal programme with planned dates for disposal. Since 2009, a total of five government-built NDQ sites have been disposed of by land sale, generating substantial revenue for the Government at a total of $31 billion.

Table 2.2 – Disposal of NDQ Sites since 2009

	NDQ Sites	**Sale Date**	**Revenue Generated**
1.	103 Mt. Nicholson Gap	July/2010	$10 billion
2.	1 Ede Road	August/2010	$1 billion
3.	3 & 5 Ede Road	October/2010	$2 billion
4.	21, 23, 25 Borrett Road	June/2011	$12 billion
5.	Glendale, 8, 10 & 12 Deep Water Bay Drive	May/2012	$6 billion
		Total	**$31 billion**

2.21 **NDQ units in private developments.** Individual surplus NDQ units in private developments are disposed of in the open market by public tender or auction. Since 2009, a total of 165 NDQ units in private developments have been disposed of, generating revenue at a total of $4,205 million.

Table 2.3 – Disposal of NDQ units since 2009

Year	No. of NDQ Units Sold	Revenue Generated
2009	102	$2,495 million
2010	16	$381 million
2011	15	$397 million
2012	20	$563 million
2013	-	-
2014	12	$369 million
Total	**165**	**$4,205 million**

2.22 As an interim arrangement pending permanent disposal, surplus NDQ units are normally leased out to make gainful use of the surplus buildings and help generate revenue. As at November 2014, there were 189 surplus NDQ units on leasing, generating annual rental revenue of about $108 million.

2.23 In considering whether the NDQ sites and units should be disposed of or retained with the surplus units leased out on a long-term basis to maximise possible returns, the Working Group has considered the following relevant factors –

(a) **Age of NDQs.** Some of the NDQ units are over 30 years. If the Government were to pursue the leasing option, there would be recurrent maintenance costs which could increase over time as the buildings further age. To maximise their rental value, substantial refurbishment works may be required which would incur significant capital outlays.

(b) **Role of Government.** NDQs were built or purchased to meet operational needs. A conscious policy decision would have to be made if the Government were to take up the role of a landlord and leasing agent.

(c) **Land and housing priorities.** Given the Government's policy priority of increasing land supply for housing and other developments, it may be difficult to justify retaining some surplus under-utilised NDQ sites to generate revenue.

2.24 Generally speaking, there may be greater room and flexibility for maneuvering in exploring the leasing-out option for NDQ units in private developments (compared with government-built NDQ units), as they are not site-tied and can be sold or leased out individually as and when appropriate. These NDQ units may also be potentially more attractive to prospective tenants. The choice between disposal or leasing-out of these surplus units would hinge on the cost-benefit appraisal for each case concerned.

2.25 The Working Group has considered the estimated disposal value vis-à-vis the estimated rental value of the NDQ sites and NDQ units within private developments that may be vacated and disposed of in the coming years. The analysis is set out in the following table –

Table 2.4 – Comparison of estimated disposal value and estimated annual rental value of NDQ sites and units

	Estimated disposal value (as at 1 Sept 2014)	**Estimated rental value** (per annum)	**Breakeven**
Nine NDQ sites*	$51 billion	$523 million	97.5 years
220 NDQ units in private developments	$8 billion	$144 million	55.5 years

* Excluding five NDQ sites which have already been included in the Government's NDQ disposal programme with planned disposal dates or have alternative government uses.

Recommendations – Surplus NDQs

2.26 Given the relatively low annual rental yield and the general shortage of land resources, the Working Group did not consider it worthwhile to retain the surplus NDQs and pursue the leasing-out option. The Working Group also considered it not advisable for the Government to keep surplus NDQs for the purpose of possible capital appreciation as it might create the misperception that the Government was participating in property market speculation.

2.27 In view of the above considerations, the Working Group **recommends** that the Government should continue with the established policy of disposing of NDQ sites and units by sale as and when they become available to generate one-off revenue. This will also free land and help increase land supply for housing or other development purposes. The potential revenue, depending on the timing of disposal, could be in the order of $59 billion.

2.28 For the disposal of these surplus buildings, the Working Group **recommends** that a pragmatic approach should be adopted to allow flexibility in the disposal mechanism. This is to ensure that valuable government buildings are not disposed of when market conditions are unfavourable. The disposal priority should be guided by the status of the NDQ decanting programme, the potential revenue to be captured, the site utilisation to be enhanced through redevelopment, and the sentiment of the market. As an interim arrangement pending permanent disposal, the existing practice of leasing out surplus NDQ units should continue.

Government Utilities ($105 billion)

2.29 The provision of water, sewage, ferry embarkation, and other services relating to the use of toll tunnel and bridges – generally referred to as "government utilities", involves very substantial upfront capital investment of public funds. In order to recoup the costs of investment as well as the costs of resources in managing the utilities, the Executive Council decided in 1995 that target rates of return should be set for government utilities with reference to those in the relevant industry sectors, in terms of the return on average net fixed assets valued at historical cost of the respective utilities. The Executive Council also decided that the target rates should be reviewed at five-year intervals taking into account the actual performance of the utilities and the changes in policy, economic and investment market conditions.

2.30 There are four government utilities, namely –

(a) Waterworks (managed by Water Supplies Department)

This utility covers the operation of the fresh and salt water supplies to the territory.

(b) Government Toll-tunnels and Bridges (managed by Transport Department)

This utility covers the operation of five Government-built toll-tunnels (namely Aberdeen Tunnel, Lion Rock Tunnel, Shing Mun Tunnels, Tseung Kwan O Tunnel and Route 8K between Sha Tin and Cheung Sha Wan) and the Lantau Link.

(c) Marine Ferry Terminals (managed by Marine Department)

This utility covers the operation of two marine ferry terminals (namely the Hong Kong-Macau Ferry Terminal at Sheung Wan and the China Ferry Terminal at Tsim Sha Tsui).

(d) Sewage Services (managed by Drainage Services Department)

This utility covers the treatment and disposal of sewage through the public sewerage system.

2.31 Following the last review in 2012, the prevailing target rates of return for the relevant utilities are set out below –

Waterworks	3.4%
Government Toll-tunnels and Bridges	6.6%
Marine Ferry Terminals	7.5%
Sewage Services	Cost recovery

The target rates of returns are derived with the use of the Capital Asset Pricing Model to evaluate the cost of capital for individual government utilities, and are measured in terms of return on average net fixed assets valued at historical cost. They are reviewed at five-year intervals taking into account the latest economic and investment market conditions as well as the risk return characteristics of companies in the relevant industry sectors.

2.32 As revealed in the Operating Accounts in respect of the four government utilities over the past five years from 2009-10 to 2013-14, the Marine Ferry Terminals operation has achieved a higher-than-target return, while the other three utilities have not been able to meet their respective financial targets.

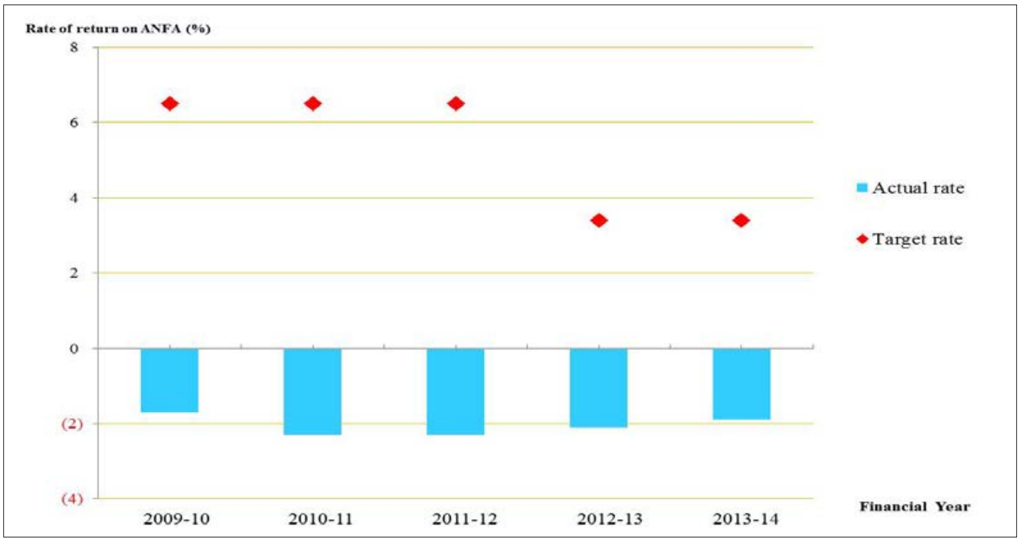
Waterworks

2.33 The Executive Council decided in 1995 that the target rate of return for Waterworks should be set at a risk-free rate (conceptually, this is the rate of return that can be earned with certainty such as rate of government bonds), on the ground that water was regarded as basic necessity and that the Government should absorb through general revenue any business risk associated with the Waterworks.

2.34 The Waterworks has been operating well below the target rate of return throughout the past five years from 2009-10 to 2013-14. In fact, it has been operating at deficits since 1998-99.

2.35 The Water Supplies Department has been implementing various measures to reduce expenditure through outsourcing, computerisation, streamlining work process, automation and remote control of plant operation, optimisation of plant maintenance, re-organisation and re-engineering the work flow, and implementation of electricity saving measures. Notwithstanding the various measures to reduce expenditure, the revenue of the Waterworks operation has still fallen short of meeting its expenditure. Water tariff, which constitutes 33% of the revenue of the Waterworks operation in 2013-14, has not been revised since 1995, contributing to the under recovery of the operating cost of the Waterworks operation.

Chart 2.5 – Target and actual rates of return for Waterworks

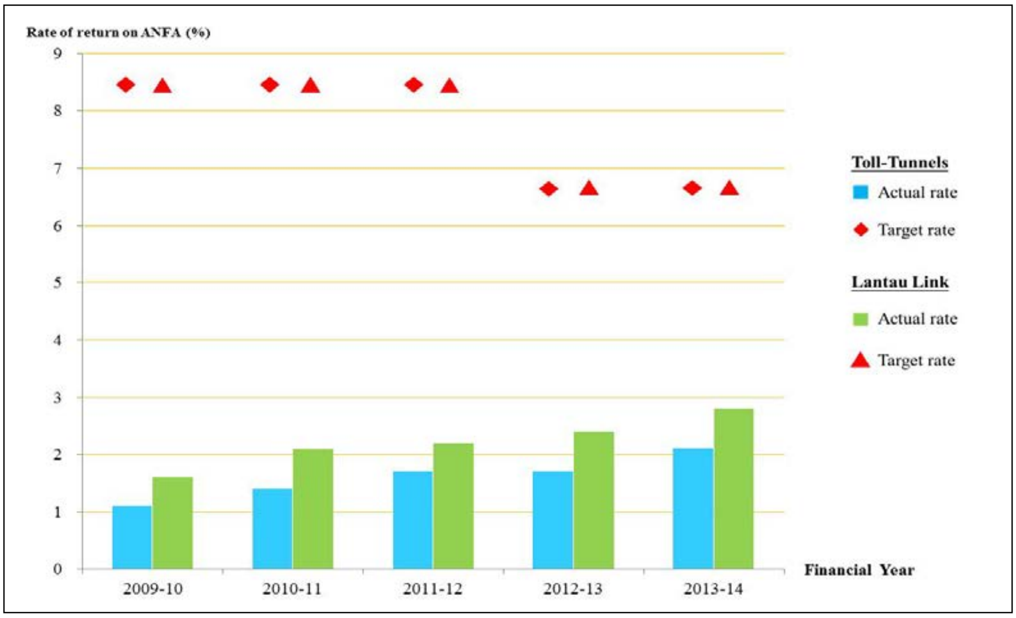


Government Toll-tunnels and Bridges

2.36 The Government Toll-tunnels and Bridges operation could not meet the target rate of return throughout the past five years from 2009-10 to 2013-14.

2.37 The daily operation of the five government toll-tunnels and Lantau Link has been outsourced to contractors who have to bear all recurrent expenses for maintaining and operating the facilities. While the Government has been striving to control the management costs by awarding the management contracts through open tender, the tolls, which account for about 99% of the revenue of the Government Toll-tunnels and Bridges operation, have not been revised for years. The toll levels for Aberdeen Tunnel, Shing Mun Tunnels and Tseung Kwan O Tunnel were last revised on 26 February 1993, Lion Rock Tunnel on 1 April 1999, and those for Route 8K and Lantau Link have not been revised since their respective commissioning on 21 March 2008 and 22 May 1997. In response to concerns expressed by the Legislative Council, the toll for Route 8K was set at a level lower than those originally put forward by the Government to meet the target rate of return.

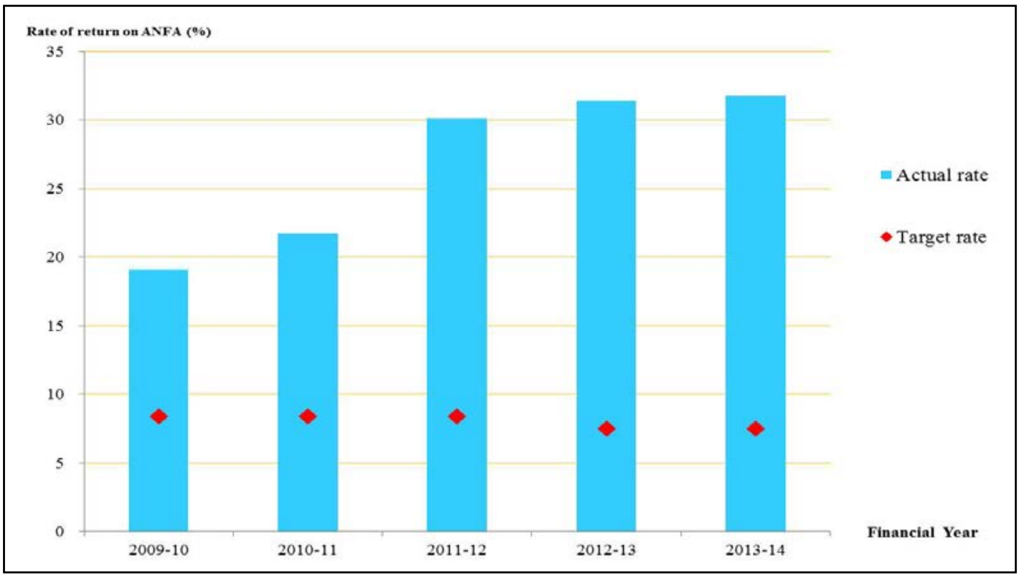
Chart 2.6 – Target and actual rates of return for Government Toll-tunnels and Bridges



Marine Ferry Terminals

2.38 The Marine Ferry Terminals have been operating above the target rate of return over the past five years from 2009-10 to 2013-14. In anticipation of continuous patronage growth, the operation of the two Marine Ferry Terminals is forecast to continue to meet the target rate of return in the coming years. The commissioning of the Hong Kong-Zhuhai-Macau Bridge may have a dampening effect on patronage.

Chart 2.7 – Target and actual rates of return for Marine Ferry Terminals

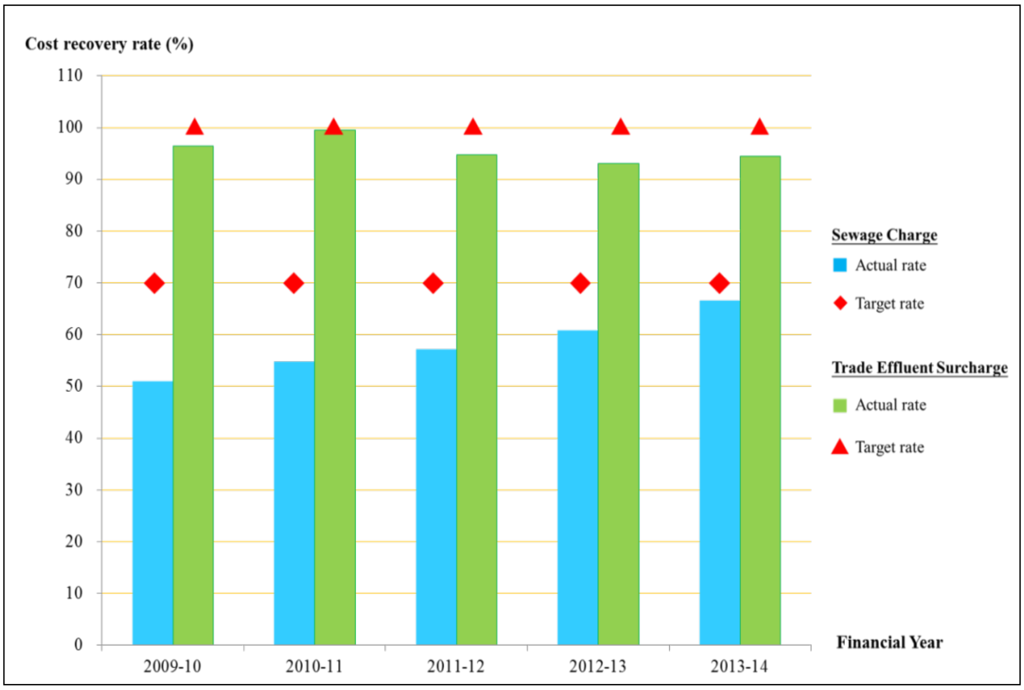


Sewage Services

2.39 In order to gain public acceptance of the sewage services charging scheme upon its introduction back in 1995, the Sewage Charge and the Trade Effluent Surcharge have each been set to recover the operating cost of Sewage Services only, but not the capital cost.

2.40 The Sewage Services operation has yet to achieve the target cost recovery rates, i.e. 70% recovery of the cost of treatment of waste water from Sewage Charge by 2017-18 and full (100%) recovery of the additional cost of treating effluents from Trade Effluent Surcharge. Nonetheless, revenue from Sewage Charge is still forecast to rise steadily up to 2017-18 because the Legislative Council agreed in May 2007 that the Sewage Charge be increased by ten annual increments of 9.3% from 2008-09 to 2017-18. To ensure that the Sewage Services operation will be able to achieve the target cost recovery rates beyond 2017-18, the Government will conduct a review of the Sewage Charge and the Trade Effluent Surcharge in due course.

Chart 2.8 – Target and actual cost recovery rates for Sewage Services



Monitoring mechanism for Government Utilities

2.41 An Operating Accounts Committee is set up for each of the government utilities to monitor their financial performance. Chaired by the Permanent Secretary for Financial Services and the Treasury (Treasury) and comprising representatives from the relevant policy bureaux and departments, each of these Committees is tasked to –

(a) vet the annual Operating Accounts, five-year projections, and any necessary cost-saving and revenue-generating measures;

(b) vet and approve fee revision proposals; and

(c) review periodically the target rates of return.

Recommendations – Government Utilities

2.42 The Working Group agrees that the structured mechanism for monitoring the financial performance of the government utilities on a periodic basis should continue.

2.43 The Working Group **recommends** that government utilities should continue to seek to improve their financial performance, by exploring cost-saving opportunities and implementing fee revision proposals.

2.44 The Working Group **recommends** that a review of the water tariff last adjusted in 1995 would be timely. This is necessary to uphold the "user pay" principle and help the Waterworks operation attain its target rate of return. With water tariff averaging at only about $50 a month for a domestic household, the Working Group considers that affordability should not be a real hurdle to a reasonable upward adjustment. The extra cost burden to the community can be allayed by greater efforts to economise on the consumption of water as a scarce resource.

2.45 The Working Group **recommends** that the Government should step up its efforts to encourage water savings while continuing to identify further ways to operate and maintain the Waterworks in an economical, efficient and effective manner.

2.46 As regards the Government Toll-tunnels and Bridges operation, the Working Group **recommends** that the Government should continue to keep in view the traffic situation of the government toll-tunnels and Lantau Link and opportunities for toll adjustment where it is justified on traffic grounds. The Working Group sees a need to improve the financial performance of the Government Toll-tunnels and the Lantau Link operations for attaining the target rate of return in the long run, while appreciating the political reality and the impact any toll adjustment may have on the overall scheme of development in Hong Kong.

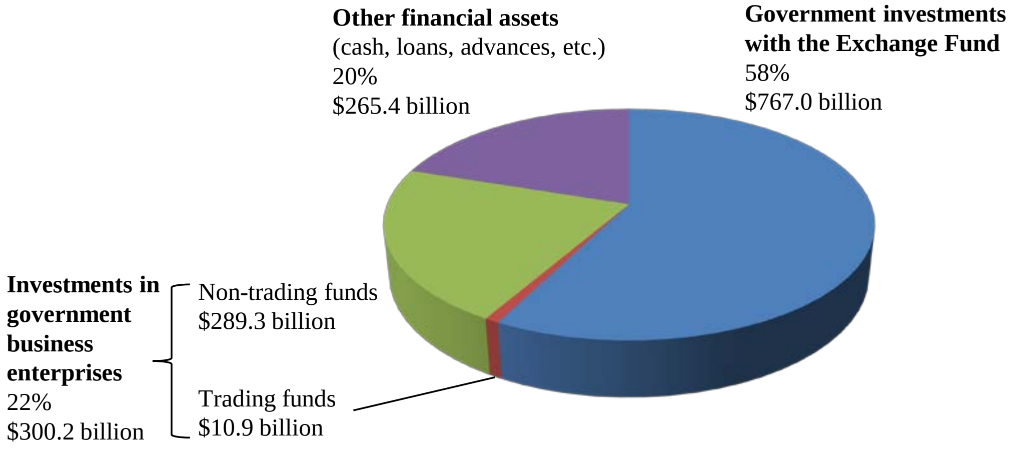
2.47 The Working Group **recommends** that the Government should continue to explore and discuss with the management contractors of the government toll-tunnels and Lantau Link ways to increase non-toll revenues and keep in view cost-saving opportunities.

(C) Investment in Financial Assets

Financial Assets

2.48 The financial assets of the Government include the fiscal reserves placed with the Exchange Fund; other cash, loans and advances, etc.; and most importantly for the current purpose of the Working Group, the Government's investment in a group of "government business enterprises" ("GBEs"). An overview is set out below –

*Chart 2.9 – Government's financial assets**
($1,332.6 billion as at 31 March 2014)



* The above does not include the financial assets held by the Exchange Fund, the Hong Kong Link 2004 Limited and the Hong Kong Housing Authority. These are outside the Terms of Reference of the Working Group.

2.49 $300.2 billion or 22% of Government's financial assets (totaling $1,332.6 billion) at end March 2014 relates to investments in GBEs. A list of GBEs in which the Government has an investment holding of not less than 20% as at 31 March 2014 and of which the Government shares the net earnings is at below –

Table 2.5 – GBEs

Government Business Enterprises		Government investment holding
1.	Airport Authority	100%
2.	Companies Registry Trading Fund	100%
3.	Electrical and Mechanical Services Trading Fund	100%
4.	Hong Kong Cyberport Development Holdings Limited	100%
5.	Hongkong International Theme Parks Limited	52.4%
6.	Hong Kong Science and Technology Parks Corporation	100%
7.	Hong Kong IEC Limited	74.9%
8.	Kowloon-Canton Railway Corporation	100%
9.	Land Registry Trading Fund	100%
10.	MTR Corporation Limited	76.5%
11.	Office of the Communications Authority Trading Fund	100%
12.	Post Office Trading Fund	100%
13.	Urban Renewal Authority	100%
14.	West Rail Property Development Limited	100%

2.50 The Government has shareholding in 14 GBEs, including five trading funds and nine “non-governmental” entities.

Management of GBEs other than Trading Funds ($289.3 billion)

2.51 Past investments in non-governmental GBEs were mainly designed to provide a worthwhile public service or to meet an important policy objective while generating a reasonable rate of return to the Government. Investments in these GBEs have been made through the Capital Investment Fund to meet public purposes in different forms, as follows –

(a) Public statutory corporations with shareholding structure –

(i) **MTR Corporation Limited** – to build and operate mass transit railway in Hong Kong;

(ii) **Airport Authority of Hong Kong** – to provide, operate, develop and maintain an airport for civil aviation in the vicinity of Chek Lap Kok;

(iii) **Kowloon-Canton Railway Corporation** – to hold railway system and to grant and oversee the service concession to the MTR Corporation Limited for operation of its railway system;

(iv) **Hong Kong Science and Technology Parks Corporation** – to oversee and manage the Hong Kong Science Park, InnoCentre, and the three industrial estates at Tai Po, Tseung Kwan O and Yuen Long;

(b) Private companies with shareholding structure formed under Companies Ordinance (Cap. 622) –

(i) **Hongkong International Theme Parks Limited –** to operate the Hong Kong Disneyland Resort;

(ii) **Hong Kong Cyberport Management Company Limited** – to operate the Cyberport which includes four office buildings, a hotel and an arcade;

(iii) **Hong Kong IEC Limited –** to develop and operate the AsiaWorld-Expo in Hong Kong;

(iv) **West Rail Property Development Limited** ("WRPDL") – to undertake residential development projects along the West Rail line; and

(c) Public statutory bodies without a shareholding structure –

(i) **Urban Renewal Authority –** to undertake, encourage, promote and facilitate the regeneration of the older urban areas of Hong Kong.

2.52 Except for the five Trading Funds, other GBEs are independent legal entities and have their own boards of directors for overseeing the business operation of GBEs. They have their own corporate governance and are accountable to their boards of directors. As such, the objectives of the Government, being a shareholder, are to ensure that the relevant corporations and companies –

(a) operate their business on commercial principles, creating and maximising shareholder value within their policy and regulatory environment; and

(b) provide a reasonable financial return to Government's investment, both in terms of achieving a specified level of dividend payments and optimising their financial structure.

2.53 Since the Government-invested corporations, companies and public bodies are serving a public purpose and operating under heavy policy requirements, the Government's investment would seek primarily to meet the relevant public policy objectives rather than to achieve a financial return. Unless there is a change in the objective of Government's investments, commercial return to Government may not always be overriding.

2.54 The financial performance of GBEs (except for Trading Funds to be analysed separately) varies. Some operate at an accounting profit with dividends paid to Government as shareholder; others may not be able to pay dividends but still suffice to generate operating cash to support their missions and functions. The financial performance of GBEs may be affected by quite a number of factors. For example, some companies, though profitable, have been undergoing expansion plans while some others are carrying heavy non-cash expenses like depreciation. Some GBEs are also tasked with public mission projects for nurturing specific industries, and this may affect their profitability.

2.55 The Government monitors the financial performance of the non-governmental GBEs through directorship appointments on the relevant governing boards. The official directors tender their views on the formulation of the business plans and financial forecasts of GBEs by taking into account the individual mission and objectives as well as financial performance of the GBEs.

Recommendations – GBEs other than Trading Funds

2.56 The Working Group notes that past investments of the Government in GBEs other than the Trading Funds are mainly to provide a worthwhile public service or to meet an important policy objective. As such, the Government's investment would seek primarily to meet the relevant public policy objectives. The Working Group also acknowledges that these GBEs have their own corporate governance and are accountable to their boards of directors. Direct instruction from the Government on the operation of business of these GBEs is not appropriate. The Working Group therefore focuses on exploring the fiscal options for the Government as the shareholder of GBEs, i.e. whether the Government should maintain its shareholding level in GBEs or dispose of its shareholding, either partially or fully, if the Government faces structural deficit, having regard to the financial performance of GBEs and their investment return to the Government as the shareholder.

2.57 The Working Group **recommends** that the Government should consider reducing or disposing of the Government's shareholding in non-governmental GBEs in times of serious financial distress. However, the one-off revenue from asset disposal **cannot** resolve the structural deficit problem. In considering adjusting the Government's shareholdings in GBEs, the overriding public policy objectives and the interests of minority shareholders should also be carefully considered. The Working Group believes that the Government should continue to be the majority shareholder in those GBEs which hold strategic assets like railways and the airport. For other GBEs, the Government should periodically review whether the extent of its shareholding in each remains commensurate with the public policy objectives.

2.58 The Working Group **recommends** that the Government should institute a more structured review for monitoring all GBEs as a group. Rather than monitoring the performance of individual GBEs, this proposed review is meant to –

(a) evaluate the relative financial performance of GBEs;

(b) compare their performance over time and/or against industry benchmarks; and

(c) assess whether the government investments have paid off, achieved their policy objectives and remain fit-for-purpose.

It would suffice for the structured review to be conducted once every three years.

Management of Trading Funds ($10.9 billion)

2.59 Trading funds are distinct accounting entities established under the Trading Funds Ordinance (TFO) (Cap. 430) for the provision of specific government services. While remaining as part of the Government, they are allowed greater financial and operational flexibilities to run their operations as businesses with a view to improving the quality of services and responding to customer demands.

2.60 Under the TFO, trading funds are required to achieve the following financial objectives –

(a) within a reasonable time, meeting expenses incurred in the provision of the trading fund services and financing liabilities of the trading fund out of the income of the trading fund, taking one year with another; and

(b) achieving a reasonable return, as determined by the Financial Secretary, on the fixed assets employed (target rate of return).

2.61 There are currently five trading funds, and their major nature of business and respective target rates of return are as follows –

Table 2.6 – Trading Funds' target rates of return

Trading Fund	Target Return
(a) Companies Registry Trading Fund (Incorporation of companies and ancillary services, company search)	6.7%
(b) Land Registry Trading Fund (Land search, registration of deeds)	6.9%
(c) Office of the Communications Authority Trading Fund (Regulation of telecommunication and broadcasting services)	6.7%
(d) Post Office Trading Fund (Postal and ancillary services)	5.9%
(e) Electrical and Mechanical Services Trading Fund (Electrical and mechanical engineering services)	7.8%

2.62 The target rates of returns are derived with the use of the Capital Asset Pricing Model to evaluate the cost of capital for individual trading funds, and are measured in terms of return on average net fixed assets valued at historical cost. They are reviewed at five-year intervals taking into account the latest economic and investment market conditions as well as the risk return characteristics of companies in the relevant industry sectors.

2.63 Except for the Post Office Trading Fund (POTF) which has not been able to meet the target rate of return since 2009-10, the other trading funds have more than achieved the respective target rates of return over the past five years from 2009-10 to 2013-14.

Table 2.7 – Actual (vs target) rates of return

Trading Fund	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14**
Companies Registry Trading Fund	35.3% *(8.3%)*	59.4% *(8.3%)*	54.9% *(8.3%)*	63.6% *(6.7%)*	72.5% *(6.7%)*
Land Registry Trading Fund	38.5% *(8.3%)*	52.6% *(8.3%)*	19.7% *(8.3%)*	34.0% *(6.9%)*	15.8% *(6.9%)*
Office of the Communications Authority Trading Fund	32.2% *(8.5%)*	44.7% *(8.5%)*	48.8% *(8.5%)*	31.4% *(6.7%)*	26.0% *(6.7%)*
Post Office Trading Fund	6.6% *(8.4%)*	3.8% *(8.4%)*	-1.9% *(8.4%)*	-3.9% *(5.9%)*	-0.5% *(5.9%)*
Electrical and Mechanical Services Trading Fund	49.1% *(8.5%)*	58.1% *(8.5%)*	45.5% *(8.5%)*	38.1% *(7.8%)*	31.7% *(7.8%)*

2.64 A standing mechanism exists for the respective policy bureau and the Financial Services and the Treasury Bureau to regularly monitor the financial performance of the trading funds through –

(a) vetting and approving their annual business and corporate plans;

(b) vetting and approving their fee revision proposals and investment strategies; and

(c) reviewing and monitoring their interim and annual financial results twice a year.

2.65 In order to improve its financial performance, the POTF will continue to implement measures to generate revenue and manage costs. These include periodic review and adjustment of the principal postage rates and miscellaneous postal fees; introduction of new services to meet the delivery needs of online merchants and online shoppers; provision of one-stop customised philatelic souvenir service to generate additional revenue; and cost-savings measures through automation, mechanisation and business process re-engineering of postal operations.

Recommendations – Trading Funds

2.66 The Working Group agrees that the structured mechanism for monitoring the financial performance of the trading funds on a periodic basis should continue.

2.67 The Working Group **recommends** that trading funds should continue to enhance operational efficiency and achieve a reasonable rate of return while maintaining appropriate standards of public services.

2.68 The Working Group **recommends** that the POTF should continue to strive to improve its financial performance. This includes exploring outsourcing opportunities and implementing fee revision proposals.

(D) Asset Valuation

2.69 The Government's fixed assets are stated at cost less accumulated depreciation in the accrual-based consolidated financial statements whereas the investments in GBEs are stated at the Government's share of their net assets, less any impairment losses recognised.

2.70 Land is generally not capitalised as fixed assets because it would be difficult, if not impossible, to obtain objective valuation of all the land owned by the Government most of which do not have parallel instances in the private sector (e.g. land under roads and streets, police/fire stations, or prisons). The cost of land is not measurable in a reliable manner since it may involve different extent of land formation costs as well as the cost of ancillary facilities such as roads, drains and other social infrastructure. To demonstrate the Government's accountability, a Stewardship Statement is attached to the accrual-based consolidated financial statements to disclose the areas of land employed by the Government for delivery of public services and land allocated to the Housing Authority for public rental housing estates.

2.71 The Working Group noted that the existing approach of valuation of assets is basically in line with the generally accepted accounting practices and is appropriate. To enhance transparency, the Working Group suggests that the Government may consider, to the extent possible, disclosing additional information on the market value of the GBEs other than trading funds by way of notes to the accrual-based consolidated financial statements.

(E) Recommendations

Fixed Assets

2.72 **Government Buildings** ($89.7 billion as at 31 March 2014). The Working Group does not see any immediate fiscal need for the Government to consider disposing of the many high-value government buildings it possesses. However, if a need for cash arises, the Working Group **recommends** that the Government may consider raising funds through using some high-value government buildings as underlying assets to support the issue of bonds, or using them under a sale-and-lease-back arrangement.

2.73 **Non-departmental Quarters** (NDQs) (subset of Government Buildings). Nine NDQ sites and 220 NDQ units in private developments are expected to become surplus in the coming two decades upon the retirement of eligible civil servants who joined the Government before 1 October 1990. The Working Group **recommends** that the Government should continue with the established policy of disposing of NDQ sites and units by sale as and when they become available to generate one-off revenue. A pragmatic approach should be adopted to allow flexibility in the disposal mechanism and to avoid "fire sale". The disposal priority should be guided by the status of the NDQ decanting programme, the potential revenue to be captured, the site utilisation to be enhanced through redevelopment, and the sentiment of the market. As an interim arrangement pending permanent disposal, the existing practice of leasing out surplus NDQ units should continue.

2.74 **Government Utilities** ($105 billion as at 31 March 2014). Only one of the four government utilities (namely the Marine Ferry Terminals) managed to operate above the target rate of return from 2009-10 to 2013-14. The Working Group **recommends** that all government utilities, especially the other three (namely, waterworks, government toll-tunnels and bridges, and sewage services), should continue to seek to improve their financial performance, by exploring cost-saving opportunities and implementing fee revisions in a timely manner.

Financial Assets

2.75 **Government Business Enterprises (GBEs) other than Trading Funds** ($289.3 billion as at 31 March 2014). The Working Group appreciates that the Government's investments in many GBEs are guided by public policy objectives not limited to financial considerations. In times of serious financial distress, the Working Group **recommends** that the Government should consider reducing or disposing of the Government's shareholding in some GBEs. The Working Group believes that the Government should continue to be the majority shareholder in those GBEs which hold strategic assets like railways and the airport. For other GBEs, the Government should periodically review whether the extent of its shareholding in each remains commensurate with the public policy objectives. The Working Group would caution that one-off revenue from asset disposal **cannot** resolve a structural deficit problem; the overriding public policy objectives and the interests of minority shareholders should also be carefully considered.

2.76 The Working Group **recommends** that the Government should institute a more structured review for monitoring all GBEs as a group. Rather than monitoring the performance of individual GBEs, this proposed review is meant to –

(a) evaluate the relative financial performance of GBEs;

(b) compare their performance over time and/or against industry benchmarks; and

(c) assess whether the government investments have paid off, achieved their policy objectives and remain fit-for-purpose.

It would suffice for the structured review to be conducted once every three years.

2.77 **Trading Funds** ($10.9 billion as at 31 March 2014). The Working Group notes that four of the five trading funds – namely, the Companies Registry, Land Registry, Office of the Communications Authority, and Electrical and Mechanical Services Trading Funds, have been able to meet the target rates of return. The Working Group **recommends** that they should continue to enhance operational efficiency and achieve a reasonable rate of return. As for the Post Office Trading Fund, the Working Group appreciates the historical and legal constraints within which it operates and **recommends** that it should continue to strive to improve its financial performance. This includes exploring outsourcing opportunities and implementing fee revision proposals.