

ITEM FOR FINANCE COMMITTEE

CAPITAL INVESTMENT FUND

HEAD 962 – INDUSTRY

New Subhead “Equity in the Hong Kong Science and Technology Parks Corporation”

New Subhead “Loan to the Hong Kong Science and Technology Parks Corporation”

Members are invited to approve a commitment to inject \$2,435 million as equity and to provide \$1,043 million as a loan from the Capital Investment Fund to the Hong Kong Science and Technology Parks Corporation to enable the Corporation to proceed with the construction of Science Park Phase 2.

PROBLEM

The Hong Kong Science and Technology Parks Corporation (HKSTPC) does not have sufficient money to construct Phase 2 of the Science Park to meet strong market demand for lettable space therein.

PROPOSAL

2. We propose that Members approve a commitment to inject \$2,435 million as equity and to provide a loan of \$1,043 million from the Capital Investment Fund to the HKSTPC to enable it to proceed with the construction of Science Park Phase 2.

/JUSTIFICATION

JUSTIFICATION

Urgency of Phase 2

3. The Science Park is an important segment of technological infrastructure to help Hong Kong industries move up the technological ladder. Since its formal launch in November 1999, there have been very encouraging responses from both local and overseas technology-based companies. As at end-May 2001, there are 42 applications for admission, ten of which have already been approved. Discounting seven applications which have been rejected and one which has withdrawn, the total demand for space from the remainder amounts to about 140 000 square metres. On the other hand, the total space available for lease in the entire Phase 1 is only 109 400 square metres. We expect the demand for space would further increase as the HKSTPC has started a series of marketing efforts both locally and overseas and it is likely to receive new applications in due course.

4. While the HKSTPC would be selective in admitting only the most appropriate tenants, it is essential for the Science Park to have space readily available for worthwhile tenants in order to keep up the momentum. There is thus an urgency to start the construction of Phase 2 as soon as possible lest the Science Park, and Hong Kong as a whole, lag behind the opportunities. Subject to Members' funding approval, our target is to open Phase 2 in mid 2004 and complete the construction of the entire Phase 2 by end 2005.

Estimated construction cost

5. A site in Phase 2 has been reserved for the permanent building of the Applied Science and Technology Research Institute, whose construction cost will be separately funded by the Government. Discounting this site, Phase 2 will have a gross floor area of 95 500 square metres. It will accommodate lettable space for technology-based companies, and space for ancillary facilities (e.g. conference rooms and exhibition areas) and supporting facilities (e.g. restaurants and shops). Using the construction cost of Phase 1 as a base for projection and taking into account the need for certain building design features to meet expected requirements of tenants, the construction cost of Phase 2 is estimated to be \$3,914 million at money-of-the-day (MOD) prices. The estimate includes construction cost for buildings, carparks, internal roads, landscaping, sewage and drainage facilities, etc.

/Financing

Financing arrangements

The approach

6. Construction of Science Park Phase 1 was put under the Public Works Programme (PWP), with the Architectural Services Department (ArchSD) being responsible for the construction process. The reason for treating Phase 1 as a PWP project was that given the urgency to proceed with the construction of the Science Park, design and detailed planning for Phase 1 had to start in 1998. On the other hand, however, the then Provisional Hong Kong Science Park Company Limited¹ was newly set up at that time and did not have the resources, manpower, or experience to handle such a large scale development project on its own.

7. Experience in Phase 1 reveals that the PWP approach may not be the best way for the Science Park project. This is because HKSTPC is the owner of the buildings and physical facilities in the Science Park and is responsible for managing, maintaining and marketing the Science Park. Given its close liaison with both approved and potential tenants, HKSTPC also has a deeper understanding of the needs of the tenants in terms of facilities and building features required. It would therefore be more logical and effective if HKSTPC could have direct input into and control over the design, development and construction process, instead of routing through ArchSD in an indirect manner. We therefore propose a different funding approach for Phase 2 with a view to enabling HKSTPC to engage its own architect and consultants, hence having a direct control over the design and construction process.

8. Having been closely involved in the development process of Phase 1, HKSTPC staff have now accumulated relevant experience essential for development of Phase 2. The merger with the Hong Kong Industrial Estates Corporation and the Hong Kong Industrial Technology Centre Corporation has also strengthened the staffing and financial resources of HKSTPC. We therefore consider HKSTPC has the capacity to take up the development of Phase 2 on its own.

9. The accumulated cash of HKSTPC as at 31 March 2001 amounts to \$930 million. Taking into account HKSTPC's financial position, its projected income in the coming years, and committed capital projects and initiatives in the

/pipeline

¹ The Company was dissolved upon the establishment of the Hong Kong Science and Technology Parks Corporation on 7 May 2001.

pipeline which will incur expenditure, we estimate that HKSTPC would be able to contribute \$436 million (MOD prices) towards the construction cost of Phase 2. We propose the Government to fund the remaining \$3,478 million (MOD prices) from the Capital Investment Fund. Having regard to the projected repayment ability of HKSTPC, we propose the funding support to be in the form of equity and loan in the ratio of 70:30. This translates into an equity injection of \$2,435 million and a loan of \$1,043 million. From Government's perspective this funding arrangement also presents an appropriate balance of risk and reward for public funds.

Financial Support to the HKSTPC

- Encl. 10. As seen in the illustrative cash flow projections at Enclosure, HKSTPC would be able to make use of its own resources to fund the construction of Phase 2 in the initial years. Funding support from the Government will be required starting from 2003-04. The proposed equity of \$2,435 million to be provided to the HKSTPC, if approved, will be injected in phases in the light of the expenditure pattern of the construction work, with the first injection to be made in 2003-04.
11. The proposed loan of \$1,043 million, if approved, will be provided to HKSTPC after the amount of equity has been fully injected. Interest on the loan will be charged at the prevailing "no-gain-no-loss" rate². Depending on its actual needs, HKSTPC has the flexibility to minimise drawdown of the loan. The loan will be repaid by equal annual instalments (covering both loan principal and interest) over 15 years. Repayment will start one year after completion of the construction of Phase 2, or on 31 March 2008, whichever is the earlier. Interest accrued before completion of Phase 2 (or 31 March 2007 as the case may be) is to be capitalised. In case HKSTPC has unexpected cashflow problems to repay the loan, it may amend the repayment schedule or extend the loan repayment period with the prior approval of the Financial Secretary.
12. Detailed terms of the Government's equity injection will be provided for in a shareholding agreement between the Government and HKSTPC, while terms of the Government loan will be provided for in a loan agreement to be entered into between the same parties.

/FINANCIAL

² The no-gain-no-loss interest rate is currently set at two percentage points below the average best lending rate of the note-issuing banks. This formula ensures that the interest rate will move in tandem with the market lending rate. We will review the interest rate at the end of each month and adjust it when the difference between the updated rate and the prevailing rate is one percentage point or more, or when the prevailing rate has remained stationary for over six months. The prevailing no-gain-no-loss interest rate is 5.5% per annum.

FINANCIAL IMPLICATIONS

13. Subject to Members' approval, the Government proposes to inject \$2,435 million as equity into and to provide a loan of up to \$1,043 million to HKSTPC. The forecast cash flow for equity injection and loan drawdown is as follows –

	Equity \$ million	Loan \$ million
2003-04	1,240	–
2004-05	1,195	248
2005-06	–	795
Total	2,435	1,043

CONTROL MECHANISM

14. HKSTPC is required by its Ordinance to operate in accordance with prudent commercial principles. HKSTPC will put in place a proper control mechanism to monitor the Phase 2 development. The HKSTPC Board of Directors³, assisted by its Projects and Facilities Committee, will assume overall responsibility in steering and monitoring the Phase 2 development. An in-house professional team will support the Committee and the Board and implement their decisions. HKSTPC will also engage a project management consultant to handle day-to-day monitoring of the design and construction work. Duties to be performed by the project management consultant include checking and verifying requests for interim payments from contractors, reporting regularly to HKSTPC on the status of spending, watching out for and proposing measures to deal with variance with baseline implementation plans and contracts, etc. Demarcation of duties and level of responsibilities of all parties involved will be clearly laid down in a manual at the outset for compliance. The budget control and tendering procedures for works contracts will be modelled on Government's procedures and practices.

/ENVIRONMENTAL

³ The Board of Directors comprises prominent members from the industry, academia and business sectors. The Commissioner for Innovation and Technology is the official member of the Board.

ENVIRONMENTAL IMPLICATIONS

15. In May 1998, Director of Territory Development completed an Environmental Impact Assessment (EIA) report as an integral part of the Pak Shek Kok Development Feasibility Study, which included the Science Park. The Advisory Council on the Environment endorsed the findings and recommendations of the EIA report. HKSTPC will implement the mitigation measures, environmental monitoring and auditing requirements in the relevant works contracts in accordance with the recommendations of the EIA reports.

BACKGROUND INFORMATION

16. The Science Park is located at Pak Shek Kok, Tai Po with a total area of 22 hectares. It will be a low density development with an average plot ratio of 2.5 to create a park-like environment in line with the international norm. The Science Park will be developed in three phases. Phase 1 will occupy an area of eight hectares. Phase 2 and Phase 3 will each occupy an area of seven hectares. On 20 January 1998, the Executive Council gave approval in principle for a Private Treaty Grant with nominal land premium for the development of the Science Park.

17. The mission of the Science Park is to bring together world-class technology-based enterprises and researchers to carry out intensive research and development as well as high value-added business activities, thereby enhancing the long-term economic development of Hong Kong. The four initial clusters of companies which HKSTPC is establishing in the Science Park are from the electronics, information technology, biotechnology and precision engineering sectors.

18. HKSTPC was established on 7 May 2001 under the Hong Kong Science and Technology Parks Corporation Ordinance. It was formed by merging the Hong Kong Industrial Estates Corporation, the Hong Kong Industrial Technology Centre Corporation and the Provisional Hong Kong Science Park Company Ltd. HKSTPC takes over the functions of these three organisations and offers one-stop support services to technology-based companies, ranging from nurturing technology start-ups through the incubation programme, providing premises and services in the Science Park for applied research and development activities, to providing land and premises in the industrial estates for production.

19. We consulted the LegCo Commerce and Industry Panel on 26 June 2001. Members supported the proposal in principle.

Commerce and Industry Bureau
June 2001

An Illustrative Cash Flow Projection of the Hong Kong Science and Technology Parks Corporation (in \$ million)

	<u>2001-02</u>	<u>02-03</u>	<u>03-04</u>	<u>04-05</u>	<u>05-06</u>	<u>06-07</u>	<u>07-08</u>	<u>08-09</u>	<u>09-10</u>	<u>10-11</u>	<u>11-12</u>	<u>12-13</u>	<u>13-14</u>	<u>14-15</u>	<u>15-16</u>	<u>16-17</u>	<u>17-18</u>	<u>18-19</u>	<u>19-20</u>	<u>20-21</u>
Opening cash balance	930	667	217	–	–	–	32	18	9	5	15	30	53	91	103	122	159	202	286	392
Reserve for new initiatives (Note 1)			(100)																	
Net cash flow of HKSTPC's operations	(234)	(200)	(166)	17	189	137	91	96	101	115	120	128	143	117	124	142	148	189	211	223
Net cash available for funding Phase 2 construction	696	467	(49)	17	189	137	123	114	110	120	135	158	196	208	227	264	307	391	497	615
Construction Cost of Phase 2	(29)	(250)	(1,191)	(1,460)	(984)	(= 3,914)														
<i>Equity Injection</i>			1,240	1,195		(= 2,435)														
<i>Loan</i>				248	795	(= 1,043)														
Government's Funding Support (Note 2)			1,240	1,443	795	(= 3,478)														
Loan repayment (Note 3)						(105)	(105)	(105)	(105)	(105)	(105)	(105)	(105)	(105)	(105)	(105)	(105)	(105)	(105)	(105)
Ending Cash Balance	667	217	–	–	–	32	18	9	5	15	30	53	91	103	122	159	202	286	392	510

Note 1: An amount of \$100 million is reserved for funding new initiatives of the HKSTPC. For new major capital projects such as the construction of Science Park Phase 3 and the fourth industrial estate, separate funding support from the Government will be worked out in future.

Note 2: Out of the \$3,914M construction cost, HKSTPC will fund \$436 M using its own resources. Details are as follows -

<u>01-02</u>	<u>02-03</u>	<u>03-04</u>	<u>04-05</u>	<u>05-06</u>	Total
\$29M	\$250M	(\$49M)	\$17M	\$189M	\$436M

Note 3: The loan repayment schedule is projected on the basis of an interest rate of 5.5%. The actual repayment amount would vary with the movement of the prevailing prime rate.