

Legislative Council Panel on Commerce and Industry

Proposed New Exhibition Centre at Chek Lap Kok

Introduction

At its meeting held on 12 November 2001, the Legislative Council Panel on Commerce and Industry endorsed the proposal to establish a new exhibition centre at Chek Lap Kok (CLK) (copy of Panel paper at [Annex A](#)). However, at the Finance Committee meeting held on 21 December 2001, when considering FCR(2001-02)50 (copy at [Annex B](#)), Members raised a number of queries on some aspects of the project. We undertook to return to the Panel with further information and this paper seeks to address the specific concerns expressed by Members about the new exhibition centre.

Construction Cost

2. Some Members queried the estimated construction cost of \$4 billion.
3. The exhibition centre will be a multi-purpose, exhibition focused facility, with a net usable area of 50,000 m² (or a gross floor area of 112,000 m² inclusive of areas for public ancillary facilities, food and beverage and back of house), to be opened in 2005 and with the ability to expand later. The centre will be a single-storey design with a 14-metre high ceiling and high floor loading capacity.
4. The construction cost estimates (at MOD prices) quoted in FCR(2001-02)50 are as follows:

	Single-phase Development (\$ million)	Two-phase Development	
		Phase I (\$ million)	Phase II (\$ million)
Exhibition centre construction cost	2,100	1,360	1,110
Carpark construction cost	530	370	245
Infrastructure construction cost	170	110	70
Transportation facilities	110	110	-
Professional fees	230	150	110

Contingency	310	210	155
Total	<u>3,450</u>	<u>2,310</u>	<u>1,690</u>

5. The above estimates were provided by the quantity surveyor engaged by the Hong Kong Airport Authority (AA). The Government subsequently commissioned its own consultant who produced similar figures. We also sought comments from the Architectural Services Department, which found the estimates reasonable.

6. As can be seen, much depends on whether the centre is built in a single phase (\$3.45 billion) or in two phases (\$4.0 billion). Moreover, under both scenarios substantial provisions for infrastructure, transportation facilities, carpark and professional fees are included. Excluding these items, and with a pro-rata reduction in the contingency, would result in an estimate of \$2,307 million under the single-phase approach, or \$20,601 per m² of the gross floor area of 112,000 m². The corresponding figure for the extension of the Hong Kong Convention and Exhibition Centre (HKCEC) in Wanchai is \$23,700 per m², excluding reclamation. As can be seen the estimated cost per m² for the new exhibition centre is some 13% lower than that of the HKCEC, because the former will be more basic in design than the latter.

7. We will only know the actual construction cost of the new exhibition centre after the project has been tendered on a competitive basis.

Location of New Exhibition Centre

8. Some Members queried the proposed location of the new exhibition centre. We recommend CLK as the most suitable location for the centre, ranking ahead of the other six possible locations which we considered, namely, North Lantau, South East Kowloon, West Kowloon Reclamation, Central/Wanchai Reclamation, Pak Shek Kok and Kwu Tung/Border Area. Due to height restrictions, a single storey exhibition centre on the airport island would provide for better use of land resources than the sites in the urban area which could accommodate high rise buildings. The CLK site is conveniently located for the purpose of air, sea and ground transportation for attendees and exhibits, particularly the heavy and bulky items of exhibits. It is also the only site that can meet the 2005 target opening date. Moreover, the site will allow future expansion beyond the planned 50,000 m² net usable area. The option of Expansion to 80,000 m² is already provided for in the agreement with the AA. Expansion beyond 80,000 m² is possible, but would require considerable replanning and probably reclamation.

Economic vs Financial Analysis

9. An economic analysis measures the costs and benefits to the community as a whole of a particular project. A financial analysis measures the costs and revenues captured by the project itself, in order to assess its viability as an investment. In December 1999, a consultancy study commissioned by the Government concluded that by 2005, Hong Kong would need a new exhibition centre with a net usable area of about 50,000 m² and that CLK was the most suitable location. The study also concluded that the proposed centre would bring in a considerable amount of economic benefits to Hong Kong as a whole. However, without government financial assistance, the project would not be financially viable from an investment standpoint. The AA came to the same view in its subsequent study completed in February 2001. In April last year, we formed an interdepartmental steering group to coordinate the Government's consideration of the proposal to build a new exhibition centre, taking into account the economic benefits, the financial returns, and the appropriate form of government involvement if any. The group conducted a reality check on the main assumptions underlying the original consultancy study and the AA's subsequent proposal and found them to be valid and reasonable.

Economic Analysis

10. On the basis of a conservative set of assumptions, the Government Economist estimates that the new exhibition centre will bring a substantial net economic benefit of \$10.4 billion in present value to Hong Kong over a 25-year period, with an economic rate of return of around 18% and a cost/benefit ratio of around 1:4.7. According to the AA, a total of 3,500 jobs will be created during the construction period. When the centre opens, it will probably directly employ about 150 staff. However, the employment created indirectly in support of the activities at the centre and for the tourism sector as a whole will be much larger.

11. Apart from promoting trade, the centre will also enhance tourism by attracting additional visitors to Hong Kong, estimated at up to around 80,000 a year by the tenth year and considerably more thereafter. The new centre is targeted to open in 2005, shortly before the scheduled opening of the Hong Kong Disneyland. This will provide synergy between the two new facilities in attracting business travellers to the centre accompanied by their families for leisure. The exhibition centre will provide a new venue to showcase Hong Kong's products and services. Moreover, it will reinforce the image of Hong Kong as Asia's centre for business, finance and services and as the preferred location for conventions and exhibitions in the region. These economic benefits will spread throughout the economy, notwithstanding the centre's location.

Financial Analysis

12. In the proposal provided by the AA, the overall Internal Rate of Return (IRR) (excluding reversionary value) of the project will only reach about 6.7% in a single-phase approach or 6.1% in a two-phase development for a 25-year franchise period. This return would be regarded as unattractive by any potential private investor.

13. The Government subsequently conducted a sensitivity analysis on the projected IRR based on the key assumptions adopted in the AA's proposal. The reality checks confirmed the assumptions on the likely lease rates, occupancy rates and the construction costs. On the respective projected IRR aspects, even a 10% improvement in each of the assumptions would only result in a less than 1% improvement in the overall project return. This impact would not be significant enough to turn the project into a commercially viable investment.

Case for Government Support

14. Government support for major exhibition and convention facilities is not uncommon. The construction of the two phases of the HKCEC was heavily subsidised. The old wing was paid for by giving the TDC land at nil premium and allowing extensive commercial development including hotels, with the convention and exhibition centre being only part of the overall package. The construction cost of the extension (about \$4.8 billion) was borne by the Government. Internationally the position is the same. In Singapore and Kuala Lumpur the corresponding facilities are 100% government funded. In Las Vegas, the facilities are effectively cross-subsidised by the casinos.

15. Bearing in mind the very considerable economic benefits on the one hand, but the rather modest financial return on the other, we believe there is a strong case for a degree of government support for the new centre.

Case for Private Sector Involvement

16. As a matter of principle, to the extent that the private sector is interested in financing part of the project, it should not be 100% government funded. Also, we believe that a private company with extensive market knowledge and direct experience of operating a world class exhibition centre is better placed to manage the new facility, rather than the Government or AA. Bringing in such a company purely as a manager would bring some advantages, but there would be less incentive to minimise costs because the remuneration for such managers is normally expressed as a percentage of gross revenue. There are some remuneration/bonus structures which can address this problem, but our preferred approach is to bring in the third partner as an investor as well as a

manager. In that way they would have a stake in ensuring the project is the best possible in all aspects, including design, layout, flexibility of usage, construction cost, etc, so as to achieve a reasonable return on his capital as well as the management fee. It would not be so easy to capture these benefits if the project were 100% government funded.

Ownership Structure

17. In terms of the potential ownership structure, the AA recommended a tripartite partnership among the Government, the AA and a private sector consortium. The AA also suggested that an ownership equity ratio of 45%, 10% and 45% would provide a viable option for implementation. A Board of Directors will be set up comprising representatives of the shareholders to oversee the development, management and marketing of the centre. The shareholding structure of the company will result in the public sector (the Government and AA) retaining the majority control.

18. The private sector consortium will contribute cash equity towards the construction cost, including the costs of related infrastructure and transportation facilities apportioned to the Centre site. Its investment objective is to get a reasonable return on its investment in the project. It will obtain a preferred return on its investment as specified in its tender bid. Any surplus of income over the preferred return will be distributed among the three parties according to their equity contribution ratio, but the consortium will have to re-distribute half of its share in this second slice to the Government and AA on the basis of their relative equity contribution ratio.

19. The Government will contribute cash, in return for equity, to cover its share of the construction cost (say 50% but capped at \$2 billion). Its investment objective is to facilitate the provision of additional exhibition facilities to meet anticipated demand from 2005 onwards. This will enhance Hong Kong's competitiveness in this area which will in turn bring in wider consequential economic benefits by stimulating economic growth, creating jobs and increasing tourism.

20. We have been negotiating with the AA on the appropriate form of cooperation and have finally agreed that the AA, in return for a 10% equity shareholding, will:

- a) provide the land required for the 50,000 m² centre and reserve, in the first 10 years of the centre's operation, land for ultimate expansion to a total net usable area of 80,000 m²;
- b) share with the Government, on a pro rata basis, the reversionary value of the facility up to June 2047;

- c) forgo revaluation of the land during subsequent development phases of the centre and upon expiry of the initial 25-year term;
- d) lead the entire process of project planning, feasibility study, market sounding, expression of interest, tendering and development of the centre from inception to completion;
- e) plan for and secure the necessary infrastructure and transportation facilities to tie in with the commencement of the operation of the centre in 2005; and
- f) cooperate with the management of the centre to ensure successful operation of the new facility in attracting more new exhibitions to Hong Kong.

The AA's investment objective is on the premise that there will be direct and indirect benefits to the airport in terms of increased commercial activities and air passenger volume.

21. Some Members queried whether the land valuation of 10% equity stake was overly low when compared with other sites in Hong Kong. We had sought land valuation estimates from both the Lands Department and professional agencies. There was a very substantial difference between these estimates and the AA's own valuation which was on an opportunity cost basis. The situation is further complicated because the exact construction cost is not known at the moment and the equity share would be more in a lower construction cost scenario and less in a higher one for a given land value. The final figure of 10% equity in exchange for the land is a negotiated one, between the government and the AA, in order to provide greater certainty for potential tenderers. It should be noted that the proposed government contribution is not being given to the AA for it to invest in the new exhibition centre. The sum will be invested by the Government directly, and we will receive equity in exchange.

Financing Model

22. In considering how best to finance the project, we looked at the 100% equity option and the possibility of leveraging the financing on various debt equity ratios. However, for any given debt equity ratio, the impact of leverage on the Return on Equity is negligible and in any case would not attract support from the potential lenders.

23. With the assumed 100% equity option and the proposed ownership structure and taking for example a 10% developer's preferred return, we estimate that the ROE of the private sector consortium, the Government and AA would be about 11%, 7.5% and 7.0% respectively. (The latter two include reversionary value of the site upon expiry of the 25-year franchise term.)

Contract Details

24. We propose to select the private sector by open international tender in accordance with the following evaluation criteria:

- a) proposed rate of preferred return;
- b) experience in operating world class exhibition centre;
- c) track record in attracting new exhibition business;
- d) robustness and quality of business plan, including demonstrated commitment to Hong Kong; and
- e) financial capability of the consortium members.

25. In order to promote competition in the provision of exhibition space, we consider that the management and operation of the new centre should be independent of that of the HKCEC. Such an arrangement should be conducive to the further growth of the local exhibition industry as a whole, through the provision of responsive service and competitive pricing. In this connection, as the Hong Kong Trade Development Council and the New World Development Company Limited are involved in the management and operation of the HKCEC, we propose that both of them, as well as the latter's associate companies, should be excluded from the tender exercise.

26. In view of the significance of the project, we prefer to seek funding approval for the government investment before the tender. We believe that this course of action would give more credibility to the project because it will provide prospective private bidders with the assurance of the government's determination and sincerity to proceed with the project and make it a success. If on the other hand we only had approval in principle, some potential bidders may be deterred from preparing a bid because of the resources required against the uncertain prospect of financial approval later. Alternatively, they may regard the uncertainty as a risk factor prompting them to look for a higher preferred return in the deal than otherwise contemplated. Hopefully, potential bidders would, under our proposed scenario, respond more positively with confidence. This approach should help to attract more bidders.

27. We will report back to the Panel on the main elements of the final contract in due course.

Forecast Lease Rates of New Exhibition Centre

28. Some Members asked about the future lease rates of the new exhibition centre and the control mechanism.

29. Under the tripartite partnership, a joint-venture company will be formed to develop, manage and operate the centre on a build operate and transfer basis. The Government, private sector consortium and AA would be represented on the Board of Directors in proportion to their equity stake. The new centre will be operated on prudent commercial principles.

30. The lease rates of the new exhibition centre will be determined by the free market. Given the difference between the proposed centre and the existing HKCEC in terms of location, business focus, together with a degree of competition between the two centres, we estimate that the lease rates of the new centre will be considerably lower than that of the existing HKCEC. The AA's consultant estimated that on opening the rates might be as much as 45% below existing HKCEC rates. Although the differential would diminish over time as the new centre becomes more popular, rates would likely continue to be around 25% lower even in the longer term. From a macro perspective, the new centre will also face competition from its counterparts in the region. Thus market forces should help keep lease rates at the new centre competitive.

Possible Additional Convention and Exhibition Facilities

31. A concern was expressed at the relevant Finance Committee meeting that this project should be considered in the broader context of other proposals for new exhibition facilities in Hong Kong, such as a possible extension to the HKCEC. Plans for an extension to the HKCEC are only at a very preliminary stage and, as analysed above, the proposed facility at CLK is the only one that can fulfil the projected space requirement as well as the 2005 timeframe. Any future proposals for more exhibition facilities in addition to the new exhibition centre at CLK can only be considered at a later stage on the basis of new demand projections and availability of resources.

Way forward

32. Subject to Members' views, we propose to return to Finance Committee to seek approval for the government equity investment as soon as possible.

Proposed International Exhibition Centre at Chek Lap Kok

Introduction

This paper informs Members of the Administration's plan to develop a new International Exhibition Centre (IEC) at Chek Lap Kok (CLK).

Hong Kong as a Premier Destination for Exhibitions and Conventions

2. With excellent facilities and services, Hong Kong has become a premier destination for exhibitions and conventions in the Asia-Pacific region. Almost 730 international conventions, exhibitions and corporate meetings were held in Hong Kong in 2000, attracting some 312,700 overseas visitors to these events. These represent an increase of 23.1% in the number of events and 19.9% in the number of overseas visitors from 1999.

3. The convention and exhibition industry is a high-yield business, and a high-value-added segment of the tourism industry. The per capita spending of convention and exhibition delegates is two and a half times that of the average visitors. In 2000, these delegates spent over \$3 billion in Hong Kong.

Need for a New Exhibition Centre

4. In the past few years, the convention and exhibition industry expressed concern over the lack of competitive convention and exhibition space in Hong Kong against a background of growing regional demand for such facilities.

5. In December 1999, a consultancy study commissioned by the Government concluded that by 2005, a new exhibition centre of about 50,000m² net usable area would be needed and that CLK would be the most suitable location. There would however be no significant shortfall in convention facilities¹. The consultancy study also concluded that without government financial assistance, the new exhibition centre project would not be financially

¹ It was considered that apart from the Hong Kong Convention and Exhibition Centre, other venues such as hotels also offer top-class venues for smaller or specialty conferences and meetings.

viable from an investment standpoint. The Government subsequently invited the Hong Kong Airport Authority (AA) to consider the way forward on the provision of a new exhibition centre at CLK.

6. Meanwhile, the exhibition industry, including the Hong Kong Exhibition and Convention Organisers' and Suppliers' Association (HKECOSA), has continued to demand proactive government involvement in providing additional exhibition facilities. The LegCo Panel on Commerce and Industry discussed the provision of additional exhibition facilities at its meeting held on 12 February 2001.

7. In response to the Government's invitation, in February this year, the AA proposed forming a tripartite partnership involving the Government, a private developer/operator consortium, and the AA to build an International Exhibition Centre (IEC) in its Airport City development within the North Commercial District. In April 2001, an inter-departmental steering group under the Chairmanship of the Director-General of Investment Promotion was formed to coordinate the Government's consideration of the AA's proposal.

8. Having conducted reality checks on the key assumptions underlying the findings of the consultancy study and the AA's subsequent proposal, the Government is satisfied that:

- (a) there is a need for a new exhibition centre, and CLK is superior to other possible sites, and in any case is the only site that can meet the 2005 target opening date;
- (b) the proposed new exhibition centre would bring significant economic benefits for the economy at large; and
- (c) while the centre could cover its operating costs, the investment return would be below the cost of capital. Hence, the project would not be viable from the investment standpoint and a degree of government support is required for it to proceed.

9. In relation to (a) above, the occupancy rate of the exhibition halls of the Hong Kong Convention and Exhibition Centre (HKCEC) is expected to reach 70%, normally regarded as the saturation point, by year 2006. At the moment, certain types of exhibitions, e.g. super heavy machinery and boat exhibitions could not be held at the HKCEC. It is considered that the new IEC should aim to cater for new events as well as those that the HKCEC could not accommodate, so as to allow differentiation between the two facilities.

10. In relation to (c) above, government support for major exhibition and convention facilities is not uncommon. The construction of the two phases of the HKCEC was subsidised. The old wing was paid for by giving to the Hong Kong Trade Development Council land at nil premium and allowing extensive commercial development including hotels, with the convention and exhibition centre being only part of the overall package. The construction cost of the extension (about \$4.8 billion) was borne by the Government. Internationally the position is the same. In Singapore and Kuala Lumpur, similar facilities are fully funded by the respective governments.

Proposal

11. Having had several rounds of negotiations, the Government and the AA have agreed on the following development parameters in respect of the proposed IEC:

- (A) The Government and the AA will enter into a joint venture, and will select a third party, by way of open international tender, to develop and operate the IEC.
- (B) Based on consultants' estimates, the construction cost of the new exhibition centre is estimated to be about \$4 billion, assuming an initial commitment to build a 50,000 m² facility either in one go or in two separate phases of development, i.e. 30,000 m² in Phase I and the balance in Phase II. The bidders will be asked to indicate which option they prefer.
- (C) The Government and the selected developer/operator consortium will jointly provide equity funding to finance the construction cost of the IEC.
- (D) The AA, in return for a 10% equity shareholding, will:
 - (i) contribute the land required, including reserve, in the first 10 years of the IEC's operation, land for ultimate expansion to a total net usable area of 80,000m²;
 - (ii) share with the Government, on a pro rata basis, the reversionary value of the facility up to June 2047;
 - (iii) forgo revaluation of the land during subsequent development phases of the IEC and upon expiry of the initial 25-year term;
 - (iv) lead the entire development process from inception through to

- completion;
- (v) plan for and secure the necessary infrastructure and transportation facilities to tie in with the commencement of the IEC's operation in 2005; and
 - (vi) cooperate with the management of the IEC to ensure successful operation of the new facility in attracting more new exhibitions to Hong Kong.
- (E) The developer/operator will be a single consortium selected by open international tender using the following evaluation criteria:
- (i) proposed rate of preferred return;
 - (ii) experience in operating world class exhibition centre;
 - (iii) track record in attracting new exhibition business;
 - (iv) robustness and quality of business plan, including demonstrated commitment to Hong Kong; and
 - (v) financial capability of the consortium members.
- (F) The selected consortium will obtain a preferred return on its investment as specified in the open tender. Any surplus of income over the preferred return will be distributed among the three parties according to their equity contribution ratio, but the consortium will have to re-distribute half of its share in this second slice to the Government and AA on the basis of their relative equity contribution ratio.

12. In addition, to promote competition in the provision of exhibition space, we consider that the management and operation of the IEC should be independent of that of the HKCEC. Such an arrangement should be conducive to the further growth of the local exhibition industry as a whole, through the provision of responsive service and competitive pricing. In this connection, we propose that the organisation / companies that are involved in the management of the HKCEC should be explicitly excluded from the tender exercise. However in assessing bidders' business plans, we will have regard to the extent to which they complement the services of the HKCEC in attracting more new exhibitions to Hong Kong.

Way forward

13. Subsequent to the announcement by the Chief Executive in his Policy Address, the proposal has received a welcoming response from the

business sector, key members of the HKECOSA, airlines, etc.

14. We plan to seek the Finance Committee's approval of the proposed government investment in December. We will collaborate with the AA and maintain dialogue with the exhibition industry in working to the following timetable:

2002	1 st Quarter	AA to conduct international road show.
	2 nd Quarter	AA to conduct tender exercise.
	end-year	Finalise the partnership agreement among the Government, AA and the private sector consortium.
2003	early-year	Start construction works.
2005	mid-year	New centre to open.

Commerce and Industry Bureau / Invest Hong Kong
6 November 2001

For discussion
on 21 December 2001

FCR(2001-02)50

ITEM FOR FINANCE COMMITTEE

CAPITAL INVESTMENT FUND

NEW HEAD - "NEW EXHIBITION CENTRE AT CHEK LAP KOK"

New Subhead "Equity in the International Exhibition Centre"

Members are invited to approve a new commitment to inject a maximum of \$2 billion from the Capital Investment Fund, to partly finance the construction cost of the new exhibition centre at Chek Lap Kok, in exchange for equity in a joint venture to be established to build and operate the centre.

PROBLEM

Without additional quality exhibition facilities, Hong Kong will lose competitiveness in capturing the growing exhibition business in the face of keen competition from major cities in the region. A proposal to develop a new exhibition centre at Chek Lap Kok (CLK), however, is not financially viable from an investment standpoint, and cannot proceed without financial support from the Government.

PROPOSAL

2. The Government plans to enter into a tripartite joint venture (the joint venture) involving the Government, a private sector participant, and the Hong Kong Airport Authority (AA) to develop and operate a new exhibition centre at CLK within the North Commercial District of the Airport (location map at the Enclosure). The Director-General of Investment Promotion (DGIP), with the support of the Secretary for Commerce and Industry, proposes that Members approve a new commitment to inject a maximum of \$2 billion from the Capital Investment Fund, to partly finance the construction cost of the new exhibition centre, in exchange for equity in the joint venture.

Encl.

/JUSTIFICATION

JUSTIFICATION

The need

3. The existing Hong Kong Convention and Exhibition Centre (HKCEC) is a highly successful convention and exhibition facility. The utilisation rate of its exhibition halls is expected to reach 70%, normally regarded as the saturation point, by year 2006. Moreover, the HKCEC currently cannot accommodate certain types of exhibitions, such as superheavy machinery and boat exhibitions, due to insufficient floor loading capacity and configuration constraints.

4. In response to the concern of the local convention and exhibition industry over the lack of competitive convention and exhibition facilities in Hong Kong, the Government commissioned a study on the provision of such facilities in Hong Kong. The consultancy study, completed in December 1999, concluded that, against a background of growing regional demand for exhibition facilities, a new exhibition centre of about 50,000 m² net usable area would be needed by 2005, and that CLK would be the most suitable location for it. The Government subsequently invited the AA to consider how to take the recommendation forward. In February this year, the AA put forward a proposal to form a tripartite joint venture to develop a new exhibition centre at CLK by 2005.

5. Having conducted reality checks on the key assumptions underlying the findings of the consultancy study and the AA's subsequent proposal, the Government is satisfied that :

- (a) to sustain Hong Kong's position as a prime destination of major exhibitions in the Asia-Pacific region and to enhance its competitiveness in capturing the growing exhibition business, Hong Kong needs to have an additional exhibition centre of 50,000 m² net usable area by 2005;
- (b) CLK is the preferred site for the new exhibition centre, and is the only site that can meet the 2005 target opening date;
- (c) the new exhibition centre will bring significant economic benefits to Hong Kong; and
- (d) while the new exhibition centre should be able to generate enough revenue to cover its operating costs, the projected investment return would be below the estimated cost of capital. The project would therefore not be viable from the investment standpoint and financial support from the Government is required.

/Funding

Funding arrangement

6. The Government and the AA will jointly select a participant from the private sector through an international bidding exercise. The Government and AA will form a joint venture with the selected participant to build and operate the new exhibition centre at CLK. This joint venture will be given a 25-year franchise to operate the centre.

7. The Government and the private sector participant will jointly finance the construction cost of the new exhibition centre, say on a 50:50 basis, in exchange for equity in the joint venture. In exchange for a 10% equity stake in the joint venture, the AA will contribute the site, time and money, and reserve for the first ten years of the centre's operation an additional piece of adjoining land to cater for the optional further expansion of the centre to 80,000 m². The AA will undertake not to revalue the additional land reserved for later stages of the centre's development, lead the international road show, manage the open bidding exercise through to completion, and be responsible for meeting all costs prior to tender award. During the 25-year franchise period, the selected private sector participant will be allowed to secure a return on its investment on a priority basis up to a preferred return rate specified in its bid. Any surplus of income above the preferred return will be distributed among the three parties according to their equity stake in the joint venture, but the private sector participant will have to re-distribute half of its share in this second slice to the Government and the AA on the basis of their relative equity share. At the end of the 25-year franchise period, the tripartite joint venture will be dissolved and the Government and the AA will share the reversionary value of the facility in accordance with their relative equity stakes.

Economic benefits

8. The new exhibition centre will enable Hong Kong to host a greater number and a wider range of exhibitions, reinforcing Hong Kong's position as an international trade and business centre, and as a trade fair capital in the region.

9. The proposed exhibition centre project is expected to bring substantial net economic benefit to Hong Kong, estimated at \$10.4 billion in present value over a 25-year period, with an economic rate of return of around 18% and a cost-benefit ratio of around 1:4.7. It will also promote tourism by attracting additional 80,000 visitors to Hong Kong by the tenth year and considerably more thereafter. According to the AA, a total of 3,500 jobs will be created during the construction of the new exhibition centre. When the new exhibition centre opens, it will directly employ about 150 staff, but many more employment opportunities will be created indirectly in support of activities held at the new centre and through tourism.

/Timetable

Timetable

10. The Government and the AA are working to the following timetable :

2002	1 st Quarter	AA to conduct international road show.
	2 nd Quarter	AA to conduct tender exercise.
	4 th Quarter	Finalise the joint venture agreement among the Government, the AA and the private sector participant.
2003	1 st Quarter	Construction works to start.
2005	2 nd Quarter	New centre to open.

FINANCIAL IMPLICATIONS

11. On the basis of an initial commitment to build a 50,000 m² exhibition facility either in one go or in two phases (i.e. 30,000 m² in Phase I and the balance in Phase II), we estimate the construction cost of the new exhibition centre to be about \$4 billion (at money of the day (MOD) prices). Under a two-phase scenario, the construction of Phase II would be triggered on the basis of a mechanism agreed among the joint venture parties beforehand. For example, it may be agreed that Phase II should become operational by the time occupancy rate of Phase I reaches 70% (forecasted for 2011), and allowing a two-year construction period, development of the Phase II would commence in early 2009. Bidders will be asked to indicate which option they prefer and their choice will be taken into account in the tender assessment.

/12.

12. A rough breakdown of the construction cost (at MOD prices) is as follows :

	Single-phase Development (\$ million)	Two-phases Development	
		Phase I (\$ million)	Phase II (\$ million)
Exhibition centre construction cost	2,100	1,360	1,110
Carpark construction cost	530	370	245
Infrastructure construction cost	170	110	70
Transportation facilities	110	110	-
Professional fees	230	150	110
Contingency	310	210	155
Total	3,450	2,310	1,690

13. Subject to Members' approval, we propose to invest a maximum of \$2 billion in equity in the joint venture in accordance with the cash flow needs of the construction of the centre. The forecast cash flow for capital injection is as follows -

	Single-phase Development (\$ million)	Two-phases Development (\$ million)
2002 – 03	85	55
2003 – 04	345	230
2004 – 05	950	640
2005 – 06	345	230
2008 – 09	-	85
2009 – 10	-	420
2010 – 11	-	340
Total	1,725	2,000

/CONTROL

CONTROL MECHANISM

14. The Government and the AA will form a working group to plan, implement and monitor the international road show and the tendering process.

15. Once a private sector participant has been selected, the Government, AA and the chosen private sector participant will form a joint venture, which will take over the responsibilities of planning and carrying out the construction and operation of the new exhibition centre. The Government will be represented on the Board of Directors of the joint venture to ensure proper monitoring of both the construction and the future operation of the centre.

ENVIRONMENTAL IMPLICATIONS

16. The proposed project is not a designated project controlled under the Environmental Impact Assessment Ordinance. The joint venture will be responsible for meeting any environmental requirements, if needed, to address the short-term impacts during construction, upon advice of the Director of Environmental Protection.

BACKGROUND INFORMATION

17. In the 2001 Policy Address, the Government announced that it would collaborate with the AA to develop a new exhibition centre at CLK. The business sector has generally responded positively to the initiative.

18. We consulted the Legislative Council Panel on Commerce and Industry on the proposed project on 12 November 2001. Panel members were generally supportive of the proposal.
