

## **For Information**

### **Legislative Council Subcommittee to Follow Up Issues Relating to the Three-Runway System at the Hong Kong International Airport**

#### **Follow-Up to Meeting on 7 February 2017 and Members' Joint Letter**

## **Introduction**

When discussing LC Paper No. CB(4)491/16-17(01) on the Airport Authority Hong Kong's ("AAHK") cost and financial arrangement plan of the Three-Runway System ("3RS") at the Subcommittee meeting on 7 February 2017, Members requested supplementary information on a number of issues. In addition, some Members asked for further information through a joint letter to the Chairman of this Subcommittee on 13 February 2017 (vide LC Paper No. CB(4)560/16-17(01)). This paper sets out the information requested.

## **Follow Up on Issues Raised at the meeting on 7 February 2017**

2. Members requested the following supplementary information at the meeting on 7 February 2017 :

- (a) similar to the Government's public works programme projects, the 10-year "snap-shot" cash flow figures of the 3RS project;
- (b) the ruling and action number of the judicial review cases with respect to, amongst other things, the financing arrangement of AAHK for funding the 3RS project;
- (c) how the outcome of the sensitivity tests on changes in revenue and construction cost of the 3RS project would be affected in the light of the recent downward trend of the money-of-the-day ("MOD") factors;

- (d) the form(s) of the construction contract adopted by AAHK for the 3RS project and the reasons for adopting such form(s) of contract; and
- (e) the updated annual growth of air passenger throughput of the Hong Kong International Airport (“HKIA”) projected by AAHK.

3. As explained at the meeting on 7 February 2017, AAHK has appointed The Hongkong and Shanghai Bank Corporation Limited (“HSBC”) as its financial advisor to study the Detailed Funding Plan for the 3RS. The study is expected to be completed by mid-2017. As part of HKIA’s next master planning cycle (i.e. Master Plan 2035), AAHK is also updating its traffic forecast, the results of which should be available in 2018. Accordingly, AAHK could provide substantive reply to the requests in paragraph 2(a) and (e) above only after these studies are completed, and as and when the necessary information is available.

4. As regards the request in paragraph 2(c) above, we have explained at the meetings on 5 December 2016 and 7 February 2017 that the Detailed Funding Plan for the 3RS will make detailed recommendations regarding the timing, size, tenor, etc. of the financing instruments required for raising the necessary funding for the 3RS project in the most optimal manner. Given that AAHK’s capacity in coping with the various downside scenarios has already been established in the HSBC 2015 Report, the current study will not conduct any further sensitivity analysis of the downside scenarios again. As regards the construction cost of the 3RS, it should be noted that the project spans over a period of eight years during which many factors, including the MOD factors, are bound to fluctuate. For planning purposes, we would maintain the construction cost of \$141.5 billion as the reference cost and we would strive to complete the project on time and within that budget.

5. The information requested in paragraph 2(b) and (d) is set out in paragraphs 6 to 7 below.

**(a) The ruling and action number of the judicial review cases**

6. AAHK reported to this Subcommittee at the meeting on 7 February 2017 that the ruling of the High Court handed down with respect to three judicial review cases, (i.e. HCAL 99/2015, HCAL 102/2015 and HCAL 104/2015) in March 2016 affirmed AAHK’s power granted by the Airport Authority Ordinance (“AAO”) (Chapter 483) to

charge the Airport Construction Fee (“ACF”). The full judgement can be found at: [http://legalref.judiciary.gov.hk/lrs/common/search/search\\_result\\_detail\\_frame.jsp?DIS=103172&QS=%2B&TP=JU](http://legalref.judiciary.gov.hk/lrs/common/search/search_result_detail_frame.jsp?DIS=103172&QS=%2B&TP=JU).

**(b) The form(s) of the construction contract for the 3RS project**

7. AAHK has an established set of conditions of contract for construction of airport infrastructure works; these conditions have been used for airport projects since the construction of the Chek Lap Kok Airport in the 1990s. The conditions of contract have proven to be effective. For the 3RS project, an independent contract consultant has been engaged by AAHK who confirmed that the current form of contract remained suitable for the 3RS project. However, AAHK will explore the potential use of the New Engineering Contract form of contract, in future, where appropriate.

**Other Issues Raised in Members’ Joint Letter**

8. Members also asked for additional information relating to AAHK’s credit rating as discussed in the two reports prepared by HSBC separately in 2011 and 2015 (vide LC Paper No. CB(4)560/16-17(01)).

9. Before going into detailed answers to the questions raised, it would be useful to clarify the background and different purposes of the two HSBC Reports.

10. The “HKIA Airport Master Plan 2030 Financial Feasibility Assessment – Financial Advisor Report”, commonly referred to as the “HSBC 2011 Report”, was conducted in the context of the HKIA Master Plan 2030. The study compared the relative financial feasibility between the two-runway system (“2RS”) and the 3RS scenarios on the basis of AAHK’s prevailing financial position at that time, i.e. in 2011, before considering any additional revenue stream and/or borrowing, and hence the funding gaps for both scenarios, for consideration if 2RS or 3RS should be pursued.

11. In contrast, the “3RS Consultancy Study, Financial Arrangement for 3RS at HKIA – Financial Advisor Report”, commonly referred to as the “HSBC 2015 Report”, was conducted after the 3RS scenario was determined as the development option for HKIA. The primary objective of the study is to look into a possible financial

arrangement plan for the implementation of the 3RS project. The study updated the cost of the 3RS, HKIA's operating surplus based on updated traffic forecast as well as new revenue stream (e.g. the levy of ACF). The recommended funding arrangement plan has also looked into the proposed debt/borrowing levels having regard to AAHK's dividend policy. In conclusion, the study provided a professional opinion on the robustness of the recommended funding arrangement plan and the compliance with AAO.

12. Both the 2011 and 2015 Reports have conducted sensitivity analysis of five downside scenarios but they are for very different purposes. The analysis of the potential impact on AAHK's credit ratings in the 2011 Report was to illustrate the varying limitations of AAHK's ability in raising additional debt between the two development options (i.e. 2RS and 3RS scenarios). On the other hand, the sensitivity analysis of the 2015 Report was conducted to confirm the robustness of the recommended financial arrangement plan for 3RS.

13. With the clarification above, AAHK's consolidated responses to questions 1 to 4 in LC Paper No. CB(4)560/16/17(01) are set out below.

**(a) Anticipated Changes to AAHK's Credit Rating under the Working Case Scenario (Question 1)**

14. The "underlying credit rating" of AAHK represents Standard and Poor's ("S&P") evaluation of AAHK's business and financial position, while the "actual credit rating" reflects S&P's combined view on the underlying credit rating and its assessment of the impact of the Government's 100% ownership of AAHK. It is the actual rating, rather than the underlying rating, that determines the ability of an issuer in raising debt at a competitive cost.

15. AAHK's actual rating is identical to the sovereign rating of Hong Kong, which is currently at AAA by S&P. AAHK's financial advisor has opined that, on the basis that the actual credit rating reflects the Government's 100% ownership of AAHK, AAHK is expected to retain an actual rating the same as Hong Kong's sovereign rating throughout the construction period under the Working Case. In short, even though the Government is not required to provide any forms of financial guarantees to AAHK, the expected strong actual rating will stand AAHK in good stead to raise the required funding on reasonable terms.

**(b) Basis for AAHK to Maintain Investment Grade under the Downside Scenarios (Questions 2 and 3)**

16. Answer to (a) above explains the basis of AAHK's strong credit rating. It is on that basis that AAHK's financial advisor considers that AAHK can expect to retain a strong actual rating even in the event that AAHK needs to raise additional debt to fund the hypothetical severe downside scenarios on reasonable terms as described in the 2015 Report.

17. Given AAHK's strong actual rating which ultimately determines the ability to raise debt on competitive terms, the 2015 Report has not discussed the underlying rating of AAHK under the five hypothetical downside scenarios. Hence, no such information was provided in the report.

18. Should AAHK be required to raise additional debt to meet shortfalls under the five downside scenarios, it could resort to a wide spectrum of possible third party financing available in the financial market, such as commercial bank loans, institutional bonds, retail bonds, etc., without requiring any forms of financial guarantees from the Government.

**(c) Provision of the Study of the Detailed Funding Plan (Question 4)**

19. As explained in paragraph 3 above, the study of the Detailed Funding Plan is expected to be completed by mid-2017. Upon its completion, the financial advisor will submit to the Board of AAHK a report with their recommendation on the suitable financing instruments in relation to timing, size, tenors etc. for funding the 3RS project. After considering all the relevant factors, the Board will determine whether and to what extent the recommendation of the financial advisor would be adopted by AAHK. The Board will then decide on the most appropriate arrangement for publishing the report with due consideration of Members' request and the commercial sensitivity of information contained in the report.

## **Advice Sought**

20. Members are invited to note the supplementary information set out in this paper.

**Airport Authority Hong Kong**  
**March 2017**