

**For Discussion  
on 29 September 2017**

**Legislative Council Subcommittee  
to Follow up Issues Relating to the  
Three-Runway System at the Hong Kong International Airport  
  
Detailed Funding Plan for the Three-Runway System**

**Introduction**

1. This paper briefs Members on the detailed funding plan for the Three-runway System (“3RS”) project.

**Background**

2. At the meeting on 7 February 2017, Members noted, vide LC Paper No. CB(4)491/16/17(01), that in devising the overall financial arrangement plan for the 3RS project which is estimated at \$141.5 billion in money-of-the-day (“MOD”) prices, the Airport Authority Hong Kong (“AAHK”) has proposed to fund the 3RS through three funding sources, namely : (a) retaining AAHK’s operating surplus; (b) levying an Airport Construction Fee (“ACF”); and (c) borrowing/ raising funds up to an estimated \$69 billion from the market. The breakdown of these three funding sources is set out at **Annex A**. In the financing of the 3RS, AAHK does not require any form of financial backing or guarantee from the Government.

3. In December 2016, AAHK appointed The Hongkong and Shanghai Banking Corporation Limited (“HSBC”) as its financial advisor to conduct a study on the detailed funding plan. The objective of the study is to analyse different debt structures, identify suitable forms of financial instruments, and make recommendations on the financial instruments in relation to their timing, size, tenor etc., that will enable AAHK to raise funding for the 3RS project in the most optimal manner. The detailed funding plan was recently completed and has been made available at AAHK’s webpage (<https://www.threerunwaysystem.com/en/information/publications/3rs-detailed-funding-plan/3rs-detailed-funding-plan-report/>). The main findings of the above funding plan are summarized in this paper.

## **Key Funding Objectives and Approach**

4. HSBC recommends the following key objectives and approach in developing the 3RS detailed funding plan : -

- (a) raise debt on cost-effective terms (including tenors) that are consistent with AAHK's investment plans and funding needs;
- (b) allow flexibility in the timing of market approach, by maintaining sufficient committed but undrawn bank facilities, and ensuring that the current multi-currency Medium Term Note ("MTN") programme<sup>1</sup> will be in place and suitably upsized to facilitate swift issuance of bonds;
- (c) examine all potential forms of financing to reduce over-reliance on a single funding source;
- (d) engage closely with relevant rating agencies, investors and banks to ensure that the strength of AAHK's operation is well recognized, so as to secure funding on competitive terms; and
- (e) minimize the refinancing risk and manage financial risk exposure at a reasonable cost.

## **Analysis of Available Financial Instruments**

5. On the basis of the above, HSBC conducted a comprehensive analysis of the debt market conditions and a broad spectrum of financial instruments available.

6. HSBC has noted that following the quantitative easing ("QE") initiatives introduced during the 2008/2009 financial crisis and its aftermath, liquidity has been high in debt markets in recent years, including the Hong Kong bank loans and international bonds markets which are expected to be the key funding sources for AAHK. Notwithstanding the expectation of the managed reversal of QE and other

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<sup>1</sup> The MTN programme allows AAHK to raise funds in the international institutional market. The multi-currency feature of the programme enables AAHK to issue notes in major currencies (such as Hong Kong dollars, US dollars, Australian dollars, pound sterling, euro, Japanese yen etc.).

political uncertainties around the globe, debt markets have remained open and strong. Against this backdrop, HSBC expects that debt market volumes in 2017 would exceed the strong volumes in 2016.

7. In summary, HSBC is confident that AAHK will be able to raise the required debt of up to \$69 billion on competitive terms, for two major considerations. First, the total debt market capacity is substantially in excess of AAHK's funding needs. Both the bank loan and debt capital markets have sufficient liquidity to fund the incremental debt required by AAHK. Secondly, operating on prudent commercial principles under the Airport Authority Ordinance, AAHK has a good track record of raising debts to finance its operation and enjoyed access to a wide range of financing options, including bank loan and bond markets. Given AAHK's financial capability, its 100% ownership by the Government and its excellent credit rating, HSBC believes that AAHK could retain strong access to the debt market in the foreseeable future.

8. The analysis of the various financial instruments available is set out below –

**(a) Commercial Bank Loans**

9. The Hong Kong Dollar (“HKD”) loan market currently offers deep liquidity to borrowers, with \$349 billion of loan executed in Hong Kong in 2016 and \$269 billion in the first half of 2017. Banks are expected to have a strong appetite to lend up to five years at competitive costs to high investment grade issuers like AAHK.

**(b) Institutional Bonds**

10. The United States Dollar (“USD”) bond market which is the largest bond market, is expected to offer substantial liquidity from US as well as international investors. USD bond issuance in Asia ex-Japan<sup>2</sup> totalled \$1,416 billion in 2016 and \$1,175 billion in the first half of 2017. Given the longer tenor debt financing available which helps reduce the refinancing risk, USD bonds are anticipated to be a core element of AAHK's funding plan. AAHK last issued a USD bond in 2003 which matured in 2013. AAHK has a good track record of issuing HKD bonds in the past. However, as the capacity of HKD bond market is not as liquid as

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<sup>2</sup> Asia ex-Japan refers to all regions in Asia with the exception of Japan. It is a key market standard metric by which issuers and investors in the region measure bond market activity.

that of the USD bond market, the issuance size of HKD bond is expected to be significantly smaller than that of USD bond.

**(c) Green Bonds**

11. The green bond market has grown rapidly in recent years, with global issuance of green, social and sustainability bonds totalling \$780 billion in 2016 and reaching \$499 billion in the first half of 2017. Green bonds could be offered at competitive pricing in the market with equally favourable terms as that of conventional institutional bonds. Issuing green bonds can also offer AAHK a way to showcase its green credentials and appeal to investors who are increasingly focused on environmental issues. With the range of green and sustainable features incorporated into the design, construction and operational aspects of the 3RS project, there are a number of assets, for example, the Third Runway Passenger Building (estimated at a cost of \$26 billion in MOD prices) etc., which can potentially be qualified for green bond financing.

**(d) Retail Bonds**

12. A retail bond from AAHK would attract strong demand from the local retail investor base and allow the general public to participate in, and take home financial benefits arising from investment in the 3RS project. However, as the interest costs associated with a retail bond is more expensive than borrowing from the bank and institutional bonds markets, retail bonds should represent a smaller portion of the overall funding.

**(e) Revolving Credit Facilities**

13. Maintaining revolving credit facilities is considered important for AAHK to provide standby liquidity in case capital expenditure of the 3RS is faster than expected or if the capital markets are unattractive for a period of time. AAHK signed a five-year \$5 billion revolving credit facility in December 2015 with 21 local and international banks at a very competitive price. This clearly demonstrated AAHK's ability to obtain funding from the market on very competitive terms. As the revolving bank facilities serve to provide liquidity and are only drawn on a temporary basis, they do not form part of the core debt funding requirement for 3RS.

**(f) Export Credit Facilities**

14. Export Credit Facilities can be used to finance AAHK's purchase of large equipment or services for 3RS project from overseas suppliers. The Export Credit Agency ("ECA") from the country of origin of suppliers would typically provide a guarantee or insurance to commercial banks that lend to AAHK to fund such purchase. Export Credit Facilities would therefore provide AAHK with an opportunity to obtain longer term bank loans (e.g. up to a 13-year bank loan covering the 8-year 3RS construction period plus a 5-year repayment period) at competitive costs. However, the application of export credit financing would be limited to major equipment and services sourced from countries that can offer ECA supported financing and AAHK should compare the cost against the terms of other sources of funding.

**General Principles of the Detailed Funding Plan**

15. HSBC has laid out some general principles for governing the selection and mix of financial instruments, as follows –

- (a) bonds should represent a significant component of the 3RS detailed funding plan. In particular, given the depth and very liquid USD international bond market, AAHK should consider issuing long-tenor USD bonds (e.g. 10 years) in the earlier years of the detailed funding plan and 3RS construction period to reduce any need to refinance the debt prior to project completion, and to establish a long-dated USD benchmark to facilitate price transparency for future issuance;
- (b) a retail bond offering towards the start of the AAHK's funding timetable would facilitate public engagement in the project from an early stage and strengthen public support for the 3RS;
- (c) revolving bank facilities with sufficient headroom should be maintained to meet any potential unexpected liquidity requirements and allow flexibility in timing market approaches; and
- (d) shorter-dated USD, HKD or other foreign currencies bonds (with tenors of five to seven years) and HKD bank loans (with tenors up to five years) are more appropriate for the later

years of the 3RS project to match the expected cash flow and create an appropriate overall debt maturity profile.

## **Recommended Detailed Funding Plan**

16. HSBC's recommended detailed funding plan can be divided into three parts :

- (a) Preparatory work (from now until the end of first half of FY2018/19)
  - (i) ensure that the current MTN programme is kept up to date and suitably upsized as appropriate;
  - (ii) provide updates to credit rating agency;
  - (iii) prepare for compliance with the Equator Principles<sup>3</sup> to facilitate best access to commercial bank funding;
  - (iv) develop the necessary Green Bond framework and guidelines so that AAHK is ready for the issuance of bonds in green format; and
  - (v) prepare investor marketing materials and conduct non-deal road shows to increase AAHK's appeal to investors. HSBC recommends AAHK to consider some preliminary investor engagement to ensure potential bond investors are kept up to date on AAHK's 3RS development.
- (b) Near term funding activities (from second half of FY2018/19 to FY2019/20)
  - (i) issue longer-dated 10-year USD bonds to institutional investors (e.g. a benchmark transaction of USD500 million or HKD4 billion equivalent under the MTN programme);

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<sup>3</sup> The Equator Principles is a risk management framework, adopted by financial institutions for determining, assessing and managing environmental and social risk in projects and is primarily intended to provide a minimum standard for due diligence to support responsible risk decision making.

- (ii) issue an appropriately-sized offering of HKD retail bond (e.g. \$5 billion with a three-year tenor). AAHK may also coordinate with the Government's retail bond offering program to ensure that both timing and terms are appropriate and optimized; and
  - (iii) increase the size of AAHK's existing \$5 billion revolving bank facility, which is largely undrawn, up to \$10 billion, or arrange multiple facilities.
- (c) Medium term funding activities (from FY2020/21 to 3RS project completion)

Subject to the prevailing market conditions, expenditure profile as well as debt requirements at the time, the exact issuance size and timing of each financing instrument during this period may vary. The following plan provides some general guidance for different debt instruments :

- (i) raise HKD bank loans with tenors of up to five years and individual target sizes of up to \$10 billion or potentially larger per issuance, with a total issuance of up to \$20 to \$30 billion over the medium term;
- (ii) issue shorter-dated USD or other foreign currency bonds, with tenors of five to seven years and individual issuance sizes of up to \$10 billion (in HK\$ equivalent) per issuance, with a total issuance of up to \$29 billion (in HK\$ equivalent) over the period. Some bonds may be in green format, up to the amount equal to eligible green investments of AAHK; and
- (iii) tap long-dated, fixed rate HKD bond market when pricing is attractive through multiple issues under the MTN programme, with a total issuance of up to \$10 billion over the medium term.

As it is impossible to forecast precisely how the macro-economic and debt market conditions would pan out throughout this period, the above package has been designed with the necessary flexibility to cope with the changing situation.

17. The indicative implementation timeline of the detailed funding plan and the indicative range of cumulative incremental debt balance are set out in **Annex B** and **Annex C** respectively.

## **Financial Risk Management**

18. AAHK will, on an ongoing basis, identify, assess and mitigate to the extent necessary, the following financial risks involved in implementing the 3RS detailed funding plan :

- (a) risks that the financing is not available or is at a significantly higher cost than expected – this can be mitigated by securing funding or funding commitments in advance of the time when the debt is actually required through bond issuance and bank loan. AAHK may also maintain sufficient undrawn funding commitments to provide liquidity;
- (b) risks that the benchmark rates<sup>4</sup> to which the overall cost of debt is linked and/or credit spread increase during the period – this can be mitigated by locking in benchmark rates in advance of an actual debt raising through the use of hedging instruments;
- (c) interest rate exposure arising from floating rate debt instruments – AAHK currently adopts a policy of ensuring that between 40% and 60% of its borrowings are effectively on a fixed rate basis. Given the large quantum of debt and relatively long tenor of some borrowings, HSBC recommends AAHK to maintain a higher proportion of debt on a fixed rate basis either through debt contractual terms or a prudent hedging strategy through the use of interest rate swaps or caps; and
- (d) foreign currency exposure arising from any debt denominated in non-HKD – AAHK’s major revenues are denominated in HKD and the funding plan contemplates raising a major component of debt in USD. As HKD and USD are pegged, the currency risk is manageable. However, for bond issued in

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<sup>4</sup> Bonds are typically priced relative to a benchmark. Common pricing benchmarks are U.S. Treasuries. Many bonds are priced relative to a specific Treasury bond. For example, the 10-year Treasury may be used as the pricing benchmark for a 10-year corporate bond issue.



foreign currencies, AAHK may consider using currency swaps, forwards, etc., to hedge any volatility of foreign currency rate fluctuations.

## **Conclusion**

19. HSBC concludes that AAHK has strong access to debt markets and is confident that AAHK will be able to raise the required incremental debt of up to \$69 billion on reasonable terms, and that the recommended detailed funding plan is robust and practicable.

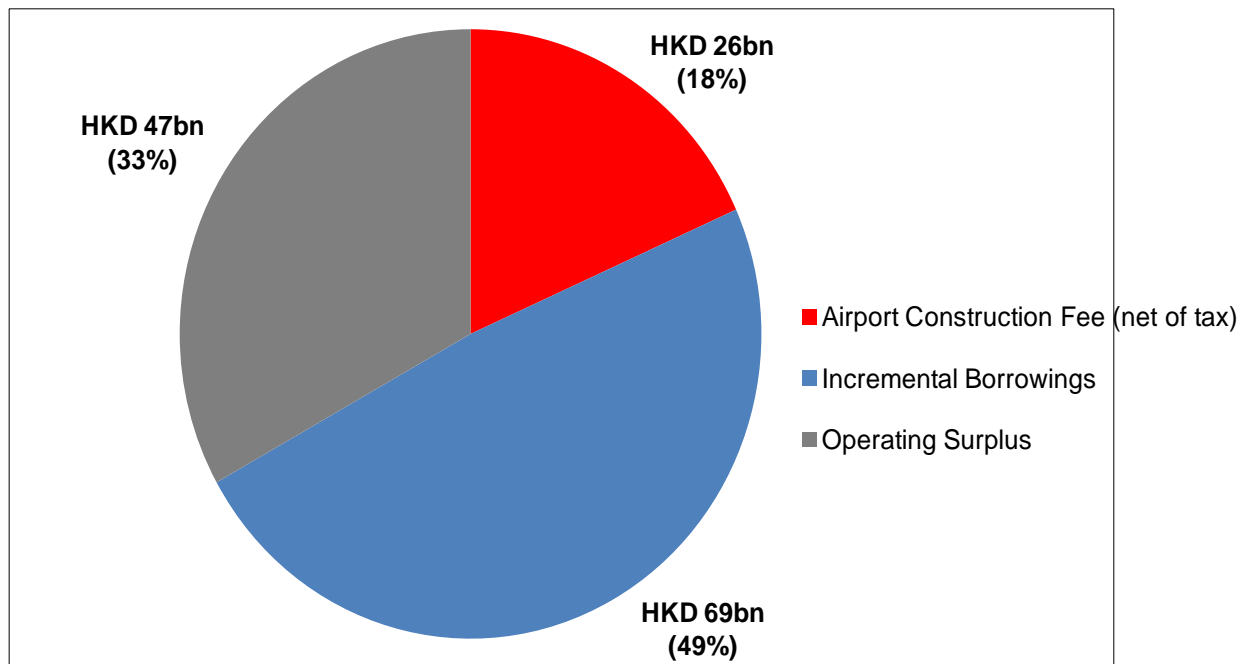
20. The 3RS detailed funding plan is indicative only and prepared on the basis of the current market situation and funding requirements. During the course of the 3RS project, AAHK will review the plan regularly and fine-tune it in the light of a whole host of changing factors (e.g. the debt quantum, timing, market conditions, interest rate outlook, and liquidity across the range of financial instruments and financial risk management, etc.). AAHK will execute the detailed funding plan in accordance with its prudent financial management principles and as the market allows.

## **Advice Sought**

21. Members are invited to note the content of this paper.

**Airport Authority Hong Kong  
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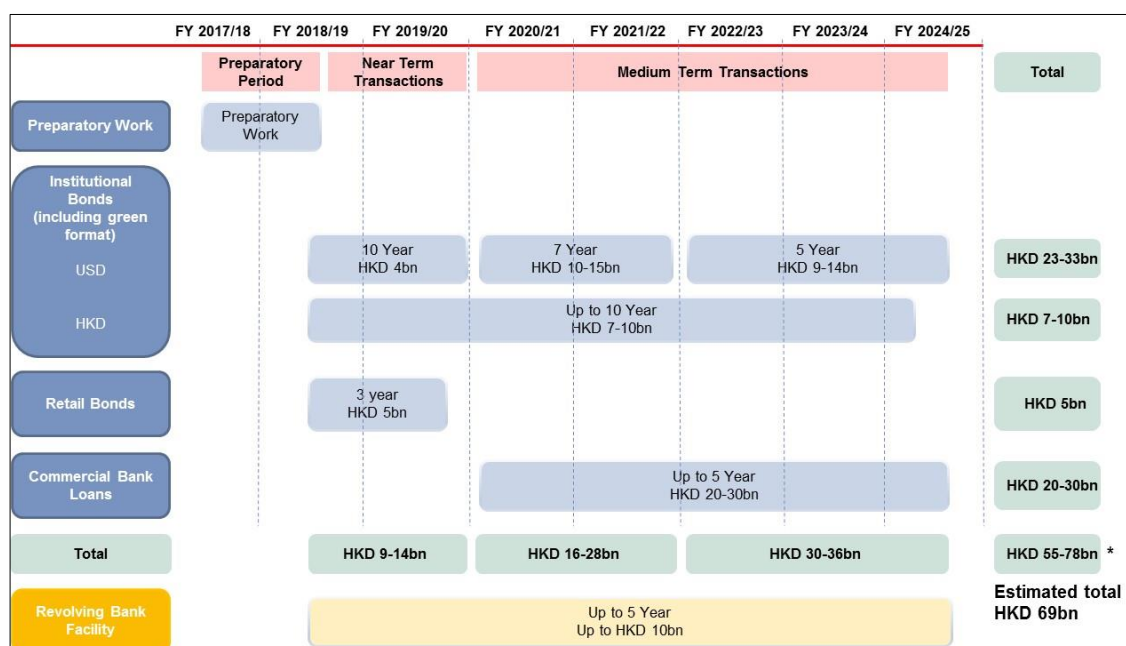
Breakdown of 3RS Funding Sources



Source: AAHK, 3RS Consultancy Study: Financial Arrangement Plan for Three-runway System (3RS) at HKIA – Financial Advisor Report, HSBC (2015)

Note :  
The numbers above are subject to rounding.

**The Detailed Funding Plan and Indicative Implementation Timeline**



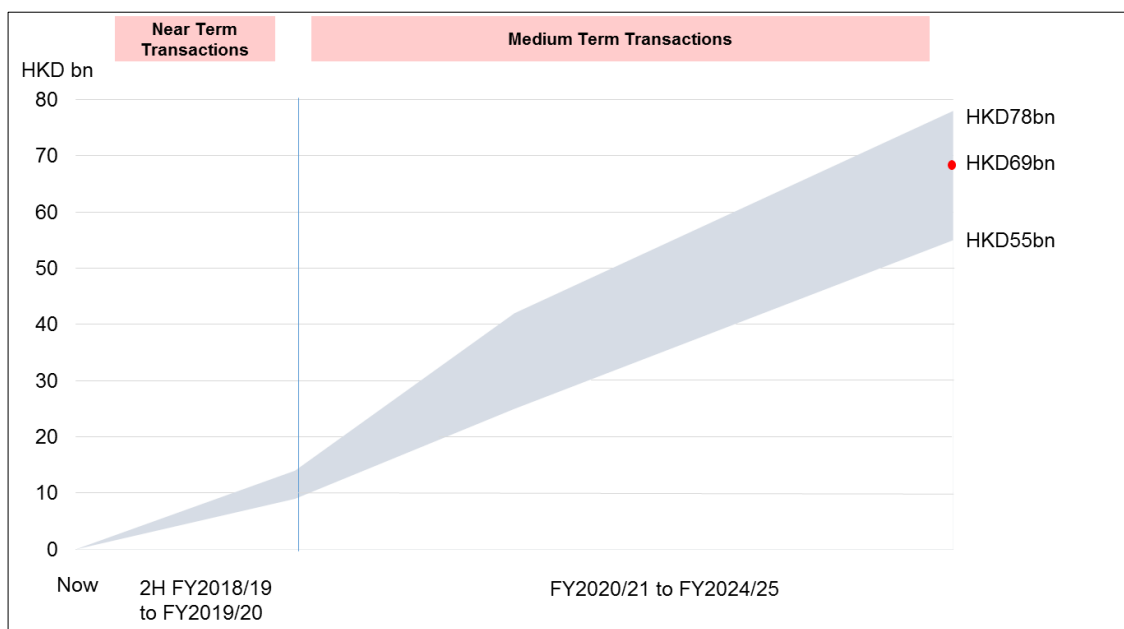
Source: AAHK, 3RS Consultancy Study: Detailed Funding Plan for Three-runway System (3RS) at HKIA – Financial Advisor Report, HSBC (2017)

**Notes :**

1. Revolving bank facilities serve to provide liquidity only and do not form part of the core debt funding required for the 3RS.
2. As market conditions and the terms of different instruments would vary from time to time, ranges indicating the potential issuance sizes for each debt instrument in the medium term are used to provide flexibility for AAHK to optimize the choice of instruments closer to the time of fund raising.
3. For the avoidance of doubt, the total aggregate debt issuance across all instruments in the recommended funding plan is not expected to exceed the debt requirement to fund the 3RS.
4. \$55-78 billion represents the summation of the lowest and highest range of each debt instrument type.

**Indicative Range of Cumulative Incremental Debt Balance**

The graph below shows the cumulative incremental debt balance according to the schematic graph in **Annex B**.



**Note :**

\$55-78 billion represents the summation of the lowest and highest range of each debt instrument type in **Annex B**.