

## **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**

Encl. 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.

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

**FINANCIAL IMPLICATIONS**

11. On the basis of an initial commitment to build a 50,000 m<sup>2</sup> exhibition facility either in one go or in two phases (i.e. 30,000 m<sup>2</sup> 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
<b>Total</b>	<b>3,450</b>	<b>2,310</b>	<b>1,690</b>

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
<b>Total</b>	<b>1,725</b>	<b>2,000</b>

/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.

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### Location of the Proposed New Exhibition Centre at Chek Lap Kok

