

LEGISLATIVE COUNCIL BRIEF

MASS TRANSIT RAILWAY PENNY'S BAY RAIL LINK PROJECT AGREEMENT

INTRODUCTION

At the meeting of the Executive Council held on 9 July 2002 the Council ADVISED and the Chief Executive ORDERED that the draft Penny's Bay Rail Link (PBRL) Project Agreement (the Project Agreement) should be approved in principle for execution subject to any drafting changes to the Project Agreement which may be necessary before execution.

BACKGROUND AND ARGUMENT

Government's obligation under the Hong Kong Disneyland Master Project Agreement

2. Under the Master Project Agreement (MPA) entered into by the Government, The Walt Disney Company and Hongkong International Theme Parks Limited^[1] (HKITP) in 1999 on the development of a Disney-branded theme park to be known as "Hong Kong Disneyland" (HKD) and associated and supporting infrastructure at Penny's Bay, Lantau Island, the Government will procure a rail shuttle service between Yam O and HKD.

^[1] This is the joint venture company set up by Government and The Walt Disney Company to build and operate Hong Kong Disneyland. Government owns a 57% share of HKITP and The Walt Disney Company 43%

Previous Executive Council decisions

3. On 16 November 1999 the Executive Council took note of the Administration's undertaking to contract with a railway operator to provide the PBRL. On 16 January 2001 the Executive Council authorized the Mass Transit Railway PBRL scheme which provides for an approximately 3.5 km long, single-track system, connecting the existing Tung Chung Line at Yam O, and a station at HKD.

The Project Agreement

4. The draft Project Agreement sets out how the PBRL project will be undertaken, and the respective obligations of Government and MTRCL for the design, construction, operation and financing of the PBRL. The estimated capital cost of the PBRL is \$2 billion (in money of the day).

5. Broadly speaking, the draft Project Agreement :-

- (a) fixes the scope of works of the PBRL, which MTRCL will plan, design and construct in consultation with HKITP to ensure compatibility with the overall technical and aesthetic design of HKD;
- (b) obliges MTRCL to work in accordance with a Baseline Programme, which shall be reviewed on a monthly basis to ensure that the PBRL will be completed and operating by the Scheduled Operating Date on 1.7.2005;

- (c) sets the conditions under which MTRCL can seek deferrals to the Scheduled Operating Date (i.e. when there is a delay caused by an agreed change in the scope of work; or by a failure of Government to discharge its obligations under the PA; or by an event of force majeure);
- (d) obliges Government to complete relevant supporting public infrastructure works relating to sites to be handed over to MTRCL and to hand over such sites to MTRCL according to an agreed schedule and provides an indemnity to MTRCL in case Government fails to meet such obligations;
- (e) provides for the land required for the operational railway to be leased to MTRCL by means of a Supplemental Lease to the Running Line Lease for the Lantau and Airport Railway (MTR Lot No. 2);
- (f) obliges MTRCL to comply with all requirements in the environmental permit issued under the Environmental Impact Assessment (EIA) Ordinance (Cap 499) and the relevant environmental protection legislation;
- (g) sets out the Government's agreement to waive its claim for \$798 million (at present value) worth of dividends otherwise payable by MTRCL to the Government as a shareholder in order to fill the funding gap identified;

- (h) provides for an increase in the size of the funding gap identified and to be filled by further dividend waiver by up to \$5 million per month (at present value) in the event that opening of HKD is more than three months after its target completion date of October 2005, up to a period of 12 months;
- (i) provides an indemnity to MTRCL in the event that opening of HKD is more than one year after its target completion date of October 2005;
- (j) provides that MTRCL's sole liability would be to procure the provision of adequate bus services at a level commensurate with the anticipated number of guests at HKD if it fails to complete the PBRL on time;
- (k) allows both parties to be relieved of liability for failure to perform their obligations under the project agreement in the event of force majeure; and
- (l) sets out Government's intention with respect to the level of franchised bus services serving HKD and obliges the Government to consult MTRCL before raising the level of bus services.

Details of the more important aspects of the project agreement are further elaborated below :-

Financing Arrangements

6. On a standalone basis, it is estimated that the PBRL will generate a less than commercial rate of return (this is defined in the MTR IPO Prospectus as being between 1% to 3% above the cost of capital of MTRCL). To bring the project rate of return to a minimum acceptable commercial level of 11.25%, it has been estimated that Government support to fill a funding gap of \$798 million (in present value) is required. In order to close the funding gap, Government has agreed to waive its claim for \$798 million (at present value) worth of dividends otherwise payable by MTRCL to Government as a shareholder over the next few years.

Completion Date of the PBRL

7. HKD is targeted to open in 2005. All government works are programmed towards a target completion date of HKD in October 2005. To tie in with this target and to cater for interfaces between government works and PBRL construction works, the corresponding target completion date of PBRL is set at July 2005. The Project Agreement has therefore set the Scheduled Operating Date of the PBRL at 1 July 2005.

Indemnity in relation to the Opening Date of HKD

8. Given the Scheduled Operating Date of the PBRL at 1 July 2005, and since HKD is the major source of patronage for PBRL, MTRCL has a legitimate concern about the actual opening date of HKD. To address MTRCL's concern and to avoid exposing the government to undue risk, the Project Agreement provides for the financing arrangements described in paragraph 5(g) above to be extended to cover a

period of nine months, beyond the initial three-month period which would be absorbed by MTRCL. MTRCL has estimated that if HKD is not opened three months beyond the target completion date, the monthly net loss it would suffer is about \$5 million (at present value). In other words, the funding gap to be filled will be enlarged by up to \$45 million (in present value) if HKD is not opened for as much as one year beyond the target completion date. The risk of fixing a target date for completion of HKD beyond October 2006 is considered remote. The indemnity clause would only apply thereafter.

Land Matters

9. On land acquisition, MTRCL will be required to bear all land acquisition and related costs, including the costs incurred by Lands Department in connection with the project. Land required for the operation of the PBRL will be granted to MTRCL under a Supplemental Lease to the Lantau and Airport Railway Running Line Lease. A nominal premium is proposed and MTRCL will pay an annual rent equivalent to 3% of the ratable value from time to time of the land. The Supplemental Lease will essentially make the PBRL a part of the Lantau and Airport Railway from the point of view of land ownership and tenure.

10. Grant of works areas in relation to the project would be by way of tenancies at the standard tenancy rates or the cost of making such land available to MTRCL, whichever is the greater. The rental payable for the land required for the purpose of railway construction (other than works areas) will be nominal.

Design, Construction and Operation

11. To ensure compatibility with the overall technical and aesthetic design of HKD, HKITP will be fully consulted on the design, construction as well as operational details of the PBRL. After completion of the PBRL, MTRCL will be required to operate and maintain the railway for the Franchise Period up to June 2050.

FINANCIAL AND STAFFING IMPLICATIONS

12. A total funding of \$13.74 billion in money-of-the day prices for the development of the Penny's Bay, which includes government reclamation, infrastructure works and entrustment works mentioned in the Project Agreement, has already been secured under Public Works Programme Item No. 5662CL, 5322WF, 5687CL, 5697CL, 5740TH and 5779TH. The work of executing the Project Agreement and monitoring the construction of the PBRL can be absorbed within existing resources allocated to various Government bureaux and departments. No additional staffing resource is required for the implementation of this project. All land acquisition and related costs including but not limited to Land's Department staff costs arising from the implementation of the project will be borne by MTRCL and have been included in the estimated project costs. To implement the financing arrangements as described in paragraph 5(g) and (h) above, Government will also waive its claim for a minimum of \$798 million worth (at present value) of dividend otherwise payable by MTRCL to the Government as a shareholder.

ECONOMIC IMPLICATIONS

13. The implementation of the PBRL will provide ready access to HKD and associated facilities, which are expected to strengthen Hong Kong's position as a major tourist destination in Asia and generate a net economic benefit in present value terms of \$148 billion over 40 years. The railway scheme itself will also generate employment opportunities during both the construction and operation of the railway.

ENVIRONMENTAL IMPLICATIONS

14. An EIA study for the proposed HKD and its associated infrastructure including the construction and operation of the PBRL was completed in March 2000. In essence, the EIA stated that all these works would meet the established environmental standards and legislation after the implementation of the recommended mitigation measures during the construction and operation stages. Environmental monitoring and audit programmes have also been recommended for the construction of the PBRL.

15. The EIA study was endorsed with conditions by the Advisory Council on the Environment on 17 April 2000 and approved by the Director of Environmental Protection on 28 April 2000 under the Environmental Impact Assessment Ordinance. MTRCL will comply with all the conditions in the relevant environmental permits for the construction and operation of the PBRL.

SUSTAINABILITY IMPLICATIONS

16. Given its relatively small scale, the proposed PBRL itself should not have major sustainability implications. It will provide an environmentally friendly and efficient rail shuttle service for visitors going to and from HKD, which will bring about substantial tourism development and associated employment opportunities.

PUBLIC CONSULTATION

17. The PBRL scheme is based on the Recommended Outline Development Plan under the Northshore Lantau Development Feasibility Study, which was endorsed by the Committee on Planning and Land Development at its meeting on 6 July 2000 and generally supported by the Tsuen Wan District Council (TWDC) and Islands District Council (IsDC) during the consultations held in March 2000. The PBRL scheme was presented to the IsDC in May 2000 and an information paper on the railway scheme was circulated to the TWDC in June 2000. Members of the two District Councils made no adverse comment on the Scheme.

PUBLICITY

18. A press release will be issued after the closing of the stock market on the same day. A spokesman each from the Environment, Transport and Works Bureau and the Financial Services and the Treasury Bureau will be available to answer media enquiries.

SUBJECT OFFICER

19. The subject officer is Ms Ava Chiu, Principal Assistant Secretary for the Environment, Transport and Works (Transport and Works).

Environment, Transport and Works Bureau

9 July 2002

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