

## **ITEM FOR FINANCE COMMITTEE**

### **CAPITAL INVESTMENT FUND**

### **NEW HEAD "INTERNATIONAL EXHIBITION CENTRE AT HONG KONG INTERNATIONAL AIRPORT"**

### **New Subhead "Equity in the International Exhibition Centre"**

Members are invited to approve a new commitment to inject \$2 billion from the Capital Investment Fund, to partly finance the construction cost of the international exhibition centre at Hong Kong International Airport, in exchange for equity in the centre.

### **PROBLEM**

For Hong Kong to retain its leadership position as a hub for international exhibitions in Asia and to enhance its competitiveness in capturing the growing exhibition business in the face of keen competition from other major cities in the region, it is essential that we develop further quality exhibition facilities as soon as possible. A proposal to develop a new international exhibition centre (IEC) at Hong Kong International Airport (HKIA), however, is not financially viable from an investment standpoint, and cannot proceed without financial support from the Government.

### **PROPOSAL**

2. The Government, along with the Hong Kong Airport Authority (AA), plans to enter into a joint venture with a private sector participant to develop and operate a new exhibition centre within the North Commercial District of HKIA (location map at the Enclosure 1). The Director-General of Investment Promotion, with the support of the Secretary for Commerce, Industry and Technology, proposes that Members approve a new commitment to inject \$2 billion from the Capital Investment Fund, to partly finance the construction cost of the IEC, in exchange for equity in the centre.

Encl. 1

**/JUSTIFICATION .....**

## JUSTIFICATION

### **The need and urgency of developing a new exhibition centre**

3. Hong Kong is a premier location for international exhibitions in the region, and the existing Hong Kong Convention and Exhibition Centre (HKCEC) is a highly successful convention and exhibition facility. A consultancy study completed in December 1999 concluded, however, that Hong Kong would need a new exhibition centre of about 50 000 m<sup>2</sup> net usable area by 2005 to sustain its competitiveness in capturing the growing exhibition market in Asia. Also, for a number of years the local convention and exhibition industry has been expressing concern over the lack of competitive convention and exhibition facilities in Hong Kong.

4. The urgency for an additional exhibition facility has been intensified by the development of high quality exhibition centres in other major cities in the region in recent years. At the same time, the utilisation rate of the exhibition halls of the HKCEC is expected to reach 70% during the peak season, normally regarded as the saturation point, by year 2006. At present, the HKCEC already has to turn away exhibition business during peak periods. Even though a possible Phase 3 extension of the HKCEC is being studied, it is unlikely that such an extension could be completed before 2009. Furthermore, a further expanded HKCEC will still not be able to accommodate certain types of exhibitions, such as super-heavy machinery and boat exhibitions, due to insufficient floor loading capacity and configuration constraints.

5. From various studies as well as market consultations, the Government is satisfied that –

- (a) Hong Kong needs a new IEC of at least 60 000 m<sup>2</sup> by 2005 to meet the growing demand for high quality exhibition facilities and to sustain its leading position as a prime location for all kinds of major international exhibitions in the Asia-Pacific region;
- (b) HKIA is the preferred site for the IEC, and is the only site that can enable it to be built and commissioned by 2005, which coincidentally is also the target opening date for Hong Kong Disneyland. This coincidence would help to optimise synergies;
- (c) the IEC will bring significant economic benefits to Hong Kong (see paragraph 6 below);

/(d) .....

- (d) whilst the new IEC should be able to generate enough income 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 (see paragraph 10 below); and
- (e) the Government and AA should enter into a public-private joint venture with a private sector participant to finance, design, construct, manage and operate the IEC.

### **Economic benefits**

6. The IEC 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. The project is also expected to bring substantial net economic benefits 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 an additional 80 000 visitors to Hong Kong by the tenth year of operation and considerably more thereafter. According to the AA, a total of 3 500 jobs will be created during the construction period. When the IEC 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.

### **Development approach**

#### Joint venture between Government /AA and private sector consortium

7. It is proposed that the Government and AA should select a partner from the private sector through competitive international tendering, who would carry out the planning, design, construction and operation of the IEC. The AA will contribute the land, whilst the Government and the private sector participant will fund the construction cost of the facility, in exchange for equity stakes in the joint venture. The private sector participant will be responsible for the design, construction, management and operation of the facility.

8. The AA has reserved a site within the North Commercial District of HKIA sufficient for the IEC development of up to 100 000m<sup>2</sup> net usable area, in exchange for a fixed 10% equity stake in the joint venture. It will conduct the open tendering exercise, and co-operate with the Government to ensure the timely delivery of all necessary utilities, infrastructure and transportation facilities.

9. As regards returns, any surplus of income above the preferred return to the private sector participant (to be determined through the open tendering exercise as set out in paragraph 14(d)(vi) below) will be distributed among the 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 AA in accordance with their relative equity shareholdings. At the end of the 25-year franchise period, the Government and AA will share the reversionary value of the facility in accordance with their relative equity stakes.

#### Case for Government support

10. As the IEC would not be viable from an investment standpoint, and in view of the considerable economic benefits flowing from the project, we believe it is justified for the Government to partly finance the construction cost (see paragraph 17 below). Indeed, government support for major exhibition and convention facilities around the world is quite common. The development of both phases of the HKCEC were also subsidised by the Government.

#### Case for private sector involvement

11. An arrangement whereby the Government funds all the construction cost of the IEC is not preferred. 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. If the private sector participant is an investor as well as a manager, he would have a stake in ensuring the IEC is the best possible in all aspects, including design, layout, flexibility of usage, construction and maintenance costs, etc., so as to achieve a reasonable return on his capital. It would not be so easy to capture these benefits if the project were 100% government funded. From the feedback obtained from the expressions of interest (EOI) exercise, we believe it would be reasonable to ask the selected private sector participant to contribute not less than 15% of the total construction cost.

## Tendering

12. In preparation for the tendering exercise, the AA, in conjunction with the Government, invited EOI from the private sector in July 2002 for the financing, design, construction, management and operation of the IEC comprising a net usable area of up to 100 000m<sup>2</sup>. At the same time, to ensure that the tender terms of the IEC would be based on realistic market expectations and information, the EOI respondents were also requested to give their views on the optimum size and construction cost of the centre. We have reported the outcome of the EOI exercise to the Legislative Council (LegCo) Panel of Commerce and Industry on 9 December 2002 (copy of Panel paper at Enclosure 2).

Encl. 2

13. After detailed study of the EOI submissions supported by external expert advice, an evaluation board (comprising representatives from the Government and the AA) short-listed four consortia for the tender stage. All these consortia are composed of high-calibre participants with extensive experience in developing and operating exhibition centres of an international standard.

14. Taking into account the views received from the market in the EOI submissions, Members' opinions, our previous overseas soundings and consultancy studies, the Government and the AA propose to go to tender on the following basis –

- (a) The IEC must have a minimum net usable area of 60 000 m<sup>2</sup> as the first phase to be available on opening in 2005, but with preference given in the assessment for bids with larger initial phases.
- (b) The business plan must specify an ultimate net usable area of 100 000 m<sup>2</sup>, with milestones stating the expansion phases to the ultimate size, without further injection of government funding beyond the \$2 billion.
- (c) The developer/operator must make a minimum equity contribution equal to 15% of the total construction cost of the first phase of the IEC, to be injected upfront in the initial phase, with preference given to bids offering a larger percentage contribution.
- (d) The tender will be evaluated on the following criteria –

/(i) .....

- (i) financial capability and commitment to undertake the project, including percentage of equity contribution;
- (ii) development capability including design and construction experience, and quality and efficiency of the preliminary design;
- (iii) robustness and quality of the business plan, including proposed initial size upon opening, phased development, and demonstrated commitment to Hong Kong;
- (iv) experience in operating a world class exhibition centre;
- (v) marketing capability in attracting and developing new exhibition business; and
- (vi) proposed rate of preferred return.

### **Timetable**

15. To ensure that the IEC can start operations in 2005, the Government and the AA are working to the following timetable –

|      |                      |   |
|------|----------------------|---|
| 2003 | January/February     | Issue tender documents.                 |
|      | April                | Closing date for tenders.               |
|      | June                 | Award tender, sign contracts.           |
|      | 2 <sup>nd</sup> Half | Finalise design, commence construction. |
| 2005 | 2 <sup>nd</sup> Half | Complete construction.                  |

### **FINANCIAL IMPLICATIONS**

16. In their EOI submissions, most of the consortia have estimated the cost of construction to be in the range of \$18,000 to \$20,000 per m<sup>2</sup> gross, for a building quality comparable to other leading exhibition facilities in the region.

17. On the basis of our proposal for an initial exhibition facility of 60 000 m<sup>2</sup> net (or about 120 000 m<sup>2</sup> gross floor area applying the standard net-to-gross floor area ratio of 1:2) and assuming a construction cost of \$18,000 per m<sup>2</sup> plus \$250 million for the necessary supporting infrastructure, we estimate the total construction cost of the new exhibition centre to be \$2.41 billion at present. This

/estimate .....

estimate includes the construction cost for buildings, interior fitting-out, building services, the necessary supporting infrastructure and transportation facilities. As the private sector consortium will be asked to contribute not less than 15% of the total construction cost, the Government's contribution is therefore estimated at \$2 billion.

18. Subject to Members' approval, we propose to proceed to the tender stage and upon the award, invest the \$2 billion as equity into the newly formed IEC joint venture. The amount will be injected in phases in the light of expenditure pattern of the construction work, with the first injection to be made in 2003-4. The forecast cash flow for equity injection draw down is as follows –

|              | <b>IEC of a net<br/>60 000 m<sup>2</sup><br/>(\$ million)</b> | <b>Percentage<br/>of the Total Cost</b> |
|--------------|---|---|
| 2003 – 04    | 250   | 12.5%                                   |
| 2004 – 05    | 800   | 40.0%                                   |
| 2005 – 06    | 900   | 45.0%                                   |
| 2006 – 07    | 50  | 2.5%                                    |
| <b>Total</b> | <b><u>2,000</u></b>   | <b><u>100%</u></b>                      |

19. In the event that the full \$2 billion is not required towards the construction cost of the first phase, the balance of the investment will be deferred and applied to the subsequent phase(s).

20. The income generated by the IEC should be able to cover its recurrent operating expenditure.

## **CONTROL MECHANISM**

21. The Government and the AA will form a working group to plan, implement and monitor the tendering process. Once a private sector participant has been selected, the IEC joint venture will take over the responsibilities of planning and carrying out the construction and operation of the IEC. The AA will deal with and monitor the work of the private sector participant during the development of IEC and the subsequent operation of IEC. 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 IEC. The joint venture will have a separate service agreement with the operator which could be terminated in the event of a breach of contract or unsatisfactory performance.

/ENVIRONMENTAL .....

**ENVIRONMENTAL IMPLICATIONS**

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

**BACKGROUND INFORMATION**

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

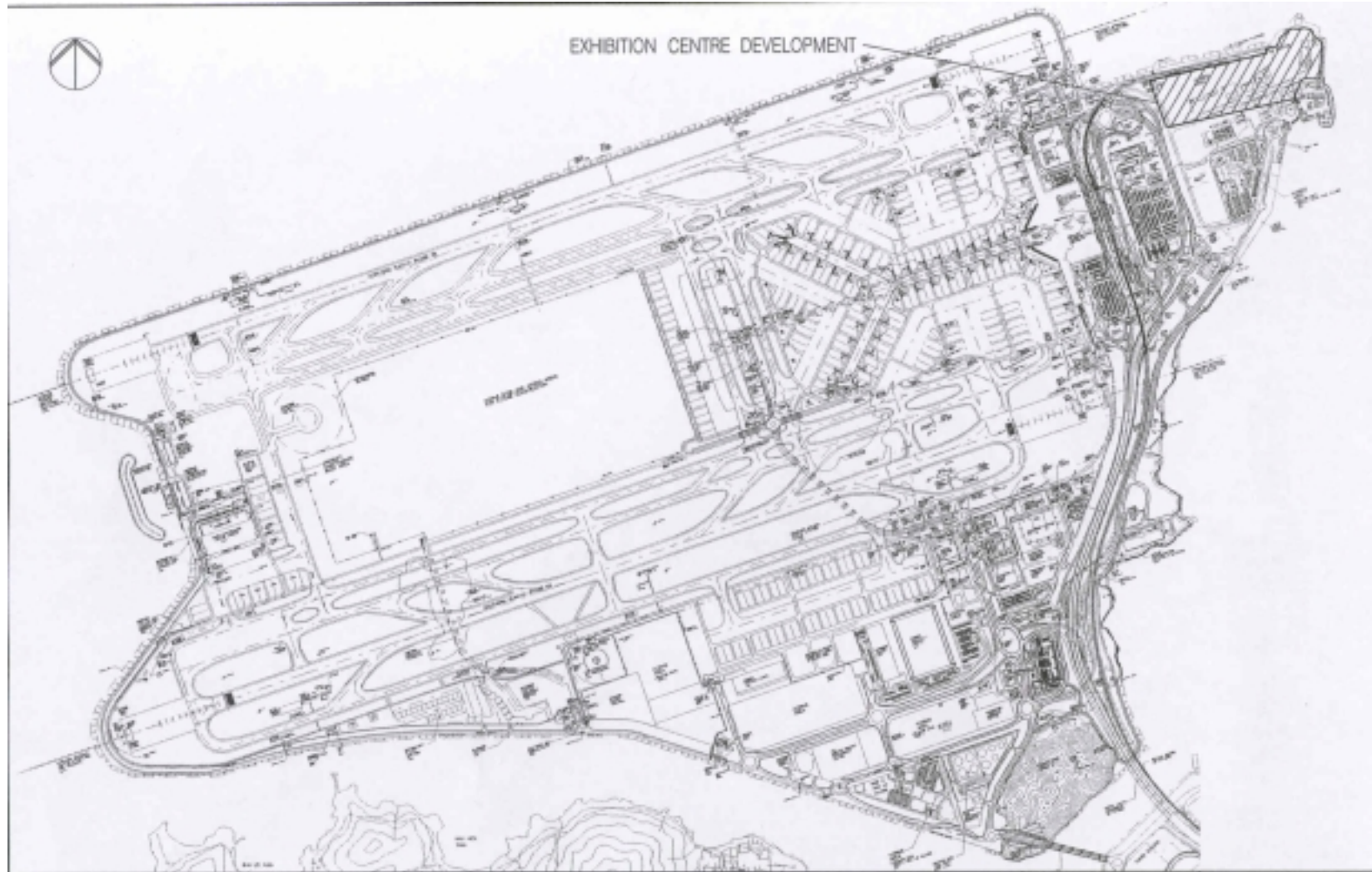
24. In November 2001, the LegCo Panel on Commerce and Industry supported the proposal to establish a new IEC at HKIA. At the subsequent Finance Committee meeting in December 2001, Members raised questions on some aspects of the project. We returned to the Panel in January 2002 to address the specific concerns, and again in April to report on an international road show of meetings conducted with key exhibition centre operators in the first quarter of 2002. It was then agreed that the Government and the AA would proceed to the formal EOI stage to seek the market's view on key parameters of the proposed centre.

25. We consulted the LegCo Panel on Commerce and Industry about the proposed project on 9 December 2002. Panel members were generally supportive of the proposal.

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**Location of the Proposed New Exhibition Centre at Hong Kong International Airport**



**Legislative Council Panel on Commerce & Industry**

**Proposed International Exhibition Centre  
at Chek Lap Kok**

**Introduction**

This paper informs Members of the outcome of the invitation of expressions of interest (EOI) for the proposed new international exhibition centre (IEC) at Chek Lap Kok (CLK) and seeks Members' endorsement to proceed to the Finance Committee for approval for a proposed government investment of \$2 billion.

**Background**

2. In November 2001, the Legislative Council Panel on Commerce and Industry supported the proposal to establish a new IEC at CLK. At the subsequent Finance Committee meeting in December 2001, Members raised questions on some aspects of the project. We returned to the Panel in January 2002 to address the specific concerns, and again in April to report on an international road show of meetings conducted with key exhibition centre operators in the first quarter of 2002. It was then agreed that the Government and the Airport Authority (AA) would proceed to the formal EOI stage to seek the market's view on key parameters of the proposed centre.

**Report on the EOI Exercise**

3. EOI invitation. The AA, in conjunction with the Government, on 26 July 2002 invited EOI from the private sector for the financing, design, construction, management and operation of an IEC comprising a net usable area of up to 100,000 m<sup>2</sup>.

4. Public announcement. At the launch of the EOI exercise, a press release was issued to 150 media organisations worldwide. Advertisements were placed in the local media and international specialist journals. The AA sent the EOI invitation document to 260 parties. These included potential members of a private

developer/operator consortium, such as local and international financiers, developers, and exhibition centre operators. Subsequently, we also conducted a number of meetings and briefing sessions with consulates, chambers of commerce and individual local and overseas companies.

5. EOI invitation document. The EOI document specified some preliminary development details including the expectation that upon opening, the IEC would have a net usable area of at least 80,000 m<sup>2</sup>. The EOI document also required respondents to complete a general questionnaire to gauge the market's view on the optimum size and cost of the centre so as to ensure that the tender terms of the development would be based on realistic market expectations and information.

### **Response**

6. More than 10 submissions from both local and overseas respondents were received by the EOI closing date of 9 October 2002. An evaluation board, comprising representatives from the Government and the AA, met on 15 October to analyse and evaluate the capability and competency of the respondents and to recommend which short-listed consortia should be invited to the tendering stage. A third party exhibition consultant was also engaged to provide an independent opinion, expert advice and an assessment of the submissions. The board scored the submissions according to the five criteria specified in the EOI invitation. These were organisational structure, development capability, operational capability, marketing capability and preliminary business plan.

7. Feedback from the EOI submissions on key parameters of the IEC is as follows:

- (a) Size. Contrary to the proposed initial size of 80,000 m<sup>2</sup> to 100,000 m<sup>2</sup> as stated in the EOI, all respondents indicated that the centre should start smaller, then expand when justified by demand. All but two indicated that a centre of 50,000 m<sup>2</sup> net usable area on opening was appropriate (the remaining two proposed 56,000 m<sup>2</sup> and 60,000 m<sup>2</sup>).

- (b) Construction costs. Most submissions estimated the cost of construction would be in the range of \$18,000-20,000 per m<sup>2</sup> gross, for a building quality comparable to others in the region including the Shanghai New International Expo, etc. The standard net to gross floor area formula for exhibition centres is 1:2. Applying these figures and allowing for \$250 million for necessary infrastructure, the construction cost of a centre of 60,000 m<sup>2</sup> net usable area would be around \$2.41 billion.
- (c) Equity Contribution. Some of the EOI submissions indicated a willingness to make an equity investment.
- (d) Other issues raised.
  - (i) Confirmation of the Government's funding and the timing for injection of this contribution.
  - (ii) The impact of a possible third phase expansion of the HKCEC and the likely timing of the development.
  - (iii) Autonomy to operate the IEC commercially.

## **Way Forward**

8. After an exhaustive study of the EOI submissions supported by external expert advice, the evaluation board short-listed four consortia for the tender stage and recommended the broad parameters for the IEC project to be taken forward.

9. Taking into account the views received from the market in the EOI submissions, Members' opinions, our previous overseas soundings and consultancy studies, the Government and the AA propose to go to tender on the following basis:

- (a) The IEC must have a minimum net usable area of 60,000 m<sup>2</sup> as the first phase to be available on opening in 2005, but with preference given in the assessment for bids with larger initial phases.

- (b) The business plan must specify an ultimate net usable area of 100,000 m<sup>2</sup>, with milestones stating the expansion phases to the ultimate size, without further injection of government funding beyond the \$2 billion.
- (c) The developer/operator must make a minimum equity contribution equal to 15% of the total construction cost of the first phase of the IEC, to be injected upfront in the initial phase, with preference given to bidders with a larger percentage contribution.
- (d) The tender will be evaluated on the following criteria:
  - (i) Financial capability and commitment to undertake the project, including percentage of equity contribution;
  - (ii) Development capability including design and construction experience;
  - (iii) Robustness and quality of the business plan, including proposed initial size upon opening, phased development, and demonstrated commitment to Hong Kong;
  - (iv) Experience in operating world class exhibition centre;
  - (v) Marketing capability in attracting and developing new exhibition business; and
  - (vi) Proposed rate of preferred return.

10. Subject to Members' views, we plan to return to the Finance Committee on 20 December 2002 to seek approval for the government equity investment in the IEC. In the event the full \$2 billion is not required towards the cost of the first phase, the balance of the investment will be deferred and applied to subsequent phases. Subject to funding approval, we will proceed to the tender stage in the first quarter of 2003.

11. The timetable for the project would then be as follows –

|      |                      |   |
|------|----------------------|---|
| 2003 | January/February     | Issue tender documents.                 |
|      | April                | Closing date for tenders.               |
|      | June                 | Award tender, sign contracts.           |
|      | 2 <sup>nd</sup> Half | Finalise design, commence construction. |
| 2005 | 2 <sup>nd</sup> Half | Complete construction of Phase I.       |

Commerce, Industry & Technology Bureau / Invest Hong Kong  
November 2002