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Panel on Economic Services

Background Brief on Hong Kong Disneyland

This paper provides background information on the Hong Kong Disneyland (HKD) project.

Background

2. In December 1999, the Government entered into an agreement with The Walt Disney Company (WD) to build HKD (Phase 1) at Penny's Bay. A joint venture company, the Hongkong International Theme Parks Limited (HKITP), was set up for this purpose.

Financing

3. The estimated total project cost to HKITP of developing HKD Phase 1 is \$14.1 billion in money-of-the-day (MOD) prices. This is in addition to the cost of reclaiming the land for Phase 1 of the project, which was estimated at \$4 billion in MOD prices. The Government also needs to provide land, associated infrastructure and government, institution and community facilities to support the development of HKD. Details are set out below.

Land Grant

4. Under the Project Agreement reached between the Government and the WD, a site of about 126 hectares at Penny's Bay, Lantau Island (the "Phase 1 Site") should be granted by private treaty to HKITP for 50 years, with a right to renew for a further 50 years, subject to an annual rent of 3% ratable value. The land premium is \$4 billion, being the estimated pro rata cost of the reclamation and site formation.

5. WD's forecast of the financial performance of HKD (the "Base Case"^{note 1)}) showed that the project could cover the cash cost of building and operating the theme park and related facilities, but could not cover the cost of the land. Given the very substantial economic and other benefits that HKD would bring to Hong Kong, the Government agreed not to demand cash up front for the land premium, subject to certain conditions, the main ones being -

- (a) the full premium would be paid in subordinated shares which would convert to ordinary shares progressively during the life of the project to the extent that operating performance exceeded the Base Case. In this way the Government would capture its fair share of the project's upside potential;
- (b) WD would agree to take a significant initial equity stake and retain most of it for the life of the project. In this way the Government would ensure the sustained commitment to the project; and
- (c) the Government would hold a majority stake initially to protect its interest, but with the ability to sell down subsequently to third party investors.

6. In order to ensure that HKD would remain attractive as a commercial venture to existing and potential third party investors, the subordinated shares would be converted in a gradual manner. This would ensure that the benefits of the ordinary shares held by other investors would not be diluted substantially within a short period of time. Moreover, to allow for fluctuation in business in the early years of HKD, both sides also agreed that conversion would only begin after five years of theme park operation. The permitted conversion ceiling would thereafter rise by 5% per annum cumulatively thus rendering full conversion of the subordinated shares possible 25 years after opening. In order to prevent excessive equity dilution in any one year there would be an annual cap of 10% on conversion.

Option for Phase 2

7. Under the Project Agreement, it had been agreed that HKITP should be given an Option to buy the site immediately to the east of the Phase 1 Site for a second phase of the development ("Phase 2 Site"). The Option is valid for 20 years from signature, with an automatic right to extend for a further five years and a conditional right to extend for a second five year period. The premium has been fixed at \$2.812 billion (1999 prices, to be adjusted for

^{note 1} The base case is based on several assumptions, including:

- (a) The park opens in 2005
- (b) The park's attendance in its first year of operation is estimated at 5.2 million
- (c) The park gradually reaches full annual capacity of 10 million after 15 years

inflation in line with Composite CPI) payable in cash or in such other manner as the parties may agree. The Option lapses after 20 years if it has not been exercised or renewed but HKITP may have two five-year extensions of which the second is conditional upon the target capacity of 10 million not being reached but the secondary target capacity of 8 million being reached. While the land is subject to the Option, it may be used for a variety of temporary purposes provided these are compatible with the adjacent theme park.

Right of 1st Refusal

8. In due course the site to the east of the (intended) Phase 2 Site will also be reclaimed and available for disposal. In order to keep open the possibility of a third theme park, HKITP has sought a right of first refusal to buy that site at then prevailing market prices and on normal lease terms. In view of the substantial advantages for Hong Kong's tourism industry of a third Disney park going ahead in the same location, with obvious opportunities for synergy, the Administration has agreed to grant such a right which will be valid for up to 10 years from the date of exercise by HKITP of the Option or the expiry or surrender of the Option if earlier.

Land use planning

9. The Government also agreed to take special measures to ensure that the HKD site will be pleasing and undisturbed from undesirable visual intrusion and incompatible land uses in surrounding areas. This protection would be achieved by a combination of planning controls (via OZP preparation), inclusion of appropriate conditions in future land disposals, lease controls and by executing a Deed of Covenant which would limit the height of future buildings in the area.

Cost of construction

10. The Government and WD agreed that the cost of constructing HKD, at \$14.1 billion should be financed by a mixture of debt and equity at a commercially prudent ratio of approximately 60:40. This translates to \$5.7 billion in equity and \$8.4 billion in debt.

11. Initially WD would put up \$2.45 billion in equity for one-dollar shares and hold a 43% stake in HKITP. It would later be allowed to sell down but not below the level of 1.9 billion shares. The Government would initially put up \$3.25 billion in equity for one-dollar shares in HKITP and hold a 57% stake. The Government could sell down its stake to a minimum of one billion shares up to the end of the first year of operation. Thereafter, it could sell its shares (and also any subordinated shares that convert to ordinary shares) without any requirement for a minimum holding.

12. The debt of \$8.4 billion would be raised by a commercial loan of \$2.3 billion and a Government loan of \$6.1 billion, the latter repayable over 25 years from park opening. (Both loan figures include capitalized interest estimated at \$0.7 billion.) The reason for raising just over a quarter of the debt from the open market was that in the early years the project cash flows could only prudently cover loan servicing of that amount. Repayment of the Government loan would begin ten years after HKD opens when the commercial loan has been paid off.

13. To help the project in its early years, the Government loan would carry interest on a sliding scale as follows -

- Prime minus 1.75% from drawdown to the first eight years after park opening
- Prime minus 0.875% for the next eight years
- Prime for the next nine years

14. The following summarizes the financing of the project.

Funding Sources	Amount (\$ billion)	% to total
Equity, of which	5.7	40.4%
- Government	3.25	23%
- WD	2.45	17.4%
Debt, of which	8.4	59.6%
- Government	6.1*	43.3%
- Commercial	2.3*	16.3%
Total	14.1	100%

* Including capitalized interest.

Associated and supporting infrastructure

15. To implement the development of HKD Phase 1, the Government has to provide a fully formed and serviced site on reclaimed land at Penny's Bay including associated and supporting infrastructure and government, institution and community (GIC) facilities. In this regard, various funding proposals had been submitted to the Finance Committee for consideration. Details are set out in the ensuing paragraphs.

16. On 17 December 1999, the Finance Committee approved the upgrading of part of 660CL to Category A as 662CL entitled "Reclamation of Penny's Bay Stage 1 works, design of site formation at Yam O and design of associated infrastructure and GIC facilities for the development of Hong Kong

Disneyland Phase 1 on Lantau Island” at an estimated cost of \$6.9 billion in MOD prices. The Administration commenced the reclamation works in May 2000.

17. On 27 April 2001, the Finance Committee approved the upgrading of another part of 660CL to Category A as 322WF entitled “Infrastructure for Penny’s Bay Development, Package 1 – Yam O Tuk fresh water service reservoir and associated works” at an estimated cost of \$165 million in MOD prices. The Administration commenced the construction works on 9 August 2001.

18. On 22 June 2001, the Finance Committee approved the upgrading of another part of 660CL to Category A as 687CL entitled “Infrastructure for Penny’s Bay Development, Package 2” at an estimated cost of \$3.9 billion in MOD prices. The Administration commenced the construction works of the first infrastructure contract on 24 October 2001.

19. On 24 May 2002, the Finance Committee approved the upgrading of another part of 660CL to Category A entitled "Infrastructure for Penny's Bay Development, Package 3 and Penny's Bay Reclamation Stage 2" at an estimated cost of \$2.3 billion in MOD prices. The scope of the project also includes the decommissioning of the former Cheoy Lee Shipyard at an estimated cost of \$450 million in MOD prices.

Environmental impact assessment

20. In accordance with the Environmental Impact Assessment Ordinance (Cap. 499) (EIAO), the Civil Engineering Department had completed the following EIA studies and submitted the reports to the Director of Environmental Protection (DEP) on 1 March 2000 -

- (a) an EIA study under the Northshore Lantau Development Feasibility Study which looked at, among other things, the cumulative environmental impacts of the proposed developments at north-east Lantau, including Penny’s Bay, Tsing Chau Tsai East and Yam O, and the construction of the Chok Ko Wan Link Road; and
- (b) an EIA study for the construction of an International Theme Park at Penny’s Bay of North Lantau and its essential associated infrastructures, including reclamation, a water recreation centre, roads, a pedestrian walkway, a rail link, a public transport interchange, piers, stormwater drainage system, sewerage facilities, irrigation, water supply and utility services, slope formation and stabilization, screening and landscaping works.

21. On 11 March 2000, DEP decided that the two EIA reports had met the requirements of their respective Study Briefs and the Technical Memorandum of the EIAO. Following this, the reports were made available for public inspection since 13 March 2000 for a period of 30 days.

22. In accordance with the EIAO, DEP issued a series of Environmental Permits for the HKD project between April and July 2000.

Fireworks

23. HKD will have a fireworks display every night as a climax to the day's entertainment. It will last for about 12 minutes and take place between about 9 p.m. and 9:30 p.m. according to season. In order to cope with this very different set of circumstances, the Administration says it would proceed on the following basis -

- (a) for the first year of operation, HKITP to be given a series of rolling 3-month licences;
- (b) thereafter the licences would be rolling annual ones;
- (c) HKITP would need to inform the relevant authority if particulars of the fireworks display changed and apply for a new licence if the conditions attached to the previous one were no longer applicable; and
- (d) renewal of the rolling licences would be subject to the safety and security requirements in force at the time.

In the longer term, the Administration would also consider the desirability of issuing licences with longer validity.

24. The Administration has advised that HKITP would have to comply with all existing safety and environmental standards in operation at the time the licences are first issued. In addition the company would comply with any new safety standards - and, to the extent possible, any environmental ones - upon each re-issue of the licence. However WD has expressed concern that over the years environmental standards - particularly in relation to noise - may change to the extent that the fireworks display would be rendered impossible. As the fireworks display is an integral part of the Disney experience, WD has sought an undertaking on HKITP's behalf, and the Administration agreed, that if such revised legislation were ever being contemplated, special regard would be given to the position of HKD.

Decommissioning of Cheoy Lee Shipyard

25. Cheoy Lee Shipyard (CLS) was located on the north and eastern shores of Penny's Bay with a site area of about 19 hectares. CLS had been in operation for boat manufacture, repair and maintenance from 1964 to April 2001 when the site was returned to the Government on voluntary surrender^{note 2} in support of the HKD. The CSL site falls within the area designated for the construction of roads, including the Penny's Bay Section of Chok Ko Wan Link and Road P2, leading to the park. As the decommissioning of CLS was a designated project under the EIAO which required an Environmental Permit, an EIA study on the decommissioning project was commenced in April 2001. The primary objectives of the study were to analyze the conditions of the CLS site and examine all possible environmental impacts.

26. The EIA report was published on 21 February 2002 for public inspection until 22 March 2002. It revealed the existence of hazardous substances, inter alia, dioxins^{note 3} in the soil at the CLS site. To return the site to a condition suitable for development, the EIA report recommended a remediation and clean up plan under which the 30 000 m³ dioxin-contaminated soil would be excavated and treated off-site in a thermal desorption^{note 4} plant to be set up at To Kau Wan (TKW). About 600 m³ of organic oily residue would be generated from the process over a period of one or two years. They would be collected and despatched in batches for incineration at the Chemical Waste Treatment Centre in Tsing Yi. The soil after thermal desorption would be solidified by adding cement to immobilize the remaining metals in the soil.

27. The financial arrangements for the decommissioning of CLS was discussed at the meeting of the Economic Services Panel on 20 March 2002. Members were concerned about the substantial rise in the decommissioning cost from \$22 million quoted in November 1999 to \$450 million in the revised proposal put forward by the Administration. While acknowledging that the rise was attributed to the treatment of dioxin-contaminated soil which was very expensive, some members were of the view that the situation could have been avoided if the decommissioning project was included in the original EIA for HKD. They pointed out that the Administration had allowed the HKD project to proceed in the absence of the EIA for the decommissioning of CLS in order

^{note 2} Apart from a land compensation of \$22.7 million, Government also paid out an ex gratia payment of \$1.48 billion in accordance with the zonal compensation rate for Zone A land which was required for essential project with territory-wide significance.

^{note 3} Dioxins are highly toxic substances that can bioaccumulate in the fatty tissues of animals and humans. They are carcinogenic and will adversely affect immune and reproductive systems.

^{note 4} Thermal desorption is an enclosed separation process in which indirect heat is applied to the contaminated soil. Upon indirect heating, the contaminants will be evaporated into gaseous phase, trapped and subsequently condensed for further treatment.

to adhere to the scheduled opening of HKD to achieve maximum economic gains. As a result, the huge decontamination cost had not been considered during the planning stage and the community had to bear the consequences in the end.

28. Given that the extent of contamination at the CLS site was much higher than expected, doubt had been cast on whether CLS had been operating under approved conditions. Questions had been raised on whether CLS should be held responsible for the decontamination cost under the polluter-pays principle. Members asked the Administration to brief the Panel on the options available for the Government to seek legal remedies from CLS for the additional decommissioning cost.

29. The environmental impact of the decommissioning of CLS was also discussed at a number of meetings of the Panel on Environmental Affairs.

30. The funding proposal for the decommissioning of CLS, together with the proposal for the construction of infrastructure and GIC facilities to serve HKD Phase 1 and the reclamation works for the future development of HKD Phase 2 was endorsed by the Finance Committee on 24 May 2002.

Concerns expressed by Members

31. At previous meetings, members also expressed concern over a wide range of issues. The major ones included the following -

- (a) financial arrangements for HKD and economic benefits and employment creation of HKD;
- (b) need for additional financial information on the HKD project to facilitate members' monitoring of Government expenditure and the performance of Government investment in HKD;
- (c) possible development of another Disneyland project in the Mainland and the forecast base tourists and attendance of HKD;
- (d) development of complementary facilities in the vicinity of HKD;
- (e) environmental and sustainability impact assessment of HKD, including the impacts of the combined firework and laser shows, and potential environmental impact of the Penny's Bay Reclamation Stage 2 on the operation on HKD Phase 1;
- (f) progress of the decommissioning of CLS and whether the related works would affect the scheduled opening of HKD in 2005; and

- (g) progress of settlement of the mariculturists' claims against fish loss caused by the reclamation works during Penny's Bay Reclamation.

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