For discussion
on 2 May 2014

FCR(2014-15)6

ITEM FOR FINANCE COMMITTEE

CAPITAL INVESTMENT FUND
HEAD 973 – TOURISM
Subhead 101 Equity in Hongkong International Theme Parks Limited
Subhead 102 Loan in Hongkong International Theme Parks Limited

Members are invited to approve an increase in the Government's equity in the Hongkong International Theme Parks Limited (HKITP) through conversion of part of an existing loan from the Capital Investment Fund (CIF) to the HKITP, and approve the provision of a new term loan from the CIF to the HKITP, as part of the financial arrangements to enable the company to implement a new hotel development project at the Hong Kong Disneyland.

PROBLEM

The Government has reached an in-principle agreement with The Walt Disney Company (TWDC) to implement a new hotel development project at the Hong Kong Disneyland (HKDL) subject to the approval of the Legislative Council (LegCo) Finance Committee (FC). As part of the financial arrangements for the project, the Government needs to – (a) convert $1.7 billion of the existing loan from the CIF to the HKITP into equity; and (b) provide a new term loan not exceeding $0.8085 billion from the CIF to the HKITP.

PROPOSAL

2. The Commissioner for Tourism, with the support of the Secretary for Commerce and Economic Development, recommends that Members approve –

(a) the conversion of $1.7 billion of an existing loan under the CIF to the HKITP into equity; and

(b) the provision by the Government to the HKITP of a new term loan not exceeding $0.8085 billion under the CIF at a floating interest rate equivalent to 2% over the 3-month Hong Kong Interbank Offered Rates per annum, subject to the condition of advancing the final maturity date for the unconverted portion of the existing loan to the HKITP (of around $0.3 billion) from fiscal year[1] 2030 to fiscal year 2022.

JUSTIFICATION

The New Hotel Proposal

3. Currently, there are two hotels providing a total of 1 000 rooms at the HKDL, namely the Hong Kong Disneyland Hotel (DLH) (with 400 rooms) and Disney's Hollywood Hotel (DHH) (with 600 rooms). In the past three years, the two hotels consistently recorded high occupancy rates of over 90% on average. Background information on the two hotels is at Enclosure 1. Encl. 1

4. The Hong Kong Disneyland Management Limited (HKDML) has conducted extensive research in Hong Kong and other key markets of the HKDL to estimate the demand for a new hotel. Based on market data, the HKDML proposes to develop a 750-room hotel located at the site between DLH and DHH. The target opening date is early 2017. Enclosure 2 shows the location and design drawings of the proposed hotel. The new hotel will have a theme dedicated to the spirit of exploration. It will feature three restaurants, a merchandise shop, as well as an outdoor swimming pool and recreation areas. The HKDML estimates that the projected cost of the new hotel will be $4.263 billion. Encl. 2

Sustained Growth of the HKDL

5. It has been a shared vision of both the Government and TWDC that the resort should be expanded on an ongoing basis with new attractions, entertainment offerings and hotels to broaden its appeal to a wider tourist segment. Between 2011 and 2013, the addition of three new themed areas – Toy Story Land, Grizzly Gulch and Mystic Point – has enlarged the footprint of the park by about one-fourth and increased the total number of attractions and entertainment offerings to over 100.

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[1] The fiscal year adopted by the HKITP is from October to September next year and ends on the Saturday closest to 30th September of each year.

6. A stay at a Disney hotel is not only an integral part of a Disney resort experience but also reinforces the positioning of the HKDL as an overnight vacation destination and enhances its appeal to local and overseas visitors for lengthened stays. With the addition of the new hotel, the total lodging capacity in the HKDL will increase from 1 000 rooms to 1 750 rooms, representing an increase of 75% compared with the current provision.

Intensifying Competition in the Region

7. The Asia Pacific region has seen a rapid proliferation of leisure choices growing in number, scale and diversity. New or expanded theme parks are found in neighbouring markets such as Mainland China, Singapore, South Korea, Japan, etc. The vigorously changing competitive landscape among different tourist destinations in the region has underlined the importance for the HKDL to continue developing novel and distinctive elements.

8. The proposed third hotel will be positioned between the existing two hotels and will add to the variety of hotel offerings at the HKDL. It will broaden the HKDL's appeal to different guest segments, increase hotel penetration of theme park guests and encourage repeat visitations. This will in turn provide further stimulus to the resort's operating and financial performance.

Increase Hotel Room Supply in Hong Kong

9. From a territory-wide perspective, the proposed new hotel will provide much-needed additional hotel room supply to cater for the strong growth in visitor arrivals and demand for hotel accommodation. As land is already available and has been earmarked for hotel development purpose, the lead time for planning and construction can be reduced, thus enabling a timely additional supply of hotel rooms.

Financial Arrangements

Considerations

10. The Government and TWDC, as shareholders of the HKITP, share the common vision that ongoing expansion of the HKDL is critical to the continued success of the resort as the premier destination in the Asia Pacific region. In considering the financial arrangements for the new hotel, one of the primary objectives is to achieve a financing solution that will limit near and medium-term debt service requirements of the joint venture so that it could reinvest as much of its operating cash as practicable in the further development of the Phase 1 site.

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11. Within the Phase 1 site, the theme park has several land parcels
Encl. 3 available for further expansions, as shown at Enclosure 3. Developing these land parcels would help broaden the HKDL's appeal and substantially increase the theme park's annual capacity to over 10 million. In determining the scale and nature of an expansion project, the joint venture will take into account a wide range of factors, such as the preference of target customer segments, the popularity of specific Disney franchises, the balance and distribution of guests among different areas of the park, etc. The current plan anticipates that further expansion projects will be carried out in phases over the next decade and will include attractions that target both the family and young adult market segments. These expansions will further enrich the number and variety of attractions and entertainment offerings at the HKDL and boost park attendance and revenues. The first of these expansions will be a new themed area based on Marvel's Iron Man franchise, which is to be opened by late 2016. In light of the positive feedback on and contribution to park attendance driven by the recent expansions (i.e. Mystic Point, Grizzly Gulch, Toy Story Land), both shareholders agree that additional attractions should optimally utilize the remaining land parcels, and build on the key elements of success of the recent expansions through, for example the adoption of creative storylines, innovative technology, or unique elements to expand the appeal of the park as far as possible. Given the strengthened business momentum and assuming that growth continues, the HKDML expects that sufficient operating cash could be generated so that future expansion of the theme park on the Phase 1 site would be self-funded by the HKITP. In considering the financial arrangements for the new hotel development, both shareholders reckon the need to ensure HKITP to be able to self-fund the Phase 1 expansion.

Funding Proposal

12. The HKDML estimates that the new hotel development will cost
Encl. 4 $4.263 billion. A breakdown of the cost estimate is at Enclosure 4.

13. Having regard to the considerations in paragraphs 10 to 11 above, the Government and TWDC have reached an agreement on the financial arrangements set out in the ensuing paragraphs, the gist of such is summarised in the table below –

(in HK$ billion)	**HKSARG**	**TWDC**	**HKITP**
Cash equity injection		1.700 (A)	
Conversion of existing Government loan to equity	1.700 (Note)		
New shareholder loans	0.8085(B)	1.1545(C)	
Contribution by operating cash			0.600 (D)
Total Cash Contribution	**0.8085**	**2.8545**	**0.600**
Estimated Project Cost = (A) + (B) + (C) + (D) = $4.263 billion			

(Note: The proposed conversion of the existing Government loan is intended to maintain the Government's majority shareholding in the joint venture. It is not part of the funding for the project cost.)

14. The HKITP will contribute $600 million for the new hotel development, as generated by the operating cash of the resort. TWDC will contribute $1.7 billion as cash equity and provide up to $1.1545 billion as a new term loan to the HKITP.

15. While the Government will not inject new cash equity for the new hotel development project, it will provide the HKITP with a new Government term loan of up to $0.8085 billion. The key terms of the loans by the Government and Encl. 5 TWDC are identical, as set out in Enclosure 5. To maintain the Government's position as the majority shareholder, we will progressively convert $1.7 billion from the existing Government loan into equity to match, on a dollar-to-dollar basis, the new cash equity contribution by TWDC. According to the original repayment schedule of the existing Government loan, the first repayment date and the maturity date are September 2016 and September 2030 respectively. Under the proposed conversion, the maturity date of the remaining unconverted Government loan of around $0.3 billion will be advanced to fiscal year 2022 while the first repayment of such will be deferred to the end of the drawdown availability period of the new shareholder term loans, estimated to be in late fiscal year 2018, and subject to the HKITP's cash position at that time.

16. Overall, in terms of cash contribution, the Government will commit to a new loan to the HKITP of up to $0.8085 billion while TWDC will commit to a total of $2.8545 billion ($1.7 billion equity in cash to the HKITP and a new loan of up to $1.1545 billion). The Government and TWDC are expected to have similar post-financing term loan balances to the HKITP of slightly over $1.1 billion. The Government will maintain a majority shareholding in the HKITP after the proposed loan conversion.

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17. In addition to the hotel financing arrangement described above, TWDC will renew its revolving credit facility (RCF) to the joint venture to provide short-term liquidity in case of unforeseen circumstances which could seriously affect the latter's cash flow. To account for the growth in the scale of the HKDL's business, the size of the RCF is proposed to increase from $300 million to $400 million.

Financial and Economic Returns

18. The new hotel will enhance the appeal of the HKDL and contribute to the resort's revenue and profitability. Based on current trend, the HKDML projects that all three hotels will achieve healthy occupancies in medium term, as driven by persistent growths in both theme park attendance and hotel penetration of theme park guests. In addition, the new hotel will benefit from leveraging the scale economies of the HKDL's resort-wide infrastructure, management overhead, and brand and marketing awareness. According to the HKDML's estimates, similar to the two existing hotels, the new hotel will be a key revenue driver for the HKDL and assuming a steady growth in tourist arrivals, attendance and per guest spending, the HKDL will continue to be profitable after the opening of the third hotel and the HKDL's brand and positioning as a premier leisure and vacation destination in the region will be strengthened.

19. In evaluating any potential new investment at the HKDL, the investment must support the resort's brand and strategy and be able to deliver attractive returns on invested capital which is acceptable to shareholders, for example, by at least meeting the cost of capital. While TWDC does not disclose its cost of capital, the average analyst estimate is 8%, and the expectation on the third hotel is to deliver returns at or above that threshold.

20. On economic benefits, the HKDML estimates that the new hotel will create 600 to 700 full-time equivalent jobs in the HKDL after the new hotel commences operation. It will also be able to generate additional economic benefits for Hong Kong through additional hotel room supply and incremental tourist spending. Taking the first eight years of operation together, the total value added generated by the HKDL amounted to $50.4 billion or 0.35% of Hong Kong's GDP. A total of 148 900 jobs (in terms of man-years) were also created over these years, providing considerable job opportunities to the tourism industry, especially for frontline workers.

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FINANCIAL IMPLICATIONS

21. As at end of fiscal year 2013, the HKITP had an ordinary share capital of $16.4 billion, a loan from the HKSAR Government with a balance of $2 billion, as well as a subordinated share capital of $4 billion held by the Government. According to the plan and on the basis of current projections, following the conversion of part of the Government loan, the Government would maintain a majority shareholding of 52% in the HKITP. The capital structure of the HKITP before and after the proposed financial arrangements is set out in Enclosure 6.

Encl. 6

PUBLIC CONSULTATION

22. We consulted the LegCo Panel on Economic Development on 24 February 2014 on the proposal. Members generally supported our submission of the proposal to the FC for approval of the proposed loan-to-equity conversion and new term loan outlined in paragraph 13.

BACKGROUND

23. The HKDL was opened in September 2005, and consists of a theme park and two hotels. The site of the HKDL amounts to 125.4 hectares (ha.), of which 72 ha. is allocated for theme park, retail, dining and entertainment uses, while the rest of the site is for hotel and car park uses. The theme park now provides seven themed areas[2].

24. To improve the resort's operating and financial performance and facilitate future expansions, the Government and TWDC reached agreement in 2009 on capital realignment and launched three new themed areas in the existing theme park between 2011 and 2013. To further enhance its appeal, the HKDL will unleash a series of new initiatives such as a night time parade called "Disney Paint the Night" (to be launched in September 2014) and a new themed area based on Marvel's Iron Man franchise (to be opened by late 2016).

Tourism Commission
Commerce and Economic Development Bureau
April 2014

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[2] Fantasyland, Tomorrowland, Adventureland, Main Street USA, Toy Story Land, Grizzly Gulch, and Mystic Point.

Background Information on Hong Kong Disneyland Hotel and Disney's Hollywood Hotel

Hong Kong Disneyland Hotel (DLH)

Grand Hotel with Victorian Style

This deluxe, 400-room, Victorian-style family hotel has three restaurants, a grand ballroom, indoor and outdoor pools, a gift shop, a four-story atrium lobby, a Mickey Mouse-inspired maze and 15 concierge level suites with a view of the South China Sea and surrounding mountains. The hotel houses 16 meeting and banquet rooms, which are perfect venues for Disney 'Fairy Tale Weddings' and MICE events (Meetings, Incentives, Conventions and Exhibitions).

Disney's Hollywood Hotel (DHH)

Fun for the Whole Family

Designed in an Art Deco-style, the 600-room family-friendly hotel has two restaurants, shops, and terrace gardens laid out like a miniature map of Hollywood, U.S.A. The eight-story hotel overlooks the Hong Kong Disneyland Resort and the South China Sea. Recreational facilities include a piano-shaped swimming pool with a slide, the Malibu Games room, a children's play area and spacious grounds that are perfect for picnics, play or relaxation.

DLH and DHH combined occupancy rate from FY08 to FY13

	FY08	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**
Combined Occupancy Rate	78%	70%	82%	91%	92%	94%

Location Plan and Design Drawings


PROPOSED THIRD HOTEL
HONG KONG DISNEYLAND RESORT
Artist Concept Only © Disney

Enclosure 3 to FCR(2014-15)6

Available land parcels for future theme park expansions on Phase 1 site

Site available for development

Iron Man themed area

Site within fireworks fallout zone

Breakdowns for Estimated Project Cost

Items	Cost Estimates (HK$ million)	Remarks
Project Development	2,958 (A)	Cost Estimates for this item include: Area development & facility (HK$2,581M); Interior fixtures (HK$161M); Operating requirements (HK$132M); and General requirements (HK$84M)
Direct labor & Consultants	513 (B)	
Contingencies	217 (C)	Equivalent to about 6% of the "Total" at 2013 price level
Total (at 2013 price level)	3,688 (A) + (B) + (C)	
Price Adjustment	575 (D)	
Total Investment	**4,263** (A) + (B) + (C) + (D)	

Proposed terms of the new Shareholder Term Loans for the New Hotel Development at Hong Kong Disneyland (HKDL)

Borrower:	Hongkong International Theme Parks Limited
Lenders:	Hong Kong SAR Government (HKSARG) and An affiliate of The Walt Disney Company (TWDC)
Type:	Term Loan
Maximum Commitment:	HK$808,500,000 from HKSARG HK$1,154,500,000 from TWDC
Purpose:	Solely to finance a portion of hotel development costs, not to exceed HK$1,963,000,000
Drawdown Availability Period:	Commence upon the completion of the equity injection from TWDC (and equivalent conversion of the existing HKSARG Loan) and end no later than the last day of the fiscal quarter falling 18 months after the opening of the new hotel
Final Maturity:	End of Fiscal year 2025[Note]
Ranking:	All Shareholder Term Loans from HKSARG and TWDC rank *pari passu* and are subordinate to a revolving credit facility
Interest rate / Interest:	2.00% over the 3-month Hong Kong Interbank Offered Rate per annum, and the related interest to be capitalised during the Drawdown Availability Period
Repayment:	Repayment schedule is as follows: Last business day in fiscal year 2022: 10% Last business day in fiscal year 2023: 25% Last business day in fiscal year 2024: 30% Last business day in fiscal year 2025: 35%

[Note] Final maturity date for the unconverted portion of the existing Government loan will be brought forward from fiscal year 2030 to fiscal year 2022.

Payment / Repayment:	Scheduled debt service payments prior to final maturity will be made subject to the Borrower having sufficient cash available to make such payments
Prepayment:	Voluntary
Fees:	Nil
Security:	Nil

Enclosure 6 to FCR(2014-15)6

Current and Projected Capital Structure of HKITP

	HKSARG ($ billion)	TWDC ($ billion)	Total ($ billion)
Capital structure as at end of fiscal year 2013:			
Ordinary equity	**8.6 (52%)**	**7.8 (48%)**	**16.4**
Subordinated equity	**4.0**	**-**	**4.0**
Loan	**2.0**	**-**	**2.0**
Projected capital structure after completion of the new hotel			
Ordinary equity	**10.3 (52%)**	**9.5 (48%)**	**19.8**
Subordinated equity	**4.0**	**-**	**4.0**
Loan	**1.1**	**1.1**	**2.2**

Note – There would be some adjustments to the capital structure depending on the interest rate applicable to the Government loan, progress of construction and the company's cash flow during the expansion period.
