

For information
on 21 November 2017

**Legislative Council
Panel on Commerce and Industry**

Development of the InnoCell adjacent to Hong Kong Science Park

PURPOSE

This paper provides supplementary information regarding the proposed InnoCell to be developed by the Hong Kong Science and Technology Parks Corporation (“HKSTPC”) at a site adjacent to the Hong Kong Science Park (“Science Park”).

BACKGROUND

2. At the meeting on 18 July 2017, this Panel was briefed on the development plan of the proposed InnoCell project, including the anticipated accommodation demand and economic benefits, proposed admission criteria and rental, scope of development and the financial arrangements, etc.

3. Members generally supported the plan and considered the InnoCell project effective for attracting and retaining innovation and technology talents in Hong Kong. On the other hand, they raised a number of issues, which mainly included: the reason why the Government have to inject a relatively high proportion of equity into HKSTPC for the project (i.e. to provide government equity injection equivalent to 70% of the total development cost, and government guarantee for the commercial loan and accrued interest of the remaining 30%); that the HKSTPC should draw up detailed admission criteria and suitable tenancy period for the InnoCell; whether the expected rental income from the InnoCell could cover its management and operating costs and generate profits; and that there should be more elaboration on the economic benefits that would be derived from the project.

4. The Administration undertook at the meeting to provide further information on —

- (a) the proposed funding arrangement;
- (b) details of the anticipated demand and the admission criteria of the InnoCell;
- (c) financial analysis of the project; and
- (d) the projected economic benefits to be brought about by the project.

SUPPLEMENTARY INFORMATION

Proposed Funding Arrangement

5. In examining the funding arrangement of the InnoCell, we consider it necessary to take into account HKSTPC's overall financial position and cash flow projections, including the projects to be financed, the new initiatives, as well as the need to maintain adequate cash balance¹ to cope with operational needs and unforeseen business risks.

6. In this connection, it must be noted that HKSTPC is already shouldering loans amounting to \$4.453 billion and associated interest liability of about \$790.3 million, to be fully repaid by 2035/36. These comprise —

- (a) an outstanding government loan of \$496 million for the development of Science Park Phase 2;
- (b) a commercial loan of \$1.707 billion in the form of medium term note for the development of Science Park Phase 3;
- (c) a government loan of \$600 million to be drawn for developing Science Park Phase 3; and
- (d) a government loan of \$1.65 billion to be drawn for the development of the Data Technology Hub and Advanced Manufacturing Centre at Tseung Kwan O Industrial Estate.

¹ The Board of Directors of HKSTPC has set a requirement that HKSTPC should maintain a minimum cash balance of \$200 million, which is equivalent to some three months of HKSTPC's average monthly operating expenses in 2017/18.

7. At the moment, the rental income from the Science Park is generally adequate for HKSTPC to cover its operating costs, as well as loans and interest repayments. It is further estimated that with the proposed loan (30%) : equity (70%) financial arrangement for the InnoCell, HKSTPC's total loan and interest liability will increase to \$4.693 billion and \$896.3 million² by 2035/36 respectively. The total rental income from the Science Park and the InnoCell should still be marginally adequate to cover the aforesaid expenses.

8. However, if the InnoCell is to be 100% financed by commercial loan, HKSTPC's total loan and interest burden will increase to \$5.253 billion and \$1.135 billion² respectively by 2035/36. The problem created can be illustrated by the cash flow projection of HKSTPC from 2017/18 to 2030/31 (**Annex**)³. In the proposed loan (30%) : equity (70%) scenario, HKSTPC's cash balance will be above the threshold of \$200 million for the entire period from 2017/18 to 2030/31, except 2024/25. A higher proportion of commercial loan will bring the cash balance to fall below the threshold for a longer period. A 100% commercial loan scenario will likely lead to negative cash balance in 2024/25 and another three years' of cash balance below the safety threshold of \$200 million. Such a heavy financial burden will critically affect the financial health of HKSTPC, rendering it difficult to operate on prudent commercial principles⁴ and at the same time fulfil its public mission of facilitating innovation and technology development in Hong Kong.

Anticipated Demand and Admission Criteria

9. HKSTPC has conducted a market survey in 2016. The survey indicated that the anticipated demand for the InnoCell in 2015/16 was more than 420 units. Based on this estimate and having taken into account other related factors, such as the expected annual growth of employment in the Science Park, potential new employment to be brought about by the InnoCell and the mix of origins of new employees, the consultant further projected that the demand would be around 580 units in 2020/21.

² Assuming interest rate of the commercial loan is 2.8% for the InnoCell project, which is the average of the rates quoted by banks in November 2016, plus an anticipated future increase in interest rate when the loan is drawn down in 2019/20.

³ All cash flow projections adopt the same assumptions i.e. (a) occupancy of the InnoCell would start at 30% in 2020/21, gradually increase to 95% in 2022/23 onwards; and (b) the rental would be \$9,000 per unit per month in 2020/21 with 3% annual increase thereafter.

⁴ It is estimated that to make up for the cash shortfall, HKSTPC will need to increase the overall rental of Science Park by around 8% every year for seven years (from 2018/19 to 2024/25), in addition to the normal cost and market rent adjustments.

10. To make the best use of the InnoCell, applicants will be subject to a set of pre-determined admission criteria. All applications will be considered by an assessment panel to be formed by HKSTPC on a case by case basis, using a uniformed scoring system that covers both “Merit” and “Need” considerations. The preliminary admission criteria include —

- (a) **Principals of tenants/incubatees** in Science Park: a key eligibility criterion is that the applicant should not solely, jointly nor through a company own any residential property in Hong Kong. The “Merit” considerations may include technology skills or knowledge, academic achievements, contribution to/ participation in the local technology ecosystem and willingness to interact with other residents etc., whereas the “Need” considerations will likely cover the operational characteristics of the applicant’s company, the location and condition of his/her own home and other relevant factors. The tenancy period will be based on the rental period of their offices / laboratories in the Science Park or the length of their incubation programmes, but will not exceed two tenancies, each lasting up to 24 months. This tenant group is expected to take up about 40%-45% of the InnoCell;
- (b) **Overseas or Mainland employees of tenants/ incubatees**: a key criterion is that the applicant should be a full-time staff of the tenant/ incubatee with a valid working visa in Hong Kong. The “Merit” considerations will be similar to those of 10(a) above, while the “Need” considerations will likely cover the applicant’s income level and the priority accorded to him/her by the employer. The tenancy period will be based on his/her period of employment, but will not exceed two tenancies, each lasting up to 24 months. This tenant group is expected to take up about 40%-45% of the InnoCell; and
- (c) **Overseas or Mainland visiting scientists/ researchers**: the applicant will have to demonstrate his/her participation in research and development projects at the Science Park. To facilitate the processing of their applications, the applicants will be advised to ask their business contacts in the Science Park to submit applications prior to their arrival in Hong Kong. The tenancy period will follow the length of the projects or programmes that they are attached to. It is expected that this tenant group will take up about 5%-10% of the InnoCell.

The aforesaid proportion of tenant groups in the InnoCell is preliminary estimates only. The assessment panel will from time to time review the composition of tenants, the admission criteria, and the scoring system, taking into account operational experience, the actual demand and supply situation, etc.

Financial Analysis of the Project

11. Based on the assumptions set out in footnotes 2 and 3, the average annual rental income for the InnoCell will be around \$58 million between 2020/21 and 2033/34. The average annual operating and other costs⁵ will be around \$56 million during the same period. Any surplus arising will be credited to the general revenue reserve account of the HKSTPC for the sustained development of the Science Park, the InnoCell, the InnoCentre and the three Industrial Estates.

Projected Economic Benefits

12. The HKSTPC has commissioned a study to assess the economic impact of the development of InnoCell. Based on the findings of the consultant, an earlier study on the Science Park Expansion Phase 1 Development, as well as industry statistics and figures published by the Census and Statistics Department, the consultant concluded that the InnoCell would benefit the companies in the Science Park by attracting talents from the Mainland/ overseas and retaining existing ones, thereby generating wider economic benefits to Hong Kong. It is estimated that the InnoCell would create 300 direct and indirect employment opportunities, of which 100 are direct supporting staff of the InnoCell. The consultant also estimated that there would be a direct value added of around \$110 million, as well as indirect and induced value added of \$56 million per year (at 2014 prices)⁶.

⁵ Including operating costs (i.e. staff costs, general administration, miscellaneous costs, as well as marketing and promotional expenses) (18%), property management costs (21%), interest expenses (12%) and depreciation (49%).

⁶ Direct impact refers to the direct effect on employment and value added of the companies that are attracted to or retained at the Science Park due to the InnoCell. Indirect impact refers to the economic effect arising from the non-wage expenditure of these companies at the Science Park on services and goods provided by the supporting sectors (e.g. utilities, transportation, professional and financial services). Induced effect refers to the economic effect arising from wage-related expenditure of the employees in these companies at the Science Park and the supporting sectors.

13. Separately, it is estimated that during the three-year construction period, the development of the InnoCell would generate \$180 million added value and 354 man-years of employment.

ADVICE SOUGHT

14. Members are invited to note the above supplementary information on the development of InnoCell.

**Innovation and Technology Bureau
Innovation and Technology Commission
November 2017**

Cash Flow Projection of the Hong Kong Science and Technology Parks Corporation (in \$ million) under Different Funding Arrangement of InnoCell Project

The Proposed Ratio of Government Equity to Commercial Loan with Government Guarantee (GG)	Projected Cash Balance (in \$ million)														
	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31
70% Government Equity and 30% Commercial Loan with GG	10,475	10,047	6,072	2,766	899	211	219	489	17	291	533	746	950	1,041	1,244
60% Government Equity and 40% Commercial Loan with GG	10,475	9,967	5,991	2,762	893	203	209	476	1	273	512	723	924	1,012	1,213
50% Government Equity and 50% Commercial Loan with GG	10,475	9,886	5,910	2,758	887	194	198	463	(15)	254	491	699	898	983	1,181
40% Government Equity and 60% Commercial Loan with GG	10,475	9,806	5,828	2,754	880	185	186	449	(31)	236	468	673	869	953	1,147
30% Government Equity and 70% Commercial Loan with GG	10,475	9,725	5,747	2,750	874	176	175	435	(47)	217	447	650	843	924	1,116
20% Government Equity and 80% Commercial Loan with GG	10,475	9,645	6,113	2,564	862	162	159	416	(69)	193	422	622	813	891	1,080
10% Government Equity and 90% Commercial Loan with GG	10,475	9,565	6,110	2,559	855	152	146	401	(86)	173	398	595	783	858	1,045
100% Commercial Loan with GG	10,475	9,775	5,789	2,727	844	139	130	383	(107)	149	372	566	752	824	1,008

Remarks:

- The shaded cells indicate the projected cash flow falls below the safety threshold of \$200 million.
- Figures in brackets indicate negative cash balance.
- Major assumptions of HKSTPC's cash flow projections include:
 - Occupancy rates of the Science Park in 2017/18, 2018/19 and beyond 2019/20 are assumed to be 88%, 91% and 92% respectively. Rental will be frozen for three years from 2017/18 to 2019/20. After that, rental per square foot will be increased by 3% annually.
 - Occupancy rates of Science Park Expansion Phase 1 in 2020/21, 2021/22 and beyond 2022/23 are assumed to be 40%, 70% and 95% respectively. Occupancy rates of Data Technology Hub in 2020/21, 2021/22 and beyond 2022/23 are assumed to be 30%, 60% and 95% respectively. Occupancy rates of Advanced Manufacturing Centre in 2021/22 and beyond 2022/23 are assumed to be 30% and 60-95% respectively. Rental for these new facilities per square foot will be increased by 3% annually upon dates of completion.
 - Vigorous cost control measures will be adopted to control increase in operating costs.