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Panel on Economic Development
Meeting on 23 April 2018

Background brief on the development of the three-runway system
at the Hong Kong International Airport

Purpose

This paper provides background information on the development of the three-runway system ("3RS") at the Hong Kong International Airport ("HKIA") and deliberations of the Subcommittee to Follow Up Issues Relating to the Three-runway System at the Hong Kong International Airport under the House Committee ("HC") of the Sixth Legislative Council ("LegCo").

Background

Key milestones of the 3RS project

2. HKIA is operated and maintained by the Airport Authority Hong Kong ("AAHK"), a statutory body wholly owned by the Government and whose functions, powers and duties are governed by the provisions of the Airport Authority Ordinance (Cap. 483).

3. To meet future air traffic growth, AAHK has been planning to expand HKIA into a 3RS since 2008. In June 2011, AAHK published the HKIA Master Plan 2030 which outlined HKIA's future development options. A three-month public consultation was carried out to collect views and feedbacks of the public.

4. On 20 March 2012, the Executive Council ("ExCo") granted AAHK its in-principle approval to adopt, for planning purpose, the 3RS as the future development direction for HKIA.

5. In August 2012, AAHK received the Environmental Impact Assessment ("EIA") Study Brief from the Director of Environmental Protection ("DEP") which sets out the scope of environmental issues to be addressed in the EIA study. Based on the Study Brief, AAHK commenced the EIA study covering 12 environmental areas¹, assessing the potential environmental impact of the project.

6. AAHK submitted the 3RS EIA Report to the Environmental Protection Department in April 2014. The 3RS EIA Report was available for public inspection from June to July 2014.

7. On 7 November 2014, DEP approved the 3RS EIA Report and issued the associated Environmental Permit which sets out a number of conditions covering proposed environmental mitigation measures, enhancement initiatives, monitoring, and submission requirements during different stages of the project.

8. At the meeting on 17 March 2015, ExCo affirmed the need for the 3RS project at HKIA.

9. On 8 May 2015, the Lands Department issued a Government Notice for the reclamation works of HKIA's expansion into a 3RS. In addition, the Town Planning Board issued a Government Notice announcing the amendments to the approved Chek Lap Kok Outline Zoning Plan.

10. On 29 September 2015, AAHK announced the financial arrangement for the 3RS project.

11. On 26 April 2016, the Chief Executive-in-Council granted the approval for the draft Chek Lap Kok Outline Zoning Plan under the Town Planning Ordinance (Cap. 131), as well as the authorization of the proposed reclamation under the Foreshore and Sea-bed (Reclamations) Ordinance (Cap. 127) for the expansion of HKIA into a 3RS.

¹ The 12 environmental areas include (i) air quality; (ii) hazard to human life; (iii) noise impact; (iv) water quality; (v) sewerage and sewage treatment; (vi) waste management; (vii) land contamination; (viii) ecology (terrestrial and marine ecology, including Chinese White Dolphins); (ix) fisheries; (x) landscape and visual; (xi) cultural heritage; and (xii) health impact (air emissions and aircraft noise).

12. A subcommittee was formed under HC of the Fifth LegCo on 15 May 2015 to study issues relating to 3RS at HKIA. The former Subcommittee completed its work and submitted its report to HC on 17 June 2016 (LC Paper No. CB(4)1123/15-16).

13. The construction of 3RS was kicked off on 1 August 2016.

Overview of the 3RS project

14. As advised by AAHK, the 3RS project is more than building an additional runway. It includes the following seven core components –

- (a) formation of approximately 650 hectares of land north of the existing airport island by reclamation;
- (b) construction of the Third Runway, taxiways and apron;
- (c) construction of the Third Runway Passenger Building ("TRPB") with 57 parking positions upon 3RS commissioning;
- (d) expansion of the existing Terminal 2 ("T2") and construction of associated road network;
- (e) provision of a new automated people mover system and an integrated maintenance depot;
- (f) provision of a new high-speed baggage handling system serving between TRPB and T2; and
- (g) construction of airport support infrastructure, utilities and facilities.

Construction works of 3RS is expected to be completed in 2024, with the target commissioning of the new runway in 2022.

Cost and financial arrangements

15. AAHK has advised that the estimated construction cost of the 3RS is \$141.5 billion at money-of-the-day prices, of which approximately 40% will be used for land formation. The financial arrangement for the 3RS will be based on the "joint contribution and user-pay" principle. With the advice of its financial consultant, The Hongkong and Shanghai Banking Corporation Limited ("HSBC"), AAHK will fund the 3RS project through the following three sources:

- (a) retaining AAHK's operating surplus (\$47 billion);
- (b) levying a new Airport Construction Fee ("ACF") (\$26 billion);
and
- (c) borrowing/raising funds from the market (\$69 billion).

The revenue generated by (a) and (b) above will provide around 51% of the funding required to finance the 3RS project. The remaining 49% will be raised from the market as mentioned in (c).

Retaining operating surplus

16. AAHK has advised that in accordance with the 3RS financial arrangement proposal submitted to the Government in 2015, it would retain all distributable profits from 2014-2015 onwards until the commissioning of 3RS. The decision of retaining operating surplus for the purpose of funding the 3RS project was duly considered and approved by AAHK Board. At the same time, AAHK will optimize various revenue sources to provide funding to the 3RS project.

Introducing a new ACF

17. AAHK has begun collecting ACF on air tickets issued from 1 August 2016 for departing passengers at HKIA. ACF will be in effect until all borrowings related to the 3RS project are fully repaid, which is expected to be in 2030-2031. AAHK intends to maintain the charging levels of ACF throughout the collection period. A table summarizing the charging mechanism of the ACF regime is set out below:

ACF (HK\$ per departing passenger)		First/ Business Class	Economy Class
	Long haul	\$180	\$160
Short haul	\$160	\$90*	

* To maintain the competitiveness of HKIA's hub status, ACF for short haul economy transfer/transit passengers is set at \$70.

Raising funds from the market

18. Taking account of the funding sources outlined in paragraphs 16 and 17 above, there remains a funding shortfall of \$52 billion. To fill this funding gap, AAHK plans to borrow/raise funds from the market. Together with the estimated borrowing cost of \$17 billion, the total incremental borrowings will be \$69 billion which will be raised from the market in phases.

19. In September 2017, AAHK released the report on the detailed funding study for the 3RS project submitted by HSBC, which was appointed by AAHK to analyze different debt structure, identify suitable forms of financial instruments, and make recommendations on the financial instruments in relation to their timing, size and tenor that will enable AAHK to raise funding for the 3RS project in the most optimal manner.

20. Based on prevailing assumptions as well as an assessment of the current market conditions, HSBC recommends AAHK to raise debt closer to the time when funds are required with the following general principles for governing the selection and mix of financial instruments:

- (a) bonds should represent a significant component of the detailed funding plan. AAHK should consider issuing long-tenor United States Dollar ("USD") bonds (e.g. 10 years) in earlier years of the detailed funding plan so as to establish a favourable benchmark interest rate to facilitate subsequent borrowings;
- (b) a retail bond offering towards the start of the funding timeline to allow the general public to participate in and share the financial benefits arising from investment in the 3RS project;
- (c) revolving bank facilities be maintained to meet potential unexpected liquidity requirements; and
- (d) shorter-dated USD, Hong Kong Dollar ("HKD") or other foreign currencies bonds (5 to 7 years) and HKD bank loans (up to 5 years) for later years.

The detailed funding plan with implementation timeline is summarized in a schematic graph in **Appendix I**.

Discussions of the Subcommittee

21. In view of the wide public concern about 3RS and as the issues involved various policy areas, a subcommittee was formed under HC of the Sixth LegCo on 28 October 2016 to study issues relating to 3RS at HKIA.

22. The Subcommittee held a total of eight meetings and focused its work on the feasibility of 3RS, its scope and design details, financial arrangement, existing capacity of HKIA, environmental impacts, and related matters. The deliberations of the Subcommittee covered the capacity of HKIA; the design of TRPB; airspace management in the Pearl River Delta region; an air traffic management arrangement; the impact of the "air wall" constraint on 3RS; cost and financial arrangement, financial viability and sustainability, and detailed funding plan of the 3RS project; cost control mechanism for the 3RS project; development of the North Commercial District; filling materials used and the reclamation methods adopted in the 3RS reclamation works; marine works safety of 3RS; manpower plan of HKIA to meet the increased manpower required after commissioning of 3RS; the progress of implementing the key EIA commitments by AAHK; and aircraft noise after the commissioning of 3RS. The Subcommittee also took the opportunity to discuss a number of issues relating to the current operation of HKIA, namely flight delays; parking spaces at HKIA; efficiency of baggage delivery; and transport infrastructure on Lantau.

23. Some members of the Subcommittee expressed support for the early implementation of the 3RS project given that the two-runway system was reaching its full capacity; and that the project would help strengthen Hong Kong's position as an international aviation hub, bring tremendous economic benefits, and create ample job opportunities for Hong Kong. Some members, however, had grave reservations about the project given the unsolved airspace issues, doubtful cost-effectiveness and financial viability of the project, and adverse environmental impact. They also expressed dissatisfaction to the financial arrangement for the project which was regarded as bypassing the vetting and approval mechanism of LegCo.

24. Given that the sourcing of filling materials for the 3RS project had significant bearing on the project costs, the Subcommittee passed a motion at the meeting on 11 April 2017 calling on AAHK to provide detailed information on the quantities and prices of all the filling materials procured and ordered by its contractors. AAHK's and the Administration's responses to the relevant matters were issued to members vide LC Paper Nos. CB(4)1178/16-17(02) and (03) respectively.

25. The Subcommittee completed its work in November 2017 and put forward relevant recommendations in its report to HC (LC Paper No. CB(4)205/17-18). A summary of the recommendations is in **Appendix II**.

Council questions

26. At the Council meetings on 4 February, 15 and 22 April, 27 May and 8 July 2015, 7 December 2016 and 17 May 2017, questions relating to the development and funding proposal of 3RS, aircraft noise, capacity and nearby developments of HKIA had been raised by Members. Hyperlinks to the relevant written replies from the Administration are provided in **Appendix III**.

Latest development

27. To continue to monitor the progress of the 3RS project, the Subcommittee recommended that issues relating to the 3RS project should continue to be followed up by relevant Panels of LegCo. The Administration/AAHK should provide the progress update of the 3RS project to the Panel on Economic Development ("the Panel") on a half-yearly basis.

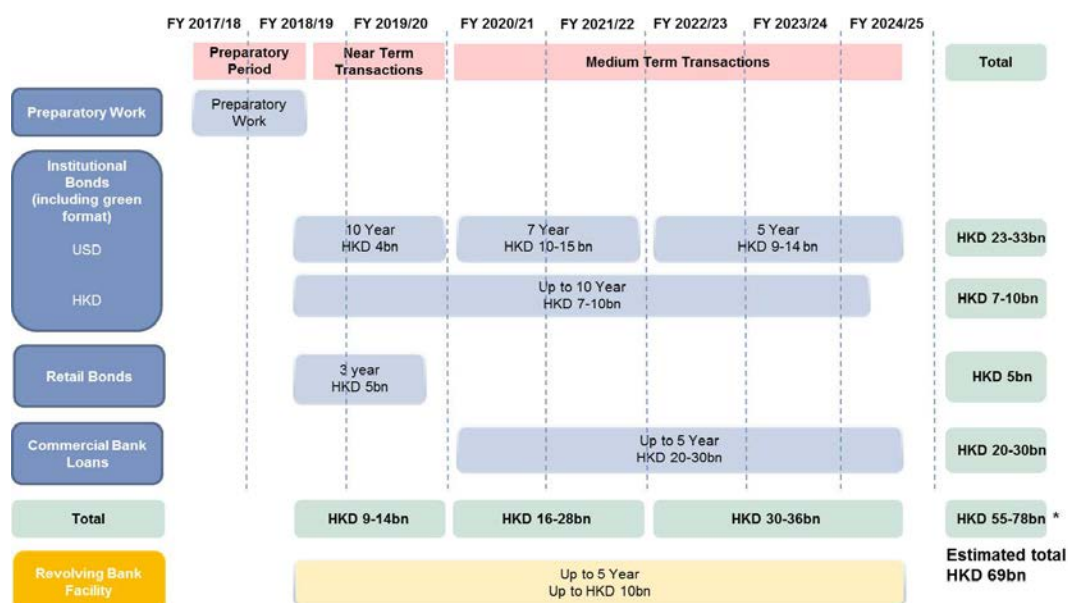
28. At the meeting of the Panel on 12 October 2017, Hon Jeremy TAM proposed to discuss the 3RS development, including the construction progress and project expenditure, on a yearly basis. He also requested the Administration/AAHK to provide a progress report every half-year on this subject.

29. The Administration will brief the Panel on the update on the development of 3RS at HKIA at the meeting on 23 April 2018.

Relevant papers

30. A list of relevant papers which are available on the LegCo Website (<http://www.legco.gov.hk>) is in **Appendix III**.

The Detailed Funding Plan and Indicative Implementation Timeline



Source: AAHK, 3RS Consultancy Study: Detailed Funding Plan for Three-runway System (3RS) at HKIA – Financial Advisor Report, HSBC (2017)

Notes :

1. Revolving bank facilities serve to provide liquidity only and do not form part of the core debt funding required for the 3RS.
2. As market conditions and the terms of different instruments would vary from time to time, ranges indicating the potential issuance sizes for each debt instrument in the medium term are used to provide flexibility for AAHK to optimize the choice of instruments closer to the time of fund raising.
3. For the avoidance of doubt, the total aggregate debt issuance across all instruments in the recommended funding plan is not expected to exceed the debt requirement to fund the 3RS.
4. \$55-78 billion represents the summation of the lowest and highest range of each debt instrument type.

**Recommendations of the Subcommittee to Follow Up Issues
Relating to the Three-runway System
at the Hong Kong International Airport
of the Sixth Legislative Council**

As the 3RS project is one of the major large scale infrastructural projects in Hong Kong, the construction of which will straddle a number of years, the Subcommittee recommends that issues relating to the 3RS project should continue to be followed up by relevant Panels of LegCo. The Administration/AAHK should provide the progress update of the 3RS project to the Panel on Economic Development on a half-yearly basis.

2. The Subcommittee also recommends that –
the Administration should:

- (a) closely monitor AAHK's implementation of the 3RS project in view of its unprecedented scale, cost and complexity;
- (b) consider disclosing the contents of the "Pearl River Delta Region Air Traffic Management Planning and Implementation Plan (Version 2.0)" in liaison with relevant government authorities;
- (c) consider providing more information on achieving the target maximum capacity of 102 air traffic movements per hour under the 3RS operation at HKIA, including the timeline for achieving such target;
- (d) consider commissioning a consultancy study on the impact of "air wall" constraint on the runway capacity of HKIA;
- (e) consider appointing an independent consultant to review AAHK's detailed funding plan; and
- (f) closely monitor the compliance by AAHK with all mitigation measures stipulated in the Environmental Permit for the 3RS project.

AAHK should:

- (a) continue to enhance the capacity of the two-runway system prior to the full commissioning of the 3RS;
- (b) take all necessary project management and cost control measures to ensure that the 3RS project will be delivered on time and within budget;
- (c) improve the transparency in the process of procuring filling materials;
- (d) consider arranging LegCo Members to have sight of the 3RS construction contracts under confidential undertaking;
- (e) consider allocating a larger portion of its borrowings for funding the 3RS project in the form of retail bonds and green bonds;
- (f) relay the travel agencies' concern to airlines on collecting ACF;
- (g) formulate long-term manpower plans and measures as well as develop better transport connectivity to facilitate and encourage more people to work at HKIA;
- (h) consider conducting a survey on the travelling expenses of airport staff; and
- (i) implement measures to shorten the baggage delivery time.

Source: Report of the Subcommittee to Follow Up Issues Relating to the Three-runway System at the Hong Kong International Airport formed under the House Committee of the Sixth Legislative Council (LC Paper No. CB(4)205/17-18, paragraphs 93 and 94)

List of relevant papers

Issued by	Meeting date/ Issue date	Paper
The Subcommittee to Follow Up Issues Relating to the Three-runway System at the Hong Kong International Airport of the Sixth Legislative Council	5 December 2016	Administration's paper Background brief Minutes
	7 February 2017	Administration's paper Administration's paper Minutes
	11 April 2017	Administration's paper Motion passed Administration's follow-up paper Airport Authority Hong Kong's follow-up paper Minutes
	12 June 2017	Administration's paper Minutes
	10 July 2017	Administration's paper Minutes
	29 September 2017	Administration's paper Minutes
	18 October 2017	Administration's paper Minutes
	House Committee	17 November 2017 (Item V (b))

Issued by	Meeting date/ Issue date	Paper
Council Meeting	4 February 2015	<u>Council question on "Expansion of the Hong Kong International Airport into a three-runway system" raised by Hon Gary FAN</u>
	15 April 2015	<u>Council question on "Expansion of the Hong Kong International Airport into a three-runway system" raised by Dr Hon KWOK Ka-ki</u>
	22 April 2015	<u>Council question on "Funding proposal for the project to expand the Hong Kong International Airport into a three-runway system" raised by Hon Mrs Regina IP</u>
	27 May 2015	<u>Council question on "Aircraft noise" raised by Hon Albert CHAN</u>
	8 July 2015	<u>Council question on "The Hong Kong International Airport's capacity to receive visitors" raised by Hon YIU Si-wing</u>
	8 July 2015	<u>Council question on "Development of North Commercial District and payment of relevant land premium by the Airport Authority" raised by Dr Hon KWOK Ka-ki</u>

Issued by	Meeting date/ Issue date	Paper
	7 December 2016	<u>Council question on "The project to expand the Hong Kong International Airport into a three-runway system" raised by Hon CHU Hoi-dick</u>
	17 May 2017	<u>Council question on "Reclamation works under the project of the expansion of the Hong Kong International airport into a three-runway system" raised by Dr Hon YIU Chung-yim</u>