

1 EXECUTIVE SUMMARY

1.1 Purpose of the Study

The Tourism Commission appointed Evans & Peck to undertake an advanced market survey and to analyse, assess and advise the Government on the financial viability of the Aberdeen Tourism Project (ATP) and its optimum implementation mode.

1.2 Background

In the 2007-08 Policy Address the Chief Executive mentioned that the South Island Line (East) would be commissioned no later than 2015. In tandem, Ocean Park is being redeveloped into a world-class marine-themed park covering about 70 attractions by 2011-12, to be complemented by three hotels. To meet the development needs of the Southern District and enhance the tourism appeal of Aberdeen in light of future visitor growth, the Government intends to develop and enhance tourist facilities in Aberdeen, particularly on both sides of the waterfront of Aberdeen Harbour.

The Tourism Commission (TC) commissioned LCK Architects Limited (LCK) in December 2006 to develop a preliminary conceptual design for tourism infrastructure development of Aberdeen. In essence, LCK proposed that both sides of the Aberdeen Harbour should be redeveloped and revitalised along the theme of a "Fisherman's Wharf", with a view to preserving the unique features of a "traditional fishing harbour" and the local culture of Aberdeen together with additional new creative uses.

The conceptual design prepared by LCK was presented to the Southern District Council (SDC) in April 2007. TC also consulted other interested parties and stakeholders in 2007-08 and they were in general supportive of the concept plan.

To take the project forward, TC appointed Evans & Peck in early 2008 to undertake an assessment on the business potential and financial viability of the concept plan, which had been revised taking into account the comments received from the SDC and other stakeholders. The study was also tasked to assess which implementation mode would be most appropriate, for example, whether the project should be designed, built and operated by the private sector or the Government.

Initial findings of the business viability study were available in mid 2008. However, as there were a number of ongoing developments along both sides of Aberdeen Harbour, it was necessary to review the scope of the concept plan and, hence, further assessment on various scenarios, to ensure the study could realistically reflect the current situation and be more reliable.

In latter half of year 2008, the extent of the global economic crisis became apparent, as issues in the financial sector spread into the real economy with significant adverse effects on global and local business activities as well as the tourism industry of Hong Kong. It was necessary to further review the business viability study to take into account the effects of the global economic downturn. This further study and assessment was completed in early 2009.

1.3 Study Methodology

The methodology used in this consultancy followed 5 broad steps:

1.3.1 Market Review/ Engagement

The market review was devised with the aims of identifying potential investors and seeking their views on the Revised Concept Plan (RCP), as well as gauging their interest and commitment to be involved in the project.

A questionnaire was developed (Appendix 1) that was designed to capture various aspects of the respondent's knowledge of the existing proposal as well as encourage them to submit suggestions for improvement of the project. After submission of the questionnaire, selected interviews were held with key developers and industry bodies such as MTRCL and the Real Estate Developers Association to further solicit opinions and gauge market interest.

1.3.2 Overseas Examples

Four overseas projects were assessed as being suitable for direct comparison with the ATP in order to gauge what makes a venue successful and learn from overseas experience.

The four examples chosen were Clarke Quay (Singapore), Boat Quay (Singapore), Darling Harbour (Sydney, Australia) and Fisherman's Wharf (Macau).

Each was assessed in terms of:

- The main attraction for this venue
- How successful was the venue
- What were the mix of facilities offered
- What was the management model
- What was the target market

1.3.3 Project Assumptions and Major Influential Factors

Key assumptions were developed and major influential factors that may affect the viability of the project were also identified. These were then used as key input parameters for modelling, reviewing and comparing the options available.

Examples of the type of assumptions derived were patronage projections, construction costs, average spend per visitor. Examples of major influential factors include, inter alia, land ownership issues, reprovisioning of existing facilities, land traffic impact, availability of parking facilities, town planning consideration, and interfaces with other projects.

1.3.4 Financial Modelling

A custom discounted cash flow model was developed in order to value the different scenarios and options. This model allowed projections out to 30 years for revenues and costs.

Key inputs into the model were assumptions like timing, tax, inflation, CAPEX, OPEX, funding, revenue etc.

Key outputs of the model were results such as standard financial metrics (e.g. IRR, NPV, DSCR, ROE), cash flow forecasts, debt service schedule, uses and sources of funds.

1.3.5 Funding / Operating Scenarios

The last step and a major portion of the study involved developing potential funding and operating scenarios. The starting point for this step was the Revised Concept Plan, this was then developed into two further scenarios with adjusted patronage and gross floor areas to explore how to make the project more attractive to private investors and the public.

Further modelling of another 2 scenarios then took place to assess the viability of the project in view of the latest developments along both sides of Aberdeen Harbour and the current global and local economic situation.

1.4 Major Findings of the Study

1.4.1 Views obtained from Market Engagement

The results of the market engagement were diversified. They can be summarised as follows:-

- Some major food and beverage groups (F&B) have doubts on the project's viability because they have reservations whether the project could have an adequate commercial GFA to form a critical mass to generate patronage, particularly on weekdays.
- Some are very concerned about the adequacy of car and coach parking facilities in Aberdeen.
- Developers with current investments in Aberdeen were keen to review further investment opportunities.
- Whatever investment model is selected must satisfy commercial "minimum return" criteria.

- Some general consensus for the need for Government to produce a master plan for Southern District.
- Most interested organisations expressed a desire to contribute to the planning and analysis of alternative development proposals.
- Any proposed redevelopment must become an integral part of and maintain the Aberdeen Harbour fishing village theme.
- Private sector involvement is critical to the success of the ATP.

1.4.2 Overseas Examples

The major conclusions from the study of the 4 overseas developments were:

- The establishment of the facilities as a "destination" is a key factor.
- It must establish its own cultural identity.
- It must have a good mixture of dining/entertaining, recreation and retail uses to make sure the area is vibrant.
- It must develop a constantly changing cultural community in order to persuade the local residents to make a number of repeat visits each year.
- A single ownership or a simplified management structure is preferred, so that the development can have a more coherent style and theme, and can make prompt responses to changing market demands.

When comparing the features of these overseas examples, we found that there were a number of common factors that have rendered them successful, which Aberdeen may also possess. These factors include:-

- Location and Accessibility - the project should be conveniently located, preferably as near the Central Business District as possible and well served by public transport. The location of Aberdeen Harbour would be an important factor to enhance the viability of the project. The proximity to Ocean Park would also be a supporting factor as it would be acting as a feeder of patrons. Being near the waterfront is a further beneficiary factor as it would present a more attractive atmosphere and environment to the visitors, while at the same time there may be possibility of water-based transport services to help in feeding the patrons from other tourism attractions.
- Historical background and character - each project should have its own identity and preferably has an attractive historical background and set of values, so that its unique character can attract more visitors and add more dimension to the area, rather than being a mere entertainment centre or food court not dissimilar to that offered by an ordinary shopping mall.

1.4.3 Major Influencing Factors

Drawing from the experience of the overseas tourism projects, the views obtained from the surveys, and through the process of the study, the major considerations that may affect the chance of success of a tourism project and its business viability are:-

1.4.3.1 Planning and Land Considerations

Except for the wholesale fish market, the industrial land in Lee Nam Road of Ap Lei Chau and the Aberdeen Marina Club, most of the land within the RCP is Government land. However, it should be noted that some of the existing facilities, even within Government land, especially the tennis/squash courts in Aberdeen, the basketball courts and football pitch in Ap Lei Chau, would require reprovisioning so as to ensure the recreational opportunities of the local residents would not be adversely affected due to the ATP. On the other hand, reprovisioning of these facilities is unlikely given the limited availability of suitable land in the vicinity. There are also a number of short term tenancies in the area. While some of them might not significantly affect the ATP, others such as the boatyard repairing workshops would also require reprovisioning. Reprovisioning location for this kind of facilities is normally very difficult and complicated.

With the exception of a number of temporary works areas occupied by WSD / DSD which expire on or before February 2009 and the Aberdeen fisheries and licensing office, the vast majority of the permanent land allocations within the core component of the ATP are recreational facilities managed by LCSD. It should also be noted that this core component part of the ATP falls within the 'Open Space' zone on the Aberdeen and Ap Lei Chau Outline Zoning Plan (OZP), which means that if the area is not used for recreational purposes as stipulated on the OZP, depending on the extent of changes and exact use in future, it would need to obtain the approval of the Town Planning Board for rezoning or require a planning application. If rezoning is required, the statutory planning process would take at least 15 to 18 months, sometimes longer. This would increase the uncertainty of the project and hence affect the interest of potential investors.

1.4.3.2 Traffic

Previous working papers and the initial Land Traffic Impact Assessment (LTIA) indicate that the Aberdeen Tourism Project would have no impact on the surrounding road network and Aberdeen Tunnel. However this was based on a projected volume of only 1.46 million patrons.

The introduction of the MTRCL's South Island Line (East) is critical as the Ocean Park redevelopment and the Aberdeen Tourism project will increase road traffic until the MTR service is commissioned.

1.4.3.3 Car Parking

The survey and interviews have highlighted the need for additional car and coach parking. The final development will need to include a significant increase in parking above the level currently proposed in the RCP.

1.4.3.4 Scale of Development

In order to ensure the project has significant attraction to attract overseas visitors as well as local visitors to visit multiple times in a year, the project needs to be of a reasonable size, so that it can accommodate a variety of facilities and to create a comfortable and enjoyable space for visitors. It is also believed that with more space and more variety of facilities, the spending per capita will also likely be higher, which will increase the overall project viability.

1.4.3.5 Patronage Level

The one single most important factor that can affect the success of a major tourism project is the patronage level, which can in turn be affected by a number of factors, such as the availability of facilities and services, the accessibility, the location, etc.

1.5 Analysis of Models of Private Participation and Funding Arrangements

By making reference to the revised concept plan carried out by the previous consultant LCK, the Study has examined various ways to enhance the business viability of the ATP, including analysing different business models, phasing the development, packaging elements and generation of third party revenue. Upon analysis, the study suggests that, to turn the project from non-viable to viable, the original RCP would need to be revised by increasing the commercial GFA by 70 -75% (to over 10,000 m²) while the proposed car and coach parking facilities should increase about 100% (to 208 spaces). That is to say a considerable size of public open space will need to be commercialized to enhance the financial viability of the project. At the same time, the Government would need to bear the financial responsibility for providing the capital and operational costs for the non-revenue generating facilities such as tourist information centre, open space, etc.

1.6 Analysis of the Financial Viability of the Project

Taking into account the views obtained from the stakeholders, lessons learnt from overseas experience, analysis of various business models and other ways to enhance business viability such as phasing of development, packaging elements and generation of third party revenue, the study has developed and tested various financial scenarios, using the RCP as the baseline scenario (Scenario A) and modified by our market research and technical review. The model inputs were:

- Capital expenditure (CAPEX)
- Life Cycle operating and maintenance cost (OPEX)
- Estimated revenues

Both PPP (Public Private Partnership) and DBO (Design, Build, Operate) procurement options were modelled for a number of scenarios. The following scenarios were included in the financial analysis that was conducted:

1.6.1 Scenario A

This scenario is the RCP baseline scenario with 1.46 million visitors per annum.

This would result in an operational funding gap of -HK\$451 million, under a 22-year concession and discount rate of 8%, i.e. this scenario is unviable as revenue cannot cover project operational expenses, let alone any debt repayment.

1.6.2 Scenario B

This scenario assumed that the GFA of alfresco dining and retailing facilities have increased by 70-75%, car and coach parking facilities increased by 100%, patronage level increased to 3.175 million per annum and the private sector would bear all costs.

This scenario, with an expanded development, eliminates any funding gap and delivers a surplus of HK\$185 million. However, a project IRR before tax of 7%, a return to shareholders of 8%, a negative NPV on equity and average debt service cover ratio of only 1.7, reveal that the project is still financially unviable.

1.6.3 Scenario C

This third scenario assumes 3.175 million visitors per annum and direct Government participation (i.e. scenario B modified by the Government assuming responsibility to fund the construction and operation of non-revenue generating facilities). Under these assumptions, this scenario would give a project IRR before tax of 9% and a return to shareholder of 13%.

This scenario provides a marginally viable alternative. The Study has then further tested its viability through various funding/operating models to identify the most viable option (illustrated in Appendices 7.1 - 7.6). It is found that the viability of this option can be further enhanced by adopting a two-stage DBFO model (Appendix 7.5). Under these conditions, the IRR is about 11% with 14% return on equity. This was considered financially viable by the private sector under pre-economic downturn conditions (i.e. before mid 2008).

1.6.4 Scenario D

Owing to ongoing developments in Aberdeen and subsequently announced ones since the study commenced, it was considered necessary to review the project area of the ATP under the original RCP to ensure that the viability of the project was still being realistically assessed.

Upon investigation, it was revealed that a significant part of the original area under the RCP would now need to be removed from the project. These excised parts include:

- Aberdeen Wholesale Fish market
- Active ball courts in the existing open space
- The waterfront park that is currently under construction by LCSD

- Active industrial land in Ap Lei Chau
- The existing Aberdeen Marina Club
- The existing shipyards

This resulted in a reduction of the project area by 73% (from 17.3 ha to 4.68 ha) and a significant reduction in the scope of the project from 7 distinctly themed zones to 2, i.e. the Aberdeen and Ap Lei Chau dining and entertainment zones.

Under this scenario, even assuming that the original patronage level of 1.46million under Scenario A could be maintained, the project becomes unviable. The project IRR will be reduced to 2% and NPV on equity will be -HK\$73M..

With such a significant reduction in both the scale of the project and range of facilities, the patronage risk increases as the project is reduced to just be a concentration of dining and entertainment venues whilst high cost, loss making facilities such as the Dragon Boat and Heritage Centre have less profit generating facilities to offset their losses.

The reduced scale is also inherently less attractive to developers, who commonly rely on a certain scale of development to justify corporate effort and profitability. The negative financial returns and financial metrics are far worse than with scenario C. The reduced scale and increased risk profile would mean that non financial considerations would equally dominate decision making and definitely preclude private sector interest and participation.

1.6.5 Scenario E

By the latter half of year 2008, the effects of the global economic downturn had become apparent in Hong Kong. At the same time, the MTRCL also confirmed their need to take up some of the land in Ap Lei Chau for works areas for the SIL(E), and Drainage Services Department indicated that they would also require a piece of land in Ap Lei Chau for the works area of the Harbour Area Treatment Scheme (HATS). This resulted in an even further reduction of the original site area of the ATP from 17.3 ha to 3.63 ha (-79%).

Using the current scope of the project and using the original concept plan levels of projected visitor numbers for 2010 of 1.46M, the project is unviable, giving a return on equity of -3% and an NPV on equity of -HK\$76.8M. As the potential visitor numbers that the project can attract with the significantly revised scope is in all probability lower than the 1.46M per annum used in the modelling for Scenario E, the viability of the project will further decrease with each decrease in patronage.

Aside from the unfavourable financial results, the non financial considerations would significantly influence private sector decision making, as the additional reduced area and even greater uncertainty in patronage has further reduced the project's overall attractiveness when compared to scenario D.

1.7 Recommendation

The original RCP scope and scenario is not viable even under a more optimistic economic climate than currently exists. To enhance the viability of the project, the GFA of the alfresco dining, retailing, etc would need to be increased by the order of 70 to 75% and strong transport links would need to be made available to feed patrons from Ocean Park, while the Government would need to bear the cost of the non-revenue generating facilities of the ATP. With these improvements, the IRR rate would only be 9%, which was marginally viable when the economic situation was better.

When the RCP was further reviewed in mid-late 2008 to take into account the latest developments in Aberdeen (Scenario D), it was revealed that the advantage of a successful tourism project with adequate variety of entertainment and recreation facilities would be fatally weakened by the inevitable reduction of the project area available for development. The effect of 'detonations' would be significantly compromised which would result in a reduction in business viability.

During the latter part of year 2008 and early 2009, the global spread of the financial credit crisis to other sectors of the economy has had devastating effects on the international trade and transportation industries. Long-haul overseas visitor numbers to Hong Kong were down 22.8% in January 2009 compared with a year earlier and the decrease in visitor numbers is accelerating as the major overseas visitors' home markets increasingly enter recession.

For potential private sector investors for the project, the unprecedented reduction of global credit availability has resulted in considerable risk adverse sentiment, a reassessment of what projects are desirable to invest in and their requirements for a financial return have become much more stringent. Credit lines are also becoming very tight.

All of the above factors have contributed to turn the project from a marginally viable project into an unviable one and have essentially negated all of the original conclusions and recommendations presented for the RCP scenarios.

Given all of adverse conditions described above, the current recommendation as of March 2009 is not to proceed with the project, as the risk profile has significantly increased, the commercial business case is unviable and the project is therefore unlikely to attract any private sector involvement or interest.