

## **Financing and Financial Benefits of Hong Kong Disneyland**

It is the intention of the Administration to make available to Members as many details as possible of the proposed Hong Kong Disneyland (HKD) project so that they may form a clear view of the deal we have negotiated with The Walt Disney Company (WD). We recognise that the greater the degree of transparency, the greater the acceptability to the public at large and the greater the confidence of Members in giving approval for the commitments we are seeking to be financed from public funds. That is why from the outset we have been careful to explain all the main features of the equity injection, the Government loan and the subordinated equity investment in the project. We have also sought to demonstrate that not only will the money be well-spent for the economic benefit of the Hong Kong community at large, but it will also be capable of yielding a respectable return on our investments, both equity and loan, in its own right.

2. Members have expressed a wish to have more details of the financial arrangements and wish us to quantify the impact on our investment if, for whatever reason, the project performs below the Base Case. Before doing so, it is necessary for us to make clear that we have undertaken to WD to keep in confidence the sensitive proprietary information it has made available to us and our financial advisers during the course of negotiations. It would be wrong for us to disclose information that may prejudice WD's discussions in future with third parties. We have a duty to Hong Kong not to disclose information that

may prejudice possible future discussions with other theme park operators. We also have a duty to the joint-venture Hong Kong International Theme Parks Limited (HKITP), which will operate commercially and in which we will have a major financial interest, not to disclose commercially sensitive information in the project. From this company's perspective, there is a danger that premature release of financial and commercial project details could be prejudicial for potential third party investors.

3. WD is the world's leading theme park operator, but it nevertheless operates in a commercially competitive environment. The Base Case financial projections have been assembled based on WD's experience at its existing theme parks, including proprietary information and details of these operations which are not in the public domain. A further consideration is that WD is a publicly-listed company in the United States where disclosure is regulated by the Securities and Exchange Commission. We have consulted two of our financial advisers on this point and they have confirmed our understanding of the position.

4. The three pieces of HKITP's capital structure that will be financed from the Capital Investment Fund are the equity injection, the Government loan and the subordinated equity.

### Equity Injection

5. The Government will inject \$3.25 billion cash as equity into HKITP pro rata with WD, who will contribute \$2.45 billion, from 2000–2005. Our return on that equity will be pro rata the same as WD, although we have the ability to sell our entire stake to third party shareholders one year after park opening, whereas WD must retain a minimum 1.9 billion shares in HKITP. In the Base Case, our return will be higher than our benchmark for investment in major commercial infrastructure projects of 10%. As we have noted elsewhere, there will be considerable upside potential, because we and WD have agreed to use conservative forecasts of patronage for the Base Case: many commentators are indeed now suggesting these could be easily exceeded. As for potential downside, it is clear that the project would need to have encountered significant adversity over its lifetime before our return would be diluted below our cost of capital. This equity risk is one that we and WD bear equally, although as a private company, their cost of capital may not be the same.

### Government Loan

6. The Government will lend \$5.6 billion to HKITP from 2000–2005, which, upon capitalisation after park opening of interest during construction, will amount to \$6.1 billion. In order to support the project cashflow in its early years the rate of interest is Prime minus 1.75% during construction and for the first eight years after opening, rising to Prime minus 0.875% for the next eight years, and to Prime for

the remaining nine years. We calculate the average rate over the life of the loan to be around 7.5%, well above Government's cost of capital, as represented by the return on the Exchange Fund. The loan will be repaid within 25 years of park opening by HKITP with the first repayment of principal taking place in the 11th year of park opening. This timetable is determined to enable HKITP to raise a commercial loan, amounting to \$2.3 billion upon capitalisation after park opening. It is intended that the commercial loan be repayable within 10 years of park opening.

7. In the Base Case the interest and principal of the Government loan can be comfortably repaid over the stipulated period. In order to guard against the risk that a longer period is required, in the event that project revenues appear insufficient to repay the loan in a severe downside, WD have agreed to a predetermined mechanism to bring equity support to the project to allow repayment by final maturity.

#### Subordinated Equity

8. The Government will inject \$4 billion in subordinated equity into HKITP, representing the cost of forming 126 ha for Phase I of HKD which the project economics in the Base Case do not permit the Company to pay in cash. This is to ensure that, in the Base Case, HKD can achieve a reasonable return. Otherwise, projected returns on equity would be unacceptably low from an investor standpoint, and the project could not be commercially funded. The subordinated equity will

nevertheless be able to convert to ordinary shares through the life of the project in upside scenarios which permit a return that is better than forecast in the Base Case.

Finance Bureau

8 November 1999