For discussion **FCR(2017-18)1**
on 1 April 2017

ITEM FOR FINANCE COMMITTEE

CAPITAL INVESTMENT FUND
HEAD 973 – TOURISM
New Subhead "Equity in Hongkong International Theme Parks Limited for the Expansion and Development Plan at Phase 1 site of the Hong Kong Disneyland Resort"

Members are invited to approve a commitment to inject $5,450 million as equity from the Capital Investment Fund (CIF) to the Hongkong International Theme Parks Limited (HKITP) to support an expansion and development plan at the Phase 1 site of the Hong Kong Disneyland Resort (HKDL).

PROBLEM

The Government has reached an in-principle agreement with The Walt Disney Company (TWDC) in respect of an expansion and development plan at the Phase 1 site of HKDL (the Plan), subject to the approval of the Legislative Council (LegCo) Finance Committee (FC). As part of the financial arrangements for the Plan, the Government needs to inject $5,450 million as equity from CIF to HKITP.

PROPOSAL

2. We propose that Members approve a commitment to inject $5,450 million as equity from CIF to HKITP to enable it to proceed with the Plan.

/**JUSTIFICATION** …..

JUSTIFICATION

Proposed Expansion and Development Plan of HKDL

3. Opened in September 2005, HKDL is a major component of the tourism infrastructure in Hong Kong which helps consolidate our position as an international premier tourist destination. In its past 11 years of operation, HKDL received over 64 million guests, generated around $83.6 billion of total value-added at 2014 prices (equivalent to 0.37% of Hong Kong's Gross Domestic Product) and created a total of 214 800 jobs (in terms of man-years). HKDL has all along been strengthening its appeal to guests from all over the world and locals through progressively enriching its attractions and entertainment offerings. This does not only add impetus to drive the business of HKDL, but also promotes the tourism development in Hong Kong.

Phase 1 expansion

4. The Government and TWDC, as shareholders of HKITP[1], have been discussing the overall development of HKDL, with a view to identifying an optimal strategy that would best serve the interest of tourism development in Hong Kong and that of the joint venture. The experience of HKDL's operation has demonstrated that new entertainment offerings and attractions are effective in driving the attendance and business of HKDL. To enable HKDL to continue to play to its strength in attracting high value-added visitors from all over the world to Hong Kong and fostering tourism development amidst intensifying competition in the region, we consider that it necessary to roll out a series of new attractions at the Phase 1 site of HKDL.

Details of the Plan

5. The Plan aims to sustain and refresh HKDL's appeal through the launch of at least one new attraction almost every year from 2018 to 2023 within the Phase 1 site of HKDL. The types of new attractions include new immersive themed areas, new/updated facilities and expansion of existing facilities. Brief descriptions of the planned attractions and the development cadence are as follows[2] –

/Year …..

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[1] The joint venture set up by the Government and TWDC for the development and operation of the HKDL project.

[2] The year indicated is target opening date. The actual opening will depend on the timing of securing funding approval, progress of works, and market situation.

Year	Details of New Attractions
2018	✧ transforming the existing “Buzz Lightyear Astro Blasters” into a ride using “Marvel Super Heroes” as the theme with new effects to create a whole new experience
	✧ an atmosphere stage at Adventureland with “Moana” as the theme
2019	✧ expanding and transforming the existing “Sleeping Beauty Castle”, the centerpiece of the theme park, with day and nighttime shows, shops and other entertainment offerings
2020	✧ new immersive themed area using “Frozen” franchise, with two rides and other entertainment offerings
2021	✧ “re-imagined” project[3]: transforming an existing attraction, details of which to be determined
2023	✧ new immersive themed area using “Marvel” intellectual property, with one ride and other entertainment offerings

6. The new attractions will be progressively rolled out, hence sustaining visitors’ excitement and visitation desire. These attractions also represent a good mix of different rides and entertainment offerings (e.g. castle shows, stage shows and character greeting experience), catering for a wide spectrum of guests, including family visitors and young adults. The Plan, when completed, would increase the number of themed areas of HKDL from seven to nine and the number of offerings from about 110 currently to over 130 (an increase of about 18%).

Proposed financial arrangements

Encl. 1

7. TWDC estimates that the Plan would cost $10,900 million, with breakdown of project cost estimates[4] as shown at Enclosure 1. To enable the new entertainment offerings and attractions to be launched as soon as possible, we propose that the project cost would be funded by the two shareholders of HKITP through concurrent cash equity injection. Our original proposal to the LegCo Panel on Economic Development (ED Panel) in November 2016 was that the two shareholders would share the project cost according to the existing shareholding ratio (i.e. 53% by the Government and 47% by TWDC). In the light of the concerns raised by ED Panel regarding the partnership arrangements between the Government and TWDC, the Government and TWDC have now agreed that the project cost would be funded on a 50:50 basis or $5,450 million each. We have also

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3 “Re-imagined” projects are those transforming the existing rides/facilities into ones with different franchise, storyline, ride system or technology so as to keep the rides/facilities refreshed.

4 In response to members’ comments as raised at the LegCo Panel on Economic Development meeting on 28 November 2016, Enclosure 1 presents a more detailed breakdown.

considered the option of raising debt to fund the Plan. Having regard to the common vision of the two shareholders to limit the near and medium-term debt service requirements of the joint venture, we consider it most appropriate to fund the Plan through cash equity injection.

8. In order to contain the Government's financial exposure, the amount of cash equity injection from the Government would be capped at $5,450 million. The capital injection will take place progressively as the implementation of the Plan progresses. The two shareholders will inject capital concurrently and the Government will maintain its status as the majority shareholder of HKITP after the completion of the capital injection, holding 52% of HKITP's equity (see Enclosure 2 for the current and projected capital structure of HKITP). While TWDC is confident that the Plan would be completed within the estimated project cost of $10,900 million, should there be any budget overage, the Government will not provide further funding support and HKITP is expected to identify project cost savings or seek other funding sources to bridge the funding gap.

Encl. 2

9. To provide the necessary short-term liquidity buffer to HKITP during the construction period, TWDC has agreed to increase its existing revolving credit facility for HKITP from $400 million to $2,100 million, available until 2023, by which time the implementation of the Plan will almost be completed. The upsized revolving credit facility will continue to rank senior to all existing shareholder term loans from the Government and TWDC. This revolver does not involve a guarantee from the Government. Thus, the financial commitment from TWDC is $7,550 million (including the upsized revolving credit facility).

10. While the up-to-date overall financial investment in HKITP by the Government has been higher than that by TWDC, the difference has been narrowing down over the years. Under the agreement between the Government and TWDC reached in 1999 when the Hong Kong economy was hard hit by the Asia financial crisis, the Government initially invested $3.25 billion as cash equity and $6.10 billion (including capitalised interest) as loan to HKITP, and TWDC provided cash equity of $2.45 billion. In the past 11 years of HKDL's operation, the Government has converted a substantial part of its existing loan into equity to maintain the majority shareholder status and provided a new loan of about $800 million for the third hotel development agreed in 2014. No new capital injection from the Government to HKITP has been made. During the same period, TWDC has invested some $8.2 billion in HKITP by way of equity and loan under the

expansion plan for the three new themed areas agreed in 2009 and the third hotel development[5].

11. As a result, the level of financial investments in HKITP by the Government and TWDC is getting more balanced throughout the operation of HKDL. It is projected that by the end of Fiscal Year 2017 (FY17), total financial investment (in terms of equity and loan) in HKITP by the Government would be \$11.85 billion (holding 53% of HKITP's equity), while that by TWDC would be \$10.65 billion (holding 47% of HKITP's equity).

Other matters agreed with TWDC

12. The ED Panel has commented on the Government's existing partnership terms with TWDC, in particular the calculation of royalties and management fees of HKDL as compared with other Disney resorts outside the United States. The royalty rate charged by TWDC on all Disney resorts outside the United States is largely the same. Regarding management fees, while the exact calculation mechanism varies across different Disney resorts outside the United States, HKDL's mechanism, which is tied to HKITP's EBITDA[6] instead of revenues, provides greater incentives for the management company to enhance HKITP's financial performance. Having regard to ED Panel's views, the Government has put forward different ideas[7] in adjusting the existing management fee arrangements to TWDC, but TWDC has reservations given that TWDC's business in other Disney resorts outside the United States may be impacted, and that improvements to HKDL's management fee structure were already made in 2009. Nonetheless, in order to show its commitment to Hong Kong and the HKDL project, TWDC has agreed to waive the variable management fees payable by HKITP for FY18 and FY19, which would be conducive to HKITP's financial performance during the initial stage of the implementation of the Plan, in particular at the time before the incremental attendance and hence the revenue as driven by the completion of new offerings and attractions fully materialise. Features of the agreement between the Government and TWDC *vis-à-vis* similar Disney resort projects outside the United States (including the calculation of royalties and
Encl. 3 management fees) are summarised at Enclosure 3.

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5 The \$8.2 billion investment by TWDC in HKITP includes equity of \$2.8 billion for retiring the company's commercial loan, \$2.6 billion for the three themed area expansion and \$1.7 billion for the third hotel development, as well as a loan of \$1.15 billion for the third hotel development (assuming that the loan will be fully drawn).

6 Earnings before interest, taxes, depreciation and amortisation.

7 Including linking the management fees to net income, calculating the management fees after deducting depreciation and amortisation from EBITDA.

13. The ED Panel has also expressed concerns regarding the development restrictions in the vicinity of HKDL. TWDC believes that HKDL, being part of Lantau, stands ready to benefit from the overall planning and development of the area which would bring new business opportunities to HKDL. TWDC has been and will continue to be supportive of the Government's development in the Lantau area. In order to facilitate the Government's potential developments around the Lantau area, TWDC has agreed in-principle to relax height restrictions on the Government land in the vicinity of HKDL. The Government will continue to discuss with TWDC the specific details in this regard.

14. Separately, in addition to its wide array of corporate social responsibility programme, community work and volunteer services which usually involve sponsoring more than 100 000 underprivileged community members for free admission every year, HKDL will offer 50 000 complimentary tickets to locals through lucky draw in the coming year in conjunction with the implementation of the Plan.

Economic and financial assessments

15. TWDC has provided the Government with its attendance forecast. The Government considers the two sets of projection (namely, Situation A and Situation B) prudent and realistic, and has adopted the projection as the basis of our economic and financial assessments. According to TWDC, Situation A takes into account the effects of the new offerings and attractions under the Plan, while Situation B also includes the effects of other potential self-funded initiatives made possible by the revenue generated by the Plan. The following table summarises TWDC's attendance forecast under Situations A and B in FY25 and FY30 –

Fiscal Year	**Annual Total Attendance (million)**	
	Situation A	**Situation B**
2025	9.0	9.3
2030	9.1	9.3

16. The Government has conducted an economic assessment of the Plan, including the economic costs and benefits for two situations. The economic assessment concludes that the Plan is likely to bring about considerable net benefits to Hong Kong's economy, mainly from additional tourist spending in Hong Kong, after netting out the economic costs of capital expenditure involved.

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17. For Situation A, the present value of net economic benefits of the Plan for Hong Kong is estimated at $17.7 billion (at 2014 prices) over a 20-year operation period (i.e. FY16 to FY35) and $38.5 billion over a 40-year operation period (i.e. FY16 to FY55), with economic internal rates of return (EIRRs) of 23.2% and 24.3% respectively.

18. As regards Situation B, the present value of net economic benefits of the Plan is estimated at $18.7 billion (at 2014 prices) over a 20-year operation period and $41.6 billion over a 40-year operation period, with EIRRs of 22.9% and 24.1% respectively.

Encl. 4

19. In the light of the discussion at the ED Panel meeting on 28 November 2016, we have included in Enclosure 4 the sensitivity test for the more conservative Situation A by reducing TWDC's projected incremental visitors to HKDL brought by the Plan by 15%. The sensitivity test indicates that even under very prudent assumptions, the Plan is still likely to bring about considerable net benefits to the economy.

20. TWDC estimates that the Plan would create about 3 450 jobs (in terms of man-year) during the construction stage, and another 600 jobs in 2023 from the expanded HKDL operation. The Government estimates that the total number of jobs created in the economy stemming from the additional spending of the incremental visitors would be 7 200 in Situation A and 7 900 in Situation B from FY30 onwards.

21. As regards the financial return of the Plan, we estimate that the additional capital injection for the Plan would have a financial return of over 5% in real terms[8], and consider this level of return acceptable.

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[8] The financial return is calculated based on the net cash flow in present value arising from the revenues generated from, and additional costs (e.g. capital and operating expenditure) brought about by, the Plan.

FINANCIAL IMPLICATIONS

22. Subject to Members' approval, the Government will inject $5,450 million as equity to HKITP from 2017-18 to 2022-23 having regard to the cashflow requirements of the Plan. An indicative capital injection schedule by the Government and TWDC is as follows[9] –

	Injection of new capital as equity by the Government *($ million)*	**Injection of new capital as equity by TWDC** *($ million)*	***Sub-total*** *($ million)*
2017-18	1,298.0	1,298.0	*2,596.0*
2018-19	1,241.5	1,241.5	*2,483.0*
2019-20	1,200.5	1,200.5	*2,401.0*
2020-21	914.5	914.5	*1,829.0*
2021-22	545.0	545.0	*1,090.0*
2022-23	250.5	250.5	*501.0*
Total	**5,450.0**	**5,450.0**	**10,900.0**

23. The capital structure of HKITP before and after the completion of the capital injection by both shareholders for the implementation of the Plan is set out at Enclosure 2.

Encl. 2

24. The Plan has no recurrent financial implications for the Government.

PUBLIC CONSULTATION

25. We consulted the ED Panel on 28 November 2016 on the Plan with financial arrangements which proposed the project cost of the Plan to be funded by the Government and TWDC through cash equity injection into HKITP according to the existing shareholding ratio (i.e. 53% by the Government and 47% by TWDC). ED Panel members expressed some views on the partnership arrangements between the Government and TWDC, and we provided supplementary information to ED Panel on 24 February 2017 to address members' questions. At the ED Panel meeting on 27 February 2017, members further discussed the Plan and passed a

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9 The actual capital injection schedule will depend on the timing of securing funding approval, progress of works, and market situation.

motion expressing concerns over HKDL's royalty and management fee arrangements. In the light of the Panel members' comments, the Government has further discussed with TWDC and together come up with a package of refinements, which include adjusting the sharing ratio of the project cost of the Plan to on a 50:50 basis between the Government and TWDC.

BACKGROUND

26. HKDL consists of a theme park and two hotels, and the officially opening of the third hotel is scheduled for 30 April 2017. The Phase 1 site of HKDL amounts to about 125 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 (i.e. Fantasyland, Tomorrowland, Adventureland, Main Street USA, Toy Story Land, Grizzly Gulch, and Mystic Point).

27. To improve HKDL'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, HKDL has been making continuous efforts to launch new offerings and attractions, such as a nighttime parade "Disney Paint the Night" (in 2014), a new stage show "Mickey and the Wondrous Book" (in 2015), a new walk-through experience "Fairy Tale Forest" (in 2015), a "Star Wars"-themed programme "Star Wars: Tomorrowland Takeover" (in 2016) and a new themed area based on the "Iron Man" franchise of "Marvel" at Tomorrowland (officially opened in January 2017).

Tourism Commission
Commerce and Economic Development Bureau
March 2017

Detailed breakdown of project cost estimates for expansion and development plan of Hong Kong Disneyland Resort

Item	**Sub-item**	**Cost estimates ($ billion)**
Facility	➢ Site development	0.5
	➢ Area development	0.4
	➢ Facility construction (including buildings, structures, landscape and other related works)	2.7
	➢ Construction preliminaries (including site surveying, ground investigation, various assessment and other related items)	0.7
Sub-total		**4.3**
Show	➢ Show and stage construction and management	0.3
	➢ Show and stage production (including media, audio/visual systems, special effects, props, show sets, etc.)	1.6
	➢ Mechanical and electrical engineering works, as well as installations of various facilities related to show and stage	0.3
Sub-total		**2.2**
Ride	➢ Works and installation of ride (including ride vehicles and tracks, security, surveillance control systems, as well as support and electrical systems)	0.3
	➢ Purchase of ride and relevant security/surveillance control systems, as well as support and electrical systems	0.7
Sub-total		**1.0**
Design and management costs	➢ Design and creative work	1.1
	➢ Project management/construction management/field costs of construction works	0.9
	➢ Operational requirements	0.1
Sub-total		**2.1**
Creative entertainment	➢ Entertainment shows (including stage shows, meet-and-greet with Disney characters, and atmosphere entertainment programme)	0.1
	➢ Production and installation of the above items	0.4
Sub-total		**0.5**
Contingency reserve		**0.8**
Total		**10.9**

Current and projected capital structure of the Hongkong International Theme Parks Limited

Current capital structure of the Hongkong International Theme Parks Limited (HKITP)

	Government	**The Walt Disney Company (TWDC)**
Equity *(shareholding ratio)*	$10.70 billion *(53%)*	$9.50 billion *(47%)*
Loan	$1.15 billion[(a)]	$1.15 billion[(a)]
Subordinated shares	$3.60 billion[(b)]	

(a) *Assuming the new Government loan of $0.81 billion and the new TWDC loan of $1.15 billion for the new "Disney Explorers Lodge" hotel, are fully drawn in Fiscal Year 2017 (FY17).*

(b) *Representing the $4.0 billion land premium for the Phase 1 site of the Hong Kong Disneyland Resort (HKDL), of which $400 million was converted into ordinary shares in 2015 in accordance with the agreed mechanism.*

Projected capital structure of HKITP in FY25

	Government	**TWDC**
Equity *(shareholding ratio)*	$16.15 billion *(52%)*	$14.95 billion *(48%)*
Loan	Nil[(c)]	Nil[(c)]
Subordinated shares	$3.60 billion[(d)]	

(c) *Assuming all shareholders' loans are fully repaid by FY25 in accordance with the agreed repayment schedule.*

(d) *Representing the $4.0 billion land premium for the Phase 1 site of HKDL, of which HK$400 million was converted into ordinary shares in 2015 in accordance with the agreed mechanism. No further conversion of the subordinated shares is assumed from now until completion of the equity injection for the Plan for simplicity sake.*

Features of the agreement between the Government and The Walt Disney Company *vis-à-vis* similar Disney resort projects outside the United States

Each of the Disney resorts outside the United States has its own unique partnership arrangements with The Walt Disney Company (TWDC) which are different from one another. The gist is summarised in the ensuing paragraphs.

2. For Disneyland Paris and Shanghai Disney Resort, some forms of government participation as well as TWDC's ownership are involved in the projects. Specifically, the French government does not hold any stake in Disneyland Paris. At the initial development stage, the French government sold the land for Disneyland Paris (formerly known as Euro Disney) at farmland prices to TWDC. It also provided financial incentives, including loan of about US$770 million at lower-than-market interest rate and cash grant of about US$30 million, as well as basic infrastructure support, including financing subway and motorways, arranging trains to stop at the resort's entrance and arranging direct link with traffic from Euro-tunnel. Moreover, the French government offered tax concessions to the resort.

3. As for Shanghai Disney Resort, the Shanghai government holds 57% ownership of the joint venture (i.e. about RMB 13 billion equity). The Shanghai government built and financed the basic infrastructure in the vicinity. In addition, the Shanghai government provided loan and revolving credit facility to the Shanghai resort (about RMB 8 billion financial commitment in total). The land for Shanghai Disney Resort is state-owned and rented to the joint venture of the resort.

4. Tokyo Disney Resort was a commercial partnership deal. The Tokyo resort is wholly owned by a private company, Oriental Land Co., Ltd. (OLC), without any ownership by TWDC, and is built on the land owned by OLC.

5. The Government of the Hong Kong Special Administrative Region currently owns 53% of the equity of the Hong Kong Disneyland Resort (HKDL) (i.e. about $10.7 billion equity). Similar to the situations of Disneyland Paris and Shanghai Disney Resort, the Government provided the infrastructure in the vicinity of HKDL as well as some loans (currently about $1.15 billion in total) to the joint venture, i.e. the Hongkong International Theme Parks Limited (HKITP). The land premium for the Phase 1 site of HKDL was paid in the form of $4 billion subordinated shares of HKITP which would be converted to ordinary shares progressively throughout the life of the project subject to operating performance.

6. Payment of royalties and management fees to TWDC is common to Disney resorts outside the United States in general. For royalties, TWDC charges all Disney resorts outside the United States for the access to and use of Disney's intellectual properties for the resorts' development and operation. Based on publicly released information, the royalty rate charged by TWDC on Disney resorts outside the United States is largely the same at about 5% to 10% of revenues, depending on the source of revenues (e.g. merchandise, food and beverage, admission, etc.). Having regard to the industry practice, TWDC advises that its royalty rate is in-line with the comparables in the media and entertainment sector[Note].

7. As regards management fees paid by Disney resorts outside the United States, the exact calculation mechanism varies across different resorts. For Disneyland Paris, the base management fees are charged at 1% to 6% of revenues, while the variable management fees are calculated based on 30% of pre-tax adjusted cash flow, in excess of 10% of gross fixed assets. As for Shanghai Disney Resort, its management fee mechanism was designed with reference to HKDL's arrangements before the improvement agreed in 2009 as elaborated in paragraph 8 below.

8. Since 2009, HKDL's management fees are fully linked to the resort's performance (i.e. earnings before interest, tax, depreciation and amortisation (EBITDA)), which is an improvement over the arrangement based on revenues as agreed in 1999 and can better incentivise the management company (i.e. the Hong Kong Disneyland Management Limited) to drive the business performance and operational efficiency of HKDL. According to the arrangements between the Government and TWDC in 2009, the formula for calculating the base management fee is adjusted to 6.5% of EBITDA, instead of the original formula of 2% of gross revenues, and the formula for calculating the variable management fee is adjusted from 2% to 8% of EBITDA to 0% to 8% of EBITDA. Under normal operations of Disney resorts, compared with the situations of Paris and Shanghai resorts as well as Hong Kong's arrangements before the improvement in 2009 where the management fees are tied to revenues, linking management fees to EBITDA could better align the fees with the resort's financial interest. Indeed, since the implementation of the improved management fee arrangements in 2009, HKITP has recorded positive EBITDA for seven consecutive years between Fiscal Year 2010 (FY10) and FY16. This shows that the current arrangements have provided incentives for the management company to enhance HKITP's financial performance, while at the same time not being inferior to the management fee arrangements for other Disney resorts outside the United States.

[Note] For royalty rates in the media and entertainment industry, the median was 8% based on the market financial data up to 2000 (Russell Parr. *Royalty Rates for Licensing Intellectual Property.* Hoboken: John Wiley & Sons, Inc., 2007.).

9. It should be noted that each Disney resort outside the United States has its own unique development history and specific circumstances, and due regard should be given to these specific factors in making comparison among them. The partnership arrangements with TWDC for HKDL have some similarities to those for other Disney resorts outside the United States in terms of capital structure and infrastructure provision, and there is no indication that the partnership arrangements for HKDL are inferior to the Disney resorts at other sites.

**Economic assessment of
expansion and development plan of Hong Kong Disneyland Resort**

INTRODUCTION

The Government has conducted an economic assessment of the expansion and development plan of the Hong Kong Disneyland Resort (HKDL). The economic costs and benefits for two situations have been studied, both based on the attendance projections provided by The Walt Disney Company (TWDC).

SCOPE AND METHODOLOGY

2. Two rounds of economic assessment were conducted in the past, one in 1999 before the construction of HKDL and the other in 2009 when the expansion with three new themed areas was considered. Both assessments studied the economic costs and benefits for the whole theme park. Given that HKDL has been in operation for over ten years and that the current objective is to study the economic viability of the expansion and development plan, the assessment this time studies the economic costs and benefits of the expansion and development plan only.

3. The current methodology is broadly similar to that of the two previous assessments, with broadly comparable assumptions. The quantifiable economic benefits of the expansion and development plan stem from the additional spending in Hong Kong by incremental visitors to HKDL brought by the plan. The methodology involves, firstly, forecasting the net increase in HKDL visitors owing to the plan (i.e. the difference in attendance to HKDL with and without the plan) and its composition, secondly, estimating the additional spending brought about by these incremental visitors, and finally, assessing the total value added and employment that can be generated by this additional spending.

4. For analytical purpose, the incremental visitors to HKDL could be grouped into two categories, namely local visitors and tourists. The latter could be further broken down into base tourists (i.e. who would have visited Hong Kong even without HKDL, but will spend additional time and money in Hong Kong to visit HKDL) and induced tourists (i.e. tourists whose main purpose of coming to Hong Kong is to visit HKDL).

5. The additional spending in Hong Kong by the incremental visitors to HKDL covers spending not only within the theme park, but also elsewhere in Hong Kong, over and above what would have been spent without the theme park. The gross economic benefits or value added thus derived from this additional spending are calculated in accordance with the specific operating cost structure of the sectors concerned. The value added comprises direct and indirect value added. Direct value added represents the gains of the respective business establishments and employment income for the workforce involved, generated initially from the additional spending of the incremental visitors to HKDL. The sectors concerned are the theme park operation itself, as well as the retail, hotel, restaurant, transport and other tourism-related industries in the territory, and the local airlines. Indirect value added refers to the income generated from subsequent rounds of indirect spending on the further range of economic activities in support of these tourism-related sectors. The net economic benefits of the expansion and development plan are then obtained by matching the gross economic benefits against the economic costs of the plan.

INPUT PARAMETERS

(a) Attendance and spending

6. TWDC has provided its projection for the net increase in attendance to HKDL brought by the expansion and development plan under different situations, and we have adopted two sets of projection (namely Situation A and Situation B) as the basis of the economic assessment. According to TWDC, Situation A takes into account the effects of the new offerings and attractions under the plan, while Situation B also includes the effects of other potential self-funded initiatives made possible by the revenue generated by the plan. In addition to the net increase in visitors, TWDC has also provided the breakdown of these visitors into local residents and tourists.

7. The net increase in tourists visiting HKDL due to the expansion and development plan was further broken down into base tourists and induced tourists with reference to the historical split as shown in survey results done by the Hong Kong Tourism Board (HKTB). The additional spending of the various types of visitors (namely local residents, base tourists and induced tourists) are then estimated by making reference to survey data compiled by HKTB and HKDL. The following table summarises the major assumptions used to estimating the various input parameters –

Table 1: Major assumptions adopted in the assessment

	Assumptions
Share in incremental attendance (%)	
Base tourists	37%
Induced tourists	31%
Locals	31%
Additional length of stay of base tourists	0.6 night
Length of stay of induced tourists	2.8 to 3.0 nights#
Crowding-out effect on spending by local visitors*	50%

Notes:

\# *There is a slight variation for induced tourists from different markets.*

* *This refers to the extent of reduction in consumption spending on items not related to HKDL, in terms of percentage of additional spending due to HKDL.*

(b) Economic costs

8. The economic costs cover the capital expenditure for the expansion and development plan. Based on TWDC's estimated capital expenditure corresponding to the two situations as mentioned above, the present value of the total capital cost during Fiscal Year 2016 (FY16) to FY55 amounts to HK$7.3 billion at 2014 prices for Situation A, and HK$8.6 billion for Situation B.

ECONOMIC ASSESSMENT

(a) Situation A

9. In Situation A, net of the economic costs involved, the present value of net economic benefits is estimated at around HK$17.7 billion at 2014 prices for a 20-year operation period (FY16 to FY35), and around HK$38.5 billion for a 40-year operation period (FY16 to FY55). The corresponding economic internal rates of return (EIRRs) in real terms are estimated at 23.2% and 24.3% respectively for the two operation periods.

(b) Situation B

10. In Situation B, the present value of net economic benefits is estimated at around HK$18.7 billion at 2014 prices for a 20-year operation period, and around HK$41.6 billion for a 40-year operation period. The corresponding EIRRs in real terms are estimated at 22.9% and 24.1% respectively for the two operation periods.

(c) Sensitivity test

11. A sensitivity test for the more conservative Situation A is also conducted by reducing TWDC's projected incremental visitors to HKDL brought by the expansion and development plan by 15%. Under this very prudent scenario, the present value of net economic benefits is estimated at around HK$14.0 billion at 2014 prices for a 20-year operation period, and around HK$31.6 billion for a 40-year operation period. The corresponding EIRRs in real terms are estimated at 20.1% and 21.5% respectively for the two operation periods.

Table 2: Summary of economic assessment of the expansion and development plan

	Total gross economic benefits ($2014 prices in present value)		**Total net economic benefits ($2014 prices in present value)**		**Economic internal rate of return in real terms**		**Benefit/cost ratio in present value terms**		**Breakeven year @**
	Over the operation period of		**Over the operation period of**		**Over the operation period of**		**Over the operation period of**		
	20 years	**40 years**	**20 years**	**40 years**	**20 years**	**40 years**	**20 years**	**40 years**	
Situation A	24.7 bn	45.8 bn	17.7 bn	38.5 bn	23.2%	24.3%	3.5	6.3	FY25
Situation B	27.0 bn	50.2 bn	18.7 bn	41.6 bn	22.9%	24.1%	3.2	5.8	FY25
Sensitivity Test	21.0 bn	38.9 bn	14.0 bn	31.6 bn	20.1%	21.5%	3.0	5.3	FY26

Notes:

@ *"Breakeven year" refers to the year when the present value of the cumulative gross economic benefits just offset the cumulative economic cost.*

EMPLOYMENT CREATION

(a) Construction

12. According to TWDC, the expansion and development plan involves capital expenditure of HK$7.9 billion at 2014 prices during the construction period of FY17 to FY22. TWDC estimates the employment to be generated from the above capital expenditure would be about 3 450 man-years, which include about 690 man-years for professional/technical labour and about 2 760 man-years for other labour.

(b) Operation

13. The additional spending in Hong Kong from the incremental visitors to HKDL would also generate local employment. With reference to the structure of the Hong Kong economy and assuming that labour productivity remains unchanged, the number of jobs created from this additional spending during the operation stage has been estimated. In Situation A, the number of jobs (in terms of man-years) created in the economy would increase gradually from about 4 700 in FY25 to about 7 200 from FY30 onwards. In Situation B, the number of jobs created would increase from about 5 600 in FY25 to about 7 900 from FY30 onwards. In the sensitivity test, the number of jobs created would increase from about 4 000 in FY25 to about 6 100 from FY30 onwards.

CONCLUSION

14. The economic assessment indicates that the expansion and development plan, even under very prudent assumptions of the sensitivity test, is likely to bring about considerable net benefits to the economy, mainly from additional tourist spending in Hong Kong, after netting out the economic costs involved.

15. It should be noted that long-term economic assessment of this nature is inevitably subject to a range of uncertainties, as many parameters used in the assessment may turn out to be different from the assumptions. For example, the number of visitors to HKDL and the benefits thus generated depends a lot on how successful HKDL could run the theme park. Future regional competition could also impact on the number of visitors to HKDL.

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