

LEGISLATIVE COUNCIL BRIEF

HONG KONG INTERNATIONAL AIRPORT

**THREE-RUNWAY SYSTEM:
AIRPORT CONSTRUCTION FEE**

INTRODUCTION

At the meeting of the Executive Council on 29 September 2015, the Council took note of the outcome of the review conducted by the Airport Authority Hong Kong (AAHK) on the charging level of the Airport Construction Fee (ACF) at the Hong Kong International Airport (HKIA) and the revised financial arrangement proposal for the three-runway system (3RS) project.

JUSTIFICATIONS

AAHK's Original Proposal

2. According to AAHK, the estimated capital cost for 3RS was around \$84.5 billion (in 2010 prices) or \$141.5 billion in MOD prices¹. Having regard to its current strong financial position and projected steady growth in revenue in the coming years, AAHK planned to finance the project by itself through the following means:-

- (a) retaining all distributable profits earned from FY2014/15² onwards until the full commissioning of 3RS in 2023/24;
- (b) implementing robust approach in maximising revenue under the “joint contribution” principle; and

¹ The capital cost estimate has not included the cost of design and construction of various new government facilities, e.g. a new air traffic control tower, fire stations, a police station, weather monitoring system, additional immigration and customs facilities, etc which are essential for the operation of the 3RS.

² The AAHK Board has already approved retaining distributable profits earned in FY2014/15 by not declaring any dividend for the year, upon its approval of the financial result on 26 May 2015.

- (c) raising funds/borrowing from the market to bridge any funding gap after exhausting (a) and (b) above.

3. Insofar as revenue is concerned, AAHK proposed that under the “joint contribution” principle, users of HKIA including passengers, airlines and operators at HKIA should contribute to the project cost. For airlines, the Airport Charges³ would be increased in 2016/17 so as to bring the charges back to the level in 2000. The charges would then be increased in subsequent years in line with inflation. For passengers, AAHK would introduce an ACF on departing passengers at HKIA. Under AAHK’s original proposal, the ACF would be set at \$180 per departing passenger (excluding transit passengers) from 2016/17 to 2030/31. AAHK estimated that the ACF would generate an additional revenue of \$51 billion for AAHK for the period up to 2023/24. According to its original financial arrangement proposal, AAHK advised that it would have to raise debt at around 3.1 times EBITDA to bridge the funding gap of around \$39 billion⁴.

4. Whilst levies/charges on passengers similar to ACF were not uncommon in other airports in the world to finance airport expansion/development projects, the proposed level of \$180 per departing passenger would be on the high side. Taking into account other direct charges currently imposed on passengers at HKIA⁵, AAHK was requested to consider reducing the level of ACF through maximising borrowing from the market so as to lower the burden of air passengers using HKIA.

AAHK’s Revised ACF Proposal

5. AAHK has reviewed the charging level of the ACF. In the process, it consulted key stakeholders including home-based carriers and the travel industry, and conducted a survey on transfer and transit (TT) passengers. In brief, the feedback from the consultation and the survey

³ Airport Charges include landing, parking, air-bridge and terminal building charges payable by airlines. The charges were reduced by 15% in 2000.

⁴ Together with the existing debt of \$8 billion and the associated debt service charges of \$14 billion, AAHK’s total borrowing would be around \$61 billion in FY2023/24.

⁵ These include the Passenger Security Charge (\$45 per passenger) and the Air Passenger Departure Tax (\$120 per passenger aged 12 and above).

are as follows:-

- (i) the travel industry generally agreed that ACF would only constitute a small percentage of the air ticket price for both premium class and long haul air passengers;
- (ii) for short haul economy passengers, who represent the majority of the travelling public at HKIA, the ACF should not be more than \$100 per passenger in view of the relatively low air ticket prices;
- (iii) some concession should be given to short haul economy transfer/transit (TT) passengers so as to maintain HKIA's competitiveness as an important regional aviation hub. Yet, the concession should not be too material, otherwise it would be seen as making origin/destination (OD) passengers subsidise TT passengers; and
- (iv) for TT passengers, their top five considerations for choosing to transfer/transit at HKIA are ease of transfer/transit, efficiency, safety and security of HKIA, variety of retail outlets, and the number of connecting flights. Passenger fees have not been mentioned as a consideration.

6. AAHK has also assessed the feasibility of stretching its borrowing capacity further in light of its excellent credit rating (i.e. AAA). It came to the view that it would be viable to increase its debt level to beyond 3.1 times EBITDA, as proposed under its original financial arrangement proposal, to cover the additional funding shortfall arising from a reduction in ACF level (see paragraph 14 below).

7. Having regard to the considerations outlined in paragraphs 5 and 6 above, AAHK proposes a revised ACF regime with differential charging levels which distinguish :-

- (i) short haul passengers from long haul passengers;
- (ii) premium class passengers from economy class passengers;

and

(iii) OD passengers from TT passengers

8. On paragraph 7(i) above, the definition of long/short hauls follows that adopted by the Civil Aviation Department in determining fuel surcharges. Long haul destinations include those in North and South America, Europe, Middle East, Africa, Southwest Pacific and Indian Subcontinent. The rest are short haul destinations. Based on 2014 data collected at HKIA, the passenger split between long haul and short haul destinations was 19% and 81% respectively for OD passengers.

9. On paragraph 7(ii) above, premium class passengers include first and business class passengers. Based on the information provided by a major home-based carrier, the split of premium and economy class⁶ passengers is around 9% and 91% respectively.

10. On paragraph 7(iii) above, based on historical data and traffic forecast at HKIA, the proportion between OD and TT passengers was 70% vs 30%. Among the TT passengers, based on data collected in 2014, the proportion of long haul vs short haul was 35% vs 65%.

11. A table summarising AAHK's revised ACF regime is as below.

Table 1 – Revised ACF regime

ACF (HK\$ per departing passenger)	OD	Premium	Economy
	Long	\$180	\$160
	Short	\$160	\$90
	TT	Premium	Economy
	Long	\$180	\$160
	Short	\$160	\$70

12. According to AAHK, with the revised ACF pitching at \$90 per short haul economy class passengers, HKIA's ranking in terms of

⁶ AAHK advised that premium economy class passengers are categorised as economy class passengers for the purpose of levying ACF.

“aeronautical charges paid by passengers” will rise to 24th among the 49 major airports surveyed⁷, and the ranking in terms of “total aggregated charges” will rise to 40th out of the 55 airports⁸. AAHK’s survey also suggested that the revised ACF level would only form a small percentage of the overall air ticket cost to a number of major destinations from HKIA (see Annex A) and hence should not have material impact on passenger numbers at HKIA.

13. Under AAHK’s revised proposal, transit passengers, which totalled around 0.6 million passengers per annum at HKIA in 2014, will also be charged similar to transfer passengers. This is because under current procedures, transit passengers are required to disembark the aircraft and thus they will also be using terminal facilities at HKIA. AAHK therefore considers that transit passengers should be treated in the same way as transfer passengers as far as ACF is concerned. On the other hand, having regard to the views of the travel industry relating to the price sensitivity of TT traffic market, the significance in maintaining HKIA as a competitive transfer hub, and the fact that TT passengers will be paying ACF twice (since, for each round-trip involving a stop in Hong Kong, they will be departing Hong Kong twice), AAHK has proposed to impose a slightly lower ACF on short haul economy TT passengers, i.e. \$70 per passenger, which is around 80% of that levied on short haul economy OD passengers (i.e. \$90 per passenger).

14. With the revised ACF scheme, AAHK estimates that there will be some \$16 billion less in net revenue (after deducting tax and airlines’ handling fees) as compared to the original proposal for funding the 3RS project. AAHK will therefore need to raise an additional debt of \$16 billion from the market to cover the funding shortfall, which brings its total debt (including AAHK’s existing debt and the associated debt service charges) to \$77 billion in FY 2023/24 or around 4.5 times EBITDA in FY2022/23. Given its healthy financial position and the

⁷ According to the Aeronautical Charges Benchmarking Study conducted by LeighFisher (Aug 2012). HKIA currently ranked the lowest on the amount of charges paid by passengers to airports among the 49 airports that charge passengers directly.

⁸ According to the same study, HKIA currently ranks 54th out of the 55 airports benchmarked in terms of total aggregated charges (excluding government taxes). “Total aggregated charges” refers to all charges that are borne by airlines and passengers at an airport excluding government taxes. In the case of HKIA, the charges comprise Airport Charges (see footnote 3) and Passenger Security Charge.

anticipated steady growth in air traffic in future years, AAHK is confident that the increased funding gap would still be manageable and can be met by sufficient loans raised from the market on competitive terms.

The Government's Views

15. Notwithstanding AAHK's power under the Airport Authority Ordinance (Cap. 483) (AAO) to introduce ACF on its own right, the Government considers that a reduced level of ACF lower than \$180, that differentiates the charges between long and short haul passengers, premium and economy class passengers as well as OD and TT passengers, would be more acceptable. As a result of AAHK's revised ACF regime, the ACF to be charged to the bulk of departing passengers at HKIA, i.e. short haul OD economy class passengers (constituting 52% of all passengers, and 74% of OD passengers), will be substantially reduced to **\$90 per passenger**.

16. The independent financial consultant engaged by the Government has vetted AAHK's revised proposal to increase borrowings from the market to cover the additional funding shortfall arising from the reduced ACF charging level. The financial consultant is satisfied that, given AAHK's strong balance sheet and excellent credit rating, AAHK's proposed borrowing in the order of 4.5 times EBITDA is still viable without adversely affecting its credit ratings, although the proposed debt level may possibly approach the practical limit achievable in the market benchmarking from the experience in overseas airports.

PUBLIC CONSULTATION

17. In the past months, AAHK has consulted key stakeholder groups including the home-based carriers and the travel trade on issues relating to the ACF charging regime. AAHK has also conducted a survey at HKIA on TT passengers who were asked to list their considerations for choosing an airport for transfer/transit. The feedback of the key stakeholder groups and the survey results are summarised in paragraph 5 above. The feedback from key stakeholders and the survey results have been taken into account by AAHK when it drew up the revised ACF regime.

18. A new high-level consultative committee, the Aviation Development and Three-runway System Advisory Committee (ADTAC) was formed by the Government on 1 August 2015. Chaired by the Secretary for Transport and Housing and comprising members who are leaders and experts in relevant sectors such as aviation, engineering and architecture, business and finance, environmental protection and academic, ADTAC advises the Government on broad policy matters concerning Hong Kong's civil aviation and developments at HKIA, as well as issues concerning the implementation of the 3RS at HKIA. The committee held its first meeting on 8 September 2015 and members were briefed by AAHK on its proposal to adopt a differential charging approach under the revised ACF regime. The committee was briefed on the principles AAHK would adopt in setting the charging levels (along the line of paragraph 7 above). Members were generally supportive of such proposal and considered that the charging level should be lowered as far as practicable so as to minimise any impact on HKIA's competitiveness as well as its status as an important aviation hub particularly for transfer/transit passengers.

PUBLICITY

19. AAHK will arrange press announcement, followed by relevant publicity, on the revised ACF regime. The Government and AAHK will in due course brief the LegCo Subcommittee on 3RS, after it has been formed, on the revised ACF regime as well as other issues concerning the implementation of the 3RS project.

BACKGROUND

20. On 17 March 2015, the Executive Council affirmed the need for the 3RS project at HKIA for maintaining Hong Kong's competitiveness as a global and regional aviation hub, and for catering to our long-term economic and development needs. AAHK was invited to actively explore, in consultation with the Government, ways to facilitate the early implementation of the 3RS project. AAHK was requested to further refine the financial arrangement proposal to maximize borrowing from the market with a view to lowering the amount of ACF. AAHK has completed the review of its financial arrangement proposal and

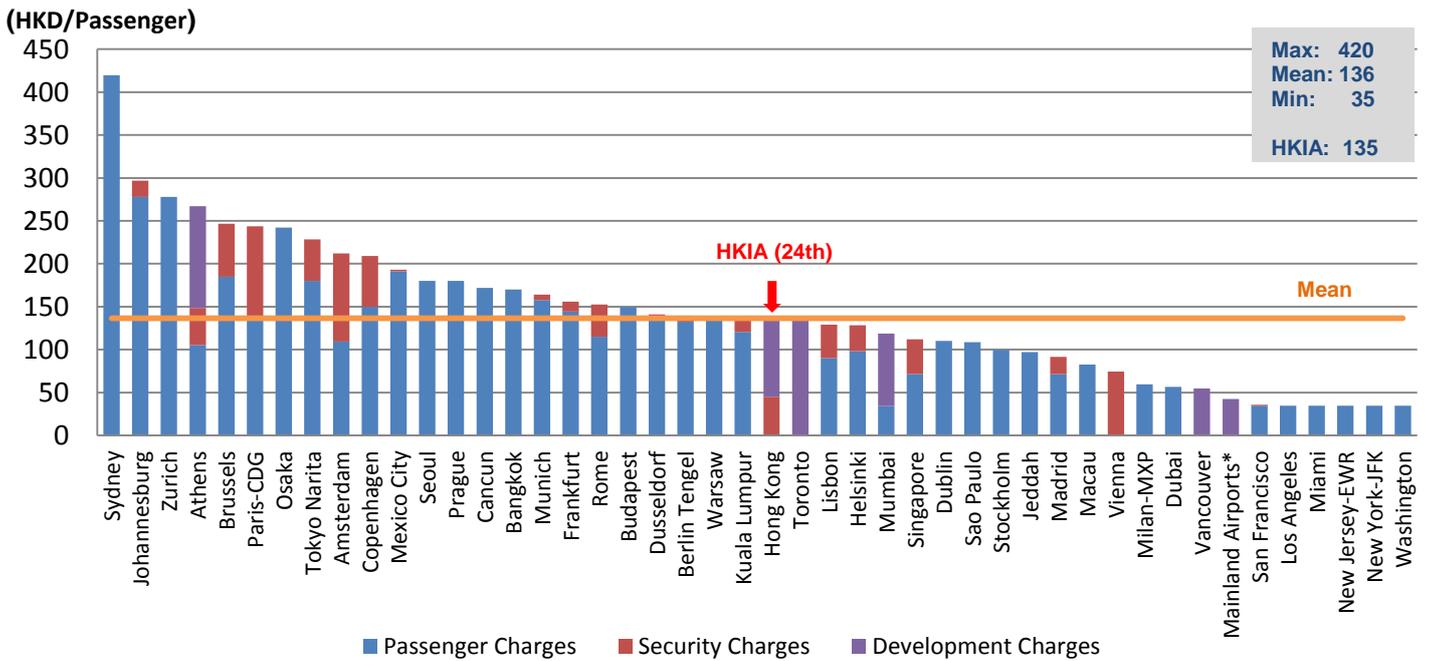
submitted its revised proposal to Government.

ENQUIRIES

21. Any enquiry on this brief should be directed to Miss Grace Kwok, Principal Assistant Secretary (Special Duties) (telephone number 3153 2913).

Transport and Housing Bureau
29 September 2015

Annex A

Total Aeronautical Charges paid by Passengers**(Assuming the adoption of the revised proposed ACF)**

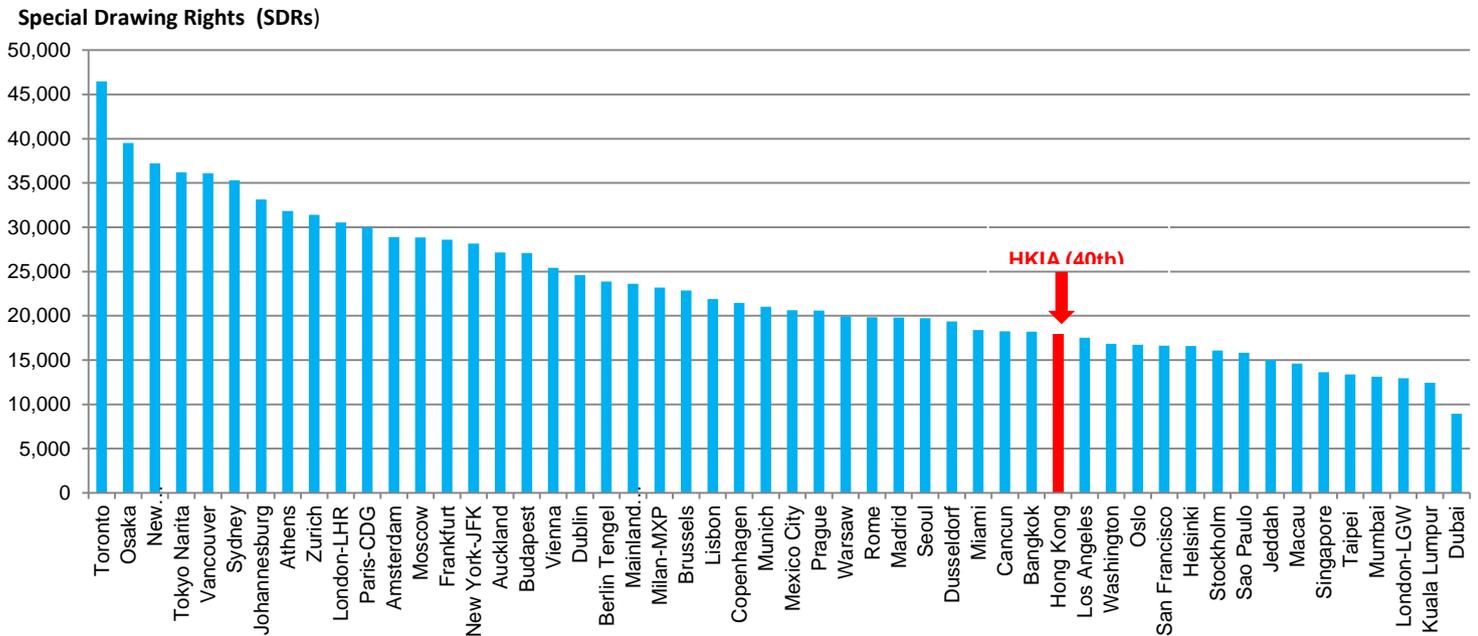
Notes:

- (1) The chart is compiled based on aeronautical charges payable to airports by passengers, but excludes taxes or fees payable to the governments
- (2) Auckland, London-LGW, London-LHR, Moscow, Oslo and Taipei airports do not levy aeronautical charge on passengers.

Source: Aeronautical Charges Benchmarking Study, LeighFisher (Aug 2012)

Total Aggregated Charges Excluding Tax

(Assuming the adoption of the revised proposed AC)



Notes:

- (1) Aggregated charges includes all charges which can be identified to recover or contribute to the infrastructure and environmental costs associated with the arrival at and departure from an airport
- (2) Mainland Airports refer to Beijing, Guangzhou Baiyun, Shanghai Pudong, and Shenzhen Bao'an; all of which have the same charges for international flights
- (3) Total aeronautical charges is based on the aggregate charges for four aircraft types, Airbus A320, Boeing 767-300, Boeing 777-300ER and Boeing 747-400

Source: Aeronautical Charges benchmarking Study, LeighFisher (Aug 2012)