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15 June 2017

Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong
(Attn: Ms Sharon Chung)

Dear Ms Chung,

**Public Works Subcommittee
Supplementary Information on Kai Tak Sports Park Project**

We submitted additional information relating to the Kai Tak Sports Park (the Sports Park) project to the Public Works Subcommittee (PWSC) meeting on 29 May 2017, and undertook to follow up on some of the issues mentioned therein. The relevant information relating to those issues is attached in Annex for Members' reference.

Yours sincerely,

(Original signed)

(Ms Linda Law)
for Secretary for Home Affairs

Supplementary information on the Kai Tak Sports Park Project

(A) Increasing the amount of performance bond

To protect the interests of the Government and the public, we will specify in the terms and conditions of the Kai Tak Sports Park (Sports Park) contract the requirement of depositing a performance bond by the Contracted Party. As what we advised the Public Works Subcommittee (PWSC) earlier, the performance bond should be an amount equivalent to the basic operating expenditure¹ of the Sports Park for a period of six to nine months. If calculated on the basic operating expenditure of the third year (i.e. 2025) of operation, the performance bond will be around \$150 million to \$200 million, an amount to be updated regularly subject to factors such as inflation.

2. Having considered Members' views, we agreed to increase the Contracted Party's commitment to the Sports Park during the operational stage. It is suggested that, apart from the deposit of a performance bond of \$200 million (i.e. equivalent to the basic operating expenditure for nine months) by the Contracted Party, its parent company is required to provide an additional amount of no less than \$700 million as a financial guarantee, with a view to ensuring that the Contracted Party will fulfil its contractual obligations to operate the Sports Park and compensate the Government for any loss in case of an early termination of the contract. In sum, the Contracted Party shall provide **a performance bond and a financial guarantee totalling no less than \$900 million**, equivalent to the basic operating expenditure of the Sports Park for about three years (calculated in the first five years).

(B) The weighting in tender evaluation for both the fixed payment to be paid by the Contracted Party during the operational stage and the percentage of operating income to be shared with the Government

3. Under the "Design-Build-Operate" (DBO) approach, the Contracted Party is required to operate the entire Sports Park, including community sports facilities and public open space, on a self-financing basis as well as to regularly make fixed payments to and share a percentage of its operating income (i.e. total sales) with the Government. Tenderers are required to, in accordance with the requirements set out in the tender documents, provide in their bids a price proposal including (i) the cost of design and construction; (ii) the fixed payment to be made to the Government during the operational stage; and (iii) the percentage of operating income to be shared with the Government. The Tender Assessment Panel will evaluate the bids based on a

¹ In 2025 (i.e. the third year of operation when the business performance becomes stable), the basic operating expenditure is estimated to be about \$300 million.

tender marking scheme and make recommendations to the Central Tender Board. Since the tender marking scheme is still under preparation and subject to the approval of the Central Tender Board, its details and the weighted score for each item are not available at this stage. With regard to a Member's suggestion that **a relatively higher weighting should be given to the fixed payment than to the income sharing arrangement** (e.g. 2:1) in the marking scheme, we will deliberate on it **and make a recommendation to the Central Tender Board.**

(C) Procurement Approaches for the Sports Park

4. A Member suggested that the Contracted Party should shoulder part of the construction cost to best reflect private sector participation in the Sports Park development. As set out in our supplementary information submitted to the PWSC on 16 May, since the Sports Park is a social infrastructure (including community sports facilities and public open space), its investment return is unlikely to be attractive enough for the private sector. Even if we request the Contracted Party to join as an investment partner, the Government still has to bear the largest part of the construction cost. It is estimated that the investment that the Contracted Party is prepared to make will not exceed 5% of the construction cost. Under this joint venture (JV) approach, although the Government will hold a large majority stake in the project, the JV partner still has a considerable degree of control over the project as it directly operates the Sports Park. The Government, being a shareholder, will, in general, have its financial return from the dividends after deducting all operating costs.

5. For the design, build, finance and operate (DBFO) approach, as stated in the appendix to our document submitted to the PWSC on 16 May, although the Government is not required to pay the costs during the construction stage under the DBFO approach, the Government will have to pay by instalments all design and construction costs to the Contracted Party, as well as relevant interest expenses and return on capital during the operational stage. Furthermore, the Government will have to bear most of the operating cost. A government body adopting the DBFO approach indicated that the approach was not a desirable one since Government's participation during the design and construction stages was limited, making it impossible to fully achieve its policy objectives in the design and the future operation. The complexity of financing, debt and equity structure might also cause disputes among members of the Contracted Party.

6. On the contrary, under the proposed DBO option, the Government will finance the construction and have full ownership of the Sports Park, as well as having a high degree of influence and control in all aspects of its operation (such as facility charges and time slots for sports activities). For the financial return, the Government can also request the Contracted Party to make a fixed payment and share a percentage of its total income. In fact, under the DBO option, the Contracted Party will have to make an initial investment of \$300 million to \$400 million in order to start the

operation of the Sports Park, and provide a performance bond and a financial guarantee totalling \$900 million (see paragraph 2 above) to increase its total financial commitment to about \$1.2 billion or \$1.3 billion. We believe that, with these measures, the Contracted Party will be effectively motivated to maintain good performance during the contract period.

(D) What are the reasons for the income from retail and dining outlets and car parks under the “design and build, then operate by Government” (DBG) procurement approach lower than that under the DBO approach?

7. With rich experience and expertise in designing and operating commercial and retail facilities, the private sector has the flexibility to adjust its strategies and increase the attractiveness of commercial facilities in response to market situation.

8. Under the DBG approach, sports and commercial facilities in the Sports Park will be operated by the Leisure and Cultural Services Department (LCSD). As a government department, the LCSD does not have commercial expertise in putting forward enhancement proposals for the design of retail and dining outlets, and also lacks experience in developing promotion and marketing strategies, as well as in tenancy planning. More importantly, government departments generally can only follow the established procurement policy and rules on tendering of the above commercial facilities. Government properties (e.g. shops, canteens, areas for advertising, car parks and automatic teller machines) are usually let out by the Government Property Agency for specified uses through open tendering/quotations. Price is normally the only criterion in assessing these revenue contracts. Currently, the LCSD is also required to follow the above principle when identifying contractors to run the dining and retail outlets in its recreational and sport facilities. If the LCSD wishes to add a non-price element (such as giving a higher weighting to the design, quality and technical feasibility) to the assessment criteria for bids for individual dining and retail outlets, it will take quite a long time to go through and complete the internal approval process for a breakthrough. In fact, the LCSD has had to convert the dining outlets of its individual recreational and sport facilities into other uses due to the absence of tenders after repeated tendering exercises.

9. Under the DBO approach, however, the Contracted Party, with a wide spectrum of professional expertise in designing and operating commercial facilities, will be greatly motivated to enhance the design of retail and dining outlets taking the market into consideration and lease them to tenants who can provide users and spectators of the Sports Park with the most suitable services and products. In sum, commercial facilities provided under the DBG approach will, as compared with those under the DBO approach, be less attractive to both tenants and consumers, and have less rental yields and lower tenancy rates. The Operations Consultant estimated that the average annual income from retail and dining outlets and car parks under the DBO approach would approximately double the amount under the DBG approach. Taking 2025 as an example, according to the estimation of the Operations Consultant, the

income (before deducting the expenditure) from retail and dining outlets and car parks will be \$261 million under the DBG approach and \$549 million under the DBO approach respectively.

(E) The organisational structure to monitor the operation of the Sports Park

10. As mentioned in the supplementary information submitted to the Panel on Home Affairs on 4 May, the Home Affairs Bureau (HAB) and the Contracted Party will set up a **Joint Review Committee** during the operational stage. Comprising officials of the HAB and representatives from the leadership of the Contracted Party, the Committee will review the performance of the Contracted Party with a focus on the operation outcome of the Sports Park. This high-level committee will meet on a quarterly basis to discuss strategic issues. The Chief Executive Officer(s) (CEOs) of the head company(ies) of the Contracted Party is required to attend the meetings. **Monitoring sub-committee(s)** will be set up under the Joint Review Committee and meet on a monthly basis. The CEO responsible for the operation of the Sports Park, together with his/her senior management team, will report to the HAB specifically on the issues of operation, event applications and arrangements, repairs and maintenance, etc.

11. We now suggest that, in addition to the above monitoring structure formed by the HAB and the Contracted Party of the Sports Park, a **Kai Tak Sports Park Advisory Committee** would be set up about one year before the formal commencement of operation of the Sports Park to provide advice and recommendations on the strategies, business development, operation and management of the Sports Park as well as the performance of the Contracted Party. The Committee will comprise representatives from the sports sector (including the Sports Federation and Olympic Committee of Hong Kong, China, the Hong Kong Paralympic Committee and Sports Association for the Physically Disabled, and the Hong Kong Schools Sports Federation) and people from different sectors (including retired athletes, representatives from the entertainment sector, professionals experienced in management and marketing, Legislative Council Members and members of relevant District Councils). The main duties of the Committee are to give advice and suggestions on the business plans, strategic development targets, operation reports and performance of the Contracted Party. Moreover, the Contracted Party will, take into account the operational circumstances of the Sports Park and users' comments collected, put forward advice and recommendations on ways to enhance the management of facilities and the provision of services in the Sports Park.

(F) Mid-term Review

12. The Sports Park will have an operation period of about 20 years. Taking this into account, we plan to introduce a mid-term review system to further examine the

operational performance of the Contracted Party. The mid-term review will be **conducted in the tenth year** after the commencement of operation of the Sports Park, during which the development of the Sports Park and the infrastructural, residential, commercial and other developments nearby should become steady. In conducting the mid-term review, the Government will examine comprehensively the Contracted Party's overall and aggregate performance in the first ten years of the operation period based on operational requirements, key performance indicators and other terms and conditions in the contract. If the performance is not satisfactory, the Government may impose a penalty or even exercise the right to terminate the contract. The HAB will consult the **Kai Tak Sports Park Advisory Committee** on the mid-term review report.