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**Joint Subcommittee to Monitor the Implementation of
the West Kowloon Cultural District Project**

Meeting on 9 February 2018

**Updated background brief on
the financial situation of and the enhanced financial arrangement
for the West Kowloon Cultural District project**

Purpose

This paper summarizes the major views and concerns expressed by members of the Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project ("the Joint Subcommittee") on the financial situation of and the enhanced financial arrangement for the West Kowloon Cultural District ("WKCD") project.

Background

Upfront endowment to the West Kowloon Cultural District Authority

2. On 4 July 2008, the Finance Committee ("FC") of the Legislative Council ("LegCo") approved a one-off upfront endowment of \$21.6 billion (in 2008 Net Present Value) for the West Kowloon Cultural District Authority ("WKCDA") to implement the WKCD project. According to the relevant funding proposal (FCR(2008-09)35), the upfront endowment was intended to cover the capital costs of the WKCD project,¹ while the

¹ The broad breakdown of the upfront endowment was as follows: (a) design and construction of various facilities (\$15.7 billion or 73%); (b) major repair and renovation of various facilities (\$2.9 billion or 13%); (c) collection costs and related costs for M+ (\$1.7 billion or 8%); and (d) planning of WKCD and project management (\$1.3 billion or 6%).

retail/dining/entertainment ("RDE") part of the WKCD development would be vested in WKCDA to provide a source of recurrent income through rental proceeds for meeting the operating costs of the arts and cultural facilities and related facilities. Other communal and government facilities and related engineering works, such as roads, drainage, fire station, etc. which were designed to support the whole WKCD development (including residential, commercial and hotel developments) would be undertaken by the Administration, and funding approval for such works would be sought separately in accordance with the development programme.²

3. In July 2013, the Administration and WKCDA advised the Joint Subcommittee that in view of the expansion in project scope and the significant escalation of construction costs, a pragmatic approach would be adopted to implement the WKCD project through, among others, rigorous cost containment of individual facilities. Furthermore, the Administration intended to fully fund the capital works of the integrated basement as general enabling works to facilitate the development of the whole WKCD project.

4. In May 2014, the Administration and WKCDA advised that the portion of the upfront endowment for the design and construction of facilities (i.e. \$15.7 billion) plus the apportioned interest income (i.e. \$2.1 billion) would only be sufficient to cover the costs of the design and construction of the Batch 1 and most of the Batch 2 facilities,³ while the implementation programme of the Batch 3 facilities would have to be reviewed. A table showing the batching and target completion dates of major WKCD facilities, and a schematic plan of these facilities are in **Appendices I** and **II** respectively.

² Funding proposals relating to WKCD development approved by FC included: (a) \$478 million for the design and site investigation of government infrastructure works for supporting Phase 1 of the WKCD project (approved in January 2013); (b) \$840.5 million for carrying out the first package of the construction of public infrastructure works in WKCD (approved in July 2015); and (c) \$2,919.5 million for the first and second stages and \$3,638.5 million for the third stage of the design, site investigation and construction works of the integrated basement in WKCD (approved in July 2015 and January 2018 respectively, totalling \$6,558 million).

³ Batch 2 facilities originally included the Lyric Theatre, the Centre for Contemporary Performance ("CCP") and Medium Theatre II ("MTII"). MTII and one of the three black box theatres in CCP have subsequently been incorporated into the Lyric Theatre Complex. According to WKCDA, the mode of development of the remaining two black box theatres in CCP (i.e. the remaining Batch 2 facilities) will be further reviewed.

Enhanced financial arrangement

5. According to the Administration, as a result of various unforeseeable developments and changes after the upfront endowment was granted in 2008, WKCDA has been facing critical challenges both in terms of capital and recurrent costs. To provide WKCDA with the financial capability to operate sustainably the various facilities in WKCD and continue to develop the remaining planned facilities, the Government has agreed to provide an enhanced financial arrangement for WKCD, under which WKCDA would be granted the development right of the entire hotel/office/residential ("HOR") portion of WKCD. The key components of the enhanced financial arrangement for WKCD are set out below:⁴

- (a) *grant of development right of entire HOR portion of WKCD to WKCDA with upfront payment to the Government:* the Government plans to grant the development right of the entire HOR portion of WKCD to WKCDA at nominal premium so that the Authority may tender out the development packages of HOR together with the RDE embedded therein, develop these commercial developments under the Build-Operate-Transfer ("BOT") model and receive rental income. Meanwhile, upfront payments should be paid by WKCDA to the Government according to the financial arrangements to be specified in a Project Agreement to be signed between the Government and WKCDA as well as the relevant tendering results;
- (b) *grant of development right of the Exhibition Hub Development Area ("EHDA") to WKCDA without upfront payment to the Government:* the Government plans to grant the development right of 81 066 square metres of the Gross Floor Area ("GFA") of hotel and office uses (i.e. about 22% of the total GFA of the HOR sites) in the U-shaped site adjacent to the Exhibition Centre to WKCDA at nominal premium without the need for paying an upfront payment to the Government. WKCDA should tender out a BOT development package of EHDA comprising the Exhibition Centre, rental offices and hotel(s) together with the embedded RDE facilities;
- (c) *WKCDA to raise funds to finance the development of the remaining core arts and cultural facilities, and other arts and*

⁴ Please refer to the [LegCo Brief](#) on the enhanced financial arrangement for WKCD issued to Members on 19 January 2017.

cultural facilities: WKCDA will explore various financing options (e.g. issuing bonds or raising bank loans) pursuant to the WKCDA Ordinance (Cap. 601)⁵ by leveraging against its development right of HOR sites and long-term income stream. WKCDA will engage a financial consultant to draw up a comprehensive and affordable external borrowing plan taking into account the interest risks involved and cash flow requirements; and

- (d) *sharing of surplus*: the Government will share the income generated from the HOR and EHDA development packages, upon expiry of the term of the BOT agreements, having regard to the funding requirements and financial position of WKCDA.

6. As advised by the Administration in February 2017, it would enter into a Project Agreement with WKCDA in late 2017 to set out the legal rights and responsibilities of both parties, including the financial arrangements on upfront payments and on the right to share income generated from the HOR and EHDA development packages.

Major views and concerns of members

7. Issues relating to the financial situation of and the enhanced financial arrangement for the WKCD project were discussed at meetings of the Joint Subcommittee. The major views and concerns expressed by members are summarized in the ensuing paragraphs.

Adequacy of the upfront endowment

8. Members expressed grave concern over the serious cost overrun of the WKCD project as well as the uncertainty about the extent of the cost overrun problem. Some members were worried whether, with the spiralling cost of the WKCD project, the Administration was planning to shelve the

⁵ Section 24(1) provides that WKCDA may borrow from the Government, or otherwise raise, moneys as may be required for the performance of its functions on such terms and conditions as may be approved by the Financial Secretary ("FS"). Section 24(2) provides that subject to section 24(3), WKCDA may borrow moneys from any person other than the Government for performing its functions while section 24(3) provides that the Chief Executive may issue a direction in writing for the purposes of this section of the WKCDA Ordinance (Cap. 601) to WKCDA that it is not to borrow or raise any sum (or its equivalent in a currency other than Hong Kong dollars) which exceeds an amount specified in the direction without the prior written approval of FS.

development of the Batch 3 facilities or cut down on the resources to be allocated for the WKCD development. Some other members, however, expressed the view that given the huge cost overrun of the WKCD project, the Administration and WKCDA should critically examine the scope of the project and come to an early decision on which facilities would and would not be taken forward.

9. The Administration and WKCDA explained that the increase in the capital costs of the WKCD project was attributed to a number of factors, including the significant escalation of construction costs in Hong Kong in recent years, the inclusion of an integrated basement as an integral part of the approved Development Plan ("DP") of WKCD, enhanced project scope to meet public aspirations reflected during the public engagement exercise on DP (such as adding space for education facilities in different venues), and longer time taken to complete the master planning and planning approval process for WKCD.

10. In view of the above, the Administration considered it a pragmatic arrangement for WKCDA to make efficient use of the endowment fund and the associated investment return to complete the Batch 1 and Batch 2 facilities for early public enjoyment. As for the Batch 3 facilities, WKCDA had been working with the Administration to identify alternative approaches to take forward the development of the Exhibition Centre through some forms of public-private-partnership, and the Musical Theatre possibly through BOT model.

11. Some members considered that it was unreasonable to cap the funding allocation to the WKCD project at the upfront endowment of \$21.6 billion, given that additional funding had been granted to almost all major public works projects in recent years due to construction cost escalations. Some other members opined that as the Administration had agreed to fully fund the capital works of the integrated basement for WKCD, it had, in effect, already rendered additional funding support to WKCDA.

12. The Administration and WKCDA advised that the Authority would not seek further injection to the upfront endowment prior to the completion of the Batch 1 facilities. However, the Administration had not ruled out the possibility of seeking FC's approval for further funding for the WKCD project.

Funding arrangements for the integrated basement

13. Some members were concerned about the significant increase in the cost estimate of the integrated basement from some \$10 billion (as at

July 2013) to around \$23 billion (as at May 2014).⁶ Some members queried why the integrated basement and the associated public infrastructure works had not been accounted for in the Administration's funding submission to LegCo on the one-off upfront endowment back in 2008.

14. The Administration explained that the integrated basement for WKCD had not been planned for in the recommendations of the Consultative Committee on the Core Arts and Cultural Facilities of WKCD.⁷ It emerged as a key feature of the "City Park" conceptual plan in 2011 and was one of the major factors for the cost increase of the WKCD project. The rough cost estimate of around \$23 billion was derived in mid-2013 based on WKCDA's preliminary basement layout plans/site investigation results and the assumption that the construction of the whole integrated basement would be completed in one go by 2020.⁸

Financial analysis for the enhanced financial arrangement

15. Some members enquired about the details of the financial projections for the enhanced financial arrangement, including the estimates on the upfront payments to be paid to the Government and the income to be shared by WKCDA, whether the income generated for WKCDA could cover the shortfall in the funds for developing and operating the arts and cultural facilities in WKCD. They also queried if a financial advisor had been engaged to examine the enhanced financial arrangement.

16. WKCDA indicated that in preparing the proposal for the enhanced financial arrangement, it had engaged a financial advisor to conduct a financial assessment based on a set of assumptions and market information.

⁶ According to the paper ([LC Paper No. CB\(2\)1591/13-14\(03\)](#)) provided by the Administration in May 2014, of this \$23 billion, about \$19 billion in money-of-the-day prices would contribute to the cost of the foundations and substructure of the integrated basement for the topside developments. The remaining \$4 billion would be for the cost of the public infrastructure works and protection works for the Airport Express tunnels and the associated foundations and substructure there.

⁷ Following the discontinuation of the Invitation for Proposals process for developing WKCD in February 2006, the then Chief Executive appointed in April 2006 the Consultative Committee on the Core Arts and Cultural Facilities of WKCD to re-examine and re-confirm, if appropriate, the need for the core arts and cultural facilities in WKCD as well as the financial implications of developing and operating these facilities. The Consultative Committee submitted a [recommendation report](#) to the then Chief Executive in June 2007.

⁸ FC had so far approved a total estimated cost of \$6,558 million for implementing the first three stages of works of the development of the integrated basement for WKCD.

As the assumptions adopted in the financial assessment involved commercially sensitive information the disclosure of which would affect relevant tendering process, the details of the financial projections could not be provided to the Joint Subcommittee at that stage.

17. The Administration advised that the enhanced financial arrangement would allow WKCDA to share the rental income from the HOR developments during the BOT period to sustain the operation of WKCD under pre-determined ratios. The amount of income to be shared by WKCDA would depend on the prevailing market situation and the development parameters set by WKCDA for the individual development packages.

18. Some members further pressed for information including the terms of the BOT agreements, the estimated land value of the HOR and RDE portions of WKCD and the return on the rentals of the HOR portion, etc. They opined that in the absence of such relevant information, it was doubtful whether it was appropriate to grant the HOR and RDE portions of WKCD to WKCDA at nominal premium. Some members were worried that the granting of the HOR and RDE portions of WKCD to WKCDA under the enhanced financial arrangement would amount to making WKCDA an "independent kingdom".

19. The Administration clarified that it had always been the Government's plan to vest the RDE portions of WKCD in WKCDA at nominal premium to provide it with a steady source of recurrent income through rental proceeds to meet the operating deficits of the core arts and cultural facilities and related facilities. An estimation of the land sale value of the RDE facilities had been made in 2007. As for the HOR portion, the land sale value would depend on the specific tender conditions, the prevailing market situation and the GFA distribution ratio among the HOR uses which had yet to be determined. WKCDA's plan was to develop the major portion of the GFA of the HOR sites into rental offices and a small portion into rental residential units.

Monitoring the financial situation of the West Kowloon Cultural District project

20. Some members enquired how the Administration could effectively monitor the financial situation of the WKCD project under the enhanced financial arrangement, and ensure that WKCDA would be provided with sufficient but not excessive resources.

21. The Administration advised that a mechanism would be built into the enhanced financial arrangement to give the Government the right to share with WKCDA the income generated from the developments upon expiry of the

BOT agreements. The Administration would set out in the Project Agreement to be signed with WKCDA the principles for the income sharing mechanism and would formulate the detailed arrangement with WKCDA in due course. Moreover, the Administration would, in conjunction with WKCDA, continue to report regularly to the Joint Subcommittee the progress of the WKCD project, including its hardware and software developments, the financial situation of WKCDA, as well as the implementation of the enhanced financial arrangement.

Latest development

22. At the meeting to be held on 9 February 2018, the Administration and WKCDA will update members on the latest financial situation of and the enhanced financial arrangement for the WKCD project.

Relevant papers

23. A list of the relevant papers on the LegCo website is in **Appendix III**.

Appendix I

Batching and target completion timeframe of major West Kowloon Cultural District facilities

Batching	Facilities	Status and target completion date
Batch 1	Temporary Nursery Park	Opened in July 2015
	M+ Pavilion <i>(previously called Arts Pavilion)</i>	Opened in July 2016
	Xiqu Centre <i>(including Tea House)</i>	Main works in progress Target for completion in late 2017 and opening in latter half of 2018
	Art Park	Construction works in progress Target for completion in 3 phases and opening in stages starting from 2018
	Freespace <i>(including Outdoor Stage and Black Box Theatre)</i>	Construction works in progress Target for completion in 2018 and opening in 2019
	M+ Building	Main works in progress Target for completion in 2018 and opening in latter half of 2019
Batch 2	Lyric Theatre Complex <i>(including a Lyric Theatre, a Medium Theatre and a Studio Theatre)</i> <u>note 1</u>	Foundation works in progress Detailed design substantially completed
	Centre for Contemporary Performance ("CCP") <i>(including two Black Box Theatres)</i>	Mode of development of the remaining two Black Box Theatres to be reviewed as one of the three Black Box Theatres in CCP have been incorporated into the Lyric Theatre Complex
	Medium Theatre II <u>note 1</u>	Incorporated into the Lyric Theatre Complex

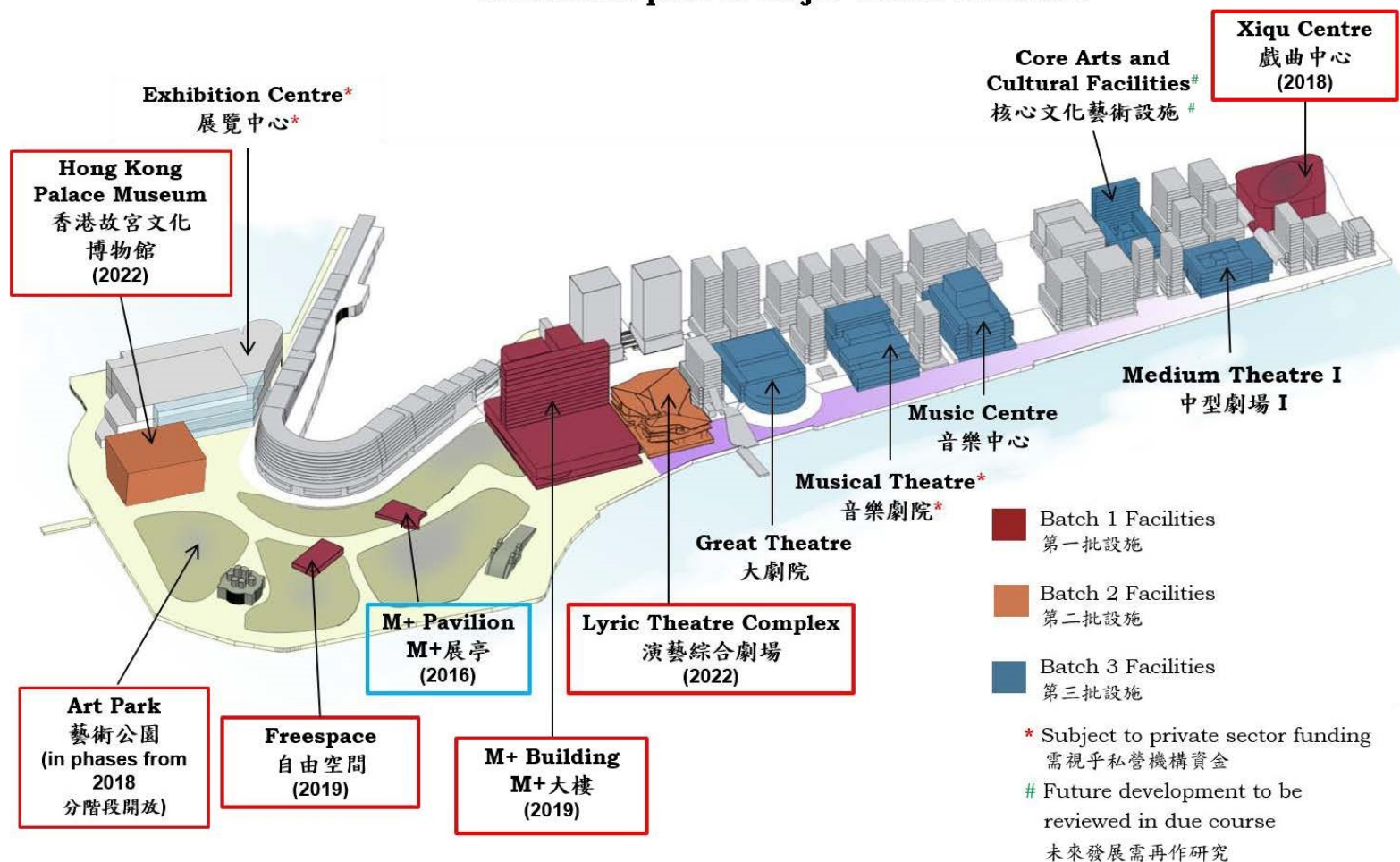
Batching	Facilities	Status and target completion date
Batch 3 facilities	Music Centre <i>(including Concert Hall and Recital Hall)</i>	High priority under the enhanced financial arrangement
	Musical Theatre	To be developed through public-private partnership subject to private sector funding
	Great Theatre	To be reviewed by WKCDA and delivered gradually having regard to demand in line with the organic growth approach of WKCD
	Medium Theatre I	
Not phased	EC <u>note 2</u>	To be developed through public-private partnership subject to private sector funding
	M+ Phase II	To be reviewed by WKCDA and delivered gradually having regard to demand in line with the organic growth approach of WKCD
	Xiqu Small Theatre	

Notes:

1. The originally proposed Medium Theatre II and one black box theatre (now called Studio Theatre) of CCP were incorporated into the original Lyric Theatre to form the Lyric Theatre Complex to advance their provision.
2. In September 2016, the Board of WKCDA agreed that the original proposal to build a MPV co-located with the EC in WKCD was no longer a suitable proposition and that the EC should be developed into a medium-sized, multi-purpose venue for exhibition, convention and performance purposes. Furthermore, the Board of WKCDA has approved the proposal for the development of the Hong Kong Palace Museum in November 2016.

Source: [Legislative Council Brief on Enhanced Financial Arrangement for the West Kowloon Cultural District](#) (File Ref: SF(37) to HABCS CR 7/1/27/1)

西九文化區主要設施示意圖
Schematic plan of major WKCD facilities



資料來源: [立法會 CB\(1\)215/17-18\(04\)號文件的附件一](#)

Source: Annex 1 to [LC Paper No. CB\(1\)215/17-18\(04\)](#)

Appendix III

Relevant papers on Financial situation of and the enhanced arrangement for the West Kowloon Cultural District Project

Committee	Date of meeting	Paper
Public Works Subcommittee	18.6.2008 (Item 1)	Agenda PWSC(2008-09)31 Minutes
Finance Committee	4.7.2008 (Item 2)	Agenda Minutes
Council Meeting	20.3.2013	Official Record of Proceedings Pages 7506-7517 (Oral question on "Planning and Capital Cost of West Kowloon Cultural District")
Council Meeting	26-27.6.2013	Official Record of Proceedings Pages 14119-14141 (26.6.2013) Pages 14148-14235 (27.6.2013) (Motion on "Concern about the expenditure of the West Kowloon Cultural District Project")
Former Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project (in operation in the Fifth Legislative Council)	3.7.2013 (Item II)	Agenda Minutes
	24.1.2014 (Item II)	Agenda Minutes
	28.3.2014 (Item II)	Agenda Minutes

Committee	Date of meeting	Paper
Former Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project (in operation in the Fifth Legislative Council)	28.5.2014 (Item I)	Agenda Minutes Response of the Administration/WKCDA to members' concerns raised at the meeting
	24.11.2014 (Item II)	Agenda Minutes
	12.1.2015 (Item III)	Agenda Minutes
	19.5.2015 (Item III)	Agenda Minutes
	7.7.2015 (Item I)	Agenda Minutes
	30.5.2016 (Item I)	Agenda Minutes
Finance Committee	10.7.2015 (Sessions 2 and 3) (Item No.1)	Agenda Minutes (Session 2) Minutes (Session 3)
-	-	Legislative Council Brief on Enhanced Financial Arrangement for the West Kowloon Cultural District (File Ref.: SF(37) to HABCS CR 7/1/27/1) (Issued on 19 January 2017)
Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project	21.2.2017 (Item II)	Agenda Minutes