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Clerk to Panel on Planning, Lands and Works
Legislative Council Secretariat
3/F Citibank Tower 3
Garden Road
Central
Hong Kong

Attn: Ms Sarah Yuen

Dear Sir/Madam

Panel on Planning, Lands and Works
Special meeting on 16 December 2004

Thank you for your fax letter of 24 November informing the special meeting of the Panel on Planning, Lands and Works to be held on 16 December 2004 on the development of West Kowloon Cultural District.

Pleased be informed that HKIS has been following the subject and submitted our comments to the Housing, Planning and Lands Bureau in February 2004. A copy is enclosed for your easy reference.

HKIS is interested in meeting the Panel on Planning, Lands and Works. However, as we have yet received detailed information from the 3 proponents, we may not be able to attend the meeting on 16 December 2004. Nonetheless, we would be happy to give comments when more information is available.

Yours faithfully

Gordon Ng
Secretary-General

Encl.

West Kowloon Cultural District Development

Introduction

1. In HKIS' preliminary submission to the Legislative Council Panel on 14 November 2003 we indicated our support of the idea of engaging the private sector in the procurement of the West Kowloon Cultural District Development (WKCD). However, we did not see that there was sufficient justification for Government to let the development agreement under a single package.

2. In response to the LegCo's request, Government has postponed the deadline for response to the Invitation for Proposal (IFP) for three months, pending further consultation with the public. While we welcome this positive move, we remain to be concerned that Government is not prepared to revise its stance on single package.

3. We have submitted our view that the project can be, and should be, broken down into smaller packages without jeopardizing the integrity of the whole development. Government, however, argues that it is undesirable for it to draw up a master layout plan based on uncertain assumptions of what would be commercially viable (LegCo paper of 18/11/03, para. 12). As we have pointed out in paras. 5 and 7 of our submission of 14/11/03, the success of the project, and indeed of any project, will depend on an appropriate balance being achieved between commitment, risks and control. In the case of the WKCD, the temporary convenience that Government appears to enjoy by not drawing up the master layout plan is offset by the difficulties that it will face in justifying value-for-money; in conducting fair assessment of proposals; in negotiating the best deal; and in dealing with post-agreement changes that are bound to arise over the long life-span of the project.

4. Further to the discussion forum held at HKIS on 19 December 2003, and as requested, our comments in this paper are focused on the assessment criteria and assessment process of the IFP. It will be noted that the inadequacies / limitations that we identify below stem principally from the absence of a value-for-money benchmark; Government not being in control of the master layout of the project; Government unaware of the land management plan in the method of disposal, temporary or permanent as well as day to day management; and consequently the project having to be let under a single package.

Output Specification

5. In the IFP document, the WKCD is specified as a "high-quality state-of-the-art development" (paras. 4.2.5(c) and 4.3.1) and "a district with a distinct cultural flavour that will provide the critical mass needed for continuous development of a vibrant cultural district" (para. 4.2.2(c)).

6. In para. 2.1 of the Important Note of the IFP, it is stated that "all words and

expressions which convey, or may convey an obligation on the part of the Proponents in respect of the preparation and submission of their Proposals, are indicative only of Government's Baseline and the obligations are open to the Proponents and are subject to negotiations. Any failure on the part of a Proponent to submit a Proposal in accordance with Government's Baseline will **NOT** (*original emphasis*) render the Proposal non-conforming."

7. The key development components and GFA of the Foster Scheme and Government's Baseline are indicated in Section 4.2.4 of the IFP. Government's Baseline anticipates a total GFA of 726,285 m² and a plot ratio of 1.81. In para. 4.2.4(b)(ii), it is provided that "the Proponent is allowed to propose development with a different intensity and development mix of its choice, with justifications in a Business Plan (The) design concept, particularly the undulating Canopy and flowing form of the Foster Scheme, should not be compromised as a result of change in the development intensity and development mix."

8. In paras. 5.1.1 and 5.1.2 of the IFP, the proponents are required to submit "financial models and financial assessments on a yearly basis". "All assumptions adopted should be clearly stated with basis and source of assumptions elaborated". In para. 5.5.1, the proponents are required to provide estimates of the revenue of the project categorized by facility types. The revenue is to be further broken down into turnstile / ticketing revenue, venue rental income, etc. (for arts and cultural facilities); sales proceeds, rental income, management fees, etc. (for commercial and residential property development); and fare and advertising income (for Automatic People Mover System). In para. 5.11.2, it is stated that "Government expects the Project to be run on a self-financing basis". In para. 5.11.1, the proponents are required to submit Financial Proposals to show any projected payment to Government in the form of annual royalties, profit sharing arrangement or land premium.

9. In para. 5.13, the proponents are required to specify their assumptions for, *inter alia*, deflation / inflation, interest rates on debt, taxation, depreciation, residual / terminal value, bank and subordinated debt, and distribution of profit.

Affordability / Value for Money

10. While we support Government's insistence on a high quality, state-of-the-art development, we are concerned that it has so far not put forward a proper business case or a detailed cost / benefit analysis for the proposed procurement. In the UK where Public Private Partnerships (PPP) / Private Finance Initiative (PFI) has been used as a mode of delivery for over 600 public facilities for over 10 years, the National Audit Office made the following observations in an audit report published in June 2003:

"Under the PFI a (government) department gets its project now and pays for it

later. The attractiveness of not having to find the money up front to meet the initial capital costs creates a strong incentive for departments to present their PFI deals as the preferred choice simply to get them to proceed. Departments may also be under pressure to choose the PFI option so as to keep debt off the public sector balance sheet. These potential risks underline how important it is that the PFI route should be chosen only after a robust value for money assessment of all the options.

“To help in assessing whether or not to go ahead with a PFI option, departments are required to prepare a public sector comparator – an estimate of what a project would cost if conventional procurement methods were used. Decisions on PFI deals need to be based on a realistic, systematic and comprehensive analysis of benefits and risks as well as costs. A robust public sector comparator should be one of the factors in this assessment.”

11. Government has assured the public that the project proponent will be selected and managed fairly with a high degree of transparency. In our opinion, transparency can only be achieved through a properly constructed business case together with a detailed cost / benefit analysis (or in PPP/PFI terms, a “public sector comparator”).

The Moving Goal Post

12. A direct consequence of Government disassociating itself from the formulation of the master layout is that the project proponents are free to come up with proposals. This is evident in the IFP provisions which we have cited in paras. 6 and 7 above.

13. We do not doubt Government’s intention of being open and fair in the assessment of IFP proposals. However, because of the lack of certainty of its own requirements, no matter how good Government’s intentions are, it is simply not possible for it to demonstrate that justice will be served. How can the bidders accept that they are fairly treated when the goal post is not fixed before the game is played, and worst still, when the winner is seen to win only because the goal post has been moved in his favour?

14. How will Government compare a scheme which provides a low density development (based on Government’s Baseline plot ratio of 1.81) but with a “nil” financial return to Government per IFP para. 5.11.1, with one which provides a high density development (exceeding Government’s Baseline of 1.81 per IFP para. 4.2.4(b)(ii)) but with a handsome yearly return of \$X M to Government? The marking scheme that Government has published is totally silent as to the relative weighting between quality and cost. This is a blunt indication that Government does not have a properly constructed business case in the first place. We would quote the following passage from the Public Private Partnership Programme Guide of the UK Treasury:

“Without clear standards, the output specification will be open to wide misinterpretation in terms of the required facility provision and service levels, and therefore cost. Responses from bidders are more likely to be less consistent, making a fair evaluation difficult. A lack of clarity in the output specification will also make it harder to build up the ‘public sector comparator’ making value-for-money more difficult to establish.”

(Page 7, Output Specifications for PFI Projects)

15. To be accountable to tax-payers, Government must retain control over the master layout of the project. On the other hand we agree that flexibility must be allowed to encourage innovation. As noted in para. 7 of our preliminary submission of 14/11/03, the success of the WKCD project depends on how these two fundamental but somewhat contradicting criteria are properly balanced. In our opinion, this can be achieved through a multi-stage bidding process whereby initial bids are invited based on a preliminary master layout plan issued by Government. Taking into account proposals received from the initial bids Government then revises / fine-tunes the master layout plan and output specification. This process is then repeated until Government is satisfied with a final set of baselines and output specification, which will form the basis of a final bid. On the basis of the previous rounds of submissions, a final shortlist of prospective bidders will also be drawn up. The most suitable proponent will then be selected in the final round of competitive bid relative to Government’s firm and final baselines.

16. This multi-stage bidding process will allow cross-fertilization of ideas from bidders. Development of the master layout plan will take place in a controlled, competitive environment involving a manageable number of bidders and not compromising Government’s negotiation position. Government, and tax-payers ultimately, will also benefit from “owning” the master layout plan:

(a) Government will be free to decide whether and how to divide the project into smaller packages, in terms of timing and/or location, in order to optimize competition, incentivize delivery, and limit overall risk exposure.

(b) The project agreement(s), including land grant(s), will be structured in more definite terms, thus avoiding ambiguities and legal disputes that may arise from the loose arrangement of a basic term offer, followed by a short term tenancy, before a firm land grant is drawn up (IFP para. 7.4).

(c) Government will help make the project more accessible to small and medium businesses.

17. As regards quality requirement of the facilities, the present IFP provides only general descriptions about the “hard” deliverables, e.g.

“The design of (the Theatre Complex) should be of the highest standard and architecturally distinguished” (IFP para. 4.2.5(d)(i))

“(The Museum Cluster and Art Exhibition Centre) should be state-of-the-art and facilitate the carrying out of core museum functions including acquisition, preservation, exhibition, education and extension programmes.” (IFP para. 4.2.5(d)(iii))

“(The Commercial / Office / Hotel Uses) should be designed as an attractive gateway along Canton Road with distinguished architectural and aesthetic qualities and should integrate well with the Canopy” (IFP para. 4.2.5(f))

“The overall design (of the Landscape and Open Space) should aim to provide public areas with a liveable, open-air, festive atmosphere to attract tourists and residents to enjoy various arts, cultural and associated entertainment activities” (IFP para. 4.2.5(h))

18. The above statements, on their own, do not adequately set out Government's quality requirements. “Soft” information about Government's intent and constraints should be provided in the IFP, covering Government's visions and policies on cultural development and tourism; expected population growth and demography within and around the district; land management strategies; expected utilization of facilities in terms of nature, frequency and user population; and metropolitan planning adjacent to the district such as transportation network, medical and schooling facilities that may have a bearing on the attractiveness and potential growth of the facilities within the WKCD.

Demand Risks vs. Facilities Risks

19. In the IFP provisions cited in para. 8 and 9 above, the project proponent is expected to shoulder risks not only for the provision of facilities but also for the facilities' revenue potentials relative to future demands.

20. From a risk management point of view, risks should be borne by the party that is best able to manage them. We consider that it is reasonable and practicable for the project proponent to assume risks in respect of facilities provision, e.g. financing risks, design risks, construction risks and operational risks. However, Government is better placed than the project proponents in forecasting and managing the risks emanating from changes in future demand for / utilization of the facilities due to many variables (e.g. sociological, economical and demographical factors), of which no information is provided in IFP document, and over which the project proponents will have no control.

21. The recognition of the project proponents' ability in forecasting and coping with risks is also crucial in the assessment of project proposals. How will

Government evaluate a proposal which looks promising but with a higher level of risk, against one which generates less revenue but is of a lower level of risk? In the present IFP, Government's attitudes towards risks are totally unknown to the bidders.

22. We consider that it is more viable for the project proponents to submit reimbursement packages that are geared to actual utilization of the facilities, such as \$ per seat or \$ per turnstile. This will help limit the risk exposure of the project proponents, and make assessment of IFP proposals more equitable and transparent.

Land Management Plan

23. The decision of lease and sale of the facilities, the grouping of lease and sale, the timing and the order in which they take place, and the allocation of undivided shares are all factors that will have a huge impact on the initial value, marketability, operation and maintenance, sustainability, and long-term value of the project. While there are some references to the requirement for a business plan (e.g. para. 6.1.2) and there are some limitations on sale or lease (e.g. para. 6.1.3), a land management plan has not been mentioned at all in the IFP or the marking scheme. In our opinion, a detailed land management plan is an essential tool for Government to justify value-for-money, benchmark the proponents' proposals, and monitor the selected proponent's performance in the implementation stage.

Marking Scheme

24. In response to criticisms about possible favouritism and lack of transparency, Government appears to rely on a set of published marking scheme. However "objective" or "scientific" the marking schemes may be, they cannot correct the inadequacies of the IFP which we have identified above, namely, the lack of an affordability benchmark; the moving goal post; and the risks being unfairly transferred to the project proponents. More specifically:

- In respect of the scenario outlined in para. 14 above, how many marks (out of a total of 100 for Part B, Technical Proposal) are considered relevant to the comparison between a low-density and a high-density development? How many marks (out of a total of 100 for Part C, Financial Proposal) are considered relevant to the incremental income generated by a high-density development?
- In respect of the scenario in para. 21 above, what are Government's relative weightings between revenue, reasonableness and future risk, i.e. "acceptability in terms of amount of revenue" (marking scheme item 12(c)), "justification and reasonableness of the assumptions used" (item 12(a)) and "acceptability in terms of robustness of financial model" (item 12 (c))?
- With regard to marking scheme item 12(a), how can Government benchmark the reasonableness / robustness of a proponent's assumption

about future utilization of facilities, when it is a subject of Government's own planning and control, and the relevant information may not be available in the public domain?

25. Objectivity can never be achieved, no matter how meticulously a marking scheme is drawn up, before the broader issues that we have identified above are properly addressed.

Conclusion

26. In conclusion, we support a strong partnership between the public sector and the private sector, and we support "picking the private sectors' brains" to ensure innovation of design, construction and management of the development. We have in this paper emphasized the need for a proper business case, and the need for Government to justify value-for-money (paras. 3, 4, 10 and 23). In the public consultations and the LegCo deliberations so far, it is clear that the perception of favouritism (and we underscore the word perception) in the selection and management of the project proponent has been a real cause for concern. This public concern cannot be dispelled unless Government assumes some control over the formulation of the project master layout plan (paras. 12 to 16 and 24 to 25), including the land management plan.

27. We have proposed a multi-stage bidding process, which allows Government to better structure its requirements and risks, as well as cross-fertilization of ideas from bidders (paras. 15 and 16). We have also made some suggested improvements to the IFP documentation (para. 17, 18 and 23) and remuneration arrangement (para. 19 to 22).

28. We have identified issues and made comments on the basis of our professional expertise in estate valuation and construction procurement. In addition, we have made reference to studies and reports overseas, particularly the UK and Australia where there is a wealth of experience in Public Private Partnerships (PPP) / Private Finance Initiative (PFI) (paras. 10 and 14).

29. It is hoped that our comments have provided helpful insight into a subject which is relatively new to the local industry. Some of our comments may be of a technical nature which Government may require further discussion. HKIS are always at Government's disposal to provide professional advice, as well as to tap local and international talent / expertise on a wide range of subjects, such as land management techniques, risk management, affordability benchmarking, financial appraisal, output specification, tender assessment, due diligence audit, facilities management, and life-cycle costing.

The Hong Kong Institute of Surveyors
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