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

Background brief prepared by the Legislative Council Secretariat for the meeting on 3 July 2013

Financial arrangements for the West Kowloon Cultural District project

Purpose

This paper provides information on the financial arrangements for the West Kowloon Cultural District ("WKCD") project. It also summarizes the relevant views and concerns of the joint subcommittees formed under the Panel on Home Affairs ("the HA Panel") and the Panel on Development in the Fourth and Fifth Legislative Council ("LegCo") to monitor issues relating to the implementation of the WKCD project on the subject.

Background

- 2. On 4 July 2008, the Finance Committee ("FC") of LegCo approved a one-off upfront endowment of \$21.6 billion (in 2008 Net Present Value ("NPV")) per Consultative Committee Case¹ for the West Kowloon Cultural District Authority ("WKCDA") to implement the WKCD project. The upfront endowment was intended to cover the capital costs of the following components parts of the WKCD project -
 - (a) design and construction of various facilities (\$15.7 billion or 73%);

Consultative Committee Case refers to the recommendations of the Consultative Committee on the Core Arts and Cultural Facilities of WKCD ("Consultative Committee"), which was appointed by the Chief Executive in April 2006. The one-off upfront endowment of \$21.6 billion in 2008 NPV is the sum total of the estimated capital costs of all the various component parts of the WKCD project compiled on the basis of a detailed financial study conducted by the Financial Adviser GHK (Hong Kong) Ltd engaged by the Home Affairs Bureau to assist the Consultative Committee to assess the financial requirements for the project.

- (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%).
- 3. According to the Administration, the retail/dining/entertainment ("RDE") part of the WKCD development will be vested in WKCDA to provide a source of recurrent income through rental proceeds to meet 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 are designed to support the whole WKCD development (including residential, commercial and hotel developments) will be undertaken by the Government, and funding approval for such works will be sought separately.
- 4. At its meeting on 26 August 2011, the Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project formed in the Fourth LegCo ("the former Joint Subcommittee") received a briefing from the Administration and WKCDA on the financial strategies adopted by WKCDA for taking forward the WKCD project. Details of the strategies are set out in When the Administration and WKCDA updated the former Joint Subcommittee on the financial situation of and arrangements for the WKCD project at its meeting on 27 June 2012, members were advised that while the current financial position of WKCDA was healthy and the upfront endowment had accumulated to over \$23 billion, WKCDA would endeavour to seek the best return from the endowment according to its investment objectives, monitor closely the construction tender price trend and update the expenditure position upon the issuance of building tender for the Xiqu Centre by mid-2013. WKCDA would also actively look into alternative financing options and private sector involvement for some of the venues that might be better managed and operated by commercial service providers, and strive to adopt cost-effective designs and an optimal strategy to package and phase the design and construction of the WKCD project works, with due consideration of the target completion dates of the Core Arts and Cultural Facilities ("CACF") as well as the RDE facilities.

Members' concerns

5. Issues relating to the financial arrangements for the WKCD project had

been raised and discussed at a number of meetings of the former Joint Subcommittee. The major views and concerns expressed by members are summarized in the ensuing paragraphs.

Adequacy of the upfront endowment fund

- 6. Pointing out that the construction cost had been on the rise in recent years and the potential additional revenue sources (such as naming right) might be one-off only, members expressed concern about the adequacy of the approved \$21.6 billion upfront endowment for implementing the entire WKCD project and the alternative funding options.
- 7. The Administration explained that the WKCD project would span over a decade, during which short-term changes in economic conditions might affect the construction costs and other relevant factors. The estimated project costs were subject to fluctuations for the following reasons -
 - (a) external economic factors including construction cost escalation, investment returns and inflation rates;
 - (b) phasing of CACF;
 - (c) outcome of design processes including design competitions; and
 - (d) costs of the integrated basement infrastructure and green features to be apportioned between WKCDA and the Government.
- 8. The Administration assured members that WKCDA was committed to adopting prudent financial management in the implementation of the project and ensuring that the existing resources were spent effectively through suitable phased development of facilities, innovative procurement modes, alternative revenue sources, cost-effective designs, etc. WKCDA was prepared to look alternative funding sources, which might include public-private-partnership mode for the development of three venues with commercial contents (namely, the Mega Performance Venue, Exhibition Centre complex and Musical Theatre), apart from donations and sponsorships. WKCD project was still at its planning stage and the designs of various buildings had yet to be available, more realistic cost estimates could only be drawn up when the designs were in place and the tendering for Phase 1 facilities WKCDA would continue to closely monitor the had been completed. economic conditions, in particular the construction tender prices.
- 9. Noting that the Mega Performance Venue, Exhibition Centre and Musical Theatre of WKCD were subject to alternative funding options, members sought clarification on whether a Build-Operate-Transfer ("BOT")

mode would be adopted for such facilities. Some members pointed out that the Subcommittee on West Kowloon Cultural District Development formed in the Third LegCo had considered BOT inappropriate for the WKCD development, as WKCDA could neither exercise effective monitoring over the arts and cultural programmes in WKCD nor put in place the artistic accountability system. These members called on WKCDA to rule out the BOT option.

- 10. WKCDA advised that the WKCDA Board did not have any specific discussion on BOT. At the current stage, it would prefer to "rule in" rather than rule out options. WKCDA stressed that the exercise of artistic control would be its paramount consideration in its discussions about funding options.
- 11. There was a suggestion that WKCDA might consider scaling down the WKCD project or developing the arts and cultural facilities in phases to keep its cash flow healthy. WKCDA should also liaise with the Administration on what communal and government facilities and related engineering works, which were designed to support the WKCD development, would be undertaken by the Government. Another suggestion was made that there might be room for reducing the collection costs and related costs for M+, such as borrowing more collections from other museums and providing more opportunities for local artists to display exhibits about the life and history of Hong Kong.
- 12. On members' suggestions, WKCDA advised that WKCDA was in detailed discussion with the Government on the demarcation and phasing of pubic infrastructure works to be funded and undertaken by the Government. WKCDA would strive to take forward the discussion as quickly as possible with a view to facilitating the WKCD development. The Administration advised that it would provide detailed information on the communal and government facilities and related engineering works to be undertaken by the Government, when seeking funding approval from LegCo.

Alternative revenue sources

- 13. Members cautioned that WKCDA should exercise political sensitivity in considering the issue of naming right. There was a suggestion that WKCDA should consider the feasibility of expanding its fund-raising network, such as looking for donations from overseas philanthropists.
- 14. WKCDA advised that until the detailed designs and financial planning of individual arts and cultural venues in WKCD had taken place, it was almost impossible for WKCDA to ascertain the phasing of the RDE facilities on the site. WKCDA would remain conservative about the likely returns from RDE.

WKCDA further advised that naming right was a common fund-raising way in overseas countries. Noting members' views, WKCDA would keep open the option of naming right as an alternative revenue source and give due regard to its sensitivity in Hong Kong.

15. Concern was raised about whether WKCDA would increase its revenue by setting up more RDE or hotel/office/residential facilities. WKCDA explained that the key development parameters of WKCD including plot ratio, cap on residential gross floor area, provision of open space and building height control had been laid down in the relevant draft Outline Zoning Plan. The Development Plan for WKCD had been formulated in accordance with these development parameters. WKCD site, as a whole, was subject to a maximum plot ratio of 1.81, provision of not less than 23 hectares of public open space, residential development of not more than 20% of total plot ratio, as well as building height restrictions of 50, 70 and 100 metres above Principal Datum under three sub-zones.

Transparency of cost estimates

16. Members raised grave concern about the lack of information on the financial implications of the preferred Conceptual Plan Option, "City Park" designed by Foster+Partners, for the development of WKCD and expressed worry that WKCD would become a white elephant. In view of the public's concern over the possible cost overrun of the WKCD project, they called on the Administration/WKCDA to enhance the transparency of the cost estimates of the project and particularly the financial arrangements for the arts and cultural facilities in each phase of WKCD as soon as possible.

Latest development

17. The Administration issued two information papers to the HA Panel in May and November 2012 respectively, providing details of its financial proposal at a project estimate of \$478 million in money-of-the-day prices for the design and site investigation of government infrastructure works for supporting phase 1 of WKCD development. When the proposal was considered and discussed at the meeting of the Public Works Subcommittee ("PWSC") on 17 December 2012, some Members raised concern about the Administration's plan to entrust part of the design and site investigation works to WKCDA, and enquired how it would ensure that there would not be multiple layers of entrustment giving rise to higher costs. The Administration explained that the proposed entrustment arrangement would help meet the implementation programme of WKCD

development and allow better coordination of interface issues between the government infrastructure works and WKCD development. The Administration also assured Members that the proposed arrangement would not give rise to multiple layers of entrustment, as WKCDA would directly engage suitable contractors and consultants to carry out the works. The proposal was endorsed by PWSC and subsequently approved by FC on 11 January 2013. According to the Administration, the design and site investigation works were scheduled to commence in January 2013 for staged completion from early 2014 to December 2017 to tie in with the commissioning of the CACF of phase 1 of WKCD development from 2015 to 2020.

- 18. In response to an oral question raised at the Council meeting of 20 March 2013 on the planning and capital cost of WKCD, the Secretary for Home Affairs advised that upon the finalization of the designs of the first batch of facilities and confirmation of the construction programmes, it would be possible to make more reliable cost estimations and to consider the need for additional funding. WKCDA would update the public on its latest financial status at a suitable juncture. The WKCD Project Management Team of the Home Affairs Bureau would continue to monitor WKCDA in terms of the progress of project delivery, methods of procurement and tendering, as well as expenditures for various construction projects.
- 19. The Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project of the current LegCo ("the Joint Subcommittee") discussed issues relating to the Xiqu Centre Design Competition at its meetings on 25 February and 8 April 2013. Members noted with grave concern that based on the chosen design, the estimated cost for the Xiqu Centre (Phase 1) and related facilities stood at \$2.7 billion (at money-of-the-day prices), which was more than double the cost estimate of \$1.3 billion for the relevant parts of the Xiqu Centre in 2006. At the Joint Subcommittee's meeting on 23 April 2013, concern was also raised about the acquisition of artworks by M+. The major views and concerns expressed by members in relation to the financial issues of the WKCD project and the responses of the Administration and WKCDA are set out in **Appendix II**.
- 20. The Administration and WKCDA will update the Joint Subcommittee on the financial situation of and arrangements for the WKCD project at its meeting on 3 July 2013.

Relevant papers

21. A list of the relevant papers with their hyperlinks on LegCo's website is in **Appendix III**.

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Financial and other strategies for implementation of the West Kowloon Cultural District Project

a) Phasing and cash flow:

To review and develop an optimal and sustainable phasing arrangement for the core arts and cultural facilities, taking into account the need for organic growth. The Authority has conducted a series of engagement meetings to seek stakeholders' views on the priority, artistic positioning and technical requirements of core arts and cultural facilities. There is general support for developing the arts and cultural facilities in phases which would better meet the dynamic and changing needs and demand of the arts and cultural sector over a longer time span and allow better co-ordination of the software and hardware development. Developing the facilities in phases would also allow the Authority to retain a portion of the endowment for investment which will be beneficial to the cash flow and budgeting.

b) Procurement strategy review

To actively explore and adopt, where considered favourable, innovative procurement modes for the core arts and cultural facilities to achieve the most effective use of financial resources. Many factors have to be considered including the importance of architectural merits, timing, administrative and change control, cost and future maintainability. Following the initial financial studies under the CC Case, the possibility of private sector involvement in project procurement will also be further reviewed.

c) Value engineering

To exhaust all possible measures during the planning and detailed design stage in cost planning and value engineering to attain the highest cost-effectiveness without compromising the overall venue quality and provisions. This has to bear in mind that a world-class arts and cultural district is to be developed with many of the key venues having to meet best in class quality.

d) Expand revenue sources

To actively explore alternative sources of revenue, including sponsorship, naming right, donation, etc.

e) Design and life cycle cost

To encourage and adopt innovative design that can save capital and life cycle cost. Innovative and aesthetically pleasing design may also be cost effective. As the Authority is also responsible for the future major renovation, maintenance and operation of the arts and cultural facilities and related facilities, the life cycle costing and maintainability aspects of the design have to be carefully reviewed.

f) Reduction of car park numbers

To actively look into the possibility of reduction of car parking for venue goers and encourage the use of public transport. Connectivity to all modes of public transport is to be enhanced. Due to floor area constraint, many of the car parks if required have to be provided underground. Reduction of car parks will help lower construction and maintenance costs.

Source: Information extracted from the Administration's paper entitled "Financial Strategy for the Implementation of the West Kowloon Cultural District Project" (LC Paper No. CB(2)2530/10-11(03))

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

Summary of the major views/concerns expressed by members at the meetings on 25 February, 8 and 23 April 2013 in relation to the financial issues of the West Kowloon Cultural District ("WKCD") project

Members' views/concerns		Responses from the Administration/WKCDA	
(1)	Budget for the Xiqu Centre (Phase 1) and related facilities		
(a)	The Administration/the West Kowloon Cultural District Authority ("WKCDA") should provide detailed explanations for the substantial increase in the estimated cost for the Xiqu Centre, including the extent to which the cost increase was caused by construction cost escalation and/or a revision/enhancement of the project scope.	(a) The original project estimate for the Xiqu Centre was \$1.3 billion (in money-of-the-day prices ("MOD")) according to the Recommendations of the Consultative Committee on the Core Arts and Cultural Facilities of the West Kowloon Cultural District ("CC Case"), comprising both Phase 1 and Phase 2 of the Xiqu Centre but without any design details for the project. The present estimate of \$2.7 billion (MOD) was based on the current scope of the Xiqu Centre (Phase 1), which included	
(b)	The Administration/WKCDA should provide a breakdown of the latest cost estimate of \$2.7 billion for the Xiqu Centre (Phase 1) and related facilities. The Administration/WKCDA should also provide details of the newly added features/facilities which were not accounted for in the original project estimate of \$1.3 billion in	additional accommodation in response to public views, such as the arts education facilities and increased open space, plus the costs for retail, dining and entertainment facilities and open space which had been included in the CC case but outside the scope of the original estimate of \$1.3 billion in 2006. Hence, the current estimate of \$2.7 billion was not directly comparable to the original estimate of \$1.3 billion. As reflected by the	

	Members' views/concerns		Responses from the Administration/WKCDA
of treason	the respective features/facilities and the ons for inclusion of them. Administration/WKCDA should critically ew the latest cost estimate for the Xiqu tre (Phase 1) and related facilities and advise whether and how the project cost could be aced.	(b)	upsurge of the Government's Building Works Tender Price Index (BWTPI) over the past six years, i.e. from 751 in the third quarter of 2006 to 1467 in the third quarter of 2012(increase by 95.3%), construction cost escalation was the major factor leading to the substantial increase in the project estimate. The budget of \$2.7 billion was an estimated ceiling based on the current accommodation for the Xiqu Centre (Phase 1), taking into account the projected magnitude of increase of BWTPI of 237% from the third quarter of 2006 to 2016. The estimated target budget of \$2,723 million was made up of two parts, viz. total construction cost (\$2,269 million) and fee, management, and other project wide expenses (\$454 million). The sum of \$2,269 million allowed for the total construction cost of the Xiqu Centre (Phase 1) was the target budget and WKCDA, together with its design consultant and the quantity surveying consultant, would make every effort to adhere to this target budget. As the detailed design of the Xiqu Centre was being developed by the design consultant and the value engineering process was underway, a more detailed breakdown of the updated cost estimate and a more accurate estimate of the construction costs of individual facilities in the building would be available after the detailed design had been finalized.

Members' views/concerns	Responses from the Administration/WKCDA
	(c) WKCDA would undertake the following measures during the detailed design and construction stages of the Xiqu Centre to control cost and to ensure value for money –
	(i) during design stage: rigorous value engineering and cost planning would be carried out to maximize the cost effectiveness of the final design of the Xiqu Centre without compromising the quality of the Xiqu Centre as envisaged by stakeholders, the public and the international community. WKCDA would make reference to the prevailing economic environment, market prices and independent quantity surveyor's assessments in managing the cost; and
	(ii) <u>during construction stage</u> : stringent cost control and change management procedures would be implemented to ensure that the out-turn cost would not exceed the target budget as a result of unnecessary design changes.
(2) Adequacy of the upfront endowment and fina	incial arrangements for the WKCD project
(a) Given the possible overspending of various works under the WKCD project as foreshadowed by the drastic increase in the	project as compared with the CC Case back in 2006, which was

	Members' views/concerns		Responses from the Administration/WKCDA
	estimated cost for the Xiqu Centre, the approved upfront endowment of \$21.6 billion might not be sufficient for the entire WKCD project.		not based on any master plan or design of individual facilities. Newly added features include the Park (as compared with open space), the integrated basement infrastructure with a public road
(b)	WKCDA should provide information on the financial arrangements considered/to be adopted to ensure completion of the planned facilities in WKCD within the approved upfront endowment of \$21.6 billion.		and car parking facilities serving WKCD as a whole (compared with the isolated and substantially fewer basement comparks and at-grade public roads), a district cooling system at other green initiatives, universal accessibility design information and communications technology initiatives, etc. These were not accounted for in the estimate for the upfro
(c)	WKCDA should have more regard to cost-effectiveness and exercise tighter cost contol in taking forward the WKCD project. Given that the criterion on "cost aspect/value for money" only carried a weighting of 10% in the assessment of the submissions for the Xiqu Centre Design Competition, WKCDA should review the weighting to be adopted in assessing the proposals submitted for the forthcoming design competitions for individual landmark facilities in WKCD, so that due regard would be given to the cost aspect.	(b) 7 (c) 1 (d) 1	endowment. The WKCD development spanned over a long period of time, during which changes in economic conditions and other relevant factors might affect construction costs. There were significant changes in the economic climate in recent years and construction costs had been on the rise as many infrastructure projects were being undertaken in Hong Kong and the region. As a result, the cost escalation and investment return over the past few years deviated significantly from the long-term assumptions adopted in deriving the endowment.
		(c)	WKCDA was committed to adopting prudent financial management in the implementation of the WKCD project and

Members' views/concerns	Responses from the Administration/WKCDA
	ensuring that the existing resources were spent effectively through, inter alia, phased development of facilities. WKCDA would proactively explore a combination of financial strategies with the aim to deliver the WKCD project as planned. These strategies included designing to approved budgets, value engineering, exploring alternative procurement strategies and seeking donation, sponsorship and funding through naming rights.
	(d) WKCDA had made reference to international practices in setting the adjudication criteria for the Xiqu Centre Design Competition and their respective weighting, which were subsequently endorsed by the Design Competition Steering Committee and an independent professional advisor. The purpose of the competition was to select a design team with a design that could be further developed in detail and for construction. Value engineering and refinement would be made during the detailed design and construction stages to control cost and to ensure value for money. Nevertheless, given the need for stringent cost control, consideration would be given to increasing the weighting of the criterion on "cost aspects/value for money" if WKCDA would launch any design competitions in future.

	Members' views/concerns		Responses from the Administration/WKCDA	
(3)	3) Funding arrangement for the infrastructure works/communal facilities for the WKCD development			
		(a)	As mentioned in the funding submission for the one-of \$21.6 billion endowment fund for WKCDA approved by the Finance Committee ("FC") (vide PWSC(2008-09)31), other communal and government facilities and related engineering works for supporting the whole WKCD would be undertaken by the Government with funding approval for such works to be sought separately. These government infrastructure works would be implemented in phases to dovetail with the WKCD development. The Civil Engineering and Development Department had proceeded with the design and site investigation of these government infrastructure works under "753CL - Infrastructure works for West Kowloon Cultural District phase 1 – design and site investigation" as approved by FC (vide PWSC(2012-13)43).	
(4)	(4) Acquisition of artworks by M+			
(a)	Concern was expressed about WKCDA's decision to adopt the "part gift/part purchase" model in accepting a donation of 1 463 Chinese contemporary artworks, conservatively valued at HK\$1.3 billion, from Dr Uli Sigg and in	(a)	To seize acquisition opportunities as early as possible, the Board of WKCDA established the Interim Acquisition Committee and approved the M+ Acquisition Policy in June 2012. The "part gift/part purchase" model was increasingly common in the	

Members' views/concerns	Responses from the Administration/WKCDA	
acquiring from Dr Sigg 47 pieces of artworks for a sum of HK\$177 million. WKCDA should provide information on the selection, reporting and approval procedures for the acquisition of artworks (including the Sigg Collection) by M+.	endorsed by the Board of WKCDA.	
	(i) all proposed acquisitions (both purchases and donations) would be carefully reviewed in accordance with the strategy and acquisition criteria as set forth in the M+ Acquisition Policy;	
	(ii) a written justification recommending/supporting the proposed acquisitions was required for discussion and approval;	
	(iii) proposed acquisitions were to be approved by different tiers	

Members' views/concerns	Responses from the Administration/WKCDA
	of authority according to the value of the work and the approving authority could set conditions including price ceilings for negotiation purpose. Acquisitions exceeding a certain specified amount had to be submitted to the Board for approval;
	(iv) procedures on avoidance of conflict of interest of staff who were involved in the acquisitions and Chairman/members of the authorities involved in advising on/approving acquisitions were set out in the Acquisition Policy; and
	(v) M+ management was required to report to the Museum Committee and the Board of WKCDA on acquisitions made on a regular basis.

Sources: LC Paper Nos. CB(2)889/12-13(02) and CB(2)1295/12-13(01)

Council Business Division 2
<u>Legislative Council Secretariat</u>
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Relevant papers on Financial arrangements 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
Former Joint Subcommittee to Monitor the Implementation of the West	29.3.2011 (Item II(c))	Agenda Minutes
Kowloon Cultural District Project	11.7.2011 (Item I (a))	Agenda Minutes
	26.8.2011 (Item II)	Agenda CB(2)2530/10-11(03) Minutes
	29.11.2011 (Item IV)	Agenda Minutes
	27.6.2012 (Item III)	Agenda CB(2)2369/11-12(05) Minutes
Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project	25.2.2013 (Item III)	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")

Committee	Date of meeting	Paper
Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project	8.4.2013 (Item II)	Agenda CB(2)889/12-13(02)
Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project	23.4.2013 (Item II)	Agenda

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