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

**Updated background brief prepared by the Legislative Council Secretariat
for the meeting on 28 May 2014**

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 major views and concerns of the Joint Subcommittee to Monitor the Implementation of the WKCD Project ("Joint Subcommittee") formed in the Fifth Legislative Council ("LegCo") 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%);
- (b) major repair and renovation of various facilities (\$2.9 billion or

¹ 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.

- 13%);
- (c) collection costs and related costs for M+ (\$1.7 billion or 8%); an
- (d) planning of WKCD and project management (\$1.3 billion or 6%).

3. According to the Administration, the retail/dining/entertainment 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 3 July 2013, the Joint Subcommittee received a briefing from the Administration and WKCDA on the financial situation of and arrangements for implementing the WKCD project. Members noted that the upfront endowment of \$21.6 billion for the WKCD project, less operating and capital expenditures incurred in the past few years (details of which are set out in **Appendix I**), had grown to \$23.6 billion as at March 2013 due to investment returns. Members were advised that taking into account the expansion in project scope and the rise in construction costs since the Consultative Committee Case, WKCDA had made a ballpark estimate of around \$47.1 billion in money-of-the-day ("MOD") prices for the design and construction costs of all facilities. The Administration and WKCDA would adopt a pragmatic approach to implement the WKCD project through rigorous cost containment, among others. The WKCDA would also proactively explore alternative sources of funding, such as donations and sponsorships through naming rights. Members were also advised that the Administration planned to fully fund the capital works of the integrated basement as general enabling works to facilitate the development of the whole WKCD project.

Members' concerns

5. Apart from the meeting of the Joint Subcommittee on 3 July 2013, issues relating to the financial arrangements for the WKCD project had also been raised in the context of the discussions on the proposal for minor relaxation of the development intensity of the WKCD site at the meetings on 24 January and 28 March 2014. The major views and concerns expressed by members are summarized in the ensuing paragraphs.

Project costs and adequacy of the upfront endowment fund

6. Noting that the estimated cost for the Xiqu Centre (Phase 1) and related facilities based on the chosen design stood at about \$2.7 billion, which was more than double the cost estimate of \$1.3 billion in 2006, members expressed grave concern about the cost overrun of the WKCD project and the adequacy of the upfront endowment for financing the capital costs of the project. Members also sought clarification whether the Administration/WKCDA would seek additional funding from LegCo for the WKCD project in the event of any over-budget in the future.

7. The Administration and WKCDA explained that the increase in the capital costs of the WKCD project was attributed to a number of factors, including high construction cost escalation 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. The Administration and WKCDA stressed that given the long time span of the WKCD project, the current ballpark estimate of around \$47.1 billion in MOD prices for the design and construction costs of all facilities in WKCD was no more than a mechanical update based on a set of assumptions of cost escalation. It was not a revised budget to be adopted for the WKCD project.

8. The Administration and WKCDA assured members that a pragmatic approach would be adopted to implement the WKCD project through rigorous cost containment of individual facilities to a level as close to the recommendations of the Consultative Committee Case as possible, emphasis on content rather than form of the facilities, and early delivery of the Park as well as some arts and cultural facilities for public enjoyment. Despite rising costs, the Administration and WKCDA did not plan to seek additional funding from LegCo to supplement the original upfront endowment in the next few years, until at least completion of the first batch of facilities in WKCD². WKCDA would consult relevant stakeholders on the implementation programme and

² According to the information provided by the Administration/WKCDA in July 2013 (LC Paper No. CB(2)1492/12-13(02)), the core arts and cultural facilities and the Park will be delivered in three batches. The five facilities to be delivered in the first batch are Xiqu Centre, M+, eastern portion of the Park facing the waterfront (including the Arts Pavilion), Freespace (a blackbox and an outdoor stage in the form of an acoustic shell) and one modular performance venue. The portion for design and construction costs of the WKCDA's facilities of the endowment granted in 2008 (\$15.7 billion) plus the associated investment return (\$2.1 billion) amounts to \$17.8 billion. While \$9 billion has been reserved for the five facilities in the first batch, around \$8.8 billion remaining will be shared by the facilities in the second and third batches.

keep under review the need to seek additional funding in light of any changes in circumstances and WKCDA's continued effort on cost containment.

9. When WKCDA's proposal for the minor relaxation of the development intensity of the WKCD site was discussed at the meetings of the Joint Subcommittee on 24 January and 28 March 2014, members sought information on the potential benefit of the proposal on the financial situation of the WKCD project. Some members considered that the revenue to be generated from the disposal of the additional gross floor area ("GFA") for hotel, office and residential ("HOR") developments on the WKCD site arising from the proposal should facilitate more favourable consideration by the Government to injecting additional funding into the WKCD project where the situation warranted.

10. The Administration explained that as stated in its funding submission to LegCo for the provision of the upfront endowment in 2008, the land sale proceeds from the disposal of the HOR sites in WKCD would become the Government's General Revenue, the use of which would be determined having regard to the funding needs of different bureaux/departments and the overall funding priorities set by the Government. The Administration further advised that while the proceeds from the disposal of the HOR sites in WKCD could not be designated to be used for financing the WKCD project, the Government would consider the appropriate form of support to be rendered to facilitate the WKCD development should the need for additional funding arise in future.

11. On the benefit of the proposed minor relaxation of the development intensity of WKCD on the financial situation of the WKCD project, members were advised that WKCDA would further study the nature of the various facilities to be built on the additional GFA to be allocated to WKCDA and look into the development programme of the WKCD as a whole to formulate an appropriate development and financial portfolio. WKCDA would be in a better position to assess the potential benefit of the proposal on the financial situation of the WKCD project when more information was available.

Funding for public infrastructure works

12. Noting that the Administration proposed to undertake and fully fund the capital works of the integrated basement, some members queried why the public infrastructure works for WKCD, including the integrated basement, had not been accounted for in the Administration's funding submission to LegCo for the provision of the upfront endowment in 2008 and whether it was an attempt to cover up the overspending of the WKCD project.

13. The Administration explained that when the funding proposal for the upfront endowment fund was submitted to LegCo in 2008, Members were advised that while WKCDA would cover the design and construction costs for the arts and cultural facilities with the endowment fund, other communal and government facilities and related engineering works for supporting the whole WKCD would be undertaken by the Government and funding approval for such works would be sought from LegCo separately. In January 2013, FC approved funding of \$478 million (MOD prices) for the design and site investigation of government infrastructure works for supporting Phase 1 of the WKCD project.

14. The Administration further explained that as the integrated basement, which was an essential feature to meet the statutory minimum requirement for 23 hectares of public open space in WKCD, was not accounted for in the estimate for the upfront endowment and was one of the major factors for the project cost escalation, the Government planned to fully fund the capital works of the integrated basement as general enabling works to facilitate the development of the whole WKCD project, subject to funding approval by LegCo. As a preliminary ballpark estimate, the capital costs of the public infrastructure works for WKCD, including the integrated basement, to be undertaken and funded by the Government would exceed \$10 billion. The Administration also advised that a decision had yet to be taken on whether the costs of building a district cooling system, which would serve to support the entire WKCD and was another newly added facility outside the original scope of the WKCD project, should be borne by the Government/WKCDA or shared between the two sides.

Transparency of cost estimates

15. In view of the public concern over the possible cost overrun of the WKCD project, members stressed the need for the Administration/WKCDA to exercise stringent control over the cost in developing various facilities in WKCD without compromising the overall functions and quality of the facilities. Some members also called on WKCDA to rigorously control its own expenditure, in particular consultancy fees. The Administration/WKCDA was also urged to enhance the transparency of the cost estimates of the project and to report regularly to LegCo on the expenditure and financial situation of the WKCD project.

16. WKCDA assured members that in addition to rigorous cost containment of individual facilities, it would also strive to maintain effective internal control over its expenditure and adopt a prudent approach in engaging consultants to facilitate the implementation of the WKCD project. A set of

procedures and guidelines governing the expenditures of WKCDA had been in place since 2010. Depending on the amount of the proposed items of expenditures, approval by different tiers of authority, viz. Executive Directors, CEO, the Executive Team and the Board of WKCDA, was required. For instance, any proposed item of expenditure exceeding \$5 million had to be submitted to the Board for approval. Furthermore, WKCDA conducted internal audits and its statements of accounts were audited annually by external and independent auditors. The audited statements of accounts had been uploaded onto WKCDA's website for the public's information.

Alternative funding sources and arrangements

17. Some members cautioned that the Administration and WKCDA should take heed of public concern about the granting of naming rights as an alternative source of funding for the WKCD project. Mr Gary FAN was of the view that individual venues/facilities in WKCD should not be made available for naming. Ms Claudia MO enquired whether a cap would be set on the number of facilities to be provided for naming.

18. According to WKCDA, it was appropriate to balance out the contributions by the Government for the WKCD project with philanthropic/private contributions. WKCDA would keep open the option of naming right as an alternative revenue source for the project and give due regard to its sensitivity in Hong Kong. Instead of granting the naming rights of individual buildings/facilities in WKCD, consideration would be given to making available parts of the facilities (e.g. a gallery or an education facility) for naming with reference to international practice.

19. Members were also advised that apart from donations and sponsorships, 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. At the meeting of the Joint Subcommittee on 3 July 2013, members were advised that WKCDA was exploring the feasibility of having the Mega Performance Venue ("MPV") and Exhibition Centre ("EC") wholly private funded. Members cautioned that in considering alternative funding arrangements for MPV and EC, WKCDA should ensure that it would be able to exercise appropriate control and monitoring over the development and management of the two facilities.

20. The Administration and WKCDA advised that in exploring private sector involvement for the development of MPV and EC, WKCDA would endeavour to strike a balance between reducing the capital investment required

of and the risk incurred by WKCDA in constructing the facilities, and retaining appropriate flexibility and control over how the facilities should be developed and managed. WKCDA would consult the Joint Subcommittee as appropriate when detailed proposals were available.

Latest development

21. The Administration and WKCDA will update the Joint Subcommittee on the financial situation of and arrangements for the WKCD project at its meeting on 28 May 2014.

Relevant papers

22. A list of the relevant papers on the LegCo Website is in **Appendix II**.

Council Business Division 2
Legislative Council Secretariat
23 May 2014

Appendix I

Operating Expenditure of the WKCDA since its establishment in 2008 (in HK\$'000)

<u>Operating Expenditure Items¹</u>	<u>2012-13</u>	<u>2011-12</u>	<u>2010-11</u>	<u>2009-10</u>	<u>2008-09</u>
Staff costs	67,169 ²	71,866 ³	42,616	20,254	7,249
Cost of hired services through employment agencies	1,249	1,248	2,814	2,137	620
Consultancy fees ⁴	40,741	72,460	146,385 ⁵	40,627	-
M+ Collection related costs ⁶	4,660	-	-	-	-
Performing Arts Programme costs ⁷	14,333 ⁸	6,918	-	-	-
M+ Programme costs ⁹	16,818	2,967	-	-	-
Accommodation costs and management fees ¹⁰	14,941	15,042	5,435	345	-
Overseas travelling ¹¹	4,173	1,049	850	160	252
Entertainment	252	247	112	17	-
Site facilities management ¹²	7,665	961	-	-	-
Public engagement exercises ¹³	-	-	9,417	1,021	-
Advertising, promotion and public relations expenses	5,899	4,477	3,115	938	-
Legal fee	2,299 ¹⁴	330	90	250	-
Executive search and recruitment costs	3,075	1,190	9,150 ¹⁵	3,961	313
Other operating expenditure ¹⁶	8,696	8,388	5,500	3,439	790
Total (Exclude depreciation and amortisation)	191,970	187,143	225,484	73,149	<u>9,224</u>

¹ The above does not include capital expenditure items (see [Annex 2](#)).

² The staff costs in the financial year of 2012-13 decreased as the project delivery staff costs were accounted as capital expenditure items (see [Annex 2](#)).

³ As the WKCD project progresses, the number of staff required by the WKCDA has increased, resulting in a more substantial increase in the staff costs in

the financial year of 2011-12. The relevant number of staff is shown at [Annex 3](#).

⁴ Consultancy fees include fees for consultancy studies and other consultancy services.

⁵ In the financial year of 2010-11, three Conceptual Plan Consultants, viz. Foster + Partners, Rocco Design Architects Limited and Office for Metropolitan Architecture, formulated three Conceptual Plan Options for public comments during the Stage 2 Public Engagement Exercise. The WKCDA also had to pay for other consultancy studies, thus resulting in higher consultancy fees in that year.

⁶ M+ Collections related costs mainly comprise the storage, management and insurance costs for the M+ Collection. The WKCDA has begun acquiring its collection since 2012. Acquisition costs are accounted as the capital expenditure of the WKCDA. Please see [Annex 2](#) for details.

⁷ Since the financial year of 2011-12, the WKCDA has been collaborating with the arts community to organise various cultural activities and education programmes. The WKCDA also obtained a short term tenancy from the Lands Department in 2012 for organising temporary events in the headland area and waterfront promenade.

⁸ Performing Arts Programme costs in the financial year of 2012-13 include the costs for conducting Freespace Fest, West Kowloon Bamboo Theatre, Advanced Cultural Leadership Programme, Cultural Leadership Summit and other related costs.

⁹ M+ Programme costs in the financial year of 2012-13 include the preparation costs for the Venice Biennale (interns and related exhibition costs included), Mobile M+: INFLATION! (documents and exhibition costs included), Song Dong: 36 Calendars exhibition, as well as the costs for other symposia and forums.

¹⁰ In view of the increase in staff, the WKCDA's former office in a Government site was no longer adequate. The WKCDA relocated to the current office at The Gateway in 2011, thus resulting in higher accommodation costs and management fees.

¹¹ The item on overseas travelling include the costs incurred by the Project Delivery Department, Performing Arts Department and M+ & Exhibition Centre Department to study overseas facilities, such as attending a conference on park development, visits by Performing Arts Department to overseas facilities with experts of Chinese opera, as well as trips in preparation for the Venice Biennale etc.

¹² The increase in the site facilities management fees in the financial year of 2012-13 is mainly due to the engagement of a management company to manage the WKCD site of 206 000 square metres under short-term tenancy.

¹³ This item only covers the costs in relation to the three-stage public engagement exercise in preparation for the Development Plan. The three stages of the exercise were held between October 2009 and October 2011, thus the expenditures were reflected in the financial years of 2009-10 and 2010-11.

¹⁴ As the WKCD project progresses, the WKCDA needs to seek legal advice on more issues pertaining to construction works, financial matters and formulation of bylaws etc.

¹⁵ The WKCDA conducted recruitment of senior executives in the financial year of 2010-11, thus resulting in higher executive search and recruitment costs.

¹⁶ Other operating expenditure includes IT expenses, staff training, stationery and periodicals and insurance etc.

Annex 2

Capital Expenditure of the WKCDA since its establishment in 2008 (in HK\$'000)

<u>Capital Expenditure Items</u>	<u>2012-13</u>	<u>2011-12</u>	<u>2010-11</u>	<u>2009-10</u>	<u>2008-09</u>
Project delivery staff costs	31,384	-	-	-	-
Project delivery consultancy fees	31,623	-	-	-	-
M+ Collection	187,860	-	-	-	-
M+ Programme equipment costs	377	-	-	-	-
Leasehold improvements, furniture and equipment	631	6,773	3,156	110	-
Other capital expenditure [#]	3,895	962	1,713	1,389	228
Total (Exclude depreciation and amortisation)	<u>255,770</u>	<u>7,735</u>	<u>4,869</u>	<u>1,499</u>	<u>228</u>

[#] Other capital expenditure includes computer equipment, software, licences and systems etc.

Number of Staff of the WKCDA since its establishment in 2008

<u>Total no. of Staff at the financial year end</u>	<u>2012-13</u>	<u>2011-12</u>	<u>2010-11</u>	<u>2009-10</u>	<u>2008-09</u>
Government staff	-	-	-	7	12
Senior executives	9	9	9	-	-
Other staff	126	90	45	14	1
Hired services through employment agencies	8	7	12	11	7
Total	143	106	66	32	20

Source: Annex 1 to Annex 3 to LC Paper No. CB(2)1298/12-13(01)

Appendix II

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
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")
Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project	8.4.2013 (Item II)	Agenda Minutes
Council Meeting	26-27.6.2013	Official Record of Proceedings Pages 14669-14691 (26.6.2013) Pages 14698-14785 (27.6.2013) (Motion on "Concern about the expenditure of the West Kowloon Cultural District Project")

Committee	Date of meeting	Paper
Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project	3.7.2013 (Item II)	Agenda Minutes
Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project	24.1.2014 (Item II)	Agenda Minutes
Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project	28.3.2014 (Item II)	Agenda

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