

For discussion on  
7 July 2015

**Legislative Council**  
**Panel on Home Affairs and Panel on Development**  
**Joint Subcommittee to Monitor the Implementation of the**  
**West Kowloon Cultural District Project**

**Update on the Financial Situation of and Arrangements for**  
**the West Kowloon Cultural District project**

**PURPOSE**

This paper serves to update Members on the latest financial arrangements for the West Kowloon Cultural District (WKCD) project following the last report on this subject on 28 May 2014.

**BACKGROUND**

***Granting of an upfront endowment to the West Kowloon Cultural District Authority***

2. In July 2008, the Finance Committee (FC) of the Legislative Council (LegCo) approved an upfront endowment in the sum of \$21.6 billion (in 2008 Net Present Value (NPV)) via PWSC(2008-09)31 for the West Kowloon Cultural District Authority (WKCDA) to implement the WKCD project<sup>1</sup>, including the core arts and cultural facilities (CACF) costs and collections costs which formed the basis of the funding application.

3. Members were advised in 2008 that other communal and government facilities and related engineering works, such as roads, drainage, fire station, public pier, etc. which are designed to support the whole WKCD (including residential, commercial and hotel developments, the land proceeds of which would accrue to the Government) would be undertaken by the Government. Funding approval for such works would be

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<sup>1</sup> FC noted that the actual capital costs amongst the different categories and facilities would have to be computed by WKCDA following detailed planning and budgeting.

sought separately by the Government in accordance with the development programme<sup>2</sup>.

4. Following the approval of the endowment fund, WKCD conducted a three-stage public engagement exercise from 2009 to 2011 to prepare a Development Plan (DP) for WKCD. WKCD thoroughly analysed public comments and selected the Foster + Partners' "City Park" conceptual plan in March 2011 as the preferred option for developing into a DP. Following the statutory planning procedures, the DP was approved by the Chief Executive-in-Council in January 2013. This forms the basis for the WKCD development. Additional features proposed in Foster + Partners' conceptual plan and included in the DP like the integrated basement and green initiatives were not envisaged when working out the funding application of the \$21.6 billion endowment approved by LegCo in 2008.

5. There has been significant escalation of construction costs since the approval of the endowment in 2008. With reference to the Architectural Services Department's tender price indices (TPI) for building works in the public sector, there was a continuous upsurge in construction costs (increased by 131% from Q3 2006<sup>3</sup> to Q1 2015). This upward trend is expected to continue in the next few years in light of the Government's infrastructure and public housing programmes.

6. On the other hand, the global investment markets have

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<sup>2</sup> In January 2013, FC approved the PWP item 7753CL with an approved project estimate of \$478 million for the design and site investigation of government infrastructure works for supporting phase 1 of the WKCD development. The scope of the project comprises the design and site investigation of underground and at-grade carriageways, a flyover, four pedestrian linkage systems, underground stormwater and sewerage systems, underground fresh and salt water supply systems, berthing/landing facilities for vessels, and other ancillary works. The project commenced in the fourth quarter of 2013 for phased completion from early 2014 to end 2017. In addition, the design and site investigation for the proposed advance works adjoining M+, comprising foundations, protection works for the Airport Express tunnel and essential enabling works for supporting the topside developments with an estimated cost of \$27.3 million, were funded as a block vote item. The design and site investigation works started in end-March 2014 to enable the proposed advance works commenced in August 2014 and to complete in stages tentatively from end 2015 onwards.

<sup>3</sup> The recommendations of the Consultative Committee on the Core Arts and Cultural Facilities of the West Kowloon Cultural District were prepared by the Financial Advisor in 2006. The Building Works TPI has gone from 751 in Q3 2006 to 1,732 in Q1 2015.

experienced a significant decline in investment rates of return and high volatility. Despite the fact that WKCDA managed to increase the annual investment rate of return from around 1% in 2008-09 to around 3-4% in recent years, the actual rate of investment return is significantly lower than the assumed rate of 6.1% in the recommendations of the Consultative Committee on the Core Arts and Cultural Facilities of the West Kowloon Cultural District (base case).

### ***A pragmatic approach to implement the WKCD Project***

7. In view of the challenges faced by WKCDA cited above, the Government and WKCDA announced on 28 June 2013 that a pragmatic approach would be adopted to implement the WKCD project along the following principles:

- (a) Rigorous cost containment of individual facilities to a level as close to the base case as possible;
- (b) Emphasis on content rather than form of these facilities; and
- (c) Early delivery of the Park as well as some arts and cultural facilities for public enjoyment.

8. To address the funding gap, it was mentioned in the announcement that the Park and CACF in WKCD would be delivered in three batches. In addition, the following steps should be pursued to implement the WKCD project:

- (a) Subject to funding approval by LegCo, Government to fully fund the design and construction of the core and shell of the integrated basement, except for the architectural/mechanical and electrical provisions, as general enabling works to facilitate the development of the whole WKCD project, in addition to public infrastructure works (roads, drains, sewerage etc.); and
- (b) WKCDA to proactively explore donations, sponsorship and fundraising (such as through the granting of naming rights of certain parts of the facilities).

A schematic plan showing the phasing of major WKCD facilities

is at **Annex A** and a table showing the latest completion timeframe is at **Annex B**.

## **LATEST DEVELOPMENTS AND FINANCIAL POSITION**

### ***Section 16 Application***

9. To optimise the development potential of the WKCD site, WKCD submitted a planning application for minor relaxation of the development intensity of the WKCD site under Section 16 of the Town Planning Ordinance (Cap. 131) in March 2014. The application was approved with conditions by the Town Planning Board on 14 November 2014<sup>4</sup>. The 15% increase in gross floor area (GFA), which yields additional GFA of 111,050 m<sup>2</sup> will be shared between the Government facilities, commercial developments<sup>5</sup> and WKCD facilities based on the original development mix adopted in the DP. The additional GFA to accrue to commercial development will increase the land value receipts of Government. The extra space at WKCD's disposal will enable the Authority to provide other arts-related uses not envisaged in the original plan such as a hostel for visiting artists, rehearsal facilities/offices for arts groups and creative space for young people and artists. The additional GFA will also be used to provide more retail/dining/entertainment (RDE) facilities to generate additional rental income and improve the overall financial situation of the WKCD in the long run.

### ***Progress of Various Facilities***

10. During the past year, good progress has been made in the design and construction of all the Batch 1 and most of the Batch 2 facilities. The key achievements and milestones to

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<sup>4</sup> The conditions include the submission of a refined building height profile and a revised air ventilation assessment; submission of a study on the implementation and operation arrangements of the proposed car parking sharing concept; and submission of a study to assess the demand for the Environmentally Friendly Transport System Proposal. These conditions are targeted to be met in 2015.

<sup>5</sup> Commercial developments refer to hotel, office and residential developments in the DP, of which the total GFA shall not exceed 366,620m<sup>2</sup> in accordance with the approved section 16 application for 15% increase in total GFA for the whole WKCD site.

date include:

- (a) Construction works for Xiqu Centre is on-track for completion by 2017. Construction of the foundation is completed, substructure construction is on-track and the main superstructure works commenced in December 2014;
- (b) Construction works for the Temporary Tree Nursery Park is underway and it is planned to open the facility to the public in mid-July 2015. This temporary facility provides a good opportunity for testing out the proposed park management philosophy, bylaw and guidelines aiming at a flexible, user-friendly mode of park management. Upcoming programmes include the Freespace Happening that aims to reach out to the youth community, encourage public participation, groom new partners and provide a platform for the artistic development. From August 2015 to March 2016, the Nursery Park will feature a diverse range of events including light music performances, street dance, outdoor film screenings, street performances, freestyle soccer, art jams, handicraft stalls, tree nursery tours and other leisure activities for young audiences and families to enjoy. These regular events will help test the operation of the systems to be adopted in the future park and help build community support for and audience loyalty to WKCD;
- (c) Construction works for the Arts Pavilion commenced in April 2015 with target completion in 2016;
- (d) The 11.6-ha Park with Freespace (Black Box and Outdoor Stage) is under detailed design and construction works is planned to be completed in 2017;
- (e) M+ foundation works commenced in August 2014. Detailed design is completed and the main superstructure works contract is planned to be awarded by October 2015. Completion of the venue is targeted for the second half of 2018; and
- (f) To meet the pressing demand for performing arts

venues, a modified facility framework for the Lyric Theatre Complex, a Batch 2 facility, involving the incorporation of the Medium Theatre II (MT II) and one of the black box theatres of the Centre for Contemporary Performance (CCP), also a Batch 2 facility, has been proposed. As a result, there will be a larger capacity Dance-focused Theatre, one Medium Theatre and one black box Studio Theatre in the Complex. This helps bring forward the delivery of some Batch 2 facilities (i.e. MT II and one black box in CCP) by several years. Detailed design for the Lyric Theatre Complex is now underway for target completion of the construction works in 2020.

Some photos of existing project works on site are at **Annex C**.

11. Development of the remaining Batch 2 facilities (including two black box theatres in the CCP) will be deferred till the site now occupied by the Hong Kong Section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link is handed over to WKCDA. As for the Batch 3 facilities, comprising venues such as the Music Centre, Great Theatre, Musical Theatre, etc., the Government and the WKCDA informed the Joint Subcommittee to Monitor the Implementation of the WKCD Project (Joint Subcommittee) at its meeting in May 2014 that there was no definite timetable for the delivery of these facilities. In light of the cost escalation and the Government's indication that there are no plans to seek additional funding injection into WKCDA before completion of Batch 1 facilities, WKCDA and the Government are now reviewing the financial arrangements to enable the implementation of the Batch 3 facilities, taking into account the costs of construction of the first two batches of facilities, the changing circumstances of the local arts scene and relevant stakeholders' views.

### ***Integrated basement***

12. With the Government's commitment to fully fund the core and shell of the integrated basement mentioned in **paragraph 8** above, the Government plans to develop the integrated basement in phases to dovetail the phased implementation of WKCD. The Joint Subcommittee was consulted on a funding application for the first and second

stages of design, site investigation and construction works of the integrated basement on 19 May 2015, which was supported by the Public Works Subcommittee (PWSC) on 16 June 2015. Subject to FC's funding approval before the end of the current LegCo session, the Government will entrust the relevant works to WKCD to be carried out concurrently with the implementation of M+ and the Lyric Theatre Complex. This is a crucial step in the development process, and failure to secure funding will result in serious delays and consequential additional expenses, to the project.

### ***Artist Square Development Area***

13. Pursuant to the pragmatic approach to implement the WKCD project, the Artist Square Development Area (ASDA), comprising M+, Lyric Theatre Complex, other arts and cultural facilities (OACF), RDE facilities as well as office and residential developments, will be developed into a "mini-WKCD" with target completion by around 2020. The ASDA will form a precinct supported by a balanced mix of various land uses to facilitate "destination building" in the early phase development of WKCD and enhance vibrancy in the vicinity of M+. The ASDA will be connected to Elements via a new footbridge to enhance connectivity with the neighbouring developments. Members were updated on the implementation progress of ASDA on 23 March 2015.

### ***Overall financial position***

14. As a result of the adoption of a prudent financial management and investment strategy, the original endowment of \$21.6 billion approved by LegCo in 2008 has grown to \$23.5 billion by the end of the financial year 2014-15, after netting off all expenditures incurred since the establishment of WKCD in 2008.

### **Investment Return**

15. The accumulated return on investment of the endowment fund since 2008 up to 31 March 2015 was \$4.6 billion. It represented an average annual return of 3% on investment. WKCD projects that a further \$1.9 billion investment return from 2015-16 to 2018-19, making a total

investment return of \$6.5 billion.

### Design and Construction of Various Facilities

16. Based on the information currently available and on the premise that the integrated basement will be funded by the Government subject to funding approval by LegCo, it is estimated that the endowment fund and investment income will be sufficient to cover the costs of the design and construction of the Batch 1 and Batch 2 facilities, with related facilities including RDE and OACF. Subject to the actual tender prices for the relevant works contracts, redeployment of funds from other components may be necessary to finance the construction of the remaining Batch 2 facilities.

### Collection Costs and Related Costs for M+

17. From the \$1.7 billion (in 2008 NPV) tranche of funds for the collection and related costs of M+, \$0.4 billion has been spent as at the end of the 2014-15 financial year. M+ will continue to expand its collection until the opening of the museum and beyond. Currently, around \$0.1-0.2 billion is budgeted per year for the next three years on collection acquisitions. The WKCDA Board is prudently managing the acquisition budget and donations (in kind and in cash) are being sought, although there is no intention for the time being to adjust the fund allocation for this component.

### Major Repair and Renovation of Various Facilities

18. An amount of \$2.9 billion in 2008 NPV was the sum originally estimated to be required for major repair and renovations of the WKCDA facilities. As the WKCD project is still at the planning and construction stage, no expenses have been required for major repair and renovation and are not expected to be incurred in the next 20 years. This component may be used to cover other expenses of the WKCDA at a later stage.

### Planning, Project Management and Programming

19. A sum of \$1.3 billion was earmarked for the planning of



the WKCD and for project management (including staff and operating expenses). When the Financial Advisor estimated the capital costs of the WKCD project, it was assumed that the arts and cultural facilities would be delivered in two phases and Phase 1, which consisted of more than ten venues, would be completed by 2014-15. The longer lead time required for conducting the three-stage public engagement exercise from 2009 to 2011, the preparation of the DP and the decision announced in 2013 to develop the WKCDA facilities by batches means that the development timeframe for the WKCD project has been considerably extended. Hence, it is obvious that the planning and project management stage will span over a much longer timeframe than was envisaged when the endowment was approved by LegCo.

20. The results of the three-stage public engagement exercise indicated that the public and stakeholders supported an organic growth approach for the WKCD development. The current implementation programme of delivering facilities in three batches would allow WKCDA to more closely monitor the project cost and formulate financial strategy to make the best use of the available resources, taking into account relevant factors like the development programme of the integrated basement, fluctuations in construction prices, inflation, investment return, etc., while building ASDA and delivering a sufficiently critical mass of facilities in the initial stage to create vibrancy in the district.

21. WKCDA plays an important role in the promotion of the cultural software development of Hong Kong as well as arts education. Hence, prior to the commissioning of the WKCDA facilities, WKCDA has been organising pre-opening programmes for performing arts and visual culture to enhance public awareness, groom arts talents and build audiences as part of the area marketing expenses for the WKCD project. Such software development<sup>6</sup> is considered vital to the success

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<sup>6</sup> In the past year, WKCDA organised and/or supported a wide array of performing arts and visual culture programmes on audience building including Freespace Fest, Rising Stars of Cantonese Opera, Take a Swing, Building M+: The Museum and Architecture Collection Exhibition, Mobile M+: 'You.' - Lee Kit, the online exhibition Mobile M+: NEONSIGNS.HK, M+ Public Forum: Where We are Now and Where We are Going, the recent exhibition and screening programme Mobile M+: Moving Images, and the existing 56<sup>th</sup> International Art Exhibition of the Venice Biennale in Italy with related Talk Series in Hong Kong etc. which successfully attracted

of the project. However, the expenditure on cultural software development inevitably increased the planning cost of the WKCD project.

22. By the end of 2014-15, the accumulated net expenditure on planning and project management was \$1.1 billion. Based on currently available information, it is estimated that an additional \$2.0 billion might be incurred by the end of 2018-19. The total net expenditure of \$3.1 billion would be covered by the portion of the endowment so earmarked (i.e. \$1.3 billion) plus the investment return of the endowment fund.

### Operating Deficits for running Batch 1 Facilities

23. It was mentioned in PWSC(2008-09)31 that the RDE income would be used to meet the deficits of various venues/facilities operations and WKCDA's costs. It was also estimated that an annual RDE income of \$0.55 billion (in money-of-the-day (MOD) prices) would be generated from 2014 in the original plan when WKCD migrates from the planning stage to the operating stage. Unfortunately, due to the extended development timeframe and as a large portion of the RDE facilities are located in the latter phases of the development, the WKCD project will remain in the construction stage for a longer period of time and the realisation of RDE income would occur at a much later period than originally envisaged. Based on information currently available, the total amount of RDE income that would be received by WKCDA was estimated to be less than \$0.1 billion per year by 2018-19. After taking into account this RDE income, it is estimated that the deficits of running the Batch 1 facilities will accumulate to about \$0.4 billion by 2018-19. WKCDA considers that it will be necessary to redeploy funds from the endowment to support the initial operational stage of the facilities.

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hundreds of thousands of people to participate in the events. In addition, WKCDA was dedicated to artistic and professional development through taking forward different capacity building initiatives, such as Xiqu Centre Seminar Series, M+ Matters Series, Xiqu Cultural Exchange Programme, New Works Forum, Workshop Series, Decade (an interactive online music and film platform), M+ Docent Volunteer Programme as well as internship programmes at M+ and Performing Arts Departments etc.

24. Under the base case, all RDE facilities were assumed to be completed by 2015, along with the vast majority of other facilities. The current development programme provides for less than 35% of the RDE facilities to be in place alongside the venues<sup>7</sup>. Coupled with this is the fact that the anticipated annual operating deficits are much higher than expected both in planning and operational modes. The result is that there is clearly going to be a shortfall in RDE facilities and in turn rental income. Management is proactively exploring different options to address this shortfall including but not limited to cost containment and fundraising opportunities.

### Funding for Public Infrastructure Works (PIW) and Integrated Basement (IB)

25. On 5 January 2015, in view of the delays in approving funding by FC, Government withdrew its PWSC Paper No. PWSC(2014-15)37 that sought to upgrade part of Item 763CL to Category A for the first stage of design and advance works for the IB. To avoid delaying the project and the significant cost and programme implications on M+ and the Lyric Theatre Complex as well as the imminent completion of the M+ foundation works by the third quarter of 2015, the WKCDA Board approved, as an exceptional and one-off arrangement, on 31 December 2014 for WKCDA to charge the costs of the construction of the advance works for Zone 3A of the IB to its endowment fund. The WKCDA Board further agreed in principle to adopt the same funding arrangement in respect of the design of essential basement structures and associated works for Zone 3B of the IB.

26. In approving the above funding arrangement, the WKCDA Board was aware that its commitment was unconditional. Nevertheless, the Government has included in its funding application in June 2015 the transfer of the costs of the first stage of design and advance works for the IB to WKCDA in recognition of the works undertaken on behalf of the Government.

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<sup>7</sup> RDE facilities to be provided in Xiqu Centre, M+, the Park, Lyric Theatre Complex and ASDA (including office/residential developments) are less than 35% of total RDE facilities in WKCD.

## **PROGRESS OF COST CONTAINMENT AND BUDGETARY CONTROL**

### ***Cost containment measures***

27. In the past year, WKCDA has exercised the following measures to contain cost:

- (a) Conducted rigorous value engineering exercises for all the construction projects. Cost containment measures have been implemented for the Xiqu Centre, M+ Foundation and Arts Pavilion contracts. Design and use of materials were also critically reviewed with a view to reducing the construction cost without compromising functionality and quality. Efforts to ensure cost-effective design and construction will continue;
- (b) Adopted a cost-effective design for M+ including one additional RDE floor and two OACF floors as a result of the Section 16 application to fully utilise the development potential, which will generate further income for WKCDA and to create more vibrancy to the area. The refinements are taken into account in the works contract tender brief;
- (c) Adopted a simple and functional design for the Park, including the Freespace (Black Box and Outdoor Stage) throughout the concept and detailed design stage. Worked with the Design and Quantity Surveying teams at tender stage to attract bidding interest and effective procurement;
- (d) Adopted an integrated approach to combine the development of a Medium Theatre, a Studio Theatre with the Lyric Theatre to form the Lyric Theatre Complex in order to achieve design efficiency and economies of scale; and
- (e) Conducted a critical review to minimise the growth of operating expenses and staff costs in the coming years by all departments. The budgeted headcount for 2015-16 has been controlled and certain non-core IT activities will be outsourced.

### ***Other budgetary control initiatives***

28. Aiming at further budgetary control, WKCDA will continue to proactively implement/consider the following cost containment measures/revenue-generating initiatives:

- (a) Proactively seek donation/sponsorship income and explore various potential fundraising initiatives (e.g. incorporate fundraising functions in the website, grant naming rights, establish a charity vehicle to encourage philanthropic efforts through tax deductible incentives, etc.) In addition to donated artwork secured in the past years, WKCDA has received cash donations from a donor in 2014-15 for the acquisition of collection. Management is also in active discussions with a few targeted donors/sponsors for potential donation and sponsorship relating to the venue facilities;
- (b) Implement the development of ASDA as mentioned in **paragraph 13** to bring in RDE income while enhancing vibrancy of the district;
- (c) Critically review the central management, planning and support costs; and
- (d) Consider more cost-effective operation models by a newly set up internal operation taskforce in order to optimise functionality and the mix of revenue/cost of different arts and cultural facilities.

### **OTHER FINANCING/FUNDING OPTIONS**

29. Even with cost containment measures and other budgetary control initiatives in **paragraphs 27 and 28**, the funding gap is substantial. To bridge the gap, the WKCDA Board has instructed Management to work with the Government to come up with alternative financial arrangements.

30. Management has so far explored a range of alternative funding sources. It is clear, however, that the only realistic option available to WKCDA is to consider how to advance the commercial developments on the site to leverage financing and

funding alternatives. Preliminary studies indicate that if WKCD were given the development right with payment of land premium in respect of some or all of those commercial developments, there would be potential for the Authority to complete the planned construction programmes in full, fund the operation of the CACF and support the wider development of arts and culture in Hong Kong.

31. In addition, the WKCD Board is taking a holistic and strategic assessment to identify alternative approaches to fund the outstanding facilities and to pursue those venues requiring alternative funding, for example, the development of the proposed Mega Performance Venue/Exhibition Centre on the site currently occupied by the Temporary Tree Nursery Park and the Musical Theatre through some form of private-public partnership. These options will be reported to the Joint Subcommittee when ready.

### ***Continuous financial monitoring***

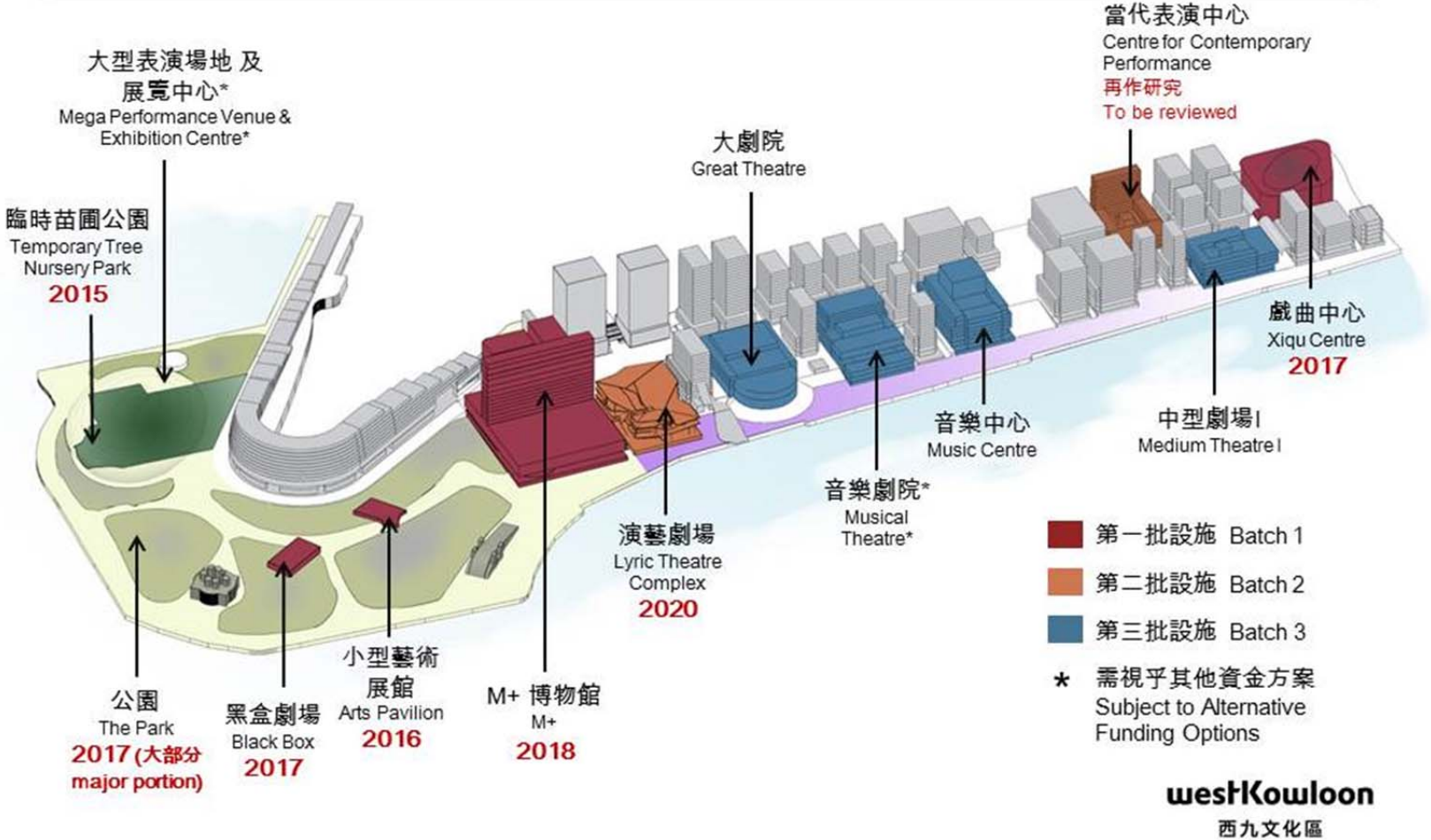
32. As committed to LegCo in July 2013, WKCD has no intention to seek further injection to the upfront endowment fund prior to completion of the Batch 1 facilities. For accountability and transparency purposes, WKCD will present annual financial updates to the Joint Subcommittee. This will take into account the progress made in those budgetary control measures adopted and likely changes to the development programme of WKCD.

## **RECOMMENDATIONS**

33. Members are invited to note the content of this paper.

**West Kowloon Cultural District Authority  
July 2015**

# 西九文化區設施(第一及第二批)預計完成時間表 Completion Timeframe of WKCD (Batches 1 and 2) Facilities



**Phasing of major WKCD facilities under the pragmatic implementation approach in June 2013**  
**(as modified in 2015)**

<b>Batch 1 facilities</b> (Target completion by 2018)	<b>Batch 2 facilities</b> (Target completion by around 2020)	<b>Batch 3 facilities</b> (Target completion beyond 2020)	<b>Not phased</b>
Xiqu Centre (including Tea House)	Lyric Theatre Complex (including one Medium Theatre and a Studio Theatre) <sup>@</sup>	Musical Theatre*	Mega Performance Venue/ Exhibition Centre Complex*
Freespace (including Outdoor Stage and Black Box)	Centre for Contemporary Performance <sup>#</sup> (including two Black Boxes)	Great Theatre	M+ Phase II
M+		Music Centre (including Concert Hall and Recital Hall)	Xiqu Small Theatre
Park and Temporary Tree Nursery Park		Medium Theatre I	
Arts Pavilion			

\* Subject to alternative funding options

<sup>@</sup> The revised approach to advance the Medium Theatre II and one black box theatre from the Centre for Contemporary Performance to become the Lyric Theatre Complex was reported to the Joint Subcommittee on 23 March 2015 (via LC Paper No. CB(2)1066/14-15(04))

<sup>#</sup> Target completion date to be reviewed



**Photos of design of facilities and project works on site**

**Xiqu Centre Design**



**Works on site (June 2015)**



**M+ Design**



**Works on site (June 2015)**



**Arts Pavilion Design**



**Works on Site (June 2015)**

