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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 7 July 2015**

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 WKCD project, with broad breakdown as follows -

- (a) design and construction of various facilities (\$15.7 billion or 73%);
- (b) major repair and renovation of various facilities (\$2.9 billion or 13%);

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.

- (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. In January 2013, FC approved funding of \$478 million for the design and site investigation of government infrastructure works for supporting Phase 1 of the WKCD project. In May 2015, the Administration briefed the Joint Subcommittee on the funding application for the first construction package of public infrastructure works for WKCD at an estimated cost of \$0.8 billion, which was supported by the Public Works Subcommittee ("PWSC") on 16 June 2015.

4. The Joint Subcommittee received briefings from the Administration and WKCDA on the financial situation of and arrangements for implementing the WKCD project at its meetings on 3 July 2013 and 28 May 2014. At the meeting on 3 July 2013, the Administration/WKCDA advised the Joint Subcommittee that in view of the expansion in project scope and the significant escalation of construction costs, a pragmatic approach would be adopted to implement the WKCD project through rigorous cost containment of individual facilities, 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 intended to fully fund the capital works of the main integrated basement² as general enabling works to facilitate the development of the whole WKCD project. In May 2015, the Joint Subcommittee was briefed on the funding application for the first and second stages of design, site investigation and construction works of the integrated basement at an estimated cost of about \$2.9 billion. The funding application was supported by PWSC on 16 June 2015.

5. According to WKCDA, the upfront endowment of \$21.6 billion for the WKCD project, less operating and capital expenditures³, had grown to \$23.7 billion as at end March 2014 due to investment returns.

² The main integrated basement is the central portion between Xiqu Centre and M+.

³ For information provided by WKCDA on details of its operating and capital expenditure and number of staff from 2008-2009 to 2012-2013, please refer to Annexes 1 to 3 to LC Paper No. CB(2)1298/12-13(01).

Members' concerns

6. Apart from the two meetings of the Joint Subcommittee on 3 July 2013 and 28 May 2014, concerns relating to the financial situation of and 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, the implementation of the integrated basement and individual WKCD venues/facilities. The major views and concerns expressed by members are summarized in the ensuing paragraphs.

Project costs and adequacy of the upfront endowment

7. Members expressed grave concern over the serious cost overrun of the WKCD project as well as the uncertainty about the extent of the cost overrun problem. As advised by the Administration/WKCDA at the meeting of the Joint Subcommittee on 28 May 2014, it was estimated that the portion of the upfront endowment for the design and construction of the WKCD facilities (i.e. \$15.7 billion) plus the apportioned interest income (i.e. \$2.1 billion) would be sufficient to cover the costs of design and construction of the Batch 1 and Batch 2 facilities⁴ as well as other related facilities; while the funding for and the implementation programme of the Batch 3 facilities would be reviewed at a suitable juncture. Members sought clarification whether the Administration/WKCDA had any plan to seek additional funding from LegCo for the WKCD project in the future.

8. Given the uncertainty for the delivery of the Batch 3 facilities, some members were worried whether, with the spiralling cost of the WKCD project, the Administration was planning to shelve the development of the Batch 3 facilities or cut down on the resources to be allocated for the WKCD development. Some other members, however, expressed the view that given the huge cost overrun of the WKCD project, the Administration and WKCDA should critically examine the scope of the project and come to an early decision on which facilities would and would not be taken forward.

9. The Administration/WKCDA explained that the increase in the capital costs of the WKCD project was attributed to a number of factors, including significant escalation of construction costs in Hong Kong in recent years, the inclusion of an integrated basement as an integral part of the approved Development Plan ("DP") of WKCD, enhanced project scope to meet public

⁴ The Batch 1 and Batch 2 of WKCDA's facilities include, among others, the Park (with Arts Pavilion), Freespace (Black Box and Outdoor Stage), Xiqu Centre, M+ and Lyric Theatre Complex. Batch 3 facilities comprise venues such as Music Centre, Great Theatre and Musical Theatre, etc.

aspirations reflected during the public engagement exercise on DP (such as adding space for education facilities in different venues), and longer time taken to complete the master planning and planning approval process for WKCD.

10. The Administration further advised that given the various challenges being faced by the WKCD project and having regard to the public support for adopting an organic growth approach to the development of WKCD, the Administration considered it a pragmatic arrangement for WKCD to make efficient use of the endowment fund and the associated investment return to complete the Batch 1 and Batch 2 facilities for early public enjoyment, and review the implementation programme of the Batch 3 facilities at a suitable juncture taking account of, among others, the public's feedback on the first two batches of facilities and the overall position of the arts and cultural development in Hong Kong. If it was considered necessary and appropriate to seek additional public funding for developing the Batch 3 facilities, the Administration/WKCD would seek funding approval from LegCo accordingly. The Administration stressed that although a phased approach was adopted, the WKCD site would be developed into an integrated arts and cultural district as planned. The Administration also advised in May 2014 that, as committed to LegCo in July 2013, WKCD had no intention to seek further injection to the upfront endowment prior to the completion of the Batch 1 facilities.

Funding arrangements for public infrastructure works and the integrated basement for WKCD

11. Noting that the Administration would undertake and fully fund the capital works of the integrated basement, some members queried why the public infrastructure for WKCD as well as the integrated basement had not been accounted for in the Administration's funding submission to LegCo for the provision of the one-off upfront endowment in 2008 and whether it was an attempt to cover up the overspending of the WKCD project. The Administration was requested to provide details on the respective funding responsibility of the Administration and WKCD for the development of public infrastructure for WKCD and the costs covered by the Administration for WKCD in implementing the integrated basement.

12. The Administration explained that when the funding proposal for the upfront endowment was submitted to LegCo in 2008, Members were advised then that while WKCD 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 accordance with the development programme.

13. The Administration further explained that the provision of an integrated basement was not included in the original scope of the WKCD project when the upfront endowment was sought in 2008. The basement design was only proposed in the three conceptual plan options for WKCD presented for public consultation in 2010. Given that 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 Administration planned to fully fund the capital works of the integrated basement (as opposed to the original plan of cost-sharing between the Administration and WKCDA of 50:50) as general enabling works to facilitate the development of the whole WKCD project, subject to funding approval by LegCo.

14. Members expressed concern about the high cost estimate of the integrated basement, which had increased from over \$10 billion as advised by the Administration/WKCDA in July 2013 to around \$23 billion. The Administration was requested to explain the basis upon which the \$23 billion cost estimate was drawn up. The Administration was also urged to ensure that there would not be any further increase in the cost estimate for the integrated basement in future other than that caused by escalation of material and staffing costs.

15. According to the Administration, the rough cost estimate of around \$23 billion for the main integrated basement and the associated public infrastructure works was derived in mid-2013 based on WKCDA's preliminary basement layout plans/site investigation results and the assumption that the construction of the whole integrated basement would be completed in one go by 2020. It included about \$19 billion (breakdown by zone is in **Appendix I**) being the cost of the foundations and substructure of the main integrated basement, which, according to the original plan, should be shared between the Administration and WKCDA. The remaining balance of about \$4 billion was the cost of the public infrastructure works in the basement which served to support the whole WKCD and had all along been planned to be funded by the Administration.

16. The Administration further explained that based on the phased implementation arrangement, the estimated total amount of funding sought/to be sought for implementing Zones 3A, 3B and 2B of the integrated basement and the associated public infrastructure works in the years up to 2016-2017 would be about \$10 billion. However, the cost estimates for the remaining portions of the integrated basement (i.e. Zones 2A and 2C), which were to be implemented at a later stage, were not available yet. The Administration would be in a better position to provide more updated estimates for the whole

integrated basement project when the detailed design and construction programmes for the different phases of the integrated basement were firmed up. Members were also assured that the cost of developing the portions of the integrated basement for the hotel, office and residential ("HOR") sites incurred by the Administration would be duly reflected in the land premium for such sites.

Financial implications of the proposal on minor relaxation of the development intensity of the WKCD site

17. 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 HOR developments on the WKCD site arising from the proposal should facilitate more favourable consideration by the Administration to injecting additional funding into the WKCD project where the situation warranted.

18. 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.

19. 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.

Financial management

20. In view of the public concern over the 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. Members also called on WKCDA to rigorously control its own expenditure, in particular consultancy fees. The Administration/WKCDA were 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.

21. 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. On efforts made in controlling staff costs, WKCDA advised that while it had an approved staff establishment of 247 according to its business plan for the 2013-2014 financial year, it had engaged only 186 staff members (including interns and staff hired through employment agencies) as at March 2014 having regard to actual operational needs. WKCDA had also rigorously controlled the expenditure on consultancy fees, with only one-third of the approved budget for the conduct of consultancy studies in the 2013-2014 financial year expended as at May 2014.

22. WKCDA further advised that 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, Chief Executive Officer, 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. In line with good corporate governance practices, the WKCDA Board had established a set of internal guidelines for the salary disclosure of the senior executives of WKCDA, and had been disclosing the information in its annual reports in accordance with the relevant guidelines⁵. For transparency and accountancy purposes, WKCDA had undertaken to closely monitor the project's overall financial situation and present annual updates to LegCo.

23. Some members considered that to strengthen the long-term financial sustainability of the operation of WKCD, WKCDA should attach importance to recruiting not only arts and cultural talents but also relevant professionals in the financial and commercial fields to assist in the development of WKCD. In response to members' enquiry about the investment return of the endowment fund for the WKCD project, WKCDA advised that with a view to formulating a

⁵ For information provided by WKCDA on the remuneration received by senior executives of WKCDA in 2013-2014, please refer to LC Paper No. CB(2)1859/13-14(01).

prudent investment strategy for managing the endowment fund, WKCDA had spent around 6-12 months after its establishment in 2008 on consultations with investment experts in the financial sector. Taking into account a number of investment considerations including capital preservation, WKCDA had then placed an initial \$10 billion of the endowment fund with the Hong Kong Monetary Authority with a yield of about 5%-6% per annum for the first two years and currently at about 3% per annum, whereas the remaining half of the endowment fund had been placed in deposits with an average return of about 2%-3% per annum. The accumulated return on investment of the endowment fund since 2008 up to March 2014 was \$3.8 billion.

Alternative funding sources and arrangements

24. Some members cautioned that the Administration and WKCDA should take heed of the 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.

25. According to WKCDA, it was appropriate to balance out the contributions by the Government for the WKCD project with philanthropic/private contributions. WKCDA was devising an overall strategy for and plans on raising funds through, among others, seeking donations and sponsorship through naming rights. Instead of granting the naming rights of individual facilities/venues in WKCD, consideration would be given to making available parts of the facilities/venues (e.g. a gallery or an education facility) for naming with reference to international practice.

26. In view of the huge funding gap for the WKCD project, some members enquired whether WKCDA had considered other financing options such as issuing bonds to raise funds for the project and further increasing the plot ratio of the WKCD site. The Administration/WKCDA advised that while WKCDA might issue bonds with the approval of the Financial Secretary, account had to be taken of WKCDA's ability to repay the funds raised having regard to the nature of its business. It was also considered not practical to seek a further increase of the plot ratio of the WKCD site as any proposed changes to the development parameters for WKCD would likely be controversial. The Administration/WKCDA further advised that since RDE was the major income-generating land use for WKCDA to meet the operating expenses of the arts and cultural facilities, WKCDA had proposed to accelerate the development of the area around the Artist Square (comprising M+, Lyric Theatre Complex, other arts and cultural facilities, RDE facilities as well as office/residential developments) into a mini-WKCD to facilitate early provision of RDE facilities

in WKCD to generate income to meet part of the operating expenses of the Batch 1 facilities.

27. 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. The Mega Performance Venue ("MPV") had been identified as one of the venues with commercial value the development of which would be subject to alternative funding options. In response to Miss CHAN Yuen-han's concern about the funding arrangement for MPV and whether the construction cost of MPV had been included in the estimate for the one-off upfront endowment for the WKCD project, the Administration/WKCDA advised that of the \$21.6 billion upfront endowment, an amount of \$2,218 million (in 2008 NPV) was assumed in calculating the estimated capital cost for the design, planning and construction of MPV. The estimation was based on the design and build approach while WKCDA might consider different modes of public private partnership in the development and operation of the facilities with reference to their distinctive features.

Latest development

28. The Administration and WKCDA will update the Joint Subcommittee on the latest financial situation of and arrangements for the WKCD project at its meeting on 7 July 2015.

Relevant papers

29. A list of the relevant papers on the LegCo website is in **Appendix II**.

Rough Cost Estimates of Integrated Basement by Zone

Integrated Basement Zone	Rough Cost Estimate (in MOD prices)
1A	Cost of basement funded by WKCDA as part of Xiqu Centre project
2A	About \$5 billion
2B	About \$5 billion
2C	About \$5 billion
3A	Cost of basement funded by WKCDA as part of M+ project
3B	About \$4 billion
Total funded by Government:	About \$19 billion

Note: The above rough cost estimates were derived in mid-2013 on the assumptions that construction of the integrated basement would start in 2014 for completion in one go by 2020. The above estimates have not taken into account the impact of the delay in the XRL project.

Source: Annex 4 to the Administration's response to issues raised at the meeting of the Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project on 12 January 2015 [LC Paper No. CB(2)1032/14-15(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 Minutes
Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project	28.5.2014 (Item I)	Agenda Minutes Response of the Administration/WKCDA to members' concerns raised at the meeting
Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project	24.11.2014 (Item II)	Agenda Minutes
Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project	12.1.2015 (Item III)	Agenda Minutes
Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project	19.5.2015 (Item III)	Agenda Minutes