

For discussion on
30 May 2016

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 7 July 2015.

BACKGROUND

2. In July 2013, the West Kowloon Cultural District Authority (WKCDA) informed the Joint Subcommittee to Monitor the Implementation of the WKCD Project (Joint Subcommittee) of the Legislative Council (LegCo) that it had no intention to seek further injection to the upfront endowment fund prior to completion of the Batch 1 facilities. For accountability and transparency purposes, WKCDA undertook to present annual financial updates to the Joint Subcommittee, which would take into account the progress made in the budgetary control measures adopted and likely changes to the development programme of WKCD.

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

3. In July 2008, the Finance Committee (FC) of LegCo approved an upfront endowment in the sum of \$21.6 billion (in 2008 Net Present Value (NPV)) via PWSC(2008-09)31 for

WKCDA to implement the WKCD project¹, including the core arts and cultural facilities (CACF) costs and collections costs which formed the basis of the funding application.

4. 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. The Government has been seeking funding approval for such works separately in accordance with the development programme².

5. Following the approval of the endowment fund, WKCDA conducted a three-stage public engagement exercise from 2009 to 2011 to prepare a Development Plan (DP) for WKCD. WKCDA thoroughly analysed public comments and selected 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.

¹ 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.

² 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. In addition, the design and site investigation for the proposed advance works adjoining M+, comprising foundations, protection works for the Airport Express tunnels and essential enabling works for supporting the topside developments with an estimated cost of \$27.3 million, were funded as a block vote item. In July 2015, FC approved i) the PWSC item 754CL with an approved project estimate of \$840.5 million for the Infrastructure Works for WKCD phase 1 – first construction package and ii) the PWSC item 763CL with the approved project estimate of \$2,919.5 million for the Integrated Basement for WKCD – first and second stages of design, site investigation and construction works.

6. 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 substantial upsurge in construction costs (by 136%) from Q3 2006³ to Q4 2015. This upward trend may continue in the next few years in light of the Government's infrastructure and public housing programmes.

7. On the other hand, the global investment markets have experienced a significant decline in investment rates of return and high volatility. This downward trend in the financial market is expected to continue. 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) made in 2006.

A pragmatic approach to implement the WKCD Project

8. 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.

³ 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 1 775 in Q4 2015.

9. 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

Increased Development Intensity for the WKCD Site

10. To optimise the development potential of the WKCD site, WKCDA 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. The 15% increase in gross floor area (GFA), which yields additional GFA of 111,050m² will be shared between the Government facilities, commercial developments⁴ and WKCDA facilities based on the original development mix adopted in the DP. The capital cost for developing the additional GFA for the WKCDA facilities (about 62,000m²) is not covered by the upfront endowment and

⁴ Commercial developments refer to hotel, office and residential developments in the DP, of which the total GFA shall not exceed 366,620m² in accordance with the approved section 16 application for 15% increase in total GFA for the whole WKCD site.

their development is therefore subject to funding availability.

Development of Arts and Cultural Facilities

11. 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. For details, please refer to the separate paper entitled “Update on the Progress of Hardware Development in the WKCD” to be discussed at the Joint Subcommittee meeting on 30 May 2016. The key achievements and milestones to date include:

- (a) Construction works for Xiqu Centre is on-track for completion by 2017 and for opening in 2018;
- (b) Construction works for M+ Pavilion (previously called Arts Pavilion) will be completed for opening in July 2016. It will provide exhibition space for M+ before the opening of the M+ building;
- (c) The detailed design of the Park with Freespace (Black Box and Outdoor Stage) was completed in Q4 2015 with construction works target to commence in mid-2016;
- (d) The main superstructure works for M+ is in progress with target completion in the second half of 2018; and
- (e) The detailed design of Lyric Theatre Complex (LTC) is in progress. In parallel, the foundation works for LTC and Zone 3B of the integrated basement commenced in January 2016. LTC is targeted for completion by around 2020.

12. As reported to the Joint Subcommittee in July 2015, development of the remaining Batch 2 facilities (including two black box theatres in the Centre for Contemporary Performance) will be deferred until the site being 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 and Medium Theatre I, there is no definite timetable for their delivery. In light of the cost escalation and WKCDA’s indication that it has no plan to seek funding

injection into the endowment before completion of Batch 1 facilities, WKCD 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.

13. Pursuant to the pragmatic approach to implement the WKCD project, the Artist Square Development Area (ASDA), comprising M+, LTC, other arts and cultural facilities (OACF), retail, dining and entertainment (RDE) facilities as well as commercial developments, will be developed into a "mini-WKCD" with target completion by around 2020. 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+. Accessibility will be instrumental to the attraction of visitors to ASDA and contribute to the popularity of the arts and cultural facilities as well as RDE facilities there. To enhance the connectivity of ASDA with adjacent developments such as the MTR Kowloon Station and Elements shopping mall, an Artist Square Bridge across Austin Road West is being planned. Funding approval from FC of LegCo will be sought tentatively in the first half of 2017, following consultation with the Joint Subcommittee and the Public Works Subcommittee.

Cultural Software Development

14. In preparation for the commissioning of the WKCD facilities, WKCD has been organising pre-opening programmes for performing arts and visual culture to enhance public awareness, groom arts talents and build audiences. WKCD has updated the Joint Subcommittee in July and December 2015 on the cultural software development for WKCD (LC Paper No. CB(2)1902/14-15(01) and CB(2)440/15-16(03)). Such software development is considered vital to the success of the project. However, the expenditure on cultural software development inevitably increased the planning cost of the WKCD project.

15. WKCDA has continued to organise an array of programmes to prepare the audience and nurture young artists for the opening of the Xiqu Centre in 2018 via initiatives including an innovative double bill production under the City Exchange programme (Xiqu) 2016 entitled “The Ghost Seller & His Butterflies (Version 80)” in February 2016; the ongoing Xiqu Centre Seminar Series; Xiqu Cultural Exchange Programme which brought young Cantonese Opera artists to Hangzhou and Chongqing, etc.

16. On audience building, WKCDA has organised and/or supported a wide array of performing arts and visual culture programmes including 12 Freespace Happening events from August 2015 to March 2016 (which attracted over 53,000 visitors); M+ Sigg Collection: Four Decades of Chinese Contemporary Art Exhibition from February to April 2016 (which attracted 40,509 visitors); Mobile M+: Live Art, M+ Screening; M+ Matters seminars, etc.

17. In addition, WKCDA is dedicated to artistic and professional development through taking forward different capacity building initiatives, such as New Works Forum from August to October 2015; International Workshop Festival of Theatre from August to November 2015; Producers’ Network Meeting and Forum in early May 2016; and internship and volunteer programmes including M+ Docent Volunteer Programme; Venice Biennale Internship Programme as well as internship programmes within both M+ and Performing Arts Departments.

18. WKCDA has also been constantly engaging the public and young people. M+’s first major school outreach programme, M+ Rover: Travelling Creative Studio, was launched in March and will run until July 2016, with 45 school visits and 11 community visits scheduled. Other programmes include M+ Summer Camp; Culture Mixer Workshop in October 2015 and March 2016 for students to better understand the WKCD project and the District; WKCDA Xperience Day, a job shadowing experience at WKCDA, in November 2015 and April 2016; and “West Kowloon Youth Exchange” in July 2015 to gauge views from WKCDA’s past interns.

19. Since the opening of the Nursery Park in July 2015, WKCDA has organised 12 Freespace Happening events to animate the site as mentioned above. WKCDA is also working with a range of other organisers to host a wide variety of events in the Nursery Park, which aim to reach out to the youth community, encourage public participation, groom new partners, provide a platform for artistic development and provide visitors with opportunities to experience the atmosphere of the future Park. It also provides a good opportunity for testing out WKCDA's park management philosophy which is enshrined in its proposed West Kowloon Cultural District (Public Open Spaces) Bylaw and guidelines, aiming at a flexible, user-friendly mode of park management.

20. Photos of some recently organised programmes and events are at **Annex C**.

Overall financial position

21. 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, after netting off all expenditures incurred since the establishment of WKCDA in 2008, has grown to \$22.6 billion by the end of the 2015-16 financial year.

Investment Return

22. The accumulated return on investment of the endowment fund since 2008 up to 31 March 2016 was \$5.4 billion. It represented an average annual return of 3% on investment. WKCDA projects that a further \$1.3 billion investment return from 2016-17 to 2018-19, making a total investment return of \$6.7 billion.

Design and Construction of Various Facilities

23. 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 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. As at 31 March 2016, the total committed contracts on capital projects were approximately \$10 billion, of which \$2.3 billion had been incurred.

Collection Costs and Related Costs for M+

24. From the \$1.7 billion (in 2008 NPV) tranche of funds for the collection and related costs of M+, \$0.6 billion has been spent as at the end of the 2015-16 financial year. M+ will continue to expand its collection until the opening of the museum and beyond. Currently, around \$0.1 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

25. 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 expenses are not expected to be incurred in the next 20 years. This component may be used to cover other expenses of WKCDA at a later stage.

Planning, Project Management and Programming

26. 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 long 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 mean 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.

27. 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.

28. By the end of 2015-16, the accumulated net expenditure on planning and project management was \$1.4 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 \$3.4 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

29. 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. However, 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. The current

development programme provides for less than 35% of the RDE facilities to be in place alongside the venues⁵. The result is that there is clearly going to be a shortfall in RDE facilities and in turn rental income. 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 by 2018-19.

30. On top of this is that the anticipated annual operating deficits are much higher than expected both in planning and operational stages. After taking into account these factors, it is estimated that the deficits of running the Batch 1 facilities will accumulate to about \$0.3 billion by 2018-19. As reported in the Joint Subcommittee meeting on 7 July 2015, WKCDA considered that it would be necessary to redeploy funds from the endowment to support the initial operational stage of the facilities. WKCDA is also proactively exploring different options to address this shortfall including but not limited to cost containment and fundraising opportunities.

PROGRESS OF COST CONTAINMENT AND BUDGETARY CONTROL

Cost containment measures

31. 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+ and M+ Pavilion main works 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;

⁵ RDE facilities to be provided in Xiqu Centre, M+, the Park, LTC and ASDA (including office/residential developments) are less than 35% of total RDE facilities in WKCD.

- (b) Adopted a cost-effective design for the M+ building by including one additional RDE floor and two OACF floors and maximising the development potential for the RDE/OACF building adjacent to the M+ building. This will help generate more rental income for WKCDA at earlier time;
- (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 LTC 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.

Other budgetary control initiatives

32. Aiming at further budgetary control, WKCDA will continue to proactively implement/consider the following cost containment measures and 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.) WKCDA is developing a donation and sponsorship policy setting out the principles and guidelines governing the acceptance and management of donations and sponsorships, as well as an institutional setup in WKCDA to coordinate fundraising efforts;

- (b) Closely monitor the development of ASDA with a view to bringing in RDE income earlier while enhancing vibrancy of the district. WKCDA is devising a RDE strategy in consultation with external industry experts; and
- (c) Continue to critically review the operation, management, planning and support costs; and consider more cost-effective operation models by an internal operation taskforce in order to optimise functionality and the mix of revenue/cost of different arts and cultural facilities.

OTHER FINANCING/FUNDING OPTIONS

33. In view of the substantial funding gap, WKCDA has been working closely with the Government to explore alternative financial arrangements for bridging the gap.

34. At the Joint Subcommittee meeting on 7 July 2015, Members were informed that the only realistic option available to WKCDA was to consider how to advance the commercial developments on the site to leverage financing and funding alternatives; and that if WKCDA 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. WKCDA is working on different scenarios on advancing the commercial developments with a view to bridging the funding gap.

35. WKCDA continues to work with Government to identify alternative approaches to take forward those venues requiring alternative funding, for example, the development of the site designated for Mega Performance Venue / Exhibition Centre currently occupied by the Nursery Park through some forms of private-public partnership and taking account of changes in territory-wide requirements in Hong Kong's arts and cultural development. The key issue is to ensure that the projects are commercially viable, while meeting our city's needs as a prospering cultural hub.

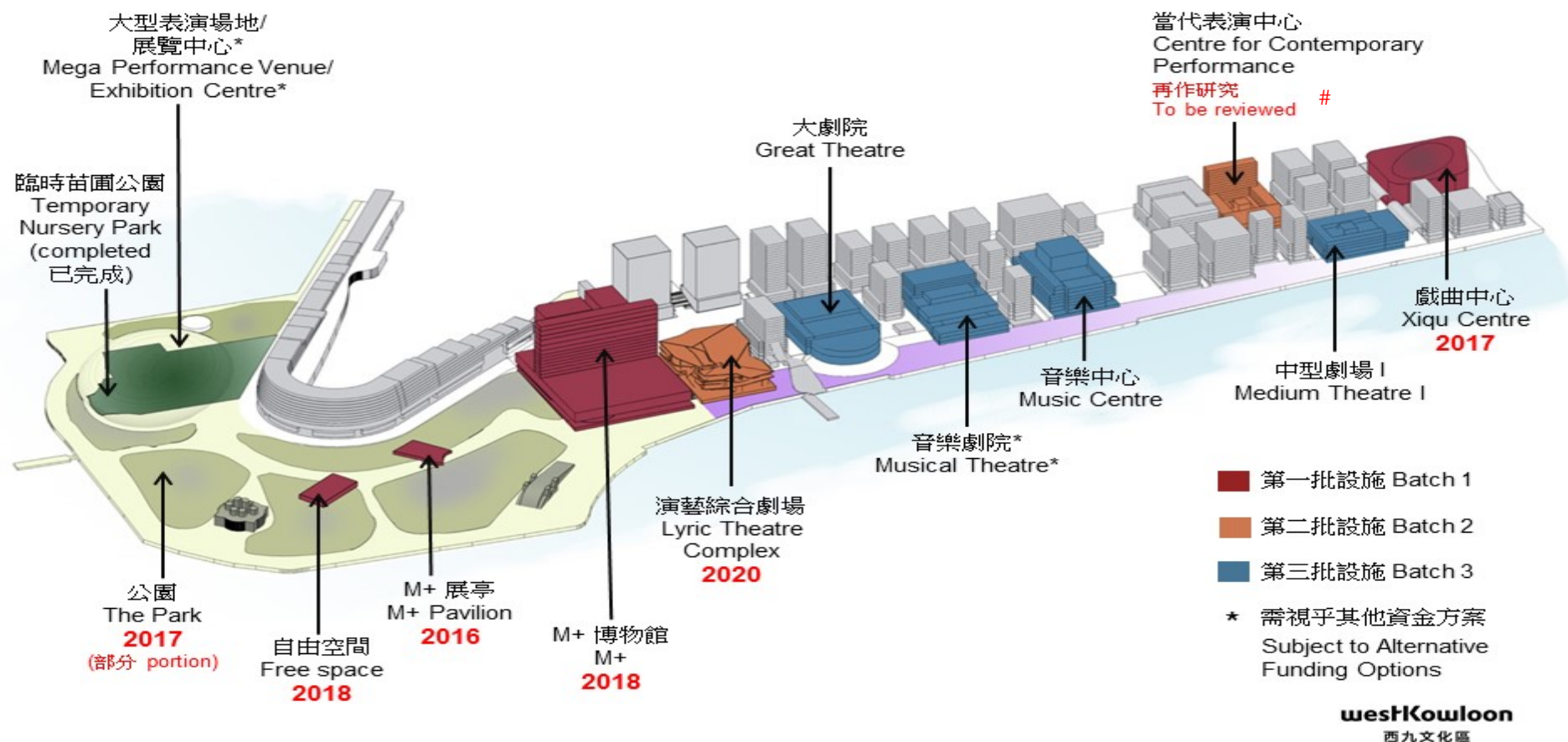
RECOMMENDATIONS

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

West Kowloon Cultural District Authority
May 2016

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



Due to the advancement of the Medium Theatre II and one black box theatre from the Centre for Contemporary Performance to the Lyric Theatre Complex

Phasing of major WKCD facilities under the pragmatic implementation approach in June 2013
(as modified in 2016)

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

* Subject to alternative funding options

[^]Development proposed through some form of public-private partnership

[@]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))

[#] Target completion date to be reviewed

^{**} Completed in July 2015.

Photos of recently organised programmes and events

Freespace Happening



**The Ghost Seller & His Butterflies
(Version 80)**



M+ Summer Camp



M+ Rover: Travelling Creative Studio



**M+ Sigg Collection: Four Decades of
Chinese Contemporary Art
Exhibition**

