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

Meeting on 21 February 2017

**Updated background brief on financial arrangements for the
West Kowloon Cultural District project**

Purpose

This paper summarizes the major views and concerns of members of the Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District ("WKCD") Project formed in the Fifth Legislative Council ("the former Joint Subcommittee") on issues relating to the financial arrangements for the WKCD project.

Background

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

2. On 4 July 2008, the Finance Committee ("FC") of the Legislative Council ("LegCo") approved a one-off upfront endowment of \$21.6 billion (in 2008 Net Present Value) 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,¹ while the retail/dining/entertainment ("RDE") part of the WKCD development will be vested in WKCDA to provide a source of recurrent income through rental

¹ The broad breakdown of the upfront endowment was 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%); (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%).

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 Administration, and funding approval for such works will be sought separately in accordance with the development programme.²

3. The former Joint Subcommittee received briefings from the Administration and WKCDA on the financial situation of and arrangements for implementing the WKCD project at a number of meetings between 2013 and 2016. In July 2013, the Administration and WKCDA advised 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, among others, rigorous cost containment of individual facilities. Furthermore, the Administration intended to fully fund the capital works of the main integrated basement as general enabling works to facilitate the development of the whole WKCD project. In May 2014, the Administration and WKCDA advised 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 the design and construction of the Batch 1 and Batch 2 facilities 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.³

Other financing/funding options

4. As stated in its funding submission to FC for the provision of the upfront endowment in 2008, the land sale proceeds from the disposal of the hotel/office/residential ("HOR") sites in WKCD would become the Government's General Revenue, the use of which would be determined having

² Funding proposals relating to WKCD development approved by FC included: (a) \$478 million for the design and site investigation of government infrastructure works for supporting Phase 1 of the WKCD project (approved in January 2013); (b) \$840.5 million for carrying out the first package of the construction of public infrastructure works in WKCD (approved in July 2015); and (c) \$2,919.5 million for implementing the first and second stages of the design, site investigation and construction works of the integrated basement in WKCD (approved in July 2015).

³ 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.

regard to the funding needs of different bureaux/departments and the overall funding priorities set by the Administration. In July 2015, WKCDA advised that as the funding gap was substantial, the Authority considered that the only realistic option was to consider how to advance the HOR developments on the site to leverage financing and funding alternatives. According to WKCDA, preliminary studies indicated that if the Authority were given the development right with payment of land premium to the Government in respect of some or all of those commercial developments, there would be potential for WKCDA to complete the planned construction programmes in full, fund the operation of the core arts and cultural facilities and support the wider development of arts and culture in Hong Kong.⁴

5. As advised by WKCDA in May 2016, the Authority would continue to work with Administration to identify alternative approaches to take forward those venues requiring alternative funding, for example, the development of the site designated for Mega Performance Venue ("MPV")/Exhibition Centre ("EC") 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.

Mega Performance Venue

6. As regards MPV, according to a press release of WKCDA issued on 5 September 2016, the Board of WKCDA noted the further findings of a review on the possible development of MPV and EC sharing a site on the western part of WKCD, in particular its business viability in the light of relevant government policies and the market environment. Those findings indicated the increasing use of alternative venues for performances in recent years and reported on the Administration's public commitment to press ahead with the Kai Tak Sports Park including a 50 000-seat stadium with a retractable roof which is suitable for mega performances. Following thorough discussions, the Board of WKCDA came to the view that the original proposal to build MPV in WKCD was no longer a suitable proposition. According to WKCDA, as MPV was always intended to be developed with private sector financing, the Board's decision would have no impact whatsoever on the Authority's finances but the site could be considered for alternative use.

7. On 23 December 2016, the Administration announced that WKCDA would collaborate with the Palace Museum to develop the Hong Kong Palace

⁴ Latest development on the development right of the HOR sites is reported in paragraph 22.

Museum in WKCD. The Hong Kong Jockey Club Charities Trust has agreed to donate \$3.5 billion to fund the capital cost of the project, covering design, construction and exhibition development cost. The site for the Hong Kong Palace Museum was part of the site reserved for the co-located MPV and EC.⁵

Members' views and concerns

8. Issues relating to the financial situation of and arrangements for the WKCD project were discussed at various meetings of the former Joint Subcommittee between 2013 and 2016. Those issues were also raised by members of the former Joint Subcommittee ("members") during 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.

Adequacy of the upfront endowment

9. 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. 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.

10. The Administration and WKCDA advised 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 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. 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 WKCDA to make efficient use of the endowment fund and

⁵ [LC Paper No. CB\(2\)544/16-17\(01\)](#)

the associated investment return to complete the Batch 1 and Batch 2 facilities for early public enjoyment.

11. Some members opined that it was unreasonable to cap the funding allocation to the WKCD project at the upfront endowment of \$21.6 billion, given that additional funding had been granted to almost all other public works projects in recent years due to construction cost escalations. They considered that WKCD should not rule out the possibility of seeking additional funding from LegCo for taking forward the project in the long run. Some members held a different view, i.e. as the Administration had fully funded the capital works of the main integrated basement, it had, in effect, rendered additional funding support to WKCD.

12. The Administration and WKCD confirmed that the Authority would not seek further injection to the upfront endowment prior to the completion of the Batch 1 facilities. However, the Administration had not ruled out the possibility of seeking FC's approval for further funding for the WKCD project in the long run.

13. As advised by the Administration in May 2016, WKCD had not given up the implementation of the Batch 3 facilities. The Authority had been working with the Administration to identify alternative approaches to take forward the development of EC through some forms of public-private-partnership. As for the Musical Theatre, which was a Batch 3 facility with no concrete development schedule, consideration would be given to different development and financing approaches, including the Build-Operate-Transfer model.

Funding arrangements for the integrated basement

14. Some members noted with concern that the cost estimate of the main integrated basement had increased from more than \$10 billion as advised by the Administration in July 2013 to around \$23 billion inclusive of design and site investigation,⁶ a rough cost estimate given in May 2014. Noting that the

⁶ According to the paper ([LC Paper No. CB\(2\)1591/13-14\(03\)](#)) provided by the Administration to the former Joint Subcommittee in May 2014, of this \$23 billion, about \$19 billion in money-of-the-day prices contributes to the cost of the foundations and substructure of the integrated basement for the topside developments. The remaining balance of about \$4 billion is for the cost of the public infrastructure works and protection works for the Airport Express tunnels and the associated foundations and substructure there. In July 2015, FC approved a funding of \$2,919.5 million for implementing the first and second stages of the design, site investigation and construction works of the integrated basement in WKCD.

Administration would fully fund the capital works of the integrated basement, some members queried why the public infrastructure works ("PIW") 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.

15. The Administration explained that the integrated basement for WKCD had not been planned in the recommendations of the Consultative Committee on the Core Arts and Cultural Facilities of WKCD.⁷ It emerged as a key feature of the "City Park" conceptual plan in 2011 and was one of the major factors for cost escalation of the WKCD project. The funding proposal for the upfront endowment submitted to LegCo in 2008 proposed that WKCD would cover the design and construction costs for the arts and cultural facilities with the endowment fund, while other communal and government facilities and related engineering works for supporting the whole WKCD would be undertaken by the Government. The rough cost estimate of around \$23 billion for the main integrated basement and the associated PIW was derived in mid-2013 based on WKCD'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. The Administration would be in a better position to provide up-to-date estimates for the whole integrated basement project when the detailed design and construction programmes for the different phases of the basement were firmed up.

Financial implications of the minor relaxation of the development intensity of the West Kowloon Cultural District site

16. The Town Planning Board approved with conditions an application for minor relaxation of the development intensity of the WKCD site in November 2014. The 15% increase in the total gross floor area ("GFA") for the WKCD site, which yielded an additional GFA of 111 050 m², would be shared between the Government facilities, commercial developments and WKCD facilities based on the original development mix adopted in DP. According to WKCD, the additional GFA focused primarily on arts and cultural facilities, as well as RDE uses.

⁷ Following the discontinuation of the Invitation for Proposals process for developing WKCD in February 2006, the then Chief Executive appointed in April 2006 the Consultative Committee on the Core Arts and Cultural Facilities of WKCD to re-examine and re-confirm, if appropriate, the need for the core arts and cultural facilities in WKCD as well as the financial implications of developing and operating these facilities. The Consultative Committee submitted a [recommendation report](#) to the then Chief Executive in June 2007.

17. Some members sought information on the potential benefit of the minor relaxation of the development intensity of the WKCD site on the financial situation of the WKCD project. Some members considered that the revenue to be generated from the disposal of the additional GFA for the HOR developments on the WKCD site arising from the minor relaxation of the development intensity of the WKCD site should facilitate more favourable consideration by the Administration to injecting additional funding into the WKCD project where the situation warranted.

Financial management for the West Kowloon Cultural District project

18. Some members urged the Administration and WKCDA to enhance the transparency of the cost estimates of the WKCD project and to report regularly to LegCo on the expenditure and financial situation of the project. 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. In respect of efforts made in controlling staff costs, WKCDA advised in May 2016 that while it had an approved staff establishment of 300 according to its business plan for the 2015-2016 financial year, it had engaged only 249 staff members as at March 2016 having regard to actual operational needs. WKCDA also controlled the expenditure on consultancy fees, with only 28% of the approved budget for the conduct of consultancy studies in the 2015-2016 financial year expended up to March 2016.

19. WKCDA further advised that a set of procedures and guidelines governing the expenditures of WKCDA had been in place since 2010. Furthermore, WKCDA had 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. For transparency and accountancy purposes, WKCDA had undertaken to closely monitor the project's overall financial situation and present annual updates to LegCo.

Alternative funding sources and arrangements

20. 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. There was a view that individual venues/facilities in WKCD should not be made available for sponsored naming. Some other members were concerned that no concrete plans had been drawn up for seeking donations and sponsorships for the WKCD project. They urged WKCDA to establish a dedicated fund-raising

division/office to devise concrete plans/strategies and take forward initiatives for seeking donations/sponsorships for the WKCD project.

21. WKCDA advised that it was devising an overall strategy for 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.

Latest development

22. In his 2017 Policy Address, the Chief Executive announced that the Administration had decided to provide WKCDA with an enhanced financial arrangement by granting it the government-owned development rights of the HOR portion of WKCD. WKCDA may develop the HOR facilities jointly with the private sector through open tender and a Build-Operate-Transfer arrangement, and share rental revenue from such facilities to sustain the operation of WKCD. Details about the enhanced financial arrangement are given in the [LegCo Brief](#) on the subject issued to Members on 19 January 2017.⁸

23. The Administration and WKCDA will update the Joint Subcommittee on the latest financial situation of and arrangements for the WKCD project at the meeting to be held on 21 February 2017.

Relevant papers

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

Council Business Division 1
Legislative Council Secretariat
16 February 2017

⁸ File Reference: SF(37) to HABCS CR 7/1/27/1

**Relevant papers on
Financial arrangements for the West Kowloon Cultural District Project**

Committee	Date of meeting	Paper
Public Works Subcommittee	18.6.2008 (Item 1)	Agenda PWSC(2008-09)31 Minutes
Finance Committee	4.7.2008 (Item 2)	Agenda Minutes
Former Joint Subcommittee to Monitor the Implementation of the West 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")
Former 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 14118-14141 (26.6.2013) Pages 14148-14235 (27.6.2013) (Motion on "Concern about the expenditure of the West Kowloon Cultural District Project")

Committee	Date of meeting	Paper
Former Joint Subcommittee to Monitor the Implementation of the West Kowloon Cultural District Project	3.7.2013 (Item II)	Agenda Minutes
	24.1.2014 (Item II)	Agenda Minutes
	28.3.2014 (Item II)	Agenda Minutes
	28.5.2014 (Item I)	Agenda Minutes Response of the Administration/WKCDA to members' concerns raised at the meeting
	24.11.2014 (Item II)	Agenda Minutes
	12.1.2015 (Item III)	Agenda Minutes
	19.5.2015 (Item III)	Agenda Minutes
	7.7.2015 (Item I)	Agenda Minutes
	30.5.2016 (Item I)	Agenda Minutes
Finance Committee	10.7.2015 (Sessions 2 and 3) (Item No.1)	Agenda Minutes (Session 2) Minutes (Session 3)
House Committee (special meeting)	6.1.2017	Agenda Minutes

Committee	Date of meeting	Paper
-	-	<u>Legislative Council Brief on Enhanced Financial Arrangement for the West Kowloon Cultural District</u> (File Ref.: SF(37) to HABCS CR 7/1/27/1) (Issued on 19 January 2017)