

For discussion on
3 May 2021

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

Update on the Financial Situation of
the West Kowloon Cultural District Project

PURPOSE

This paper provides an update on the financial situation of the West Kowloon Cultural District (WKCD or the District) project.

BACKGROUND

2. Over the past year, the West Kowloon Cultural District Authority (WKCDA or the Authority) has made continuous progress on various fronts notwithstanding the challenges brought by the COVID-19 pandemic. Since the last update on the financial situation to the Joint Subcommittee to Monitor the Implementation of the WKCD Project in June 2020, WKCDA remains focused and determined to grapple with the issue of cashflow shortfall arising from a combination of structural and external factors beyond the Authority's control. The financial arrangements and challenges faced by WKCDA since the approval of the endowment fund in 2008 are recapitulated in **Annex 1**.

THE YEAR IN REVIEW

3. The Financial Year (FY) 2020-21 has been an exceptionally challenging year for the Authority. On the one hand, the Authority has to cope with unprecedented challenges brought by the COVID-19 pandemic and the stringent social distancing measures, resulting in prolonged closure of venues and repeated rescheduling and cancellation of programmes, all of these have caused severe interruptions to operations and adverse impact on the Authority's income. On the other hand, Management has strived to come up with creative plans and innovative measures to mitigate the impact on the stakeholders including venue hirers and artists.

4. With Practical Completion achieved in February 2021, the opening of **M+** is now scheduled at the end of 2021. The M+ team is pressing ahead with different facets of preparation work, including the shipment and move-in of collections, installation of artworks and exhibitions, delivery of unique retail, dining and commercial offerings, etc.

5. Having completed its building structure in November 2020, the **Hong Kong Palace Museum (HKPM)** is on track to obtain Occupation Permit in around July 2021 with opening scheduled for mid-2022. The HKPM team is making good progress in exhibition planning as well as building up its curatorial and museum operation capability. In parallel, it is working closely with the Palace Museum to confirm the list of over 800 loan objects for display in HKPM in the initial years, many of which are Grade One relics that have never been displayed outside Mainland China.

6. WKCDA is committed to supporting the local arts and cultural industry. As a continued commitment and due to international travel restrictions, **performing arts** programmes in 2020 featured almost exclusively Hong Kong artists. In response to social distancing measures, the Authority has moved more artistic programmes online to provide wider public access to quality arts offerings via the District's website and social media platforms, and to enable artists to reach out to the audience. Market responses have been positive. The Authority will continue to explore new modes of content delivery with the industry with a view to widening the audience base and identifying viable business models for online programmes.

7. The huge popularity of the **Art Park**, which is the green heart of the District with a rich variety of trees and plants as well as large open lawn space offering stunning views of Victoria Harbour, has brought vibrancy to the District and resulted in increased patronage and income from the food and beverage (F&B) outlets and carparks.

CURRENT FINANCIAL SITUATION

8. With WKCDA's sustained efforts in maintaining financial discipline and cost containment, the Authority has achieved substantial reduction in operating expenses (OPEX) and higher than expected investment income. For FY2020-21, total OPEX amounted to \$901 million, a reduction of more than \$400 million (or 32%) from last year's estimate of \$1,333 million. The reduction in OPEX is

accompanied by a 19% (or \$64 million) increase in operating income, from \$346 million in the original estimate to \$410 million in the final outturn. As a result, there was material improvement in the operating results of the Authority's FY2020-21, with operating deficit before depreciation and interest expenses significantly narrowed to \$491 million as compared to original estimate of \$987 million, representing a 50% reduction. For details, please see Table A in paragraph 17.

9. Up to the end of FY2020-21, a cumulative total of \$7.8 billion (equivalent to 3.1% per annum) has been generated from the upfront endowment of \$21.6 billion which was approved in July 2008 by the Finance Committee (FC) of the Legislative Council (LegCo). With a cumulative spending of \$21.5 billion in capital projects, museum collections and related cost and operating expenditures net of operating income, the remaining balance of the endowment stood at \$7.9 billion at the end of FY2020-21¹.

10. As reported before, the upfront endowment and the investment income will only be sufficient to complete the design and construction of the Batch 1 and most of the Batch 2 arts and cultural facilities. The latest cost estimates for the Batch 1 and most of the Batch 2 facilities are within \$21.2 billion as reported last year. Up to the end of FY2020-21, \$15.7 billion has been incurred in these projects. The timing of the implementation of the remaining of Batch 2 and Batch 3 facilities will be subject to funding availability and the completion of the Integrated Basement. Please refer to **Annex 2** for the status and target completion date of WKCD facilities.

11. Of the upfront endowment, \$1.7 billion was earmarked for the acquisition of M+'s collections, as well as exhibition development, library setup and conservation laboratory equipment. Up to the end of FY2020-21, \$1.0 billion has been incurred in preparation for the museum opening. A further \$0.1 billion is forecasted to be spent in the next three years. In addition, M+ has received \$1.43 billion of donated artworks to-date, being the value at the time the donations were approved by the relevant authorities.

¹ \$21.6 billion Endowment Fund + \$7.8 billion Investment Return – \$21.5 billion cumulative expenditure = \$7.9 billion.

THE YEARS AHEAD

Strategic Priorities of WKCD

12. While the Authority will continue to contain cost, more emphasis will be put on revenue generation in the years ahead. By fully leveraging the world-class artistic content and value as well as WKCD's location and assets, the Authority will devise a proactive revenue generation strategy. The upcoming opening of two global cultural institutions in the District, namely M+ and HKPM, will give fresh impetus to drive local and international exposure. The Authority will focus on building the brand equity of M+ and HKPM and redefining museum experiences so as to cultivate audience, drive visitations, institutional and commercial partnerships, donations and sponsorships as well as a wide variety of revenue opportunities such as sales of merchandise and publications not only locally but also in Mainland China and overseas. The museums will also adopt a cross-platform mindset that enables content to flow across a range of museum touchpoints, from online experiences to physical platforms. Digital propositions will become an essential part of the museum offers to maintain accessibility in the post-pandemic era.

13. The Authority will also adopt a new programming approach for performing arts to drive growth in attendance and box office revenues while deepening the relationship with the audience and artistic community through engagement and participation. This new approach will feature a seasonal structure focusing on audience demographics to better cater for the different audience groups, as well as initiatives for smarter and more diversified use of open space in the Atrium at the Xiqu Centre. The Authority will also explore means to support artists and performing arts groups in applying art tech in their productions. It will also develop the Art Park into a vibrant venue for open-air performances as well as exhibitions and other events to attract more visitation and business opportunities.

14. With the commissioning of two world-class museums in the near future, followed by the completion of the Lyric Theatre Complex scheduled in 2024, WKCD as a cultural quarter is taking shape. It will position itself as a must-visit cultural and tourist destination to drive footfall and business. Positioned as the anchor of Hong Kong's arts and cultural scene, the District is driving a broader strategic agenda to connect with institutions and venues in Hong Kong and the region to form a bigger cluster, hence generating synergy and partnership opportunities.

15. Situated on a 40-hectare site facing Victoria Harbour and being next to the High-Speed Rail Hong Kong West Kowloon Station, the MTR West Rail Line Austin Station and the Airport Express Kowloon Station, WKCD is well positioned to be the arts and cultural hub of the Guangdong-Hong Kong-Macao Greater Bay Area (GBA) and the Asian region. WKCD is in discussion with the Hong Kong Tourism Board on the strategies to promote WKCD post COVID-19. Moreover, with the joint promulgation of the Culture and Tourism Development Plan for the GBA by the Ministry of Culture and Tourism, the Office of the Leading Group for the Development of the Guangdong-Hong Kong-Macao Greater Bay Area and the People's Government of Guangdong Province in December 2020 and the featuring of Hong Kong to develop into a hub for arts and cultural exchanges between China and the rest of the world in the Outline of the 14th Five-Year Plan for National Economic and Social Development of the People's Republic of China and the Long-Range Objectives Through the Year 2035, the Authority will explore with the relevant authorities in Hong Kong with a view to contributing to the development of Hong Kong as an international cultural exchange hub and a world-class tourism destination. This is also in line with the vision and mission of WKCD to develop Hong Kong as an international cultural metropolis.

16. The cultural capital of the global institutions in the District will elevate the harbourfront precinct into an international brand, giving its commercial developments unique exposure. The Authority will adopt a market-driven approach to unleash the value of its commercial land for Retail, Dining and Entertainment (RDE) as well as Hotel/Office/ Residential (HOR) developments, through partnership with developers by the Build, Operate and Transfer (BOT) model, with a view to creating a unique art-themed commercial destination and generating long-term sustainable income to support the cultural mission of the District. Clouded by the uncertainties of the post-pandemic market, the Authority is cautiously optimistic with the market response to the upcoming BOT tenders, the first one being the Artist Square Towers (AST) in Zone 3B of the District mainly for office development. The AST will provide total gross floor area of about 65 000 square metres and is expected to be tendered in the second half of 2021 for completion in 2024.

Financial Projections

17. In preparing the latest financial projections, Management

has continued to critically examine its staffing and business requirements to further contain costs. With concerted efforts to increase income and reduce costs, it is expected that the projected operating results of WKCDA's operations in FY2021-22 will show improvement as compared to last year's estimates (please see Table A below). Details of the financial projections of FY2021-22 to FY2023-24 are set out in **Annex 3**. Key takeaways of the financial projections for the coming three financial years are as follows.

Table A: Projected Operating Results of WKCDA's Underlying Operations

| (\$ million) | FY2020-21 (Unaudited) | FY2021-22 (Estimates) | FY2022-23 (Estimates) | FY2023-24 (Estimates) |
|--|--------------------------|--------------------------|--------------------------|--------------------------|
| Operating Income * | | | | |
| - Latest estimates | 410 | 548 | 564 | 722 |
| - Last year's estimates | 346 | 364 | 506 | N/A |
| Operating expenses (OPEX) | | | | |
| - Latest estimates | (901) | (1,643) | (2,000) | (2,178) |
| - Last year's estimates | (1,333) | (1,734) | (2,057) | N/A |
| Operating deficit before depreciation and interest expenses | | | | |
| - Latest estimates (a) | (491) | (1,095) | (1,436) | (1,456) |
| - Last year's estimates (b) | (987) | (1,370) | (1,551) | N/A |
| - Favourable variance (a versus b) | 50% | 20% | 7% | - |

* For prudent planning, and given the commercial sensitivity in tendering, the operating income has not factored in the estimated BOT income.

18. In the next three financial years, **operating income** from arts and cultural activities and associated commercial activities will increase gradually following the opening of M+ and HKPM. However, OPEX arising from the progressive full commissioning of arts and culture facilities will also increase substantially. At the same time, in tandem with the development of WKCD, balance of the endowment fund will also decline with time, a corollary of which is a continuing decline in investment income generated from the remaining balance of endowment fund.

19. On **OPEX**, apart from reduced expenditure last year in FY2020-21 due to COVID-19-induced closure of arts and cultural facilities, the Authority has also implemented cost containment efforts. As a result, last year's estimates register a significant cutback in facilities management, utilities, IT expenses and legal fees. Total OPEX is expected to increase from \$901 million in FY2020-21 to over \$1.6 billion in FY2021-22 (mainly due to the opening of M+, ramped up operations of HKPM and the full-year activities in Performing Arts and

district operations assuming stabilisation of the pandemic towards the end of 2021) but still below last year's projection of \$1.7 billion. With the opening of three major new venues, staff cost will experience an increase of 19.1% per annum on average in the coming three financial years, in line with the headcount increase to cope with operational needs. Total headcount of WKCD is estimated to increase from 704 at the end of FY2020-21 to 869, 978 and 1 034 at the end of FY2021-22, FY2022-23 and FY2023-24 respectively, similar to last year's estimates.

20. In preparing the FY2021-22 Business Plan and FY2021-22 to FY2023-24 Corporate Plan, the Authority has not factored in the incomes to be received from the various BOT tenders because of the uncertainties of the post-pandemic market situation. The Authority will be in a better position to update the financial projections after the successful tendering of the first BOT package in the second half of 2021.

The Way Forward

21. The Authority sees a lot of enthusiasm from different quarters in the opening of the two world-class museums in the near future, which will be key milestones of the WKCD project and in the arts and cultural development of Hong Kong. The unprecedented challenges brought by COVID-19 further proves that arts and culture play an instrumental role in livening up people's life and driving new economic and social opportunities. The Authority will continue to make its best efforts to fulfil its mission to facilitate the long-term development of Hong Kong as the international arts and cultural hub and to achieve the long-term sustainability of the project.

ADVICE SOUGHT

22. Members are invited to note the financial update of the WKCD Project.

West Kowloon Cultural District Authority
April 2021

Financial Arrangement and Challenges of the WKCD Project

| Date | Key events |
|--------------|--|
| July 2008 | An upfront endowment of \$21.6 billion was approved via PWSC (2008-09)31 for WKCD to implement the WKCD project |
| June 2013 | The Government and WKCD announced that a pragmatic approach ² would be adopted to implement the WKCD project. |
| July 2013 | The Government announced that it was prepared, subject to funding approval by the LegCo, to fully fund the design and construction of the core and shell for the main Integrated Basement (IB), as general enabling works to facilitate the development of the whole WKCD project, in addition to public infrastructure works (roads, drains, sewerage, etc.). |
| January 2017 | The Government announced the implementation of the Enhanced Financial Arrangement (EFA) for the WKCD project in the Policy Address and explained in the LegCo Brief (SF(37) to HABCS CR 7/1/27/1) about the HOR and RDE development rights in the District. |

The EFA was expected to provide sufficient but not excessive resources to WKCD to meet its financial difficulties reported to the Joint Subcommittee to Monitor the Implementation of the WKCD Project on various occasions since 2013. In addition, it has also reported that the endowment fund of \$21.6 billion and the apportioned investment income would only be sufficient to build the Batch 1 and most of the Batch 2 facilities³ and that the implementation programme of the remaining Batch 2 and Batch 3 facilities would be reviewed.

WKCD has continued to face financial difficulties, which are the result of a combination of development and changes since the adoption of the Consultation Committee on the Core Arts and Cultural Facilities (CACF) of the WKCD (CC Case) in 2006, in addition to other external factors that took place throughout the development of the WKCD project in past years. Key factors and

² The pragmatic approach requires the implementation of the WKCD project to include the delivery of the major facilities in three batches, rigorous cost containment and emphasis on content rather than form.

³ Batch 2 facilities originally included the Lyric Theatre, the Centre for Contemporary Performance (CCP), and Medium Theatre II (MTII). In order to advance the provision of the performing arts venues, the configuration of the Lyric Theatre was modified in early 2015 to include Medium Theatre (previously MTII) and Studio Theatre (previously a black box theatre in the CCP) to form the Lyric Theatre Complex. With the reconfiguration, the development of the remaining two black box theatres in the CCP (i.e. the remaining Batch 2 facilities) will be further reviewed.

developments leading to WKCDA's financial difficulties are summarised as follows:

Cost escalation and extended development timeframe

- a) There has been significant **escalation of construction costs** since the approval of \$21.6 billion upfront endowment in 2008 (by 115% from Q3 2006 to Q3 2020⁴ or by average increase of 5.6% per annum compounded since 2006 as opposed to 2% assumed in the CC Case);
- b) The **almost 4-year prolonged planning and public engagement process** had resulted in approval of the Development Plan by the Chief Executive in Council only in 2013. The **cost** for delivering the CACF had **escalated** significantly during this period;
- c) The **complexity** in implementing the 'City Park' design concept, which makes construction of an integrated basement (IB) a prerequisite of any topside developments, has **increased construction costs** and **extended the delivery timeframe** of CACF;
- d) In 2013, the Government and WKCDA decided to adopt a pragmatic approach to implement the WKCD project in **three batches** that the **development timeframe** has been considerably **extended**;
- e) In 2014, a planning application for minor relaxation of the development intensity was made to optimise the development potential of the WKCD site. **Additional funding is required** for the development of the **additional gross floor area (15%)** for arts and cultural facilities and RDE in the District;

Prolonged mismatch between revenue and expenditure

- f) WKCDA suffers from **serious delay in the receipt of recurrent income** generated from major RDE facilities to meet the operating deficits of CACF in the interim. This is the result of the prolonged mismatch in the timing of cashflows due to the **extended development timeframe**, and the **priority** given to developing **CACF**, as well as the **deferred possession (around 5 years) of the site** occupied as construction site/work areas for the High Speed Rail (Hong Kong Section);
- g) Investment return from the endowment has significantly declined for a sustained period due to the high volatility of global investment markets. The actual investment return from the endowment (3.1% per annum from 2008-09 to 2020-21) is significantly lower than the assumed rate of 6.1% per annum in the CC Case;
- h) Since 2013, WKCDA has reported on various occasions about the financial challenge ahead and, the endowment and the investment income would only be sufficient to build the Batch 1 and most of the Batch 2 facilities whereas the remaining of Batch 2 and Batch 3 facilities

⁴ The estimated costs in the CC Case were prepared by the Financial Advisor in 2006. The Architectural Services Department's tender price indices for building works in the public sector has gone up from 751 in Q3 2006 to 1618 in Q3 2020.

would be reviewed subject to funding availability;

- i) Under the EFA announced in 2017, the Government granted the long-term development rights of HOR portion of WKCD to WKCDA. However, the majority of topside HOR and RDE will only be completed in phases beyond 2025 after the IB is completed.
- j) In March 2020, the LegCo FC approved the design and construction cost of Zone 2 IB infrastructure and the associated works. The approved funding does not cover the installation of necessary Mechanical, Electrical and Plumbing works (MEP) and Architectural Builders Works and Finishes (ABWF) other than those for the underground road and communal areas, as well as works related to the avenue, promenade and district cooling system. The MEP and ABWF works, the cost of which is expected to be substantial, will have to be funded by WKCDA and the funding source is being identified.

Status and target completion date of major WKCD facilities

| Facilities | Status and target completion date |
|--|--|
| <i>Batch 1</i> | |
| Temporary Nursery Park | Opened in July 2015 |
| <i>Arts Pavilion (previously called M+ Pavilion)</i> | Opened in July 2016 |
| Xiqu Centre | Opened in January 2019 |
| Art Park | Phase 1 of the Art Park and a section of the waterfront promenade was opened in early 2018 Phases 2A and 2B of the Art Park were opened in March 2019 The remaining Phase 3 was opened in March 2020 |
| Freespace | Operations started in June 2019 |
| M+ and Conservation and Storage Facility | Achieved Practical Completion in February 2021, with opening of the Museum scheduled for the end of 2021 |
| <i>Batch 2</i> | |
| <i>Lyric Theatre Complex (LTC) (including a Lyric Theatre, a Medium Theatre and a Studio Theatre) (note)</i> | Main works in progress. Target to complete in 2024 |
| <i>Medium Theatre II (note)</i> | Incorporated into the LTC |

| Facilities | Status and target completion date |
|---|--|
| Batch 3 <i>(requires extra funding for the development)</i> | |
| Music Centre <i>(including Concert Hall and Recital Hall)</i> | High priority, to be reviewed by WKCDA |
| Musical Theatre | To be developed through public-private partnership subject to private sector funding |
| Great Theatre | To be reviewed by WKCDA and delivered gradually having regard to demand in line with the organic growth approach of WKCD |
| Medium Theatre I | |
| Others | |
| Art, Commerce and Exhibitions (ACE) | To be developed through BOT model with a U-shaped hotel, offices together with embedded RDE facilities and an adjacent Exhibition Centre Tender withdrawn in August 2020 as tender response was not as positive as expected due to uncertain market economic outlook amid the COVID-19 pandemic and the changing market demand for exhibition venue. The way forward is being reviewed by WKCDA |
| Hong Kong Palace Museum | Construction of superstructure commenced in April 2019 and the building structure completed in November 2020, with the Occupation Permit on track to be granted in July 2021 for opening in mid-2022 |
| WKCDA Tower | Achieved Practical Completion in February 2021 |
| M+ Phase II | The need for these two facilities will be reviewed by WKCDA |
| Xiqu Small Theatre | |

Note:

The originally proposed Medium Theatre II and one black box theatre (now called Studio Theatre) of the CCP were incorporated into the building of the original Lyric Theatre to form the LTC to advance their provision.

Annex 3

Income and Expenses Projections of WKCDA's Underlying Operations

| (\$ million) | Note | FY | FY | FY |
|--|------|---------|---------|---------|
| | 1 | 2021-22 | 2022-23 | 2023-24 |
| Operating Income | | | | |
| Investment income | 2 | 305 | 8 | 1 |
| Retail, Dining and Entertainment income | 3 | 51 | 134 | 164 |
| Venue hire and programme income | 4 | 60 | 262 | 375 |
| Sponsorship income | 5 | 26 | 36 | 40 |
| Donation | 6 | 3 | 3 | 3 |
| Other income | 7 | 103 | 121 | 139 |
| | | 548 | 564 | 722 |
| Operating Expenses | | | | |
| Staff costs | 8 | (528) | (591) | (652) |
| Programme and research | 9 | (181) | (386) | (450) |
| Facilities management | 10 | (195) | (237) | (273) |
| Venue operations | 11 | (174) | (295) | (334) |
| Museum collections management | 12 | (78) | (11) | (10) |
| Information and communication technology | 13 | (91) | (101) | (106) |
| Other operating expenses | 14 | (396) | (379) | (353) |
| | | (1,643) | (2,000) | (2,178) |
| Operating deficit before depreciation and interest expenses | | (1,095) | (1,436) | (1,456) |
| | | | | |

Note:

1. FY2021-22 and FY2022-23 will mark the opening year of M+ and HKPM respectively. With the completion of LTC scheduled for 2024, its pre-opening expenses are included in the financial projection of FY2023-24.
2. Investment income mainly includes the return on the placements with the Exchange Fund and bank interest income.
3. Retail, Dining and Entertainment (RDE) income represents rental income generated from letting out the RDE facilities, retail and food and beverage income.
4. Venue hire and programme income mainly includes ticket and venue hire income of the Xiqu Centre, Freespace, M+ and HKPM.

5. Sponsorship income provides a sustainable revenue source which can be in the form of income supporting the expenditure to the programmes, exhibitions and initiatives.
6. The lingering impact of COVID-19 and challenging economic environment is expected to reduce the appetite for donation.
7. Other income includes car park income and facilities management fee recovery from tenants and commercial hire income etc.
8. Total headcount of WKCDA for FY2021-22, FY2022-23 and FY2023-24 is expected to reach 869, 978 and 1 034 respectively, majority of which are arts and cultural personnel.
9. Programme and research expenses represent the costs to organise performing arts programmes and museum exhibitions and curatorial programmes.
10. Facilities management expenses mainly include manning, cleaning and building maintenance.
11. Venue operations mainly covers the venue operations costs for M+, HKPM and Performing Arts and mainly includes technical and venue consumables, casual labour, ticketing costs, venue opening costs etc., as well as costs for utilities, park operations and security services for museums.
12. Museum collections management includes conservation and storage, shipping and handling and insurance expenses.
13. Information and communication technology expenses include IT supplies and support costs, application systems maintenance and infrastructure maintenance.
14. Other operating expenses mainly represent administrative expenses, government rent and rates, marketing and communication expenses, legal fees and consultancy fees etc.