

Government's response to LegCo Subcommittee's questions on WKCD's financing arrangement

Following is the response of the Home Affairs Bureau today (June 5) to the questions raised by the Legislative Council (LegCo) Subcommittee on West Kowloon Cultural District (WKCD) Development regarding the financing arrangement of the WKCD project:

1. How could the Government assure Members that the WKCD project would not end up as a failure? Could the Government figure out the "worst scenario" of the WKCD project and provide an estimate on any supplementary funding provision required in such a scenario?

Government's response:

* The financing arrangement as proposed by the Government has taken into account the recommendations of the Consultative Committee on the Core Arts and Cultural Facilities of the West Kowloon Cultural District (Consultative Committee) as well as the detailed financial assessment made by the Financial Advisor (FA) on the development and operation of the WKCD.

* The financial assessment has undergone a professional and stringent process. The assessment and its revisions, which took 15 months to complete, were examined by the Financial Matters Advisory Group led by the Hon Ronald Arculli. The conclusion was that it is a sustainable financing approach to provide a one-off upfront endowment of \$21.6 billion (in 2008 Net Present Value (NPV)) to finance the capital cost and to use the rental proceeds generated from the retail, dining and entertainment (RDE) facilities in the WKCD to meet the operating deficits of the arts and cultural facilities.

* According to the present assessment, we do not think there are sufficient reasons for a "worst scenario" in which any of the proposed venues may not be constructed as planned. If Members insist in figuring out a "worst scenario", and no additional funding is to be provided, we may come up with an assumption whether Phase II of the project would be delayed until after 2026-31 because of cash flow difficulties i.e. the 1,900-seat great theatre and the two 800-seat theatres had to be built at a later stage and the expansion of M+ would have to be implemented later.

2. The Government is requested to conduct further analyses on the investment returns and the inflation of construction costs?

Government's response:

* When estimating the capital cost, apart from inflation, consideration has also been given in a prudent manner in respect of the on-costs and the risk premium so as to provide sufficient leeway to accommodate cost increase due to various factors.

* Construction costs of the core arts and cultural facilities included a risk premium of 23% to 29% to guard against price hike due to the risks. The risk premium is conventionally set at 10% to 15%. In view that the need for the construction of the venues and other related works to start as soon as possible and other factors may give rise to construction cost fluctuations exceeding the original estimates, a higher risk premium has been included.

* If we reduce the on-costs and the risk premium to a maximum of 15%, the one off upfront endowment of \$21.6 billion can accommodate an annual nominal increase of 3.4% in construction cost (an accumulative increase of 31%) between 2007-2104. If we have to support an annual nominal 6% increase in construction cost (an accumulative increase of about 60%) between 2007-14, the one-off upfront endowment has to be increased to \$25.0 billion. The latter's assumption of assuming continuous increase of construction cost escalation rates in several consecutive years to an accumulative increase of about 60% is not realistic.

* As to investment returns, the estimated 6.1 % investment return in the Government's FA's assessment is comparable to the investment return of a variety of investment vehicles (both long term and short term), as listed in the Annex.

* It should also be noted that part of the \$21.6 billion upfront endowment will be spent at the latter part of the 50-year project period for the construction of Phase 2 facilities as well as periodic major renovations. The unutilised funds may be used for longer term investment.

3. As returns from retail, dining and entertainment facilities make up the lifeline of WKCD, the Government is requested to provide more details of these facilities such as their layouts, settings, anticipated pedestrian flow, business plans and measures to enhance the viability of these

facilities. The Government should also advise on its plans to strengthen WKCD's connectivity with neighbouring areas.

Government's response:

* In the process of consultation on the WKCD project, the public has expressed the view that they were concerned about the connectivity of the WKCD with its neighbouring areas. The preparation of the development plan for the WKCD is one of the foremost tasks of the West Kowloon Cultural District Authority (WKCDA). The WKCDA and the Planning Department in coordination with the WKCD Office which will be set up soon, will work to ensure early formulation of plans to connect the WKCD and its neighbouring areas.

* Regarding the details of the RDE mentioned by Members, we need to point out that these facilities will take up a gross floor area (GFA) of about 119,000 square metres, and according to our present planning, the development and operation of these facilities are not comparable to the operation of large scale shopping malls. Instead, the facilities will be scattered throughout the WKCD to integrate with the arts and cultural facilities, so as to create synergy and bring about increase in people flow to keep the district in vibrancy at all times. Thus, our estimated rental level is pitched at a rather conservative level i.e. monthly rental of \$30 per sq. ft. GFA (in 2006 price), which is lower than the monthly rental of shopping malls of other districts in Hong Kong (\$27-\$80 per sq. ft. GFA (in 2006 prices)).

4. Will the Government consider seeking funding approval only for the Phase I development of WKCD at this stage and conduct a thorough review before moving onto Phase II to ascertain whether any adjustment in the scale of the project is required?

Government's response:

* According to the FA's assessment, the recommended one-off upfront endowment and the arrangement to cover operating deficits of arts and cultural facilities by rental proceeds from retail, dining and entertainment facilities would be sufficient for the development and sustainable operation of the facilities in Phase I and Phase II of WKCD. We have no intention to change the plan.

* The facilities in Phase II are estimated to be completed between 2026-2031, we believe that the WKCDA will certainly conduct a serious and thorough review on the development of WKCD before moving onto Phase II.

5. The current estimates are worked out by assuming that the "design and build" approach will be adopted for the arts and cultural facilities. Will the Government consider adopting other approaches such as drawing up the detailed design first and then tender out the construction works under a separate contract for certain facilities such as the M+ and the major performance venues? What will be the impact on the estimated funding requirement if the latter approach is adopted?

Government's response:

* The WKCDA may consider different modes of Public Private Partnership (PPP) in the development and operation of the arts and cultural facilities with reference to their distinctive features. We would like to point out that the FA has examined the PPP mode in detail in respect of the operation of the arts and cultural facilities with reference to overseas examples. The FA recommended the design and build model, because the private sector does not express much interest in life-cycle public private partnership covering construction, operation and maintenance stages in view of the construction and operation risks involved.

* Even if the design and building of the facilities are included in two independent contracts, the FA's estimated construction costs have already included a considerable amount of on-costs and risk premium to accommodate increase in costs due to various factors.

6. Will the Government give second thoughts to engaging an international operator to operate M+?

Government's response:

* The proposal of commissioning an international operator to operate M+ was not made by the Consultative Committee. Such arrangement is no different from allowing a foreign institution to have complete control of the operation and curatorial work of M+, and restrict cooperation between M+ and other world-class museums in the future. As such, we do not think that

commissioning an international single operator to operate M+ will be supported by the cultural sector. Moreover, the cost of commissioning an international operator could possibly be higher than expected. However, upon its establishment, M+ can cooperate with world-class museums in the Mainland or abroad. Actually more than one renowned overseas museum has indicated interest to cooperate with the M+..

7. On what basis does the Government consider that the provision of \$1,214 million (covering \$1 billion initial collection cost and an annual collection budget of \$20 million) is enough for acquiring collections of world standards?

Government's response:

* Leisure and Cultural Services Department's museums currently possess over 60,000 items of visual culture collection. The collection could not be all displayed due to inadequate venue space. Besides, world famous museums have quite often exhibited their collections in Hong Kong (for example the recent Treasures of the World's Cultures from the British Museum).

* Like other world-class institutions on visual culture around the world, M+ will not establish its own position solely by its collection, but also through exhibit loans, hire of collection, contracting out to artists to produce creative exhibits and splendid programmes to attract audience. M+ is itself an innovation. Its curatorial concepts are very different from those of the traditional museums. It is a new platform to incorporate many themes. With a forward-looking, flexible and responsive approach, M+ encourages collaboration, interaction and cross-discipline ideas. Community participation is essential to breathing life and energy into M+. It is under an open-ended format that encourages partnership, interaction and cross-fertilisation of ideas—with the general public, sector professionals and experts worldwide.

* One-third of the annual estimated expenditure (around \$100 million) of M+ would be used for programming, including commissioning artists for creative art works.

8. Is it possible to further downsize M+?

Government's response:

* The scale of the M+ originally recommended by the Museums Advisory Group (MAG) was bigger than that of some of the world-renowned museums. After consulting the MAG and the Financial Matters Advisory Group, the Consultative Committee decided to reduce the scale of M+ by 30%. It would be necessary to conduct a new round of consultation before a decision can be made to further downsize M+. Nevertheless, Members are advised to note that we adopt a step-by-step approach in the development of M+, with 70% of the reduced area to be developed in the first phase and the remaining 30% in the second phase. The scale of M+ is still comparable to the scale of world-renowned museums. Further downsizing the M+, however, will hinder the development of M+ into a world-class contemporary cultural and arts institution. M+ will also not be able to realize its vision.

9. The Government is requested to illustrate the ideas/concepts for M+ using concrete local and/or overseas examples. The Government is also requested to make use of the existing museum facilities and collections on visual culture to demonstrate to the public on what M+ is like?

Government's response:

* The existing museum facilities cannot be compared with M+. Their curatorial concepts and directions are also different from those of M+. The effect will not be good if we hastily make use of these facilities to demonstrate the innovative approach of M+ in the display of visual culture. It may also mislead the public in forming an opinion and impression of M+. Hence, we are not inclined to adopt this approach to illustrate M+.

* We had already used concrete visual representations and examples to illustrate the ideas and concepts for M+ to the LegCo Members and the public to enable them to have a better understanding of M+'s future operation.

10. The Government should explain how the costs for major renovation or reconstruction of the aged buildings in WKCD would be financed after 50 years.

Government's response:

* The Government's FA uses a 50-year period for the assessment of the WKCD. It is even more

stringent than that used for the professional assessment of other long-term development projects. In the financial analysis, provision has already been made for periodic major overhaul and annual maintenance during the 50-year period. All facilities will be in good condition and fully functional beyond 50 years, requiring no immediate allocation of additional funds for demolition, reconstruction or major renovation beyond that period.

Ends/Friday, June 5, 2008