

Summary of the Report submitted by the Specialist Advisor engaged by the Subcommittee on the West Kowloon Cultural District Development (the Subcommittee)	The Administration's Response
<p>1. This report assumes the principle that the West Kowloon Cultural District (WKCD) should be self sufficient and financially sustainable. Capital and operating deficits would have to be met by land sales and operating income within the 40 hectares of land.</p>	<p>1. Only the land for residential, office and hotel uses within the 40-hectare site would be sold. The land would be sold by the Government separately. The land revenue would be paid into the general revenue and will not be used on the WKCD project.</p>
<p>2. The method of three comparing scenarios of private sector involvement is questionable. Scenarios 1B and 2 are not sufficiently realistic to be considered as practical options for meaningful comparisons. Moreover, despite greater private sector participation in these two scenarios, no additional efficiency gain has been allowed for.</p>	<p>2. The three Private Sector Involvement (PSI) scenarios demonstrate various levels of private sector involvement. In deciding which scenario is more appropriate, the following factors have to be taken into account, namely, the risk and financing costs, market response, the overall costs as well as operating revenue and expenditure. In the light of the operational risk of arts and cultural facilities, the existing PSI model has already balanced various considerations.</p>
<p>3. Design and Build contracts may not be a suitable procurement method for M+ and other core arts and cultural facilities.</p>	<p>3. The Government and local construction industry have many years of experience in executing design and build contracts. Being an effective model, it can bring about earlier delivery, and the contractor will bear the design and construction risks.</p>

4. Arts and Cultural Facilities: unit construction costs range from \$22,200 to \$29,200 are on the high side. If it is of a high quality, it would be considered as falling within reasonable range. On-costs are, however, higher than conventional.	4. Agree. In estimating the on-costs, the Financial Advisor (FA) has taken into account the experience of technical consultants in various professional areas, made reference to charging standards of professional services issued by local professional bodies and the costs of some relevant facilities overseas.
5. The Financial Advisor (FA) sensitivity analyses have not tested the financial implications of risks in investment returns and in construction costs escalations. These tests should be carried out, and contingency plans should be formulated well in advance.	5. Construction costs and operation costs have included prudent risk premium to accommodate cost increase incurred by various risks. Investment return rate is similar to historical returns of high quality bonds overseas and is considered reasonable.
6. The FA analysis is confined to 50 years. There is no fund set aside for major renovations or re-constructions after 50 years, beyond which the WKCD may not be financially sustainable. An extra saving of \$3.38 billion on capital and operating costs, equivalent to 16% of the \$21.6 billion seed fund, is needed.	6. <ul style="list-style-type: none"> • The use of 50-year project period is even more stringent than the professional assessment of other long-term projects. • We estimate that the retail, dining and entertainment facilities would generate an estimated rental income of \$8.4 billion (2008 Net Present Value) over the first 50-year project period which is around 10% higher than the estimated total operating deficit of \$7.6 billion (2008 Net Present Value) of the arts and cultural facilities. Arts and cultural facilities could be operated in a financially sustainable manner.

	<ul style="list-style-type: none"> • Provision has already been made for regular major overhaul as well as annual building maintenance during the 50-year project period. All facilities will be in good condition and fully functional beyond 50 years. No question of demolishing or re-building the facilities immediately after 50 years.
<p>7. Under the FA operating assumptions, M+ would cost \$10.7 billion to construct and operate for 50 years. By 2059, M+ would contribute 89% of the WKCD yearly deficit. M+ might become a long-term financial burden of the WKCD.</p>	<p>7. • The estimated construction cost of M+ is \$2.6 billion.</p> <ul style="list-style-type: none"> • The estimated annual operating deficit of M+ is around \$300 million, which is comparable to the total recurrent expenditure of around \$500 million for all Leisure and Cultural Services Department museums. • The rental income from retail, dining and entertainment (RDE) facilities can fully cover the overall total operating deficit of the arts and cultural facilities (including M+).
<p>8. According to the information provided by the FA so far, should M+ be run by an international operator, the potential saving, in very crude terms, could be as high as \$4.8 billion (i.e. 22% of the \$21.6 billion seed fund). There is a big difference prima facie and should be studied carefully.</p>	<p>8. Engaging an international operator to operate M+ will not achieve M+'s vision and M+ would lose Hong Kong's unique cultural character and curatorial freedom. It will also restrict M+'s future development and hinder its co-operation with internationally renowned museums on a mutually beneficial basis. This development model may also incur higher costs than expected.</p>

<p>9. Annual deficits of the WKCD would have to be met by RDE rentals. RDE is therefore the life line of the WKCD. Yet compared to the detailed operating assumptions provided for Core Arts and Cultural Facilities (CACF), down to the smallest of theatres, those provided for RDE are clearly insufficient.</p>	<p>9. The estimated rental income level for retail/dining/entertainment facilities is considerably conservative, because it has taken into account the need for these facilities to integrate with the arts and cultural facilities and that they are not comparable to the operation of large scale shopping malls. The estimated rental has not taken into account the positive impact on rental of commercial facilities due to the increase in people flow arising from connecting WKCD with the Express Rail Link.</p>
<p>10. In considering the funding priority for each individual facility/cost item, factors including uncertainty in financial performance, potential benefits on further investigation and its financial significance, should all be taken into account. To build up the financial strength of the WKCD, considerations in (a) reduction of on-costs; (b) a more efficient operation mode of M+; and (c) an effective business plan for RDE facilities are essential.</p>	<p>10. While we have no objection to point (a), points (b) and (c) should be duly considered by the future WKCD Authority. However, WKCD Authority at the same time has to take into account the need for integrated development and the need to be conducive to the objectives of WKCD in promoting arts and cultural development.</p>
<p>Note 1</p> <p>The core team formed by the Legislative Council's Specialist Advisor comprises the following professors and researchers:</p> <ul style="list-style-type: none"> • Associate Professor at the Department of Real Estate and Construction, The University of Hong Kong (HKU) 	<p>The multi-disciplinary professional team formed by the Government's FA comprises:</p> <ul style="list-style-type: none"> • financial experts • public private partnership experts • performing arts venue and museum

<ul style="list-style-type: none"> • Chair Professor of Real Estate and Construction, HKU • Assistant Professor of the Department of Real Estate and Construction, HKU • Post-Doctorate Fellow of the Department of Real Estate and Construction, HKU • Associate Dean of Faculty of Business and Economics and Associate Professor of Finance, HKU 	<p>advisors</p> <ul style="list-style-type: none"> • architects • engineering experts • quantity surveyors • land and property market specialists
<p>Note 2</p> <ul style="list-style-type: none"> • The report took more than one month to complete. 	<p>The report took more than one year to complete.</p>