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Clerk to Subcommittee
Legislative Council
8 Jackson Road
Central
Hong Kong

Attn: Ms Alice AU

Dear Sir/Madam

**Subcommittee on West Kowloon Cultural District Development
Meeting on 16 March 2005**

Thank you for your letter of 24 February 2005 informing us the subject Subcommittee meeting on 16 March 2005 for which we will attend and make a presentation.

HKIS will have 3 representatives for the meeting and they are President, Mr. T T Cheung, Hon Secretary, Mr. Francis Leung and Vice Chairman of the Quantity Surveying Division, Dr. Paul Ho.

I have pleasure in enclosing our submission of paper that our representatives will present tomorrow.

Your sincerely,

Gordon Ng
Secretary-General

Encl.



West Kowloon Cultural District Project

Introduction

1. In response to the current public consultation on the West Kowloon Cultural Development District (WKCD) project, the Hong Kong Institute of Surveyors (HKIS) submitted and presented its comments to the Panel on Planning, Lands and Works on 31st January 2005. HKIS supports the Government's idea of developing the southern part of the West Kowloon reclamation as a world-class integrated arts, cultural and entertainment district.
2. In the above submission, HKIS expressed a number of issues relating to the implementation of the WKCD project. HKIS pointed out *inter alia* that WKCD may not be a financially free-standing project; that there is limited competition due to the single package development approach; that the assessment method is not able to ensure value for money; that there is no master layout plan for proper utilisation of land resources; that the uncertain output specifications in respect of various arts and cultural facilities and services are open to misinterpretation; that higher plot ratios proposed by all shortlisted developers lead to the public concern that WKCD will become a property development project under the guise of a cultural project; and that public exhibition on hard deliverables without disclosing its financial implications is inadequate. HKIS also suggested that the Government should follow good international practices on implementation of this public private partnerships (PPP) project.
3. HKIS is pleased to have the opportunity of meeting LegCo's Subcommittee on WKCD Development to elaborate our views on good PPP practices in relation to the WKCD project. It is understood that the said meeting will address the following agenda items:
 - (a) To study the principles adopted by the Government for its Public Private Partnerships (PPP) projects:
 - (b) To identify deviations, if any, in the approach adopted for the West Kowloon Cultural District development from standing practices and general principles; and

(c) To examine the appropriateness of using PPP for developing WKCD.

In this regard, HKIS would like to express our views specifically related to the above three items.

Development Approach adopted by the Government in the WKCD Project

4. It appears that in face of the huge fiscal deficit, the Government wishes to utilise the commercial experience and financial resource of the private sector for the planning, design, finance, construction, maintenance and operation of the whole WKCD project for a period of 30 years. It is thus clear that the development of the WKCD is a Public Private Partnership (PPP) project.
5. Based on the available information particularly the Invitation for Proposals (IFP) for the WKCD project, it is our impression that the development approach adopted by the Government largely follows the old-fashioned design-operate-transfer model traditionally used for financially free-standing infrastructure projects. It is noted that the Government issued its document entitled "Serving the Community by Using the Private Sector: An Introductory Guide to Public Private Partnerships (PPPs)" in August 2003. The Invitation for Proposals for the WKCD project was issued about one month later on 5th September 2003. It is HKIS's observation that many of good principles and practices developed in other countries for PPP projects have been neglected, leading to wide criticisms by the public.

Deviations from Internationally Established Good Principles and Practices

6. In a paper (No. WKCD-91) submitted by the Housing, Planning and Lands Bureau to the Subcommittee on WKCD Development in February 2005, the Government stated that "the IFP process is well in line with the underlying key principles of the Introductory Guide. The WKCD project can satisfy the common elements of the PPPs set out in the Introductory Guide". The Government also argued that "while the Introductory Guide sets out the general guidelines for PPPs, it is well

recognised from the outset and as stated in the Introductory Guide that detailed arrangements for PPPs can and should be crafted individually to suit the particular circumstances that are encountered in each instance". The fundamental issue in question is what sort of guiding principles for PPP projects the Government should have followed, but have not followed. Probably, the Government's Efficiency Unit is in the best position to make comments on its internal practices. HKIS would give our opinions based on internationally established good practices for PPP projects.

Government's Introductory Guide to Public Private Partnerships

7. The PPP approach for the procurement of public facilities and services has been widely adopted by a number of countries around the world, including the United Kingdom, Ireland, Australia, Canada, United States of America, South Africa, Ireland, Germany, Netherlands, Finland, Denmark and Japan, etc. In these countries, PPP projects play a limited but important part in public sector capital investment. Therefore, the governments in these countries have developed their own guidance notes for PPP projects in order to ensure that it can meet their requirements of efficiency, equity and accountability and that it can offer the best value for money. It is noted that the Introductory Guide developed by the Efficiency Unit also shares many of the good principles and practices of PPP models currently used in other countries.
8. In other countries, the PPP approach is not limited to the procurement of public building and infrastructure projects, but also used in a wide range of other public facilities and/or services such as water treatment, waste disposal, IT system and defence, etc. Thus, some governments have also developed more detailed (or secondary level) guidance notes for different types of facilities and/or services. It is therefore not abnormal that the Introductory Guide states "the detailed arrangements for PPPs can and should be crafted individually to suit the particular circumstances that are encountered in each instance." Obviously, such "detailed arrangements" should not deviate from some good principles and practices for PPP projects.

Financially Free-Standing or Subsidized Project

9. According to the Introductory Guide, if a PPP project requires funding support, the client department should submit a bid for funds through the Resource Allocation Exercise process. For capital costs, the bureau will need to secure capital funding under the Capital Work Reserve Fund. For operating costs, the bureau has to confirm whether it can absorb the recurrent funding or whether it needs topping up from the centre. On the other hand, “a financially free-standing project would require no formal legislative or financial approvals from the LegCo (p.10)”. Apparently, the Government argues that the WLCD is a self-financing project. Interestingly, the Introductory Guide states the following:-

“There are differences between these types of PPPs, depending on the means by which the private partner receives a return on his investment:

- At one end of the spectrum are financially free-standing projects where the services are provided for the use of the public which pays the private partner direct. Examples of this are toll-charging road bridges and tunnels.
- At the other end of the spectrum, the services are provided direct to the government sector which pays the private partner for those services. Overseas examples of this include the provision of prisons, government office accommodation and hospitals.
- In between the two ends of the spectrum are projects which provide services to the public, but the payments to the private partner involve a mix of public subsidy from the government and end-user charges imposed on consumers of the services. Examples of such services are sports centres, where the consumer pays a subsidised fee for the use or hire of facilities and equipment. (p. 1).”

10. It is also noted from the Introductory Guide that “a project where the government intends to grant land for less than the paid-up market value would normally require consultation with the LegCo (p. 10)” and also that the “client department must ensure that the private partner is not permitted to sell, sublet or otherwise dispose of the land, or reduce its economic value without the approval of the government (p. 51)”. It is further noted from the Introductory Guide that “the client department needs to consider how to ensure that the public purse receives its fair

share. This might involve the cross-subsidy of loss making services that the private partner must provide. As a general point, these arrangements should be as transparent as possible. If there are to be cross-subsidies, it should be made possible for the extent of the subsidy to be determined (p. 52).”

11. HKIS is not in a position to comment on whether the Government has followed the aforesaid guides and/or its usual accounting, land disposal and funding approval procedures or practices. Nevertheless, it is clear that the arts and cultural provisions of the WKCD project cannot be run on a truly self-financing basis and will require cross-subsidies through the commercial and residential property development within the 40 hectares of land. HKIS wishes to point out that in many developed countries (like the United Kingdom, Australia, Canada and United States), all public projects are subject to stringent administrative and legislative approval procedures, no matter whether it is delivered through the conventional or PPP approach. In addition, if there is any transfer of Government’s assets (such as land and property) to the private partner in a PPP project, it should be fully and properly accounted at its market value.

Project Justification by Business Case

12. In line with some good practices developed in other countries, the Introductory Guide states that “once the client department has identified a project or a service that is required, and is considered to have potential as a PPP, a feasibility study including an initial assessment of the business case should be conducted (p. 9)”. However, the Introductory Guide provides no specific detail in respect of the functions and contents of the required business case.
13. In the United Kingdom¹, the sponsoring department must justify its PPP projects by means of a business case submitted for approval in two stages. An Outline Business Case is submitted at an early stage of the project, and a Final Business Case is submitted before entering into any contract with the preferred private partner. The Public Private Partnerships

¹ There are also similar practices in other developed countries. The preparation and submission of a justifiable business case is an essential element of a PPP project.

Programme (4Ps) has published detailed Guidance Notes for the Outline Business Case and Final Business Case. Typically, an Outline Business Case includes the following two important elements:-

- Options appraisal to identify the preferred project and procurement option.
- An assessment of the economic benefits, value for money, affordability and bankability of the preferred service delivery option, including confirmation that soft market testing has demonstrated the market interest in the preferred service delivery option.

Options Appraisal

14. Options appraisal typically consists of two stages; firstly, the appraisal of project options to identify the project that best meets the service delivery needs, and secondly, the appraisal of procurement options to identify the procurement route that is likely to offer best value. In respect of the WKCD project, the appraisal of project options is to identify the types and standards of arts and cultural facilities and services that will best serve the community at large. It includes the analysis of existing arts and cultural facilities and services, key service standards and outputs, the condition of current assets, trends in public opinion about the arts and cultural facilities and services, and the overall cultural policy of Hong Kong. HKIS is of the view that should the Government have thoroughly carried out this appraisal exercise, there should be more precise output specifications for various arts and cultural facilities and services. There should also be fewer criticisms from the arts and cultural sector.

15. The appraisal of procurement routes is to identify the potential procurement options (i.e. traditional, PPP or other approaches) available to deliver the arts and cultural facilities and services of the WKCD project, and also to establish which route is likely to offer the best value for money. In a paper (No. WKCD-91) submitted to the Sub-committee on WKCD, the Government stated that "the development of the WKCD is a Public Private Partnership (PPP) project which fosters a long term relationship between the Government and the private sector in the development of world class arts and cultural facilities and the provision of high quality arts and cultural programmes by bringing in the private

sector's financial strength and commercial knowledge and expertise (p. 4)". The Government also argued that the conventional way of dividing the project into smaller packages and inviting tenders would require the Government to draw up its own master layout plan based on uncertain assumptions of what would be commercially viable in an integrated development. The Government considers that tendering out smaller packages with a view to using the land sale proceeds for developing the cultural facilities impractical and this would involve hypothecating the general revenue². It appears that the Government has directly decided to adopt the PPP model for the development of WKCD project based on two key reasons; the first is to tap the financial resources of the private sector, and the second is to utilize their commercial knowledge and expertise as "the market-sensitive business sector can bring in more innovative ideas and greater flexibility"³.

16. HKIS is of the view that the above two arguments are *prima facie* not totally unreasonable. Some overseas experiences indicate that when the government faces a budget deficit while the public demands for more and better public facilities and services, there is a strong temptation for them to adopt the PPP model to deliver public facilities and services. This situation may also appear in the WKCD project as observed from the speech of the Chief Secretary for Administration who stated that

"It is unfortunate that we have to face a huge fiscal deficit at this time. There will not be sufficient public resources to support such a mammoth project worth over \$20 billion in the next five years or beyond. We all know that while the Government has limited resources, the resources of outside world are in abundance. The private market is having a very strong liquidity It is the ideal time to bring in the partnership of the business sector in public facilities development"⁴.

17. While appreciating the Government's good intention and responsible attitude for the provisions of new and better public arts and cultural facilities and services for Hong Kong people, HKIS would draw the Government's attention to the following comments made by the UK's

² LC Paper No. CB(1) 318/04-05(02) Background brief of the West Kowloon Cultural District

³ Speech by the Chief Secretary for Administration on the Motion on West Kowloon Cultural District Development Project in the Legislative Council on 26th November 2003.

⁴ Same reference as footnote 3.

National Audit Office:

“The attractiveness of not having to find the money up front to meet the initial capital cost creates a strong incentive for departments to present their PFI⁵ deals as the preferred choice simply to get them to proceed. Departments may also be under pressure to choose the PFI option so as to keep debt off the public sector balance sheet. These potential risks underline how important it is that the PFI route should be chosen only after a robust value for money assessment of all the options.”

18. The Government's second reason for adopting PPP approach for the WKCD project is based on the belief that the private sector is superior to the public sector in terms of commercial management, expertise, efficiency and quality for the provision of relevant arts and cultural facilities and services. At this stage, all the screened-in proponents have submitted and exhibited their preliminary proposals. The Government should be able to clearly demonstrate this theoretical advantage both quantitatively and qualitatively, bearing in mind that the Government could also directly appoint the same or similar local and international architect, museum operator, etc. under the conventional approach.

Value for Money Assessment

19. In other countries, the PPP approach is only pursued where it delivers value for money (VfM) in order to safeguard the public interest relating to effectiveness, accountability, transparency, equity and public rights⁶, where value-for-money is the optimum combination of whole life cost and quality to meet the user's requirement. The Introductory Guide also calls for preparation of a Public Sector Comparator (PSC) at an early stage of a PPP project. The Introductory Guide states that “this allows the client department to ascertain the expected full cost of pursuing the project by traditional means. The Introductory Guide further states that if no PSC is constructed, “the client department will still wish to establish value for money, especially if public land has been provided at less than full market value (p. 32)”. It is understood that before signing

⁵ PFI means private finance initiatives which is one type of PPP model in the UK.

⁶ In other words, the Government's budget deficit should not be a reason for adopting the PPP approach.

any provisional agreement with the successful proponent for the WKCD project, the Government would disclose all the financial information. However, should the Government have carried out this assessment exercise at the early stage of the project, the Government should be able to justify that the PPP approach would offer value for money and that there should be no "transfer of interest" as alleged by the public. More fundamentally, the best value assessment cannot be run in parallel or at the end of the procurement stage; otherwise, there is no agenda for questioning the basis of the PPP project.

20. In many countries (like the United Kingdom and Australia), the Public Sector Comparator can be disclosed (in an aggregate figure) to short-listed bidders in order to assist the competitive bidding process. In fact, in line with the international practices, the Introductory Guide also states that "the final PSC will be public knowledge by the time of the Request for Proposal as it will have normally been disclosed to LegCo' FC in the course of obtaining approval to proceed with the project (p. 32)". The Government should be aware that democratic accountability is weakened in disclosure of information with use of commercial confidentiality used to limit the release of information and to constrain the public being consulted.

21. Overseas experiences indicate that even this kind of assessment is carried out, there may also be certain manipulation because the government may wish to "prove" value for money and may exaggerate innovation and benefits of a PPP option, whilst assuming limited scope for innovation and efficiency in the public sector. Whether similar situation would happen in the WKCD project is yet to be known, as the Introductory Guide provides limited requirements or details on this critical exercise. Nevertheless, many developed countries (like the United Kingdom, Canada and Australia) have developed very comprehensive guidance notes relating to this value for money assessment to avoid "artificial" or "biased" assessments. It is worth to mention that the UK government requires both qualitative and quantitative assessments according to the "Value for Money Assessment Guidance" and "Quantitative Assessment User Guide" published by the HM Treasury.

22. In addition to the value-for-money assessment, the Government should also prepare an assessment of the economic benefits associated with the WKCD project, including both financial and non-financial (e.g. whether more tourists will stay and spend in Hong Kong) benefits. The cost-benefit analysis is essential to determine whether the WKCD project is justifiable.

Affordability

23. Unless the project is financially free-standing⁷, there will be a definite cost to the Government of all schemes procured through either the traditional or PPP procurement route. As pointed out above, both the capital and operating costs of the arts and cultural facilities and services will require cross-subsidies through the commercial and residential development within the 40 hectares of land. Under such a circumstance, the public and LegCo members should have the right to know the amount of subsidy to see whether it is reasonable, justifiable and affordable, bearing in mind that the whole or part of the said subsidy can also be used to support other public facilities and services which are in greater demand by the society. Disregarding other indirect issue, the amount of affordable subsidy in the WKCD project will directly determine the quality and standard of the arts and cultural hard facilities (including the expensive compulsory canopy) and the subsequent provision of the arts and cultural soft services, including the possible fees to be charged. While the Government argues that the WKCD project will be subject to the normal statutory planning control, the apparent solution adopted by the Government is to let the proponents justify their higher plot ratio development in order to make the whole WKCD project to be self-financing.

Degree of Competition

24. One of the key aspects for achieving the best value is to ensure a high degree of competition in the bidding/negotiation process. That is why the outline business case normally requires a soft market test to demonstrate that there will be an adequate market interest in the

⁷ HKIS would define a financially free-standing project as the cost of the project can be fully met by users of the service.

bidding of the preferred service delivery option. Given the large scale of the WKCD project, the single package development approach may result in restricting the number of bidders, thus placing the Government in an unfavourable position in negotiating the best deal. Under such a circumstance, the Government may not be able to demonstrate value for money.

Appropriateness of Using PPP for Developing WKCD

25. It appears that the development approach for the WKCD project fundamentally hinges on its funding source. If it is justifiable and affordable to use public funding to finance the whole project, there will be no need for the private sector's participation. Under such a circumstance, the Government can utilize the traditional or other procurement approach for the development of the WKCD project. On the other hand, if it is desirable to utilise the financial resource and commercial expertise of the private sector and if the arts and cultural facilities and services proposed by the private sector are clearly demonstrated to be affordable, value for money and in the best interest of the public, the PPP approach can be adopted. It is HKIS's belief that if the Government strictly follows most fundamental principles and good practices relating to the PPP projects, it would safeguard the public interest relating to the Government's effectiveness, accountability and transparency.

26. The aforesaid views and comments are more related to the current procurement stage of the WKCD project. There may be other important issues (such as risk management, benchmarking, contract provisions, contingency planning, etc.) at its later stages of development. HKIS is also very pleased to provide further views relating to this project.

The Hong Kong Institute of Surveyors
16th March 2005