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Translation

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29 May 2017

Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong
(Attn: Ms Sharon Chung)

Dear Ms Chung,

**Public Works Subcommittee
Supplementary Information on Kai Tak Sports Park Project**

At the Public Works Subcommittee meeting on 20 May 2017, some Members requested additional information relating to the Kai Tak Sports Park project. The relevant information is attached in Annex for Members' reference.

Yours sincerely,

(Original signed)

(Ms Linda Law)
for Secretary for Home Affairs

Supplementary information on the Kai Tak Sports Park Project

Follow-up item 1(a): In the light of the controversial “bid incentive” arrangement, will the Government consider putting it aside and taking the traditional tendering approach instead?

The construction of the Kai Tak Sports Park (the Sports Park) is the largest investment of the Government in promoting sports development and is crucial to the promotion and implementation of sports policies. Both the sports sector and the general public are looking forward to the early completion of the Sports Park so that they may enjoy the various facilities soon.

2. In view of the scale, complexity and uniqueness of the Sports Park project, the consortiums participating in the tendering exercise are required to gather a team comprising a wide spectrum of professional expertise ranging from design to construction and operation of large-scale sports and commercial facilities. It is estimated that \$100 million to \$200 million will be required to prepare a conforming and quality bid. The high tendering cost may dampen the interest of some companies in bidding or affect their capacity in forming a consortium.

3. After a detailed study conducted by the consultant appointed by the Home Affairs Bureau (HAB) and Government’s careful consideration, we have decided to provide an appropriate but not excessive bid incentive during the tendering exercise of the Sports Park. This is to attract more eligible tenderers to participate in the exercise and submit quality and detailed bids, with a view to increasing competition for the sake of public interest and reducing the chance of “price-gouging”.

4. We suggest that an amount of no more than 50% of the bid cost be refunded to a maximum of three unsuccessful tenderers who have submitted a bid meeting all the requirements. The ceiling on the refund for each unsuccessful bid is \$60 million, representing 0.188% of the estimated capital cost of \$31.9 billion (in money-of-the-day prices). Taking an amount of \$200 million as the cost for submitting a bid, the unsuccessful tenderer will only be able to receive a refund equivalent to 30% of the bid cost. In that case, the consortium participating in the tendering exercise is still required to bear 70% of the bid cost itself, i.e. \$140 million. Besides, tenderers who apply for the bid incentive are required to provide proof of the bid cost, and give consent for the Government to use the intellectual property rights in the tender submission.

5. In fact, a number of major projects overseas (e.g. the International Convention Centre Sydney and the new Champlain Bridge in Montreal, Canada) have also provided bid incentives to increase competition during

tendering. Each unsuccessful tenderer under the above two examples was given 0.34% and 0.126% of the estimated project cost respectively as a bid incentive, which are of a similar scale to our proposed cap of 0.188% for the Sports Park project.

6. We have also studied carefully Members' suggestion of adopting the traditional approach (i.e. without a bid incentive) to invite bids for the Sports Park first. Should the approach fail to attract a sufficient number of bids, a bid incentive will then be provided. We consider it impracticable as interested consortiums will not submit their bids in the first round until a bid incentive is provided by the Government. The above suggestion will not only end up rendering the first tendering exercise fruitless and time-wasting, but also lead to an increase in the construction cost of the Sports Park due to a delay in tendering, as well as hindering the sports sector and the public from enjoying the long-awaited sports facilities earlier.

7. As mentioned earlier, if no incentives are provided, we estimate that it is likely that we will not be able to attract a sufficient number of conforming bids, which will result in re-tendering. If the project is delayed for 12 to 18 months, the cost of the Sports Park project will be increased by \$1.6 billion to \$2.4 billion (i.e. causing the cost to rise from \$31.9 billion to \$33.5 billion or even up to \$34.3 billion).

8. We have considered Members' suggestions carefully. However, as it is necessary to increase competition during the tendering process, we consider it necessary to provide bid incentive in the Sports Park project.

Follow-up item 1(b): Will the Government consider an increase in the amount of a performance bond by requesting the Contracted Party to submit such a sum equivalent to approximately three years of the basic operating expenditure of the Kai Tai Sports Park (the Sports Park)?

9. To ensure completion of the contract by the Contracted Party and protect the interests of both the Government and the public, we will specify in the terms and conditions of the Sports Park contract the requirement of performance bond. We initially suggest that the performance bond should be an amount equivalent to the basic operating expenditure¹ of the Sports Park for a period of six to nine months (totalling about \$150 million to \$200 million in the first five years, with the amount updated regularly taking account of inflation), with a view to compensating, if circumstances require, the Government's loss and preventing the Contracted Party from easily giving up the operation of the Sports Park. Moreover, the Contracted Party will have to make an initial investment of \$300 million to \$400 million in order to start

¹ In 2025 (i.e. the third year of operation when the business performance becomes stable), the basic operating expenditure is estimated to be about \$300 million.

operating the Sports Park. As the Contracted Party is required to provide in advance the performance bond and an investment for operation totalling \$500 million to \$600 million while the operating income and profits of the Sports Park are expected to increase during the later years of operation, the Contracted Party should be greatly motivated to complete the contract and maintain good performance during the operation phase².

10. In determining the amount of a performance bond, while we may wish to increase the costs of the Contracted Party for giving up the operation of the Sports Park, we must also bear in mind that the project will become less attractive if the required amount is too large. The costs of arranging the performance bond by the Contracted Party will also be reflected in tender price as well as the fixed payment to be made to and the percentage of the income to be shared with the Government. Nevertheless, we will seriously consider Members' views and further examine the room for **increasing the amount of performance bond and/or taking other approaches (including to request the Contracted Party and its parent company to provide a financial guarantee)** in order to increase the Contracted Party's commitment and reduce the possibility of contract default. We will reply to the Public Works Subcommittee prior to the approval of the Sports Park project by the Finance Committee (FC).

Follow-up item 1(c): Will the Government consider "capping" the construction cost of the Sports Park project?

11. Provided that the funding application for the Sports Park project is approved by the FC in the current legislative session, there is sufficient competition in the tendering process (including attracting a sufficient number of conforming bids), and the construction cost proposed by the successful Contracted Party does not exceed the approved project estimate, we are very confident that the Sports Park project can be completed within the budget of \$31.9 billion without the need to seek additional funding from the Legislative Council.

Follow-up item 1(d): Will the Government develop a set of clear standards to monitor the performance of the Contracted Party (including the possible penalties to be imposed by the Government when the performance of the

² As pointed out in the consultancy study of the Development Bureau on profit margins, with a few exceptions, the profit margins of local contractors on public works are mostly 2% to 3%. Among the capital expenditure of \$31.9 billion, it is estimated that the contract value for the Main Contracted Party is about \$27 billion. The remaining capital expenditure (e.g. the costs of appointment of consultants by the Government for contract administration, remuneration of resident site staff, contingencies, etc.) falls outside the contract scope of the Contracted Party. Based on the profit margins of 2% to 3%, the contract profit of the Contracted Party is in the region of \$500 million to \$800 million.

Contracted Party is not satisfactory)?

12. We have developed a set of operational requirements and key performance indicators (KPIs) to ensure that the Sports Park can achieve the policy objective of promoting sports development. The KPIs include the following: the quantity and quality of events held in each venue shall reach the level proposed by the Contracted Party in its tender (event level is an important criterion in tender evaluation); the opening hours, arrangements and hiring charges for community sports facilities there must be set by making reference to similar facilities operated by the Leisure and Cultural Services Department (LCSD), educational institutes and other non-profit making organisations. Regarding the charges for community and sports facilities, **the Contracted Party must obtain prior approval from the HAB.** The HAB will assess the performance of the Contracted Party based on the KPIs and **will impose fines with deterrent effect on the Contracted Party for failure to achieve the KPIs.**

Follow-up item 2: Regarding the supplementary information (Paper No. CB(2)1330/16-17(01)) submitted by the Government to the Panel on Home Affairs, the Government is required to provide additional information to further explain the Operations Consultant's financial projection for the Sports Park in the first five years of operation under the "design and build, then operate by Government"(DBG) procurement approach, and make a comparison with the financial projection in the first five years of operation under the DBO procurement approach.

13. The comparison of financial projections in the first five years (2022-2026) under the DBG and DBO procurement approaches is given in the Appendix. In a gist, the Operations Consultant expects that, under the DBO procurement approach, the Sports Park will have an annual surplus (calculated before sharing the income with the Government) in a stable market condition, with the amount growing gradually from \$51 million in the first year to \$291 million in the fifth year. However, under the DBG approach, the Sports Park will be running a deficit estimated to be \$52 million and \$32 million respectively in the first two years of operation until the third year when a small surplus (\$6 million) is recorded. It should be noted that the difference in overall surplus of the Sports Park under the two approaches is huge (taking the year 2025 as an example, the surplus produced under the DBO approach is \$248 million more than that under the DBG approach). We do not recommend operating the Sports Park under the DBG approach with the following major considerations:

- Under the DBG approach, sports and commercial facilities in the Sports Park will be operated by the LCSD. As a government department, the LCSD lacks commercial expertise in promotion and marketing strategies, tenancy planning for dining and retail space, and

commercial sponsorship. In addition, should the Sports Park be operated by the Government, we generally have to adopt the established procurement policy and rules on tendering of commercial facilities. Therefore, if the Sports Park is managed by the LCSD, it is anticipated that the number and types of events and the overall revenue of the Sports Park produced from ticketing, commercial sales, leasing of dining and retail space will be much less than the DBO approach. As such, the Sports Park will be less attractive with low visitor flow and less vibrant as a whole. As shown in the Appendix, the average annual revenue from the Main Stadium and the dining and retail outlets under the DBO approach doubles approximately the revenue under the DBG approach.

- The Government has to take all operational risks, including cost overruns, price adjustments, change of market demand, etc. Under the DBO approach, these risks will be borne by the Contracted Party.
- The Government is required to be responsible for the lifecycle replacement costs of retail/dining and carpark facilities, but these costs will be borne by the Contracted Party under the DBO approach³.
- Apart from the construction cost of the Sports Park, the Government is required to put in an additional capital of \$300 million to \$400 million for furniture, fixtures, consumables, and other start-up costs. The Government will also be required to continue to pay for the replacement cost of these furniture and equipment. Under the DBO approach, these expenditures will be borne by the Contracted Party.

Follow-up item 3: Please describe the organisational structure of the committee to be set up by representatives from the HAB and the Contracted Party.

14. As mentioned in the supplementary information submitted to the Panel on Home Affairs on 4 May, during the operational stage, the HAB and the Contracted Party will set up a **Joint Review Committee**, underpinned with monitoring sub-committee(s).

15. Comprising senior officials of the HAB and representatives from the Contracted Party, the Joint Review Committee will review the performance of the Contracted Party with a focus on operation outcome. This high-level committee will meet on a quarterly basis to discuss strategic issues. The Chief Executive Officer(s) (CEOs) of the head company(ies) of the Contracted Party is required to attend the meetings. The meetings will focus on the following issues:

- Business plans and strategic targets for the Sports Park

³ Under the DBO and DBG approaches, the lifecycle replacement costs of sports and community facilities are both borne by the Government.

- Contractual performance and penalties against failure to meet KPIs
- Follow-up plans against areas of under-performance
- Plans and targets for continuous improvement
- Other important contractual matters

16. **Monitoring sub-committee(s)** will be set up under the Joint Review Committee and meet on a monthly basis to discuss issues on operation, event arrangements, and repairs and maintenance. The CEO responsible for the operation of the Sports Park, together with his/her senior management team, will be required to report the following issues to the HAB at these meetings:

- Performance in the past month
- Event applications received in the past month and event calendar for the coming events
- Key operational outcome, including utilisation of facilities and asset maintenance
- Complaints received and actions taken
- Other issues raised by the HAB

17. Furthermore, **the Task Force on the Kai Tak Sports Park** (the Task Force) **under the Sports Commission (SC)** gives advice on the Sports Park. Members of the Task Force include representatives from the Sports Federation & Olympic Committee of Hong Kong, China, local national sports associations, the Hong Kong Schools Sports Federation, retired athletes and the music sector. Apart from the above-mentioned Joint Review Committee formed by the HAB and the Contracted Party to review the operation and development of the Sports Park, we would consider requiring the Contracted Party to report regularly to the SC or its Task Force and listening to their views in the future.

Follow-up item 4: The Government is required to provide supplementary information to explain the penalty to be imposed on the Contracted Party of the Sports Park when it fails to complete the project on schedule.

18. We will specify in the contract the construction period from the commencement of the contract to the completion of the construction work. If the Contracted Party of the Sports Park fails to complete the construction work on schedule as specified in the contract (or according to the extension of time for completion set down in the contract terms) and is liable for the delay, it shall pay the Government damages. The amount of the liquidated damages shall be determined in accordance with the Works Technical Circular No. 4/2003 of the Development Bureau, which will be about \$130 million per month based on the current estimated project cost.

Translation

Appendix

A comparison of financial projections of DBO and DBG procurement models over the initial five years of the operating period

DBO model					
HKS million	2022	2023	2024	2025	2026
Operating income					
Main Stadium	134	277	287	297	307
Public Sports Ground	3	7	7	7	8
Indoor Sports Centre	30	63	65	67	69
Public Open Space	8	16	16	17	17
Retail and Dining Facilities and Car Park	173	417	523	549	572
Total operating income	348	779	899	937	974
Less:					
Facility specific operating costs					
Main Stadium	(178)	(340)	(354)	(366)	(379)
Public Sports Ground	(87)	(168)	(174)	(180)	(186)
Indoor Sports Centre	(14)	(25)	(26)	(27)	(27)
Public Open Space	(22)	(35)	(36)	(38)	(39)
Retail and Dining Facilities and Car Park	(15)	(30)	(31)	(32)	(33)
	(40)	(82)	(87)	(90)	(93)
Precinct wide overheads	(86)	(177)	(184)	(190)	(197)
Non-operating expenses¹	(33)	(81)	(99)	(103)	(107)
Net financial result (before revenue sharing with Government)	51	181	263	278	291

General assumptions under the DBO model

- Analysis is from the perspective of the Contracted Party;
- Amounts presented in Money of the Day; and
- All other general assumptions are as stated in Annex 2 of Appendix 1 of supplementary information on Kai Tak Sports Park Project to the Panel on Home Affairs on 4 May 2017.

¹ Non-operating expenses include working capital funding, taxes and capital expenditure for commercial facilities.

DBG model

HKS million	2022	2023	2024	2025	2026
Operating income					
Main Stadium	56	135	165	170	176
Public Sports Ground	3	6	6	6	6
Indoor Sports Centre	30	61	64	67	68
Public Open Space	8	16	16	17	17
Retail and Dining Facilities and Car Park	90	202	226	261	296
Total operating income	187	420	477	520	564
Less:					
Facility specific operating costs	(177)	(325)	(339)	(353)	(363)
Main Stadium	(85)	(152)	(159)	(165)	(171)
Public Sports Ground	(14)	(25)	(26)	(27)	(27)
Indoor Sports Centre	(22)	(35)	(36)	(39)	(39)
Public Open Space	(15)	(30)	(31)	(32)	(33)
Retail and Dining Facilities and Car Park	(41)	(83)	(87)	(90)	(93)
Precinct wide overheads	(50)	(102)	(106)	(110)	(114)
Non-operating expenses	(12)	(25)	(26)	(27)	(28)
Net financial result	(52)	(32)	6	30	59

General assumptions under the DBG model

- Analysis is from the perspective of the Government;
- Amounts presented in Money of the Day; and
- All other general assumptions are as stated in Annex 2 of Appendix 1 of supplementary information on Kai Tak Sports Park Project to the Panel on Home Affairs on 4 May 2017.