



Development Bureau
Hong Kong Special Administrative Region Government

Business Viability Study for Development of Site 4 in the New Central Harbourfront

Final Report Executive Summary

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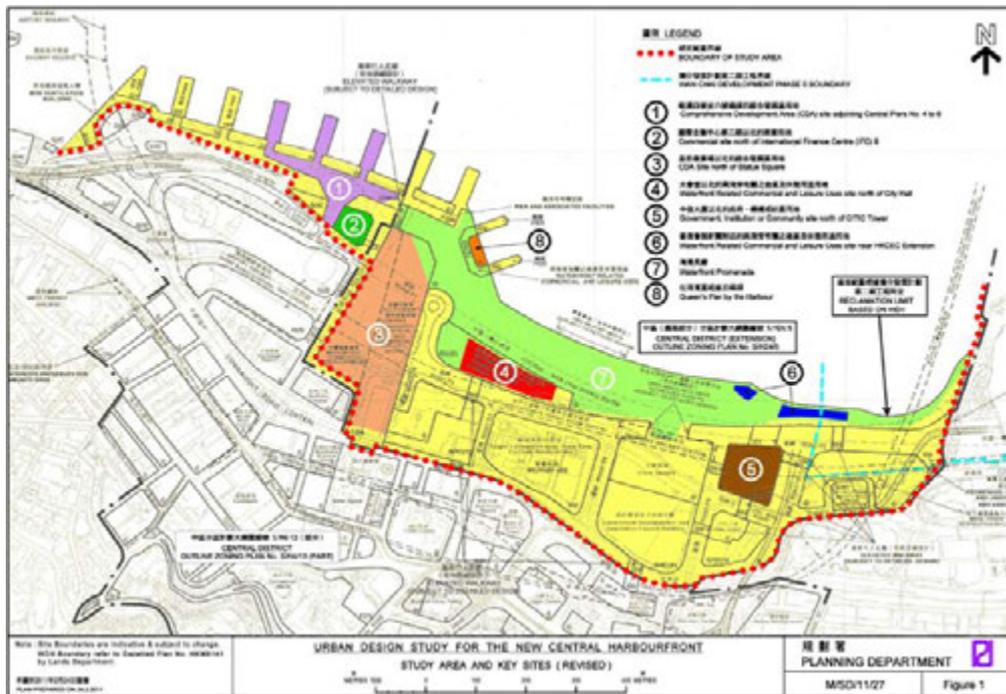
1 EXECUTIVE SUMMARY

1.1 Introduction and Approach

1.1.1 Introduction

Sites 4 and 7 are key sites in Hong Kong's new Central harbourfront. Site 4 is a small-scale commercial site in front of City Hall. Site 7 is a much larger site planned to provide open space, parkland and a new waterfront promenade running from the Star Ferry Pier to the Hong Kong Convention and Exhibition Centre. Presently vacant and undergoing preparatory infrastructure works, the Hong Kong Government's intention is to procure Site 4, and as much of Site 7 as possible, in one package using Public Private Collaboration (PPC)¹. The objective of this *Business Viability Study for the Development of Site 4 in the New Central Harbourfront* (the Study) was to determine the viability of involving the private sector in procuring Sites 4 and 7 (the Project) in this manner. The Study, undertaken by GHK (Hong Kong) Ltd, with support from Professional Property Services, Minter Ellison, Red Hill Limited, EarthAsia Limited and Franklin+Andrews (the GHK Team), started in January 2011 and concluded in March 2012.

Figure ES-1: Urban Design Study Map for the New Central Harbourfront



Source: Map provided by Hong Kong Government Development Bureau

1.1.2 Study Approach and Content of this Executive Summary Report

In undertaking this Study, the GHK Team adopted a three-stage approach:

¹ Under a PPC approach, Government would retain ownership of the land, which it would lease to the private sector on a medium to long-term contract at nominal premium. In return, the private sector would finance, design, build, manage, maintain and operate the site. Government's starting preference for this Study – to procure Site 4 and as much of Site 7 as possible using PPC – reflects the Government and Harbourfront Commission's belief that the most likely way of realising a truly vibrant new Central harbourfront is through tapping into the private sector's creativity and expertise.

- **Stage 1: Initial Evaluation of Business Potential:** covered a review of the characteristics of Sites 4 and 7, the creation of an initial development concept for what could be developed on these sites and an initial financial analysis of this concept
- **Stage 2: Market Sounding, Concept Revision and Financial Analysis:** included a non-committal market sounding exercise (MSE) to determine private sector appetite and capability for the Project, the formation of a revised and detailed development concept on the basis of this MSE and the results of Stage 1, plus a detailed financial analysis of this revised concept
- **Stage 3: PPC Approach and Institutional Arrangements:** considered and selected a PPC approach for implementing the Project in light of the Stage 2 results and proposed possible institutional arrangements

This Executive Summary presents an overview of the Study for public consumption. Information and analysis that may be commercially sensitive in nature, including for example site designs and detailed financial results, has therefore not been included in this document.

1.2 Stage 1: Initial Evaluation of Business Potential

1.2.1 Fundamental Characteristics of Sites 4 and 7

In order to determine business viability, it was first necessary to determine what could feasibly be developed on Sites 4 and 7 according to each site’s key planning parameters, intended uses and any on-site constraints.

Table ES-1: Key Site Parameters and Constraints

	Site 4	Site 7
Site area	0.93 hectares (ha)	9.87 ha
Zoning	“Other Specified Uses” annotated “Waterfront Related Commercial and Leisure Uses”	“O” (open space)
Planning Intention	Under the Urban Design Study (UDS) the site is to become “a Harbour Place” providing “waterfront related commercial and leisure uses” with al fresco dining in a courtyard setting	Under the UDS the Site is to provide a continuous waterfront promenade with attraction nodes such as plazas, viewing platforms and al fresco dining opportunities in an “urban park”/“urban green” setting
Maximum GFA	7,500 square meters (sqm)	480 sqm
Key Site Constraints	<ul style="list-style-type: none"> ▪ Three non-building areas totaling 1,844 sqm to provide landscape buffer ▪ Underground utility network including intermediate pressure town gas pipelines buried in the vicinity ▪ The areas running along the northern boundary as well as the northwestern and southwestern corners of the site are reserved for public open space 	<ul style="list-style-type: none"> ▪ Substantial development is not permitted over the CWB tunnel and buffer area ▪ Permanent structures are not permitted above the MTR Cross Harbour Tunnel ▪ Two non-building areas, each 22m wide plus 3m reserve, for culverts ▪ 150m long PLA berth reserved along the waterfront with 18m wide access to be provided from the berth to the PLA HQ ▪ Three groups of Electricity Supply Buildings (ESBs) (total 5 ESBs), four groups of pump houses (total of 8) and several underground cooling water mains ▪ An unobstructed 6m Emergency Vehicle Access (EVA) along the waterfront

1.2.2 Initial Development Concepts

Based on the above, the GHK Team proceeded to generate indicative 'development concepts' for what could be developed on Sites 4 and 7, such that indicative cost and revenue streams to each site could be estimated. Two initial development concepts were devised²:

- **The UDS Project Concept**, which strictly followed the key parameters and intended uses set out by the UDS
- **The Alternative Project Concept**, which sought to create a more integrated concept by blurring the boundaries between the two sites, reallocating some Gross Floor Area (GFA) from Site 4 to Site 7 and moving Site 7 nodes closer together in order to increase the potential number and flow of site visitors

1.2.3 Initial Review of Financial Viability

An initial financial assessment of the above concepts was undertaken on the assumption a single private sector entity taking on either Site 4 alone, Site 7 alone or both Sites 4 and 7 together, under a 30 year contract covering all development and operating costs and revenues. The results, comprising both Net Present Value (NPV) and Internal Rate of Return (IRR) calculations, raised concerns about the potential viability of involving the private sector in the Project. In particular:

- Site 4 alone was marginally viable, Site 7 alone was not viable and combining Sites 4 and 7 into a single package was not viable: Project development and operations would not be possible based on Project revenue streams alone
- This result was consistent across development concepts: the increased rents obtained under the Alternative Project Concept was not sufficient to offset the significant costs associated with taking on the whole of Site 7

1.3 Stage 2: Market Sounding, Concept Revision and Detailed Financial Analysis

1.3.1 The Market Sounding Exercise

A MSE was conducted May – June 2011 by the Hong Kong Government Development Bureau with support from the GHK Team. A comprehensive questionnaire was sent to a wide range of potential stakeholders³ with a view to determining appetite and capability from the market for taking on the Project as well as views on overall viability, appropriate PPC arrangements and the likelihood of the Project delivering a vibrant Central harbourfront. Follow-up meetings were then arranged where necessary, as were a small number of informal market engagement meetings, to elicit and explore additional expert views on the proposed Project. The private sector comprised the majority of responses. Key findings were as follows:

- The MSE identified market interest and capability but the market did not consider the Project as originally envisioned under the UDS to be an attractive business proposition
- The market thought Site 4 might be 'marginally viable' but the site was not considered attractive. The market thought the site to be too small and too isolated for the private sector to take on as a project in its own right

² Both concepts were devised with reference to the thoughts of the Project Steering Committee and the Harbourfront Commission's Task Force on Harbourfront Developments on Hong Kong Island (HKITF), whilst adhering to the Harbour Vision and the Harbour Planning Principles and Guidelines.

³ Some 600 questionnaires were distributed to potential stakeholders including developers, financiers, investors, community groups and NGOs.

- In order to overcome these issues and make Site 4 a success, the market was of the view that greater control over Site 7 was necessary. However, the limited GFA available on Site 7 (just 480sqm on a 9.87ha site) meant that including Site 7 in the Project would increase the costs considerably with little increase in revenues, such that the entire Project became unfeasible

The over-riding feedback from the MSE endorsed the conclusions of Stage 1: the development and operation of both sites on a commercial basis was unlikely to be viable. Moreover, respondents also thought the Project as originally envisioned would not attract enough people to the sites to create a vibrant harbourfront.

1.3.2 The Revised Project Concept

To increase the success, vibrancy and viability of the Project, the MSE identified that a number of changes needed to be made to the Project. These included:

- Changes to key planning parameters to allow for the creation of a major destination / attraction on Site 7 so as to draw people to the new Central harbourfront, whilst still retaining its waterfront-park feel
- Improved site accessibility, including more transport nodes, parking areas and drop-off points to increase the likelihood of visitors coming to the Sites
- Improved connectivity along the length of Site 7, and particularly between Sites 4 and 7, through the creation of a series of appropriately spaced and designed activity nodes in Site 7 to draw people along the harbourfront
- Incorporating only the western end of Site 7 in the Project

These findings were presented to the Hong Kong Island Task Force and accepted. On this basis, a revised and detailed development concept was developed. Key components of this revised development concept included:

- Reducing the Project area to some 55,000sqm (as per ES-2) and the development of a single, integrated land-use concept for this area
- Retaining the 7,500sqm GFA in Site 4 but increasing the GFA in the western end of Site 7 a small amount to allow for a series of linked activity nodes, including a gateway attraction, waterfront dining and performance areas⁴

1.3.3 Results of the Detailed Financial Analysis

A detailed financial model was developed to determine the financial viability of the revised Project concept. NPV and IRR analyses were again conducted but both, again, came to the same conclusion: the Project, even under the revised development concept, was still not commercially viable. The same problem from the initial analysis remained, despite the smaller site: that the initial capital cost was still too large for the private sector to earn its required return⁵.

⁴ This increase in GFA was proposed with a view to boosting the vibrancy of the Central harbourfront sites, rather than to boost revenues to the private sector proponent per se. The park concept with very low plot ratios was retained. This proposed increase in GFA and the associated revised development concept was agreed by the HKITF.

⁵ Two alternative estimates of the required return were developed: one based on GHK's analysis of the Project's likely cost of funds and a second based on market preferences as identified during the MSE. The financial analysis found the projected rate of return to the Project to be considerably less than both.

1.4 Stage 3: PPC Approach and Institutional Arrangements

1.4.1 Possible PPC Approaches

Stage 2 showed that a significant viability gap remained, even with significant changes to the Project. If private sector involvement were to be secured, more fundamental changes to the Project would be necessary or the original PPC approach would need to be changed.

Five possible approaches were therefore developed, seeking either to increase Project operating revenues or to secure an alternative source of capital funding⁶.

Table ES-2: Overview of Possible PPC Approaches

Option	
1	<p>Increase Project Revenues through Increased Commercial Development</p> <ul style="list-style-type: none"> ▪ Continue to seek implementation via the original PPC approach by asking the private sector to design, build, finance and operate the Project ▪ Increase the amount of allowable GFA on-site until the private sector is able to earn its required rate of return on its initial investment
2a	<p>Seek Partial Capital Injection from Government, Private Sector Covers Rest</p> <ul style="list-style-type: none"> ▪ Amend the original PPC approach such that the private sector still designs, builds and operates the Project but with some finance provided by Government ▪ Government injects sufficient capital funding to allow the private sector to achieve its required rate of return on the portion it invests
2b	<p>Seek Full Capital Injection from Government, Delivery by NPO</p> <ul style="list-style-type: none"> ▪ Revise the PPC approach such that the Project is taken forward by a non-profit organisation (NPO) rather than the private sector ▪ Government pays for all capital expenditure ▪ The NPO designs, builds and operates the Project on a non-profit basis
3	<p>Seek Capital Injection from Donors</p> <ul style="list-style-type: none"> ▪ Revise the PPC approach such that while the private sector still designs, builds and operates the Project, finance is now provided by philanthropists / charitable institutions in the form of a donation⁷
4	<p>Seek Capital Injection from Statutory Authority</p> <ul style="list-style-type: none"> ▪ Seek implementation via an existing statutory authority rather than PPC

Source: GHK Team

An initial evaluation of these five options led to Options 1, 2a and 4 being dismissed:

- Sensitivity testing of the financial model showed that the magnitude of the increase in GFA required to allow the private sector to earn its required return would not be politically or publicly acceptable, so Option 1 was dismissed
- Sensitivity testing of the financial model showed that the Government would need to inject over half of the upfront capital cost if the private sector were to earn its required return on its remaining capital cost share. Such a use of public funds would not be politically or publicly acceptable⁸
- Option 4 was dismissed because a Project of this nature is not within the ambit of existing statutory organisations

⁶ The option of providing the private sector with an ongoing operating subsidy or with recurrent payments for services performed – for example, via a management contract – was not considered due to Government funding restrictions.

⁷ The possibility of donor funding was raised by interviewees during the MSE and may be an option.

⁸ The difficulties of this approach were noted and agreed by the HKITF.

Two possible options remained for further investigation: Options 2b and 3. The choice between these options essentially came down to:

- Under Option 2b there would be a guaranteed source of funding for the Project, albeit subject to Legislative Council approval and scrutiny. However, there were concerns as to whether NPOs exist with the range of skills necessary to make the Project a success
- Under Option 3 there was no guarantee that donor funds would be forthcoming but there was greater confidence in the existence and ability of the private sector delivery agent to make the Project a success

This analysis was presented to the Harbourfront Commission in December 2011. Option 2b was preferred as it was the only readily available option unless either donor funding comes forward or a new authority, such as a Harbourfront Authority, is created in the interim.

1.4.2 Institutional Arrangements

On the assumption that the Project would be taken forward under Option 2b, the Study also determined how this option might best be arranged institutionally and implemented, including the roles and responsibilities of Government, NPOs and private sector service providers; possible contractual structures for delivering the Project; and the performance management structures for overseeing the Project.

1.5 Conclusions

This Study has shown that the development of Sites 4 and 7 in the new Central harbourfront via PPC and in accordance with the key planning parameters laid down in the UDS would not be a viable business proposition for the private sector. Even substantial revisions to the overall Project concept would not yield a financially viable outcome. Consequently, alternative PPC approaches were sought, with delivery via NPO the only readily available option.

Concerns still exist about the suitability of this option for delivering a world class new Central harbourfront, such as the lack of incentives it creates for direct private sector participation. There are also a number of issues that need to be resolved with this option, including whether NPOs actually exist with the necessary expertise and capacity to deliver, and if not whether the private sector would be willing to form a NPO to take up the project. If these issues are to be investigated further then the GHK Team would recommend that opportunity be provided for possible donors to come forward in support of Option 3 at this time.

Finally, a number of substantive breakthroughs have also been made during the course of this Study to help deliver an active, vibrant new Central harbourfront and should be noted. These primarily refer to the identification of necessary changes to the key planning parameters, including greater GFA in the western end of Site 7 for the creation of small-scale activity nodes in the waterfront park, and a more feasible Project area. The need for such changes has been recognised by the Harbourfront Commission for inclusion in future plans for the Sites.