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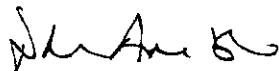
Dear Ms Cheng

Appraisal of the options for developing a Cyberport

I attach the responses to the various questions and clarification which you sought on the above report.

If you have any further questions, please do not hesitate to contact me.

Yours sincerely



Mark Ambler
Director

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Appraisal of the options for developing a Cyberport

Introduction

This note provides responses to the questions raised by Government on PricewaterhouseCoopers' report entitled "Appraisal of the options for developing a Cyberport".

(1) The total cost to Cyberport office tenants of the (a) management fee and (b) PCG's estimate of the satellite communication link fees

- (a) Based on information available today, the estimated management fee per Cyberport office tenant would be approximately HK\$5.5 per square foot (GFA) per month including air conditioning charges for normal office hour supply. The quoted management fee should be sufficient to cover general property management and air conditioning expenses. Since Cyberport office rent is expected to be much lower than market rent and the quoted management fee would be at the normal level to cover the actual costs for providing such services, the proportion of monthly management fees to rentals would be different to market norms. (Source: Larry H.C. Tam & Associates LTD.)
- (b) Satellite communication link fees will be charged to the users of the related equipment at cost. The investment and operating costs for the network and linking hardware are dependent on the bandwidth required, the originating and landing countries.

Assuming that a typical user at Cyberport is a technology company which requires 64 Kbps satellite circuit which can be configured as 4 voice/fax at 8 Kbps compression and one 32 Kbps data channel. The estimated fees chargeable monthly would be between HK\$40,000 to HK\$60,000 in today's dollars if the circuit required is between Hong Kong and one of the cities in North America, Western Europe or China. The monthly cost will include satellite transponder network monitoring & maintenance services. Please note that this is only a budgetary quote and the final fees chargeable are dependent on the tailored made service package of each user. (Source: Hutchison Corporate Access (HK) Ltd)

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(II) The definition of and formula for calculating "Return on capital employed"

The definition/formula used to calculate the return on capital employed before tax is as follows:

$$= \frac{\text{Total cash flows after financing}}{\text{Residential costs before financing} + \text{Cyberport costs before financing} + \text{Interest expense (on net cashflows)}}$$

i.e.

$$= \frac{2,437}{10,477 + 6,903 + 2,902} = 12\%$$

(III) The assumptions and formula for calculating government's interest cost of \$10.9 billion

The Government's real interest rate is assumed to be 5% per annum (or 1.2% per quarter) and it is also assumed that the project would be wholly debt financed. Interest is charged on a quarterly basis on the average balance of each quarter. For example (using "dummy" numbers):

Line	Q1	Q2	Q3	Q4
1) Opening loan	-	1,000	2,000	3,000
2) Loan drawdown in period	1,000	1,000	1,000	1,000
3) Closing loan	1,000	2,000	3,000	4,000
4) Interest roll-up in period	-	6	18	30
5) Interest roll-up b/f	-	-	6	24
6) Interest roll-up accumulated	-	6	24	54
7) Liability used to calculate interest = Line 1 + (Line 2 x 50%) + Line 6	500	1,506	2,524	3,554
8) Interest expense in period = Line 7 x 1.2%	6	18	30	43

For the purpose of the cash flow projections, it is assumed that the Cyberport as a 25 year life and the HK\$10.9 billion interest cost is accumulated accordingly.

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(IV) What is the "estimated gross cost of the Cyberport of HK\$7.3 billion" on page 16

This should read HK\$7.2 billion. The estimated gross cost of the Cyberport includes:

Cyberport costs before financing to be borne by Developer	HK\$ 6,903 million(1)
External infrastructure costs to be borne by Government	HK\$ 338 million(2)
Total	HK\$ 7,241 million

Equally, the estimated gross cost of Residential is HK\$10.7 billion. This includes:

Residential costs before financing to be borne by Developer	HK\$10,477 million (3)
External infrastructure costs to be borne by Government	HK\$ 210 million (4)
Total	HK\$10,687 million

(1) See page 12, Appraisal of the options for developing a Cyberport

(2) This is 58.5% of the total Cyberport infrastructure costs of HK\$578 million (see Appendix 3, B Construction timetable and costs). The remaining HK\$240 million is borne by the Developer and included in the HK\$6,903 million above.

(3) See page 12, Appraisal of the options for developing a Cyberport

(4) This is 56.8% of the total Cyberport infrastructure costs of HK\$370 million (see Appendix 3, B Construction timetable and costs). The remaining HK\$160 million is borne by the Developer and included in the HK\$10,477 million above.

(5) The breakdown of external infrastructure costs is listed on the attached cost estimates prepared by Levett & Bailey

(V) Reasons/assessment to support the assumption that all the residential and office space would be fully let from the third quarter of 2002 onwards

The assumed rate of take-up of the office space under Phase 1 of Option 1 is driven by three key factors:

- (a) Pacific Convergence Corporation's potential willingness to become an anchor tenant under Option 1;
- (b) PCC's ability to encourage other related technology companies to locate at the Cyberport too; and
- (c) the availability of office space at an attractive rental in an attractive development (see pages 9 - 11 of the original report).

No residential space is planned to be completed within the Cyberport site until the fourth quarter of 2002. Its take up is then linked to the occupation of the office space and PCG does not expect any difficulty in letting such residential units to Cyberport office tenants at the concessionary rental.

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(VI) Under the economic costs and benefits section (p.13), the benefits quoted there should be net of the displacement effect

It is recognised that allowance needs to be made for "displacement" when assessing the economic benefits of the proposed Cyberport. "Dead-weight" or additionality also needs to be taken into account. This has been reflected in the overall assessment of the benefits.

In assessing the benefits of the Cyberport, it is acknowledged that not all the activities which will be undertaken at the Cyberport will necessarily be additional to Hong Kong. For example, some of the businesses might operate from other sites in Hong Kong and some of the businesses might displace other businesses' development or start-up. Also some of the people employed at the Cyberport might find alternative employment in Hong Kong if the Cyberport were not to proceed.

Overall, however, it is believed that the nature of the project is such that the level of additionality will be high and the level of displacement low. This is for the following reasons:

- (a) Hong Kong's weaknesses in the area of information services mean that there are few established firms in the sector in Hong Kong – indeed, the strategic purpose of the Cyberport would be to "fast-track" Hong Kong's development in this area by attracting firms to set-up in Hong Kong;
- (b) most of the initial Cyberport tenants are expected to be multinational companies which will be servicing a broad regional market as well as the local Hong Kong market and facing competition from outside Hong Kong not within it – accordingly displacement will be low; and
- (c) it is expected that, at least initially, the key skills needed by firms operating at the site will be imported – this is a key reason why the residential accommodation is planned for the Cyberport – and this will mean that the level of employment in Hong Kong will increase together with the quality of the jobs (as reflected in the level of skills required); both effects represent net additional benefits to the Hong Kong economy.

Moreover, the level of additionality does not need to be very large for the overall benefits to be considerable when considered over the project's lifetime.

HONG KONG CYBERPORT

PRELIMINARY INDICATION OF COSTS
(at January 1999 prices)

16/1/99

1. CYBERPORT

Site area = 180,820m²
Total GFA = 241,230m²

	Estimated Costs	
	HK\$M	HK\$M
A. Infrastructure		
a. Site Formation, Access Road and Permanent Sewage Treatment (by Government)		
Site stabilization including surcharge	50.00	
Site Formation (site area = 180,800m ² approx)	20.00	
Southern access road to Victoria Road (assume about 11,500 m ²)	80.00	
Road D1 (within site) (assume about 22,000 m ²)	60.00	
Road D2 (assume about 4,000 m ²)	23.00	
Northern access road to Sha Wan Drive (assume about 8,300 m ²)	45.00	
Permanent sewage treatment plant	30.00	
Sub-total A(a)	338.00	
b. Site Formation and Utilities (by Developer)		
Temporary Sewage treatment plant		20.00
Internal Road		20.00
Underground drainage, incoming services and distribution		180.00
Temporary access road		30.00
Temporary pier (for construction)		10.00
Sub-total A(b)		240.00
B. Buildings		
Commercial Office (115,778 m ² @ \$20,000/m ²)		2,320.00
Cyber Mall (38,180 m ² @ \$25,000/m ²)		955.00
Low Rise Residential including Houses (28,945 m ² @ \$20,000/m ²)		580.00
Mid Rise Residential (48,240 m ² @ \$15,000/m ²)		725.00
Serviced Apartment (4,580 m ² @ \$20,000/m ²)		96.00
Hotel (7,477 m ² @ \$25,000/m ²)		190.00
Recreational ie tenant's club (4000m ² @ \$15,000)		60.00
Carpark (say 2,000 No @ \$180,000/No)		360.00
Sub-total (B)		5,235.00
C. External Works		
Park and landscaped external areas (allowance)		200.00
Lake or water feature (allowance)		30.00
Sub-total (C)		230.00
D. Contingencies (10% allowance)	29.00	571.00
E. Professional Fees (7% consultant + 3% PM)	43.00	827.00
Total for CYBERPORT (A to E)	410.00	6,903.00

Note: Refer to page 3 for the list of Excluded items

Refer to page 4 on allocation of construction costs of recreational area

HONG KONG CYBERPORT

PRELIMINARY INDICATION OF COSTS
(at January 1999 prices)

16/1/99

2. RESIDENTIAL

Site area = 98588m²
Total GFA = 492830m²

	Estimated Costs	
	HK\$M	HK\$M
A. Infrastructure		
a. Site Formation, Site stabilization and Sewage Treatment (by Government)		
Site stabilization	30.00	
Site formation (site area = 98588m ²)	10.00	
Permanent sewage treatment plant	170.00	
Sub-total A (a)	<u>210.00</u>	
b. Site Formation and Utilities (by Developer)		
Temporary sewage treatment (allowance)		50
Internal Road		10
Underground drainage, incoming services and distribution		100
Sub-total A (b)		<u>160</u>
B. Buildings		
Low Rise Residential including Houses (14,500 m ² @ \$20,000/m ²)		290
High Rise Residential (478,330m ² @ \$13,000/m ²)		\$220
Recreational to tenants club (27,000m ² @ \$15,000/m ²)		405
Carpark (say 5,000 No @ \$180,000/No)		900
Sub-total (B)		<u>785</u>
C. External Works		
Park and landscaped external areas (allowance)		100
Lake or water feature (allowance)		20
Sub-total (C)		<u>120</u>
D. Contingencies (10% allowance)	21.00	810
E. Professional Fees (7% consultant + 3% PM)	24.00	890
Total for CYBERPORT (A to E)	<u>255.00</u>	<u>9795</u>

Notes: Refer to page 3 for the list of Excluded items
Refer to page 4 on allocation of construction costs of recreational area

HONG KONG CYBER PORT

PRELIMINARY INDICATION OF COSTS

18/1/99

Notes:

1. All of the costs are based on Architect's preliminary sketches/information received in January 1998 and Project Development Schedule dated 11th January 1998 subject to checking and verification when detailed design information becomes available;
2. The following are excluded from the above costs:
 - a. Route 7 and associated services;
 - b. Reprovision of Pokfulam Government Kennels;
 - c. Promenade and footbridges across Route 7;
 - d. Stream improvement and realignment;
 - e. Upgrade existing sea wall;
 - f. Land costs, finance charges and legal expenses;
 - g. Marketing expenses;
 - h. Future fluctuations in building costs between time of preparing the costs and time of calling tenders