

PACIFIC CENTURY GROUP

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Delivery by hand

RICHARD LI
CHAIRMAN AND CHIEF EXECUTIVE

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Mr. K.C. Kwong
Secretary for Information
Technology and Broadcasting
Government of the Hong Kong
Special Administrative Region
2/F., Murray Building
Hong Kong

K.C.
Dear Mr. Kwong,

Cyber-Port

Thank you for your letter of yesterday's date setting out the Government's latest thinking on the Cyber-Port and the alternative proposals you have presented to PCG. I note that many of the points we have made in previous correspondence have been encompassed in the Government's position.

After consideration of the alternative proposals I have formed the conclusion that alternative #1 offers the better way forward. We have some points we would like to pursue on this alternative and the Attachment has been marked up to address these. In the spirit of trying to reach an early agreement with Government, our comments are more of the nature of fine-tuning than substantive changes to alternative #1.

I believe that this proposal has the advantage of being more straight-forward administratively and better to understand from the public perspective. The Government would retain ownership of the land and would obtain 100% of the constructed Cyber-Port. This would simplify land premium issues in particular; no land premium on the Cyber-Port proper need be levied and the constructed Cyber-Port would be payment in lieu of the land premium on the residential property that is sold. While noting your proposal to the appointment of an independent valuer in the event of disagreement on the land premium on the residential portion of the Cyber-Port project, and while not accepting the Government's previous \$5.5 billion valuation, I am proceeding on the basis that the land premium would certainly not exceed this amount. I would hope that we can agree to any outstanding points on alternative #1 today so that we can draft up a Heads of Agreement document that can be signed before the end of the week.

PACIFIC CENTURY GROUP HOLDINGS LIMITED

PCG confirms that it wishes to manage the Cyber-Port after its construction. To this end we are willing to enter into detailed discussions on a suitable set of commercial arrangements. We agree that under alternative #1 PCG would have no equity in the Cyber-Port proper but we believe we have much to offer in the professional marketing, management and operation of the facility. We would expect that financial arrangements could be structured whereby PCG could be given an incentive to be rewarded based on its achieved results in maximizing the occupancy and utilisation of the Cyber-Port. We will study this issue in greater depth and revert separately within a few days.

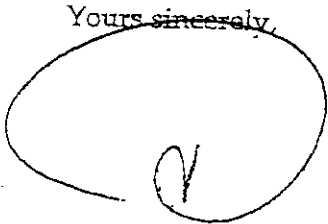
We note that in the Government's alternative #2 the JV is entitled to raise debt by mortgage of the development right (with consequent adjustment to the profit share arrangements). We believe that similar arrangements should apply in the case of alternative #1. Given the Government's concern about possible exposure to risk in these circumstances, we have suggested that the capital commitment on such debt raised could be of a bank guarantee standard or of other standard of guarantee acceptable to Government.

On a point of clarification, alternative #1 requires that PCG's capital commitment to be supported by appropriate guarantee. My understanding is that such guarantee will be provided in phases as PCG actually contributes capital to the project rather than in one large up-front guarantee.

There are two related issues on which I would like some comfort in parallel with finalising the Heads of Agreement document. The first relates to the proposed Route 7. This road (if built) would have a major negative impact on the site and we have been concerned about minimising its impact. At a minimum the road must be depressed as it passes in front of the Cyber-Port. However, we believe that there is much merit in building a tunnel section for this road. We would like the Government to work on a best endeavours basis to tunnel Route 7 and enable the Cyber-Port environment to be enhanced considerably. This would also allow scope for the expansion of the Cyber-Port in the future by allowing building over the tunneled section. The second issue relates to the various licences that PCC requires if it is to make Hong Kong an effective headquarters location. PCC has applied for five licences all of which have significant impacts on its business economics. You are aware that PCC is proposed to be a key anchor tenant of the Cyber-Port and your confirmation that it will be able to obtain all the licences it has applied for would be important in confirming PCC's commitment to Hong Kong as its base.

Let me conclude by stating my appreciation for the hard work that you and your colleagues have put into the Cyber-Port Project. Since we raised the idea with the Government in mid-last year we always knew that a project of this nature would require a different approach to become a reality. I am pleased that we are edging closer to making it a reality.

Yours sincerely,



RICHARD LI

Principal Terms of the Heads of AgreementAlternative #1 – {PCG MODIFICATIONS}

- Development Right

The Government will grant PCG the exclusive development right to design, develop and construct the Cyber-Port and the Residential Project as an integrated development. Unless specifically agreed by the Government, the development right cannot be transferred or assigned, as collateral or otherwise, to any person other than a majority-owned subsidiary of PCG, the shares of which will also be restricted from such transfer or assignment. PCG may mortgage the development right subject to adjustment to the Profit Sharing Scheme and the capital commitment conditions outlined in this document.

The development right allows PCG to share profits from the sale of the residential portion of the Cyber-port, subject to other terms and conditions as outlined in this document.

For the avoidance of doubt, the development right discussed herein does not include the right to receive and collect rental income from the Cyber-Port proper. Such arrangements are discussed separately under the section headed "Management Concession".

- Responsibility of Government

The Government will be responsible for contributing the site at Telegraph Bay site. The Government will retain ownership and titles to the land. Moreover, the Government will be responsible for the cost of the associated investment in infrastructure. This infrastructure is to include the northern and southern access roads, roads D1 and D2, public transport interchange, public promenade, footbridges, advance site works, sewerage treatment plant and sewerage outfall and any works associated with Route 7.

- Responsibility of PCG

PCG will be the designer, developer and contractor for the Cyber-Port and the Residential Project. PCG will be responsible for all construction costs (including any cost overrun) and bear any financing risk associated with the development of this project. PCG will provide performance guarantees as described below.

- Profit Sharing Scheme

Based on the equity contribution by Government and capital contribution by PCG. The land value on that part of the site for the Residential Project (i.e. excluding the Cyber-Port proper) assessed by Government will be deemed to be the Government's equity. In the event that PCG could not accept the land value on the residential portion of the Cyber-port project assessed by Government, Government would be agreeable to the appointment of an independent valuer to carry out the valuation as at a mutually agreed time.

PCG's capital contribution will be the funding requirement of the project net of debt raised by mortgage of the development right.

- **Capital Commitment by PCG** Capital Commitment by PCG must be supported by a corporate guarantee or a Letter of Credit issued by an international bank, provided that the corporate entity or the international bank providing the credit support, as the case may be, will be rated no less than A- by Standard and Poor's and Moody's or other guarantee acceptable to the Government.

Should PCG raise debt by mortgage of the development right the capital commitment to cover this amount of debt must be in the form of a bank guarantee unless specifically agreed otherwise by the Government.
- **Profit Distribution** Profit is before interest expense (i.e. assuming project is 100% equity financed).

Unless otherwise agreed, no profit distribution is allowed prior to the completion of each of the agreed phases of the Cyber-port proper. After completion of the Cyber-Port proper, profit can be distributed net of the provision of the Development Fund as described below.
- **Development Fund** A Development Fund will be set up with injection from the profit on the basis of the Profit Sharing Scheme set out above. The total injection must be sufficient to cover (a) the full reinstatement of shared facilities, assuming their renovation, as necessary, in year 5 from the start of operation; and (b) the accumulated deficit, if any, of the Cyber-Port Project for the first 5 years of operation.
- **Completion Guarantee** PCG will guarantee the timely completion of the Cyber-Port project at a pre-determined time table and a fixed-price, and will guarantee completion to pre-agreed specification. Penalty provisions to be discussed with the Government.
- **Project Specification and Construction** To be agreed with Government. A consultation process, with Government and anchor tenants' participation to be set up. In addition, an independent engineering firm (to be mutually agreed) will be appointed to review the design and monitor construction.
- **PCC's Take-Up Guarantee** PCG to undertake to sign a long-term lease as one of Cyber-Port's anchor tenants. In addition, PCG would occupy at least 7,000 sq.m. of office space, and if the remaining space was not taken up by other tenants 36 months after completion of construction, PCG will undertake to occupy not less than 20% and not more than 50% of the total office space in the first 5 years of the completion of Phase I of the Cyber-Port project and such residential space as permitted under an allocation mechanism to be agreed with Government.

- **Mix and Rights of Tenants** PCG must come up with at least 5 anchor tenants' names to be agreed with the Government before announcement. In addition, tenants should enjoy free, unrestricted access to multi-media and telecommunication services.
- **Management Concession of the Cyber-Port** Managed by PCG with accountability of management to a Board appointed by the Government. PCG will provide a detailed proposal on how to manage and run the Cyber-Port proper following which commercial arrangements will be negotiated and agreed between PCG and the Government.
- **Rental Levels** At a level to be agreed, with reference to comparable rental levels at the Silicon Valley and other Cyber-ports, and subject to annual increase according to inflation.
- **Provision of Financial Statements and Construction Costs** Government to have reasonable access to PCG accounts and to receive timely provision of financial statements from PCG.

(Subject to contract and receipt of Town Planning Board approvals).