

File Ref.: ITBB/CP 303/2 (00)

LEGISLATIVE COUNCIL BRIEF
CYBERPORT PROJECT AGREEMENT

Introduction

At the meeting of the Executive Council on 9 May 2000, the Council noted that we had reached agreement with Pacific Century Group (PCG) on the Project Agreement relating to the Cyberport project at Telegraph Bay, Pokfulam. The Project Agreement was subsequently signed on 17 May 2000. This note sets out the main terms of the Project Agreement.

Background

2. The Financial Secretary announced in the 1999-2000 Budget the Government's intention to proceed with the Cyberport project at Telegraph Bay, Pokfulam in cooperation with PCG. The Cyberport (Cyberport Portion) aims to create a strategic cluster of leading information technology (IT) and information services (IS) companies and a critical mass of professional IT/IS talents in Hong Kong in the shortest possible time. By providing a high quality living and working environment supported by a state-of-the-art telecommunication backbone and wide range of IT facilities, leading IT/IS companies as well as professional IT/IS talents will be attracted to, and retained in, Hong Kong. This is our flagship project to put Hong Kong firmly on the global IT/IS map. The ancillary residential development (Residential Portion) will generate revenue to drive the Project.

3. On 29 April 1999, the Administration submitted a paper to the Information Technology and Broadcasting (ITB) Panel and the Planning, Lands and Works Panel of the Legislative Council (LegCo) setting out the main terms of the Letter of Intent (LOI) we had entered with PCG, as follows –

- (a) PCG would be responsible for the total construction cost of the Project (both the Cyberport Portion and the Residential Portion);
- (b) after setting aside sufficient funds to complete the Project and the setting up of a \$200 million Development Fund (to offset any operation deficit during the initial operating period and cover cost for replacement of common facilities), surplus sales proceeds from the sale of the units in the Residential Portion will be shared according to the respective capital contributions by both parties. Government's capital contribution will be the value of the land for the Residential Portion (Residential Portion Land Value) at the time of grant of Development Right to PCG, while PCG's capital contribution will be the outturn of the peak funding requirement;
- (c) PCG will be responsible for the design, construction, development and marketing of the Cyberport, including risks related to the financing and construction of the Project. PCG will provide :
 - (i) a completion guarantee to Government that the Project will be completed on time and all cost overrun will be PCG's responsibility;
 - (ii) a bank guarantee (or corporate guarantee of the same quality), at any point before the completion of the whole Project, to ensure the availability of six months anticipated cashflow;
 - (iii) a bank guarantee (or corporate guarantee of the same quality) if PCG creates encumbrances on the Development Right in raising financing for the Project. In addition, such debt will not be counted towards PCG's capital contribution for the purpose of profit sharing; and
 - (iv) a take-up guarantee by PCG to take up extra space if the Cyberport Portion does not attract tenants as envisaged. PCG would occupy at least 7,000 sq. m of office space in Phase I, and if the remaining space of the Cyberport Portion was not taken up by other tenants 36 months after completion

of construction, PCG will take up not less than 20% and not more than 50% of the total office space within the first 5 years of the completion of Phase I; and

- (d) PCG may not assign or transfer its right to design, construct, develop and market the Cyberport to any person without the prior approval of Government except in the case of an assignment or transfer to a majority-owned subsidiary of PCG. This company will be subject to the same restrictions as PCG was in which event PCG must guarantee all the obligations assumed by such subsidiary.

4. The LOI set out the broad framework for the development of the Cyberport project and was "Subject to Contract". In our earlier progress reports to the ITB Panel, we told Members that we had prepared a draft detailed Project Agreement to serve as the basis for discussions with PCG and we would brief Members on the main terms of the Project Agreement after it had been concluded. We also informed Members that the title of the land earmarked for the Cyberport project would be vested in a limited company which we had set up for this purpose, namely Hong Kong Cyberport Development Holdings Limited. The Financial Secretary Incorporated (FSI) was the sole owner of this Holdings Company (FSI Holdings) which in turn held two wholly-owned subsidiaries. The first subsidiary (FSI SPV1), named "Hong Kong Cyberport Management Company Limited", would take a sub-lease of the Cyberport Portion while the second subsidiary (FSI SPV2), named "Hong Kong Cyberport (Ancillary Development) Limited", would be assigned with the Residential Portion. These three companies (FSI companies) would sign the Project Agreement with PCG and would grant the Development Right to PCG by mid-2000.

The Project Agreement

5. On 17 May 2000, the three FSI companies signed the Project Agreement with Cyber-Port Limited, which is a company set up under PCG to perform the role of the Cyberport Developer, and with its Parent Company, which is Pacific Century CyberWorks Limited (PCCW). The Project Agreement provides a detailed, legally binding contract for the whole project

period which would last from the commencement of the Cyberport works (mid-2000) to completion of the sale of all the units in the Residential Portion (at least up to mid-2007). The main terms of the Project Agreement are summarised in paragraphs 6 to 25 below.

Grant of Development Right, Parent Company Guarantee and Control Undertaking

6. The Developer, Cyber-Port Limited, will be granted the Development Right which will enable it to design, develop, construct and market the Cyberport Portion and the Residential Portion as an integrated development. The Developer will not obtain any right, title or interest in or to the land comprised in the Cyberport Portion and the Residential Portion, save for the grant of the Development Right. The Developer will be required to hand back to the FSI SPV1 the completed Cyberport Portion and to sell the units in the Residential Portion in the open market. While the Developer is entitled to receive a share of the surplus sales proceeds to be derived from the sale of the units in the Residential Portion (after applying the sales proceeds to meet any outstanding Project costs), the rental income and any other income to be generated from the Cyberport Portion belong to the three FSI companies.

7. The Development Right may not be transferred, assigned or otherwise disposed of by the Developer without the prior consent of the FSI companies. PCCW, as the Parent Company of the Developer, will provide a Parent Company, Performance and Completion Guarantee to guarantee the due performance and timely completion of the Cyberport project. If there is any change of control of PCCW without the consent of the FSI companies prior to termination of the Project Agreement, the FSI companies may terminate the Project Agreement with no compensation payable to the Developer.

8. FSI Holdings, on the other hand, is entitled to transfer or assign its rights to a minority part of its share of the Proceeds Available for Distribution to third parties. Any transferee or assignee will be provided with customary minority shareholder protection of rights, but the FSI companies shall remain responsible for all its obligations and liabilities under the Project Agreement.

Design and Construction

9. The Developer will bear all the construction risks for this Project which will span over a total of seven years. The Developer guarantees that it will proceed with the Project in accordance with the pre-agreed design and specifications, according to a pre-determined timetable and at a fixed price.

10. On the design and specifications for the Cyberport, the Developer is required to procure a world-class IT/Telecommunications infrastructure. As to the residential works, the Developer is required to provide a high class residential development. The Developer must adhere to the design and specifications approved by the FSI companies for both the Cyberport Portion and Residential Portion. The FSI companies may also disallow part of the construction costs if the Developer fails to meet the approved design and specifications and such disallowed construction costs will be solely borne by the Developer (as a PCCW Expense).

11. The Developer is required to meet the following completion dates (Key Dates) for these eight phases of works: December 2001 (Cyberport Phase 1); December 2002 (Cyberport Phase 2); December 2003 (Cyberport Phase 3); June 2004 (Residential Phases 1 and 2); June 2005 (Residential Phase 3); June 2006 (Residential Phase 4); and June 2007 (Residential Phase 5). The Developer will need to pay liquidated damages, on a daily base, for its failure to complete the different phases within the prescribed timetable.

12. On 29 April 1999, we advised Members that the total construction cost for the Project was estimated to be \$13.7 billion(Bn) as at December 1998 prices. This figure of \$13.7Bn (at December 1998 prices) will become \$16.2Bn at the Money of the Day (MOD) prices. However, PCG agreed to use a lower figure of \$15.8Bn as the agreed fixed price, in MOD terms. If and when any construction costs incurred by the Developer exceeds this fixed price (i.e. cost overrun) the Developer must pay the cost overrun and any cost overrun related expenses out of its own resources (as a PCCW Expense).

13. The construction costs to be borne by the Project will be the actual construction costs or the fixed price, whichever is the lower figure. The Developer is required to adopt open and fair tendering procedures. The

Developer shall also ensure that the tender specifications will allow open and fair competition. The FSI companies may raise reasonable objections in respect of the identity of any proposed contractors. Each contractor is required to provide a warranty and performance bond.

Financing Arrangement

14. The Developer is responsible for the provision and procurement of funds to meet all Project Expenses. It has therefore taken on all the financing risks of the Project. Part of the Project Expenses will be met by the sales proceeds collected from the sale (and pre-sale) of the units in the Residential Portion, starting from the 4th quarter of 2002. The Developer is required to fund the shortfall, particularly so at the early stage of construction before sales proceeds are made available. The Developer may contribute money from its own equity or from borrowings at its corporate level, thus counting such amount towards the Developer's capital contribution. The Developer agrees to provide from its own resources (as a PCCW Expense) a Cashflow Guarantee provided by a bank (rated no less than A- by Standard and Poor's and A3 by Moody's) or any other guarantee of the same quality for an amount not less than the forecast net cashflow requirements for six months in advance at any point in time throughout the Project.

15. The Developer may fund part of the Project Expenses from debts raised by encumbering its Development Right. This will be Project Level Debt (PLD) and will **not** be counted towards the Developer's capital contribution. Such PLD will be repaid by the Project. However, the Developer is expressly prohibited from creating any Security Interest over the Land (which the Developer acknowledges that it has no title to), the Cyberport Portion and the Residential Portion and any building or structure thereon. PLD Lenders will not be able to exercise a power of sale in respect of the Residential Portion or the Cyberport Portion.

16. The LOI provides that the Developer should provide a bank guarantee (or corporate guarantee) if it raises PLD. PCG has agreed that a bank guarantee should be obtained for PLD Lenders that either they will step in to rescue the Project if the Developer defaults or they will have to surrender the Development Right to the FSI companies. To protect the interests of the FSI

companies, we have prescribed the form of the Direct Agreement to be entered into with PLD Lenders. PCG agrees that it should solely pay for the costs for the Direct Agreement as a PCCW Expense.

Sale of Units and Application of Sales Proceeds

17. The Developer is required to procure the sale of all units in the Residential Portion in accordance with budgets approved by the FSI companies. However, FSI SPV2, as owner and vendor, retains rights to approve the form of the Sale and Purchase Agreement, the sale prices and other sales arrangements proposed by the Developer. FSI SPV2 may also terminate the Developer from its responsibilities to perform the sales services if the Developer commits a breach of its obligations and duties or if the Developer engages in any conduct materially prejudicial to the Developer's obligations in relation to the sale of these units.

18. We have agreed with the Developer a set of agreed principles to be used to form the basis of the Secured Accounts Agreement which governs how the sales proceeds (and other project income) will be held in a secure environment by an "A" rated Account Bank (and managed by an independent Security Trustee) strictly in accordance with the following manner and order:

- a) **first** towards funding construction costs due and payable at the relevant time in respect of the Cyberport Portion and thereafter towards funding construction costs due and payable at the relevant time in respect of the Residential Portion;
- b) **secondly** towards establishing an amount adequate to cover the outstanding construction costs of the Project;
- c) **thirdly** towards funding interest payments, principal repayments or prepayments and payments of other sums due to PLD Lenders;
- d) **fourthly** towards funding at least \$200 million to cover the replacement costs of the shared facilities on the fifth year of operation of the Cyberport and the accumulated operating deficit of the first five years;

- e) **fifthly** towards funding other project expenses; and
- f) **thereafter**, any balance will be distributed as surplus sales proceeds in accordance with the agreed percentages based on the respective contribution of both parties. The Developer's distribution will be first credited into a Developer's surplus proceeds suspense account and such money will only be paid to the Developer until and after the completion of the entire Cyberport Portion; the receipt of confirmation that there are no events of default occurring and continuing and that the Developer has paid all cost overrun and other PCCW Expenses.

Marketing and Promotion

19. The Developer agrees to work together with the FSI companies in general marketing and promotion of the Cyberport project upon obtaining approval of the FSI companies of budgets, promotion material and publicity programmes. The FSI companies or their nominated representatives may also engage in any general marketing and promotion of the Cyberport project and charge the expenses to the Project as well.

IP Rights

20. The Developer has agreed that all IP created, acquired or used by the Developer or any of its consultants, sub-contractors, agents or licensees prior to or after the execution of the Project Agreement will be owned by FSI Holdings.

Tax

21. The Developer has agreed that it should pay its tax from its own resources as a PCCW Expense and not to charges such tax payment to the Project.

Take-up Guarantee

22. Under the LOI, PCG was required to provide LOIs signed by at least 5 anchor tenants to be agreed with the Government. PCG itself should also undertake to sign a long-term lease as one of the anchor tenants and to provide a take-up Guarantee to take up extra space if the Cyberport Portion does not attract tenants as envisaged. PCG have now produced LOIs from 14 multinational companies (Cisco, CMGI, Hewlett-Packard, Hikari Tsushin, Hua Wei, IBM, Legend, Microsoft, Oracle, Portal, Silicon Graphics, Softbank, Sybase, and Yahoo!) and has committed that Pacific Convergence Corporation (a PCG company) will sign a long-term lease as one of the anchor tenants. In addition, another 105 companies, local and overseas, have approached us to register interest in becoming tenants.

23. As demand is likely to greatly exceed our office provision and we would wish to accommodate about 130 companies in the Cyberport, we firmly believe that dropping PCG's take-up guarantee would be in our favour. PCG has agreed not to pursue its space requirement in the context of the Project Agreement. As in the case of those other companies which have signed LOIs to become anchor tenants, PCG's space requirement will be determined by the tenants selection committee set up under FSI SPV1.

Representations, Warranties, Undertakings and Indemnities

24. The Developer has agreed to provide extensive representations and warranties in favour of the FSI companies. The Developer also will undertake to the FSI companies in respect of an extensive range of matters, such as effecting and maintaining in full force the insurances necessary for the Project, provision of audited financial statements, compliance with laws, environmental matters, etc. Furthermore, the Developer will give a broad indemnity in favour of the FSI companies (in connection with their exercising of their approval rights and provision of information).

Remedies Upon Default or Termination

25. An extensive range of events of default are provided for in the Project Agreement, including insolvency, change of control of PCCW and the

Developer, non-payment, failure to complete the various phases of works by the Key Dates and any breach of other obligations under the Project Agreement. Where an event of default occurs, the Developer will no longer be allowed to issue any funding request and its other performance obligations may also be suspended. The Developer is required to remedy its breaches within the specified grace periods out of its own resources (as a PCCW Expense) and to reimburse the FSI companies for any cost/loss incurred as a result of its breaches (again as a PCCW Expense). If any of the breaches is not remedied by the Developer (or the PLD Lenders as referred to in paragraph 16 above), the FSI companies may terminate the Project Agreement. The compensation for the costs already incurred by the Developer may be provided only at any such time as FSI Holdings may deem appropriate if there are still sales proceeds left after the completion of the Cyberport, after enough money has been reserved for meeting other project requirements and for compensating the FSI companies for their loss and costs, but subject always to the amount of compensation not exceeding the Developer's deemed share of surplus proceeds up until the time the Project Agreement is terminated. In some circumstances (such as change of PCCW or the Developer), the Developer is not entitled to any compensation upon termination of the Project Agreement.

Conclusion

26. We managed to arrive at an agreed version of the Project Agreement that is consistent with the broad framework prescribed by the LOI. Some new terms (in relation to tax, IP rights, sales services, management of sales proceeds, promotion of the Project, warranties and undertakings, defaults and termination, etc) have been negotiated to give the best protection to the Government. The Project Agreement provides a detailed, legally-binding contract specifying Government's controls and PCG's obligations in all aspects.

27. The Government has transferred most of our risks to the Developer, and we are only required to share the market risk relating to the sale of the units in the Residential Portion. Our risk analysis is as follows –

- a) Construction Risks - The FSI companies have significant control and influence on the Project while the risks are to be borne by the Developer itself. The Developer is required, for example, (i) to

seek consent to the appointment of key officials (such as Designer, Project Manager, Quantity Surveyor and Independent Checker); (ii) to seek approval on changes to the scope of the Project, design and specifications; (iii) to provide timely forecast cashflow requirements and audited financial statements; (iv) to go through open and fair tendering procedures in selecting contractors; (v) to obtain warranty and performance bonds from individual contractors; (vi) to pay liquidated damages for failure to meet the Key Dates; and (vii) to pay for any cost overrun above the fixed price.

- b) Financing Risks – The Developer has agreed to take on all the financing risks. PCG should make capital contribution to the Project out of its own resources (and guaranteeing such capital contribution by an ongoing six-monthly Cashflow Guarantee) and/or raise PLD (and entering into a prescribed form of Direct Agreement with the Lenders). PCG should pay a range of expenses (e.g. the Developer's tax, the cost of providing the six-monthly Cashflow Guarantee, and cost of its capital contribution) out of PCG's own resources.
- c) Management Risk – The Developer has agreed to protect the interests of the FSI companies by providing an extensive range of guarantees, undertakings and indemnities. PCG should procure the sale of the Residential Portion in accordance with the arrangements to be approved by the FSI companies, but the sales proceeds will be held in an "A" rated bank and managed by an independent security agent strictly in accordance with the prescribed manner and order.
- d) Default/Completion Risks – The FSI companies will be protected from default or completion risks as the following arrangements: (i) the restriction imposed on the transfer or assignment of the Development Right; (ii) PCCW providing a Parent Company, Performance and Completion Guarantee; (iii) the extensive rights enjoyed by FSI companies in a wide range of events of default; (iv) no or limited compensation to the Developer on termination of the Project Agreement; (v) absolute ownership of the land and IP rights

to enable the FSI companies to proceed with the Project upon termination of the Project Agreement; and (vi) right to drawdown the prevailing six-monthly Cashflow Guarantee upon the occurrence of an event of default or upon termination of the Project Agreement.

- e) Market Risks – The financial returns for the Government and PCG will be affected by the timing and percentage of units to be sold during pre-sale, at completion and post-completion, variations in the residential sales price, the Developer's mix of its capital contribution and PLD, and the Residential Portion Land Value. However the Government's risks are minimised by our receipt of the asset of the completed Cyberport Portion in phases in three consecutive years starting end 2001. The FSI companies will retain 100% ownership of the Cyberport Portion. Therefore prior to, and in addition to, the pro-rata sharing of surplus sales proceeds with the Developer, the FSI SPV1 also receives "early recoupment" of at least part of Government's equity contribution through the receipt of the Cyberport Portion (which would cost \$6.1Bn).

Next Steps

28. We shall be in a position to grant the Development Right to the Developer soon (around early-June 2000), upon compliance with the conditions precedent as specified in the Project Agreement, such as receipt of the Cashflow Guarantee and insurance documents, and acceptance of conceptual design, etc. The Residential Portion Land Value will be assessed by the Lands Department on the date of the grant of the Development Right. The Developer may dispute the Residential Portion Land Value within 14 days. If no agreement can be reached between the Developer and the FSI companies, not less than two or not more than three independent valuers mutually acceptable to the Developer and FSI Holdings may be appointed to determine the Residential Portion Land Value within 21 days after their appointment. We will brief the LegCo ITB Panel at its meeting on 12 June 2000 on the main terms of the Project Agreement and the grant of the Development Right.

Financial and Staffing Implications

29. The open market value of the land for the Residential Portion (i.e. the Residential Portion Land Value) will be used in determining Government's equity contribution to the Cyberport project for the purpose of calculating our share of the surplus sales proceeds available under the Project Agreement. We will therefore be in a better position to make financial projections upon receipt of the Lands Department's assessment of the Residential Portion Land Value as at the date of the grant of the Development Right.

Publicity

30. A press release will be issued on the signing of the Project Agreement in the afternoon of 17 May 2000.

Enquiries

31. For any enquiries relating to this Brief, please contact Miss Annie Tam, Deputy Secretary for Information Technology and Broadcasting at telephone number 2189 2266 (fax number: 2827 2424).

Information Technology and Broadcasting Bureau
17 May 2000