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**Cabinet Memorandum**

Number:

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**MEMORANDUM FROM FINANCE MINISTER**

**PORT KLANG FREE ZONE DEVELOPMENT PROJECT,  
PULAU INDAH SELANGOR**

**PURPOSE:**

This Memorandum is to seek the Cabinet's consideration and approval for:

- (i) to give retrospective approval for the project costs of developing Port Klang Free Zone at Pulau Indah, Selangor to be increased from RM1.088 billion to RM4,632,732,000;
- (ii) Klang Port Authority to be given soft loans up to RM4,632,732,000; and
- (iii) to give retrospective approval to the government to guarantee the bonds issued and created to the total sum of RM4,632,732,000 including the coupons of Kuala Dimensi Sdn Bhd. This approval is needed due to the series of *Letter of Support* issued by the honourable Transport Minister these letters of which are implicit of the government's guaranty in law.

**BACKGROUND**

2. Port Klang Free Zone (PKFZ) Project is a project between the Malaysian government and the government of United Arab Emirates (Jebel Ali Free Zone International) with the vision to attract foreign investors to Malaysia and to improve our country's competitiveness comparing with others and also to make Port Klang the main port in this region. This project will be a principal catalyst to boost economic activities and development at Pulau Indah and to increase the number of cargo handled by Port Klang.

3. The Cabinet had on 24 Mac 1999 given approval for Port Klang Authority (PKA) to buy a parcel of land in Pulau Indah measuring 830-acres for the development of the PKFZ Project. On 14 February 2001, the Cabinet had accepted the offer for the government to purchase additional land in the vicinity measuring 170 acres hence giving it a total acreage of 1,000 acres.
4. The Cabinet was on 21 February 2001 notified that the 1000-acres land costs RM1.088 billion at RM25 per square foot. Taking into consideration the development cost and interest of RM1.352 billion, the total project cost is RM2.44 billion. However, the Finance Ministry and the Attorney-General's Department are concerned with the Finance burden borne by the government, the status and costs of land together with the issue of landownership.
5. Be that as it may, on 2 October 2002, the Cabinet agreed to purchase the land for the PKFZ project at Port Klang after the honourable Transport Minister explained that this project is poised to proceed without any Finance support from the government and that legal issues concerning the land had been resolved. However, on 9 October 2002, the Cabinet agreed to defer its decision pending the Finance Ministry perusing the assessment report submitted by the Attorney-General's Department with regards the land acquisition.
6. On 23 October 2002, the Cabinet had considered the Memorandum from the Finance Ministry which annexed the assessment report submitted by the Attorney-General's Chambers as Appendix A. In consequence thereof, the Cabinet agreed that the land be acquired by the Transport Ministry pursuant to section 3(1)(a) of the Acquisition Act 1960. The value of the land is to follow the valuation of the Valuation and Property Service Department (*Jabatan Penilaian & Perkhidmatan Harta*) at RM10.16 per square foot. Syarikat Kuala Dimensi Sdn Bhd is given the opportunity to prepare the land and carry out infrastructural development on the *design and build* basis and the price is to be negotiated provided that approval from the Finance Ministry must be sought if the cost exceeds RM100 million.
7. On 6 November 2002, the Cabinet has agreed and reaffirmed its decision made on 2 October 2002 that is to acquire the land by way of sale and purchase. An Agreement of Sale and Purchase was to be entered into between PKA and KDSB, and PKA was to make initial payment of 10% (RM108.8 million) with the balance (RM979.6 million) to be paid within 15 years.

8. The honourable Transport Minister had on 28 May 2003 issued a Letter of Support to the Malaysia Rating Corporation Berhad (MARC) stating that the government shall at all times ensure that PKA will fulfill all its obligations in accordance with the time and amount specified. Based on this Letter of Support, a series of bonds were issued by Syarikat Tujuan Khusus (SPV) to KDSB to finance the purchase and development of the land. The issuance of the bonds had attracted many interested investors with its AAA rating. Details of the bonds issued are as follows:-

<b>DATE ISSUED</b>	<b>AMOUNT ISSUED (RM)</b>	<b>PERIOD</b>	<b>PURPOSE</b>
30 July 2003	1.31 billion	30 July 2007 to 28 July 2017	Purchase of Land
3 November 2004	1.095 billion together with Medium Term Note (MTN) 360 million	Bond: 2 November 2007 to 2 November 2012 MTN: 3 November 2010 to 2 November 2012	To pay for Land Development
30 March 2006	510 million and MTN 85 million	Bond: 30 November 2007 to 30 November 2011 MTN: undetermined	To pay for Land Development
26 September 2006	RM410 million and MTN RM70 million	Bond: 3 November 2008 to 3 November 2010 MTN: undetermined	To pay for Land Development

9. On 25 February 2004, the honourable Transport Minister had obtained approval in principle from the honourable Prime Minister to complete the entire project in a single phase and appoint a *turn key developer* to complete this project. In its premise, PKA had negotiated the extra scopes with KDSB and the project cost has increased to RM4,632,732,000.00 consisting of land purchase price RM1.7 billion and development cost RM2.9 billion. However, the increase in the project cost was affirmed without any reference to any approving agency.

10. On 6 April 2005, when presenting the PKA Annual Report and Finance Statement for the Year 2003, the Cabinet agreed that PKA takes all necessary action to prepare sufficient funds without the Finance assistance of the Federal government for the finance of the PKFZ development project cost, estimated at RM1 billion commencing 2007.

11. On 26 August 2005, 14 December 2005 and 16 October 2006, the Transport Ministry had applied to the Finance Ministry to the effect that PKA be given Finance assistance in grants, government loans with 4% interest and a moratorium to repay in 6 years. Loan to the sum of RM1.8 billion to be disbursed progressively at the same time the land purchase price is satisfied by government grant. However, these applications were rejected by the Finance Ministry premised upon the Cabinet decision of 6 April 2005.

12. In early December 2006, the Finance Ministry was informed by *lead arranger* that Letters of Support were issued by the honourable Transport Minister for the issuance of several bonds. On 14 December 2006, the Finance Ministry sought clarifications from the Transport Ministry and gave notice that any letter of guarantee can only be issued with prior approval from the Cabinet and such letter of guarantee can only be issued by the Finance Ministry.

## **BASIC ELEMENTS FOR CONSIDERATION**

Based on the records of actions taken, the Finance Ministry noted the following matters:

- (i) PKFZ was approved by the Cabinet as a result of information that this project is progressive and self-financing. However, when the project was carried out, it was found not progressive and the project costs soared to RM4,632,732,000.00. The initial cost of the project was only RM1.088 billion and if there is any extra work scopes exceeding RM100 million, the same must be transmitted to the Finance Ministry for consideration.
- (ii) As a matter of principle, if there is any change to be made to the earlier decision of the Cabinet, such a change must be brought to the Cabinet for consideration.

- (iii) Government guaranty can only be issued by the Finance Ministry after it has first obtained Cabinet approval. Letter of Support issued by the honourable Transport Minister can be considered illegal and void. However, the content of the letter carried with it the elements of guaranty because the rating given to those bonds were AAA, same as the rating given on bonds issued by the government. Further, if PKA as a government authority defaults, it is an obligation of the government to bear the liabilities, and,
- (iv) The PKFZ project has been completed and in use. Further, there is an agreement executed between PKA and KDSB. In the premise, retrospective approval is necessitated.

## **FINANCE IMPLICATION**

14. Government must assume the financial consequences of the loan to the sum of RM4,632,732,000.00 granted to PKA. There was no financial allocation under the 9<sup>th</sup> Malaysia Plan and the Transport Ministry will have to apply for the allocation. The government's contingent liability may increase to as much as RM4,632,732,000.00 if PKA cannot redeem the bonds that had been issued. This amount does not include Medium Terms Notes amounting to RM85 million and RM70 million respectively which are not issued yet.

## **CONCLUSION.**

15. The PKFZ project was carried out to realize the government's vision to turn Port Klang into the main port in the country and distribution hub in this region. This project is also a new free zone concept known for the merging of two activities, i.e. *Free Industrial Zone* and *Free Commercial zone* in one locality.

16. To retrospectively approve it by the government will enable the PKA to continue its active involvement in the development of PKFZ. In addition, PKA as a government concern cannot be left to

become insolvent and the government must give its assurance to boost the confidence of investors who took up those bonds issued. To this, we are only obligated to the pay KDSB commencing this year, in the sum of RM510 million and additional grants must be ready for the years 2008 until 2010.

## **EXPLANATION BY MINISTRY / PRINCIPAL AGENCY**

### **17. Economic Planning Unit**

The Economic Planning Unit, the Prime Minister's Department (UPE, JPM) took notice that the cost of developing PKFZ will escalated from RM1.088 billion to RM4.6 billion. To protect the image of the government as PKA is a government authority, UPE agreed to the suggestion at Paragraph 20 of the Finance Ministry's Memorandum which is to ensure that the development of PKFZ be proceeded smoothly. The 5-Year Malaysia Plan will have to allocated to pay the project costs of RM4.6 billion. The Transport Ministry is requested to make use of its allocations under the 9<sup>th</sup> Malaysia Plan to rationalize and re-organize all its projects. The allocation under the 9<sup>th</sup> Malaysia Plan must ensure that it has the cash flow for the years 2007-2010. Following from this, the UPE, JPM will seriously censure any act to carry out any project without Cabinet decision, as the one detailed in this Memorandum.

### **18. Transport Ministry**

“The Transport Ministry supports and agrees with the suggestions as stated in Paragraph 20 of this Memorandum. The suggestions thereat will ensure that *Port Klang Free Zone* (PKFZ) will be developed according to plan. At this juncture, a total sum of RM470 million has been invested by foreign companies in PKFZ and this represent 14% occupancy of the land/building in PKFZ. It is projected that another RM341 million will be invested here by the end of the year and bringing the occupancy rate to 35%.”

### **19. Attorney-General's Department.**

This Department has perused the suggestions of this Memorandum concerning the development project of *Port Klang Free Zone* (PKFZ), Pulau Indah, Selangor and we give our opinion as follows:

- (a) the suggestion to retrospectively approve the escalated costs for the development of *Port Klang Free Zone* (PKFZ), Pulau Indah, Selangor from RM1.088 billion to RM4,632,732,000.00; and
- (b) PKA be given loan of up to RM4,632,732,000.00

are basic issues.

2. However, our department wishes to draw to the attention of the Cabinet the following issues:

- (a) through the Memorandum of the Finance Ministry submitted to the Cabinet meeting on 23 October 2002, the Attorney-General's Department had given the opinion that the 1000-acres land in Pulau Indah should be acquired pursuant to section 3(1)(a) Land Acquisition Act 1960 [Act 486] and not to buy directly from KDSB because –
  - (i) the market price as valued by the Valuation and Property Services Department (*Jabatan Penilaian & Perkhidmatan Harta*) is RM10.16 per sq ft whereas the purchase price is a hefty RM25 per sq ft; and
  - (ii) KDSB has no capacity to transfer its land proprietorship to the government as the subject land has too much encumbrances such as charges and caveats.

[ A copy of the detailed opinion of the Attorney-General's Department with regards to the matters above is appended as Appendix B].

- (b) Despite that, the Cabinet had made a decision on 6 November 2002 to purchase the subject land and the sale and Purchase Agreement dated 12 November 2002 was signed between Kuala Dimensi Sdn Bhd (KDSB) and the Port Klang Authority (PKA). In the premise, PKA had bought 1000 acres of land in Pulau Indah, Selangor from KDSB at a purchase price of RM1,088,456,000.00 with a payment of M108,845,600.00 (equivalent to 10% of the purchase price) paid by PKA to KDSB. Thereafter, the balance of the purchase price in the sum of RM979,610,400.00 is to be paid by PKA to KDSB over a

period of 15 years with interests chargeable at 7.5% per annum. The formula of payment resulted in the balance of the purchase price payable by PKA to be escalated to RM1,699,625,000.00.

- (c) the PKFZ Project Development Agreement dated 27 February 2003 to develop the subject land in Pulau Indah was signed between PKA and KDSB granted the project cost at RM400 billion subject to professional fees and interests of 7.5% per annum chargeable on the amount to be paid by PKA to KDSB. However, 5 Supplementary Agreements were executed on these dates, respectively:
- (i) 26 May 2003- First Supplementary Agreement;
  - (ii) 27 March 2004- Second Supplementary Agreement;
  - (iii) 30 November 2005- Third Supplementary Agreement, appointing KDSB to design, build, fund and complete the additional development works of PKFZ project under the *turn-key* concept;
  - (iv) 26 April 2006- Fourth Supplementary Agreement with the purpose to raise the interest rate to from 5% to 7.5% and that the amount to be paid by PKA for the additional development works to be paid in 2011 with an increased costs of RM156.490 million; and
  - (v) 26 April 2006- Fifth Supplementary Agreement that KDSB was appointed to carry out further additional development works for the PKFZ project under the *turn-key* concept valued at RM335.8 million subject to final costing to be done by PKA and KDSB.

The effect of the five Supplementary Agreements and the formula used to calculate the

payment for land under the Sale and Purchase Agreement is the escalating costs of the entire PKFZ project from RM1.088 billion to RM4,632,701,000.00.

- (d) As the PKFZ Development Project is under the *turn-key* concept, KDSB as a contractor has to fund the project development cost. In this regard, KDSB had incorporated four (4) Single Purpose Vehicle (SPV) companies and they are:-
  - (i) Special port Vehicle Berhad;
  - (ii) Free zone capital Berhad;
  - (iii) Valid Ventures Berhad; and
  - (iv) Transshipment Megahub Berhad.
- (e) All these four SPV have already issued bonds valued at RM3.840 billion (including the Medium Term Notes valued at RM0.515 billion) with the repayment valued at RM 4,632,732,000.00 (not including the Medium Term Notes valued at RM 0.515 billion)
- (f) It should be noted that the bonds issued by all the four SPV were given rating of “AAA” based on, amongst others, the Letters of Support issued by the honourable Transport Minister, on 28 May 2003, 23 April 2004, 8 December 2005 and 23 May 2006.
- (g) Besides that, it should be noted that one of the SPV that is the Special Port Vehicle Berhad had made use of part of the proceeds of the issued bonds in the sum of RM1,008,412,150.00 to acquire the balance of the Purchase Price which is receivable by KDSB from PKA pursuant to the Sale and Purchase Agreement. It means that KDSB had assigned its right to balance of the Purchase Price under the Sale and Purchase Agreement to Special Port Vehicle Berhad and this was agreed to by KPA.

3. In the premise, the Attorney-General’s Department is of the opinion that it is legitimate proper

and clear to ascertain that the soft loan in the sum of RM4,632,701,000.00 to be given to PKA represents the actual the sum that is to be paid to the SPV. It is also proper to ensure that the said sum of payment is made in accordance with the terms and conditions specified in the Sale and Purchase Agreement and the PKFZ Development Agreement (including all the Supplementary Agreements made thereunder).

4. With regards the suggestion for retrospective approval of the government guaranty concerns the issued bonds valued at RM4.633 billion include KDSB coupons, this department is of the opinion that the Letters of Support issued by the honourable Transport Minister represents a guaranty, that the provisions of section 14 Financial Procedure Act 1957 (Act 61) must be complied with, that prior consent must be sought and obtained from the Treasury.

5. In the premise of the above opinion, the suggestion in Paragraph 20 of this Memorandum can be given due consideration.”

## **SUGGESTION**

20. That the Cabinet is requested to consider and approve:

- (i) to give retrospective approval for the project costs of developing Port Klang Free Zone at Pulau Indah, Selangor to be increased from RM1.088 billion to RM4,632,732,000;
- (ii) Klang Port Authority to be given soft loans up to RM4,632,732,000; and
- (iii) to give retrospective approval to the government to guarantee the bonds issued and created to the total sum of RM4,632,732,000 including the coupons of Kuala Dimensi Sdn Bhd. This approval is needed due to the series of *Letter of Support* issued by the honourable Transport Minister these letters of which are implicit of the government’s guaranty in law.

- signed -

Finance Ministry  
Putrajaya

22 June 2007