



APG Asset Management Asia  
荷蘭匯豐投資亞洲有限公司

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To: **The Securities and Futures Commission**  
35/F Cheung Kong Center  
2 Queen's Road Central  
Hong Kong

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**APG Asset Management**

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**Re: Consultation Paper on Amendments to the Code on Real Estate Investment Trusts**

Dear Sirs/Madams,

We are writing on behalf of APG Asset Management ("APG"), an asset manager of pension schemes in the Netherlands, with assets under management totalling approximately EUR345 billion as of December 2013. As a longstanding investor in the Hong Kong listed real estate market, we submit our views on the Consultation Paper on Amendments to the Code on Real Estate Investment Trusts ("REIT Code").

First of all, we appreciate the Commission's clear approach to the spirit of the new REIT Code proposal, particularly that: *"the Commission is mindful of the need to strike a proper balance between facilitating market development and competitiveness on the one hand, and ensuring the protection of investors' interests and market integrity on the other."* We firmly believe that investor protection and market integrity are fundamental to achieving sustainable market development and long-term economic success.

The main purpose of REITs is to generate a stable and recurring income stream for investors, where their risk profiles may be maintained at manageable level. Such characteristics of REITs are important features which long-term investors such as pension asset managers look for in their investments. In particular, pension asset managers are responsible for generating sustainable absolute cash returns to assist their clients, i.e. pension funds, in meeting their pension liability requirements at any given year. Therefore, we hope that any amendments to the REIT Code would not undermine these important REIT features.

In contrast to their nature and main characteristics, REITs in Hong Kong are misconceived as rather risky assets among investors, which may have resulted from a number of issues including certain groups of asset owners, such as MPFs, being restricted from investing in REITs. Whether such market misconception can be resolved may not be the main purpose of the Consultation Paper and should perhaps be discussed separately. However, we hope that the proposed amendments to the REIT Code would not further such market misconception. We submit that this can perhaps be resolved by: 1) building clear rules/guidance to mitigate potential risks arising from the proposed relaxed rules, 2) enhancing disclosure requirements so that investors can make an informed decision on their investments, and 3) resolving issues that may have been sources of concerns for investors, such as fair value calculation of property development.

Our submissions in response to the specific questions in the Consultation Paper on Amendments to the REIT Code are set out in Annex 1 to this letter.

We appreciate the opportunity to submit our views on the proposed amendments to the REIT Code for the Commission's consideration. We would welcome any opportunity to engage in further discussions in the future. Please contact :



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## Annex 1:

### APG Response to the List of Specific Questions Raised in the Consultation Paper

#### Question 1: Do you consider that flexibility in respect of property development investments and related activities should be introduced for REITs?

We support in principle REIT Code amendments that will allow REITs to participate in property development investments and related activities within certain limits.

#### Question 2: Do you consider that the 10% GAV Cap is set as an appropriate threshold?

We view the proposed 10% GAV Cap as a reasonable threshold.

#### Question 3: Do you have any comments on how the Property Development Costs should be calculated?

The Consultation Paper proposes a revision of the REIT Code to calculate Property Development Costs on an "at cost" basis. We believe calculation on a fair value basis is more appropriate.

A clear and explicit set of guidance on fair value calculation needs to be set out in the REIT Code. It is stated in paragraph 16 of the Consultation Paper that: "In ensuring compliance with the 10% GAV CAP, the Commission proposes that the upfront calculation of Property Development Costs...should be based on a fair estimate made by the REIT Manager in good faith and supported by the opinion of an independent expert acceptable to the Commission." We think that the language stated seems a bit weak compared to the utmost importance attached to this issue and degree of potential impact when something goes wrong.

Having regard to the potential impact of issues which may arise from this, we submit that for the purpose of paragraph 16 of the Consultation Paper, the REIT Code should be amended to clearly state that the upfront calculation of Property Development Costs shall be conducted by an independent valuer with appropriate expertise and profile and shall be disclosed to the public. We also submit that there should at least be a review on an annual basis of the fair value of the property development once the property development commences.

Interests incurred associated with property development should be accrued, in-line with general accounting standards.

#### Question 4: Do you have any comments on the frequency of periodic updates that should be provided to unitholders on the status of property development investments and related activities?

Periodic updates should be provided on a half-yearly basis. Disclosure required for such purpose should include progress of development and any changes in costs and fair value.

#### Question 5: What additional safeguards do you consider appropriate to ensure there will not be any material change to overall risk profile of a REIT despite the flexibility to engage in a limited extent of property development investments and related activities?

Alignment of interest between unitholders and REITs is extremely important. Fees and other costs and expenses related to property development should be properly disclosed. Any development in excess of 5% GAV should require unitholders' approval.



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**Question 6: Do you have any comments on the proposed scope of the Relevant Investments and the proposed Maximum Cap?**

We have a few concerns with regards to the proposed scope that allows a greater flexibility for REIT managers to invest in a broad range of financial instruments. We think that this is an area where REIT investors may potentially witness a material change in the risk profile of REITs in light of reverse / volatile market conditions. We would like to emphasise that the responsibilities of REIT managers should be primarily placed on: (1) managing cash prudently; and (2) implementing active investor-reward policies. From an investor perspective, these responsibilities are far more important than making extra returns from investing in financial instruments.

The Consultation Paper refers to comments from some REIT managers requesting the SFC to consider more flexible cash management approaches, especially when it is difficult to identify suitable property acquisition opportunities due to market conditions. We think that such a situation should be considered as a good opportunity to increase distributions to unitholders, which is in fact in line with REITs' main objective and broadly recommended as one of the good governance practices.

We do agree that there may be an aspect of mutual benefits which REITs and REIT investors may enjoy if REIT managers are allowed to invest cash in financial instruments. However, the proposed scope of financial instruments is too broad and loosely defined, which may give REIT managers excessive flexibility, leading to unwanted consequences. Therefore, we submit that the proposed scope of investment by REITs in financial instruments should be considerably narrowed down and clearly defined with more detailed guidance. We believe this is necessary to keep the overall risk profile of REITs at a manageable level—a more fundamentally crucial objective for the sake of the REIT market.

More specifically, we think that a REIT investing in unlisted debt securities should not be allowed, in order to keep the REIT Code consistent with paragraph 35(ii) of the Consultation Paper which states: "*the Relevant Investments should be sufficiently liquid, could be readily acquired/disposed of under normal market conditions...and has transparent pricing.*" In addition, we also believe that, when allowing a REIT to invest in government and other public securities, there should be a clear threshold that takes into account the credit quality of such securities.

The "property funds" as referred to in the proposed 7.2B of the REIT Code should be clearly defined to take into account the characteristics of currently available property funds in the market. For instance, it should be made clear 1) whether fund of funds investments are allowed or not, 2) whether or not investing in property funds which involve in development activities should fall under the 10% GAV cap.

We also suggest that the amended REIT Code should explicitly emphasize that REIT managers, prior to deploying cash into the "Relevant Investments" referred to in the proposed paragraph 7.2B of the REIT Code, should conduct a thorough review and disclosure to investors on the following in respect of managing these "Relevant Investments":

- Expected degree of management distraction;
- Quality of internal expertise and/or external resources to be used; and
- Risks arising from such investments and the quality of the related compliance / internal control / risk management systems in place.

We submit that the cap on holding of the Relevant Investments issued by any single group of companies to no more than 5% of the gross value of a REIT can be deleted from the proposed paragraph 7.2B(i) of the REIT Code. In our view, the REIT Code should not dictate how concentrated or diversified a REIT's holding in the Relevant Investments should be. The REIT managers as investment professionals should be allowed to use their expertise to manage concentration risk where there is adequate disclosure. Instead, we submit that any "Relevant Investments" over 5% of the gross value of a REIT should be subjected to unitholders' vote.

We are not particularly concerned about the Maximum Cap set at 25% of GAV. In our view, this is an appropriate level of flexibility.



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**Question 7: What other safeguards do you consider appropriate to be put in place corresponding to the proposal to allow for the Relevant Investments?**

The exact holdings of all Relevant Investments and each of their respective fair values should be disclosed in the financial reports.

We encourage the Commission to review the application of the Codes on Takeovers and Mergers and Share Repurchases to REITs, and resolve and/or provide guidance on the SFC's regulatory approach to any inconsistencies between the application of these Codes in light of the REIT Code. For example, the currently proposed limits may have unintended consequences of prohibiting any takeover opportunity of another REIT.

—The End—