



香港證券經紀業協會有限公司
HONG KONG STOCKBROKERS ASSOCIATION LIMITED

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**RESPONSE TO
DRAFT PRACTICE NOTE ON
OVERSEAS INVESTMENTS
BY
SFC-AUTHORISED
REAL ESTATE INVESTMENT TRUSTS**

**Hong Kong Stockbrokers Association
26 April 2005**



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Background

1. The SFC proposes to relax restrictions on SFC authorised Real Estate Investment Trusts (REITs) which limited investments only to Hong Kong situated properties.
2. The consultation paper is a draft practice note on overseas investments by authorised REITs. The key provisions of the practice note relates to the safeguarding of overseas investments, valuation issues, and enhanced disclosure of risks.
3. We agree that authorised REITs should be allowed to invest in non-Hong Kong situated properties. This would put Hong Kong in line with other major jurisdictions, and allow REITs management to tap into opportunities in the other markets, including China market.
4. However, we also concur that additional steps should be taken to ensure that there are appropriate and sufficient safeguards for investors, including:
 - a. Due diligence on ownership.
 - b. Valuation.
 - c. Timely and transparent disclosure.



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Management

5. We concur with the SFC's view on restricting REITs management company to management of one REITs until it has demonstrated sufficient expertise and resources.
6. With regards to competence requirement, we agree that management of REITs falls within the definition of Type 9 and therefore must be licensed by the SFC. We believe that the core competence is asset management and that property management expertise is of secondary importance.

Due diligence and valuation

7. We agree with the stipulation that a Hong Kong qualified "principal valuer" be responsible for the valuation of all properties. Where the "principal valuer" uses an overseas valuer, it should ensure that the accepted standards are used to avoid disparities. This would also ensure that underlying value of properties of different Hong Kong licensed REITs are comparable.
8. This is a similar arrangement to using a single firm of auditors in all overseas locations so as to ensure that the same set of standards is applied throughout. However, we are concerned that valuers are not regulated either by a regulatory authority (as required of asset managers or securities dealers) or by a self-regulatory organization (such as with the HKICPA). Therefore, even though the Hong Kong based "principal valuer" is held ultimately responsible, there is still no guarantee on the quality of the valuation.
9. We concur with the need to appoint a trustee to safeguard the assets of the REITs, and to ensure that the management company acts in the best interests of the REITs holders. Therefore it is imperative that due care should be given to the appointment of independent and credible trustees. In this connection, we suggest that only bank owned trustees be eligible as trustees of REITs.



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Gearing

10. We agree that currency risks can be hedged by borrowing a higher percentage of the property costs in the foreign currency. We are not in a position to comment on the appropriate level of gearing although REITs are often perceived by the general public as a relatively low risk investment vehicle. We suggest that the level of gearing proposed and employed be included as required disclosure.

Regulation of REITs

11. We concur that the SFC should levy charges on all regulated products and entities on a cost recovery basis. We understand that cost recovery will be on an overall basis for a class of products and not on a case-by-case basis on individual application.
12. It is clear that where a REITs is listed on the HKEx, it is subject to the listing requirements (in future to be strengthened by statutory backing). However, we are concerned that a licensed REITs selling unit to the public at large have all the hallmarks of a listed company but is only required to adhere to a voluntary Code of Practice and the SFC's Practice Notes.
13. The over-riding principle is that the management of REITs must be fair and that investors' interests must be properly safeguarded. In view of this, we would like to point out that allowing payment of management fees by way of issuance of units may pose a moral hazard in that the management company may have insider knowledge, and may have the ability to influence disclosed valuations.