

Response to the Consultation Paper on Relaxation of the Geographical Restriction on Overseas Investments by SFC-Authorised Real Estate Investment Trusts

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Firstly, we would like to state our strong support for the proposal to relax the geographical restriction on overseas investments being included in Hong Kong registered REITs authorised by the SFC. This is a restriction which should not have been introduced in the first place and which has limited the development of REITs in Hong Kong.

We also support the following principles:

- that all REITs, whether invested in Hong Kong or overseas properties, should be regulated by the same Code on REITs and there should not be separate rules for different jurisdictions. This will ensure confidence in the product.
- that the management company in each case must have the requisite competence, experience, resources and appropriate risk control systems. It should also be required to conduct all proper due diligence taking into account the risks and characteristics of the relevant overseas jurisdictions and the types of properties intended for acquisition by the REIT. In this connection, the proposed amendment of the SFO to clarify that managers of SFC-authorised REITs are asset managers and are required to be licensed as such is considered acceptable so long as property portfolio management is designated as a core competency for such licensees together with relevant investment management experience.
- that each operator of a REIT, including its management company, valuer, listing agent, trustee and auditor, has its own duties and responsibilities with respect to the REIT and its investors. All parties should be expected to discharge these responsibilities properly, professionally and with all due care; and
- that clear, proper and timely disclosures must be made at all relevant times.

In general, we support the thrust of the draft Practice Note but would make the following comments:

Qualifications of Valuers in Overseas Jurisdictions

Whilst the principle regarding commensurate qualifications as expressed in the Practice Note is clearly correct, it should be noted that in practice it may be difficult in some locations/jurisdictions to demonstrate the comparability of local qualifications with those recognised in Hong Kong and that due weight should be given to local experience and reputation in such circumstances. In particular, there may not be a national professional

organisation for valuers as such, even though valuation practice in the jurisdiction may be quite acceptable by international standards, due to local valuers adhering to the standards of international rather than national organisations or institutions.

Valuation Reports

It is noted that the Practice Note call for a valuation report in respect of an overseas property should include, in addition to the normal information, “socio-economic information on the relevant market and a description of the political, environmental or other risks associated with the relevant market”. Such commentary, particularly in respect of socio-economic conditions and political risk, would not normally form part of a property valuation and not all valuers, no matter how experienced in the valuation of local properties, may have the knowledge and expertise to form such judgments.

The following are our comments on the specific issues set out in the Consultation Paper:

(1) Based on the experience of REITs in other jurisdictions, do you think the limit on gearing should be raised to 40-50% from the current 35% stated in the Code?

We would be in agreement with an increase in gearing to 40-45%.

(2) What special product features do you think that the Commission should consider permitting in product application?

We have no strong views on features as such but care needs to be taken that any feature, while seeming to align the interests of those managing the REIT, does not create a perceived or real conflict of interest.

(3) Should the REIT application fee be levied on a cost recovery basis?

Yes, in principle we would agree with this approach.

(4) Do you have any views on whether the management company could/should take out professional indemnity insurance and title insurance?

In our view, management companies should take out both professional indemnity (PI) insurance cover and title insurance. However, satisfactory PI insurance cover is not easy to secure in Hong Kong and prior to any requirements being put in place, the SFC should ensure that suitable and applicable cover at reasonable rates can be obtained in the local market.