

Comments on the SFC's Consultation Paper on Draft Practice Note on Overseas Investments by SFC-Authorised REITs

29 Apr 2005

Privacy

Please withhold our name from publication. Thank you very much.

Introduction

We are pleased to submit comments to the Hong Kong Securities and Futures Commission ("SFC") in response to its Consultation Paper on Draft Practice Note on Overseas Investments by SFC-Authorised REITs (the "Consultation Paper").

Lifting of restriction on overseas investments for REITs

The SFC has decided to lift the restriction on overseas investments for Hong Kong-listed REITs.

Comment: We are pleased and congratulate the SFC on its decision as we believe this will improve the attractiveness of Hong Kong as a listing location for REITs without compromising the protection afforded to investors.

We support the SFC's proposed operational requirements. For instance, the need to have the relevant competence, experience and resources in assessing overseas properties, to establish the property management and risk management systems, to use IFRS reporting standards etc.

We also support the SFC's disclosure requirements. For instance, title issues and risks, and valuation methods.

However, we feel other proposed rules could be restrictive if not interpreted flexibly. These include:

- ◆ SFC will license a manager to manage only one REIT that holds overseas properties

Comment: We support this requirement provided that this is interpreted at the manager level only, and not also at the holding company of the manager, if any. This is because most managers would form dedicated teams to manage each REIT.

- ◆ SFC may impose restrictions on the type of overseas properties, their locations, and the maximum size of the REIT.

Comment: We argue that, for investor choice, this decision is best decided by the market, the caveat being sufficient disclosure.

- ◆ The same high standard of due diligence is required regardless of location

Comment: Whilst we are in general concurrence with this, we believe that under a disclosure regime, setting a minimum due diligence standard may not be appropriate due to different local circumstances. Rather any deficiency in actual due diligence should be disclosed.

- ◆ The REIT must own at least 50% of the property, and the terms of any joint-venture must be assessed by legal opinion and disclosed

Comment: We argue that the key is full payout from any property which the REIT is to own. Whether it is majority ownership or not is secondary but would be decisive if it was indeed majority ownership. In cases of minority ownership, there ought to be sufficient provisions to ensure that full payout will be achieved.

- ◆ The Principal Valuer must be qualified in Hong Kong, but can appoint an overseas valuer with supervision

Comment: We argue that this ought to be decided on a case-by-case basis, and internationally recognised valuation qualifications being sufficient. Otherwise, imposing this requirement strictly would unnecessarily increase the costs to the REIT and, ultimately, investors.

Proposals for Competence Requirements of REIT Managers

The SFC is proposing to recognise property portfolio management expertise as being a core competency, which means it is now prepared to directly accept a property portfolio manager as a REIT manager provided that it also possesses in-house relevant investment management expertise.

Comment: We support this change as this would facilitate existing property owner-managers in setting up REITs. However, we would also emphasise that strict standards ought to be followed to ensure the REITs are managed by managers with sufficient skills.

Specific questions asked in the Consultation Paper

Comments were also sought for four other questions

- (i) SFC has not decided to relax the gearing restriction of 35%. The Consultation Paper seeks the public's comments on whether to increase this to up to 50%

Comment: We are in favour of the optimal gearing level being judged by the market as is the case in Australia and Japan. However, if a gearing restriction is to be imposed, we would support a level higher than the current 35% imposed by

the SFC for reasons mentioned by the SFC in the Consultation Paper (ability to reduce currency risks for overseas investments and also lowers the overseas tax expenses). We would argue that the limit ought to be at least 50%.

- (ii) SFC is considering allowing special product features on a case-by-case basis, e.g. payment of fees in units. What features should be allowed?

Comment: We are supportive of this change on a case-by-case basis. In addition, the features that the SFC should give blanket approval include payment of base fee in units and allowing performance fees based on net property income.

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

Comment: We do not have any strong views on this question but would support measures that do not make it overly expensive for REITs to list in Hong Kong.

- (iv) Should the manager take out professional indemnity insurance and title insurance?

Comment: We support the argument that managers should take out professional indemnity insurance. As for title insurance, we argue that it should be taken on a case-by-case basis, and not mandatorily, based on an assessment of the risks to title by the manager.