

24-February-2014

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

Dear Sir/Madam,

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

I am submitting this letter in response to the invitation by the Securities and Futures Commission to comment on its Consultation Paper on Amendments to the Code on Real Estate Investment Trusts (the "Consultation Paper"). This letter is focused on questions concerning property development investments (question 1), GAV Cap threshold (question 2), and Relevant Investments and proposed Maximum Cap (question 6).

**I. Property development investments and related activities should be introduced for REITs (question 1)**

The Consultation Paper proposes to increase the flexibility for REITs by introducing property development investments and related activities. My comments begin by totally opposing this consideration. The REITs market in Hong Kong has been growing steadily and healthily for the past years. Investors also have gained confidence in this market mainly because of the well-structured legal and regulatory frameworks and the Commission's close scrutiny of the compliance with REIT Code by the REIT managers.

To begin, under the current REIT Code, REITs is restricted to investment in income-generating real estate where investment in vacant land or engaging or participating in property development is prohibited. By introducing the property development investments and related activities into the REIT Code, this will incur a whole new spectrum of risks and uncertainties associated with property development activities.

The Commission, being the gatekeeper on this front, has at the same time illustrated some of the potential risks like construction risk, legal risks, time delay risks and other concerns, which could be mitigated by implementing comprehensive process to safeguard the stability of the REIT. However, those risks are not exhaustive, where some risks may not be identifiable at the time of entering into the development project, such as SARS in 2003 or global financial crisis in 2008/09, nor be enough to educate the market and investors of the inherent risks associated with property development.

Finally, and critically, given Hong Kong REIT market relatively small in the Asia Pacific region, together with the prevailing volatility of the property market in Hong Kong, It is simply not a right time to permit REITs to participate or engage in property development. Also, given the

individual asset size of the REITs, I do believe most of the REITs cannot benefit from this flexibility.

Question 1: I strongly dis-agree that introducing property development investment and relevant activities can bring flexibility to the REIT market. **In contrast, this proposal will add more risks and uncertainties to the originally stable REIT market.**

## **II. 10% GAV Cap is set as an appropriate threshold (question 2)**

I have expressed my view in opposing the property development proposal. I also hold a strong view that using GAV as a cap and a measurement of the threshold is too aggressive. In order to mitigate the risk in using a high-ceiling threshold, I would like to suggest using net asset value as a basis for calculation of the cap for the permissible amount of participation in property development. This could minimize the degree of the risks to which REIT stakeholders will be exposed.

## **III. Proposed scope of the Relevant Investments and the proposed Maximum Cap (question 6)**

Firstly, I am not supportive to this particular proposal to permit a REIT to invest in non-real estate assets. Investment in non-real estate assets requires completely different skillset and knowledge and new expertise may need to be hired.

Secondly, the range of investment strategy may create an investment strategy overlap with existing unitholders which are also equity or debt investors. This will create more confusion to the market participants.

Thirdly, investment in such non-real estate assets may, directly or indirectly, encourage the REIT to engage in the investments of speculative nature, or high risk investments and the REIT managers to raise capital blindly by investing in those non-real estate assets which may not require unitholders' approval.

Lastly, the Maximum Cap of 15% of the gross asset value of the REIT to invest in this proposal will definitely be damaging the fundamentals of a REIT, that are initially setup primarily to generate recurrent rental income from property. The scope is also too wide as in contradicting one of the fundamentals of REITs, which is having a well-defined and focused investment strategy.

Question 6: Proposed scope of the Relevant Investments is too wide and overlapping with the investment strategy of equity/debt investors, damaging the uniqueness of REIT as an investment instrument. The Maximum Cap is also too large (15%) of the gross asset value.

Thank you for the opportunity to comment on the Consultation Paper. If further discussion of these comments would be help to the Commission, I would be pleased to assist.