



羅兵咸永道

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

26th February 2014

Dear Sirs,

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

We refer to the subject consultation paper ("the Paper") and would like to put forward below our comments for your consideration. Unless otherwise defined, terms used herein shall have the same meanings as those defined in the Paper.

In general, we welcome the proposal to allow greater flexibility in the investment scope of REITs by permitting REITs to invest in properties under development, engage in property development activities and invest in certain types of financial instruments, subject to certain conditions. We consider such relaxation will be beneficial to the development of REITs and investors. This in turn will facilitate the long-term development of the Hong Kong REIT market and thus promote the role of Hong Kong as an international financial centre.

10% GAV Cap

We consider it is appropriate to set a cap for property development investments and related activities as this can help maintaining a REIT's profile as primarily a recurrent rental income generating vehicle, limiting the REIT's exposure to the risks associated with property development investments and related activities and protecting investors' interests. However, we consider setting the cap at 10% of GAV may not benefit REITs with a small property portfolio, say less than 10 properties held, or a small GAV, and may put them at a less competitive position than REITs with a larger property portfolio or a larger GAV. Currently, 7 of 10 REITs listed in Hong Kong hold less than 10 properties. Setting the cap at 10% of GAV will hinder these REITs from enjoying the benefits of the relaxation, or even making the relaxation completely impractical for them. Accordingly, we consider it is important for the Commission to take into account the views of REITs with a small property portfolio or a small GAV in finalising the appropriate percentage of the cap.

Calculation of Property Development Costs

The Paper sets out that the Property Development Costs refer to the total project costs borne and to be borne by the scheme, inclusive of the costs for the acquisition of land (if any) and the development or construction costs. We consider it is beneficial to have such guidance in the Code. For further clarity, we consider the Commission can set out in the Code that "the total project costs borne" should be adjusted to reflect the latest fair value in arriving at the Property Development Costs for considering whether the 10% GAV cap is exceeded or not. This is to ensure the Property Development Costs are calculated on the same basis as the GAV. In calculating the GAV, both investment properties under development and completed investment properties are accounted for using fair value basis pursuant to Hong Kong Financial Reporting Standards ("HKFRS") or International Financial Reporting Standards ("IFRS").

Frequency of periodic updates

We agree that REIT managers should keep unitholders informed of the position of the property development investments and related activities undertaken by the REIT by issuing an announcement upon the REIT entering into the relevant contracts and providing updates in the subsequent interim and annual reports. However, we consider requiring REIT managers to issue an announcement irrespective of the amount of the contract may create an undue burden where the individual contractual amount is insignificant. We propose that a threshold shall be set for such purpose. In this regard, the Commission may consider the threshold adopted for discloseable transactions under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

Scope of the Relevant Investments

In the Paper, it is proposed that the Relevant Investments can be unlisted debt securities and local or overseas property funds provided that, among others, the Relevant Investments should be sufficiently liquid, could be readily acquired/disposed of under normal market conditions and in the absence of trading restrictions, and has transparent pricing. Given it may be quite judgemental in assessing whether an unlisted debt security and / or a local or overseas property fund, in particular in the case of an unlisted local or overseas property fund, meet the aforementioned liquidity and transparent pricing requirements, we recommend the Commission to provide further guidance on this area.

Further to the conditions set out in the Paper for the Relevant Investments, for investments in debt securities, we propose that the Commission can consider limiting the investments to debt securities with a certain minimum credit rating so as to manage the REITs' exposure to risks associated with such investments and protect investors' interests. For example, in Singapore, REITs can only invest to debt securities with either a minimum short-term rating of F-2 by Fitch, P-2 by Moody's or A-2 by Standard and Poor's, or where it only has a long-term rating, such a rating of A by Fitch, A by Moody's or A by Standard and Poor's.

25% GAV Maximum Cap

In the Paper, it is proposed that "real estate related assets" should be included as "other miscellaneous non-real estate holdings" for the purpose of determining whether the 25% GAV Maximum Cap is exceeded. However, we consider that as real estate related assets are integral parts of the real estate that generates recurrent rental income and contribute to the rental value of the investment properties, these items should not be included in the calculation of the 25% GAV Maximum Cap. Rather we consider that the "real estate related assets" should be included in calculating and determining whether the REIT fulfils the requirement of having at least 75% of the gross asset value of the REIT being invested in real estate that generates recurrent rental income at all times. Accordingly, we urge the Commission to revisit whether the "real estate related assets" should be excluded from the calculation of the 25% GAV Maximum Cap.



Disclosures on Relevant Investments

Note (2) of 7.2B in Appendix A of the Paper sets out that the management company shall publish the full investment portfolio of the Relevant Investments of the scheme with key information relevant to such Relevant Investments on its website on an ongoing basis which shall be updated monthly within five business days of each calendar month end. We recommend the Commission to consider setting a threshold for the disclosure of the investment portfolio since the disclosure of the full investment portfolio may be excessive. Further, assuming the key information relevant to such Relevant Investments includes the fair value of the Relevant Investments, it may be difficult for the scheme to obtain the fair value of unlisted property funds within five days of each calendar month end.

In addition, we recommend the Commission to clarify the disclosure requirement for the Relevant Investments. It is currently unclear on the extent of disclosure of the Relevant Investments: by name of the investments held or by type or by other classifications and the key information of the Relevant Investments. In considering this, the Commission could consider to take into account the disclosures required under the current Hong Kong Companies Ordinance and HKFRS. Under the current Hong Kong Companies Ordinance, companies listed in Hong Kong have to disclose the aggregate amounts of their listed investments and unlisted investments separately. In addition, HKFRS requires companies to disclose the hierarchy of fair value of their financial instruments by classifying them into levels 1 (based on quoted prices in active markets), 2 (based on observable inputs) and 3 (based on valuation technique). More extensive disclosures are required for financial instruments under level 3 since more judgement is involved.

Taxation

We understand REIT taxation is not specifically consulted in the Paper. Nevertheless, we would like to set out our high level view over this matter in this letter for your reference.

We believe tax incentives will be an effective tool to grow the REIT market and this has been supported by the growth of REIT markets in other jurisdictions. We consider that there are three possible ways to deal with the taxation of REITs – Option (1) a combination of exemption from tax at the REIT level (and its subsidiaries) and imposing withholding tax on the distribution to investors, Option (2) full tax transparency, and Option (3) outright exemption from profits tax. The choice among these alternatives or the retention of the status quo should be subjected to further discussion as each approach has its potential advantages and disadvantages.

In addition, currently, a REIT or its subsidiaries pay stamp duty on a direct property acquisition. Stamp duty makes it unattractive to transfer properties directly to a REIT or its subsidiary. Providing a remission of stamp duty on property acquisition by a REIT or its subsidiary may encourage greater REIT formation.

We urge the Commission to work with the Hong Kong SAR Government on this matter.

We hope the above are helpful. If you would like to discuss any matters further, please do not hesitate to contact

Yours faithfully,