



SECURITIES AND  
FUTURES COMMISSION  
證券及期貨事務監察委員會

**CONSULTATION PAPER ON INVESTMENTS  
IN REAL ESTATE INVESTMENT TRUSTS BY  
COLLECTIVE INVESTMENT SCHEMES  
AUTHORISED UNDER THE CODE ON UNIT  
TRUSTS AND MUTUAL FUNDS**

《有關根據〈單位信託及互惠基金守則〉  
獲認可的集體投資計劃投資於房地產  
投資信託基金的諮詢文件》

Hong Kong  
February 2005

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**A CONSULTATION PAPER ON  
INVESTMENTS IN REAL ESTATE INVESTMENT TRUSTS BY  
COLLECTIVE INVESTMENT SCHEMES AUTHORISED UNDER  
THE CODE ON UNIT TRUSTS AND MUTUAL FUNDS**

The Securities and Futures Commission (“SFC”) invites market participants and interested parties to submit written comments on the proposals discussed in this consultation paper or to comment on related matters that might have a significant impact upon the proposals **no later than 24 March 2005**. Any person wishing to submit comments on behalf of any organization should provide details of the organization whose views they represent.

**Please note that the names of the commentators and the contents of their submissions may be published on the SFC website and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this consultation paper.**

**You may not wish your name and/or submission to be published by the SFC. If this is the case, please state that you wish your name and/or submission to be withheld from publication when you make your submission.**

Written comments may be sent

By mail to: Investment Products Department  
The Securities and Futures Commission  
8/F Chater House  
8 Connaught Road Central  
Hong Kong

By fax to: (852) 2877 0318

By on-line submission: <http://www.sfc.hk>  
(Please enter into the subsection “Consultation papers and Conclusions” under the section “Speeches & Publications” on the website <http://www.sfc.hk>)

By e-mail to: [ipconsult@sfc.hk](mailto:ipconsult@sfc.hk)

For further information, please contact the Investment Products Department at (852) 2840 9259.

Additional copies of the consultation paper may be obtained from the above address of the SFC. A copy of this paper can also be found on the SFC website at <http://www.sfc.hk>.

Investment Products Department  
Securities and Futures Commission  
Hong Kong

February 2005

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# **CONSULTATION PAPER ON INVESTMENTS IN REAL ESTATE INVESTMENT TRUSTS BY SCHEMES AUTHORISED UNDER THE CODE ON UNIT TRUSTS AND MUTUAL FUNDS**

## **INTRODUCTION**

The Securities and Futures Commission invites comments from the public on the proposal to allow investments in real estate investment trusts (“REITs”) which are listed and traded on a stock exchange by collective investment schemes authorised under the Code on Unit Trusts and Mutual Funds (collectively termed as “SFC-authorised schemes”).

The aim of this consultation paper is to solicit market feedback on the proposals that will enable SFC-authorised schemes to invest in listed REITs. A summary conclusion will be published after the end of the consultation period and all comments from the public will be carefully considered before the proposals are finalized and incorporated into the Code on Unit Trusts and Mutual Funds (the “Code”).

## **BACKGROUND**

### ***Current prohibition on investments in real estate by SFC-authorised funds***

Real estate is generally illiquid and real estate transactions may not be effected on a timely basis. The lead-time between the sale of real estate and the receipt of sale proceeds is also longer than that of financial asset transactions. Given these characteristics, significant investments in real estate by SFC-authorised schemes, which are open-ended schemes, will adversely affect the ability of the schemes to liquidate their real estate assets to meet redemption requests and to pay redemption proceeds to scheme holders on a timely basis. According to Chapter 6.14 of the Code, payment to holders should be made no more than one calendar month after the receipt of a properly documented request for redemption.

From a valuation perspective, an SFC-authorised scheme that invests in real estate will not be able to derive a timely valuation of the scheme’s assets on a frequent basis. The absence of such valuation impairs the ability of the scheme to ascertain subscription and redemption prices on a monthly basis at the minimum, as a scheme is required under Chapter 6.13 of the Code to provide at least one regular dealing day per month.

Given the above, Chapter 7.14 of the Code provides that “*a scheme may not invest in any type of real estate (including buildings) or interests in real estate (including options or rights but excluding shares in real estate companies).*” In order to prevent circumvention of such prohibition, Chapter 7.11 of the Code further stipulates that where investments are to be made in a collective investment scheme, “*such scheme’s objective may not be to invest primarily in any investment prohibited by this Chapter, and where such scheme’s objective is to invest primarily in investments restricted by this Chapter, such holdings may not be in contravention of the relevant limitation.*”

### ***Recent developments in real estate investments and REITs***

In recent years, to the extent permitted within their investment mandates, some investment managers have added real estate investment into their portfolios, due to the attractive yields generated on such investment vis-à-vis the interest rates generally earned on interest-bearing instruments. Interest in real estate investments has also been driven by the unique attributes of real estate:

- (1) the correlations of real estate with both stocks and bonds are fairly low, thus the inclusion of real estate in a portfolio provides diversification benefits in terms of risk and return;
- (2) a relatively large percentage of the total return of real estate investment is derived from recurrent yield, thus adding a stable source of income to an investment portfolio;
- (3) real estate investments have historically generated stable average annual real rates of return of 4% to 6%, which are competitive risk-adjusted returns given the low volatility of such returns; and
- (4) real estate exhibits hedging capabilities.

Investments in real estate have increasingly been conducted through REITs. Supported by the demand for real estate investments and the move to securitize real estate assets, there has been a strong growth of REITs in recent years. In addition to the US, there has been a proliferation of REITs in various countries, such as Australia, Korea, Japan and Singapore.

Originally formed in the 1960s as unlisted schemes in the US and Australia, professional operators and managers of REITs in these countries generally took their REITs public since early 1990s. As a result, the number of listed REITs in the US grew from around 90 in 1991 to around 170 in 2003. Market capitalization of listed REITs in the US nearly doubled during the period to US\$210 billion by 2003. The growth in listed REITs was also seen in jurisdictions such as Australia, Japan and Korea.

In some countries, like the US, Australia and Singapore, some REITs were also included in the S&P 500 Index, the Australian All Ordinaries Index and the Straits Times Index respectively. Since the mid-1990s, a number of appraisal-based benchmarks have also been formulated by database providers and property-related organizations like the Property Council of Australia to track the performance of real estate stocks (including REITs). All these developments suggest the mainstream status achieved by REITs.

In general, listed REITs are subject to stringent disclosure requirements. Such requirements, together with the need to file reports with the regulatory authorities, contribute to a high level of transparency of the REIT market.

Information transparency is also attributable to the increase in research coverage on REITs as a result of investors' interests in such investment vehicles. Detailed research reports on individual REITs and the markets in which they invest in have become prevalent.

In view of the above growing popularity of REITs and their unique investment characteristics, investment managers of SFC-authorized funds have also indicated interest in investing in REITs as a means to improve the returns of their portfolios without substantially altering the risk profile of the same. Therefore, the SFC issued a circular in November 2004 to inform the fund management industry that SFC-authorized schemes may invest in SFC-authorized REITs by way of Chapter 7.11 of the Code.

The SFC now seeks to review the Code provisions regarding real estate to provide SFC-authorized schemes with more flexibility in investing in REITs listed overseas without affecting the interests of investors. This consultation paper sets out the basis for reviewing the relevant Code provisions and proposes the parameters for regulating investments in listed REITs by SFC-authorized schemes.

## **BASIS FOR CONSIDERING LISTED REITS FOR INVESTMENT BY SFC-AUTHORISED SCHEMES**

### ***Investment in listed REITs under Chapter 7 of the Code***

#### Trading

To the extent that a REIT is listed and traded on a stock exchange, where an SFC-authorized scheme encounters subscriptions or redemptions by investors, it may purchase or sell its investments in such REIT in a timely and transparent manner, without adversely affecting its ability to invest subscription proceeds or to pay redemption monies. In this respect, an SFC-authorized scheme should be able to comply with the provisions of Chapters 6.13 and 6.14 of the Code.

It should be emphasized that although no specific distinction or requirement is placed on the liquidity of a listed REIT, the managers of the schemes have to pay regard to the liquidity of such REIT and make appropriate disclosures in the offering documents of the schemes accordingly.

#### Valuation

Where a REIT is listed on a stock exchange, there is an established platform to record the traded price of a REIT in a transparent and timely manner. SFC-authorized schemes that invest in such REIT can therefore value their REIT investments objectively without delay, and in the same manner as they value any other investments listed on a stock exchange.

#### Legal form of a REIT

Currently, REITs are structured either in the form of a company or a unit trust. However, regardless of the legal form they adopt, they are both investment vehicles that enable investors to primarily invest in real estate. They also share similar investment characteristics, in that they both aim to invest in real estate to generate a stable source of dividend income. Therefore, it is now suggested that SFC-authorized schemes may invest in listed REITs regardless of the form of legal structure they

adopt. This approach is also in line with the suggestions made by investment managers as it is reasonable, simple and easy to implement and monitor.

### Investment limits

In terms of the investment limits applicable to each listed REIT, the SFC considers that they should be equivalent to those applicable to securities in which SFC-authorized schemes are currently allowed to invest in. In this respect, they are embodied in Chapter 7.1 of the Code, which stipulates that “*the value of a scheme’s holding of securities issued by any single issuer may not exceed 10% of its total net asset value*” and Chapter 7.2, which stipulates that “*a scheme may not hold more than 10% of any ordinary shares issued by any single issuer*”.

*Proposal: SFC-authorized schemes are allowed to invest in REITs that are listed on any stock exchange that is open to the international public and on which the REITs are traded. Accordingly, Chapter 7.14 will be amended as follows:*

*“A scheme may not invest in any type of real estate (including buildings) or interests in real estate (including options or rights, but excluding shares in real estate companies and interests in real estate investment trusts (REITs) that are listed on a stock exchange).*

*Note: In the case of investments in such shares and listed REITs, they shall comply with the investment limits as set out in Chapters 7.1 and 7.2.”*

The proposal, if implemented, will allow investments by SFC-authorized schemes in listed REITs in general, with no specific requirements on either the stock exchanges on which the REITs are listed or the liquidity of such REITs. This is in line with the existing practice towards the regulation of listed securities as permitted investments by SFC-authorized schemes under the Code, and industry practitioners are required to give appropriate disclosures to inform investors of the nature of their investments and any attendant risks, such as the stage of development of the relevant stockmarket and any liquidity risk involved.

### ***Unit Portfolio Management Funds (UPMFs)***

Chapter 8.1 provides for the setting up of a scheme that invests in other collective investment schemes. Among various things, the rules therein set out the investment and borrowing limits, limitation on charges and the acceptable jurisdictions of the underlying schemes of a UPMF. Chapter 8.1(b) stipulates that “*a UPMF may only invest in units/shares of schemes authorised by the Commission or in recognized jurisdiction schemes (whether authorised or not), except that not more than 10% of the UPMF’s total net asset value may be invested in non-recognized jurisdiction schemes not authorised by the Commission*”.

The SFC recognizes that the inclusion of SFC-authorized REITs for investment by a UPMF can broaden the investment opportunities of a UPMF and provide diversification benefits. Therefore, the SFC now clarifies that the “schemes authorised by the Commission” for the purpose of UPMFs include schemes that are



authorised by the SFC pursuant to the Code on Unit Trusts and Mutual Funds or the Code on Real Estate Investment Trusts.

### **THE WAY FORWARD**

The SFC seeks the public's comments on the above proposals regarding investment in listed REITs by SFC-authorised schemes, in particular, whether specific provisions on liquidity or stock exchanges should be made in respect of the REITs that SFC-authorised funds may invest in.

Comments have to be submitted to us in writing no later than 24 March 2005. A final set of proposals and the relevant changes to the Code will be published upon consideration of the comments received in the consultation. Furthermore, such proposals, if adopted, will supersede the announcement made in the circular issued by the SFC in November 2004 titled "Investment in SFC-authorised Real Estate Investment Trusts by Unit Trusts and Mutual Funds authorised under the SFC Code on Unit Trusts and Mutual Funds".