

The 2nd Annual Asia Pacific Real Estate Congress

Keynote Address 25 September 2007

Good morning Ladies and Gentlemen,

Thank you for inviting me to speak at this annual conference. Real Estate is a vital sector of our economy. What I would like to do in the next 20 minutes is to share with you our vision for the Hong Kong REIT market – where we are, and where we plan to go.

The development of the REIT market is very important to the financial market in Hong Kong, for various reasons. REITs broaden the choice of investments products for Hong Kong investors and promote a new type of investment management expertise. REITs add depth to our real estate and asset securitisation markets and also provide an alternative and long term source of funding capital for real estate. The SFC is fully committed to the further development of REITs in Hong Kong and to ensure that our regulatory platform is conducive to Hong Kong's evolution to become Asia's hub for REITs.

Hong Kong's REIT market

Hong Kong has already established itself as a premier investment management hub in Asia, with an aggregate fund management business of HK\$6,154 billion as at the end of 2006, according to SFC's annual fund management activity survey. The introduction of REITs has not only contributed to the size of the fund management business, it has also opened up a new type of investment management expertise, and has added a new dimension to the scope of alternative investment products offered in Hong Kong. You will recall that in 2002, we introduced hedge funds as an alternative investment. REITs is a new addition to this growing list of alternative investment options and we intend to keep on adding suitable new products to this list.

We now have a range of REITs investing in both Hong Kong and Mainland properties. The aggregate market capitalisation of the Hong Kong REIT market has grown to HK\$65 billion at the end of August 2007, with an average daily turnover of HK\$197 million.

Of course, these numbers are currently dwarfed by the phenomenal growth and volume of the Hong Kong stock market so far this year. However, it should be emphasised that, over time, as the pool of unlisted real estate in the region, particularly from Mainland China, taps the capital markets for funding, REITs will become a major investment choice, and a significant contributor to the market capitalisation of Hong Kong.

Hong Kong currently has seven listed REITs invested in different property types both here and in the Mainland and we feel that the market should be ready for the next phase of growth. We are keen to facilitate this growth. To this end, the SFC has set up REIT working groups, comprising industry players, like investment bankers, legal advisers and REIT managers, to analyse the REIT market in Hong Kong and to identify new engines of growth. Through discussions with the working group members, we have identified two avenues for further development:

- Growth of existing REITs – by way of acquisitions; and
- An IPO market that favours the launching of new REITs

Growth of REITs

Although REITs are billed as stable income plays, their success in other major markets like US and Australia has been due to no less than their ability to grow, not just income-wise but also in the size, depth and diversity of their investment portfolios. To do this, REITs have to make acquisitions. Issuers look for REIT markets where REITs can readily grow through new acquisitions. Investors look for REITs that have good and sustainable growth stories.

So far, we have not yet begun to see significant growth among our listed REITs in Hong Kong. From our discussions with the different REIT managers, it is clear to us that they understand the importance of acquisition and growth. Once Hong Kong listed REITs enter this next phase of development, this should attract more issuers (from within and outside Hong Kong) to the Hong Kong market thus building critical mass. This, in turn, will attract greater investor interest.

While it is the job of the REIT managers to grow their REITs, we, as the regulator, will do what we can to facilitate this. In this regard, let me stress a couple of points:

1. If you have a strategic/business plan for acquisition and growth, please do not be shy in spelling it out in your IPO offering document. Investors want to know about such plans. For those of you who have already listed but you did not discuss your strategic/business plan for growth and acquisition, it is not too late. Just like any listed company, you may develop a new acquisition and growth plan after your listing. For instance, it is perfectly legitimate for you to expand your investments into the Mainland or any other market outside Hong Kong even if your offering documents said that you intended to invest only in Hong Kong. REITs are businesses, and they need to be flexible enough to grow with the market.
2. If you are a REIT manager licensed by us to manage a REIT, your licence will continue to be valid (and you will not need to be re-licensed) if your REIT expands operations into other markets or jurisdictions or different property types. Of course, you must demonstrate that you, as the manager, have the expertise to manage properties in these different markets or jurisdictions or in respect of new property types. This means that before you commit to these new businesses, you must have sufficient and appropriate in house skills in place (e.g. by hiring relevant expertise). This is a business call for you.

As I said, we are fully committed to helping the REIT industry grow. To this end, I would encourage those of you contemplating an acquisition to come in to talk to us, so that you can get a better sense of direction on the best way forward.

IPO market

Market participants tell us that because the recent REIT IPOs have not been received with the same degree of euphoria as listed company IPOs, this has deterred new REIT issuers. It has also dampened the enthusiasm of retail and, in turn, institutional investors. Further, because of the

generally high valuations, the yields offered by REITs in their IPOs have not been as attractive as the potential upside anticipated in the case of many listed company IPOs. Our view on this is that REITs are first and foremost steady yield plays and alternative investments with lower correlation to the equities market. Markets work in cycles and different investors have different needs at different stages of the cycle. REITs certainly have a place in a diversified investment portfolio. To this end, we will conduct further investor education to get our investors to better understand the function and relevant positioning of such a product within their overall investment holdings. In any event, once the currently listed REITs move into their next phase of growth, investors may view the REIT market from a different perspective.

Going forward

The growth of the REIT market hinges on building sufficient critical mass. Needless to say, this has to come from the Mainland. To date, we have not seen this happening. We are told that because of the recent changes in legal requirements in respect of property ownership and the existing problems of providing title and ownership, it has not been easy for anyone to bring Mainland property REITs to market. I am confident that, as the pieces come together and the appropriate structure becomes more developed, we will eventually see securitisation of Mainland properties into REITs.

Hong Kong is the preferred market for launching Mainland REITs, not only because investors in Hong Kong are familiar with Mainland properties, but also because Hong Kong has a rich pool of talent, from various disciplines, that are well-versed with the business practices and regulatory requirements in the Mainland, and have a proven track record of conducting deals for Mainlanders.

Hong Kong also has an established track record for facilitating fund raising by Mainland entities. In 2006, Hong Kong ranked 2nd worldwide (after London) in terms of total funds raised through IPOs, and Mainland enterprises accounted for almost 90% of the funds raised. Some of these huge IPOs, considered among the world's largest, may be well known to you – such as China Construction Bank, Bank of China, China Merchants Bank, and the record breaking ICBC. This year, much has been said about fewer H companies coming to Hong Kong to list. But this masks a more important development – which is that Mainland liquidity and Mainland intermediaries are coming to Hong Kong to invest in our market. That is an even more cogent reason for us to have on our shelves Mainland property REITs.

Concluding remarks

The SFC will continue to work with members of the REIT workgroups to identify areas in our processes that can be streamlined to facilitate the further development of the REIT market. Of course, this will be achieved without compromising investor interest. In this regard, we expect sponsors to conduct their due diligence responsibilities to a high standard. We are confident that by working in partnership with the industry practitioners, the SFC can further the growth of the REIT market in Hong Kong.