

**Legislative Council Panel on Financial Affairs**

**Financial issues relating to the listing of  
The Link Real Estate Investment Trust**

**Purpose**

This paper briefs Members on certain financial issues related to the listing of The Link Real Estate Investment Trust (The Link REIT).

**Structure of The Link REIT**

2. The Link REIT is organised and managed in a manner consistent with the provisions and requirements of the REIT Code promulgated by the Securities and Futures Commission (SFC).

3. The principal assets of The Link REIT are the 180 retail and car-parking (RC) facilities which have been divested by the Housing Authority (HA). These assets are held on trust by the Trustee of The Link REIT - HSBC Institutional Trust Services (Asia) Ltd - on behalf of unit-holders of The Link REIT. The Trustee is qualified to act as a trustee for collective investment schemes authorised by SFC pursuant to the REIT Code. The Trustee has a duty to exercise due diligence and vigilance in protecting the rights and interests of unit-holders.

4. The Link Management Limited (The Link) is the Manager of The Link REIT. Functionally independent of the Trustee, the Manager is licensed by the SFC to manage the assets of The Link REIT for the benefit of unit-holders as required by the REIT Code. In the case of The Link REIT, The Link is also owned by the Trustee on trust for the unit-holders of The Link REIT.

**Control by HA of The Link REIT after listing**

5. It was the stated objective of HA to divest completely its ownership and control of the 180 RC facilities. This objective has been achieved through the injection of those facilities into The Link REIT, the public

listing of The Link REIT on 25 November 2005, and the exercise of the over-allotment option<sup>1</sup> by the underwriters for the listing on 2 December 2005. After the divestment, HA does not have any interest in The Link and The Link is fully independent of HA.

6. In July 2005, the Court of Final Appeal (CFA) has affirmed that the divestment by HA of RC facilities is consistent with HA's object, as laid down in Section 4(1) of the Housing Ordinance, "to secure the provision of housing and such amenities ancillary thereto as (HA) thinks fit". CFA has ruled that to secure the provision of RC facilities does not mean that HA needs itself to be the direct provider, but HA secures the provision of RC facilities so long as the RC facilities are available, although they are provided not by HA but by a third party. CFA opines that tenants of public rental housing do not have a statutory right to the continued retention and control by HA of the RC facilities, while the tenants are still using the facilities. In reaching its conclusions, CFA has noted that The Link will adopt a market-oriented commercial approach in operating the RC facilities, whereas HA's approach may not always be in line with private sector practice, and that under The Link REIT, there may be changes in relation to the operation of the RC facilities, including, for example, the tenant trade mix.

### **Impact of emergence of significant unit-holders**

7. As the Secretary for Housing, Planning and Lands stated in his closing speech during the Legislative Council Adjournment Debate on 1 December 2004 on the divestment, in a free economy like Hong Kong, trading will follow market forces and the Government will not preclude any investor from acquiring units of The Link REIT from the market to become a significant unit-holder.

8. Nevertheless, in designing the structure of the divestment vehicle, HA has taken into account the multiple layers of protection available to a REIT, with a view to addressing concerns about one or a group of investors acquiring a controlling interest in The Link REIT.

9. A REIT is under the oversight of an independent, professional

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<sup>1</sup> The over-allotment option is a right exercisable at the discretion of the underwriters. It forms part of a technical arrangement commonly deployed for the sole purpose of post-listing stabilisation of unit price.

trustee; regulated by SFC under the REIT Code; and managed by a manager licensed and monitored by SFC. Under the REIT Code and/or the Trust Deed of The Link REIT, there are, in particular, the following features that may limit the ability of a significant unit-holder from controlling The Link REIT to its advantage beyond what is realised by unit-holders generally–

- (a) The Link REIT’s key business must be to invest in real estate which will generally produce sustainable income. It cannot engage in property development or speculative investments. If The Link REIT wishes to sell a property within two years of its acquisition, the sale must be approved at a general meeting of unit-holders by a special resolution<sup>2</sup>.
- (b) No unit-holder has a right to require that any assets of The Link REIT be transferred to him. A significant holder<sup>3</sup> and its related parties are prohibited from voting their units or being part of a quorum for any meeting of unit-holders convened to approve any matter in which the significant holder has a material interest in the business to be conducted.
- (c) If The Link REIT is terminated, its real estate assets must be disposed of under the oversight of the Trustee by either public auction or open tender. Proceeds from the disposal will then be distributed to all unit-holders according to provisions of the Trustee Deed.
- (d) There is no provision which compels minority unit-holders to sell their units to any significant unit-holder.
- (e) Under the REIT Code, the Manager is required to distribute to unit-holders as dividends each year at least 90% of the audited annual net income after tax of The Link REIT.
- (f) The gearing ratio of The Link REIT cannot exceed 45% of its gross asset value.

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<sup>2</sup> The passing of a special resolution requires a quorum of two or more unit-holders holding at least 25% of all units in issue.

<sup>3</sup> Under the Trust Deed, a significant holder means a person who owns 10% or more of the units in issue.

10. In establishing The Link, HA has put into place certain best-practice corporate governance policies, endorsed by SFC and published in the Offering Circular, including but not limited to the following features –

- (a) at least half of the directors of The Link's Board of Directors must be independent non-executive directors;
- (b) the chairman of The Link's Board of Directors must be an independent non-executive director; and
- (c) an independent director cannot be an individual who is or was connected with a significant holder of The Link REIT within two years immediately prior to the date of his proposed appointment.

The above features will help to ensure that The Link will operate in a way that serves the interests of all the unit-holders as a whole, rather than the specific interests of some significant unit-holders.

11. The emergence of a significant unit-holder will not affect the facilities under The Link REIT being continuously used for retail and car-parking purposes, and will not affect the terms of use prescribed by the applicable government lease.

12. In selling the RC facilities to The Link REIT, HA has imposed certain restrictive covenants on The Link REIT including, in particular, a requirement that, if The Link REIT (or its successors in title) subsequently sells a retail facility or a car-parking facility, subject to certain conditions, that facility must be sold as a whole and not in parts.

### **Allocation mechanism in Initial Public Offering of The Link REIT**

13. The Initial Public Offering (IPO) of The Link REIT consisted of the Hong Kong Public Offer (HKPO) and the International Offering (IO). Allocations to the HKPO and IO were made in accordance with the terms set out in the Offering Circular for the IPO. Initially, 30% of the units available under the IPO (excluding units under the over-allotment option) were allocated to the HKPO. Since the HKPO was over-subscribed by close to 18 times, more units were allocated to the HKPO according to the clawback mechanism

stated in the Offering Circular, resulting in a total allocation to the HKPO of 40% of the units available<sup>4</sup> (excluding units already committed to The Link's strategic partner and units under the over-allotment option).

14. In deciding the allocation to the HKPO, HA took into account the level of demand<sup>5</sup> from retail investors and general market conditions prevailing at that time. Allocations to applicants under the HKPO were made so that no valid applicants would get less than what they would have got in the previous offering had they applied for the same amount of units. As a matter of fact -

- Over 85,000 subscribers were allocated the full amount of units they had applied for.
- Over 60% of those who applied for more than three board lots were allocated more units than in the previous offering.
- On average, 6.7% of the demand under the HKPO was met in this offering, as compared with 4.7% in the previous offering.

Based on feedback from the industry and feedback reported in the media, the allocation to investors under the HKPO has been generally well accepted by the public.

15. As regards allocations under the IO, the 400-plus investors which had subscribed for units were categorised into different tiers according to certain criteria, including participation on the management roadshow, experience in property sector investment, nature and size of the fund under management, and typical investment size, strategy and holding period. MPFs and local charities / foundations were given priority allocations. After approval by HA and the Board of Directors of The Link, these criteria were applied objectively to each single investor by the Joint Global Co-ordinators<sup>6</sup> to finalise allocations in the IPO. The tiering of investors had also been reviewed by the Financial Adviser<sup>7</sup> of HA. Investors in the same tier, subject

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<sup>4</sup> Upon the full exercise of the over allotment option on 2 December, the allocation to the HKPO equated to about 34% of the total allocated units of The Link REIT. Taken into account the allocation to Mandatory Provident Funds and charities or foundations, about 45 per cent of the total units of The Link REIT were allocated to local investors

<sup>5</sup> The demand in dollar value was 62% less than that in the previous offering, and in terms of number of applications, some 54% lesser.

<sup>6</sup> Goldman Sachs, HSBC and UBS are the Joint Global Coordinators..

<sup>7</sup> JPMorgan is the Financial Adviser to HA.

to their actual demand, were given broadly the same level of allocations.

### **Disclosure requirements for The Link REIT**

16. Where the IPO for The Link REIT is concerned, any information which may be necessary for investors to make an informed judgement requires disclosure in the Offering Circular. Material information known after the publication of the Offering Circular must be disclosed by a public announcement or where appropriate by the publication of a supplementary Offering Circular.

17. As required by the REIT Code, The Link will ensure that public announcements of material information and developments with respect to The Link REIT will be made on a timely basis in order to keep unit-holders apprised of the position of The Link REIT. Pursuant to its best-practice corporate governance policy, The Link has set up a Disclosures Committee under the Board of Directors to review matters relating to regular, urgent, and forward-looking disclosure of information, and to oversee the continuity, accuracy, clarity, completeness and currency of the information disseminated.

### **Disclosure requirements for significant unit-holders of The Link REIT**

18. Under the Trust Deed of The Link REIT, a person having an interest in 10% or more of all the units in issue is a "significant holder". A significant holder must notify the Trustee and the Manager of The Link REIT within three business days of acquiring such interest and of every subsequent change in unit-holding by a whole percentage point above such threshold. This is intended to enhance the transparency of any such "significant holding".

### **Declaration of interest requirements for The Link**

19. According to The Link's Compliance Manual, which has been reviewed by SFC, Directors of the Board are required to inform the Board of any interest they may have in relation to a matter being considered and, where a potential or perceived conflict of interest situation arises, they may be excluded from relevant meetings. Directors are also required to inform The Link of their directorships with other companies and their holdings in The Link REIT.

## **Question of conflict of interest between Mr Paul Cheng's advisor role with Deutsche Bank and his role as Chairman of the Board of The Link**

20. Mr Paul Cheng became the Chairman of the Board of Directors of The Link on 1 April 2005. Deutsche Bank announced the formal appointment of Mr Cheng as a member of its Asia Pacific Regional Advisory Board on 25 April 2005 (the appointment took effect from 1 April). Mr Cheng informed the HA and The Link about his adviser role with Deutsche Bank shortly before 1 April. The Link included Mr Cheng's advisor role with Deutsche Bank in his profile published on The Link's official website on 1 April.

21. As Deutsche Bank was not involved in the IPO preparatory work or in providing services to The Link or The Link REIT, the question of conflict of interest between Mr. Paul Cheng's advisor role with Deutsche Bank and his role as Chairman of The Link's Board did not arise. His adviser role was not material information that required disclosure in the Offering Circular published on 14 November 2005.

22. Deutsche Bank and Deutsche Asset Management were among the 400-plus subscribers for The Link REIT units under the IO. In accordance with the objective criteria and the procedure set out in paragraph 15 above, Deutsche Bank and Deutsche Asset Management were allocated in total some 13.5 million units, or 0.63% of the total units in issue. Deutsche Bank apparently has acquired additional units from the market after the listing day to increase its total holding to over 5%.

23. During the meeting to decide the pricing and the allocations to investors under the IO, Mr Paul Cheng did not remind the meeting of his advisor role with Deutsche Bank. Since Deutsche Bank was one of the 400-plus investors under the IO, the question has emerged as to whether this 'non-declaration' has prejudiced decision making by the Board and whether Deutsche Bank has been given any unfair advantage. We have carefully examined the matter and are satisfied that in the circumstances of the case, allocations to all investors under the IO have been made objectively and impartially, and the 'non-declaration' by Mr Paul Cheng did not have any impact on the outcome of the allocations. A summary of our findings is set

out in Annex A.

**Other issues set out in Hon Albert Cheng's letter of 9 December 2005**

24. In his letter of 9 December 2005 to Chairman of the LegCo House Committee, Hon Albert Cheng raised a number of non-financial issues relating to The Link REIT, including rental increases in retail facilities and arrangements for welfare letting. While these matters may not be within the scope of the current agenda item, for the sake of completeness we have included the Administration's response in Annex B for Members' information.

Housing, Planning and Lands Bureau  
December 2005

**Summary of findings on ‘non-declaration’ of Mr Paul Cheng’s adviser role with Deutsche Bank during Board meeting to decide allocations**

On 19 November 2005, The Link’s Board of Directors, in a joint meeting with HA’s Supervisory Group on Divestment, formally approved pricing and allocation for The Link REIT IPO. The discussion paper setting out the recommendations was prepared by JGCs and was tabled at the meeting. This paper set out in detail the outcome of the HKPO and IO, and JGCs’ recommendations on pricing and allocation for both the HKPO and IO. In particular, regarding the IO, it set out JGCs’ recommendation on the objective criteria for categorising investors into different tiers and the broad level of allocation to investors in each tier. JGCs also set out in an appendix tentative lists of individual investors classified under different tiers on the basis of the proposed categorisation criteria.

2. During this meeting, the discussion of the Board and HA’s Supervisory Group on Divestment focused on the setting of the unit price as well as allocation of units between the HKPO and IO, and to a lesser extent on the objective criteria for tiering of institutional investors and the broad level of allocation to investors in each tier. Given that there were over four hundred investors under the IO and that individual investors would only be allocated a relatively small amount of units (as a percentage of the total units in issue), the meeting was content to leave the detailed categorization of individual investors and the actual allocations to the professional judgement of the JGCs and the Financial Adviser of HA after the meeting. As a result, the appendix which set out the tentative categorisation of individual investors was not discussed at the meeting.

3. As the meeting did not go over the lists in the appendix and Directors were not given the discussion paper before the meeting, Directors might not have examined whether they had any association with individual investors on the list.

4. We are satisfied that the final allocations to individual institutions

have been made objectively and impartially according to the agreed criteria. The 'non-declaration' by Mr Paul Cheng of his adviser role with Deutsche Bank did not have any impact on the outcome of the allocations.

**Administration's response  
to non-financial issues raised by Hon. Albert Cheng**

**(I) Rental increases by The Link**

- As stated in the Offering Circular (OC), rental increase is not a key point of The Link's business strategies. The Link's primary focuses will be on controlling operating costs and improving operational efficiency of the divested retail and carparking (RC) properties.
- The RC facilities are located in public housing estates and, given the nature of the business, will essentially serve public housing residents. Given the highly competitive retail market in Hong Kong, the Link can hardly ignore the interests and needs of its major clientele. It only makes good commercial sense for the facilities to continue to attend to the need of the residents, especially those of the estates in which the facilities are situated.
- In its judgement on the appeal by Madam Lo in July 2005, the CFA has noted that The Link intends to adopt a market-oriented approach with regard to setting rents, based on normal commercial considerations. In addition, The Link intends to implement various initiatives aimed at improving the overall commercial attractiveness of, and shopper traffic and tenants' sales at, the RC facilities, which will in turn enhance their rental potential.

**(II) Availability of rent concessions to welfare tenants**

- As the Administration pointed out in the reply to the questions raised by the Hon Fernando Cheung in the Legislative Council on January 26 and 2 March this year, HA had agreed with The Link that, upon divestment, non-profit-making welfare agencies and kindergartens enjoying rent concessions before the listing of The Link REIT could continue to lease

the premises at concessionary levels. These agencies and kindergartens would still be given rent concessions when renewing their tenancy. According to the agreement between the HA and The Link, the rent concession measure mentioned above applies to the premises leased to eligible non-profit-making welfare agencies and kindergartens before the listing of The Link REIT, or alternate premises of similar sizes within the commercial facilities (generally referred to as "agreed premises"). All eligible non-profit-making welfare agencies and kindergartens will be given rent concessions when they lease the "agreed premises" from The Link.

- According to the agreement between the HA and The Link, The Link is required to give rent concessions to any eligible non-profit-making welfare agencies and kindergartens which rent any of the "agreed premises". The Link has been operating in accordance with the agreement, and there has been no departure from the arrangement.
  
- On the media report that a welfare agency was not given rent concession when proposing to rent premises in one of The Link's shopping centres, we have been informed by The Link that the premises which the welfare agency proposed to rent is not one of the "agreed premises" for welfare use, and hence normal commercial rent will be charged<sup>8</sup>. We understand that The Link has explained this to the agency concerned, and that The Link has been trying to identify a suitable alternative location for the agency so that it can enjoy rent concession (i.e. \$45 per square metre). The discussion is still on-going.

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<sup>8</sup> For the purpose of the IPO, the valuation by the independent valuer of the shopping centre concerned has been based on the assumption that the centre has no "agreed premises" and normal commercial rent will be charged for all the premises within that centre.