

Information Note for Legislative Council Panel on Housing

Divestment of Housing Authority's Retail and Carparking facilities

Purpose

At the request of the Panel, this paper sets out the Administration's view regarding possible divestment of the Housing Authority (HA)'s remaining retail and car-parking (RC) facilities and those to be built in the future. The paper also explains how certain public concerns about The Link REIT will be handled in future HA divestment projects.

Divestment of HA's remaining and future RC facilities

2. In July 2003, the Chief Executive in Council (CE-in-C) decided that the Government should seek the HA's agreement in principle to divest its RC facilities. The rationale for this decision was –

- (a) to enable the HA to focus on its core function as a provider of subsidized public housing; and
- (b) to help the HA tide over its financial difficulties, allowing it to pursue in the longer term various cost-saving initiatives to improve its financial position.

3. In making this decision, the CE-in-C noted that a small proportion of the HA's RC facilities may be unsuitable for sale to The Link REIT for various reasons, and that alternative means would be devised to deal with these properties on a case-by-case basis, such as outright sale or change to other uses. The CE-in-C also noted that some RC facilities would need to be provided in public housing estates to be built in the future, and that in principle such RC facilities should similarly be owned and operated by the private sector.

4. The HA divested a majority (180) of its RC facilities through the public listing of The Link REIT in November 2005. The HA has stated that it will look for opportunities to divest the remaining RC facilities and those to be built in the future. The Government supports this position of the HA. At present, the HA has no concrete timetable for any further divestment exercise.

5. The HA has entered into an agreement with The Link REIT whereby the HA will offer to The Link REIT a right of first refusal in the event that the HA wishes to sell certain RC facilities over the next ten years. The price at which the HA will be obliged to offer any such facility to The Link REIT will be the higher of two independent valuations. If The Link REIT elects not to purchase the offered facility, the HA may sell it to any third party

within two years on such terms as the HA determines; otherwise the right of first refusal will apply again to that facility.

Certain public concerns about The Link REIT

(a) Potential conflict of interest

6. The Chairman of The Link Management Limited¹ (LML), Mr Paul Cheng, is currently an adviser of Deutsche Bank². There have been public concerns about potential conflict of interest between Mr Paul Cheng's advisor role with Deutsche Bank and his role as the Chairman of LML.

7. As we have stated in the paper considered by the Legislative Council Panel on Financial Affairs on 14 December 2005, since Deutsche Bank was not involved in the IPO preparatory work or in providing services to The Link REIT or LML, the question of conflict of interest between the above-mentioned two roles of Mr. Cheng did not arise before the publication of the Offering Circular for The Link REIT IPO. Deutsche Bank was a subscriber of units of The Link REIT during the IPO. The question emerged as to whether Mr Cheng's adviser role with Deutsche Bank had prejudiced decision making by the board of the LML on allocations to subscribers, and whether Deutsche Bank had been given any unfair advantage. After careful examination of the circumstances of the case, we are satisfied that allocations to subscribers under the IPO have been made objectively and impartially.

8. In establishing LML, the HA has put in place a robust set of corporate governance policies for it, including rules for declaration of interest and for handling potential conflict of interest. After the listing of The Link REIT, LML has become a private entity and is responsible for enforcement of its own corporate governance policies. Nevertheless, The Link REIT and LML are under the oversight of an independent, professional trustee, and are regulated by the Securities and Futures Commission under the REIT Code.

9. The HA has a well-established set of rules governing its members' registration and declaration of interests. When considering any plan to divest its remaining and future RC facilities, the HA will take careful consideration of any potential conflict of interest situation and will handle such situations in accordance with relevant rules.

(b) The Link REIT being controlled by hedge funds

10. In designing the structure of The Link REIT, the HA has taken into account the multiple layers of protection available to a REIT, with a view

¹ The Link Management Limited is the Manager of The Link REIT.

² Mr Paul Cheng has announced that he will cease to be an advisor of Deutsche Bank after his current appointment expires in March 2006.

to addressing concerns about one or a group of investors acquiring a controlling interest in The Link REIT. Under the REIT Code of the SFC and/or the Trust Deed of The Link REIT, there are 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. Such features are set out at the Annex³.

11. In the divestment of the 180 RC facilities, HA has adopted a fundamental principle that the facilities should continue to be used for retail or car-parking purposes after the divestment. This principle has been incorporated into relevant provisions in the property sale and purchase agreement and in the land leases for the facilities concerned. Any entity owning or controlling those facilities must comply with those provisions. That is to say, any change in the management or control of the facilities will not affect the facilities to be continuously used for retail or car-parking purposes, and will not affect the terms of use prescribed by the applicable land lease. The same principle will apply in any future divestment of the HA's remaining and future RC facilities.

Housing, Planning and Lands Bureau
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³ These features have been set out in our paper for the Legislative Council Panel on Financial Affairs in December 2005.

**Features under the REIT Code of the SFC and/or
the Trust Deed of The Link REIT**

- (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 resolution¹.
- (b) No unit-holder has a right to require that any assets of The Link REIT be transferred to him. A significant holder² 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.

¹ The passing of a special resolution requires a quorum of two or more unit-holders holding at least 25% of all units in issue.

² Under the Trust Deed, a significant holder means a person who owns 10% or more of the units in issue.