

**Link Asset Management Limited's Submission for
The Legislative Council Panel on Housing
Relating to Disposals of Properties
Divested by the Hong Kong Housing Authority**

Purpose

1. This submission references the Legislative Council Panel on Housing's upcoming meeting to discuss Link Real Estate Investment Trust's disposals of properties divested by the Hong Kong Housing Authority (HA). As the manager of Link Real Estate Investment Trust (Link REIT), we, Link Asset Management Limited (Link), would like to provide members of the Legislative Council's Panel on Housing (Panel) with more information. We hope to assure Panel members that we have been working hard to improve the lives of those around our properties, and we have exercised due care in ensuring a smooth transition when disposing of assets.

Background

2. Link REIT was listed on The Stock Exchange of Hong Kong Limited on 25 November 2005 as Hong Kong's first listed real estate investment trust (REIT). Being Hong Kong's first complete privatisation of government assets, Link REIT was created to enable HA to focus its valuable resources on its core function as the provider of subsidised public housing in Hong Kong, to improve HA's financial position in the short-to-medium term and to maintain the principle of "big market, small government". It was also hoped that after the facilities were divested, operational efficiency would be enhanced to benefit both the residents and the commercial tenants concerned.¹
3. From the outset, Link was expected to adopt a market-oriented approach with regards to setting rents, based on normal commercial considerations.² It was designed that Link should have a free hand to decide its tenancy policy and parking fees based on market conditions.³ According to the government's plan then, Link would implement various initiatives aimed at improving the overall commercial attractiveness of,

¹ Report by Permanent Secretary for Housing, Planning and Lands (Housing) Mr CM Leung, JP, paragraph 18 in minutes of the special meeting of LegCo's Panel on Housing held on 22 November 2004 <https://www.legco.gov.hk/yr04-05/english/panels/hg/minutes/hg041122.pdf>; the objective of the privatisation was also in the written reply by the Secretary for Transport and Housing, Mr Frank Chan Fan, to a question by the Hon Alice Mak in LegCo on 17 January 2018 <https://www.info.gov.hk/gia/general/201801/17/P2018011700587.htm>

² Responses by HA/The Link under item 1.2 of Summary of comments on the divestment project and the future business plan of The Link (June 2005) <https://www.legco.gov.hk/yr04-05/english/panels/hg/papers/hg0621cb1-1787-5-e.pdf>

³ Comment by Permanent Secretary for Housing, Planning and Lands (Housing) Mr CM Leung, JP, paragraph 35 in the document referred to in Note 1.

and shopper traffic and tenants' sales at, the properties divested by HA, which would in turn release the full potential value of these properties.⁴

4. In Link REIT's offering circular, we promised investors that we would provide unitholders with stable distributions and the potential for sustainable long-term growth.⁵ To achieve this objective, we have been guided by a set of key business strategies to: (i) increase returns through asset management and enhancement; (ii) expand and optimise Link REIT's portfolio through selective acquisitions, development, and disposal; (iii) optimise Link REIT's capital structure. In Link REIT's daily operations, we strive to proactively manage our properties, with an aim to revamp and modernise them and raise their profile. We also hope to enhance operational efficiency in terms of power and water consumption, and waste treatment.
5. We have been adhering to these strategies in managing Link REIT over the past 14 years. Our work has created positive social impact: research shows that our investment in asset enhancement has resulted in socio-economic benefits in the local community, including the increase in economic activities and the number of job opportunities.⁶

Value Created by Link

6. From our home in Hong Kong, we aspire to be a world-class real estate investor and manager. To achieve this objective, we proactively manage our portfolio via *Management, Enhancement, Acquisition, Divestment and Development*. We strive to build a productive portfolio and maintain a balanced capital structure, while at the same time we endeavour to help our communities flourish and improve the lives of those around our assets.
7. *We create value for our tenants.* Since Link REIT's listing in 2005, we have completed 71 asset enhancement projects with a total investment of over \$7 billion to improve the shopping environment. As a result of the increasing tenant demand, the occupancy rate of our Hong Kong portfolio rose from 89.3% in 2008 to 95.5% in 2018.
8. Meanwhile, our Hong Kong tenants' sales growth has ranged from 5% to 10% per annum since 2013, outperforming the local retail market. These tenants' occupancy cost, or their rent-to-sales ratio, which stood

⁴ Responses by HA/The Link under item 1.1 of the document referred to in Note 2.

⁵ Page 1 of Link REIT's Offering Circular Summary

<https://www.linkreit.com/SiteAssets/CorporateWebsite/InvestorRelations/FinancialReports/2005/Offering%20Circular/EN/EWP105.pdf>

⁶ "Total Value Assessment of the Asset Enhancement of Lok Fu Plaza and Fresh Market", a research commissioned by Link and conducted by KPMG in 2015

at 13% in 2018, is at a healthy level when compared with a selection of major retail landlords and retailers listed in Hong Kong.⁷

9. We constantly engage our tenants. As part of our commitment to “growing with tenants”, we established the Link Tenant Academy 10 years ago. Numerous programmes have been organised to educate tenants about the latest trends and equip them with business know-how in the retail industry. CONNECTION conferences were also organised where tenants, service providers and our employees can discuss common operational challenges, such as resources conservation, and explore possible solutions together.
10. *We create value for our shoppers.* Shoppers’ expectations of the retail environment, as well as their choice of goods and services, have evolved significantly, along with lifestyle changes, over the years. Since 2012, we have invested \$229 million to enable barrier-free accessibility at our properties, allowing physically-challenged shoppers to move freely in our fresh markets and malls. We also revitalised the shopping experience in traditional fresh markets by providing a dry and clean environment, with an appropriate tenant trade mix.
11. *We create value for our communities.* In our Hong Kong portfolio, we have rented out over 660,000 square feet (sqft) to 127 charities and non-governmental organisations (NGOs) at an average monthly unit rent of under \$7 per square foot as at March 2019. Ninety-nine of these charities are under welfare letting covenant, while the other 28 organisations were offered rent with substantial discount from market rate.
12. Established in 2013 as Link’s flagship charity and community engagement programme, Link Together Initiatives supports charitable organisations to advance sustainable development in the communities that we serve, by offering monetary and other support to selected projects. Each year, we contribute an amount of up to 0.25% of Link REIT’s net property income from the previous financial year to Link Together Initiatives. We have thus far earmarked over \$61 million for over 130 charitable projects, with an expected 4.5 million direct and indirect beneficiaries after the completion of the projects this year.
13. One of our signature youth empowerment programmes under the scheme, the Link University Scholarship, aims to promote upward social mobility of Hong Kong youths. Since its launch in 2015, \$11.2 million in scholarship aid has been awarded to 560 local youths who are their

⁷ The rent-to-sales ratio of Café de Coral Holdings Limited, Tsui Wah Holdings Limited and Fairwood Holdings Limited are 12.3%, 18.4% and 14.9% respectively, according to their respective annual reports for the year ended 31 March 2018. The rent-to-sales ratio of International Housewares Retail Company Limited (Japan Home Centre) was 17.1% for the year ended 30 April 2018, also according to its annual report.

families' first-generation university students, supporting them to realise their dreams and ambitions.

14. We also see sustainability as an integral part of our business model. Over the past 10 years, energy consumption of Link REIT's Hong Kong portfolio has been reduced by nearly 30%. We also support an all-round surplus food recycling programme at our fresh markets and shopping malls. In 2018, the programme benefited 1.3 million people and saved 334 tonnes of food from waste, and this year the programme aims to benefit almost 2 million people and save up to 625 tonnes of food from waste. We are also an early supporter of the Organic Resources Recovery Centre, a pilot initiative of the Government's Environmental Protection Department. We have been working closely with tenants and NGOs to implement organic waste separation.
15. *We create value for our unitholders.* We adopt a total return policy by paying out 100% of our distributable income as dividends. Link REIT is now Asia's largest REIT and the world's second largest retail-focused REIT in terms of market capitalisation. Wholly-owned by private and institutional investors, Link REIT has made stable financial contributions to many charities, university endowment and pension funds. Link REIT is not only a constituent stock of the Hong Kong market benchmark Hang Seng Index, but also an index component of the Dow Jones Sustainability Asia Pacific Index and the FTSE4Good Index. The two international sustainability indices follow a best-in-class approach, including companies across all industries that outperform their peers in numerous sustainability metrics, including corporate governance, environmental and social criteria. It is evident that Link REIT is internationally recognised for the value we create, which is determined by both financial achievements and non-financial contributions.

Link REIT's Disposals of HA's Divested Properties and Acquisitions

16. In accordance with the Securities and Futures Commission's Code on Real Estate Investment Trusts (REIT Code), an REIT should hold good marketable legal and beneficial title in all its real estate, with the only restriction to disposal being that it is prohibited from disposing of its properties for at least two years from the time such properties are acquired, unless unitholders pass a special resolution consenting to the proposed sale.⁸ Regarding Link REIT's properties divested by HA, there is no restriction on resale by Link or other new owners because of the concern of unnecessary interference in normal market transactions, but any property resold will still be subject to relevant lease conditions, such as the amount of retail space and the number of carpark spaces to be provided in the property.⁹

⁸ Code provisions 7.7 and 7.8 of the SFC's REIT Code

⁹ Responses by HA/The Link under item 11.5 of the document referred to in Note 2.

17. To maintain a resilient portfolio with sustainable growth, we began acquiring properties in Hong Kong in 2011 and extended our acquisitions to include the first-tier cities in the Mainland China in 2015. We pursue a capital recycling strategy to ensure we continue to have a balanced capital structure while we strengthen our portfolio quality. We examined various growth options under our strategic review, with reference to leading property companies and international peers, as well as views of market practitioners. It was concluded that disposal of certain assets is in line with our strategic objectives and current growth trajectory. We made the first disposal in 2014, and a total of 57 properties, most but not all of which are properties divested by HA, have since been sold.
18. Link REIT's Hong Kong portfolio now comprises 126 properties, including integrated retail and carpark facilities, office development, as well as standalone retail and standalone carpark facilities. These properties, in total, amount to about 8 million sqft or 6.5% of Hong Kong's total retail space, and about 56,000 car park spaces or 7.4% of Hong Kong's total commercial car park spaces. The average occupancy rate of the portfolio's retail facilities stood at 95.5% as at 30 September 2018. Outside Hong Kong, Link REIT also has a Mainland China portfolio spanning Beijing, Shanghai, Guangzhou and Shenzhen. The portfolio focuses on retail real estate assets, with one office property. The Mainland portfolio accounts for 13.1% of Link REIT's combined portfolio in terms of valuation. At present, we intend to allocate not more than 20% of our gross asset value for assets in the Mainland China.
19. With diversification of markets and asset classes, we continue to play to our strengths to offer investors steady income and long-term growth.

Responses to Public Concerns

20. There are some public comments that our sale of HA's divested properties might have resulted in non-compliance with the relevant land lease conditions and covenants, as well as deteriorated management services of the properties, which adversely affect nearby residents' livelihoods and tenants' business prospects. We wish to reiterate that we have continuously observed the relevant land lease conditions and covenants. In selecting buyers of our assets, we have diligently examined their financial strengths and past experience in managing retail properties. We have ensured that all the relevant covenants have been incorporated in the legal documents of the transactions, such as assignment deeds. At the time of completing the transactions, we reminded the new owners in writing of their obligations to observe the relevant land lease conditions and covenants, including the obligations under the welfare-letting covenant. In the same reminder, we also proposed for their consideration to continue our concessionary offers, such as deeply discounted car park tariffs for physically challenged

individuals¹⁰, as well as maintaining barrier-free accessibility and a balanced tenant trade mix, and so forth. Meanwhile, new owners of the properties were also required to sign an undertaking with HA directly to take upon the compliance obligation originally shouldered by Link.

21. Some members of the public may be concerned about the split ratio or the cost-sharing arrangement for the management and maintenance cost of estate common areas of certain individual disposed properties. We would like to clarify that undivided shares specified under the Deed of Mutual Covenant (DMC) are widely used by residential estates in Hong Kong as the basis for sharing common area expenses. We have, in accordance with the requirements under the DMC for the respective properties, paid our share of the management and maintenance expenses of estate common areas with reference to undivided shares. On top of the above-mentioned expense sharing arrangement, the “split ratio covenant” is an additional commitment undertaken by us at HA’s request before Link REIT’s listing with respect to non-Link areas. We believe HA, as the DMC manager, should have informed the Incorporated Owners (IO) of all relevant properties about the split ratio arrangements at the time of the divestment. Under the deed of assignment, payment demands should be made by the IO or the DMC manager. According to the records on hand, we have settled all split ratio covenant payment requests made by the IO or management companies of the concerned Home Ownership Scheme estates.

22. There are also public comments that our asset enhancement and rent hikes might have pushed up prices of necessity goods being offered at our malls and fresh markets. Some people are concerned that prices would further inflate as new owners take over the properties and raise the rent again. We believe it is a misperception that goods and services are more expensive at retailers in Link REIT’s portfolio. Independent research commissioned by the Food and Environmental Hygiene Department in 2016 showed that among a basket of 31 fresh food items surveyed, 28 were more expensive in government markets. The study concluded that lower rents made possible by government subsidies would not necessarily translate into lower consumer product prices.¹¹ In fact, in September 2018 the average monthly rent of Link REIT’s Hong Kong retail portfolio was \$65.7 per sqft, compared with the average monthly rent of \$127.4 per sqft for the private retail space in the New Territories at the same time.¹²

¹⁰ Link offers eligible physically challenged individuals a 60% discount on parking space rent in its car parks.

¹¹ Survey on Prices of Fresh Food Items in Different Retail Channels, an independent study commissioned by the Food and Environmental Hygiene Department in 2016

<https://www.legco.gov.hk/yr16-17/english/panels/fseh/papers/fseh20170613cb2-1580-5-e.pdf>

¹² Figures as of September 2018, sourced from the Rating and Valuation Department.

23. Some individuals may have the misperception that our asset disposals may be related to our joint venture development project, The Quayside. They are unrelated. As mentioned above, our key objective is to maintain a resilient portfolio with sustainable growth so we continuously refine our portfolio. We have no plans to significantly increase our portfolio exposure in property development or redevelopment. In fact, Hong Kong's REIT Code stipulates that an REIT may acquire uncompleted units or properties in the course of development, redevelopment or refurbishment as long as the value of such real estate does not exceed 10% of the REIT's total net asset value at the time of acquisition. This is a requirement more restrictive than the REIT regulations in many overseas jurisdictions.

Our Commitment

24. To conclude our submission, we wish to reiterate that Link is committed to adding value to our many stakeholders, making contributions to the community while attaining financial achievements. We endeavour to be a professionally-managed home-grown company that Hong Kong can be proud of.

25. We have been running our business along commercial principles: we serve the community by creating vibrant and unique retail experiences that meet the changing needs of the people who live around our shopping centres, and by providing an effective platform with which the tenants of our retail and office properties can flourish. In doing so, we enhance value for unitholders of Link REIT and support the local economy while linking people to a brighter future.

26. We reckon we have room for improvement. Therefore, we will continue to closely communicate with various stakeholder groups and actively engage them as we advance.

Link Asset Management Limited
28 March 2019