

財經事務及庫務局

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FINANCIAL SERVICES AND THE
TREASURY BUREAU

24/F, Central Government Offices,
2 Tim Mei Avenue, Tamar
Hong Kong

23 June 2020

Legislative Council Secretariat
1 Legislative Council Road
Central, Hong Kong
(Attn: Miss Sharon LO)

Dear Miss LO,

**Matter relating to Securities and Futures Commission's Proposed
Amendments to the Code on Real Estate Investment Trusts**

I refer to your email of 12 June 2020, enclosing the letter from the Hon Andrew WAN Siu-Kin requesting for the Panel on Housing and the Panel on Financial Affairs to convene a joint special meeting to discuss the proposed amendments to the Code on Real Estate Investment Trusts ("REIT Code") by the Securities and Futures Commission (the "SFC"). After consulting with the SFC, our response is set out below.

2. Hong Kong's first real estate investment trust ("REIT") was listed in 2005. As of May 2020, a total of 11 Hong Kong REITs were listed and available for trading. During the period from December 2005 to May 2020, the total market capitalisation of Hong Kong REITs increased by more than four times to HK\$200.7 billion. In addition, since the launch of the Hang Seng REIT Index Total Return Index in October 2008 up to May 2020, this index had increased by 592%, while the Hang Seng Index (Gross Total Return Index) had increased by 211% during the same period¹.

¹ As a REIT must distribute to unitholders as dividends each year an amount not less than 90% of its audited annual net income after tax, the total return indexes are quoted here.

3. The Financial Services and the Treasury Bureau and the SFC are determined to further develop the REIT market in Hong Kong, hoping to bring more diversified investment opportunities and relatively stable investment returns to local investors on the one hand, and increase the diversity and liquidity of the local financial market to strengthen Hong Kong's function as a major fundraising and financing centre on the other.

Background of the SFC's proposed amendments to the REIT Code

4. The SFC's statutory regulatory objectives and functions are to maintain and promote the orderliness and competitiveness of the securities and futures industry, and provide appropriate protection for investors investing in financial products. By issuing the REIT Code to regulate REITs, which is an investment product, the SFC aims to facilitate the development of the REIT market while safeguarding the interests of investors. Since the introduction of the REIT Code in 2003, the SFC has reviewed its requirements from time to time to keep abreast of the changing market environment.

5. Subsequent to the REIT Code amendments made in 2005, 2010 and 2014, early this year, the SFC reviewed the development of local and overseas markets (including the United States, Australia, Singapore and Malaysia). After discussing with various industry organisations and participants regarding matters in relation to the development of the Hong Kong REIT market, the SFC proposed to amend the REIT Code with the view to maintaining the competitiveness of Hong Kong's regulatory regime for REITs and to facilitate the long-term development of the Hong Kong REIT market. On 9 June of this year, the SFC published the consultation paper on proposed amendments to the REIT Code to consult the public².

Proposed amendments to the REIT Code

6. The SFC hoped that by amending the REIT Code and relaxing certain investment restrictions, REITs will have more flexibility in acquiring properties and will be able to expand their investment portfolios or enhance the quality of their assets. This would enhance liquidity as well as the

² A copy of the consultation paper can be found at:
<https://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=20CP2>

breadth and depth of the market, attract more new REITs to list in Hong Kong and thereby further expand Hong Kong's REITs market while protecting investors' interests and maintaining market stability. The SFC is proposing amendments to the REIT Code in the following key areas:

- (a) Minority holdings – to allow a REIT to invest in minority-owned properties subject to various conditions³ to provide Hong Kong REIT managers with more flexibility in sourcing properties for listings and acquisitions thereby increasing the growth potential of Hong Kong REITs. Given that many Hong Kong REITs provide relatively high returns and the choices of yield-accretive properties may be limited in the local market, this proposal would allow REITs to acquire suitable properties in overseas jurisdictions that prohibit foreign investors from holding majority stakes in domestic properties.

- (b) Property development – to allow a REIT to invest in property development projects in excess of the existing limit of 10% of gross asset value (“GAV”) subject to unitholders' approval and other conditions, but together with other non-core investments⁴, it may not exceed 25% of GAV⁵. As mentioned above, REIT managers have difficulties in sourcing yield-accretive properties. Allowing REITs to participate early in the property development stage could broaden the range of acquisition targets, lower acquisition costs and enhance yields.

³ There are generally no explicit restrictions on investment in minority holdings for REITs in the United States, United Kingdom, Australia, and Japan. Singapore allows REITs to invest in real estate as joint owner subject to certain conditions.

⁴ Non-core investments include investments in property development projects (including uncompleted units), non-qualified minority-owned properties, financial instruments and other ancillary investments.

⁵ Since January 2016, the Monetary Authority of Singapore has increased the limit for property development from 10% of a REIT's total asset value to 25% of its total asset value (subject to the approval of unitholders), and the additional 15% of total asset value shall be used to redevelop existing real estates. Since April 2018, Malaysia has allowed REITs to engage in property development up to 15% of the total asset value of the REITs.

- (c) Borrowing limit – to increase the limit on aggregate borrowings from 45% to 50%⁶. This would give REITs more flexibility to optimise their capital structures as debt tends to take less time to raise and can be a cheaper source of capital compared to equity. This also helps REITs raise funds within a short period of time for acquisitions.

Other matters

7. The REIT Code requires that the management company of the REIT to act in the best interests of the unitholders, which is in line with the regulatory approach for retail REITs in major overseas financial markets. REITs may adjust and manage its investment portfolio subject to compliance with the provisions of the REIT Code and its constitutive documents. Such actions are commercial decisions and the SFC has no right to interfere. The social impact that may arise from disposals of properties by REITs are beyond the regulatory remit of the SFC and REIT Code.

8. In fact, before the SFC revised the REIT Code in 2014, REITs already had the right to dispose of their assets and indeed certain REITs had done so. When a REIT disposes of its assets, it must act in the best interest of unitholders and comply with the relevant provisions in the REIT Code, including the requirement that a REIT shall hold each property within the scheme for a period of at least two years⁷ as well as other relevant requirements such as those related to disclosure, reporting and obtaining unitholders' approval. In addition, the proposed amendments to the REIT Code will not change the original core requirement that at least 75% of GAV of the REIT must be invested in real estate that generates recurrent rental income, and non-core investment will be limited to no more than 25% of GAV to maintain the nature of the REIT as an investment vehicle for generating recurrent rental income.

⁶ The leverage limit for Singapore REITs was raised from 45% to 50% in April 2020 (subject to a minimum interest coverage ratio of 2.5 times with effect from January 2022). The leverage limit for Malaysia REITs is 50%.

⁷ Unless unitholders have given their consent to by way of a special resolution at a general meeting. Please see 7.8 of the REIT Code for details.

9. We wish to emphasise that the REIT Code applies to all REITs, and the requirements therein and any amendments thereto should not be tailored to any individual property market or REIT, but should cover and cater for the development of the entire REIT market whilst ensuring investor protection. The consultation period for the consultation on proposed amendments to the REIT Code will end on 10 August 2020. The SFC welcomes all sectors of the community (including members of the Legislative Council) to provide their comments to the SFC during the consultation period.

Yours sincerely,



(Ms Estrella CHEUNG)

for Secretary for Financial Services and the Treasury

c.c. Secretary for Transport and Housing (Attn: Ms Jenny CHAN)
Chief Executive Officer, SFC (Attn: Ms Grace CHAN)