SUNLIGHT REIT
陽光房地產基金

Our Ref: HSAM/CM/SFC/2014/L007

26 February 2014

The Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong

By Hand

Dear Sirs

Re: Consultation Paper on Amendments to the Code on Real Estate Investment Trusts

We refer to the Consultation Paper on Amendments to the Code on Real Estate Investment Trust issued by the Securities and Futures Commission (the "**Commission**") on 27 January 2014 (the "**Consultation Paper**"), and submit below our views and comments on the proposals discussed in the Consultation Paper. Capitalised terms used in this letter shall have the same meaning as defined in the Consultation Paper unless defined otherwise in this letter or the context otherwise requires.

Question 1: Do you consider that flexibility in respect of property development investments and related activities should be introduced for REITs?

We in principle welcome and support this proposal, but raise below our views and concerns on certain critical issues pertinent to this proposal for consideration by the Commission.

There is one issue related to the proposal not covered by the questions below, which we will raise here. In generally, REITs (and their management companies) have limited experience in property development; in this respect, their competitive advantage relative to typical property developers is therefore low. In the circumstances, REITs may find it necessary or advantageous to enter into joint venture partnerships with developers if they are to undertake property development activities. Also, where a development site contemplates a composite development as is often the case in Hong Kong, a joint venture arrangement may need to be structured to allow a REIT to own appropriate portions of the completed property for rental income generation, while the other joint venture partner takes other portions of the property which are not for leasing. However, currently the Code on Real Estate Investment Trusts (the "**REIT Code**"), when read with the frequently asked questions ("**FAQs**") issued by the Commission and/or authorisation conditions, stipulates that the aggregate value of properties in which a REIT owns less than a majority ownership and control should not exceed 10% of the net asset value of the REIT (as per FAQ 19 in respect of REITs). This is inconsistent with the proposed change in benchmark from net asset value to gross asset value in the proposed amendments to Chapter 7 of the REIT Code and also discourages and restricts minority ownership of good property development projects. We suggest changing the maximum threshold for properties with less than majority ownership and control from 10% of net asset value of the REIT to 10% of gross asset value of the REIT. We also suggest that, when calculating the 10% threshold permitted for aggregate value of properties in which a REIT does not have majority ownership and control, properties under development should not be included in the numerator even if they are not majority owned/controlled by the REIT, considering that

questions of control are sometimes given effect through arrangements (such as sub-deeds of mutual covenant) which may not be in place yet during a development period.

Question 2: Do you consider that the 10% GAV Cap is set as an appropriate threshold?

We note that the 10% GAV Cap is proposed to be complied with "at all times". However, fluctuation of valuation of portfolio/ Property Development Costs may cause uncertainty in meeting this requirement. We propose that, as long as the 10% GAV Cap requirement is met at the time when a REIT commits to a property development project, the REIT's continuing obligation will be to use its reasonable endeavours to maintain the 10% GAV Cap, instead of requiring the maintenance of that cap on a continuing basis as an absolute obligation.

Question 3: Do you have any comments on how the Property Development Costs should be calculated?

We also note that under the proposal, Property Development Costs would be the total project costs borne and to be borne by the REIT, inclusive of the costs for the acquisition of land (if any) and the development or constructions costs of the project. Footnote 10 on page 9 of the Consultation Paper states that in the case of re-development of existing property, no additional payment may be required to be made by the REIT to acquire the land on which the property is re-developed. We suggest that this clarification be added into the revised REIT Code as a proposed amendment, so as to remove any doubt that in such situation no land cost will need to be included as part of the Property Development Costs.

Question 4: Do you have any comments on the frequency of periodic updates that should be provided to unitholders on the status of property development investments and related activities?

We consider that an annual updated valuation of the property concerned, plus a description of the status of the property development activities of the REIT in the management discussion and analysis section of the interim and annual reports of the REIT would be appropriate.

Further, in the event that a REIT undertakes a joint venture with a property developer which is a connected person within the meaning of the REIT Code, or obtains services or supplies from a connected person in connection with a property development activity, thus constituting a connected party transaction, prior approval from holders may be required for the annual cap amounts arising out of such connected party transaction. However, we foresee difficulty in setting the annual caps amounts given the lengthy property development cycle. We suggest that, if and to the extent that continuing connected party transactions are to be entered into in relation to property development activities, the requirement for annual caps may be waived or relaxed. Further, in view of the nature of typical property development projects, we suggest that the maximum contract period for this kind of continuing connected party transactions should be permitted to be longer than three years without requiring an expert's confirmation. If the management company considers appropriate, contracts or arrangements relating to property developments entered into with connected persons may also be treated, as an alternative, for the purpose of compliance with relevant REIT Code requirements, as a connected party transaction rather than a continuing connected party transaction.

Question 5: What additional safeguards do you consider appropriate to ensure there will not be any material change to overall risk profile of a REIT despite the flexibility to engage in a limited extent of property development investments and related activities?

In relation to the two-year property holding period under 7.8 of the REIT Code, we propose that an exception be allowed for any disposal made for the purpose of enabling the REIT to comply with REIT Code requirements (such as the 10% GAV Cap requirement).

Question 6: Do you have any comments on the proposed scope of the Relevant Investments and the proposed Maximum Cap?

We in principle also welcome and support the proposal for introducing flexibility in respect of investments in financial instruments but raise below our views and concerns on certain critical issues pertinent to this proposal for the Commission's consideration.

We note that the proposed definition of "Relevant Investments" includes "unlisted debt securities". This would allow investments into all types of debt securities. We would recommend that debt securities should be restricted to those of investment grade.

We also note the inclusion of "hedging instruments" in calculating the Maximum Cap. We question the appropriateness of this as it may reduce the amount available for Relevant Investments if hedging instruments were in positive values and classified as assets. Also, please clarify how the Maximum Cap would be calculated if hedging instruments were classified as liabilities. As a point of principle, we do not think it is appropriate for a REIT to be penalised in flexibility in its Relevant Investments as a result of keeping the value of its hedging instruments positive. In the circumstances, we would suggest that "hedging instruments" not be included in the calculation of the Maximum Cap.

We also suggest that disclosure of the full investment portfolio of the Relevant Instruments of REITS should be done semi-annually instead of having monthly updates on REITs' websites. We agree with the need for transparency but consider that this factor should be balanced by the danger of information overload to unitholders.

Question 7: What other safeguards do you consider appropriate to be put in place corresponding to the proposal to allow for the Relevant Investments?

We have no other comments in this regard.

Yours faithfully,
For and on behalf of
Henderson Sunlight Asset Management Limited
(as Manager of Sunlight REIT)