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

19 February 2014

Dear Sir,

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

I refer to the above consultation paper released on 27 January 2014 (the "Consultation Paper"). I am in general disagreement with the proposed amendments to the Codes on Real Estate Investment Trusts.

I do not agree to introduce flexibility such as property development investments and related activities to REIT. REITs are primarily setup as a defensive investment scheme and are prohibited to invest in vacant land or engaging or participating in property development. This is because property development investments and related activities will incur risk and uncertainties to the REIT's operation. Therefore why do we have to introduce such flexibility now?

The risks that will be incurred include construction risk, delay risk, legal risk and other concerns. The Commission has illustrated some of those. One would argue by implementing thorough due diligence process, sufficient monitoring with strong project team could mitigate those. However, those risks are not exhaustive. Some risks may not be able to identify at the time of entering into the development contract, such as SARS or global financial crisis.

Property development will create uncertainty to the REIT's operation, as no proven record of income can be established. By only inducing cost for the first couple years, the return on this strategy will be heavily depend on prevailing property market condition or Government's policy.

Some case studies in other jurisdictions, which allow REIT or business trust to participate, can be a good reference. One of these cases is Indiabulls Properties Investment Trust ("IPIT"), a Singapore-based business trust. IPIT comprised two properties under development when it went public in 2008. After its listing, there had been substantial delay in the completion of the property developments and the leasing environment in the country (India) was worse than what IPIT projected in the IPO prospectus. As a result, the forecast figures and the actual figures had a huge deviation. To make thing worse, no dividend was declared to unitholders in subsequent years. In this case, even IPIT management team and board of directors possess the experience and skills and IPIT's compliance with the disclosure requirements, they still experienced the inherent risks and uncertainties associated with property development and unpredictable market condition. It was ultimately the investors of IPIT who suffered from such situation.

Given the current market condition and taking into account the prevailing volatility of the property market in Hong Kong, I can form a view that it is not a right time to permit REITs to participate in this proposal. In addition, adding development element into the REIT structure will make it unclear from property companies, losing it attractive uniqueness as an investment instrument. Without prejudice to my stance of not supporting the proposal of REIT to engage in property development and related activities as mentioned above, I am not in favour of using the GAV as a basis of calculation of the Cap.

This approach is too aggressive. It will be more prudent to use net asset value (“NAV”). After removing the liabilities from the gross asset, this figure shows a true value of the REIT and also can minimize the degree of risks to which the unitholders and investors will be exposed.

I do not agree to allow a REIT to invest in non-real estate assets. Investment in non-real estate assets requires a complete set of skill and expertise, where the existing REIT manager may not possess. Investment in non-real estate assets may encourage the REIT manager to engage in more risky and speculative instruments, which deviates from the principle value of REITs. The REIT manager can also raise capital from both the equity and debt market to invest in such risky assets, where unitholders’ approval may not require to be sought. The risk profile of the REIT itself will increase, or even worse than investing in development project.

In regards to the proposed Maximum Cap (15%) of GAV, I strongly believe REIT manager should be focusing on improving the performance of existing property. Putting such a large cap on this investment scheme will damage the fundamental value of the REIT, where REIT should be only focusing on recurrent rental income-producing vehicles investing in real estate.

Without prejudice, the proposed scope under the Relevant Investments is also too wide, exposing the unitholder/investor in a whole new risk tolerance level. Again, this is not helping the growth of the REIT market. The non-real estate asset should only focus on investment instruments with principal protected function.

In summary, I am in total disagreement with the two proposals within the Consultation Paper. REITs should be a very defensive investment instruments which focus on existing up-and-running properties. I have great concern if the Commission is planning to implement these proposals, as this will affect the existing stakeholders and also the future development of the REIT market in Hong Kong.

Should the Commission wish to discuss any of my comments, please do not hesitate to contact

Yours faithfully,

Gary Fong