Comments and suggestions from members of Hong Kong Investment Funds Association on the SFC Consultation Paper on Amendments to the Code on Real Estate Investment Trusts (Feb 2014)

- Q1 – HKIFA members in general support the SFC proposals as outlined in the consultation paper to amend the Code on REITS (Jan 2014) in respect of property development investments (the proposed maximum threshold limit of 10% of the GAV), related activities and other Relevant Investments (the proposed financial instruments) as they opine that these amendments provide an appropriate level of flexibility. In addition, individual members believe that the SFC can go further by allowing more flexibility than those outlined in the Paper (such as a higher GAV Cap or no GAV Cap, or allowing each REIT to itself determine how to calculate Property Development Costs). They opine that ultimately, the investment decisions should be best left with the investors (individuals and institutions) which are best positioned to determine the level of risks appropriate to their particular circumstances. Thus, they are in support of changes that would allow investors maximum flexibility and freedom to choose the level of risks and protection they deem as appropriate.

- Q2 – Members generally believe that the 10% GAV Cap is a good starting point and an appropriate threshold (as stated above, some members do suggest a higher threshold.) It has been suggested that the SFC can consider revisiting the threshold in three to five years' time upon a reassessment of Hong Kong's REIT sector development over the said periods.

- Q3 – Members agree with the current proposal that "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 construction costs of the project". Also, some suggest to include in the total cost estimate the financing costs and currency impact in the case that the development investment is overseas.

- Q4 – With respect to the frequency of periodic updates that should be provided to unitholders on the status of property development investments and related activities, some members suggest this to be part of the REIT's regular earnings reporting.

- Q5 – Members are generally fine with the current proposed set of safeguards.

- Q6 – Members agree with the proposed Maximum Cap of 25% GAV. However, individual members do point out that the scope of investment maybe too lax in the proposal.

  Also, it would be helpful if the SFC can clarify what "property funds" mean under the proposed 7.2B(d). For instance, does this include REITs, authorised and unauthorised collective investment schemes (it is unclear why the SFC refers to "funds" rather than "collective investment schemes"). Will "property funds" need to invest in physical real estate (e.g. so funds investing property companies may not qualify)? Also, does the term refer to (i) funds investing in local or overseas property or (ii) funds domiciled locally or overseas but investing in property?

- Q7 – individual members have suggested the following additional constraints on the Relevant Investments:
  - The investments should be in entities with over 95% of their income from real estate activities;
  - REITs cannot own more than 10% of another company's stock other than in another REIT or an entity that derives over 95% of its income from real estate rental activities.
  - In regular earnings reports, there should be clear disclosure on the impact of marking these investments to market.

- Other comments and questions:
  - Currently, fund managers cannot not invest in any fund(s) with underlying that is specifically prevented by the UT Code. Will this revision of the REITS code expand the investible REITS universe for SFC authorized funds?
  - Tax treatment is the biggest hindrance to Hong Kong REIT sector's growth. Under the current tax code, Hong Kong REITs receive no tax benefit over a regular corporation, which is different from the vast majority of global REIT jurisdictions. Would the FSTB and other relevant authorities pursue the tax initiatives described in Section 4.2 of the FSDC Research Paper "Developing Hong Kong as a Capital Formation Centre for Real Estate Trusts"? And if yes, when?
  - It would be important to provide more flexibility in the regulations to allow more M&A activities within the sector. A more dynamic environment should encourage improvement in REIT corporate governance which ultimately helps boost unitholder returns.
  - It would be helpful to relax the Hong Kong MPF's maximum REIT investment limit.

(End)