26 February 2014

Securities and Future Commission
35/F, Cheung Kong Centre
2 Queen's Road Central
Hong Kong

Dear Sirs,

Re : Consultation Paper on Amendments to the Code on Real Estate Investment Trust (REIT)

Before I (**in my own personal capacity**) endeavor to answer the 7 questions in this consultation exercise, let us revisit the position which the investment vehicle of Real Property Investment Trust ("RPIT") should adopt.

To members of the public, they expect RPIT to provide a kind of investment option on real property through the share market and holding units of the Trust fund as a unitholder, thus eliminating the problems with direct property investment which include, inter alia, the followings :-

(a) the huge investment or capital outlay that an individual small investor can afford;
(b) the direct property investment expertise involved for example, knowledge on government lease, town planning control, Buildings Regulations, deed of mutual covenant, plot ratio and site coverage etc;
(c) the financial accounting knowledge and expertise on property yield, internal rate of return and discounted cash flow analyses etc;
(d) the legal expertise on buying and selling of properties, in particular for the shopping arcades and malls, as well as the transaction costs involved; and
(e) the hustle in managing the properties so acquired.

In investing in the RPIT, small individual investors can hold a "small portion" of the property asset and thus can gain the benefits of having a capital gain, as well as the steady streams of rental income of the properties that the RPIT is holding, through the securitization and unitization. Securitization is the creating of tradable securities from a property asset. Unitization is also the creation of a tradable securities but the aim in this case is to parallel a return comparable to direct ownership.

Since RPIT is a kind of investment trust, the small individual investors virtually have lost their right in picking the properties for their investments. Instead they rely on the expertise and knowledge of those investment trust fund managers as well as the property professionals to look after the investment portfolios.

The Security and Future Commissioner ("SFC") who is the regulator should uphold and enforce the relevant provisions of the Securities and Futures Ordinance Cap. 571 ("SFO") and the applicable provisions of the Code on Real Estate Investment Trusts ("CREIT"). The increased in the flexibility in investment to improve the return to small individual investors should be balanced with the necessary increase in risk. New measures and mechanisms to protect small individual investors should be the important agenda for the regulatory regime.

Put it in a nutshell, RPIT should address the constraints of the direct property market in terms of liquidity, divisibility, problems of management and costs, price signaling (meaning a traded securities market place with real-time price information providing immediate indications of value and performance), risk control, information transparency, investment timing, diversification and breadth of investment opportunity.

Based on the above position, and further to my perusal of the consultation document, I would like to provide my observations as below :-

(a) Do you consider that flexibility in respect of property development investments and related activities should be introduced for REITs ? Do you have any comments on the proposed scope of the Relevant Investments and the proposed Maximum Cap ? What other safeguards do you consider appropriate to be put in place corresponding to the proposal to allow for the Relevant Investments ?

For small investors who are looking for good dividends from REIT, they would expect a continuous steady stream of rental incomes. I certainly would not expect REIT become a market trader, and through actively buying and selling of real properties to make profits and thus providing dividends to investors, since it might render a bigger fluctuation in the profits gained, and the share price could become very volatile.

Based on this rationale, I support the suggestion that REIT should be allowed to have a broader range of investment options, however only by allowing the "Maximum Cap" of 25% of the gross asset value of REIT be invested in "Relevant Investments", which should comprise of listed shares of real estate or property companies (local or foreign), or some blue chips shares (local or foreign), or government bonds (local or foreign). These would allow a wider spectrum of investments balanced with the acceptable risk involved. I disagree that REIT should invest in unlisted debt securities or junk bonds because they involve much higher risk.

The provisos for the Relevant Investment (i) – (iii) under Paragraph 35 of the Consultation Paper should be maintained.

The proposed relaxation on the spectrum of investment is in alignment with that in other countries like : Singapore which allows about 25%, Japan about 30% and Australia unlimited for their Maximum Cap in the Relevant Investments. The sole rental return from buying existing properties is similar to that from PINC (Property Income Certificates) which form of investment vehicle is already old-fashioned and is obsolete to suit the Hong Kong market.

(b) Do you consider that the 10% GAV Cap is set as an appropriate threshold ? Do you have any comments on how the Property Development Costs should be calculated ?

I am in agreement with the direct property investment. I opine that, at a start, 10% Gross Asset Value ("GAV") should be the limit for acquiring not only partly completed property but vacant site as well. However, for these properties, they must be completed (with the issuance of the Occupation Permit) in 5 years' time since their acquisition. This would obviate the problem of holding the vacant land for mere speculation, and thus defeating the purpose of generating streams of rental income. Having said that, both streams of rental income and capital gain in property prices are the main foci expected from the viewpoint of small investors. I do not see any problem in vacant land investment brought through public auction since most of the new government leases do have a "building covenant" clause stipulating the maximum period of time for the development, in default of which the Government can re-enter the land.

Development through buying vacant land has its beauty in that the building to be constructed will be in strict accordance with the size, shape and facilities as what REIT would like for their better return in investment.

I also agree that the way that the "Property Development Costs" should be calculated on the "at cost" basis cumulatively, and all uncompleted or vacant properties should not exceed 10% of GAV at all times.

(c) Do you have any comments on the frequency of the periodic updates that should be provided to unitholders on the status of property development investment and related activities ? 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 ?

Basically, I am in support of more transparent board governance for listed REITs. Other than the basic protection under the newly revamped Companies Ordinance and the listing rules, I am in support of the proposed "responsibilities and duties of REIT manager" and the proposed "disclosure requirements".

In addition, I would endeavor to suggest that REIT shall have more than 3 independent non-executive directors ("INEDs") (Paragraph 3.10(1) of Chapter 3 of Listing Rules) under the Listing Rules, or one-third of the board as recommended under the Cadbury Report to provide expertise in planning and development on real properties. I opine that we should have 5 INEDs, who should have qualifications or even in dual qualifications in property, architecture, engineering, surveying to act as "advisor" and as "supervisors" on the board, in addition to their orthodox role in the audit committee, remuneration committee and nomination committee. They should all have proper training in corporate governance. The traditional view of having merely accountants for the whole board is no longer the most appropriate way to run the REIT for her proper and healthy development.

Yours faithfully,

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