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

- REIT has grown in popularity and size in many overseas markets. But after over 10 years of the launch of the REIT market in Hong Kong, only 10 REITs are currently listed here, substantially lagging the growth of other REIT markets in the region.
- Given the restrictiveness of the current REIT regulations, many property owners and new issuers have either listed their assets abroad where the regulatory regime is less biased against growth, or opted for the convoluted structure of a business trust to avoid the regulatory hurdles associated with the REIT Code.
- The rapid growth of wealth in the region and need for investment products to cater to the growing retirement savings market in Asia will give rise to substantial demand and growth for REITs. Hong Kong must strengthen its position and increase its competitiveness to capture the potential growth of REIT market.
- Hong Kong should enhance its REIT regulations to align itself with market changes and international norms, thereby securing its role as a centre for REIT listings.
- More flexibility to Hong Kong REITs will translate into more variety for investors, who will have the opportunity to choose the right investments according to their own needs and risk appetite.

- Further background information
  - Hong Kong is lagging behind other regional markets in terms of the number of listed REITs, size of the REIT market (except Malaysia) and diversity of asset types and geography:

(as at end Jan 2014)	Hong Kong	Singapore	Japan	Malaysia
Total market cap	US$21.6 billion	US$42.7 billion	US$72.3 billion	US$6.6 billion
Number of REITs	10	30	43	16
Types of assets	Retail, mixed, office, hospitality	Retail, mixed, office, hospitality, industrial, healthcare	Retail, office, residential, logistics, hotel, others	Retail, office, mixed, healthcare, hospitality, agriculture

Source: Bloomberg

  - Currently, Hong Kong has the most stringent investment limitations among regional and international REIT markets:

	Hong Kong	Singapore	Japan	Malaysia	Australia	United States
Property development	×	✓	×	✓[1]	✓	✓
Invest in financial instruments	×	✓	✓	✓	✓	✓

[1] Property development activities are restricted but a fund may enter into arrangement at any stage during construction phase to acquire real estate subject to certain criteria.

- Asian pension funds are increasing their real estate allocations which will become a significant stimulus for the REIT market in Asia:
  - Real estate has been an important asset for pension funds in many countries because of the investment characteristics of high quality, income-producing real estate and its low risk and portfolio diversification benefits.
  - Pension funds in Asia are expected to increase their assets to over US$4.3 trillion by 2020. In particular, significant growth is expected in the developing pension fund systems in China.
  - Domestic REITs and international REITs are among the top three types of real estate investments considered suitable for pension funds.
    Source: "The Significance of Real Estate in Asian Pension Funds", APREA (2010)

- Hong Kong must seize the opportunity as the preferred listing venue for REITs:
  - Hong Kong stands as the best-positioned market to tap into the substantial potential of REIT listings for Chinese and regional assets.
  - As Hong Kong develops its REIT market, more investment analysts and property specialists will be required to cover the stocks. Brokerage service will also benefit from the increase in trading.
  - Asset management market will also develop, leading to more opportunities for fund managers and professionals.
  - With frequent financing and acquisition activities, REITs will increase the demand for services from various experts such as lawyers, accountants, valuers, surveyors and tax advisors.

- REIT regulations should seek a fine balance between investor protection and choice:
  - Acquisition is currently the only form of inorganic growth stipulated by the REIT Code.
  - The current REIT Code denies investors the choice as it restricts Hong Kong REITs from undertaking any property development activities.
  - If REITs were allowed to pursue property development, it would be equivalent to acquiring projects at an earlier stage, designing the assets to suit their specific needs, and achieving better returns on the investments. More specifically:
    1. It would allow better integration with the infrastructure, e.g. connections to planned footbridges or mass transit systems to serve the community better and to add value to the asset;
    2. It would produce less material wastage and achieve higher efficiency during construction since the REITs could tailor-make their own assets to suit their particular operational structures and business targets;
    3. It might lower fundamental cost on land acquisition, design development and overall construction compared to purchasing a built-asset at a higher price; and

4. It would offer a more sustainable solution than a major overhaul of the existing property and alleviate unnecessary disturbances to the existing tenants, users and public.

- With more flexibility in their investment scope, REIT investors will have a wider variety of investment products to choose from. Investors can assess their respective risk appetite and choose the appropriate REIT whose business strategy matches their appetite. This choice should be the prerogative of the REIT investor.

Question 2: Do you consider that the 10% GAV (Gross Asset Value) Cap is set as an appropriate threshold?

- 10% GAV Cap for REITs to undertake property development investments and related activities is an appropriate threshold to safeguard the overall risk profile of the REIT.
- The cap at 10% of GAV is in line with market practice in other overseas REIT regimes.

- Further background information
  - Certain Asian markets (such as Singapore and Malaysia) impose a cap on property development investments by REITs of 10% of total assets.
  - Matured REIT markets (such as United States and Australia) have no cap on property development investments by REITs.
  - Some of the largest and most notable REITs have a significant portion of development investments:

	Westfield Group	Simon Property Group	Unibail-Rodamco SE
Background	Largest listed REIT in Australia	Largest listed REIT in the United States	Largest listed REIT in Europe
Market cap	A$20.4 billion	U$47.2 billion	€17.4 billion
Development value	A$12 billion[1]	U$6.2 billion[2]	€6.7 billion[3]
Total asset	A$35.8 billion	U$32.6 billion	€29.6 billion
Development as percentage of total asset	34%	19%	23%

Source: Bloomberg as at 29th January 2014; latest annual reports.
[1] Includes "identified pipeline of development work".
[2] Includes "developments" and "expansions and renovations".
[3] Includes "total investment cost of consolidated development pipeline".

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

- To keep unitholders informed, REIT managers have the fiduciary duty to provide a fair estimate of the total cost for each property development project.

- Property Development Cost should include the cost of land acquisition (if any), REIT manager's estimates of the development/construction costs and a prudent buffer.
- Thus SFC's proposal on the calculation of Property Development Costs is appropriate.

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?

- REIT managers should provide the estimate upfront at the time of acquisition.
- REIT managers should also provide in good faith periodic updates to inform the market and unitholders of any subsequent increases to the Property Development Cost.

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?

- The proposed 10% GAV Cap already provides an appropriate threshold to safeguard the overall risk profile of a REIT.
- The proposed 10% GAV Cap is also in line with regional market practices.
- The two-year minimum holding requirement will allow REITs to mitigate some of the volatility to their earnings given the much longer term investment horizon.
- In addition, REIT managers owe a fiduciary duty to unitholders to ensure property development investments and related activities:
  - Must be made solely in the best interests of unitholders;
  - Should not result in a material change in the overall risk profile of the scheme;
  - Management company should have the requisite resources, competence, expertise, effective internal controls and risk management system for conducting such investments or activities.

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

- The proposed scope of the Relevant Investments (Hong Kong and overseas listed securities, unlisted debt securities, government and other public securities, and local or overseas property funds) and Maximum Cap (not exceeding 25% of the gross asset value of the REIT) are appropriate thresholds and in line with comparable regional regimes such as Singapore and Malaysia.

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

- The proposed scope of Relevant Investments is appropriate and in line with comparable regional regimes.