Urban Land Institute

Asia Pacific

TO: The Securities and Futures Commission

FROM: Urban Land Institute (ULI) North Asia Council

DATE: 25 February 2014

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

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On behalf of our members, the North Asia Council of the Urban Land Institute (ULI-NA) is submitting comments on the proposed Amendments to the Code on Real Estate Investment Trusts (January 2014). The Urban Land Institute (ULI) is a global multi-disciplinary organization with a mission to provide leadership in the responsible use of land and in creating and sustaining thriving communities worldwide. Our 30,000 members worldwide and nearly 2,000 members in Asia represent numerous professions including real estate investors and developers, architects, planners, urban designers, engineers and consultants. ULI-NA recognizes and supports the SFC's efforts to strengthen the Hong Kong REIT sector. Given the complexities of the issues, ULI-NA believes the discussion which should guide the amendments to the Hong Kong REIT sector should be within the following framework.

(1) Continue refining the Hong Kong REIT as a long-term investment product which is unique and does not duplicate other investment opportunities/products in both the public and private real estate space;
(2) Set the 'gold standard' for Hong Kong while taking reference of global industry regulations; and
(3) Ensure the REIT product complements other broader Hong Kong objectives.

With respect to the two current proposed amendments, we have the following comments which are made within this framework.

Proposal for introducing flexibility in respect of investments in properties under development or engagement in property development activities

We are supportive of the proposal to allow REITs to engage in property development, subject to a maximum threshold of 10% of the REIT's GAV, for the purposes of increasing their recurring income base. While some may argue that REITs should only acquire existing lower-risk income producing assets, the 10% development threshold does not substantially change the risk profile of the investment product while providing it another avenue to grow its recurring income base.

We would also recommend that the 10% GAV threshold should be calculated at the time of investment and be based on the manager's best estimate of total development costs including a market-based contingency. Such an approach would avoid putting the REIT in a position of forced liquidation of assets in the event the GAV falls in the future.

Also, the SFC may want to consider revising the minimum holding period for development projects which has been set at two years. While two years is in-line with the current REIT code for acquisition of existing property, given that additional risk is being taken in the development process, in order to reap the income benefits of that development, a longer holding period of 4-5 years would be merited to minimize potential overlap with the activities of local property developers and encourage REITS to develop properties for longer-term income production for their unit-holders rather than strata-title/speculative sale, which generally has a higher risk profile.

Proposal for introducing flexibility in respect of investments in financial instruments

While we understand that the income producing nature of the REITs results in a build-up of cash on the balance sheet, we feel that the proposed 'Relevant Investments' are too broad. The key here is to allow more efficient treasury management without changing the risk profile of the REIT and without duplicating other investment products available to investors.

First, these financial instruments should be limited to investments which are basically consistent with the income producing and liquid nature of the REIT. Investing spare cash prior to dividend distribution into other low-risk, high-quality income producing investments should not substantially change the risk profile of the REIT.

Second, the 25% maximum threshold is too high. Investors are investing into REITs as a focused means of securing stable property income and not as a general property play with investment capabilities (there are plenty of Hong Kong-listed stocks which do this). Investors want the REIT managers to be focused on their specialty – investing and managing income producing property. While most REIT managers are unlikely to reach this 25% threshold, the uncertainty this high limit creates would negatively impact the sector. And since REITs should be making dividend distributions regularly, a 10% limit should be more than sufficient.

Maintaining the REITs as a low-risk, income-generating investment product is critical to providing investors a range of offerings across the risk spectrum, particularly as Hong Kong's elderly population increases and the need for recurring income rises as they retire from the work force.

Urban Land Institute (ULI) - Background

Established in 1936, the Institute today has over 30,000 members worldwide, representing the entire spectrum of the land use and development disciplines. ULI relies heavily on the experience of its members. It is through member involvement and information resources that ULI has been able to set standards of excellence in development practice. The Institute has long been recognized as one of the world's most respected and widely quoted sources of objective information on urban planning, growth, and development.

ULI has a strong presence in Asia. The ULI Asia office was opened in Hong Kong in the fall of 2007 and now has nearly 2,000 members across the region with National Councils in Hong Kong, Mainland China, Singapore, Japan, Australia and the Philippines.

ULI is committed to:

- Bringing together leaders from across the fields of real estate and land use policy to exchange best practices and serve community needs;
- Fostering collaboration within and beyond ULI's membership through mentoring, dialogue, and problem solving;

- Exploring issues of urbanization, conservation, regeneration, land use, capital formation, and sustainable development;
- Advancing land use policies and design practices that respect the uniqueness of both the built and natural environments;
- Sharing knowledge through education, applied research, publishing, and electronic media; and
- Sustaining a diverse global network of local practice and advisory efforts that address current and future challenges.

ULI currently has six main program priorities:

Advising communities in need
Deliver the experience and expertise of ULI members to communities facing critical land use challenges

Shaping cities and regions
Foster the planning and development of vibrant, competitive metropolitan areas through sharing global best practices and promoting effective relationships among business, government, and community stakeholders

Developing excellence through education
Create learning experiences that develop professional expertise and personal leadership skills in support of the individual, the community, and the real estate industry

Driving innovation in real estate and urban development
Analyze the evolution of real estate market demand, changing technology, policy trends, and investment patterns to help identify opportunities, develop creative responses, and manage risk

Building sustainably
Clarify the connections between responsible use of resources, the built environment, and long-term environmental health, and demonstrate a compelling business case for resource efficiency

Connecting capital and the built environment
Ensure the attractiveness of real estate to global allocators of capital by understanding and explaining the dynamics affecting real estate value