Standard Chartered Securities (Hong Kong) Limited as a market participant in the Hong Kong REIT market, supports the proposals by the Securities and Futures Commission (the "Commission") in its consultation paper dated 27 January 2014 (the "Consultation Paper") on amendments to the Code on Real Estate Investment Trusts (the "Code") allowing greater flexibility in the investment scope of REITs in regards to investments in properties under development or engagement in property development activities and investments in financial instruments. Our responses and suggestions are set out below. Unless otherwise defined, capitalised terms used herein shall have the same meanings as those defined in the Consultation Paper.

RESPONSES TO QUESTIONS 1 TO 7 OF THE CONSULTATION PAPER

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

We concur with the Commission's views that REIT regulations should be updated to allow REITs flexibility in respect of property development investments and related activities. We also take the view that a REIT should be primarily recurrent income generating with investors expecting attractive yields but lower risk profile, thus limits to investment amount into property development activities should be imposed in order to distinguish REITs from traditional property development companies.

Factors considered include:

With only 10 REITs listed, Hong Kong REIT market is relatively smaller with generally less activity as compared to other more established Asian REIT markets (30 and 16 REITs in Singapore and Malaysia respectively). Up to now, only a few REITs in Hong Kong have acquired assets from their sponsors and the Hong Kong REIT market has failed to attract any listings of overseas assets. Hong Kong REIT regulations are based on a more restrictive regime as compared to other developed markets in Asia and around the world, and have not changed much since its introduction in 2003. Both Singapore and Malaysia REIT regulations allow property development and construction subject to a limit of 10% of the REIT's total asset value.

For Hong Kong to maintain and reinforce its role as a leading financial centre within the region, Hong Kong needs to step up its efforts to stay up to date on changes to its market landscape, to stay competitive, to keep abreast of investors' interest and demand. A thriving REIT market will benefit Hong Kong's capital markets activities.

Aging and deteriorating properties held by REITs should be given the flexibility to be re-built and re-developed and be given the option to be able to design and build an asset (according to their specific needs) instead of being stuck with designs built by third parties. Thus, "design and build" should be included within the permitted activities under property development investments in the revised Code provisions, this allows REITs to possess more assets in their portfolio which would fit into their strategy, helps differentiate themselves from others and provides more appealing story to investors.

As long as the REIT manager has the capabilities and resources to undertake property development investments, the risks of development are properly controlled and timely disclosures are made to unitholders and the public, REITs will be able to take advantage of lower purchase price in early participation in a project. This in turn, might benefit REIT investors due to potentially lower costs resulting in higher yields and returns to unitholders.

2. ***Do you consider that the 10% GAV Cap is set as an appropriate threshold?***

We note that the proposed Code amendments have changed the threshold basis from total net asset value to that of gross asset value, provides REITs with more flexibility. A REIT is a stable yield instrument with lower risk investment profile for investors, the risk profile of REITs should remain distinctly different from that of property development companies. We support the proposal that REITs should be given the flexibility to make property development investments, however, we believe an appropriate threshold should be set.

Similar thresholds are set in other REIT markets in the region: in Singapore, the total contract value of property development activities undertaken and investments in uncompleted property developments should not exceed 10% of the property fund's deposited property (the property fund's total assets based upon the latest valuation); in Malaysia, the total value of real estates under construction acquired by the fund does not exceed 10% of the fund's total asset value (after the acquisition).

Having considered the above, we concur with the Commission's views in order to align regulations to that of other regional markets, REITs should be allowed to make property development investments, in addition to the existing regulation that REITs are allowed to acquire uncompleted units; whereby the aggregate value of such real estates together shall be capped at 10% of the gross asset value of the scheme.

However, in the proposed amendments (Code 7.2A), this 10% GAV Cap threshold is to be maintained at all times, this would be too restrictive, creates extra administrative work for the REIT manager and affect the REIT to keep the property development project ongoing should the threshold rises above the stipulated 10% GAV Cap (e.g. brought about by unforeseen property development costs increases, asset divestment from the REIT portfolio). We recommend that the 10% GAV Cap threshold be set upfront at the commencement of the property development or at announcement, e.g. the value of the development properties is calculated upfront as (i) the total acquisition consideration for the new project (including land cost) or the total value of the existing development property (under construction), and (ii) any additional development cost to be incurred for the new project; whereas the gross asset value is based on the latest published balance sheet of the REIT.

We also note that the proposed minimum property holding period of 2 years from project completion by REITs, is in line with the principle of existing regulation requiring minimum holding period of 2 years for acquired properties by REITs, we therefore concur with the Commission's views that a minimum holding period of 2 years is appropriate, this would serve as an extra safeguard to prevent REITs from developing an asset for the benefits of selling it immediately (pocketing the development gain) rather than to hold the asset for stable income generation. We suggest the Commission to include in the Code provisions when project completion date is, we recommend it to be the date when the new property becomes ready for renting out, in any event no earlier than the date it becomes fit for occupation, i.e. the date the Building Authority issues the Occupation Permit.

We note that no such concept of a holding period exist in Singapore and Malaysia, it is generally the aim of REITs to increase its portfolio / acquire more assets to increase its asset value size. In Singapore, a property fund is not allowed to undertake property development activities unless it intends to hold the developed property upon completion; in Malaysia, a fund may enter into an arrangement or agreement during construction phase to acquire the real estate; no specific holding periods were stipulated in both markets.

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

We do not have additional comments on how Property Development Costs should be calculated, as long as the REIT manager uses its best estimate to come up with all the costs borne (coupled with receipt of an opinion from an independent expert) including a prudent buffer, has the ability to try to control costs and time spent in project development, coupled with timely and transparent disclosure, meeting its fiduciary duty to its unitholders and complying with the Code and regulations. We suggest that in any event of material cost overruns, disclosure in the form of an announcement (setting out the reasons and measures to control costs) is recommended.

In Singapore and Malaysia, similar regulation is drafted in less specific ways: in Singapore, this is equivalent to the contract value of property development activities undertaken whereby such value of investments refer to contracted prices and not the value of progress payments made to date; in Malaysia, it states that the total value of real estates under construction acquired by the fund does not exceed 10% limit of the fund's total asset value (after the acquisition) and that a fund is not permitted to conduct property development (does not apply to refurbishment, retrofitting, renovations or extensions carried out on existing real estates within a fund's portfolio).

We also note that the Commission has set out the criteria of the independent expert (under paragraph 17 of the Consultation Paper), being valuers or surveyors, which the Commission would normally find acceptable, we suggest these criteria to be added to the revised Code. As the role of this independent expert is to opine on costings, cost overruns and project timing aspects, we recommend the Commission to also consider qualified quantity surveyors or qualified architects as they might be better placed than valuers or surveyors.

4. Do you have any comments on the frequency of the periodic updates that should be provided to unitholders on the status of property development investments and related activities?

We agree that a REIT manager should issue an announcement to inform unitholders when a REIT is to enter into a contract for property development investment and related activities (regardless of size), including a summary of the key terms, conditions and risks involved. We recommend that periodic updates about the status of property development to be included in the interim and annual reports. In addition, if there are material deviation in costs and development progress, the REIT should provide additional timely disclosure so that unitholders are kept informed.

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?***

Since Hong Kong's regulatory regime is a disclosure based regime and transparency is key to investors, thus, we recommend that as part of the announcement (as required under the proposed Code 7.2A(6)) the business plan of the REIT Manager in relation to its property development investments should be clearly set out including the REIT Manager's views why and how its property development investments are made in the best interests of the REIT and of its unitholders.

Generally, the proposed amendments are in line with that of the Singapore and Malaysia regimes whereby transparency and adequate disclosure should be sufficient safeguards.

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

We concur with the proposed scope of the Relevant Investments to introduce flexibility for REITs by making available a broader range of investment options. We agree with the proposed Maximum Cap of 25% of the gross asset value of the REIT to be permitted to invest in financial instruments with the remaining 75% of the gross asset value to be used to invest in real estate to maintain a REIT's profile as primarily recurrent rental income generating vehicle. We note that this is in line with Singapore and Malaysia regimes.

In the proposed amendments, permissible investments under Relevant Investments include listed securities, unlisted debt securities, government and other public securities, and local or overseas property funds together with the REIT's other miscellaneous holdings. However, given the more stable nature and lower risk profiles of REITs, the main purpose for allowing REITs to invest in alternative financial instruments is to better manage its cash position as a treasury function for the benefits and interests of the unitholders, rather than involving in speculative investments. We agreed with the Commission that the Relevant Instruments should be sufficiently liquid and have transparent pricing, thus, should only be limited to listed financial instruments instead of unlisted securities / unlisted debt instruments / unlisted property funds. This is similar to current MPF regulation in respect of their permissible investments.

The Commission should be mindful that certain REITs might be able to invest in some high risk financial instruments, such as listed warrants, which would significantly increase the REITs risk profile, thus, we suggest the Commission to clarify the exceptions to its proposed Code provision 7.2B. We concur that the spread limit of restricting investments into any single group of companies be capped at 5% of the gross asset value of the REIT. We also suggest the Commission to consider setting a concentration limit of restricting investments into any single class of relevant investment instruments (to be defined in the Code) be capped at say, 10% of the gross asset value of the REIT. In addition, the Commission should consider whether it is appropriate that these investment restrictions are applicable at the time the transactions are entered into, and not at later dates.

We notice that in the proposed Code 7.1 Note 1 and Code 7.2B (iii), at least 75% of the gross asset value of the scheme shall be invested in real estate that generates recurrent rental income at all times. Some real estate assets might be temporarily out of income as a result of refurbishment or renovation activities, thus, we suggest the Commission to reconsider the wording in these provisions to take these temporary events into consideration.

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

Since Hong Kong's regulatory regime is a disclosure based regime and transparency is key to investors, thus, we are of the view that disclosure of the REIT's full investment portfolio on its website on a monthly basis and in the REIT's interim and annual reports is adequate.

In relation to breaches of the 10% GAV Cap and / or the Maximum Cap, we concur with the Commission that the REIT manager should inform the Commission in writing immediately and issue an announcement to inform unitholders. Such announcement should include magnitude of breach, reasons for breach, proposed rectification plan and to seek and obtain consent from the Commission a proposed time for rectification.

OTHERS / ADDITIONAL PROPOSALS COVERED IN THE FSDC REPORT

8. *Proposal relating to removal of profits tax on REITs, exemption from stamp duty on transfers of non-residential property, allowance for MPF constituent funds to invest in units in REITs without referencing to current 10% investment limitation*

To further enhance competitiveness of the REIT market in Hong Kong, we are generally supportive of certain other initiatives included in the FSDC report issued in November 2013. However, we agree that other relevant authorities such as Inland Revenue Department and MPF Authority would need to consider these proposals, support from the Commission on these would no doubt be an initial step to push for further changes.

Whilst we acknowledge that the provision of tax advantages for REITs would contribute popularity amongst investors, different jurisdictions have different tax structures. We understand the overall tax structure is a matter of government policy and introducing changes to tax structure is a complicated matter. To increase competitiveness of REITs, we suggest further work be done to explore the viability of introducing some tax advantage such as lowering corporate tax on a REIT's profits instead of the full 16.5% and / or eliminating stamp duty for non-residential property acquired / transferred by a REIT in Hong Kong.

The size of Asian pension funds continues to grow rapidly as a result of growth of wealth, real estate has been an important asset for pension funds in many countries due to similar risk profiles and diversification characteristics. We support the proposal to remove the threshold of 10% of total MPF scheme funds on their investments in REITs in Hong Kong. In Singapore, investors who are members of the Central Provident Fund may use up 35% of investible savings to subscribe for REITs.

9. *Proposal to extending the compulsory acquisition and scheme of arrangement provisions under the Companies Ordinance to REITs*

We agree with the proposal to extend compulsory acquisition and scheme of arrangement provisions to include REITs, bringing REITs to a level playing field with listed equity securities and bringing Hong Kong's regulatory regime closer to international practice. We note that Singapore also has similar regulatory provisions subject to unitholders' approvals.

Currently, REITs in Hong Kong suffer two key deficiencies: absence of "squeeze out" provisions facilitating takeover of a REIT and non availability of "scheme of arrangement" in the privatisation of a REIT.

The absence of statutory compulsory acquisition following a general offer for REITs in Hong Kong renders a complete takeover impossible as an offer with 100% acceptance by all unitholders (consist of sizeable portion of individual / retail investors) is impossible to achieve and may result in the offeror being stuck with minorities.

At present, REITs can be privatised by way of disposing its assets followed by a delisting or by a complete takeover by another REIT. Disposing assets in such a way can be time consuming, uncertain and optimal disposal prices might not be achieved. Introducing an additional way for privatisation will provide minority unitholders more protection as they can compare available options and choose the one that is in their best interests. Therefore, we support such proposal made in the FSDC report.

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