



CONSULTATION ON PROPOSED AMENDMENTS TO THE CODE ON REAL ESTATE INVESTMENT TRUSTS

THE LAW SOCIETY'S SUBMISSIONS

The Securities and Futures Commission (“SFC”) issued a consultation paper on 9 June 2020 on the proposed amendments to the Code on Real Estate Investment Trusts (“Consultation Paper”). In response thereto, the Law Society provides the following submissions on the consultation questions posed.

Question 1. Do you agree with the proposal to allow flexibility for REITs to invest in Minority-owned Properties¹? Please explain your view.

Law Society’s response:

We agree with the proposal to allow flexibility for REITs to invest in Minority-owned Properties. This would bring the position in Hong Kong in line with the position in other comparable jurisdictions, and give greater flexibility, more diversity and increased opportunity in the REIT market. We note Singapore allows investments through joint ownerships subject to requirements similar to those proposed by the SFC in the Consultation Paper, and we are not aware of any significant adverse comment to that position in Singapore or consultation to further tighten the applicable rules.

Question 2. Do you consider that the proposed overarching principles and specific conditions for Qualified Minority-owned Properties² are appropriate? Do you have any comments on the principles and conditions proposed? Please explain your view.

Law Society’s response:

We broadly agree with the proposed overarching principles and specific conditions. We have comments on the specific veto matters:

¹ As defined in the proposed new 7.7B of the REIT Code.

² As defined in paragraph 20 of the Consultation Paper and the proposed new 7.7C of the REIT Code.

- 7.7C(h)(ii)(d) - The SFC should propose a threshold to determine the level of significance for the identification of “material transactions”.
- 7.7C(h)(ii)(d) - The reference to “merger” is unclear. The SFC may wish to clarify whether a “merger” is a separate example of a “material transaction”, or whether the SFC considers a “merger” is a transaction that a REIT may undertake in the ordinary course of its business. We suggest the SFC should consider whether the decision to enter into a merger that constitutes a material transaction should be a separate specific veto matter under 7.7C(ii); and
- 7.7C(h)(ii)(j) – the SFC should include a clear threshold for a transaction to be regarded as “major acquisition, transfer or disposal”.

Question 3. Do you have any comment on the proposed requirements for Non-qualified Minority-owned Properties³? Please explain your view.

Law Society’s response:

We do not have comments on the proposed requirements for Non-qualified Minority-owned Properties.

Question 4. Do you have any comment on the proposed disclosure and other requirements for investments in Minority-owned Properties?

Law Society’s response:

We refer to *Note 7.7C, Note 2(iv)*. The obligation to disclose financial information should be framed so that it is consistent with the financial information the REIT can reasonably expect to receive in respect of an investment in a Minority-owned Properties. This should be, for instance, the information available in the audited report of the entity holding the Minority-owned Property. The REIT may not be in a position to insist on receiving information proposed to be disclosed by the SFC, to the extent that it is not disclosed in audited financial statements.

Question 5. Do you agree with our proposal to align the diversification limit on the REIT’s holdings of Relevant Investments⁴ issued by any single group of companies with the Single Investment Cap⁵ on Non-qualified Minority-owned Properties of 10% of GAV? Please explain your view.

³ As defined in the proposed new 7.7D of the REIT Code.

⁴ As defined in the proposed new 7.2B of this Code.

⁵ As stated in paragraph 23A of the Consultation Paper.

Law Society's response:

We generally agree with the proposal to increasing the REIT's holding limit of Relevant Investment. This aligns with the objective to enhance flexibility and diversify risks. We have no comments on the appropriate threshold to be applied.

Question 6. Do you have any comment on the proposal to adjust the 10% GAV Cap and the safeguards imposed? Please explain your view.

Law Society's response:

We agree with the proposal to adjust the GAV Cap. This aligns with the objective to allow the REITs to have more flexibility.

However, the SFC should consider the following when deciding the appropriate threshold and safeguards to be imposed:

- The proposed adjustment to 25% GAV may result in a REIT having up to 25% of the REIT's GAV invested in property development projects. This would deviate from the business intention of REIT. We make this comment as property markets can be volatile, both in Hong Kong and elsewhere; and
- The SFC could consider whether substantive conditions should be imposed as additional safeguards, instead of the proposed procedural conditions. The SFC could consider:
 - requiring that any investment in property development projects cannot be disposed within three years after completion of the development; or
 - requiring that the total contract value of property development activities can only exceed 10% GAV, but not more than 25%, if the additional allowance is used solely for development or redevelopment activities that meet specific public policy objectives for the property development market. For instance, in a comparable jurisdiction, any property development activity that exceeded 10% GAV could only be utilized for the redevelopment of an existing property.

Question 7. Do you have any comments on the proposed increase of the borrowing limit from 45% to 50%? Do you think a higher borrowing limit above 50% should be allowed? Please explain your view. If you think a higher borrowing limit should be allowed, what should be the appropriate limit and what other conditions or safeguards (if any)

should be imposed?

Law Society's response:

We generally agree with the proposal to increase the borrowing limit from 45% to 50%. Comparable jurisdictions have also adopted a borrowing limit of approximately 50%. Trustees, acting as fiduciary, will be in a position to make a prudent decision on the appropriate borrowing liability that the REIT should incur, and this will typically be significantly less than 50%. However, a maximum borrowing limit of 50% is an appropriate ceiling.

Question 8. Do you have any comments on the proposed amendments to the definition of “connected persons”? Please explain your view.

Law Society's response:

The SFC should consider whether the exceptions under Chapter 14A (in particular 14A.09 – 14A.11) of the Listing Rules should also be incorporated into or referred to in the REIT Code. Otherwise we agree with the proposed amendments to the definition of “connected persons”.

Question 9. Do you agree with the proposal to align the connected party transactions and notifiable transactions requirements for REITs with the Listing Rules? Please set out your reasons.

Law Society's response:

We agree with the proposal to align the connected party transactions and notifiable transactions requirements for REITs with the Listing Rules.

Question 10. Do you have any comments on the other proposed amendments to Chapter 8 and Chapter 10 of the REIT Code?

Law Society's response:

We do not have comments on the other proposed amendments to Chapter 8 and Chapter 10 of the REIT Code.

Question 11. Do you have any comments on the proposed miscellaneous amendments? Please explain your view.

Law Society's response:

We have no comments on the proposed miscellaneous amendments.

Question 12. Do you have any comments on the proposed implementation timeline?

Law Society's response:

We agree with the proposed implementation timeline.

**The Law Society of Hong Kong
21 July 2020**

