HKREITA
香港房託基金協會有限公司
Hong Kong REITS Association Limited

10 October 2023 **BY POST and EMAIL**

Financial Services and the Treasury Bureau
24/F, Central Government Offices
2 Tim Mei Avenue
Tamar
Hong Kong

Attention: Mr Carlson Tong, Chairman of the Task Force on Enhancing Stock Market Liquidity

Dear Mr Tong,

Policy Recommendations on Enhancing Stock Market Liquidity

Introduction

On behalf of the Hong Kong REITS Association ("HKREITA"), its members and the Hong Kong REITs ("H-REIT") industry, we are writing to provide policy recommendations the Task Force on Enhancing Stock Market Liquidity ("Task Force") could consider for its efforts to enhance stock market liquidity and boost Hong Kong's status as an international financial centre.

HKREITA is an industry association for the REITs in Hong Kong, with Link REIT, SF REIT and Yuexiu REIT as our co-founding members. HKREITA represents the local REIT market, with a vision to promote the overall development of the H-REIT industry and drive it to greater prominence in global capital markets.

Given its strength as an international financial centre and proximity to Mainland China, Hong Kong is in a unique position to become the Asia Pacific REIT hub. The Task Force could take on an advisory role to the Government in fully capitalising on the significant growth potential of the H-REIT market, thereby enhancing stock market liquidity and strengthening Hong Kong's status in the global REIT market.

Policy Recommendations

HKREITA supports and appreciates the effort made by the Government and other regulatory bodies in fostering the development of the H-REIT market. However, while some progress has been made, H-REITs have faced several constraints, notably the lack of tax incentives and the relative restrictiveness of structure in which H-REITs should operate in. In this regard, we would like to put forward the following six key policy recommendations for the Task Force's consideration:

(i) Stamp duty exemption for the transfer of properties into H-REITs

The stamp duty rate in Hong Kong is unduly onerous for potential sponsors wishing to inject their properties into new H-REITs or for H-REITs to grow by acquiring newly built properties, especially when the properties are held directly by the property owner. The sale and transfer of non-residential properties in Hong Kong is subject to stamp duty of up to 4.25%, which is even higher than one year's net property income of certain properties. In comparison, overseas REITs in competitor markets such as Japan and Singapore enjoy lower stamp duty rates of up to 1.6% and 3%, respectively.

Where a property owner holds properties via a special purpose vehicle ("SPV"), the transfer of that property would typically take the form of the sale and purchase of the shares of the relevant SPV, which is subject to a stamp duty rate of 0.26%. The above differential stamp duty treatment puts those landlords who do not hold their properties in separate SPVs in a highly disadvantaged position.

The unfavourable stamp duty in Hong Kong has also represented a significant cost for property owners and H-REITs, substantially diminishing any incentive to deploy a H-REIT structure or spin off assets into a H-REIT.

To facilitate growth from asset injection and to encourage the establishment of H-REITs, the Government should consider exempting H-REITs from stamp duty on the sale and transfer of property from existing holding structures to that of a H-REIT or lowering the stamp duty rate for the direct transfer of properties into H-REITs to 0.26%, aligning with the stamp duty levied on property transaction through the transfer of SPVs.

(ii) Stamp duty exemption for the trading of H-REITs

To further support the H-REIT market, the Government may consider providing stamp duty concessions on trading H-REIT units. Currently, trading of H-REIT units is subject to a stamp duty rate of 0.26%. We note that the Government has extended the stamp duty exemption to the transfer of certain collective investment schemes that are authorised by the Securities and Futures Commission ("SFC"), such as exchange-traded funds and leveraged and inverse products. We believe the same arrangements should be extended to H-REITs. Reducing the transaction costs associated with trading H-REITs would encourage more H-REIT listings in Hong Kong and drive the depth and liquidity of our securities market.

(iii) Inclusion of REITs into the Stock Connect regime

Hong Kong has long played the role of a global investment connector between the Mainland and the rest of the world. The launch of Stock Connect has further strengthened Hong Kong's position as a destination for Mainland investors and opened the door for Mainland and international investors to trade in each other's stock markets.

Trading in Stock Connect has been active since its launch. Further, the SFC recently announced the inclusion of foreign companies which are constituents of Hang Seng Composite Indices and meet the relevant criteria of the Stock Connect regime. Nonetheless, H-REITs are yet to benefit from the regime as they are excluded from the list of eligible securities under the Stock Connect regime.

In this regard, we propose to include H-REITs as eligible securities under the Stock Connect regime. This would allow global investors to benefit from a broader exposure to Mainland assets, particularly in infrastructure sectors. Mainland investors could leverage these platforms to invest in overseas real estate assets through H-REITs and diversify their investment portfolios. The investor bases of the two markets would thus be expanded, further enhancing liquidity provision and price discovery in each market. As a result, Hong Kong would continue to prosper as a REIT investment hub, rivalling other markets and contributing to the continued economic transformation and expansion of Hong Kong.

(iv) Inclusion of REITs into the HKD-RMB Dual Counter Model

The HKD-RMB Dual Counter Model was recently launched in June 2023 to support the Renminbi development in the Hong Kong securities market. We propose to include H-REITs as eligible securities under such model, so that investors have a choice of trading H-REIT units in either Hong Kong Dollar or Renminbi. This will provide consistent liquidity in the Renminbi counter and minimise price discrepancies between the counters. More choice for investors will mean bigger capital pools for issuers and increased cross-border capital circulation, further enhance liquidity of the stock market. Coupled with the inclusion of H-REITs into the Stock Connect regime, it will be even more attractive for Mainland investors to trade Renminbi denominated H-REIT units via southbound trading.

(v) Tax transparency

Tax transparency in this context refers to the situation where a REIT will not be subject to income tax at the trust level if it meets certain requirements in distributing income to unitholders. Rather, tax is payable at the investor level, at their respective marginal rates.

Hong Kong adopts a simple and low tax regime. No tax is levied on capital gains or dividend income from investing in H-REITs. Nonetheless, when a H-REIT directly holds properties in Hong Kong and derives rental income thereon, such rental income will be subject to a property tax of 15%. When a H-REIT indirectly holds properties in Hong Kong via SPVs, such SPVs will be subject to profits tax at 16.5% (in respect of the profits derived from those properties).

Currently, the absence of tax transparency fosters the impression that H-REITs are subject to highly disadvantageous tax treatment and produce lower yields than those available in other markets, disincentivising potential REITs from listing in Hong Kong and existing H-REITs from acquiring properties. The above property and profit tax treatment for H-REITs will disadvantage small investors in the lower tax bracket and disincentivise them from buying H-REIT units. Those investors will be subject to a higher tax rate than in cases where rental income from properties is charged at their individual tax rate.

Appropriate tax structures have repeatedly been proven as key tenets in growing and sustaining both H-REIT and stock markets. Hong Kong should consider following the successful path of other mature REIT markets in adopting tax transparency.

While removing profit and property tax for the entire H-REIT could lead to a full tax exempt situation, we consider that a partial concession might represent both a more viable and an attractive economic incentive for new REITs to launch in Hong Kong and for more properties to be acquired by H-REITs, aiding H-REITs in approaching parity with regional peers. Hong Kong could also follow Mainland China's practice in offering tax benefits for setting up REITs. We believe that special tax treatment shall be provided to H-REITs, which could further stimulate H-REIT development and enhance stock market liquidity.

(vi) Diversify the legal structure of H-REITs

We note that in other mature REIT markets, such as the United States, Australia and Japan, REITs are given broad discretion to choose the legal structure that best suits their business needs and are permitted to adopt corporate structures. We believe H-REITs should be given the same level of flexibility and freedom to choose their legal structure.

Currently, H-REITs must be established as unit trusts under the REIT Code. The rationale is to ensure a clear segregation of assets. However, a clear segregation of assets can also be achieved via a corporate structure by appointing an independent custodian with the equivalent supervisory and oversight responsibilities as a trustee.

The inability to structure a H-REIT as a corporate may serve as a severe deterrent for real estate companies that may otherwise develop REITs in Hong Kong. For example, from an accounting perspective, a H-REIT (being a trust with a limited lifespan) cannot be treated as equity on a sponsor's balance sheet nor consolidated by the said sponsor. As sponsors may only treat H-REITs as liabilities on the balance sheet, the whole concept of forming and listing of H-REITs is rendered unattractive.

Therefore, introducing greater flexibility to the legal structure would improve investors' coverage, allowing investors with various mandates to participate in H-REIT investments. This will eventually help Hong Kong to compete more robustly in the global arena against other international financial centres as the domicile of choice for REIT managers and sponsors. Some investment funds or institutions have certain restrictions on investment in trusts/funds or rules against becoming a fund of funds, thus preventing them from investing in REITs in a trust form. Such technical investment hurdles could be surmounted if H-REITs were permitted to be structured as corporates.

Conclusion

We believe that implementing the above recommendations will help foster a more vibrant H-REIT market, which will enhance the stock market liquidity and drive more business opportunities in the real estate and financial services sectors.

HKREITA would be pleased to have a meeting with the Task Force to further discuss the policy recommendations. Should you have any questions, please contact our Mr. Kenneth Wong, Secretary General of HKREITA, at secretariat@hkreita.com or 2175 1383. We look forward to receiving your favourable reply.

Yours sincerely,

George Kwok Lung HONGCHOY
Honorary Founding President & Chairman
Hong Kong REITS Association Limited