

## Prospects for Real Estate Funds / Investment Trusts in Hong Kong

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September 2002

Recently, the government has been contemplating the idea of real estate investment trusts (REIT) for Hong Kong and has commissioned the SFC to look into the matter. Opinion from the business sector and relevant professionals will also be sought.

To recap a bit, REIT has a long history in the USA, and has spread to Asia in the past few years and to Australia in the last 15 years or so. Put simply, a REIT usually has a pool / portfolio of real estate which is securitized for consumption / investment by the institutional and / or retail investors. Using the USA arrangement, its dividends and earnings are tax-free at the REIT level provided more than 95% of these are distributed to the investors, who may or may not be required to pay tax on such distributions, and double-taxing is avoided. Most REIT are equity-based.

Notwithstanding the various processes and eventual outcomes, and subject to further details, **the author is basically supportive of the idea** and thinks there is a good market for such investment vehicles assuming certain parameters are met:

- a) **Currently, there is no specific law or legal framework for REIT in Hong Kong** = though this in itself should not be a hurdle as it is basically a technical concern. In addition, various places such as the USA, Australia, Japan or Singapore which have some experience in REIT could be researched or modeled upon.
- b) **Some say the best quality and investment grade properties** are in the hands of the largest real estate developers, who are mostly well-financed and may not wish to part (unless being paid handsomely) with their portfolios = admittedly this is true for now yet the world / region does not stand still, meaning that due to changing environment and evolving opportunities there is always the chance that some developers may wish to dispose of some of their currently held prime real estate in order to capture opportunities elsewhere etc. It is reasonable to expect that a few developers may even use the REIT vehicle to liquidate their assets.
- c) **The Hong Kong taxes are low** and offer little incentives for structuring a REIT = True though again, the world changes and Hong Kong taxes should not be taken for granted (remember we have been having government deficits!). Moreover, even a saving of some 16% taxes could be enormous as REIT are likely to be relatively sizable in terms of investment capital and earnings.

Your humble author is optimistic of the REIT prospect because:

- 1) **The population is graying** = currently the average age is around 36 and is likely to rise given the demographic distribution and the imminent retirement of the "baby-boomers". People will tend to look for relatively steady investments and REIT tend to buy established properties with good rental yields etc, thus a potential good match. Compared to bank savings and bonds, REIT offer some

hope of capital appreciation in addition to the rental income, thus kind of falling between a bond and a real estate stock, which may include non-real estate assets (i.e. a REIT is typically more focused on real estate) and which earning distribution may be subject to the board (while REIT distribute most earnings as mentioned above to keep the tax-free status).

- 2) **The MPF is growing** = and REIT offer one more option for placing such funds, notwithstanding the possibility of having to add / amend some laws to suit.
- 3) **Many middle class would like to invest** in other regional real estate markets especially the major cities in China yet may not wish to spend large amounts on direct ownership and to have the trouble of maintaining the bricks and mortar etc = your humble author does not have any formal data on this nor has he performed a survey. Yet most of his friends would consider such vehicles if good and well managed ones are found. Nonetheless, it is not specifically known if the Hong Kong REIT may invest in non-Hong Kong properties, though the market appeal would be higher if regional markets could be included.
- 4) **Hong Kong having the necessary and ready legal, financial and marketing infrastructures**, especially if China portfolios are involved = Notwithstanding the views that Shanghai / Beijing are improving fast, and that China is also looking into REIT herself etc, your author thinks Hong Kong is still the best place and possibly the only place where REIT could be run as far as China / regional markets are concerned.
- 5) **REIT, if adopted, are likely to fall under some form of government-related monitoring** = while it is important that items like organization structure, accounting administration, earning distribution, and the like be tightly monitored, the business or investment decisions should be less so in order not to deplete unnecessarily the flexibility and nimbleness required in today's investment environment.

Like other investments, no matter how well REIT are structured and monitored, **the performance of the various real estate markets and properties** that they invest in largely decides the performance of the REIT themselves. Also, REIT will only become a significant part of the overall real estate scene in the long run if the REIT involved are responsibly and competently managed.

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