

## China REITs: New guidelines for acquisitions and equity fundraising by PRC infrastructure REITs, and expanded coverage for affordable rental housing

### In brief

The Shenzhen Stock Exchange (SZSE) and Shanghai Stock Exchange (SSE) published new trial guidelines on 31 May 2022 for follow-on acquisitions and equity fundraising by PRC infrastructure REITs ("**C-REITs**").

The New Acquisition Guidelines set out detailed requirements for post-listing acquisitions by C-REITs, including which targets and transaction parties may qualify, as well as the applicable disclosure and shareholders' approval requirements. The New Acquisition Guidelines also provide parameters for post-listing equity offerings by C-REITs to finance these acquisitions or asset enhancement initiatives.

These guidelines represent another important development in the C-REIT regime as they effectively pave the way for C-REITs to grow organically through acquiring new assets, as well as raising new funds and expanding investor base by equity offerings, which distinguish them from their quasi-REITs predecessors.

In another important C-REIT development, the SZSE and SSE also published the Affordable Rental Housing Guidelines on 15 July 2022, setting out certain criteria for establishing an affordable rental housing C-REIT. These guidelines also follow the SZSE's approval of Hotland Innovation Shenzhen Talent Affordable Rental Housing C-REIT on 11 July 2022, and the SSE's approval of CICC Xiamen Affordable Rental Housing C-REIT on 14 July 2022.

The recent promotion of C-REITs to cover affordable rental housing, along with other strategic assets such as clean energy, signifies the PRC authorities' determination to, by enhancing the regime for new financial products such as C-REITs, address social issues and further broader national policies and objectives.

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### New acquisition and equity fundraising guidelines

C-REITs are now permitted to acquire new infrastructure projects, and finance such acquisitions through equity offerings, under "Guidelines No. 3 on public infrastructure REITs - new acquisition of infrastructure projects (trial)" (《公开募集基础设施证券投资基金业务指引第3号—新购入基础设施项目(试行)》) and "Shanghai Stock Exchange Guidelines No. 3 on public infrastructure REITs - new acquisition of infrastructure projects (trial)" (《上海证券交易所公开募集基础设施证券投资基金(REITs)规则适用指引第3号——新购入基础设施项目(试行)》) published respectively by SZSE and SSE on 31 May 2022 ("**New Acquisition Guidelines**").

#### Qualifying C-REITs

C-REITs may enter into new acquisitions if they have been in operation for at least 12 months and are in good operating condition with stable cash flow.

#### Qualifying assets

The target infrastructure project(s) to be acquired must generally be of the same type as the existing assets in the C-REIT's portfolio, and must meet the same requirements applicable to the initial assets at listing, such as generating stable cash flow with at



least three years of operation. Acquisition of such project(s) must also be beneficial to the operation and the overall competitiveness and attractiveness of the C-REIT.

## Qualifying original owner

The original owner of the target infrastructure project ("**Seller**") must meet similar requirements as the originator of the initial assets of the C-REIT, including those pertaining to credit worthiness, internal control and compliance.

## Sources of funding

C-REITs may finance acquisitions using one or more of these sources of funds: (i) retained earnings; (ii) borrowings; and (iii) equity offering.

At present, C-REITs are permitted to borrow for financing acquisitions so long as the amount borrowed does not exceed 20% of net assets of the C-REIT and its gross assets does not at any time exceed 140% of its net assets.

## Shareholders' approval

Acquisitions that have a transaction value exceeding 20% of the C-REIT's net assets, or are financed by equity offerings, must be approved by shareholders in general meeting. The requisite approval threshold is by simple majority, except for the following cases where two-thirds approval is required: (i) the transaction value exceeds 50% of the C-REIT's net assets; (ii) the transaction is a connected transaction and the transaction value exceeds 20% of the C-REIT's net assets; or (iii) the transaction involves an equity offering with gross amount exceeding 50% of the C-REIT's net assets.

## Equity fundraising

Under the New Acquisition Guidelines, C-REITs may raise equity by way of: (a) offerings to specific target investors ("**Targeted Fundraising**"); and (b) offerings to existing shareholders or the general public ("**Non-Targeted Fundraising**"). The following table summarises the corresponding requirements.

	Targeted Fundraising	Non-Targeted Fundraising	
		Placing to Existing Shareholders	Public Offering
<b>Subscribers</b>	<p>Maximum 35 subscribers (each time) who meet the criteria approved by shareholders in general meeting.</p> <p>Subscribers may be: (i) the largest existing shareholder (&gt;20%) or anyone who will through such subscription become the largest shareholder (&gt;20%); (ii) the Seller or its affiliates under common control; or (iii) strategic investors.</p>	<p>Existing shareholders of C-REIT.</p> <p>Mandatory refund of subscription moneys in the event that: (i) the largest shareholder or the Seller or its affiliates under common control fails to meet its undertaking to subscribe for placing shares; or (ii) less than 80% of placing shares are subscribed by existing shareholders.</p>	<p>General public.</p> <p>Priority may be given to existing shareholders.</p>
<b>Pricing</b>	<p>As determined through bidding process initiated by the fund manager and financial advisor (if any), save for issuances to the Seller or its affiliates under common control.</p> <p>Must be no less than 90% of the average trading price of 20 trading days before the pricing benchmark date.</p>	<p>As reasonably determined by the fund manager and financial advisor (if any) having regard to factors including the trading price in the secondary market and the market value of the target project.</p>	<p>As reasonably determined by the fund manager and financial advisor (if any) having regard to factors including the trading price in the secondary market and the market value of the target project.</p> <p>Must be no less than the average trading price for the 20 trading days or the trading day preceding the date of the public offering prospectus.</p>
<b>Other features</b>	<p>Lock up period of six months from listing of new shares (save for issuance to the Seller or its affiliates under common control, who are subject to a lock up period of 18 months from listing of new shares).</p>	<p>The number of shares to be placed must not be more than 50% of the existing shares.</p> <p>Mandatory suspension of trading from the start of the subscription period until the listing of the new shares.</p>	<p>Mandatory suspension of trading from the start of the subscription period until the listing of the new shares.</p>



While the New Acquisition Guidelines focus primarily on fundraising for new acquisitions, the same rules also apply to financing material asset enhancement initiatives.

## Other key developments

### Other incentives and directives

Following the publication of the New Acquisition Guidelines, the National Development and Reform Commission (NDRC) issued a notice on 13 July 2022 directing the local Development and Reform Commissions to, among other things: (i) streamline and perfect the local filing requirements and procedures for new acquisitions; (ii) safeguard the quality of new acquisition projects; and (iii) guide Sellers to deploy the sale proceeds into construction of new projects, especially other types of under-developed infrastructure projects.

To encourage new acquisitions by equity financing, SSE and SZSE have announced that they would waive all initial listing fees, monthly listing fees, transaction handling fees and other fees relating to equity offering until further notice.

### Joint venture between originators and fund managers

On 20 May 2022, the China Securities Regulatory Commission (CSRC) also published "Measures for the Supervision and Administration of Managers of Publicly Offered Securities Investment Funds" (《公开募集证券投资基金管理人监督管理办法》) and the supporting rules "Regulations on Issues Concerning the Implementation of the Measures for the Supervision and Administration of Managers of Publicly Offered Securities Investment Funds" (《关于实施〈公开募集证券投资基金管理人监督管理办法〉有关问题的规定》) (collectively, the "**C-REIT Fund Manager Regulations**").

Under these regulations, original owners of infrastructure projects may now form joint ventures with fund managers to act as the fund manager of C-REITs subject to the joint venture parties meeting certain requirements. Specifically, the qualifying fund managers must have rich management experience in C-REITs, and must hold at least 51% of equity interest in and maintain control over the joint venture subsidiary. Qualifying original owners must have a rich reserve of infrastructure projects qualified for injection into C-REITs but must not be a major shareholder or actual controller of other fund managers.

### Affordable rental housing guidelines for C-REITs

To align with the State Council's policy to expedite the development of affordable rental housing as part of a larger effort to tackle housing issues for migrant workers and young talents, on 27 May 2022, the NDRC and CSRC issued a joint "Notice on Betterment of the Trial Works on Public Infrastructure REITs" (《中国证监会办公厅 国家发展改革委办公厅关于规范做好保障性租赁住房试点发行基础设施领域不动产投资信托基金 (REITs) 有关工作的通知》), which reconfirmed affordable rental housing as an asset type eligible for investment by C-REITs.

Under "Guideline No. 4 on public infrastructure REITs - Affordable Rental Housing (trial)" (《公开募集基础设施证券投资基金业务指引第4号—保障性租赁住房(试行)》) published by the SSE and SZSE on 15 July 2022 ("**Affordable Rental Housing Guidelines**"), qualifying rental housing projects are generally required to be in operation for at least three years, although dispensation to this requirement may be given to cases that have a high occupancy rate and a long-term stable rental income.

Pursuant to the Affordable Rental Housing Guidelines, a qualifying original owner of affordable rental housing projects must itself not be engaged in private residential or commercial property development, or otherwise be raising capital in the name of rental housing for non-rental housing development. Where the controlling shareholder or a person affiliated to the original owner is engaged in private residential or commercial property development, the original owner must nonetheless remain independent from such person in terms of asset ownership, business, finance and management.

One of the key restrictions applicable to original owners of affordable rental housing projects concerns the use of proceeds from the sale of such projects to C-REITs. The Affordable Rental Housing Guidelines require an original owner to undertake and put in place strict measures to ensure that the proceeds from the C-REIT offering will only be used in the construction of other affordable rental housing projects or, where no such projects are available, development of other types of under-developed infrastructure projects.



## Contact Us

We are actively monitoring further developments in the China REIT regime. If you have any questions on the regime, or on developments to date, please do not hesitate to liaise with your usual contact at Baker McKenzie or the lawyers listed in this client alert.

## Contact Us



**Jeremy Ong**

Partner, REITs  
+852 2846 1642

[jeremy.ong@bakermckenzie.com](mailto:jeremy.ong@bakermckenzie.com)



**Hang Wang**

Partner, Capital Markets  
+86 10 6535 3866

[hang.wang@bakermckenzie.com](mailto:hang.wang@bakermckenzie.com)



**Dorothea Koo**

Partner, Mergers & Acquisitions  
+852 2846 1962

[dorothea.koo@bakermckenzie.com](mailto:dorothea.koo@bakermckenzie.com)



**Rico Chan**

Partner, Real Estate  
+852 2846 1971

[rico.chan@bakermckenzie.com](mailto:rico.chan@bakermckenzie.com)

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