Zeppelin's Real Estate Tech

1Q 2014: A Real Estate Newsletter by Zeppelin Real Estate Analysis Limited

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The USA stocks and real estate have done well in 2013, the EU still has the same issues, and China faces big challenges in carrying out the claimed reforms. Meanwhile, Hong Kong residential properties appear to be heading for harder times. In this issue:

- **The LINK REIT: top price growth, volatile, and jives not with the HSI**
- **The UK Real Estate Market: London dominates!**
- **USA Real Estate Investment: 8% rental return and US$75 unit price**
- **Lack of evidence is not the same as evidence of non-existence**

"Minds need a brain to exist but brains do not necessarily come with a mind."

We would also like to hear from prospective readers / writers who wish to share their real estate experience with us.

This quarterly (generally published in January, April, July and October) newsletter is circulated freely via email to over thousands of readers comprising real estate developers, investors, fund managers, financiers, owners, users, top executives, senior managers, prominent academics and related professionals from Hong Kong and abroad. Our content is / has also been published in newspapers and web portals such as the **South China Morning Post, China Daily**, **Hong Kong Economic Journal**, **21st Century Business Herald**, **Apple Daily**, **Sing Tao**, **Quamnet Magazine**, **The Standard**, **MITCRE Alumni Newsletter**, **Surveying Newsletter**, **Reidin.com, Centanet.com, Netvigator.com, Hongkong.com, E-finet.com, Red-dots.com, PacificProperties.net**, **Soufun.com** and **House18.com**. We had also been quoted in the **Asian Wall Street Journal** and interviewed by **USA Today**, **i-Money**, **Ming Pao, Radio Hong Kong**, **Cable TV (Money Café)** and **Commercial Radio**. We also publish monthly articles and analyses in the months in between. This newsletter is now into its **18th year** and **70th** issue.

We also operate a website www.real-estate-tech.com through which we intend to share some of our real estate knowledge and ideas with interested parties. There are close to 1,000 content items, in English or Chinese, including analyses, articles, charts, and tables, plus spreadsheets, tutorials, e-books, and the like, the majority of which is free with some requiring a token fee. The website is regularly visited by thousands from all over the world and focuses on China / Hong Kong real estate markets.

Zeppelin Real Estate Analysis Limited is involved in real estate development, investment, and management with a focus on **independent real estate analysis**. Together with Zeppelin Property Development Consultants Limited, we offer services related to real estate asset management [analysis, investment strategy, and portfolio allocation], project management [architectural design, cost control, and contract administration], and facility management [facility utility assessment, facility strategy, and building maintenance]. We are part of the Zeppelin Group headquartered in Hong Kong with office operations in Mainland China and we also have access to networks covering Asia, North America, and Europe.

Who? Me?

Stephen Chung
Managing Director, Zeppelin Real Estate Analysis Limited
Founder and Editor, Real Estate Tech Quarterly Newsletter
Real Estate Website Developer, www.Real-Estate-Tech.com

Stephen is an independent real estate analyst – number cruncher and chartered surveyor and has been involved in real estate development, investment, and management in Hong Kong / China / Asia and North America.

Stephen provides relevant real estate market insights and macro-micro assessments to real estate developers, investors, owners, financiers, funds, and civic organizations, and possesses many years of experience in building economics, project management, facility strategy, marketing, and research.

Stephen is also a regular real estate writer - columnist and his articles have been published in both English and Chinese media including the following:

- China Daily
- Hong Kong Economic Journal
- South China Morning Post
- Apple Daily
- Quamnet Magazine
- Real estate and finance websites such as Soufun.com, Finet.com etc
- Journals of professional institutes such as the Hong Kong Institute of Surveyors

Stephen is an honorary adjunct professor of the University of Hong Kong and the City University of Hong Kong and has been invited to speak to audiences from:

- Universities: such as the University of Hong Kong, City University of Hong Kong, York University
- Professional Institutes: such as the Hong Kong Institute of Surveyors, Canadian Institute of Quantity Surveyors, Royal Institute of Chartered Surveyors
- Business Associations: such as the Rotary Clubs

Stephen has 3 real estate books in Chinese published to date as follows:

Online book = Easy Real Estate Lectures

Hard copy = Real Estate Investment Know-How above 101

Most recent and hard copy = The Real Estate Market Turning Point

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Our services can be obtained and delivered via a) tailor-made professional consultation; b) online report purchases; c) emailed discussions and advice; and / or d) phone discussions.

The LINK REIT: top price growth, volatile, and jives not with the HSI

Real Estate Tech, 1Q 2014

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To date more of a price growth play

Your humble author had done in late last year (2013) a simple snap shot on a few of the locally listed Real Estate Investment Trusts (REIT) and found that the LINK REIT appears to offer the lowest dividend rate (around 4%) of all which average between 5% to 6% in general.

But is this a reason not to acquire the LINK REIT? Depends. If one wants dividend yield over stock price gain, then perhaps the LINK is not for you. If however one prefers price gain over regular dividend income, then the LINK might be a good choice based on past performances.

Here are some angles for reference:

A) Data and calculations = abstracted via the internet from Yahoo! Finance etc and starts from early November 2007 to the present (November 2013 for this article). A REIT or two are not included being relatively new (i.e. set up after November 2007) but Cheung Kong Holdings, Sun Hung Kai Properties, and the Hang Seng Index are included for comparison.

B) Stock price performance from early November 2007 to November 2013 = the LINK outperforms the rest. Refer to the chart below [Row A].

C) Lowest correlation with the overall stock market = or for that matter, with popular (real estate developer) stocks such as Cheung Kong and Sun Hung Kai Properties as well. Its correlations with the other REIT are also lower. Refer to the chart below [Row B].

This may imply the LINK does have a bit more resistance i.e. not jive so much in tandem to broad stock market fluctuations.

D) Maximum / Minimum stock prices ratio during the period is not tops = but still very competitive. Assuming one is skillful or lucky enough to capture the highest (buy in) and lowest stock prices (sell off) on every REIT, then the LINK still offers a good choice giving a ratio of 4, comparatively better than doing the same on the Hang Seng Index. Refer to the chart below [Row C].

E) But its stock price volatility is increasing with time = which means risks may also be heightening. Using each REIT's standard deviation and dividing it by the related average, the LINK is 0.347 while the Hang Seng Index is 0.147, which is a significant gap. The REIT with the second highest volatility measure is Prosperity, and it is 0.288. Refer to the chart below [Row D].

	Champion	YueXia	LINK	Prosperity	Regal	Sunlight	Cheung Kong	SHKP	Hang Seng Index
A) Stock Price Nov 07=1.00	0.83	1.25	2.33	1.45	0.93	1.28	0.85	0.69	0.80
B) Correlation with HSI	0.88	0.60	0.29	0.56	0.75	0.55	0.94	0.93	1.00
C) Max / Min Ratio	3.82	3.97	3.98	5.24	3.97	4.24	2.71	3.41	2.70
D) Volatility (Risk) Ratio	0.21	0.22	0.35	0.29	0.25	0.27	0.16	0.19	0.15

As the popular saying goes "you can't win them all", no REIT can score tops in all aspects for any meaningful period of time, and selecting which one(s) to invest is not always easy. Perhaps personal circumstances (e.g. being gutsy or not) and preferences (e.g. dividend versus price gain) may help a bit in deciding.

Disclosure: your humble author has invested in REITs.

The UK Real Estate Market: London dominates!

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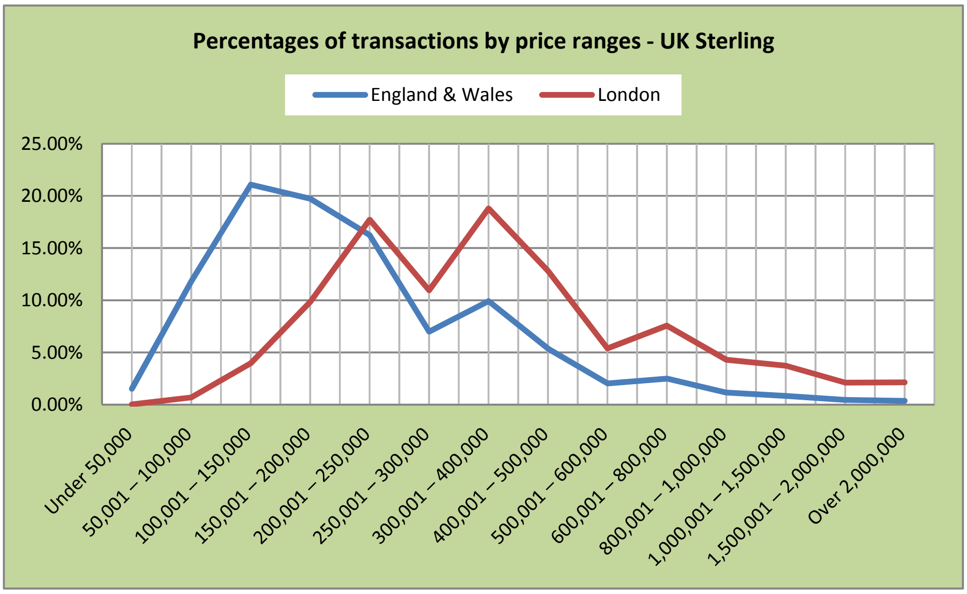
A merry go round?

UK properties are a favorite among investors from Hong Kong and China, especially when it comes to London. So how significant is London to the UK real estate market? Let's find out:

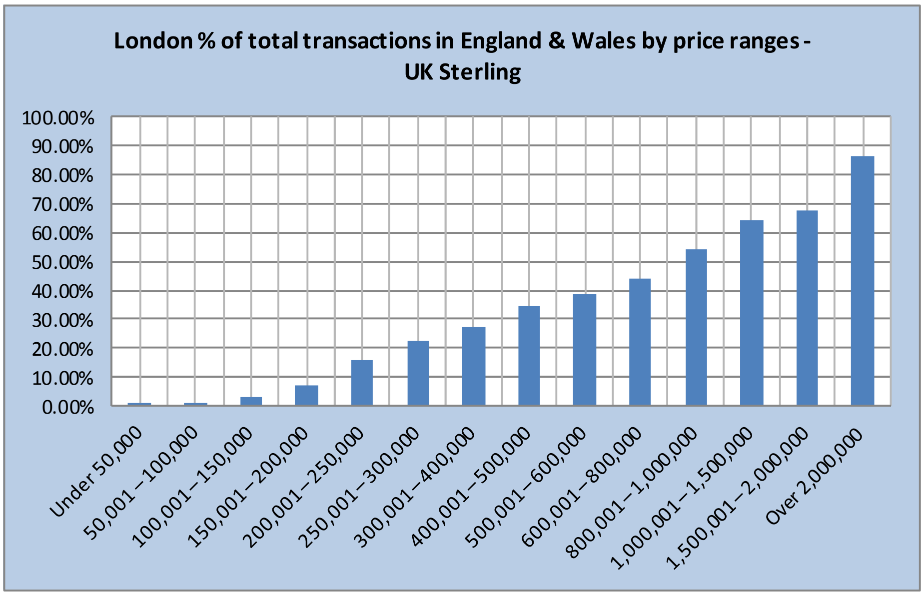
1) Data sources = mostly from the websites of the UK statistics bureau and the land registry authorities.

2) The average home price in Greater London is 2.36 times the average of England and Wales = a London home costs around 400K pounds while the England and Wales average price is 170K pounds. Note that Northern Ireland and Scotland have not been included in the calculations.

Note the chart below: while a significant portion of transactions hover in the 100K pounds to 250K pounds price range for England and Wales, many transactions in the Greater London region loiter in the 250K pounds to 500K pounds bandwidth.



3) Without London, the UK real estate market will have a much reduced 'pricey' market sector = of all transactions within the 400K to 800K pounds range, London occupies a third to close to half of them, and within the 800K to 2M pounds range, London accounts for 50% to 66%. Anything above 2M pounds, 85% of these are found in London.



4) London home prices seem the most detached from the related income factor = for it has the highest home price divided by disposable family income ratio. We have randomly picked several regions and cities in the UK and compared their respective aforesaid ratios. London ranks No. 1 meaning its inhabitants need to dish up more years of income to acquire a typical home there.

Counties:	Price to Income
Blackpool	6.18
Buckinghamshire	12.27
Cambridgeshire	10.74
Cardiff	9.68
City of Bristol	12.36
City of Nottingham	7.87
City of Plymouth	9.18
Derbyshire	8.73
East Riding of York	8.22
Greater London	18.63
Greater Mancheste	7.42
Hartlepool	5.63
Herefordshire	10.75
Milton Keynes	9.58
North Yorkshire	9.83
Northumberland	7.42
Oxfordshire	13.68
Southampton	11.33
Swansea	7.76

A city of international focus and investor interest does stand out, not least in its real estate prices.

USA Real Estate Investment: 8% rental return and US$75 unit price

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Florida: the sunshine state, and simple construction

Note to readers: Your humble author has been a real estate columnist for one of Hong Kong's prominent Chinese financial daily, the Hong Kong Economic Journal, for many years. Recently, he published an article outlining one of the real estate investments he had made in the USA. There was much interest from readers and the following article is a lay interpretation of that article. Disclaimer though: caveat emptor applies; what entices your humble author may not be suitable for the readers and no investment guarantee is given or implied herein.

What was invested? Here is an outline:

a) What = Apartment complexes and units for renting out with professional property management, leasing, and maintenance services. These are generally well located but old buildings which in turn require some form of touching up, upgrading, and renovating.

b) Where = various cities in Florida.

c) How much = around US$60K to 70K per apartment unit comprising studios, 1 bedroom, 2 bedroom, and some 3 bedroom units. Price per square foot is around US$75.

d) Return = the leveraged rental yield can be as high as 8% with prospects of some asset price appreciation in years to come owing to economic improvement and building upgrade.

Reasons for investing:

1) US$75 per square foot is well below replacement cost = based on rough market data obtained via the internet, the current average cost to build similar apartment units is US$150 / ft2. And this is just for the construction alone. No land costs are included. This in turn implies new developments would not be too or as profitable thus limiting their future supply.

2) Projected returns are in the double digit tens range on an IRR pretax basis = this is not high by any standard but given it is a relatively stable and hassle free venture, this is competitive return given the low market risks.

3) The demand for affordable rental housing exists and is expected to increase = given the demographics, the economics, the household wealth composition, the internal migration patterns, and perhaps lately the weather conditions.

4) While the USA 2008 financial saga is not entirely over and potential trouble lays ahead, economics alone will not bring the house down = because first, part of the problem has to do with the baby-boomers who are now getting old but who will also start (putting it lightly) to fade away in years to come thus alleviating part of the financial challenge, and second, the USA still has some of the best and valuable assets in terms of technologies and corporations which means while the public budgetary accounting is in a mess, the nation as a whole is still in the black.

5) The local (USA) real estate investment manager (general partner) has skin in the game = they own / occupy some 10% to 20% of the venture. That is, if things turn sour, they hurt too.

By the way, the mortgage is non-recourse too.

Some drawbacks exist e.g. the money invested in the fund is not easily taken out anytime (no efficient market to list and sell it) and has to wait some 3 to 5 years prior to exiting. There are also the cumbersome USA taxes to consider.

Lack of evidence is not the same as evidence of non-existence

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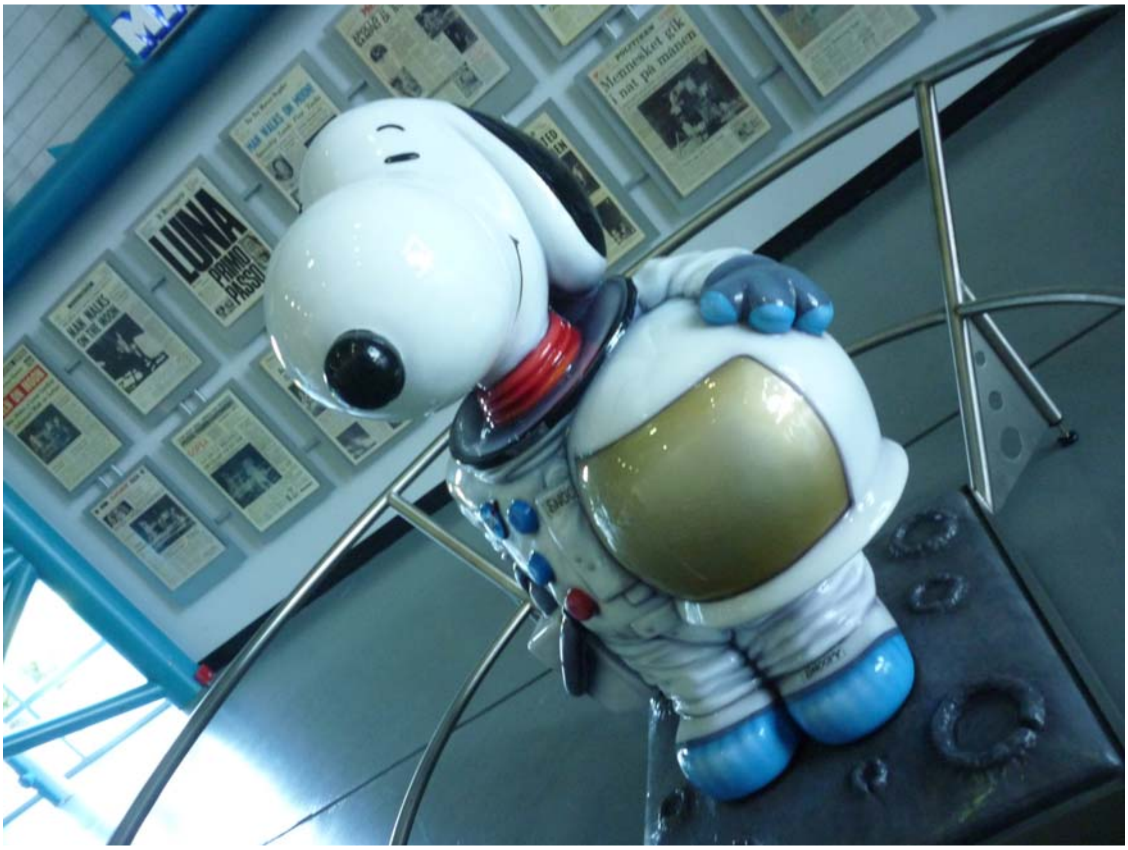

Are we alone in the universe?

Many market commentaries have been focusing on the effects of the Fed's tapering and interest rate intention. Broadly, most appear to be saying the effects might not be huge because first, so called tapering does not mean ceasing debt purchases entirely, and second, the economy in the USA does not allow for significant rate increases anytime soon.

Indeed, the USA stock and real estate markets have been performing quite well, at least compared to Hong Kong's. However, your humble author thinks it is erroneous to deem nothing will go wrong as long as debt are still being bought and / or interest rates are kept (artificially) low. And this market tendency to rely significantly on government-central banker's policies and interest rate intentions is <u>not healthy</u> because the reliance or confidence is built on something not quite sturdy: QE, which in turn is shaky as it no longer jives with economic productivity which lags behind it miles away.

This QE business we have been witnessing since 2008 to date has a) raised asset prices in many parts of the world; b) increased the gap between the haves and have-nots; c) punished savers; d) encouraged or even forced people to take on riskier ventures knowingly or unknowingly; e) <u>not</u> been quite successful in materially improving or even stabilizing the broad economy especially in economies where the population is greying (e.g. older people do not respond to economic stimulants as younger people do). Furthermore, this QE is only kicking the financial can down the road and will lead a bigger problem later = it is not a question of if but when.

This kicking the can tactic might have worked if the economy is not already burdened with debt prior to the 2008 crisis but this was not and still is not the case. And employing more debt to cover the previous debt appears illogical = if QE, a.k.a. money printing can “really” solve economic-financial problems, then there will be no more economic crises from now on. All we need to do is to print some legal tender and belle, a rosy economy again. Naturally this is wishful thinking.

Rather than expecting that someday some market crisis will come forth when rates are actually to be raised, a sudden and unexpected loss of confidence in the government-central banker’s power to QE further and to resolve problems thus leading to some form of market panic is the likelier future scenario.

Why the expectation? Because the longer this QE phenomenon drags on, the more difficult it would be for governments and central bankers to pull the plug, which in turn implies greater likelihood of continued QE one way or another, and on and on, until the whole thing blows up.

Any proof? None, other than the reasoning above as 1) this QE is unmatched in scale even if it is not the first time the world had embarked on money printing; and 2) as such, there is no immediate precedent to which we may refer for clues. Nonetheless, a word of caution*: a lack of concrete proof or evidence (of the possibility that this QE won’t end well) does not equate to evidence of non-existence (of a QE caused crisis).

Just as we have not met any outer space aliens to date [UFO believers might disagree], we cannot however jump to the conclusion that there are no space aliens out there.

*Idea from the book Anti-Fragile written by Black Swan author Nassim Nicholas Taleb.

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- **In Real Estate Development:** you encounter overestimated proceeds, cost overruns, underestimated time schedules, design and quality issues, construction contractual disputes, joint venture conflicts, or the like…you need an experienced project manager like us

- **In Real Estate Investment:** you encounter challenges in 1) Selecting which markets (cities), sectors (residential, office, retail etc), and properties-projects to invest; 2) Striving for the best possible risk-adjusted portfolio return; or 3) Sensing the volatility of a market or sector; 4) Deciding which corporate strategies, tactics, priorities, properties, and projects to pursue; 5) Getting a INDEPENDENT SECOND OPINION on which you can trust…you need an independent real estate analyst like us

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