Zeppelin's Real Estate Tech

1Q 2015: A Real Estate Newsletter by Zeppelin Real Estate Analysis Limited
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The Swiss surprised the market with its policy change in currency matters leading to numerous speculation and hypothesis of what to come next, especially for the EU region…an even lower Euro perhaps. While this will be bad for EU asset investors, it is music to the ears of tourists and shoppers. Meanwhile, Hong Kong has scrapped its investor immigration scheme.

- **Hong Kong residential parking: from 1st hand < 2nd hand to 1st > 2nd**
- **What were observed in a recent real estate expo**
- **Guessing which markets might be riskier using a price to construction ratio**

"Don't always equate intangibility to illusion or tangibility to reality."

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), DBC Radio,** and **Commercial Radio**. We also publish monthly articles and analyses in the months in between. This newsletter is now into its **19th year** and **74th** 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 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.

Hong Kong residential parking: from 1^{st} hand < 2^{nd} hand to 1^{st} > 2^{nd}

Real Estate Tech, 1Q 2015

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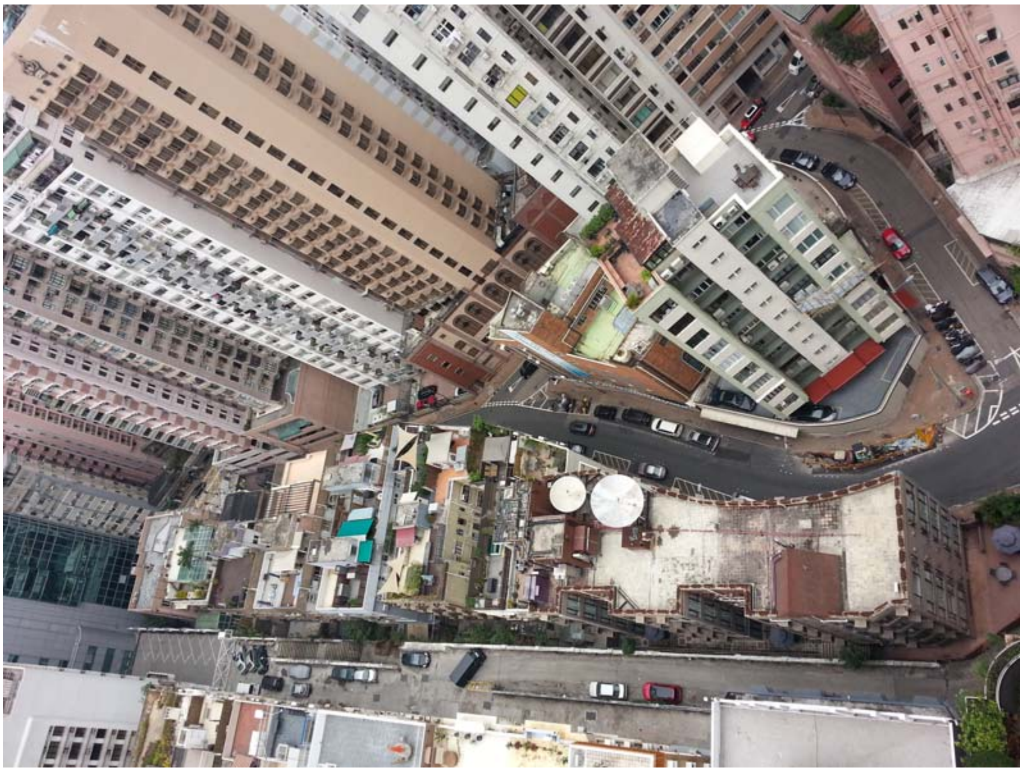


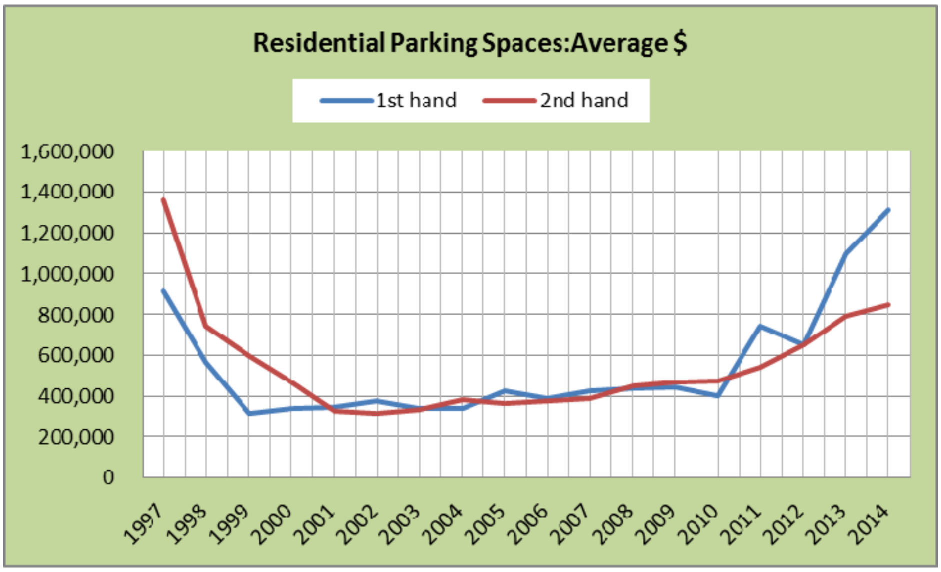
US$150K for a parking space? Can one buy a car and sleep there?

Last year in 2014, some 6700 plus private residential parking spaces were bought and sold, slightly more than 2013. These transactions include both 1^{st} hand and 2^{nd} hand parking spaces with 1^{st} hand representing 56% of the total transactions, and averaging HK$1.03M per space. A bit more detail would be to say the average for a 1^{st} hand space is HK$1.31M, while that for a 2^{nd} hand is HK$840K. Furthermore, the average price for a Hong Kong Island parking space is HK$1.41M, HK$ 1.22M for Kowloon, and HK$780K for the New Territories.

The data comes from the website of Centaline Agency and starts from 1997 to 2014, although 2014 represents only 11 months up to November. **More observations:**

1) The parking space price volatility is high at 0.48 based on standard deviation = this means investment risk is not light and is greater than that of residential properties as a whole. Also, 1^{st} hand parking space appears to exhibit a slightly higher volatility than that of 2^{nd} hand.

2) The average price of a 1^{st} hand parking space has already more than exceeded its 1997 peak, while that of a 2^{nd} hand space still lags behind its former 1997 top = in 1997, a 1^{st} hand traded for an average of HK$970K, while a 2^{nd} hand space required HK$1.36M. Speeded to 2014, the 1^{st} hand space is now HK$1.31M, while the 2^{nd} hand is only HK$840K. In short, the 1^{st} hand and 2^{nd} hand parking spaces have traded places (read the title of this analysis again, and the chart below).

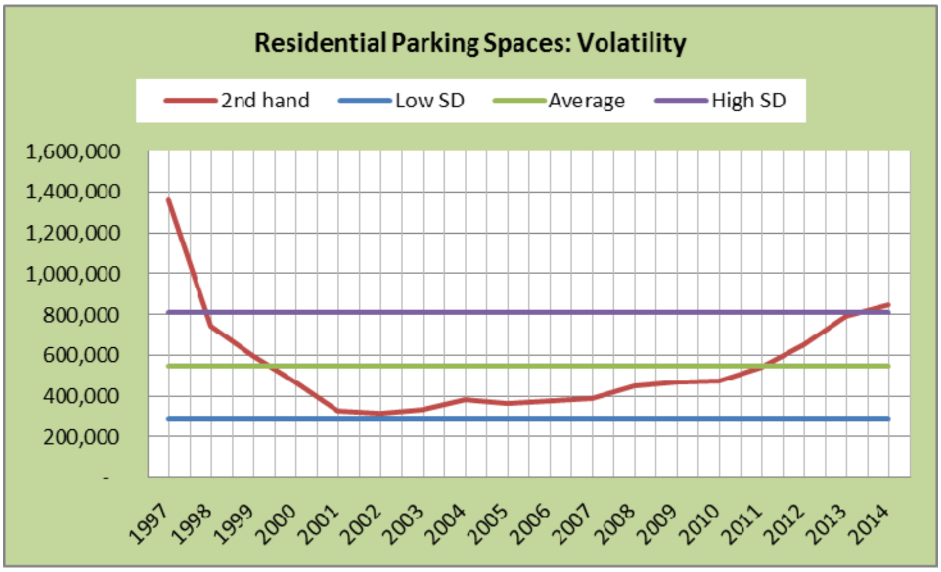


From an analytical angle, the above phenomena does not necessarily mean that 1st hand parking spaces are now more popular – or for that matter more "investible" – than 2nd hand spaces because economics is just one factor affecting parking space prices. For instance, the intention to reduce traffic and to discourage car ownership has led to tighter parking space provision in recent projects. Given all things being equal, a parking space in a newer project can be sold for a price higher than its counterpart in an older one.

Furthermore, in 1997, many then new developments were 'ordinary' grade private residential projects and were located in the New Territories. Coupled with more generous parking space provisions, it is not a surprise 2nd hand spaces were pricier than 1st hand ones. Of course such 1st hand spaces have now become the 2nd hand ones.

Today, practically all new residential developments are 'luxurious' in terms of design and construction. Also, prices have skyrocketed 100% on average since 2009 making Hong Kong one of the most expensive places on Earth to buy a home. Even discounting the tighter parking space provisions, can one really expect a real estate developer selling someone a HK$20M [around US$2.50M] home to ask for, say, only HK$500K for the related parking space? Course not. HK$1M is THE minimum. Your humble author would price it at HK$2M, not so much out of a fair evaluation but to have a "matching" price befitting the property itself.

3) The 2nd hand parking space prices have just protruded above the "risk" level = using standard deviation and the average, we can calculate a high and low range for gauging the price volatility, above and below this high-low bandwidth can mean prices being too high or too low respectively. Referring to the second chart below, one can see prices have just exceeded the high level mark slightly. This implies some risks yet not overly worrying…yet. Note again this is not for prediction, just for assessing where the market now stands. Also, using different start and end years will bring different results.



In the worst of times, people still need a place to sleep but they do not need to drive (for readers not familiar with Hong Kong, we have very efficient and reasonably affordable public transportation), or for that matter, drive more than one car.

What were observed in a recent real estate expo

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The very scenic Sun Moon Lake, Taiwan

Your humble author had been invited to speak at a real estate exhibition recently and naturally real estate was the subject of the talk. Taking advantage of the occasion, he also strolled around the premises (at the Hong Kong Convention and Exhibition Centre) to look-see and to gauge the mix of exhibitors who came or presented properties from almost all corners of the globe. **Here are some casual observations:**

1) More Japanese real estate booths (compared to last year)
2) More Taiwanese real estate booths (some along with immigration schemes)
3) More German real estate booths (apparently with a focus on Berlin)

Of course there were the usual British, American (including one specializing on Detroit homes), Australian, and the like exhibitors who seemed to enjoy reasonable attention. However, exhibitors of Eastern European properties appeared fewer, and probably so were some of the South East Asian counters. In terms of ‘shopping convenience’, few cities in the world can beat Hong Kong: if one so wishes, one can practically acquire a dozen properties from all over the world in just one afternoon…and with time still for afternoon tea.

The above observations also led to the following contemplation:

A) Japan = admittedly your humble author knows little about real estate there, notwithstanding prices have been rising and some commercial investors have done very well. However, overseas individuals contemplating to acquire a residential home or two need to take its currency trend into account because any real estate price gain might be offset by the loss in currency exchange value. Also, rental contracts and the like might not be written in English and unless one is facile in Japanese or have access to good property management services, looking after one's invested properties could be tedious. Perhaps a Japanese property fund could be an alternative if one has strong conviction of its real estate market viability.

B) USA = Manhattan and other leading cities aside, some homes in the USA – like those in Detroit - could be bought for a few tens of thousands US dollars, often times with existing tenants and thus rental income, and plus probable upsides. Can't say this is not attractive given the close to 0 interests from banks. However, US taxes could be burdensome and complex. For instance, individuals buying in their personal names should seek proper tax and legal advice because in the (unfortunate) event that the buyers – now owners – should pass away, his or her entire estate – i.e. not just his or her US assets – could be subject to US estate taxes despite not being Americans or its immigrants (Green Card holders).

C) Germany = Germany will increasingly be the center of European economics and as such, and with Berlin being the capital, and notwithstanding the economic malice there, German properties deserve some investment attention. With Berlin prices still being a fraction of London, there seems room for price growth intuitively. However, German laws are pro-tenant and so a strong property management service is a must. Buying just one unit and handling it yourself, while being 8000 miles away and dealing with German laws and taxes at the same time, does not sound enjoyable, not to mention workable. Again, if a well-run German property fund, where found, could be an option.

All three places mentioned above harbor potentials and pros (advantages), yet cons (disadvantages) exist at the same time in terms of currency exchange rate, taxes, and tenancy laws, all of which might be overcome with proper planning and strong back up support management services.

Guessing which markets might be riskier using a price to construction ratio

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Fun and playful architecture: the price tag?

Recent market commentaries indicated in some instances, the construction cost per floor area has outpaced the land cost per floor area in Hong Kong. This is interesting given (residential) prices have gone up some 10% in 2014 especially for the smaller units and are quite high in global price rankings. Normally one would expect construction costs to constitute only a fraction of the overall costs in such conditions. This tends to occur in places where the economic productivity is high and the higher land prices are a reflection of such productivity.

But on second thoughts, this is not surprising given all new Hong Kong residential developments are nowadays 'luxurious' in nature, no matter where and in what neighborhood they are built. Half-jokingly, our developers have forgotten how to develop 'ordinary' flats for quite some time. Yet casting blame on them alone could be unfair because it always take two to tango: at least (some) buyers appear to want such luxurious bells and whistles in their homes. Using cars as an analogy, today not only buyers of BMWs and Mercedes expect leather seats and upgrade interiors to come with the car, so do buyers of Corollas.

Here we have collected the rough average price per floor area for private residential homes and the related construction cost per floor area data for a variety of cities. As such, we not only have a feel of how much of the price one pays has gone for the actual "bricks and mortar" when purchasing a home, we may also gauge which cities carry might higher market risks.

Property price data, with a focus on the secondary residential market, were collected from the various real estate statistical sources and websites related to the cities selected, and the relevant construction costs came from the website of global quantity surveying firm Rider Levett Bucknall (RLB). Note we have adjusted the residential price data to better match the construction cost data as the two data sets use slightly different floor area demarcations. We have also assumed the construction quality to be of higher than average grade.

Technically speaking, construction costs do not affect how much a residential property, be this a 1st hand or 2nd hand property, can be sold for, although they do affect the profitability of a development project. Yet it is the ratio between the two, property price and construction cost, which is important. Also, one ratio might not mean much, but a bunch representing numerous cities can probably tell something – in this case the potentially riskier cities. Here we go:

Cities / Markets	**Residential Price to Construction Cost Ratios**
Hong Kong	2.38
Beijing	6.24
Shanghai	5.10
Guangzhou	3.42
Shenzhen	4.92
Tianjin	2.81
Chengdu	1.62
Wuhan	1.81
Xian	1.39
Wuxi	1.29
Zhuhai	2.45
Macau	4.63
Greater New York	1.15
Boston	1.56
Los Angeles	1.61
San Francisco	2.27
Chicago	0.83
Honolulu	0.89
Greater London	2.50
Singapore	2.66
Kuala Lumpur	3.94
Jakarta	3.05

Here are the preliminary results:

1) Using standard deviation, most of the cities above have ratios ranging within the 1.17 to 4.15 spectrum and this includes Hong Kong.

2) Beijing, Shanghai, Shenzhen, and Macau are above the 4.15 mark implying potentially riskier price levels.

3) Chicago, Honolulu, and to a lesser extent Greater New York have ratios lower than 1.17, and in some cases not even 1.00, thereby implying that prices might not be sufficient to pay for construction, let alone for land. These may mean lower market risks.

Do note the above results will be different IF different combinations of cities are used. Nonetheless, cities which ratios are high compared to those of cities of similar scale and status might harbor larger market risks. By no means are these ratios predictive of future price trends, they just alert us to probable riskier markets.

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- **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

- **In Real Estate Management:** you encounter questions on 1) if it is more economical to buy or rent the real estate facilities and assets, and if so where and what; 2) how best to manage and maintain such facilities and assets; 3) what level of human resources are required, all with a view to maximize their utility to help achieve the corporate objectives… you need a seasoned facility strategist like us

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