Zeppelin's Real Estate Tech

2Q 2009: A Real Estate Newsletter by Zeppelin Real Estate Analysis Limited
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Happy days are here again…the skies above are clear again…Let us sing a song of cheer again…may we, can we, shall we? With the G20 meeting, steep rising stock markets, USA confident of meeting their treasury note obligations, China pouring lots of dough domestically…hmm…things appear to be looking up again. Especially when one walks around cities in this part of the world, few signs of despair or even frugality are detected. A few (stock) analysts are again touting the decoupling concept. We advise great caution = go for a deal if the price is "really" right but retain some reserves for potentially better opportunities.

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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** (a Chinese daily), **21st Century Business Herald** (China), **The Standard** (a Hong Kong English Daily), **MITCRE Alumni Newsletter**, the **Surveying Newsletter** of the Hong Kong Institute of Surveyors, **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 **Radio Hong Kong** and **Commercial Radio**. We also publish monthly articles and analyses in the months in between. This newsletter is now into its **13th year** and **51th** 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 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 assessment], 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 Beijing and Shenzhen and we have access to networks covering China / Asia, North America, and Europe.

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Global Residential Ratios: US$ Price per m2 to US$ GDP per capita

Real Estate Tech, 2Q 2009

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While searching for some global residential data and information, your humble author came across these 2 web-pages:

http://www.globalpropertyguide.com/investment-analysis/Most-expensive-real-estate-markets-in-2009
http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(nominal)_per_capita

The Global Property Guide offers rough average residential price per m2 and the Wikipedia website provides rough Gross Domestic Product (GDP) per capita. Hence, one can compare the two data sets and obtain a simple ratio of price to GDP for each city involved.

Before divulging the results thus calculated, readers should note a few points:

1) The residential price per m2 is city-based while the GDP per capita is country-based, i.e. the two are not exactly on the same plateau yet city GDP per capita data is generally not easy to come by. Nonetheless, the results could be good for rough gauges.

2) It is not so much the nominal value of the ratios which count but the relative (to one another) value of such ratios which matter, i.e. one may spot the potential riskier markets by looking at which of them have higher than average ratios.

And here are the results in tables and charts:

Cities	Average Prices US$/m2	GDP/capita US$	Price/m2 to GDP/capita Ratios
Moscow	20,853	12,579	1.66
London	20,756	45,681	0.45
Tokyo	17,998	37,940	0.47
Hong Kong	16,125	31,849	0.51
New York	14,898	47,025	0.32
Paris	12,122	48,012	0.25
Singapore	9,701	41,291	0.23
Rome	9,166	40,450	0.23
Mumbai	9,163	1,043	8.79
Dublin	9,069	64,660	0.14
Helsinki	8,404	54,578	0.15
Athens	7,858	33,434	0.24
Dubai	7,151	56,667	0.13
Barcelona	6,523	36,970	0.18
Montenegrin Littoral	6,184	5,928	1.04
Geneva	6,178	67,379	0.09
Luxembourg	6,165	118,045	0.05
St. James	5,767	13,701	0.42
Madrid	5,672	36,970	0.15
St. Petersburg	5,527	12,579	0.44
Munich	5,255	46,499	0.11
Bucharest	5,184	9,953	0.52
Bratislava	5,088	18,585	0.27
Sydney	4,994	50,150	0.10
Sint Maarten	4,889	54,445	0.09
Amsterdam	4,650	54,445	0.09
Milan	4,624	40,450	0.11
Tel Aviv	4,582	26,536	0.17

Prague	4,559	21,041	0.22
Nevis	4,463	10,561	0.42
Frankfurt	4,407	46,499	0.09
Warsaw	4,301	14,893	0.29
Antigua	4,275	13,386	0.32
Nassau	4,078	20,589	0.20
Toronto	4,007	47,073	0.09
Taipei	3,968	18,306	0.22
Copenhagen	3,815	67,387	0.06
Ljubljana	3,802	28,328	0.13
Riga	3,716	14,930	0.25
Tallinn	3,691	18,809	0.20
Malta	3,656	20,744	0.18
Krakow	3,557	14,893	0.24
Zurich	3,463	67,379	0.05
Saint Lucia	3,279	6,064	0.54
Brussels	3,267	49,430	0.07
Limassol	3,265	32,195	0.10
Baja California Sur	3,227	10,747	0.30
Zagreb	3,215	14,414	0.22
Montreal	3,211	47,073	0.07
New Delhi	3,171	1,043	3.04
Saint Kitts	3,168	10,561	0.30
Trinidad	3,091	18,864	0.16
Berlin	3,030	46,499	0.07
Crete	2,981	33,434	0.09
Algarve	2,925	24,031	0.12
The Hague	2,922	54,445	0.05
Shanghai	2,918	3,180	0.92
Vilnius	2,907	14,456	0.20
Lisbon	2,891	24,031	0.12
Sofia	2,877	6,849	0.42
Budapest	2,868	16,343	0.18
Paphos	2,792	32,195	0.09
Phnom Penh	2,503	742	3.37
Rio de Janeiro	2,441	8,676	0.28
Beijing	2,362	3,180	0.74
Cape Town	2,355	6,170	0.38
Auckland	2,347	31,714	0.07
Buenos Aires	2,293	8,522	0.27
Nicosia	2,256	32,195	0.07
Bangkok	2,238	4,099	0.55
Beirut	2,229	7,376	0.30
Belize	2,220	4,318	0.51
Larnaca	2,174	32,195	0.07
Marrakech	2,043	2,902	0.70
Manila	1,914	1,908	1.00
Puerto Plata	1,872	5,132	0.36
Sao Paolo	1,860	8,676	0.21
Montevideo	1,753	8,860	0.20
Hanoi	1,749	1,047	1.67
Panama City	1,740	6,883	0.25
Kingston	1,654	4,990	0.33
San Jose	1,602	6,726	0.24
Viña Del Mar	1,586	10,814	0.15
Guangzhou	1,526	3,180	0.48

Bogota	1,402	5,174	0.27
Kuala Lumpur	1,347	7,866	0.17
Chisinau	1,316	1,830	0.72
Istanbul	1,291	11,463	0.11
Santiago	1,221	10,814	0.11
Lima	1,154	4,610	0.25
Amman	1,150	3,267	0.35
Jakarta	1,102	2,181	0.51
Managua	1,080	1,060	1.02
Chengdu	999	3,180	0.31
Quito	820	3,927	0.21
Concepción	669	10,814	0.06
Bangalore	657	1,043	0.63
Cairo	574	2,109	0.27

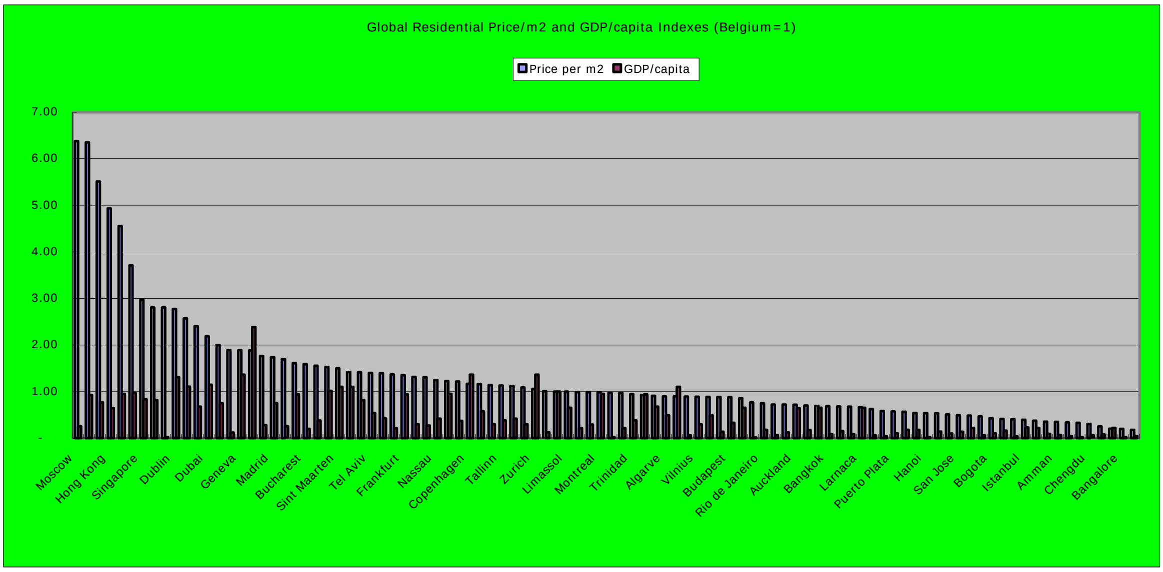
The average ratio for the above cities is 0.19 and many of the above cities are higher than this average ratio to varying degrees. Essentially, the higher the ratio is above this average, the likelier (not a must though) that the related market (city) will have riskier residential prices.

This is based on the general observation that over time, residential prices tend to correspond or reflect the economic performance of the economy concerned. If the ratio is on the low side, it may imply that residential properties are more affordable, and if the ratio is on the high side, the reverse i.e. residential properties being less affordable or even overpriced, may be true.

As such, and to mention a few examples, Moscow, Mumbai, or Hanoi could have somewhat riskier residential markets. Nonetheless, readers and investors are recommended to view this as a first sieve, i.e. the ratios are just / only to be used as initial probes of PROBABLE riskier markets, they are by no means conclusive of market risk levels.

To better assess the risks, one needs to look at details such as the price and GDP distribution and structure, not to mention transaction costs, taxes, and market restrictions, if any.

We have also out of curiosity used the middle ranked Brussels market as a benchmark and the price and GDP of the other cities are compared to this benchmark city. Here is the chart thus obtained:



Brussels (benchmarked as 1.00) is located in the middle of the chart and cities to its left have higher residential prices per m2, while cities to its right have lower residential prices per m2.

Likewise, Brussels' (Belgium's) GDP per capita is deemed as 1.00 and thus cities (countries) with GDP per capita higher than it will have values of more than 1.00, while those with GDP per capita lower than it will have values of less than 1.00.

As such, a market (city) with a price per m2 bar way higher than its GDP per capita bar may (note: it is may, not must) have a riskier residential market in that there could be a higher probability of downward price adjustment.

On this score, Mumbai, New Delhi, Hanoi, Phnom Penh, Moscow etc appear to be some of the more risky markets.

Interestingly, Hong Kong appears less risky when compared to Beijing or Shanghai.

Hong Kong Residential: A Naughty Boy - either a Leader or a Laggard

Real Estate Tech, 2Q 2009

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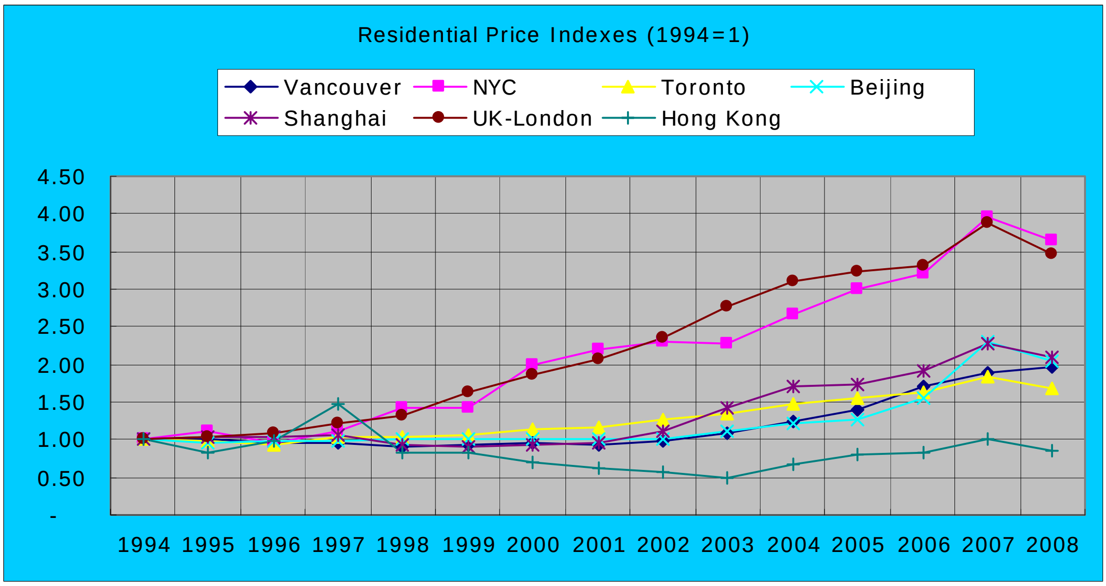
We have just compiled the 2008 Global Home Indexes which report could be viewed in our website = http://www.real-estate-tech.com/zeppelin_Global_Index.htm.

Briefly, we have since 2005 been comparing on an annual basis 6 other residential real estate markets (cities) with the one in Hong Kong and the goal is to find out how many typical homes in such markets could be exchanged for 1 typical Hong Kong home.

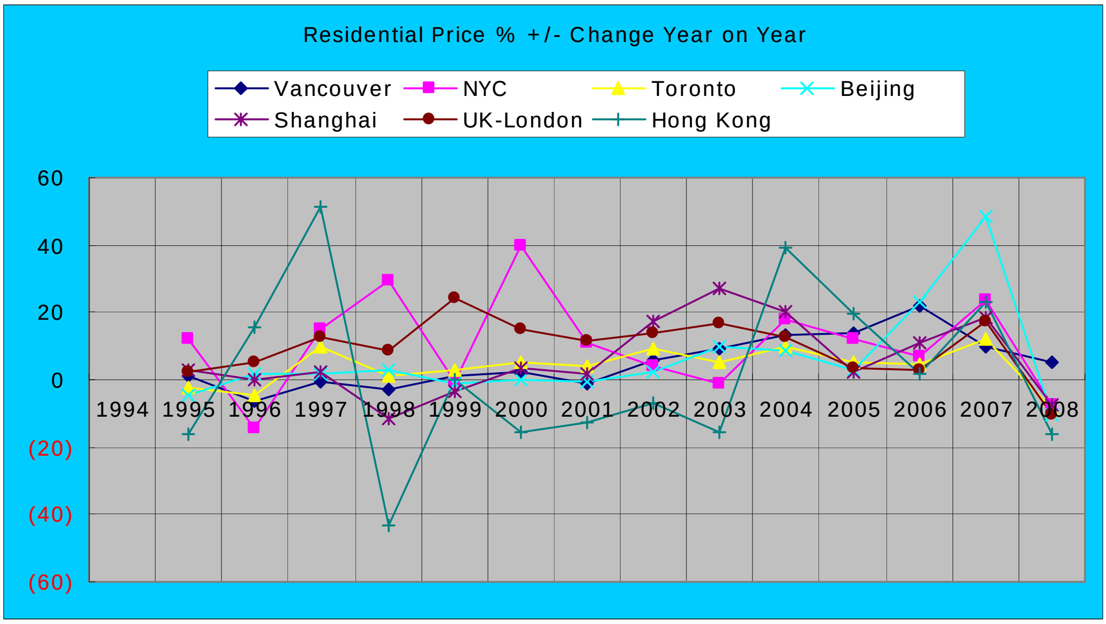
The 6 markets are London, New York City, Vancouver, Toronto, Beijing, and Shanghai and these are no strangers to many real estate investors from Hong Kong. Compared to 2007, a Hong Kong typical home in 2008 could buy more London and Toronto homes but less New York City, Beijing, and Shanghai homes. Vancouver remains the same.

In the process, we have also observed some interesting market trends [the data start from 1994 to 2008 and performances quoted herein are purely based on price appreciation in local currencies without regard to taxes, transaction costs etc]:

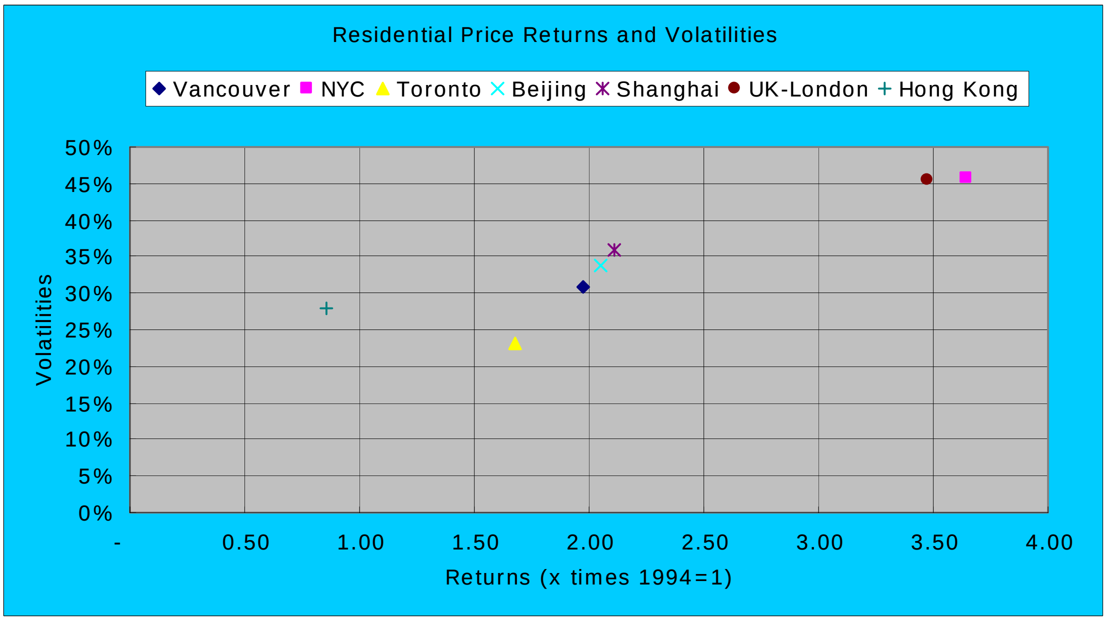
1) **Hong Kong is the worst residential market (Laggard) during the period** = i.e. assuming an investor was to acquire a residential property in 1994, hold onto it throughout the years, and sell it in 2008, he or she would have the worst performance via investing in Hong Kong. How bad? Refer to the chart below.



2) **But Hong Kong provides the biggest short-term winnings (Leader) during the period** = most notably in the couple of years prior to the 1997 crash and not too long after the recovery from SARS in 2003. Close matches come only from the Big Apple some time ago and Beijing more recently. How good? See the chart below.



3) **Still Hong Kong also has the worst return and risk (volatility) combination** = return is obtained by dividing the difference between the 2008 and the 1994 prices by the 1994 price while volatility is obtained via dividing the standard deviation of the data stream by its average during the period. How bad again? Read the chart below.



A bit of chart interpretation: the X-axis represents returns while the Y-axis represents the risks (volatilities).

Investors wanting a certain minimum level of return may wish to pick markets which provide at least this return but are less risky e.g. an investor wanting at least a 100% increase in price within the period may wish to pick Vancouver rather than Beijing. This is because both

Vancouver and Beijing offer around a 100% price gain but Beijing has a riskier (more volatile) market.

Likewise, an investor willing to tolerate a certain maximum (i.e. no higher than) level of risk would want to go for markets which offer better or the best returns. For instance, an investor wanting to go no higher than a risk (volatility) measure of 30% would want either Vancouver (around 30% volatility but offers close to 100% gain compared to Hong Kong's 28% and -15% respectively) or Toronto (around 23% volatility but still offers around a 67% gain).

Overall in the past 15 years, Hong Kong has not been very competitive as a residential real estate investment market except for relatively short runs, like a naughty student excelling at times but playing truancy at most other times.

The LINK REIT Leads the REIT Pack

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In the early part of last year (2008), stock market experts were suggesting to investors to turn their attention to the listed REITS (Real Estate Investment Trusts) in Hong Kong, numbering seven in all, namely the Champion, GZI, The Link, Prosperity, Regal, Sunlight, and RREEF. The experts told us these REITS were likely to offer better 'price resistance' as the stock market began to soften.

Your humble author was intrigued and inquisitively ran some numbers and found that from November 2007 [the stock price data came from Yahoo! Finance]:

a) **Up to February 2008** = most of the said REITS did not correlate much with the rest of the stock market based on the Hang Seng Index or to one another i.e. yes, the REITS might have some price defensive play value [refer to our previous analytical article: http://www.real-estate-tech.com/articles/SRS020802.htm]

b) **Up to July 2008** = while some REITS still demonstrated little correlation with the rest of the stock market, some had become quite correlated with the market and thus might not offer much value in terms of being a price defensive play. Cautious selection was required [refer to our previous analytical article: http://www.real-estate-tech.com/articles/RET3Q08.pdf - 1st article]

c) **Up to January 2009** = for one reason or another, practically all REITS have become quite correlated with the stock market AND between themselves. This implied not only REIT were not the defensive plays for which many had hoped, they offered little risk-reducing value as a investment asset category [refer to our earlier analytical article: http://www.real-estate-tech.com/articles/RET1Q09.pdf - 4th and last article]

d) **Up to March 2009** = the picture remains more or less the same, however, one REIT stands out from the rest of the crowd in terms of being a price defensive play. This REIT is, you've guessed it (or isn't this just obvious from the article title?), The LINK REIT [hereafter referred to as 'the Link'].

How obvious? Outstanding in what way, you may wish to ask. Some numbers, tables, and charts speak better than a thousand words:

1) **The Link loses the least money for its investors in terms of stock prices** = assuming an investor had bought the Link on November 08, 2007 and sold it on February 27, 2009 i.e. around 16 months apart, he or she would have suffered only a 13% loss. The other REITS, the HSI, plus two popular listed real estate developers, Cheung Kong Holdings (stock code 0001) and Sun Hung Kai Properties (stock code 0016), would have lost their investors anywhere from 40% to much more in the same period. The Link is also the only REIT which has both the minimum and maximum prices recorded being above the IPO price. The others at best have IPO-matching recorded maximum prices and way-below-IPO recorded minimum prices [refer to the last 3 rows in table 1].

2) **The Link offers the lowest volatility in terms of stock price movements during the mentioned period** = and the lower the volatility, the less the investment risk tends to be. This volatility is measured by dividing the standard deviation of the reported daily closing stock prices during the mentioned period by the average of such daily closing stock prices of the same period and is expressed as a ratio. The lower the ratio, the lower the volatility and this implies the less the investment risk there is generally. The ratio for the Link hovers around 0.12 while most of the rest have ratios between 0.20 to 0.25, with three of them, namely Champion, Regal, and Sun Hung Kai Properties exceeding even 0.30 [refer to the 8th row Volatility in table 1].

Items / REITS	Since November 07	Champion	GZI	LINK	Prosperity	Regal	Sunlight	RREEF	Cheung Kong	SHKP	HSI
IPO Nominal Price	for reference only	5.10	3.08	10.30	2.16	2.68	2.60	5.15	-	-	-
Maximum		4.86	3.15	19.96	1.72	2.43	2.49	4.20	152.00	172.80	29,708.93
Minimum		1.31	1.23	11.66	0.59	0.69	0.92	1.53	60.00	50.70	11,015.84
Maximum / Minimum		**3.71**	**2.56**	**1.71**	**2.92**	**3.52**	**2.71**	**2.75**	**2.53**	**3.41**	**2.70**
Standard Deviation		1.02	0.58	2.11	0.32	0.50	0.44	0.66	25.23	35.10	5,158.42
Average		3.32	2.53	16.76	1.35	1.53	1.88	3.14	104.71	108.96	20,848.63
Standard Deviation / Average = (Volatility)		**0.3068**	**0.2283**	**0.1258**	**0.2370**	**0.3247**	**0.2340**	**0.2090**	**0.2410**	**0.3222**	**0.2474**
Maximum as a % of IPO Price		95%	102%	194%	80%	91%	96%	82%			
Minimum as a % of IPO Price		26%	40%	113%	27%	26%	35%	30%			
% 08Nov07 Price on	**27-Feb-09**	**42%**	**56%**	**87%**	**56%**	**40%**	**52%**	**60%**	**45%**	**42%**	**45%**

Table 1

3) **The Link is the least correlated stock** = when compared to the HSI, the two popular listed real estate developers Cheung Kong and Sun Hung Kai Properties, and even other REITS. Practically, all the REITS, the Link included, are now quite correlated among themselves and to probably most listed real estate developers and to the overall stock market as represented by the HSI. However, the Link is the least correlated on a comparative basis. For instance, when compared to the HSI, all REITS except the Link have correlations (R2) of 0.80 or higher while the Link exhibits only 0.66 which is still a significant correlation but is the lowest among the category. This implies IF one, for whatever reasons, really has to have a REIT yet wishes to acquire one which **offers the 'best possible' price defensive play among the REIT group of stocks**, then the Link is the answer [refer to table 2].

Correlation R2: using closed $	Champion	GZI	**LINK**	Prosperity	Regal	Sunlight	RREEF	Cheung Kong	SHKP	HSI
Champion	1.00	0.96	**0.76**	0.93	0.93	0.93	0.82	0.89	0.91	0.91
GZI		1.00	**0.78**	0.95	0.90	0.95	0.88	0.86	0.87	0.91
LINK			**1.00**	**0.83**	**0.67**	**0.76**	**0.69**	**0.62**	**0.64**	**0.66**
Prosperity				1.00	0.82	0.88	0.85	0.77	0.77	0.82
Regal					1.00	0.94	0.77	0.92	0.95	0.92
Sunlight						1.00	0.79	0.86	0.91	0.89
RREEF							1.00	0.80	0.73	0.84
Cheung Kong								1.00	0.95	0.98
SHKP									1.00	0.94
HSI										1.00

Table 2

There you have it: from the angle of stock price performance, the Link offers the best show (losing the least), the lowest volatility (risk), and the best possible defensive play (on a relative scale) among the seven REITS and probably among most real estate developer stocks and the market as a whole [refer to chart A on the Link stock price and HSI indexes].

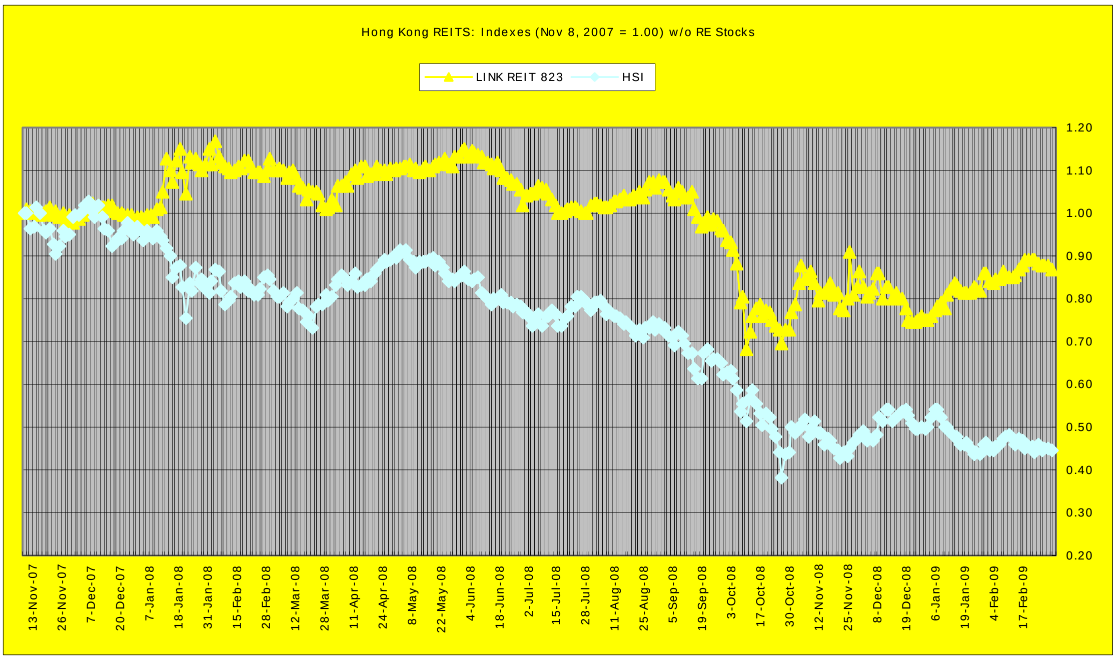

Chart A

4) **The Link is also the ONLY REIT which has offered any <u>meaningful</u> stock price increases** during the mentioned period (08 November 2007 to 27 February 2009) = by meaningful we mean the increases have to be material, i.e. a few percents do not count, and that the increases have to last for some time, i.e. not just a few days' blip on the radar [<u>refer to chart B</u>]. While chart B may not be easy to comprehend owing to having 10 data sets clustered together, one needs only to watch the yellow line which represents the Link stock price performance. This yellow line hovers 90% of the time above the crowd and is recently <u>way</u> above the crowd.

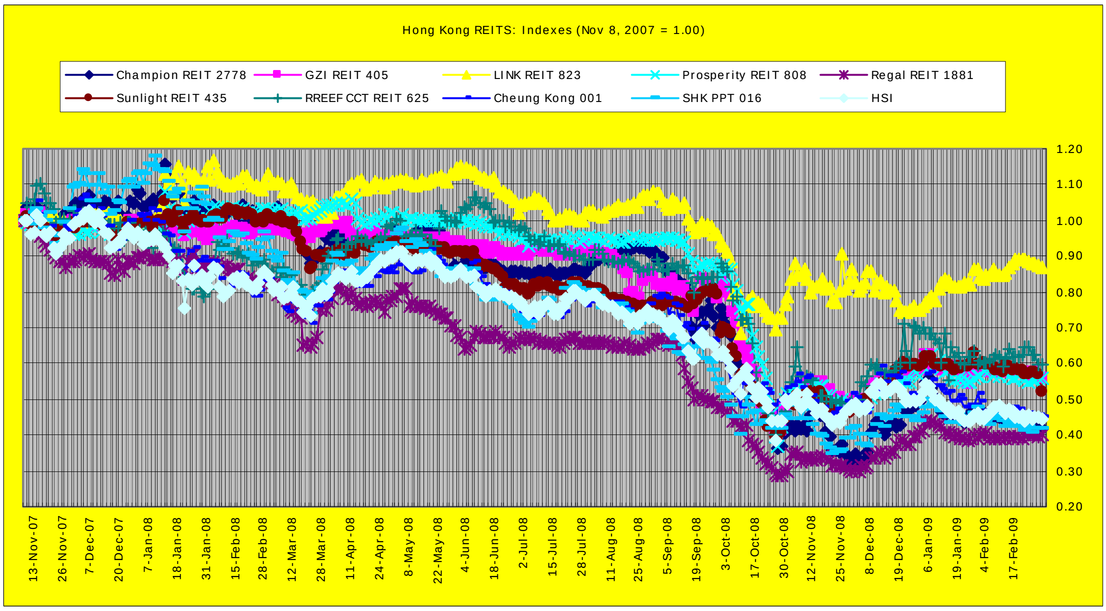

Chart B

During the above process, we also found a couple of interesting trends about the REITS:

A) **The 7 REITS could be divided to date into 3 types based on benchmarking their stock price performances to the HSI** = 1) the winners defined as having significantly better performances to the HSI; 2) the averages as having similar to slightly better performances; and 3) the losers as having slightly worse or worse performances.

For the winner category, there is only the Link REIT. For the averages, there are Champion, GZI, Prosperity, Sunlight, and RREEF. For the losers, again there is only one, Regal.

B) **There is a highly correlated but inverse relationship between REIT stock price volatility and stock price performance** = i.e. the lower the volatility (risk), the better the stock price performs. The correlation is high with the R at -0.92 and R2 at 0.85.

What about dividends? Generally the REITS pay out better dividends than many other categories of stocks and such dividends tend to range from say 6% to reportedly above 10%, perhaps a reflection of first, the REIT Code which dictates Hong Kong-listed REITS to distribute at least 90% of the net proceeds, and second, certain favorably engineered financial pay-out arrangements in the initial years in certain REITS. On this dividend aspect, the Link is not a leader.

Out of curiosity, we have collected the latest (March 2009) Price to Earnings Ratio [P/E] of each REIT and compared these to their stock price performances above. The correlation is quite high with the R2 at 0.84. Assuming a high P/E generally leads to a lower dividend rate and vice versa, this high correlation appears to suggest the REITS with better stock price performances tend to have lower dividend rate and vice versa [refer to table 3 for the P/E ratios of the REITS as abstracted from Yahoo! Finance].

REITS:	**P/E Ratios as of early March 2009**
Champion	1.35
GZI	4.64
The Link	6.21
Prosperity	3.30
Regal	0.95
Sunlight	1.81
RREEF	4.05

Table 3

Likewise, we also compared the P/E to the volatilities of the REITS and observed a very significant but inversed correlation with the R at -0.92 and the R2 at 0.84. Again assuming a high P/E generally leads to a lower dividend rate and vice versa, this high correlation seems to suggest the less volatile (less risky) REITS tend to offer lower dividend rate and the more volatile (riskier) REITS tend to offer higher dividend rate.

Summing things up, the Link REIT leads the REIT pack in overall performance, whether from a price gain / loss angle, risk angle, or defensive play angle. It does not have the highest dividend rate though. However, investors seeking high REIT dividend payouts may have to stomach lackluster stock price performances and higher volatilities-risks.

It is always a question of tradeoff.