Zeppelin's Real Estate Tech

2Q 2011: A Real Estate Newsletter by Zeppelin Real Estate Analysis Limited
Phone (852) 2401 6613 Fax (852) 2401 3084 E-mail stephenchung@zeppelin.com.hk Web: www.Real–Estate-Tech.com

Inflation is on the rise in Hong Kong and the region and some people think it is higher than reported percentages. Measures to cool real estate prices in Mainland China appear to have limited effect to date and more measures are expected. Hong Kong residential prices are on the march still and premium Grade A office rents are making new records. On the other hand, the stock market indexes have shown no significant breakthroughs.

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), **Apple Daily** (Hong Kong), **Quamnet Magazine**, **The Standard** (a Hong Kong English Daily), **MITCRE Alumni Newsletter**, the **Surveying Newsletter** of the Hong Kong Institute of Surveyors, **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 **Radio Hong Kong** and **Commercial Radio**. We also publish monthly articles and analyses in the months in between. This newsletter is now into its **15th year** and **59th** 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 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.

About the Author(s)

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 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 real estate writer 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 also an honorary adjunct professor with 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 to date compiled 2 books; one online and one in hard copy format. Both are published in Chinese (with the titles translated into English below):

Online book = Easy Real Estate Lectures
http://www.real-estate-tech.com/eBook/zeppelin_ebook.htm

Hard Copy = Real Estate Investment Know-How above 101
http://www.edpress.com.hk/Product.asp?id=6282

We welcome enquiries from interested parties and could be reached as follows:

Email: StephenChung@zeppelin.com.hk
Office Phone: 852-24016613
Office Fax: 825-24013084
Office Address: 7/F, 20-24 Kwai Wing Road, Kwai Chung, NT, Hong Kong
Website: www.Real-Estate-Tech.com

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Hong Kong 18 Districts: Which Ones Offer Easier Homes?

Real Estate Tech, 2Q 2011

Stephen Chung BS BBldg(HKU) MS in Real Estate(MIT) MRICS MHKIS MAACE FPFM PQS RPS(QS)
Zeppelin Real Estate Analysis Limited - Phone (852) 24016610 / Fax (852) 2401 3084 stephenchung@zeppelin.com.hk

The Hong Kong real estate market is hot and prices have been rising for some time. Rental yields are compressed at the same time despite rising rents and yields hovering a meager 3% are commonplace. Perhaps these are all a reflection of the various QEs.

In any event, and in any market conditions, there are still properties which prices on a relative basis are favorable to others, and vice versa.

Here we take a rough look at the typical residential prices per square foot in the 18 administrative districts and benchmarked them to a) the typical monthly household income figures in the respective districts; and b) the overall monthly household income figure for Hong Kong.

The chart below tells the story better than words:

18 Districts	A: District Household Income HK$	B: Typical RE Price Per ft2 HK$	A / B	C: Overall Household Income for Hong Kong HK$	C / B
Central	17,178	9,869	1.74	11,055	1.12

East	13,558	8,157	1.66	11,055	1.36
Kowloon	13,122	7,305	1.80	11,055	1.51
Tsuen Wan	12,860	4,732	2.72	11,055	2.34
Saigon	12,183	5,640	2.16	11,055	1.96
South Island	12,335	7,443	1.66	11,055	1.49
Shatin	11,592	5,224	2.22	11,055	2.12
*TST,Yaumati, Mongkok	11,114	9,774	1.14	11,055	1.13
Taipo	10,824	4,943	2.19	11,055	2.24
Outlying Islands	11,595	4,564	2.54	11,055	2.42
Tuen Mun	9,843	3,655	2.69	11,055	3.02
North NT	10,120	4,062	2.49	11,055	2.72
Kwun Tong	9,908	5,529	1.79	11,055	2.00
Kwai Ching	9,718	5,200	1.87	11,055	2.13
Shamshuipo	9,909	6,122	1.62	11,055	1.81
Yuen Long	9,606	3,526	2.72	11,055	3.14
Wong Tai Sin	9,701	5,528	1.75	11,055	2.00
Wan Chai	17,788	12,660	1.41	11,055	0.87

Ratio A / B

This one indicates the RELATIVE ease or difficulty in affording a home in the districts for the residents in the respective districts. The higher the ratios, the more affordable on a relative basis the homes are. As can be observed, and in absolute terms, most monthly household income figures can only buy a square foot or two.

Ratio C / B

This one shows the RELATIVE ease or difficulty to a typical Hong Kong household looking for a home in the 18 districts. Again, the higher the ratios, the more affordable the homes are for the typical household. As shown, the variance is bigger with some districts offering less than 1 square foot and others offering more than 3.

Summarizing the results, districts on the Island and Kowloon Peninsula are less affordable and families with limited buying budgets may have to consider parts of the New Territories and outlying islands.

Note: * There could be a bias for relatively new / modern apartments in the real estate price data for the TST (Tsimshatsui), Yaumati, and Mongkok district.

China Real Estate Prices: Rise > Drop in the Long Run

Real Estate Tech, 2Q 2011

Stephen Chung BS BBldg(HKU) MS in Real Estate(MIT) MRICS MHKIS MAACE FPFM PQS RPS(QS)
Zeppelin Real Estate Analysis Limited - Phone (852) 24016610 / Fax (852) 2401 3084 stephenchung@zeppelin.com.hk

First, let us define what we mean by long run = 10 years or so. Second, we are not ruling downward adjustments in the short to medium run.

As to why we hold this view, read the following:

1) **Urbanization** = the portion of urban population now in China stands at around 50% and reportedly the aim is to increase this percentage to some 65% to 70% in the next 15 years or so. As such, this would mean some 20,000,000 relocating from their villages to towns and cities each year on average, certainly a tough call.

Assuming each household has around 3.50 members, this would imply close to 6M accommodations are required each year to house such migrants, again a tough challenge. Naturally, some migrants may prefer to go into the towns and cities on their own first and to seek a steady job with sufficient income before they bring their families into town too. Even so, this would still mean more accommodations, albeit the basic grade type and in some cases, measured in terms of ‘rooms’ not ‘units’.

However, having more migrants-residents on and by its own is not a sufficient condition to boost real estate demand and prices, as this constitutes only half the equation. The other half is that these migrants must have jobs with meaningful income before they can become potential home buyers. Otherwise, urban slums may result.

As such, and despite urbanization is often touted as a factor to be optimistic about Mainland real estate, there is a logical flaw in the saying, like putting the cart before the horse.

Why? Because real estate is a derivative product and industry i.e. it relies on something else to bring about a vibrant real estate market. That ‘something else’ is usually economics in nature e.g. Hong Kong starting out as a trading port after WWII thus attracting capital and people which in turn led to what it is today including expensive real estate.

Granted, towns and cities on an initial expanding phase mean lots of construction and infrastructure which in turn would provide jobs to waves after waves of new migrants, thus creating this ‘illusion’ that real estate and construction alone would be enough to grow a city. Nonetheless, these activities would slow down sooner or later and that is when the ‘something else’ of a city, be it being one of the top finance centers, manufacturing hubs, or trading ports, becomes essential. That is, cities which lack such thriving skills would suffer ultimately.

In short, instead of attributing urbanization as a factor leading to higher real estate demand and prices, both urbanization and better real estate prices are the results of a vibrant economy.

With a vibrant economy, former migrants can settle down, raise families, and become supporters, either as buyers or renters, of the real estate market.

2) **Graying Population and the Need to Climb the Production Ladder** = reportedly, the demographics of China suggests a graying population which in turn means fewer young labor to feed the traditional low-tech low-value-added industries as in the past decades. By no means does this mean the disappearance of such industries, it simply dictates that China may also need to move up the value chain, as has already been happening, engaging in higher value manufacturing and services.

These, coupled with current inflationary pressures, would lead to even higher wages, income, and compensation. And income is usually one of the, if not the, most vital factors influencing home prices. It is also not an easy task to slow or maintain the paces of home price increases against a background of rising income.

3) **Land Preferring Culture and Significant Savings** = culturally, there has been a tendency to prefer land, perhaps owing in part to being an agricultural country throughout history. In any event, owning a home not only provides status, but also makes finding a wife easier, and TV dramas have been capitalizing on such societal phenomena.

Also, it is not a secret that Mainland households save a significant portion of their income and indeed there are now many households who have accumulated a small fortune, say, enough to make a down payment. That is, the potential buying demand can be immense.

While one can say the QE might have led to rising home prices in the short to medium run, the above factors shall support the market in the next 10 years.

Make a Bet on Las Vegas!

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Stephen Chung BS BBldg(HKU) MS in Real Estate(MIT) MRICS MHKIS MAACE FPFM PQS RPS(QS)
Zeppelin Real Estate Analysis Limited - Phone (852) 24016610 / Fax (852) 2401 3084 stephenchung@zeppelin.com.hk

Courtesy of www.citypictures.org

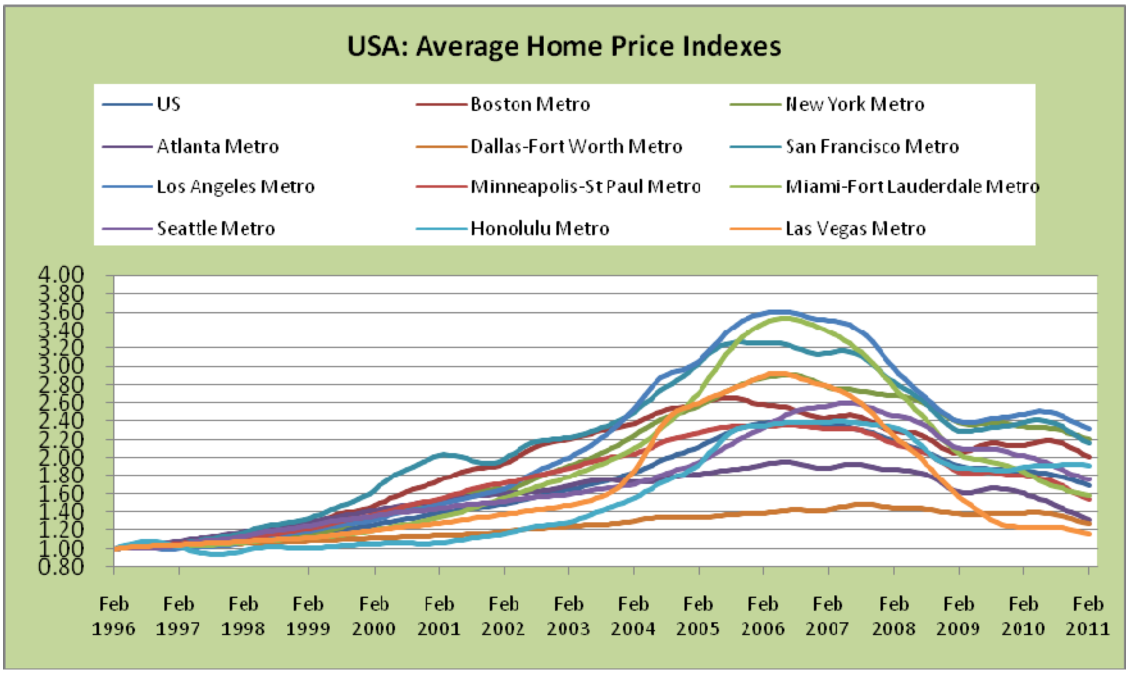
Don't misunderstand us: we are talking about betting on its real estate market, not in its casinos.

And this is despite, based on public data sources such as www.zillow.com, real estate market prices have dropped some 60% from their peak, now averaging only around US$120K, and 1/3 of transactions are below US$100K. Experts there say prices are expected to fall further. Hmm…doesn't this sound familiar to Hong Kong residents? There is really nothing new under the sun!

Not having the benefit of physically being in Vegas or the USA, your humble author finds it hard to arrive at any definitive investment suggestions. Nonetheless, digging up some figures and playing around with them with calculations may yield some macro and useful pointers:

A) **Data** = we have looked at over 100 urban centers in the USA and selected 11 which are familiar to many investors in Hong Kong and the region. These 11 cities represents the two coasts, south, interior, and outlying parts of the USA. Also, the data starts from early 1996 and ends in early 2011.

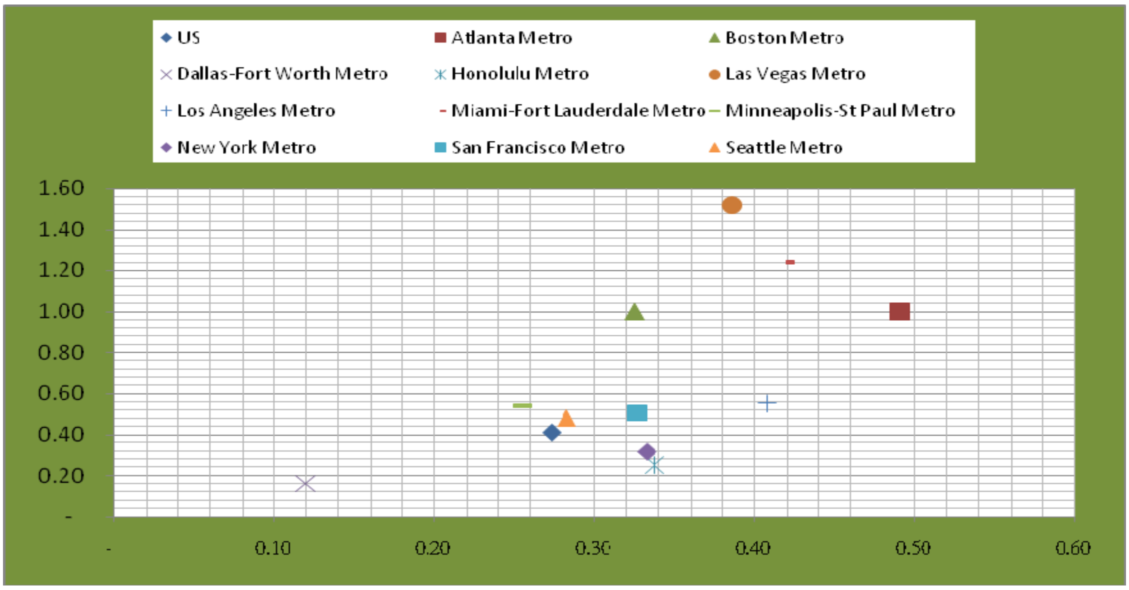
Using February 1996 as 1.00, the following chart shows how the residential prices of these 11 markets and overall USA have been performing:



B) **Las Vegas has the worst performance of the 11** = if one buys an average Vegas property in early 1996 and holds it till early this year, one would gain only around 16% in price appreciation. On the other hand, West coast cities like San Francisco and Los Angeles and the Big Apple all provide more than 100%. Dallas, the second worst, gives 28%.

C) **But Vegas also has a high peak second only to 3 cities** = which are San Francisco, Los Angeles, and Miami.

D) **Potential Return and Observed Price Volatility** = Here we plot the respective sets of return and volatility figures for each city including those of the overall USA. Potential return is calculated by assuming current prices will someday return to their respective peaks while volatility is measured by dividing the price standard deviation by the average price during the period for each city and the USA. Here is the chart:



From the chart, and compared to the other cities and the US averages, Vegas provides the best return i.e. highest along the vertical Y axis (due to it having dropped the most). Admittedly, the volatility, as a measure of price risk, is also high, but then again it is not as high as Los Angeles, Miami, and Atlanta [see the X-axis].

As such, Vegas appears to be a good choice especially for investors seeking higher returns and willing to bear more risks.

E) **Return to Risk Ratios** = we can calculate one more ratio by dividing the return figure by the risk figure for each city. The ratio will indicate how many ‘units’ of return are available for each ‘unit’ of risk. The ratio means more relatively i.e. in terms of comparison between cities than as absolute values.

Region Name	**Risk**	**Return**	**Return / Risk**
US	0.27	0.41	1.50
Atlanta Metro	0.18	0.49	2.79
Boston Metro	0.27	0.32	1.19
Dallas-Fort Worth Metro	0.12	0.16	1.35
Honolulu Metro	0.34	0.25	0.75
Las Vegas Metro	0.39	1.52	3.93
Los Angeles Metro	0.41	0.55	1.35
Miami-Fort Lauderdale Metro	0.42	1.24	2.95
Minneapolis-St Paul Metro	0.26	0.54	2.12
New York Metro	0.33	0.32	0.95
San Francisco Metro	0.33	0.51	1.55
Seattle Metro	0.28	0.48	1.70

Under this measure, Vegas offers the best ratio, even way above the runner up of Miami and certainly much better than the national average.

Henceforth, those of you wishing to seek fortunes and considering yourselves brave souls, try your luck in Las Vegas, not in its wheels of fortune but the bricks and mortar.

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- Contact us:

Hong Kong Office: Mr. Stephen Chung stephenchung@zeppelin.com.hk
Address: 7/F, 20-24 Kwai Wing Road, Kwai Chung, NT, Hong Kong
Phone: 852-24016610 Fax: 852-24013084 Web: www.Real-Estate-Tech.com

Shenzhen Office: Mr. K K Wong kkwong@zeppelin.com.hk
Address: Unit 1203, Shenhua Commercial Building, 2018 Jia Bin Road, Shenzhen
Phone: 755-28627707 Fax: 755-28687727

Beijing Office: Mr. Tomman Kwan tommankwan@zeppelin.com.hk
Address: Suite 2001, Tower G, City One, No. 48 Wang Jing Xi Road, Chaoyang District, Beijing 100102
Phone: 10-65011565 Fax: 10-65527129

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Zeppelin Group

Zeppelin **Property Development Consultants Limited**

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