Zeppelin's Real Estate Tech

2Q 2014: 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

The FED has just described the intention to raise rates and to further taper the purchase of loans. In Europe, the Crimea portion of Ukraine is likely to join up with Russia notwithstanding global political wrangling. Meanwhile in Asia, there are concerns for certain overheated markets given the QE effect may dwindle somewhat. In this issue:

- **Hong Kong REITs: Timing is vital and no first mover advantage**
- **Hong Kong Residential Real Estate: A 10% price drop is not attractive at all**
- **Toronto Residential Real Estate: Bubbly? Yes but not too**

"Thinking exercises the mind and an exercised mind controls the brain better."

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 **18th year** and **71st** 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

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

Email: StephenChung@zeppelin.com.hk
Office Phone: 852-24016603
Office Fax: 825-24013084
Office Address: 7/F, 20-24 Kwai Wing Road, Kwai Chung, NT, Hong Kong
Website: www.Real-Estate-Tech.com

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 REITs: Timing is vital and no first mover advantage

Real Estate Tech, 2Q 2014

Stephen Chung BS BBldg(HKU) MS in Real Estate(MIT) MRICS MHKIS FPFM PQS RPS(QS)
Zeppelin Real Estate Analysis Limited - Phone (852) 24016603 / Fax (852) 2401 3084 stephenchung@zeppelin.com.hk

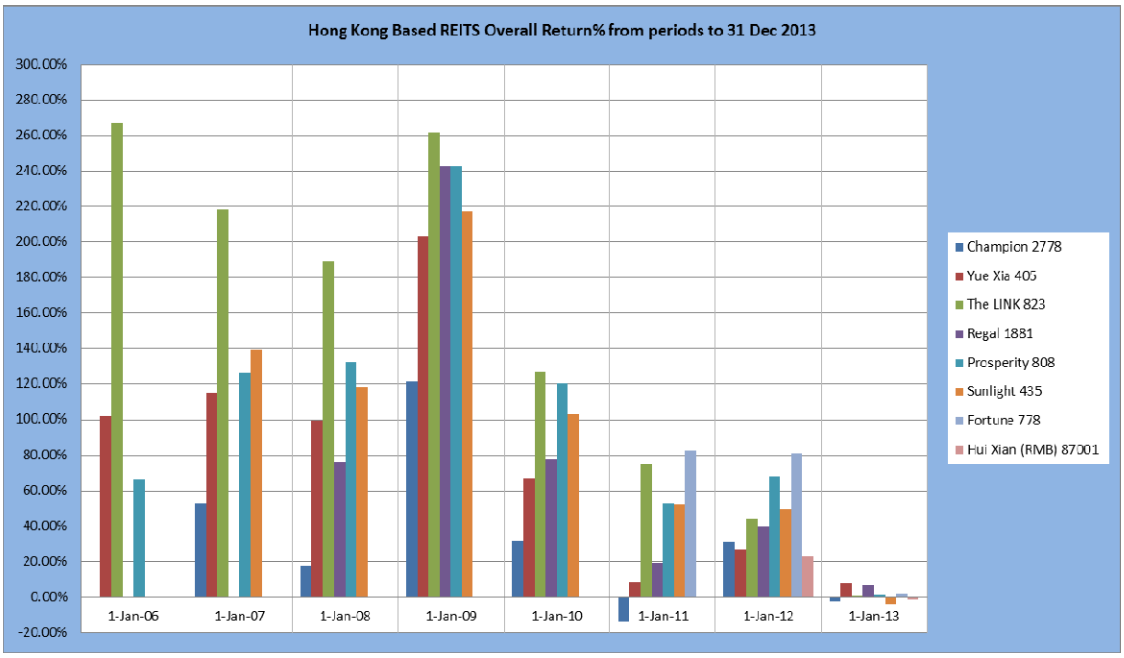
You can own part of this easily

Your humble author invests in some of the REITs (Real Estate Investment Trusts) listed in Hong Kong seeking both their dividend and (hopefully) stock price appreciation returns. Here is a rough snapshot of their performances using the data provided in www.Webb-Site.com:

A) Timeframe = from January 01, 2006 to December 31, 2013, and the number of listed REITs increased during the period i.e. there were fewer REITs in 2006 than in 2013. Where data is available for any particular REIT in any particular year, its performance, in both total and compounded returns (from the earliest work day in January of the particular year to the last work day in December of 2013), would be calculated. It is also assumed the dividend received would be reinvested into the stock.

B) Total returns during (different) periods = please refer to the chart below.

Except for the LINK REIT (which top most performance in this category occurred in 2006, being slightly higher than its performance dated from 2009), REITs which existed in or before 2009 offered their best overall return in 2009. To recap, that was the year immediately after the global financial tsunami.



While one might disagree with "timing is everything", timing at least is still "quite a lot". Naturally, one may also argue that subsequent years may also offer better overall returns. True, but here we focus on actual past occurrences, and to this end, 2009 beats most other years. Notwithstanding timing the market is very difficult, if not impossible, to achieve, going in at the right moment usually brings investment results which are not easy to match.

Stating the obvious, the LINK REIT outperformed the rest in most of the years although that has not been the case since 2011.

C) Compounded returns during (different) periods = please refer to the chart 2.

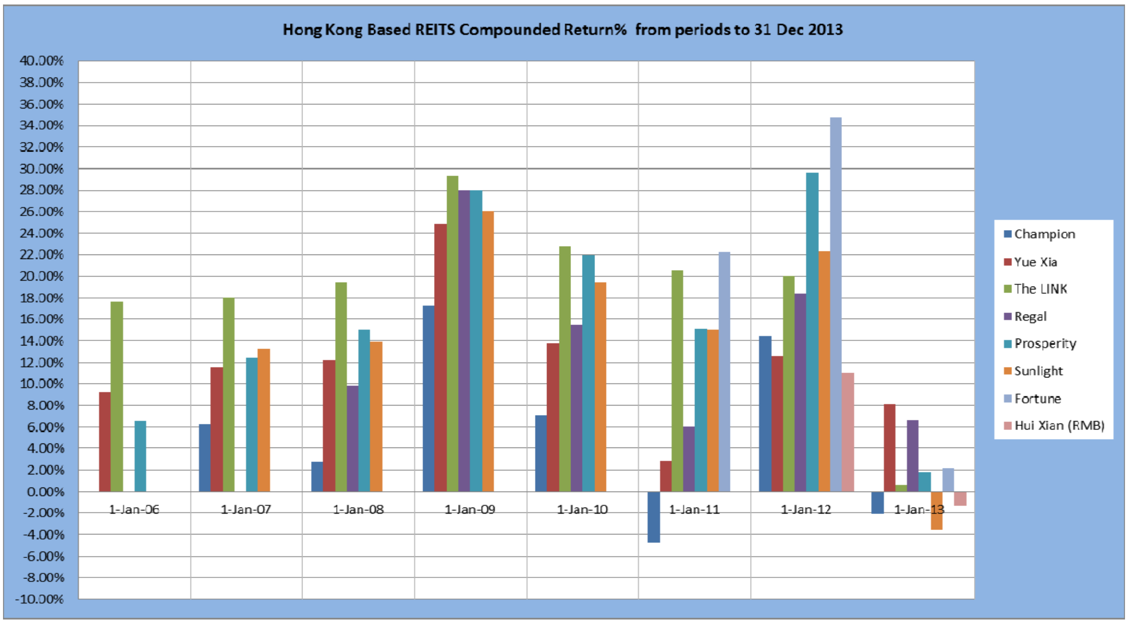


Chart 2

While overall returns have a slight bias for longer investment periods (the longer you hold, the higher the overall return you require and sometimes have – while this is not a bound to happen scenario, investors do tend to require more return if they were to hold out longer, else what's the point in being 'long term'?), compounded returns would do away any such bias.

In this respect, while 2009 still offers by and large the best compounded returns for most of the REITs, 2012 does pretty well too as a close runner-up. In fact, your compounded returns on Fortune and Prosperity REITs are better in 2012 than in 2009. Again, the LINK REIT performance has been overtaken by a few other REITs in recent years.

No first mover advantage

This carries two meanings: 1) REITs that were listed earlier do not necessarily offer better performances than those which were listed in later years; and 2) getting into the REIT market earlier does not guarantee a higher overall return, let alone a compounded one.

The pros and cons of the bricks & mortar type real estate versus REITs? This demands another analysis in its own right but say we look at 3 aspects for now:

Aspects	Bricks and Mortar	REITS
Hong Kong Taxes	Rental income taxed ☹	Dividend not taxed ☺
Long Term Financing	Mortgage ☺	Generally not available ☹
Buying and Selling	Takes time, heftier fees ☹	Click the mouse, low fees ☺

Hong Kong Residential Real Estate: A 10% price drop is not attractive at all

Real Estate Tech, 2Q 2014

Stephen Chung BS BBldg(HKU) MS in Real Estate(MIT) MRICS MHKIS FPFM PQS RPS(QS)
Zeppelin Real Estate Analysis Limited - Phone (852) 24016603 / Fax (852) 2401 3084 stephenchung@zeppelin.com.hk

Dropping 10% means cheap? R u kidding?

IF, and a very BIG IF, your humble author is given billions and billions of (Hong Kong) dollars to set up a fund and invest in Hong Kong residential properties, whether in bulk buildings or individual strata-titled units, then this is what he intends to do (right up to this point when writing this piece):

1) Prices dropped 10% overall = Not even lifting a finger, let alone buying something. 10% is just way too small a drop to entice investment into the sector given its relatively high valuations.

2) Prices dropped close to 30% or so = Yup, yours truly would start to contemplate buying some, say moving 1/4 of his chips onto the betting table. This would likely be more a defensive play than aggressive input. Defensive? Yes, defending against any potential (sudden and unexpected) market turn around, especially owing to probable actions taken by "must do something" or "need to be seen to be doing something" institutions.

3) Prices dropped close to 40% or so = Ah ha, more buying, probably moving another 1/4 of chips onto the betting table i.e. utilizing an accumulated 1/2 of chips. If prices drop further, yours truly would still have cash to cash in the opportunity, if not, at least he would have invested half of the capital.

4) Prices dropped to 50% or more = All chips in. Even if one wants to play safe, maintain no more than 1/10 of chips. Yes, your humble author bets (yes, and after all the analysis, thinking, contemplating and so on, it is still a bet, albeit an 'educated' one – which makes you feel safer and sounds more professional) the chance for much more than 50% price drop seems slim at this juncture.

But will there be more opportune (or even perfect) scenarios for entering the market than the ones above? No, I do not have any, maybe someone has, but I don't. This in turn reminds your humble author of a 1962 old movie titled "The Longest Day" on the Allied Normandy D-day Landing in France in June 1944 during WWII (which lasted from September 1939 to August 1945).

In the movie, there was a scene when the Supreme Commander of the Allied Forces in the European theatre of war (Allies = American, British, Canadian, and Free French mostly in this campaign) General Dwight Eisenhower ("Ike") had to decide whether to give the order to go on with the landing (or not go on and stand down). And the choice was between going then under marginal weather conditions with probable surprise (to the enemy i.e. the Germans. No, no Japanese were involved because we are talking about the European theater of war) AND postponing a month till July with much better weather conditions but without any surprise. Ike said "No, I don't like it, but there it is" and gave the order to go. The Germans were surprised and the landing was successful.

Not investing at all when prices have dropped close to 30%, which is more probable than a 50% drop, will risk not being able to invest IF somehow the market starts turning around suddenly due to some intervening measures. **Waiting until prices** have decreased by 50% to invest is more ideal, yet, a price drop of 50% is less probable than a 30%. No perfect combinations exist.

Rather than hoping for (close to) perfect conditions to invest, making the best use of (all or most) viable scenarios seems more practicable. Also think of return to risk ratios rather than just returns.

"No, I don't like it, but there it is".

Toronto Residential Real Estate: Bubbly? Yes but not too

Real Estate Tech, 2Q 2014

Zeppelin Real Estate Analysis Limited - Phone (852) 24016603 / Fax (852) 2401 3084 stephenchung@zeppelin.com.hk

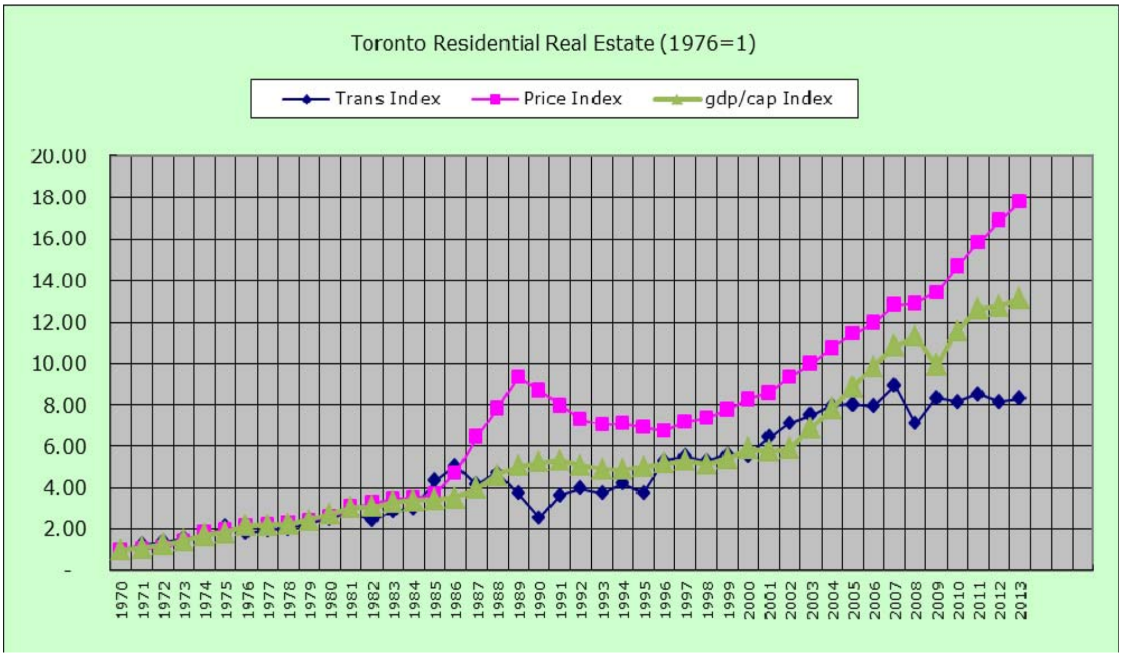
C$200K gets you a 650 ft2 net 1 bed unit in this tower located in the metro

Quite a few residents in Hong Kong have some connection to Toronto. From a Hong Kong angle, Toronto residential properties appear a steal especially given the Canadian is now C$1 = around HK$7 having dropped from HK$7.80 not too long ago.

For instance, the average price of a home (all forms included ranging from apartment condominium via townhouse to detached house) is now C$550K or a bit lower than HK$3,900,000. Depending on location, this budget can comfortably get a buyer a nice detached house in the more remote suburbs, a townhouse in the closer to metro area, or a 1000 ft2 apartment condo in the heart of Toronto. The same budget gets one at best a 400 ft2 net unit with 1 or 2 bedrooms – yes, you don't need to "go" to your bed, instead you "jump" right into it - "somewhere" in town in Hong Kong.

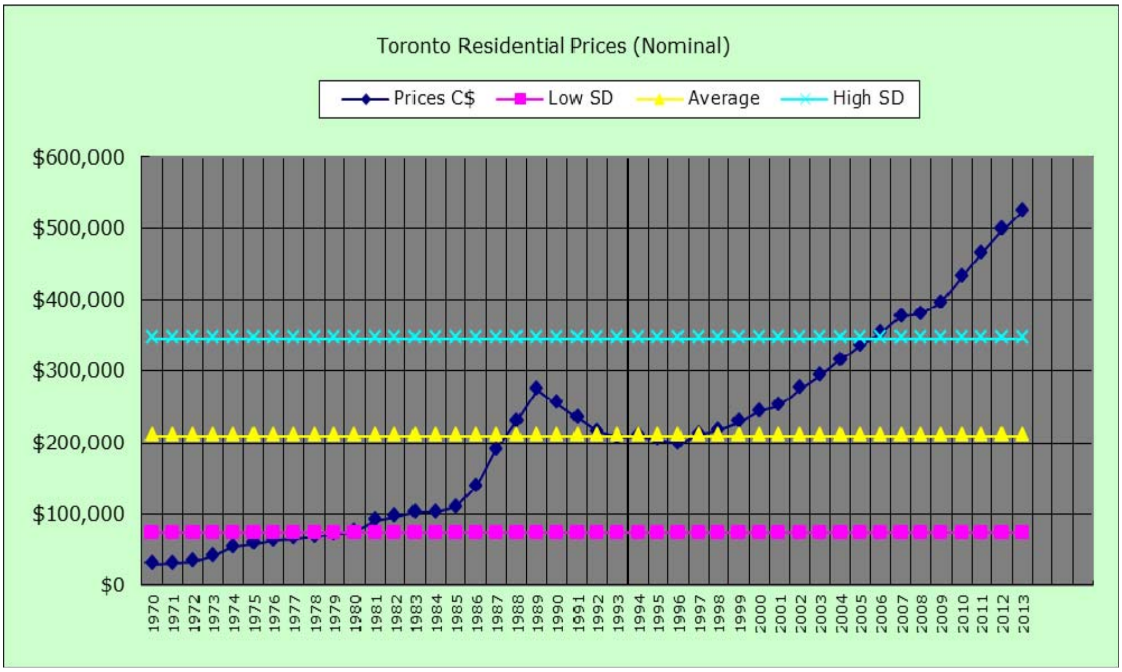
Notwithstanding the above, and if one has taken any notice of market commentaries in North America, Canada is now deemed a housing price bubble about to burst. As such, your humble author intends to gauge how bubbly Toronto might be. Data comes from relevant statistics and economics websites on Canada and that of the Toronto Real Estate Board as well. Here we go:

1) Home price, transaction volume, and GDP per capita indexes = note the latter refers to Canada as whole as we do not find a sufficiently long GDP per capita time series on Toronto i.e. the national GDP per capita is used as a proxy herein. See the chart below.



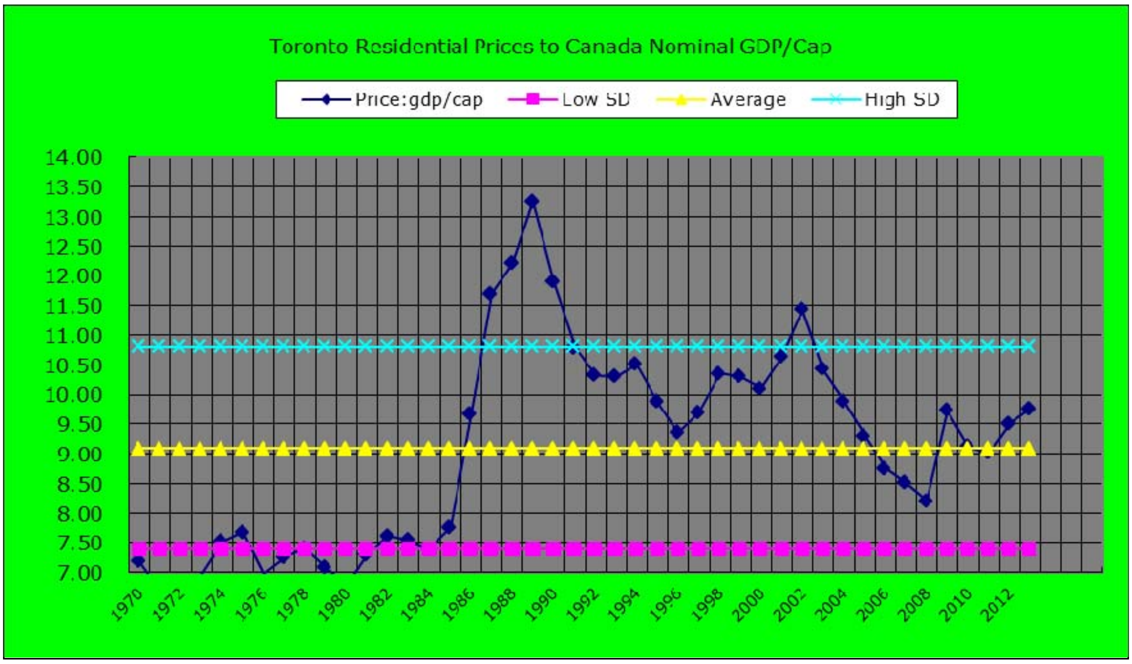
While income factors such as GDP per capita generally jive with house prices across markets, Toronto house prices have risen higher than (Canada wide) GDP per capita. Also, note transactions have not really increased much in recent times. Subject to further study, this might imply metro growth is slowing down somewhat and / or simply house prices have gone beyond reach for many households, especially the new ones.

2) Technical trend analysis does suggest a bubbly level = refer to the chart below. Here we took the nominal house prices starting from 1970 to 2013 and calculated the average and standard deviation of the series.



Given the house price tendency to trend upward, it is no surprise to see the current level being above the high standard deviation level [the bright blue line across the chart at around C$346K]. However, the protrusion does cause a bit of concern because the current level [at around C$550K] is more than C$200K above the high standard deviation mark, or close to 60% higher. As such, we concur that a concern for bubble in real estate is not unjustified.

3) Fundamental analysis suggests no need to worry (too) much = refer to the chart below. Here we divide the average Toronto house price by the GDP per capita for each year and thus a series of ratios is obtained. It is not so much the actual ratios which matter but their rises and falls during the overall period.



Putting it briefly, the average Toronto house price to (Canada wide) GDP per capita ratio hovers at around 9 with 11 and 7 being the high and low standard deviation levels respectively. While not being a cast in stone rule, a reading below average and near the low standard deviation level (or even below it) tends to indicate a potential bargain opportunity, while the reverse i.e. higher than average and near or even above the high standard deviation level does suggest probable bubbly conditions.

Currently it is nearing 10 which does cause a bit of discomfort, but then again it is not exceedingly high to cause undue stress from a historic perspective which highest point had reached above 13 around 1989.

All said, IF there is to be catastrophic downturn in Canadian real estate, probably the Toronto residential sector will not be the one which grabs the honor for having the biggest bust.

<u>A note on Quantitative Easing (QE)</u> = your humble author hypothesizes that a significant portion of the asset price appreciation seen globally in recent years has been due to QE led by the USA Fed and followed in varying degree by other major central bankers. Toronto real estate prices have benefitted from QE directly and indirectly. Yet yours truly also believes this QE phenomena will not have a happy ending and markets which have benefitted from it also tend to carry higher risks. When this QE bubble bursts, Toronto properties will be adversely affected too. However, because the Canadian dollar is floated, the exchange rate will help absorb some of the shock. For instance, to Canadians, Toronto property prices have not gone down, but to someone from Hong Kong, prices have already adjusted 10% downward.

Declaration = your humble author has investment in Toronto properties.

Do you need our services? You DO when…

- **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

- **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

- 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: 852-24016603 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

For details: please download our group introduction at http://www.real-estate-tech.com/ZPG-Group%20Introduction-sOct07.pdf

Zeppelin Group

Zeppelin **Property Development Consultants Limited**

Zeppelin **Real Estate Analysis Limited**

Hong Kong . Shenzhen . Beijing