Zeppelin's Real Estate Tech

2Q 2019: A Real Estate Newsletter by Zeppelin Real Estate Analysis Limited
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The trade negotiation between the US and China appears to have stalled if not broken down while the UK is muddling through its Brexit saga. There were also massive protests against a proposed extradition law in Hong Kong. Meanwhile, the Hong Kong residential prices are still holding up and the Hang Seng Index hovers around 27,000 points (as of early June 2019).

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"Jumping from 3 feet x 100 times = / = jumping from 300 feet x 1 time!"

The quotation above is inspired by Antifragility written by Nassim Taleb. 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 spring, summer, fall, and winter) 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 **23rd** year and **91st** 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 Partners 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 based in Hong Kong with associated operations in Mainland China and we also have access to regional and global professional networks.

Who? Me?

Stephen Chung
Managing Director, Zeppelin Real Estate Analysis Limited
Founder and Writer, 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, Sing Tao 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 written 4 real estate books in Chinese to date as follows:

Online book = Easy Real Estate Lectures
Hard copy = Real Estate Investment Know-How above 101
Hard copy = The Real Estate Market Turning Point
E-Report = USA Residential Real Estate Analysis

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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.

Real estate investing: avoid having all three highs at the same time

Real Estate Tech, 2Q 2019

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Favorability	Market Cycle	Market Volatility	Financing
☹☹☹	High (peak cycle)	High (fluctuating)	High (very leveraged)
☹☹	High	High	Low
☹☹	High	Low	High
☺☺☺	Low	High	High
☹	High	Low	Low
☺☺	Low	High	Low
☺☺	Low	Low	High
☺	Low (bottom cycle)	Low (steady)	Low (little leverage)

You don't have to agree…

Investment involves taking risks and real estate investment is no exception.

There are various kinds of risks and here we are concerned with three of these: a) market cycle risk; b) market volatility risk, and c) financing risk. Type (a) refers to the cyclical point a market is treading e.g. whether it is bottoming, peaking, or anything in between. Type (b) refers to the degree of [price] fluctuation exhibited by a market over time e.g. whether it is volatile or steady. Type (c) refers to the financing rates, terms, and leverages which investors take up for their investments.

Normally, investors, be they individual or institutional, have little practical control over type (a) and type (b) risks, assuming the 'market' is not one of the command and control category. However, investors can decide how much financing risks are to be taken up, or if at all.

While different investors would have different appetites for investment risks, most if not all would be better served if they were to avoid having all three highs i.e. investing in a volatile market at its peak with leveraged to the max financing. Such a combination can, though not necessarily must, lead to significant losses.

This said, we are neither advocating all investors to become so risk adverse that they should only invest at the bottom cycle of a steady market without leverage. Such a combination only suits a minority of investors.

Generally, having one or two of the above risk types high may still be investable. For instance, investing at the bottom of a volatile market with high leverage could mean extraordinary return. Or if one has to invest at the peak cycle of a volatile market, one might wish to use as little financing as possible, if not none (the latter won't stop a market from going down, yet the smaller to nonexistent leverage means no bank or financier will be knocking at your door with an asset seizure order).

Perhaps the table above may offer a very rough summary for further contemplation.

Overseas real estate investing: sort out your primary objective

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Toronto Downtown (courtesy of your humble author)

Many investors from Hong Kong have had experience investing in overseas real estate markets and there are mixed results; some are successful while others suffer losses. In the latter, empathy notwithstanding, part of the reason for less than desired results rests with the investors themselves…they haven't sorted out their primary objective.

1) For the overseas market's prospects or for diversifying your investment portfolio?

It would be ideal if the overseas real estate market offers bright prospects while allowing you to 'diversify' your portfolio's risks at the same time. However, this is easier said than done. Often, markets offering bright prospects may not offer much by way of risk diversification, and those that do help risk diversification may not be too prosperous.

Note ever since QE, markets worldwide have become more synchronized i.e. correlated in terms of price performances, and this defeats (geographical) diversification.

2) Overseas real estate offer good bargains

Compared to Hong Kong real estate, especially on a price per floor area basis, (almost) all real estate elsewhere would seem a good bargain. But bargains do not necessarily mean good returns.

3) For recurrent income or for price (capital) appreciation?

Again it would be ideal if a property offers competitive rental income and price appreciation. However, in many instances one would need to choose between these two i.e. properties which offer good rental yields tend to have slower price growths and vice versa. Not to mention the tax implications e.g. income tax for rentals and capital gains tax for price appreciation.

4) Keeping up with the Joneses?

Sometimes investors acquire overseas real estate simply because their relatives and / or friends have done so. Safety in numbers notwithstanding, being 'fashionable' and keeping up with the times seem to be factors too.

5) Simply to allocate some wealth abroad?

Given today's global market conditions with all the challenges, changes, and even conflicts, it is understandable that investors might want to simply put some of their wealth abroad, especially in markets which seem safe and steady.

There are probably other factors and reasons but the above reflect some of the more common drivers. Regardless, investors can serve themselves better if they have a primary factor to work on. If not, it is easy for investors to lose sight of what really matters to them and one could be shooting in so many directions that the final outcome might not be the most relevant or optimal one.

Continental European real estate: a few investment challenges

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Dresden, Germany (courtesy of your humble author)

Your humble author had a few months ago been invited to be one of the guest speakers at a real estate seminar hosted by the Estate Agents Authority in Hong Kong. The theme was on overseas real estate investing.

During the Q&A session, one question posted by the audience was related to real estate in Continental Europe especially countries such as Germany, France etc. Your humble author wasn't and still isn't facile with these countries and markets but offered the following for contemplation:

A) The language challenge

There are several primary languages e.g. German, French, Spanish, Italian, Dutch and the like, not to mention the more peripheral ones such as Hungarian, Polish, Romanian, Czech etc.

Unless one is a talented linguist, it would be difficult for most to deal with so many languages. Do note one does not just need to speak them but also to be able to read, write, and comprehend them for purposes of business, investment, and the related documentation.

Isn't English used too? Yes (to a certain extent, especially among the younger Europeans), but first, not everything is translated into English; second, there could be losses – of meaning - in translation; and third, the total volume of available real estate related data and information will definitely be greater in the respective mother tongue than that published in English (automated internet translation notwithstanding).

That is to say, English-only speakers will be at a disadvantage in terms of access to available real estate data and information, including commentaries, critiques, and even property opportunities.

B) The legal challenge

Investors from Hong Kong are generally familiar with the common law system which is practiced in most / many English speaking countries. However, Continental Europe e.g. Germany practices continental law system. In short, while both legal systems would have laws safeguarding property rights and so on, they could differ in certain details.

Moreover, countries such as Germany tend to have pro-tenant regulations i.e. the rules and laws related to tenancy generally favor and protect the rights of the tenants more than those of the landlords.

C) The historic challenge

Unlike the United States, Europe has a greater diversification in languages, cultures, and histories. It was also almost constantly at war, including the First (called the Great War) and Second World Wars. Such wars were also part of the reason that the European Union was contemplated and formed with an intention to bring the countries closer together, thus helping to avoid (future) conflicts and wars.

Noble such an idea appears notwithstanding, the various differences have not vanished nor have past ills been totally forgotten. Nor have its geopolitics changed much e.g. Germany and France are still seeking to be the leader in the continent, or Germany and Russia will be peaceful toward one another as long as there are the smaller countries dividing them, if European history is any guide.

These factors are still pretty much at play and thus affect aspects such as economics, finance, and investment, be they obvious or subtle. Investors who have an appreciation of such trends may form better decisions.

In short, there is reason why Berlin residential real estate prices are about 1/3 of London's.

As a side note, investors contemplating Continent European real estate can also research into its REITS (real estate investment trusts) and private equities as alternatives.

Toronto residential condo market: approximately 3% net rental yield
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Modern condo (courtesy of your humble author)

Investors seem keen to learn the approximate net rental yield if they were to invest in Toronto high rise condo residential units. As such, your humble has dug up some 1Q 2019 data from the Toronto Real Estate Board's website www.trebhome.com and crunched some very rough numbers. Here is a chart (do read the remarks and notes too):

City of Toronto: Condo Prices, Rentals, and Yields - A very rough estimate					As of:	1Q 2019	
Regions	Realty Districts	Median Prices	2B Rents/Month	Annual Rents	Gross Rental %	PURELY Guessed Net%(1/2 Gross)	Remarks
A) West	Overall	474,000	2,678	32,136	6.78%	3.39%	1) 2Bed (2B) condo units are the most numerous or popular, whether sales or rentals, thus used as a proxy
	W01	543,500	3,257	39,084	7.19%	3.60%	2) The gross rental yield % is pre-landlord-expenses i.e. before deduction of items such as condo fee, realty taxes etc, and before income taxes etc
	W02	540,000	3,084	37,008	6.85%	3.43%	3) Full 12 month gross annual rents are assumed though there could be vacant periods in actual circumstances
	W03	551,250	*2,300*	27,600	5.01%	2.50%	4) Median condo prices, deemed reflective of 2B units, are used to reduce undue influence by the outlying sales samples at both top and bottom ends
	W04	410,000	2,316	27,792	6.78%	3.39%	5) Net rental yields are PURELY guesses as condos vary from one another in management fees and realty taxes etc
	W05	374,000	2,209	26,508	7.09%	3.54%	6) Major condo expenses such as unforeseen repairs have not been taken into account
	W06	538,250	2,891	34,692	6.45%	3.22%	
	W07	731,000	*2,100*	25,200	3.45%	1.72%	*Italics imply only 1 transaction during the stated period*
	W08	490,000	2,394	28,728	5.86%	2.93%	
	W09	334,500	2,436	29,232	8.74%	4.37%	
	W10	374,500	2,098	25,176	6.72%	3.36%	
B) Central	Overall	598,944	3,075	36,900	6.16%	3.08%	
	C01	625,000	3,304	39,648	6.34%	3.17%	
	C02	891,000	4,684	56,208	6.31%	3.15%	
	C03	782,500	2,763	33,156	4.24%	2.12%	
	C04	620,018	2,990	35,880	5.79%	2.89%	
	C06	470,000	2,346	28,152	5.99%	2.99%	
	C07	565,000	2,778	33,336	5.90%	2.95%	
	C08	615,000	2,957	35,484	5.77%	2.88%	
	C09	929,000	3,067	36,804	3.96%	1.98%	
	C10	631,500	2,886	34,632	5.48%	2.74%	
	C11	410,000	2,327	27,924	6.81%	3.41%	
	C12	910,000	3,164	37,968	4.17%	2.09%	
	C13	494,400	2,534	30,408	6.15%	3.08%	
	C14	537,500	2,710	32,520	6.05%	3.03%	
	C15	502,000	2,525	30,300	6.04%	3.02%	
C) East	Overall	405,500	2,302	27,624	6.81%	3.41%	
	E01	650,000	3,062	36,744	5.65%	2.83%	
	E02	604,000	3,067	36,804	6.09%	3.05%	
	E03	345,000	2,110	25,320	7.34%	3.67%	
	E04	399,900	2,170	26,040	6.51%	3.26%	
	E05	412,000	2,244	26,928	6.54%	3.27%	
	E06	545,000	2,347	28,166	5.17%	2.58%	No 2B transactions, thus interpolate using 1B transactions of E06 and E05
	E07	402,000	2,092	25,104	6.24%	3.12%	
	E08	357,500	2,016	24,192	6.77%	3.38%	
	E09	435,000	2,365	28,380	6.52%	3.26%	
	E10	285,000	1,938	23,256	8.16%	4.08%	
	E11	360,000	1,953	23,436	6.51%	3.26%	
City of Toronto	**Overall City**	**540,000**	**2,964**	**35,568**	**6.59%**	**3.29%**	

Briefly, the typical net (of landlord's expenses such as condo fee, realty tax, rental fees, and the like) rental yield hovers around 3% before (income) tax. Technically, we have used the 2Bed rentals and the median condo prices as proxies for the market.

A few observations too:

1) The higher the prices, the higher the rentals = this is natural and obvious.

2) But higher rentals don't translate into higher rental yields = in fact, there is a slight hint that the reverse is true i.e. higher rentals seem to connect with lower rental yields.

3) The higher the prices, the lower the rental yields = the correlation is significant i.e. the pricier the condo units, the lower rental yields they will generally bring.

Is 3% net rental yield acceptable? Well, given today's still low rates and low inflation, perhaps an OK la.

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

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