Double Your Money by Investing in Beijing and Shanghai Real Estate?

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The quick answer is a very probable ' yes' . How long will that take? Say 5 or more years. Reasons? The usual would include ones you have already read in the newspaper such as the prospect of WTO, the so many billion people market (Author' s note = this may apply if you sell commodities and services that almost everyone uses e.g. soda pops, soaps etc but real estate developers and investors need prosperous cities with increasingly well off city folks. Even at that you do not need a dozen of such cities, a couple of good ones would be more than sufficient to build up a viable real estate development operation), trade surplus, a talent pool of well-educated urban professionals, a huge interest from foreign investors, an emerging middle class in certain major cities or even the 2008 Olympics. No doubt there are quite a few risks too, including the relative poverty in the western provinces, or having administrative policies and taxation structures not entirely conducive to achieving viable real estate investment returns, to name a few.

By no means is the above a crystal ball suggestion without default risks and even if one assumes the macro trend is there, the markets may not be suitable for all investors. The latter is advised to consider the pros and cons and see if these fit into one' s operational criteria, resource capacities and return / risk expectations before any leap is taken. Nonetheless, the following constitutes part of the reasoning, using a GDP per capita expectation approach:

a) **Beijing and Shanghai' s GDP per capita are now reportedly close to US$4,000** = this is based on information reported in the media and in real estate brokerages' presentations, notwithstanding other higher figures such as US$10,000 to 20,000, or even US$60,000 had also been stated by some. No detail investigation has been made to find out how these various figures have been arrived at or on what they are based (nominal GDP, PPP etc). Some discretion is required and perhaps it is safer to lean on the more conservative side i.e. toward the US$4,000 level, especially when compared to China' s average GDP per capita of around US$1,000 [it is not unreasonable for a developing economy to have its urban GDPs larger than its national average by several times], or for that matter to those of a few more advanced economies such as the USA (US$30,000), Japan (US$33,000), South Korea (US$8,600) or the UK (US$22,000) etc. All in all, it is felt that the lower range may better reflect the economic capacity of the cities. In any event, US$4,000 per capita generally signifies having an emerging middle class.

b) **Real Estate Prices generally reflect the economic performance and earning power of its populace** = especially the residential real estate sector. The US$4,000 per capita could be a ten-fold+ increase of what these cities might have some 20 years ago when the open door policy was at its infant stage. Say for the next 20 years this rate is to be reduced by half to a five-fold increase only. Spread evenly, it still implies a US$4,000 nominal increase every 5 years, not even counting the possible trend that the earlier years may bring in the bulk of the increase. On an internal rate of return basis, this works out to be close to 15% and it has not factored the use of financial leveraging and rental income in the equation. Nonetheless, this assumes the current prices being at 'explainable' or non-bubbly levels. In any event, when the GDP per capita goes up by 100%, it would be rare to find the economy's asset prices, including real estate, not moving in somewhat tandem fashion, unless some form of market intervention is applied. Whether the increase is synchronized in time and in quantity is another question.

c) **Going from US$4,000 per capita to US$8,000 per capita is NOT overly difficult** (it does not follow to say that it is easy though) = as both figures are more or less in the "trying to make it" economic stage of development, with one at the lower bottom of the scale and the higher figure at the top of the same scale. At this point some readers would be asking why we seem to be so sure of this. We are NOT, but it is not entirely unreasonable to expect it. For instance, based on reported statistics and on a nominal basis, Hong Kong's GDP per capita had more than doubled from HK$6,600 in 1971 to HK$14,000 in 1976, and then again to HK$33,000 in 1981. Hence, it is not unseen before. Today, Hong Kong has a GDP of around US$24,000 i.e. roughly HK$200,000, still a 30-fold increase over the last 30 years despite having been slashed from the high of US$28,000 in 1997. Depending on state of maintenance and other factors, a proper residential property bought in 1971 is likely to have increased some 20-fold (+/-5) using today's prices = some 40-fold (+/-5) in 1997 prices! Naturally, what had happened in Hong Kong may or may not be repeated elsewhere.

d) **Vacancy rates are high, but their distribution may not be even** = that is, some properties rent or sell better than others. While there are the (almost) empty buildings (especially in Shanghai), there are also a few that are much sought after due to better location, facilities, management, competitive pricing and so on. This implies the profitability is not evenly distributed too = some poor operators will lose their shirts while the more efficient investors with better properties will be rewarded.

e) **Improvements in hard and soft infrastructures** = hard ones refer to tangible improvements such as in roads, bridges, telecommunications and so on. Soft ones refer to improvements in business, finance and legal systems and arrangements. Overall, the pace is relatively fast, and many regular visitors including our colleagues, customers and friends to these cities would no doubt attest to that. These improvements enhance the values / prices of the economy's assets.

In summing up, given all things being equal, the major cities offer some good prospects for real estate investments, though investors are again cautioned to do their homework real hard before making decisions to invest. Also, the above makes no allowances for taxes and these could be hefty, thus requiring an even higher return to justify investments.

It remains to be seen if the cities would eventually have a comprehensive, sizable, efficient and viable private real estate market, especially on the residential side yet some of the ingredients and favorable circumstances for success exist today. There are some hurdles to tackle and things to watch out for, e.g. that the seemingly wide wealth gap will not imply the non-emergence (non-existence) of a sizable and financially strong middle class because without them, the scale and depth of the market would be limited.

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