Zeppelin's

Real Estate Tech January 2003

A Newsletter by Zeppelin Real Estate Analysis Limited of the Zeppelin Group
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We are pleased to announce that the content of our website **www.real-estate-tech.com** is now also published or can be viewed in **www.icfox.com**, a building construction and real estate portal. In addition, our real estate service capabilities have also been strengthened via an expanding real estate data, knowledge and professional network, especially with reference to the markets in China. Whenever there is a need for real estate researches, analyses or investment strategies, or for an independent advice or second opinion, please contact us. Our sister company **Zeppelin Property Development Consultants** may also offer assistance in project management, design, facility management, and marketing strategy.

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We are very honored to have **Dr. Vincent Mo**, PhD (Indiana), a mover and shaker in the China real estate markets, as our invited guest writer in this issue. Dr. Mo's group, Soufun, is a research and data company with operations in major cities in China. They also operate a popular real estate portal **www.soufun.com**. They have recently done a joint research with Tsinghua University on the top listed real estate companies in China. Don't miss out on this one if you would like to learn from an expert. We would also like to hear from prospective readers / writers who wish to share their real estate knowledge and experience with us.

This quarterly (January, April, July and October) newsletter is circulated freely to more than **8,000** via email, faxes and other means to real estate developers, investors, owners / users, financiers, top executives, senior managers, prominent academics and related professionals from Hong Kong and abroad. Our articles are / have also been used by the **China Daily**, **Hong Kong Economic Journal** (a Chinese daily), **21st Century Business Herald**, the **Surveying Newsletter** of the Hong Kong Institute of Surveyors, **Centanet.com, Netvigator.com, Hongkong.com, E-finet.com, Red-dots.com, Realtradex.com, FrogPondGroup.com, Soufun.com, icfox.com,** and **House18.com**. We had also been quoted in the **Asian Wall Street Journal**. This newsletter is now into its **7th year** and **25th** issue.

Zeppelin Real Estate Analysis Limited is involved in real estate development, investment, and asset management with a focus on **independent analysis**, investment strategy, and portfolio management. It can also assist in setting up real estate analytical computer systems, software applications and content development. It is part of the Zeppelin Group of Companies which collectively also offers project management, facility management, marketing management, architecture, and capital management services.

China Top Ten Listed Real Estate Companies – By Soufun

Real Estate Tech, January 2003

By Invited Guest Writer Dr. Vincent Mo / Soufun

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We are very glad and honored to have **Dr. Vincent Mo, PhD (Indiana), of Soufun**, a prominent real estate data and research group in China, as our guest writer in this issue. Soufun also operates one of the most popular websites www.soufun.com in China. Soufun, together with related government research authorities and Tsinghua University, collectively known as the "**China Real Estate Top Ten Research Team**", has recently conducted a research on the top listed real estate companies in China. The following is an abstract of some of their findings.

The research focuses on the 69 real estate companies listed in the Shanghai and Shenzhen stock exchanges. Four parameters are used and these are stock capitalization, company asset value, revenue, and profit. The companies are compared in an open and fair manner in these four criteria and a list of the top ten for each of the criteria is formed.

As of the end of last year (2002), the total stock capitalization value of the 69 listed real estate companies is RMB 207B or US$24B (US$1 = approximately RMB8.30), occupying 5.30% of the total stock capitalization value:

a) **Stock Capitalization** = 11 (16%) of the 69 listed real estate companies have total stock values above RMB 5B, 12 (17%) have total stock values between RMB3B and 5B, and the remaining 46 (67%) have total stock values lower than RMB 3B. It is interesting to note that the top 10 companies contribute around 35% of the total real estate stock capitalization.

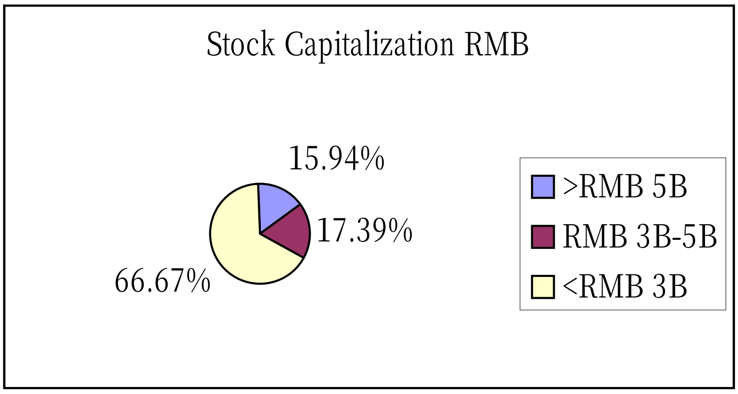
b) **Asset Value** = the 69 listed real estate companies total around RMB165B or close to US$20B. Of these, 1 company (or 1.50% of companies) has assets exceeding RMB10B, 7% with asset between RMB5B and 10B, 20% between RMB 3B and 5B, 19% between RMB 2B and 3B, 23% between RMB10B and 20B, and 30% with RMB 10B or less.

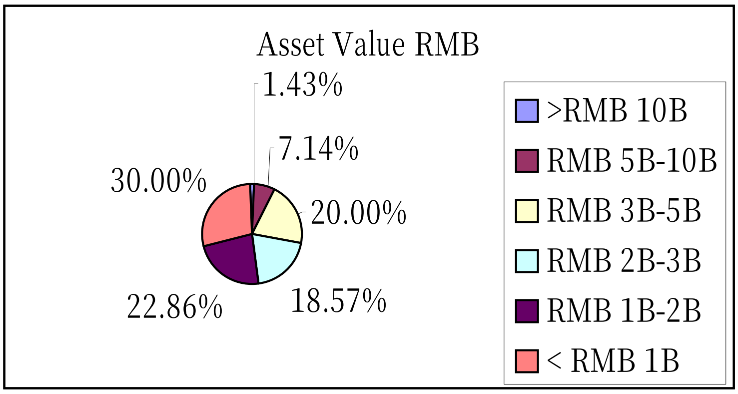
c) **Revenue** = the 69 listed real estate companies total some RMB 29B in revenue. Of these, 2 companies have revenues exceeding RMB2B, 7 have revenues between RMB 1B and 2B, another 7 between RMB 500M and 1B, more than 50% hover between RMB 100M – 500M, and a quarter of them incur revenues below RMB 100M. It is vital to note that the top 10 companies occupy a bit more than 50% of the total revenues.

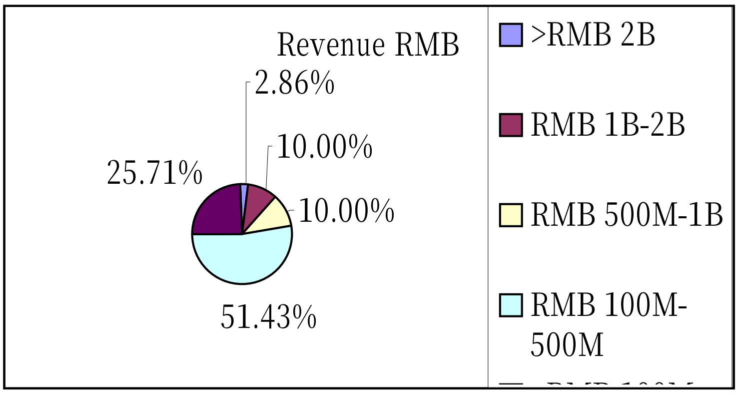
d) **Profit** = the 69 listed real estate companies total around RMB 2.80B in profit. Of these, 14% have profits higher than RMB 100M, 19% between RMB 50M to 100M, 47% between zero profit to RMB 50M, and 20% are making a loss.

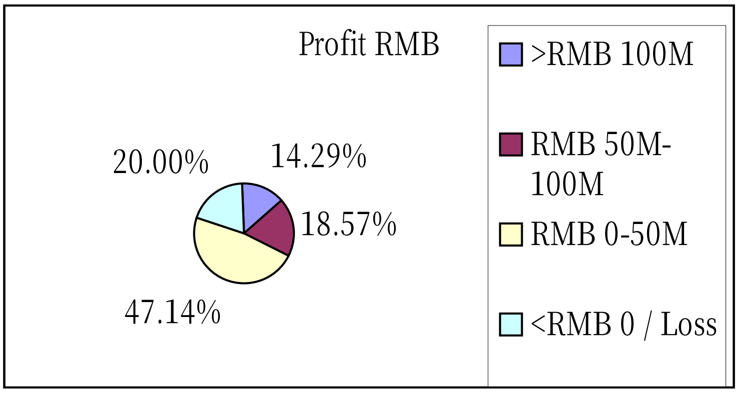
e) **China Real Estate Market Background** = as of late 2002, capital investment in real estate amounted to RMB 486B or US$ 59B, an increase of 29.40% over the same period in the year before, floor area being built amounted to 737,490,000 square meters (m2) or close to 8B square feet (ft2), up 22.10%, floor area sold amounted to 111,290,000 m2 or 1.20B ft2, up 24%, and value of sold real estate amounted to RMB 264B or US$32B, up 32%.

f) The relevant **charts, tables and lists** are shown below:









Company	Stock Cap	Revenue	Asset Value	Profit	Ranking
China Vanke	10	2	2	2	1
Shanghai Lujiazui	3	3	4	11	2
China Merchants A	17	4	6	1	3
Beijing Urban	9	13	3	6	4
China Enterprise	15	6	5	10	5
China World Trade	11	1	12	17	6
Zhangjiang Hi-Tech	1	5	17	30	7
Pudong Jinqiao	6	10	16	22	8
Jilin Yatai	29	9	7	9	9
Sanmu Group	19	8	28	8	10

China: Suggestive Real Estate Tactics

Real Estate Tech, January 2003

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The following has been abstracted from a communication that we had recently circulated to selected investors and clients. It assumes real estate investments in the major metropolitans such as Beijing and Shanghai though this assumption does not preclude other (2nd-tier) cities. By no means the observations made below apply in all circumstances or to all cases, though they may offer a brief, handy, and independent reference:

a) **China real estate markets are currently a liquidity play** = there is an underlying demand but the role of capital flows into the markets especially the major metros such as Beijing and Shanghai are just as vital if not more. These cash flows also in turn fuel further demand. If anything, one may wish to watch the Foreign Direct Investments (FDIs, and not just those on real estate) and other Mainland-local / Government instigated policies and cash flows.

b) **FDIs are important to major cities** but is insignificant to the whole of China = we have done very rough calculations on this and found there is no significant correlation between FDIs and the overall China economy. There is however a significant relation between FDIs and the economic well-being of major cities, and if these FDIs are somehow disrupted, they will cast a shadow on the economic performance of these cities.

c) **China real estate markets have around 7-10 years** or so of history only and generally have **cycles of 5-7 years** = relatively young and immature. The first cycle started from early 1990s to around 1997/98 and the current one commenced thereafter and is still by and large continuing. Also, the cycles of the various markets / cities may be different from one another with different start points, behavioral patterns, and peaks and troughs. The point is: not all real estate markets in China go up and down simultaneously.

d) **There are differences between the 2 broad cycles** = in terms of economic strength, financial policy, (effective) underlying demand, public awareness, land administration, building design, government policies, and so on = in short, in the first cycle they overbuilt (and some were substandard buildings) for a not-so-significant market. Now, in the second cycle, they are still overbuilding* (some are good-looking buildings) but for a not-so-insignificant market. *While the overall vacancy rate is not something to smear at, it is not evenly distributed across markets and sectors and there is always the possibility that some vacant spaces are not “effective” spaces i.e. these spaces are not in shape to practically be a substitute to existing occupied spaces.

e) **Recent data indicate increased investment $ being poured into real estate yet the sales $ have not gone up as much** = thus the premier's concern of a bubble is not entirely unfound. Nonetheless, as long as capital, from overseas or local, flowing into the major cities is larger than the capital flowing out of them, the chance for bursting the real estate bubble(s), if there is any, is reduced, notwithstanding no cash flow can continue heading one-way in the long run**.** Naturally, such risks may also be reduced by general improvements in earning power and economic productivity.

f) **WTO, 2008 Olympics, 2010 Expo and the like** = these events in generally do not guarantee a good economy (nor necessarily a bad one) by themselves. Some cities win, some cities lose. The real advantage lies in giving the people, particularly those in the organizing / hosting 'emerging cities-economies', aspiration, hope and a reason / catalyst to improve / upgrade themselves (skill-wise, efficiency-wise) in making the event a huge success, and for better life, wealth, or even pride = this in turn leads to higher GDP per capita for the cities and thus in general higher asset prices, real estate included.

g) **Beijing, Shanghai, Guangzhou, and Shenzhen enjoy some of the highest GDP per capita in China** = ranging from US$3000 - 6000 though care is required to assess the applicability of individual figures. Doubling these levels should not be overly difficult as an economy of US$4,000 is more or less in the same category as one of US$8,000 = developing economies = $4,000 is starting to make it; $8,000 is making it. In short, the long term, i.e. in the next 5-7 years or so, looks promising though the short term risks could be high with keen competition etc.

h) **North China versus South China** = overall, on a macro scale and as a relatively subjective note, North China including the Beijing and Shanghai regions seem to have a bit of edge over the South China regions in terms of national development policies, economic planning, and foreign (Western) investment focus (most seem to concentrate on Beijing and Shanghai a bit more than they do on say Guangzhou and Shenzhen).

i) **Development (i.e. building new) versus Investment (into existing properties)** = for emerging economies, development offers usually a higher return though less flamboyant investors may consider investing into existing properties = and yields may not be bad on a RMB basis with 7 to 12% before tax for offices etc.

j) **Summary** = good long term prospect, high short term risk, focus more on North China, real estate development > investment into existing properties in terms of return but riskier, watch over one's cash flow, and hit and run when developing riskier projects i.e. go in fast, build fast, sell fast (at least some before completion if possible) especially if one is highly leveraged. Make allowances for certain down market(s) prior to 2008 (not a prediction here, simply based on historic cycles) = have some **fall back strategies** if possible. Also, be aware of the **USA economy** that in part is kept up by having more foreign capital flowing into it than going out of it. If it busts somehow = some China cities and their real estate markets or sectors may be affected adversely, including **Grade A offices** as they have to do with foreign trade, foreign companies / tenants, local companies with foreign investors and customers (thus wanting the prestige of the Grade A offices etc), and the like.

REITS Beat Stocks In Recent Years

Real Estate Tech, January 2003

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Your humble author has been reviewing some information on the REITS (Real Estate Investment Trusts) recently and found that they have performed on the whole quite well in recent years. Not to mention that they generally give a better return than bank deposits, they also outgun the stock markets in the last several years. Here are a few observations:

a) **The information has been based on** figures published by the National Association of Real Estate Investment Trusts (NAREIT) and are compared to the indexes of S&P 500 and NASDAQ.

b) **The REITS generally reflect** the relatively better performance of the USA real estate market in recent years, in particular the residential sector, notwithstanding certain cities or market sectors are having difficulties currently.

c) **For someone who had started investing some 15 to 20 years ago**, stocks, both S&P 500 and NASDAQ, would have given the investor a better return overall than what the REITS would.

d) **For someone who had started 10 years or so ago**, REITS would tie with S&P 500 (actually by a tiny edge over) S&P 500, but would beat NASDAQ.

e) **For someone who had only begun to invest in the last 5 years**, REITS would definitely beat both S&P 500 and NASDAQ in terms of return, and it is not an issue of which one of them has a better or higher return, but which one of them offers a positive return while the rest give a negative return.

f) **Even on the REITS alone**, someone who had started to invest in them 3 years ago would have beaten someone who had just begun to invest in them last year. The annual return for the former is around 16% while the (annual) return to the latter is only 7%.

Using very basic figures, there is little correlation between the REITS and S&P 500 or NASDAQ. As such, investors concerned with risks or are risk-adverse may consider creating an investment portfolio with both REITS and S&P / NASDAQ components as a way to reduce some of the risks involved.

This leads to a possibility for Hong Kong which is currently considering the set up of REITS or some variants of it. Traditionally, and before 1997, both the Hong Kong stock and real estate markets seemed to go hand in hand, i.e. they went up and down more or less together. This was not a surprise given that publicly listed real estate companies made up more than half the capitalization. Today, this pattern might have altered somewhat e.g. while the stock market since the Asian Financial Crisis in 1998 has been moving up and down (at one point even exceeding the 1997 peak index), real estate prices have been on a steady downward trend. Instead of capital appreciation potential, investors now regard Hong Kong real estate as rental income properties. As such, there may be a scope for using real estate / REITS to balance out the volatility of stocks or other asset types.

Please refer to the table below for the annualized returns.

Years Invested	REITS	S&P 500	NASDAQ
1	6.77%	-16.51%	-23.40%
3	15.93%	-11.13%	-23.75%
5	3.21%	0.97%	-1.57%
10	10.32%	10.14%	8.52%
15	9.18%	12.48%	11.09%
20	9.33%	13.16%	9.70%