Zeppelin's

Real Estate Tech

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Phone (852) 2401 6610 Fax (852) 2401 3084 E-mail stephenchung@zeppelin.com.hk

Happy 2006! Hong Kong by and large has had a good 2005 with the economy picking up, profits (at least for some) looking rosy, real estate industry worrying about a bubble (beats worrying about a recession), REIT finally taking off, WTO session having gone smoothly, and the like. And against a global / regional background of rising oil prices, growing interest rates, increasing USA home prices, expanding consumer spending, and so on. Not a small feat and much for which to thank. We have also created a slightly different graphic appearance for this newsletter, hope you would like it.

In this Issue:

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 **China Daily**, **Hong Kong Economic Journal** (a Chinese daily), **21st Century Business Herald** (China), **The Standard** (a Hong Kong English Daily), **MITCRE Alumni Newsletter**, 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, Icfox.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**. We also publish monthly articles and analyses in the months in between. This newsletter is now into its **11th year** and **38th** 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 should be of interest to people interested in 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 assessment], project management [architectural design, cost control, and contract administration], facility management [facility utility assessment, facility strategy, and building maintenance], and marketing management [campaign coordination, leasing, and sales]. We are part of the Zeppelin Group headquartered in Hong Kong with office operations in Beijing, Shanghai, and Guangzhou and we have access to networks covering China / Asia, North America, and Europe.

China Residential Real Estate: Good Buys or Good Byes?

Real Estate Tech, January 2006

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

We have done some real estate market comparisons across different residential real estate markets including ones from China. A few probable pointers resulted but before we begin, here are a few reminders:

First, the cautionary note = is that we have applied a self-devised, extremely simple and theoretically flawed calculation model ('model' being the fancy term or 'method' being the more down-to-earth version) which enables price comparison across different real estate markets to be done, in this instance the typical residential home sector, in a way similar to what people do when they go grocery shopping. For instance, not only do people generally pay more for a well-branded product of good quality, they are also likely willing to pay more to acquire the same item from a well-lit, clean and trusted / reputable grocery shop / supermarket than a dark, dirty and less than trusted store.

Second, as the method applied is rather crude and simple = whatever outcomes / results should only be broadly comprehended and interpreted.

Third, the important point to remember is this = this method can ONLY show which of the selected real estate markets are / seem to be a better buy "compared" to others included in the group and vice versa. It does NOT project, predict, or estimate whether a real estate market or sector will go up, down, or flat. That is to say, while a real estate market is a bargain compared to others in the group, it does not automatically mean this market will go up or that the others will fall, and there is always the chance that the markets selected herein may all look better or worse IF other markets had been included in the group. More sophisticated methods and studies are required to further substantiate and complement the application used here.

Now, drum roll please and the **probable pointers** are:

1) <u>While China real estate markets, at least the major ones, seem overpriced at the time being, they are not so overpriced to the extent that (overly high) prices ALONE will cause a major collapse</u>. That is, something else, e.g. a less than running financial infrastructure / banking system, needs to exist to collaborate in such a major downfall.

2) <u>While the USA real estate markets, at least the major ones especially those along the coasts, seem overpriced at the moment, they do not seem too overpriced in a similar way mentioned above</u>. Something else, e.g. a drop in individual income, job loss or undue panic etc, needs to be present to contribute toward a big collapse.

3) <u>Some real estate markets in South East Asia, Australia and Canada seem better buys from a price for quality angle</u>. Pardon us for repeating, this alone does not translate into price appreciation.

Here are some of the related **details**:

A) **Real estate markets considered** = include Hong Kong, Guangzhou, Shanghai, Beijing, Kuala Lumpur, Bangkok, Jakarta, Manila, Singapore, Seoul, Tokyo, London, New York City, San Francisco, Toronto, Sydney and Melbourne.

B) **Major aspects / factors used in the comparison** = many aspects and factors affect real estate prices, yet in most of our studies, and as far as the residential home sector is concerned, the gross income per capita appears to be a very dominating factor. This is to say, even if other factors do play a part in influencing home prices, the gross income per capita can already explain or account for much of the home price performance. Thus, we have adopted only a few factors, such as the gross income per capita and individual tax rates etc in the calculation.

C) **Inter-market comparisons** = each market is compared to the rest of the markets in turn. This would give each market an (16-market in this case) averaged out indicative price that can be used to compare with the current-actual market price. If the former is larger than the latter, the market can be seen as being a comparative bargain and vice versa.

D) **City gross income per capita adjustments** = we have employed mostly country-wide gross income per capita, yet most cities would have a gross income per capita level higher than the country-wide level. Thus, we have made some (upward) adjustments to such gross income per capita figures and the amount of added premium depends on the wealth-income disparity gap between urban and non-urban incomes. As a general statement, the more developed countries would tend to have or be given a lower added premium.

E) **Above average residential assets considered** = instead of the average or median residential prices, we have used figures that reflect the slightly above middle (upper middle) sector residences. One reason for this is that the better quality / higher priced residences in some of the selected markets were reported to be having some form of bubbles. Thus, comparing these to their counterparts in other markets may reveal whether the former are relatively high or low priced.

F) **Prorated calculations** = while it is acknowledged that price curves tend not to be a straight line when compared and charted to influencing factors, for simplicity's sake, we have assumed them to be in this way. For instance, we find that in the long run the home price of various markets tend to correlate to their gross income per capita levels in more or less a straight gradient.

G) **Correlation between gross income per capita and residential price across these markets** = very high at over 0.90, i.e. markets with relatively higher gross income per capita tend to have higher average residential prices and likewise, markets with lower gross income per capita tend to have lower average residential prices.

H) **Rough categorizations** = as we have mentioned, the results are crude and thus the various real estate markets are only categorized in very broad terms, similar to what movie critics do as follows:

i) <u>The comparatively better bargains in random order</u> = Kuala Lumpur, Bangkok, Jakarta, Manila, Toronto, Sydney, and Melbourne, and of these, Kuala Lumpur and Toronto top the list

ii) <u>The comparatively poorer bargains in random order</u> = Hong Kong, Guangzhou, Shanghai, Beijing, Seoul, Singapore, Tokyo, New York City, London, and San Francisco, and of these, Hong Kong and Shanghai top the list though not to the extent that Kuala Lumpur and Toronto do in the better bargain list above

Please note the above apply to these markets only in the current sense i.e. they are not meant to dictate a certain market will be great or lackluster forever. 'Comparatively' is because we have somewhat arbitrarily selected these real estate markets, thus their rankings could have been different IF other markets are included or some of the existing ones not used. Also, these are city-based comparisons and may not be reflective of country-region wide conditions, which could be similar or different from observations stated herein. Again, we stress these categories are NOT price movement predictors.

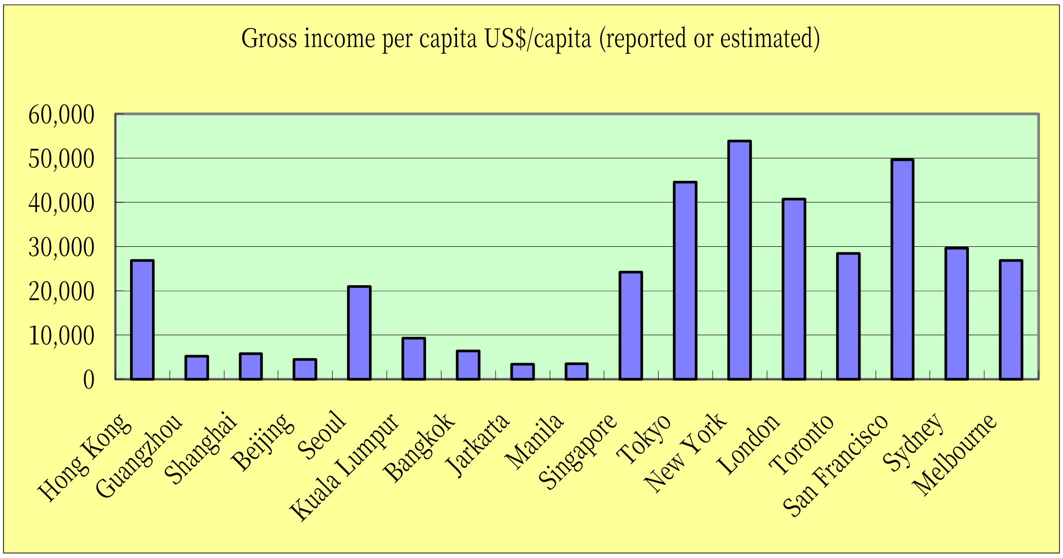
Thus, back to the question in the title, is China real estate a good buy? Not now for the residential market sector in Shanghai or Beijing, but we think it is from a medium to longer term perspective. While there is no need to rush (unless we are talking about trophy real estate or development projects) into the major residential markets listed above as a general statement and prices do seem to be on the high side, yet IF one is confident that China, despite quite a few economic and social challenges, will move up the economic development ladder and make progresses along the way notwithstanding the many hurdles, THEN one will have to assume there will be further economic growth, which in turn translates into higher gross income per capita especially in the major cities and thus higher real estate prices. It is very unusual to find a market where the inhabitants' income level rises while real estate or home prices remain stable throughout the longer period assuming a market economy.

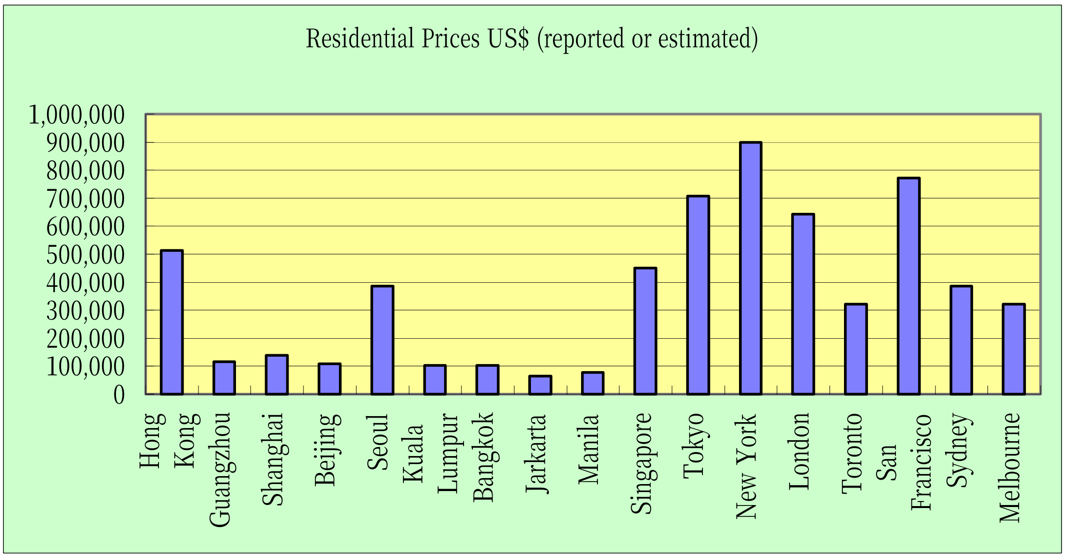
Some of the perceptions that we had way back in 2001, as shown in this article written back then when we suggested that China real estate prices might double in the next 5 or more years may still bear some relevance:

http://www.real-estate-tech.com/articles/Simple_read_stuff_200100108.PDF

As to the supporting reasons for a China that will continue to improve economically despite the hurdles, we can offer no better opinions than what others, including multinationals, major investment houses, funds, banks, real estate groups, and the like, have already put forward (sometimes with a grain of salt), other than to say that going from the current slightly above US$1,000 gross income per capita to say the US$2,000 level (bearing in mind this may mean the major cities will be increasing from the current US$4,000-6,000 gross income per capita to around the US$8,000-12,000 level) is not overly difficult despite the high rate of growth (100% in this case), because both US$1,000 and US$2,000 gross income per capita belong to more or less the same economic league, which is still a 'developing' economy-country (though for the major cities, this may mean a more daunting task because while US$4,000-6000 per capita are of similar league, US$8,000 and US$12,000 may not be as such may imply certain fundamental changes in the economic-financial and related systems). In short, the challenge to bring the less developed (less developing) regions of China into the development path can be seen as a size-scale challenge involving huge investment in infrastructures such as roads and power plants, while for the more developed (more developing) regions, namely the coastal region, the challenge may be of a more systematic or structural nature, especially in the economic, legal and financial arenas.

What to do for the time being then? Cash up, monitor the situation, identify desired property markets, sectors, and types, and wait for a suitable moment or opportunity commeasurable with your investment parameters which in turn have to be realistic.





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Robotic Butlers and Maids

Real Estate Tech, 1Q 2006

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

Many real estate development projects today emphasize on having the latest state-of-the-art technologies, including such items as energy saving devices, environmental features, fast speed telecommunication systems, and the like. They all sound fun and exciting. However, one aspect seems to have been neglected, and this is robotics for the home.

Admittedly, robotics is still at a relatively infant stage of development with most existing commercial ones being robotic ‘pets’ for family amusement, and ones that can do the household chores independently on their own are still being developed and remain a dream for now. Nonetheless, these 2nd generation robots seem to come in different functions, sizes, and shapes. For example, there are ones that resemble humanoids, yet there are also ones that look just like gadgets. Some clean carpets while others guard against thieves.

Irrespective of the foregoing, your humble author thinks there is huge market for such home-based domestic robotics particularly in the developed economies which mostly have both aging population and fewer worker challenges. Robots, if and when technically and commercially viable, may be the key. A few speculations:

A) **The maid’s room could become a room for robots** = This presents little challenge for most North American homes with their 2,400 ft2 average floor size, yet may pose a problem for most Hong Kong residences which average only 450 ft2. Despite this, assuming a robot to stand like a human, it may occupy just a few square feet of space.

B) **Installation of guiding sensors, monitoring circuits, and remote controls** = As the robots now being developed are supposed to ‘act’ on their own (artificial intelligence) without the need for constant human command input, e.g. they can maneuver around corners and obstacles on their own, a network of electronic devices for guiding, sensing, and monitoring their actions will be required and installed in the home. Nonetheless, such an electronic-computer network may not be overly complicated to install and use.

C) **Issues of compatibility** = As with the development of many electronic devices such as the cassette tape players in the 1960s or the more recent mobile phones, different manufacturers and regions may come up with different technological designs and codes initially. As such, there may be a compatibility issue between robots of different make and design. Nonetheless, given time, these issues are quite likely to be resolved one way or another, and robots should eventually present no more challenge than say with using a dishwasher.

D) **Replacement / substitute robots for temporary use** = nowadays, property management entails more than just fixing leaking pipes or collecting rents from tenants. The concept of facility management has gained much popularity in recent years and occupants-users of a property, be it a residential tower, office block, hospital and so on, expect the property-facility to enhance their daily lives. As robots, like machines, may break down every now and down, one eventual aspect of real estate management may be to supply the occupants with temporary robots while their own are being repaired or replaced. One may find this somewhat extraordinary now if not far-fetched, but think of it this way; when the TV (substitute this with the internet if you like) was invented, your humble author is sure that people back then saw it not as a necessity but an entertainment tool that they could do without, yet now the TV has become almost an integral part of life and most households would have some difficulty adjusting to a life without TV. Furthermore, while the TV still mainly entertains, the robot-to-be cleans, cooks, irons, and the like, i.e. provides services that are more essential, without which life could be very disruptive. It would be nice then to have a residential management that can supply you with a temporary robot for use.

In short, while common use of home robots remains a dream still and can only be found in movies, R2D2 (the very useful and intelligent little robot that accompanied and assisted Luke Skywalker in the Star War Movies) will come your way one day.

“Location, Location, and Location” is Too Simplistic

Real Estate Tech, 1Q 2006

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

Most people would have heard of the popular “location, location, and location” real estate rule of thumb (or the “3L” motto, your humble author’s self-created term) which implies location is the predominant factor in deciding a real estate investment venture’s well-being. Notwithstanding its merit, to view the rule as something ‘cast-in-stone’ is unnecessary, and may sometimes even hurt. Here are some of your humble author’s biased opinions:

E) **A good location helps not when the wrong market or sector is selected** = for instance, one may think that Asia is on the rise (again) and thus wishes to invest in its markets, real estate ones included. However, it is quite unlikely that all Asia markets will rise or rise at the same rate. This in turn implies some form of investment selection is required, and an improper selection hurts one’s investments, even if a / the prime real estate location is acquired. A good location in a less than competent market only means the real estate asset could be disposed of faster or rented out easier, yet the investor may still suffer a price loss or rental reduction.

F) **A good location helps not when the market timing is wrong** = there is no need to look far as Hong Kong real estate investors know very well what would happen if one had invested here in the last market peak in 1997. Prices, luxury real estate aside, have yet generally to go back to match that peak level some 8 years ago. Even for the luxury sector, prices have at best match or exceed slightly the last peak price level, and your IRR would not look too good IF you had invested since 1997.

G) **A good location helps not when the market price is wrong i.e. overpriced** = unless we are talking about really unique or trophy properties, and / or the investors harbor other reasons other than investment-financial ones, overpaying in the long run depletes one’s investment strength and performance compared to others, even if one is ‘loaded’ with cash-capital.

H) **A good location helps not when the property is poorly designed, built, and / or managed** = there are quite a bit of examples from worldwide of prime real estate locations which potentials are not revealed to their fullest, resulting in lower profitability and return.

At this point, one may be tempted to ask, if not the popular motto, then what? Try **“Selection, Timing, and Pricing”** i.e. acquiring a properly identified, selected, market-timed, and market-priced real estate asset could be just as (or even more) rewarding as (than) buying the best located property. This is not to say that location matters no more, it is just that one needs to look at more factors than just location to make money in real estate.

<u>As to why the 3L motto is so popular still</u>, your humble authors can offer no answer other than to speculate that first, it is easy to remember, and second, hundreds or more years ago economies tended to be local than global i.e. what happened in place A was not likely to affect place B and vice versa. Investment decisions involved fewer factors and complex equations. For real estate, a good location guaranteed success, if not instantly then at least at some future point in time.

In short, the 3L motto is sage and deserves recognition, but it should not be put on an idolized pedestal for unquestioning worship.