

Zeppelin's

Real Estate Tech April 2003

A Newsletter by Zeppelin Real Estate Analysis Limited of the Zeppelin Group

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

We live in challenging times: During the past quarter, not only have we seen the beginning and end of the **War on Iraq**, we have also been hit with a new virus that causes the **Severe Acute Respiratory Syndrome (SARS)** or atypical pneumonia. Geographically, we in Hong Kong are thousands of miles from the first event but are right in the midst of the second. As SARS spreads, the body of data, information, and knowledge on it and stories of how people in various places are coping with it have also grown. There will also be economic-social-administrative-political implications that are still unfolding perhaps. In terms of daily routines and as far as Hong Kong goes, one may be wearing a mask whenever one goes outside the home or to crowded venues, washing one's hands more frequently, eating out less, and the like. Nonetheless, Hong Kong is nowhere near being a ghost town, and life generally goes on. **We would also take the opportunity to thank our medical-health service workers (doctors, nurses, hospital ward assistants etc), especially those in the hospitals / frontline, for their dedication to their profession and task. We shall all do our bit too.**

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We are very honored to have **Dr. Man Wai Chan**, a practicing facility manager with a large educational institute, to share his experience and views with us on handling SARS from more a people prospect. 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 close to **10,000** via email 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**, **lcofox.com**, **PacificProperties.net**, **Soufun.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.

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People-Ware Vital in Tackling SARS

Real Estate Tech, April 2003

By Guest: Man Wai Chan, PhD, FRICS FHKIS F.PFM HKIFM – A Practicing Facility Manager

Zeppelin Real Estate Analysis Limited - Phone (852) 24016610 / Fax (852) 2401 3084 stephenchung@zeppelin.com.hk

I have had the opportunity of joining the Hong Kong Institute of Facility Management (HKIFM) delegate to attend the World Workplace Japan event held in mid March 2003 in Yokohama. Apart from learning a few new things on facility management (FM) and tasting exquisite sushi, I also noticed that quite a number of Japanese did wear facemask supposedly to counter hay fever. When I returned to Hong Kong, I found that more people were beginning to wear facemasks because of Severe Acute Respiratory Syndrome (SARS). In Japan, those who are sneezing and coughing are likely to have worn a mask, yet in Hong Kong you may find those who are without masks carry on coughing and sneezing even on the MTR or public buses!

Japanese people wear masks to prevent others from getting diseases while in Hong Kong, most wear masks to prevent getting diseases from others (as a rider, there must be some Hong Kongers who wear a mask because they do not want others to catch the disease and likewise, many Japanese wear one in order to avoid catching one from others). Fewer of us are enjoying the fresh air under these SARS days.

It is natural that as a FM or construction professional, we are pre-occupied with the hardware aspects of SARS prevention. For instance, we are interested in analyzing how the U-trap loses the seal or how the stack effect of the light well in our multi-story buildings causes the disease to spread. We also venture into gauging air pressure of habitable space and hospital wards and investigate how air-changes can affect the spread of the relatively unknown virus that is supposedly not air-borne. Some are asking whether bleaches in 1:49 or 1:99 concentration can really work. (Ironically no one has bothered to tell the public to pour in accurate concentration portions! Surely, before SARS gets to them, probably people will incur typical chemical pneumonia through breathing concentrated chlorine emitting from the bleaching solution.)

Japan teaches us that People-Ware that possesses simple common sense and public responsibility are even more fundamental in combating infectious diseases. Recently, I encountered a degree-level student of a tertiary education institution, whose family members got SARS and he himself was still within the 10 day observation period, chose to go back to his 500-resident communal student hostel for presumably peace and quiet and put his other 499 or so classmates at risk. When asked to return home, the student resisted citing his personal freedoms and rights.

One can argue that we can accommodate these People-Ware deficiencies through more people-orientated hardware. We can, for example, have an isolation ward within a hostel and I am sure my fellow FM practitioners can tell more stories of similar nature. To show their love and care, the facility management company of the apartment block where I live has given every household a complimentary bottle of bleaching solution – the type that is normally used for committing suicide.

We can fight SARS or any epidemic or crisis through technical means and sophisticated crisis planning and management. I would, however, insist that the weakest link above all, as we realized in FM, is still the People-Ware and that can only be built up from years of education and cultural changes.

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Wars, SARS, and Risks

Real Estate Tech, April 2003

Stephen Chung BS BBA(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

At the time of writing this article, the Iraqi War is progressing, world health is being threatened by the Severe Acute Respiratory Syndrome (SARS), and your humble author is wearing a surgical mask (to prevent one from catching the SARS virus believed to be spread via fluid droplets) while using his notebook computer in one of those trendy coffee places. No doubt Hong Kong is going through one of her toughest times since memory (World War II under Japanese Occupation aside), and business activities have decreased with clients postponing trips over and hotels and airlines suffering further. Naturally, health and quality of life come first, and may peace and health endure.

Such times also induce one to reflect upon the issue of risks. Irrespective of how meticulous the planning process is, or how detail the information and data collected are, or how sophisticated the mathematical models are, there are always surprises, elements that cannot be controlled or measured, and unforeseen circumstances, and catching one off-balance at times. Having fall-back strategies for / mechanisms to deal with unexpected risks is as important as having good plans.

One way to compensate for risks taken is to obtain a higher (than no risk) return. Generally, risks and returns go hand in hand i.e. the higher the (perceived) risks, the higher the returns required. More importantly, the rate of increase in the risk aspect is likely to be more than matched by the rate of increase in the return aspect. For instance, an investor may go for a project giving him a 50% return with a 25% risk i.e. losing 25% of the investment capital. The return to risk ratio is $50\% / 25\% = 2$. Say the same investor is now given a project that could cost him 100% i.e. lose all his capital yet yielding him potentially 200% (doubling his money) i.e. having the same return to risk ratio of 2. In all probability (in a real life situation), this investor would ask for a much higher return say in the region of 400% or more before he would assume the 100% risk i.e. he wants a return to risk ratio of 4 or more before he would consider taking up the project / extra risk. Another way to minimize risks is to set a maximum tolerated risk level above which the investor would not consider the project no matter how lucrative the return aspect could be.

As for how much more return one should ask for given any additional risk taken can be influenced by the business investment opportunities available at the time, the macro economic-socio-political environment, the micro investment capital and resources, the past investment experience, the financial clout of the investor, and a host of other factors. Some of these may intermingle intuitively, while others can be deduced mathematically with statistical tools etc.

All in all, while different investors may have different appetite for risks (some very little, some a lot), both look for the best possible return option for any (same) level of risk taken.

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Taking A Guess On The Long Term Prospect Of Grade A Offices in China

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Stephen Chung BS BBA(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

There has been much talk recently of whether there is a real estate bubble based on the Mainland media. Some are saying yes and some are saying no, and both camps seem to have some reasons for saying so. In a recent study on Grade A offices, we have compared a few figures and calculated a few ratios, part of which are described below:

- A) **4 Major Cities** = Only Beijing, Shanghai, Guangzhou, and Shenzhen are dealt with. As such, the following may not apply to other cities in China. Hong Kong is used more or less as a yardstick for comparison. Information has been collected from published sources including consultant reports, government statistics, and the like.
- B) **Grade A Office Floor Space Per Capita is still low compared to Hong Kong** = To put things into perspective, Hong Kong has some 60,000,000 ft² of Grade A Office properties i.e. each person in Hong Kong, a city of 7,000,000 people, has around 8 ft² of Grade A office space. The figures for the 4 cities mentioned above do not come close, with most hovering between 1 ft² to 1.60 ft² per person. Naturally, this is not a very accurate method and cities in the Mainland still harbor much industrial activity while Hong Kong is very service-orientated, putting the latter into more intense use of office space. Also, it does not take into account of 'office patterns / behaviors / practices' which may have a bearing on the average floor space per office worker into account e.g. Mainland cities may use / need more Grade B & C office space than Grade A office space. Nonetheless, from this angle, the office markets in the major cities still have room for expansion, at least in the longer run if not in the short term.
- C) **GDP \$ Per Grade A Office Floor Space** = Hong Kong has around US\$2,800 for each ft² of Grade A Office. Shenzhen and Guangzhou have even higher figures between US\$5,000 to US\$6,500. Shanghai is more or less the same as Hong Kong while Beijing has only US\$1,600. Again, this is not an entirely scientific measure yet GDP does reflect an economy's volume of economic activity some of which would translate into office demand. From this angle, one needs to be aware of Beijing's Grade A Office market in that it has less GDP per ft² than the rest. Note however when only the core Central Business District's Grade A Office is looked at, both Shenzhen and Guangzhou are roughly on par with Hong Kong and both Shanghai and Beijing falter. Please note though this is a comparative measurement and there is nothing here to suggest a nominal minimum of GDP \$ Per Grade A Office ft².
- D) **Population & GDP Ratios** = Here we assume the amount of floor space has something to do with the population and GDP levels i.e. while these figures may not correlate absolutely, it is also rare to find a small city with a small population and a small GDP needing 50M ft² of Grade A office space. Except for Shenzhen, all the other Mainland cities have population larger than Hong Kong's ranging from 1.50 to twice as many. However, their GDPs are all less than Hong Kong's. Put together, these give a rough indicative yardstick of how many ft² of Grade A Office a city may need or afford to have. Put simply, all the cities have not built to the ratio that they could afford and thus, purely from this angle, the markets still have room for expansion.
- E) **GDP Per Capita & the Affordable / Actual ft² Ratios** = This is a rough measure used to gauge roughly the sustainability of the overall office occupancy costs based on the assumption that in the long run it is rare to find a city with extremely high office rents and operating costs yet whose office workers are paid peanuts. From this angle, Beijing and Shenzhen occupancy costs seem a bit on the high side while Shanghai and Guangzhou seem explainable.

Please note the above is meant for very rough reference and other factors and measures are required for comprehensive analysis. To sum it up and from a long term view, between Beijing and Shanghai, the latter's Grade A Office seems a slightly better bet, while between Guangzhou and Shenzhen, Guangzhou has a slight edge.

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