Zeppelin's Real Estate Tech

1Q 2011: A Real Estate Newsletter by Zeppelin Real Estate Analysis Limited

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First there was QE1 and now there is QE2...and Hong Kong residential prices are still shooting up despite increased transaction taxes and decreased leverage levels. Office rents are also tipped to go up by 10% to 20%. Indeed, prices are either already exceeding or about to exceed the previous 1997 peak levels...happy days are here again...or are they?

- **33%, 66%, 99%**
- **Hong Kong: Pros and Cons of Reverse Mortgages**
- **"Location, location, and location" Sucks!**

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 the **South China Morning Post, China Daily**, **Hong Kong Economic Journal** (a Chinese daily), **21st Century Business Herald** (China), **Apple Daily** (Hong Kong), **Quamnet Magazine**, **The Standard** (a Hong Kong English Daily), **MITCRE Alumni Newsletter**, the **Surveying Newsletter** of the Hong Kong Institute of Surveyors, **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 **Radio Hong Kong** and **Commercial Radio**. We also publish monthly articles and analyses in the months in between. This newsletter is now into its **15th year** and **58th** 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 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 allocation], project management [architectural design, cost control, and contract administration], and facility management [facility utility assessment, facility strategy, and building maintenance. We are part of the Zeppelin Group headquartered in Hong Kong with office operations in Mainland China and we also have access to networks covering Asia, North America, and Europe.

About the Author(s)

Stephen Chung
Managing Director, Zeppelin Real Estate Analysis Limited
Founder and Editor, Real Estate Tech Quarterly Newsletter
Real Estate Website Developer, www.Real-Estate-Tech.com

Stephen is an independent real estate analyst 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 real estate writer 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
- 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 also an honorary adjunct professor with the University of Hong Kong and the City 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 to date compiled 2 books; one online and one in hard copy format. Both are published in Chinese (with the titles translated into English below):

Online book = Easy Real Estate Lectures
http://www.real-estate-tech.com/eBook/zeppelin_ebook.htm

Hard Copy = Real Estate Investment Know-How above 101
http://www.edpress.com.hk/Product.asp?id=6282

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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.

33%, 66%, 99%

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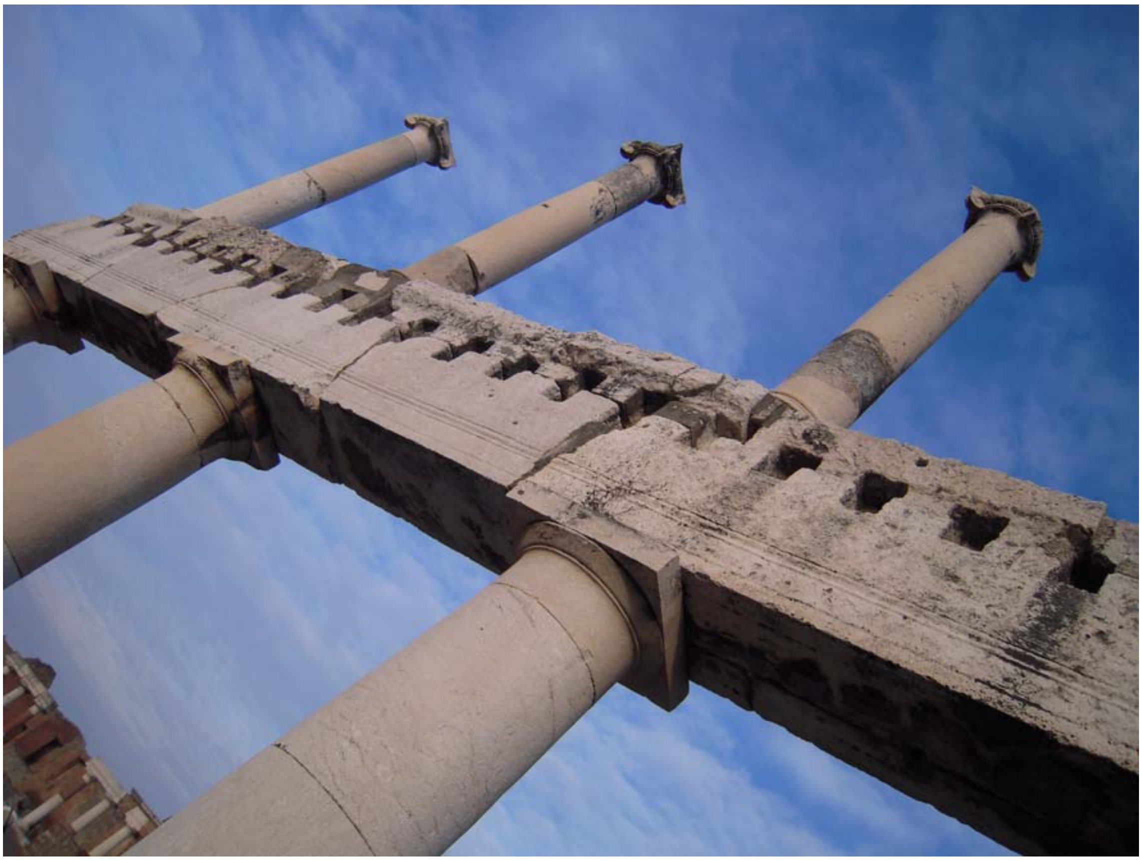

The percentages in the title above represent how your humble author feels about the chance of seeing something catastrophic occurring in the financial markets in 2011 (i.e. this year), 2012, and 2013 respectively.

And NO, these percentages are not calculated but are used instead of “likely”, “very likely”, and “almost a done deal” respectively. That is to say, IF nothing catastrophic occurs this year, then it will be very likely next year, failing which, almost a done deal in the year after next.

Almost? Of course, it is only prudent to reserve 1% (100-99) to account for the possibility of governments (again) bailing out corporations and people.

As to why your humble author feels this way, here are a few angles:

A) There seems to be more money than required to grease the global economic engine = and it seems to have been growing at a much higher speed than productivity. When money > productivity, the excess will eventually be neutralized by 1) inflation; 2) some financial bubble bursts; and / or even 3) war if history is any guide. Productivity may catch up but financial history suggests otherwise.

Yes, a world without sufficient liquidity may see many wonders, new ideas, inventions, projects, and the like depleted or hindered. However, a world with too much liquidity can suffer too.

Behavioral economists like Dan Ariely has suggested that the huge compensation paid to financial executives might have reduced their overall performances as they then tend to focus on maintaining their bonuses rather than investment results.

This brings back memories of high school math = remember the inverted parabola which helps to ascertain the 'optimal' production point of a factory operation? Generally, this point will not rest on the maximum price level nor will it likely be on the fullest production capacity.

It is doubted if the volume of liquidity is below the optimal point. Perhaps there can be too much of a good thing after all.

B) Asset prices are still shooting up = despite some government cooling measures such as increased transaction taxes for short term buys and decreased leverage levels for pricey properties, using Hong Kong real estate as an example.

There are ways to bring real estate prices down assuming this is desired, yet these 'ways' need to be more macro and macho e.g. pegging the HK$ to much less than $7.80 per US$1. Your humble author is NOT suggesting this option but is raising this to indicate the immense effects of the QEs which require more drastic measures, which in turn will affect much more than local real estate prices.

In short, the measures needed to tackle QEs suggest the severity of the impact that QEs have.

C) The internet and Extremistan = quoting Nassim Nicholas Taleb. No, your humble author is not against the internet but instead loves it as he would not have served some of his clients without it.

The internet is simply a tool which enhances communications via being faster and inexpensive. However, while it can carry useful, accurate, and goodwill messages, it can also convey useless, inaccurate, and hate messages.

Irrespective of the quality of the messages, some of these, financial and economics ones included, could be heard, taken up, and believed by a wide worldwide audience. And when this occurs, immense sums of money can be piled into an investment theme, e.g. BRIC, extremely fast thus causing potential overpricing, over-investment, and oversupply.

In short, such immense concentrations create volatilities and risks not seen before the internet age and if and when they become bubbles and burst, the fallout is beyond imagination.

Hong Kong: Pros and Cons of Reverse Mortgages

Real Estate Tech, 1Q 2011

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In the last quarter, the Hong Kong Mortgage Corporation announced a pilot scheme to introduce reverse mortgages and details can be viewed here:

http://www.hkmc.com.hk/eng/ceo/pressrelease/doc/20101216_RM_e_FINAL.pdf

What is a reverse mortgage? Suppose you are to take out a typical mortgage on your home, then you, as the mortgagor, need to 'repay' the lending bank, the mortgagee, in order to 'redeem' your property someday, along with interest of course. In a reverse mortgage, the bank pays you but you forfeit owning your property anymore.

The USA has a long history of reverse mortgage:

a) Surprise, surprise = it is not really that popular and there are only around 400,000 cases with most being Home Equity Conversion Mortgages underwritten by the Federal Housing Association. Considering that there are 30M households with elderly, this is a pretty small percentage.

b) Most users are satisfied with it = but they also cited high arrangement fees, less than clear advertisements, and the like.

c) Reverse mortgages can be arranged in various ways = apart from the regular payment type, there is also the credit line type, and some users choose to have the payment in a lump sum upfront.

In the case of Hong Kong, potential users are likely to be folks whose properties form the bulk of their net wealth. Furthermore, the properties are likely to be in the lower 7-digit HK$ range as pricier property owners may sell theirs and acquire several smaller ones for retirement. In any event, these are a few possibilities from reverse mortgages:

1) There may be fewer older and less pricey 2nd hand properties for sale = as owners go for reverse mortgages. In theory, these owners can sell the properties to higher bidders subsequently and repay the banks. However, one of their intentions may be to 'age in place' which means unless the prices are really enticing, they may tend not to move.

2) Some reverse mortgage participating banks can end up with a pool of potential redevelopment properties = it is not unreasonable to assume the banks would only evaluate the reverse mortgage properties based on their 'existing use and condition'. If so, they may end up owning some properties with relatively low existing use value but substantial redevelopment value. Note the word 'may' because not all existing sites harbor significant redevelopment potentials.

3) Timing is key = there is no indication of an evaluation model yet but generally factors such as market sentiment, current prices, economic cycle, risks, interest rates, and the like may matter. Also, as in selling one's home, and assuming all other things being equal, it is better to arrange a reverse mortgage in good times than in bad as the terms and pricings could be more favorable.

For cash-strap owners of ordinary properties with little or no redevelopment potentials, reverse mortgages can be a help.

“Location, location, and location” Sucks!

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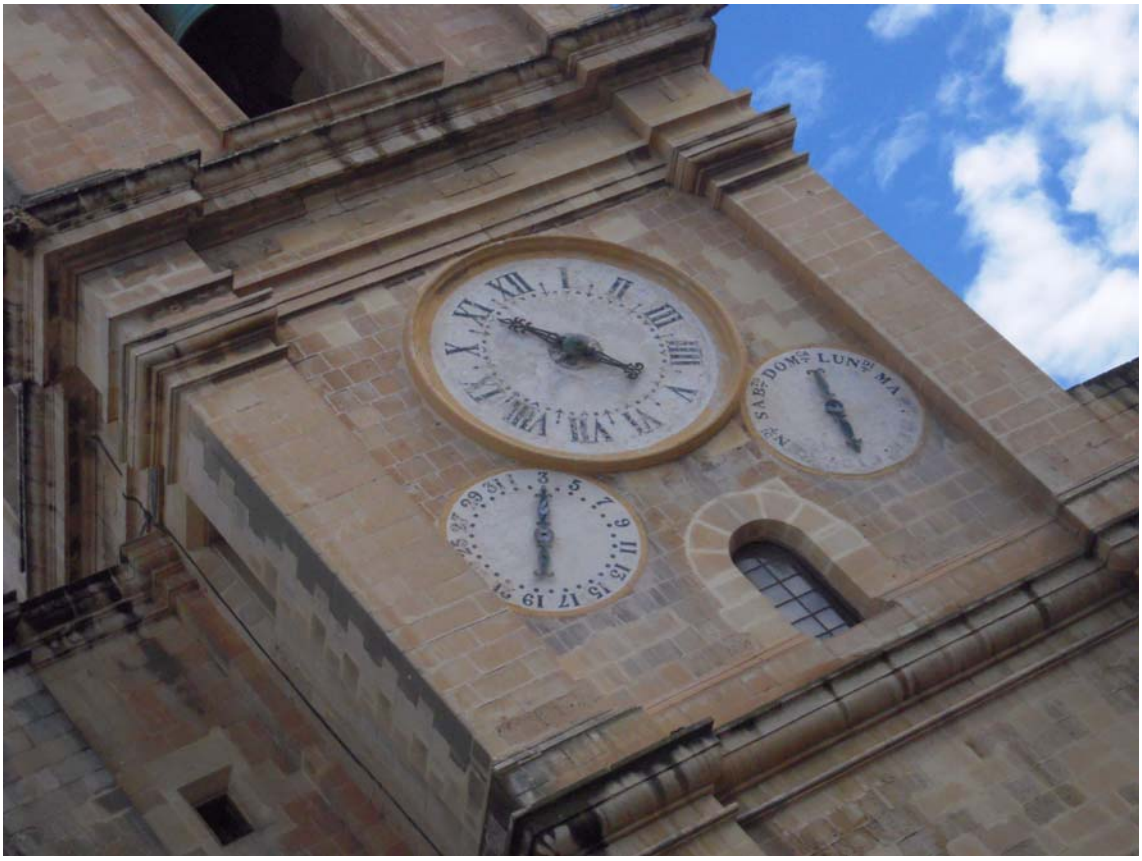

First, your humble author is NOT saying that location is not an important factor when comes to selecting real estate. However, he has significant reservation about repeating the word three times putting it on a pedestal almost for worship in the process. The popular rule of thumb might have misled investors more than helped them.

Your humble author decides to use the Hong Kong private residential market sector as a test case in order to examine if the motto has some validity (or the lack of it). Data published by the Ratings and Valuation Department of the Hong Kong Government has been used and they commenced from January 1993 to the latter half of 2010.

For the uninitiated, the said department classifies private residential real estate into 5 groups from the smallest A to the largest E by unit floor sizes and issues periodic price indexes on them. While having a large floor size does not automatically denote a good location, we do think in the Hong Kong context it generally does, at least as a rough proxy. As such, we have compared the price performance of the largest floor size group E residential units to those of A, B, C, and D.

Here are the details and results:

1) Methodology = a) we have adopted different investment timeframes ranging from 6 months, 12 months, and 24 months (short term) all the way to 5 years, 7 years, and 10 years (long term); and b) in each residential floor size group, we assume the investor will invest once every month in all foregoing investment timeframes e.g. under the 6 month investment scenario, an investor will buy in January 1993 and sell in July 1993, and buy again in February 1993 and sell again in August 1993, and March 1993 and September 1993, and so on, until he runs out of 6 month periods and likewise for other longer investment timeframes; c) the gains and losses made under each investment timeframe in each floor size group are tallied to see if a net gain or loss is made.

2) Results = assuming the investment amount each month each round is $100, the figures below indicate the net $ via summating the gains and losses made during the 1993 – 2010 period.

Floor size groups	A 40m2 or below	B 40-70m2	C 70-100m2	D 100-160m2	E 160m2or above
Investment timeframes: 6 months	428.37	458.98	596.83	726.03	948.69
12 months	841.33	878.72	1,167.79	1,440.42	1,880.57
24 months	1,153.20	1,118.35	1,554.73	2,008.20	2,663.14
5 years	1,178.89	1,041.04	2,197.68	3,243.49	4,599.47
7 years	416.07	400.57	1,856.35	3,175.55	4,840.27
10 years	(1,088.23)	(948.39)	270.62	1,538.60	3,141.09

3) Observations = group E wins in ALL investment timeframes be these short term or long although within itself, there is not much point to investing for the longest timeframe of 10 years as its summated gain [$3,141.09] is lower that either that of the 7 year timeframe [$4,840.27] or the 5 year timeframe [$4,599.47]. In short, investing longer does not necessarily bring better rewards.

Delusion of the overhyped importance of location

Now, the 'location, location, and location' supporters among you would argue and ask "isn't that proof that actually the rule of thumb is true?"

Before one gets too carried away, do note the above assumes an investor will invest (places a bet if you like) each and every month and sell only at the end of the investment timeframe, be this 6 months or 10 years. Just how many folks do it or can do it like that?

Most, even the financially endowed, invest only intermittently. If so, then simply relying on location as the sole or major investment factor is NOT sufficient because a group E investor can still lose big in some of the bets made whether in short term or long term investment timeframes [the calculations are not included herein for they would occupy too much space].

As Karl Popper suggested, as long as there is one instance where the theory, or in this case a real estate rule of thumb and popular belief, does not hold up, then it is falsified.

Timing seems to be the key

What all these studies and calculations suggest is that instead of location, timing appears to be the key. Yes, timing is much harder to grasp than location but this difficulty, if not impossibility, to time markets is not in itself a reason to assume location is.

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- **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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For details: please download our group introduction at http://www.real-estate-tech.com/ZPG-Group%20Introduction-sOct07.pdf

Zeppelin Group

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