Zeppelin's

Real Estate Tech

2Q 2008: A Real Estate Newsletter by Zeppelin Real Estate Analysis Limited

Phone (852) 2401 6610 Fax (852) 2401 3084 E-mail stephenchung@zeppelin.com.hk Website: www.Real–Estate-Tech.com

"Sub-prime, Foreclosures, Fed, Ben", these words appear to have dominated the global financial news and many minds in recent times. We in China / Asia have been fed the concept of 'Decoupling', meaning such an American mess has nothing to do with us BUT haven't we been touting Globalization and now an oxymoron of "A Decoupled Globalization"? Wow, this could be the most exciting discovery since E = mc2! Nonetheless, while stock markets in Mainland China have gone down since last year, real estate transactions appear recently to have slowed down too. In Hong Kong, while the sentiment seems buoyant still, new residential sales have slowed a bit too.

In this Issue:

- **An Average Hong Kong Home has only 1/4 of its 1997 Buying Power**
- **You Need an Astrologist, not an Analyst, to Predict Actual Sale Prices**
- **Reasons NOT to Include Currency Appreciation in Financial Analysis**

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, 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 **12th year** and **47th** 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 and Shenzhen and we have access to networks covering China / Asia, North America, and Europe.

An Average Hong Kong Home has only 1/4 of its 1997 Buying Power

Real Estate Tech, 2Q 2008

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

A friend of your humble author likes to invest in real estate and he does this in almost all 4 corners of the globe. Among his investments, he had bought a few residential properties, upper average ones, during 2003-2004 in Hong Kong.

Based on the Centaline's residential index [http://www.centadata.com/cci/cci_e.htm], which climbed from the low 30s in 2003 to beyond 70 early in this year, my friend should have been pleased. However, this is not the case.

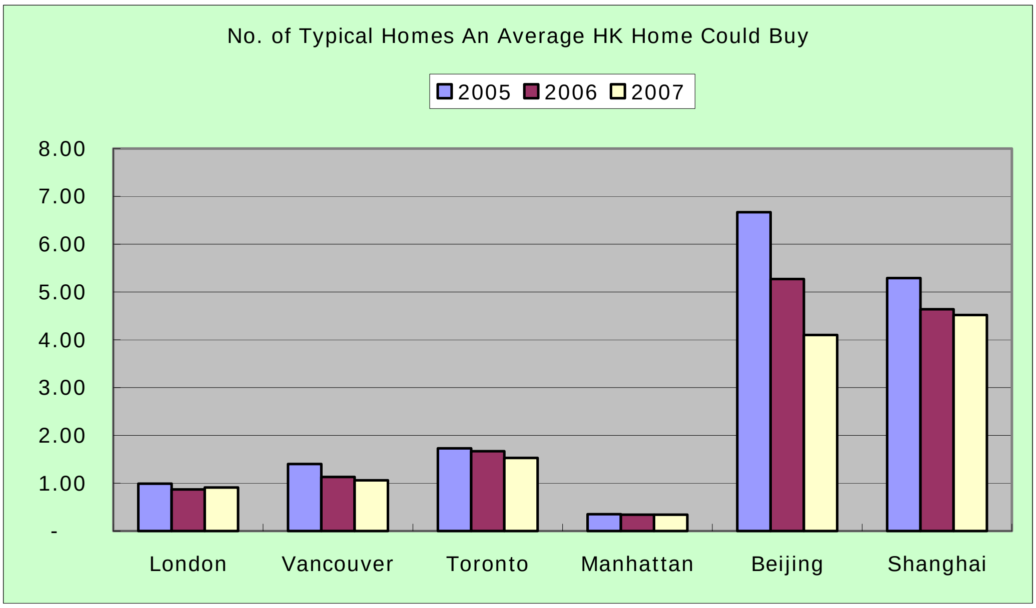
The reason is when benchmarked to the Euro (or other currencies other than the US$) and certain other real estate markets, his Hong Kong portfolio is only just holding up, or to be a bit more specific, his Hong Kong residential units could now be exchanged for less property elsewhere, not more, despite seeing such price appreciation (in HK$ terms). Overall, compared to its 1997 purchasing power, an average Hong Kong home now has only around 25% (1/4) of such power left.

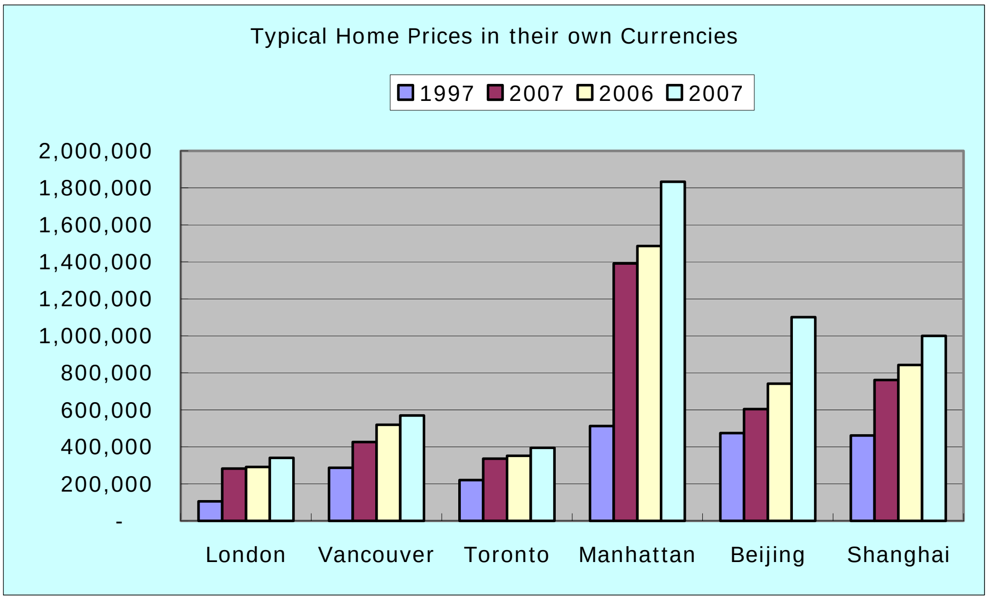
This in turn is due to: 1) the other real estate markets have seen price increases too; 2) the currencies of such other real estate markets have appreciated versus the US$ and HK$ [which is pegged to the US$]; and 3) the average Hong Kong home has yet to regain its lost ground (roughly 73% only as this is being written) since the 1997 peak.

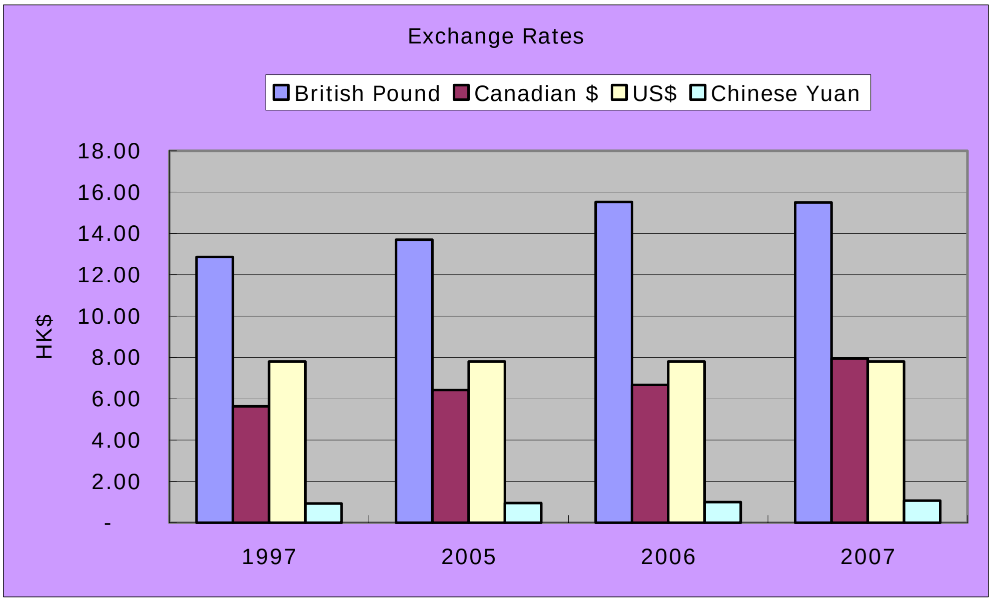
Perhaps the following tables and charts would help readers comprehend better:

No. of Typical Homes an Average Hong Kong Home Could Buy in:

Year:	**1997**	**2005**	**2006**	**2007**	**2007/1997**
London	5.13	0.99	0.87	0.91	18%
Vancouver	4.32	1.40	1.13	1.06	25%
Toronto	5.64	1.73	1.67	1.53	27%
Manhattan	1.75	0.35	0.34	0.34	19%
Beijing	15.74	6.67	5.27	4.10	26%
Shanghai	16.19	5.29	4.64	4.52	28%







Perhaps some readers may wonder if the purchasing power (or barter ratio) of an average Hong Kong home would be improved if we only look at the recent 2-3 years when prices recovered. The answer is still a NO as the average Hong Kong home buys less of OR at best holds its own against the other real estate markets listed herein. Perhaps this would help the readers comprehend the situation more closely:

% Year on year change in the number of typical homes an average HK home could buy:	2006	2007
London	-12.12%	4.60%
Vancouver	-19.29%	-6.19%
Toronto	-3.47%	-8.38%
Manhattan	-2.86%	0.00%
Beijing	-20.99%	-22.20%
Shanghai	-12.29%	-2.59%

Briefly, an average Hong Kong home can still buy more or less the same amount of typical homes in London and Manhattan but can now only settle for less when Vancouver, Toronto, Beijing, and Shanghai are concerned. Nonetheless, as in most such comparisons and studies, certain assumptions and limitations apply, not to mention the possibility of subjectivity in deciding what a typical home is. For details, readers are welcomed to read this:

Zeppelin's Global Home Indexes 2007
http://www.real-estate-tech.com/zeppelin_Global_Index.htm

Good luck investment hunting!

Related articles and analyses:

Hong Kong Residential Real Estate: Euro-Adjusted Indexes Indicate No Price Rise
http://www.real-estate-tech.com/articles/SRS020803.htm

Decoupling? What Decoupling?
http://www.real-estate-tech.com/articles/SRS020801.htm

You Need an Astrologist, not an Analyst, to Predict Actual Sale Prices

Real Estate Tech, 2Q 2008

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

Your humble author is not an expert in star-reading matters, nor is he advocating the use of such methods to gauge future actual selling prices of real estate. Nonetheless, these days it is almost a customary practice for the media to seek the opinion of real estate appraisers-analysts-surveyors on how much $ a certain piece of development site would fetch in the government land auction on the next day. This practice, in your humble author's view, is a mismatch of expertise and answer being sought.

Why? Because predicting-foretelling what a piece of land could be sold for what sum of money requires predictive power, definitely an arena belonging to the psychic and not to trained real estate professionals who could do no more than giving an opinion on the likely reasonable market price.

As such, it is not unusual to find discrepancies (at times huge ones too) between what $value the appraisers-analysts-surveyors have expected the day before and what $price the auction has actually fetched. The two aspects, a value opinion and an actual market sale, are 2 different activities though they interact with one another at times.

Upon reading this sentence, some of you may begin to wonder what practical use and worth of such appraisal or value estimation has if the prediction of sale price is not one of its applications. The short answer is = such valuation provides a benchmark which in turn may offer hints on market sentiment, price trend, perception of individual investors, possibility of return (or loss), and the like, when compared to the actual prices.

Not only it is common to find estimated prices to differ from actual sale prices, it is also NOT a surprise to find differences (and sometimes huge ones too) between the estimated values offered by different appraisers-analysts-surveyors. Why you may ask again? Because real estate value-price estimation is NOT a pure science (like physics) despite most if not all appraisers-analysts-surveyors share more or less the same market data and information pool:

1) **Reference selection** = Appraiser John may select project A B C as basis for the estimate while appraiser Jack may choose project A B E as his basis of estimation

2) **Factor weighting** = Appraiser Joan may put a heavier weighting on project A and the GDP while appraiser Jill may think project B and education level deserve to act as main reference (sometimes even the estimation methods or models employed could be different)

3) **Perception of future** = Appraiser John may be optimistic of the economy while appraiser Jack may feel relatively pessimistic about it

4) **Character skew** = Appraiser Joan may be an optimist in character thus sees the brighter side of things while Jill may be just the opposite, AND both reflect such characters-traits in their estimates without even knowing it

While it is understandable that the general public and the media may think any significant discrepancy between an estimated land sale price and an actual land sale price reflects the inadequacy of the appraisers-analysts-surveyors, it is a mistake to think this way.

The mismatch between expertise and desired outcome aside, <u>**can it be possible that it is the investor-land buyer who has got it wrong?**</u>

Reasons NOT to Include Currency Appreciation in Financial Analysis

Real Estate Tech, 2Q 2008

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

With an appreciating Chinese Yuan, it is not surprising to find nowadays financial projections on China real estate investment projects to have included the anticipated Yuan appreciation in the return side of the formula. Many also simply assume the recent observed appreciation pattern to continue and thus it is common for such investment projects to fetch a few extra percentages.

While the practice is not without reason, and from an overseas investor's viewpoint it is even required, yet **your humble author would argue that at least another financial projection which does not take such currency appreciation into account** should also be made. A few reasons as follows:

1) **The need to know if the investment project makes sense locally** = for instance, say there are 2 investment projects A and B. From a local angle, Project A gives 10% return per annum while Project B offers 20% return per annum. The return ratio between A and B is 1 to 2 [10% to 20%]. Say we assume currency appreciation can add another 5% to both projects i.e. Project A will become 15% pa while Project B will now have 25% pa. Now the return ratio between A and B becomes 3 to 5 [15% to 25%]. Sure, Project A will still be seen as inferior to Project B but the difference between them becomes smaller under the currency appreciation scenario, notwithstanding this could be a form of delusion.

2) **Currency exchange, depreciation, and appreciation are NOT based solely on economic or financial reasons** = in many instances there could be administrative-political reasons too which may or may not be fully revealed, observed, or anticipated. Indeed sometimes such currency adjustments could even be restricted knowledge.

3) **Other currency movements and actions** = the perceived prospect of Currency X may not only depend on the market expectation for Currency X, as Currency Y may be adjusted (up or down) thus changing the previous balance (status quo) leading to changed perception for Currency X.

In summary, highly skilled professional input is required before an investor could make currency changes become a more permanent portion of the return equation, and even then, there is no guarantee of a sure-win. For most investors, treating the (extra) return from currency appreciation as a bonus may be the more prudent thing to do.