Zeppelin's Real Estate Tech

2Q 2010: A Real Estate Newsletter by Zeppelin Real Estate Analysis Limited

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Just a little over a year ago markets in China / Hong Kong were pretty concerned about going down the drain with what was then happening in North America and Europe. Heck, they not only bounced back and now bubble debates are back in fashion as real estate prices have risen in paces unseen for quite a while:

- **China: What is there to buy?**
- **Hong Kong Compulsory Sale: Of course 80% is easier than 90%!**
- **Hong Kong Residential Real Estate Complexes: Which are bubblier?**

We would also like to hear from prospective readers / writers who wish to share their real estate experience with us.

Buy our (2nd) book: http://www.edpress.com.hk/Product.asp?id=6282

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), **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** and **Commercial Radio**. We also publish monthly articles and analyses in the months in between. This newsletter is now into its **14th year** and **55th** 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.

Do you need our services? You DO when...

- **In Real Estate Development:** you encounter overestimated proceeds, cost overruns, underestimated time schedules, design and quality issues, construction contractual disputes, joint venture conflicts, or the like…you need an experienced project manager like us

- **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…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

Zeppelin Property Development Consultants Limited

Zeppelin Real Estate Analysis Limited

Hong Kong ▪ Shenzhen ▪ Beijing

China: What is there to buy?

Real Estate Tech, 2Q 2010

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Some friends and investors of your humble author are wondering what they should do next. They had made handsome price gains investing in Mainland China real estate markets in the last few years, especially with respect to 1st tier cities like Beijing and Shanghai. Should they liquidate? Hold? Acquire more? A $^infinity-dollar question.

Without reference to any particular or individual circumstances, perhaps these simple thoughts may help (do note our disclaimer though):

a) Invest not unless (highly) convinced to do so

Note we are not saying not to invest at all because in whatever market conditions, there are bound to be exceptions. Nonetheless, given the current price levels, perhaps one would not miss too much, especially in some of the 1st tier cities. Also, if one wants only the real trophy properties, which are not always available for sale, then one would need to consider them even if the prices are not to one's ideal especially when one's investment timeframe is long enough.

b) If handsome price gains have already been made, consider liquidating the less prime properties

In short, sell the (relative) lemons in your portfolio and hold onto the really prime ones. IF one thinks China still has much room to go economically, THEN one can expect to see even higher asset prices somewhere, sometime, and somehow down the road.

c) If none or very little real estate investments have been made to date, consider investing to no more than 50% of the total investment capability and only when the numbers make sense

That is, reserve ammunitions (cash) to capture potential opportunities. Note the word potential i.e. there is no guarantee that such opportunities would happen anytime soon or at all given policies tend to have a significant influence on the markets. That is why we do not object to investing up to 50% of what one has for now…if only to get one's feet wet. Just in case the potential opportunities materialize, forget about what had been bought and focus on what can then be bought with the remaining cash.

As to the reasons for the above sentiment:

1) **Are real estate prices hovering above the average or below the average?** What do you think? = we all know the motto to buy low and sell high and can this be realized right now?

Naturally, if one is a real estate fund-investment manager with a mandate to invest might still have to do some investments irrespective of high or low market cycles, else investors may wish to crawl back some of the uncommitted funds and the manager would be out of a job too.

2) **What do you think the chances are for favorable return to risk ratios?** There is no hard or fast rule as to what is a favorable return to risk ratio yet something like 2:1 may be minimum.

That is to say, for every 2 dollars of possible profit, there is a chance to lose 1 dollar based on the same possibility. Some markets appear to have less than a 2:1 ratio. But what is wrong with a ratio of 1:1? Oh, nothing, just that it is simpler to bet black versus red on roulette in a casino.

Some experts and economists are touting the fact that China has plenty of reserves and cash in bank and thus they see no economic-financial busts. Hmm…your humble author is not so sure.

For instance, Hong Kong had more money in the bank in 2003 than in 1997 yet real estate prices during the period crumbled from 100% to 33%. If you think asset prices are still heading south, would you invest (your own money) just to save them from crumbling, even assuming you have trillions at your disposal?

Even if one assumes such huge savings and reserves will be utilized in case the markets turn weak, what if such were applied too late and / or too little? Banking on administrative measures to help cut losses (thus risks) renders analysis difficult and is always a big gamble.

Better to treat such administrative market-rescue measures as a windfall but not as a reason to invest.

Hong Kong Compulsory Sale: Of course 80% is easier than 90%!

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Recently the Compulsory Land Sale threshold of 90% was lowered to 80% with approval from the Legislative Council, and immediately there were debates as to whether the ownership rights and interest of individual real estate owners, in particular those of old and dilapidated properties, had been compromised.

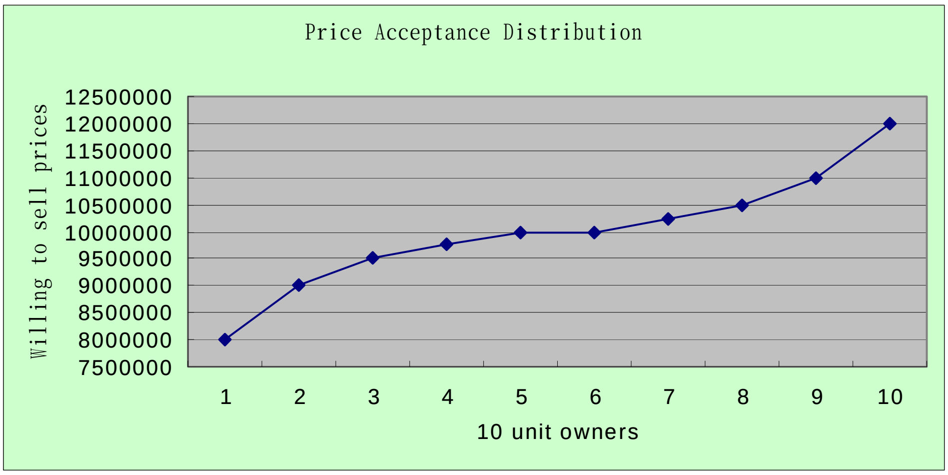
Compromised or not, lowering the threshold does in most cases make it easier to acquire such old properties for redevelopment purposes. Here is an elaboration:

A) **Assumptions** = 1) the redevelopment value of an existing property must be higher than its existing resale value, else owners are better off just selling their units as they were; 2) developers would offer a market price for the property (land site) based on redevelopment scenario; and 3) the owners of the existing old property are genuinely interested to sell and would accept a market price based on redevelopment i.e. cases where the owners do not wish to sell regardless or are wishfully asking for the moon prices are not counted.

B) **But what is market price?** = Notwithstanding the aurora of being a science, real estate analysis and evaluation are not 100% scientific as human interactions are involved. You own a unit at Tai Koo Shing and while realtor A quotes you $5M, realtors B and C could come up with $5.25M and $4.75M respectively. It is hard to tell who is right or wrong and even if the actual transacted price is $5.10M, it does not mean the seller (ie you) and the buyer are correct. In short, market prices come in ranges, not single figures down to the last dollar and cent.

Evaluating a simple residential unit is tough enough, you can guess the relatively complexity of estimating the market price of a piece of land ripe for redevelopment.

C) **Individual owners of an existing property may have different willingness to accepting a certain market price level owing to differing circumstances, characters, and the like** = Imagine an old building with 10 [and for the sake of simplicity] equal residential units and 10 owners. Let's say the price of the units is $10M each based on redevelopment. Yet, the willingness to accept certain prices may vary. For instance, the more eager to sell may go for even $8M, $9M while the tougher ones may want $11M or $12M [please refer to the chart for an illustrative price acceptance distribution].



D) **Comes along a real estate developer!** = assuming the developer makes a general offer to all unit owners. When the threshold was still 90%, the developer might have to offer $11M to each owner before he could collect the 90% ownership level required. In a sense, the first 8 owners get in varying degree some extra windfall. Now that it is 80%, the developer needs only dish out around $10.50M to each. Even if the developer is to acquire the unit one by one, and assuming he starts with the easiest to the hardest, he used to need to acquire the 9th owner. Now, he needs only the 8th.

E) What can the individual unit owners do? = one of the most, if not the most, difficult hurdles to obtaining the best possible redevelopment price is the owners themselves. It is not uncommon to find them, or some of them, being suspicious, jealous, and untrusting in one another. However, if such sentiment is not present, unit owners can always work together to find some common ground in terms of whether to sell or not, and if so, at what price and for what terms. Better redevelopment prices could be obtained when the unit owners are proactive in seeking a highest and best possible bid.

Some say this lowering is needed because there are lots of dilapidated properties which pose a danger as a recent incident in To Kwa Wan had shown. While this is understandable, dilapidated properties are best prevented by having strong and enforceable building maintenance laws, not redevelopment applications.

As to whether the unit owners are really put in a highly disadvantaged position, the related ordinance does have some safeguards e.g. the courts have to be satisfied that the prices offered are reasonable. Nevertheless, what is written is one thing, what is practiced remains to be observed.

Another curious phenomenon: the media appeared to be only concerned with whether the unit owners are given a fair redevelopment price i.e. as if the unit owners should and must sell once such prices are offered.

Is that all that matters?

Hong Kong Residential Real Estate Complexes: Which are bubblier?

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Speculators and investors should read this: we have sampled 12 popular private housing estates in Hong Kong to see which of these are bubblier. Mind you, bubbly or not might have little or nothing to do with future price paths, just that if or when there is a downward adjustment, the bubblier properties tend to drop more. Yes, you get hurt more too.

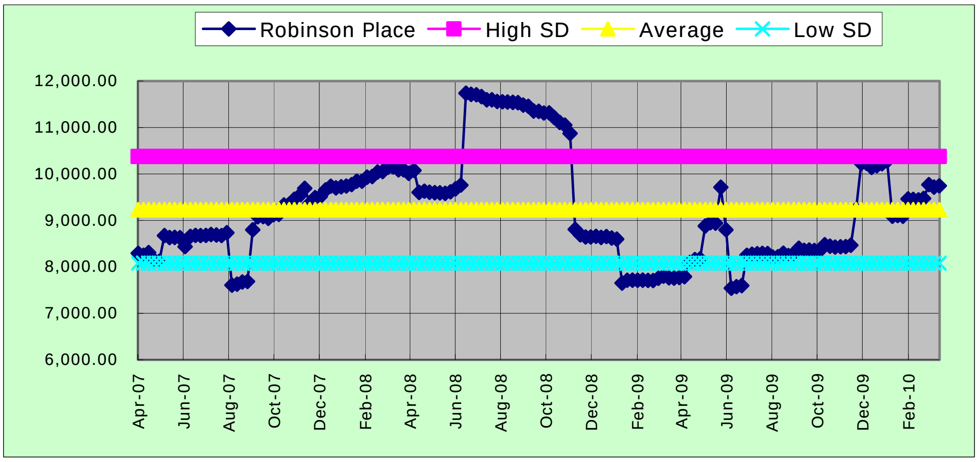
Here we go:

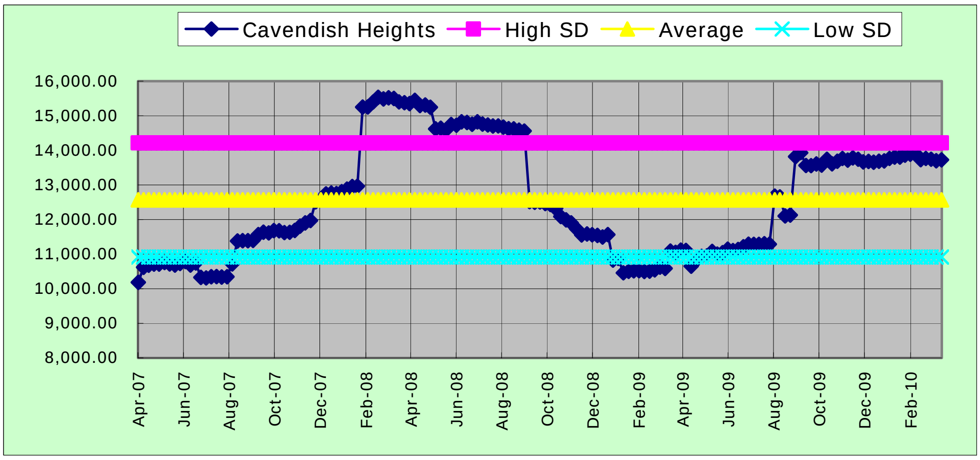
1) **Six pricey private housing estates [> HK$10,000 per ft2 GFA] and six folksy ones [<HK$10,000 per ft2 GFA]** = data comes from www.centanet.com and starts from early 2007.

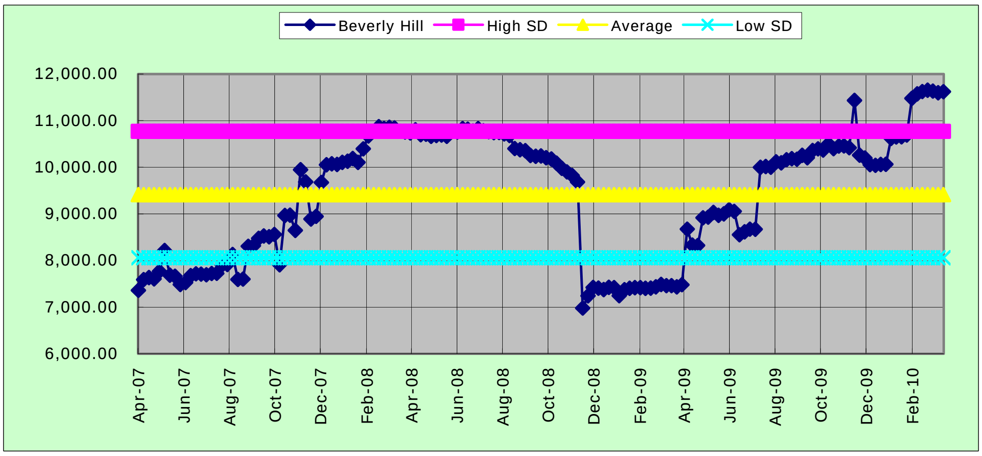
2) **Measuring bubbles** = Bubbles mean different things to different people. So, in order to avoid subjectivity and confusion, we used simple standard deviation calculations. If the current price is a) above the upper standard deviation [RED] line = bubbly; b) between this and the average price [YELLOW] line = high; c) below the average price line but above the lower standard deviation [BLUE] line = low; and d) below the lower standard deviation line = bargain.

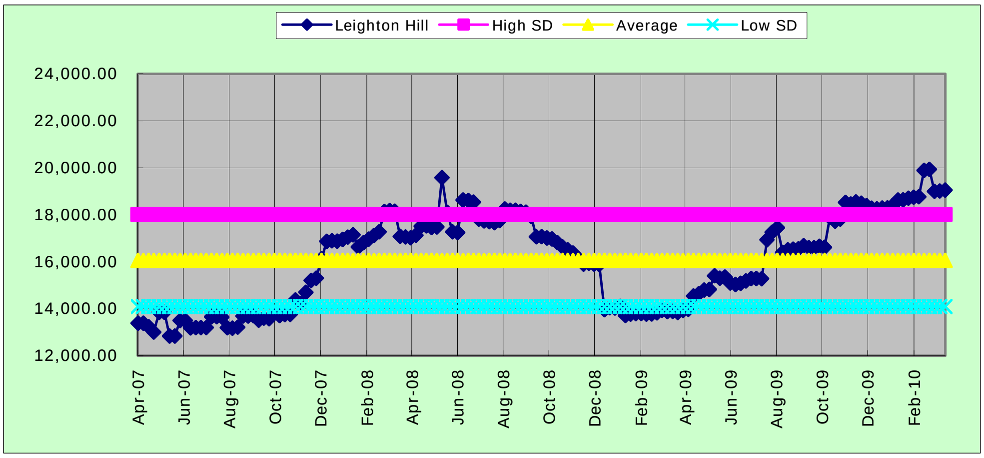
Don't worry; there aren't any bargains, not even lows, in this exercise.

3) Pricey housing estates





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High SD
Average
Low SD
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22,000.00
20,000.00
18,000.00
16,000.00
14,000.00
12,000.00
Apr-07
Jun-07
Aug-07
Oct-07
Dec-07
Feb-08
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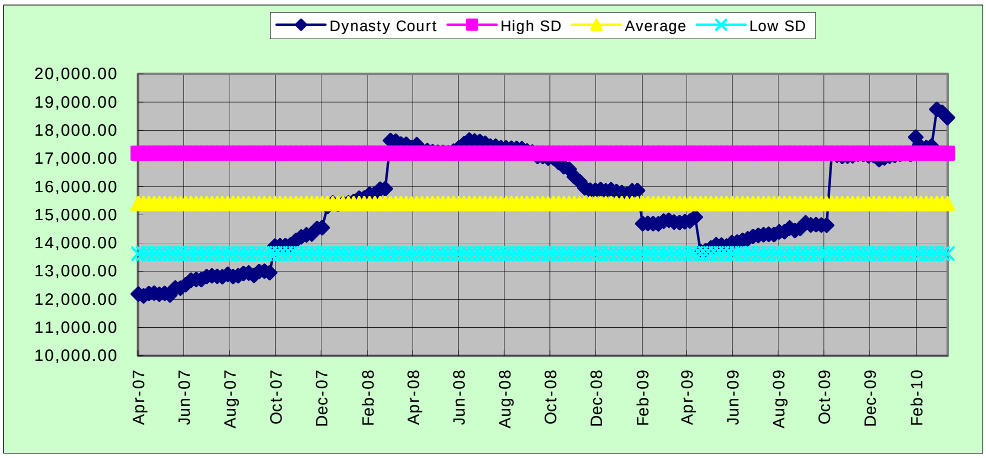
Dec-09
Feb-10


Dynasty Court
High SD
Average
Low SD
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19,000.00
18,000.00
17,000.00
16,000.00
15,000.00
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13,000.00
12,000.00
11,000.00
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Apr-07
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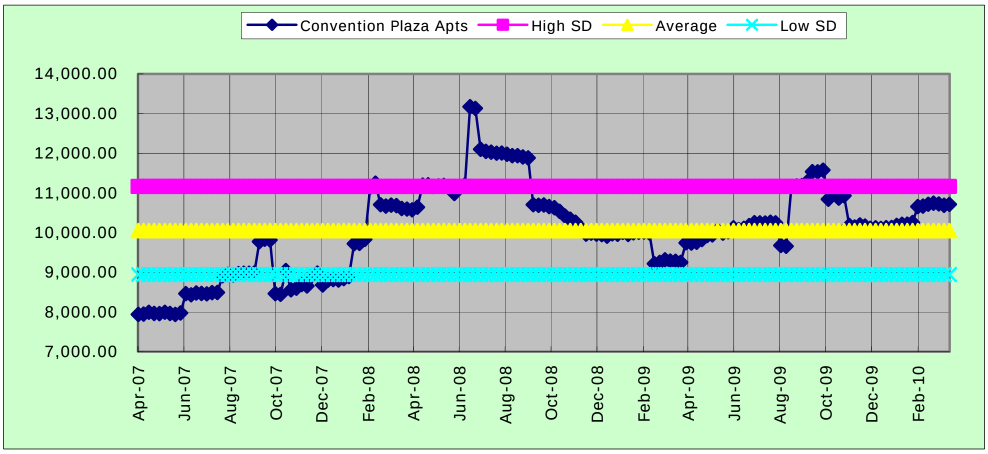
Convention Plaza Apts
High SD
Average
Low SD
14,000.00
13,000.00
12,000.00
11,000.00
10,000.00
9,000.00
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7,000.00
Apr-07
Jun-07
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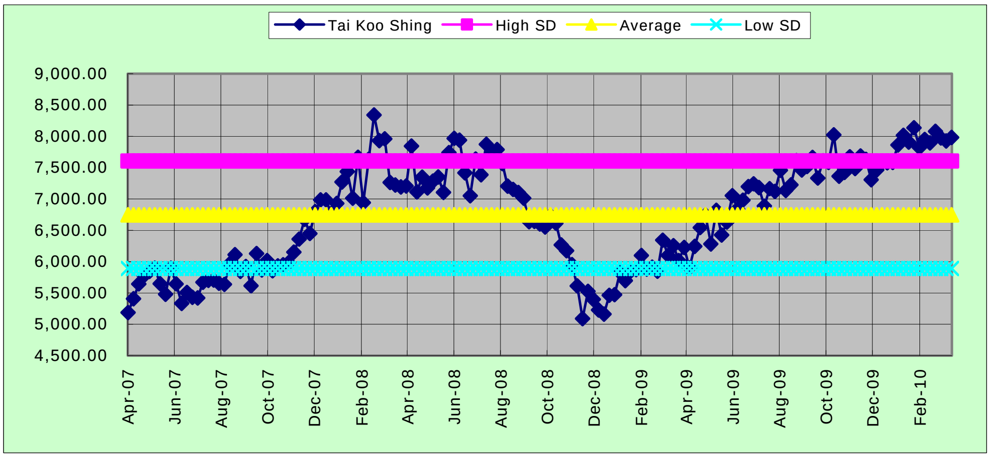
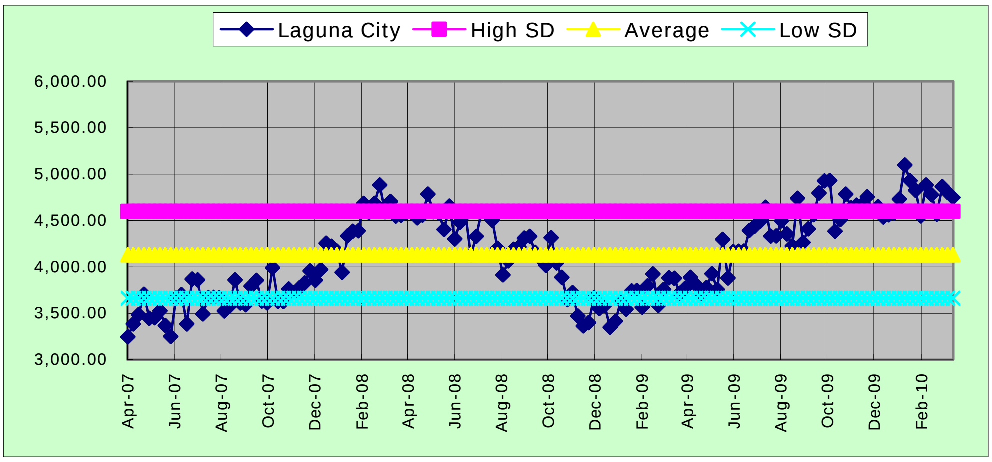
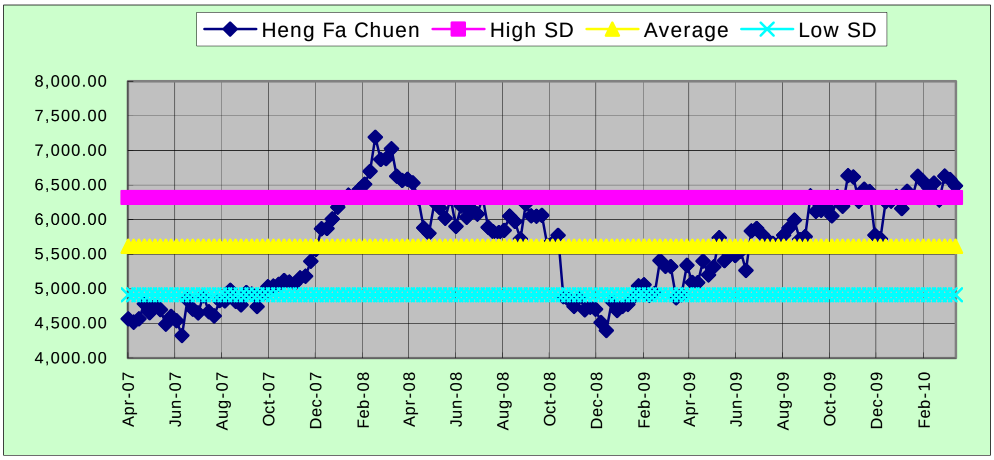
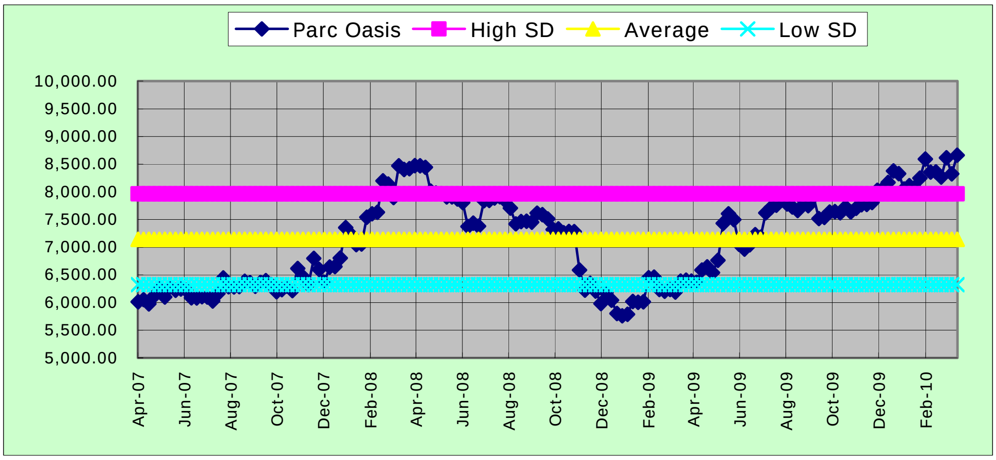
4) Folksy housing estates









Parc Oasis
High SD
Average
Low SD
10,000.00
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9,000.00
8,500.00
8,000.00
7,500.00
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6,500.00
6,000.00
5,500.00
5,000.00
Apr-07
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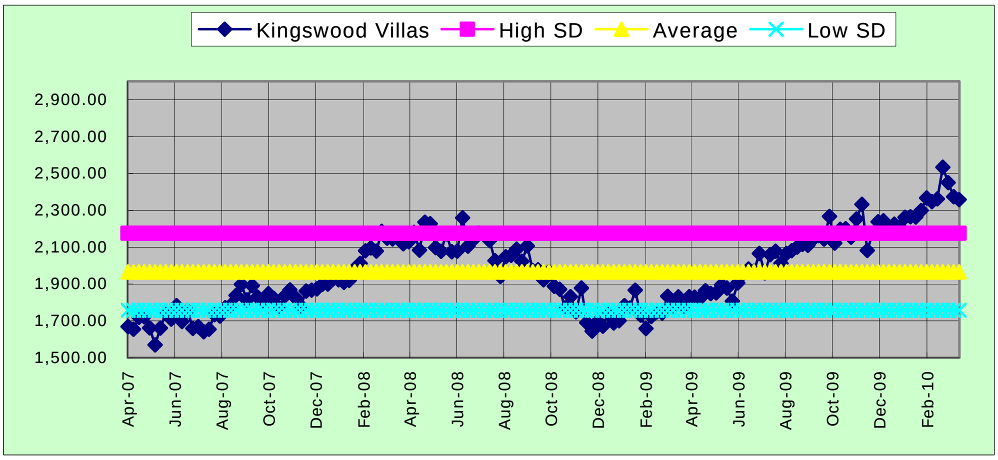

Kingswood Villas
High SD
Average
Low SD
2,900.00
2,700.00
2,500.00
2,300.00
2,100.00
1,900.00
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1,500.00
Apr-07
Jun-07
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Dec-07
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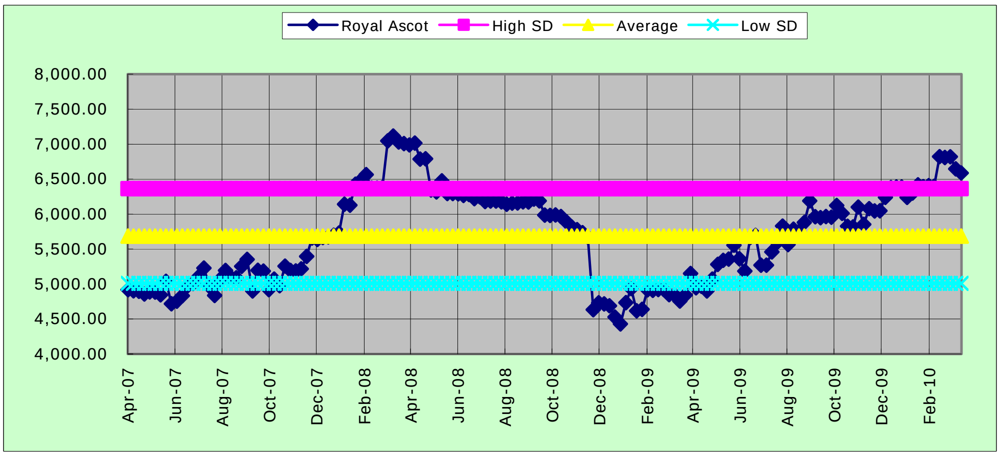

Royal Ascot
High SD
Average
Low SD
8,000.00
7,500.00
7,000.00
6,500.00
6,000.00
5,500.00
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4,500.00
4,000.00
Apr-07
Jun-07
Aug-07
Oct-07
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Apr-09
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Feb-10

5) Overall scores

This is the fun part: a) any current price which is above the higher standard deviation [RED] line = ☹☹; b) between this and the average price [YELLOW] line = ☹; c) below the average line but above the lower standard deviation [BLUE] line = ☺ (but no samples fall within this category); d) below the lower standard deviation line = ☺☺ (again no samples). Likewise, any current price higher than the 2008 peak = ☹ and if not = ☺. Each ☹ may be offset by a ☺ and the net effect can range from +3 to -3.

Residential Complexes	Above higher standard dev	Between higher standard dev & average	Higher than 2008 Peak Yes = ☹ , No = ☺	Overall Scores
Robinson Place		☹	☺	☹ - ☺ = 0
Cavendish Heights		☹	☺	☹ - ☺ = 0
Beverly Hill	☹☹		☹	☹☹☹ = -3
Leighton Hill	☹☹		☹	☹☹☹ = -3
Dynasty Court	☹☹		☹	☹☹☹ = -3
Convention Plaza		☹	☺	☹ - ☺ = 0
Tai Koo Shing	☹☹		☺	☹☹ - ☺ = -1
Laguna City	☹☹		☹	☹☹☹ = -3
Heng Fa Chuen	☹☹		☺	☹☹ - ☺ = -1
Parc Oasis	☹☹		☹	☹☹☹ = -3
Kingswood Villas	☹☹		☹	☹☹☹ = -3
Royal Ascot	☹☹		☺	☹☹ - ☺ = -1

6) Extremely short commentary

Those scoring 0 to negative 1 are not yet overly worrisome but watch out those negative 3s!