Zeppelin's Real Estate Tech

4Q 2008: A Real Estate Newsletter by Zeppelin Real Estate Analysis Limited

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Markets appear to have turned for the worse with established investment and financial groups such as Lehman Brothers, Merrill Lynch, and AIG, not to mention Fannie Mae and Freddie Mac, falling one after another. In our last issue, we mentioned that a point expressed in George Soro's recent book "The New Paradigm for Financial Markets" deserved attention and asked interested readers to email us. A few did so and the point to note is credit contraction (crunch) of unexpected degree. We think real estate investors should review their portfolios based on tighter credit assumptions.

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, 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 **13th year** and **49th** 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 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.

Real Estate Community Announcement

China Real Estate Conference
November 6-7, Thursday-Friday, 2008
Shanghai, JW Marriott Hotel

Global financial crisis, credit crunch, falling stock markets, demise of established big financial institutions such as Lehman Brothers, Merrill Lynch, AIG, Fannie Mae, Freddie Mac…fluctuating oil prices, volatile commodity markets, unstable currencies, not to mention sluggish China real estate sales…**What to make of these? Should I get out of China real estate, or is this a good time for more aggressive acquisitions? What are the dangers? Where are the rewards?**

The conference is organized by the Hong Kong Institute of Facility Management together with the Royal Institution of Chartered Surveyors, the Tongji University, and the University of Hong Kong and is titled "China Real Estate Development, Investment, and Facility Management: A Synergy of Resources, Strategies, and Tactics".

The conference targets senior professionals and top-echelon executives in real estate from local and abroad as audience and features prominent speakers involved in real estate development, investment, analysis, fund management, financing, and management, many of whom have years of experience in China.

The conference is also endorsed and / or supported by various organizations including but not limited to the Hong Kong Government, the Asian Public Real Estate Association [APREA], the National Association of Real Estate Investment Trusts [NAREIT], Hong Kong Real Estate Developers Association [REDA], the Chartered Institute of Housing, CORENET, IMFA, and the Hong Kong Institute of Surveyors. It also enjoys the sponsorships of various real estate groups.

For details, please refer to these web-pages:

http://www.hkifm.org.hk/PSDAS/speakers.shtml [list of speakers]
http://www.hkifm.org.hk/PSDAS/index.shtml [homepage and introduction]
http://www.hkifm.org.hk/PSDAS/images/PSDAS_RegistrationForm.pdf [registration]

Sign up for the conference and learn from the established experts and players in China real estate and see how they view, analyze, and plan for their next endeavors! Do so early too to obtain the early bird rates.

If you miss this conference, you may have a lot of explaining to do later to your clients, investors, shareholders, and stakeholders!

Note: Declaration of interest = Stephen Chung of Zeppelin Real Estate Analysis Limited will be one of the invited guest speakers at the conference. He will dwell on China real estate prospects and his talk is titled "China Real Estate Black Swan? Playing the Devil's Advocate".

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

Big Time Loss = Win Big Time

Real Estate Tech, 4Q 2008

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The global financial markets were recently shocked to see Lehman Brothers, Merrill Lynch, AIG, not to mention Freddie Mac and Fannie Mae, going under or being on the brink of collapse. While government actions may help calm investors, some form of credit tightening is due to come. For details on the saga, one may look up this BBC webpage: http://news.bbc.co.uk/2/hi/business/7302341.stm.

Readers may be interested to know how big a force this downturn could be, whether the USA real estate market has bottomed out, and what effects it would have on Hong Kong and China. While there is not enough time or space here to do a detailed analysis, our inclinations are as follows:

A) **How big a force? =** Compared to the Asian Financial Crisis of more than 10 years ago and using a GDP comparison basis, this current one is likely to be around 2.50 times to almost 4 times as big. Naturally, the impact may not be evenly spread and such a GDP basis provides only a very rough indicator as best, yet no one appears to know exactly how much money is involved or has already been lost.

B) **Has the USA real estate market bottomed out? =** Of course not as overall the average price has only come down by less than 20%. While we do not know at which level it may stabilize, we would not be surprised if prices were to go down a whopping 50%. Read our previous article too: http://www.real-estate-tech.com/articles/SRS070501.htm.

C) **Impact on Hong Kong =** the 'Direct' impact may not be as significant as it had been during the 1997 Asian Financial Crisis, but the 'Indirect' impact could more than make up the difference as Hong Kong is economically linked to both China and the West. First real estate thought goes to the prime Grade A office market which is dependent on having such global financial houses as tenants paying top rents, and second thought goes to some of the luxury apartment properties. Such real estate market sectors remained vibrant earlier in the year as 'the excess Wall Street talent got transferred to work in Asia which lacks such talent' thus keeping up rental demand. However, strategies to capture business opportunities in Asia are different from those to barely maintain survival. Read these too: http://www.real-estate-tech.com/articles/SRS120701.htm and http://www.real-estate-tech.com/articles/SRS030801.htm.

D) **Effects on China =** these are harder to fathom yet your humble author thinks most analyses tend to underestimate the risk or its probability. First, export is slowing owing to slower economies in the developed countries; second, FDI (foreign direct investment) may be hampered; and third, China real estate sales, especially the residential sector, are showing signs of cracks with decreased sales and prices though overall prices appear to be still on the high side, perhaps by 20% to 30%; and fourth, the recent significant price slashes made by Vanke, a relatively well known local real estate developer, causing buyers to protest and to want their money back [apparently not because of poor building quality or late completions etc] demonstrated the seriousness of certain quarters. The stock markets have already plunged around 60%, does one really think the real estate sector can hold up? Read these too: http://www.real-estate-tech.com/articles/SRS020801.htm and http://www.real-estate-tech.com/articles/SRS110701.htm.

Summing up, some people's losses could be some people's gains someday. Patience is the key, my friend.

Residential: Beijing and Shanghai, or London and New York, Anyone?

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Investors, clients, and friends have been asking which residential real estate markets in the world look bubblier, given many of the markets had seen great gains in recent years and are now on shakier parameters.

To answer such a question in detail would mean lots of effort, time, and thought. However, what we could do here is to use a relatively simple and less time-consuming (and thus perhaps less reflective) way to feel, if not to accurately measure, which markets could be the worse culprits.

We have selected 4 parameters to compare with the observed price movements and we are only concerned with 7 cities, namely Beijing, Shanghai, Vancouver, Toronto, London, New York City, and Hong Kong:

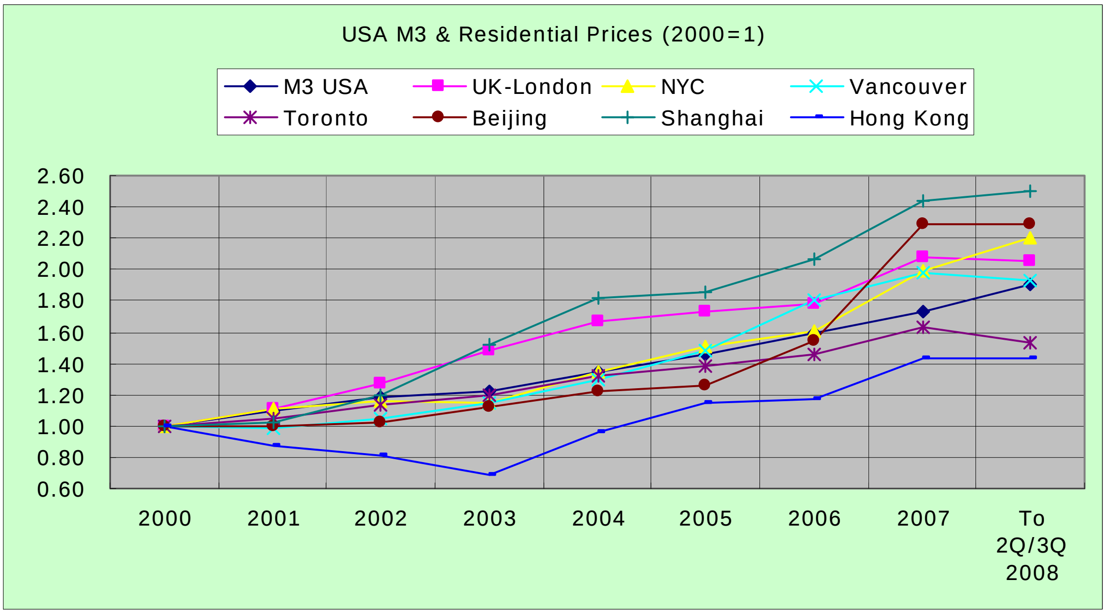
1) **USA money supply =** the global one might be more suitable but we use the USA one as it is readily found, and if the home price of a city rises more than the money supply, it could be riskier

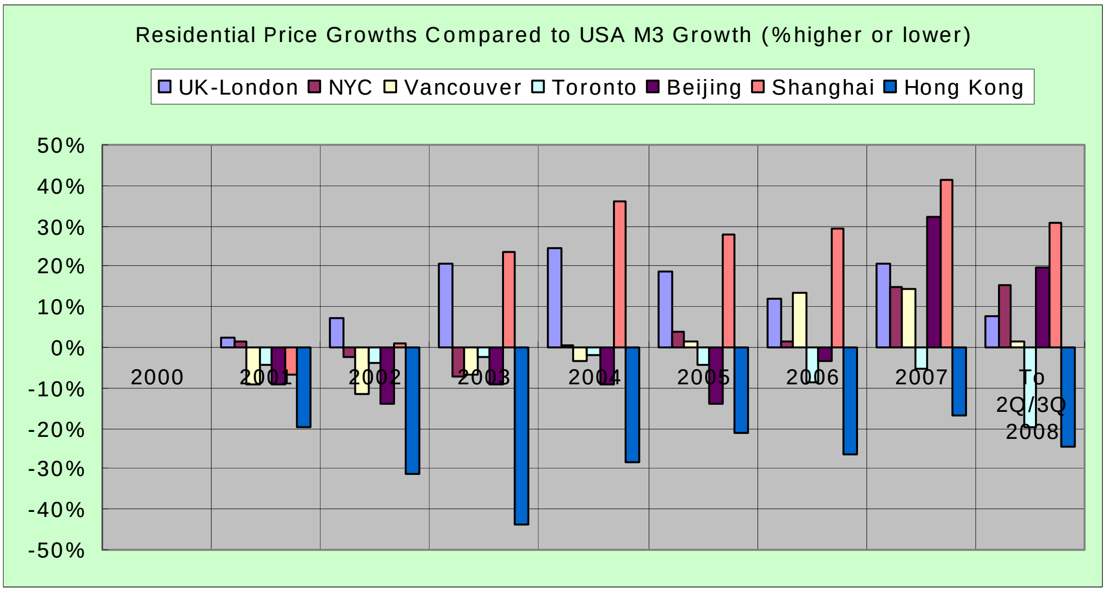
2) **City average home price to the city GDP / capita =** thus giving a ratio and the lower the better affordability

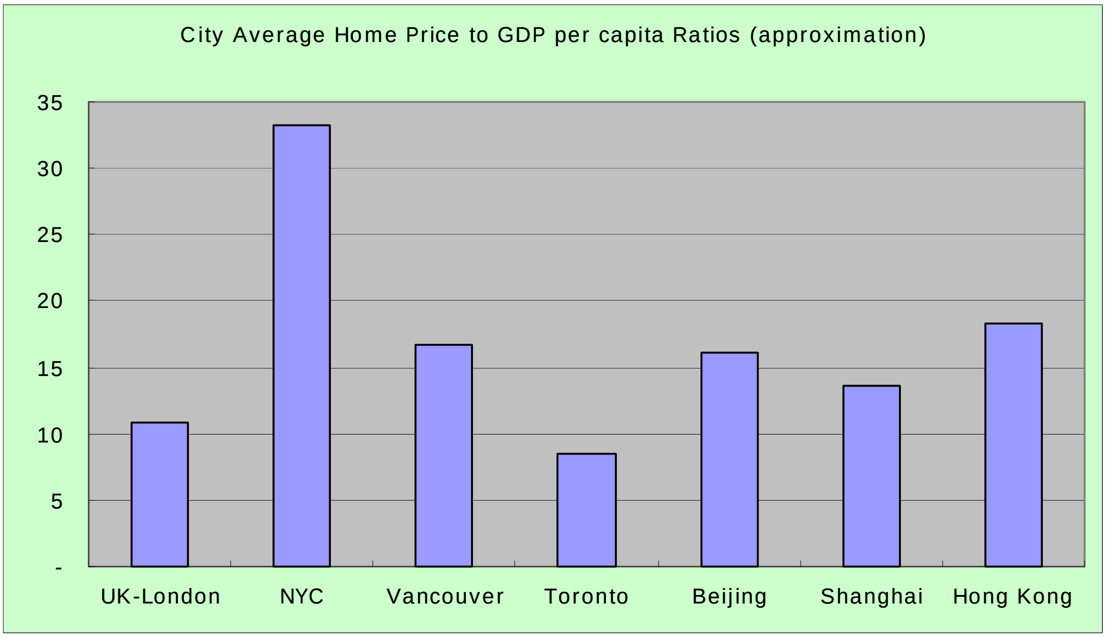
3) **Home price volatility since 2000 =** expressed generally in decimals (or percentages) and the higher the more volatile

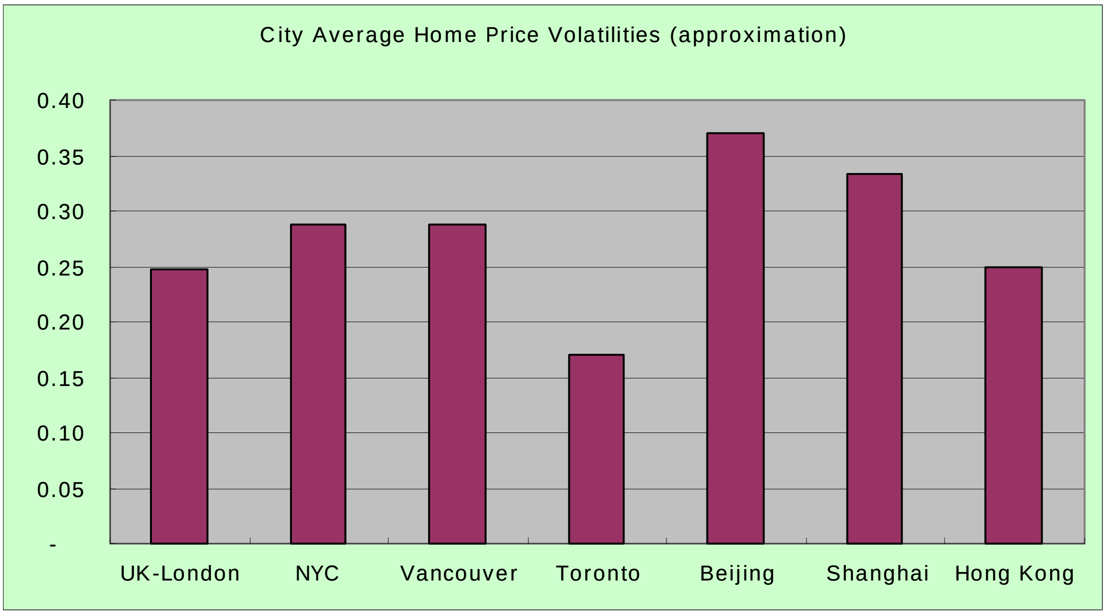
4) **Residential rental yield =** expressed in percentages and is like a form of P/E ratio

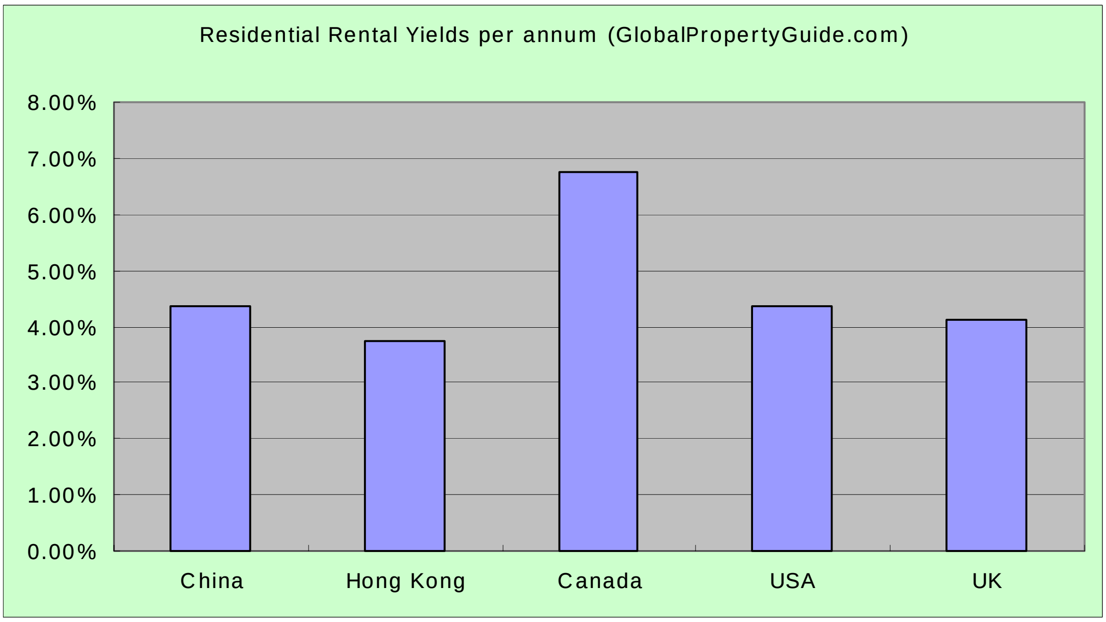
Here are the charts which your humble author thinks are self-explanatory:




Residential Price Growths Compared to USA M3 Growth (%higher or lower)
UK-London
NYC
Vancouver
Toronto
Beijing
Shanghai
Hong Kong
50%
40%
30%
20%
10%
0%
-10%
-20%
-30%
-40%
-50%
2000
2001
2002
2003
2004
2005
2006
2007
To 2Q/3Q 2008


City Average Home Price to GDP per capita Ratios (approximation)
35
30
25
20
15
10
5
-
UK-London
NYC
Vancouver
Toronto
Beijing
Shanghai
Hong Kong





Using a primitive ranking system with (undisclosed) subjective weighting factors, we obtained the following results in descending order of bubbly risk (most bubbly on left):

Beijing, Shanghai, New York City (Manhattan), Vancouver, Hong Kong, London, and Toronto

Surprise, surprise, but as mentioned, these rankings have inherent flaws and are not to be read as conclusive, comprehensive, or confirmed.

China Real Estate and Stocks: Which Leads Which?

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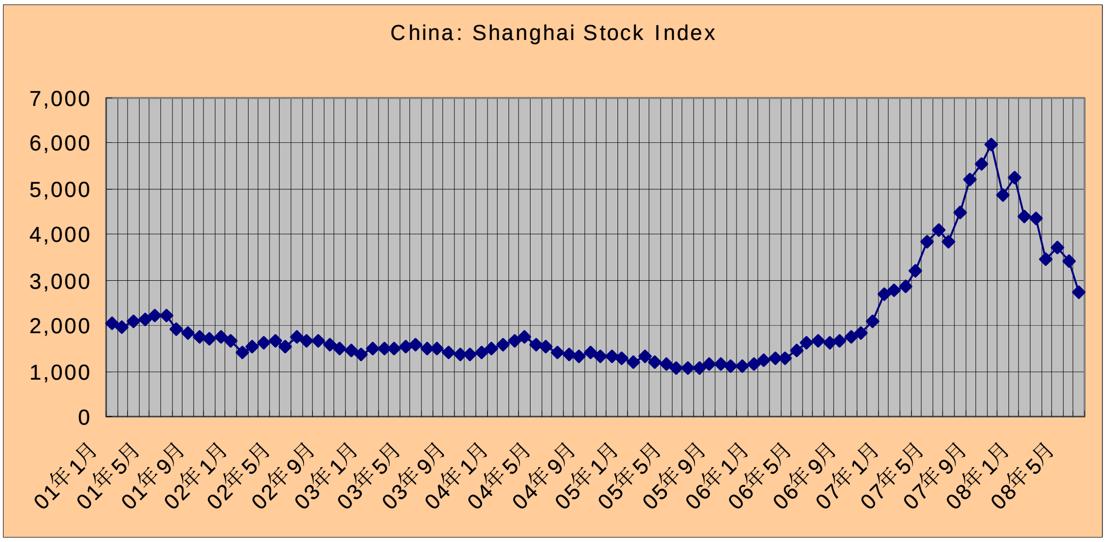
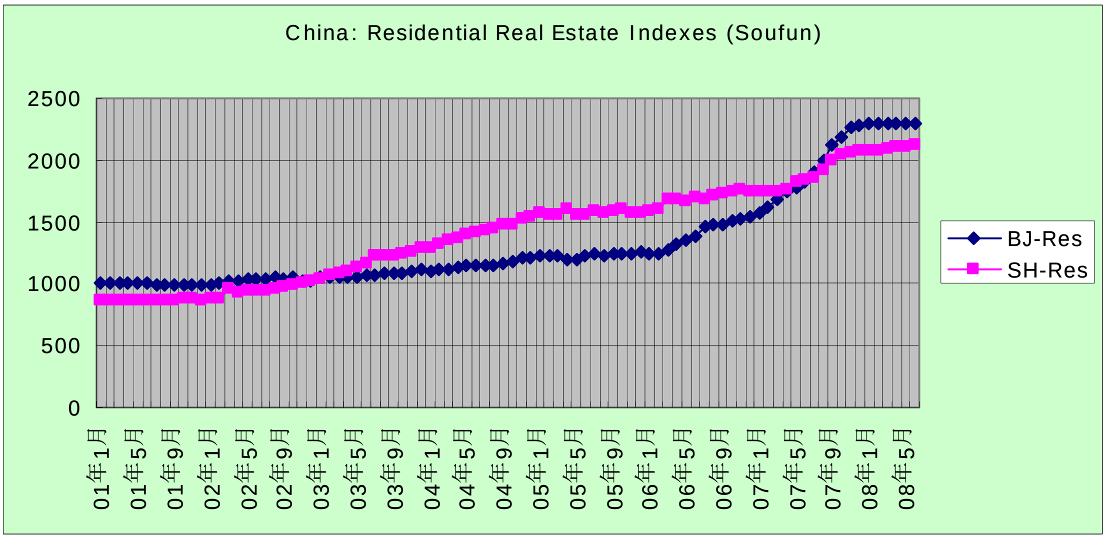
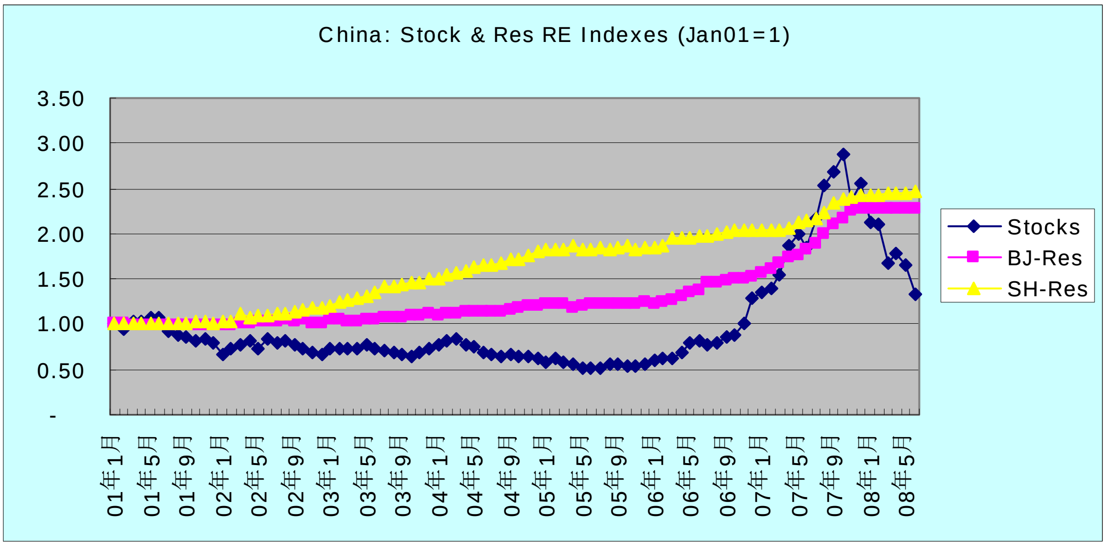
The Hong Kong stock and real estate markets appears to have a love-hate relationship; they went up and down together before 1997, they went separate ways for 6 years after that, and in the recent 5 years they tread together again.

Out of curiosity, let us find out if there are any observable patterns between the China stock and real estate markets. Yet for simplicity, we limit the stock market to that of Shanghai (index) [from Yahoo! Finance] and the real estate to Beijing-Residential and Shanghai-Residential [based on Soufun CREIS indexes]. Here are their recent performances in charts:





And if we were to treat January 2001 as being 1.00, then we could obtain the following chart:



Are there any patterns? Coincidental or otherwise? There appear to be some in that they all tread upwards most of the time yet we are not entirely sure. Hence, let us play with some correlations:

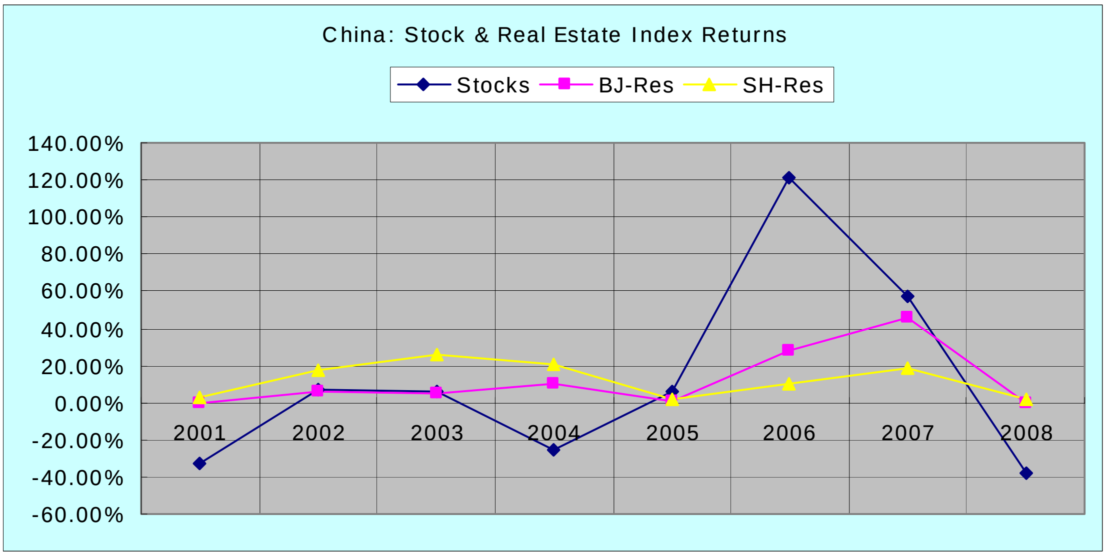
Years	Correlation R	BJ-Residential	SH-Residential
2001 - 2003	Stock	(0.63)	(0.68)
2004 - 2006	Stock	0.59	0.25
2007 - 2008	Stock	0.37	0.32

Hmm…sometimes they jive and sometimes they do not. Still hard to tell, thus let us do yearly correlations:

Year	Correlation R	BJ-Residential	SH-Residential
2001	Stock	0.59	(0.38)
2002	Stock	0.44	(0.18)
2003	Stock	(0.62)	(0.62)
2004	Stock	(0.82)	(0.88)
2005	Stock	(0.04)	(0.18)
2006	Stock	0.83	0.78
2007	Stock	0.91	0.90
2008 till June only	Stock	0.10	(0.96)

No, there do not seem to be consistent observable patterns between them and Shanghai-Residential appears to go the other way at times (austerity measures?).

One final dig: does one lead the other? Here is a chart, you decide [see that rough 1 year lag between them?]



China Real Estate and Stocks: Which Does Better?

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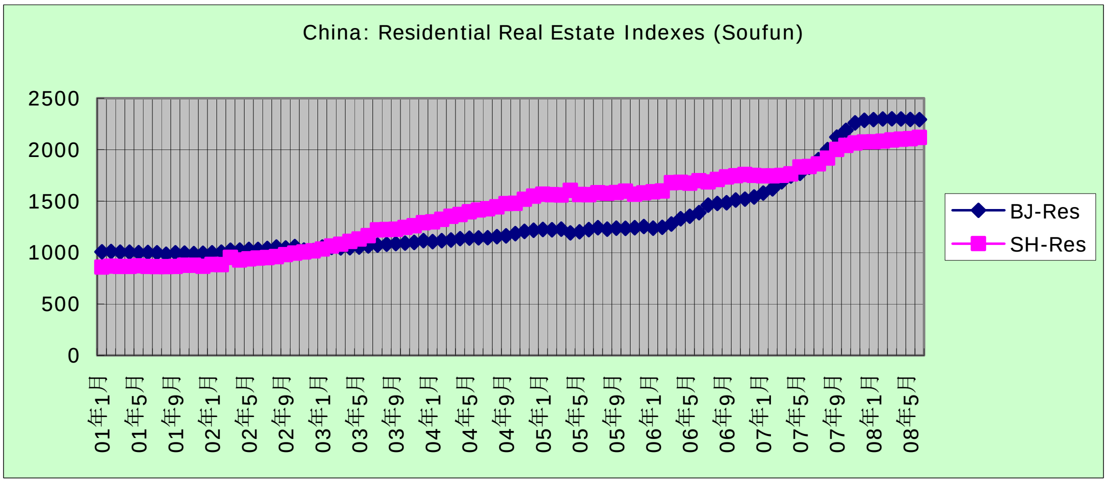
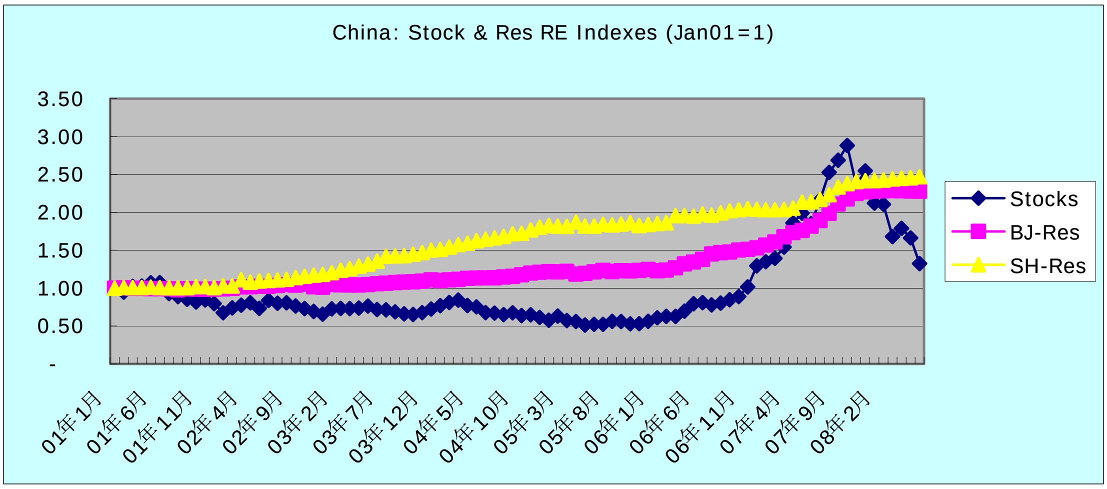
Often one finds marketing reports debating which asset types provide better returns; stocks or real estate? Stocks lovers naturally fancy stocks while bricks and mortar people say real estate.

Your humble author finds such debates meaningless, just like the fans of Singer A and the fans of Singer B arguing which singer sings the best songs, essentially a rather futile activity.

Nonetheless, out of curiosity, let us find out if there are any beyond any doubt performance differences between the China stock and real estate markets. Yet for simplicity, we limit the stock market to that of Shanghai (index) [from Yahoo! Finance] and the real estate to Beijing-Residential and Shanghai-Residential [based on Soufun CREIS indexes]. Here are their recent performances in charts:



And if we were to treat January 2001 as being 1.00, then we could obtain the following chart:



We have done the return performances for the period 2001 to 2008 and real estate is the clear winner with Shanghai-Residential beating Beijing-Residential too!

Period	Stock return	BJ-Res return	SH-Res return
2001 - 2008	32.46%	127.93%	146.97%

WAIT! Not so fast. If we only look at 2006 to 2008, we would see stock is the winner!

Period	Stock return	BJ-Res return	SH-Res return
2006 - 2008	117.49%	85.37%	33.19%

Rats! Say the real estate fans. Let us do all the years and see what we shall get:

Periods	Stock return	BJ-Res return	SH-Res return
2001 - 2008	32.46%	127.93%	146.97%
2001 - 2003	-27.53%	10.93%	50.35%
2004 - 2006	68.19%	39.24%	34.93%
2007 - 2008	-1.80%	45.31%	21.43%
2001 - 2005	-43.79%	24.55%	84.15%
2006 - 2008	117.49%	85.37%	33.19%

One can say real estate appears a bit better as it delivers return in all of the above periods observed while stocks win 3 times and lose 3 times. Yet stocks can offer huge return quickly if the timing is right. Clearer picture now or are you becoming even more undecided?