Zeppelin's Real Estate Tech

4Q 2010: A Real Estate Newsletter by Zeppelin Real Estate Analysis Limited
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Hong Kong real estate is still on an uptrend notwithstanding cooler ones across the border and the various tightened transactional measures put up by the Hong Kong authorities. Land auctions also fetched record-breaking prices. Meanwhile, there have been talks of a double dip for the USA and European economies.

- **Which is Bubblier: Mainland China Real Estate or Hong Kong Real Estate?**
- **Baby-boomers can Take Care of Themselves**
- **Differentiating between Really Luxury and Simply Pricey Homes**

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 between. This newsletter is now into its **15th year** and **57th** 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)

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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.

Which is Bubblier: Mainland China Real Estate or Hong Kong Real Estate?

Real Estate Tech, 4Q 2010

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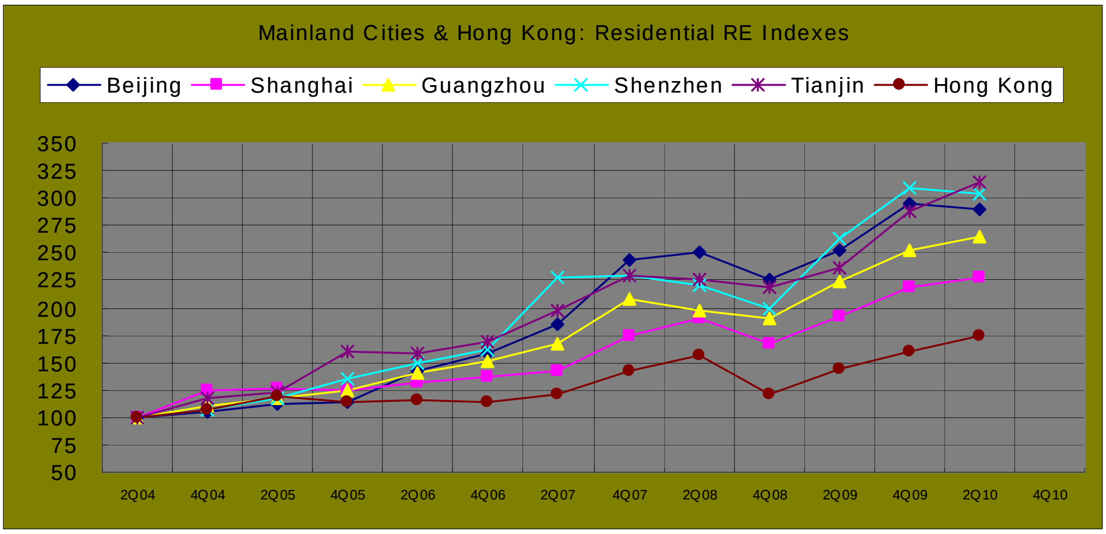
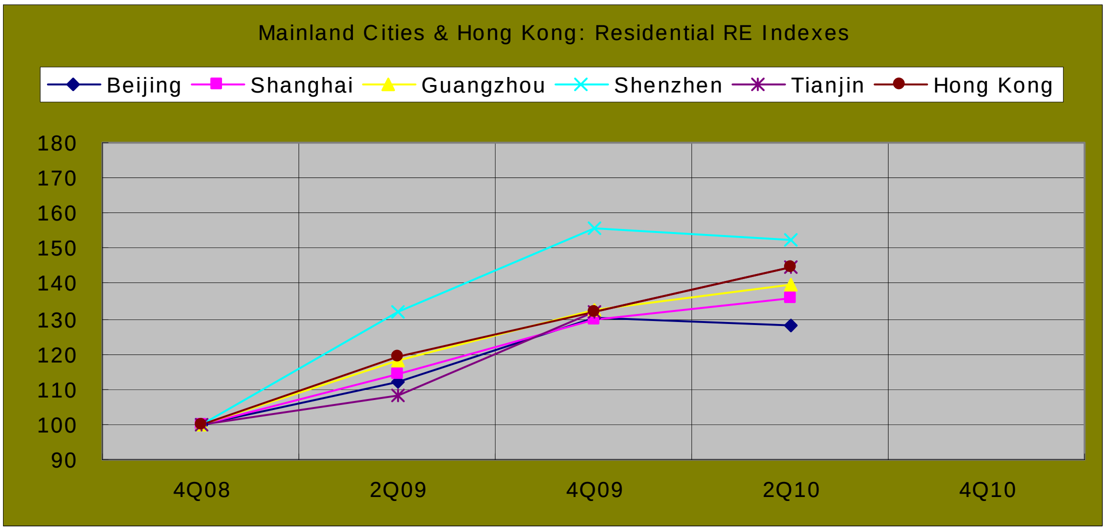
Many real estate investors have invested in both Mainland China and Hong Kong and if these were done since 2004, rather handsome gains would have been made.

Here is a chart to prove it [data comes from www.centanet.com and involves Beijing, Shanghai, Guangzhou, Shenzhen, Tianjin, and Hong Kong and their 2nd hand residential sectors]:



As can be observed, Hong Kong is the laggard while Tianjin and Shenzhen offered a gain of around 200%. The rest have also done well providing gains exceeding 100%.

Even if an investor has started late, say within the last 2 years since 2008, he or she would still be able to make averages of around 30% to 50%. Here is another chart to demonstrate it:



Note Hong Kong is only behind Shenzhen and is on par with Tianjin within this period. Guangzhou and Shanghai fair less than Hong Kong and Beijing is the laggard.

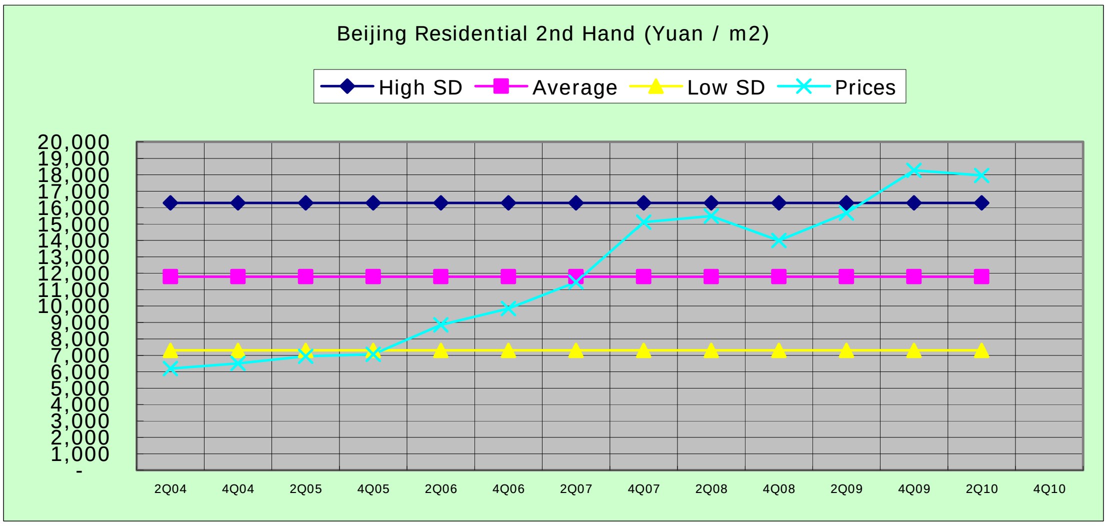
From the above charts, one may sense the impact of the 2008 Global Tsunami which ultimately led most world central bankers, China ones included, to print lots of dough (money) to stabilize their respective economies. Subject to serious studies, it is hard not to associate these extra cash with the asset price growths observed.

As such, relevant government authorities appear to be concerned with such rapid asset price inflation and a variety of cooling measures have been introduced since 2009. Nonetheless, the effects range from somewhat effective to almost unfelt.

While forecasting / projecting / predicting market trends is a tricky business, it is relatively easier to ascertain current market conditions. Here are a few often asked questions and our brief answers to them [based on the above mentioned markets during the stated period]:

A) <u>Are there bubbles in the markets?</u>

The simple answer is YES and we define a bubble as a market condition where the current price level is above the high standard deviation price level within the period being investigated. While one can dispute this definition, it does prevent too much personal preferences or human intuitions, emotions, or sentiments entering into the equation. Here are the charts to show what we mean:


Beijing Residential 2nd Hand (Yuan / m2)
High SD
Average
Low SD
Prices
20,000
19,000
18,000
17,000
16,000
15,000
14,000
13,000
12,000
11,000
10,000
9,000
8,000
7,000
6,000
5,000
4,000
3,000
2,000
1,000
-
2Q04
4Q04
2Q05
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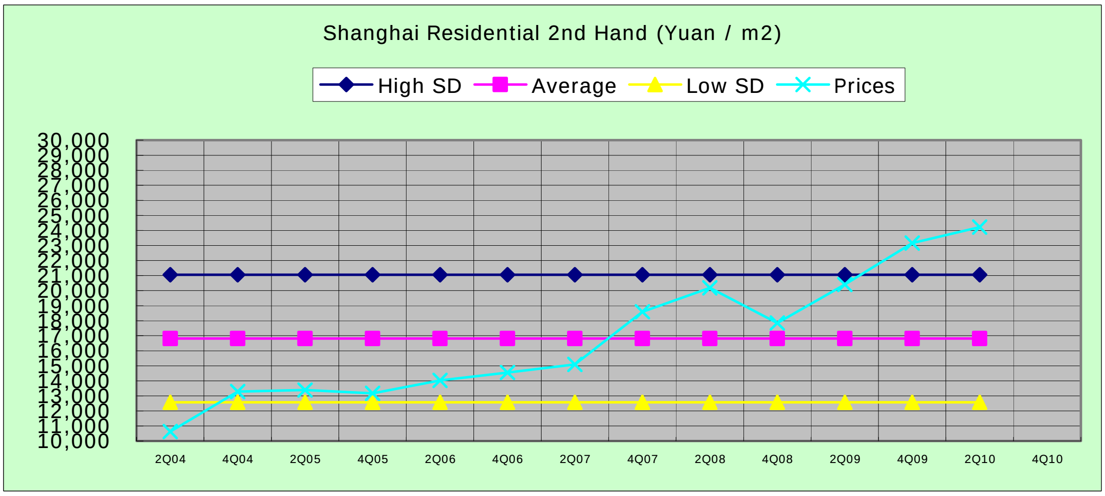
4Q09
2Q10
4Q10


Shanghai Residential 2nd Hand (Yuan / m2)
High SD
Average
Low SD
Prices
30,000
29,000
28,000
27,000
26,000
25,000
24,000
23,000
22,000
21,000
20,000
19,000
18,000
17,000
16,000
15,000
14,000
13,000
12,000
11,000
10,000
2Q04
4Q04
2Q05
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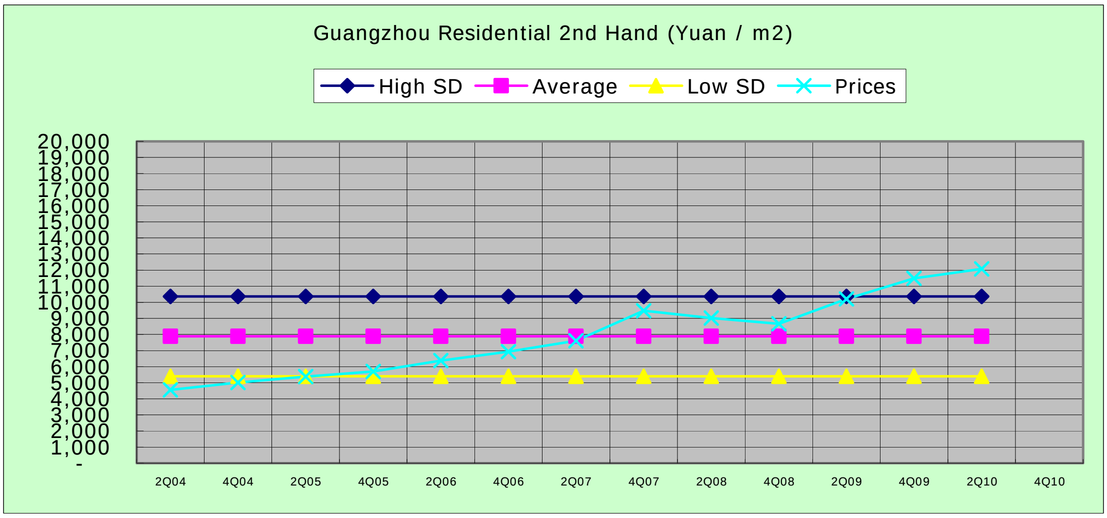
4Q09
2Q10
4Q10


Guangzhou Residential 2nd Hand (Yuan / m2)
High SD
Average
Low SD
Prices
20,000
19,000
18,000
17,000
16,000
15,000
14,000
13,000
12,000
11,000
10,000
9,000
8,000
7,000
6,000
5,000
4,000
3,000
2,000
1,000
-
2Q04
4Q04
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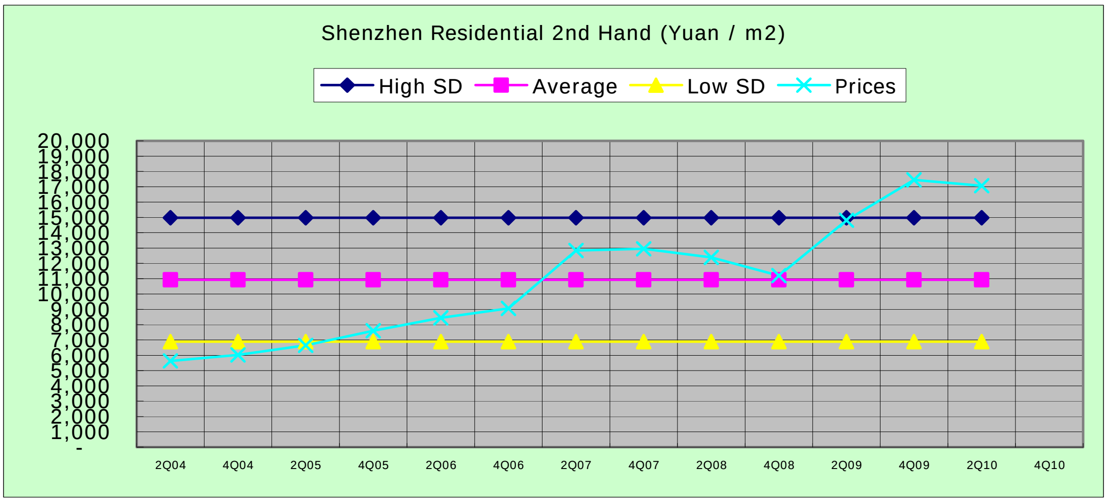
4Q09
2Q10
4Q10


Shenzhen Residential 2nd Hand (Yuan / m2)
High SD
Average
Low SD
Prices
20,000
19,000
18,000
17,000
16,000
15,000
14,000
13,000
12,000
11,000
10,000
9,000
8,000
7,000
6,000
5,000
4,000
3,000
2,000
1,000
-
2Q04
4Q04
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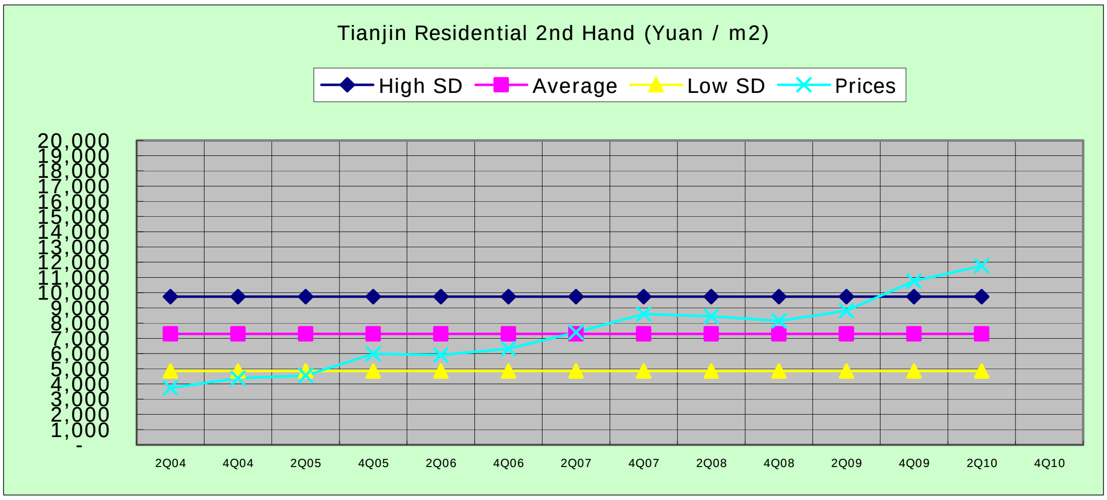
Tianjin Residential 2nd Hand (Yuan / m2)
High SD
Average
Low SD
Prices
20,000
19,000
18,000
17,000
16,000
15,000
14,000
13,000
12,000
11,000
10,000
9,000
8,000
7,000
6,000
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4,000
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2Q04
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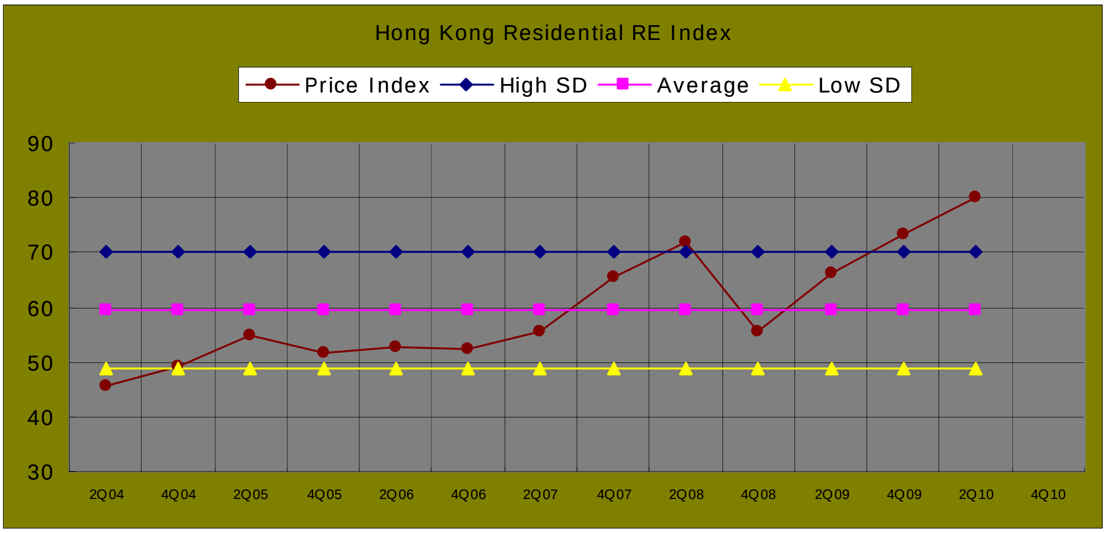
Hong Kong Residential RE Index
Price Index
High SD
Average
Low SD
90
80
70
60
50
40
30
2Q04
4Q04
2Q05
4Q05
2Q06
4Q06
2Q07
4Q07
2Q08
4Q08
2Q09
4Q09
2Q10
4Q10

And here are the volatility measures (by dividing the standard deviations by the averages) to help put the above charts into better perspectives:

Markets	Beijing	Shanghai	Guangzhou	Shenzhen	Tianjin	Hong Kong
Volatilities	0.38	0.25	0.32	0.37	0.33	0.18

Surprise! Surprise! Hong Kong appears to have the lowest volatility among them and volatility is a measure of risk i.e. the higher the number, the higher the risk level. Hong Kong seems to be the least risky of the 6 cities. And this brings up the next question…

B) <u>How risky are the markets?</u>

Treating each market like a stock and deeming the high standard deviation, average, and low standard deviation levels of each as different possibilities of price falls, then one could derive the following (price decrease) percentages:

% Drops from current price level to reach:	High Standard Deviation Level	Average Level	Low Standard Deviation Level
Beijing	9.30%	34.32%	59.35%
Shanghai	13.11%	30.60%	48.09%
Guangzhou	14.15%	34.72%	55.28%
Shenzhen	12.21%	35.92%	59.63%
Tianjin	17.32%	38.05%	58.78%
Hong Kong	12.39%	25.63%	38.88%

<u>Note a few things</u>: 1) we are NOT predicting there will be drops although these are likely; 2) if drops do occur, they may or may not reach or rest on the above High SD, Average, or Low SD levels as these levels are only used to gauge the seriousness and intensity, or the lack of them, should there be drops to them; 3) bubbly markets can sometimes last quite a while and do not always imply immediate downward adjustments.

From the tables above, the selected Mainland China 2^{nd} hand residential markets appear to be riskier and bubblier than Hong Kong.

C) <u>Will investing in most of the above markets help in terms of risk diversification?</u>

The short answer is NO. No or little market risks are averted by investing in most or all of the above six 2^{nd} hand residential sectors. Naturally, in terms of business-partner risk, local policy risk, and the like, investing with different partners or localities would help reduce these risks.

The reason is simple; the markets are highly correlated to one another. Here is a table to illustrate our view [weak correlations tend towards 0 while strong correlations tend toward 1]:

Correlations between:		R
Beijing	Shanghai	0.97
	Guangzhou	0.99
	Shenzhen	0.96
	Tianjin	0.97
	Hong Kong	0.92
Shanghai	Guangzhou	0.98
	Shenzhen	0.95
	Tianjin	0.97
	Hong Kong	0.96
Guangzhou	Shenzhen	0.98
	Tianjin	0.99
	Hong Kong	0.93
Shenzhen	Tianjin	0.97
	Hong Kong	0.90
Tianjin	Hong Kong	0.92

D) Does this mean one should invest in Hong Kong real estate more?

Not necessarily. Going back to the start of this analysis, Hong Kong can be a laggard. Read also our previous analysis published in April 2009 on Hong Kong real estate: http://www.real-estate-tech.com/articles/RET2Q09.pdf [2nd article].

Then, what can one do? IF one has already invested substantially in Mainland China and / or Hong Kong real estate, especially when handsome gains have been made, do consider selling some of them, the lesser ones in particular.

On the other hand, IF one has not made any serious or substantial investments yet, then be patient unless the opportunities make good commercial sense and / or if the properties are so unique and trophy, or for that matter, it is just to invest a bit to get one's feet wet so to speak.

At the same time, the market nature of Hong Kong could be different from that of some of the Mainland markets e.g. many cities on the Mainland could look forward to sizable expansion owing to the urbanization underway but this may not apply to Hong Kong.

Summing up, if one finds it hard to find investment opportunities that make sense, it may be time for vacations, not vocations.

Baby-boomers can Take Care of Themselves

Real Estate Tech, 4Q 2010

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Your humble author had recently attended a talk featuring Dr. Kenichi Ohmae, a renowned futurist and strategist. He attributes the current economic malaise in Japan to two factors:

1) **A low birth rate** = having fewer babies may not be a problem in itself but it does imply many households have just one kid. Given Japanese traditions, this sole kid is likely to stay around and take care of his or her aging parents, thus depleting the economy of able bodies who, as in the past when families tended to several children, can venture far into the corners of the globe for business, investment, and trade.

2) **Frugal elderly** = it is estimated that the elderly has a net worth of around US$350K per person i.e. they can afford to spend but just don't. Also, their population is huge and they have time to vote i.e. they collectively exert a political influence which tends to allocate more public resources to them.

While we have not researched seriously into other developed economies, we believe there is **a good chance that the baby-boomers of these economies also own the bulk of net wealth.** While individual boomers may require public assistance, collectively the boomer generation has stored up sufficient resources and wealth to take care of itself.

As such, your humble author **can't help feeling amused whenever governments or politicians sound the alarm bell of not having enough young people to support the elderly,** thus wanting to seek ways to encourage more births and so on.

Moreover, increasing birth rates to support the graying population defies logic because:

a) **The baby-boomer bulge is a one-off phenomenon** = baby-boomers usually refer to people born from the end of WWII (which lasted from 1939 to 1945) to 1962 i.e. the earlier batch of boomers is already approaching 65 while the latter batch 50.

Why the sudden burgeoning of babies after WWII? Your humble author has no clues other than to suspect a feeling of happiness, light-heartedness, and appreciation for life after a world war, plus no or little awareness of family planning and birth control at the time.

Assuming an aging baby-boomer requires at least 2 younger people for support, and given the elderly could look forward to live beyond 80 years of age, **the demographic mathematics between generations would need to be in geometrical progression** i.e. 2 + 4 + 8 + 16 + 32…but, political correctness aside, is it wise to perpetuate this one-time phenomenon?

b) **Economics systems should serve humans, not the other way round** = in the 1970s, the government in Hong Kong urged families to have no more than 2 kids citing (home) economics as one of the reasons. Now, it seems the reverse stance is taken.

Irrespective of the stance, **it is degrading to view humans simply as nuts and bolts in an economic machine.** Furthermore, if the system is sound, humans are generally resilient and resourceful enough to eventually find solutions to get around the problem. For instance, Japan, having one of the least young to elderly ratios, is extremely good at automation and robotics.

Just let the boomers run their course, spend their savings, and wither away, gracefully.

Differentiating between Really Luxury and Simply Pricey Homes

Real Estate Tech, 4Q 2010

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New residential sales in recent years have generally been packaged as "luxury residences" with fancy and hard to pronounce Chinese names implying kingly status and expensive taste, and are often furnished with the latest and most popular finishes and accessories. Naturally, with image inflation comes price enhancement, and even the least attractive among these command a per square foot price of close to HK$10K.

Your humble author thinks the term "luxury residences" is one of the, if not the, most abused terms used in the industry. Real luxury homes are naturally pricey but it does not automatically imply the reverse is also true i.e. pricey homes are not necessarily luxury homes.

Here are <u>a few distinct features</u> of luxury homes:

1) **Hard to access** = luxury homes are usually not built above subway stations, near bus terminals, or next to ferry piers. In fact, luxury homes seldom employ or need 'convenient transportation' as a selling point. Conversely, real luxury homes pride themselves of being secluding and difficult to reach or even to locate. Why? Avoidance of crowded traffic and public intrusion is one reason. The other being the owners tend to own cars and in many instances with chauffeurs i.e. driving and getting there are the concerns of chauffeurs, not the home owners.

2) **Little or no retail amenities in the neighborhood** = common private housing can be sold for more if shopping facilities and daily necessities are just a stone's throw away. Not so with luxury residences! Again, grocery buying is not an owner's concern but the maid's (and the chauffeur's).

3) **No need to be near schools** = while there is perhaps little harm in being close to a reputable private school, there is no need to be near one as long as the luxury home owners are concerned. Why? Having cars and chauffeurs are one reason; the other is that the kids may be studying abroad in a reputable boarding school.

4) **Low density neighborhoods** = just go to Google Earth and check out known luxury neighborhoods. Save for the Big Apple, most exclusive neighborhoods do not harbor 50+storey high rise apartment buildings which are right next to one another.

5) **No clubhouses** = residences of tycoons and the rich and famous generally come with swimming pools, tennis courts, golf ranges, or maybe even private airstrips and moors. BUT, these are NOT part of a clubhouse facility to which 'common owners' may frequent.

6) **Sometimes not even pricey and fanciful decors** = IF one has the opportunity to visit the 'show flats' of new residential developments in Hong Kong, one will get to know the popular interior trends and latest décor preferences which in turn reflect the relative ignorance of or distaste for minimalism. Instead, one is likely to find that practically all square inches, let alone square feet, of floor space would be filled up by some furniture, gadgets, or decorative items. There is a good reason for this; when one has to pay HK$10,000 or more per ft2 (US$1,200 / ft2 or more), one would be enticed to utilize each and every square inch of floor area.

However, the really luxury homes would have 'space to spare' notwithstanding a very expensive price per square foot and the decors may not be all that glitters. Sometimes, the late Mies van der Rohe would even be pleased.

Ok, but then how are the simply pricey homes differentiated? That's easy. These are homes built to make their owners "feel" as if they had made it to a luxury home and thus live a (near) luxury lifestyle. In order to create such a feeling, these need to be pricey and fancily built.

In the past, home selling involved inspecting the bricks and mortar and comparing specifications.

Today, it is about marketing a dream, realizing an aspiration, and probably, just probably, perceiving an inception as well…

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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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