Zeppelin's Real Estate Tech

4Q 2015: A Real Estate Newsletter by Zeppelin Real Estate Analysis Limited
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Expectations of price drops for Hong Kong real estate have finally gained some ground, ending the earlier monopoly of one-track mind upward only sentiment. Vacancies in prime retail locations start to appear with a few global chains scaling down or pulling out. Meanwhile, China numbers continue to appear lackluster. EU faces a migration issue and all eyes on the US FED.

- **Hong Kong real estate: start buying IF prices do drop 50%**
- **No need for or want of mortgages? Buy some REITs instead**
- **USA and Canada real estate: a few differences**
- **Toronto residential real estate: where to invest?**

"Knowledge has no boundaries, it is just that our brains have limits, thus requiring the slicing and dicing of knowledge for easier absorption."

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**, **21st Century Business Herald**, **Apple Daily**, **Sing Tao**, **Quamnet Magazine**, **The Standard**, **MITCRE Alumni Newsletter**, **Surveying Newsletter**, **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 **USA Today**, **i-Money**, **Ming Pao, Radio Hong Kong**, **Cable TV (Money Café), DBC Radio,** and **Commercial Radio**. We also publish monthly articles and analyses in the months in between. This newsletter is now into its **20th year** and **77th** 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 / Hong Kong 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 Partners 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 professional networks covering Asia, North America, and Europe.

Who? Me?

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Creator and Writer, Real Estate Tech Quarterly Newsletter
Real Estate Website Developer, www.Real-Estate-Tech.com

Stephen is an independent real estate analyst – number cruncher 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 regular real estate writer - columnist 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 an honorary adjunct professor of the 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 3 real estate books in Chinese published to date as follows:

Online book = Easy Real Estate Lectures

Hard copy = Real Estate Investment Know-How above 101

Most recent and hard copy = The Real Estate Market Turning Point

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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.

Hong Kong real estate: start buying IF prices do drop 50%

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Some people might look like this

In the past few weeks, there have been talks of imminent real estate price drops for Hong Kong with guesses ranging from a few percentages to 50%. This sounds a lot but if you were to dig deeper into the price index series, it would just put us back to around 2009 i.e. right at the start of QE.

Your humble author does not have a crystal ball and in these days of bigger-than-life central bankers, some of the old school traditional / technical / fundamental analytical methods might not even work too well.

Nonetheless, there is no stopping one from contemplating / imagining / dreaming what it would be like IF Hong Kong real estate prices do drop 50%:

1) Things will become cheaper = real estate included of course. If previously you could buy 2 properties, now you can acquire 4 with the same budget, or 2 with half the budget. Not only that, most commodities and services could be bought for less, and instead of paying $31 for a breakfast, now you might even get it for even $13!

2) Rents will also drop = however, based on the 1997 to 2003 experience, rents overall might drop at a lesser pace than prices i.e. it is likely the rental yield would improve. This in turn means there is a chance that the [nominally] lowered rents actually carry higher than before purchase power.

Barring unexpected circumstances, your humble author will be enticed to start investing when and if prices do drop 50%, especially for competitive locations and so on. There are hurdles though:

a) Need staying power to hold = it is unlikely such a debacle would be over within months. More like years, say 3 to 5. One must have sufficient staying power after purchase.

b) Need guts to buy = when prices drop that much and things are bad all around, well-meaning relatives and friends would discourage you from entering the market. News, as usual, tends to project a straight line down (and up in good times). You need strong conviction, perseverance, and patience to overcome all such well-intended advice.

How likely is a 50% price drop? Likely:

A) QE appears to be losing its luster = i.e. power in the sense that its punch seems to be growing weaker while more resources are required to produce the punch. Furthermore, there seems to be little or no coordination among nations on QE e.g. EU has just started and is still having arguments about it, Japan is doing it kamikaze-style, the USA contemplates the opposite, and China wants to cut back but can't. Also, math-wise, say you print $100 to buy a certain item – previously costing $50 - for $100, presto! 100% price gain! But economy is still a dead beat, so print $200 to buy the $100 item, another 100% gain! Economy still doesn't move much, and so print $400 to buy the $200 item, 100% gain! And on and on...naturally the foregoing is a very simplified picture of things but you get the idea, do you?

B) Developed economies licking wounds, developing not doing too great either = the latter includes China. So begs the question: who else can be "$uperman"?

C) Graying populations worldwide = tend to induce deflation rather than inflation.

Also, despite all the above, when one can still see new homebuyers becoming very excitable and exuberantly joyous upon being able to purchase a unit from the developer, one can expect to see its opposite counterpart sentiment when the tide turns.

No need for or want of mortgages? Buy some REITs instead

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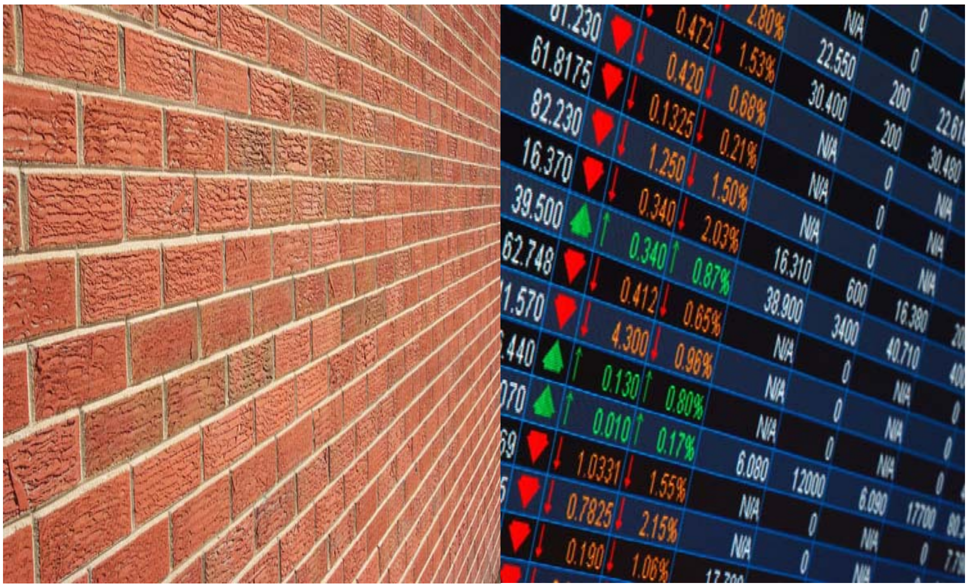

Bricks and stocks: which one to buy?

Bricks and mortar offers one advantage: long term financing in the form of mortgages which amortization or term can stretch over a very long period of time like 20 years, 30 years etc. And leverage, where applied appropriately (such as when the income derived could more than cover the debt service), will enhance the return on equity.

However, when one, for whatever reasons, decides not to borrow or take out a mortgage when investing in real estate, your humble author would suggest that bricks and mortar might not be your optimal choice. Consider buying some REITs instead. In the case of Hong Kong, that would mean buying stocks because all REITs based here must be publicly listed. Here is a list: https://www.hkex.com.hk/eng/market/sec_tradinfo/stockcode/eisdreit.htm

Why? Reasons:

1) REITs overall perform no worse than selected residential complexes or the residential market as a whole = as reflected in the Centaline Agency's CCL residential price indexes. We have collected price data starting from January 2009 to July 2015 on selected REITs, residential complexes, and the CCL index. Dividing the 2015 figure by the 2009 figure would give us a ratio; if it is > 1, then that means the price has gone up during the period, if not, then there is a price loss [in our sample there are no losses]. Please refer to the table below:

During the period, the CCL residential market price index has gone from 1.00 to 2.49, meaning an average gain (profit) of 149% in prices. As such, some REITs performed better than this, e.g. the LINK REIT, and some worse e.g. Champion REIT. Mix the table with selected popular private housing complexes, one can again see some REITs have better performances than the housing complexes, while other REITs lag behind some of the housing complexes. In short, the REITs collectively perform similarly to the bricks and mortar in terms of price appreciation.

Items	Unit of Measurement	2009年1月5日	2015年7月15日	Ratio 2015/2009
LINK REIT 823	Stock Price HK$	13.20	45.40	3.44
沙田第一城	HK$ / ft2 gross	3,436.88	10,629.70	3.09
Prosperity REIT 808	Stock Price HK$	0.98	2.84	2.90
Sunlight REIT 435	Stock Price HK$	1.47	3.95	2.69
美孚新村	HK$ / ft2 gross	3,295.71	8,253.31	2.50
Centaline CCL	Index	57.51	143.32	2.49
太古城	HK$ / ft2 gross	5,827.01	14,182.60	2.43
YUEXIU REIT 405	Stock Price HK$	1.92	4.17	2.17
駿景園	HK$ / ft2 gross	4,734.43	9,966.53	2.11
Regal REIT 1881	Stock Price HK$	1.06	2.19	2.07
凱旋門	HK$ / ft2 gross	10,590.50	21,067.00	1.99
Champion REIT 2778	Stock Price HK$	2.29	4.45	1.94
貝沙灣	HK$ / ft2 gross	8,830.61	16,162.00	1.83

2) REITs generate higher regular income (dividend) yields when compared to the rental income yields from the housing complexes = all REITs currently offer 5% or more annual dividend yields except the LINK (at around 4%), while the selected housing complexes offer only around 3%. Bear in mind there is no need to report or pay taxes on the REIT dividend income in general, but one needs to do so for rental income.

Also, one can expect REITs to pay some dividends even in the worst of times because it is unlikely that all the properties within a REIT portfolio will be empty without tenants at the same time. Furthermore, REITs can only have a maximum 45% gearing ratio i.e. the market has to be pretty bad for rentals to be so low that they cannot even cover a relatively low leverage.

Given the above, the rental yields from REITs and from bricks and mortar could have a much wider gap than what 5% versus 3% (see above) would suggest.

3) REITs offer some diversity of risks = not so much on market risks because the Hong Kong-based REITs are mostly involved in Hong Kong commercial properties (exceptions are Yuexiu, Spring, New Century, and now to a certain extent the LINK too), and all property sectors – residential, office, retail, industrial - in Hong Kong are highly correlated in terms of price trend. Rather, they offer some diversity in terms of tenant quality or type, land use, or even geography due to different land uses are located in different zones (read districts, neighborhoods).

4) REITs transacted with the touch of a computer button = not so with bricks and mortar's transactions which usually take weeks if not months. The transaction expenses are also higher for bricks and mortar.

The crucial point here is that REITs, being stocks, can be sold for and at the market price prevalent at the time (shown on the computer screen), plus or minus a few percentage points. Presto! Instant. This is vital especially when one needs to sell during a downturn. With bricks and mortar, however, say the market price of a residential unit has dropped to $20M, you can't list it at or ask for $20M. It just won't sell. You need to go below the market price, say, at least to $19M or $18M before any interest is shown. Not a pretty sight.

5) No hassle with tenants and occupants = The REIT managers and administrators do all these tenancy chores on your behalf.

For the egoist, it feels nice to own properties all over town too.

USA and Canada real estate: a few differences

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Both are found in the wild frontiers

Both the USA and Canada are North American countries and both have roughly the same land area. Nonetheless, the USA is roughly 10 plus times Canada in other aspects such as population, economic production, financial clout, military capabilities, and so on. Climate-wise, the USA offers a range from tropical to snowy, whereas Canada in most parts offers a choice of cold or colder.

In terms of culture, outsiders might be tempted to think Canada is just like the USA. But that is a mistake and a misconception. True, the USA borders Canada on the south and North West (Alaska). True also that the USA is the biggest trading partner of Canada. Also true is that Canada watches USA TV. Yet, they are not exactly alike.

On the surface, Canadians* even sound like Americans, despite the Queen of England is the head of state. But you would find very few people with British accent in Canada. Even the realty systems are similar e.g. both the USA and Canada use the MLS – Multiple Listing Service for listing properties for sale and lease.

However, there are differences too. For starters, Canadians generally keep a lower profile and behave a bit more humbly. This is not surprising; with a populous and strong neighbor to your south, Canada can ill-afford to be high profile even if she so wishes. Canada has lower crime rates overall and her welfare systems are more comprehensive and universal. Tax-wise, Canada tends to have heavier taxes, however, some studies in recent years suggest the gap has narrowed, and in some aspects, Americans may pay heftier taxes than Canadians.

As for real estate, here are a few vital differences:

1) USA allows the interest portion of mortgage payments to be deductible against income = Canada does not have such an allowance, i.e. there is no incentive for getting a larger than needed mortgage or to keep some mortgage principal outstanding – for tax reduction purpose - even if the mortgagor (homeowner) has the financial clout to discharge the whole mortgage.

2) **Canada does not charge capital gain taxes on capital appreciation related to the “principal” resident homes** = that is, no matter how much one gains from selling the

principal home, no tax is owed to the national government. The USA does not offer such an exception and capital appreciation is taxed even for the principal resident homes, notwithstanding some reliefs here and there.

3) Non-Recourse mortgages = for those unfamiliar with such mortgages, the best layman description that your humble author can come up with is that they are like mortgages with "limited liability". With a non-recourse mortgage, a homeowner who cannot repay the mortgage can simply walk away from (forfeit) the property (i.e. the lender takes over possession) and not owe the lender anything anymore, even if the property is (now) worth less than what is owed to the lender. Such mortgages are widely used in the USA. Not so in Canada.

To investors from Hong Kong and the region, both the USA and Canada offer different advantages:

A) The USA = since the HK$ is pegged to the US$, there is no need to worry about (US$) currency depreciation when one invests in USA assets, real estate included, unless the peg is to be undone.

B) Canada = with the C$1 being equal to HK$5.87 (at the time of writing this article), which is a recent low, Canadian assets could seem a bargain. And some are.

For instance, an 800ft2 or so middle class condo unit – like Tai Koo Shing - in Hong Kong might fetch a modest HK$15K per ft2 thus totaling = HK$12M = roughly C$2M. To buy a similar condo unit with similar attributes and amenities in Toronto might cost C$400K to 500K. That is, a typical Tai Koo Shing homeowner can use 1/4 of the money derived from the sale of his HK home to acquire a similar (usually larger in floor area too) condo unit in Toronto, and still has around C$1.50M left in his pocket.

Isn't this neat, eh?

*Canadians like to use "eh" which may signify "say again?", "agree?" etc.

Note: your humble author has invested in American and Canadian real estate.

Toronto residential real estate: where to invest?

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Downtown waterfront and blue sky (courtesy of www.viator.com)

In recent years, Canadian real estate sales have met good responses in Hong Kong, and while Vancouver appears to be the hot spot, Toronto is also gradually gaining attention. Most projects involve pre-sales of high rise condominium units, some of which are located in desirable neighborhoods.

With the Canadian dollar at recent lows (less than HK$6 to C1), a brand new 500 ft2 or so studio condo unit in a competitive metro location can be acquired for a bit more than C$250K, or around HK$1,500,000, which is barely enough for the required down-payment for an 'extremely modest' first-time-buyer Hong Kong property. No wonder many in Hong Kong deem the Torontonian real estate a steal.

Now, to those not quite familiar with metro Toronto, a lingering question could be "where to invest?" and here are some clues:

A) The Toronto real estate market has been steadily rising for some time = since 1996 when it started to recover from the downturn during the late 1980s and early 1990s, and there was not even much of a dent during the Financial Tsunami and Recession in 2008-2009. With the global implementation of QE in recent times, prices have been shooting up further. Like other places with rising house prices, many young people and families are finding it hard to save enough down-payment for a home. Certainly the house price to income ratio has also been marching up. Risks? Technically yes, there are some but your humble author does not expect Toronto to suffer the worst downfall in Canada IF something does happen.

B) Toronto has a 9M people economy = the metro has 3M people in it and if one extends beyond the metro boundary to include the surrounding suburbs and towns, add another 3M. And if one further expands beyond the 'green belt' to include the many countryside communities and farms, add a further 2M to 3M. That is to say, Toronto economically involves directly and indirectly close to 9M people.

C) Stick to the metro portion (especially if you intend to invest and then rent out the property) = there could be some bias on the part of your humble author as his Toronto investment portfolio is metro-centric, but there are reasons: 1) the younger generation, many of whom are potential tenants, tends to favor metro life than suburban living, and some do not even own a car; 2) the metro, under the broad "Golden Horseshoe" plan and metro-intensification program, has been reviving many urban districts and increasing the density in and around the major arteries, thus enhancing the metro appeal to many residents and drawing them back; 3) Metro neighborhoods offer convenience, nightlife, and a level of sophistication not always found in the suburbs, and using a Hong Kong analogy, the metro is like Hong Kong Island + Kowloon, and the suburbs are in the New Territories and beyond; 4) sizable developable sites, especially those of detached houses, are getting fewer day by day in the metro, almost to the point of being non-existent. That is, supply is not limitless. Net rental yields before tax vary from district to district, yet broadly hovers around 4% + or – 1%.

D) Which neighborhoods? = assuming having a very generous housing budget, then 1) Bridle Path offers some of the priciest estate lots available e.g. 20K ft2 estate home + 2 acres of land, its neighborhood quality similar to the Peak; 2) Forest Hill and Rosedale, their Repulse Bay [without a beach though]; 3) Kingsway and Yorkmills, similar to the pricey mid-levels. In the long term, detached properties in these neighborhoods are like real Van Gogh or Picasso paintings i.e. their quantities are fixed.

For the condo buyers, pricier units can be found in parts of the lakeshore locations and Yorkville – a trendy upscale downtown neighborhood. For ease of renting out, buy condos which are right at or very close to the subway stations, especially those along the major intersections of the north-south major artery Yonge Street (think Nathan Road in Kowloon, or Fifth Avenue in New York City) e.g. Yonge x Bloor, Yonge x St Clair, Yonge x Eglington, Yonge x Sheppard etc. Better stick to 1 to 2 bedroom units too.

E) A typical Hong Kong middle class property can buy 4 to 5 Toronto counterpart and comparable properties today = say a 800 ft2 or so unit at Tai Koo Shing. Using a modest HK$15K per ft2 saleable unit price, this HK unit would be worth around HK$12M which translates to a bit more than C$2M. A comparable unit in Toronto would need around C$400K to 500K each, thusC$2M can buy 4 to 5 units. The last time Hong Kong properties can trade for several Toronto units was in 1997, ominous?

There have been talks of restricting overseas buyers in Canada and the current PM says they might emulate Australia. Casual checks with professionals there suggest nothing solid has been formulated yet. Nonetheless, even if so, that would mean foreigners could not trade in the larger second-hand / secondary market. As for first-hand sales by developers, it would still be "be my guest!"

Note: your humble author has invested in Toronto real estate

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