A Load of Bull: The Year Ahead for China's Real Estate Markets

January 26th 2009

- The Year of the Ox rewards patience and hard work
- China's real estate markets are not all moving in the same direction
- China has a lesser degree of immunity from the global downturn than in previous downturns but real estate has been subject to government measures to slow growth and bank exposure.
- Markets should show a relatively quick and strong rebound in 2H 09

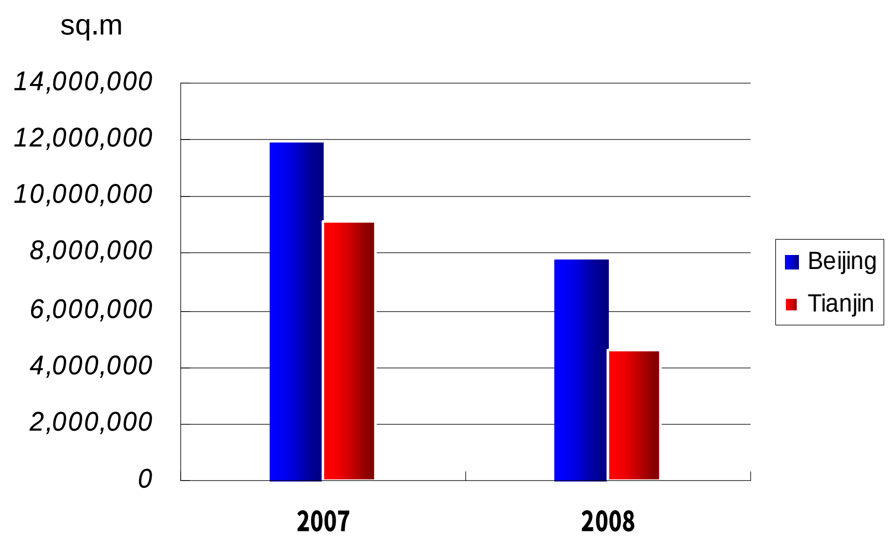
China's property markets are 12 months into a dramatic turnaround in their fortunes. The start of the year of the Mouse saw the first round of price cutting. So what can we expect from the year of the Ox? The short answer is a year for patience and hard work to sow the seeds for a turnaround late in the year rather than the bullish rampant markets we have got used to in recent years. We expect more or less a full reversal of most of the government measures to slow things down over the last 4 years; more lending, sluggish sales rates and prices falling by up to 15 to 20% or so. Things will remain patchy and as we describe in the remainder of this report, not all sectors, segments and locations are behaving in the same way. Needless to say, we are optimistic that the year of the Ox will end better then the year of the Mouse has.

Bohai Bay Area

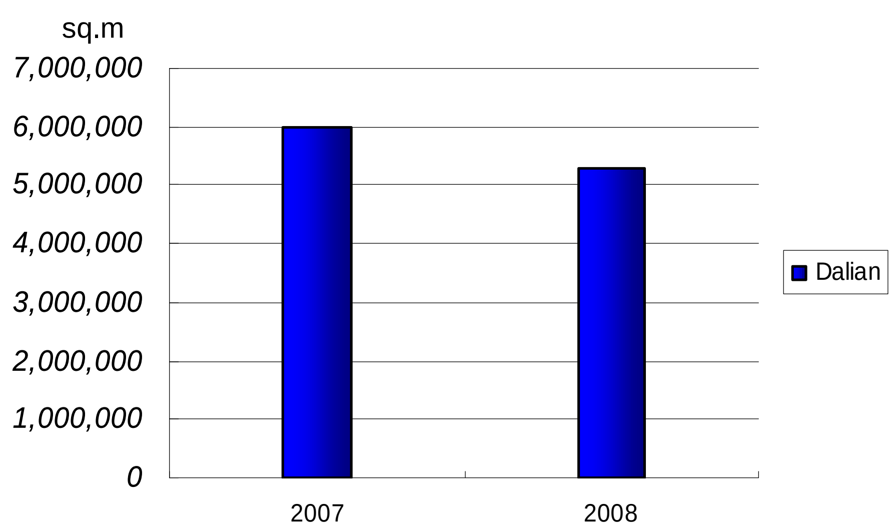
Holes in the Ground, Shenyang

The pattern of behaviour of residential property buyers has changed to the extent that there are half the number of buyers in some cities and most transactions involve lower cost properties. As adjustment takes place, it is at least possible to make more accurate forecasts about future demand based on end user demand rather than the more fickle speculator demand.

Beijing and Tianjin Transaction Volumes Jan to Nov 2008



Dalian Transaction Volume Jan to Oct 2008



Source: Crispin Research Department

Transaction volumes in Beijing and Tianjin in 2008 were 34.7% and 50% down respectively from 2007. Anomalies exist however and Dalian only saw a drop in transaction volume of 11.3% illustrating its resistance to the current downturn. Apart from Beijing the average residential price range in the Bohai Bay Area in 2008 was Rmb 6,000 to 9,000 per sq.m. In Beijing the average residential price was between Rmb 12,000 and 13,500 per sq.m.

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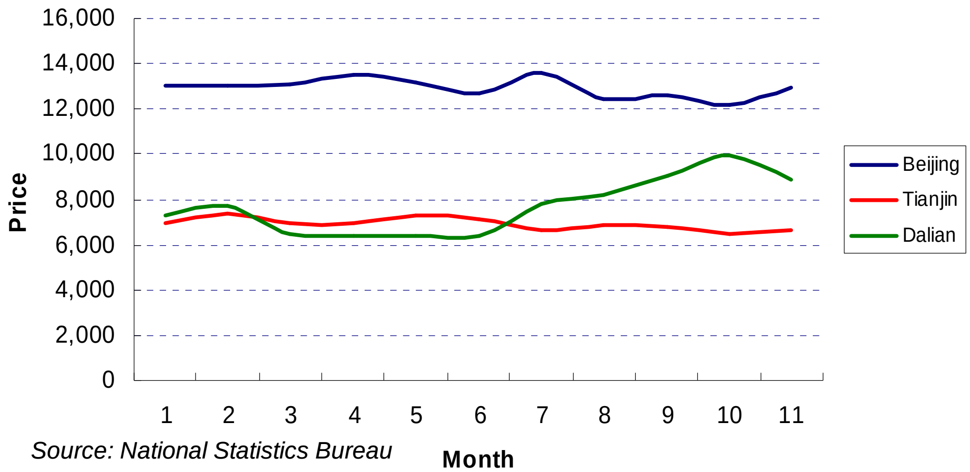
Beijing, Tianjin and Dalian Transaction Prices, 2008



Source: National Statistics Bureau

Sample of Residential Developments in Beijing

Level	Property	Price in Early 2008 (Rmb per Sq.m)	Price in Nov 2008 (Rmb per Sq.m)	Price Fall (%)
High-end	Hopson International Park	30,000	20,000	-33.33
	Beijing INN	28,000	27,000	-3.60
Middle-end	Dongwai Residence	28,000	24,000	-14.30
	Cheng Nan Da Dao	15,000	12,500	-16.67
	Xing He Cheng	18,000	11,000	-38.89
Low-end	White Moon of Milky Way	6,200	5,300	-14.51
	Repulse Bay	9,700	9,200	-5.15

Source: Crispin Research Department

Land transaction volumes and prices were greatly reduced in the region in 2008 with developers preferring to keep cash in hand instead of investing in land banks. In the Beijing CBD several sites failed to find buyers during the first half of the year.

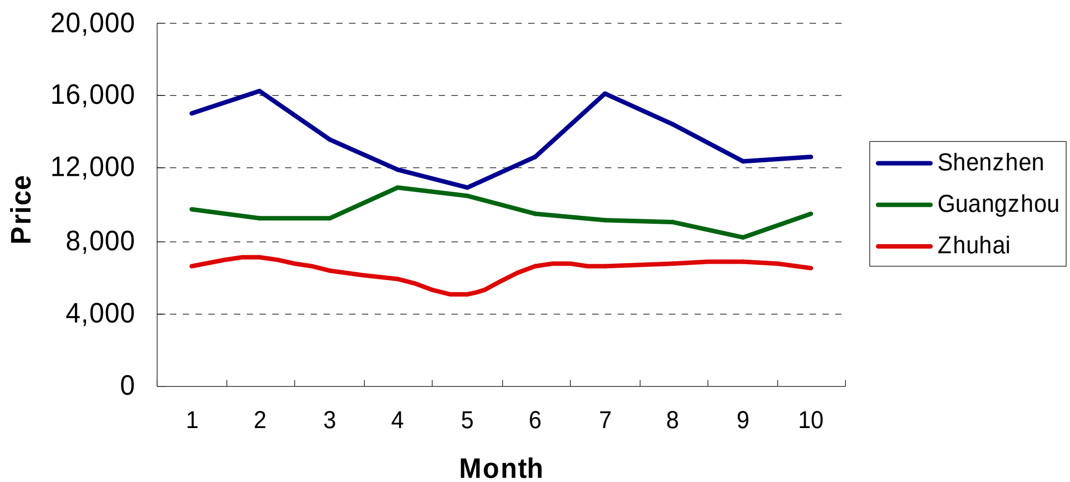
However, lured by falling prices and possible high profits, developers started to take the opportunity to buy sites in the second half of 2008. Hopson bought a site in Beijing's Chaoyang District for Rmb859 million or Rmb6,167 per sq.m compared with a site sold to Vanke in 2007 at Rmb11,000 per sq.m.

Average land prices closed at Rmb1,380 per sq.m in Tianjin, almost 42.5% down from the previous year. In December, 11 land plots sold at lower than expected prices in Dalian.

Pearl River Delta (PRD)

This is where the market started to turn 12 months ago. The main story for the PRD has been the alarming fall in house prices, especially in Shenzhen with some middle-end developments seeing a 40% loss in value. For example, apartments at Taihua Sunny Bay were Rmb 12,500 per sq.m in early 2008 but their price fell to Rmb 7,500 per sq.m by November the same year. Part of the problem was that house prices had increased so sharply from 2006 to 2008.

PRD First Hand Transaction Prices, 2008



Source: National Statistics Bureau

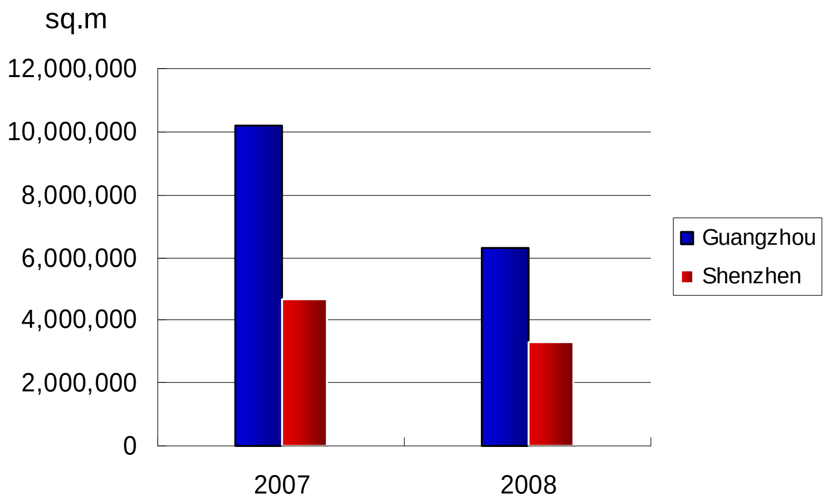
Sample of Residential Developments in the PRD

City	Quality	Property	Price in Early 2008 (Rmb per Sq.m)	Price in Nov 2008 (Rmb per Sq.m)	Price Fall (%)
Guangzhou	Middle-end	Royal Peninsula	13,000	8,600	-33.85
		Bao Li Xin Yu Garden	17,500	16,000	-8.57
	Low-end	Zhong Hai Jin Sha Wan	8,000	5,300	-33.75
Shenzhen	High-end	Xiang Mi Hu Wei Zhen Fu	45,000	28,000	-37.78
	Middle-end	The Village	14,000	10,000	-28.57
		Taihua Sunny Bay	12,500	7,500	-40.00
	Low-end	Zhu Jiang Xu Jing	9,900	8,000	-19.19
		Jia Zhao Ye Shui An	7,000	6,400	-8.57
Dongguan	Low-end	Jing Hu Chun Xiao	6,500	4,600	-29.23

Source: Crispin Research Department

Transaction volumes were also down in the PRD with Guangzhou and Shenzhen seeing 38.2% and 28.5% drops respectively in 2008 from the previous year. In Shenzhen, nearly 40% of real estate agencies went bankrupt due to the low transaction volume.

Guangzhou and Shenzhen Transaction Volumes, Jan to Nov 2008



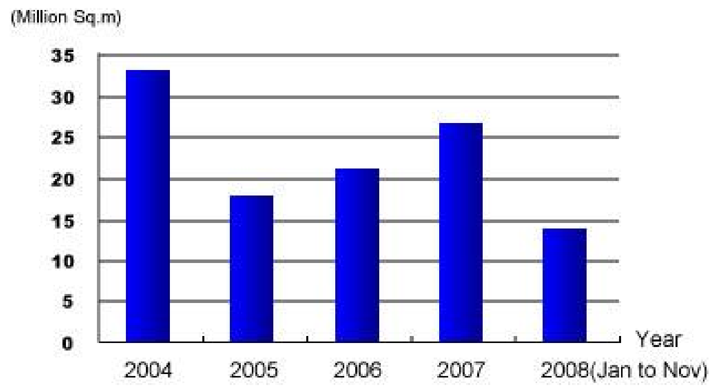
Source: National Statistics Bureau

Developers in the PRD have also struggled due to cash-flow pressures. They have been reluctant to buy newly released land in 2008 due to worries about expected profits. Developers were reluctant to purchase newly released land plots in 2008 with most deals being reached at 2006 price levels. In Shenzhen, most land only came onto the market in the second half of the year. In Dongguan, land transaction volumes closed at Rmb6.7 billion in 2008, 43% down from the previous year. These are clear signs that investors are becoming much more prudent in the South.

Yangtze River Delta (YRD)

In the Yangtze River Delta, falling transaction volumes throughout 2008 also illustrates the malaise in the property markets. But transaction volume is not far off that of 2005, hardly 'off the cliff'.

Shanghai Residential Transaction Volume (Jan-Nov 2008)



Source: China Real Estate Index System (CREIS)

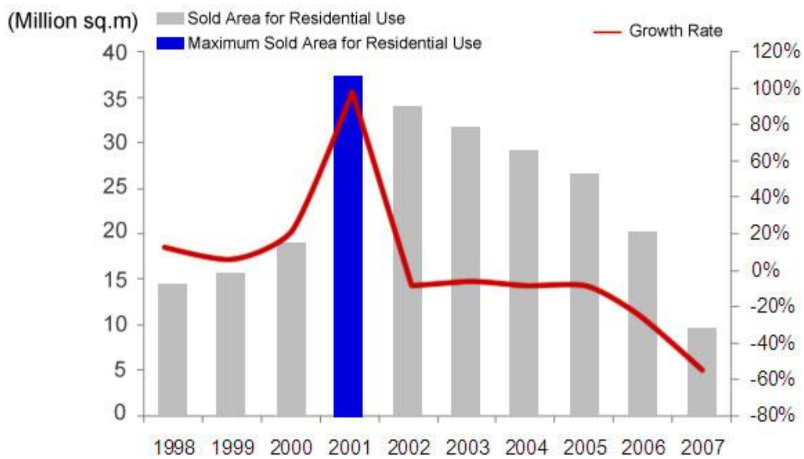
In Shanghai, house prices have dropped by an average of 11% within the inner ring road between the start and end of 2008 according to the China National Statistics Bureau. However, high quality developments in exclusive locations have survived the price drops. For example, prices at Lakeville in Xintiandi only fell by 5% between the start and end of 2008.

District	Property Name	First Half Year of 2008 Average Price (RMB/sq.m.)	Average Price from Jul. to Aug. (RMB/sq.m.)	Price Fall (%)	Average Price Fall (%)
Within Inner Ring	Zhongyuan Lianwan City Phase 4	21,527	14,743	-31.50	-11.82
	Tai Fu Min Di	33,890	29,718	-12.30	
	Tai Xin Jia Yuan	29,502	27,854	-5.60	
	Huangpu New Garden Phase2	29,886	28,304	-5.30	
	Lakeville Phase 3	86,193	82,376	-4.40	

Source: Crispin Research Department

Developers in the YRD have also been cautious with several land plots failing to sell at auction. In particular there was a large fall in the number of land plots sold outside the middle ring road down from 42 in 2007 to just 15 in 2008. Within the inner ring road there were only 8 plots sold in 2008 compared to 12 the year before.

Shanghai Year Residential Land Transaction Volume



Source:CREIS

A recent land transaction in Shanghai's Zhabei District (between the inner and outer ring roads) shows that optimists are not all dead and buried. The transacted price was Rmb11,500 which was the reserve price. Allowing for construction, financing, contingency and profit the developer seems to be expecting a sales price of Rmb20 to 30,000 per sq.m. compared with the current price of Rmb16,000 per sq.m. The seeds of the next boom are being sown in the current downturn, if they've got their numbers right.

Developers

2008 was a year that most developers will be happy to forget. In all cases the stock price of listed developers has dropped significantly with an average drop of 75% in stock price. This fall in share price does not discriminate much between different developers but is related to the performance of the market, sentiment and the global need for liquidity.

We do not analyse the companies but we have looked at a number of projects around the country and picked the following insights. Different developers have evolved different niche areas and preferred project models. Tianan for example have had some success with so called 'Cyber Parks', turning low cost land in industrial locations into well presented and packaged low density office parks. Office units are sold at higher prices than other uses to mostly local businesses with parking, banks, convenience stores and restaurants. The result for this developer has been a diversification out of the sluggish residential market.

Shimao has developed a speciality of the largest scale and best packaged mixed use projects located in development zones on the outskirts of second tier cities and has projects across the country. Unlike their earlier projects most of these now have more in the way of supporting retail and amenities to improve the finished product. Examples visited include Shaoxing in Zhejiang Province and Changshu in Jiangsu Province. In each city the Shimao projects are the 'prettiest girl at the ball' and sales were reported as good although we understand behind some rather optimistic targets.

Shimao projects in Shaoxing and Changshu

In the retail market branding is everything and not just for Gucci handbags. We have seen the emergence of the 'branded mall' with China Resources developing MixC branded shopping centre from Shenzhen to Shenyang. Intelligent planning, good mixed offers and careful positioning has resulted in some great new shopping centres with something more to offer than the traditional Chinese department store.

Similarly COFCO have developed the Joy City brand. In Shenyang the massive Joy City shopping centre is part of a large scale redevelopment of the pedestrian street Zhong Jie which will open in mid 2009. With Joy City shopping centres in other cities COFCO are raising the quality of the retail experience across China.

Without exception smaller developers are facing serious capital and cash problems which has led to construction on projects being stopped or projects being purchased by larger developers at a lower price. Shanghai Industrial and Shimao were among the worst performing property stocks in 2008. However, Lujiazui Group has not suffered so badly. This is due to its focus on commercial rather than residential development which despite looming oversupply in the office market is seen to offer better prospects than residential.

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Company	Starting Price in 2008	Starting Price in 2009	Price Fall (%)
Shanghai Industrial Development	33.02	6.37	-81
Shimao	22.46	6.90	-69
Gemdale	21.16	6.96	-67
China Merchants Property Development	39.84	13.64	-66
Pudong Jinqiao	22.89	8.01	-65
Wanke	18.19	6.45	-65
New Huangpu Real Estate	26.41	9.47	-64
Poly Real Estate	32.71	15.34	-53
Lujiazui	25.49	14.10	-45
Average Value	26.91	9.69	-64

Source: China Stock Market Centre

Among China property plays listed in European and US markets Treasury Holdings' China Real Estate Opportunities Fund (CREO) stands out. The stock had been performing well until October last year when it's share price fell by 75% in one month. It has now stablised. This steep NAV discount reflects the overall lacklustre performance of the AIM market, redemptions of funds and in common with other property plays a pessimistic outlook that appears out of all proportion to the strong performance of a quality portfolio.

Zhongjie, Shenyang

For example, the third quarter of 2008 saw 10-50% growth in office rents on lease renewals and new lettings, on a portfolio between 92-97% let. Also, CREO's retail properties saw on average a 16% increase in rents. None of this was reflected in the share price.

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Source: www.ft.com

Not All Cities are Equal: Winners and Losers in 2008

In terms of the markets, we have already seen how poorly the Pearl River Delta performed in 2008. Guangzhou and Shenzhen especially were the two worst cities in China for residential price falls. One ray of sun came from a slightly unexpected location. Hainan province, China's sunniest, turned out to be the best performing market in China in 2008 and perhaps one of the best worldwide. At the end of 2008, residential prices in Sanya and Haikou were 8.1% and 6.8% up respectively on the same period in 2007. By contrast, Beijing prices rose by 2.9% and Shanghai prices fell by 0.8% at the end of 2008 compared to the end of 2007.

Sanya, One of the Sunniest Spots in China's Property Market in 2008

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Residential Price Change in Selected Cities: Nov 2007 vs Nov 2008

City	Nov-08 vs Nov-07
Yinchuan	10.6%
Sanya	8.1%
Haikou	6.8%
Jinghua	5.9%
Wulumuqi	5.4%
Jinan	4.8%
Pingdingshan	4.4%
Tianjin	3.2%
Haerbin	3.2%
Beijing	2.9%
Qingdao	2.4%
Ningbo	1%
Wuxi	0.9%
Hangzhou	0.8%
Shenyang	0.7%
Wuhan	0.7%
Shanghai	-0.8%
Chengdu	-1.8%
Nanjing	-2.9%
Xiamen	-3.7%
Chongqing	-4.2%
Guangzhou	-4.7%
Shenzhen	-14.8%
China	0.2%

Source: National Statistics Bureau

The surprising thing in the table above is how many cities are actually shown in positive territory for the year. One is left wondering about both the accuracy of the statistics and the media headlines of China's crashing property markets. The statistics measure prices in actual transactions while media reports grab hold of a heavily discounted apartment or two and uses that to benchmark the whole market. As any buyer in China will tell you, those discounted units that are used to lure the unwary in were sold long ago and in any case were on the second floor with a view of the local mortuary.

Conclusions: Reasons to be Cheerful 1, 2, 3…

In China, government support stands at the top of the list. The power that the government wields is not all conquering but it is pervasive. All the various tightening measures introduced over the last 5 years to slow the market down can be undone, one by one. This process has started but barely begun being aimed at first time buyers and economic housing. The government in several cities is also actively buying up unsold housing for use as economic housing, the exact mechanism of how this is implemented once bought is not clear to us but no matter for now, it is a welcome boost to transactions.

Government support alone cannot achieve all that much but the Chinese economy is not in quite the same boat as the US or UK. Many of the measures implemented over the last 5 years to slow the economy down have prepared it for today's global economy. Relatively low gearing of many of the major domestic developers protects both the developers and even more importantly the banks. Smaller developers are a different story. With the Chinese banking system still standing amid a global collapse, perhaps the greatest achievement of the socialist market economy to date, lending is continuing. The authorities are permitting relaxation of the tight lending policies introduced over the last 3 years, projects are finding that development loans that were not available last year are getting approved now. That said, market expectation is for one or two of the more highly geared developers to go bankrupt, until that event happens we won't know which one(s) so all stock prices have fallen with the tide.

The urbanisation story remains as compelling as ever, if not more so. Rural land reform is the last and largest major economic reform to be undertaken. Freeing farmers to transfer their land use rights will speed up the move to the cities and demand for the housing being built on the outskirts of major cities across China. The emergence of the Chinese Megalopolis can be expected between now and 2025 when the urban population is forecast to increase by 350 million.

Return of individual and institutional buyers is expected in 2H 2009. Just as some sell up and move on 'bottom pickers' are already scratching around and financial returns look a lot different with the prospect of price increases once another 10 or 15% comes off the markets. As with the start of the previous cycle development of low cost housing should lead the way with mid markets following and luxury markets taking longer to kick off but rebounding strongly. As we said at the start, the year of the Ox will see China's property markets in better shape than the end of the year of the Mouse.

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Company Profile

Crispins Property Investment Management is a wholly foreign owned real estate consultancy company, founded in 2002 by Sam Crispin. Sam Crispin first came to China in 1988 and has been working full time in the real estate industry since 1994. CPIM specialise in providing intelligence led real estate transaction and consultancy services to Chinese and foreign, private and public companies and institutions. Our reputation in the industry is the result of a range of assignments undertaken across China and services and advice delivered with intelligence and integrity.

This report was written by Sam Crispin, Mark Miao and Edward Owen at the CPIM office in Shanghai.

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