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China Property Market *September 2011*

China Beijing

High End Residential Market Watch

Content

Highlights

- China's high-end residential market concentrate mainly in the first-tier cities: Beijing, Shanghai, Guangzhou, Shenzhen, and a few second-tier cities like Hangzhou. After nearly two decades of rapid development, China's high-end residential stock has reached about 170 million units. Prices have risen nearly 250%.

- The number of China's HNWIs with disposable asset more than RMB 10 million has risen to nearly 80 million. Almost every high income family has a home in first tier cities, because those cities enjoy better infrastructure, environment, education resources.

- To get the housing prices under control, the government adopted a series of restrictive measures. The purchase restriction in first tier cities was among the most effective. High-end residential sales market was severely affected, but the rental market was still robust. A substantial rental increase resulted in higher rental yields. In the long run, the purchase restriction policy will not affect the demand of upgraders and investors. High-end residential prices will remain firm.

- In Beijing, the demand from MNCs(multi-national corporations) was very strong in Q2, so that rental and occupancy rates both increased, but sales market remained quiet

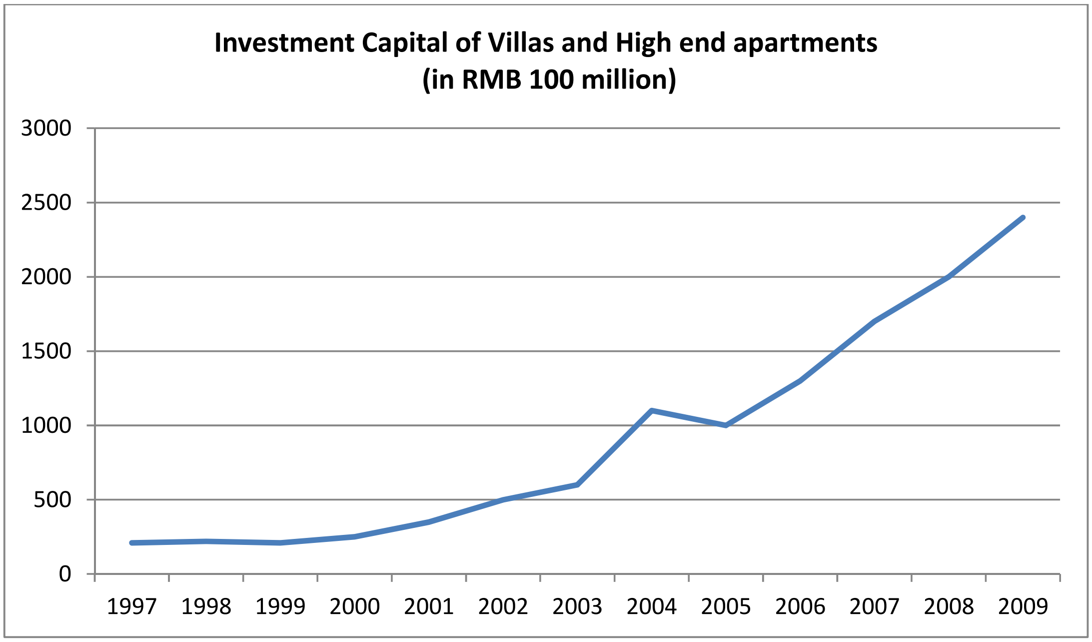
- In Shanghai, high-end residential market activity has recovered compared to previous quarter. But trading volume was still significantly lower than 2009 levels.

- In Shenzhen, MNC staff housing allowances have been relaxed which generate strong demand for high-end residence. In the sales market, investors are still on the sidelines due to the uncertainty of the policy.

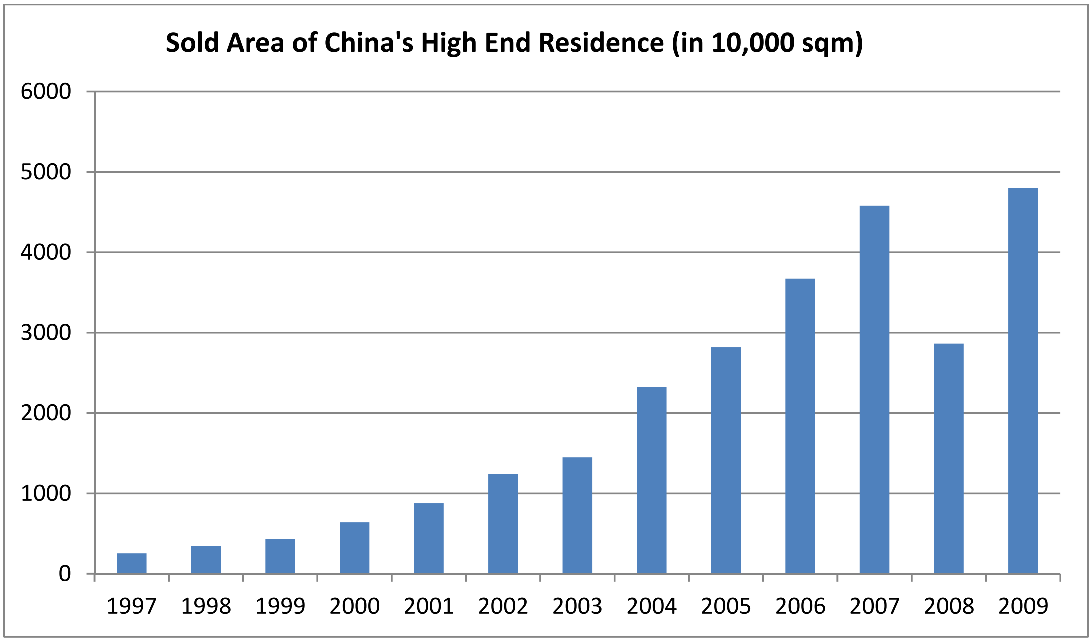
- In Guangzhou, buyers maintain a cautious wait and see attitude. The city's residential price and trading volume has decreased slightly sequentially.

Overviews of China's High End Residential Market

A booming housing market emerged since China began its reform and opening up policy. With the economy's quick development, the high end residential market advanced rapidly. Investment in villas and luxury apartments was increasing continuously from 1997 to 2010. There was a small decline in 2005, but in 2006 the amount of investment rose steadily again. High end residential investment increased 10 times during the last decade.

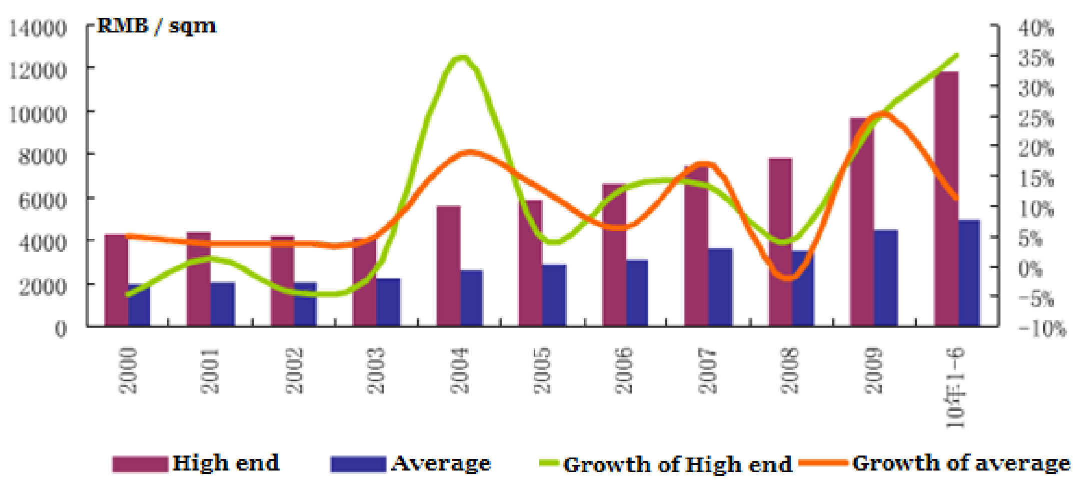


The sold area of high end residential projects has been increasing steadily from 1997 to 2007. The number dropped dramatically in 2008 because of the global financial crisis, but picked up quickly in 2009, reached 48 million sqm.



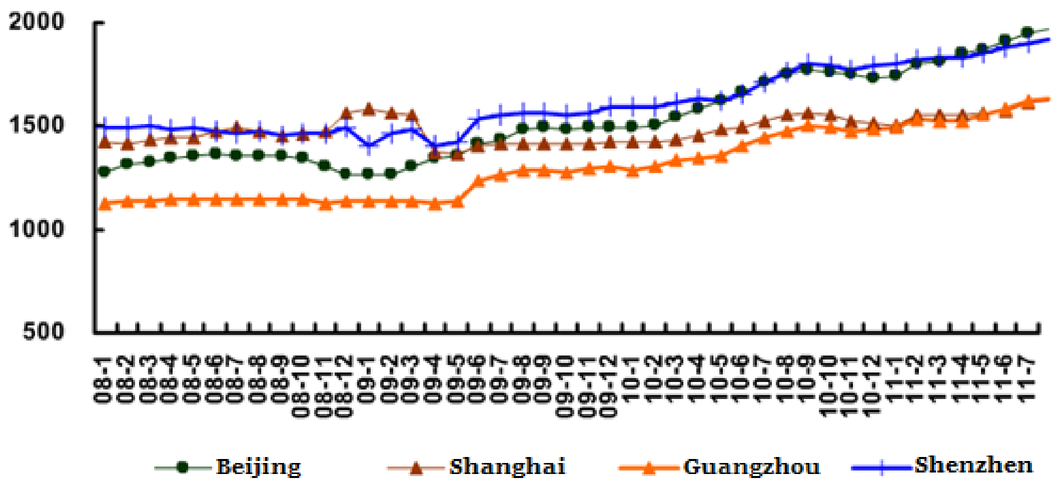
The average selling price of high end residential projects rose steadily from RMB 4,000 per sqm to around RMB 12,000 in 2010. Notably, the price was resilient even in 2008 crisis period.

Selling Price of High End and Average Residential Projects



In leasing market, the rental of high end residential apartments and villas are rising steadily from 1998 to 2011. The rents increased about 40% in this period. Rental increase has been lagging the sale price, because huge investment demand has been pressing the property yield. Compared with other asset classes, high end residences are among the most favorite investment asset for China's HNWIs. While it's noticeable the real living demand of high end residence also increases rapidly, together with the fast development of the economy. Especially from 2009, the booming high end service industries attracted large amount of high end professionals, bankers, managers. Rents accelerated its rising paces in recent years.

Rental Index for High End Residence



We believe the booming of China's high end residential market mainly due to three driving forces:

- The foremost driver is China's strong economic growth and prosperity of the capital market. Over the past decade China has maintained economic growth above 8%, creating huge wealth and lots of high income families, which built a solid foundation for the increasing demand for high end residence.
- The second driving force is the concentration of wealth. With the development of private economy and the prosperity of the capital market, a considerable China's wealth is concentrated in the hands of high-income group. Wealthy Chinese families are allocating large portion of their wealth in real estate. Wealth has been concentrating in the scarce assets such as prime real estates and luxury villas. The value of high end residence continues to rise.
- The third driving force is to avoid the concentration risk. Most wealthy families accumulated their wealth through business. But private businesses are subject to various risks in China and could be very fragile. Many wealthy families choose to diversify their wealthy by allocating their business profit to real estate. High end residential with its scarcity, uniqueness and usability of high end people become the preferred investment.

Due to these three drivers, we believe high end residence will keep its momentum in the foreseeable future.

Product and Supply of High End Residence

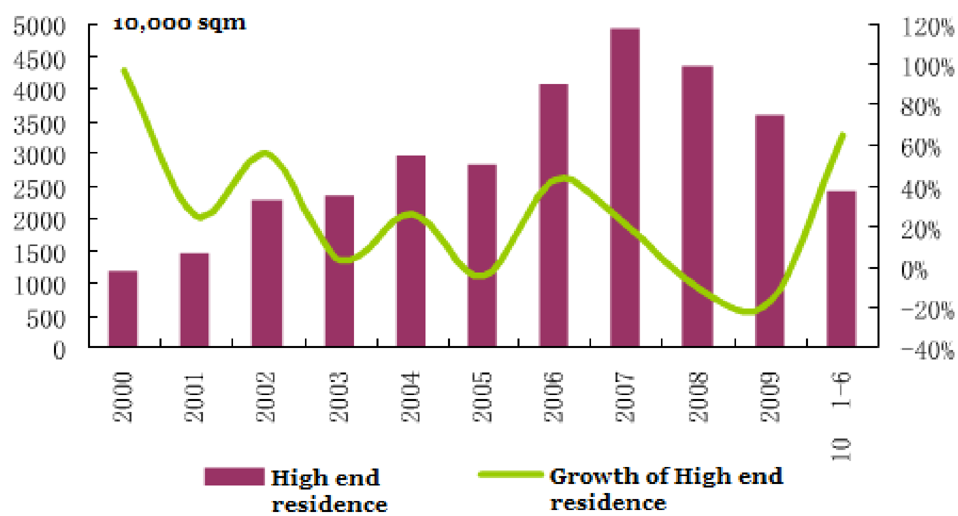
High end residential villas and apartments in general have area of greater than 150 square meters with plot ratio less than 1.0. High end residential community normally requires a good location, beautiful environment, complete facilities and modern property management.

• Villa – normally located in the suburbs or a scenic garden-style residential building, generally has its own private garage, garden, lawn, yard, etc. According to specific grades, villas in descending order can also be divided into single-family house, villas, town houses.

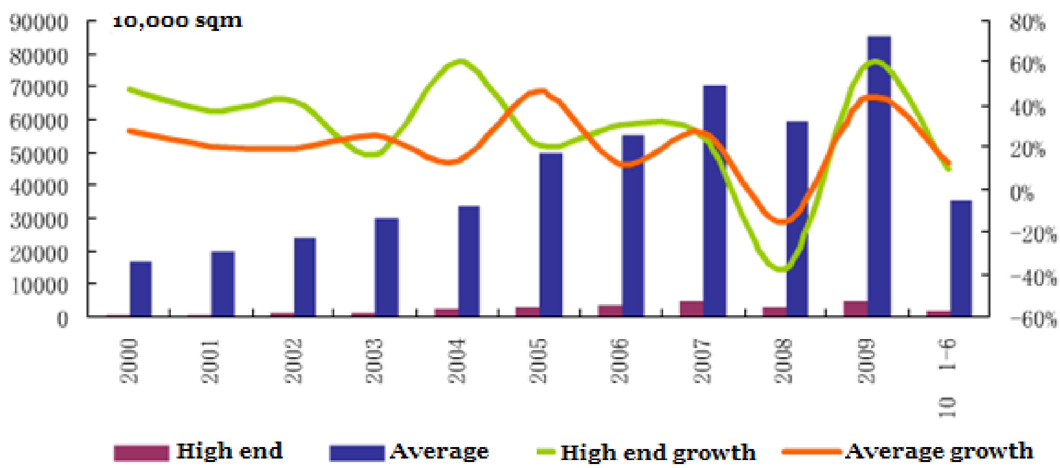
• High end apartment – normally with price more than double the local average residential sale price. High-grade apartments and office center is generally located in commercial areas with high quality by good brand developers.

According to the data from China Index Research Institute, from 2000 to 2010, new construction area of China's high end residential projects reached approximately 340 million square meters, i.e. about 1.7 million units. High end residential sales account for about 5% of the residential area in total.

New Start Construction Area of High End Residence



Sold Area of High End Residence and Average Residence



The supplies of high end residential projects are diminishing over recent years. One of the main reasons is the limited land supply for those projects. On one hand there is very limited prime land left within the traditional central areas and the cost for relocation and demolition become more and more expensive. One the other hand, the government encourages high density residential projects which can save land spaces and discourage villas or projects with low plot ratio. Such policies make low density projects even scarcer and laid a firm foundation for the prices of such projects.

Demand of High End Residence

The demand of high end residence can be divided into two parts:

- The living and investment demand of high net wealth families, high income professionals
- Foreigners, including managers of multi-national corporations and foreign businessmen or investors

According to China Private Wealth report issued by China Merchants Bank in 2011, the number of high net wealth families is rising rapidly. In 2010, there are approximately 500,000 Chinese people have investable assets more than RMB 10 million. The average investable money estimated about RMB 30 million. The group of people in total control RMB 15 trillion. By the end of 2011, the number of high net wealth individuals will reach 590,000, with total investable assets more than RMB 18 trillion.

According to another report issued by Hoogewerf in 2010, there are 875,000 Qianwan people (with assets more than RMB 10 million) and 55,000 Yiwan people (with assets more than RMB 100 million). Among them, Beijingers are the most with 151,000 Qianwan and 9,400 Yiwan. Millionaires from Guangdong rank the second with 145,000 Qianwan and 8,200 Yiwan. Shanghai ranks the third with 122,000 Qianwan and 7,300 Yiwan. HNWIs from above three places comprise almost half of the total group.

For those millionaires, the demand for high end residential places are multi-facets. On one hand is the living demand for their prime and secondary living spaces. The living demand may extend to their relatives or friends, including parents, siblings, partners and friends. On the other hand, the investment demand played an even more important role for HNWIs. Many of them bought tens or hundreds of properties just for investment.

Foreigners with long stay permits are rising in recent years. According to data from police agencies, there are more than 500,000 foreign residents in China. In Beijing only, there are over 65,000 foreigners formally registered with professions living more than 1 year. According to Korean associations in China, there are about 100,000 Koreans stayed in Beijing. Foreigners can normally afford higher quality residences and more expensive rents. It's an important driver for both sales market and leasing market of high end residential projects. The estimate demand for this group is about 400,000 units.

In summary, the demand for high end residence is continuously strong, mainly driven by increasing number of domestic HNWIs and high level foreigners. The increasing strong demand will lay a strong foundation for the high end residential market.

Polices and Trend in the Future

The price of commodity houses rose sharply in 2010 countrywide, especially in tier 1 and tier 2 cities. The government came to realize the importance of regulation in the industry to the nation's stability and economic healthy after the sharp price surges in 2009-2010.

The government promulgated a number of restrictive policies to contain the red hot housing market, mainly in three ways:

1. Increase supply: encourage the construction of subsidy housing and protection housing
2. Restrict investment demand: implement purchase quota in tier 1 cities or selective tier 2 cities; Increase property tax;
3. Squeeze the cashflow of developers: restrict banks, trusts and other financing facilities to developers

In the short term, purchase quota policy and financing restriction policy will be more effective to contain the housing price. While in the long run, subsidy housing and property tax policy will be more important measures to shift the market outlook.

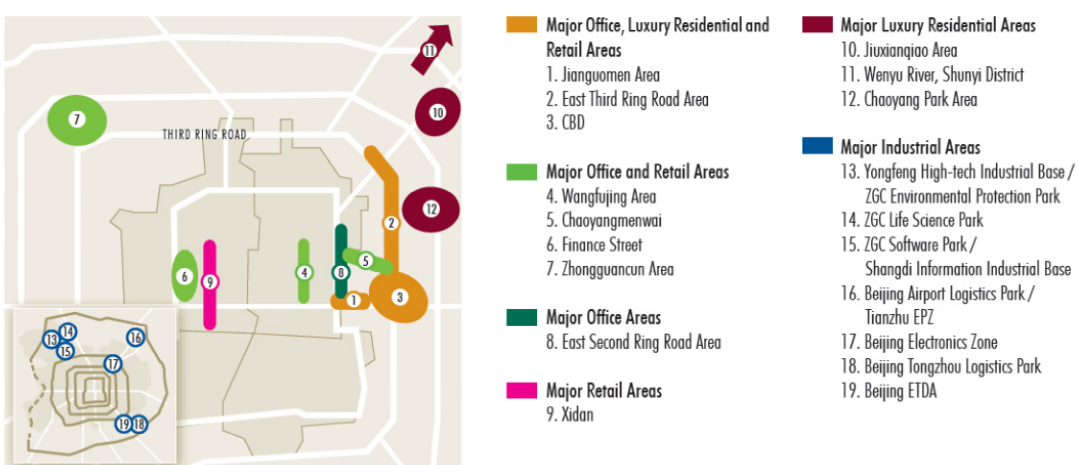
Under the restrictive measures, housing prices reached their inflection point. Mid-Low end commodity houses will be the first to be affected. The price in suburban areas began to drop. High end houses within the core city areas however are more resilient. The price could probably stay steady for a long time. The reasons behind the resilience of high end residence are two folds: high income families will be more selective and prefer to high end housing under the purchase quota polices; the scarcity and limited supply of prime lands made the investors reluctant to withdraw from this asset class.

The restrictive policies would not stop in the short term. But with the severe international financing environment and the threat of second dip, together with the slowdown of domestic infrastructure investment, China's economy will face a difficult time. There is a chance the government will relax the restrictive policies to steam up the property industry another time to propel the economy. After all the industry address the biggest demand and is said to drive more than 25 other industries. Moreover, local government's revenue is highly depended on the sale of land pieces. We believe the governments do not want to see price drop significantly, but want to maintain a steady property price.

Beijing High End Residential Market

Affected by the previously released control measures, demand in the Beijing high end residential sales market has been restrained, accompanied by the scale-back in new supply. In order to ensure stable performance of housing prices, the Beijing municipal government modestly approved pre-sale licenses for luxury residential projects during the whole quarter, resulting in an easing back of new supply for the first half of the year. Meanwhile, the uncertainty of the market drove developers to resume their fence-sitting strategy and postponed new launches. The pent-up demand caused by home purchase restrictions polarised the luxury residential prices. Projects focusing on attracting demand for improved living standards, which are usually located far from the core business districts and feature relatively low prices, started offering meaningful discounts to promote transactions. On the other hand, backed on its limited supply, some luxury projects in the central areas raised their prices notably to improve their profiles. The mixed performance led to a narrow increase of average prices, up 1.9% q-o-q to RMB 54,805 per sqm. The luxury residential leasing market remained active with steadily increasing demand registered. Within the quarter, the market experienced a lower vacancy rate and saw a growth in asking rentals. The average rental of luxury apartments rose 1.7% q-o-q to RMB 109.9 per sqm per month.

Beijing Major Micro Markets



Shanghai High End Residential Market

On entering May, Shanghai luxury residential market revived, reflected by growing transactions along with increasing new supplies which devoted new vitality to the sector. Average prices of luxury apartment edged up 0.9% q-o-q to RMB 57,604 per sqm. Luxury projects in traditional areas such as City Castle, Seasons Villas and Sun Ville all launched a new batch of units during the quarter. Meanwhile, projects such as The Bay and Tudor Villa debuted in the same period. New supply in April and May rebounded by 260% over the monthly average level of last quarter, though this only amounted to 77% of the monthly average seen in the first quarter of 2009, before the latest round of real estate control measures. Average monthly transactions in April and May also revived by 38% compared to the monthly average of last quarter. Digestion of the tightening policies and increasing supplies were seen as the main drivers to warm up transactions. However, the growth of transaction lagged behind notably than that of new supply, which boosted inventory in tandem. In the expectation of further tightening monetary policy due to the further hike of RRR by PBOC, developers will face more challenges from increasing competition and tightening funding sources should the house purchase restrictions continue. During the second quarter, 300 units of the Star River apartment, which is located in Pudong area, came on stream and led a mild swell of vacancy rate of luxury apartment leasing market. The buoyant economic activities rendered support to the market on the whole and upheld rents of the sector with a slight increase of 0.2% to RMB 148.3 psm per month.

Shanghai Major Micro Markets

Guangzhou High End Residential Market

Prices of Guangzhou luxury apartment schemes were not depressed by the tightening policies in the second quarter, albeit with thin transactions recorded. Quite a few high-end schemes were nearly sold out, while new supply was in shortage in recent months. Prices were thus upheld, and some premium residential schemes with scarce natural resources launched with aggressive quotations, pushing average prices to RMB 29,596 psm, up 5.2% q-o-q.

The average rents of Guangzhou luxury apartments continued to increase upon completion of some premium schemes. The rent averaged at RMB 61 psm per month, growing 5.1% q-o-q in the quarter. The Onelink, located in Tianhe Sports Centre business area, was completed this quarter, providing around 400 units to the market. The Onelink is a portion of a complex scheme, including an office tower, two apartment towers and a retail podium. While The Onelink is for strata-titled sale, units from another tower will be served as serviced apartments operated by Frasers Hospitalities. This is debut of the operator company in Guangzhou market.

The land sales market cooled down somewhat in the first half of 2011. Nevertheless, some large developers are actively seeking opportunities for consolidation in the downturn of the market. Vanke announced it has obtained a villa scheme under construction in Panyu District for a total consideration of RMB 3.1 billion. The scheme occupies a total land area of 340,000 sqm with a designated GFA of 572,000 sqm, around one-fifth having been already completed or under construction.

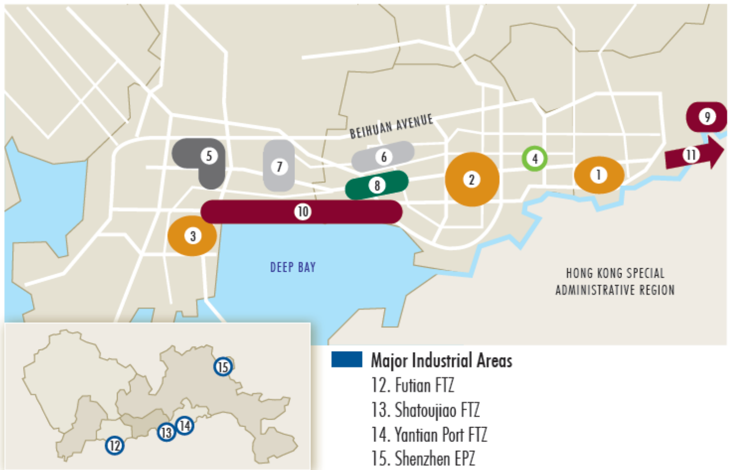
Guangzhou Major Micro Markets

Shenzhen High End Residential Market

There were initial signs of price correction for Shenzhen in the luxury residential market, which recorded an average price of RMB 39,385 per sqm in the second quarter, down 0.9% q-o-q. The municipal government adopted new measurements to restrict prices for new residential schemes in the quarter. Park Mansion, recently launched for pre-sale in Shekou and was capped at RMB 35,000 per sqm, lower than other schemes sold in the adjacent area.

During the quarter, the luxury leasing sector was boosted by the improvement of infrastructure such as the completion of the second phase of Shenzhen Metro. Supported by increasing leasing activities, average rent rose by 1.1% q-o-q to RMB 73.3 per sqm per month.

Shenzhen Major Micro Markets



Major Industrial Areas
12. Futian FTZ
13. Shatoujiao FTZ
14. Yantian Port FTZ
15. Shenzhen EPZ

Major Office, Luxury Residential and Retail Areas
1. Luohu CBD
2. Futian CBD
3. Houhai (Nanshan CBD)

Major Office and Retail Areas
4. Huaqiangbei

Major Office and Industrial Areas
5. Nanshan High-tech Industrial Park

Major Retail and Luxury Residential Areas
6. Honey Lake
7. Overseas Chinese Town (OCT)

Major Office Areas
8. Chegongmiao

Major Luxury Residential Areas
9. Liantang
10. Mangrove Area
11. Dameisha

Summary and Outlook

High end residential market has been thriving for ten years. The annual sold area increased dramatically almost every year. The selling price has been rising together with the improvement of the quality. There are three major drivers:

1. Fast economic development incubated a big group of high net wealth families
2. The scarcity of the prime high end real estates
3. High end residential properties become a major investment vehicle

The government promulgated a series restriction measures to mitigate the uprising trend of commodity housing. These measures will effectively cool down the residential market in the short term and will slow down the transactions. But due to the strong real demand from upgraders, foreigners and high income professionals, the rental market will be very strong together with rents and occupancy rates both hiking. The rising rent will lay a solid foundation for the sale market. The price of high end residence will not drop significantly due to its scarcity. We believe it’s still an attractive asset class for investment, given the expectation that the number of wealth families should continue to increase.

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My Decker Capital is a China focused investment banking and asset management company. The company was established in 2007 and moved its headquarter from New York to Beijing in July 2008. The company's business includes: Advisory, Asset Management, Research and Capital Market. My Decker Capital's main shareholders are from the United Stated and Russia and its professional team members are bilingual with extensive investment or corporate finance experience. My Decker Capital's clients include mid to large Chinese and International companies and professional investors. Its focused sectors are Real Estate, Consumer Products and Retail.

My Decker Capital manages its own private equity fund focused on investing in retail and consumer products industries. It successfully completed $40 million investment into a leading Chinese retail chain: Beijing New Cooperation Supermarket Chain. Tianjin My Decker Capital Fund, a RMB Fund, intends to benefit from the China urbanization process and is interested in investing in real estate projects. My Decker Capital's professional team would like to work with Chinese entrepreneurs with advanced management skills and clear vision together and deliver superior returns for investors.

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