

Urban Land Institute

Mainland China

Real Estate Markets 2012

ULI Analysis of City Investment Prospects

城市土地学会

2012年中国大陆主要城市房地产 投资前景分析

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About ULI

The Urban Land Institute is a 501(c) (3) nonprofit research and education organization supported by its members. Founded in 1936, the Institute now has nearly 30,000 members worldwide representing the entire spectrum of land use and real estate development disciplines, working in private enterprise and public service. As the preeminent, multidisciplinary real estate forum, ULI facilitates the open exchange of ideas, information, and experience among local, national, and international industry leaders and policy makers dedicated to creating better places.

The mission of the Urban Land Institute is to provide leadership in the responsible use of land and in creating and sustaining thriving communities worldwide. ULI is committed to bringing together leaders from across the fields of real estate and land use policy to exchange best practices and serve community needs by

- Fostering collaboration within and beyond ULI's membership through mentoring, dialogue, and problem-solving;
- Exploring issues of urbanization, conservation, regeneration, land use, capital formation, and sustainable development;
- Advancing land use policies and design practices that respect the uniqueness of both built and natural environments;
- Sharing knowledge through education, applied research, publishing, and electronic media; and
- Sustaining a diverse global network of local practice and advisory efforts that address current and future challenges.

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The ULI Center for Capital Markets and Real Estate focuses on real estate finance, real estate industry and investment trends, and the relationship between the capital markets and real estate. The mission of the Center is to promote understanding of the real estate capital markets and to provide leadership in fostering a healthy and productive real estate industry and capital markets sector that in turn promote thriving and sustainable communities worldwide. The Center pursues this mission through research, trend analysis, education, events, publications, web-based resources, advocacy, and thought leadership.

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Across Asia Pacific and Japan, the Institute has nearly 1,000 members, with a particularly strong presence in Japan, Greater China, Southeast Asia, and Australia. The regional office is headquartered in Hong Kong, with satellite offices in Tokyo and Singapore. ULI APJ brings together industry leaders with a common commitment to improving professional standards, seeking the best use of land, and following excellent practices. By engaging experts from various disciplines, the Institute can arrive at responsible answers to problems that would be difficult to achieve independently. ULI APJ shares its knowledge through various discussion forums, research, publications, and electronic media. ULI's activities in the region are aimed at providing information that is practical, down to earth, and useful so that on-the-ground changes can be made. By building and sustaining a diverse network of local experts in the region, the Institute is able to address the current and future challenges facing Asia's cities.

ULI Asia Pacific and Japan Vision Statement

ULI is the acknowledged authority for policy information and best practices in land use in the Asia Pacific region.

Supporting principles:

- Collaboration with universities, government agencies, and like-minded organizations strengthens and disseminates the Institute's expertise.
- Priority initiatives effectively address local land use issues.
- High-quality programmes enhance the integrity of the Institute.
- Substantial interdisciplinary membership is engaged throughout the region.

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Contents

Executive Summary	2
Introduction	4
Chapter 1: Investment and Development Prospects	8
Investment Prospects	9
Development Prospects	10
Buy Recommendations by Sector	11
Discussion	11
Chapter 2: Issues Affecting Development and Investment Strategies	14
Issues with Moderately Negative Impact	15
Issues With Little or No Impact	19
Chapter 3: Investment Prospects by Region	22
Southwest China	23
South China	28
East China	31
Northeast China	36
Northwest China	38
North China	39
Central China	41
Chapter 4: What's New? What's Next?	44
Housing for Seniors and Retirement Housing	44
Affordable Housing	45
Serviced Apartments	45
Resorts	45
Business Parks	46
Summary	46

Executive Summary

*M*ainland China Real Estate Markets 2012: ULI Analysis of City Investment Prospects reports on the investment and development prospects of 28 Mainland China cities and related issues, as evaluated by real estate industry leaders active in Mainland China.

City Investment and Development Prospects

- ▷ The five top-rated cities for investment prospects are, in descending order, Chengdu, Shanghai, Hangzhou, Wuhan, and Shenzhen. Three of these cities—Chengdu, Shanghai, and Wuhan—are also the highest rated for development prospects.
- ▷ Chengdu remains strong in its number-one ranking for overall investment and development prospects. Respondents continue to be impressed by the transformation of this inland city over the last decade into a leading market for corporations seeking to relocate operations from higher-cost coastal sites.
- ▷ Of the existing mature investment destinations, only Shanghai and Shenzhen continue to hold on to their rank in the top five of the 28 cities, not only because of their growing interconnectedness to cities in their urban constellations through high-speed rail, light rail, and metro, but also because of the undiminished sense of their being attractive places to live and work. Shanghai, despite the vast scale and depth of its real estate market, also impressed the survey respondents as a city that still has room for development.
- ▷ The clear tendency to assign high scores to cities that attract the best and brightest talent accounts for Hangzhou's dramatic jump to third place for investment prospects. In addition to being the cradle of a number of successful new-economy companies, Hangzhou offers scenic beauty that attracts a steady stream of domestic and overseas tourists, keeping its retail and hospitality sectors humming. Travel time to Shanghai has been halved via a recently completed high-speed railway, adding to Hangzhou's appeal.
- ▷ The cities traditionally classified as Tier 1 do not automatically achieve high ranking just because of their mature city status. Beijing and Guangzhou, for example, fare less well in this year's survey, with respondents cooling towards Beijing and with Guangzhou being left essentially treading water in its former mid-ranking position.
- ▷ Other than the few notable exceptions described above, respondents are somewhat cautious about the prospects for China's already mature northern, eastern, and southern coastal cities.
- ▷ Interest is strong and rising in inland cities—not only Chengdu, but also Wuhan, Xi'an, and Changsha. These cities were all direct beneficiaries of the three successive waves of promotion campaigns rolled out by China's central government from 2000 to 2007 to use policy settings to re-direct investment away from coastal hubs towards the less developed interior. The target of steering more investment towards these inland areas is further reiterated in the current 12th Five-Year Plan.
- ▷ A number of inland cities have begun to participate directly in China's information technology boom, and they are now better positioned to retain college graduates, who previously flocked to Beijing and Shanghai. This factor is especially significant for cities such as Chengdu, Wuhan, and Xi'an, which have strong bases of higher education.

Impact of Recent Government Tightening Measures

- ▷ Financially strong China developers, as well as overseas and domestic financial institutions and funds, have started to find opportunities in the correction that has been taking place in China's urban residential markets since early 2010. These opportunities are beginning to surface in the form of more chances to acquire development sites or stakes in already launched development projects. Although many financially stretched developers are still asking for a premium for those sites which they are being compelled to dispose of, this will likely change later this year as the clampdown continues.
- ▷ The current clampdown on the residential sector was generally not viewed as being a short-term policy direction of the central government. In response, larger developers who have previously been highly reliant on residential sales are gradually adjusting their portfolios by increasing their commercial component. In many cases, however, this shift had already begun before the imposition of the present residential market curbs, the change in policy settings merely serving to accelerate the process.
- ▷ Smaller or more financially strapped developers who are unable to make this shift are increasingly turning to enlarging the commercial element in their portfolios offered for strata-title or en bloc sale to make up for the persisting fall in their residential sales revenues. By contrast, larger developers with greater access to external sources of finance and who presently have limited commercial property exposure voiced a greater inclination to hold on to the best commercial elements in their portfolio as sources of recurring income.
- ▷ As a means to broaden their tax base, some local governments are now increasing the size of the required commercial component in sites newly put up for sale for mixed-use commercial/residential developments. For sites actively under development, they have begun to step up their insistence that the remaining floor area be developed for commercial end use, in accordance with the terms of the percentage mandated by the original land use agreement.
- ▷ Given the prevailing political winds, with development of luxury residential property now not being strongly favoured by the central government, many developers are moving to focus a larger portion of their residential development activity away from the high-end segment and more towards developing residential units targeted at middle-class, first-time homebuyers.
- ▷ In contrast, only a small number of financially strong, national-level developers intend to devote part of their resources to the narrow-profit business of developing price-capped affordable housing because the chief gain that can be achieved from engaging in this kind of socially responsible development activity is storing up goodwill with local government authorities. Henceforth, developing low-income housing projects will remain mainly the domain of local developers, but most especially a select group of national-level developers as well as local state-owned developers.
- ▷ Overall, survey respondents and interviewees did not express concern for the medium- to longer-term outlook for China's economy, although some parties interviewed stated that they would be more cautious about investing in projects in sectors or geographies that are heavily exposed to the vagaries of China's foreign trade and external economy.

Mainland China Real Estate Markets 2012

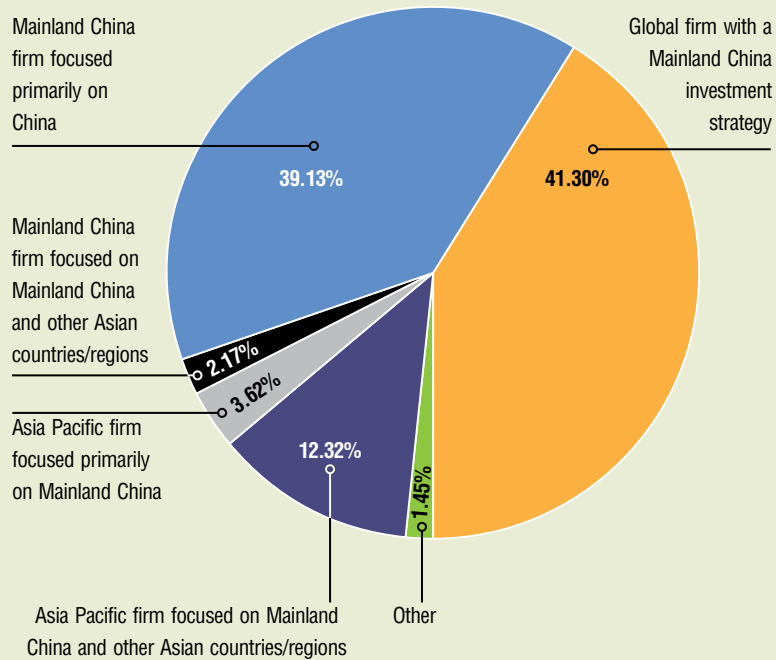
ULI ANALYSIS OF CITY INVESTMENT PROSPECTS

Introduction

*M*ainland China Real Estate Markets 2012: ULI Analysis of City Investment Prospects, the second annual ULI survey covering China cities, focuses on real estate development and investment prospects in 28 of the largest Mainland China cities over the next 12 months. Insights and expert opinions were collected through 138 surveys of and 40 interviews with real estate industry leaders in Mainland China and Hong Kong: 72 percent of the survey respondents and 55 percent of the interviewees are based in Mainland China, with the balance almost entirely based in Hong Kong. In addition, 41 percent of the survey respondents and 38 percent of the interviewees are with Mainland China firms, 41 percent of respondents and 27 percent of the interviewees are with global firms, and 16 percent of respondents and 36 percent of interviewees are with Asia Pacific (excluding Mainland China) firms. Survey respondents and interviewees were ULI members or had been otherwise identified by ULI Asia Pacific as being involved in Mainland China real estate.



Survey Responses by Geographic Scope of Firm



Source: *Mainland China Real Estate Markets 2012 survey.*

The survey, undertaken in the first two weeks of March 2012, first assesses each city's overall investment and development prospects. Respondents were then asked to indicate their recommendations for each city regarding buying, holding, or selling real estate by property sector—office, retail, industrial, hotel, and apartment residential. Respondents were also asked about the nature of their real estate activity by sector, recent changes, and issues affecting those changes. Interviewees were asked analogous questions.

The 28 cities—up from 16 covered in the pilot 2011 *China Cities Survey*—include seven metropolises with urban populations ranging from 8.5 million to 19.6 million, an additional 20 cities with populations ranging from 1.6 million to 6.4 million, and only one city of less than 750,000. The cities are considered Tier 1, Tier 2, and Tier 3, as well as Tier 4 cities transitioning towards Tier 3, according to their size and function as key economic centres. The survey was intended to focus on cities commonly perceived to be among the strongest economically.

Population (in Millions), 1995–2025

	1995	2010	2025 ^a	1995–2010 Growth	
				Change	Percent
Shanghai ^b	10.45	19.55	28.40	9.10	87%
Beijing ^b	8.31	15.00	22.63	6.69	81%
Guangzhou ^c	4.74	10.49	15.47	5.74	121%
Shenzhen	2.39	10.22	15.54	7.83	327%
Chongqing ^b	4.82	9.73	13.63	4.91	102%
Wuhan ^c	4.76	8.90	12.73	4.14	87%
Tianjin ^b	5.51	8.54	11.93	3.02	55%
Chengdu ^c	3.53	6.40	9.97	2.87	81%
Nanjing ^c	3.15	5.66	8.50	2.51	80%
Harbin ^c	3.05	5.50	8.21	2.45	80%
Shenyang ^c	4.08	5.47	7.43	1.39	34%
Hangzhou ^c	2.16	5.19	8.45	3.03	140%
Xi'an ^c	2.82	4.85	6.93	2.02	72%
Qingdao	1.88	3.68	5.44	1.80	96%
Dalian	2.31	3.31	4.48	0.99	43%
Suzhou	1.08	3.25	5.83	2.17	200%
Wuxi	1.35	3.22	5.14	1.87	139%
Changsha ^c	1.54	3.21	4.94	1.67	108%
Urumqi ^d	1.40	2.95	5.06	1.55	111%
Fuzhou ^c	1.32	2.80	4.24	1.48	113%
Shijiazhuang ^c	1.62	2.74	4.19	1.12	69%
Xiamen	0.95	2.70	4.87	1.75	184%
Wenzhou	1.32	2.64	4.04	1.32	100%
Ningbo	1.02	2.63	4.26	1.61	158%
Lanzhou ^c	1.56	2.49	3.61	0.93	59%
Nanning ^d	1.12	2.10	2.91	0.98	87%
Haikou ^c	0.49	1.59	2.28	1.09	221%
Sanya		< 0.75			

Source: United Nations, Department of Economic and Social Affairs, Population Division, Population Estimates and Projections Section, World Urbanization Prospects, World Urbanization Prospects. The 2011 Revision Data report, used here, is for urban agglomerations, which refer to the de facto population contained within the contours of a contiguous territory inhabited at urban density levels without regard to administrative boundaries. It usually incorporates the population in a city or town plus that in the suburban areas lying outside of but adjacent to the city boundaries. This source tracks only cities with an urban agglomeration of 750,000 or above.

a. Projections. b. Municipality with provincial status.
c. Provincial capital. d. Autonomous region capital.

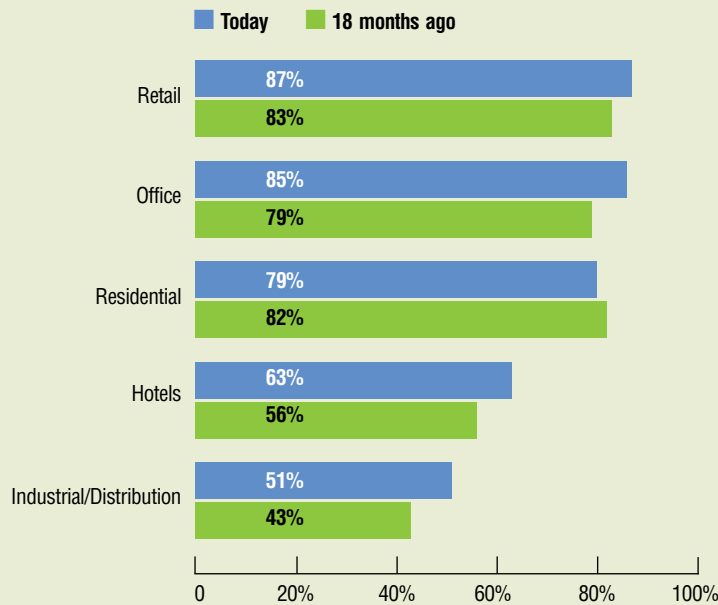
2010 Gross Regional Product

	RMB (Billions)	\$ US (Billions)
Shanghai	1,716.6	253.6
Beijing	1,411.4	208.5
Guangzhou	1,074.8	158.8
Shenzhen	958.2	141.5
Suzhou	922.9	136.3
Tianjin	922.4	136.3
Chongqing	792.6	117.1
Hangzhou	594.9	87.9
Wuxi	579.3	85.6
Qingdao	566.6	83.7
Wuhan	556.6	82.2
Chengdu	555.1	82.0
Ningbo	516.3	76.3
Dalian	515.8	76.2
Nanjing	513.1	75.8
Shenyang	501.8	74.1
Changsha	454.7	67.2
Harbin	366.5	54.1
Shijiazhuang	340.1	50.2
Xi'an	324.1	47.9
Fuzhou	312.3	46.1
Wenzhou	292.5	43.2
Xiamen	206.0	30.4
Nanning	180.0	26.6
Urumqi	133.9	19.8
Lanzhou	110.0	16.3
Haikou	59.5	8.8
Sanya	23.1	3.4

Source: National Bureau of Statistics of China.

Sector Involvement by Percentage of Respondents

Today and 18 months ago*



Source: *Mainland China Real Estate Markets 2012 survey*.

*As of survey date (March 2012).

As a group, the survey respondents are diversified in their sector involvement and slightly more so now than in 2010:

- ▷ The vast majority of respondents are active in the retail sector (87 percent of the survey respondents), office sector (85 percent), and residential sector (79 percent). Slightly more respondents are involved in the retail and office sectors today compared with 2010, whereas involvement in the residential sector inched down.
- ▷ A smaller majority of respondents are active in the hotel sector (63 percent) and industrial/distribution sector (51 percent). Involvement in those sectors has also increased slightly since 2010.

Investment Prospects

The two top-rated cities for overall investment prospects remained the same as in last year's survey: Chengdu, a Tier 2 city with an average score of 3.58, and Shanghai, a Tier 1 city with a score of 3.55. According to the standardized rating scales, Chengdu, although still rated first overall, has a slightly lower score this year, and Shanghai, although remaining second, has a slightly higher score. From a global perspective, eight of the 51 U.S. cities covered in *Emerging Trends in Real Estate® 2012* had higher scores than Chengdu's and Shanghai's standardized scores, and four of the 27 cities covered in *Emerging Trends in Real Estate® Europe* had higher scores than Chengdu and Shanghai. (It should be noted that the *Emerging Trends* surveys for the Americas and Europe were conducted respectively seven and four months earlier than the China survey.)

Investment ratings for the next seven cities (third to ninth place)—Hangzhou, Wuhan, Shenzhen, Chongqing, Nanjing, Qingdao, and Beijing—range from 3.36 to 3.29. All are Tier 2 cities except for Shenzhen and Beijing, which are Tier 1 cities. All seven cities were in last year's survey.

- ▷ Hangzhou and Shenzhen jumped dramatically to third and fifth place, respectively, in this year's survey from 13th and 11th place in last year's survey of only 16 cities.
- ▷ Wuhan moved up to fourth place from sixth.
- ▷ Qingdao remained in eighth place.
- ▷ Chongqing, Nanjing, and Beijing fell to sixth, seventh, and ninth place, from third, fifth, and fourth place, respectively, last year.
- ▷ Of these seven cities, only Hangzhou's rating score increased this year compared to last year; all the other cities' scores declined, with Beijing, Chongqing, and Nanjing experiencing the largest declines.

Investment ratings for the cities in tenth to 15th place—Changsha, Xiamen, Wuxi, Suzhou, Guangzhou, and Dalian—range from 3.23 to 3.18. All are Tier 2 cities except for Guangzhou, which is a Tier 1 city, and all but Xiamen were in last year's survey.

- ▷ Changsha jumped to tenth place from 15th place, and its rating score inched up.
- ▷ Dalian dropped to 15th place from seventh place and had one of the largest drops in rating scores.
- ▷ Wuxi, Suzhou, and Guangzhou remained relatively stable at 12th, 13th, and 14th place, respectively, although all rating scores declined this year compared to last year.

The remaining 13 cities—a mix of Tier 2, 3, and 4 cities—range from 3.14 to 2.63, although the lowest rated, Lanzhou, was not even a full rating point below Chengdu, the highest rated.

Development scores for the cities in fourth to eighth place—Chongqing, Changsha, Wuxi, Nanjing, and Xi'an (all of which are Tier 2)—range from 3.53 to 3.41. These scores, when standardized, are higher than all but three U.S. cities and three European cities rated for development prospects in the *Emerging Trends* surveys.

Chongqing, Changsha, Wuxi, and Nanjing were in last year's survey:

- ▷ Chongqing slipped to fourth place this year from second place last year.
- ▷ Changsha jumped to fifth place from 14th place.
- ▷ Wuxi moved to sixth place from 11th place.
- ▷ Nanjing is seventh this year, slipping from sixth place last year.
- ▷ Changsha's rating score increased this year, whereas those of Chongqing, Wuxi, and Nanjing declined.

Development ratings for the cities ranked ninth to 17th—Fuzhou, Xiamen, Shenzhen, Dalian, Hangzhou, Suzhou, Qingdao, Beijing, and Guangzhou—ranged from 3.39 to 3.32. These cities are mostly a mix of Tier 1 and 2 cities with Fuzhou being the only Tier 3 city. All but Fuzhou and Xiamen were in last year's survey.

- ▷ Even adjusting for the effect of Fuzhou's and Xiamen's top positions in this group, the rankings of three cities dropped noticeably from last year: Dalian's and Beijing's rankings dropped five positions, and Qingdao's ranking fell six positions.
- ▷ Suzhou dropped just two positions while Shenzhen, Hangzhou, and Guangzhou remained relatively stable.
- ▷ The standardized rating scores of all seven cities included in both years' surveys declined.

Development ratings for the remaining 11 cities (which are Tier 2, 3, and 4 cities) range from 3.27 to 2.68, with the lowest rated, Wenzhou, slightly more than a full point below Chengdu, the highest rated. Two Tier 2 cities—Tianjin and Shenyang—were in last year's survey and experienced the steepest decline of all cities from last year in standardized rating scores.

Buy Recommendations by Sector

Overall, the retail and industrial/distribution sectors received the most recommendations to buy property—rather than hold or sell—followed by the apartment residential, office, and hotel sectors.

Discussion

The respondents to the ULI survey continued to display confidence in at least a portion of China's Tier 1 cities, with Shanghai continuing to rate amongst the highest in both investment and development and Shenzhen jumping from 11th to fifth place in investment

prospects. But the 2012 survey has revealed the emergence of a changed order of preferences for other Tier 1 cities, compared with their Tier 2 rivals. Beijing slipped substantially in this year's poll in both investment and development prospects, and Guangzhou remains in a mid-level position, while Tier 2 Chengdu retained its top position and Tier 2 Huangzhou jumped to third place. Clearly, the perception that a city is mature and developed is no longer sufficient to make it the automatic winner of an investment prospects poll. To convey a sense of how fast China's city ranking is changing, in 2010 Chengdu mayor Ge Honglin addressed the American Chamber of Commerce concerning the city's prospects of attaining Tier 1 status—something he clearly does not view as being an event in the far distant future.

Similarly, a number of what were formerly the top-ranking Tier 2 cities are no longer secure in this position, with some markets, such as Suzhou, now being perceived as having been "overcultivated" in recent years, and others, such as Tianjin, viewed as possibly having an excess of some types of development activity. Finally, given the fairly crowded nature of most of China's larger investment and development markets, as places where few stones have not been turned over at least several times, one leading China investment broker noted: "For most of my big private institutional clients, Tier 3 cities are not even on the radar screen. However, provided that one is able to stomach some Tier 3 risk, it is precisely in some of the bottom-ranked cities in the present survey, such as Harbin in Heilongjiang, which most players overlook as being too distant or opaque, that an occasional deal comes up with risk-adjusted returns that are no longer obtainable in Tier 1 cities." Of course, some investment advisers still would cite numerous reasons to avoid Tier 3 cities generally, but the principle is valid that the best deals are frequently found where there is less competition, provided that one is equipped to understand and assess the risk of operating in these environments.

Although most respondents acknowledged that the original group of Tier 1 cities still held some advantages, for example, with respect to their suitability for developing Grade A offices, respondents to the ULI survey in 2012 were more inclined to view both Tier 1 and Tier 2 cities more holistically, and their awareness of those cities' drawbacks as well as their advantages showed up clearly in the scores awarded. Some of the drawbacks respondents were clearly aware of related to the heightened political sensitivity of undertaking commodity residential development in Beijing amidst the present policy-driven campaign to cool the residential sector and the persistent political gridlock that is causing delay in addressing continuing problems in urban governance, as evidenced by the city's worsening air pollution and traffic congestion. Political risk and local government stability were also clearly on respondents' minds, as indicated by Chongqing's slip in place. By the same token, the persistence of perceived economic risk and headline risk associated with Wenzhou's prolonged underground banking problems were undoubtedly a factor in the near-bottom position for that city. However, given China's policy-intensive political environment and post-survey financial reforms, which aim to allow Wenzhou residents to invest abroad directly, perceptions of the prospects for this city's real estate market may turn considerably more positive.

Conversely, a sense of the continued shift in transnational corporate investment strategies for China, as borne out by the fairly sizeable relocation of some high-tech and knowledge-intensive occupiers away from the southern coast and towards inland cities such as Chengdu and Wuhan—where average sales prices (ASPs) have not been bid up to the same level as the cities of the eastern and southern coast—was definitely a significant factor in these two cities maintaining their high relative positions.

In their assessment of cities' prospects, respondents clearly took into account the quality of life they provide. In an increasingly competitive labour market, with cities jockeying for position with respect to being able to recruit talent, a city's ability to retain graduates from local universities is critical to its overall industrial competitiveness. This factor certainly led some cities with persisting environmental problems, such as Shijiazhuang and Lanzhou, to be ranked at low positions. Contrariwise, a city such as Hangzhou, whose attractiveness is perceived not only by the residents of surrounding Zhejiang province but also by almost the entire Yangtze River Delta, rose to third of all cities surveyed for investment prospects. These investors are drawn by the beauty of the city and its location on the West Lake, which makes acquisition of housing near the lake or apartments overlooking the city's rivers desirable. Investors interested in developing hospitality facilities or retail properties are keen, in turn, to capture the spending of the tourists drawn to the city by the same scenic areas. A similar observation about the basic attractiveness of the city as a place to live and work explains why Shanghai has held onto its high ranking, whereas other Tier 1 cities have seen their positions slip.

China is emerging from a prolonged construction boom, which has witnessed a massive surge of development activity across its Tier 1, Tier 2, and Tier 3 cities. In the context of this boom, some municipal governments released what would appear to be an excessive number of development sites under urban master development plans that will take decades to implement—if ever. Respondents were sensitive to the appearance of such severe potential supply/demand imbalances, as was made apparent by Shenyang's relatively low ranking. Also, in a period when the central government is clearly displeased with cities that have recorded very sizeable rises in residential ASPs, respondents took a cautious view of the prospects of boomtown cities such as Haikou and Sanya on the southern island province of Hainan.

Finally, with respect to some cities, which have already witnessed massive commercial, residential, and industrial development over the past two decades, a sense prevails that "most of the good news about them has already been discounted in their asset prices" and that new entrants in the marketplace will find few pieces of land that have not been turned over several times by someone before them. Hence, despite the consolidation in housing prices that has been underway for more than a year now, ASPs in these formerly top-ranked Tier 2 cities have still not fallen to a level that makes them automatically attractive for residential development. For mature Tier 1 cities such as Guangzhou and well-developed Tier 2 cities such as Suzhou, which clearly fall into this category, respondents displayed only a moderate sense of interest.

Issues Affecting Development and Investment Strategies

In early 2010, the China central government, alarmed again by what appeared to be the re-emergence of runaway home prices, took the following aggressive measures to cool the residential market:

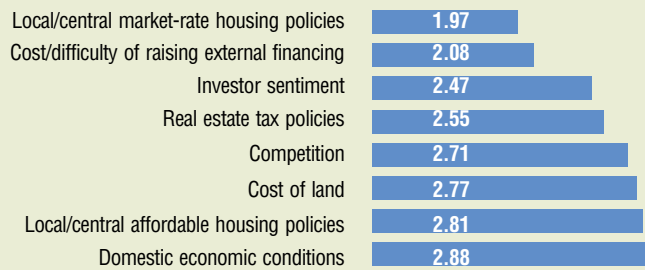
- ▷ Imposed restrictions in 40 cities on the purchase of residential units by nonresidents;
- ▷ Cancelled the 30 percent discount on mortgage interest rates originally available to first-time homebuyers;
- ▷ Increased the downpayment requirement to 30 percent for first-time homebuyers and to 50 percent for buyers of second homes; and
- ▷ Prohibited additional housing purchases by people who already own two homes.

In 2011, the People's Bank of China, again stepping in to increase borrowing costs and tighten liquidity, took the following measures:

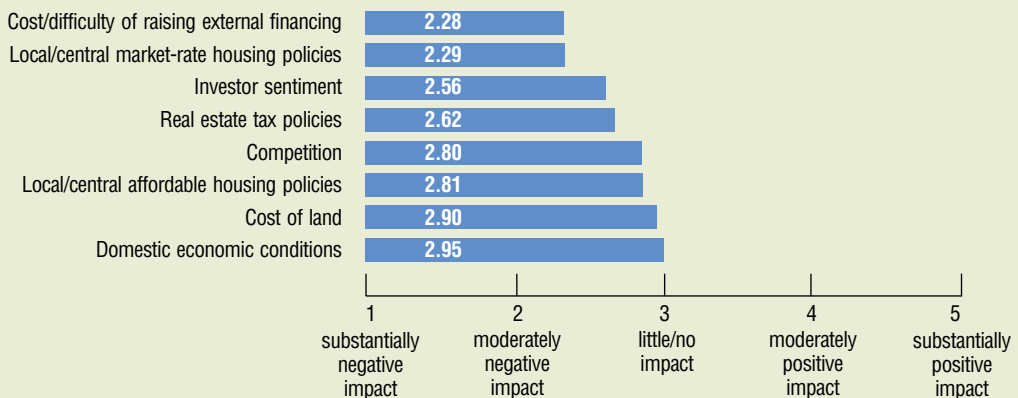
- ▷ Raised interest rates charged by China's state-owned banks six times; and
- ▷ Significantly tightened liquidity in the state banking system by hiking reserve-requirement ratios for state banks seven times.

EXHIBIT 2-1 Impact of Various Issues on Development and Investment since 2010

Impact on development



Impact on investment



Source: Mainland China Real Estate Markets 2012 survey.

By March 2012, 50 cities in China were reported to have released their price cap targets for constraining price increases for commodity housing completed in their cities in 2011. By late March, those same cities released a statement of their goals for constraining price increases for newly built housing. With the exception of Beijing, in which new measures target a price cut, the cities focused on narrowing the growth rate rather than reversing the growth trend.

Against this backdrop, the survey respondents were asked to rate the impact of eight issues on their investment and development decisions over the previous 18 months. Ratings were on a 1 to 5 scale, with 1 being substantial negative impact, 3 little or no impact, and 5 moderately positive impact.

Three issues were rated as having a “moderately negative” impact on their strategies:

- ▷ Local or central government policies on market-rate housing;
- ▷ Cost or difficulty of raising external financing; and
- ▷ Investor sentiment.

The remaining five issues—real estate tax policies, competition, cost of land, affordable housing policies, and domestic economic conditions—were rated as having little or no impact.

Issues with Moderately Negative Impact

The following three issues on the questionnaire survey were rated as having a moderately negative impact on investment and development decisions.

Local- or Central-Government Policies on Market-Rate Housing. Changes in policy during the past 24 months caused a number of major, listed Chinese developers to accelerate preparations to shift away from portfolios heavily reliant on residential sales towards more balanced portfolios, with a larger component consisting of commercial property developed for a longer-term investment horizon. This shift is not a new thing, however; many of the larger, national- and regional-level Chinese developers previously focused entirely on residential sales began making this change as early as three to four years ago, as, in the words of one senior real estate consultant: “Along with China’s major policy swings, which followed the onset of the global financial crisis, many of the bigger players began to realize that it was too risky to place all of their eggs in one basket. It was at this time that they realized that a better balanced portfolio not only would provide income from residential sales, but also would provide a substantial component of recurring income from leased commercial assets, to balance the riskier income from property sales.”

However, switching from a residential sales revenue model to the more mature development model has not proved easy for many China developers, particularly for the medium-sized developers interviewed for this survey, who do not have the financial stamina to develop properties for the longer term, and has compelled them to enlarge the commercial component in their portfolio to be offered for strata-title sale. As one

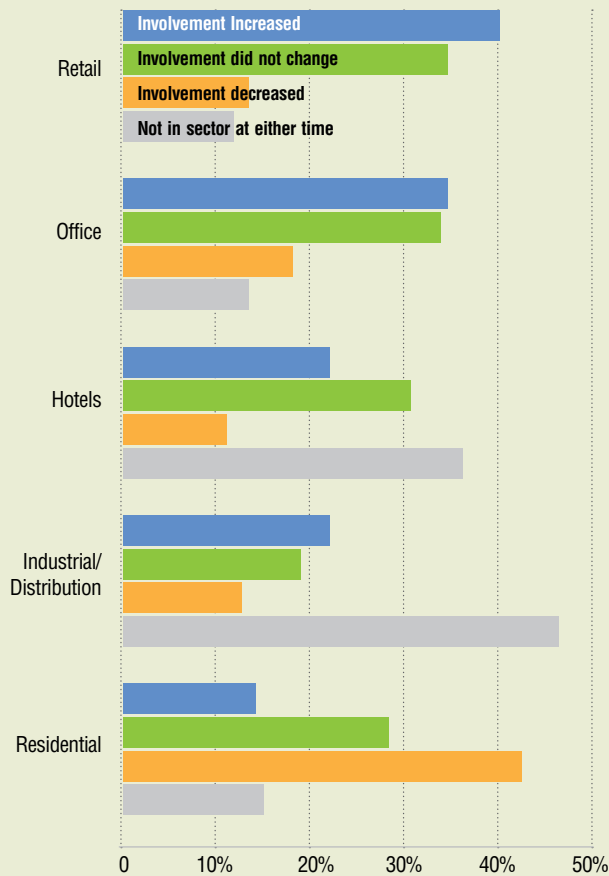
such developer stated in an interview: “We will place more emphasis on developing mixed-use commercial buildings, office buildings, and stand-alone retail buildings. However, in developing such properties (in Tier 2 and 3 cities) we will persist in the ‘build to sell mode,’ even if partially shifting the emphasis of our business away from being primarily focused on the residential sector.”

Even the more financially solid national-level developers face various issues with respect to quickly making this necessary transition. First, their historical land bank mainly consists of sites zoned for developing new urban communities. A second issue is that the skill sets of many of the senior people responsible for such companies’ operations are still largely concentrated in the field of managing residential sales development. Many of even the largest of such companies have not yet put in place the property management and commercial leasing teams that will be required to manage their future retained commercial portfolios. Finally, even over the short term, for many companies the effort of trying to create a more balanced development revenue mix is a burden on their balance sheet, particularly given the present environment in which banks are constrained in offering financing for real estate development. However, equity participation by either domestic or offshore private equity funds may provide a bridge to help manage this transition.

Although effecting this transition is a major item of corporate strategy over the medium term, in the short term, the majority of the merchant homebuilders are under some kind of stress, because sales volumes are still falling and sales prices are softening across most of the geographies in which they are active. The weakest amongst these companies are likely to be acquired by other, financially stronger developers or, at the least, stripped of their land assets. Medium-scale developers may not necessarily buckle under but may be compelled to discount the prices of properties they are currently marketing, in order to clear inventory, or to dispose of all or a portion of their equity shares in some developments that are still at earlier stages.

At the same time, the downturn in the residential sales market has been accompanied by a general cooling of interest in government land auctions. This, in turn, has put local governments under pressure because of their reliance on land sale revenues as a major source of municipal budgetary funding. Consequently, the recent downturn in China’s residential market has compelled municipal governments to seek to widen their revenue base. One means whereby municipal governments are accomplishing this is by gradually increasing the mandatory commercial component in urban sites now being put up for auction or tender. One real estate consultant observed, “By instituting this planning change, not only does government compel the creation of more property suitable for accommodating service industry, but it also allows them to capture more corporate occupiers, which in turn positions them to retain a portion of the corporate taxes payable on the revenues these companies derived from their operations in the city.”

EXHIBIT 2-2
Change in Sector Involvement, by Percentage of Respondents
Today vs. 18 months ago*



Source: *Mainland China Real Estate Markets 2012 survey.*

*As of survey date (March 2012).

Cost or Difficulty of Raising External Financing. For smaller to medium-sized developers who do not have special relations with the domestic banks in Tier 1 and 2 cities where they have developments and who are in need of bank finance to bridge their cash requirements during the construction period, the restrictions that remain in place on bank lending to most types of real estate development projects (with the notable exception of the recent lifting of the ban on financing construction of “ordinary housing” developments) is indeed creating a strain. This strain has been exacerbated by nearly a year of weaker sales performance in the residential market. However, these developers’ financial strain is opening a window for larger Chinese developers as well as private equity players, both onshore and offshore, to structure project acquisition or equity participation on terms that are much more favourable now than prior to the most recent round of financial tightening.

For overseas developers who can arrange development finance from offshore banks with a presence in China or medium-sized overseas players whose balance sheets are strong enough to fund their own construction costs, the recent bank tightening has created a relative advantage over medium-sized local players. Similarly, for some large national players, their long involvement in many of the markets in which they are active and close relations with local banks in these markets is helpful in securing a portion of the local loan quota when there is simply not enough bank lending quota to go around.

Investor Sentiment. Market sentiment varies considerably, amongst both China developers and investors, depending on whether they are on the winning or losing side of the present policy-induced residential market consolidation. Homebuilders whose core business is developing medium- to high-end and luxury housing in Tier 1 and Tier 2 cities bore the brunt of the policy changes. They are currently scrambling to make rapid adjustments in specific geographies and market segments being targeted and possibly disposing of some assets or stakes in project companies that they can no longer afford to carry.

Many of the private equity fund investors interviewed stated that although they were not worried about the prospects of their companies' business in China overall, they were concerned about investing in developments targeted at the luxury market, because they perceive this market segment as in greatest political disfavour right now. A number of fund managers interviewed said they would not give up on investing in housing development schemes, but rather be more selective about investing in developments targeting the middle market or medium-to-high-end market segment rather than the top-end segment. One fund manager interviewed acknowledged this pressure to change targeted residential market segment but stated that since "many other developers and investors have simultaneously begun thinking along the same lines, we anticipate that the middle market segment where we primarily compete will shortly become a lot more crowded." This developer is being compelled to upgrade the fit-out of its residential product, the fund manager relating, "In order to establish an even more distinct 'point of difference' for our product, we are creating different and very distinctive fit-out packages for our apartments and developing a special new brand name for marketing this apartment plus distinctive fit-out concept."

For some medium-sized to smaller municipal-level residential developers, the present market crunch is one they may possibly not survive. Their ability to weather the present storm will depend on a number of factors, including their connections with local government and local banks, the extent of their existing financial obligations and ability to service them, the time and price at which they acquired their land bank and its specific development mix, and finally their relationships with larger developers or investors that might help them through the crisis by becoming their equity partner.

For speculative investors who earlier bought numerous residential units with the aim of flipping them in the short term, the present moment is one of anxiety—unless they were

fortunate enough to have bought in a market with robust leasing demand. For buyers of both ordinary housing as well as medium- to high-end housing units, the sense of urgency that prevailed earlier of buying before further price escalation has now left, and their mood is one of caution and perhaps of waiting for further price declines, before committing to buy a house or a flat.

For overseas and onshore private equity funds, however, present sentiment is quite positive, given the range of projects now seeking outside partners to provide additional equity. One fund manager noted that “because of the appearance of major distress in the China residential sector, with many developers now unable to finance the development of sites they have already acquired, the vast majority of real estate finance opportunities which have emerged are related to the residential sales sector.” Similarly, for stronger listed developers, the present prolonged market downturn is providing them with an unusual opportunity to purchase land at auctions with few or no other bidders and to acquire development sites and equity stakes in projects under favourable terms.

Issues with Little or No Impact

The following five issues on the questionnaire survey were revealed as having little or no impact on either development or investment decisions.

Government Real Estate Tax Policies. The national real estate tax is perceived as being less of an issue at present because a property holding tax has been implemented so far on an experimental basis only in Shanghai and Chongqing. The Ministry of Housing and Urban-Rural Development will not be in a position to implement this new tax regime in China’s 38 other leading property investment locations until complete records of property ownership in all 40 cities can be computerized and stored (a task that will require a minimum of one to two more years to complete). Outstanding questions with respect to how effective the government has been in collecting revenues in the two cities in which the new real estate holding tax measures have been put into force still need to be answered as well, so with all of the potential issues affecting the market, the looming threat of a national property holding tax was deemed by respondents to be the least worrisome. (Although not included in the survey, the much stricter enforcement of laws related to taxation of property development should be noted. In the past, developers paid 1 percent of sales revenue to local tax authorities as land appreciation tax [LAT]. But starting a few years ago, some local governments have required that developers collect LAT on a much steeper graduated taxation structure based on the actual percentage of appreciation in land value. As a result, in some localities developers may now need to begin paying well over 10 percent of sales revenue as LAT.)

Domestic Economic Conditions. Few investors, developers, financial institutions, or real estate industry service providers interviewed voiced serious concern about the outlook for China’s economy overall as a major factor affecting their decision-making process.

In fact, one China residential opportunities fund remains firmly committed to the fund's theme of developing middle-class housing for sale, its fund manager saying: "Our fund is exclusively focused on establishing joint ventures with developers of middle-class housing in Tier 2 cities. Macroeconomic controls imposed on the residential market over the past 24 months have put downward pressure on land prices, and Tier 2 city residential prices have likewise softened. However, within this time period, middle-class incomes have continued to grow, and the consequence of this is that Tier 2 housing has become more affordable. At the same time, the decline in land prices has provided some protection for the margins for our residential development business, going forward."

At the same time, fund managers have grown more wary of municipal-level downside risk. One developer that had a residential property for sale in a Tier 2 city in the Pearl River Delta in the latter half of 2011, just at the time of the outbreak of the European Union credit crisis, found that sales rapidly declined as consumer sentiment in the city took a hard hit when China's exports to Europe began to sharply taper off, given the city's position as a linchpin in this export-oriented economic region. Because of the sluggishness in external demand for China's exports, the interviewee mentioned that in the future selection of development sites, the fund would exercise more caution and lean towards selecting sites in inland cities whose economies are less exposed to the vagaries of China's external economy.

Local- or Central-Government Policies on Affordable Housing. Social housing, or affordable housing, can be divided into "economic housing," which is sold at prices 20 to 30 percent below comparable commodity housing, and "price-capped housing," which is sold somewhere mid-way between the price of economic housing and ordinary commodity housing and includes a category of government-owned housing that is leased to the poorest urban residents for only a small fraction of the market rent.

For the majority of the respondents to the questionnaire and interview surveys, their business model does not permit undertaking such development. Although developing affordable housing usually requires a fairly low level of capital commitment because of the sizeable amount of government assistance that is typically available for such projects, it yields very slender profits. Thus, development of affordable housing is the preserve of larger development companies who can leverage on undertaking this kind of development activity to their advantage. Some national-level developers have sufficient resources to be able to engage in such "socially responsible development activity," which allows them to store up valuable goodwill with these local-government authorities to whom they provide construction services. In some instances, if such developers have large on-going commercial projects, they may gain tax savings by including a component of affordable housing in the mix and thereby lowering their profit margins.

Cost of Land Acquisition. Asked to comment on the changing costs of land acquisition, one fund manager stated quite positively: "The market dislocations that have occurred in China over the past 18 months have allowed us to adopt a more opportunistic approach to the market. More specifically, we see the fall in land prices which has occurred in

many cities as having opened up a whole realm of opportunity which did not exist during the period when ASPs were badly overheated.”

This sentiment was echoed by another private equity fund manager, who stated: “[The] present window that the market correction has opened on the China real estate investment market is the opening we have been waiting for. Except for a window that opened very briefly in late 2008/early 2009, we have not had a good window like this since 2006. Imposition of tightening policies over the past has created opportunity for us by giving rise to capital shortfall. Put simply, there is less competition now to acquire sites in second/third tier cities. Now you can buy land at the base price (or reserve price at which pieces of land are tendered) in these cities or simply negotiate the price for a site directly with the local government.”

Another private equity player interviewed during the course of the study agreed, saying: “During the investment boom earlier in the decade, development land costs rose so sharply, in some cities like Hangzhou which were heavily favoured by speculative interests that the AV [accommodation value] of some residential sites sold at tender rose to the same level as the cost of purchasing completed units locations near the development site. As the atmosphere surrounding these land auctions turned into a kind of feeding frenzy, there was nothing we could do but stand at the side lines and watch.”

Competition. The considerable decline in the level of competition to acquire development sites over the past 24 months is the direct result of Chinese government moves to cool the domestic residential sales sector and tighten provision of credit to real estate development. The change in policy targeted at constraining residential investment demand has affected the entire real estate sector because some 80 percent of all floor area developed in China annually is residential (excluding public facilities).

As a result of the government’s policy moves, capital has noticeably shifted towards developing more mid-market or ordinary-quality housing and towards greater concentration on developing office and retail properties. The cooling that the market has witnessed in the latter half of 2011 has given rise to a substantially different competitive landscape. It is, in fact, beneficial to overseas funds and overseas developers who still have access to liquidity. In addition, large domestic developers can leverage off their recurring income from residential sales as well as other sources of capital to acquire distressed land assets or to buy shares in viable projects that are facing capital shortfalls from the small to medium-sized developers that are bearing the main brunt of the credit tightening.

Amongst the private equity funds who were interviewed, this decline in the level of competition was welcomed as helping enable them re-enter China’s real estate investment markets. As one fund manager put it: “Perhaps the biggest single issue that affects our business in China is the intensity of competition. Competition heats up asset prices ... to a point where discussion of gross yield vs. cap rate become irrelevant, which is precisely the point at which we find markets hard to deal in. So, from our perspective, external economic factors are less worrisome than the intensity of competition for deals.”

Investment Prospects by Region

Investment prospects of the 28 cities are addressed individually in this chapter, grouped by seven regions. The regions, however, are not monolithic entities; rather, they are largely composed of subgroupings of city clusters, each constituting an urban economic region or urban agglomeration in its own right, with its own individual set of prospects and related sets of issues.

The Southwest emerged as a clear favourite in this year's survey with respect to the ranking of investment and development prospects, because views of this area were much energized by the robust display of interest in Chengdu and continued strong interest in Chongqing as it emerges from the pall of recent political events.

While views of South China were buoyed by the positive attitudes of respondents concerning Shenzhen's market prospects, feelings regarding the remaining cities in the region tended to be more subdued, with respondents seeing less immediate opportunity in Guangzhou; sensing that the timing was perhaps too early for Xiamen, Fuzhou, and Nanning; and having reservations about the run-up of Hainan property prices on the back of the earlier investment boom.

East China emerged as very much holding its own with respect to retaining the respondents' interest in its real estate markets' prospects. Its overall performance was buoyed by the continued strength of interest in Shanghai and Hangzhou, which has clearly persisted despite the market volatility of the past two years. However, respondents' views of East China were tempered by somewhat more subdued interest in the other Tier 2 and 3 industrial powerhouse cities in Jiangsu and Zhejiang provinces, where respondents generally felt that markets have not corrected sufficiently to offer incoming investors "good value for money," in the absence of special situations turning up.

Central China also emerged as another region in which respondents believe that the prospects of Wuhan and Changsha, which are amongst its main constituent cities, have already begun to follow an improving trajectory. Especially in the case of Wuhan, the underlying economic strength of the city combined with the relatively low level of asset prices was viewed by respondents as providing untapped potential for real estate investment and development.

Northwest China provided a more mixed set of prospects, containing one city, Xi'an, that is perceived as having strong untapped potential and two other cities, namely Lanzhou and Urumqi, that most respondents felt were presently too small and remote to be worth the trouble, given the wealth of choice of major economic centres with good prospects in China's other inland regions. However, it would be a mistake to count out the prospects over the midterm of either Lanzhou or Urumqi because each is the center of an urban agglomeration targeted in the 12th Five-Year Plan for accelerated growth.

Northeast China similarly presented mixed scenarios, containing one city in which respondents displayed a relatively high level of confidence, namely Dalian, and two other cities that were felt to be either troubled by prospects of overbuilding, in the case of

Shenyang, or else, from an overseas firm's view, not of sufficient economic size to merit the trouble and expense of remotely handling an investment, in the case of Harbin.

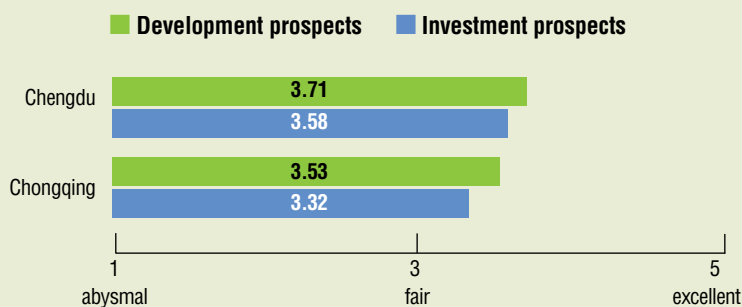
As compared to the six other regions surveyed, North China tended to generally lag behind the other regions; respondents' confidence in the region was dampened by their less than entirely positive view of the development and investment prospects for Beijing and Tianjin and the generally cautious sentiment voiced about entering the Tier 3 city of Shijiazhuang real estate investment or development sectors. This difference in the level of comfort with respect to operating in a Tier 3 city was yet another factor separating the overseas developers and private equity funds from national- or regional-scale local developers, for whom the ability to successfully take on projects in Tier 3 cities is an indication of their adaptability to local conditions and competitive strength.

Southwest China

The Southwest China region comprises the provinces of Sichuan, Yunnan, and Guizhou; the Chongqing Municipality; and the Tibet Autonomous Region. For the purpose of conducting the present ULI survey, the cities studied in Southwest China consisted of the two main constituents of the Chengdu-Chongqing Economic Region. Encompassing 15 cities in Sichuan province and 31 districts and counties in Chongqing, and with a total population of more than 100 million, the Chengdu-Chongqing Economic Region aims at becoming the pre-eminent force driving the upgrading and expansion of industry in Southwest China.

Chengdu (1). Since 2000, when the State Council launched its "Go West Policy," which was officially initiated for the purpose of "helping the western [inland] half of China catch up with the eastern [seaboard] half," the leading cities of China's inland regions, such as Chengdu, have benefited the most from China's attempt to actively rebalance its growth paradigm. Over the past decade, buoyed by both central-government policy support and its own municipal-level policies, and further leveraging on the city's large, skilled labour force and competitive wage and real estate costs, Chengdu has progressively strengthened its position. Within the short space of only a decade, Chengdu has managed the trick of re-inventing itself from being merely a major inland economic

EXHIBIT 3-1
City Investment Prospects: Southwest China

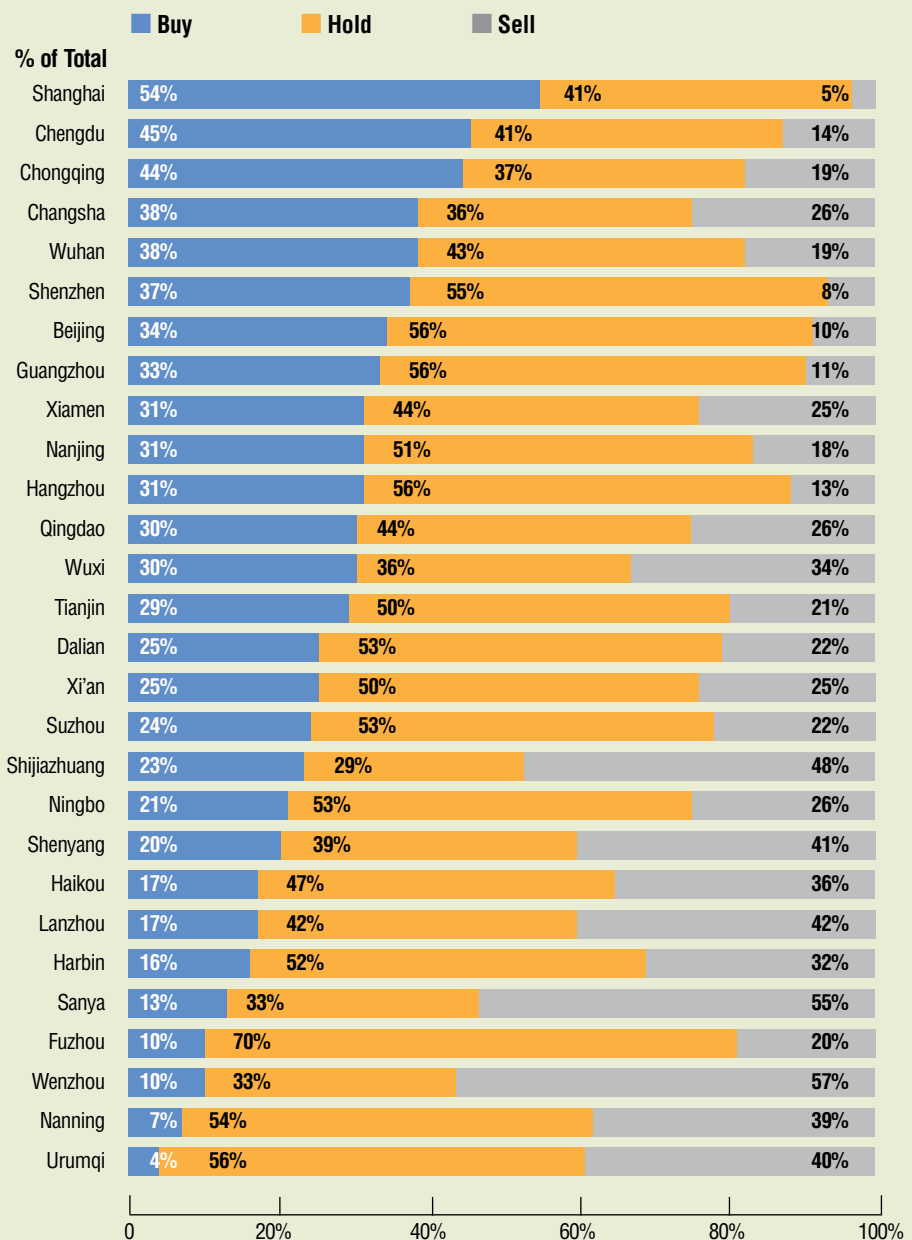


Source: Mainland China Real Estate Markets 2012 survey.

centre to being a leading inland location of choice for both multinational corporations and major domestic corporations relocating high-tech manufacturing and back-office functions from higher-cost locations along the coast.

Over the course of the past decade, both technical and white-collar employment have grown apace in Chengdu, rising in tandem with growth in the city's level of corporate

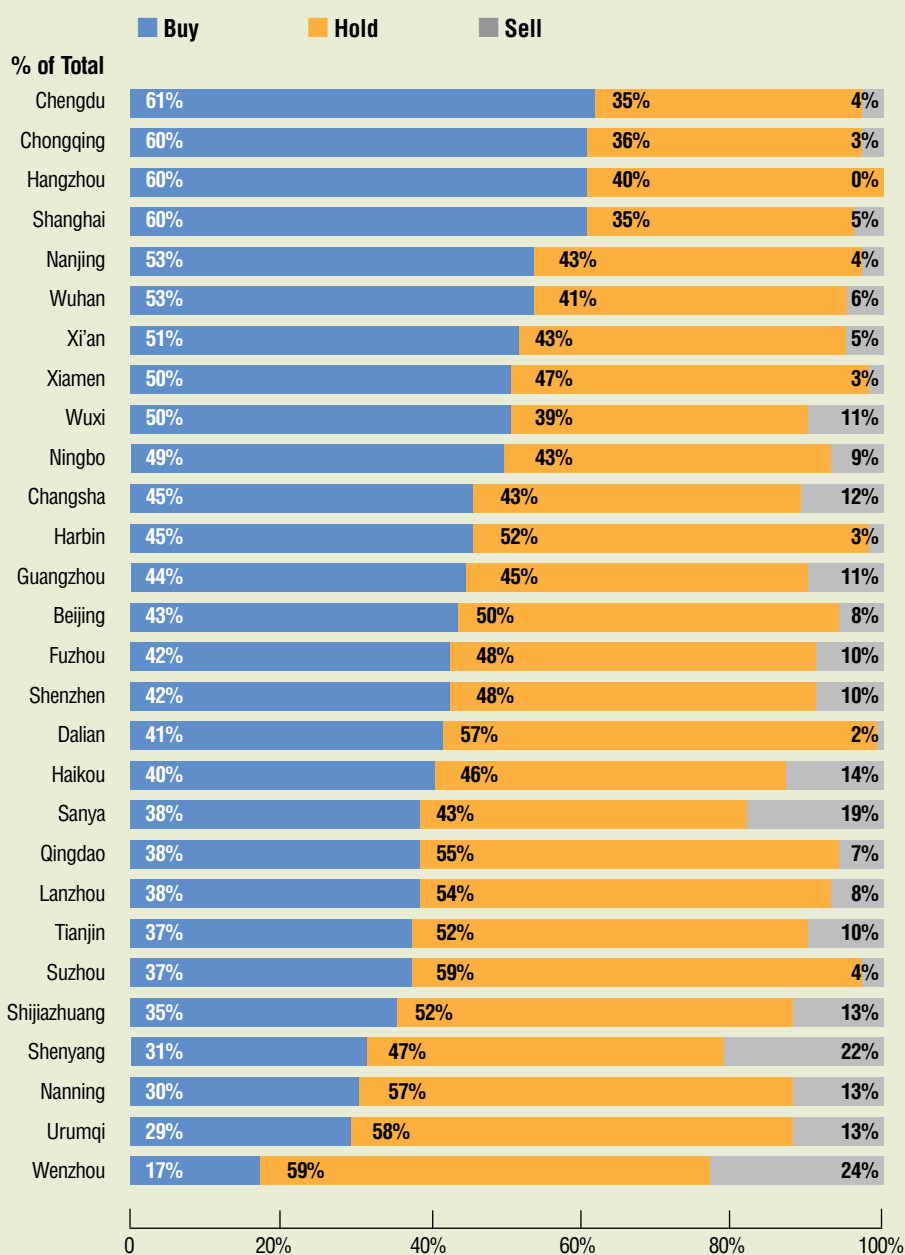
EXHIBIT 3-2
Office Property Buy/Hold/Sell Recommendations by City



Source: Mainland China Real Estate Markets 2012 survey.

concentration. One senior real estate consultant commented, "We like investment in vertical homebuilding in Chengdu, due to its rising number of primary homebuyers." The executive director of one overseas company with extensive development holdings in China further commented, "Along with its rapid growth in corporate concentration, Chengdu is emerging as one of the first Tier 2 cities that is beginning to give rise to a

EXHIBIT 3-3
Retail Property Buy/Hold/Sell Recommendations by City



Source: Mainland China Real Estate Markets 2012 survey.

real central business district, which, as it becomes more clearly delimited, is creating the potential for developing large-scale multidisciplinary complexes.”

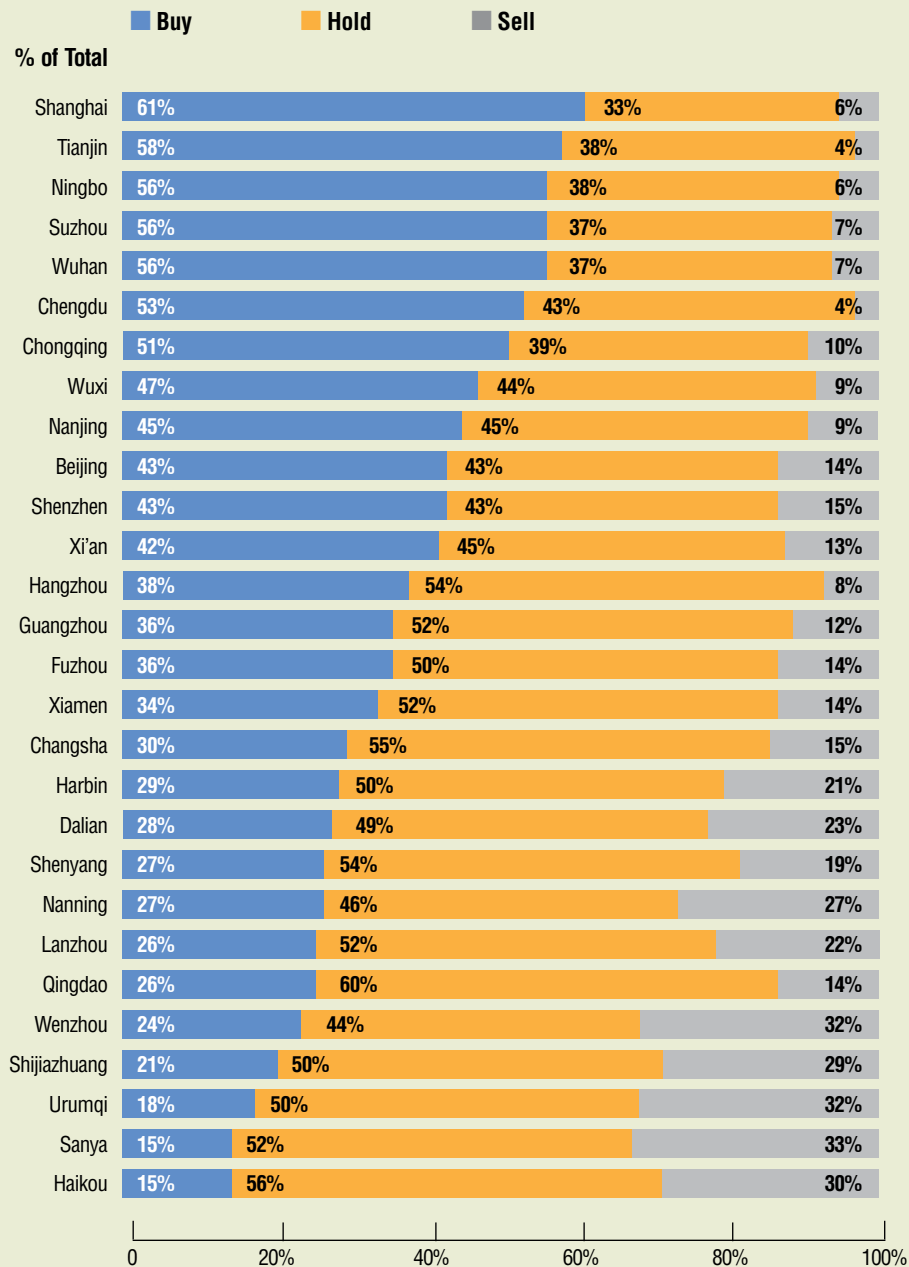
This positive view of the potential represented by both Chengdu’s employment base and its growing corporate concentration further helps explain why the city received the strongest “buy” recommendation for its apartment and retail sectors and the second-strongest “buy” recommendation for its hotel and office sectors. Growth in demand for medium-end to medium-to-high-end apartments and high-quality shopping facilities in Chengdu is a direct function of the growth in employment by the city’s producer services. By the same token, Chengdu’s growing pool of large corporate tenants is stoking demand not only for prime offices but also for hotel and conference facilities.

However, given the great success that Chengdu has enjoyed in recent years, a senior executive in one investment advisory company commented that the most opportune moment for entering the Chengdu market may have already passed, noting that “the really big, forward-looking players, realizing quite early on the city’s untapped potential, began land banking in the city in 2003, and in the subsequent nine years, prices of both development land and existing assets have risen continuously in Chengdu to the point where they are now no longer that cheap.”

Chongqing (6). Unlike Chengdu, which has only seen its star grow brighter over the past 12 months, Chongqing has seen its perception dimmed somewhat in the eyes of prospective investors in recent months, as a consequence of the political turmoil that followed the dismissal of its Communist Party chief. The city’s ranking dropped from third in last year’s survey to sixth place in the overall ranking.

In contrast to Chengdu, which has taken pains to reposition itself as being friendly to international business, Chongqing initially invested more in leveraging on its unique position as the fourth State Council–designated municipality in China (following Beijing, Shanghai, and Tianjin). This difference in strategy undoubtedly stems from the two cities’ distinct development histories: Chengdu served historically as Sichuan province’s administrative centre, with a relatively strong service sector and robust consumer industry, whereas Chongqing has traditionally been a leading domestically oriented manufacturing centre. Since 2010, however, the Chongqing municipality has made efforts to change this positioning, setting itself the goal of becoming a regional financial centre by 2015 and planning to launch a new central business district (CBD) as a platform for this repositioning. However, with the dramatic removal of Chongqing’s party secretary in March, this planned repositioning has received a short-term setback. Nonetheless, one interviewee, who heads an investment advisory company, ignoring the recent political flap in Chongqing, saw the investment opportunity currently presented by the city in a favourable light compared with Chengdu, stating, “Overall real estate market conditions in Chongqing are effectively similar to those in Chengdu about five years ago with respect to success in capturing a substantial number of corporate space occupiers and also with respect to attracting investment interest from a large number of major real estate market players. Hence its ASPs have tended to display this kind of time gap as well.”

EXHIBIT 3-4
Industrial/Distribution Property Buy/Hold/Sell
Recommendations by City



Source: Mainland China Real Estate Markets 2012 survey.

However, amongst the senior real estate developers interviewed, the head of strategy and business development for one major developer noted, “While we are now developing a major mixed-use commercial complex in downtown Chengdu, in Chongqing we have launched development of a high-quality new urban community in the municipality’s urban fringe area, since we understand that because Chongqing still lags a few paces behind Chengdu, in order to effectively play catch up, the most important task confronting the municipality is creating a better supporting environment for large companies and their employees.”

South China

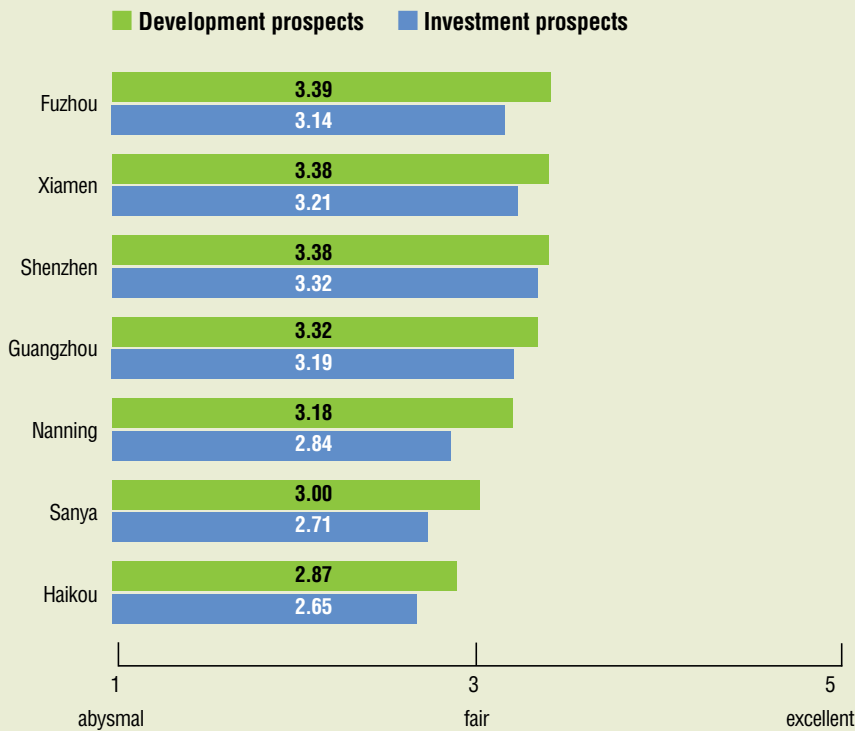
For the purpose of conducting the present ULI survey, the cities surveyed in the South China region included the two leading cities from the Pearl River Delta (Shenzhen and Guangzhou); two of the major cities in the proposed West Taiwan Straits Economic Region (Xiamen and Fuzhou); and finally three cities from the recently designated Beibu Gulf Economic Rim (Nanning, Haikou, and Sanya.)

Shenzhen (5). Even if displaying a somewhat more neutral attitude towards the Pearl River Delta overall, perceptions of Shenzhen remain quite positive, with the office sector seeming to garner most interest. Shenzhen’s close links with Hong Kong, with which it shares a border linked by an increasing number of border crossings, undoubtedly explain some of its attraction for survey respondents. In addition, Shenzhen’s relatively tight control over its land resources, the benign balance between supply and demand for commercial facilities in its Futian CBD, and the robust growth of the city’s corporate sector and employment are all acting to drive demand for real estate. With respect to the Shenzhen residential sector, a number of interviewees conveyed more of a sense of frustration at the difficulty of entering the market than of disliking its dynamics. As one private equity fund manager stated: “Theoretically, we like both Shenzhen and Guangzhou, as they have the deepest underlying demand for housing in the PRD [Pearl River Delta]. The problem in Shenzhen is that all of the remaining prime development land resources are in the hands of a relatively small number of major early local market entrants, who dominate the market and monopolize remaining land resources.”

Xiamen (11). Xiamen, as the largest city in southern Fujian, serves as a cultural centre for the population of Taiwan, an estimated 80 percent of whom speak the Minnan dialect and who have ties of culture and ancestry with the province’s southern region.

Some interviewees’ attitude to Xiamen was that although the city held interesting investment potential over the mid-term, at present, because its ASPs have been bid up to levels that are not immediately attractive to new market entrants by earlier developers, many of whom have links to the city, interviewees felt no urgency to invest there. One fund manager stated, “While investing in Xiamen is not a high priority for us at the moment, we are aware of the benefits which Xiamen is positioned to derive from the improving relationship between Taiwan and the Mainland, and this may eventually motivate us to undertake a mixed-use residential/retail/hotel project there.”

EXHIBIT 3-5
City Investment Prospects: South China



Source: *Mainland China Real Estate Markets 2012 survey.*

Guangzhou (14). In 2000, as China began to transition away from its export-driven, “development at any cost” economic paradigm, it began to shift to a more balanced pattern of economic growth, which tends to favour cities of the interior over the more developed coastal hubs, such as Guangzhou, the provincial capital of Guangdong and the economic centre of the Pearl River Delta. In the context of this change in paradigm, which has now been in motion for over a decade, a number of interview respondents voiced feelings that, for the short term at least, Guangzhou’s most exciting period of growth is now behind it, as the municipality has entered into a phase of more mature growth. As the head of a leading real estate services firm commented: “While the underlying economy and demographics of Guangzhou remain strong, nevertheless having gone through several waves of development over the past decade, the market has become fairly crowded with well-entrenched local developers, and given the fact that it does not have the prospects of quickly emerging as a world-class city, it now tends to arouse somewhat less investment interest, given the feeling that it is a city whose potential has already been thoroughly explored.”

Fuzhou (16). Whilst Fuzhou is a provincial capital, it is neither the centre of a major economic region nor does it enjoy the advantage of direct cultural ties with nearby Taiwan, as does Xiamen. Given the still early stage of the phased implementation of the Eco-

conomic Cooperation Framework Agreement with Taiwan, one developer of a commercial complex in downtown Fuzhou noted real estate investment in the city at present is still more of a play on leveraging its position as provincial capital.

Nanning (23). One interviewee succinctly summed up the view of survey respondents: “The Nanning story does not draw our attention, at present.” However, a recent report released by Jones Lang LaSalle (*China50: Fifty Real Estate Markets That Matter*) contained commentary to the effect that this attitude may soon change because Nanning has reportedly “begun to attract the interest of retailers who are consolidating their positions as they move deeper into Tier 3 cities.” One property consultant who was interviewed further noted: “China’s promotion of development of the Beibu Economic Rim as part of its larger ‘Go West’ strategy has stimulated considerable construction activity in Guangxi, of which Nanning is emerging as the chief beneficiary, having been designated as China’s key city for coordinating foreign trade with the ASEAN countries.”

Sanya (25). A majority of those interviewed voiced caution with respect to taking a plunge into the Sanya development market, one interviewee commenting: “Sanya is essentially a speculative boomtown; therefore one can only make profitable investment in the city when property prices and sales volumes are rising. But by the same token, this means that Sanya is highly vulnerable to the boom/bust cycle.” Another major institutional investor observed, “The volatility of the Sanya market means that future income streams from property sales are inherently unstable, suggesting that this market is less suitable for institutional investors.” However, alternate views were voiced, most notably by investors who have already made profitable investments in the city. In addition, institutional players reported they were preparing to establish a fund into which they intend to inject a Sanya resort property development they are now seeking to acquire, arguing, “As China’s only major city situated in a tropical zone, Sanya’s unique conditions of climate and sunshine make it ideal for establishing a resort providing facilities for both lease and for sale. We are confident that despite market fluctuations this area will maintain its attractiveness over the longer term.”

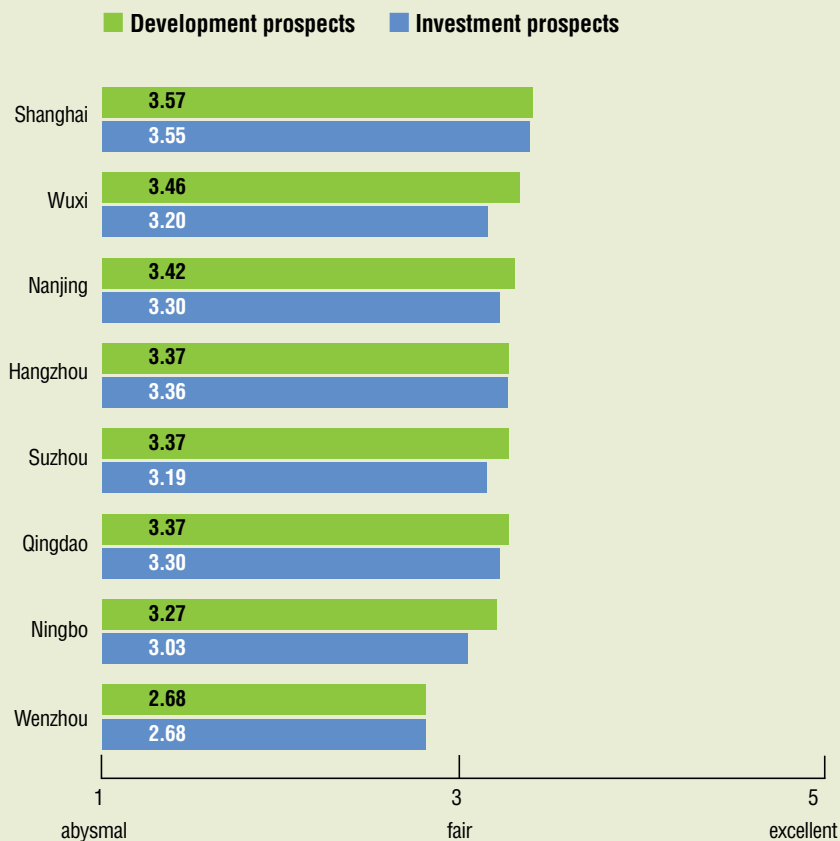
Haikou (27). As one international fund manager remarked, “The capital of Hainan province lacks drawing power, as it is not the centre of a larger regional economy, but it is a city which is disproportionately dependent on hospitality, tourism, and real estate development.” Although one developer has had reasonable success in developing a modest-scale mixed-use commercial complex in downtown Haikou, another investor remarked, “Haikou, ... as a city on the northern side of Hainan Island, and effectively outside of the tropical zone, ... has all of the defects of Hainan province but enjoys none of its advantages.” However, this statement is perhaps too much from the vantage point of a sun worshiper because Haikou is a city with considerably more economic and demographic depth than Sanya, possessing a larger population base, its own university, and non-tourism-related industry. Also, Haikou is considered more suitable than Sanya for developing retirement-living projects because of its more temperate weather in the summer and amenities such as retail and hospitals.

East China

The region termed “East China” for the purpose of this study comprises a group of seven cities selected from Yangtze River Delta, an economic region that itself comprises the Shanghai municipality, the provincial capital cities of Nanjing and Hangzhou, eight prefectural-level cities in Jiangsu, and an additional eight prefectural-level cities in Zhejiang. In addition, Qingdao, the leading city in the Shandong Peninsula economic region, was included.

Shanghai (2). Shanghai clearly emerged as most favoured amongst the four Tier 1 cities. These Tier 1 cities contain China’s most affluent urban populations, its largest corporate concentrations, and its only true CBDs. Yet this is not to suggest that respondents did not have a variety of views about the metropolis’s investment prospects. Opinions ranged from the upbeat view that “Shanghai’s economic position makes it suitable for investment in virtually any real estate sector” to the more frustrated note, sounded by at least one respondent, that “while it is not impossible to

EXHIBIT 3-6
City Investment Prospects: East China



Source: *Mainland China Real Estate Markets 2012 survey.*

invest in Shanghai real estate, its ASPs generally remain at very high levels, despite the recent market correction, making our core investment and development strategies harder to implement.”

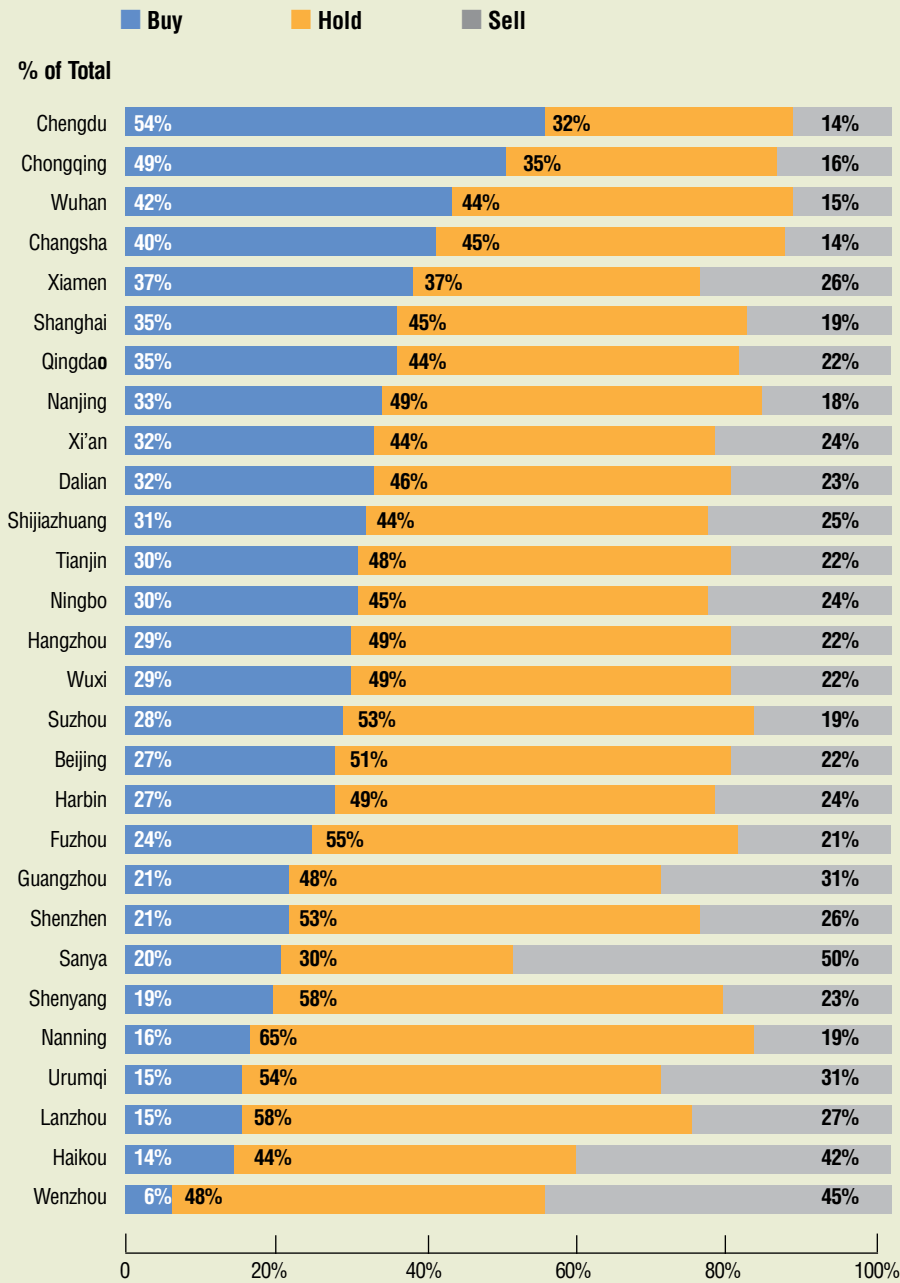
Hangzhou (3). The dramatic jump in Hangzhou’s investment ranking was supported by the interviewees, most of whom held favourable views about the city’s real estate. However, one of Hangzhou’s drawbacks is that as a city renowned as one of the most beautiful in China, with its scenic West Lake and numerous Buddhist temples and pagodas, many dating from the period the Southern Sung Dynasty, Hangzhou’s residential sector tends to overheat quickly in periods when the national residential sector is buoyant.

As one of the wealthiest provinces in China, Zhejiang has pursued its own development model, which is based on encouraging private enterprise. Consequently, Zhejiang has one of the nation’s largest concentrations of private sector companies, but that success has affected Hangzhou’s residential price levels. One senior fund manager put it as follows: “Acquiring a pied-à-terre residential property in Hangzhou as a holiday home is very popular with affluent people in Shanghai-Zhejiang-Jiangsu region due to the city’s ancient culture and history, laid back atmosphere, and beautiful scenery. As a consequence, Shanghai and Hangzhou have the highest residential land prices of any two cities within the larger Yangtze River Delta economic region.”

With respect to the viability of investing in Hangzhou, the same interviewee went on to comment, “while Hangzhou remains a city which is very attractive to us, affordability of housing in the city is still at an unacceptably low level. While ASPs have been moving in the right direction in recent months, we would still be unlikely to re-enter the market at current price levels.” Hangzhou undoubtedly also has benefited from the start of high-speed-rail service to Shanghai in 2010, which has placed the city within 45 minutes’ commuting time of China’s largest financial center. This has made the city far more accessible not only to tourists, but also to foreign investors who in the past would not make the longer trip required to visit the city.

Nanjing (7). The provincial capital of Jiangsu province, Nanjing, followed directly behind the provincial capital of Zhejiang, ranking a solid third within East China, as determined by the 2012 questionnaire survey, but dropping substantially to seventh place amongst the expanded group of 28 cities surveyed. In turning to the in-person interviews to get a sense as to why Nanjing’s popularity, viewed within a larger context, had declined, concerns about the city’s prospects appear to be fairly complicated. Although investors have a generally high level of comfort with respect to investing in the Tier 1 and 2 cities of the Yangtze River Delta, consensus appeared to be fairly common that because of the strong run-up in asset prices, ASPs in cities such as Nanjing, Shanghai, Hangzhou, Suzhou, and Ningbo had not yet fallen to a point at which re-entering the market was viable, especially from the perspective of companies whose core business is merchant homebuilding targeted at middle-class occupiers. However, Nanjing, as the capital of a province that was, until the 1990s at least, economically dominated by state-owned enterprises, is perceived as being somewhat less entrepreneurial than neighbouring

EXHIBIT 3-7
Residential Property Buy/Hold/Sell Recommendations by City



Source: Mainland China Real Estate Markets 2012 survey.

Hangzhou with respect to developing a distinct brand for itself and putting forward its key selling points. One overseas private equity fund picked up on this when he stated, “Amongst all of the major cities in the YRD [Yangtze River Delta], Nanjing seems to be the most confused with respect to articulating its overall purpose and direction.”

In another interview, the head of an international real estate services company picked up on this fact as well, but identified this gap as a kind of opportunity, noting: “Nanjing is a city with an interesting history and has potential for tourism and hospitality which at this late date still remains untapped. Hence, the city is attractive from the point of view of developing five-star hotels, possibly also integrated with serviced apartments.”

Qingdao (8). Qingdao was the only city surveyed in East China that was not part of the Yangtze River Delta; rather, it is the leading city in an entirely different agglomeration of five major cities on the Shandong Peninsula that relate to Shandong province and cities of the Bohai Rim as much as they do to the urban clusters of the Yangtze River Delta. Respondents had a distinctly positive view of Qingdao’s real estate market prospects. One manager of a large overseas private equity fund stated, “Qingdao still had good prospects for well-positioned residential and retail development, provided that one can secure an investment project which shows the right risk-adjusted rate of return.” However, the same manager had reservations about investing in the city’s office sector, given the present level of prime office supply and a perceived relative shallowness of demand. Yet another manager of an overseas private equity fund that already has exposure to mixed-use commercial developments in Tianjin, Shenyang, and Dalian stated quite specifically, “We would like to increase exposure to Beijing and Qingdao with respect to mixed-use commercial developments, and especially high quality, competitively positioned shopping malls.”

Wuxi (12). Although Wuxi is a city on a lake like Hangzhou, unlike the capital of Zhejiang, Wuxi has carved out a reputation for itself mainly as a high-tech manufacturing location rather than as a centre for culture, leisure, and consumption, and indeed has achieved the highest gross domestic product per capita in Jiangsu. The huge expansion of the Shanghai office market in recent years has had a knock-on effect in stimulating development of commercial and residential property in its surrounding satellite cities and similarly precipitated a sizeable increase in Wuxi housing prices in the period from 2006 to 2010. However, because the Wuxi market witnessed so little speculation prior to 2006, prices rose from a very low base level and consequently still remain at acceptable levels, as compared with those in Shanghai, Suzhou, or Nanjing: “ASPs for residential property in Wuxi are not nearly as high, as compared with other major emerging Tier 2 cities in southern Jiangsu, and to us this suggests that the city still offers investment potential.”

Suzhou (13). Many interviewees voiced confidence about the city’s medium-term investment prospects but expressed only lukewarm feelings about the potential of its real estate market over the short term. The main reason for this relative lack of enthusiasm about Suzhou was aptly summed up by one fund manager: “Suzhou is already a mature industrial city, and one where asset prices are not especially cheap

and which is furthermore already amply supplied with a full range of the kind of supporting facilities which corporate occupiers and their staff require ... hence the city provides relatively less room to play for incoming developers and investors.”

Ningbo (19). Ningbo, which is major port city on the coast of Zhejiang, lies 220 kilometres from Shanghai and was geographically isolated within the Yangtze River Delta until 2007, when the Hangzhou Bay Bridge was opened, which dramatically cut to 2.5 hours travel time to Shanghai. Before the opening of the bridge, the only way to reach Ningbo was to fly, or to drive by a circuitous route that took five hours. Despite this new advantage, which over the past five years has effectively helped reposition Ningbo economically, respondents to the questionnaire survey remained reserved about the prospects of Ningbo’s real estate market. In part, this caution can be attributed to the fact that Ningbo was one of the cities where housing prices rose to high levels during a speculative boom period but have not yet dropped to the point where specialist funds investing in residential sales developments find the city especially attractive. Nonetheless, one senior head of an international real estate services firm was more sanguine about the prospects for the Ningbo downtown mixed-use commercial market segment, stating: “Ningbo is a city that has been given a ‘new lease on life’ by the vast improvement in its connectedness to Shanghai that has been brought about by the construction of the Hangzhou Bay Bridge. Ningbo should therefore be viewed as a city of ‘emerging opportunity.’ Specifically, it offers a chance to participate in projects targeted at revitalizing the old inner city core, an area which offers locations which may be viable for launching high-quality mixed use.”

Wenzhou (26). Although Wenzhou is situated within economically potent Zhejiang province, one developer described it in an interview as being a city that is “slightly off centre with respect to the communications and transport network which is now beginning to connect Zhejiang’s major provincial cities together into a tighter grid.” However, Wenzhou does have one extraordinary feature in its unusually large concentration of high-net-worth individuals. Perception of the city has also undoubtedly been tarnished by its being at the centre of a recent underground banking scandal. Hence, when asked about Wenzhou, a number of interviewees commented, “We are concerned about the city’s ‘headline risk’ and also note that while the city itself is affluent, its wealthy tend to place their own funds in major commercial and residential investments in neighbouring Shanghai and Hangzhou.” Worth noting, however, is that Wenzhou has always been something of a “wild card,” and in March, the State Council gave the green light to establishing a pilot financial zone in Wenzhou, which would effectively legalize Wenzhou’s private underground banking sector and also permit Wenzhou residents to invest directly abroad. Although implementation of the plan still faces many regulatory hurdles, if ultimately realized, it would be a significant step forward with respect to China liberalizing control over capital account transactions, even if only on an experimental basis, and could potentially quickly change perception of Wenzhou from being a scandal-plagued city to being a national leader in monetary and financial system reform.

Northeast China

Northeast China comprises the provinces of Liaoning, Jilin, and Heilongjiang. For the purpose of this survey, the two main cities forming the Central Southern Liaoning economic region, Shenyang and Dalian, were studied, as well the provincial capital of Heilongjiang, Harbin, which is the main city in the Harbin-Dalian-Qiqihar urban agglomeration.

Dalian (15). As a major international port, financial centre, and information technology industry hub in North China, Dalian saw most investors who were early into the market generally pleased with the city's performance, especially in launching residential sales, mixed-use, or business park projects. The greatest dissatisfaction with the city was voiced by prospective investors who did not find a foothold in the city's real estate market earlier on. The manager of one private equity fund that specializes in investment in middle-class residential sales developments stated: "We are still quite keen to enter the Dalian market but feel that ASPs in the city rose to such high levels, as calculated on the basis of our in-house housing affordability model, that the city is still too pricey for us to enter. However, this is one market which we will continue to monitor carefully, to see if prices decline to a level where we can find a point of re-entry."

This sentiment was echoed by the head of a real estate services company, who stated: "We feel that there is still good opportunity for 'vertical homebuilding' in Dalian, Tianjin, and Shenyang. ASPs are currently fairly high in all three of these cities, and we also have issues related to overhang of unsold inventory, with unsold residential stock carried forward ranging from eight to 14 months. However, we are watching ASPs in the three cities, as they continue to decline, in order to evaluate when our clients should consider re-entering them."



A senior spokesperson for a developer that has launched a business park in Dalian was confident in the project's prospects, because of Dalian's strong base of information technology and innovative industry and the proactive attitude on the part of the Dalian government with respect to further building up this business process outsourcing sector in its economy, combined with its large pool of skilled human resources and high level of linkage with Japan and Korea.

Shenyang (21). Given Shenyang's strategic role as the capital and largest city in Liaoning province and the disproportionate amount of rustbelt industry left behind in the city and its environs after the dismantling of northeast China's larger state-owned enterprises, Shenyang not surprisingly has been a major focal point of the "Revitalize the Northeast" campaign, which was launched in 2005 in what was effectively a second wave in the larger campaign to drive new investment in China's economy deeper inland. In line with this policy change, Shenyang has set up three national-level development zones, offered cash awards to incentivize multinational corporations to relocate and also to leverage on its low labour costs and large pool of skilled workers, and indeed has witnessed a sizeable increment of annual increase in foreign direct investment over the past seven years. Despite this relative success in capturing foreign investment, however, a sense that the city has been less than skillful in managing its land market emerged from the interviews. As one private equity fund manager put it, "Unfortunately, since 2003 Shenyang government has swung from its initial position of being quite closed to the real estate economy to embracing it excessively, and in the process has become too reliant on revenues derived from the sale of commercial and residential sites, having sold a substantial number over the past several years." The senior director of an international real estate services firm further elucidated: "The Shenyang municipality's plan to develop a Jin Lang Da Dao [literally 'Great Golden Road'] envisions the development of dozens of Grade A office towers and shopping malls in a city that can at the most support only a few such projects."

Harbin (22). Despite the city's having an urban population of 5.9 million and being the capital of Heilongjiang province, with a population of 39 million, and being the centre of the Harbin urban agglomeration as well as linked with the Harbin-Dalian-Qiqihar urban economic region, the interview respondents tended to view Harbin as somewhat isolated. That being said, Harbin certainly has some features to recommend it, constituting, as it does, the main component in a plan to revitalize cross-border trade with Russia and famed for its substantial legacy of unique Russian-influenced early 20th-century architecture, housing a relatively high concentration of tertiary educational institutions, and beginning to lay the foundations of a modern retail sector. Indeed, ironically, as the senior director of one real estate investment brokerage concern noted, "It is precisely because Harbin is so completely overlooked by most investors and developers that it currently offers some of the highest IRRs [internal rates of return] for investment deals in North China ... there is little competition for this flow of good investment deals."

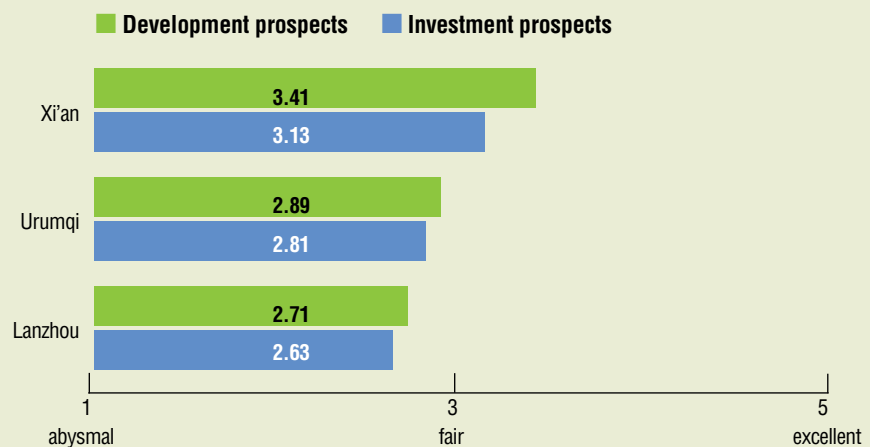
Northwest China

Northwest China comprises the provinces of Gansu, Qinghai, and Shaanxi as well as the Xinjiang and Ningxia autonomous regions. For the purpose of the present ULI survey, Xi'an, the leading city of the Xi'an Guanzhong urban agglomeration; as well as Lanzhou, the provincial capital of Gansu; and Urumqi, the capital of the Xinjiang Autonomous Region, were studied.

Xi'an (17). This city benefits from roughly the same combination of factors that is beginning to boost Wuhan to rapidly emerging Tier 2 city status. Like Chengdu, Xi'an benefits from being a provincial capital and moreover, because of its central position in Northwest China, one that is a directly named beneficiary of the "Go West" campaign. In addition, the city has a large and generally well-educated labour force, having for many decades served as a major centre of China's national security and aerospace and astronautics industry. Xi'an has benefited from the proactive stance of its municipal government in positioning the city as a major national centre for information technology, software development, and business process outsourcing industry. Xi'an is also a major tourism draw as the home of the Museum of Qin Terracotta Warriors and Horses and the only city in China to have retained its medieval wall. However, several interview respondents noted that ASPs in Xi'an are still lagging behind those of Chengdu, providing a clear indication from their perspective that Xi'an is a city that still offers value to incoming investors and developers, who are willing to weather its greater extremes of climate compared with the southwestern megalopolis.

Urumqi (24). The main potential attraction of Urumqi is not the city itself, whose gross domestic product per capita ranking is quite low amongst China's larger cities. Rather, as the capital of the Xinjiang Autonomous Region and as the principal city in the North Tianshan economic region, the city's catchment attracts economic interaction with a

EXHIBIT 3-9
City Investment Prospects: Northwest China



Source: *Mainland China Real Estate Markets 2012 survey.*

sizeable number of prefectural-level cities within the Xinjiang Autonomous Region, which itself has a population of 21.8 million and an economic interface with Russia, Mongolia, Kazakhstan, the Kyrgyz Republic, Tajikistan, Afghanistan, Pakistan, and India, with which it shares borders. However, given the city's relative remoteness from China's major coastal and inland cities, those from outside the region stated that they had "insufficient bandwidth" to consider Urumqi at the present time. In addition, one China developer cited the persistence of political risk in Xinjiang as being another factor that has motivated its decision to skip this area. However, notwithstanding this fact, given the city's reasonably large size and its geographic and economic importance, some of the more forward-looking national-level developers, such as Greenland, have already launched large-scale projects in Urumqi.

Lanzhou (28). As the principal city in the Lanzhou-Baiyin-Xining urban agglomeration, Lanzhou has only a relatively small population but nevertheless a relatively strong base of tertiary education and is a major centre of both light and heavy manufacturing and serves as a major regional logistics hub. Hence, Lanzhou is not without features to recommend it, despite the low score it received in the present survey. As the provincial capital of Gansu, a province of 25.5 million persons in China's northwest, Lanzhou will undoubtedly eventually emerge as an investment destination as the rising level of development activity in Tier 2 cities compels forward-looking investors and developers to enter Tier 4 cities that clearly have the aspiration and potential to transform themselves into Tier 3 urban centres. However, for the time being, as one private equity fund manager put it, "Given Lanzhou's remoteness from China's coastal areas and its relatively shallow demographics and limited disposable wealth, it is not yet worth devoting our time to invest there, given the presence of many other more attractive competing opportunities." Lanzhou's poor environmental quality, as a major centre of the petrochemical industry, was also mentioned as a concern by some of the interviewees.

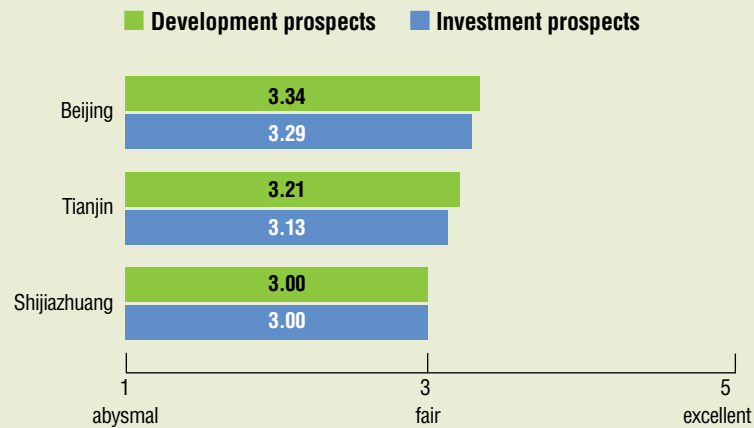
North China

North China comprises the municipalities, provinces, and administrative regions of the North China plain, including the Beijing and Tianjin municipalities, Hebei and Shanxi provinces, and the Inner Mongolian Autonomous Region. For the purpose of the present ULI survey, the two municipalities that comprise the Beijing-Tianjin economic corridor were specifically studied, as well as the provincial capital of Hebei, Shijiazhuang.

Beijing (9). As the national capital, in Beijing the home purchase restrictions, mortgage restrictions, and real estate lending restrictions are being followed to the letter of the law, so the city's residential sector is bearing the brunt of the central government campaign to cool China's commodity housing sector.

As one interviewee noted, "As Beijing plays the role of a 'model' city, it will probably also be one of the last cities in which the HPRs [home purchase restrictions] will be relaxed." The special responsibilities of being a role model were recently underscored in March 2012 when 50 cities reportedly released their housing price caps. All the cities except

EXHIBIT 3-10
City Investment Prospects: North China



Source: *Mainland China Real Estate Markets 2012 survey.*

Beijing are focused on narrowing the growth range in property prices and keeping it below gross domestic product per capita disposable-income growth; the national capital stands alone in aiming to achieve a real estate price rollback in 2012.

At the same time, certain specific real estate sectors in Beijing were viewed favourably, particularly Grade A office and shopping centre sectors. However, several respondents at the same time qualified this positive view by noting that the chances to source viable investment opportunities in these two sectors were comparatively rare, given the intensely competitive nature of the Beijing estate market. Although confident in the potential of the city's commercial markets, a number of the interviewees' views of the city were coloured by a sense that Beijing's problems in urban governance, while not new, have if anything gotten more severe in recent years. The head of an international real estate services firm further elucidated: "Our clients generally do not take a positive view of Beijing's short-term prospects. They find that the city is at once highly political, but also badly governed, having two sets of governments, the China central government and the Beijing municipal government, which are frequently at loggerheads with respect to matters related to governing the city, but in which the Beijing government always loses out. Beijing's serious air pollution and traffic gridlock problems are partially a result of this. Also, ASPs have risen to very high levels in Beijing, and it is hard to believe that they are going to witness any further substantial growth, given the mood of the China central government at the present moment." Thus, despite the fact that Beijing is the nation's capital, the relatively low ranking it received in the survey is in keeping with this report's overall indication that cities with a better living environment generally rank higher than others.

Tianjin (18). Although Beijing and Tianjin are only 120 kilometres apart, the two cities have long been rather uneasy neighbours, competing for resources and investment in a very similar space. Tianjin is often perceived as being overshadowed by Beijing, as multinationals and overseas investors have tended to gravitate towards the nexus of

power and decision making in the nation's capital. In recent years, Tianjin has attempted to rectify this imbalance by establishing the Binhai New Area on its eastern coast, providing preferential tax rates to international companies that establish their offices there. In 2006 there was discussion of designating Binhai as a new Special Economic Zone and making it a pilot city for experimenting with liberalizing control over the capital account. However, because this plan has yet to be implemented, Tianjin is a city that a number of interviewees perceive as facing oversupply issues, especially in the office and residential sectors, and this perception injected a note of caution into their views of the city. As one fund manager interviewed put it, "With a market of the scale and depth of Beijing so close by, and given the similar level of country risk of investing in either city, why should I invest in Tianjin?" However, one bright spot about Tianjin, which was pointed out in a number of interviews, was the potential for undertaking well-positioned retail offerings in good locations in the old city, given the increased flow of tourists to Tianjin following the completion of the high-speed-rail link with Beijing in 2008, which effectively places the two cities within half an hour's travelling time of each other.

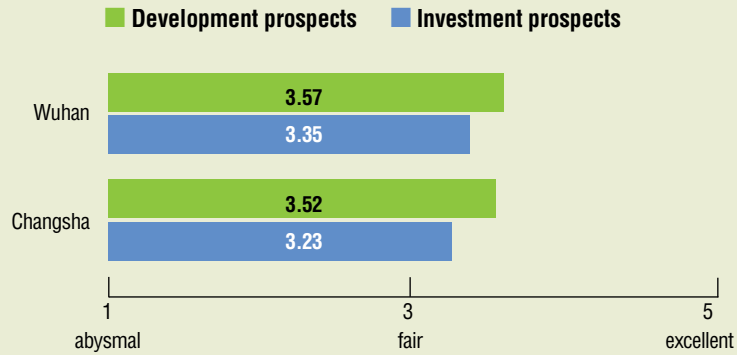
Shijiazhuang (20). As the provincial capital of Hebei, Shijiazhuang is also a constituent in the Beijing Economic Region but attracted less favourable rating of its investment and development prospects, because "its economy is so completely overshadowed by its two giant neighbours," as one fund manager put it. In addition, despite the recent launch of a major cleanup effort, the city's heavily polluted environment was cited by interviewees as a negative factor. Nevertheless, portions of Shijiazhuang's downtown area are undergoing major redevelopment, and the city will benefit from being situated at a major crossover point between the national north-south and east-west high-speed-rail line. Hence, in *China50: Fifty Real Estate Markets That Matter*, Jones Lang LaSalle has identified Shijiazhuang as one of a group of Tier 3 cities now under consideration for expansion by retailers who have already saturated China's Tier 2 cities with their outlets.

Central China

Central China consists of a very substantial, landlocked area, comprising the provinces of Hubei, Hunan, Shanxi, Anhui, and Jiangxi, which have been collectively targeted by the central-government policy to "Accelerate the Growth of China's Central Region," which was launched in March 2004. The present ULI survey specifically focused on Wuhan, an urban agglomeration that takes Wuhan as its centre and includes eight other smaller and medium-sized cities in its environs in Hubei, and Changsha, which is the leading city in the Changsha-Zhuzhou-Xiangtan urban agglomeration in Hunan, an urban cluster with three cities at its nucleus and nine other smaller cities in its environs.

Wuhan (4). The city's climb from its previous sixth-place ranking to a new ranking of fourth place, while superficially not appearing to be highly noteworthy, is actually quite noteworthy. When considering the viability of investing in given city in China, most of the potential investors interviewed, besides looking at the local economy, strength of demand, and supply/demand dynamics in the sector in which they are considering investing, normally also examine the performance of its ASPs and the degree to which they became inflated during the 2003-2007 period. Cities that invariably came out ahead and recommend

EXHIBIT 3-11
City Investment Prospects: Central China



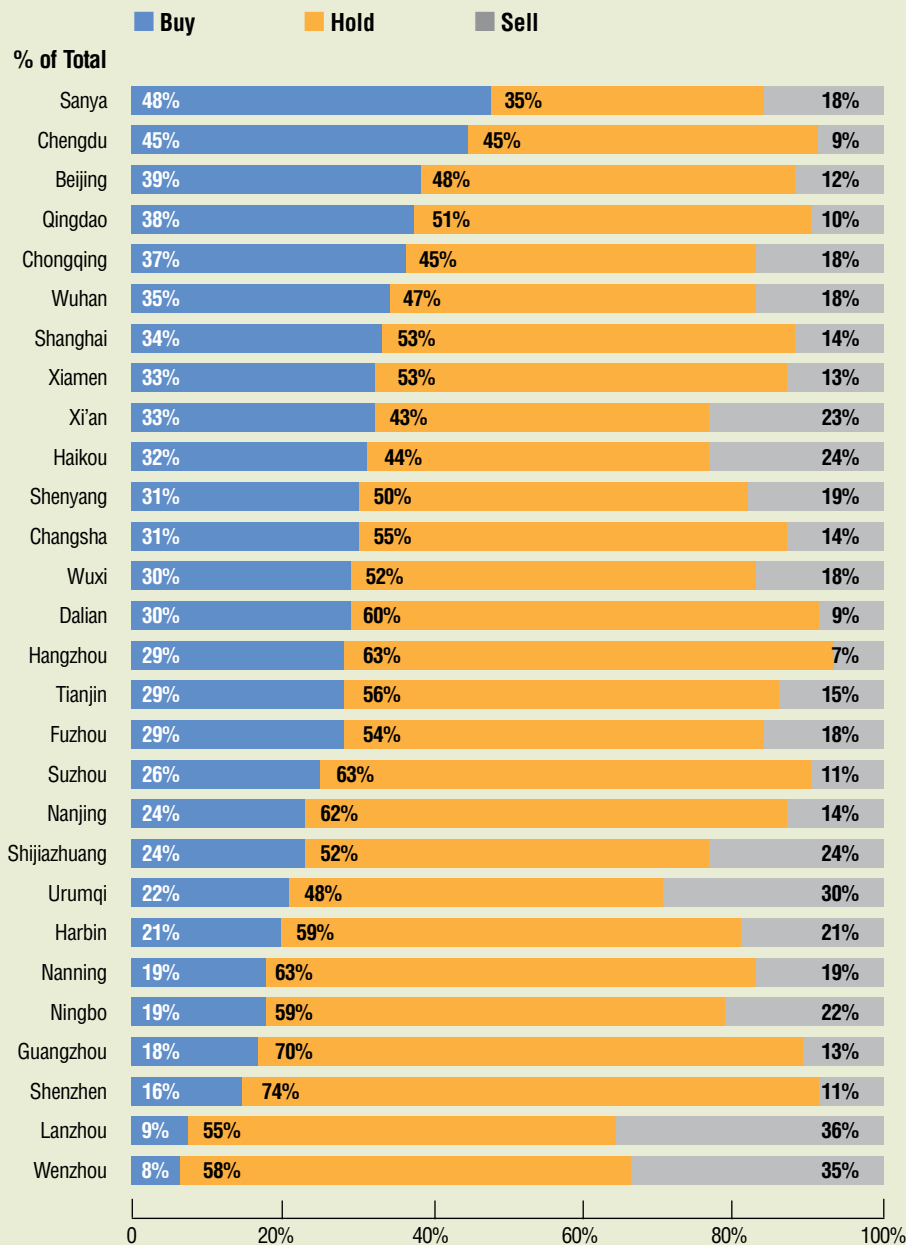
Source: *Mainland China Real Estate Markets 2012 survey.*

themselves as “buys” are major economic centres; have strong demographics, good educational bases, and government that is proactively seeking to recruit the presence of large corporations; and exhibit real estate markets where ASPs have not as yet been seriously distorted by speculation. Although the investment market in Chengdu is still attractive, over the past several years it has begun to get more crowded with big players. Hence, a number of interviewees indicated that Wuhan was the major Tier 2 city that is best positioned to take over Chengdu’s “most attractive emerging investment destination” position as Chengdu itself moves closer towards the status of being a mature market.

In addition, Wuhan’s strategic value as a transportation hub is being enhanced by its emergence as a major interchange city for two high-speed-rail lines. Wuhan has direct high-speed access to Shanghai via the Shanghai-Wuhan-Chengdu line, which began operation this year. Similarly, the north-south line will connect the cities of Beijing, Wuhan, and Guangzhou this year. The first phase of this high-speed-rail link, the Wuhan-to-Guangzhou line, began operating at the end of 2009, placing Wuhan within three hours’ travel time of Guangdong’s provincial capital.

Changsha (10). Perceptions of Changsha’s investment prospects elicited conflicting responses from interviewees. Given the city’s relatively low corporate concentration, compared with some of the other major regional centres, respondents did not feel that the city was suitable for developing prime office property. A few respondents expressed nervousness at the pace at which the Changsha government has put development sites up for sale in recent years, indicating that it was perhaps too aggressive. However, given Changsha’s relative undersupply of modern large-format shopping malls, the strong consumerist propensity of the Hunanese, and the fact that Changsha’s catchment area extends beyond nearby Xiangtan and Zhuzhou to encompass a much wider swath in Hunan province, a number of interviewees took a very favourable view of the Changsha retail sector’s prospects. With respect to the city’s longer-term competitiveness, the city’s emerging status as a major high-speed-rail hub

EXHIBIT 3-12
Hotel Property Buy/Hold/Sell Recommendations by City



Source: Mainland China Real Estate Markets 2012 survey.

of the southern Central region derives from the fact it is situated at the intersection of two high-speed-rail lines, the Shanghai-to-Kunming line running east-west and the Beijing-to-Guangzhou line running north-south.

What’s New? What’s Next?

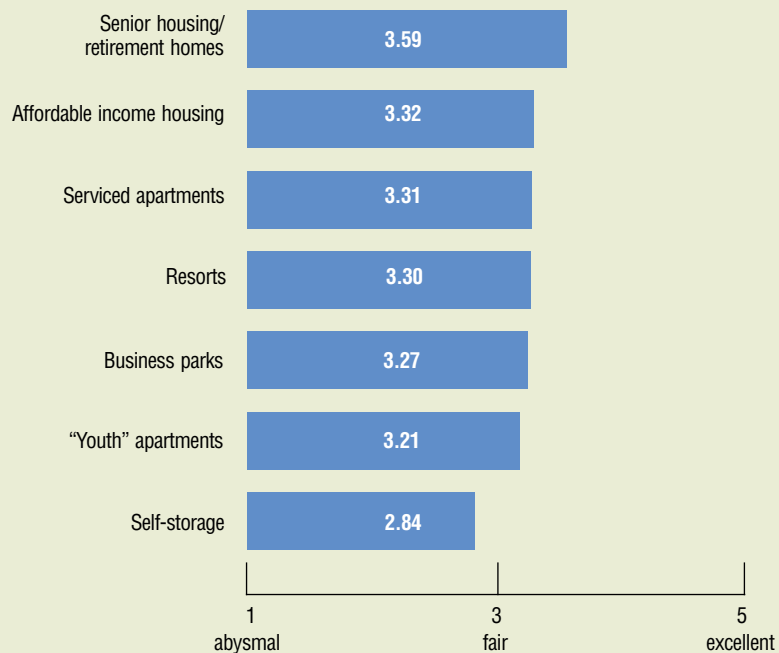
Respondents to the survey were asked to rate the investment prospects of seven niche or emerging market sectors over the next 12 months. The ratings show a clear interest in real estate segments that tap into a number of major demographic, consumer, and business trends that have been emerging in China over the past two decades. Most of these sectors are already growing and evolving, whereas others have yet to take hold.

Housing for Seniors and Retirement Housing

At 3.59, this niche received the highest average rating. The demand for such housing stems from the combination of several factors: the aging of China’s population, the rising level of urban disposable income, and the on-going shift from family-based elder care.

Some interviewees had already acquired sites to develop housing communities for still-active seniors that would not include medical care facilities. The government has adopted an ambiguous stance concerning the participation of private capital in geriatric medical care facilities and has not yet put the kind of incentives in place that would make this kind of investment attractive. One consultant commented: “There are two key pieces missing from the jigsaw. The first problem to be resolved is land zoning for housing for seniors, probably as a sub-category of health care land, and letting the market then decide the appropriate pricing for such land.” The same consultant furthermore related that “another key change which must be implemented is greater flexibility in health care

EXHIBIT 4-1
Investment Prospects for Niche Sectors



Source: *Mainland China Real Estate Markets 2012 survey.*

reimbursement, so that residents of an expensive location, for example, Shanghai and Beijing, could move to cheaper housing locations, for example, Wuxi and Weihai, and still have their medical expenses covered.”

Affordable Housing

This sector, with the second-highest rating, has recently taken on great political significance.

The continued trend of growth in China's medium-sized and larger cities is stoking the need for affordable housing. In 2010 and then with renewed force in 2011, China's central government stepped up its campaign to compel municipal and provincial governments to deliver a much larger quantity of affordable housing as the key component in the central government's campaign to defuse popular discontent over rising housing prices in almost all Tier 1 cities and a majority of Tier 2 cities. As a cornerstone of this campaign, the Ministry of Housing and Urban-Rural Development mandated that these cities enter into agreements committing them to annual delivery targets for affordable housing and making the heads of government in each locality aware that success in hitting these targets would constitute a key component of their year-end performance appraisal.

To make this kind of development activity attractive to large developers, municipal governments may reward them with more land or developable floor area on adjacent commercial sites, or sizeable exemptions from local tax charges in exchange for helping their localities meet these affordable housing delivery targets. Amongst the persons interviewed for the 2012 survey report, primarily the national-level developers agreed that the central government's housing policy changes of the past 24 months have caused them to re-orient at least a portion of their new development activity towards the lower-cost housing market segment, of which affordable housing is a constituent part. The majority of the other respondents indicated that they could not profitably involve themselves in the development of affordable housing.

Serviced Apartments

Growth in China's corporate sector is leading to a rising tide of domestic business travel, driving demand for more business-class hotel and mid-market serviced apartment accommodation. Serviced apartments are viewed as an essential component within a mixed-use complex positioned for development in the downtown business district of a major urban centre, locations attractive to business travellers.

Resorts

The high level of urban air pollution and traffic congestion in many of China's larger cities is creating demand for weekend retreats in more pristine, scenic places. This demand, in turn, is driving demand for both resorts and “weekend escape” properties. For example, a group of major listed China developers is developing a cluster of high-rise residential projects in a coastal location in Guangdong that is targeted at middle-class residents of

Shenzhen, Guangzhou, and Dongguan who seek to acquire second homes in locations that provide fresh air, sea views, and freedom from the gridlocked downtown areas of their respective cities—but which are within weekend driving distance.

Business Parks

The rising cost of office accommodation in prime office precincts of Tier 1 cities has led to interest in suburban business park properties for back-office business units of larger domestic and overseas companies as well as for use by the business process outsourcing providers to whom they are outsourcing some of their back-office work.

Business parks continue to evolve. One developer related that it has begun development of a knowledge hub designed to capture high-end innovation industry talent by combining an information technology park with an extensive range of residential, hospitality, and commercial supporting facilities, situated in the context of a city whose pleasant environment is already an attraction in itself. One element that many schemes share is that because they tend to involve very substantial sites, many of them are being launched in conjunction with quasi-governmental authorities, who are providing special support to help the projects attract the calibre of corporate occupiers that add value to their city overall.

Summary

China's property markets are continuing to evolve very quickly, and certain niche investment markets that currently do not exist in China—such as housing for young people or self-storage warehousing—will undoubtedly emerge in line with the overall trend towards increasing sophistication of urban demand for real estate.

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