



ECONOMIC OVERVIEW

In spite of the massive financial tsunami, Shanghai's economy managed to report steady growth in three consecutive quarters.

The business hub recorded 10.1% year-on-year growth in GDP in the first nine months. Exports volume increased 22% from to US\$127.9 billion during the period compared with that of a year ago.

Utilised FDI was also up 20.7% from last year, valued at US\$7.66 billion as of September. Average income of urban and rural households grew 13.3% and 11.3% respectively.

Major lenders are financially sound, as some banks have been looking to finance new projects with their sufficient liquidity.

However, with the emergence of financial crisis coupled with stock and property market downturn, sales of automobiles and properties have declined. Exports-oriented SMEs received fewer orders than last year.

Shanghai is preparing itself for the 2010 World Expo. As of early October, 179 countries and regions, as well as 44 international organisations, confirmed their attendance, already past the record made by Hannover, Germany in 2001.

KEY ECONOMIC INDICATORS

	2003	2004	2005	2006	2007	Q308
Real GDP growth	12.3%	14.2%	11.1%	12.0%	14.3%	10.1%
Inflation (CPI)	0.1%	2.2%	1.0%	1.2%	3.2%	6.7%
Utilised FDI (US\$ 'billion)	5.9	6.5	6.9	7.1	7.9	7.67 (Jan-Sep)
Fixed-asset invest- ment (FAI) (billion yuan)	245.2	308.5	354.3	392.5	445.9	326.9 (Jan-Sep)
Exports volume (US\$ 'billion)	48.48	73.52	90.74	113.57	143.93	127.92 (Jan-Sep)

Source: Shanghai Municipal Statistics Bureau, Vigers Research

(Cont'd)

On October 22, the Ministry of Finance introduced various measures in attempt to give the property market a boost, as follows:

- ◆ Deed tax will be cut to 1% for first homes smaller than 90 sq m, and stamp duty on all home transactions will be waived tentatively.
- ◆ VAT on land will be suspended when the property is sold.
- ◆ Minimum downpayment will be lowered to 20% from 30%. For first-time homebuyers, the floor for interest rates will be lowered to 70 per cent of the Central Bank's benchmark rates.
- ◆ Interest rates on loans of varying maturities taken by households from the city's public housing fund will each be cut by 27 bp.
- ◆ Individuals will be exempted from a 5.55% business tax if they sell their homes two years after the purchase, down from the current limit of 5 years. They will not be exposed to capital-gain tax for selling properties currently for their own use.
- ◆ The limit for local household mortgage loans from the public housing fund will be raised

to 800,000 yuan (US\$116,933) from 600,000 yuan.

- ◆ Some administrative fees for property transactions will be abolished.
- ◆ Supply of low-rent homes for the lower-income group will be raised. Property developers and estate agents will be monitored.

The abovementioned package is a clear sign that the Central Government has changed its stance from preventing market overheating to boosting sales the mild way, especially stimulating demand from first-home buyers and end-users. Shanghai went further and announced its own strengthening package the same day.

The pledge to increase low-rent home supply is to ensure that the lower-income group, particularly new arrivals to the city from the rural, will not be deprived of proper sheltering owing to soaring home prices and rents.

However, we believe that the Central Government has reserved some flexibility or "Plan B" depending on market development. After all, these sweeteners are a good sign and restrictions may be further loosened if the package draws lukewarm response in the forth quarter.

MAJOR LAND TRANSACTIONS

Developers were not aggressive in acquiring lands during Q308. Plots up for auction failed to attract as many bidders as they could a year ago.

For instance, a plot located in Baoshan Gu Village (宝山顾村) with a total GFA of 400,000 sq m planned for residential development fetched 3,250 yuan per sq m during the quarter. That transaction price is overshadowed by a similar plot in the same location priced 6,300 yuan per sq m last year, which was bought by Poly Group.

Likewise, two plots located in Luodian New Town, A2-2 and A2-3, were sold for 4,256 yuan per sq m and 4,635 yuan per sq m respectively, repre-

senting over 20% off last year's transaction prices.

Against the scenario of insufficient financial channels, tightened lending and poor home sales, developers have fallen into cashflow troubles. They need to boost sales volume and generate some cash flow before they can spare money to buy lands.

With the rescue package in place and a few rounds of interest rate cuts, whether land sales will pick up in the forth quarter highly depends on home sales and the effectiveness of the new and coming policies.

District	Site	Use	Site area (sq m)	Plot ratio	Leasehold years	Transaction price (million yuan)
Jinshan	A plot located in Jinshanwei Town	Commercial	87725.4	≤1.2	N/A	111.85
Baoshan	Plot 200804 in Northern Baoshan City Garden, Industrial Park Zone	Industrial	99929.9	0.6-1.5	50	49.08
Luodian New Town	Plot A2-2	Residential	62859.2	1.2	70	321
Zhabei	No. 5 in Area 117	Commercial, Office	14437.9	≤4.0	40, 50	693
Luodian New Town	Plot A2-3	Residential	29966.0	1.2	70	166.66
Changning	Area 240, Xinjing Town	Residential	13599.6	≤1.0	70	328
Baoshan	Plot 200802 in Northern Baoshan City Garden, Industrial Park Zone	Industrial	196013.7	0.8-1.5	50	91.38

RESIDENTIAL PROPERTY MARKET HIGHLIGHTS

Shanghai home sales fell 41% in the first nine months year on year, with a total GFA of 14,914,300 sq m transacted, according to Shanghai Statistics Bureau. Total sales value registered was 123.37 billion yuan, down 38% from last year. New home sales accounted for 6,880,000 sq m, representing only 41% of the numbers recorded in the same period last year.

Owing to sluggish home sales the real estate sector has made negative contribution to the city's GDP, taking the first-half GDP down by 0.4 percentage points.

“Gold September” failed to live up to sellers’ expectation, with only 22% of sales recorded compared with last year’s September. Though new homes with a total GFA of 1,206,600 sq m were up for sale in September, only 436,900 sq m was absorbed the same month. Supply has outgrown demand. By estimation, Shanghai’s inventory of new homes has increased from 5 million sq m in Q108 to 7.8 million sq m in Q308.

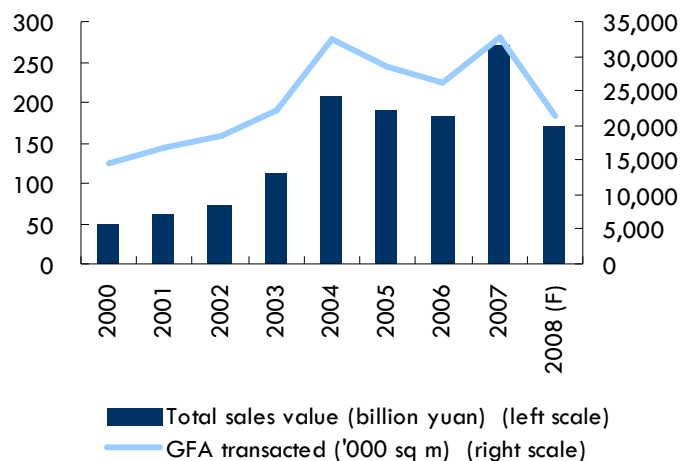
Shanghai’s own rescue package, comprising 14 sweeteners, will not revive the city’s home market back to 2007 levels. Neither does it intend to, and let alone easing fi-

ancial pressure facing property developers.

Under the new scheme, suppose that a first-time homebuyer is going for a million-yuan home and that he can reap all benefits, estimated at 22,000 yuan, with all taxes and fees waived. However, this amount is somehow far below his expectation of a price reduction, say, 10% or 100,000 yuan. As such, the new package appears not to be very appealing to most potential homebuyers if there is no deeper discount from developers in the primary market.

In the secondary market, the new package has

TOTAL SALES VALUES & VOLUME OF RESIDENTIAL PROPERTY MARKET



Source: Shanghai Municipal Statistics Bureau, Vigers Research

The new package does have better effect in the secondary market. Again, if a landlord successfully sells a million-yuan home, he could benefit from nearly 80,000-yuan tax and fee reduction, implying that he has some 8% room for price reduction to lure homebuyers in the secondary market.

We view the current package as market tester, and more likely this is just the beginning of a multiple-step approach to fixing the housing market, through which the Central Government strives to ensure that the lower-income group will not be deprived of proper sheltering under all market conditions.

In this initial stage, only first-time homebuyers benefit most from the new sweeteners and mortgage preferential policy. Yet, restrictions on second-home mortgage remain untouched so far, which we believe, if relaxed, will unleash a greater purchasing power from the middle class.

LUXURY SECTOR

Luxury home prices managed to defy mass market price declines, increasing albeit modestly 1.06%, but transaction volume fell by 73% from last quarter. Even so, prices in most luxury developments stood firm during the quarter.

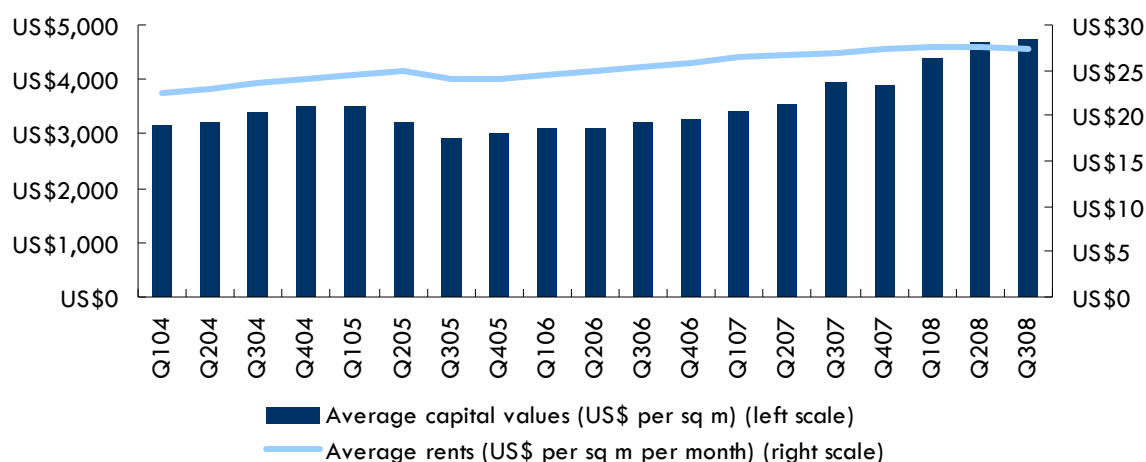
A total of 516 luxury residential properties changed hand during Q308, down from 1,918 sales recorded in Q208. Most sales involved properties in Regency Park (御翠园), Yanlord Town (仁恒河滨城), Shanghai Bay (尚海湾), etc. Transaction prices of these developments increased 3-11% quarter on quarter despite falling transaction volume.

The third phase of another high-profile development, Lakeville (翠湖天地), entered the market in June with a price tag of 86,000 yuan per sq m, marked up 57% higher than the set prices of its first and second phases.

However, the leasing market was static during the period. The occupancy level of Chateau Pinnacle (华山夏都), owned by Morgan Stanley, was still below 50% since its debut in the first quarter. Asking monthly rate is US\$35 per sq m, and actual rents averages US\$30 per sq m.

As US and Europe’s economy is slowing filled with recession fears, expansion plan in China of multi-national companies has been significantly down-scaled. So it is foreseeable that the demand for rental properties from the expatriate population will soften. Vacancy rate will continue to climb throughout Q408.

AVERAGE CAPITAL VALUES & MONTHLY RENTS OF LUXURY RESIDENTIAL PROPERTIES



Source: Vigers Research

GRADE-A OFFICE MARKET HIGHLIGHTS

Shanghai Grade-A office market began to soften in July. The global economy took a quick turn for the worse in September, and most occupiers of prime Shanghai office space, many of them multi-nationals and financial companies, became more cautious in renting or buying office space and have cut their rental budget consequently.

SALES MARKET

Office sales declined 47.5% from last quarter, marking a record low in five years. The ongoing money crisis and China's current limitation on foreign funds have prompted some foreign investors to sell off office properties or retreat from deals.

Q308 is a turning point to office sales market. We expect that vacancy rate will continue to edge up in the forth quarter and pressure on rents will mount.

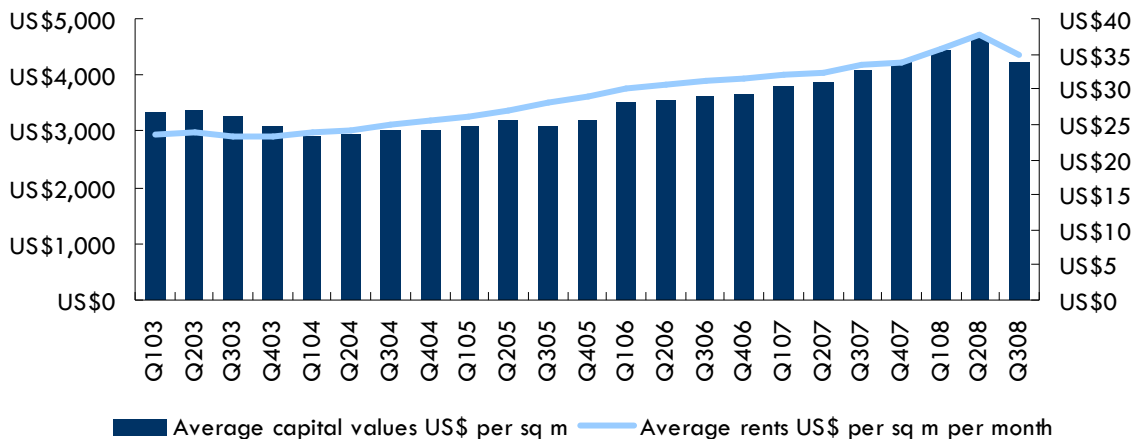
In October, US private equity firm Blackstone Group dropped a deal worth about US\$160 million to buy a commercial building in the city. Before market conditions changed dramatically in September, the hedge fund had tried to buy up to four buildings, worth as much as US\$1 billion that time.

Also, its plan to acquire 90% stake in Changshou Commercial Plaza from VXL Capital had stumbled over price disagreements. Blackstone also gave up acquiring Skymall Shopping Centre from local developer Super Ocean Group. Other scrapped deals involved Bank of Shanghai Tower in Lujiazui District and Southern Securities Mansion located on Nanjing Road.

Now in the headwind, the city is considering tax benefits as well as other incentives to lure venture capital, private equity and hedge funds to the city, such as by scrapping 20 per cent capital gains tax on hedge funds operating in the city and easing tax burden on managers of venture capital and private equity funds. They would be allowed to register legally as local equities investment firm.

Against softening demand, the construction pipeline, not expecting a financial crisis any time soon last two years, delivered 1.6 million sq m of new space in Q308 with four newly built projects being added to the inventory. Of the new supply, over 70% is located in Shanghai's CBD Pudong.

AVERAGE CAPITAL VALUES & MONTHLY RENTS OF GRADE-A OFFICE PROPERTIES



Source: Vigers Research

LEASING MARKET

Rental demand began to soften in Q308. Average rent of prime office space in Pudong fell 7% to 239 yuan per sq m quarter on quarter. Vacancy rate there increased to 12%, up 2.4% from last quarter, highest ever since Q404.

Shanghai World Financial Centre (环球金融中心) and CSC Tower (中建大厦) entered the leasing market, releasing 291,906 sq m of brand new space. Therefore, rental supply increased considerably during the quarter, which has outgrown near-term demand. Although earnings growth had been sustained in 2007 in China business, facing an adversity multinational companies as the major tenant became more cautious and adjusted rental budget down in order to endure the current crisis.

Negotiating leverage is clearly shifting in favour of tenants as 2009 progresses, with concessions packages looking more generous by this year-end. Office property owners in Pudong and Puxi have already lowered asking rentals, coupled

with more flexible lease terms, to compete for and retain quality tenants. However, as foreign companies' expansion plan was scaled down, a portion of the tenants will decide not to renew lease and relocate to a cheaper or smaller space.

In a short future, Puxi should fare little better than Pudong. Although East Sea Plaza (东海广场) has contributed 65,000 sq m of floor space, the district has relatively lesser supply. In Q308, this sub-market bucked the downtrend by reporting a moderate 1% q-o-q increase in rents.

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