Guangzhou Property Market Quarterly Snapshot

Q2, 2010

Vigers Research

Market summary

As the Guangzhou Government had also implemented a series of measures aiming to expand housing supply and squeeze speculators, both new and secondary home prices declined, albeit modestly so far, by 0.8% and 1.4% respectively from Q110 to Q210.

Harder hit were transaction volumes, however. Over the same period, both new home and secondhand home sales volumes shrank by 13% and 10.7% respectively, to 1.61 million sq m and 2.013 million sq m in terms of floor area traded.

The situation in the mass residential market is what used to be called a Mexican standoff. In the primary market, property developers appeared to be reluctant to offer much price concessions, and as such volumes contracted measurably.

Sales volumes will likely continue to thin in Q310. However, around the National Day holidays property developers may come under higher pressure to offload their vacant stock units and at that time prices will come under some serious pressure.

Though the austerity measures have weighed on the mass market, it had little impact on luxury home prices, despite that transaction volumes in the upmarket segment fell 29.4% quarter on quarter. Prices remained where they had been in Q110, averaging 26,274 yuan psm at end-June.

In the commercial sector, prime office rents have rebounded and gained 3.6% from Q110 to an average of 132 yuan per sq m at end-June. Benefitting from significant growth in the retail market, prime retail rents grew 1.3% over the same period.

Nonetheless, as the supply of office and retail space remains high in the city, with a number of large-scale office and retail projects in the pipeline due to enter the market in the second half and next year, chances are that office and retail rents will remain under pressure throughout the rest of the year.

Economic overview

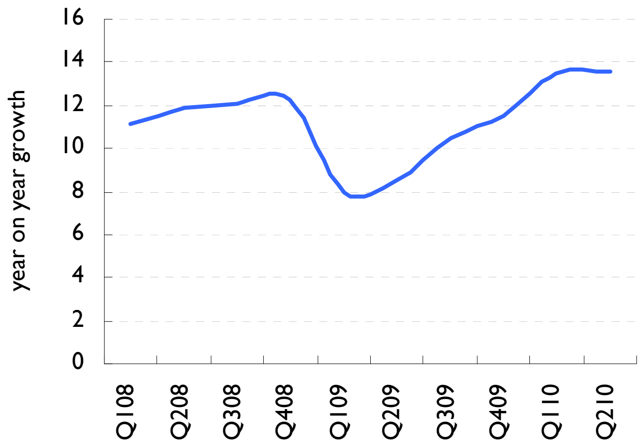
The Guangzhou Government has set a target of an annual economic growth of 10% in 2010, though local policy and economic advisors worry that the target is not ambitious to motivate local authorities to aim higher.

The economy of the southern city has been on the right track. In the first half, the city's GDP grew in real terms by 13.6% on last year. Remarkably, disposable income of urban residents grew 10.5% year on year, to 16,028.8 yuan per capita; rural residents' grew 12.7% to 7,584 yuan per capita.

However, as the economy of major export destinations remains sluggish, there are still worries for the health of the global economy. Overseas demand for Guangzhou-made products may drop as Europe's debt crisis hurts spending by the continent's consumers.

Locally, restrictions to be imposed on certain activities during the Asian Games will inevitably drag down the growth of Guangzhou's economy in the final quarter.

REAL GDP GROWTH



Source: Guangzhou Municipal Bureau of Statistics, Vigers Research

Fixed asset investment. As various projects in Asian Games City and stadiums have been complete, whilst most construction works have to be suspended in the final quarter, the first half witnessed a faster growth in fixed asset investment (FAI).

In detail, FAI was up 43.5% year on year, reaching 129 billion yuan in aggregate value. Real estate development investment was up 24.4% to 35.368 billion yuan. The aircraft purchase of China South Air, Asian Games City and stadium construction projects, extension work of metro lines, and a hydraulic engineering project, just to name a few, have been major contributors to stronger growth in FAI.

Manufacturing output rose a thinner 23.3% from last year to 647.076 billion yuan in the first six months. Significant slowdown in automobile manufacturing activity was one reason why manufacturing output growth slowed. A strike at a Honda parts supply factory in Guangzhou's suburb has affected car production volume.

Property sales growth under the raft of property cooling measures has slowed down significantly. In the first half, property sales volume in terms of floor area changed hands was down 8.7% year on year, but turnover was up 23.6% over the same period.

Retail sales grew a steady 20.6% in the first six months, to 202.155 billion yuan on a year over year basis. Figures for wholesale/retail and hospitality were up 21.8% and 13.1% year on year respectively, to 176.502 billion yuan and 25.653 billion yuan in transaction values.

Exports. As the European debt crisis deepens, with budget deficits and high unemployment rates lingering in many of the export destinations, Guangzhou's exports growth will likely continue to slow in the next few months.

Moreover, China as a whole may face a tougher situation in the face of the rise of protectionism resulted from the financial crisis. Guangzhou exporters will be no exception.

In the first five months, total exports increased 53.1% to 39.4 billion yuan by value. The growth rate has declined by 4.1 percentage point, however, pointing to a further slowdown in exports growth.

Consumer price index grew 2.8% annually. Price levels of consumer products and services increased 3.7% and 0.8% respectively. Clothing, living and food costs rose 5%, 4.9% and 4.3% respectively from last year.

Producer price index, also known as factory gate price, increased 3.0% year on year in the first half. However, manufacturers are increasingly facing a more adverse situation in which purchase prices of raw materials, fuel and energy increased 10.6% in a year. That means that price inflation of production input, as well as rising labour costs, is eating into manufacturers' profit.

KEY ECONOMIC INDICATORS

	Q109	Q209	Q309	Q409	Q110	Q210
Fixed asset investment (billion yuan)	37.7	52.2	63.4	112.7	52.1	76.9
Exports (US$ million)	7,470	8,682	10,263	10,983	9,883	12,299
Inflation (%) (year on year change)	-1.6	-3.9	-3.6	-0.8	1.7	3.9
Realised FDI (US$ million)	657	1,319	1,106	691	681	1,402
Retail sales (billion yuan)	80.7	88.3	95.6	100.1	97.5	106.7

Source: Guangzhou Municipal Bureau of Statistics, Vigers Research

Land market

There was no major deal for residential or commercial sites in Q210.

On May 31, Suning Appliance, a major chain consumer electronics retailer, acquired an industrial site in Longgang District (north of Hulin Road) for 108.07 million yuan. The site covers 30,000 sq m of land area and is designated with a maximum plot ratio of 2.5 times, on a 50 year leasehold term. Accommodation value is assessed at 1,440 yuan per sq m.

Up until June 26, a 1.295 billion yuan deal for a residential land parcel was concluded. Two residential land parcels (Sites A and B), located in a golf course at Old Longxi Road, were sold in a bundle to the real estate arm of China Railway Group. The sites fetched 625 million yuan and 670 million yuan respectively, equating to 7,408 yuan per sq m and 7,296 yuan per sq m in terms of accommodation value.

In fact, there were only 12 land deals in the first half of the year. These land deals involved 159,000 sq m of site area, worth 2.919 billion yuan. The market has only absorbed less than 10% of the supply projected for 2010, therefore it is almost a certainty that more development sites would be put on the market in the second half of the year.

There will be more land auctions in the ensuing months. So predictably lower land prices may send house prices, or bread prices, declining.

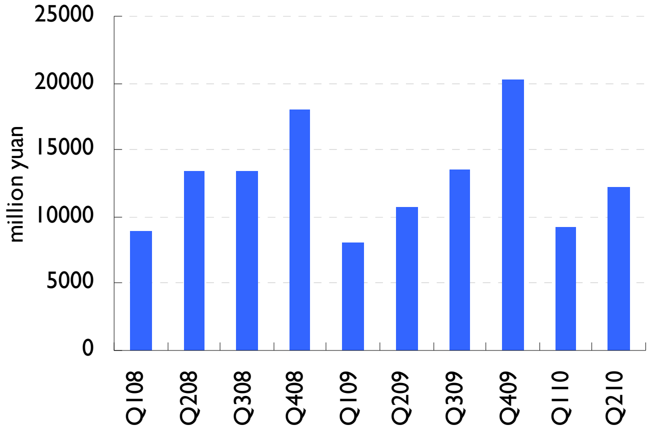
Residential market

The situation can be described as a typical Mexican standoff. The majority of developers were still persistent with selling prices of their new projects on the market, even they are holding a high number of unsold stock. On the other side of the table, more would-be buyers are apparently holding off their purchase until the stance of developers softens.

Real estate investment value grew 13.6% from a year ago to 12.2 billion yuan in Q210. Commencement of more government subsidised housing projects has contributed to the stronger growth in development activity. According to government plan, a total of 80,000 affordable housing units are planned for this year.

In addition to building more homes for lower income groups, a number of regeneration schemes in some rundown areas are under way. In a decade, the Guangzhou Government targets to tear down and regenerate over 900,000 sq m of urban land, investing up to 100 billion yuan in these projects.

RESIDENTIAL REAL ESTATE INVESTMENT

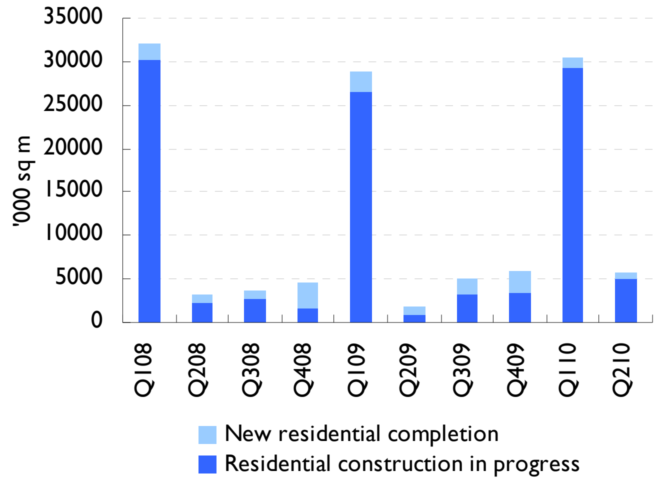


Summary of Guangzhou's austerity measures

- Increase residential land supply and accelerate construction of affordable housing schemes and allocation of public rental flats to eligible applicants
- Strengthen market oversight; for instance, the developer must sell its stock units on the open market within 10 days of approval. Also, transaction price of each flat must be disclosed
- Tighten bank lending to curb speculations; also, if house prices continue to grow at an unreasonable pace, the authorities may consider imposing more anti-speculation measures
- Reassess credit risks of developers. Developers' credit status has to be followed through especially during refinancing activities, incl IPOs, M&A, restructuring, etc

  As for home loans, banks are asked to scrutinize borrowers' income situation more carefully, and requirements for taking out mortgages are tightened
- Crack down on speculative land banking. Developers which fail to commence construction work or complete projects on time, or being found engaged in land banking [to prop up property prices], will be penalised or even have their land forfeited
- The abovementioned policies are nothing new, and in fact, they are mimics of the central government's directives. And compared with Beijing, Guangzhou has no new rule to limit personal purchases, ie third home purchase, foreigners' purchase, etc

DEVELOPMENT PIPELINE



Source: Guangzhou Land, Resources and Housing Authority, Guangzhou Municipal Bureau of Statistics, Vigers Research

Sales volumes and prices

NEW HOME SALES

In Q210, new home sales volume fell 13% from Q110, but rose 40.6% from last year, to 1.61 million sq m of floor area. It is worth to note that more new residential projects are set to go on sale in the second half. Roughly speaking about 80 new projects across the city are on the market in July and August. Under more intense competition between developers, that will likely add more pressure on the new home prices in Q310 and Q410.

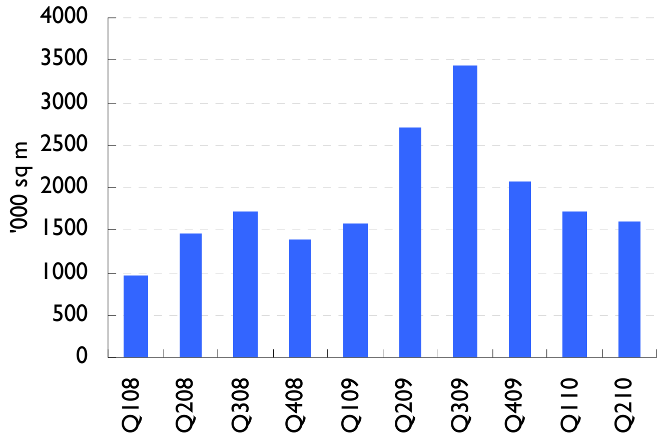
HOME RESALES

In Q210, secondhand home sales volume fell 10.7% from Q110, or fell 18.8% from last year, to approx 2.013 million sq m of floor area. By contrast, residential rents have grown 10% between the first two quarters, as tenant demand outstripped the number of rental properties, thereby pushing rents up. This is due to the reason that residents affected by the many renewal projects are looking for temporary homes before settling into a new neighbourhood.

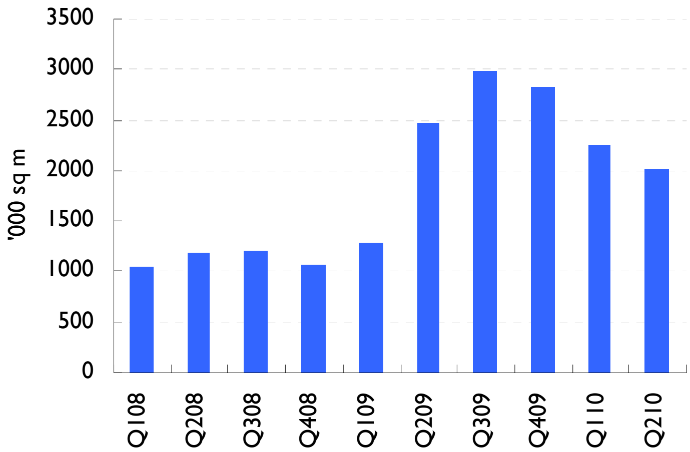
PRICING LEVELS

New home prices dropped a modest 0.8% from Q109, but were up 13.7% year on year, to approx 12,560 yuan per sq m. Average price for an average secondhand flat fell 1.4% from Q110, or 7% from last year, to approx 10,701 yuan per sq m.

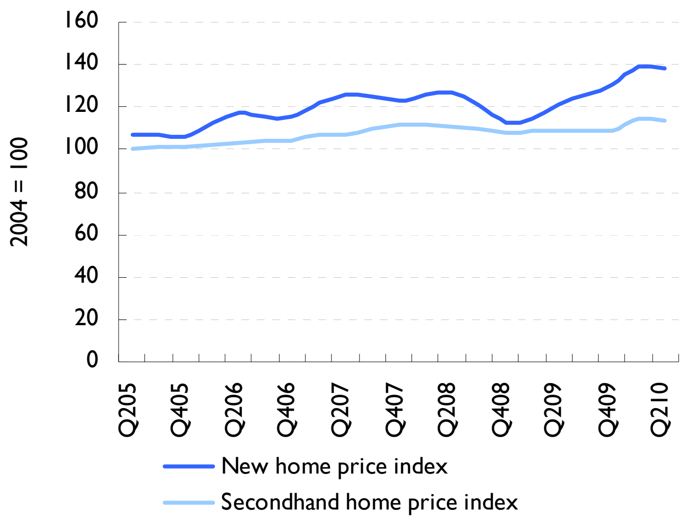
NEW HOME SALES



HOME RESALES



PRICING LEVELS



Source: Guangzhou Land, Resources and Housing Authority, Guangzhou Municipal Bureau of Statistics, Vigers Research

Prime residential

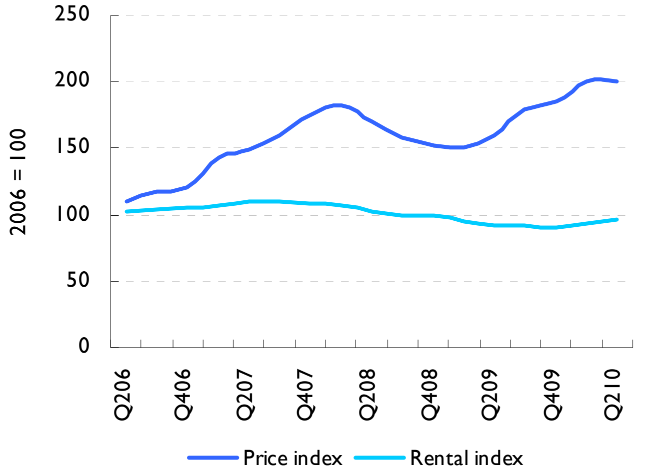
Even as the austerity measures weigh on the mass market, it had little impact on prime residential values, despite the fact that transaction volume shrank by 29.4% quarter on quarter, or down 56% year on year, to 15,640 sq m in terms of floor area traded.

Luxury home prices continued to show strength, posting only a 0.05% downward correction between the first and second quarters, ending at 26,274 yuan per sq m. That was still up 25% compared with a year ago. Rents were up 3.3% quarter on quarter, or 5.5% year on year. As the Guangzhou luxury residential market is somehow dominated by buyer occupiers, or end users, major sell off by investors has not taken place.

It is hoped that Asia Games will boost Guangzhou's role as an international city. We believe that it might draw the attention of investors from abroad seeking opportunity in its prime residential market. Most important, the Guangzhou authorities so far have imposed no rule against home purchases by foreigners.

On the other hand, as larger trade surplus of China makes yuan appreciation more likely in the coming months, the prime Guangzhou residential market could turn out to be the next investment destination.

PRIME RESIDENTIAL PRICES & RENTS



Source: Guangzhou Land, Resources and Housing Authority, Guangzhou Municipal Bureau of Statistics, Vigers Research

New luxury residential projects on sale

Project	Location	Unit sizes (sq m)	Unit prices (yuan/sq m)	Completion	Developer
Favorview Palace – Heywood Hill (Phase II) 汇景新城-龙熹山（2 期）	Tianhe	180-250 sq m (3-4 brs) 400-470 sq m (duplex units)	25,000 (standard units) 35,000 (duplex units)	April 2011	Kingold Group 侨鑫集团
Sunshine City (Garden Villa) (Phase III) 新光城市花园（三期）	Panyu	385-630 sq m (villas)	25,000-35,000	December 2011	GZ Century Sunbeam Real Estate Dev Co Ltd 广州世纪新光房地产开发有限公司
Yu Dong He Fu 御东和府	Yuexiu	65-140 sq m	28,000 (bareshell)	April 2011	GZ Jianhe Real Estate Dev Co Ltd 广州建和房地产开发有限公司
Fineland Moon Island 方圆月岛	Pearl River New City	60-170 sq m	18,000-25,000	2012	GZ Finland Group 广东方圆集团

Source: Beijing Municipal Housing and Land Administration Bureau, various property websites, Vigers Research

Prime office

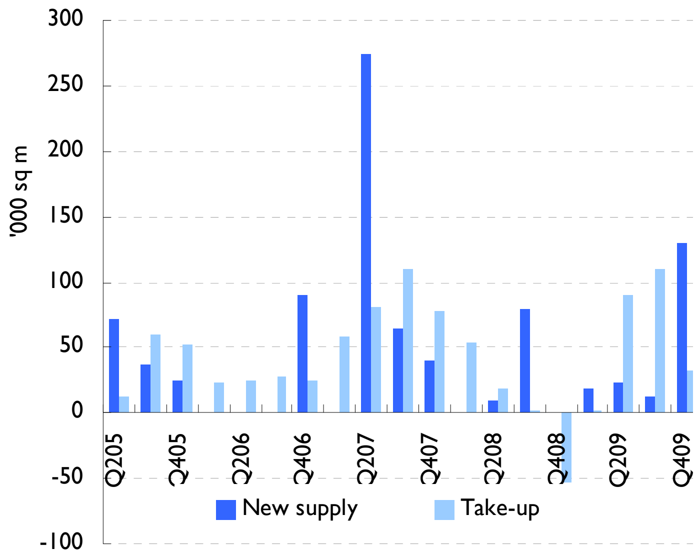
The second quarter saw an encouraging increase in office letting activity. New supply was 67,000 sq m, which slightly exceeded 51,000 sq m of net take-up.

Prime rents grew 3.6% from Q110 to 132 yuan per sq m. Vacancy rate has declined 6.8 percentage points to 14.9%. It is expected that the Asian Games will boost economic activity, and thereby the occupier demand for Guangzhou office space. Average capital value stood at 23,900 yuan per sq m, compared with 23,780 yuan per sq m in Q110.

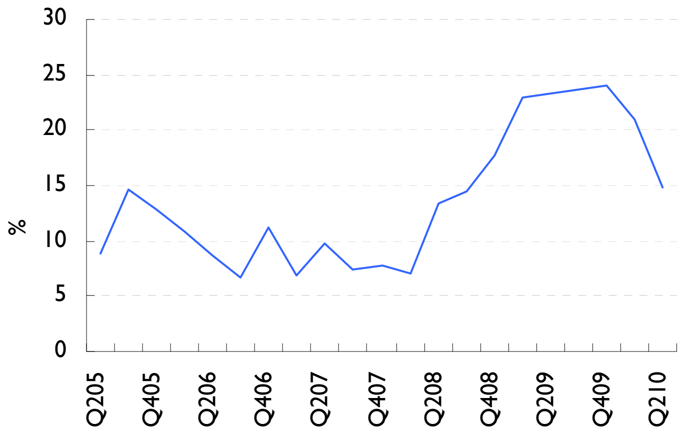
In spite of improving occupier demand the large amount of stock in the pipeline, which we estimate at 450,000 sq m of floor space, will continue to put pressure on rental prices and upward pressure on vacancy rates.

For instance, Pearl River New City will see 350,000 sq m of office space to be complete and enter the market in the second half. And by 2011, the submarket will have 20 office projects complete, bringing in 2-3 million sq m of floor space.

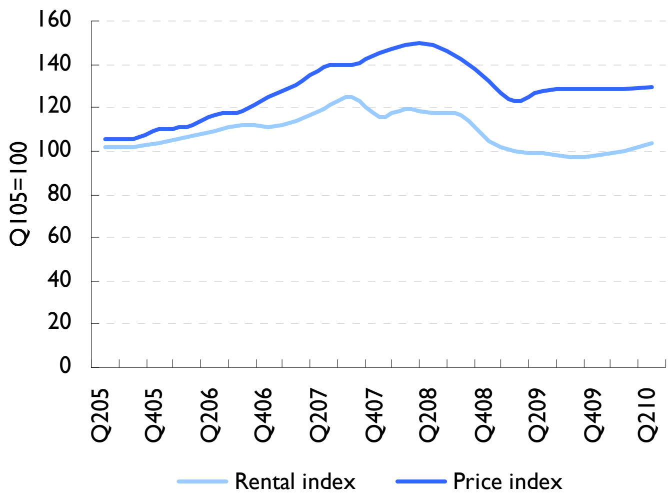
NEW SUPPLY & TAKE-UP



VACANCY



PRICES & RENTS



Source: Guangzhou Municipal Bureau of Statistics, Vigers Research

New office and retail projects

Project	Uses	GFA (sq m)	Completion	Developer
G.T. Land Plaza 高德置地广场	Office, retail	920,000	Q111	GT Land
Liede Villa Regeneration Project 猎德村商业项目	Office, hotel, retail	568,000	Q410	R&F, SHKP & KWG
Pearl River New City Underground Plaza / Central Plaza 珠江新城地下广场/暂名 “中环广场”	Retail	150,000	2011	Guangzhou New Axis
Sun City Plaza 太阳城广场	Retail	87,000	Q410	Guangzhou Huajun

Source: Vigers Research

Prime retail

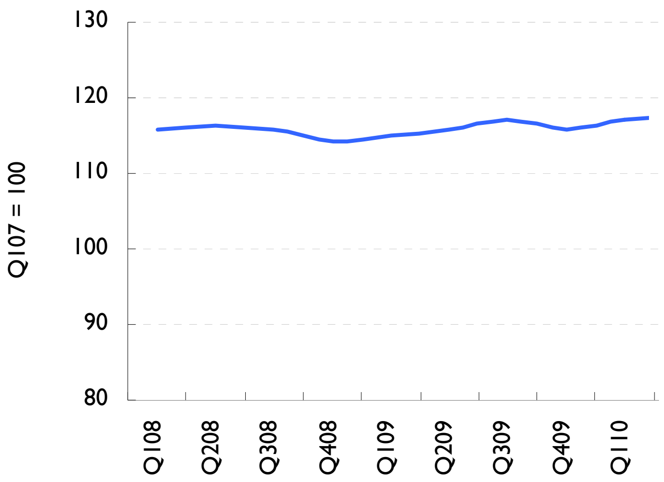
Benefitting from significant growth in the retail market, prime retail rents grew 1.3% on the first quarter, or 0.3% on last year. Retail sales grew a steady 18.1% in the first five months, to 164.602 billion yuan on a year over year basis.

There was no new supply in Q210. However, a number of projects are already in the pipeline, of which about 730,000 sq m of retail space will likely come onto the market in the second half.

Letting activity was buoyant. New brands are seeking to grab a market share by increasing their Guangzhou presence in order to cash in on the tourists brought in by the Asian Games.

In short run, vacancy will face mild upward pressure, but in the mid term, we see a larger retail supply, suggesting that rental growth would slow afterwards. In the second half, circa 890,000 sq m of retail space will complete and enter the market.

PRIME RETAIL RENTS



Source: Guangzhou Land, Resources and Housing Authority, Vigers Research

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