Living cities

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China: Opportunity and Risks

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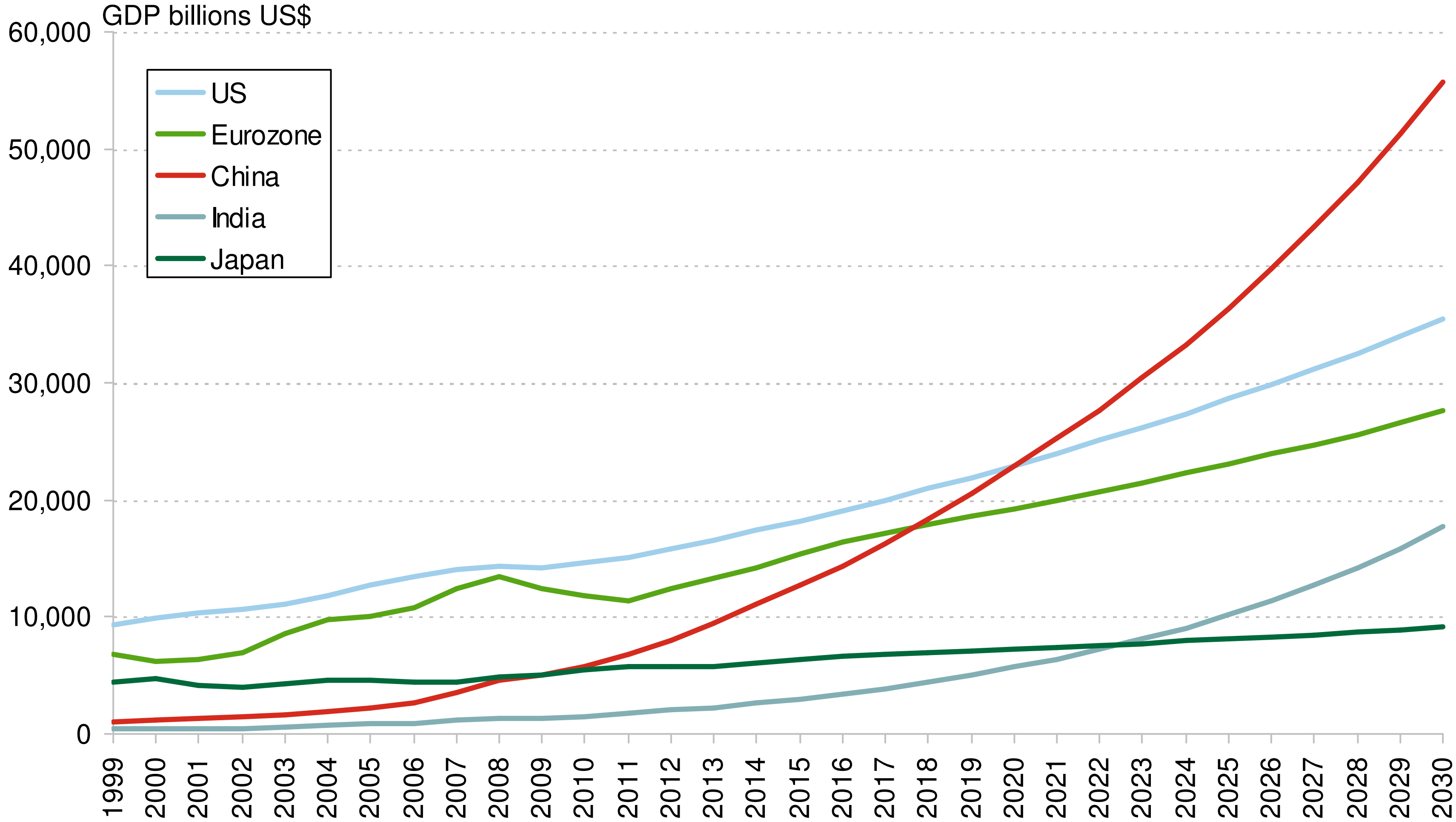
The Opportunity

One of the world's most rapidly growing economies



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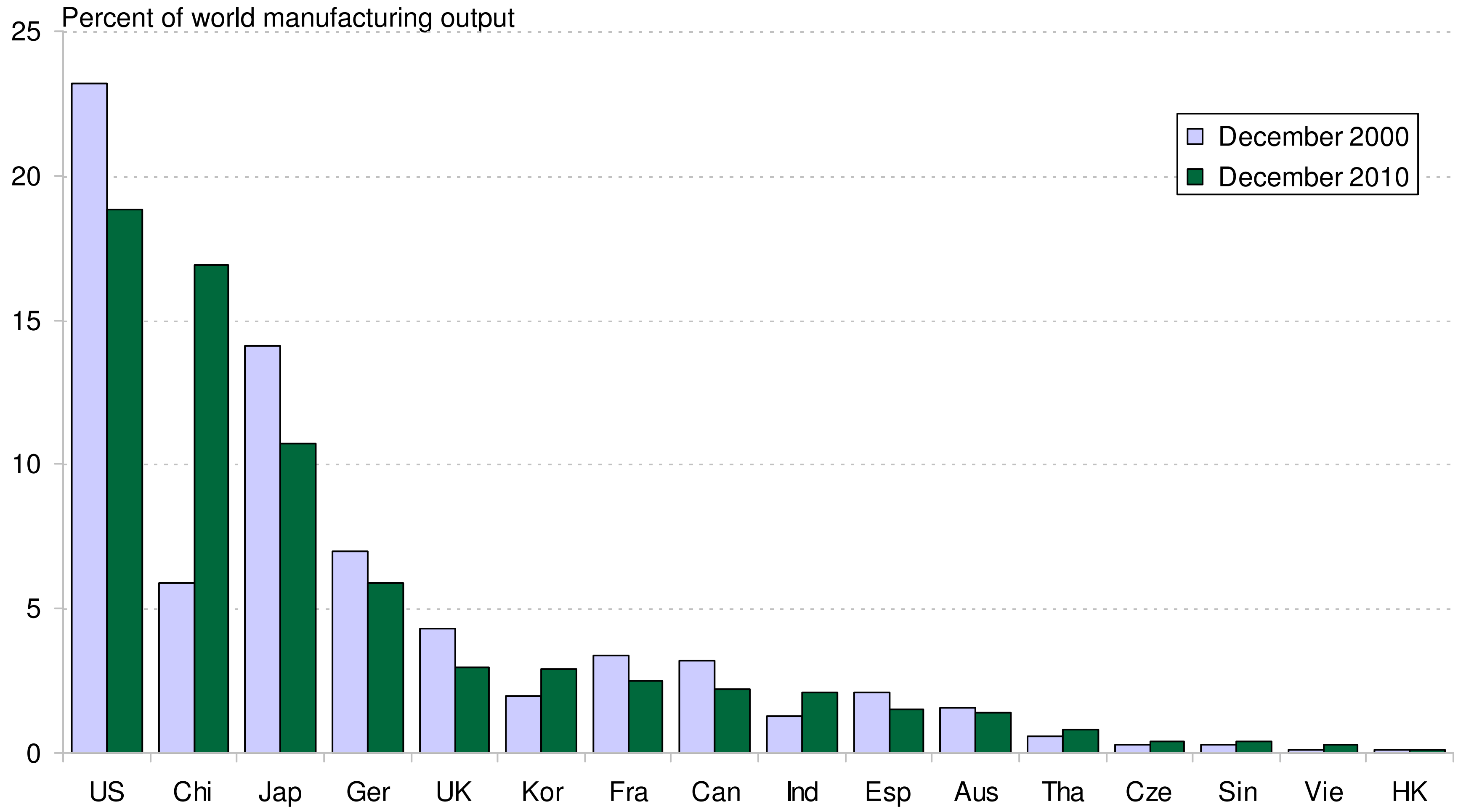
Source: Global Insight, Grosvenor Research, 2010

Growth has been export led



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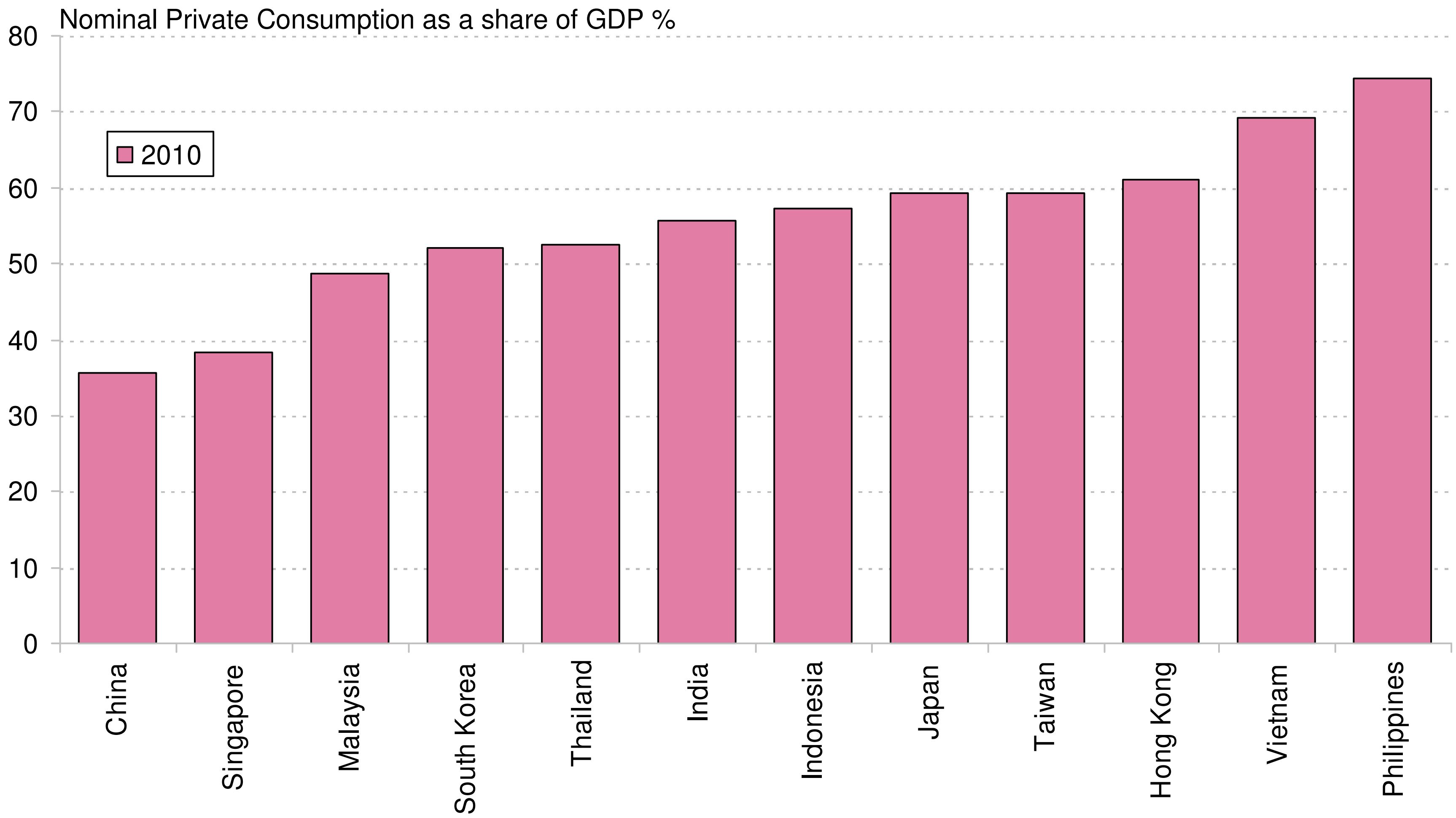
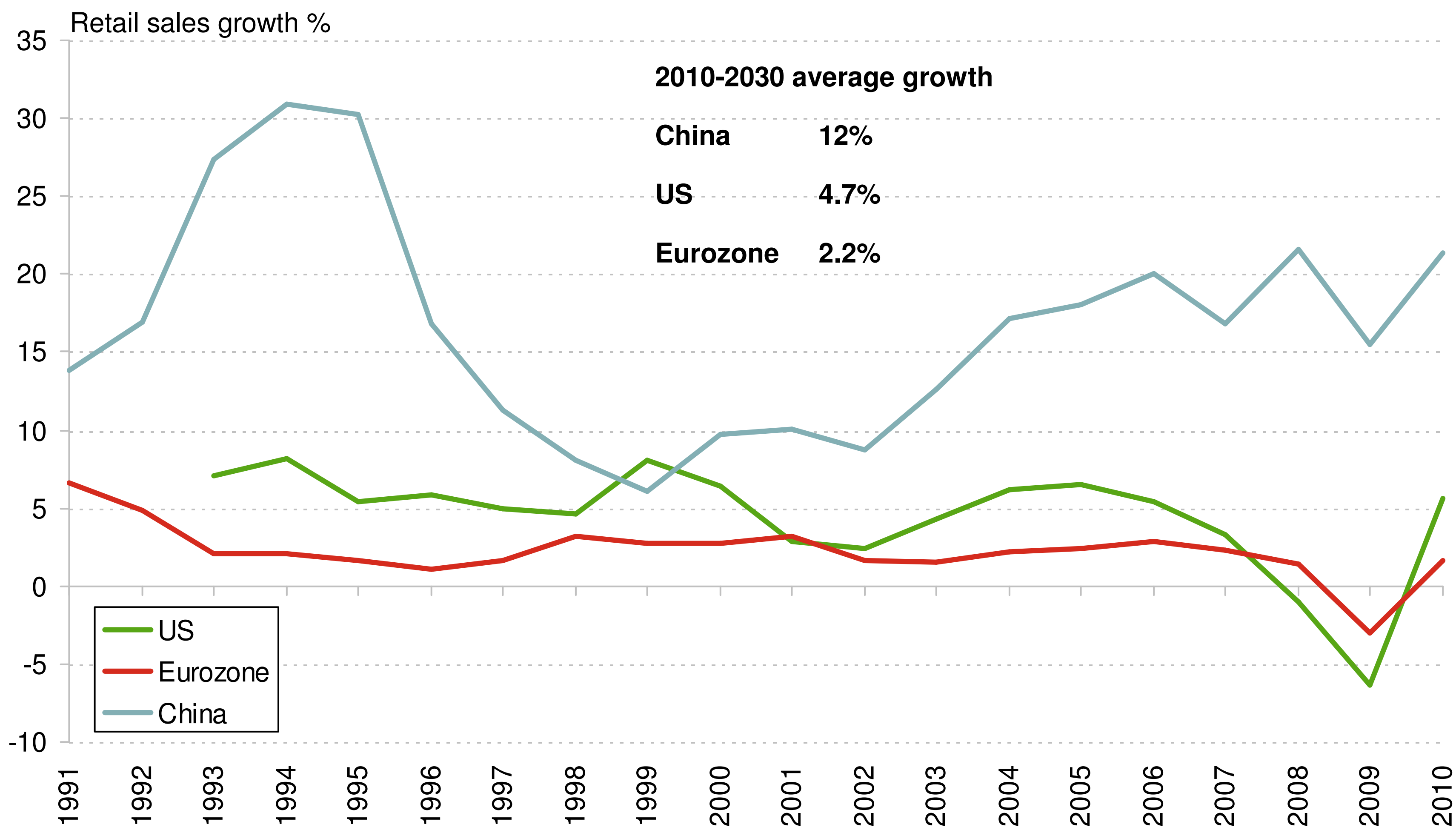
Source: EcoWin

Consumption is set to play a greater part



Source: Global Insight, Grosvenor Research, 2010

Leading to continued rapid retail sales growth



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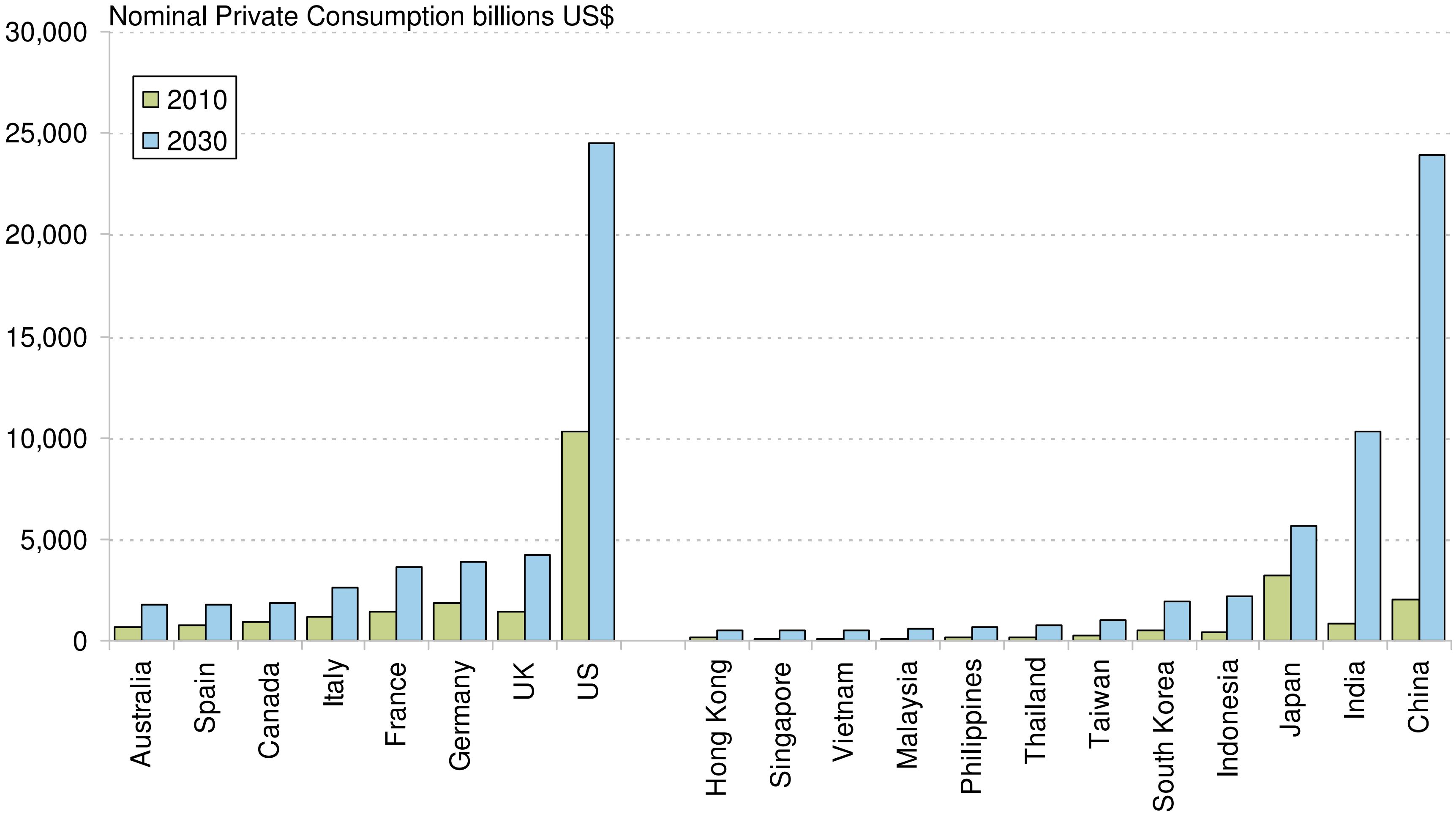
Source: Global Insight, Grosvenor Research, 2010

In 20 years China will consume as much as the US



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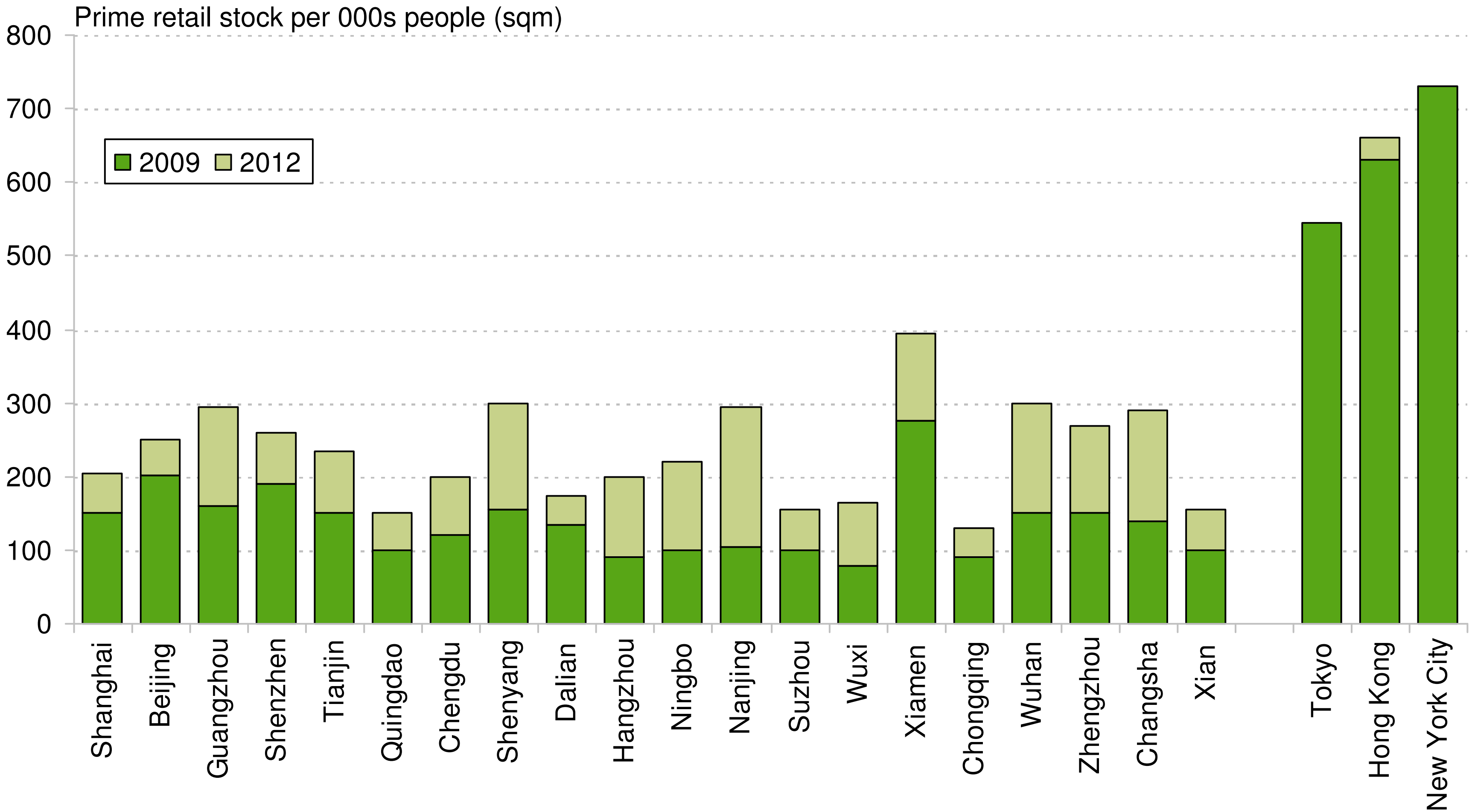
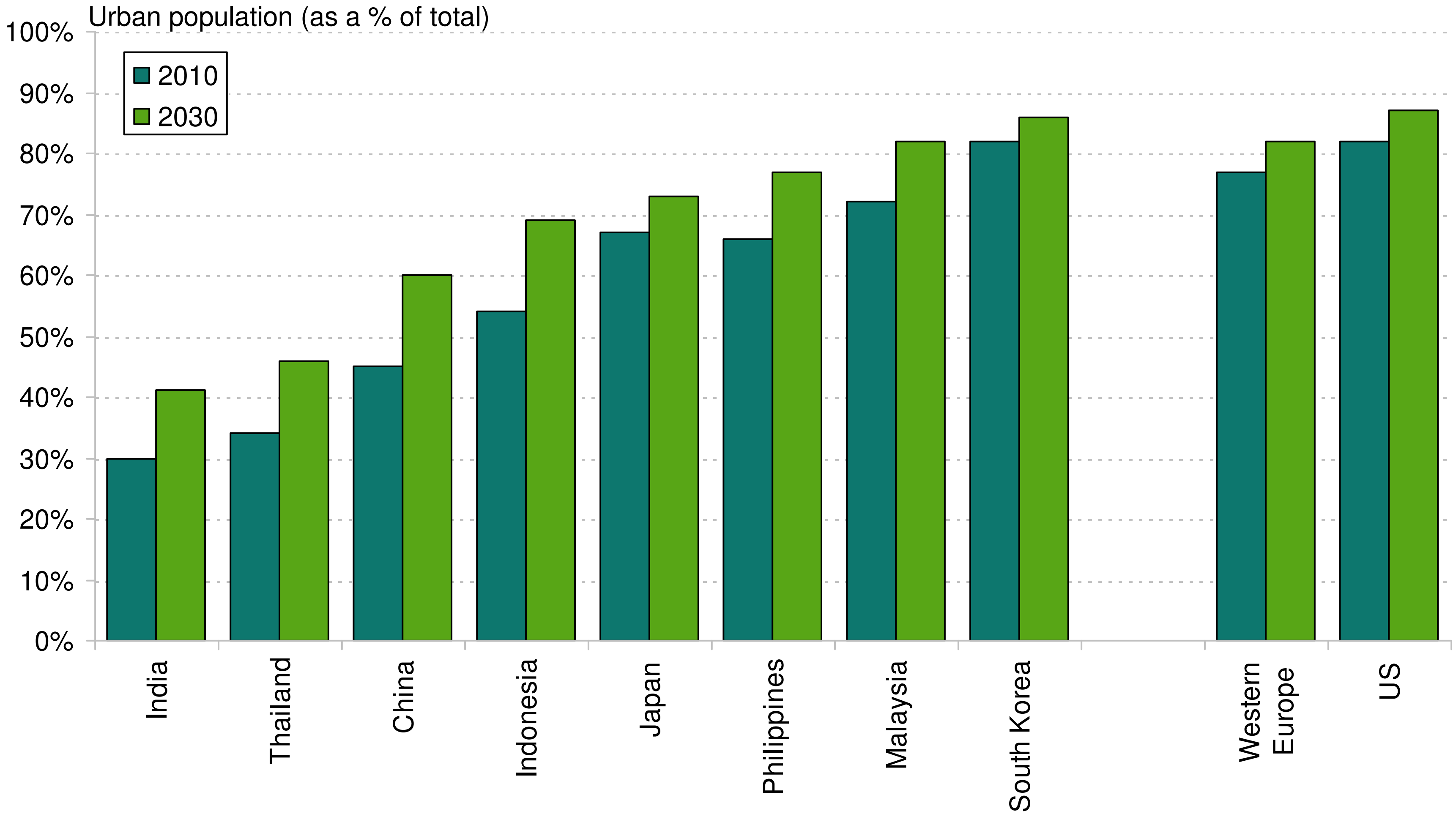
Source: Global Insight, Grosvenor Research, 2010

So retail prospects are good, even with a supply surge



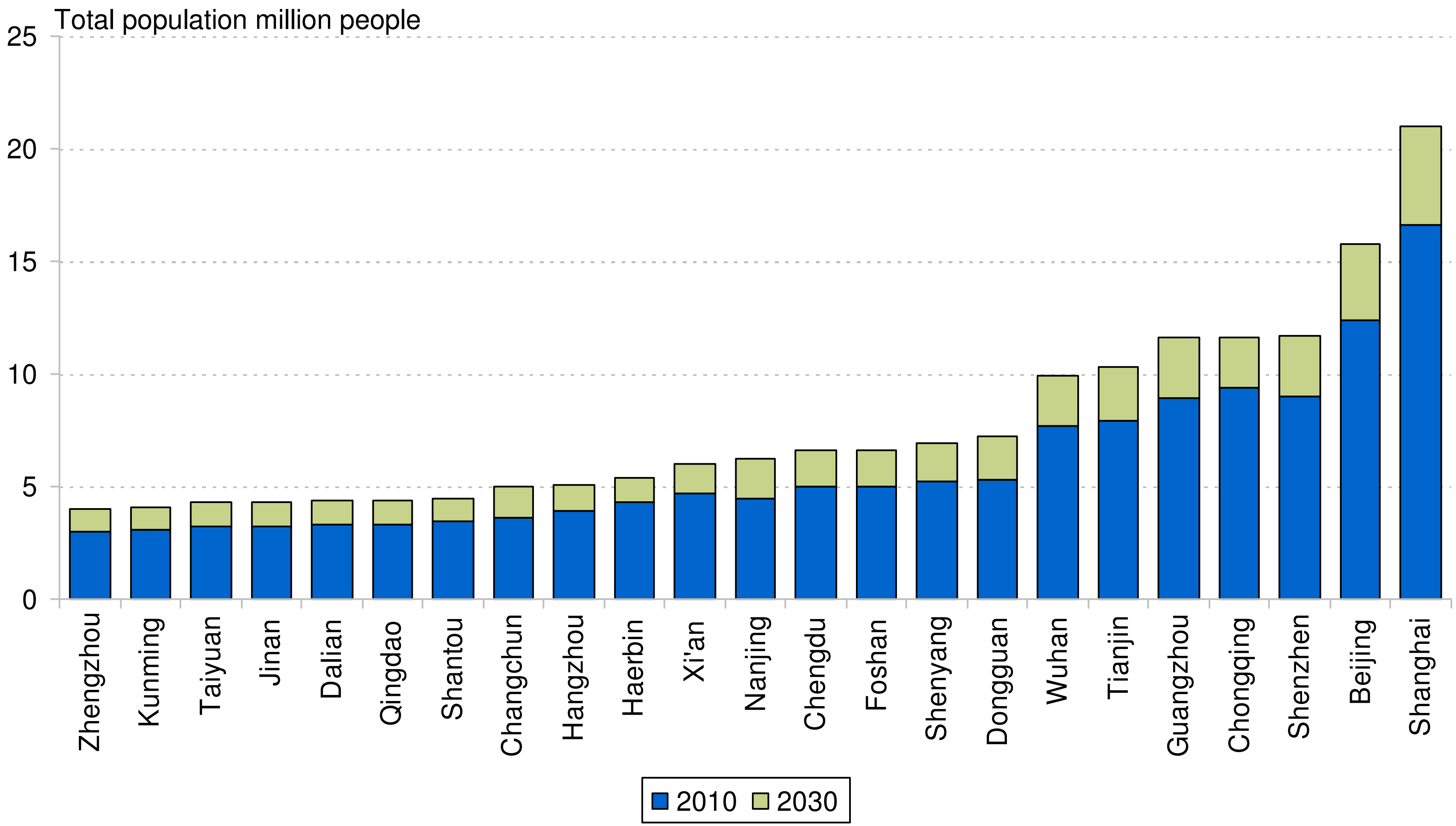
Source: Various, Grosvenor Research, 2010
N.B.: the definition of prime retail stock varies across markets. For example, it includes street shops in European cities or major department stores in Tokyo.
In China, prime retail stock is mainly concentrated in shopping malls.

China's cities are growing very rapidly



Source: UN, Grosvenor Research, 2010

There are a lot of growing cities in China



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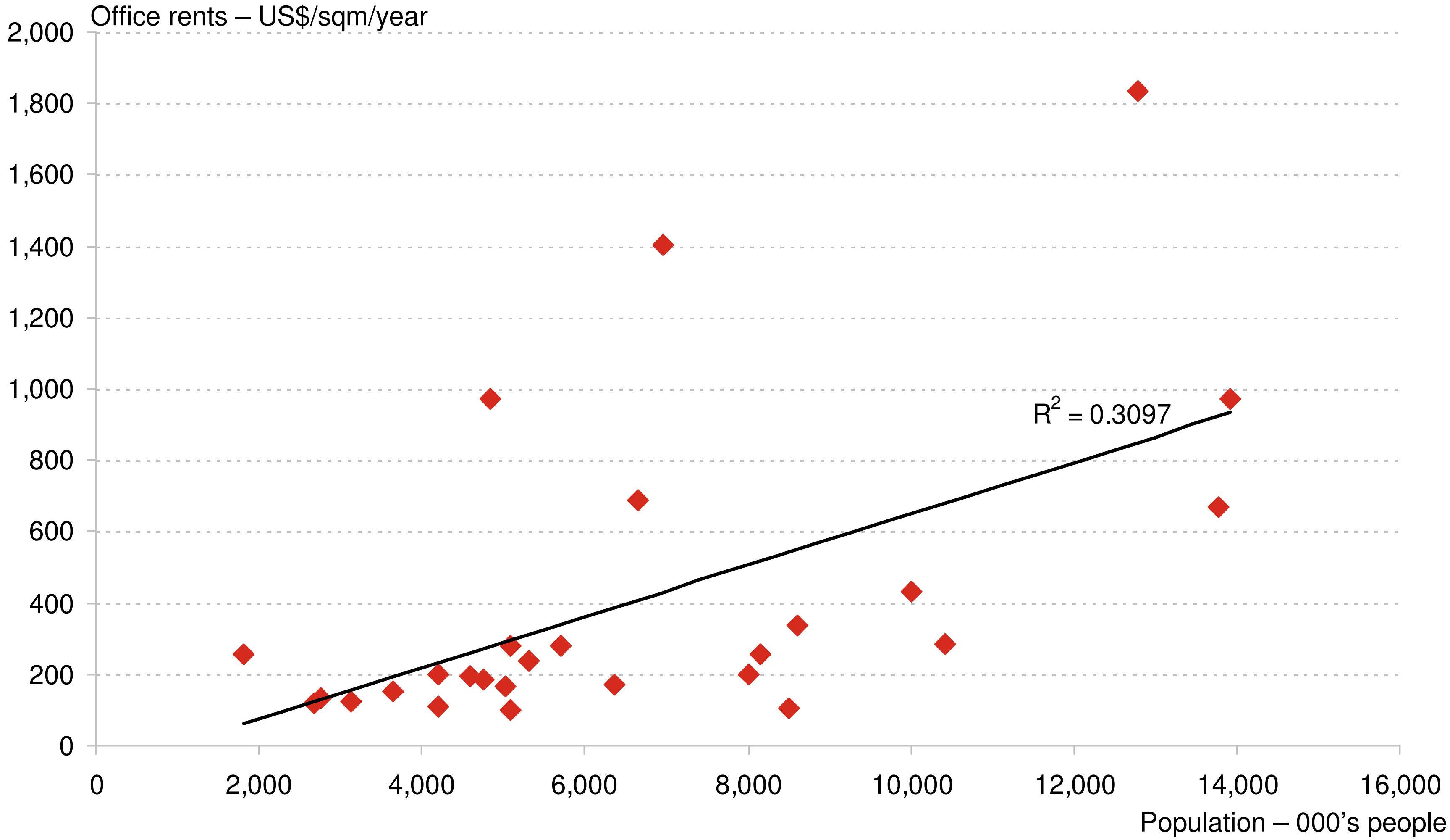
Source: UN, Global Insight, Grosvenor Research, 2010

Population and rental levels are quite well correlated



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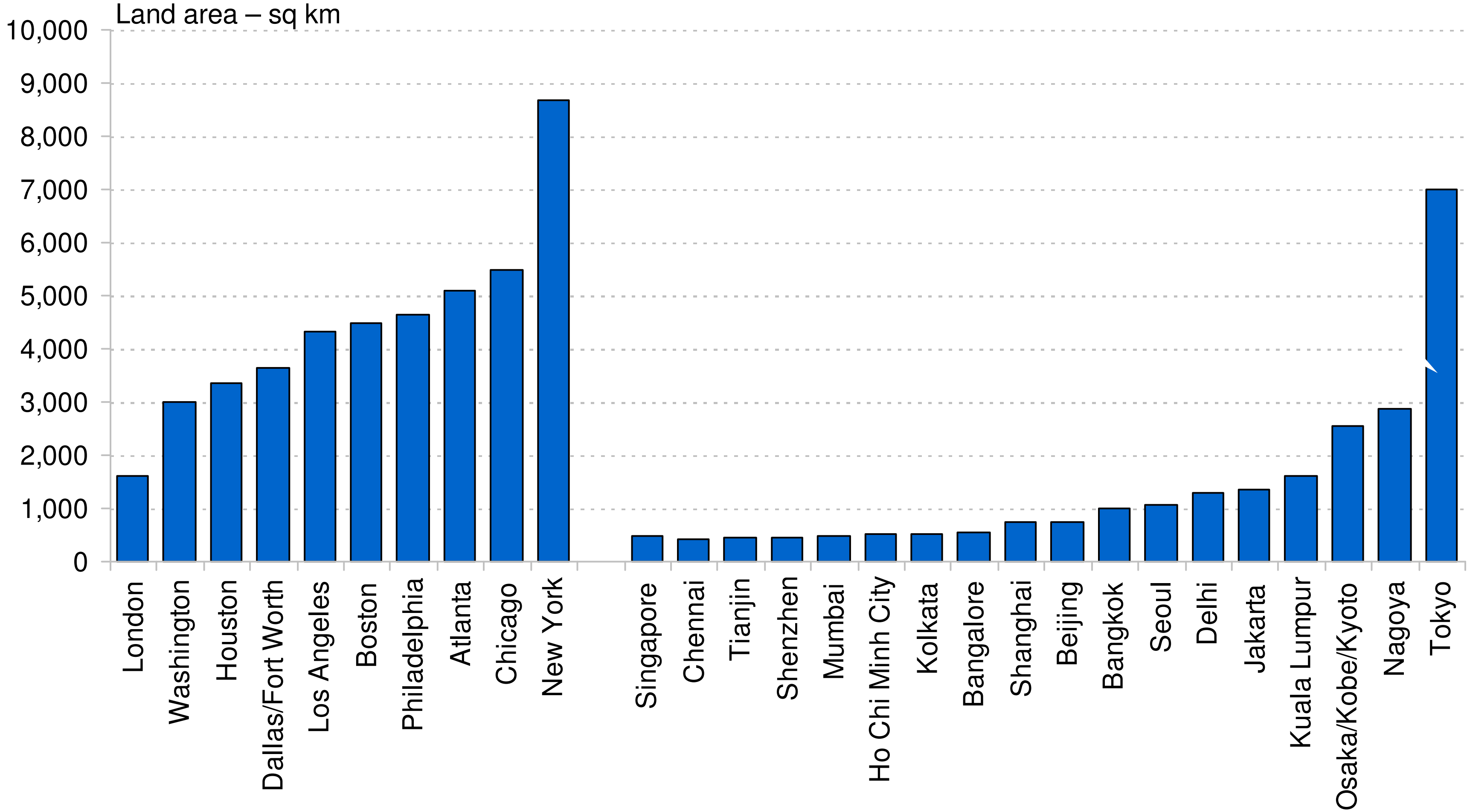
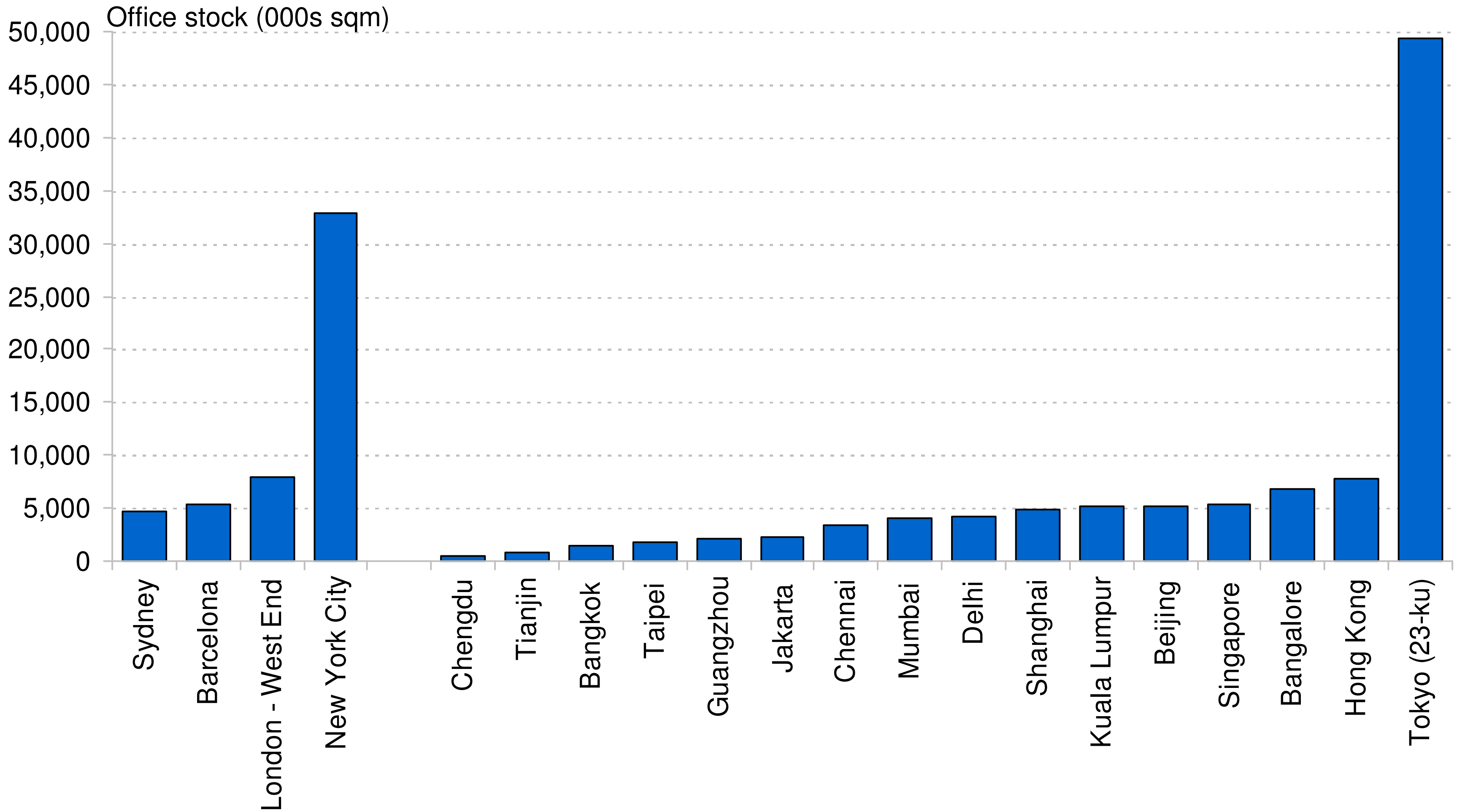
Source: Grosvenor Research, 2010

Suburbanisation is also a key driver of rents in the longer term



Source: UN, Citymayors, Grosvenor Research, 2010

As will be the development of the service sector



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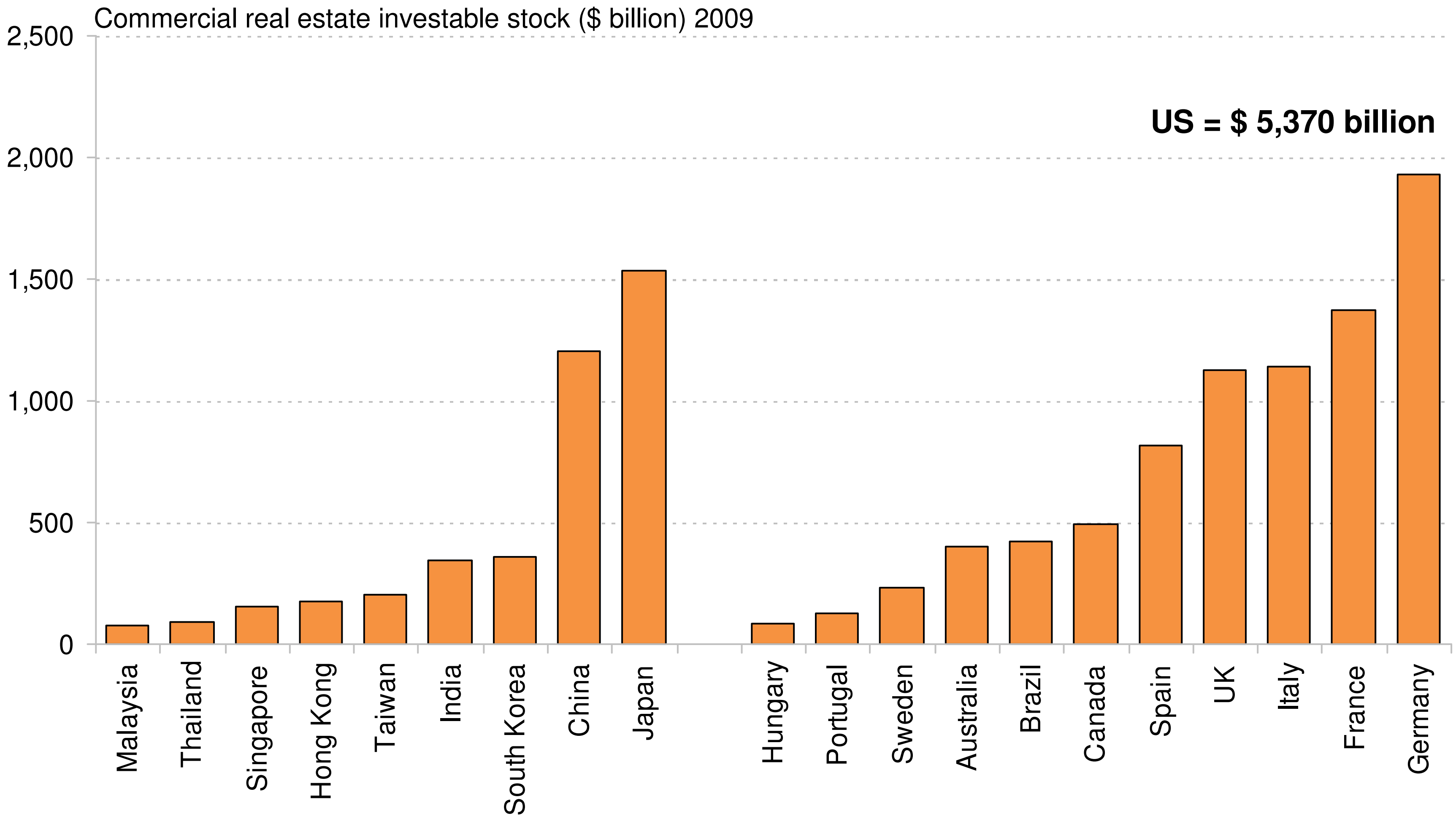
Source: Various brokers data, Grosvenor Research, 2010

China’s investment market is large and growing



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Source: DTZ, Grosvenor Research, 2010

The opportunities

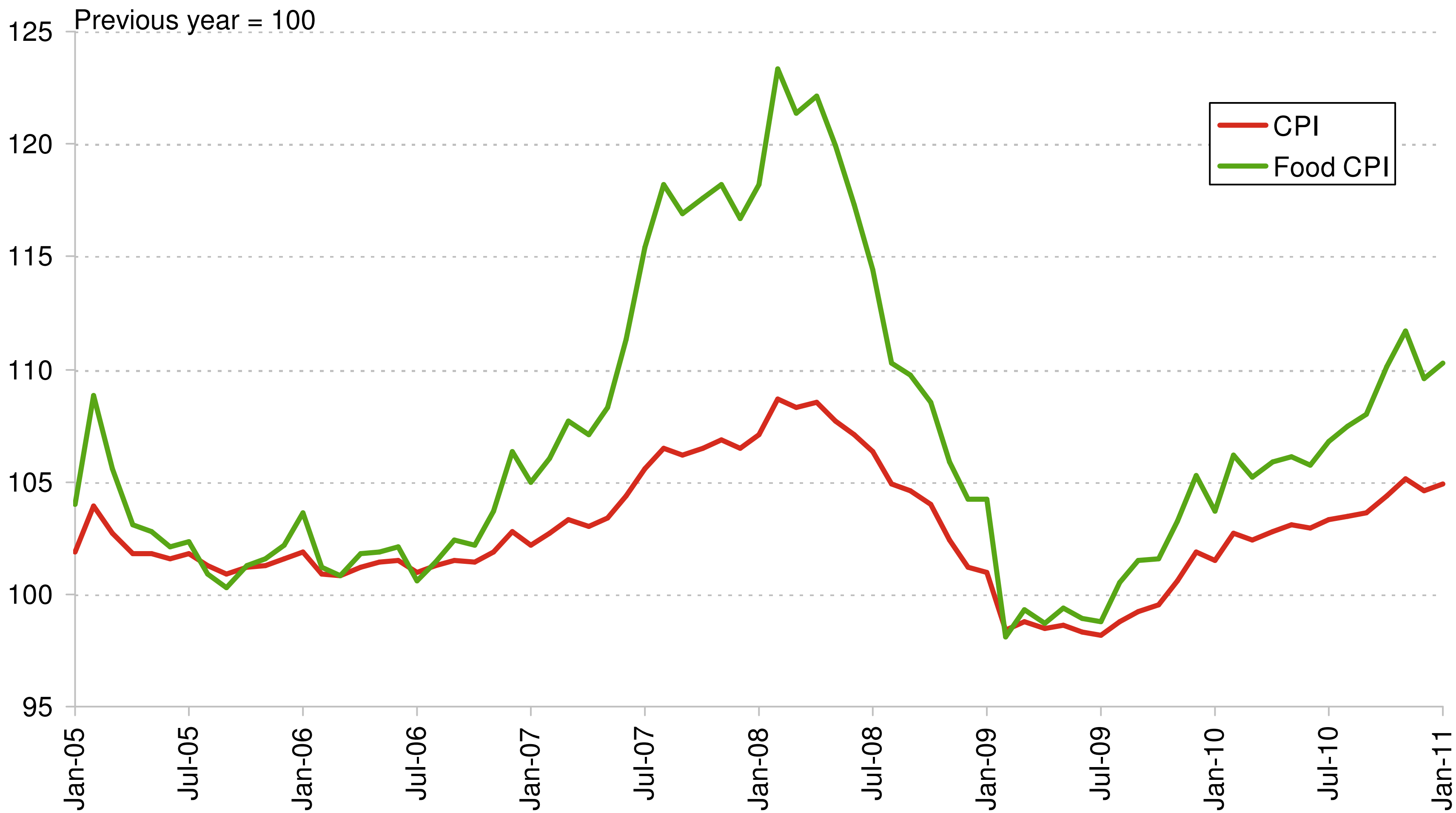
- **Retail**, offices, **residential**
- Core, **value-add**, opportunistic, **development**
- Core returns – post leverage and tax = 13% -15%
- Value add – post leverage and tax = 16% -19%
- Development – post leverage and tax = 20%

The Risks

Poor data often obscures the true economic picture

"Say … what's a mountain goat doing way up here in a cloud bank?"

Inflation could be higher than official data suggests



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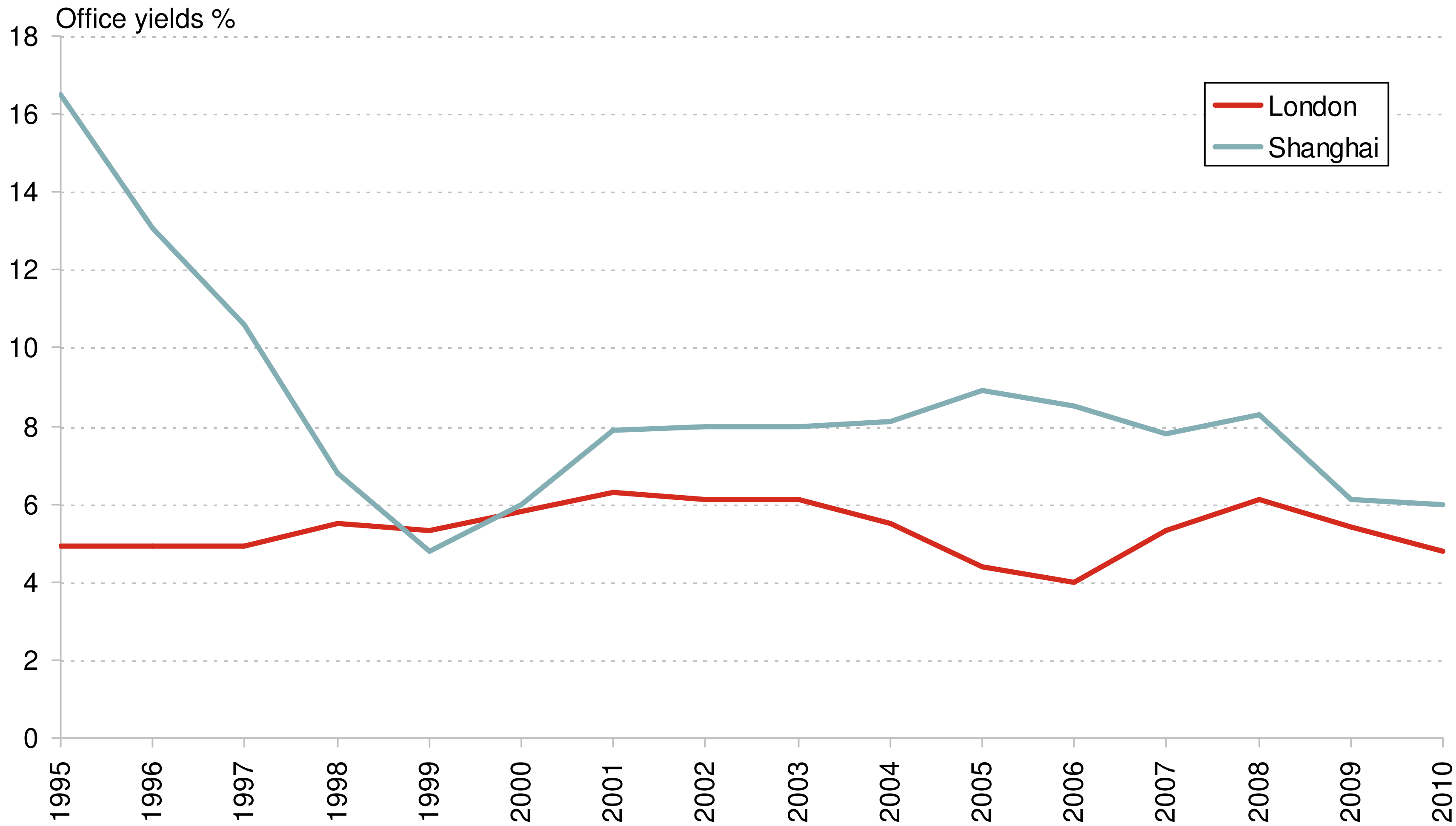
Source: CEIC, Grosvenor

Chinese yields converge on those of the developed world



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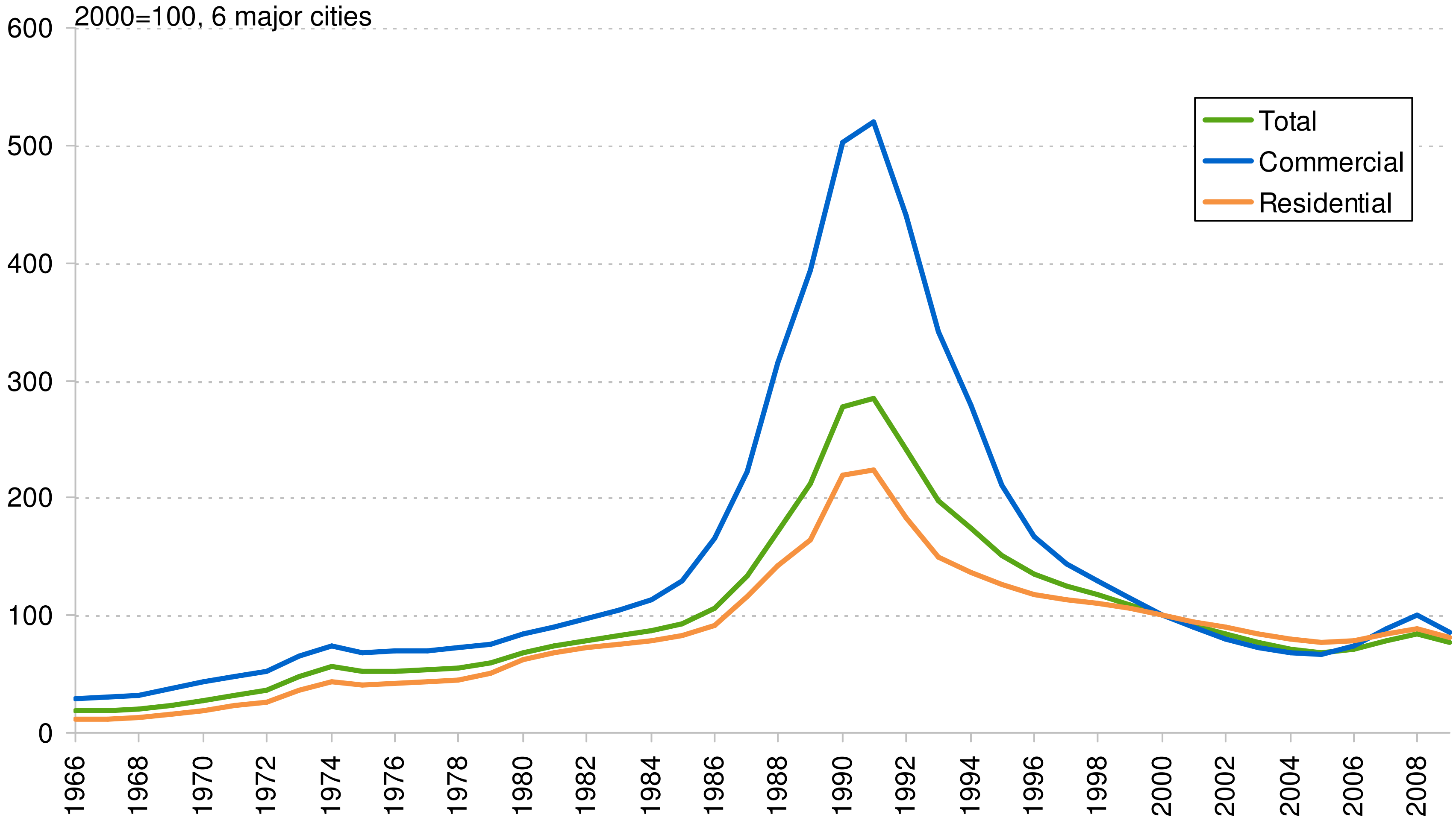
Source: Various, Grosvenor Research, 2010

The spectre of Japan looms large



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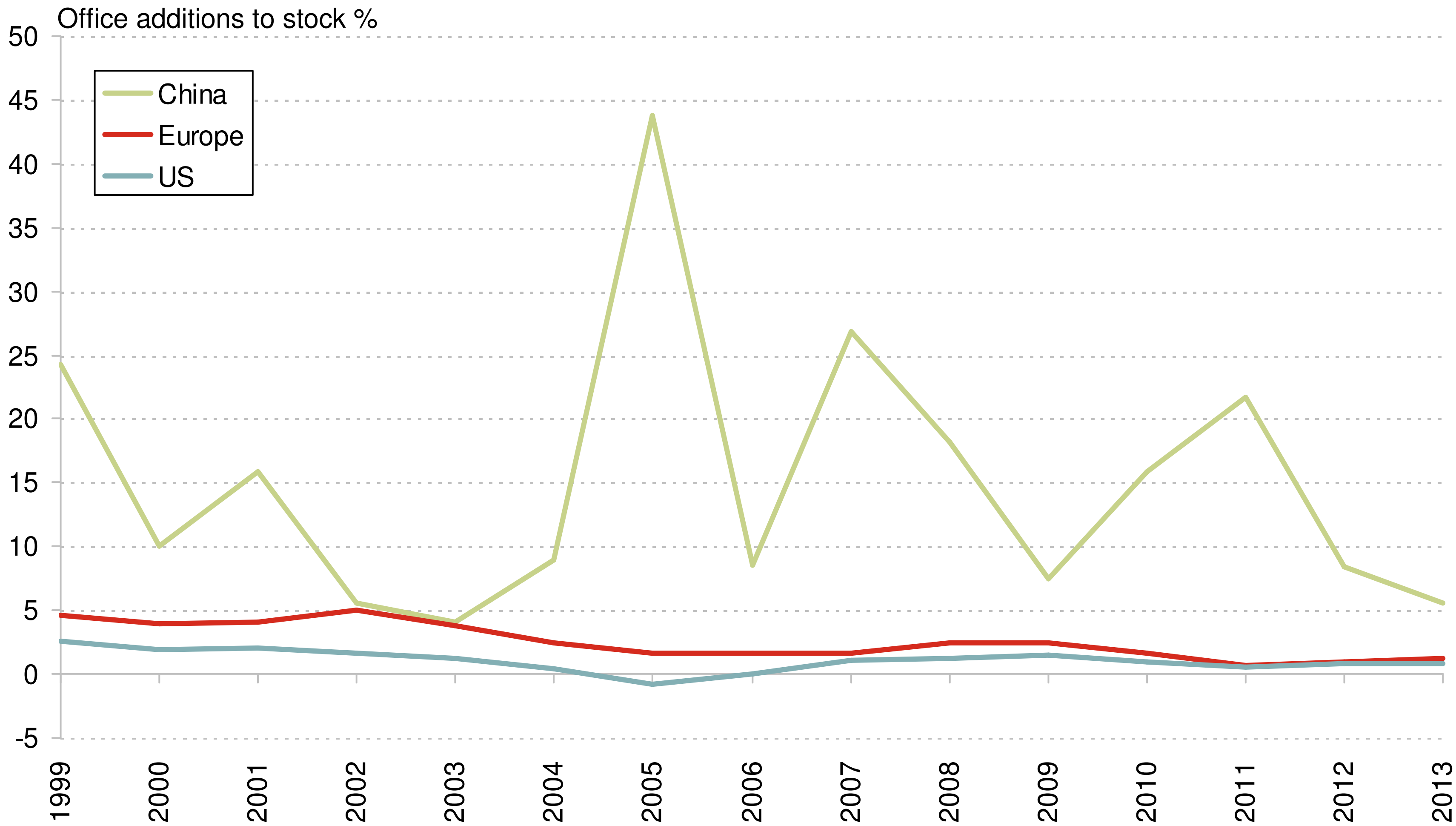
Source: Japan Real Estate Institute

Chinese supply cycles are extremely volatile



Source: Various, Grosvenor Research, 2010
N.B.: China is an average of markets in tier 1 cities

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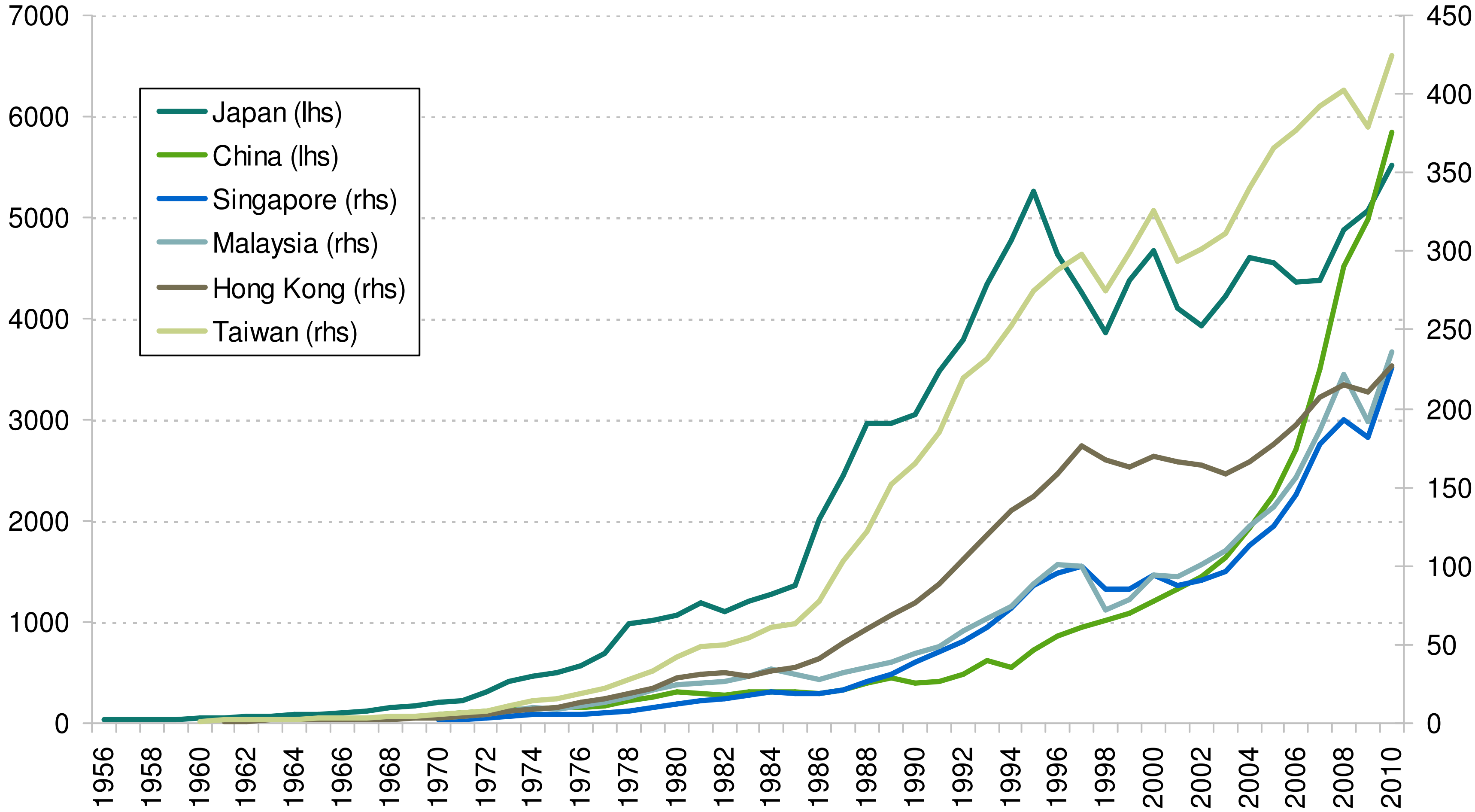
China has shown meteoric nominal GDP growth



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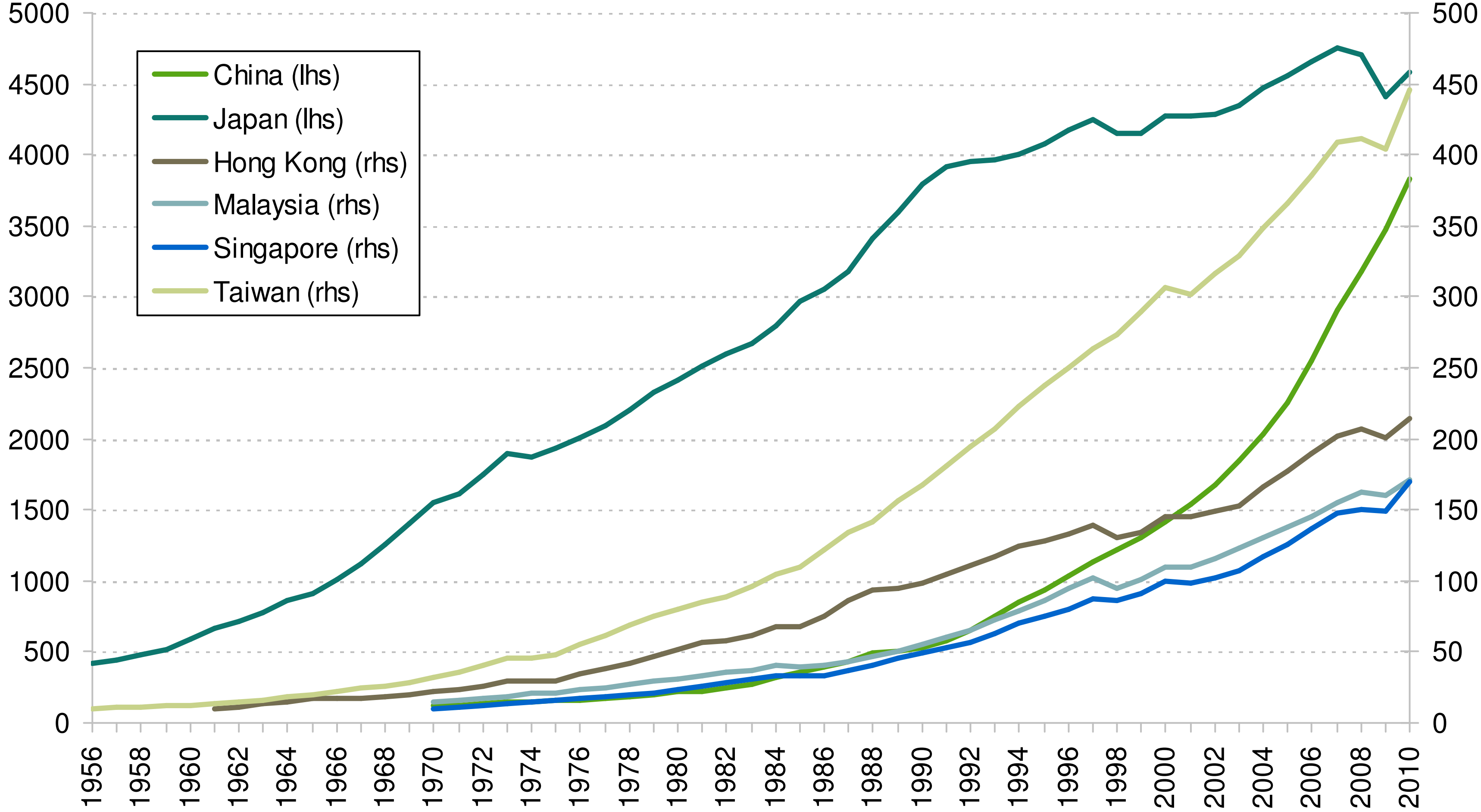
Source: IHS Global Insight

As well as meteoric real GDP growth



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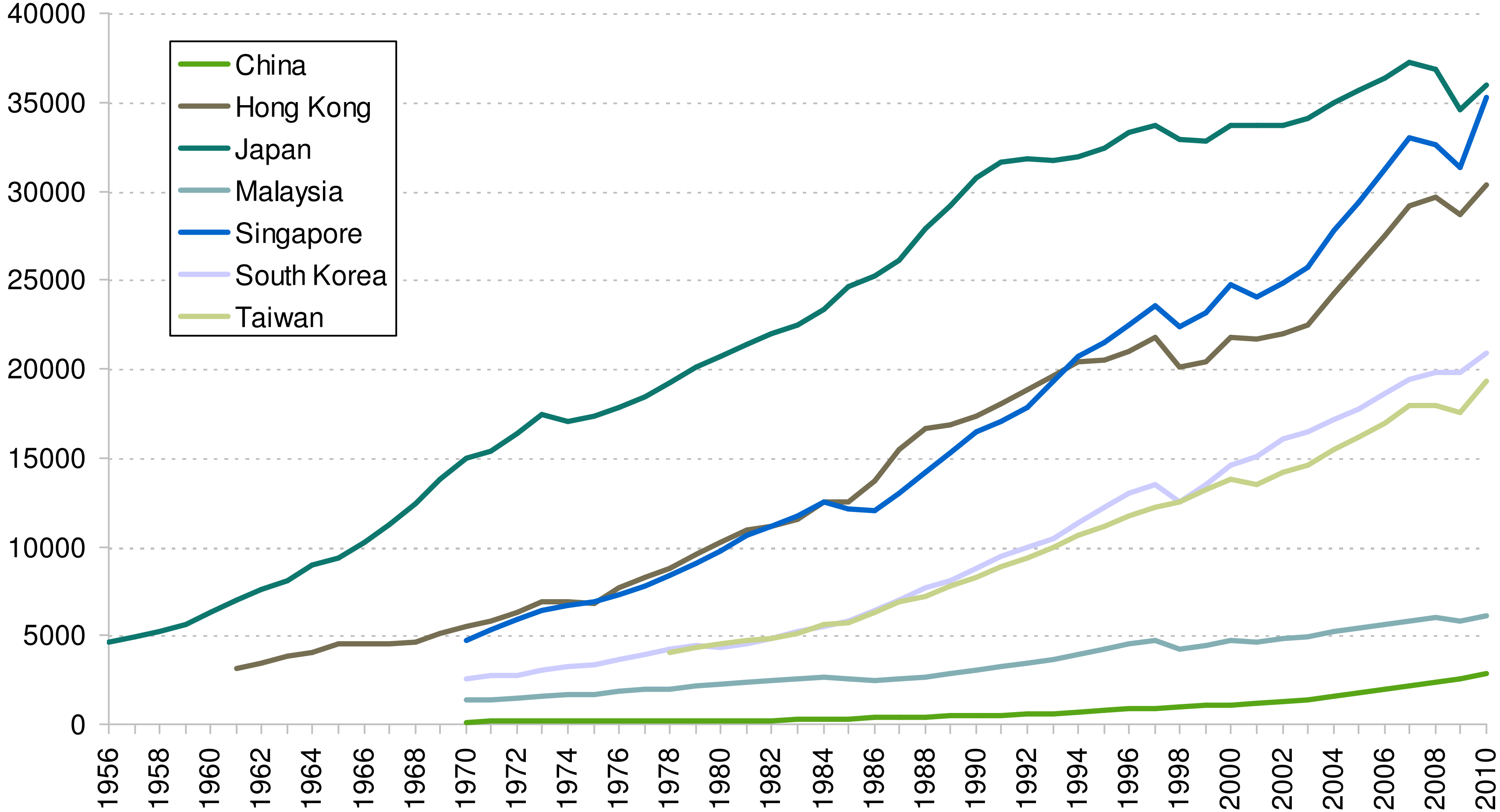
Source: IHS Global Insight

However, gains in real per capita GDP are less impressive



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Source: IHS Global Insight

Other risks

- **Excess supply**
  - Too much ‘ill-thought out real estate’
- **Sellers market**
  - many vendors are not genuine
- **Older vehicles subject to ‘hidden’ liabilities**
  - Need to look at previous owners – particularly local developers
- **Need permission to create ‘WFOE’**
  - can be withheld
- **Deeds of Mutual Covenant – in mixed use developments**
  - Restrictive and difficult to alter
- **Lack of planning approval to construct**
- **Bubble trouble?**
  - Banks LTVs are 55% but ‘finance companies’ provide top-up loans

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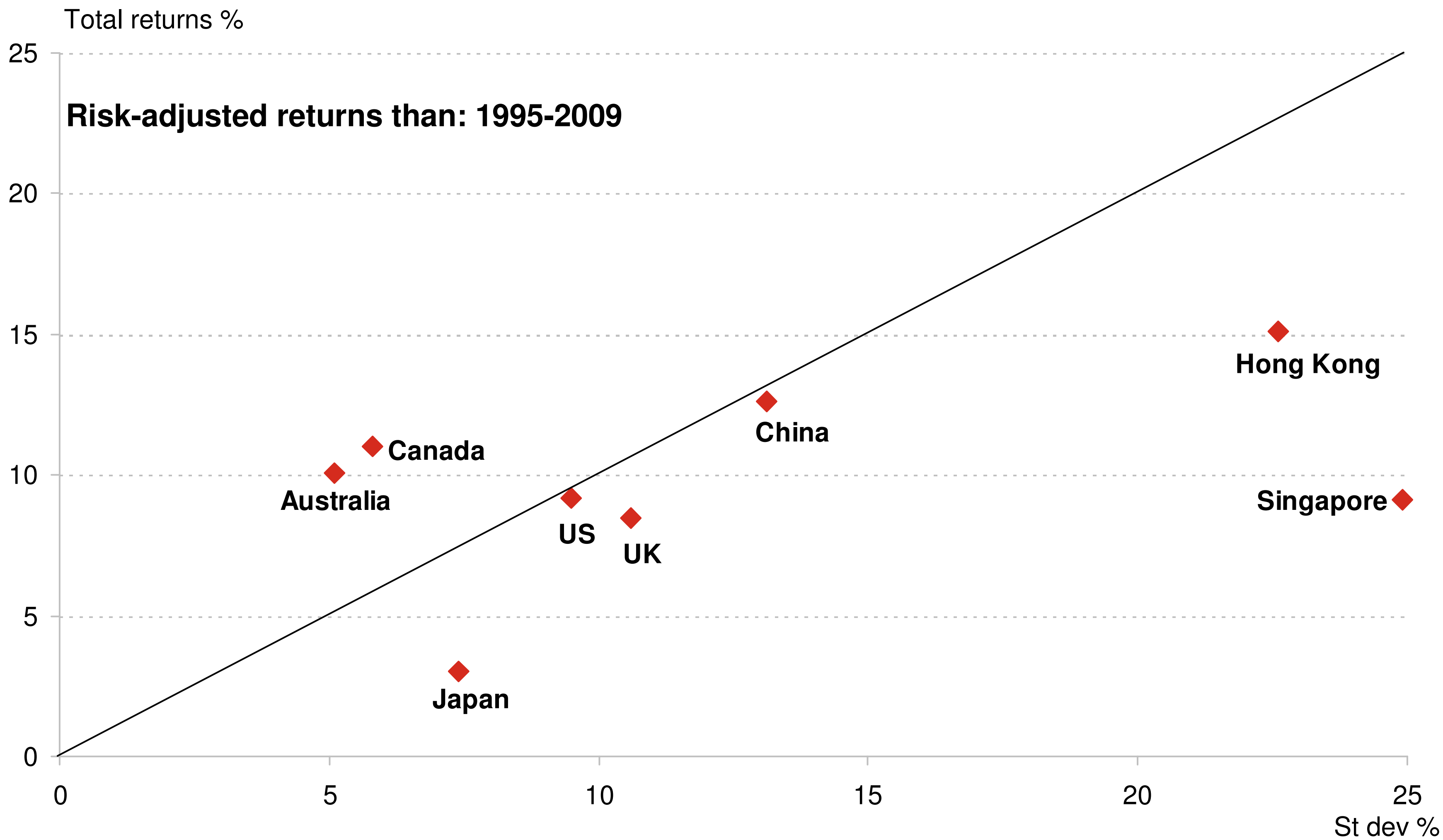
Short term: you get what you pay for



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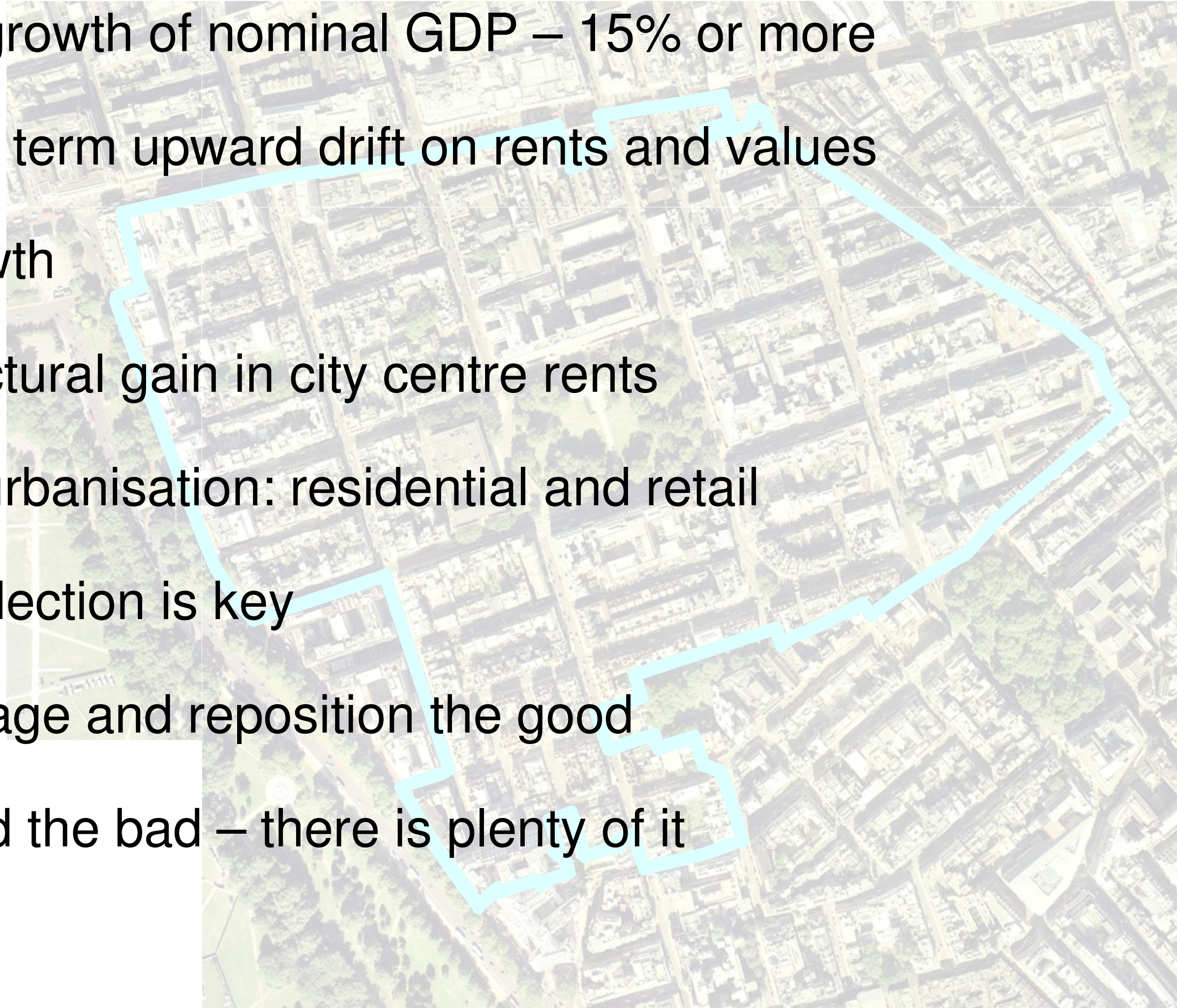
Source: Grosvenor Research, 2010

Long term: significant out-performance



- Rate of growth of nominal GDP – 15% or more
  - Long term upward drift on rents and values
- City growth
  - Structural gain in city centre rents
  - Suburbanisation: residential and retail
- Stock selection is key
  - Manage and reposition the good
  - Avoid the bad – there is plenty of it