Residential sales briefing

Shanghai, China **January 20, 2010**

"Shanghai's residential market has reached an unprecedented high both terms of transaction prices and volumes. However, the market is now faced with uncertainty as the government takes action to cool it down"

- Residential supply recorded a fall in the first two months of Q4 as developers exhaust available stock. Monthly supply was down 13.4 per cent compared with Q3
- Despite concerns that price rises would eat into property demand, first-hand transaction volume in Q4 remained healthy as buyers rushed to acquire properties before tax breaks were rolled back
- Average first hand transaction price continued to rise in the first two months of Q4 rising to an average of RMB18,699 per sq.m. in November as unsold stock on the first hand market (incl. economical housing) fells to 4.8 million sq.m.
- High end properties continue to attract significant interest recording record high transaction volume of properties priced above RMB25,000 per sq.m. in the first two months of Q4 in both the villa and apartment markets
- Second hand transaction volume was also strong in Q4, recording the highest amount to date in November. Prices, while not rising as fast as in the first hand market, showed considerable growth in the first 11 months of the year
- The government has taken initial steps to cool the market in the year ahead creating uncertainty over future prospects

Image: Grosvenor Place in Xintiandi

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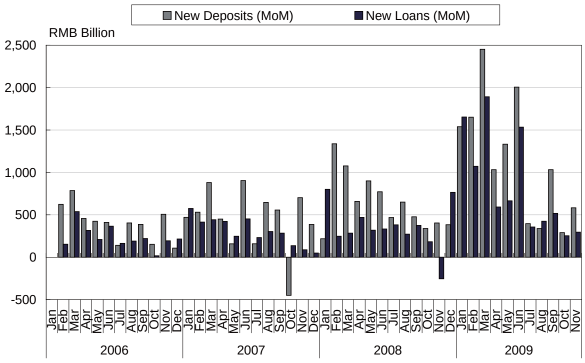
Market Overview

Shanghai's residential sales market continued to perplex watchers as recent price hikes failed to dissuade buyers from the market. Despite increasingly frequent and vehement calls warning of an asset price bubble forming in the Chinese residential market lead by the first tier cities and a number of second tier cities and concerns over affordability, home buyers continued to pile into the market with the first hand market recording all time high prices and strong transaction volume and the second hand market recording record transaction volume in November.

RMB Loan & Deposits, January 2006 - November 2009



Source: PBOC; Savills Research & Dev. Consultancy

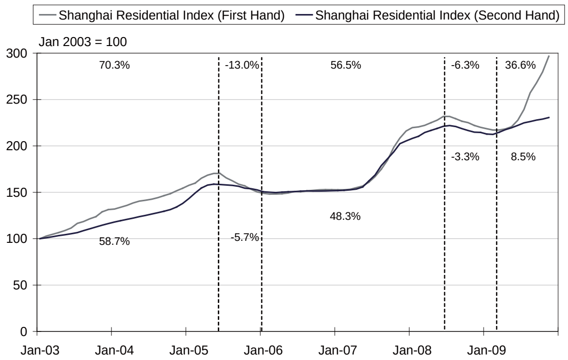
First hand residential prices are believed to have increased at a significantly faster rate than in the second hand market since the trough of the market in February, with prices rising 36.6 and 8.5 per cent respectively according to SREAA's[1] price index. With prices having only fallen marginally in the second half of 2008 this means that first hand prices are now estimated to be some 28 per cent higher than the previous peak in July 2008 while the second hand market is up 3.9 per cent over the same period.

Price hikes are thought to continue to be driven by the liquidity in the market, lower borrowing costs, buyer expectations for further price increases, low inventory levels, a recovering economy, and preferential policies initiated at the start of the year.

The growth in the residential market has not only caught the attention of the public and the media but also the government. During Premier Wen Jiabao's visit to Shanghai in November, it was made clear that it is a government priority to increase the supply of affordable / economical housing available to low and middle income groups while also reining in acquisitions by speculative buyers.

1 Shanghai Real Estate Appraisers Association (SREAA)

First & Second Hand Residential Sales Price Indices, January 2003 - November 2009

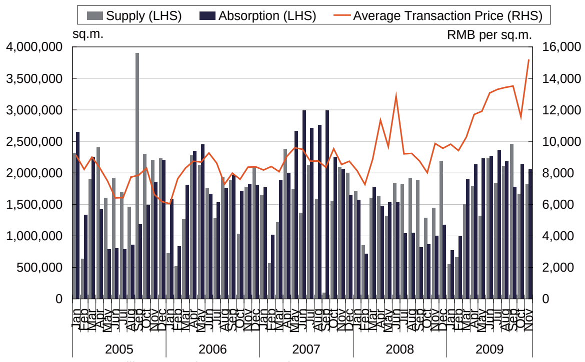


Source: SREAA, Savills Research & Dev. Consultancy

First Hand Overall Residential Market

Transaction volume in the first two months of Q4 remained on a comparable level to that of the previous quarter with an average of 1.4 million sq.m. transacted per month. This came as welcome news to many who were concerned that the drop in transaction volume in September (1.3 million sq.m.) was a sign that the market was peaking.

First Hand Residential Sales Market, January 2005 - November 2009



Source: SRETC, Savills Research & Dev. Consultancy

The average transaction price rose to a new high in November of RMB18,699 per sq.m. after suffering a dip in October.

Price rises in the fourth quarter are ascribed to two factors; the belief that prices will continue to rise and transactional costs would rise after tax breaks and government incentives are repealed at the end of the year; and the lack of available inventory currently on offer in the market.

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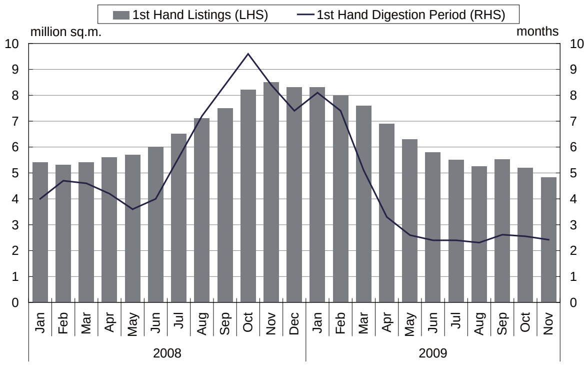
According to the Shanghai Real Estate Trading Centre (SRETC) first hand listings (incl. economical housing) at the end of November stood at 4.8 million sq.m. while second hand listings totalled 9.2 million sq.m., the equivalent of 2.4 and 5.1 months of transactions (given the average transaction volume of the preceding three months). This is compared to 8.5 million sq.m. and 8.5 months in the first hand market at the end of November 2008.

First Hand Residential Sales Listings & Digestion Period, January 2007 - November 2009



Source: SRETC, Savills Research & Dev. Consultancy

Economical Housing

One of the government's main priorities going forward will be to ensure the adequate supply of economical housing for low income families.

A large amount of economical housing is expected to be launched onto the market in Shanghai in the near term with average prices significantly lower than nearby developments. While beneficiaries are currently limited to Shanghai citizens with per capita annual incomes of below RMB27,600 as well as the other strict criteria, the government plans to expand the offering to some middle income earners in the future.

While not directly in competition with ordinary housing, as the set criteria to be able to afford economical housing eliminates those eligible from the regular market, the introduction of an estimated 20 million sq.m. of new supply over the next three years and the expansion of beneficiaries allowed to buy economical housing could have a real impact on the overall residential market.

Average Prices of Economical Housing and Surrounding Residential Property

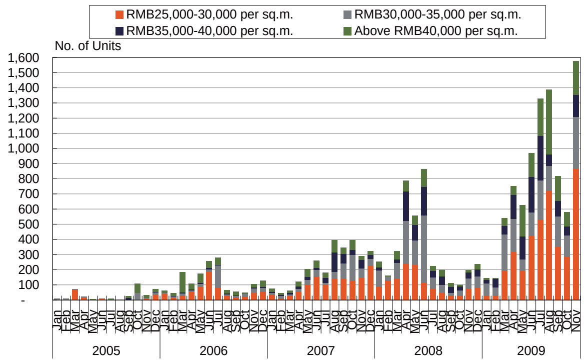
Location	Average Price of Economical Housing (RMB per sq.m.)	Average Price of Surrounding Residential Property (RMB per sq.m.)[2]
Hexiang Road (Minghang District)	5,200	10,278
Sijin (Songjiang District)	4,950	10,729
Pujiang Jidi (Minghang District)	5,000	9,928

Source: SRETC, Savills Research & Consultancy

First Hand High-End Residential Sales Market

The first two months of Q4 witnessed a strong increase in both transaction volume and price in both the high-end apartment and villa markets.

Transaction Volume of First Hand Apartments by Price, January 2005 - November 2009



Source: SRETC, Savills Research & Dev. Consultancy

The monthly transaction volume of apartments and villas priced over RMB25,000 per sq.m. rose to 1,078 and 298 respectively. This compares favourably to the first nine months of the year when monthly transaction volumes were 745 and 145 respectively.

While the previous peak in the market in the middle of 2008 was punctuated by deals just over the RMB100,000 per sq.m. mark, deals in recent months have been recorded at as much as RMB160,000 per sq.m., most notably in Tomson Riviera. While this may be a stand alone case there are now regular reports of units in the city's other high-end residential developments often exceeding the RMB100,000 per sq.m. milestone.

2 From January 1 2009 to November 30 2009

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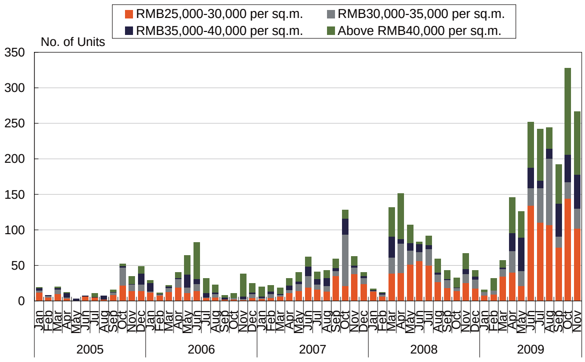
Investors are also piling into the market with news that some cash rich investors and buying multiple units at once in order to capitalise on efficiencies of scale while rapidly expanding their portfolio and exposure to the market. One extreme example, reported in the local press drew attention to an individual that acquired 54 high-end residential units throughout the city for a total of RMB353 million (average price RMB36,600 per sq.m.) at an auction.

Transaction Volume of First Hand Villas by Price, January 2005 - November 2009



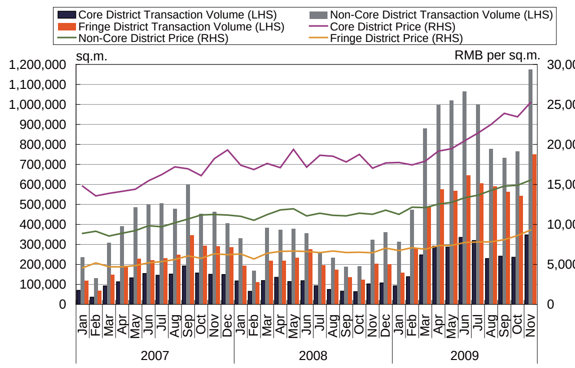
Source: SRETC, Savills Research & Dev. Consultancy

December's real estate exhibition, the last of the year, also saw high-end properties (both apartments and villas) take centre stage with developers looking to tap into the excitement revolving around the market.

Second Hand Overall Residential Market

The second hand market, similar to the first hand market, saw growth in prices (November: RMB14,965 per sq.m.) and strong transaction volume (November was actually the highest on record at 2.3 million sq.m.).

Second Hand Residential Sales Market[3], January 2007 - November 2009



Source: SRETC, Savills Research & Dev. Consultancy

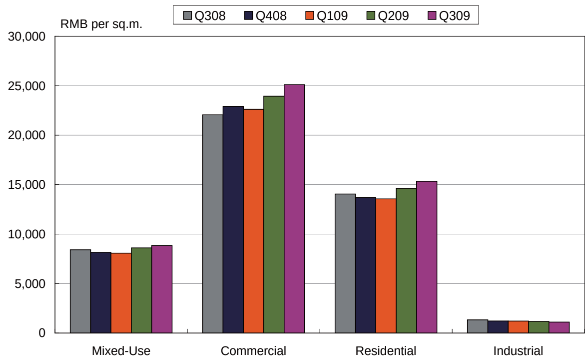
Average transaction prices have increased rapidly over the last eleven months (in contradiction to the SREAA second hand indices). Core district prices rose the fastest, rising 42.3 per cent compared with 38.0 & 38.2 per cent in the non core and fringe districts. Average prices at the end of November stood at RMB25,253, RMB15,537 and RMB9,304 per sq.m. respectively.

Buyers and sellers are eager to conclude transactions before the end of the year when transactional costs are expected to rise again to levels seen in 2008, accounting for the significant jump in transactions.

Land Market

The land market has gone from strength to strength hand in hand with the residential sales market as developers with ample liquidity from residential sales revenues and credit from domestic financial institutions look to restock their depleted land banks and capitalise on appreciating prices.

Average Land Transaction Price, Q3/2008 - Q3/2009



Source: Ministry of Land and Resources, Savills Research & Consultancy

Bids at land auctions have garnered significant interest from developers, both domestic and international, but far and away the biggest buyers have been domestic SOEs over the last six months, including the land plot acquired by China State Construction in New Jiangwan City in December for RMB3.7 billion, which set a new price record of RMB32,484 per sq.m. based on buildable GFA.

Other notable transactions include a residential plot in Tangzhen outside of the Outer Ring Road in Pudong, 20 km from People's Square, which was sold for close to RMB20,000 per sq.m. based on buildable area. The average first hand residential sales price in Tangzhen was RMB7,155 per sq.m. in the first eleven months of the year.

3 Core Districts: Changning; Jing'an; Xuhui; Luwan; Huangpu
Non Core Districts: Hongkou, Putuo; Zhabei; Yangpu; Minhang, Pudong
Fringe: Baoshan, Fengxian, Chongming, Jinshan, Jiading, Qingpu, Songjiang, Nanhui

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Selected Residential Zoned Land Deals, Q4/2009

Location	Buildable GFA (sq.m.)	Total Price (RMB million)	Unit Price (RMB per sq.m.)	Buyer
Chuansha Town, Pudong	84,855	1.19	14,024	Xiangyu Group (Xiameng)
Tangzhen, Pudong	87,245	1.66	19,040	Greenland
Changfeng Park	312,600	7.01	22,409	China Overseas Land & Investment
Longhua Road	266,000	7.25	27,231	Greenland
New Jiangwan City	114,517	3.7	32,484	China State Construction

Source: Savills Research & Dev. Consultancy

Large scale developments, such as the announcement of Shanghai Disneyland being approved, have also helped to stimulate the land sales market in the areas neighbouring such schemes. A residential plot in Chuansha Town was recently auctioned in November for RMB14,024 per sq.m., some 264 per cent above the minimum sales price. This is compared to an average first hand sales price in the neighbouring area over the first 11 months of the year of RMB7,105 per sq.m.

Residential projects will be required to sell at considerably higher levels than is currently the case should the developers wish to make a reasonable profit once the projects are completed in three to five years time.

Residential Sales Market Outlook

The recent explosive growth in China's residential market has forced the government to act in December to cool the fervour. Major steps taken so far include:

a) Increasing the future supply of normal residential and welfare housing.

b) Adjusting the current tax and credit policy to restrict speculative buyers but still support real demand in the residential market (second hand house tax levy rolling back to 5 years).

c) Raising down payment requirements on land purchases by developers (min. down payment 50%; remainder paid within one year or extended to two years for exceptional cases; 10% of land sales proceeds for social welfare housing).

While these are all steps in the right direction many of the policies will be unlikely to have an immediate impact on the market, with the exception of the adjustments to tax and credit availability. Both the promotion of welfare housing and the raising of down payments on land acquisitions will take several years to have a real impact on residential prices.

Therefore looking at the more immediate future, what are the key factors that are going to affect residential prices?

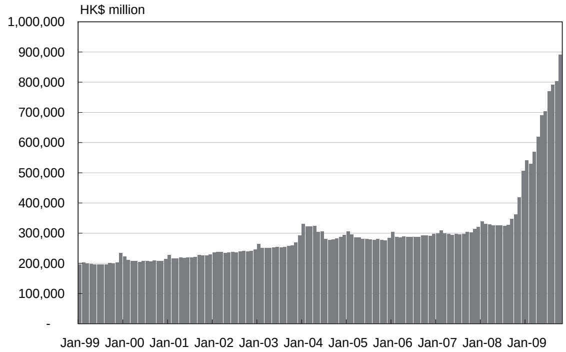
Government Policy / Regulations

The government has already shown many times its willingness to step into the fray should the market get ahead of itself. This time is no different with the government already having introduced a number of measures designed to cool the market, and especially speculative investment / over investment.

Credit Availability / Liquidity

The government is looking like it will wind down its stimulus package, however at the same time this is occurring many believe there will be an influx in foreign capital into China speculating on the appreciation of the Chinese Renminbi. This influx in capital should help the economy to wean itself of the government fuelled credit binge.

Hong Kong Monetary Base, January 1999 - October 2009



Source: HKMA, Savills Research & Consultancy

Affordability

It is an undeniable fact that prices have risen quickly in 2009 and that for many, prices have become unaffordable. Should prices continue to rise at a fast clip this will be true for an ever increasing proportion of society and result in a fall in transaction volume and potentially a correction in prices.

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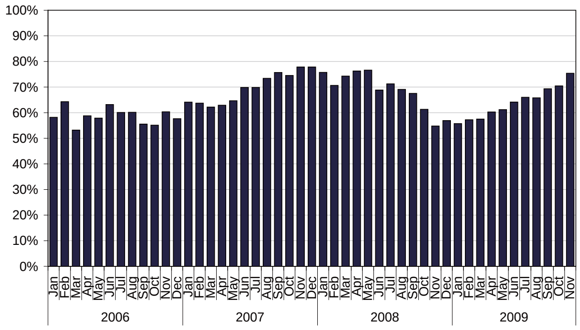
Affordability Levels, January 2006 - November 2009[4]



Source: Shanghai Statistics Bureau; SHRETC; Savills Research & Consultancy

Demand Released

It is often argued that boosting demand, such as through increasing affordability (in this case lower borrowing costs and taxes) or offering subsidies (as was initiated to boost rural retail sales), can lead to a diversion of future demand to the present.

From this perspective it could be argued that the recent boom may have brought those who would have bought property within the next few years into the market earlier, and therefore a return to the normal digestion pattern could result in a decrease in demand for housing in the coming year or two.

With borrowing costs and entry thresholds increasing, a return to previous norms is quite likely and should the government choose to increase interest rates, a decline in affordability could well result in a noticeable decline in demand.

Supply / Availability

By November only 4.8 million sq.m. of supply remained unsold on the first hand market. With supply next year unlikely to exceed 20 million sq.m. (equivalent to 2009), limited availability, should transaction volume remain at current levels, will likely support the current elevated price levels.

Conclusion

Given the above, there are both a number of upside and downside risks, however given that the Chinese economy is primarily driven by two main forces, fixed asset investment (i.e. real estate and infrastructure development) and the manufacturing / export market, and given that the manufacturing / export market still remains in a weakened state, the government, which is able to assert a significant degree of influence in the market, is unlikely to want the property market to stall. Therefore it is more likely that price growth will moderate in 2010 but still remain positive.

4 Proportion of income spent on servicing mortgages

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