

Challenges and Opportunities for Our Industry in Greater China in/after Economic Turmoil

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Background

We see markets going up and down; people come and go BUT are opportunities still there in the Greater China region? With more than 1.3 billion people looking for better accommodation, working area and leisure place AND with recent GDP growth figures of 11.4% in 2007; above 9% in 2008 and an expected rate of 6.5 to 9% in 2009; China can afford it!

As professional housing management practitioners, how can we capitalize on the opportunities in the Greater China Real Estate Market, especially, the opportunities created by the activities of the Private Equity Real Estate Investment Funds?

Real Estate Fund Investment in China

Although we see the following:-

- Total consideration of en bloc property acquisitions by overseas investors in Shanghai which stood at RMB 11.6 b in 2008 were down by 25% compared with Year 2007's RMB 15.5 b, according to statistics from CBRE Research
- Market was very static in Q4 of 2008 and there was no single acquisition activity by Foreign PE Real Estate Fund in Shanghai and Beijing
- That China Overseas Land & Investment would postpone the launch of its real estate fund indefinitely
- That after planning for months, Morgan Stanley has not yet secured any buyers for its 2 high-end serviced apartment projects in Shanghai
- Rumours were rife that Blackstone had dropped the idea for acquiring 4 commercial buildings which are worth \$1 Billion in Shanghai

At the same time we notice that: -

- Pacific Alliance China Land, in Nov 2008, has raised \$400 million and intended to invest across the residential, office, retail, and industrial sectors in China
- Also in Nov 2008, ARA Dragon Fund bought the newly completed Nanjing International Financial Centre, a 51-storey Grade A office-

cum-retail building for \$340M

- In Jan 2009 – GIC Real Estate, which is owned by Singapore Government, spent \$1 billion to buy from ProLogis, a US-based real estate investment trust, its China operations and stake in Japanese property fund
- In Jan 2009 - Citic Capital China Real Estate Investment Fund III has raised \$400 million and has prepared to invest in project developments, acquisitions and entity level investments in Chinese real estate companies. The fund focuses on development projects in the first- and second-tier cities, like Pearl River Delta, Yangtze River Delta, Pan Bohai Gulf Region and other cities, like Chengdu, Wuhan and Chongqing
- In Jan 2009 – ING Real Estate Select Asia-Pacific Property Growth Fund aims to raise \$250 in the first quarter of 2009 and a total fund size of \$675 million by the time it closes

At the same time some Cross-boarder PE Real Estate Funds are retreating from Greater China owing to various reasons, for instance: -

- Liquidity of their holding company
- Cash Out of Profit
- Pessimistic to the real estate price
- Fed up with the regulatory uncertainties.

However, appetites of other funds are growing because: -

- They need to park their excess cash in Greater China especially during these turbulent times in the financial market
- They anticipate Greater China will be the 1st one standing up after the Financial Turmoil
- They may benefit more by the long term appreciation of RMB
- They hope to take advantage of the attractive valuation in the real estate market
- Last but not the least, although the government is relaxing the fiscal and monetary policies to "rescue" the real estate industry, some small



and medium-sized enterprises will continue to find it difficult to raise funds from the equity market and financial institutions. Therefore, the jungle law comes in, Real Estate Fund could pick up those valuable assets from them at very “reasonable” price

Strategies of PE Real Estate Funds

Generally speaking, two kinds of strategy will be applied: -

- Opportunistic Funds, which purchase the properties 12 months before they are completed, so they shouldered mid-sized property tenancy risks. Investors could take a relatively higher level of risks and see for higher return. They would look for “UNDER” managed real estate asset and then acquire, reposition, develop and redevelop the assets
- Core Funds, normally invested by pension funds and other conservative investors only willing to take fewer risks, therefore get lower profits

Opportunities for Us

No matter Opportunistic Funds or Core Funds, they need our service. Put it in another way, how could we contribute to the operations of those PE Real Estate Funds in Greater China?

Opportunistic Funds

- Mr. Goodwin Gaw, Chairman & Co-founder of Gaw Capital Partner said, “as an opportunistic fund, we get active when times are bad” – Gaw has \$4.7 billion Chinese assets, spread across 14 projects
- Look for “UNDER” managed properties and acquiring them are the responsibilities of the Investment Manager of the Fund
- Assess whether the “UNDER” managed properties could be put back onto the right track is the responsibility of Profession Housing Manager

- Implementation of the repositioning need Profession Housing Manager
- Not to mention the daily operations of the properties
- Without the input and effort of Profession Housing Manager, UNDER managed properties would keep on being UNDER managed
- It is exceptionally true in China, especially in second-tier cities. There are so many “UNDER” managed assets – there are plenty of golden opportunities for the Opportunistic Funds and us.

Core Funds

- Core Funds are looking for “Steady” and “Stable” income generating from the properties
- To secure the income of the properties, Customer Service, Security, Cleaning, Maintenance, Energy Conservation and all other Housing Management functions have to be properly in place – Professional Property Manager definitely has a role here.

Rising Need for Portfolio Management Services instead of Property Management Services

Traditionally, property management services involve day-to-day management of a building or an estate of residential / commercial / industrial use or a mixture of some of them with the main objective focused on the efficient and effective running of the premises for the enjoyment and use of the occupiers, whereas the various areas of responsibility including but not limited to control of customer services, security and cleaning, operation and maintenance as well as upgrading / renovation of all common building fabric and facilities, and others like carpark operation and back up support for the full time attention of the Professional Property Manager. These duties are discharged through his or her subordinates down the line but they lay emphasis on the communal ones as a matter of fact.

Overlying the whole subject of property management services is the rising need for portfolio management services. Ultimately, our real concern is with the performance of the whole buildings, whether they are viewed as an investment, asset or facility in the widest sense. Perhaps the biggest service provided by its growth has been to focus attention more sharply on, and to promote the profile and image of the people who manage buildings.

Generally speaking, portfolio management can be defined in a number of ways: -

- It is concerned with the systematic optimisation of our property and use of our environment.
- Portfolio planning determines how an organization's tangible fixed assets can best support in achieving the organization's objectives.

Looked at in a more comprehensive view, portfolio management has the following definition: -

- The practice of co-ordinating the physical workplace with people and the work of the organization, integrating the principles of business administration, architecture, and behavioral and engineering services.

Portfolio management is also intrinsically linked to change, thus emphasising that management of buildings must operate in an essentially dynamic climate. It tends to focus management attention on those facilities or assets that are perceived as making a direct contribution to corporate profit making objectives.

The emerging role of the portfolio management manager tends, increasingly, to be involved with those issues perceived by senior management to be important to the efficient usage of buildings, such as space utilization and energy consumption. Whilst this is laudable, all too frequently, there is little or no active consideration given to the maintenance of the building fabric and facilities, as this is not perceived by senior managers to be part of the efficiency equation.

A better comprehension of the impact that building fabric and facilities may have on the productive performance of the built environment is beginning to change perceptions. For example, there is an increasing understanding of the phenomenon of sick building syndrome, and this is focusing attention on the less obvious effects of poorly maintained building fabric and facilities.

An apparent lack of interest in building fabric and facilities condition manifests itself in managerial, technical and financial neglect, which must be considered a portfolio management failure. However, there are cases where the buildings are recognized as being more directly related to corporate performance. They may, for example, be a direct generator of income, in which case there is often a presumption that market economics will

prevail to force owners to maintain buildings in proper market conditions. This belief, however, is rarely accurate. Maybe such can be changed in the current economic downturn.

Even if it was true, there is no guarantee that this leads to a rational approach to managing building condition. Rather perversely, the response to rent pressures is likely to be a superficial one. The customers in the market place tend to be rather unsophisticated in terms of building condition, and often rather easily seduced by a cosmetic response. For this reason, serious building condition problems are rarely tackled at the correct time.

Within the public sector, a fresh range of problems present themselves. The perceived importance of building fabric and facilities varies according to the use of the building, and different standards may be adopted for schools, health care buildings and local authority housing. However, many of these buildings are not seen as a generator of income, but rather as one of the means by which a whole range of society's needs are met. Although market pressures may be limited, there will be other pressures, social and political as well as economic. Almost inevitably there will be a need to reconcile conflicting demands with limited resources, which almost always militates against adequate funding being allocated for building maintenance. Parents of school children, for example, will be much more concerned that a school has adequate book stocks and that there are small class sizes than they will be about the condition of a school, so long as it is apparently in reasonable repair. Local authority managers can realistically only have one option given these political realities.

What emerges from this brief discussion is that any policy has to be considered not only in the light of a building's function, but also in relation to the user's perception of the building's condition, and its relevance to their primary needs. This latter effect is extremely difficult to quantify, but what is certain is that no management practices can operate without a clear picture of what is being managed and what the functional requirements are.

Management in all areas requires the stating of objectives against which performance is judged. The corollary of this, in relation to management of buildings, is that the defining of user needs is an essential pre-requisite for the evaluation of building performance. Only then does it become possible to determine what action, if any, is necessary to maintain the building's function, and to provide a benchmark against which performance of maintenance operations can be judged. Such

considerations should, of course, encompass not only animate users but also inanimate ones, such as plant, equipment, and machinery.

As a whole, it should embrace not only managing the building in use but also play an important part in its procurement. If this process is carried out correctly, then a comprehensive performance model of the building should be constructed at the outset, resulting in a skillfully developed design. At the completion of the construction phase, the building owner and the users, who may not be the same, should be in receipt of a building together with the necessary instructions for proper use. Unfortunately, this happens all too rarely.

How to Prepare Yourself

If you are still interested in career opportunities created by the activities of Real Estate Funds in Greater China, the following might help you find your way.

A lot of people believe that their internationally recognized qualification can bring them everywhere around the world and allow them to practice there. Allow me to be frank/blunt/truthful, it is not the case!! If you want to get on this fast moving train, I would like to put forward a series of questions to you:

- Have you read the “Property Law” of PRC issued in March 2007
- Have you read the amended “Property Management Regulations” of PRC issued in August 2007
- Do you know the utility charges in Shanghai & Beijing or Taiwan
- What's the average salary of a security guard or a cleaner in Nanjing
- Can you read simplified Chinese or speak PTH

I can keep on posting similar questions for an hour. But if you cannot answer the above simple questions, how you can expect the Funds resting their assets on your hands and expecting you to change those “UNDER” managed properties into their Cash Cows.

Typical Job Descriptions of a Professional Portfolio Manager

- Actively manage the overall development, leasing, and property teams in order to maximize value.
- Work closely with the in-house development team to supervise the development process from conceptualization through completion of construction.

- Oversee and manage local joint venture relationships with development partners and co-investors.
- Develop and implement an asset strategy for each investment including hold/finance/sell recommendations.
- Assist in strategy formation and participate in the acquisition with due diligence in review for new investments, including the negotiation/ review of contracts, development agreements, and 3rd party consultant agreements.
- Arrangement and negotiation of debt agreements.
- Review/approve the annual business plan, leasing plan, capital program and operating budgets for each asset.
- Recommend the sale of an asset and coordinate/ manage the sale through local partners/3rd party brokers.
- Manage the valuation review process, review external appraisals and present valuation recommendations.
- This includes analyzing complex deal structures in order to determine the fair market value of investments.
- Monitor and manage the investment cash flow.
- Manage and develop junior asset managers and analysts.

Then, is it hard to equip yourselves? Let's share the words of St. Matthew's Gospel:-

“Ask, and it shall be given; Seek, and ye shall be find; Knock, and it shall be opened unto you”

May we all wish the night is past and that the dawn has come.

This paper is an abridged version of the speech Mr K. C. Chu delivered on the International Conference, Opportunities of Housing Management under Economic Recession, 27 February, 2009, Taipei, Taiwan. Mr Chu has proofread this paper and gives his consent for its publication. Powerpoint version of his speech appears on the website of CIH APB http://www.cih.org.hk/English/News/events_review_folder/events_review2009022701.html