MARKET OUTLOOK

The Waterfront at Chongqing Tiandi

Stability will be the watchword for China's economic policy in 2012, against a backdrop of a slowing global economy, geopolitical turmoil in the Middle East and the upcoming leadership transition. With the dual goals of preventing an inflationary resurgence while guiding the economy to a soft landing, China's policymakers are fine-tuning the policy settings and will be vigilant and ready to deploy targeted growth-supporting measures if warranted by external events such as the ongoing Euro-area debt crisis. The People's Bank of China has proactively lowered the bank reserve requirement twice since November 2011, setting the stage for a gradual easing of monetary policy that will release funds to the government's targeted projects, including social housing.

After a year of austerity measures, land and housing prices have cooled in China's major cities. In response, some local authorities have introduced various types of housing policy adjustments. In November 2011, Chongqing announced a personal income tax rebate for first-home mortgage repayment, after its housing market had undergone a marked adjustment in transaction volume and prices.

Despite these developments, national policymakers are determined to retain the market control measures to steer housing prices to "reasonable" levels and will not lift the purchase restriction policies any time soon. The outlook for the residential sector will remain subdued, but market sentiment this year will be cushioned by an improving credit environment for first-home purchases that will attract more "wait-and-see" buyers back to the market.

In the commercial property segment, the prospects are bright in view of China's switch towards a domestic consumption-oriented and services sector-driven growth model. Rapid urbanisation, the emergence of a middle class and the construction of modern retail facilities will support consumer demand for retail property and lifestyle hubs. Notably, deregulation of the insurance sector in September 2010 has allowed insurers to invest up to 10% of their assets in commercial real estate by purchasing completed buildings or non-controlling equity stakes in publicly listed real estate companies. Total assets of Chinese Mainland insurers are projected to grow by RMB1 trillion a year from RMB6.0 trillion in 2011 to RMB10 trillion by 2015. This means that Chinese insurers will be able to invest up to RMB100 billion of additional funds in real estate a year, which affords us the opportunity to implement our strategy of selling some non-core commercial property assets to generate cash for ongoing development projects.

All our development projects are located in cities with outstanding economic prospects, namely Shanghai, Chongqing, Wuhan, Foshan and Dalian. Among these cities, Shanghai has the most mature commercial property market and continues to offer very promising development and investment prospects, while Chongqing has captured growing attention from the international investment community. According to the Urban Land Institute's (ULI's) Emerging Trends in Real Estate Asia Pacific 2012, Shanghai is second only to Singapore amongst Asia Pacific cities for both investment and development prospects. Chongqing, which was a new addition to the ULI survey this year, surpassed Beijing and Guangzhou to rank number four for investment and number three for development prospects.

Shanghai's mission to become an international financial centre received an enormous boost in January 2012 with the announcement of a plan to make the city a global centre for RMB trading, clearing and pricing by 2015. Under the plan, Shanghai is targeting annual financial market transaction volume to increase from RMB386.2 trillion in 2010 to RMB1,000 trillion in 2015, and for financial sector employment to increase from 230,000 to 320,000 over the same period. This will spur an increase in demand for Grade A office space as well as premium retail and residential property. Shanghai attracted 48 multinational companies to set up regional headquarters in 2011 bringing the total to 353, and is targeting another 50 in 2012. According to Knight Frank, Shanghai Grade A office rentals rose by 12% year on year to RMB9.2/sq.m/day in the fourth quarter of 2011, and with less new supply expected this year rentals are projected to increase by 6-10% in 2012.

Chongqing, in keeping with its status as the principal economic hub of West China, ranked number one among mainland China's provincial-level regions for growth in each of five indicators in 2011: GDP, industrial added value, foreign direct investment, foreign trade volume and air freight volume. The elevation of Liangjiang New Area to national-level status has added to Chongqing's appeal to multinational companies. Foreign direct investment rose by 66% to US$10.5 billion in 2011, and more than 200 of the top 500 global companies now have a presence in the municipality. The high-end housing market will benefit from Chongqing's new personal income tax rebate on first-home mortgage repayments, because the progressive income tax structure provides additional incentive for high-income individuals to reduce tax liabilities by taking on a home mortgage.

In Wuhan's 2012 Government Work Report issued in January, the municipal government announced its aspiration to become a National Central City, alongside Beijing, Shanghai, Tianjin, Guangzhou and Chongqing. Wuhan is well placed to achieve this status in view of its advantage as a regional transportation hub, being the interchange for the Beijing-Hong Kong, Shanghai-Chengdu and Wuhan-Guangzhou high-speed rail trunk lines. Development of Wuhan's priority industries, including financial services, exhibition and maritime, will drive demand for the city's office and retail property.

In Guangdong province, the integration of Foshan with Guangzhou will boost Foshan's commercial and residential property markets. Based on the Guang-Fo Integration Work Plan 2011-2012, 53 cooperation projects including 21 infrastructure integration projects will be launched in 2012.

Going forward, bank customers in both cities will not have to pay a fee to use cash deposit and withdrawal services within the two cities. This kind of financial sector integration will facilitate retail consumption and help Foshan to accomplish its 13% per annum retail sales growth target in 2011-2015.

Dalian's software and service outsourcing sector is on track to maintain a rapid pace of development, especially in the High Tech Zone where total revenue is expected to grow by almost four times from RMB76 billion in 2011 to RMB300 billion in 2015. In order to attract talent to support this growth, the municipal government plans to modify the local home purchase restrictions to allow recently arrived qualified talent to buy local housing. Such a policy will help to boost end-user housing demand in Dalian.

We believe that our mixed-use property development model is a competitive strength that provides risk diversification and flexibility in China's frequently changing real estate market. Our centrally located community developments in major city cores, where developable land is scarce, can command premium prices. The value of our commercial properties, including Tiandi-style and Transport Hub developments, will benefit from improved regional integration resulting from the new high-speed rail network, growing middle-class affluence as well as government policies to increase household consumption and service sector development. In view of the prospect for housing purchase restrictions to remain in place in the near term, we will achieve growth by managing the proportion of cashflow contributions from commercial and residential real estate accordingly.