



China's Real Estate Slowdown but Business Climate is Good and Offers Reasons for Optimism

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Spotlight



Overview of the real estate industry in China

In the last few years Chinese cities recorded an increase in property prices. Indeed property prices rose on September compared to August according to figures released by the Chinese government. However,

this lasted only for a short interval of time. This prompted government to reaffirm its commitment to fight against speculation in the real estate industry.

Real estate development industry is the bottom line of the impressive record of growth recorded by China over the past two decades and one of the key factors of its success story. Thus, the real estate development industry is crucial to the health of other industries such as construction, steel and cement. In addition it is

a preferred investment for Chinese seeking better returns than those reported by bank deposits.

Fearing the sector prices overheating, the Chinese authorities have taken few months ago a series of measures to discourage speculation by imposing more stringent criteria for the purchase of a second and a third property.

For the authorities, controlling real estate prices comes before boosting the economy. Indeed, new estate prices rose last month

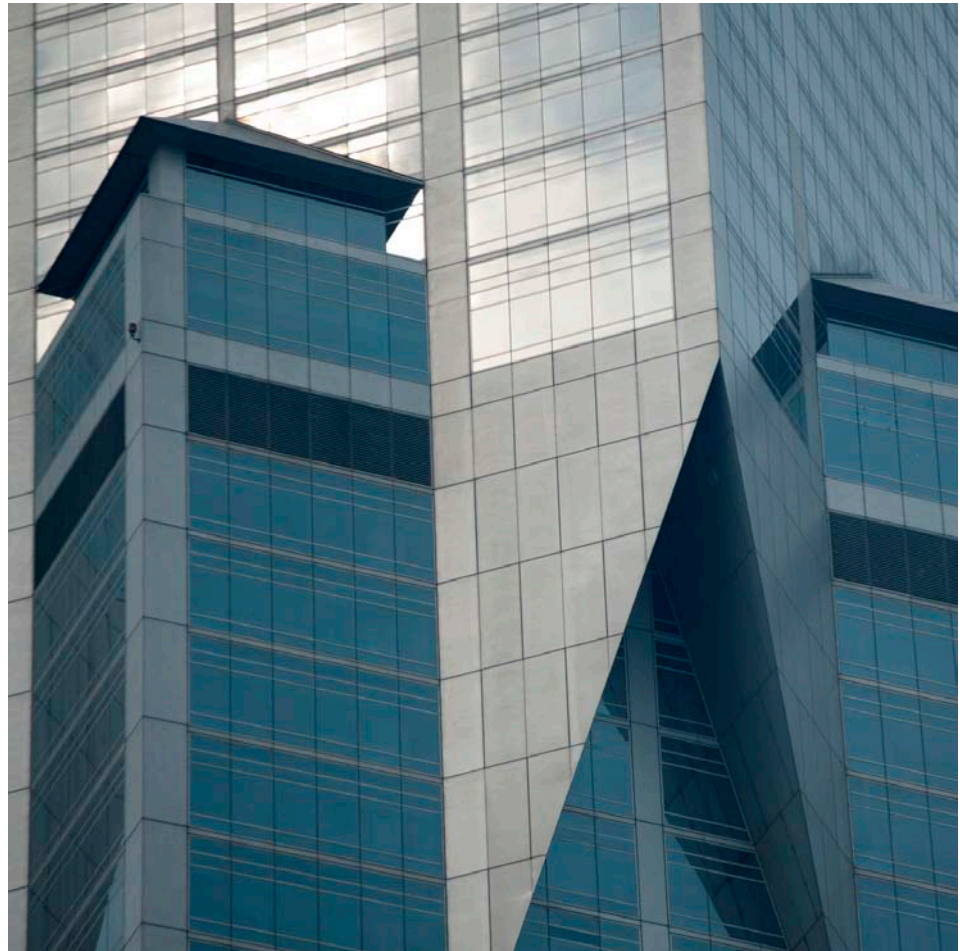
◀ in 31 cities out of 70, dropped to 24 and remained stable in 15 according to the National Bureau of Statistics of China. Thus, real estate is an attractive industry because it continues attracting investors and funds. Indeed total investment in real estate development from January to August recorded a growth of 15.6 percent compared to last year's total investment.

The Chinese government is somewhat adversely affected and will keep in place restrictions on the real estate market until prices are back down to reasonable levels. Prime Minister Wen Jiabao quoted by the New China News Agency confirmed that the government achieved initial results in the regulation of the real estate industry and will keep in place the control measures for better achievements.

At a press conference on the situation of Chinese economy, the spokesman of the National Bureau of Statistics reported that the actual real estate industry situation is relatively stable. However, a broader view of the Chinese economy demonstrates that between April and June, the domestic consumption stabilizes and exports show a slowing rate, which hasn't stopped the Chinese economy to realize a 7.6 percent growth compared to last year. Thus, Chinese growth recorded the slowest pace rate since 2009.

China decides on the fate of the growth and future of globalization

Asia, despite its impressive dynamism, is not spared from the actual world juncture. Emerging Asia will continue to be the main engine of global economy, but at a pace that will contract by more than one point on the average. China remains the main dynamo of all countries of the region, from north to south.



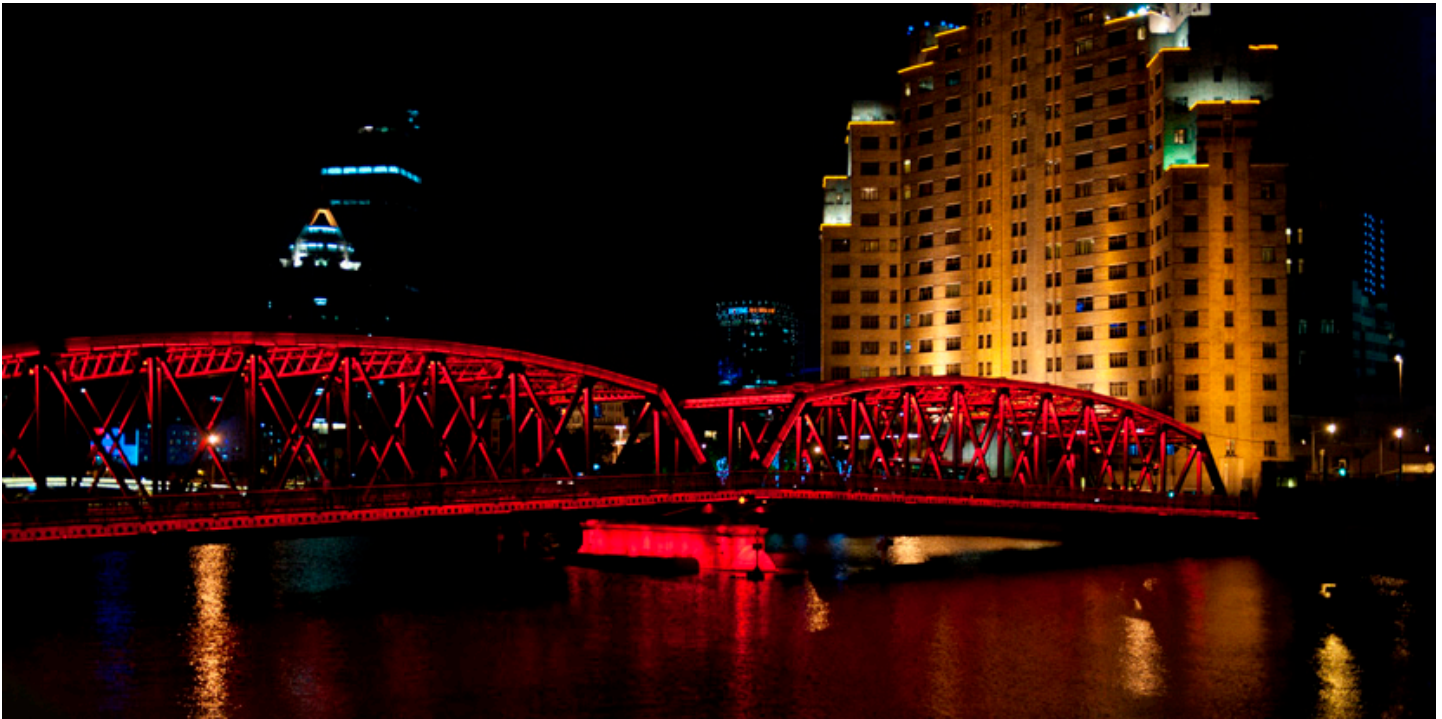
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It managed to produce a growth of 7.6 percent in 2012 but the rise of heavy structural problems combined with a growing social ferment amid political succession created a climate of uncertainty in the medium term.

Investors are often attracted by a sustained pace of growth and since other monetary policies are quite accommodating and offer low interest rates, this diverts

investors from developed countries to emerging China that offers growth and higher performance. It is true that in 2012 China remains the ultimate horizon of growth but while it is strong with its 2.5 trillion dollars of foreign exchange reserves, the Chinese growth is actually looking for a second wind to continue conquering the world and attracting investors.

China must feed the overheated economy by securing its supplies of raw materials including oil and gas as well as rare minerals. China multiplied purchases, joint ventures and cooperation agreements with other countries. Indeed, since 2000 China's overseas investments rose at an alarming rate. A geographically unbounded surfeit, indeed, they invested in agriculture and mining in Africa and South America and gained ▶



◀ control of important organizations in the United-States and Europe. Nothing escapes the munchies heirs of Mao, in fact, they are also investing in sovereign debts.

The recovery measures and massive investments to cushion the effects of the world crisis have fueled inflation and indebtedness. Thus, since last year, the rebalancing of economic development is the priority of the government.

The property sector is a big drag on China's economy

The low returns on savings and abundance of cash in circulation in the Chinese economy encourage the Chinese to look for investment in real estate rush day in and day out. Thus, the government has taken measures to curb property investment by strengthening the floodgates of credit and prohibiting loans to purchase a second or third residence. Despite these measures, the housing bubble continues inflating. According to the Chinese Academy of Social Sciences, most Chinese cities offer apartments 45% to 50%

more than their actual value taking into account local cost of living and housing supply and 14 out of 70 Chinese cities recorded an increase of prices up to 1.3% year- on- year on September.

With a total investment of 5,104.6 billion Yuan from January to September and a growth of 15.4%, the real estate industry is a major economic mainstay for China, for both residential and commercial markets. The investment in residential market recorded a growth of 10.5% with 3,512.6 billion Yuan but the floor space of commercial buildings sold stood at 864.41 square meters and recorded a year-on-year decrease of 4.0%.

It is true that China's economy is oriented toward manufacturing and production but China's long term vision is to move from labor-intensive industries to more skill -oriented industries. Thus, services, including those related to real estate industry will emerge as another key pillar for the economy.

Controlled by the government, the bursting of the Chinese real estate

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bubble affects many sectors, which partly explains the slowdown of the Chinese economy. Indeed, real estate represents 5.88% of the Chinese GDP in the third quarter and recorded a growth of 2.7% compared to the growth rate over the same period last year.

How is China Metro Rural (NYSE:CNR) linked to the real estate development?

China Metro Rural is a developer and an operator of integrated agricultural logistics and trade centers in northern China. In addition, China ▶

◀ Metro has commenced its newly-developed rural-urban migration and city re-development business. This consists of development and sales of commercial and residential properties and servicing and assignments of development rights to independent third party developers.

China Metro Rural 3-year returns are down to -81.57% in 1 year returns to -31.22% and last July, CNR Total Returns realized less returns compared to its peers but realized 8.44% in 1-month returns. Year-on-year growth is 5.19% and the average estimate is \$3.65. 1-Yr Perf is -23.19% and YTD Perf is 2.22%.

In fact the holding is directly affected by changes in the Chinese economy and especially those related to real estate industry. Thus, predicting China Metro Rural performance by looking at the real estate industry in China seems to be more significant and important than historic returns. Nonetheless, past performance is no guarantee of future results.

Real Estate Business Climate Index Declined in the third quarter

The Business Climate Index, which is a leading indicator for economic activity in China, reflects the economic situation and the expected direction. The positive or negative judgments on the business situation from the entrepreneurs from the business climate survey fell 4.1 points quarter-on-quarter. The index dropped from 122.8 to 119.7.

However, since the Business Climate Index is higher than 100, this reflects that the business climate state is still good and offers reason for optimism to anyone worried about the economic situation in China.

The National Real Estate Climate

Index from January to September was at a lower level of 94.39, rose by 15.4% compared to the same period last year and declined by 0.25 points month-on-month.

The sources of funds of real estate development enterprises recorded a growth of 10.1% compared to the

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sources during the first eight months, reaching 6,823 billion Yuan.

Qiqihar and Dezhou Projects boosted China Metro Rural Sales

Due to the Qiqihar project and the partial completion of phase one of the Dezhou project, the China Metro Rural sales increased on the fiscal year ended March 2012. Sio Kam Seng, chairman of the board and CEO of the Holdings expected the Qiqihar project to continue to expand. Thus, revenue rose 57.1% on a year-on-year basis and totaled US\$117.2 million. In addition the gross profit for the year had improved by US\$26.7 million. The Company's balance sheet remained within its historical range, with cash and cash equivalents totaling US\$44.0 million as of March ▶



◀ 31, 2012 compared to US\$20.1 million as of March 31, 2011.

However, the CNR announced on the 17th October that the company entered into an agreement for the disposition of the majority of its equity interests in its subsidiaries involved in the development of its project in Qiqihar, Heilongjiang Province, PRC to certain independent third parties.

CNR Re-positioning Plan

The Company will sell to Run Xing Investments Limited and Honour Noble Holdings 100% of its equity interest in China Focus City (H.K.) Holdings Limited ("CFC (H.K.)") and 75% of its equity interest in Qiqihar China Focus City Holdings (Group) Co. Ltd. ("Qiqihar CFC") (collectively the "Sale"), as part of the Company's business re-positioning plan.

Pursuant to the agreement, the Company, through its subsidiaries, is to receive consideration of (A) RMB150,000,000 on or prior to November 15, 2012, plus an amount of RMB 85,595,967, representing certain post-tax profits arising from Qiqihar CFC prior to the sale, and interest on the pre-tax balance of such amount calculated from July 28,

2012 through the date of payment, which shall be no later than July 28, 2013, (B) HK\$903,088.07 within thirty days of the agreement in respect of the settlement of certain intercompany balances, and (C) RMB16,000,000 within one month of the agreement with respect to the settlement of certain intercompany transactions. In addition, the Purchasers are to enter into a legally-binding guaranty with respect to the Company's remaining 25% interest in Qiqihar CFC that the Company will receive (X) a pre-tax 21% fixed annual return (equal to RMB10,500,000), payable on October 15 of each year, beginning October 15, 2013 and (Y) RMB50,000,000 on or before October 14, 2013. The Purchasers shall have the right to purchase the remaining 25% interest in Qiqihar CFC at any time for RMB 50,000,000 (plus any amounts due and payable under (X) and (Y) above). Finally, in the event that the Purchasers intend to sell their interests in Qiqihar CFC, they must first purchase the Company's remaining 25% interest for RMB50,000,000 (plus any amounts due and payable under (X) and (Y) above).

Real Estate Climate is good and

offers Reasons for Optimism

Since 2010, the Chinese government kept working so as to increase land supply and the stock of small and medium commercial properties. At the end of September, the floor space of commercial housing for sale reached 326.70 million square meters, increased by 7.12 million square meters compared with that at the end of August. The residential buildings for sale increased by 4.67 million square meters, office buildings increased by 0.73 million square meters and buildings for business use increased by 0.76 square meters.

The house prices kept rising for many years in China. Indeed, the real estate prices will remain stable and are not believed to dramatically fall. Thus, the real estate industry is attracting investors hunting for the next big stock all over the world.

One may also think that the adjustments to the Chinese monetary policy would make it easier for future home buyers to obtain loans. However, they also cautioned developers not to be too optimistic since the changes are primarily intended to support small and medium enterprises. ■