

Building up China

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Wilfred Wong, chief operating officer, Shui On Land tells Danny Chung why the company is on the right track on the mainland.

Q: How do you view the property sector in Shanghai, given the recent concern over the market overheating?

A: Actually Shanghai's property market has gone through a long downturn and has only recovered in the past few years. The recovery has been sparked by Shanghai's double-digit growth.

When the economy improves, property prices also rise. The question is whether they are rising too rapidly, too fast. Basically, in the past two years, supply and demand in Shanghai's residential market have been balanced.

In the past, when Chinese people bought property it was to live in, but now in big cities such as Beijing and Shanghai, it is for investment purposes.

Incomes have risen as there are more white-collar workers. A lot of the time, they live in one flat and invest in another. Under these circumstances, naturally, demand for property [has increased].

On considering whether there is a bubble, the circumstances in Shanghai are the same as those in the rest of China. Some policies have been put into place. For example, loans to developers have been tightened {with the actual number of loans falling}.

Also if the property is selling for more than one million yuan (HK\$942,200), only 70 per cent of the purchase price can be borrowed from banks. All this means the government has done a lot to ensure the property market will not overheat.

In the short term, property prices have risen, due mainly to Shanghai pursuing a policy since last year of reducing building density.

Originally you could build more properties, now you can build less [in central districts]. As such, prices would naturally rise. Therefore there are several things happening at the same time causing prices to go up. It is not necessarily a bubble.

Q: Shui On Group chairman Vincent Lo has said relocation costs are a major part of the land costs for the Shanghai projects. How is the company conducting the relocations?

A: In China, especially for urban renewal projects, the land price is mainly divided into two parts. The first is the land premium paid to the government, and the second is the relocation cost. Because our two projects are urban renewal projects, the government will ask for a cheaper land premium.

[As for calculating relocation costs] the government will estimate the size of the plot, how many households and businesses it contains and how many individuals actually live on the piece of land. Afterwards the government will tell us "this is what we want you to pay in relocation costs". We would then pay the amount.

The government is responsible for implementing the relocation [and it] decides on how to

reach agreement with residents. For the whole process, Shui On is only responsible for back-up financing. The frontline work is all done by the government.

Q: How confident is Shui On Land on earning a net profit of one billion yuan within two to three years' time and having its rental income account for half of its revenue?

A: Apart from our two mega projects in Shanghai, we are also holding discussions on other projects. For example, Shui On Land will undertake projects in Hangzhou and Chongqing. Therefore you can imagine, the group's entire portfolio [on the mainland will be injected into] Shui On Land.

I believe that to [earn a net profit of] one billion yuan in one year is not difficult. This is because apart from selling new units, we will also receive rental income.

An office building receiving one hundred million yuan in annual rent at any given period is very normal.

Units we sold at Rainbow City for last year alone raised 200 million yuan. If you add up [profit from sales] for each project in this manner, deriving one billion [yuan in net profit] is actually not that difficult.

Q: Media reports have said income from Shui On's Xintiandi project in Shanghai has been unsatisfactory. How is Shui On Land going to improve the situation?

A: Returns on rentals are usually slower. It is not exactly the same as in the case of selling the property, but we take a long-term view of rentals.

Xintiandi has a special character. At the early stages of the development, a lot of tenants did not understand the concept. During the initial phase of inviting tenants, very low rents were used to attract them.

We wanted to create the character [of the development] first. Now a lot of tenants are facing renewal [of their rental contracts]. For renewals we offer the market rate.

A lot of tenants have decided to stay with us and renew their agreements.

They have seen that the results of the past two to three years have been good. Our rental renewal policy will aim as far as possible to look after existing tenants.

Q: How is Shui On Land going to finance the Xihu Tiandi and Hualongqiao projects in Hangzhou and Chongqing respectively?

A: Usually for these mega projects, the total investment size would definitely be large. But no developer would do it all in one go.

For Chongqing, a lot of people say we are going to put eight to 10 billion [yuan] into it, but we are not going to put such money in all at once. We would do it in phases.

The money that is earned [from unit sales in the initial phases of the project] will be put back in [the scheme]. The total investment could probably be eight to 10 billion but as far as [pressure on] our capital [accounts] is concerned, it would not be the case of having this pressure felt all at once.

Normally in China, the land price when compared with Hong Kong is still cheap. The normal policy as far as [financing is concerned is that the developer pays for] the land premium and relocation cost while the construction cost is borrowed from banks.

Q: When does Shui On Land plan to enter other cities apart from Hangzhou and Chongqing?

A: Of course, our aim is nationwide, but we should also consider the implications on our resources. We are also receiving a lot of invitations from different cities hoping we would go there and [undertake some redevelopment work]. I think that once Hangzhou and Chongqing have progressed a bit, we would consider [projects in] another city.

Q: Would you comment on the belief held by some observers that Shui On Group decided to concentrate on the mainland property market to make up for the drop in construction business in Hong Kong?

A: This is to do with the whole strategy of the Shui On Group. [Vincent] Lo has been going to Shanghai since 1985.

At that time, there was no problem in Hong Kong.

Afterwards, for a few years after the handover, [the SAR's] construction sector was doing well. Shui On Construction & Materials' annual profit ranged between HK\$500 million [in this period].

During this time, [Vincent] Lo had already placed some of his assets in China. It is not the case of there not being enough business here so [we] had to go up north.

Injections more than a shot in the arm for property flagship

Shui On Land, set up in February by Shui ON Group chairman and chief executive Vincent Lo, will eventually become the flagship of all mainland property projects of the group.

With its headquarters in Shanghai, Shui On Land (SOL) is currently valued at US\$1 billion (HK\$7.8 billion). It is undertaking primarily two types of development projects.

The first involves city core work schemes, which consist of large-scale, mixed-use redevelopment projects.

The second are integrated residential development projects that, according to the company, are "high-quality developments offering full amenities and consistent with overall city infrastructure planning".

SOL got off to a flying start after Shanghai's Taipingqiao development was injected into the firm. It was previously a project of Shui On Properties (SOP), a unit of the Shui On Group.

Taipingqiao had a net asset value of about US\$206.8 million (HK\$1.61 billion) as of last June 30.

It covers an area of 52 hectares, consisting of Shanghai Xintiandi, Corporate Avenue and luxury residential flats. In addition, Shui On Group's listed subsidiary Shui On Construction and Materials (Socam) injected its Rainbow City residential development, also located in Shanghai, into SOL.

Rainbow City, covering 40 hectares, had a net asset value of US\$81.9 million as of last June 30.

In return for acquiring these projects, SOL will issue ordinary shares and junior preference shares to SOP and Socam worth a total of US\$481 million. Further bonus shares worth US\$82.8 million will be paid if performance targets are met.

Eight outsider investors will also pump in US\$350 million for junior and senior preference shares.

Shui On Group, via its subsidiaries, will hold a controlling 61.7 per cent stake in SOL.

Wilfred Wong joined Shui ON holdings in September 2000 after working in senior management at K Wah International, Henderson China Holdings and the China Investment Group which he founded in 1994. From 1975 to 1992, he worked in the government rising to Deputy Secretary for the Civil Service,

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