
Event Report

China: What Real Estate Bubble?

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The China real estate market is booming — so much that many wonder if it's a bubble, and if so, when the bubble will burst. The question is crucial for China, where an estimated 20 percent of the economy is exposed to the real estate sector. And any hiccup in the Middle Kingdom, which is leading the nascent global recovery, will reverberate throughout Asia and the world. As chairman of the Hong Kong-based Hang Lung Group, one of the world's largest commercial real estate firms, Ronnie C. Chan has a privileged vantage point. His firm has been investing in mainland China since 1992. On May 19, 2010, he shared his thoughts as part of the Chazen Institute's Sir Gordon Wu Distinguished Speaker Forum

Mixing bits of wisdom accrued from a lifetime in East Asian real estate markets with a healthy dose of self-deprecating wit, Ronnie Chan delivered a rousing defense of rising asset prices, rejecting the bubble hypothesis. He argued that in mainland China, demand for housing far outstrips supply. Mr. Chan also said that while housing prices in Shanghai, for example, have indeed surged in the past five years, they are still cheap relative to other global cities such as Singapore and New York.

Mr. Chan opened his speech with a prediction: As historians look back at the 21st century, the best opportunity for economic growth will have been mainland China in the first 40 years of the century. Moreover, Mr. Chan said that of the many ways to play the emergence of China, real estate was the best sector. "In the next 10 to 20 years, you will see a tremendous amount of billionaires coming from real estate in China," Mr. Chan said.

That's because real estate offers patient investors the most efficient access to a booming economy. "If you choose the market correctly — such as New York, such as Hong Kong, and such as mainland China today — property prices will go up over time," said Mr. Chan.

Two keys for real estate investors, Mr. Chan said, are to be patient and not to become overleveraged. In East Asian property markets, Mr. Chan argued, "every trough is higher than

two peaks ago.” In other words, in Mr. Chan’s experience, the momentum of the region’s real estate market has carried price levels sufficiently high over time, so that the lows reached in any cyclical downturn will likely be higher than the high points of previous bull runs. “In my part of the world, all you need to do is one thing: Don’t overborrow,” said Mr. Chan.

Mr. Chan pointed out the strategic importance of the real estate market to China, and he expects the government to focus its attention on this red-hot sector. To achieve its goal of a “harmonious society,” argued Mr. Chan, the government will likely seek to temper prices. Widespread home ownership can promote stability. Yet price fluctuations could cause public unrest, and continued runaway price increases could leave a yawning gap between have and have-nots. “The government will not allow residential prices to go crazy,” said Mr. Chan. “In the last couple of years, they don’t seem to have succeeded, but don’t underestimate the Beijing government.”

Hang Lung Properties, which invests in only commercial real estate, reported profits of \$2.35 billion in the first half of fiscal 2010. Mr. Chan said that he preferred commercial to the residential market for a number of factors, including fewer competitors, lower taxes and a smaller chance of government intervention. “Here is the catch: It is extraordinarily difficult to execute correctly,” Mr. Chan said. “You must get every step of [the value chain] correct in order to produce the kind of returns I’m talking about” — upward of 30 percent a year.

Finally, Mr. Chan emphatically disputed the notion that China’s real estate market surge was a bubble. “The fact that prices go very high does not translate automatically to a bubble,” Mr. Chan said. He pointed to demand dynamics, suggesting high prices are supported by a scarcity of supply. He acknowledged that prices have run up dramatically. “Cyclically, Chinese residential real estate, in Shanghai and Beijing included, is quite expensive,” Mr. Chan said.

But he argued that systemically, prices in Shanghai and Beijing are cheap when looked at with the right perspective. He pointed to high-end properties in Shanghai listing for \$800 per square foot, whereas comparable properties in New York may sell at \$3,000 per square foot or more. “If you were to compare Shanghai prices today with Shanghai prices five years ago,” Mr. Chan said, “then I would say you are foolish — it’s a fast-rising economy, of course real estate prices will go up very quickly.”

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