SPECIAL REPORT

on the Canada-China Real Estate Conference

Can-China Realty Fund Publication November 2005

China: Defining a New World Order

The Canada-China Real Estate Conference that took place in Toronto on October 20-21, 2005, attracted some of the most highly regarded and knowledgeable real estate professionals with extensive international experience. Throughout the two-day conference, presenters, panel participants and keynote speakers weighed in on the risks and rewards. This inaugural newsletter highlights observations, opinions and advice from the experts. Our next issue will highlight some case studies of deals that were discussed at the conference, as well as other important information about the world's fastest growing economy.

QUICK FACTS

China's estimated share of the global consumption[1] of the following raw materials is:

- Cement: 47%
- Cotton: 37%
- Rice: 32%
- Coal: 30%
- Crude steel: 26%
- Aluminium: 21%
- Copper: 20%
- Wheat: 16%
- Oil: 8%

[1] *BusinessWeek*

Donald Straszheim, Chair and CEO of Straszheim Global Advisors, believes that China is transitioning towards capitalism at an accelerated rate, and while this process is complex and not without its challenges, the country is leading the "parade towards capitalism."

Mr. Straszheim, a world-renowned economist and expert on China, said that in order for China to create a vibrant and growing economy, it must include real estate development as part of its future plans and growth. China can be seen as "a threat or opportunity or both", he says, as the country transitions into the future. While 800 million Chinese currently live in rural communities, a significant 500 million reside in urban locations.

China is experiencing the fastest urbanization in world history. By the end of 2004, its urbanization ratio – the percentage of population living in cities – stood at around 41%. Urbanization, accompanied by large infrastructure investment and massive job

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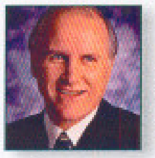

J. LORNE BRAITHWAITE
Conference Co-Chair

LEE LAM
Conference Co-Chair

Not a Question of 'If' But 'When' Will You Be in China

China is a ubiquitous topic of discussion these days. This is not surprising, given China's incredible and sustained economic growth. China is the world's factory: It produces a large and growing number of products ranging from clothing to shoes to computers. In doing so, China is becoming the world's largest consumer of raw materials.

Being the factory to the world is not the end, but rather a means to the end. China, which is already moving rapidly into other areas of technology such as biotech and space exploration, is continually repositioning itself for even higher levels of industrialization.

China's growth is only surpassed by its rate of economic and social change. Its ability to mobilize its workforce and capital has enabled it to triple its income per capita in a generation and raise 300 million out of poverty.

Today there are well over 100 Chinese cities home to populations of 1 million or more - compare this to 48 in the US, 5 in Canada and 36 in Western Europe. In the next five years alone, it is forecast that an additional 120 million Chinese, equalling almost half of the entire US population, are expected to move into urban areas to find homes and jobs. To accommodate this enormous influx of people, China intends to continue to aggressively build its infrastructure: housing, office space, roads, and communication links.

All this adds up to an enormous investment opportunity with significant return potential. It requires knowledge to manage the risk, and that was the goal for our conference. It provided a window on this opportunity for real estate investors. It became clear that "to be or not to be" in China is no longer the question. Now the questions are: how and when will you be there?

Sincerely,

J. Lorne Bratihwaite
Conference Co-Chair

Lee Lam
Conference Co-Chair

China: Defining a New World Order

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opportunities, will be highly supportive to China's ability to continue to develop its economy. It is estimated that for every one percentage point increase in urbanization, China's GDP will rise by 3 percentage points. Considering the demands of China's modernization and economic growth, the urbanization rate should rise to 75 percent in the middle of the century, which means an influx of about 10-15 million into cities each year from rural areas.

While some observers might disagree, Mr. Straszheim believes that China's economy is not overheated but is "unbalanced". He points to industrial production, which is up a significant 16% this year, and notes that a key challenge is that "half the economy is command and control, while the other half is capitalistic."

He also believes that China's growth rate is sustainable, a remarkable feat especially when compared to North America economic growth. Since 1978 China has sustained over 9% growth, derived from 1% labour and 8% productivity, as opposed to 1-2% productivity growth in North America. Mr. Straszheim predicts an average 7% annual GDP growth rate continuing for China to 2020, meaning their economy will double in size every decade.

While the reform process is being driven by the people not the government, Mr. Straszheim says, the rise in the standard of living is attributed to the rise of capitalistic reforms. "The government (of China) will be in trouble if the economic engine falters."

One of the greatest concerns from foreign companies investing in China is the country's abuse of foreign intellectual property, but Mr. Straszheim believes that the country will reform as it develops its own intellectual property. He suggests that companies like retailing behemoth Wal-Mart have the right approach. They focus, he says, on costs, quality of goods, and distribution rather than brand loyalty, which is typically not a major drawing point for Chinese consumers.

Mr. Straszheim believes that the catalyst to bring China to the world stage has been in large part due to the country joining the World Trade Organization (WTO). Looking ahead, "investors and government will use the WTO to accelerate change in the economy."

Successful Investing Means Knowing Where To Target

Ivan Ko, Managing Director, Head of Real Estate, SW Kingsway Capital Holdings Ltd., Hong Kong, believes that investing in real estate in China "has long-term upside" but that you have to know what and where to target to be successful.

China is a big country, so which cities offer the best potential return? According to Mr. Ko, there are three tiers of cities with different government policies in each:

- 1st Tier – Beijing, Shanghai, Guangzhou, Shenzhen;
- 2nd Tier – Tianjin, Nanjing, Dalian, Chengdu, ChongQing, Shenyang;
- 3rd Tier – Number in the hundreds.

Beijing derives 62% of its GDP from services, where the lion's share of foreign funds, 68%, are also invested. Beijing is the seat of the Asian head office for 20 major transnational corporations and the China headquarters for over 300 others. While rental housing in the city is not favoured by Mr. Ko, he sees residential value on the upswing. Shanghai is the financial capital of China, home of 3,500 financial institutions and deriving 48% of its GDP from services.

A key point made by Mr. Ko is to seek out and develop good relationships in the local market. The local perspective, he says, is crucial for investors to achieve a successful outcome in China.

Finding Your Way Through the Maze of Structuring Issues

Kenneth J. Snider, a partner at Blake, Cassels & Graydon LLP, Toronto, Robert Kwauk – Office Managing Partner, Blake, Cassels & Graydon LLP, Beijing, and James Lui – Senior Partner, Jinchen & Tongda Law Firm, Beijing, are experts in structuring real estate investment deals in China. They agree that there are four important points you should remember when structuring an investment there:

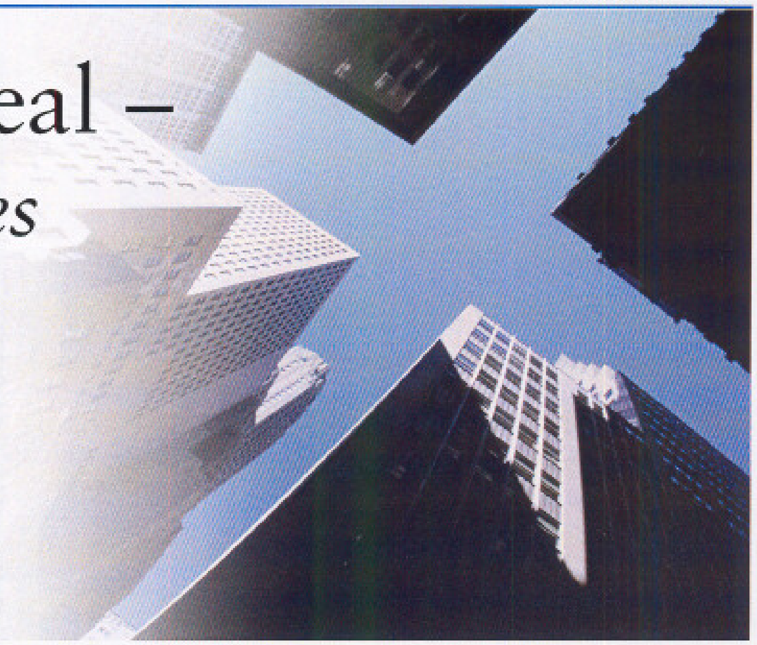
1. Real estate is heavily regulated in China
2. Local government approval is key
3. Accurate and correct registration of joint ventures is essential for successfully repatriating profits or selling equity interest
4. You need to have a joint venture partner that shares your vision and goals

Mr. Lui notes that "in China everything is heavily regulated, especially real estate because it ties into land ownership. In theory, local government law and regulations trump everything in real estate...Remember, too, that foreign companies can acquire the right to use the land but cannot own the land outright."

Foreign investors may acquire land use rights through Foreign Invested Enterprises, either as Equity Joint Ventures (EJVs) or Cooperative Joint Ventures (CJVs), or within 13 specially-designated economic zones, they can establish Wholly-Owned Foreign Enterprises (WOFEs) in China for real estate development, and you are obligated to invest through a joint venture.

Mr. Snider adds that for regulatory and tax considerations you have to keep in mind the size of investment, the source of funds and the sophistication and know-how of the investor.

Mr. Kwauk notes that only 13% of Chinese land is available for development so there is a significant degree of protection. In addition, China does not present a level playing field to foreign companies as they are held to a higher standard compared to Chinese companies, which are allowed more flexibility.



Anatomy of a Deal – *5 Not So Easy Pieces*

The Conference welcomed a panel of experts to discuss how real estate deals come together in China. The panel included: Moderator Harold Burke, Partner, PricewaterhouseCoopers LPP, Toronto; Margaret Cornish, Executive Director, Canada China Business Council, Toronto & Beijing; Nick Lo, Managing Director, Crystal Properties Development Ltd., Hong Kong; James Liu, Senior Partner, Jinchen & Tongda Law Firm, Beijing; Michael Ho, Partner, PricewaterhouseCoopers LPP, New York; and David Glickman, Partner, Wilson & Partners LLP, Toronto.

While circumstances surrounding a deal vary, the panel discussed the five 'not so easy pieces' every deal faces:

1. Ongoing changes in the financing sector will continue
2. Important requirement for success in China is to identify trends and changes and adapt accordingly
3. Tax expertise is essential
4. China's regulatory system is evolving: What is acceptable today may not be tomorrow
5. Business is founded on relationships and mutual benefit

Mr. Lo has seen a lot of changes within the financing sector over the last 10 years and change continues today. Banks in China are a lot more active in mortgage, project and developer financing than every before, he says. Because of the constant change in policies and regulations in China, the need to spot a trend and adapt to it is key to success in China.

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China 'Ripe' For Canadian Investment In Real Estate

Dr. Lee Lam, Senior Executive Vice President, Chia Tai Group (CP Group) and Co-Chair of the Canadian-China Real Estate Conference, believes that "China is ripe for Canadian involvement and investment."

Dr. Lam brings a unique perspective to investing in China. He was born in China and attended university in Canada, and has an intimate understanding of North American and Chinese cultures and their ways of doing business. Dr. Lam says sustainable growth in China "is supported by various factors: High savings rate, growing tax revenues, consistent growth in foreign reserves, and national policy support for expansion of China's private sector," all of which make real estate investment very appealing.

Dr. Lam highlights some key data which suggests a strong future for China, and ultimately a strong investment opportunity. For example, China should reach a GDP per capita of US$3,000 in the next 15 years, which will transform it into a "consumer market". The savings rate for Chinese consumers is high, at 40%, but more Chinese are starting to spend and the 'middle class' is emerging as a powerhouse of consumerism. For example, it is expected that there will be 150 million cars on the road in China by 2015 compared to 30 million now. The 2008 Olympics in Beijing is, in part, the reason for the rapid development. It's expected that 300 million-plus Chinese will use their credit cards to make purchases, and soon there will be more cell phone users in China than the entire population of the U.S., or close to 300 million people.

With this sort of buying power, the Chinese consumer will also require more space to house themselves and their belongings, which in turn is expected to push real estate values higher.

The Chinese continue to work towards technological advancements and are also striving to expand the skills of their workforce, Dr. Lam says. China already has the highest number of Chartered Financial Analyst holders in the world.

Dr. Lam says that the Chinese "renaissance" which is under way and consumers' "pursuit of dreams and success" are major drivers for economic growth. China, he observes, is the gateway for Canadian real estate investors who wish to be at the start of something big.

Anatomy of a Deal – *5 Not So Easy Pieces*

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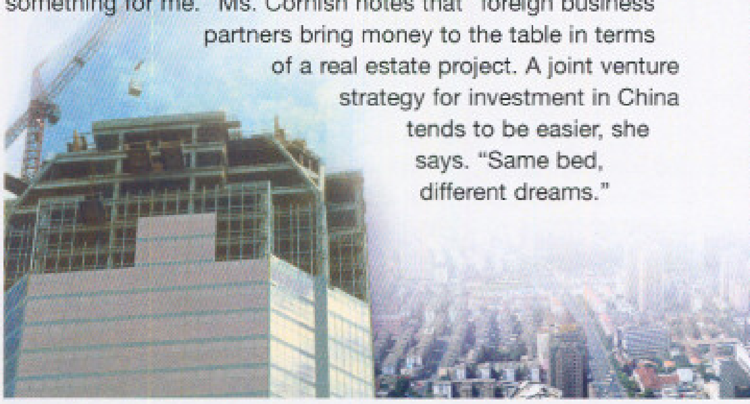
Mr. Lo says that the choice of a bank as a partner is important as it must be able to grow with the investor.

Mr. Liu adds that the deals "that stand the test of time are those that are fair and beneficial to all parties. Corporate Governance is becoming an increasingly important issue."

A "50-50 relationship" in a deal in China is rare and generally avoided. Typically, the majority owner is foreign and it's recommend that you set up the right financial and tax structures to avoid the need for litigation down the road. Tax professional Michael Ho says that foreign investment enterprises have a corporate income tax rate of 33%, and taxes are often offset by incentives. Like Mr. Liu, Mr. Ho says preparation is essential to a successful outcome. "Work well in advance to do this as significant documentation is required."

David Glickman echoes this point and notes that "Tax rules in China are under review, which could impact Canadian tax exempt status."

As someone who is also familiar with the ways in which Chinese conduct business, Ms. Cornish says that the "Chinese will not do business with you until they are comfortable with you...and if I do something for you, you do something for me." Ms. Cornish notes that "foreign business partners bring money to the table in terms of a real estate project. A joint venture strategy for investment in China tends to be easier, she says. "Same bed, different dreams."



TRADE MISSION TO CHINA

Want To Visit Leading Real Estate Projects In China?

As a result of interest expressed at the conference, we are organizing a **Trade Mission to China** in April 2006 to meet with leading developers and government officials, and see a range of development projects in both Tier 1 and Tier 2 markets.

If you would like to participate in this mission, call **Natasha Worrell** at **(416) 367-5613** for more information.

Conference Sponsored by: PricewaterhouseCoopers | 集富 匯團 KingswayGroup | Blake, Cassels & Graydon LLP Barristers & Solicitors | CAN-CHINA Realty Fund

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