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Emerging City Winners Profiles: China Xi'an

- *A key city in China's "Go West" policy*
- *Fourth largest education base in China after Beijing, Shanghai and Wuhan*
- *China's largest aviation research centre*
- *An emerging hub for IT outsourcing*
- *A tourist destination, and home to the world-famous Terra Cotta Army*
- *Best opportunities in high-end retail and hotel sectors over the next three to five years*



CITY SUMMARY

- A key city in China's "Go West" policy
- The fourth largest education base in China after Beijing, Shanghai and Wuhan
- China's largest aviation research centre
- An emerging hub for IT outsourcing
- A tourist destination, and home to the world-famous Terra Cotta Army
- Opportunities in high-end retail and hotel sectors over the next 3-5 years

Xi'an, one of the Four Great Ancient Capitals of China, is strategically located in the central part of the country, between the Weihe River in the north and Qinling Mountains in the south. The city lies at the crossroads of several of China's main inland arteries, and is a key point in the country's most important east-west trading route which runs from Lianyungang on the Yellow Sea, to Kazakhstan via Ürümqi

Due to its inland location, Xi'an was chosen back in the early 20th century as one of two locations (the other being Chongqing) where China's strategic aviation industry was actively nurtured. Many research institutions were established to cater to the requirements of the aviation industry which has contributed to Xi'an current strength as one of China's premier education hubs.

To leverage the city's well educated and skilled labour force, the Xi'an government is seeking to emulate Bangalore's success by carving out a niche in IT outsourcing. Its quickly expanding modern service industry has led to rapidly changing lifestyles and strong income growth, which has driven flourishing retail and residential markets.

With aggressive promotion by the municipal government, combined with the central government's "Go West" policy and the arrival of new large domestic and international companies, Xi'an - the most important city in north-west China - is expected to consolidate its position as one of China's key rising urban stars.

ECONOMIC DASHBOARD

Size	Population (million 2006)	8.2
	GDP (USD billion 2007)	24
	Employment (million 2006)	1.25
Growth	Population (% pa 2001- 2006)	1.6
	GDP (% pa 2002-2007)	16
Infrastructure	Air Passengers ('000 2007)	11,373
	Freight Traffic (million tonnes 2006)	84.46
Openness	FDI (USD billion 2007)	1.1
	Exports (USD billion 2007)	3.47
Wealth	GDP per Capita (USD 2006)	2,233
	Disposable Income per Capita (USD 2007)	1,758
Education and Labour	Higher Education Institutions (2006)	47
	University Graduates ('000 2006)	130
	Unemployment (% 2006)	4.3
	Average Wage Rates (USD 2006)	2,568
Business	Business Environment (Score)	C
Lifestyle	Quality of Life (Rank)	2

* Please refer to the definition of terms.

ECONOMIC BACKGROUND

Old Industrial Base and Rich Natural Resources



Xi'an was the first Chinese city that opened its doors to the outside world, not in 1980 under the 'open door' policy, but during the Tang Dynasty when Xi'an blossomed as the first major stopping point along the Silk Road. With its prominent

history and strategic location, Xi'an is today one of the key cities in the central government's policy to develop inland China.

After several decades of development, Xi'an has transformed into one of China's most sophisticated industrial bases. It has formed a comprehensive industry system embracing machinery, electronics, aviation, aerospace and petrochemical; today hi-tech industries, machinery, tourism, modern services and culture are the city's pillar industries. The modern service industry, anchored by the IT and BPO sectors, has seen very rapid growth, with employment rising from 146,000 in 2001 to 296,000 in 2006 and is expected to reach nearly 500,000 by 2020.

The city's flourishing pillar industries are attributed to the rich natural mineral resources of Xi'an. Situated about 400 km away from the country's most important natural resources base, northern Shaanxi Province, Xi'an has a key competitive edge of a stable supply of high-quality and low-cost natural resources.

Rapid Urbanization

Its solid industrial background has enabled Xi'an to develop on a fast track since 2000. Xi'an's GDP has grown by 13% per year over the last seven years. FDI escalated to USD 1.1 billion in 2007, a y-o-y increase of 37.5%.

The increasingly open and bustling economy is encouraging strong urbanization, with Xi'an's population expected to reach over 10.5 million by 2020. Urbanization not only benefits the manufacturing sector through an increased supply of cheap labour, but will also boost the city's consumption patterns and generate strong demand for mass-market residential units.

Urbanization Rate/Population Comparisons

	Xi'an	Chengdu	Chongqing
2010 Urbanization rate	72%	65%	50%
2020 Urbanization rate	80%	70%	65%
2010 Population(million)	8.62	11.8	30
2020 Population(million)	10.54	14-15	31

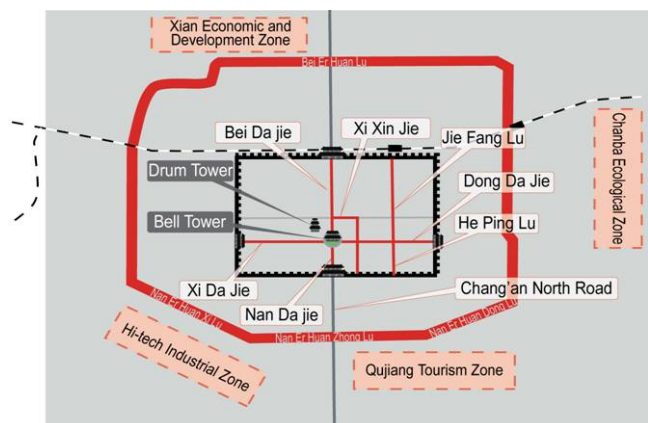
Source: Statistic Yearbook

Competing with Pear River Delta Cities for Taiwanese Investment

Xi'an's abundant and cheap labour force is proving to be a strong pull factor for Taiwanese investment relocating from the Pearl River Delta (PRD). Labour shortages, rising labour costs and power supply constraints in the PRD has forced Taiwanese companies to relocate to northern or western China, where cheap labour and rich natural resources are more readily available. Generous incentives regarding tax and land policies, which the western cities are receiving as part of the "Go West" policy, is enhancing Xi'an's attractiveness vis-à-vis coastal cities. Xianyang, a satellite city of Xi'an, is expected to emerge as China's third largest concentration of Taiwanese investment after Dongguan (Guangdong) and Kunshan (Jiangsu).

URBAN FORM AND INFRASTRUCTURE

Large-Scale City Regeneration



Xi'an has traditionally developed its commercial activities within the Ming Dynasty Wall, rebuilt during the Ming Dynasty (1644–1911) on the remains of the Tang Palace walls. This 12 sq-km area is now the main commercial and political centre of the city, housing 37% of Xi'an's high-end retail space and 25% of high-quality offices in the city. However, this has created serious congestion problems, and since 2004 the government has gradually been relocating its commercial centre into northern Xi'an. Government organisations were moved into Beijiao, and four main industrial areas have been developed to rebalance the uneven development between the downtown and suburban areas of Xi'an.

The four zones the government is targeting in the 11th Five-Year Plan are:

- Xi'an Hi-tech Industrial Zone, southwest of the city, featuring IT and hi-tech industries;

- Xi'an Economic and Development Zone in the northern part of the city, focusing on manufacturing;
- Qujiang Tourism Zone in the southern area of the city, capitalising on the rich historical sites and favourable living environment; and
- Chanba Ecological Zone in the northeast of the city.

Each of these areas concentrates on a specific industry and is committed to support the precinct's economy, with evidence of increasing policy success. Qujiang Tourism Zone, for example, has attracted China Overseas, R&F and Hutchison Whampoa to build high-end residential projects. Meanwhile, Xi'an Hi-tech Industrial Zone has emerged to compete with downtown Xi'an in terms of commercial activities.



The area within the ancient wall, together with the Daminggong area (with a total planning site of 9.4 sq km), is earmarked for massive regeneration. The ambitious regeneration plan will give the area a Tang Dynasty theme, and the

population density will be reduced to 250,000 per sq km from the current 400,000 per sq km. Transportation within this area will be restricted to environmentally friendly transport uses. Although the plan will take 50 years to complete, we foresee that it will boost the attraction of Xi'an as a place to live, work and visit.

Larger Xi'an Plan

To consolidate resources and accommodate further expansion, the municipal government has created a "Larger Xi'an Plan", which includes eight satellite cities. The current city centre, largely restricted within the ancient wall (Inner Ring Road), will expand to the Third Ring Road and four satellite cities. These cities - Lintong, Xianyang, Chang'an and Sanyuan - will become the new sub-city centre. Public transportation will be developed to connect the eight satellite cities.

Improving Connectivity/Transportation

To rebalance the uneven development of Xi'an, two subways are planned to provide easy access to downtown areas:

- Subway Line 1, which measures 24 km, will begin construction in 2010 and completed in 2015. It will connect east Xi'an to west Xi'an across the downtown area.
- Subway Line 2, which runs from north to south, is due for completion in 2010.

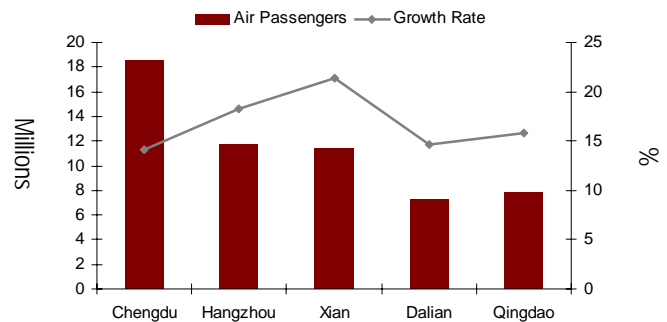
Following completion of these two lines, another four lines will then be built over the following 20 years. The completion of these six lines will facilitate economic co-operation between different areas and benefit the real estate market.

Also, to enhance inter-urban connectivity, Xi'an has invested substantial capital in establishing a comprehensive infrastructure network. Nine highways have been built to connect Xi'an with its neighbouring cities. Railway networks are also under construction - the first high-speed railway in China runs from Xi'an to Zhengzhou, the capital of Henan Province. By improving rail connectivity, the travel time from Xi'an to Beijing will be reduced from 10+ hours to only four hours.

The expansion of the city's airport is also under way. Around USD 970 million has been invested to build a second runway at Xianyang International Airport (making Xi'an only the fourth city in China to boast a second runway, after Beijing, Shanghai and Guangzhou). The number of air passengers in 2007 has far exceeded other tourist cities such as Qingdao and Dalian.

Greater connectivity between Xi'an and its nearby cities will stimulate economic co-operation and enhance the city's attraction for industry relocating from coastal cities.

Air Passengers 2007



Source: <http://www.moc.gov.cn/>

BUSINESS ENVIRONMENT

Although more challenging than coastal cities, the business environment in Xi'an is rapidly improving, boosted by the continuous reforms introduced by the municipal government.

To leverage the "Go West" policy, the Xi'an government has taken significant steps to enhance efficiency in dealing with investors, including the introduction of a 'Business Investment Environment Reform Year'. Significant improvement has been seen in company registration processes; it now only takes three days to complete registration, which previously took one month.

Xi'an has also seen increasing collaborate with the government on planning long-term investment strategies. For example, Euro-Asia Economic Forum chose Xi'an as its long-term conference venue. The forum, held every two years, attracts more than 50 Fortune 500 companies. Furthermore, Xi'an's municipal government is aggressively lobbying to host the World Economic Forum, which was held in Dalian in 2006 and received much attention.

Additionally, the active involvement of the city's municipal government and even the provincial government of Shaanxi Province in the Applied Materials case (See Corporate Activity section for more details) has increased investors' confidence.

The government's effort has paid off with FDI growing strongly. FDI level reached USD 1.1 billion in 2007, and Xi'an is renowned as having the best business environment in western China.

COPORATE ACTIVITY

Attractive Market for Telecom Companies

Xi'an hosts major telecom and electronic industries, which have produced some well-known firms such as Xi'an Datang, the main development and manufacturing offspring of Datang Telecom (itself an offspring from the Ministry of Information Industry).

EMC—a leading IT company announced a new office opening in Xi'an in September 2007, serving China's northwest market. EMC will also team up with North-West Electric Power Design to establish management information systems in China and will collaborate with Xi'an Jiaotong University and Xidian University on a college alliance plan to train skilled labour.

A further example is Huawei Technology, which secured 22,000 sq m of space in Xi'an Hi-Tech Zone, employing more than 1,500 people. The company plans to recruit another 1,500 employees to capitalise on the strong research background of the city. Huawei purchased a new site in early 2007 in Xian Hi-tech Industrial Zone to build a Huawei Business Park, with a first phase measuring 200,000 sq m.

Extensive Semiconductor Industry

In September 2005, Micron Semiconductor Technology, the world's second largest provider of advanced semiconductor solutions, announced that it was committing USD 255 million to develop a chip-packaging manufacturing and testing facility in Xi'an Hi-Tech Zone. The facility, when completed, will create 2,000 new jobs and its export volume is expected to reach USD 0.5 billion. This is the largest investment deal in Shaanxi Province in the past 20 years. Micron's entrance has led Air Products &

Chemicals Inc, UPS and Exel to follow suit. Xi'an's deep labour pool, improving infrastructure and stable cheap power supply have been the major factors in Micron Semiconductor's final decision to move to Xi'an.

Applied Materials' semiconductor R&D and production facility, International Rectifier's power semiconductor production facility and Xi'an Xiyue Electronics' six-inch semiconductor IC production facility will also be coming on-stream in the near future. The presence of world-famous companies has raised the profile of Xi'an as a hub for the semiconductor industry. In fact, Xi'an now has the fourth largest cluster of semiconductor facilities in China after the Yangtze River Delta, Pearl River Delta and Bohai Bay.

Growth of the Aviation Industry

Xi'an is also consolidating its position as a major aviation hub. In 2005 Xi'an Aircraft produced two domestically developed MA60 aircrafts. The company has announced its plans to manufacture up to 38 MA60s annually by 2008, which will be sold to African and Asian airlines.

To source components for the aircraft, the city is exploring the possibility of establishing a dedicated aviation technology park. The Xi'an General Aircraft Research Institute (XGARI) has initiated talks with foreign manufacturers, including Cessna and Cirrus from the US, to entice them to develop and manufacture small aircraft in China.

Expansion of Software Companies



Xi'an Software Park has been the cradle for Xi'an's software industry. About 20 world-famous software firms are active in the city, including Intel, which has its largest technology support centre in Asia. Other firms include SPSS, Sybase and Thortworks

from the US, Fujitsu, Sorun and Nttdata from Japan, Infineon from Germany and Nortel from Canada.

The strong presence in the software sector has encouraged NEC to commit to doubling both its number of employees and its software exports over the next two years. NEC's R&D centre occupies 3,000 sq m with 200 employees. NEC, confident in the booming market in China, is now transferring its software export business from India to China.

The entry of leading software company Reynolds & Reynolds has further proved Xi'an's strong potential in the software sector. Reynolds & Reynolds opened a branch in the city, which is also its

first in China. Its R&D centre will be home to 200 employees over the next three years. It is expected that Reynolds & Reynolds' commitment in Xi'an will help stimulate the integration of the city's software sector into the global software supply chain.

LABOUR AND EDUCATION

Large Skilled Labour Pool

As the third largest education base in China, Xi'an is home to 47 universities, 5 of which rank in the top 100 best universities across the country (Note: two to three top universities are more typical of second tier cities). These universities produce 130,000 graduates each year, 60,000 of which obtain science degrees and 40,000 are foreign language graduates. Apart from national-level universities, private universities in Xi'an are also booming both in quality and quantity. According to the city's municipal government, Xi'an is home to half of the top 10 private universities in the country. The large skilled labour pool provides investors with greater options, and is one of the most attractive features of the city for inward investors.

Universities Comparison 2006

	Universities	Total Enrollment (000 people)
Shanghai	60	466
Beijing	82	555
Xian	47	570
Wuhan	52	747
Hangzhou	36	373

Source: Statistic Yearbook 2007

Strength in R&D

Industrial policy of the early 1900s has helped Xi'an create a platform of research activities. There are now more than 500 R&D centres employing 340,000 people, representing China's third largest concentration of research functions. Xi'an has the highest percentage of university-educated workers, at around 36%, compared with Shanghai's 23%, according to World Bank. The depth and breadth of qualifications and skills mean that the labour market is able to serve, in a very cost-effective manner, different levels of job requirements. This has enabled the city to become a favoured location for R&D centres and outsourcing businesses.

How to Retain its Labour and Improve Language Skills

Although Xi'an is ahead of other cities in terms of the quantity of its labour force, retaining its skilled workforce has been a major challenge. A large proportion of graduates move to coastal cities for a better life and higher wages, leading to high attrition

problems that are an issue for most companies. Meanwhile, language skills are a further obstacle for the development of a modern service sector.

To help alleviate these problems, the Xi'an municipal government plans to spend USD 4 million each year on establishing China's first Information Service College, which will provide a training platform for graduates seeking to enhance their professional skills. In addition, more effort has been made to improve the living environment and increase wage levels.

QUALITY OF LIFE

Historical Sites



For more than 2,000 years, Xi'an was the capital for 11 dynasties. Along with Rome and Constantinople, the city was a world leader in culture and trade and played a pivotal role in bridging the gap between east and west. This incredible

history has left behind an immense historical heritage. The Terracotta Army, Huaqing Pool, Bell Tower and Big Wild Goose Pagoda (Dayanta) are among the popular tourist attractions.

Improving Living Environment

To recapture Xi'an pre-eminence during the Tang Dynasty, the rebuilding of Tang City is planned together with massive environmental repairs. Although it is expected to take 50 years to complete, it will transform Xi'an into a beautifully landscaped city, with eight small rivers embracing downtown Xi'an and Qingling Mountains. Moreover, the green area per capita will increase by 2020 from 7.6 sq m to 8 sq m.

We believe that Xi'an will gradually emerge as a key inland economic hub with a good blend of historical heritage and modern city planning, and its easy access to regional hubs in China will attract more people to work and live in the city.

REAL ESTATE DASHBOARD

Market Size/Stock	
Grade A Offices in 4Q07 (sq m)	17,812
Retail 4Q07 (sq m thousand)	874.8
Number of Five-Star Hotels (2007)	5
Market Activity	
Grade A Office Construction by 2009 (sq m thousand)	NA
4Q07 Grade A Office Vacancy (%)	0
Benchmark Values	
Offices Grade A – Rentals (USD psm pa)	197
Retail – Rentals (USD psm pa)	350–1300
Business Park – Rentals (USD psm pa)	70
Five-Star Hotels – Room Rates (USD)	67
Residential Prices (USD psm)	950–1300
Grade A Offices – Indicative Yields (%)	11.2%

Source: Jones Lang LaSalle Research

REAL ESTATE TRENDS

As the core city in northwest China, Xi'an's real estate market has grown rapidly since 2000. However, each sector is at a different stage in its evolution.

The hotel market is regarded as the most attractive sector due to a sophisticated tourism infrastructure and an increasing number of tourists visiting the city. The retail sector is also benefiting from the buoyant tourism industry as well as from the rising incomes of the city's residents.

The residential sector has witnessed exponential growth since 2004, with most of the big-name developers flocking into the Xi'an market. In the next three to five years, a large number of mid-level projects will come onto the market, capitalising on the demand generated from new immigrants and the city regeneration process.

The office sector is still in an early stage in its evolution because of limited market transparency and the inability of international developers to penetrate a market dominated by local developers. Also, limited demand and a huge amount of low-quality supply, have led to a relatively high vacancy rate. The lack of professional management skills in the city and poor quality stock further increase market risk.

INVESTMENT TRENDS

The investment market is relatively quiet with few institutional investors entering the market. The two best examples are in the retail sector, which we believe has the most opportunities.

In 2007, Printemps bought Maison Mode, a high-end retail project in Chang'an International Plaza; while Century Ginwa was purchased by China Golden Development Holdings (CGDH) in 3Q 07. CGDH is a Hong Kong firm registered in Bermuda. Century Ginwa have been expanding aggressively for the past few years and has established itself as the dominant local player in the Xi'an market. Additionally, Century Ginwa also signed a strategic alliance agreement with Citigroup in early 2007 to further push forward its development. Century Ginwa will open more than five stores in northwest China, with Citigroup as an equity partner. (Source: China REIS Jones Lang LaSalle Research)

More transactions are likely to take place in the next two to three years when Xi'an's market becomes more transparent and investors are forced to look for opportunities in Tier II cities due to strong competition in Tier I cities.

RETAIL

Xi'an's retail market serves as a retail centre not only at a provincial level but also at a wider regional level.

Centred on Bell Tower, there are four retail areas which include Xidajie, Nandajie, Dongdajie and Jiefang Roads.

- Nandajie Road is the most high-end retail area in the city.
- Xidajie Road has undergone regeneration work since 2001 and has seen some malls coming onto the market such as Zhonghuan Shopping Mall.
- Dongdajie is the most popular shopping destination for locals, hosting Kaiyuan Mall.
- Jiefang Road is now in decline due to an old retail format and tired retailing atmosphere.

The Xiaozhai retail area in south Xi'an benefits from young shoppers studying in nearby universities, and the Hi-Tech Zone retail area serves white-collar employees in the city.

The retail market in Xi'an is booming, with the luxury sector offering the most promise. The two high-end shopping malls in the city are Zhongda International (located along Nandajie Road) and Chang'an International (south of the ancient wall along Nanguanzheng Street). Zhongda International has served the

market for seven years and maintains its leading position. Luxury brands such as Louis Vuitton, Prada, Escada, MaxMara, Montblanc and Versace all have large stores in the plaza. The limited space in Zhongda Int'l forced retailers Gucci to open its first 300 sq m flagship store in northwest China in Maison Mode in Chang'an Int'l.



Century Ginwa in the Bell Tower area and Golden Eagle International in the Hi-Tech Zone are also popular high-end retail areas.

The strong performance of high end retailing reflects the consumption patterns of rich locals (who have a reputation of flaunting their wealth) as well as affluent individuals from other cities in Shaanxi Province who have accumulated their wealth from mining and other natural resources.

The mass retail market is also lucrative due to strong income growth. Xingzhengyuan Mall in Dongdajie—with a total GFA of 250,000 sq m -just came online to respond to buoyant consumer demand. Starbucks, for example, have expanded its store locations from one in early 2006 to seven in just one year. Meanwhile, Häagen-Dazs opened a very successful store in Maison Mode this year.

In line with solid demand, around 320,000 sq m of retail space is estimated to be coming onto the market by 2010. An expected balance between demand and supply points to healthy future performance.

HOTELS

Known as China's 'Natural History Museum' and one of the most developed cities in north-west China, Xi'an's tourism and hotel markets are enjoying sustained growth.

Backed by the central government's growing support for the development of west China, Xi'an recorded a 14.6% GDP growth in 2007. The city's strong economic development, particularly in the high-tech and development zones, has been the key driver for corporate lodging demand in Xi'an.

Leisure demand is also expected to remain strong. Xi'an is already a well-known tourism destination; it has a well-established tourism infrastructure and is home to an impressive number of world-class historical sites. Xi'an's historical appeal and easy access also provide the perfect draw for conferences and incentive travel. In order to further promote the city as a

convention market and compete with other regional destinations, a new USD 600 million Xi'an Qujiang International Convention and Exhibition Centre is currently under construction.

International tourist arrivals to Xi'an rose for the fourth consecutive year to reach 1 million in 2007. US tourists were the largest foreign group, contributing 17.2% of total foreign arrivals. Domestic visitors to the city also grew during 2007 to 30.2 million—up 13.9% on 2006 figures.

Based on the latest data from the Xi'an Tourism Bureau, as of end-2007 there were 95 star-rated hotels with 17,778 guest rooms in the city. Of these, five hotels received five stars, 21 were four-star hotels, 54 were three-star hotels and 15 were two-star and below. Our research shows that there are more than 1,600 international four- and five-star hotel rooms already under construction or being planned to open between 2008 and 2010.

With leisure, corporate and MICE demand expected to grow, and new hotels' broadening appeal with a more diversified product base, ADRs are expected to see stronger growth in the mid to long term. However, occupancy levels may grow at a more moderate pace as the market absorbs new hotel supply.

Source: Jones Lang LaSalle Hotels

INDUSTRIAL

Xi'an Hi-tech Industrial Zone, Xi'an Economic and Development Zone and Xi'an Yanliang Aviation Hi-Tech Industries Base are the three state-level industrial zones in the city.

- Hi-Tech Industrial Zone, one of the three national-level industry zones¹, features electronic information, equipment manufacturing, biological pharmaceuticals and automobiles. Giants such as Micron, Applied Materials, Honeywell, Intel, IR, Infineon and NEC have set up production facilities or R&D centres in the area.
- Xi'an Economic and Technological Development Zone has developed facilities catering for mechanical, electronic, light industrial and new materials industries with a manufacturing function.
- Yanliang Aviation Hi-Tech Industries Base is the only one of its kind in China to set up a State Development and Reform Commission (in 2004) which integrates the aviation industry's R&D, training of aviation-based talent,

¹ The other two are Beijing Zhongguan Technology Park and Suzhou Hi-tech Park

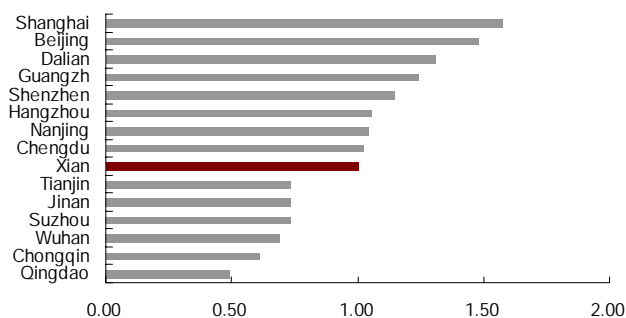
aviation-equipment manufacturing and components processing.

Build-to-suit is a popular building method for investors in these industrial zones, as industries such as pharmaceuticals and semiconductor have very specific requirements of their facilities. Therefore, standard factories available for lease are limited in these industrial zones.

With the increasing participation of industry giants, asking rents reached RMB 0.55 per day in 2007, up from RMB 0.45 per day in 2004. Land prices in Xi'an have not seen the dramatic growth as seen in Shanghai due to the new land auction policy. As the government dominates the industrial market, we foresee that future supply will remain stable in line with the growth of industrial developments. The rate of supply growth, according to administrative committee, is increasing by around 5% each year.

The business park is expected to be the next growth sector in Xi'an. The booming BPO sector in the city, underpinned by a skilled low cost labour force, has triggered the construction of business parks or decentralised office buildings. The Xi'an Software Park phase I, with a total GFA of 160,000sq m has a 99% occupancy rate with achievable rents of RMB 39 per sq m per month. Both Ascendas and Mapletree have showed interest in acquiring Phase I Software Park. Phase II of Software Park, with a total GFA of 265,000 sq m, is under construction and will be completed by 2010. The BPO sector, which differs from Dalian's BPO sector that targets the Japanese market, is more focused on the North American market, specialising in IT outsourcing in the automotive sector. The Xi'an government's ambition is to emulate Bangalore's success by carving out a niche in the BPO sector which should bring more high-quality tenants into the business park sector, and the rental market is expected to see steady growth.

Business Park Activity Index



Source: Jones Lang LaSalle Research

- Business Park Activity Index measures sector dynamics. Looks at supply, demand and asset performance.

RESIDENTIAL

The residential market in Xi'an was dominated by local developers until 2004 when China Overseas and Greenland, the well-known national residential developers, entered the isolated Xi'an market. China Overseas secured 550,000 sq m of land with a total investment of USD 39 million in 2004 and launched its project "Classic Palais" in 2005 with a sales price of USD 533 per sq m. This set a new benchmark in the market at that time, when the average price was only around USD 370 per sq m. Meanwhile Greenland purchased a 774,000 sq m land plot in Hi-Tech Zone in the same year.



The entry of these pioneering developers has encouraged other national developers, such as R&F and Hutchison Whampoa, to move into the market. These developers are keen to secure a place in a fiercely competitive market, which has pushed them to increase their land banks by

acquiring even larger plots to hedge against potential future land shortages. Hutchison successfully acquired a 486,000sq m land plot in Hi-Tech Zone near Greenland's land. In addition, they are seeking land in Qujiang, where they plan to develop a high-end residential cluster. R&F secured a 425,000 sq m land plot, whilst Dahua Group followed the same route as Hutchison by purchasing land in Hi-Tech Zone as well as a 667,000 sq m land plot in Qujiang. China Resources is also expected to enter the market soon.

A benchmark deal was achieved by Surbana Land, a subsidiary of Temasek Holdings and GIC, who teamed up with Henderson Land. The joint venture invested USD 685 million for a 137 ha residential project in Chanba —Xi'an Shangri-La. The investment was the biggest real estate investment from Singapore. The entire project will accommodate 60,000 people and has a 10 year construction period.

The aggressive activity of the big-name developers has helped to mould the residential geography of Xi'an, with all four directions from the downtown area expected to see huge amounts of supply over the next three to five years. We expect more new projects will emerge around the Third Ring Road over an eight to ten year horizon, following the completion of projects in Qujiang, Hi-Tech Zone, Beijiao and Chanba.

The large residential supply has been supported by the even faster growth in demand in recent years. According to the statistics bureau, new completions increased by 40% y-o-y in

2007, while sales registered a 41% growth. The city regeneration programme and rapid urbanisation have contributed to solid demand. It is noteworthy that around 88.5% of buyers are local residents; a further 6.9% are from cities in Shaanxi Province, 4.5% from other provinces and 0.1% are overseas buyers. The residential market is domestically driven for owner-occupation.

Sales price increased 6% y-o-y during 2006-2007. As most major projects have targeted the middle to high-end sectors, average sales prices have risen. However, in the next three to five years, we anticipate a price adjustment due to oversupply. We are concerned that there is insufficient demand to absorb all the new supply over the medium term, unless there is a substantial rise in immigration from other cities and provinces, and/or if the wealth levels of local residents increases rapidly. And we estimate this trend is likely to happen in the future.

We believe that in the longer term, the Xi'an residential market is likely to see rapid transition, with large residential developers dominating the market and smaller developers being forced out. The quality of residential projects will also rise to a new level.

OFFICES

Commercial office space in Xi'an is mostly concentrated in four main areas:

- Areas within the ancient wall, where most prime buildings are located, e.g. Zhongda International, the only single-ownership building in the city;
- Xi'an Hi-Tech Zone, home to most decentralised office buildings and future new supply;
- Second South Ring Road(Nan Er Huan Lu), which has seen an increasing concentration of Grade B office buildings, benefiting from easy access to downtown Xi'an;
- Xi'an Economic and Development Zone, where offices are being developed to cater for the needs of SMEs.

Currently, the area within the ancient wall (with a land area of 12 sq km), accommodates almost 25% of the total office space in the city. However, further development of this area is severely constrained due to a shortage of available land and policy restrictions. We therefore expect the future focus of office development will be in suburban Xi'an, while the area within the ancient wall will increasingly focus on retail uses.

This trend has already begun - Xi'an Hi-Tech Zone has emerged as the key decentralised location, and with its easy access to the

downtown area and cluster of large firms, it is becoming a favoured office location. Most new supply is located along Tangyan Road in Hi-Tech Zone, which has developed in response to the requirements of R&D firms. Xi'an Hi-Tech Zone is home to the Hi-Tech International Business Centre – managed by Jones Lang LaSalle and has ABB, Siemens and Lenovo as its anchor tenants.



The only Grade A office buildings in Xi'an is Zhongda International, providing a total of 17,812 sq m, and accommodate most of the high-quality tenants in the city. The building is fully occupied due to the sound management skills.

However, vacancy rate in high-quality Grade B buildings in central Xian is still relatively high at around 18.7%. Demand is currently not strong enough to absorb the existing stock, as most MNCs only occupy 100–200 sq m, and their expansion rate is slow. The largest tenant groups are manufacturers and IT firms, which tend to be located in decentralised office buildings.

Nevertheless, several top MNCs have expanded their office space. They include Siemens, which upgraded its representative office into a branch and expanded its office space to 1,800 sq m; Hutchison Whampoa, which expanded to 1,200 sq m from 700 sq m in Hi-tech International Business Centre; BEA, which purchased two floors of 2,800 sq m in Chang'an International Plaza; and HSBC, which expanded to 1,000 sq m in the same building. However, these deals haven't dented the available supply, and we expected it will take two to three years for the vacant space to be absorbed. Rents are expected to remain stable

As the office market is still in an early stage of evolution, a lack of transparency has led developers to rush to build new development. More supply will come into the market in the next two to three years, most of which is below the standard required of international occupiers. Only those developers that can deliver quality product will succeed. The market will see further adjustment, with the rents for low-quality buildings declining, while rents for high-quality buildings will remain stable at current levels.

CLOSING THOUGHTS

During the Tang Dynasty (of the 7th Century) Xi'an became the world's first truly international city, and housed a population of over one million. This city is certainly steeped in history like virtually no other Chinese city – two out of the three “glorious” periods in Chinese history (Emperors Wen and Jing of the Han Dynasty, and the reign of Emperor Zhenguan of the Tang Dynasty) were staged in Xian.

The sleeping tiger is now awakening and endeavouring to transform into a new city for the next millennium. Significant progress has been made in large-scale city regeneration, urban planning (the “big Xi'an plan”) and opening up of the economy to foreign investors.

By recognizing its strengths and weaknesses, the Xi'an municipal government has a clear plan to develop Xi'an into a modern, sustainable and cultural city. Unlike other Tier II cities which are all trying to evolve into regional, financial and commercial centres, Xi'an is seeking its own path.

However, Xi'an still faces big challenges – its economy has lagged behind coastal cities, while the “Go West” policy, which has paved the way for the rapid development of Chengdu and Chongqing, has not proved entirely beneficial to Xi'an.

Therefore, Xi'an needs to utilise its inherent advantages and seize the opportunity to attract manufacturing and services firms that are relocating from coastal China and South East Asian, and to create more job opportunities in order to improve the wealth of its local residents.

DEFINITION OF TERMS

ECONOMIC DASHBOARD

Population: Refers to the total population as of 31 December 2006.

There are two definitions of population:

- Registered population – those officially registered with the police
- Permanent residence population – those who actually reside permanently in a location, usually longer than one-half year

Xi'an's population refers to total population.

GDP: Refers to the gross domestic (i.e. regional) product of a location.

Employment: Refers to the number of persons engaged in labour and receiving remuneration payment or earning business income, including fully employed staff and workers in state-owned, collective-owned or other kinds of economic sectors and otherwise employed persons.

Population Growth: Refers to the compound annual growth rate over the five-year period of 2001–2006.

GDP Growth: Refers to the annual GDP growth rate over the five-year period from 2002 to 2007.

Freight Traffic: Refers to the volume of freight transported by various means, measured in millions of tonnes.

FDI: Refers to investment made inside China by foreign enterprises and economic organisations or individuals (including overseas Chinese, compatriots in Hong Kong, Macau and Chinese enterprises registered abroad).

GDP per Capita: Refers to the total GDP divided by the registered population.

Disposable Income: Refers to the actual income at the disposal of a household that can be used for final consumption, other non-compulsory expenditure and savings, which is part of the urban households' income that can be disposed by the urban households themselves.

High-Education Institutions: Refer to the number of higher-education institutions that provide higher-education courses and training for senior professionals. These include full-time universities, colleges, high-professional schools, high-professional vocational schools and others. High-education institutions are set up according to the central government evaluation and approval procedures.

Unemployment Rate: The registered urban unemployment rate refers to the ratio of the number of the registered unemployed to the sum of the number of persons employed and registered unemployment in a location.

Average Wage Rate: Refers to the average wage of fully employed staff and workers. It is calculated as follows:

Average wage of fully employed staff and workers = total wages of fully employed staff and workers/average number of fully employed staff and workers.

Business Environment: Jones Lang LaSalle's grading, measured by an assessment of a location's macroeconomic environment, its policy towards private enterprise and foreign investment and its labour market and tax regimes. A location's business environment is graded from A (highest) to C (lowest), with Shanghai providing the benchmark.

Quality of Life: Jones Lang LaSalle's grading refers to the quality of health, culture and environment in each city. A city is ranked among 15 cities. (Shanghai, Beijing, Guangzhou, Shenzhen, Chongqing, Chengdu, Tianjin, Wuhan, Xi'an, Qingdao, Hangzhou, Suzhou, Nanjing, Dalian and Xiamen).

REAL ESTATE DASHBOARD

Offices Grade A Stock: Refers to the total completed Grade A office space (occupied and vacant). Grade A reflects an above-average property in the market, with quality criteria being at the upper end of the scale. The only Grade-A office meeting our standard is Zhongda International.

Retail Stock: Represents the total stock of all department stores in Xi'an.

Number of Hotels: Refers to the number of five-star hotels.

Office Construction Grade A: Refers to the total amount of Grade A office space in properties where construction has commenced and completion is expected in 2008 or 2009.

Office Vacancy Grade A: Refers to Grade A office floor space (as a % of the total Grade A stock) in existing properties that are physically vacant, ready for occupation today and being actively marketed.

Benchmark Rentals: Refer to typical open-market rentals (within a range) that could be expected for a unit of the highest quality and specification in the best location expressed in US dollar per square metre per annum.

Grade A Office Rentals: Refer to gross rents. Sum of net rents and management fees.

Business Park Rentals: Refer to rentals of pre-built business parks, mainly in Xi'an Hi-Tech Industries Development Zone.

Residential Prices: Refer to typical prices (within a range) for high-end residential projects in US dollar per square metre.

Grade A Offices – Indicative Yields: Refer to the best (i.e. lowest) yield estimated to be achievable for a notional office property of the highest quality and specification. Indicative yields represent Jones Lang LaSalle's 'market view', based on a combination of market evidence where available and a survey of expert opinion.



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