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Investment Newsletter – April 2006

Thailand: Focus on Pattaya



Pattaya Bay from the North Looking South

This month I returned to Thailand to research the resort real estate markets of Pattaya and Koh Samui. The October to December 2005 newsletters provided an overview of the real estate market in Thailand, explained the investment thesis, and analyzed the risks in this market. Now we will look at supply and demand in the Pattaya market and the implications for price appreciation. But first let's put this in context with some background on the market.

Historical Context

In the 90's there was a building boom in Pattaya that ended with the currency devaluation in '97. Demand collapsed with the local economy and banks foreclosed on a huge supply of condos. Consequently no new class A condominiums were built in Pattaya until 2004. Once the excess supply of condos was worked off, prices of second hand condos took off in 2003. Prices have been rising rapidly since then. With strong demand for 10 year old condos, developers started selling projects in late 2003. Since then, 4,888 units have been built or are currently under construction.

Market Segments

To understand the market we must distinguish between Class A, B, and C properties. Class A units have sea views and top quality construction with finished units. Class C units have limited or no sea view and/or lower quality construction. Often these units are sold as concrete shells and the buyer puts in finishes. These units are generally 500 square foot studios but they can be combined to form larger units. Class B includes finished units with good quality but limited or no views. About 75% of the units in the market are Class C. Only 10% of units are Class A and the rest are class B. Because the new supply of Class A units is very limited, prices have been rising rapidly. In contrast, there are a large number of Class C units on the secondary market and plenty of land to build new units.

Geography

Exhibit A at the end of the newsletter shows where Pattaya is in relation to Bangkok and the rest of the country. Exhibit B is a detailed map of Thailand's Eastern Seaboard area showing Pattaya, Jomtien and surrounding areas.

Metropolitan Pattaya can be segmented by area from north to south:
Naklua is the northern part of Pattaya away from the bay which developed first. This is a prime spot for people working in the industrial zone just to the north. There is still some vacant land in this area, but not a lot.
Pattaya Bay is the central area (pictured on page 1) which has been fully developed and is now seeing some redevelopment of older properties. Most of this area is devoted to tourism: hotels, shops, restaurants, bars, and nightclubs. There are a few condo buildings at the beach here, most notably the new Northshore development.
Pratamnak Hill separates Pattaya Bay from the neighboring beach of Jomtien. This is not beachfront land but this is a convenient place to live and land is relatively cheap, so developers are building plenty of class B and C units here.
Jomtien is the slightly less developed and calmer version of Pattaya Bay about 2 miles south. This is a very desirable location and there are still bank owned properties here that offer opportunities to add value. The biggest new class A projects are going in here.

Na Jomtien is the area south of Jomtien proper where there is no road at the beach. Most future development will happen here over the next few years. A casino is sitting out here waiting for gambling to be legalized in Thailand after the king dies. Bang Saray is even further south and is still somewhat undeveloped. This is a place to buy and hold land for appreciation.

North of Naklua is the start of the Eastern Seaboard industrial area and thus it is not desirable for residential development. South of Bang Saray is a peninsula owned by the Thai military that marks the southern boundary of the area.

Demand Analysis

Tourist arrivals in Thailand have been growing 19-20% annually and were up 34% in the first two months of 2006. In 2005, over 12 million tourists visited Thailand. In 2004, 4.3 million tourists visited Pattaya; the 13 four and five star hotels in Pattaya received 936,940 visitors in 2004 (total rooms = 4,962). The chart below shows tourists arrivals by country of origin for January to February in 2005 and 2006.

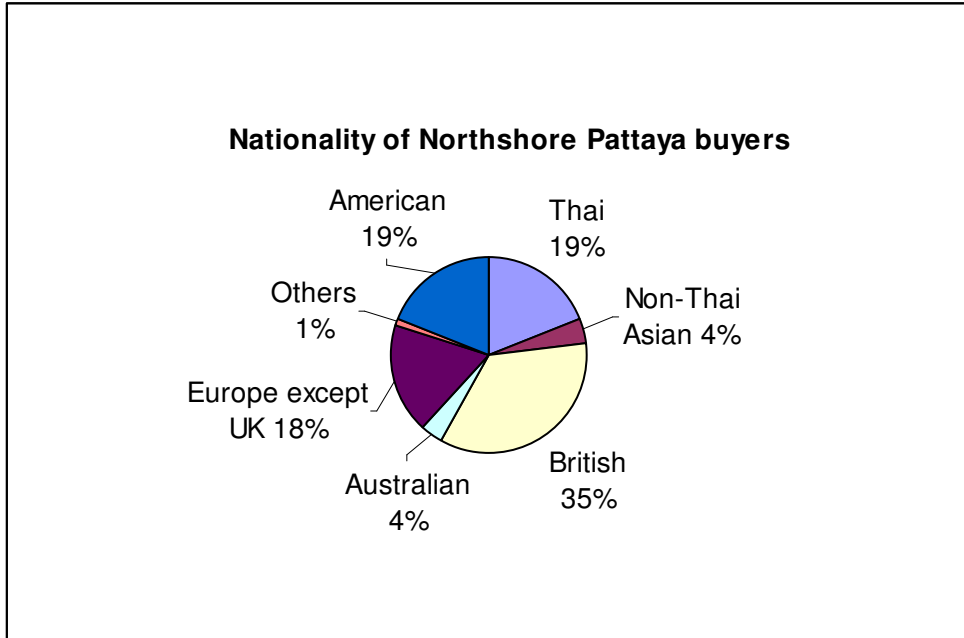
Tourist Arrivals – January + February

	2006		2005		% Change from 2005
	visitors	%	Visitors	%	
East Asia	832,070	48%	556,311	43%	50%
ASEAN	195,180	11%	159,307	12%	23%
Japan	207,885	12%	174,480	13%	19%
Korea	160,588	9%	80,878	6%	99%
China	156,727	9%	61,846	5%	153%
Taiwan	61,326	4%	40,612	3%	51%
Hong Kong	46,082	3%	36,695	3%	26%
Others	4,282	0%	2,493	0%	72%
Europe	548,299	32%	452,781	35%	21%
UK	118,341	7%	107,392	8%	10%
Germany	85,084	5%	76,672	6%	11%
Sweeden	50,378	3%	42,643	3%	18%
France	47,019	3%	42,704	3%	10%
Russia	39,491	2%	17,282	1%	129%
Others	207,986	12%	166,088	13%	25%
U.S.	106,111	6%	97,835	8%	8%
All Others	248,028	14%	187,819	15%	32%
Total	1,734,508	100%	1,294,746	100%	34%

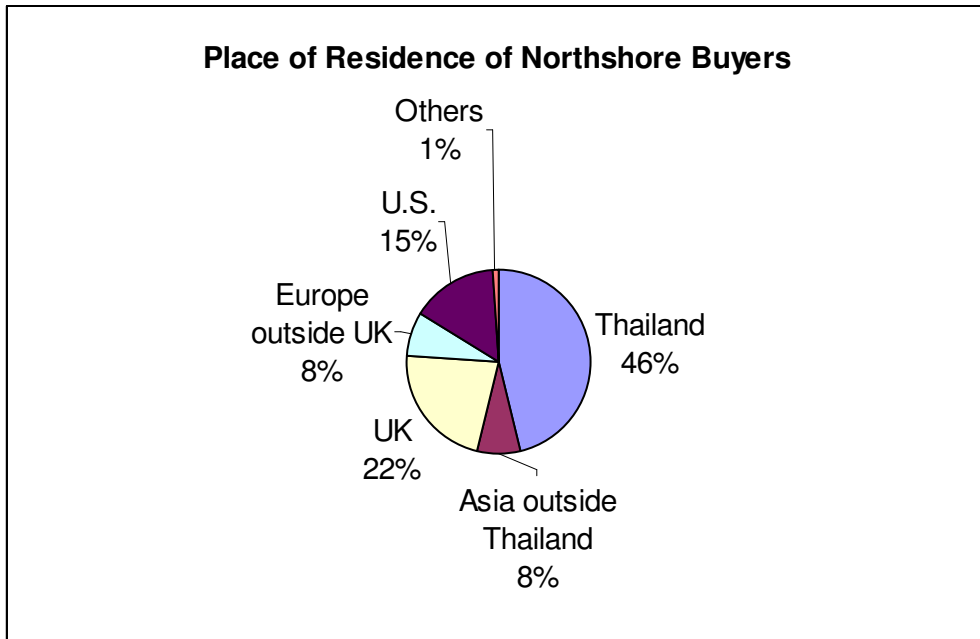
Some proportion of these tourists will eventually decide to buy property in Thailand as a second home or for retirement.

Looking at the Class A projects, all have sold more than 90% before completion. Over 500 units have been sold in class A projects that started selling units since the beginning of this cycle in 2004. Raimon Land, the developer of the 195-unit Northshore at Pattaya Bay (the first Class A project in the cycle), claims they could have sold twice as many units if they had a greater number of smaller units available in their mix. Over 2,500 people visited Northshore in 12 months

and they ended up with a waiting list of potential buyers. Consequently they are planning a second Class A project in the Naklua area that will break ground in June. The following charts breakdown the buyers in the Northshore project by nationality and by country of residence.



Going forward, I expect more non-Thai Asian buyers as people in Hong Kong, Singapore and China discover the quality of the units coming onto the market here.



While almost half of the buyers in this pioneering project were from in country, I expect that proportion to drop going forward; the percentage coming from other Asian countries should rise dramatically.

Another indicator of the high level of demand is the number of real estate agencies catering to western buyers – 150 at last count.

Catalysts for Demand Growth

While the British are already the biggest group of Class A condo buyers in Pattaya, a recent change in their pension law should spur further buying from U.K. nationals. As of April 6, 2006, residential real estate can be held by British citizens in self invested personal pension (SIPP) plans. This will allow a large shift of retirement assets into real estate without any taxes becoming payable.

Easier transportation will also help. Although there is an airport 30 minutes from Pattaya, it gets little use. Most people fly into Bangkok and take a 2 hour taxi ride to Pattaya (cost is \$23). This makes Pattaya a bit less accessible than places like Phuket and Koh Samui that have frequent direct flights. By the end of this year, Bangkok will get a new airport an hour closer to Pattaya. Later, a high speed train will make Pattaya just as convenient as Phuket and Koh Samui. This new airport south of Bangkok will also significantly boost the industrial area to the north of Pattaya and accelerate the migration of businesses southward from Bangkok.

Gambling, when eventually legalized in Thailand, will bring a further burst of growth to Pattaya. A casino has already been built in Na Jomtien. The politicians favor legalization as a necessary condition to compete with other tourist destinations in Asia. They delay it only in deference to the king. It is rumored that gambling will be legalized upon the king's death.

Although Chinese tourist arrivals have surged as the country has prospered, so far they have not been able to take capital out of China to buy real estate. There are signs this will soon change. The Chinese government must soon free up capital flows to keep the inflow of dollars from overheating their economy and driving up inflation. In fact they have already taken steps to allow businesses to invest outside China. When China finally allows its citizens to invest outside the country, Thai real estate will draw a huge amount of interest. Thai real estate is desirable, close by, and relatively inexpensive. I expect a significant run up in prices immediately after capital controls are relaxed.

Supply Analysis

New supply coming in 2006-07 should break down roughly as follows: 11% Class A, 11% Class B and 78% Class C. Given the projects currently announced and indications that Class C supply is roughly in line with demand, there should be a shift towards a higher ratio of class A units going forward.

Two class A projects were complete and two were under construction at the time of my visit in April. Of the 529 units in these buildings, 96% have been sold. This means that roughly 250 class A condos have sold each year over the last two years. Given that construction doesn't start until roughly 50% are sold, and some

buyers won't buy until construction starts, the market could probably have absorbed many more units (the developer of Northshore has made this point).

There are three class A properties that have been announced but not started. One of these has sold about 30% of the units and the other two are just starting to sell units. The three combined will add another 1,241 units - if all get built. The largest of these projects will be 587 units in a 92 story tower in Jomtien. This will take till at least the end of 2009 to complete. Thus the forecast is for about 654 new units over the next two years. This looks like it will be well short of indicated demand.

In class B, 520 units are in buildings under construction and another 237 are in announced projects that have yet to break ground. This segment may well absorb a portion of the excess demand from class A. Virtually all the Class C units are built by the same company under the View Talay brand. Currently building #3 with 600 units is complete but not completely sold out. I estimate that 10% or less of the units remain to be sold. View Talay 5 and 6 are under construction. Combined these buildings will add 2,961 units to supply, but about 1,800 have already been sold.

Developers can build class A space for less than \$63 per square foot; the class C product is probably half of that. Given the prices discussed below, I expect developers to keep buying land for new projects until the supply of condos starts catching up with demand.

Prices Imply Huge Development Profits

It is surprising that there are not more projects underway given the strong sales that routinely take place prior to any construction. Selling prices for Class A buildings are averaging at least \$200 per square foot, while construction costs are less than \$63/s.f. Beachfront land in Naklua can be had for \$1.64 million per acre. Even assuming a very conservative floor to land area ratio of 1 to 1, land would cost no more than \$37 per square foot of building. Thus, development profit, before marketing and common area expenses, is roughly 100% of costs. This should encourage a lot of developers to come to build units and bid up land prices.

Typical unit sizes are 600 to 800 square feet for Studios and one-bedroom units, 1,140 s.f. for two-bedrooms and 2,900 s.f. for 3-bedroom units. Pricing is set based on indoor area, how high up the unit is, and the view. On a middle level floor, units would be priced roughly as follows:

Type	Square Feet	Price in Dollars
Studio	600	\$120,000
One Bedroom	800	\$160,000
Two Bedroom	1,140	\$228,000
Three Bedrooms	2,900	\$580,000

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Condo projects often include some very high-end villas in front of the condo tower. Since these include land, prices per square foot can be higher than the top floors of the tower; thus prices for large villas will often exceed \$1 million.

Conclusion

Given the current shortage of class A units and the catalysts I see for further increases in demand in the future, investors in these Pattaya condos are likely to be rewarded with double digit appreciation for the next couple of years at a minimum. I expect developers to raise prices slowly, but consistently, to ensure their projects sell out early enough to fund the construction of the buildings. Correspondingly, land investments and development projects will pay huge returns for those who can get in now before more developers rush in to bid up prices. Pattaya looks to be in the 3rd year of a gold rush and there is still land to be claimed. Contact us to find out how to invest in this market.

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Exhibit A



Exhibit B

