Chair's Letter to Shareholders

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Chair

Results and Dividend

For the year ended December 31, 2021, revenue increased by 15% to HK$10,321 million against the backdrop of the coronavirus (COVID-19) pandemic and in the absence of revenue from property sales.

Net profit attributable to shareholders amounted to HK$3,868 million, compared to a net loss of HK$2,571 million a year ago. Earnings per share stood at HK$0.86.

When excluding all the effects of property revaluation, underlying net profit attributable to shareholders rose by 4% to HK$4,365 million. Underlying earnings per share increased in tandem to HK$0.97.

The Board recommends a final dividend of HK60 cents per share payable on May 19, 2022 to shareholders of record on May 4, 2022. If approved by shareholders, total dividends per share for the year ended December 31, 2021 will be HK78 cents.

Business Review

While the world, including Hong Kong, is confronting multiple serious challenges, of which the pandemic is but one, we have turned in a rather satisfactory set of results. Although we did not have any revenue from property sales, rental income alone brought us over the HK$10 billion mark. We have never collected so much rent in our history. The Mainland market now accounts for 67% of our total leasing revenue and will continue to rise.

Provided that the recent fifth wave of COVID-19 does not drag on for too long, the hemorrhage in the Hong Kong rental business due to the pandemic should be behind us. Although for the full year, revenue was still down 7% from 2020, the second half to second half comparison of retail rent was already flat. I expect 2022 to improve slightly more.

As can be expected, the star performance came from our Mainland properties. Both our retail space and our high-rise offices have done very well. To assess the results for our malls, we should not only look at 2021 versus 2020 numbers since the first half of 2020 was an anomaly. From end January to approximately mid-April of 2020, shops were almost all closed due to the onslaught of the first outbreak of COVID-19. As such, it makes sense to also compare the second halves of the last two years, as well as the last six months of the year under review to the first six months of the same year. I should also call attention to the fact that business in the second half of 2020 was particularly strong, after luxury goods consumers were deprived of the pleasures of shopping earlier that year. It persisted until the summer of 2021, when periodic outbreaks returned. A few months later, eastern Chinese cities such as Shanghai and Wuxi were hit by storms which interrupted business. Consequently, the last six months under review could have seen even stronger business.

For the full year, rental revenue in RMB from our 10 malls grew by 25% when excluding the 7% appreciation of RMB. Not counting the newly opened Heartland 66 in Wuhan, that number would be 21%. As has been widely reported in the media, general personal consumption in China was not strong. What was often missed was that the luxury goods market was very robust. These facts are reflected in our performance. Rents at our six luxury facilities (not counting Heartland 66 in Wuhan which was only inaugurated in March of last year) rose between 12% and 47%. The average was 25%. Our three sub-luxury properties grew 2%.

The two best performers were Center 66 in Wuxi and Spring City 66 in Kunming. Their growth rates reached 40% and 47%, respectively. Our two flagship malls in Shanghai continued to trade well — rents advanced by 25% at Plaza 66, and by 18% at Grand Gateway 66. Because the Asset Enhancement Initiative (AEI) at the latter was only completed in the last quarter of 2020, and some top brands only moved in early 2021, the momentum there is actually stronger than that of Plaza 66.

Comparing the last six months with the corresponding period a year ago, which reported very strong sales, all luxury malls increased in rent. This ranged from 5% at Plaza 66 in Shanghai to 41% at Olympia 66 in Dalian. The average for all such facilities was 11%. The same group of properties collected 7% more rent in the second half of 2021 than in the first half. Growth ranged between the 4% of Plaza 66 in Shanghai and Center 66 in Wuxi, and the 45% of Olympia 66 in Dalian.

Rental margin and occupancy improved everywhere, and were particularly strong in Spring City 66 in Kunming and Olympia 66 in Dalian. Later, I will comment on the transformation of this latter, stand-alone mall.

A good indication of the future is tenant sales and their trend. Year-on-year, all our luxury malls grew strongly. Shops did between 33% and 89% more business than in 2020. Not counting the newly opened (March 2021) Heartland 66 in Wuhan, the average increase was 50%. Comparing the second half of 2021 to the corresponding period in 2020, all but one property saw sales rise by double digits. The most spectacular performer was, as expected, Olympia 66 in Dalian. It did 95% more business. Measuring the last six months of 2021 against the first six, all facilities advanced except one. Center 66 in Wuxi registered a slight fall due to several virus outbreaks and bad weather, but sales picked up towards year-end. By far, the best performer was again Olympia 66 which jumped 56%.

Olympia 66 in Dalian is our third mall which for different reasons started life in the sub-luxury space, but has successfully been upgraded to the luxury category. The rewards are huge. In time sequence, they are Center 66 in Wuxi, Grand Gateway 66 in Shanghai, and now Olympia 66 in Dalian. As I have more than once written over the past decade, our strategy on the Mainland is to be the number one (or a close but ambitious number two) top-end mall in economically vibrant metropolises.

Circumstances allowing, and if we get it right, ideally a property should be born as the best luxury mall in the city. Examples are Plaza 66 in Shanghai, followed by Spring City 66 in Kunming, and, as of last year, Heartland 66 in Wuhan. When Plaza 66 opened, there were no shopping centers in Shanghai, or indeed across the entire country, that were truly "luxury". As such, some people have said that we created that market. But to be more exact, we were merely the first one to exploit a market whose time had arrived.

The stories of Spring City 66 in Kunming and Heartland 66 in Wuhan are slightly different. Before the two were inaugurated, respectively, in August 2019 and March 2021, there were already malls with numerous top fashion brands. But because of a combination of factors, including location, size, design, quality of construction, and, I suppose, management, we were able to wrest the crown from the existing number one player and became the undisputed preeminent luxury mall in the city. We successfully attracted — not bullied, like some of our competitors — a critical mass of top global fashion brands to be our tenants. Because their profit margins are far higher than retailers of goods sold in sub-luxury or mass consumption malls, they can pay much higher rents, both base rents and sales rents. Like Plaza 66 in Shanghai, now Spring City 66 in Kunming and Heartland 66 in Wuhan have both achieved that status.

Center 66, Wuxi

However, Center 66 in Wuxi, Grand Gateway 66 in Shanghai, and Olympia 66 in Dalian were not as fortunate at birth. In the case of Center 66 in Wuxi, it opened in 2013 during a severe bear market for luxury goods that lasted from mid-2011 to 2017. High-end fashion companies froze all expansion plans. We had to take whatever brands that were willing to come, mostly sub-luxury or even more affordable names. All the top fashion houses were already located in two other sub-standard properties whose operators did their best, not always fairly, to keep those tenants. But as we worked out our initial limitations, the superiority of our malls began to shine through. Top global brands took note, although their headquarters still did not permit their shops to make a move.

Nevertheless, no later than 2016, my team already knew that it was only a matter of time before we would win. Sure enough, once the bear market began to fade in 2017, we were courted by many of the most famous names. They began to move in over a period of two to three years. By 2019-2020, the battle was won. We became the undisputed winner. Tenant sales and rental revenue both soared over the past three years and will likely continue for a while. There is no denying that the pandemic benefited all luxury malls in China due to the repatriation of previously overseas sales. But who by far benefited the most? The market leader!

The second property to have made the same transition may be surprising to the casual market observer. It is Grand Gateway 66 in Shanghai. It is a 22-year-old facility, and actually our very first mall on the Mainland. At the time we opened for business in 1999, there were no truly five-star shopping centers. Our one-year-younger Plaza 66 in the same city became the very first. The Shanghai market in those days was much smaller, and Grand Gateway 66 was planned as a four-star facility. It was hugely successful for what it was, but the rents it commanded could not compare with a five-star property. Yet in the 10 to 15 years after Grand Gateway 66 came into existence, Shanghai, and indeed the entire country, had greatly advanced economically. Nowadays, Shanghai is so prosperous that it can sustain six to eight stores for each of the top brands. Following the example of Plaza 66, other developers (mostly from Hong Kong) have built successful high-end facilities, so why not Grand Gateway 66?

Taking advantage of the AEI in 2017-2020, we turned it into another luxury mall approaching that of Plaza 66 in Shanghai down the street. Many top fashion brands agreed with us and began to move in. The AEI was completed towards the end of 2020, and soon the number of top brands doubled. Rents rose quickly and are expected to continue this trajectory for some time to come.

Olympia 66, Dalian

Olympia 66 in Dalian is our third successful upgrade from sub-luxury to luxury. Originally opened in 2015 in the midst of the abovementioned bear market, difficulties were compounded by its sheer size. At 222,000 square meters, it is by far the biggest mall in our portfolio. Moreover, it is a stand-alone shopping center without the synergy of office towers or expensive residential units. The location is new to high-end retail, for all the fashion brands were previously located in two other districts of the city. The combination of the above challenges compelled us to reserve about 13% of the space in 2015. It is called phase two and is now finally available for business.

The reason we had the confidence to undertake the project was not just the reasonable land price. Surveying the potential competitors in the city, we found none that were well-designed and well-built. We thought we had a fair chance of attracting top brands. So, like Center 66 in Wuxi, once the bear market was over in 2017, we made our move. But unlike Center 66, the competitor was financially strong, and our location was challenging. We knew that with our superior hardware, we had a fighting chance. And given our size, any success could be huge, for we had room for all the top brands. After much hard work, we made it, and the numbers presented above are the beginning of our reward.

Seldom does one see a speed of transformation like that at Olympia 66 in Dalian. Just a year ago, we housed hardly any luxury names. Now we have as many as Center 66 in Wuxi. There, the improvement was gradual over a few years; here, it was done in a little over a year. While we enjoyed fast growth last year, the full effect will only be felt in the coming few years. Revenue improvements will also be derived from the leasing up of phase two.

Although Heartland 66 in Wuhan is only 10 months old, all signs point to a repeat of the recent success in Spring City 66 in Kunming and more. Six months ago, I presented some reasons for optimism; now I am even surer. Not only was the sales trend very strong, but it already boasts more of the top fashion houses as tenants than any of our other properties, except Plaza 66 in Shanghai. There will be more in the coming few months. I will not be surprised if, in the next two to three years, it will catch up with Center 66 in Wuxi in terms of tenant sales. When Westlake 66 in Hangzhou tops out in 2024 and opens soon thereafter, they will likely be our top two malls outside Shanghai.

Counting Heartland 66 in Wuhan, we now have seven luxury shopping centers. By our reckoning, there are close to 100 international luxury brands with a presence in China. Of that, not much more than say 25 can be considered truly premier names. They include the "Big Six", who are most influential.

If we take the bigger group of 100 or so, as far as our properties are concerned, five years ago they were primarily found in our two malls in Shanghai and in Forum 66 in Shenyang. Today, our seven malls each has 30 of them on average. Over half of the 100 are in Plaza 66 in Shanghai. In the past two years, plus the coming few months, we would have almost doubled the number of such stores in our portfolio.

For the smaller set of 25 or so of the very top brands, they were formerly found almost exclusively in the two facilities of Plaza 66 in Shanghai and Forum 66 in Shenyang. Now they are in all seven, with each mall home to a minimum of seven of them. By the time I write to you again in six months, Plaza 66 should have 23 (now 22), and Heartland 66 in Wuhan, 17 (now 13).

The number of "Big Six" stores in our seven luxury malls have gone from eight in 2018 to now 23. Four more have signed up and will move in this year, making a total of 27. This number has tripled in a little over three years. Indeed, we have become one of the few important partners in China for almost all of the most prestigious brands.

Our Mainland offices have also performed satisfactorily. For the year, our rents grew by 16%; excluding the newly opened tower in Heartland 66 in Wuhan, the rise was 11%. Every project recorded an increase. Rental margin and occupancy either held steady or advanced.

Some may ask: You wrote previously that in almost all tier-one and tier-two Mainland cities, oversupply is serious. It is not uncommon that for so-called Grade A offices — and frankly most of the so-designated are at best Grade B in other advanced economies — vacancies stand at around 30% to 50%. It was pure insanity that developers continued to build new towers over the past decade or two. Why, then, is Hang Lung able to maintain high occupancy while collecting reasonable rents?

For the answer, we have to go back to our thinking in the mid-2000's when we decided to build offices outside Shanghai. To be sure, our high-rise towers are always ancillary to the mall downstairs. The two product types mutually enhance each other's reputation and help bring in quality tenants. Frankly, often the government as the land seller stipulates their coexistence in a complex. All that is true, but in the minds of Management, there is another calculation. There are good reasons why we can thrive in the presence of stiff competition.

China is a fast-growing economy. The national aspiration to lift millions out of poverty as quickly as possible makes urbanization a necessity. In fact, its scale and speed are unprecedented in human history. Cities old and new will become more vertical than ever, and population density can only increase. Service providers of many kinds will be greatly concentrated in high-rise office buildings — financial services like banks, insurance and asset management, professional services such as accounting, legal, engineering, architectural, and by extension, corporate headquarters or regional head offices. They are all critical components of GDP, but they need to be, or like to be, near each other. Consequently, many of them will be crammed into skyscrapers.

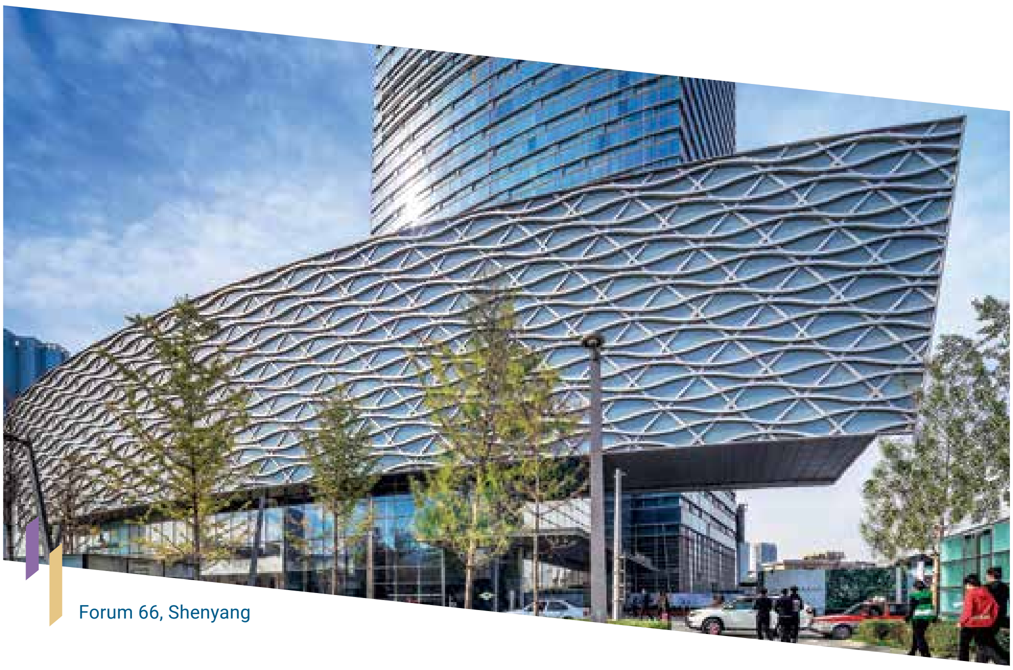
While no businessman will unnecessarily overpay, such operations can afford more rent. After all, office outlay is not a big part of their cost of doing business. However, location, building quality, and property management are important to them for reputational and practical purposes. The fact that thousands of people will be in close proximity of each other means that geographic convenience is critical. Complementary facilities, such as eateries and shopping, should be nearby.

In come our office towers. In the face of severe oversupply, only the very best will get filled up. Almost as important is the fact that the best tenants with financial stability and prestige will congregate there. It is always easier to draw poor tenants, but only good tenants will attract other good tenants. Just examine our office tenant roll. In every building of ours, in whichever city, it reads like the who's who of top international and Chinese businesses.

To be sure, rent level is affected by oversupply, and office tenants are by nature not as sticky as retail tenants. Nevertheless, as an asset class, rental yield is acceptable even purely from a financial perspective. But as mentioned earlier, offices bring other less tangible yet still important benefits, like quality footfall and prestige. They also make the shopping center below more defendable, and vice versa. Both types of tenants like the presence of the other asset class. The simplest example is perhaps the restaurants in the mall. They like the white-collar workers above, and office tenants enjoy the convenience.

In mainland China, our strategy is capable of succeeding even amidst rampant oversupply. The assumption of most office developers is: I build and tenants will come. Nothing is further from the truth. Those people do not respect the market, and so the market does not respect them. More often than not, they would end up with a huge vacancy. Moreover, their locations are usually not suitable for Grade A offices, and the quality of their design and construction is usually poor. To compound their woes, most of them are sold with strata title. This ensures poor property management forever. From what we can tell, other than Shanghai, all the cities in which we own offices share the same problem. Such is the competitive landscape in which we play; it is quite favorable to us.

In three of our seven luxury complexes — Forum 66 in Shenyang, Spring City 66 in Kunming, and Center 66 in Wuxi — we have hotels. Certain dynamics for offices described above apply. As a stand-alone asset class, hospitality is less desirable than offices. Only when it makes eminent sense, i.e., when we are compelled by economic realities, will we build them. Since around



Forum 66, Shenyang

1966, the predecessor entity to our parent company, Hang Lung Group (HLG), had owned hotels in Hong Kong. However, in the decade of 1994 to 2003, we converted all three of them to other usage, mostly offices, and have received much better financial returns. Fortunately, so far, our only hotel that has opened on the Mainland, the Conrad Shenyang at Forum 66, has been performing reasonably well. We have managed this through identifying and targeting a specific market segment, and then both constructing and operating the hotel to that segment with discipline. The same will apply to our future hotels.

All signs show that our Hong Kong rental business has turned the corner. For our retail rental, the first half of 2021 was 14% lower than the same period in 2020. This past six months, rents collected were about the same as the second half of the preceding year. Comparing the second half to the first half of the year under review, it improved by 2%. Although the full-year figure was still 7% below that of 2020, this set of results strongly indicates that the market is on the mend, unless the pandemic worsens significantly again. With the recent fifth wave of the pandemic, we cannot ignore that possibility. But, at least for the past year, citywide market trends and our tenant sales were both positive. The drag in Hong Kong on our overall performance may be over.

Hong Kong offices are still weak, although the trend is in the right direction. However, I do not foresee a quick or meaningful recovery any time soon.

All construction works on the Mainland and in Hong Kong are progressing as anticipated. Planning for the luxury residential project in Shouson Hill is proceeding. We may only build four or five freestanding houses. Market demand is so far very strong.

As of year-end, we sold 123 units of The Aperture, our residential project in Kowloon East. Unit prices achieved were quite respectable. Once all sold, I expect a pleasing level of profit. Due to accounting rules, however, much of it had already been recognized as fair value gains in prior years and such gains will not be recognized again upon sale completion.

One house at our Blue Pool Road project was sold last June at a good price. Completion will be in this quarter, at which time its profit can be booked.

The office tower on Electric Road will be kept for long-term rental. For historic reasons, the project is one-third owned by our parent company HLG and two-thirds by us. Completion is targeted for the second half of this year.

The gross revaluation gain was HK$460 million — value appreciation of HK$1,750 million on the Mainland and value diminution of HK$1,290 million in Hong Kong. At year-end, capitalization rates everywhere remain basically unchanged from 12 months ago. After taking into consideration the effects of tax and minority interests, the net revaluation loss came to HK$497 million.

Financially, the Company remained relatively lowly leveraged with a net gearing of less than 25%. 30% of our total debt, including available facilities, is categorized as sustainable finance. In the coming few years, I anticipate, on average, an annual capex of HK$3-4 billion which can be easily met with existing facilities and property sales proceeds. Any land purchase will be on top of that amount.

In May, we will publish our 10th *Sustainability Report*. Not desiring to repeat anything you would read therein, I will merely say that Spring City 66 in Kunming has achieved an important milestone where all of our electricity is now derived from renewable sources. We will do our best to keep improving everywhere.

Prospects

As is often my practice, I begin this section with analyses of our Company's strategy, the industry, as well as the broader economic and/or geopolitical landscape that may impact us. Let me begin with the first: our business. I will then address three troubling issues often raised by our investors: Beijing's recent common prosperity policy and related issues, the financial problems of many Mainland property developers, and Hong Kong's policies in dealing with the pandemic and their economic ramifications. I will wrap up with a brief outlook on our Company's future in the near to medium term.

Our 2021 results clearly demonstrate several points. First, we are in a sweet spot in an economy that is growing nicely — China, in spite of the sea of turbulence all around.

As I have publicly stated before, although China and the U.S. are locking horns in almost every arena, the two best places in which to invest are precisely these two big countries. Short of accidents, which can always happen, both economies will thrive. As an American venture capitalist said to one of our directors, in the past they only invested in technology; now they invest in almost every sector of the economy because of the increasing ubiquity of technology. This phenomenon will be prevalent in both countries but especially in the U.S. China will have many other impetuses for growth. Moving to higher value-added manufacturing would be one, and the rapid expansion of the still less-developed service sector would be another, just to name two major fields for improvement. There are many other areas where both economies can evolve and grow. Since we are a Hong Kong-based company, geography dictates that our primary market can only be mainland China.

To be sure, China has many domestic challenges, but this has always been so. For example, the latest blow-up of many property developers is one. Over the past two to three decades, Western pundits would from time to time proclaim doom and gloom at the slightest whiff of bad news on China, but the economy and society remain basically intact. Reasons for the wrong calls are primarily two. One is a lack of understanding of the Chinese system, which is related to Chinese culture. The other is politically driven. Some Western capitals do not want to see China thrive, so they only single out the negatives for disparagement. Of late, the exaggeration has been blown out of all proportion, and even many outright lies are being propagated. Not only do their citizens believe what is said; they themselves begin to blur facts with fiction. Such is an underside of human nature. As I have often said, the best way to misread China is to exclusively read the Western press. Indeed, one should avoid it.

Will China's economy one day fall? It's possible, but highly unlikely. Chances are good that it will continue to grow for many years and decades to come. We are fortunate to be playing in that market.

But China's growth will not be even. It never is. Over time, this industry or that will ebb and flow. For example, due to the pandemic and advances in technology, mass consumption is increasingly moving online. It is an irreversible trend, just like technology; once developed, it cannot be "undeveloped"! The opposite is true for the purchases of luxury items. Both market data and our own experience prove the point. Whereas tenant sales in our sub-luxury malls grew last year by 20%, that in their top-end siblings saw a jump of 55%.

This leads me directly to an analysis of our recent business operation on the Mainland. Once the pandemic was basically contained in April 2020, less than three months after it literally went viral in the last week of January, tenant sales began to rise briskly, especially in our high-end malls. It has remained so to this day. The last six months of 2021 slowed a little, but this was due to the appearance of the Omicron variant and extreme weather events in eastern China around Shanghai and Wuxi. Even so, although the second half of 2020 and the first half of 2021 had already set a very high base, our results for the last six months of 2021 in virtually all our luxury malls surpassed both of the two previous six-month periods.

This set of results tells a powerful story. As overseas travel has basically been suspended since the onslaught of the pandemic, one would expect that the 70% plus of total luxury sales formerly transacted overseas would repatriate. It indeed happened as I had previously reported. But the effect could only produce a one-time jump that lasted, at most, a year. Thereafter, a much higher base has been established and any further rise must be from organic growth. We are now 20 to 21 months after the pandemic was brought under control and the market had recovered, yet sales growth is still strong. I will not be too surprised if the phenomenon continues for some time, especially in our top-end malls in tier-two cities.

Here let me add a word. I do not believe that, after international travel resumes, there will be much leakage of sales gained by the repatriation of high-end spending, the process of which was greatly sped up by the pandemic. This worry is the flavor of the month for some analysts, but it is not well founded. To have a better assessment of what might happen, we need to ask the question: why did the Chinese previously travel overseas to shop? From what follows, it is not difficult for me to argue that, even without the pandemic, repatriation is sooner or later an inevitability.

Until a few years ago, prices of luxury goods in mainland China were considerably higher, by as much as 20% to 30% for the same item sold in Paris, London, or Tokyo. This is no longer the case. The brands voluntarily closed the gap, and the effort was led by none other than Chanel, one of the most prestigious luxury brands in the world. Their management is known for foresight and prudence.

A second reason for buying overseas was that the Chinese taxes on luxury goods were very high, which pushed up the sales price in mainland China. A few years ago, Beijing lowered these taxes in order to keep the sales at home. In fact, at international points of entry, China's Customs have begun to screen for and impose stiff import duties on luxury products purchased overseas.

Third, luxury goods stores in mainland China previously carried a narrower line of products compared to their sister stores in places like Milan or Hong Kong. Many items could only be bought overseas. The reverse is now true. Recognizing that China is by far the single biggest market for these top brands, they now carry as full a lineup of styles and sizes as any other country in the world. In fact, some of these brands even designed special product lines exclusively for the Chinese market that are unavailable elsewhere in the world.

Another reason the Chinese travelled overseas to buy was that the shopping experience there was better. Whether in Rome, Madrid, Seoul, or New York City, there was an army of well-trained Chinese-speaking sales associates ready to serve. However, one can be assured that today, the staff at Chinese luxury malls such as our own are every bit as knowledgeable and hospitable. The quality of the shopping experience in China today is second to none.

Credit must also be given to Customer Relationship Management (CRM) programs in Chinese malls, and not just those in stores, as they can be very effective. Our own program, HOUSE 66, has proven to be superb, and those of our competitors are also not bad. A Chinese Very Important Customer (VIC) in Paris may have to line up outside a shop for quite a while to gain access, and even upon entering, would not be recognized by the sales staff. In our malls, this would not happen. We work closely with the brands to ensure a first-class experience for their (and our) VICs. Together, we also offer unique experience-based programs that are only available to certain tiers of our HOUSE 66 members. The more one spends at our mall, the more services one receives, so why shop overseas?!

Given the above, VICs of our tenants become very sticky to our properties. They are not just customers of a particular brand but also of our malls. In view of all of the above, I envisage limited leakage once these sales have been repatriated.

Grand Gateway 66, Shanghai

After analyzing the industry, let me now drill down on our own operation. We entered the Mainland commercial real estate market in December 1992 and this is our 30th year. That period of time can be roughly divided into three stages. For the 12 years or so between 1993 and 2004, we operated exclusively in Shanghai and completed two highly successful projects — Plaza 66 and Grand Gateway 66. For the 14 years of 2005 to 2018, we bought land outside Shanghai and built six projects in five cities. They were all basically completed by the end of 2016 and were operating successfully, the minor exceptions being Center 66 in Wuxi and Forum 66 in Shenyang, both of which are now completing their last phases of development.

Stage Three began in 2019 after the six-year bear market ended (in 2017) and when we inaugurated the latest batch of projects, the first of which being Spring City 66 in Kunming. It opened in August 2019. This was followed by Heartland 66 in Wuhan, and the next will be Westlake 66 in Hangzhou. The two that are already open became the number one luxury mall in the city from the get-go. Rises in rental margin are much faster than their six older cousins in Stage Two, all but the first one of which opened during the long bear market.

Also beginning in 2019, globally significant luxury brands have moved almost en masse into many of our malls of all genres — Grand Gateway 66 in Shanghai of Stage One, Center 66 in Wuxi, Olympia 66 in Dalian, and even Parc 66 in Jinan, all of Stage Two, and of course the two malls of Stage Three. This renders seven out of our 10 existing properties as full luxury malls, with Parc 66 hopefully joining this echelon after its AEI completion in 2024.

Throughout the three decades during which we developed this business from scratch, we have learned a lot. Stage Two, in particular, was painful, mainly because of the bear market in luxury goods. It coincided with the opening of five of the six malls of that period. In some ways, we have learned the most during that time. To learn what not to do is often every bit as significant as to know what to do.

Before that bear market, we thought we might have two lines of products, called luxury and sub-luxury. Afterwards, we changed our mind. The only business worth doing is the luxury kind. The results of these past two years have borne out that fact. We always knew that higher-end properties will always do better, and so we invariably strived to upgrade our sub-luxury portfolio to luxury. We once thought that the four-star facilities might still be an acceptable sector to be in. Now we are convinced that, unless one does not have the ability to create five-star shopping centers — and fortunately very few have that capability — one should stick with top-end malls. Besides much richer rental margins, they are far more difficult to be replaced by e-commerce. They are much more defendable.

A newly published update by a reputable international consulting firm on its regular report on China's luxury goods market apparently agrees with our conclusion. We are indeed in a sweet spot of the Chinese economy. The number of capable and successful players in that space is rather limited, and most of them are, like us, from Hong Kong. Yet we seem to have trodden a slightly different path — few have operated successfully in so many cities. Some have restricted themselves to only tier-one cities, a strategy which I respect tremendously. (In the luxury goods market, only Beijing and Shanghai are tier-one. The size and depth of the two are unmatched on the Mainland. Guangzhou and Shenzhen are on par with other better tier-two metropolises.) A handful, including us, have also gone to top tier-two cities. There is no denying that, if done right, the return from Beijing and Shanghai should be better if you are the market leader, like Plaza 66 and Grand Gateway 66 in Shanghai. But if you are merely an also-run, then returns will be much lower.

Here I should add that there are a few top tier-two metropolises that are better than the rest — call it "tier-1.5". For the luxury market, besides Guangzhou and Shenzhen, there are three or four more, including Hangzhou and Wuhan. To qualify, a city must be economically very strong, and its population sizeable. Recently, Wuxi was reported to have the highest per capita income in the entire country, but its population is not big enough. To illustrate, a "Big Six" brand can have six or more stores each in Beijing and Shanghai, perhaps three shops in a tier-1.5 city, and only one or two in a good tier-two city.

Plaza 66, Shanghai

So, what is our strategy moving forward? There are two elements, both long held by us. The first is to build only properties that have a good chance to become the leading luxury mall in the city, preferably from day one. As I have written repeatedly in years past, the number one most successful mall in a city will have a sizeable difference in financial return versus the number two. This is not just to assuage our sense of pride, but there is a very pragmatic reason — we are here to maximize shareholder value. The second element is, if possible, to upgrade a sub-luxury property as fast as possible, if for whatever reason it could not open as a luxury facility.

Plaza 66 in Shanghai was probably the only top-end mall we have ever developed where there was no decent cluster of top fashion brands in any other property in town. So, before entering a market, we must carefully assess the competitive landscape. If there is no reasonable chance of dominating the market in a city, we should not proceed. We should refrain from buying land. Even when we think that the probability is high, we may still be forced to operate first as a sub-luxury facility before we can lure the premier brands over. The anticipated wait should not be overly long, for it would affect our financial return.

Of the six projects in Stage Two, when land was bought between 2005 and 2010, all malls were expected to achieve five-star status except Palace 66 in Shenyang. Given its location, it was destined to be four-star. It was our first attempt at that product type. Unfortunately, soon after Riverside 66 in Tianjin was completed, we realized that the city's economy was far weaker than what statistics indicated. We have been watching this once prosperous metropolis for 30 years and have yet to see one successful luxury mall. So, for the foreseeable future, our facility will have to remain sub-luxury. Given the excellent hardware, one day it can still be upgraded when the market and competitive landscape allow.

All the other four have potential. In the case of Forum 66 in Shenyang, we miscalculated. We allowed a competitor to complete constructing their shopping center some 18 months ahead of ours. Together with certain design issues, we had to play second fiddle since opening. Although not fatal, it was nevertheless a costly mistake.

Of the remaining three malls, two have been successfully upgraded while one is on the way. Center 66 in Wuxi and Olympia 66 in Dalian are both the undisputed number one luxury property in their respective cities. The former acquired that status in 2019 with concurrent financial reward. The strong rental growth since that time is expected to continue. Two years behind but behaving similarly is Olympia 66 in Dalian. This past year was when top fashion brands moved in in droves. This explains the amazing jump in rental revenue. The process is not yet finished; it will continue this year and likely the next as well. Parc 66 in Jinan began its AEI last year, which should signal the gradual migration to luxury mall status. Already we are beginning to see the addition of higher value brands these past two years.

Such transformation is critical to the long-term success of our Company. It not only affirms our land purchase decisions as well as our assessment of the competitive landscape, but also proves Management's capability to fight and win. Frankly, the successes in both Center 66 in Wuxi and Olympia 66 in Dalian would have arrived a few years earlier if not for the six-year severe bear market that only ended in 2017. I estimate that it has probably delayed our ascendancy by at least two to three years. In fact, if not for the prolonged market downturn, Center 66, which opened in 2013, could have dominated the market from day one. The delay was financially costly.

This leads me to my next point. In most cases, and under normal market circumstances, we should be able to assume the top spot from the get-go. Our confidence has been boosted in recent years with two successive bonanzas — Spring City 66 in Kunming, which opened in August 2019, and Heartland 66 in Wuhan, now 10 months old.

Heartland 66, Wuhan

Before we came along, there were already one or two major players in the two cities of Kunming and Wuhan. They are all equally well or even better located than we are. But because of our superior design and construction, as well as the reputation of our management among global top brands, we were able to attract them to our malls before we opened our doors. A weaker competitor will lose their best tenants to us; a stronger one may, often by non-economic means, retain certain big names, even though those brands would also open stores at our place. Whereas those malls may force the brands to keep shops in their premises for now, they cannot dictate where shoppers will buy. Major fashion houses know this all too well — they know where their customers like to shop.

This scenario is particularly true in Heartland 66 in Wuhan. Eventually, sales are flowing our way. In fact, I expect this property will be among our most successful outside Shanghai. Center 66 in Wuxi will give it a run for its money, but there is no comparison in terms of both the size of the mall as well as the scale of the city's economy. As a metropolis, Wuhan is just so much bigger, and so is Heartland 66 compared to Center 66 — almost 180,000 square meters versus less than 120,000 square meters.

If there is one project that can challenge Heartland 66 in Wuhan as our most profitable mall outside Shanghai, it may be Westlake 66 in Hangzhou. Obviously, it is too early to tell since the latter will not open for three years. As explained earlier, Hangzhou is one of the tier-1.5 cities where each of the top brands can sustain at least three stores. Westlake 66 is located near the center of the historic number one high-end shopping district. The competitive landscape is rather favorable to us, and so the chances of a repeat of Spring City 66 in Kunming and Heartland 66 in Wuhan are quite high. The design is, I believe, very enticing and the entire complex is supported by many offices above our mall. We have also signed a world-class hotel, Mandarin Oriental, who will join us in Hangzhou.

The only drawback may be that the mall's size, which is less than 110,000 square meters, could have been bigger. We are under planning constraints. Nevertheless, it is still almost twice the size of Plaza 66 in Shanghai. Apparently, the latter's size does not prevent it from being by far the most efficient — as defined by sales per square meter — luxury mall in all of China.

Now let me turn to two major societal and economic issues on the Mainland. The first is common prosperity and associated policies such as limiting Internet platform companies and certain educational institutions. The second is the "Evergrande Phenomenon" relating to financial difficulties of property developers. Thereafter, I will discuss the way Hong Kong is dealing with the pandemic and what the city's economic future may be. These have troubled many investors and policy pundits alike.

Everyone who overreacts to Beijing's common prosperity pronouncement has forgotten that China is a socialist state, albeit practicing market economics in the past four decades. Many in the West still cannot accept that there are other forms of capitalism that can also create wealth for society. Consequently, they subconsciously or unconsciously reject China's mode of market economy with socialistic characteristics. It is my way or no way. No wonder such narrow-minded individuals have a hard time understanding China. The source of their prejudice is usually more emotional than intellectual.

Remember what Mr. Deng Xiaoping said at the very beginning of the Reform and Opening Up Policy — let some get rich first. The key words are of course "get rich" but let no one forget the word "first" as well. Every society must first create wealth and then distribute it somewhat fairly.

To me and my family, the best way to "distribute" is to voluntarily give all, or substantially all, of the wealth away. As a principle, which we have held for many decades, we do not believe in inherited wealth; we prefer to recycle the capital back to society. But this should not be done involuntarily, so the government's role becomes significant. Taxation and other means of redistribution are necessary, and every country must decide for itself what the right level is.

Enlightened wealthy people should accept, if not welcome, such measures, as long as they are not excessive to a point where the incentive to create further wealth is seriously curtailed. After all, the balance of wealth redistribution is an important factor in maintaining a relatively peaceful social environment. If not, history amply demonstrated that there will be severe backlashes, which is not good for anyone. By definition, the one who has the most will, in such a situation, also have the most to lose.

Let us also not underestimate the intelligence of the Beijing leaders. They did not greatly lift the standard of living of 1.4 billion people by being foolish. When China did not adopt market policies from 1949 to 1978, the country was poor, very poor. Once she changed, she became rich. Will Beijing reverse policies again? Only the foolish would think so. From what I as an outsider can observe, Beijing knows well what they are doing. The methods they employ are far from perfect, but there is a clear logic to their decisions. And when they discover that they are wrong, they usually quickly adjust, and adjust they can. Can they falter? Of course, but so far so good after 43 years of reform.

So why common prosperity? In fact, the question should be: why not? On the questions of why now and what it means, I have the following opinions. First, timing. After four decades of fast economic growth, considerable wealth has been amassed. However, its distribution in society is highly uneven. As long as most people in society still see their livelihoods improving and their future may well be better off than the past, people are relatively content. Economic opportunities are still available to those who try. Consequently, society is still somewhat calm. However, it is also true that some of the nouveau riche, including some super wealthy, have not been behaving wisely. For example, flaunting wealth is usually not a good idea. As a result, there is always the possibility that tensions may one day rise between economic strata. The government's job is better to prevent tension than to fix it after it causes serious trouble.

To be sure, China does not have a monopoly on these problems. Huge wealth gaps are also found everywhere, including in almost all advanced Western economies. For the past 20 years or so, financial wizards from investment bankers to private equity investors have accrued an inordinate amount of wealth. Around the same period, tech moguls have racked up perhaps even more personal fortune. In my opinion, the latter group at least added tremendous value to society (with concomitant problems) compared to the former. Whatever the case, the phenomenon of Trumpism is a clear warning to the American society of impending bigger problems.

All that goes to show that humankind in the West and East probably has never witnessed another time when personal wealth could have piled up as much as in the past two decades. If not handled carefully, this cannot end well. Whereas the U.S. seems incapable of addressing this issue, Beijing is at least trying to do something about it.

In China, because the government is very cautious about financial security, the private sector's participation in the financial services sector is limited. However, some of the technology firms, mostly in software, have grown to unimaginable sizes, and certain of them have increasingly encroached on financial services. Not being regulated as financial services entities, some have become extraordinarily powerful.

Elsewhere in the world, the largest banks, which are considered a systemic risk to the global economy if they fail, have been put under severe prudential rules, especially since the Global Financial Crisis of 2008. In China, some non-bank financial institutions, a prime case being Ant Financial, are hardly regulated at all, but in size, they are far bigger than any of those highly regulated banks around the world. Precisely because they are at best lightly supervised, their growth rates can be wild. If some of them become publicly listed with shareholders from around the world, the ramifications will be even more complicated. What if one of them fails? How contagious will this be to other similar institutions? Imagine the systemic risks that will be posed to the Chinese economy, and indeed the global economy given how connected the world has become. The risk to the world of one such bankruptcy is incalculable! But even if such a calamity does not happen, one can foresee the further concentration of wealth.

In the 20^{th} century, it was said that oil was black gold. Remember the two oil shocks of 1973 and 1979. In general, it redistributed wealth from the energy poor countries to those that are naturally endowed. Today, in the 21^{st} century, data is digital gold. Companies and individuals with access to data will be king. With China being one of the most advanced digitalized economies in the world, and with Internet companies being predominately privately owned, the wealth gap can only widen further.

There are two added complications. First, the regulation of data anywhere in the world is a new phenomenon. With new technology such as AI, the amount of data will proliferate. Who then will own this digital gold and to what end? It can be seriously misused and create grave social or even political disasters. Every government is watching it with a hawk's eyes. The second complication is that, given terrible China-U.S. relations, data security has become a top national security issue.

From this discussion, it is clear that Beijing's clamping down on certain Internet platform companies is not to rob the rich to give to the poor. It is not a matter of the government now being against rich people. It has many bigger and more critical considerations of national financial stability, data security, and even political stability.

If common prosperity is not to pull the wealthy down, then what is it? First, it is to enlarge the pie so that more people can benefit. Second, much work remains to bring the lower economic echelon up. Yes, China has successfully lifted some one hundred million of her people out of abject poverty, but that poverty line is still rather low compared to international standards, such as those set by the World Bank. Besides preventing those recently lifted out of poverty from falling back, Beijing now has to meet a higher bar in the coming years and decades. Yes, Beijing is encouraging the haves to take care of the have-nots. But as both theory and practice tell us, philanthropy alone can never solve the poverty issue. It is helpful but inadequate.

The only solution is to enlarge the pie, while using administrative measures including taxation to redistribute. If anyone understands the consequences of removing individual incentives, it is Beijing. For the first 30 years of its existence, the PRC tried, and the result was common poverty and not common prosperity. Beijing leaders today all grew up in the 1950's and 1960's. They know this lesson best.

I believe there may be at least one other critical reason why the Chinese government is cracking down on some Internet platform companies and educational entities. Educationalists, psychologists, and social workers in the U.S. know all too well that their society is increasingly suffering from another epidemic, that of mental illness, especially among young people. 70% of the undergraduates of a top Ivy League school need some form of psychological counseling. In my alma mater, which is a large reputable American university of which I was once a trustee, the mental health of students was solemnly discussed at the board. These are definitely not isolated cases. The problem is ubiquitous.

I do not believe that the U.S. has a monopoly on this, although unfettered personal freedom, not properly balanced by responsibility, must have exacerbated the problem. Europe is not exempt, and Asian countries including China have their share. At issue is what is being done about it. Given their social norms and political systems, what Western governments can do to prevent the problem is rather limited. They can at best do more to treat the symptoms. But it is frankly already too late. The Chinese system, on the other hand, may have a better chance, if not to prevent it, at least to minimize it.

Herein is a negative aspect of technology. We know all the good that technology has brought to humankind, but it is almost a taboo to discuss its negative sides. Let me illustrate this with an anecdote.

Recently I bumped into a longtime friend. He and his 30-year-old daughter both love computer games and have more recently taken up virtual reality (VR) games. He told me that whereas now they have to put on a pair of goggles to get into the VR world, the next generation technology may just be a pair of contact lenses with a chip in them. Whatever the case, his daughter often has nightmares because of the long hours spent in the VR realm, and we know how violent such programs can be.

My friend's experience and his daughter's troubled me greatly. I ask the question: what if our ten-year-olds spend hours each day in the VR world? What would happen to them? After a while, would they be able to differentiate between the real world and the virtual world? Whether such children are being actively manipulated — easily done with technology — or are passively responding to what they see and experience, what would be their mental state and mental health? What would happen to their independent thinking, analytical ability, moral discernment, and social skills? I do worry greatly for the next generation everywhere, but especially in the West.

I suspect that such an epidemic could not have escaped the attention of China's top leaders. Could it be that the limiting of students' daily time on computer games and the like is a way to protect the country's youth from mental distortion? I believe so.

The curbing of certain educational institutions is also meant to prevent exacerbation of a similar problem. Chinese schools are known for the pressure they exert on students such as for rote learning. It cannot but have an effect on the overall development of the youths of the country. The latest policy will hopefully improve their general well-being, including their psychological health. Moreover, the new policy attempts to equalize opportunities of the poor versus the rich. Whether it is effective is another issue. The purpose nevertheless seems clear.

A second major issue often discussed among investors is what I call the "Evergrande Phenomenon". Namely, financial defaults or near defaults by a good number of Mainland property developers. Will it affect our business and, if yes, how?

To be sure, I have publicly stated for over a decade that the game being played by Mainland developers is unsustainable. They are about size and speed over profitability and quality. Sooner or later, the musical chairs would end, many companies would go under, and shareholders and bondholders would be hurt. One could absolutely see it coming. It is not difficult to pick out who were the wildest many years ago. They would have likely made the biggest mess. Conversely, we have also known for a long time who are the more solid players. They think and act more logically, and are much more lowly-geared.

Years ago, a friend told me about four companies that would disappear. I fully agreed with him. Today one is gone; two have been restructured, and the last one is Evergrande. My friend was correct not because he was smart (although he was), but because he kept his head cool.

Some pundits in the West called Evergrande the "Lehman Moment" for China. At no time did I believe this. In fact, the comparison baffles me. It is true that the amount of debt at Evergrande is grand, but a decent accountant can quantify exactly what the total obligations are, after dissecting the off-balance sheet items. It is a finite number, whereas for investment banks, like Lehman Brothers, the financial derivatives can be bottomless. The number of clients, including first, second, and third orders, is also much more broadly distributed.

Unlike financial institutions, real estate companies including Evergrande have on their books hard assets — land, bricks, and mortar. Their value may be less than the associated debt instruments, so at bankruptcy, many people will lose a lot of money. But at least the first lienholder will likely receive something, especially if the process of liquidation is orderly. Since almost all the Chinese financial institutions are under the strict direction of the government, orderliness seems assured. And since the same government also controls many huge enterprises, financial or non-financial, with or without real estate expertise, the real assets of a bankrupt developer can be divided by such companies. In principle, very few jobs have to be lost, and the original management is altogether dispensable.

History shows that, with an orderly disposal of hard assets, and after a haircut to the original owners and lenders, there is a chance that whatever remains may still be a going concern. Oddly, one good thing about the Chinese system in this case is that the government is at once the referee and a player. What is unheard of, or impossible in the West, may be possible in China.

All that notwithstanding, the process will be painful. I only wonder why the government allowed the situation to deteriorate to such an extent before intervening. Could corruption have played a role? Of course, but it cannot explain the whole story. One reason may be that the government was relying on housing developments to keep the overall economy going. It is hard to imagine that so many smart bankers would close their eyes and keep lending to these now or soon-to-be defunct developers. The only reason is that someone upstairs said go ahead. At that higher level, considerations must not be only on a particular company. There must be other economic, societal, even political calculations. All one can say is that this, too, is part of a market economy with socialistic characteristics.

Will this mess affect our business? Not really. But if it does, it may actually be quite positive. We are not affected because we are in a very different industry. Nevertheless, there is the outside chance that, with fewer property developers buying land, local governments may become short of cash. They may need to sell certain commercial land fast. If it coincides with a plot that we like, we may be able to pick it up on the cheap. In the past 15 years or so, we had more than once done the same. As I explained, not many jobs would be rendered redundant. As such, the impact on consumption should not be big. Moreover, those people are not our target clients anyway.

Now let me turn to Hong Kong and address the issue of the way the pandemic is being handled, and its possible effects on our economy and our business. For regular readers of this letter, you know that I am of the opinion that the riots of 2019 have fundamentally changed our economy, and the subsequent National Security Law (NSL), while absolutely necessary, has nevertheless altered the nature of our society in a fundamental way. When I speak of such a transformation, I do not make a value judgment on whether it is beneficial or detrimental to Hong Kong. As far as the new reality is concerned, it is what it is. After all, change is perhaps inevitable.

With the pandemic, Hong Kong is truly caught between a rock and a hard place. The government's handling of it certainly leaves a lot to be desired, but external realities also present us with some unique challenges. The public health issue is not easy for any country or city to handle, for governments must balance containing the viral spread and protecting the economy. Officials have to make very hard choices between how many deaths the society can accept and how much longer the economy can continue before collapsing. Embedded herein are hard realities such as how prepared the medical establishment is (e.g. the number of hospital beds and medical staff), the availability of vaccines, their effectiveness, and the readiness of the population to receive them, as well as a whole host of other societal and economic issues, almost all of which are sensitive. The worst is to allow fear to spread among the community.

Recognizing these complexities, I have withheld from publicly commenting on the topic in the past two years. Only those with ulterior motives (such as political) or who are ignorant would lightly speak up, for almost all of them are, like me, a novice on the subject. The reason I am writing now is that Management needs to make our assessment known to stakeholders, for many have rightly shown serious concerns.

For decades, Hong Kong, as a small island, has successively relied on the U.S., Europe, Japan, and now mainland China for our livelihoods. Unlike the relationship with foreign countries, which was primarily economic, ours with the Motherland is today much more comprehensive. Our society is inextricably tied to the Mainland. Before the pandemic, the border checkpoints with Shenzhen are among the busiest in the world! On average, over 600,000 passengers cross the border on a daily basis. This is more than twice the busiest border crossing in North America, between San Diego, U.S. and Tijuana, Mexico. Many of our citizens live on this side but work on the other, or vice versa. Children cross it to go to school in the morning and back in the afternoon. People, for business or leisure, walk or drive across almost nonstop. Long lines of trucks with cargoes waiting to cross is a daily phenomenon. If access is blocked or impeded such as due to the pandemic, our economy and our society both suffer greatly. For example, much of our foodstuffs come from the other side of the border. The livelihoods of many of our citizens of almost all economic strata will be hurt.

Yet on the other hand, Hong Kong is an international metropolis. We also rely heavily on the rest of the world for our economic well-being. Ours is an outward-facing economy, not just towards the Mainland. We probably have more headquarters or regional headquarters of multinational corporations than most if not all major Asian cities. Having experienced riots for seven months in 2019, our economy was already damaged. Our economic but especially political relationships with our Motherland have fundamentally changed. We cannot afford to now lose the confidence of the international business community as well.

As we all know, there are basically two ways to deal with a pandemic — zero infection and herd immunity. If the "bug" is really deadly, then the former must be employed if at all possible; if it is mild, then the latter is preferred because it is less damaging to the economy especially in today's interconnected world.

COVID-19 was first reported in Wuhan, China two years ago. At the time, no one knew how lethal it would be. Beijing took resolute actions to contain it. Methods employed were drastic but effective. Since then, they have been perfecting what they call dynamic zero infection. Compare China to the U.S. On a per capita basis, America has had over 2,000 times more cases and 600 times the number of deaths. (By far, the majority of China's cases took place in the first three months of the outbreak back in early 2020, when there was no vaccine and no experience in handling the spread. As such, the death rate was much higher then.)

Since Hong Kong has cast her lot with the Mainland to go for zero infection, the reasons for which I will later present, we have to understand where the Mainland may go with the pandemic before we can predict what may happen here.

As we all know, the rest of the world has chosen the way of herd immunity. Only when the pandemic is particularly severe will some governments impose city-wide or district-wide lockdowns. Frankly, it will take a much more deadly virus (or bacterium) to force those communities to follow China's example. People in Western societies are so insistent on their individual freedoms unfettered by responsibilities to the community that it is hard for their governments to compel citizens to be vaccinated or to follow strict social distancing rules. They literally value their freedom more than their own lives. The only problem is that they also value their individual freedom more than other people's lives. On the other hand, it is not easy to find a country, let alone the world's biggest with 1.4 billion people, that is so organized to successfully execute a zero infection plan. Frankly, it takes a highly competent authoritarian country like China to achieve that.

Just as the West cannot do what China has done, it is also so far not advisable for Beijing to adopt the approaches taken by the rest of the world. Will the Chinese accept a much higher death rate like in the West? Can the medical establishment cope if various mutations of the virus remain deadly? Might there be social, even political, consequences? These are questions with no easy answers. But once the country chose the road of zero infection, it is not easy to switch.

But in the longer run, can China economically stand apart from the rest of the world that will one day achieve herd immunity? Can strict quarantine requirements be enforced forever for anyone entering the country, be they foreigners visiting or her own citizens returning from overseas? What will that do to the world which is already deglobalizing because the U.S. has decided to make China an enemy? After all, already being the number one or number two biggest in the world in terms of trade, China cannot afford to close off herself from the rest of the world. China needs the world just as the world needs China. As such, sooner or later, China has to open up and relax her zero infection policies.

When might that be? There are several prerequisites. The first is that China must develop a more effective vaccine. Whereas the best of the West can protect to the extent of some 95% in vaccine efficacy, China's vaccines are well below that number. If this cannot be achieved, her citizens may not be adequately protected to the point that opening up in haste will bring highly undesirable consequences. Local newspapers reported that China was doing exactly that — developing a more potent vaccine.

It will also depend on how the virus mutates. If successive new strains become more deadly, then China will not and should not open up. But if it evolves in the opposite direction, then there is a chance. The Omicron variant while highly contagious is considered less severe. Could this mark the gradual relaxation of the current policy? Whatever the case, hopefully the world, including China, will soon develop better prophylactic medicine as well as improved treatments.

Once both prerequisites are met, Beijing can declare victory and open up. Many Chinese lives have been preserved as noted above, and her economy has remained relatively healthy throughout the past two years. Domestic circulation which is the dominant of the two circulations (the other being international), as enunciated by President Xi Jinping not long ago, has done what it is supposed to do.

Being the world's biggest manufacturing hub, China's exports have boomed of late. All other smaller production bases such as in South and Southeast Asia were effectively shut down because those countries could not contain the pandemic. The reliance of the world on China, America's deliberate efforts to slow down her exports through a trade war notwithstanding, has got even higher. In fact, if anything, the world should thank China for taking the zero infection route such that the global supply chain was not otherwise more disrupted. If not, shortages of many products and parts thereof would have brought chaos, a good number of many industries would have been grounded to a halt, and the global economic system would have been further damaged. Imagine where inflation would have been in that case!

What about Hong Kong? China is a continental economy such that even if connection to the rest of the world is somewhat affected, domestic activities can still keep things going for some time. But Hong Kong is an entrepôt and an international financial center. Our economy is much smaller and simpler, and hence more vulnerable. Connectivity to the Mainland and to the rest of the world are both critical.

Like our Western friends, Hong Kong citizens are deeply opinionated and sometimes express themselves indiscriminately. If they do not like to get the vaccine, they simply refuse, it being free of charge and efficiently administered notwithstanding. Together with a challenged administration, the attempt to practice dynamic zero infection in Hong Kong has failed, and freer passage with the Mainland could not be achieved. And since this approach requires strict quarantine rules, personal travel with the rest of the world has also been severely limited.

Multinational corporations with regional headquarters here are clamoring to relocate. After seven months of violent riots in 2019 and the subsequent NSL, many companies were already questioning Hong Kong's future as an international business center. Now, with the mismanagement of the latest wave of the pandemic, while many countries are gradually reopening their borders, we are certainly not making it easier for those firms to remain in our city.

The upshot is this: we ended up not being able to freely open to either the Mainland or the rest of the world. We are stuck, and the long-term economic consequences are huge.

The only one who can now revive Hong Kong's economy, in the short to medium term, is Beijing. But in whatever form they help, we will be different from what we were before. Perhaps it is inevitable. It may not be bad since the most critical element to this city's economy is the Mainland. To keep it healthy and strong, we will have to develop new business sectors with the rest of China and with the rest of the world.

Of immediate concern is the next Chief Executive of the SAR government come July 1. Six months ago, I was hoping that by now, we will have a clearer picture. That has proven not to be the case.

In the face of all of the above, what should Hang Lung's strategy be? How shall we move forward?

First, we are fortunate to have greatly expanded our Mainland portfolio in the past decade or two. Outside Shanghai, we began to buy land in 2005 and opened our first mall in 2010. Momentum for further growth especially since 2019 has been very strong. At the same time, we have not initiated any major project in Hong Kong since 2001. We only take potshots for specialized situations. In light of the challenges in Hong Kong and the opportunities up north, we are well-positioned indeed.

Consider these facts: our brand is highly reputable on the Mainland. We are known to build, own, and manage some of the best commercial projects there. Our luxury retail properties are particularly robust; our office towers are always the best in each city. To illustrate, the smallest mall of ours, Plaza 66 in Shanghai, makes about 2.4 times in tenant sales of all our retail shops in Hong Kong put together. It is quite possible that, in about two years, our second highest grossing shopping center Grand Gateway 66, also in Shanghai, will do as much business as all of our Hong Kong stores as well. The combined sales of our next two malls, Center 66 in Wuxi and Spring City 66 in Kunming, have already exceeded our Hong Kong total by quite a margin. And it would not be surprising if, within the next two years, both of those Mainland properties will be surpassed by our new kid on the block, Heartland 66 in Wuhan, which as of now is only less than one year old.

In the office sector, 2021 was the first year that our total rent collected on the Mainland surpassed that in Hong Kong. There is little doubt that the margin will only enlarge further in the coming years. Today, office supply in Hong Kong is rising, while demand cannot catch up. In fact, there is a possibility that demand may shrink as multinational companies depart our city as explained above. What is unknown at this stage is whether Mainland corporates will come to our city in meaningful numbers.

Hong Kong is very small compared to the rest of China. Historically, our city has exceptionally high unit price and rent for real estate. Relative to much of the world, and given our size and location, it will remain so even if price and rent moderate somewhat. What is not anticipated is continuous increase, except perhaps in residential prices. Overall, Hong Kong is a city on the wane. Unless Beijing were to do something drastic, our economy would unlikely advance much.

Mainland China, on the other hand, is the exact opposite. Territory and population are both humongous. Its economy is the world's second largest and is still growing like a developing country. A 5% to 6% per annum GDP growth for the next several years is possible. Urbanization is still ongoing, even though it has already been moving ahead briskly for some three decades. There remains plenty of room for advancement in terms of the quality of its economy. The two reasons are a relatively low base, and the fast development and deployment of technology. For example, the service sector is still small as a percentage of GDP compared to advanced Western countries. Actually, there are few economies in the world that have the combination of low base and advanced technology, which are conducive to very fast growth. This may well be the case for China in the next decade or so.

Some are concerned by the present severe competition between China and the U.S., which touches upon all critical aspects of her economy. Uncle Sam is doing all he can to slow down China's growth, especially in technology. This is obviously an area of concern, for when the most powerful country the world has ever seen treats you as an enemy, life can get very tough.

But after careful consideration, I believe that China has already reached a point of overall development where she can withstand the comprehensive onslaught, short of all-out war, of course. In fact, America's pressure will spur China onward faster than otherwise. For example, cutting China off from certain technologies will only push her to develop them herself. In the longer run, this will make the country less dependent on the West and more competitive. This is not what Washington, D.C. would like to see, but picking on China would most likely have this outcome.

In the past few years, I have analyzed at length in this letter the ongoing China-U.S. relations. As such, I will not repeat much except to say that this is a contest that neither side can win. If it becomes a long, drawn-out brawl, then the party that is better prepared psychologically will have a huge advantage. In the face of a contest where there cannot be a winner, the American political system will face a huge centrifugal force, while the opposite may be the case across the Pacific. Consider the Korean War, the Vietnam War, and the Afghanistan withdrawal last year. Washington, D.C. will back off. Nobody wins.

Before that time, the Taiwan Strait would remain a hot spot where accidents can be dangerous. Doing business in Hong Kong and on the Mainland, this is a risk that we must be keenly aware.

Irrespective of what happens outside the Mainland, further development of the domestic economy will be paramount. With exports no longer a dependable driver of the economy — use it as much as possible while the going is good, like under the pandemic — and limits to increases in infrastructure development, Beijing will have to ensure a vibrant but healthy domestic consumption market. This can only be good for our business.

Besides keeping a reasonable pace of economic expansion, much attention would be paid to improving the quality of the economy. Pundits in the West and East will immediately think of further reform, but I prefer to put it another way. The reason is that, in the minds of all too many people, reform — economic or political — is to become more like the West. Not necessarily.

What is needed is the rationalization of previous irrational systems and practices. This includes better coordination among different parts of the economy and different departments within the government. This will remove or mend dislocations and so improve efficiency. One aspect of the superiority of the American economy is its rationality. China will have to learn it, although no one should think that there is only one way to do things. For the past 40-some years since China opened up, leaders have always been pragmatic. They will learn from others if it works well at home, or will find their own ways that would work best for their particular situations. One way or another, China will rationalize her domestic systems, economic or otherwise, to make them more efficient. This is critical in times of intense international competition.

Here, let me say a word about why so many Western pundits have, more often than not, gotten China wrong. They think that their way is the only way and are not open to learning new things. They are simply too proud and self-righteous. The average Westerner has something that further works against his or her ability to see China as it is. News media led by the elites have been spinning every story related to China against China. Inaccurate at best, people reading such stories day in, day out will inevitably be brainwashed by them. Before long, a chorus is formed. What happened in Hong Kong in 2019, as reported in the West, is a reminder of this. The distortion was ghastly.

As the quality of China's economy improves, one should see a rapid rise in salaries, especially in major cities. More and more people, old and especially the young, will be able to own better quality products. Luxury spending will be one area that will benefit. As long as we run our own house well, we should be a prime beneficiary. This includes developing new projects wisely, managing our properties well, and remaining lowly geared. We should be able to do all that.

To capitalize on coming opportunities, we will as before continue to look for land for new commercial projects. In the past almost 30 years on the Mainland, on average we added one new project every two to three years, although purchases tended to come in lumps given market conditions. Such is the cyclical nature of the business. This pace is quite agreeable for our financial planning and personnel management. Chances of our repeating it in the coming few years are reasonably good.

We are not abandoning Hong Kong; it is still our home. But like in the past 20 years, we will only buy land when the timing and price are both very attractive. None of us can say that such opportunities will not appear, although I do not see any on the horizon yet. If we buy land, it will likely be residential, especially for top-end market. Our city's low tax rates, and many other aspects of society, are still very attractive to the wealthy from the north.

Before concluding the letter, let me say a word about our management team. Like any organization, staff turnover is inevitable. Among our senior ranks, seldom do we see voluntary departures. It is mostly due to retirement. About 12 years ago, we were not as fortunate and saw a rapid change of personnel. Our then CEO Mr. Philip Chen did a commendable job in rebuilding management to suit our needs at the time. Under his leadership, we opened six huge commercial complexes in seven years between 2010 and 2016. Consequently, the staff count increased greatly throughout the 2010's. Few from our senior management team have been with us for more than 12 years. In that period, we have also built bench strength.

A key member of the team was Mr. Norman Chan who retired last year after eight years of service. I dare say that he was the best head of our investment properties in the past 50 years that I have been an observer or participant. Thanks to him, a few of those trained by him are now sharing his job. It is a very good team with some depth. After retirement, Norman has been invited by Management to serve as an advisor.

After 13 years with the Company, our CFO Mr. H.C. Ho will retire at the end of next month. He has been a steady pair of hands for all these years. I wish him a well-deserved retirement that is happy and healthy.

I am pleased to introduce our incoming CFO Mr. Kenneth Chiu. A Hong Kong local of modest upbringing made good by sheer intelligence and hard work, his previous career has prepared him well for the present position. His age belies his breadth of experience. Since university and acquiring professional qualifications, Kenneth has worked for a European investment bank, a top rung sovereign fund in charge of real estate investments, including those in mainland China, and, more recently, as CFO of a successful regional property fund, whose duties included doing investments. I welcome him to our senior management team.

Ronnie C. Chan
Chair
Hong Kong, January 27, 2022