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**Investment Newsletter – May 2006**

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### **Thailand: Focus on Koh Samui**

This is the fifth (!) newsletter in my series on Thailand. Prior installments (October to December 2005 and April 2006 are available at the education page on [www.BerkeleyInvestment.com](http://www.BerkeleyInvestment.com). In April I was in Thailand to gather information on demand and supply. First I will provide some context for the market analysis.

#### **Historical Context**

Back in the 80's, Koh Samui became popular with budget travelers (backpackers). Back then you could rent a bungalow on the beach for \$2/day and live quite well for \$6/day. There were roughly a dozen sets of bungalows at Chaweng Beach and a couple less at Lamai. In 1986 Bangkok Air built an airport just north of Chaweng Beach and it became possible to get to Koh Samui from Bangkok in one hour. This accessibility brought growth in tourists and some higher spending tourists into the mix. Over time this supported development of the first one to three star hotels on the island.

As Bangkok air added more flights and word of the beautiful island spread, tourist arrivals grew rapidly and new developments increased in quality. Once the first golf course was built, the five star hotels started coming to Samui. Chaweng and Lamai beaches are almost completely developed and the other towns in the north of the island have developed into separate centers as well. There are very few empty parcels left on resort suitable beaches. Consequently land prices have escalated rapidly and are now roughly five times what they were in 2001. Most of the budget places have been upgraded as far as possible without tearing them down and rebuilding. At current land prices these places probably yield about 3% of land value annually. Given that the yield on a four or five star property would exceed 8%, there is a significant incentive to redevelop these properties.

Meanwhile, the other major tourist island, Phuket, was attracting the top quality international hotel chains long before the interest in Koh Samui. Phuket has many more flights landing than Koh Samui. Because it is more established and easier for more people to fly directly into, the real estate market here is more

expensive than Koh Samui. As flights to Koh Samui increase and it moves upscale, I expect prices in Koh Samui to converge towards those in Phuket.

### **Geography**

Exhibit A at the end of the newsletter shows where Koh Samui is in relation to Bangkok and the rest of the country. Exhibit B is a detailed map of Koh Samui. The most developed beaches are Chaweng and Lamai, but Bophut, Big Buddha, and even Maenam all have concentrations of resorts, restaurants and shopping. The areas in the South and West of the island are much less popular. A big reason is driving time from the airport, but most of these areas also lack good swimming beaches. There are some areas in the south that have decent beaches and these areas may well develop - despite the distance from the airport. Road improvements could make these areas quicker to get to in the future.

### **Market Segments**

Unlike Pattaya and Phuket, Koh Samui has yet to see its first Condos. The first Condos are currently in the planning stage for the south part of the island. Up until now, developers have focused on building high end villas. Most, but not all, of these are on hills overlooking the ocean rather than at the beach. Beach land is expensive and better used for higher density hotels. A Condo Hotel (Condotel) development could be quite competitive for the segment of the market that is price sensitive and focusing on investment returns.

The relevant segments in the Koh Samui market for second homes are distinguished by location. The most desirable locations are in the northeast of the island from Lamai to Maneam. For our purposes we will consider three segments:

- A. Beachfront Class A in the most desirable locations
- B. Beachfront Class B in less desirable locations
- C. Hillside and other inland locations

### **Building Regulations**

Local building regulations govern what can be built. New developments must comply with the following rules when building near the beach:

Area	Distance from high tide mark	Max Land Coverage	Height limit in meters (stories)	Max building size - sq. mt.	Min Space between Buildings
A	1 <sup>st</sup> 10 meters	0%	1 m. (0)	0	N/A
B	2 <sup>nd</sup> 40 meters	25%	6 m. (1)	75	4 meters
C	3 <sup>rd</sup> 150 meters	50%	12m. (3)	2,000	6 meters
D	Beyond 200 meters	100%	12m. (3)	Anything	N/A

In addition, flat roofs are no longer allowed. These regulations effectively reduce building heights and development density - depending on distance from the ocean.

### Demand Analysis

Nearly 800,000 foreign tourists and 162,000 Thais visited Samui in 2005, spending Bt11 billion. This year tourist arrivals are expected to hit 1.12 million, up 20% from 2004. Tourist arrivals in Thailand have been growing 19-20% annually and were up 34% in the first two months of 2006. There are 70 real estate agencies on Koh Samui catering to western visitors.

Assuming the average visitor stays 5 nights and that average occupancy is 70%, Koh Samui must have averaged approximately 18,800 rooms available in 2005. Thus 20% annual growth in visitors implies the need for an additional 3,760 rooms in order for occupancy to remain at 70%.

Although market data is virtually non-existent, I estimate that foreigners bought between 500 and 1,000 newly built villas on Koh Samui during the last year. Given that beachfront land will be most valuable if developed into resort property, we can get a sense of demand by looking at rents and occupancy. This is particularly relevant if we are contemplating a Condotel for which these statistics will ultimately determine investment yields and therefore value.

Five star resorts are running at 60-70% occupancy while charging \$200-\$300 per night for studio rooms. The following table shows rents for villas managed by one of the major property management and development companies.

Average Villa Rates			Occupancy: 65%
Bed	Bath	Daily	Annual \$1,000s
1	1	\$ 304	72.1
2	1	\$ 447	106.0
3	1	\$ 447	106.0
3	2	\$ 485	115.0
3	3	\$ 496	117.7
4	2	\$ 510	120.9

The three and four star hotels at lower price points have higher occupancy. Even at 60% occupancy, the income for a one bedroom villa would support a valuation of \$400,000 (assuming expenses at 40% of gross and a 10% capitalization rate). The implied valuations are more than 50% higher than typical selling prices.

### Catalysts for Growth

Growing accessibility is bringing lots of new visitors and their capital. In April, Bangkok Air added direct flights from Hong Kong; in October direct flights from Singapore commenced. When you consider that condominiums cost \$9,000 per square meter<sup>1</sup> in Hong Kong and \$8,180<sup>2</sup> per square meter in Singapore, property on Koh Samui is a fantastic bargain at \$2,700/s.m. The Thai government is known to favor giving Thai airways access to this market as well – though this

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<sup>1</sup> A square meter is 10.76 square feet.

<sup>2</sup> This price is at The Sail, a new luxury condo under construction on Singapore's downtown waterfront.

would probably require building a new airport. Once Thai Airways has a place to land jets, we can expect direct flights from Tokyo, Seoul, and probably London. The more exposure Koh Samui gets to wealthy people nearing retirement, the more demand there will be for property.

Besides flights, the island is adding attractions. A new golf course is planned as is the island's first yacht marina. Four Seasons and Marriot have both announced plans to build resorts on Koh Samui and the Thai government has committed \$53 million to upgrade the island's infrastructure. When gambling is legalized in Thailand, a casino will most likely be built either on Koh Samui or one of the nearby islands. All of these increase the appeal of the island and should spur continuing rapid growth in both visitors and residents from abroad.

While the British are already a major buying group, 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.

So far, mainland Chinese have been absent from this market. There are signs this will soon change. As I've argued before, the Chinese government must soon free up capital flows to keep their economy from overheating. When this happens, Thai real estate will draw a huge amount of interest. I expect a significant run up in prices immediately after capital controls are relaxed.

### **Supply Analysis**

As of April 2006, there were 52 subdivisions at some stage of development on Koh Samui. Geographically, 49% of projects are in the Northwest, 42% are in the Northeast, and 9% are elsewhere on the island. I estimate 1,558 units have or will be built in these projects, broken down as follows:

Project Type	Total Units	% of Total
Class A Beachfront	132	8%
Class B Beachfront	214	14%
Hillside and Other	1,211	78%

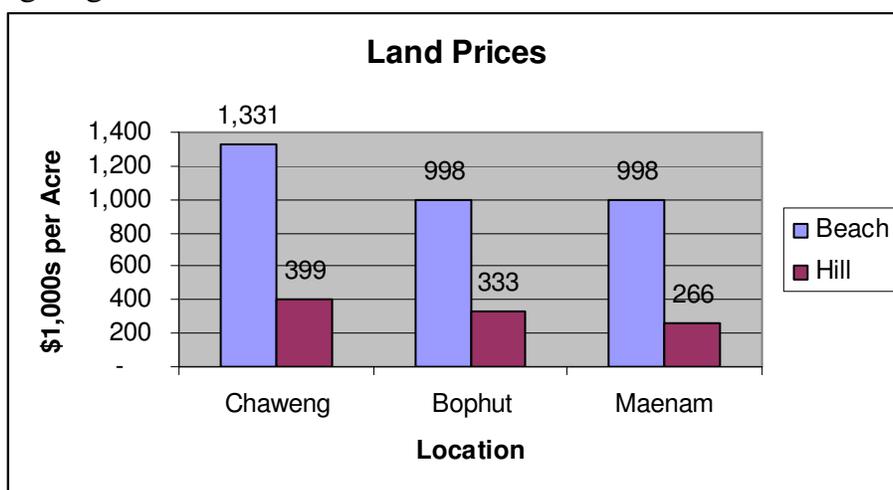
The scarcity of available land limits the number of new Class A beachfront units.

For projects reporting sales, roughly 25% of units were sold at the time of our research. Most of the unsold units are either in the planning stage or priced very high relative to the market. Units under construction, in a decent location, priced at market, will sell easily.

Construction cost estimates vary between \$30 and \$70 per square foot for top quality construction. A well managed project should have no problem building for \$50 per square foot as long as plenty of time is allowed. The best construction firms are very busy. Therefore work must be scheduled 6 months in advance. This tends to limit how fast new units come into the market.

### Prices Imply Big Development Profits

Land prices have been rising dramatically on Koh Samui (hill land is up more than 80% since 2004). Still, land is cheap relative to the value of finished houses. Prices in the major submarkets in the North part of the island are shown in the following chart. Calculated on a per square foot basis, prime beach land near Chaweng is going for about \$31/s.f.



Prices of villas and apartments vary widely and are very specific to location and quality. You could expect to pay at least \$244 per square foot for a luxury house on a decent beach within 15 minutes of the airport. Prices would be at least 30% lower at a grade B beach location and 40% lower away from the beach. The numbers imply development margins of at least 70% on costs. With leverage, these margins provide very high returns on development capital and should encourage more projects and higher land prices.

### Conclusion

Given the current shortage of beach land and the catalysts I see for further increases in demand in the future, investors in Koh Samui beachfront properties are likely to be rewarded with double digit appreciation for the next couple of years at a minimum. 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. Koh Samui, like Pattaya, is in the middle of property price boom. Land with great return potential can be found but the best opportunities require a lot of work to uncover. Contact us to find out how to invest in this market.

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**Exhibit A**



