

A nighttime photograph of a modern landscape. In the foreground, there's a large, calm pool of water reflecting the sky and distant city lights. To the left, a tree with large, dark leaves hangs over the pool. In the background, a city skyline is visible under a deep blue twilight sky, with some buildings and construction cranes illuminated. The overall mood is serene and sophisticated.

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# Country Garden's Forest City: Growth Through Overseas Expansion

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Globalization is not just for manufacturers. It is increasingly a preferred choice for infrastructure and real estate developers as well. This is no different for Chinese firms. Country Garden, one of the largest and most successful vertically integrated real estate developers in China, is at the forefront of a new wave of global expansion. Forest City, located in Malaysia's Johor state, is a prominent example of its 'go global' growth strategy. While seeking to replicate its domestic success abroad, Country Garden has nonetheless faced a new set of challenges that highlight the kinds of adaptations needed to succeed internationally.

## Country Garden: A Business Overview

Yang Guoqiang founded Country Garden in 1992. Frequently described as a farmer and bricklayer turned real estate developer, Yang hails from the Shunde district of Foshan City, located in Guangdong Province. Early on, while working on construction projects, Yang was able to see value in land that others had disregarded. In time, he began to buy land long before there was anything like a full-fledged real estate market in China. He brings the same foresight to Forest City, noting, "If Dubai can become a sprawling city in a desert, I do not see why Johor Baru cannot do the same, if not better."<sup>1</sup> Indeed, it was Yang's persistence and vision that transformed

Country Garden into a national brand in China.

Today, Country Garden is known especially for its residential projects, with the majority of its revenue coming from real estate development, and the remainder from property management and hotel operation earnings. The company went public on the Hong Kong Stock Exchange in 2007 to access global capital markets. In 2016, Country Garden generated 308.8 billion RMB (USD \$48.6 billion) in total contract sales, representing a 59.6% annual growth since 2012. In 2017, the company took the top spot as China's best-selling developer, with 580.9 billion RMB (USD \$89.3 billion) in contracted sales.<sup>2</sup>

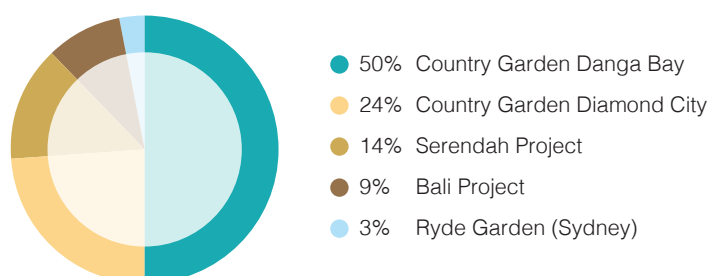
<sup>1</sup> "A Living Legend from Guangdong" December 10, 2017. Accessed February 18, 2018. <https://www.thestar.com.my/opinion/columnists/on-the-beat/2017/12/10/a-living-legend-from-guangdong-from-the-land-of-sun-yat-sen-and-ip-man-a-new-giant-has-emerged-one-w/>

<sup>2</sup> "Country Garden Tops Evergrande to Take China's 2017 Real Estate Sales Crown." January 4, 2018. Accessed February 18, 2018. <https://www.mingti-andi.com/real-estate/finance-real-estate/country-garden-tops-evergrande-to-take-chinas-2017-real-estate-sales-crown/>

According to the latest available figures, Country Garden owns 728 real estate projects at various stages of development, of which 722 projects are located in China, four in Malaysia, one each in Indonesia and Australia, with 94,500 employees worldwide.<sup>3</sup>

Looking ahead, its management team plans to allocate up to 10% of capital to overseas investments.<sup>4</sup> The timing seems right. Since 2011, domestic development profit margins have been under pressure in China. Increased competition, higher land inventory costs, and policy shifts are dampening the growth prospects of domestic developers.<sup>5</sup> Facing this market inflection point, Country Garden, like many others, made the strategic decision to expand overseas. Instead of looking to properties in Europe and the United States, however, Country Garden turned to Southeast Asia and Australia. As of December 31, 2016, excluding its latest Forest City project, Country Garden's overseas property investments total 2.04 million square meters by gross floor area (GFA), 65% of which is under construction (Exhibit 1).<sup>6</sup>

**Exhibit 1: Country Garden Overseas Portfolio Composition, 2016 (Gross Floor Area by location)**

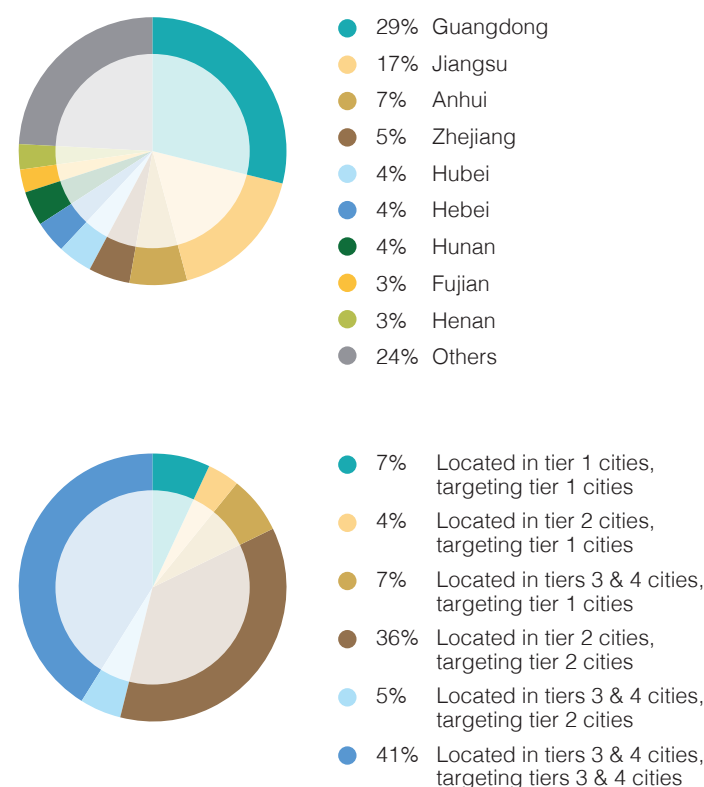


Source: Country Garden 2016 Annual Report

## Country Garden's Recipe for Growth: Vertically Integrated Residential Urban Development

Country Garden's success starts with a simple promise: To provide a first class lifestyle (or '5 Star Living' as described in its annual reports) to the millions of Chinese people who live outside of such major metropolises as Beijing and Shanghai. Such strategic positioning of its urban development projects meant less competition from large developers and local governments that welcomed a partnership. They offered reduced land acquisition

**Exhibit 2: Country Garden Domestic Contracted Sales by Geographic Location and City Type, 2016**



Source: Country Garden 2016 Annual Report

<sup>3</sup> "Country Garden 2016 Annual Report." March 22, 2017. Accessed February 18, 2018. <http://www.bgy.com.cn/UploadFiles/cnn/Files/2017/4/20170405180826.pdf>; <https://www.forbes.com/companies/country-garden-holdings/>

<sup>4</sup> CRIC [碧桂园] 马来西亚森林城市项目调研纪要 Country Garden Malaysian Forest City Project Research Summary

<sup>5</sup> E-House Internal Report, Country Garden Appendix: Page 4

<sup>6</sup> "Country Garden 2016 Annual Report." March 22, 2017. Accessed February 18, 2018. <http://www.bgy.com.cn/UploadFiles/cnn/Files/2017/4/20170405180826.pdf>

costs to Country Garden in exchange for improvements in residential housing and urban infrastructure. To this day, the largest concentration of Country Garden's contracted residential sales in China are within fast-growing 3rd and 4th Tier cities (Exhibit 2).

Construction alone, however, is no recipe for project success. What has distinguished Country Garden over the years has been its ability to provide high-quality, competitively priced apartments, or luxury living at low cost. To get there, the company has relied on three pillars — cost control, economies of scale, and a volume-driven sales approach.

On the cost control front, the company has long taken a centralized approach to supply chain and operations management so as to maximize negotiation power and to increase cost efficiency. Its preference for large scale land acquisitions also enhances Country Garden's leverage. Not only does it ensure oversight over the planning of areas surrounding its properties, but it also positions Country Garden to offer early stage city planning in exchange for reduced land costs. Moreover, Country Garden properties only increase in value as demand increases, creating a virtuous cycle for the company.

Further supporting its goal of providing affordable, luxury residential units, Country Garden front-loads the majority of its planning and design prior to official zoning approval and seeks to obtain economies of scale in design. Specifically, the company develops multiple projects across the country at the same time, all based off the same architectural designs, which minimizes predevelopment costs and maximizes efficiency of designs.<sup>7</sup> Its centralized purchasing system also provides the parent company with increased negotiation power on pricing and other trade terms, further reducing the overall costs of any project. As a result, the time between project approvals to pre-sale is typically seven months and eight to 10 months between pre-sale and final payment.<sup>7</sup>

Country Garden also hedges the risk of delays by maintaining a highly diverse portfolio that is spread out over several Chinese provinces (Exhibit 2). As of December 2016, Country Garden had a vast land bank of 166 million square meters, which represents a multitude of projects in various stages of development. Of note, many of their properties sell pre-construction.

To understand this, consider Country Garden's customer base — namely, a rising middle class that is price sensitive, ready to spend on improved quality of living, and possibly in search of investment opportunities. By offering competitive pricing, Country Garden was able to drive sales volume growth and increase inventory turnover. To increase its potential customer base, the company also adopted a mass marketing approach that maximizes brand awareness through national advertising campaigns, and to complement showrooms that it opens in select locations.

Country Garden's success has been recognized nationally and internationally. Starting initially with recognition as the top Guangdong Province-based real estate company, Country Garden went on to win recognition over several years as one of the "Ten Favorite Chinese Real Estate Brands by Civil Servants." Over the past few years, the brand has also gained international recognition. In 2011, it was named one of Forbes' 'Asia Fab 50,' referring to the best publicly traded companies in the Asia Pacific.<sup>8</sup> Country Garden was one of only a handful of real estate companies to earn this honor.

## Going Global: Taking the Model Overseas

Given Country Garden's tremendous success in China, the decision to head overseas requires some context-setting. It begins, of course, with Chairman Yang Guoqiang, who expects demand for high-quality housing to continue to grow in China, albeit with greater

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7 "万科眼中的碧桂园：南京碧桂园营销模式解读 An Analysis on Country Garden's Sales Approach." April 5, 2015. Accessed February 9, 2018. <http://www.mydcyj.com/frontier/industry/2014/0711/3903.html>

8 "Who is Country Garden" Accessed February 18, 2018. <http://www.countrygarden.com.au/company/about-us>



competition. As a result, it has become even more important for Country Garden to seek new markets as a way to prepare for its future.<sup>9</sup>

According to Country Garden, its domestic development project gross margin averages around 10% but the company expects to achieve a higher gross margin on overseas development projects, especially as it intends to focus efforts outside of Europe and the United States where costs could be higher.<sup>10</sup> Another factor encouraging Country Garden's overseas expansion is the continued and growing demand for global capital allocation from China's domestic middle-class and upper-middle class.

Of note, China currently has the largest middle-class population in the world, approximately 109 million.<sup>11</sup> They are very focused on global asset allocation and generally prefer savings accounts or real estate investments over other investments when investing overseas.<sup>12</sup> According to one study, close to 50% of high-net-worth-individuals in China have focused their overseas investments on real estate, owning on average 2.3 real estate investment properties. Around 15% of these individuals have more than four investments abroad.<sup>13</sup> This is also a customer base that Country Garden already knows well, allowing them to leverage existing data to support the global expansion of Country Garden by reaching out to the 'aspirational classes' that live outside of China's major cities.

## Building on the 'One Belt, One Road Initiative'

The timing for overseas expansion was right for Country Garden in other ways as well. Most significantly, it is in line with the Chinese government's 'One Belt, One Road Initiative,' an ambitious policy that aims to boost trade, stimulate regional economic growth and improve infrastructure in neighboring countries. The plan covers two regions — the "Silk Road Economic Belt," a land route that connects China with Eastern Europe via Central Asia, and the "Maritime Silk Road," a sea route that links China's southern coast to East Africa and the Mediterranean (Exhibit 3).<sup>14</sup>

**Exhibit 3: The Belt and Road Initiative**



Source: McKinsey and Co. "One Belt and One Road: Connecting China and the world" July 2016. Accessed February 9, 2018. <https://www.mckinsey.com/industries/capital-projects-and-infrastructure/our-insights/one-belt-and-one-road-connecting-china-and-the-world>

9 "China's Home Builder Country Garden Constructs a New Strategy." August 24, 2016. Accessed February 18, 2018. <https://www.forbes.com/sites/michaelschuman/2016/08/24/chinas-home-builder-country-garden-constructs-a-new-strategy/#79f5c7f85517>

10 "Country Garden 2016 Annual Report." March 22, 2017. Accessed February 18, 2018. <http://www.bgy.com.cn/UploadFiles/cnn/Files/2017/4/20170405180826.pdf>

11 "中产富裕阶层收入信心研究报告Upper Middle Class Income Analysis Research by FT Intelligence." July 2017. Accessed February 9, 2018. <http://www3.ftchinese.com/edm/FTI/renrendai1.pdf>

12 "胡润:地产仍是中国高净值人群最主要投资方向 Real Estate Remains the Main Investment Focus for Chinese High Net Worth Groups." January 25, 2018. Accessed February 9, 2018. <http://forex.jrj.com.cn/2018/01/25114224004575.shtml>

13 "胡润百富《2017年中国高净值客户海外置业展望》Hurun Report — 2017 Chinese High Net Worth Customers' Overseas Investment Prospects." June 23, 2017. Accessed February 9, 2018. <http://res.hurun.net/Upload/file/20170623/201706231347191437630.pdf>

14 "The \$900bn question: What is the Belt and Road initiative?" May 11, 2017. Accessed February 18, 2018. <https://www.theguardian.com/world/2017/may/12/the-900bn-question-what-is-the-belt-and-road-initiative>

Most of the countries along these two routes are developing countries with low levels of infrastructure development. The Belt and Road Initiative aims to match excess capital and productivity within China with the need for basic infrastructure development in these developing countries to drive regional economic growth. Against this backdrop, real estate markets in these developing countries are uniquely positioned to benefit from secular trends such as local infrastructure development, commercialization, and urbanization.

Opening these markets also allows China's largest real estate firms to diversify their international portfolios even further.

Since 2012, more than 20 Chinese developers have invested approximately USD \$20 billion in foreign real

estate projects, such that by late 2016, China has replaced the United States as the world's largest cross-border investor in the real estate industry.<sup>15</sup> This is part of a wider effort by Chinese firms to go global, as reflected in the stunning increase in Chinese overseas investments in the past five years.

## Why Malaysia?

Country Garden had a proven track record in large scale urbanization projects, but where to apply its known processes overseas was a critical decision for the company. Ultimately, it chose Malaysia for the majority of its overseas projects, and more specifically the state of Johor, located at southern end of the country, right next to Singapore.

**Exhibit 4: Chinese Developers' Overseas Investments Summary since 2012**

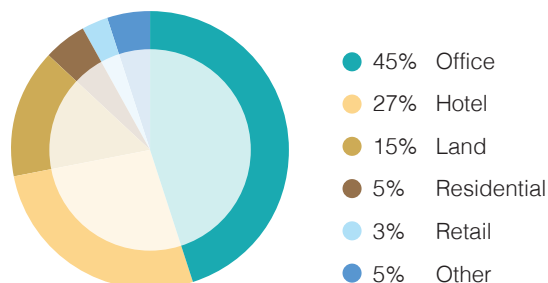
COMPANY NAME	EXPANSION LOCATIONS	PROJECT TYPE	INVESTMENTS	MAJOR PROJECTS
Greenland	NYC, L.A., San Francisco, London, Sydney, Melbourne, Toronto	Residential condos, luxury high-rise rentals, hotels	Wholly owned	Sydney city center condo development; Brooklyn Pacific Park mixed-use development; London Canary Wharf financial district
Wanda	L.A., Sydney, Paris, Madrid	Hotels and residential condos	Equity investments	London city redevelopment project; Australia Golden Coast condo + hotel development; AMC Movie Theatres
Vanke	NYC, San Francisco, Seattle, London	Office and residential condos	Equity investments	201 Folsom Street in San Francisco; 100 E. 53rd Street in NYC
Country Garden	Malaysia, Indonesia, India, Sydney	Residential condos and mixed-use new development	Wholly owned	Danga Bay and Forest City projects in Malaysia
R&F Properties	Malaysia, Londo	Residential condos	Wholly owned	Two residential condo developments in the U.K.; mixed-use development in Malaysia
Sino-Ocean Land	Australia	Residential condos and luxury high-rise rentals	Wholly owned	Residential development in Australia
Aoyuan	Sydney, Vancouver	Residential condos and luxury high-rise rentals	Equity investments	Residential condo development in Sydney city center; Acquisition of Vancouver residential properties
Shenglong Group	Sydney	Residential condos	Wholly owned	Sydney CSIRO mixed-use development
Shimao Property	Sydney	Office	Equity investments	Sydney CBD office
Gemdale	Boston	Mixed-use development	Joint venture	Boston mixed-use development
Shokai	London	Office	Equity investments	London trophy office tower

Source: China Real Estate Information Corp. (CRIC) - Country Garden Malaysian Forest City Project Research Summary

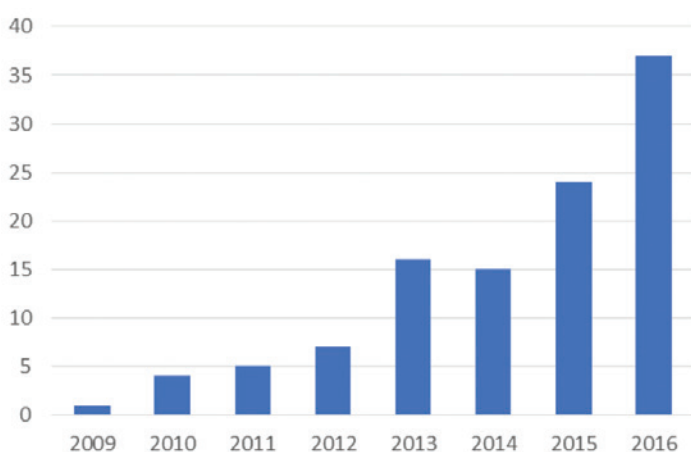
<sup>15</sup> JLL, Chinese real-estate enterprises overseas investment 2015 is approximately 20 billion USD: <http://news.dichan.sina.com.cn/2015/11/11/1136479.html>; “超越美国，中国已成为2016年全球最大房地产跨境投资者China Has Surpassed U.S. as the Largest Cross-Border Real Estate Investor in 2016.” December 28, 2016. Accessed February 18, 2018. [http://www.guancha.cn/economy/2016\\_12\\_28\\_386483.shtml](http://www.guancha.cn/economy/2016_12_28_386483.shtml)

Geopolitically, there was also a strong case for selecting Malaysia. Not only was the country the first Southeast Asian nation to establish diplomatic relations with the People's Republic of China, but China today is its largest trade partner and foreign investor

**Exhibit 5: Snapshot of Overseas Chinese Investment**



**All Overseas Investments by Year (USD in billions)**



Source: Top panel: E-House Internal Report, Country Garden Appendix; Bottom Panel: Cushman & Wakefield 4Q 2016 China Overseas Investment Market Report

in manufacturing. China's outgoing ambassador to Malaysia described the growing interdependency of these two countries to be "like lips and teeth."<sup>16</sup> No wonder Malaysia has become a strategic point on

the 'Maritime Silk Road' sea route for China, with nearly USD \$50 billion worth of projects slotted for development under the 'One Belt, One Road Initiative.'

With China opening up, Malaysia has also benefitted from waves of Chinese tourists, and particularly to areas such as Kuala Lumpur, Penang and Johor, each noted for their large Malay-Chinese populations. Numbers continue to rise, such that Malaysia has moved toward a

**Exhibit 6: Regional Map: Forest City Location**



Source: "The \$100 billion City Next to Singapore has a Big China Problem." June 22, 2017. Accessed February 18, 2018. <https://www.bloomberg.com/news/features/2017-06-22/the-100-billion-city-next-to-singapore-has-a-big-china-problem>

visa waiver program that would allow select Chinese up to 15 days in-country without additional requirements.<sup>17</sup> The number of Chinese tourists who chose Malaysia for their New Year's vacation also continues to rise, nearly doubling between 2016 and 2017, with over 300,000 visitors expected this year.<sup>18</sup>

The country's conducive political, social, and economic environment has propelled Chinese real estate developers to increase investments in Malaysia. Country

<sup>16</sup> "For Malaysia, Relations with China are Good — Maybe Too Good." November 19, 2017. Accessed February 18, 2018. <https://asia.nikkei.com/magazine/20171109/Politics-Economy/For-Malaysia-relations-with-China-are-good-maybe-too-good>

<sup>17</sup> "Interview: Malaysia Ramps Up Efforts to Attract Chinese Tourists." October 13, 2017. Accessed February 18, 2018. [http://www.xinhuanet.com/english/2017-10/13/c\\_136676857.htm](http://www.xinhuanet.com/english/2017-10/13/c_136676857.htm)

<sup>18</sup> "Chinese Tourists Flock to Malaysia to Celebrate Lunar New Year Here." February 10, 2018. Accessed February 18, 2018. <http://www.themalaymailonline.com/malaysia/article/report-chinese-tourist-flock-to-malaysia-to-celebrate-lunar-new-year-here#81vMslh4wzK5F5GH.97>

Garden is among the leading players in this wave of expansion, and views Malaysia's urban development pattern as quite similar to those of domestic tertiary markets in China. In 2013, Country Garden launched sales of its first residential project in Malaysia — Danga Bay, which contracted sales for nearly 70% of its residential units within just four weeks of opening. Most of these buyers were from China, resulting in contracted sales of 7 billion RMB (USD \$1.1 billion) in 2013, making Danga Bay the highest sales contributor for Country Garden that year.<sup>19</sup> Currently the company has four developments underway in Malaysia. Besides Danga Bay, there is Diamond City, Central Park, and its jewel in the crown, Forest City, which is located in Johor State, an area with more than 35% of its local population being ethnically Chinese.<sup>20</sup>

## Forest City: Malaysia's Green Star?

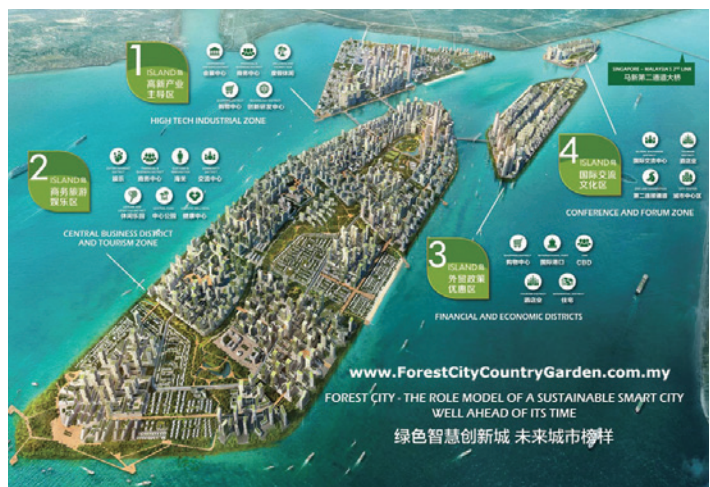
Forest City is a large-scale mixed-use USD \$100 billion mega-development project to be comprised of four artificial islands. The largest island, Island 2, will be largely comprised of residential units. Island 1 will house Forest City's central business district, shopping malls, the IT industrial park and others. The remaining two islands will include a convention center, additional hotels, a customs and border control clearance area, as well as duty free shopping.

Initially projected to be 1,978 hectares (4,900 acres), the project was scaled back to 1,386 hectares (3,400 acres) in the wake of environmental impact assessments, but nonetheless remains China's largest overseas real estate project.<sup>21</sup> Forest City has a gross buildable area of 48 million square feet, with an estimated total construction budget of 250 billion RMB (USD \$39.4 billion) to be

deployed over the next 20 years to 25 years. The size of each island is as follows: Island 2 (1,896 acres), Island 1 (979 acres), Island 3 (405 acres) and Island 4 (145 acres).

Once completed in 2040, Forest City is expected to have 250,000 residential units, with an expectation of 700,000 new residents arriving to an area that had been little more than fishing villages and beaches before construction began.<sup>22</sup> Supporting these residents will be a wide range of quality-of-life amenities, including schools, hospitals, golf courses, shopping malls, parks, amusement parks, beaches, and conference centers, as well as dozens of industries, large and small.

**Exhibit 7: Map of Forest City, all Islands**



Source: "Forest City Country Garden Project Overview." Accessed February 18, 2018. <http://www.forestcitycountrygarden.com.my/>

The design of Forest City embodies Country Garden Chairman Yang Guoqiang's vision of what all future cities should aspire to be — places that are "smart" and "green," distinguished by use of the latest technology

<sup>19</sup> "Country Garden Current Projects." Accessed February 18, 2018. <http://www.countrygarden.com.au/projects>

<sup>20</sup> "Country Garden 2016 Annual Report." March 22, 2017. Accessed February 18, 2018. <http://www.bgy.com.cn/UploadFiles/cnn/Files/2017/4/20170405180826.pdf>; "City Population Malaysia Johor Bahru." Accessed February 9, 2018. <https://www.citypopulation.de/php/malaysia-admin.php?adm2id=0102>

<sup>21</sup> "Country Garden Restarts Work on Scaled Back \$121B Malaysian Project." March 22, 2015. Accessed February 18, 2018. <https://www.mingtiandi.com/real-estate/outbound-investment/country-garden-restarts-work-on-scaled-back-121b-malaysian-project/>

<sup>22</sup> "Drone Footage Reveals What Malaysia's New \$100 billion 'Dream Paradise' City Looks Like." May 10, 2017. Accessed February 18, 2018. <http://www.businessinsider.com/forest-city-malaysia-chinese-ghost-city-2017-5>



and best planning principles to ensure the long-term sustainability of a community and its surrounding environment.<sup>23</sup> For example, the Forest City design discourages above ground vehicular traffic, while requiring that residents' cars be parked underground so as to not disrupt the landscape."<sup>24</sup>

In addition, vertical greening systems will be used on exterior building surfaces to reduce pollution and enhance air quality. Finally, best-in-class communication systems, as well as energy efficient utilities and transport provisions are promised. To ensure the security of the community, and maintain watch over amenities such as delivery, Forest City also intends to make ample use of drone technology and smart security measures inside residential and business areas. All this has variously been described in Forest City marketing materials as "the model of the future" and the basis for an "exclusive island-living paradise."

In sum, Forest City is not only China's largest overseas real estate development project, but also the largest for Country Garden, and will be Malaysia's first smart city. Given this, it is a highly strategic project for all parties, including the governments of China and Malaysia.

## Good Geography, Great Partnerships

The geographic location of this mega-project make its economic potential hard to doubt. Indeed, many observers were quick to suggest that Forest City will be Malaysia's Shenzhen, referring to the once-sleepy Chinese market town that borders Hong Kong, and which has now surpassed that once-major metropolis in population, and perhaps even in economic significance.

Forest City is located just south of the Iskandar Economic Zone, a 2006-launched national-level initiative aimed to facilitate economic integration between Johor state and Singapore. Pitched between Iskandar and Singapore, Forest City is just five kilometers from the Second Link (a

**Exhibit 8: Rendering of Forest City, Below Ground Transport Network**



Source: "Sasaki's 'Forest City' Master Plan in Iskandar Malaysia Stretches Across 4 Islands." February 2, 2016. Accessed February 18, 2018. <https://www.archdaily.com/781247/sasaki-forest-city-master-plan-in-iskandar-malaysia-stretches-across-4-islands>

bridge linking Johor state to Singapore), and a 40-minute drive to Singapore's central business district, making it an attractive draw for Singapore's own middle class, looking for lower cost, modern housing. There are also plans to provide rail links between Forest City and Singapore.

Country Garden's government relations were also very strong throughout the launch of this mega-project, particularly with the Johor state which holds an equity stake in Forest City. Specifically, Forest City came about through a joint venture between Country Garden (60% of equity) and Esplanade Danga 88 (40% of equity). This joint venture is named Country Garden Pacific View (CGPV).

Country Garden's local partner, Esplanade Danga 88, is 64% percent owned by the Sultan of Johor Ibrahim Ismail. Remaining equity in Esplanade Danga 88 is owned by the Johor state development agency (Kumpulan Prasarana Rakyat Johor), holding 20%, with the remaining stake held by a member of the Sultan's royal court who also serves as a director of CGPV. Country Garden's Malaysia subsidiary has also raised funds through the issuance of Islamic bonds (or '*Sukuk*'), a practice that is increasingly common among non-Muslim

<sup>23</sup> "Troubles in Malaysia's Forest City 'Paradise'." May 16, 2017. Accessed February 18, 2018. <http://www.atimes.com/article/troubles-malysias-forest-city-paradise/>

<sup>24</sup> Forest City Marketing Video in English. Accessed February 18, 2018. <http://www.forestcitycountrygarden.com.my/vvip/>

## Exhibit 9: Renderings of Forest City as a Sustainable, Green Development



Source: "Sasaki's 'Forest City' Master Plan in Iskandar Malaysia Stretches across 4 Islands." February 2, 2016. Accessed February 18, 2018. <https://www.archdaily.com/781247/sasaki-forest-city-master-plan-in-iskandar-malaysia-stretches-across-4-islands>

firms. Country Garden, however, was the first Chinese corporate issuer of such debt.<sup>25</sup>

## Facing Challenges, Making Adaptations

In November 2013, CGPV was granted rights to five parcels of marine area on which to begin the Forest City Project. As exhibit 10 shows, these parcels are located in the Johor Straits, near the Port of Tanjung-Pelepas and the Second Link crossing.<sup>26</sup> This area also includes the Merambong Shoal, which is the largest seagrass bed in peninsula Malaysia.

In January 2014, land reclamation efforts quickly got underway, starting with completion of a causeway linking the mainland to the body of a nascent artificial island. This road cuts across the Merambong seagrass bed. Environmentalists worried about the impact of land

reclamation on this fragile ecosystem. The surrounding fishing communities also began to voice complaints, finding that their daily catches were reduced once land reclamation began.<sup>27</sup>

By March 2014, the government of Singapore also began to take notice, initially with an exchange of letters from Singapore's Ministry of Foreign Affairs to its Malaysian counterpart, inquiring about environmental impact assessments, as well as project scope and timeline. After all, the creation of Forest City literally moves Malaysia physically closer to Singapore, raising concerns about transboundary violations and security risks. By April 2014, Singapore's Prime Minister Lee Hsien Loong inquired directly with Malaysia's Prime Minister Najib Razak.<sup>28</sup>

Soon thereafter, it emerged that CGPV had failed to engage several key stakeholders, including not only surrounding communities but also representatives from the Port of Tanjung-Pelepas who feared their own

25 "碧桂园伊斯兰债券计划评级调升至“稳定” 森林城市前景再获认可 Country Garden's Islamic Bond (Sukuk) Credit Rating Unchanged and Outlook Upgraded to Stable; Forest City's Financial Prospects Reaffirmed." July 12, 2017. Accessed February 9, 2018. [http://www.sohu.com/a/156670069\\_771771](http://www.sohu.com/a/156670069_771771); "Islamic Finance Attracts Non-Muslim Countries." December 20, 2017. Accessed February 18, 2018. <https://tribune.com.pk/story/1588519/3-islamic-finance-attracts-non-muslim-countries/>; "China's Realty Player Country Garden Plans \$340m Sukuk Bond Issue in Malaysia." October 6, 2015. Accessed February 18, 2018. <https://www.dealstreetasia.com/stories/chinas-realty-player-country-garden-plans-340m-sukuk-in-malaysia-14680/>

26 Please note that "Tapak Cadangan" translates as "proposed project site."

27 "Malaysia's Forest City and The Damage Done." August 30, 2017. Accessed February 18, 2018. <https://thediplomat.com/2017/08/malysias-forest-city-and-the-damage-done/>

28 "Forest City Project Alarms Singapore." June 23, 2014. Accessed February 18, 2018. <https://www.thestar.com.my/news/nation/2014/06/23/forest-city-project-alarms-singapore-republic-expresses-concern-over-transboundary-impact-of-reclama/>

expansion would be hampered by the Forest City project. Increased attention on the developers also revealed that only a preliminary site assessment had been completed before land reclamation began. There was no full environmental impact assessment.

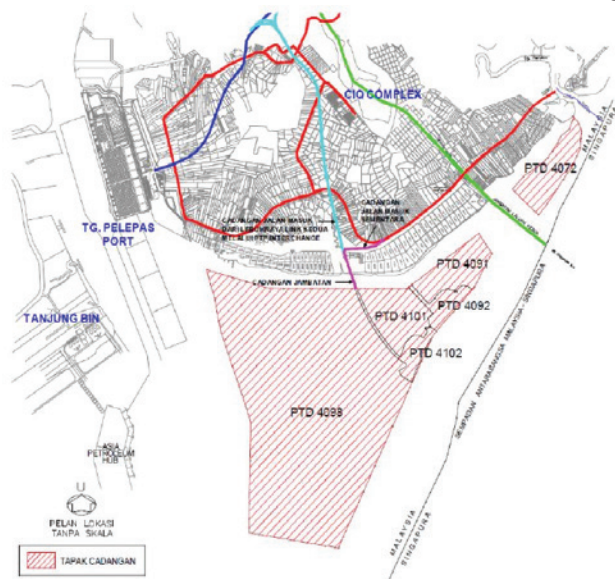
In June 2014, the Forest City project was stopped. What followed was eight months of clarifying regulatory obligations, conducting public meetings with local stakeholders, including fishing communities, and assessing the environment impact. In the course of the investigations, it was discovered that a significant piece of the Merambong seagrass bed has been smothered from the reclamation work. In turn, local Johor state politicians began to voice concerns over the project, leaving CGPV in a very sensitive position.

The company argued that they were not required to submit a full environmental impact assessment as their initial reclamation work was limited to less than 50 hectares. The Johor government confirmed this position in September 2014. Others pointed to Malaysia's National

Plan which states that any reclamation over 20 hectares requires federal approval. Indeed, a 2011 report linked to the development of the Iskandar Zone had described this area of the Johor Straits as “environmentally sensitive.” The area, however, had never been declared a protected zone. Additionally, there were questions over which federal-level government offices needed to provide approvals.

In March 2015, the project began again, but was now smaller in scope, reduced to 1,386 hectares, and included a host of measures to limit the environmental impact, including preservation of 48 hectares of seagrass bed.<sup>29</sup> In late June 2015, CGPV recruited G-Energy, a leading global environmental consultant, to assist Forest City with attaining various leading environmental standard certifications, including “Green RE” and “BCA Green Mark,” the green rating standards for the built environment used by Malaysia and Singapore, respectively.<sup>30</sup> If certified, Forest City's developers would be entitled to a 100% tax exemption until 2028.

**Exhibit 10: Forest City's Marine Area Parcels (in red) and Seagrass Bed (highlighted in green in the map on the right)**



Source: Joseph Marcel R. Williams 2016. “Evaluating Mega-Projects: The Case of Forest City in Johor, Malaysia.” Massachusetts Institute of Technology (MIT), Malaysia Sustainable Cities Program, Working Paper Series.

<sup>29</sup> “Forest City Country Garden Pacific View FAQ.” Accessed February 18, 2018. <https://www.forestcityiskandarhome.com/faq-read-before-you-buy>

<sup>30</sup> “Country Garden Granted Duty Free Zone Status.” Accessed February 18, 2018. <http://www.countrygarden.com.au/media/5/forest-city-granted-duty-free-zone-status>



In addition, CGPV committed to ongoing stakeholder engagement, especially with local communities. Reparations were provided to the local fishing association, as well as donations to area schools. Signaling its desire for full transparency, the company also posted copies of its approved environmental impact assessment report in several key cities, in addition to making it available in all Malaysia Department of Environment offices.

Country Garden's Chairman Yang Guoqiang took these early stage challenges in stride, noting, "No business can always be smooth sailing. The most important thing is that we are law-abiding."<sup>31</sup>

## Open for Business

Although facing initial challenges, Country Garden's relations with local government partners remained strong, and ultimately, Malaysia's prime minister provided his full-fledged support for Forest City, stating that the development had an important role to play in the modernization and economic development of Johor state. He declared that Forest City would have a duty-free zone (one of only three in Malaysia). In addition, the Ministry of Home Affairs will provide an exclusive customs and immigration service channel for Forest City residents and businesses, thereby expediting travel to and from Singapore.

Other awarded government benefits include no corporate income taxes in the first five years of operation for companies in tourism, health care and education (vs.

24% in corporate income tax rate in Malaysia). Import and consumption taxes are also waived for home buyers in Forest City.<sup>32</sup> Moreover, the project is not subject to the country's "Bumiputera quota," a policy that would have required the developers to set aside a portion of available housing for the indigenous Malay population to buy at a lower cost. Finally, the government significantly lowered the minimum residential purchase price for Forest City foreign buyers to USD \$126,000 (800,000 RMB). Elsewhere in Malaysia, the standard bottom purchase price for foreigners is USD \$256,000 (1.6 million RMB).<sup>33</sup>

In terms of construction progress, Country Garden completed approximately 370 acres of land reclamation (25% of the total reclamation target for Island 1) and developed over 1.5 million square feet with an additional 14 million square feet of space currently under development. As of year-end 2016, in addition to residential units available for purchase, the following amenities were open to the public — an exhibition hall, transportation hub, oceanside park, fisherman's wharf and the first hotel, the Phoenix Hotel. The Shattuck-St. Mary's international school is also expected to open to students in late 2018.<sup>34</sup>

It was no surprise that residential sales were quite brisk. In 2016, 15,000 homes were sold, equal to 10 billion RMB (USD \$1.6 billion) in contracted sales.<sup>35</sup> Eighty percent of these buyers were from China.<sup>36</sup> The developers also kept their promise to create employment through the Forest City project. As of late 2016, Country Garden reported that more than 50% of Forest City's operational staff and more than 85% of its hospitality

31 "Country Garden's Ambition in Malaysia Backed by Johor's Royal Family." February 11, 2016. Accessed February 18, 2018. <http://www.scmp.com/property/international/article/1911966/country-gardens-ambition-malaysia-backed-johors-royal-family>

32 "新加坡旁打造森林城市; 探知未来之城Singapore Embraces Forest City and Explores the Future of City." December 20, 2015. Accessed February 8, 2018. [http://www.xinhuanet.com/house/wh/2015-12/20/c\\_1117516806.htm](http://www.xinhuanet.com/house/wh/2015-12/20/c_1117516806.htm); "A Property's Developer's Vision Becomes Reality." December 12, 2016. Accessed February 18, 2018. <https://custom.forbes.com/2016/12/06/forest-city/>

33 "Minimum Property Purchase Prices for Foreign Buyers." January 24, 2017. Accessed February 18, 2018. <https://www.edgeprop.my/content/1045775/minimum-property-purchase-prices-foreign-buyers>

34 E-House Internal Report, Country Garden appendix, page 24

35 "Country Garden Bets on China Property, Hikes Sales Target." August 12, 2017. Accessed February 18, 2018. <https://www.reuters.com/article/country-garden-results/update-2-room-to-grow-country-garden-bets-on-china-property-hikes-sales-target-idUSL4N1L436L>; "China Curbs Challenge \$100bn Forest City's Malaysia Home Sales." August 4, 2017. Accessed February 18, 2018. <https://www.reuters.com/article/forest-city-strategy/china-curbs-challenge-100-bln-forest-citys-malaysia-home-sales-idUSL4N1KP3ZC>

36 E-House Internal Report, Country Garden Appendix, page 23

staff were local hires.<sup>37</sup> Top Chinese companies, such as Huawei, Tencent, Bank of China, the China Construction Eighth Engineering Division Corp., and global firms such as Cisco, Accenture and Deutsche Bank partnered with Forest City to support its goal of becoming a hub for innovation and productivity.<sup>38</sup>

The Forest City business ecosystem aims to complement, but not duplicate the Iskandar Development Zone. Forest City will encourage the following industries: tourism, health care, education, foreign investments, onshore financial institutions, e-commerce, innovative technologies and green industries. For smaller domestic companies, Forest City also plans to provide a platform that will enable them to access overseas markets. These mutually beneficial collaborations, in turn, should expedite economic growth in the region and increase returns on investment for Country Garden.

## Looking Ahead: Risk Management Lessons

Undoubtedly Country Garden has achieved impressive growth both domestically and internationally. In 2016 alone, the developer recorded 308 billion RMB (USD \$45 billion) in contracted sales or a total of 37.47 million square meters of floor space.<sup>39</sup> These accomplishments would not have happened without the company's willingness to take on certain risks. Moreover, these risks cannot be overlooked when analyzing the success of Country Garden — in particular, customer concentration risk, stakeholder management risk, and policy risk are the most pressing.

From a sales positioning perspective, the majority of Country Garden's overseas development projects have been primarily targeted at domestic Chinese buyers. While their increasing desire for global asset allocation

and higher purchasing power make these buyers an attractive customer segment to target, an over-concentration of this customer group makes Country Garden very vulnerable to changes in their purchasing behaviors, whether due to changing preference or policy-related changes. For example, when Danga Bay first launched in 2013, many Chinese buyers backed out of their condo purchase contracts once their mortgage applications were rejected by local banks owing to income verification issues.

Today, the Forest City development is facing a similar challenge as many domestic Chinese buyers can no longer purchase foreign properties due to tighter capital controls from the Chinese government. The need to diversify its customer base is now imminent. Whether Country Garden can attract global buyers on a scale similar to Chinese buyers of its international developments remains unclear. As a start, Country Garden no longer markets its international projects to Chinese buyers and has instead opened showrooms across Southeast Asia.

While no mega-development project can have zero impact, there are additional reputational and financial costs to any business that does not early on address potential social, economic or environmental impacts. In the case of Forest City, these costs included months of work stoppage, negative press reports, the need to reconceive and downsize the project's scale, and other costs associated with environmental and community impact mitigation efforts. The lesson here is clear: Engage all stakeholders, large and small. The developers ran afoul of national laws in no small part as they likely assumed that Johor state officials and their local partner were fully aware of all rules and regulations. They were not.

37 “万亿时代：3000亿碧桂园海外正加速The Decade of the Trillions: Acceleration of Country Garden's Overseas Expansion.” December 20, 2016. Accessed February 8, 2018. [http://www.bgy.com.cn/news\\_details.aspx?id=9979169](http://www.bgy.com.cn/news_details.aspx?id=9979169); “Forest City Has Created Lots of Jobs.” November 28, 2017. Accessed February 18, 2018. <https://www.nst.com.my/news/exclusive/2017/11/308263/exclusive-forest-city-has-created-lots-jobs>

38 “Country Garden Forest City Collaborates with 36 Synergistic Partners to Build Future City.” December 7, 2016. Accessed February 18, 2018. <https://www.prnewswire.com/news-releases/country-garden-forest-city-collaborates-with-36-synergetic-partners-to-build-future-city-300374356.html>

39 “Country Garden Reports Doubling of Stock Price and Sales for 2016.” March 26, 2-17. Accessed February 18, 2018. <https://www.prnewswire.com/news-releases/country-garden-reports-doubling-of-stock-price-and-sales-for-2016-300429483.html>

Equally important, Country Garden's overseas expansion is heavily policy driven by both the Chinese and Malaysian governments. Due to its 20-year development cycle, Forest City will inevitably be impacted by the diplomatic relationships between China and Malaysia. It is also impacted by other large-scale developments underway, with risk of market oversaturation. The success of the Forest City project is also predicated on continued capital support from Country Garden, especially in the construction stage. However, in 2017 the Chinese government has taken a harsher stance on companies' overseas investments, real estate in particular, in an effort to curb capital outflows. Most of the active Chinese real estate investors and developers, such as Wanda, HNA Group and Anbang, have all trimmed their overseas real estate holdings and practically stopped making new foreign investments in order to satisfy China's regulatory requirements. This political headwind further threatens

the sustainability of the Forest City project as Country Garden will likely face increased difficulties in allocating its capital abroad.

## Lessons for the future

Several important lessons can be learned from Country Garden's overseas expansion case. First and foremost, strategic partnerships with the local governments are a necessary, but not a sufficient, condition for the success for any foreign investment, especially for large-scale projects. Further, in order to expand globally, companies need not only to understand the local environment, but "to go local to go global." That is to say, a company's ability to succeed locally is often directly tied to its ability to develop local talent as a means of establishing a global footprint. Lastly, policy risk needs to be taken into serious consideration in the process of business development and strategic planning. ■