Briefing
Investment

July 2015

Image: Sandhill Plaza

SUMMARY

Key international funds continue to raise core money for Asia's gateway cities, focusing on income-generating assets with stable leases.

- Five key deals were concluded in Q2/2015, for a total consideration of RMB8.5 billion, up from RMB5 billion in Q1/2015, with a rebound in international buyer activity.
- Gross reversionary yields for Grade A offices transacted by international funds remained unchanged at 6.1%.
- Gross retail yields remained unchanged at 6.5%, due to subdued rental growth.
- The disposal of Four Seasons Hotel Pudong and its unsold serviced apartment units to Wing Tat Development Limited for RMB2.8 billion was the landmark deal of the second quarter.
- China Resources Land (CR Land) and the Huafa Group jointly acquired land zoned for residential and office use in Shibei, Zhabei district, for a total consideration of RMB8.8 billion, and an accommodation value (AV) of RMB38,062 per sq m.

"International investor deal flow picked-up, with transactions accounting for 40% of total consideration in the second quarter." James Macdonald, Savills Research

Market commentary

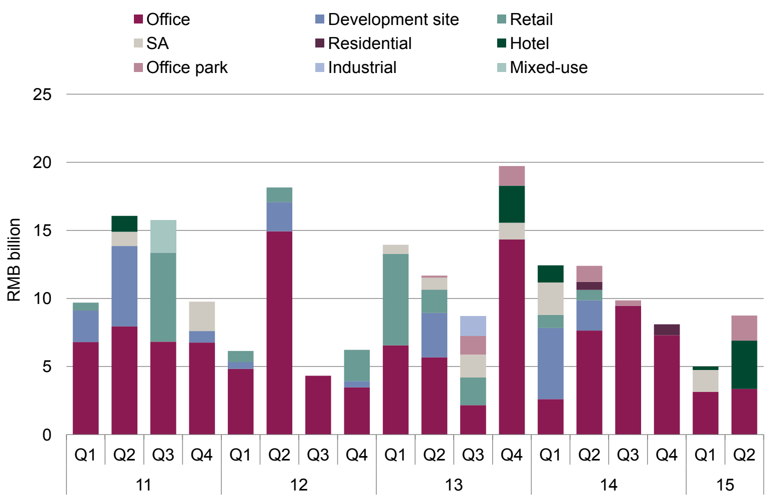
Shanghai's investment market remained active in the second quarter, with five key deals concluded for a total consideration of RMB8.5 billion, up 70% quarter-on-quarter (QoQ). Three key office deals concluded in Q2/2015 accounted for nearly 60% of the total consideration. Two of these office projects were located in non-prime business areas, People's Square and Zhuyuan, while the third was a premium office asset in Zhangjiang Hi-Tech Park, Sandhill Plaza.

International investors recorded an increase in activity in Q2/2015, with their deals accounting for 40% of total sales consideration. AEW acquired Baolong Tower in People's Square, while Mapletree Greater China Commercial Trust (MGCCT) bought Sandhill Plaza in Zhangjiang Hi-tech Park. International investors continue to seek value-add opportunities in downtown locations and unique office buildings in established business parks. As Shanghai's investment market matures, a number of international funds have been introducing more capital in an array of funds and other investment vehicles targeting income-generating stable assets. Domestic developers continue to look for premium commercial assets for long-term hold.

The reduction in interest rates and bank reserve requirement ratios (RRRs) are expected to result in an influx of capital into the market. Lower financing costs, combined with a pick-up in market transactions and improved developer liquidity, has continued to place upward pressure on land prices as developers adopt more aggressive land acquisition strategies, primarily in the four first-tier cities. The nine land transactions with high accommodation values (over RMB20,000 per sq m) in Q2/2015, recorded an average premium of 57.5% over the reserve price.

GRAPH 1

Shanghai large scale real estate acquisitions, Q1/2011–Q2/2015



Source: Savills Research

Office Sector

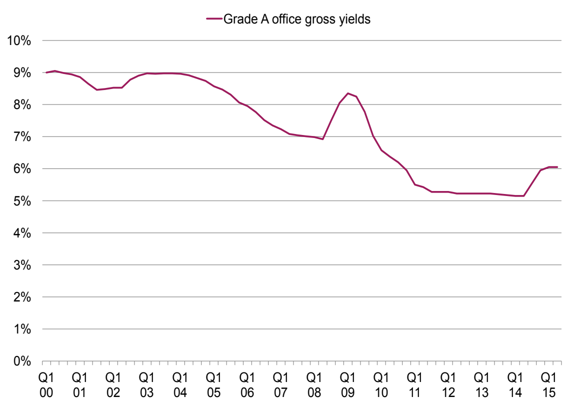
Three new projects were launched onto Shanghai's Grade A office market in Q2/2015, adding 130,500 sq m and bringing city-wide stock to nearly six million sq m. Net take-up totalled 172,350 sq m in Q2/2015, 43% of which was for pre-leasing levels of new supply handed over this quarter.

Grade A office rents increased 0.5% to an average of RMB8.6 per sq m per day, as Puxi rents increased 0.4% and Pudong rents increased 0.6%.

Despite new supply, city-wide vacancy rates fell to 7.2% in Q2/2015, as strong leasing demand from financial enterprises continued to drive take-up in Pudong and firms in Puxi upgraded and consolidated space requirements in Puxi's recently handed over projects. Three areas saw an increase in vacancy rates, namely Huaihai Road (M) (0.9 of a ppt), Changning district (1.3 ppts) and Zhabei BD (1.8 ppts), all a result of new supply.

GRAPH 2

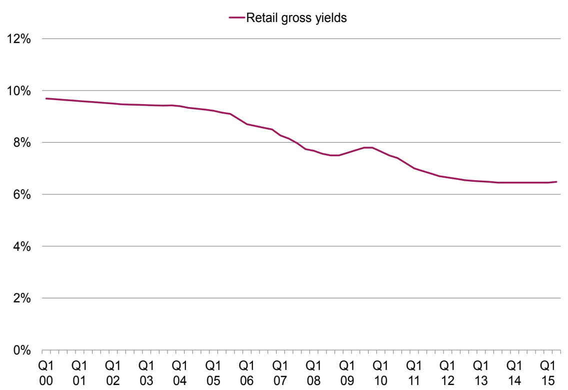
Office gross yields, Q1/2000–Q2/2015



Source: Savills Research

GRAPH 3

Retail yields, Q1/2000–Q2/2015



Source: Savills Research

Retail sector

The retail market showed signs of stabilising in Q2/2015, with retail sales growth rates picking up compared to the lacklustre first quarter figures. Three new shopping malls held soft openings in Q2/2015, adding 174,000 sq m of retail space to the market.

Average first-floor shopping mall rents in prime retail areas remained unchanged in Q2/2015, at RMB46.0 per sq m per day, while non-prime areas recorded a mild decrease of 0.1% QoQ to RMB16.8 per sq m per day.

Overall vacancy rates in prime areas increased 0.9 of a ppt to 5.3%. Huaihai Road (M) is the only area to witness a decrease in vacancy rates over the last 12 months.

The market is expected to remain tough for the foreseeable future, with rents forecasted to remain flat or even fall in certain locations and projects. Gross yields for retail projects remain unchanged at 6.5% largely as a result of subdued rental growth and strong leasing competition.

En-bloc investment market

Five key deals were concluded in Q2/2015, for a total consideration of RMB8.7 billion, up 70% QoQ. International investors recorded an increase in activity with their deals accounting for 40% of total consideration in the second quarter. AEW acquired Baolong Building in Huangpu district and MGCCT bought Sandhill Plaza in Zhangjiang Hi-tech Park. International investors continue to seek value-add opportunities in downtown assets and unique office buildings in established hi-tech parks.

- Shun Tak Group, a Hong Kong-based developer, acquired a hotel project in the MixC mixed-use development for RMB700 million from a 50/50 joint venture between CR Land and Shentong Metro Assets. With a GFA of 29,000 sq m, this 478-room hotel will be operated by Shun Tak's hotel management subsidiary, Artyzen.

- Four Seasons Hotel and Apartments was sold to Wing Tat Development Limited for RMB2.8 billion. This transaction includes Four Seasons Hotel Pudong (187 rooms), unsold units in its serviced apartment Four Seasons Place (43 units), and car parking spaces (131 units).

- GC Tower, a Grade A office building in Zhuyuan district, was acquired by Ping An Real Estate for a total consideration of nearly RMB2.2 billion. The asset was completed in 2009 and has a total GFA of 59,600 sq m comprising a 30-storey office building and a five-storey retail podium.

- AEW, a real estate fund from the United States, acquired Baolong Tower in Huangpu district from Blackstone for a total consideration of RMB900 million.

- MGCCT acquired Sandhill Plaza in Zhangjiang Hi-tech Park, Pudong, from Morgan Stanley (MSREF VII) for a total consideration of RMB1.84 billion. Sandhill Plaza is a premium office asset in Zhangjiang Hi-tech Park, one of Shanghai's leading business parks, comprising a 20-storey office tower, seven, three-storey office buildings, and two basement level car parking floors.

Land market

Shanghai's land market saw its total sales consideration increase 2.1% in Q2/2015, to RMB33.4 billion, with commodity residential and commercial sectors accounting for 55% and 43%, respectively. AVs of both commercial and residential land plots witnessed new highs,

TABLE 1

Yields and capital values by sector[1] , Q2/2015

	Grade A Office	Prime shopping mall	Prime retail street store	High-end serviced apartments	High-end strata apartments	5 star hotel
Gross reversionary	4.5-6.5%	6.0-7.0%	4.0-5.0%	4.0-5.0%	2.5-3.0%	6.5-8.0%
NOI	3.5-5.0%	4.0-4.5%	3.0-3.5%	2.2-2.8%	2.0-2.5%	1.5-2.0%
Approx. values (RMB per sq m)	50-90,000	60-100,000	150–250,000	55-70,000	100-200,000	40-50,000

Source: Savills Research

[1]Yields refer to stabilised assets in downtown locations free of any impediments and with a clean holding structure owning 100% of the building, assuming 100% occupancy. Capital values refer to the average for the building on a GFA basis – retail assets will have higher CV for lower floors.

reaching RMB19,320 per sq m and RMB22,286 per sq m, respectively.

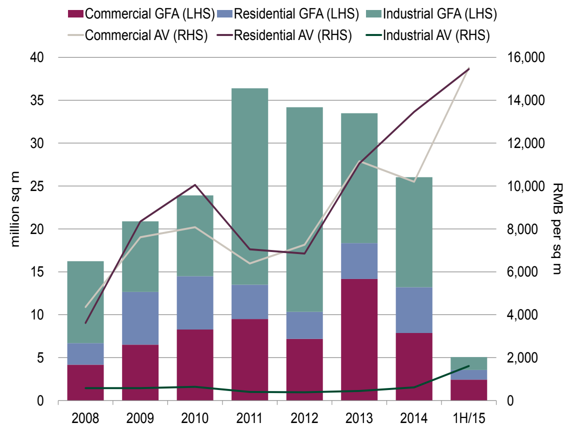
According to the land supply schedule announced in April, the total residential land supply, including economic housing, will not exceed six million sq m in 2015, 35% lower than the average of the past three years. At the same time, the Shanghai government has set an ambitious target of constraining total constructible land to 3,226 sq km by 2020. Given that reports indicate that the total construction land was already 3,070 sq m by the end of 2013, and that annual additions had averaged 50 sq km, this would imply that new additions over the next seven-year period would have to average less than 23 sq km, a significant reduction. The target is likely to be achieved by repurposing existing land stock to the most effective and efficient usage while also limiting the supply of new land plots onto the market. The more tightly controlled land supply will most likely place a greater upward pressure on land prices.

The most expensive plot of land by AV was a mixed-use land plot in the East Bund area, Yangpu district. The land plot was acquired by a joint venture between Beijing Capital Land, Poly Property and Shandong Gold. It sold for an AV of RMB42,725 per sq m and comprises 53,350 sq m of residential space and 27,500 sq m of commercial space.

The most expensive plot of land by total consideration was a residential and office land plot in Shibei, in Zhabei district, jointly acquired by China Resources Land (CR Land) and the Huafa Group for RMB8.8 billion. This is the second land plot purchased by CR Land and the Huafa Group in the Shibei area since the beginning of this year.

GRAPH 4

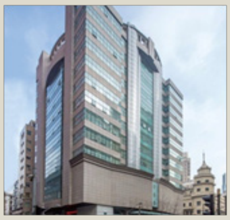
Land transaction spaces and AVs, 2008 – 1H/15



Source: Savills Research

TABLE 2

Key investment deals, Q2/2015

Project	Artyzen Hotel, MixC	Four Seasons Hotel and Apartment	GC Tower	Baolong Tower	Sandhill Plaza
					
Location	Minhang	Pudong	Pudong	Huangpu	Pudong
Date	Apr, 2015	May, 2015	Jun, 2015	Jun, 2015	Jun, 2015
Property type	Hotel	Hotel	Office and retail podium	Office	Office
Transacted price (RMB mil)	700	2,845	2,200	940	1,840
Above-ground GFA (sq m)	29,000 (total GFA)	49,986 (total GFA)	59,563 (total GFA)	25,000	63,457
Vendor	CR Land & Shengtong Metro Assets (50/50)	SOCAM	CGGC	Blackstone	Morgan Stanley (MSREF VII)
Purchaser	Shun Tak	Wing Tat Development Limited	Ping An Real Estate	AEW	Mapletree Greater China Commercial Trust (MGCCT)

Source: Savills Research

Market news

Interest rate cuts

The People's Bank of China (PBoC) cut interest rates once again at the end of June 2015, bringing the over-five-year lending rate down to 5.4%. This is the fourth rate cut since November 2014. In addition, bank RRRs were lowered by 50 basis points (bps), showing the government's determination to mitigate the risk of economic slowdown, prop up the waning stock market, and calm fears of potential deflation.

Since the first cut in November 2014, interest rates have been lowered by a total of 115 bps, effectively lowering developers' onshore financing cost and improving their overall liquidity. Additionally, lower mortgage rates have boosted home buyer sentiment. 70 cities' residential price indices indicate that 20 cities recorded month-on-month price increases in May. This, together with more generous housing provident fund loans and lower down-payment requirements, is expected to result in further improvements in residential transaction volumes during the remainder of this year.

Property capital raising

Five international funds closed their Asia-Pacific real estate investment fund with China allocation in the second quarter.

- CLSA Capital Partners closed its third Asia-Pacific real estate investment fund (Fudo III) at a hard cap of US$1 billion. Fudo III focuses on value enhancement strategies of assets located in first-tier cities throughout Asia-Pacific.

- Apollo Global Management is setting up a real estate PE platform in Asia, primarily focusing on investments in China and India, after having absorbed US$500 million of assets under management of Venator, a China-dedicated fund.

- The Blackstone Group has added US$1 billion-plus of equity for core real estate investments in Asia. The capital collected is expected to be deployed into stabilised, income-generating assets in gateway cities across Asia over the coming two years.

- KaiLong REI has reached a final close of US$238 million on its maiden US-dollar fund, KaiLong Greater China Real Estate Fund. The fund was launched with an objective of making investments in value-add and opportunistic commercial investments in mainland China and Hong Kong.

- Ascendas has launched its Ascendas China Business Parks Fund 4 (ACBPF 4), worth S$333 million, to invest in a portfolio of premium business park assets in

TABLE 3

Key land deals, Q2/2015

Plot	District	Use	GFA (sq m)	Consideration (RMB million)	AV (RMB per sq m)	Buyer
Pingliang 01e2-01,02	Yangpu	Mixed-use	80,842	3,454	42,725	Beijing Capital Land, Poly Property, Shandong Gold
Shibei 09-03	Zhabei	Residential & office	231,073	8,795	38,062	CR Land & Huafa
Jiangwanzhen a06-02	Hongkou	Residential	20,528	652	31.793	Jingrui Properties
Tangzhen d-04-07	Pudong	Residential	73,072	2,170	29,697	Shanghai Greattown
Tangzhen d-03-05a	Pudong	Residential	104,123	2,906	27,909	Shanghai Greattown
Xujing 08-02	Qingpu	Residential	40,427	1,104	27,309	Gezhouba
Expo a03c-01	Pudong	Commercial	27,893	760	27,247	Alltrust Insurance
Nanmatou 14-03c	Pudong	Office	24,075	605	25,130	Shenzhen Tagen
Dachang 38-02	Baoshan	Residential	129,313	3,010	23,277	China Merchants Property, Ping An

Source: Savills Research

Shanghai, Suzhou and Xi'an. The portfolio will comprise completed properties and a development project.

Equity acquisition by international investors

- Ivanhoé Cambridge and CBRE Global Investment Partners have committed to investing in the LOGOS China Logistics Club ("LCLC"). The LCLC investment vehicle is managed by a member of the LOGOS China Group. The venture was formed with the strategy of owning and developing high-quality modern logistics properties located in key hubs serving large Chinese cities, particularly Shanghai. The commitments secured will allow LCLC to make investments that could total up to US$400 million.

- The Dutch pension asset manager APG Asset Management N. V. and Canadian real estate company Ivanhoé Cambridge have led a US$920 million investment in Chinese real estate firm Chongbang Holdings (International) Limited. Chongbang owns and operates 428,000-sq m of commercial space in Shanghai with another 417,000-sq m of space under development.

OUTLOOK

- The office sector is expected to continue to dominate Shanghai's investment market despite weakening fundamentals and concerns about substantial supply in many areas, particularly in decentralised Puxi. International investors are expected to remain focused on downtown commercial assets and business parks.

- As a number of investment funds are coming to the end of their fund life, the remainder of this year is expected to witness some significant transactions. Key international funds continue to raise Asia core funds, focusing on gateway cities, and the pool of capital is expected to be allocated over the coming two years. Both domestic and international investors are increasingly trying to acquire premium assets with stable income for long-term lease hold, a marked divergence with previous investment strategies.

- The continued easing of monetary policies will most likely bring an influx of capital into the real estate market. This, in addition to the tighter land supply going forward, will cause fierce competition within Shanghai's land sales market, resulting in developers' aggressive bidding strategies and higher land prices as well as higher property prices.

Please contact us for further information

Savills Research

James Macdonald
Director, China
+8621 6391 6688
james.macdonald@savills.com.cn

Savills Agency

Albert Lau
Head & Managing Director
+8621 6391 6688
albert.lau@savills.com.cn

Simon Ha
Head of Shanghai Investment
+8621 6391 6688
simon.ha@savills.com.cn