Briefing
Investment

January 2016

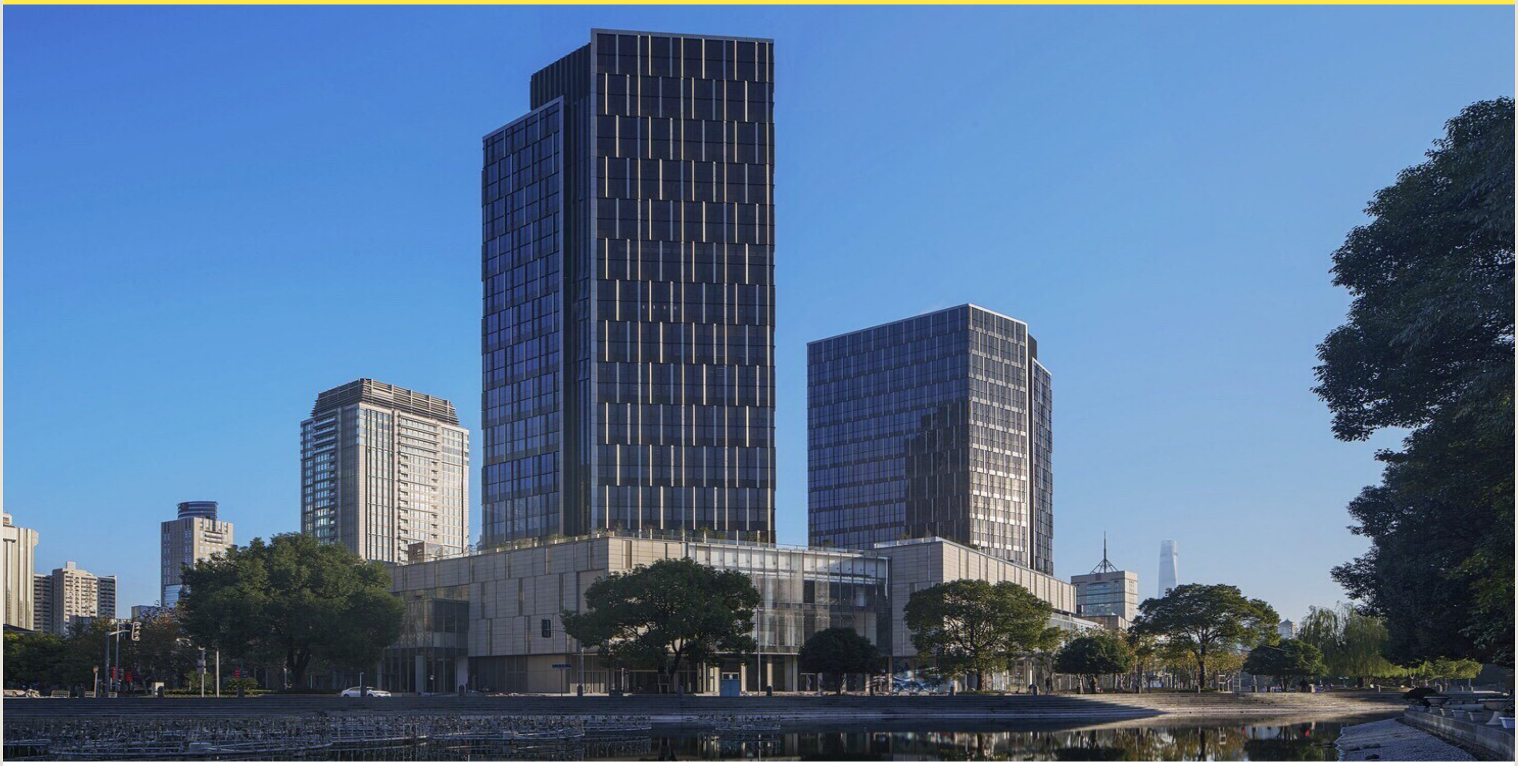


Image: Corporate Avenue 3

SUMMARY

Shanghai witnessed a record year, reaching RMB52 billion in transactions and accounting for close to 50% of sales consideration for mainland China in 2015.

- Eight key deals were concluded in Q4/2015, for a total consideration of RMB16 billion, down 12% quarter-on-quarter (QoQ), with continued activity coming from international investors.

- Total en-bloc sales transactions reached RMB52 billion, up 21% year-on-year (YoY), with a focus on office acquisitions and a rising appetite for serviced apartments.

- Gross reversionary yields for Grade A office projects by international investors compressed 25 basis points (bps) to 5.6%, as investment activity picked up.

- Gross reversionary yields for retail projects remained unchanged at 6.5%.

- Land prices hit new highs in Q4/2015, with four land plots outside the outer ring road selling at accommodation values (AVs) exceeding RMB20,000 per sq m.

- Monetary policy remained loose towards the end of 2015, with another drop in interest rates by 25 bps.

"Insurance companies sparked off a buying spree in property firms' shares and land auctions, greatly increasing their exposure to the real estate sector." James Macdonald, Savills Research

Market commentary

Shanghai's investment market had an active year in 2015, with 36 key sales transactions concluded for a total consideration of RMB52 billion, up 21% YoY. Acquisitions for pure investment purposes made up 85% of the total sales consideration in 2015; international players accounted for 52% of the total consideration.

Investors continued to focus on downtown office assets, making up 84% of the total consideration. Transactions shifted from end-users to institutional investors, a significant divergence from the previous year. The investment market also saw a rising appetite for serviced apartments, echoing the robust residential sales market. A lack of stabilised retail assets on the sales market and expertise in mall management meant that investors remained cautious about investments in the retail sector, with only one retail project, 818 Mall, sold in 2015.

Insurance companies have sparked a buying spree in property firms' shares and land auctions, greatly increasing their exposure in the real estate sector. According to public sources, insurance companies have invested more than RMB80 billion in buying property companies' stakes in 2015. This aggressive purchasing also became common in the land market. For example, Ping An Real Estate has been involved in over RMB40 billion worth of land acquisitions in first and second tier cities.

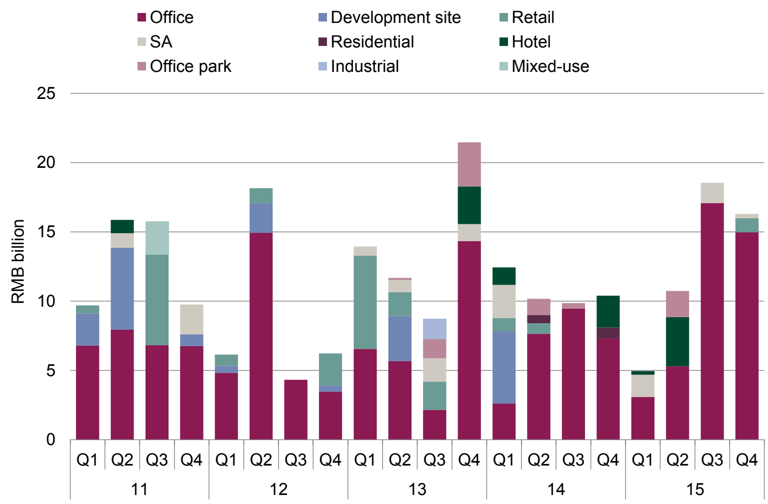
International REITs have started to become more active in the Shanghai office market, one of the most transparent and liquid markets in China. Recent deals included the purchase of Corporate Avenue #1&2 by Link REIT, and Hongjia Tower by Yuexiu REIT. Meanwhile, domestic developers continued their efforts in spinning off assets in asset-backed securities (ABS) or REITs. The Vanke Group has teamed up with Penghua Fund Management to launch a quasi-REIT structure on the Shenzhen Stock Exchange, with a fundraising target of RMB3 billion. Shanghai Housing Provident Fund Management Centre established an ABS backed by housing provident fund loans on China's interbank bond market. The HNA Group, together with Hengtai Securities, also listed their first quasi-REITs product on the Shanghai Stock Exchange in January 2016.

More developers are following this trend by establishing a self-managed real estate fund, focusing on property development and asset acquisitions. Shanghai Industrial Investment and Shanghai United Media Group were leaders in establishing a private equity fund, Real Power Innovation Fund (瑞力创新基金), completed the acquisition of two blocks in KIC in 2015; and V Capital, a subsidiary of the Vanke Group, is the asset manager of Corporate Avenue 3, which was acquired by the Lee Kum Kee Group and Vanke Group in December 2015.

The reductions in onshore lending rates, devaluation of the RMB and interest rate hikes in the United States have stimulated the onshore bond issuance market significantly

GRAPH 1

Shanghai large scale real estate acquisitions, Q1/2011–Q4/2015



Source: Savills Research

TABLE 1

Yields and capital values by sector, Q4/2015

	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

Note: 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.

in 2015. Developers have tended to replace offshore bonds with onshore bonds for lower financing costs as well as protection against currency uncertainties. By the end of October 2015, domestic-developed onshore bond issuance amounted to US$28 billion, compared with just US$1.9 billion for 2014.

Office Sector

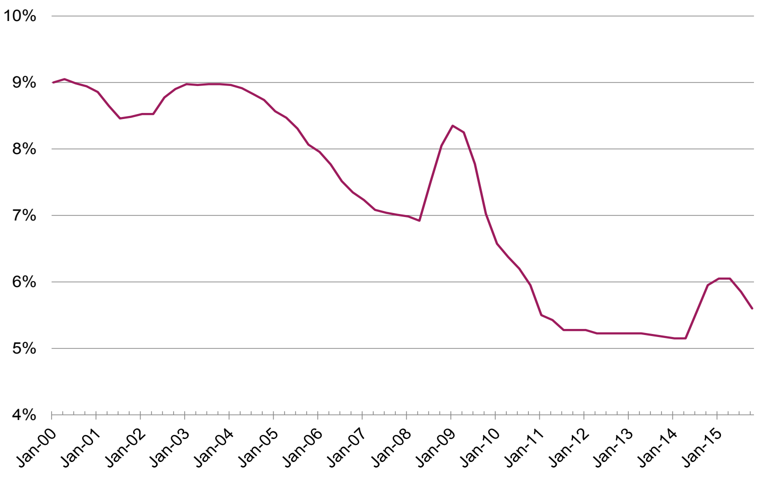
Four Grade A office projects were launched onto the core office market in Q4/2015, bringing 280,000 sq m of supply to the market and pushing total stock to 6.3 million sq m.

Net take-up in core areas totalled 325,000 sq m. 90% of these transactions occurred in non-prime areas, and 60% of all transactions were in Pudong. Vacancy rates in core areas fell by 1.0 percentage point (ppt) QoQ to 6.1%, as a result of strong take-up in projects handed over in the last few quarters.

Average rents in core areas increased by 0.5% QoQ to an average of RMB8.7 per sq m per day, as Puxi rents remained stable and Pudong rents increased 0.7%. Non-prime Pudong continues to record the strongest YoY rental growth at 5.6%, due to the spill over demand from Lujiazui and growth in the financial sector.

GRAPH 2

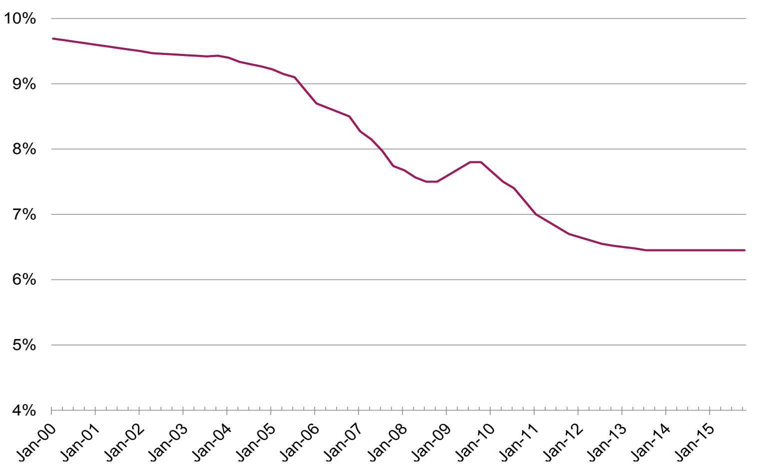
Office gross yields, Q1/2000 – Q4/2015



Source: Savills Research

GRAPH 3

Retail gross yields, Q1/2000–Q4/2015



Source: Savills Research

Gross office yields compressed 25 bps to 5.6%, due to an influx of capital into the real estate market.

An influx of supply into the core markets is expected to continue in 2016, with the completion of projects totalling approximately 1.8 million sq m. This includes the 280,000 sq m Shanghai Tower. Decentralised areas are also anticipated to see around 2.3 million sq m of sales and leasable supply in 2016, with half of the supply located in the Hongqiao Transportation Hub. As a direct consequence of the supply glut, despite the strong demand, a downward pressure will be placed on rents and occupancy rates as new projects compete to attract and retain tenants.

Retail sector

Ten retail projects opened in 2015, bringing 621,400 sq m of new space to the market. Three of these are subsequent phases of existing projects.

First-floor shopping mall rents in prime retail areas increased 0.9% in Q4/2015, to an average of RMB48.4 per sq m per day by the end of 2015. Non-prime areas remained flat at RMB17.2 per sq m per day.

2015 saw vacancy rates in prime areas increase by 1.0 ppt to 4.8%, while non-prime retail areas (including downtown and decentralised areas) fell by 0.8 of a ppt YoY to 9.5%.

Twenty new shopping mall projects (1.3 million sq m of new space) are expected to come onto the market in 2016, only 10% of which will be located in prime areas. Though pressure from supply persists, the market will also welcome some new demand momentum in the coming years, with the tourism market boosted by the opening of Disneyland and the development or renovation of more culture-centric locations.

En-bloc investment market

Eight key deals were concluded in Q4/2015, for a total consideration of RMB16 billion, down 12% QoQ. International investors remained active towards the end of 2015, accounting for 62.5% of total investment consideration.

- Carlyle acquired Manpo International Plaza in the Changning District for RMB1.5 billion from Shanghai Yuchang Real Estate. This is the first asset acquisition by Carlyle since the purchase of Central Plaza in 2013.

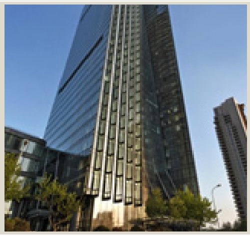
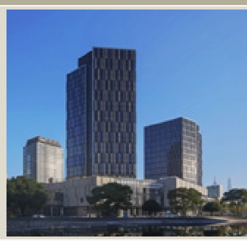
- Shanghai Chengli Properties acquired One Prime in the Sichuan (W) Road area in the Hongkou District. One Prime comprises a 38,000 sq m office tower and a 28,000 sq m shopping mall.

- Shanghai Chengli Properties also completed the acquisition of 818 Mall from CBRE Global Investors for RMB1.0 billion. This was the only pure retail acquisition concluded this year.

- China Science & Merchants Investment Management Group, a private equity company, acquired #5, Star Bund in North Bund in the Hongkou District for RMB2.3 billion. Some of the office space will be occupied by the purchaser and its subsidiaries while the remaining space will be for sale or leasing.

TABLE 2

Key investment deals, Q4/2015

Project	Manpo International Plaza 万宝国际广场	One Prime 壹丰广场	#5, Star Bund 星外滩5号楼	BEA Finance Tower 东亚银行金融大厦
				
Location	Changning	Hongkou	Hongkou	Pudong
Date	Oct 2015	Oct 2015	Nov 2015	Nov 2015
Property type	Office	Office and retail podium	Office	Office
Transacted price (RMB mil)	1,466	2,226	2,282	2,700
Above-ground GFA (sq m)	31,788	74,192 (total GFA)	24,702 (total GFA)	41,000
Vendor	Shanghai Yuchang Real Estate	AM Alpha	China Jinmao JV Shanghai Int'l Port Group	Gaopeng
Purchaser	Carlyle	Shanghai Chengli Properties	China Science & Merchants Investment Management Group	ARA Asset Management
	China Garden 华园大厦	818 Mall 818 广场	Corporate Avenue 3 企业天地3号楼	Tower C of Hongqiao Green Valley Plaza 虹桥绿谷广场C座
				
Location	Changning	Jing'an	Huangpu	Minhang
Date	Nov 2015	Dec 2015	Dec 2015	Dec 2015
Property type	Serviced apartment	Retail	Office	Office
Transacted price (RMB mil)	309	1,012	5,700	595
Above-ground GFA (sq m)	9,484	20,661	87,295	17,860
Vendor	Tysan Group	CBRE Global Investors	Shui On Land	Shanghai Zhonghe Property Development Ltd.
Purchaser	LaSalle Investment	Shanghai Chengli Properties	Lee Kum Kee (90%) & Vanke (10%)	Xinhu Zhongbao

Source: Savills Research

- ARA Asset Management, a Hong Kong-based real estate fund, bought all the saleable space from Gaopeng in the BEA Finance Tower. This was the second transaction concluded by ARA in 2015, following the acquisition of the Platinum Tower.

- LaSalle Investment acquired China Garden, a serviced apartment project in Gubei in the Changning District, for RMB309 million in November. China Garden was completed in 1994, renovated in 2014, and comprises 84 serviced apartment units.

- A joint venture between the Lee Kum Kee Group and the Vanke Group acquired Corporate Avenue 3 from Shui On Land for RMB5.7 billion. A subsidiary of Vanke, V Capital, will be assigned as the integrated asset manager of the project going forward.

- Xinhu Zhongbao, a domestic developer, acquired Tower C of Hongqiao Green Valley Plaza for self-use, aiming to enhance their business operations in Shanghai.

Land market[1]

Shanghai's total land sales consideration fell by 14.6% in 2015 to RMB136.6 billion, with commodity residential[2] and commercial sectors accounting for 54% and 44%, respectively. Commercial and residential AVs averaged RMB14,593 per sq m and RMB19,271 per sq m, respectively.

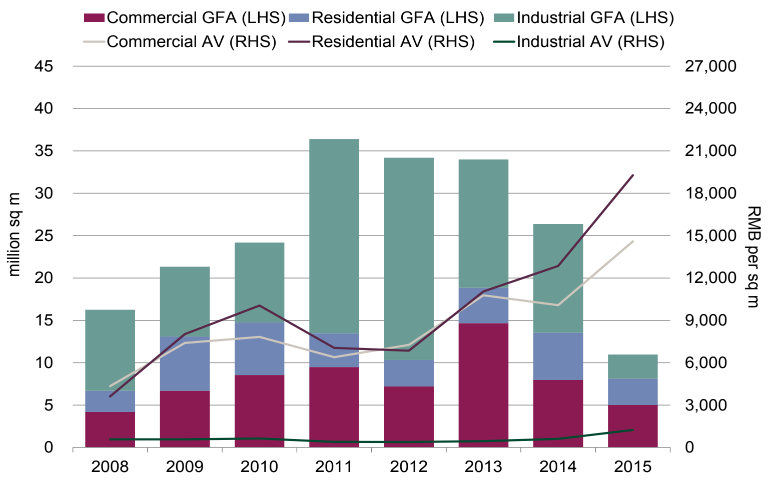
Land supply was significantly reduced in 2015, with the total buildable GFA amounting to just 11.0 million sq m in 2015, down 58% YoY. This is primarily a result of the government's efforts to restrict urban sprawl and retain green spaces within the city. When stripping out industrial land usage the drop off has been less severe, but still notable, having fallen 40% YoY. The tight land supply, combined with strong demand from developers seeking a foothold in one of the strongest markets in China, has enhanced competition in the public auction market, pushing up land prices to new highs, particularly in suburban districts.

Developers all over the country are flooding into Shanghai looking for a safe haven as investors look for protection from the weakening markets in lower-tier cities. Developers, along with insurance companies, have sparked off a buying spree in Shanghai's residential land auctions. Thirty-one land plots with AVs exceeding RMB20,000 per sq m were transacted in 2015. Among these, eight land plots are located outside the outer ring road. Xinzhuang 01-01-15a land plot recorded an AV of RMB43,790 per sq m, the highest ever AV of all land plots outside the outer ring road.

1 Land sales exclude public and economic housing
2 Residential excludes public housing

GRAPH 4

Land transaction spaces and AVs, 2008 – 2015



Source: Savills Research

Land acquisition via equity transfer

As the land auction market hit new highs in 2015, developers are actively seeking strategic cooperation with industry peers to diversify their risks and share the burden of financing costs. At the same time, other developers are looking to get exposure to development sites held by cash-strapped developers via equity injections, typically at discounted prices compared to the public land auction market.

- China Vanke acquired a 60% equity stake in SRE Albany Oasis Garden (上置•绿洲雅宾利花园) in the Zhabei District from the SRE Group for a total consideration of RMB548 million in October. This residential project has a total GFA of 480,000 sq m and will be developed in four phases. The third phase, with a GFA of 159,500 sq m, is currently under development, with some units already on the pre-sale market. The fourth phase, with a GFA of 185,500 sq m, has yet to see the relocation of its previous residents commence. Both the first and second phases have been completed.

- Sunac raised its stake in a development project in Pudong to 58.0% by the end of 2015 by acquiring a 17.5% and 9.4% stake from Shanghai Yuehua and Shanghai Pudong Development, respectively. The total consideration of these two deals was RMB2.152 billion. This mixed-use project has a total saleable GFA of 1,010,100 sq m.

- Evergrande Real Estate announced the acquisition of two land plots in the Qingpu district, along with a project in Qingdao and the Niceline Garden project in Beijing from Chow Tai Fook for a total consideration of RMB13.1 billion. The two land plots are adjacent to each other in Zhujiajiao and have a combined site area of 751,806 sq m and a consideration of RMB3.5 billion. The plot ratio is only 0.5, generating a total planed GFA of nearly 380,000 sq m.

- Thaihot Group announced an investment in a "New Jiangwan Project Cooperative Development Agreement" with Cinda Real Estate and its subsidiaries. Thaihot Group will invest a total of RMB1.14 billion to participate in the development of the New Jiangwan project. Cinda Real Estate acquired the residential land plot for RMB7.299 billion in December.

Market news

Property capital raising

Two international funds launched their Asia-Pacific real estate investment fund with China allocations, or announced their intentions to increase their China property portfolio in Q4/2015.

- Gaw Capital launched a Pan-Asia opportunity fund, Gaw Capital Real Estate Fund V, in November, aiming to raise US$1.5 billion. About 50% of the vehicle is expected to be deployed in China.

- Starcrest Capital Partners, a Hong Kong-based private equity firm, officially launched its Starcrest China Real Estate Fund II in October, with a fundraising target of US$300 million. This closed-end fund, with a term of eight years, will be US dollar-denominated and focus on investing in first-tier cities, with a special focus on Shanghai. The investments will emphasise distressed asset acquisitions, repositioning and renovation of older assets.

Interest rate cut

The People's Bank of China (PBoC) cut interest rates by 25 bps once more in October, bringing the over-five-year lending rate down to 4.9%, the lowest ever. This was the fifth drop in interest rates since November 2014. The reductions seen so far have already helped to stimulate investments, with capital rushing to the real estate market. Further reductions are predicted for 2016.

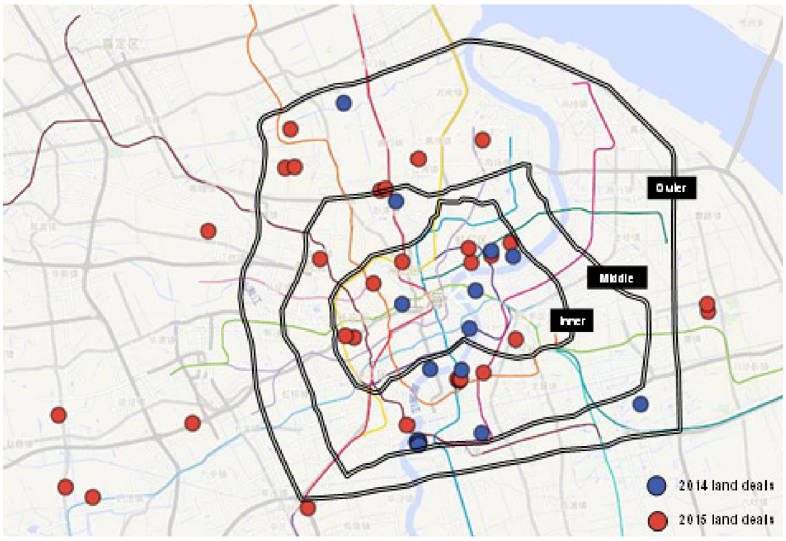
ABS backed by housing loans to issue

The Shanghai Housing Provident Fund (HPF) Management Centre issued their first securitised product backed by personal residential mortgages in December 2015, with a total amount of RMB6.96 billion. The notes are the first asset-backed securities backed by housing fund loans to be offered in China's interbank market. The move is designed to replenish housing funds that local government uses to lend to homebuyers at a cheaper rate than bank mortgage loans.

Increasing the volume of loans from the HPF has the benefit of increasing affordability at the lower end of

MAP 1

Key land deals, 2015 vs. 2014



Source: Savills Research

TABLE 3

Key land deals, Q4/2015

Plot	District	Use	GFA (sq m)	Consideration (RMB million)	AV (RMB per sq m)	Buyer
New Jiangwan c1-02	Yangpu	Residential	148,498	7,299	49,152	Cinda Real Estate
Xinzhuang 01-01-15a	Minhang	Residential	64,284	2,815	43,790	Radiance Property
Jiangqiao j1-01-04	Jiading	Residential	171,688	4,650	27,084	Longfor Group
Tilanqiao hk324-01	Hongkou	Commercial	126,705	3,260	25,729	Shanghai Industrial Investment JV Mori Building Company
Changshou d5-6	Putuo	Commercial	45,427	1,005	22,123	Gemdale Group
Zhaoxiang b5-01	Qingpu	Residential	67,863	1,465	21,588	Macrolink Group
Sijing 05-04	Songjiang	Residential	112,515	2,310	20,531	Shanghai Tongji Real Estate

Source: Savills Research

market and being more targeted than other more macro, monetary and financial policy measures.

Shanghai Stock Exchange (SSE) received its first quasi-REIT product

The “Hengtai Haorui – HNA Pufa Tower Asset-backed Plan” was created in December 2015, and was officially launched on the SSE on 13 January 2016. This is the first quasi-REIT backed by one office asset in China, targeting RMB2.5 billion. This product is split into two tranches and will be managed by Hengtai Securities. Located in Lujiazui, HNA Pufa Tower is a 46,380-sq m Grade A office building held by HNA. The majority of tenants are banks, securities and fund companies. Occupancy rates were roughly 98.5% by the end of September 2015.

Outlook

China’s economic growth rate slowed to a 25-year low of 6.9% in 2015, as the country continues to shift away from its manufacturing roots. Under the gloomy economic situation, the easing of monetary policy is expected to continue in 2016. Quality assets in Shanghai and other first-tier cities are expected to continue to attract capital looking for a safe haven as investors look to capitalise on the loosening of monetary polices and look for protection from weakening markets in lower-tier cities.

Downtown office assets will remain top choices, thanks to the depth and liquidity of the market as well as the ease of management and market transparency. Project usage conversion opportunities will be another investment focus, given the sometimes quite different pricing attributed to different asset classes and changing demand patterns in the city. Investors are also seeking higher yields and capital value appreciation in more niche markets.

Domestic developers are also exploring the opportunities presented by the ABS to get projects off balance sheets while maintaining management fees. Premium commercial assets in mature submarkets will likely be top choices for such products. This adds another exit option for investors, making the sector more attractive. Meanwhile, domestic funds are increasingly seeking value-added opportunities and getting involved in asset management, a divergence with previous strategy.

The Shanghai municipal government recently announced that it had reduced its target total for construction land for 2020 from 3,226 sq km to 3,185 sq km, meaning that additional construction land supply would be limited to merely 60 sq km for the next five years. Tight land supply and high land prices will continue in the near future. Developers are seeking joint venture opportunities to share risks and the burden of financing new developments. Market consolidation is expected to continue in 2016, and potentially gain momentum as stronger developers with lower financing costs absorb smaller developers.

International funds will remain active in the China market, but will keep a close eye on currency movements. Meanwhile domestic developers and investors will continue to expand their overseas footprint as these investments could prove more lucrative should the RMB devalue against the currency of the destination country.

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