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Savills World Research
Shanghai

Briefing
Investment

May 2016

Image: Suzhou Creek

SUMMARY

Domestic investors have become the top bidders in the early stages of negotiation in recent deals.

- Four key deals were concluded in Q1/2016, for a total consideration of RMB4.3 billion, down 34% year-on-year (YoY).
- Decentralised office and serviced apartments drew the most attention in Q1/2016, with two deals concluded in each sector.
- The market has witnessed an increase of platform deals, including HNA's purchase of a majority stake of Tysan and the merger between COLI and CITIC.
- Frenzied buying in the land auction market continued, with accommodation values (AVs) of six land plots exceeding RMB20,000 per sq m.
- The awaited transition from Business Tax to Value Added Tax for the real estate sector was finally released, coming into effect on May 1st.

"Shanghai's property market, and in particular downtown office assets, remains attractive for international investors, in the context of comparatively low yields in other global markets, and expected interest rate cuts."

James Macdonald, Savills Research

Market commentary

Shanghai's investment market had an active start in the first quarter of 2016, with four key sales transactions concluded for a total consideration of RMB4.3 billion. Decentralised office and serviced apartments drew the most attention in Q1/2016, with two deals concluded in each sector.

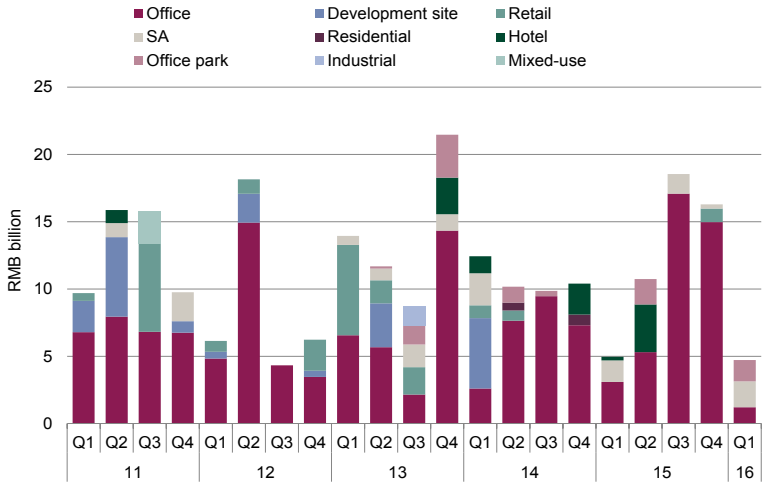
Given the relatively lower lending rate and price hike in the city's property market, domestic funds are actively seeking opportunities to acquire new assets. In view of current deals in the early stages of negotiation, domestic investors have become the top bidders. High-net-worth individuals (HNWIs) are one of the major capital sources supporting domestic funds' expansion into en-bloc investment.

The consolidation of key developers persisted in Q1/2016, with COLI buying CITIC's residential development assets. This trend is likely to continue as some developers believe better prices can be obtained through development portfolio acquisitions. Developers with lower financing costs will have the upper hand over more indebted rivals.

The transition from Business Tax to Value Added Tax for the real estate sector will commence on May 1st. Developers and investors are exploring whether the new system could slow deal activity in the short term.

GRAPH 1

Shanghai large scale real estate acquisitions, Q1/2011–Q1/2016



Source: Savills Research

The central government halted certain outbound investment schemes because of massive cash outflows through both official and unofficial channels over the past three months. The State Administration of Foreign Exchange has also delayed the launch of a programme for domestic individual investors to invest directly overseas, known as the Qualified Domestic Individual Investor scheme (QDII2). While Anbang has made headlines with recent overseas purchases, many other companies have seen their approvals delayed.

Sectors and deals

Four key deals were concluded in Q1/2016, for a total consideration of RMB4.3 billion, down 34% YoY.

Domestic investors were active at the beginning of this year, concluding three deals that accounted for over 80% of total consideration.

Office market

Market fundamentals

In the previous quarter, 140,000 sq m of new supply was offset by 162,000 sq m of net take-up, resulting in vacancy rates falling by 0.4 of a percentage point (ppt) to 5.7%, while rents remained unchanged at RMB8.71 per sq m per day.

Decentralised markets saw 180,000 sq m handed over, resulting in vacancy rates rising by 3.3 ppts to 30.4%. Rents also remained unchanged at RMB5.1 per sq m per day

TABLE 1

Yields and capital values by sector, Q1/2016

	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.

Investor sentiment
Funds still remain focused on the office market for deal volume, eyeing older developments in central locations for value add, while they are also exploring quality business park developments. Some REIT and securities core money are still looking for core stabilised assets.

Deals
Two deals were concluded in the office market in the first quarter:
- Pramerica Real Estate Investors bought the last remaining property from ARA Asset Management's Asian Dragon Fund. This was an offshore deal and the total consideration was around RMB800 million.

- Everbright Ashmore acquired H88 Plaza in Caohejing in the first quarter. Developed by Jinhe Group, the two towers have a total GFA of roughly 56,000 sq m and were completed in March 2015.

Retail market

Market fundamentals
One new project opened in the first quarter, the 140,000-sq m Hopson One in Wujiaochang. Vacancy rates in prime areas increased by 1.0 ppt in Q1/2016 to 4.8%, while non-prime areas (including downtown and decentralised areas) fell by 0.5 of a ppt quarter-on-quarter (QoQ) to 9.0%.

First-floor shopping mall rents in prime retail areas increased by 0.3% QoQ to an average of RMB48.6 per sq m per day, while non-prime areas increased by 0.1% QoQ at RMB17.0 per sq m per day.

Investor sentiment
Investors are still interested in the retail market but suitable assets are rare. Platform and portfolio purchases or equity injections into strong local operators seem to be a preferred method at the moment.

Deals
No deals were concluded in the first quarter.

Hotel market

Market fundamentals
Despite being stigmatised as one of the worst performing real estate sectors in China, the hotel market has started to see a pick-up in occupancy rates and average daily rates (ADRs) are beginning to increase in leading cities. Shanghai's five-star market ended 2015 with ADRs of RMB992 and an average occupancy rate of 68%, while the four-star market stood at RMB521 and 70.1%. Boutique operators and young, trendy brands are looking to acquire a foothold in the China market via Shanghai.

Investor sentiment
Historical purchases of hotels have been for the purpose of converting them to other uses. More recently, however, as developers look to rationalise portfolios, specialised investors are looking at the opportunity of picking up hotel property portfolios at a steep discount.

Deals
No deals were concluded in the first quarter

Residential market

Market fundamentals
The sales market has been red hot over the last nine months, with city-wide prices rising by nearly 20% YoY, and by much more in some individual cases. The leasing market has also seen a significant improvement in both rents and occupancy rates, with an increasing demand coming from seconded Chinese locals, business owners and HNWIs .

Investor sentiment
Despite the leasing market's improvement, the main play for residential investors is to acquire existing developments and then renovate them for sale as strata-title, as long as LVATs (Land Value-added Tax) don't increase in price. While projects may be held for a longer period of time as the market slows, investors still favour strata-title sales to dispose of assets.

Deals
- Fuxing Group, a Chinese investor, bought Hongqiao Plaza in the Changning district for RMB1.35 billion. This serviced apartment has 270 one- to three-bedroom units. It was acquired by SK Securities for RMB1.05 billion in Q2/2011.

- Top Spring acquired the entire stake in Grand Pujian Residence for US$88 million (equivalent to RMB573 million). This serviced apartment, together with its commercial podium, has a total GFA of approximately 26,000 sq m, comprising 120 residential units, 4 commercial units and 43 car parking spaces.

Logistics market

Market fundamentals
Strong demand from 3PLs (third-party logistics providers) and e-commerce companies continues to drive demand and expectations in the logistics sector. Support for cross-border e-commerce will likely benefit this sector further. Rents have risen steadily over the last five years, reaching roughly RMB1.2-1.3 per sq m per day

Investor sentiment
The market is dominated by a handful of players, with most investment cases comprised of acquisitions of individual assets or development sites by these players, or equity injections into platforms. Many see logistics as a good investment, capitalising on rising consumer demand while avoiding many of the headaches inherent in the retail segment.

Deals
No deals were concluded in the first quarter.

Land market[1]

Total land sales consideration reached RMB13.8 billion in Q1/2016, down 51.6% YoY. Commodity residential[2] and commercial sectors accounted for 56% and 43% of total sales, respectively. Commercial and residential AVs averaged RMB10,470 per sq m and RMB20,396 per sq m, respectively.

The tight land supply continued in Q1/2016, with the total buildable GFA amounting to just 1.1 million sq m, roughly 10% of 2015's total. The red hot residential sales market continued to attract investments, helping this sector record an average premium of 94% over reserve prices. Six land plots with AVs exceeding RMB20,000 per sq m were transacted in the first quarter, four of which were located outside the outer ring road.

Land acquisition via equity transfer

Developers, eager to enter the local market but unable to entertain the prices recorded at public land auctions, have been actively pursuing equities of developers and development sites.

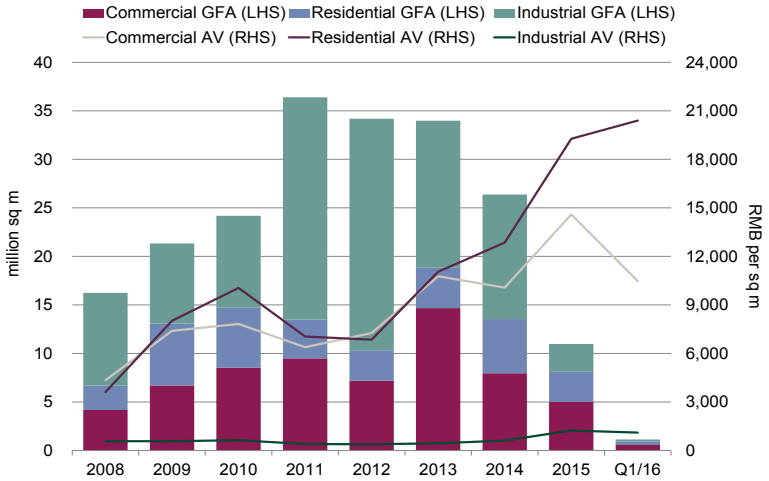
Shanghai Sunac and Shanghai Moke formed a joint venture to acquire two projects in Pudong. Shanghai Sunac and Shanghai Moke will hold 80% and 20% stake in these two projects, respectively. The total consideration for Shanghai Sunac will be approximately RMB3.3 billion. Both the residential developments are located in a southern suburb of the Pudong district and together have a total buildable GFA of 53,700 sq m and a plot ratio of 0.41.

Top Spring and a domestic third party jointly acquired a commercial development site in the Pudong

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

GRAPH 2

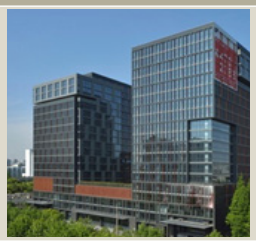
Land transaction area and AVs, 2008–Q1/2016



Source: Savills Research

TABLE 2

Key investment deals, Q1/2016

Project	Towers E & G, Waterfront Place 北岸长风E、G栋	H88 Plaza H88 越虹广场	Rainbow Plaza 虹桥公寓	Grand Pujian Residence 浦建雅居
				
Location	Putuo	Xuhui	Changning	Pudong
Date	Feb 2016	Feb 2016	Mar 2016	Mar 2016
Property type	Office	Office park	Serviced apartment	Serviced apartment and commercial podium
Transacted price (RMB mil)	800	1,580	1,350	573
Above-ground GFA (sq m)	27,805	56,432	42,185	24,056
Vendor	ARA Asia Dragon Fund	CLSA	SK Securities	Recap
Purchaser	Pramerica Asia Fund	Everbright Ashmore	Fuxing Group	Top Spring

Source: Savills Research

district for a total consideration of RMB885 million. Top Spring and its partner will hold 85% and 15% in this project, respectively. The commercial development (Plots 07-02, 07-07 and 07-08, Puxing) was bought by the vendors for RMB660 million in March, 2015. The combined plots have a site area of 21,300 sq m, an above-ground GFA of 41,200 sq m and an underground GFA of 16,200 sq m.

Market news

Property capital raising

Three funds launched Asia-Pacific real estate investment funds with China allocations in the first quarter of 2016.

- Gaw Capital was reported to have raised nearly US$700 million for the first closing of Gaw Capital Real Estate Fund V, more than half of the target. It was originally planned to deploy 50% of Fund V's Capital in China, but Gaw Capital has decided to invest at least 70% of its latest fund in China. None of the capital raised for Fund V has been invested yet.

- Everbright Ashmore, the Beijing-based real estate investment platform of the state-owned enterprise China Everbright Group, has raised RMB1.6 billion for a blind-pool private equity real estate fund for investing in China.

- PAG, the Hong Kong-based investment management firm, has raised more than US$1 billion for its first pan-Asia, core-plus strategy private real estate fund, PAG Real Estate Partners. Chinese investments could be made for up to 20% of the fund's capital.

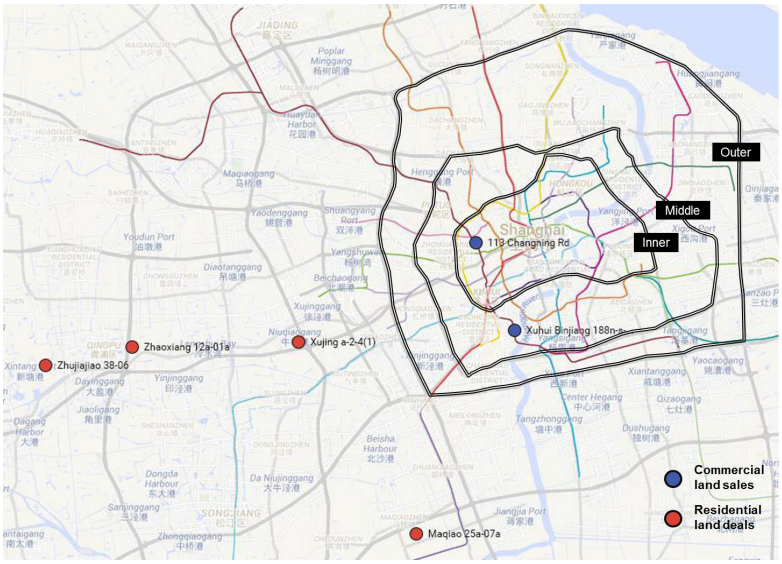
Platform deals

Blackstone Group disposed of its investment in Tysan Holdings, selling its 66% stake in the Hong Kong developer to China's HNA Group for HK$2.62 billion (equivalent to RMB2.2 billion). The profit of this 66% stake earned by Blackstone was estimated to be roughly HK$960 million. Currently Tysan Group has three developments in China, including The Waterfront in Shanghai, The Riverside in Tianjin and The Pinnacle in Shenyang.

Macquarie Capital (the Australian advisory firm), and Ivanhoe Cambridge

MAP 1

Key land deals, Q1/2016



Source: Savills Research

TABLE 3

Key land deals, Q1/2016

Plot	District	Use	GFA (sq m)	Consideration (RMB million)	AV (RMB per sq m)	Buyer
Maqiao 25a-07a	Minhang	Residential	90,777	2,630	28,972	Yuzhou Properties
Xujing a-2-4(1)	Qingpu	Residential	18,752	535	28,530	Beijing Capital Land
Zhujiajiao 38-06	Qingpu	Residential	38,794	857	22,091	Zhongnan Construction
Xuhui Binjiang 188n-s-1, 188n-s-2(below ground)	Xuhui	Commercial	36,967	810	21,912	Guangqi Culture & Mengxiang Qiangyin
113 Changning Rd	Jing'an	Commercial	13,266	273	20,579	Greenland
Zhaoxiang 12a-01a	Qingpu	Residential	51,288	1,050	20,473	Yunjie Property

Source: Savills Research

(the Canadian pension fund), are in the process of taking over LOGOS Property Group. LOGOS Property Group reportedly controls close to US$1.4 billion of logistics assets across Australia and China.

China Overseas Land and Investment Limited (COLI) will acquire CITIC Group's residential assets for an initial consideration of RMB31 billion. The final consideration will be settled with 10% of COLI's enlarged share and a portfolio of certain properties owned by COLI. Upon the completion of this acquisition, CITIC Group will become the second largest shareholder of COLI. The residential projects acquired by COLI are located in 25 cities, primarily first- and second-tier cities across the Pan Bohai Rim, Yangtze River Delta, Pearl River Delta and other regions. The total GFA was approximately 24 million sq m.

Chinese developers to list in Hong Kong or Singapore

Greenland Group is looking to set up and list a real estate investment trust (REIT) on the Singapore Exchange. The REIT is to be established by Greenland and the investment company Amare and aims to purchase 19 hotel assets in China from Greenland for RMB21 billion. The first investment includes six hotels in Shanghai, Nanjing, Jinan, Xi'an, Zhengzhou and Yangzhou. Greenland will acquire a 30% stake in the REIT as well as participate in hotel management.

The Shanghai-based e-Shang merged with Singapore's Redwood Group in January 2016, to create a logistics real estate platform, the e-Shang Redwood, across Asia Pacific. This new platform is targetting a US$1 billion initial public offering (IPO) on the Hong Kong Stock Exchange within 2016.

Shanghai Yupei Group, backed by Carlyle, plans to raise US$300 million in Hong Kong through an IPO. The company aims to list as early as the middle of 2016.

VAT reforms launched

The awaited transition from Business Tax (BT) to Value Added Tax (VAT) will begin on May 1st. The current business tax is 5% of the sale of immovable property and 3% on construction services, while the VAT will be set at 11% under the new system. There will be the introduction of input tax credits which will allow companies to offset some of their costs. Meanwhile, companies can deploy simplified VAT tax (5%) for old projects during a transitional period. This reform may increase the tax burden for certain companies, but is expected to create significant tax savings once all industries have shifted to the VAT system in 2016.

Outlook

Shanghai's property market, downtown office assets in particular, remains an attractive market for international investors, with higher yields than other prime investment destinations and the expectation of further interest rate cuts. As sovereign wealth funds have started to allocate more assets in the real estate sector towards achieving higher yields, more core and core-plus money is exploring core assets in the most transparent and liquid market in China.

As several deals are currently in the final stages of negotiation, the second quarter is expected to see an active investment flow.

Retail and logistics markets are expected to see more portfolio and platform deals as international investors look for strategic investments in these sectors.

Please contact us for further information

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