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Savills World Research
Shanghai

Briefing
Investment

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Image: Lujiazui

SUMMARY

Domestic investors were especially active in the first half of 2016, accounting for 93% of transaction consideration.

- Six key deals were concluded in Q2/2016, for a total consideration of RMB9.3 billion, down 13% year-on-year (YoY).
- The serviced apartment sector saw significant increasing deal flow, with four deals concluded in 1H/2016.
- Grade A office gross yields compressed by 0.8 of a percentage point (ppt) YoY to 5.3%, due to abundant capital chasing for limited deals.
- The total land sales volume in the first half of 2016 stood at just 26% of 2015's total figure, increasing competition in the land auction market.
- The central government announced several plans to support the residential leasing market and provide greater flexibility in converting usage of real estate assets.

"Greater flexibility in converting usage of real estate assets could see more investors targeting older, non-traditional asset class developments." James Macdonald, Savills Research

Market commentary

Shanghai's investment market remained strong in the second quarter of 2016, with six key sales transactions concluded for a total consideration of RMB9.3 billion. The serviced apartment sector saw significant increasing deal flow, with four deals concluded in 1H/2016, accounting for 40% of total consideration.

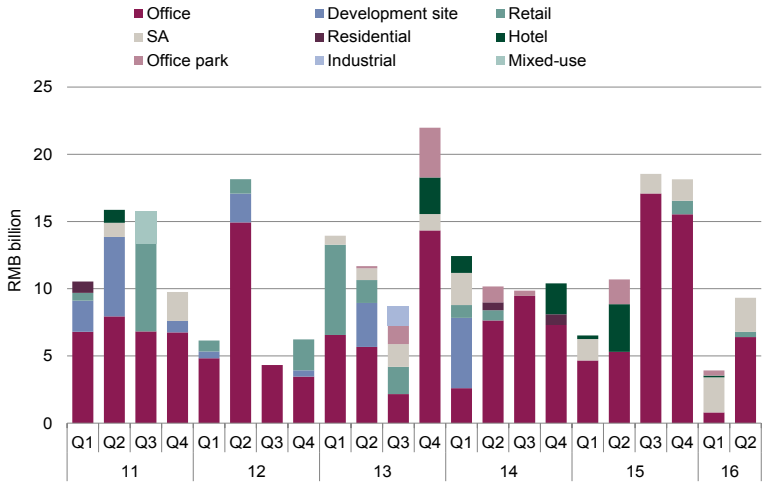
Domestic investors were especially active in the first half, completing 10 deals with a total consideration of RMB12.3 billion. As an influx of capital is chasing for limited assets, asset prices continued to climb and yield compression persisted. Meanwhile, the buying spree increased asset values, which in turn may incentivise more owners to place their properties on the market, resulting in an increasing number of investment opportunities.

The central government announced several plans to foster housing reform and encourage the residential leasing market. The supporting measures for promoting the conversion of commercial use properties to residential leasing use attracted the most attention. The flexibility in converting the assets' usage will help the reposition of commercial properties and improve the assets' value. However, the details of the implementation have yet to be disclosed.

The awaited transition from Business Tax (BT) to Value Added Tax (VAT) started on 1 May, and the VAT system is now applied to all industries. As most landlords deploy simplified VAT tax (5%) for old projects, the impact of this transition is currently limited.

GRAPH 1

Shanghai large scale real estate acquisitions, Q1/2011–Q2/2016



Source: Savills Research

Sectors and deals

Six key deals were concluded in Q2/2016, for a total consideration of RMB9.3 billion, down 13% YoY. All deals were concluded by domestic purchasers in the second quarter.

Office market

Market fundamentals

Two projects were launched onto the core office market in Q2/2016, adding 340,000 sq m of supply. Vacancy rates in core areas increased by 1.9 percentage points (ppts) QoQ to 7.6%, as some peer-to-peer (P2P) companies closed operations in Puxi. Grade A office rents in core markets remained unchanged at RMB8.65 per sq m per day.

Decentralised markets saw 118,000 sq m handed over. Vacancy rates fell by 0.1 of a ppt to 30.3%, while rents increased by 0.3% quarter-on-quarter (QoQ) to RMB5.4 per sq m per day

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. Greater flexibility in converting usage of assets, especially for office use, could see more investors targeting older, non-traditional asset class developments.

TABLE 1

Yields and capital values by sector, Q2/2016

	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	3.5-4.5%	4.0-4.5%	2.0-3.5%	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 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.

Deals

Four deals were concluded in the office market in the second quarter:

- Sino Ocean bought the East Ocean Centre from CLSA for RMB2.4 billion. This office project was renovated in 2014.

- The Shanying Paper company purchased Tower 6 of Riverside International Plaza for RMB805 million. This office building will be the buyer's research and development centre and operating headquarters in Shanghai.

- Real Power Capital acquired the Evergo Tower from China Estates for RMB1.2 billion. This office tower is located in the primary area, Huaihai Middle Road, and has a total GFA of 26,370 sq m.

- Huaxi Securities bought one building of Poly International Centre for self-use. The unit price reached RMB83,138 per sq m.

Retail market

Market fundamentals

Three retail projects launched soft openings, with a total retail GFA of 162,000 sq m. Vacancy rates in both prime and non-prime areas increased by 0.5 of a ppt in Q2/2016, to 6.2% and 9.5%, respectively.

First-floor shopping mall rents in prime retail areas increased by 0.2% QoQ to an average of RMB48.9 per sq m per day, while non-prime areas increased by 0.1% QoQ at RMB16.8 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 of investment at the moment.

Deals

Xujiahui Centre Group, the local-level, state-owned company, acquired the Best Buy Xujiahui project. This 5,527-sq m retail project will be renovated, with the purpose of upgrading the commercial environment of the Xujiahui area.

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 May 2016 with ADRs of RMB965 and an average occupancy rate of 69%, while the four-star market stood at RMB527 and 72%. Boutique operators and young, trendy brands are looking to acquire a foothold in the China market via Shanghai.

Investor sentiment

Historically, 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 second quarter.

Residential market

Market fundamentals

Affected by the cooling measures released in March 2016, first-hand commodity residential transaction volumes shrunk by 25% in the second quarter. 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 high net worth individuals (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

- Chengli Properties acquired Amenity Garden in the Pudong district for RMB2.5 billion. This serviced apartment is home to Japanese expats, and has a total GFA of 80,884 sq m, comprising 486 units.

- Jingrui Holdings, a listed local developer, acquired Upper Riverside from Nan Fung International and Wing Tai Property for a total consideration of RMB1.4.billion. Upper Riverside is a serviced apartment complex managed by Lanson Place, comprising 97 units, ranging from 89 sq m to 477 sq m.

Logistics market

Market fundamentals

Strong demand from 3PLs (third-party logistics providers), e-commerce and retail companies continues to drive demand and expectations in the logistics sector. Support for cross-border e-commerce will likely benefit this sector further.

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

China Logistics Property Holdings, formerly known as the Shanghai Yupei Group, has attracted cornerstone investors including Anbang Life Insurance and Sino Ocean to purchase more than half of its Hong Kong initial public offering, targeting US$433 million.

Goodman Group acquired A-REIT Jiashan Logistics Centre in Jiashan from Ascendas REIT for S$26 million (equivalent to RMB128.7 million). This

logistics centre is located at the south western border of Shanghai, and has a total GFA of 35,729 sq m.

Land market[1]

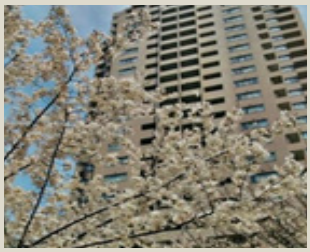
Total land sales consideration reached RMB37.5 billion in Q2/2016, up 29% YoY. Commodity residential[2] and commercial sectors accounted for 80% and 19% of total sales, respectively. Commercial and residential AVs averaged RMB24,146 per sq m and RMB27,595 per sq m, respectively.

The tight land supply improved in Q2/2016, with the total buildable GFA amounting to 1.7 million sq m, increasing 49% compared with the first quarter. Nevertheless, the land supply remained the lowest ever, with no land supply in April. The total transaction volume of the first half stood at just 26% of 2015's total figure. As a result, the buying spree continued in Shanghai's land sales market. Except for two land plots on Chongming Island, all land sales with residential components recorded AVs exceeding RMB20,000 per sq m. Additionally, all these land plots are located in suburban areas.

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

TABLE 2

Key investment deals, Q2/2016

	East Ocean Centre 东海商业中心	#6, Riverside International Plaza 滨江国际广场6号楼	Amenity Garden 东樱花苑
			
Location	Huangpu	Yangpu	Pudong
Date	Apr 2016	Apr 2016	Apr 2016
Property type	Office	Office	Serviced apartment
Transacted price (RMB mil)	2,390	805	2,540
Above-ground GFA (sq m)	49,800	15,200	66,850
Vendor	CLSA	Shanghai Oriental Pearl	Angelo Gordon
Purchaser	Sino Ocean	Shanying Paper	Chengli Properties
	Evergo Tower 爱美高大厦	Best Buy Xujiahui 百思买徐家汇	Poly International Centre 保利国际中心
			
Location	Xuhui	Xuhui	Pudong
Date	May 2016	May 2016	Jun 2016
Property type	Office	Retail	Office
Transacted price (RMB mil)	1,220	384	1,992
Above-ground GFA (sq m)	24,660 (total GFA)	5,527 (total GFA)	23,956
Vendor	China Estates	Best Buy	Poly
Purchaser	Real Power Capital	Xujiahui Centre Group	Huaxi Securities

Source: Savills Research

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.

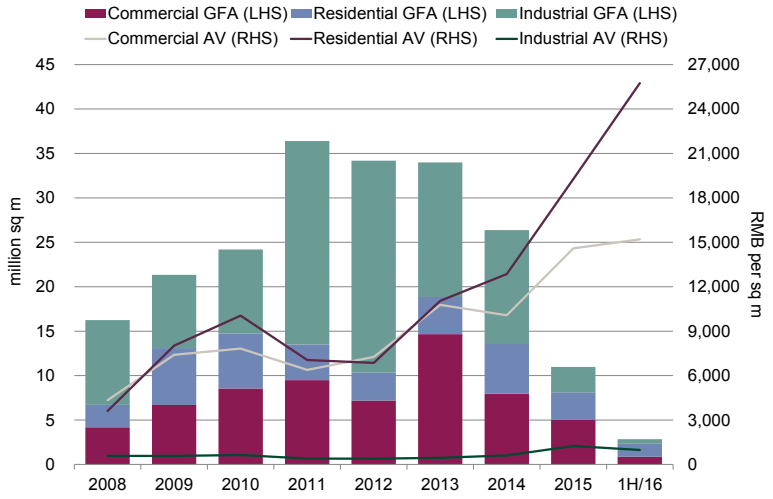
Zhonggeng Group acquired a 40% stake in SUD Longcheng (上海城开龙城) from Shanghai Urban Development Group (上海城开集团) for RMB1.9 billion. Zhonggeng will own the entire stake in SUD Longcheng. SUD Longcheng owns a mixed-use development site, U Center, in the Minhang district.

Powerlong bought the entire stake of a land plot in Lingang from Shanghai Lingang Nanhui New town for RMB308 million. This land is zoned for retail and residential use, and has a total GFA of 62,100 sq m.

BJ Capital Land and Poly Real Estate established a joint venture to develop a project in Zhou. BJ Capital Land acquired a 51% equity stake in this joint venture for RMB2.78 billion, which is equivalent to 51% of the land price, and Poly Real Estate will hold the remaining 49% equity stake. The land was acquired by Poly Real Estate in May 2016, and has a total GFA of 124,980 sq m.

FIGURE 2

Land transaction area and AVs, 2008–1H/2016



Source: Savills Research

Market news

Property capital raising
Five funds launched Asia Pacific real estate investment funds with China allocations in the second quarter of 2016.

- Gaw Capital has raised US$150 million in an initial capital raise for its first Asian hotels investment fund in May. The final close is expected to secure total commitments of US$250 million.

- Carlyle plans to raise in excess of US$500 million for a China-focused real estate fund. The investment strategy of the fund was not disclosed.

- Starcrest Capital Partners has raised US$100 million in the first close of its debut China-focused private equity

TABLE 3

Key land deals, Q2/2016

Plot	District	Use	GFA (sq m)	Consideration (RMB million)	AV (RMB per sq m)	Buyer
Gucun 10-03 & 10-05	Baoshan	Residential & retail	159,554	5,805	36,383	Cinda Real Estate
Zhoupu a-03-11	Pudong	Residential	124,980	5,450	43,607	Poly Real Estate
E27-1 Jiading New Town	Jiading	Residential	138,597	4,198	30,289	C&D Real Estate
Sijing 12-01	Songjiang	Residential	78,477	3,005	38,291	Sunac
Xinchang a10-1	Pudong	Residential	68,264	2,440	35,744	COFCO Property
Sijing 10-05	Songjiang	Residential	52,157	1,965	37,675	Gree Real Estate
Nanqiao New Town 01d-03	Fengxian	Residential	50,640	1,722	34,005	Fengxian Development
Sichuan (N) Road hk172-13	Hongkou	Commercial	18,280	750	41,028	Foresea Life

Source: Savills Research

real estate fund. Starcrest launched Starcrest China Real Estate Fund II late last year, targeting US$300 million.

- Additionally, Gaw Capital announced that it had launched a China outlet mall fund together with TH Real Estate. TH Real Estate is a real estate investment management firm owned by US pension manager TIAA. The two companies aim to raise a total of US$1.2 billion for this fund.

- Lasalle Investment Management launched Asia Opportunity Fund V (LAOF V), targeting US$750 million. LAOF V is a closed-ended, pan-Asian real estate fund focusing on acquiring assets in need of repositioning, development or redevelopment, leasing and active asset management. Japan, Australia and China, especially Chinese logistics assets, will be the primary markets for the fund. LAOF V has received US$20 million and US$30 million of commitments from San Diego City Employees' Retirement System and Arkansas Teacher Retirement System, respectively.

Launches of quasi-REITs products
Orient Asset Management acquired Qingpu Injoy Plaza from Future Holdings for RMB1.05 billion, for the purpose of asset securitisation. Qingpu Injoy Plaza has a total GFA of 132,900 sq m and a retail GFA of 86,300 sq m.

The "Tianfeng – AVIC Macalline Aegean Mall Asset-backed Plan" was created in June 2016, targeting RMB1.4 billion. The retail project is the Kunming Aegean shopping centre and has a total GFA of 156,883 sq m.

Supporting measures on residential leasing market
The State Council announced plans to encourage the residential leasing market in China in order to improve housing conditions and promote urbanisation. The measures included: allowances for individuals that qualified for low income housing, encouraging them to lease from the open market; promoting the conversion of commercial use properties to residential leasing use; and financial tools, such as REITs.

Outlook

The subdued rental growth and ongoing yield compression made Shanghai's assets more expensive and less profitable compared with other global markets. As a result, international investors remain conservative and it is more likely that their purchasing activities will slow down. However, domestic investors are increasing their exposure on real estate sectors for preservation of capital, as the RMB is expected to devalue further in the near future. As some deals have come to the final stage, certain prime assets are expected to be concluded and the second half will see active deal flows.

The government is trying to provide greater flexibility in converting usage of real estate assets, in order to support a strong leasing demand market and foster real estate reforms. These measures are likely to add more value to older, non-traditional asset classes in key areas, which will make them a target for investors. Meanwhile, financial tools, such as asset securitisation and REITs, will be involved to support the development of the real estate sector.

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