

Briefing Investment

November 2016



Image: Lujiazui

SUMMARY

Transaction volumes grew by 45% quarter-on-quarter, as office properties with stable incomes in centralised markets continue to draw the attention of local investors.

- Nine key deals were concluded in Q3/2016, for a total consideration of RMB13.5 billion, down 27% year-on-year (YoY), but up 45% quarter-on-quarter (QoQ).
- Domestic investors are still the major players in the investment market, accounting for 53% of the total sales consideration in Q3/2016.
- Rising prices of Grade A office assets continue to compress gross yields, which fell by 0.1 of a percentage point (ppt) QoQ to 5.2%.
- Bidding on land plots remained highly competitive, with one residential plot recording an accommodation value (AV) in excess of RMB100,000 per sq m, a new record for China.

.....
 “Some domestic developer landlords and international players see an opportunity to recycle assets for higher returns as capital values increase.” James Macdonald, Savills Research

→ Market commentary

Shanghai's investment market remained active in the third quarter of 2016, with nine key sales transactions concluded for a total consideration of RMB13.5 billion, up 45% QoQ.

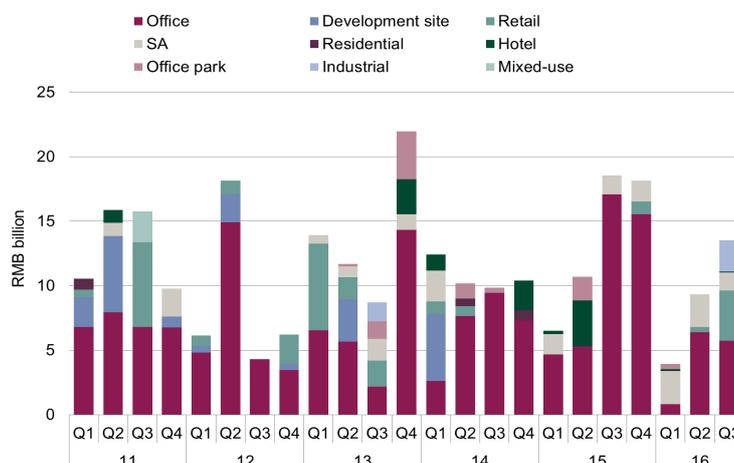
Domestic investors are still the major players in the domestic market, accounting for 53% of the total sales consideration in Q3/2016. The majority of acquisition targets by domestic investors were office properties, while the ones by international investors were retail properties, including Chongbang Group's purchase of an 80% stake of Jinqiao Life Hub for RMB3.4 billion. International investors purchased retail projects in key Chinese cities, with the intention of leveraging their property management capabilities to add value.

Office properties drew the most attention in Q3/2016, accounting for 42% of total sale considerations. State-owned institutional buyers remained focused on office properties, with stable incomes for long-term lease hold and partial self-use. Guohua Life Insurance bought SOHO Century Plaza from SOHO China and Shanghai Life Insurance acquired a 49% stake in SCB Tower during the third quarter.

Projects that operate in the sharing economy continue to attract investment as the affordability of traditional office and residential units continue to decrease in Shanghai. WeWork, the Manhattan-based co-working space operator, launched its first Asian centre in the Jing'an district during July, with plans to open another two in Shanghai in the coming months. Domestic developer giant SOHO China also emphasised their faith in the future of their own co-working business line, SOHO 3Q, which has expanded to 16 stores in Shanghai and Beijing. Pamflet bought 70% of Starway Parkview South Station in September, with a plan to convert the building into a co-living community.

GRAPH 1

Shanghai large-scale real estate acquisitions, Q1/2011–Q3/2016



Source: Savills Research

Sectors and deals

Nine key deals were concluded in Q3/2016, for a total consideration of RMB13.5 billion, down 27% YoY. Office properties were the most transacted asset class.

Office market

Market fundamentals

Three projects were launched onto the core office market in Q3/2016, adding 150,000 sq m of supply. Net take-up decreased 22% in the first three quarters of 2016, compared to the same period last year. New supply and sluggish demand pushed up vacancy rates in core areas by 1.7 ppts QoQ to 9.1%. Influenced by some projects which received steady occupancy, especially in Pudong's non-prime area, Grade A office rents in core markets increased slightly, by 0.5% to RMB8.77 per sq m per day. Decentralised markets saw 68,000 sq m handed over. Vacancy rates fell by 7.2 ppts to 23.1% as 205,000 sq m was taken up in the market. Rents increased by 0.3% QoQ to RMB5.5 per sq m per day during the same period.

Investor sentiment

Institutional buyers still place a focus on high-quality office properties located in downtown areas. At the same time, investors will keep an eye on opportunities to convert older office buildings with clear property rights into residential or serviced apartments, which may achieve higher returns through strata-title sale.

Deals

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

- Guohua Life Insurance bought SOHO Century Avenue from SOHO China for RMB3.2 billion. The company is expected designate part of the building as self-use.

- Shanghai Life Insurance purchased a 49% stake in Standard Chartered Bank Tower for RMB1.25 billion. The office building is located in the Little Lujiazui Financial District and has an above-ground GFA of 38,520 sq m.

- Sino-Ocean Land acquired the Wiselogic International Centre through a non-performing assets auction for

TABLE 1
Yields and capital values by sector, Q3/2016

| | 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.

→ RMB829 million, with a unit price of RMB26,407 per sq m. The building is located in the Jing'an district next to the Yan'an Elevated Highway and was previously sold partially through strata-sales.

- Glodon bought one building of the Hongqiao Zhenrong Centre for self-use, with an average unit price of RMB34,838 per sq m.

Retail market

Market fundamentals

Three retail projects held soft openings in Q3/2016, adding a total retail GFA of 214,000 sq m to the market. In prime areas, vacancy rates increased by 0.7 of a ppt to 6.9%, while in non-prime areas they decreased by 0.4 of a ppt to 9.1%.

First-floor shopping mall rents in prime retail areas increased by 0.3% QoQ to an average of RMB50.2 per sq m per day. Non-prime areas recorded an increase of 0.1% QoQ to RMB16.9 per sq m per day.

Investor sentiment

While the retail market continues to come under pressure, international investors with ample experience in managing shopping malls seek opportunities to take over retail properties. They see this as a market where competition is less forthcoming from the domestic money. Platform and portfolio purchases, or equity injections into local operators, are currently the preferred investment vehicle.

Deals

Chongbang acquired the balance of the 80% stake of Jinqiao Life Hub for RMB3.4 billion from a JV between Keppel Land Ltd and Alpha Investment Partners. The stake was previously purchased from Morgan Stanley for RMB2.6 billion in 2013. Keppel purchased Haoshi Plaza in May, from Mitsui Real Estate and Marubeni Investment, for RMB500 million.

Hotel market

Market fundamentals

Despite being stigmatised as one of the most challenging real estate sectors in China, the hotel markets in first- and second-tier cities have seen a steady pick-up in occupancy rates. Average daily rates (ADRs) reached the highest levels since peaking during the World Expo in 2010, possibly due to the opening of the Shanghai Disney Resort. Shanghai's five-star market ended June 2016 with ADRs of RMB971 and an average occupancy rate of 72.9%,

while the four-star market stood at RMB529 and 71.7%. Mid-level hotels appealing to leisure and family travellers continue to attract more demand than luxury hotels targeting business travellers.

Investor sentiment

Purchases of hotels have risen for the purpose of converting them into other asset classes. However, as developers look to rationalise portfolios, specialised investors are looking for opportunities to pick up hotel property portfolios at a steep discount.

Deals

Pamfleet bought 70% of Starway Parkview South Station from Deson Development International for RMB57 million. It plans to convert the building into a co-living community with 80 units.

Residential market

Market fundamentals

The residential sales market remained strong in the third quarter, especially the luxury apartment market. First-hand, high-end apartment transaction volumes totalled 330,600 sq m, up 78.5% QoQ.

Vacancy rates increased across the board in the residential leasing market. Serviced apartments saw the greatest rise in vacancy rates, at 3.3 ppts QoQ, which pushed average rents for this segment down by 0.6% to RMB229.3 per sq m per month.

Investor sentiment

With a limited number of serviced apartment properties available in the market, investors will keep an eye on the opportunities to convert older office buildings into residential or serviced apartments.

Deals

- 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. The property is located along the Huangpu River, just to the south of Little Lujiazui.

Logistics market

Market fundamentals

Strong demand from third-party logistics providers (3PLs), e-commerce and retail companies continues to drive demand and

expectations in the logistics sector. Government support for cross-border e-commerce is expected to help improve this sector further. In July, China Logistics Property Holdings successfully listed on the main board of the Hong Kong Stock Exchange, raising approximately USD460 million.

Investor sentiment

The market is dominated by a handful of players who are responsible for most investment cases. These players typically look for acquisitions of individual assets and development sites, or equity injections into platforms.

Deals

Kerry Properties bought an 18.9% stake in Shanghai Krupp Stainless Co. Ltd., which owns an industrial site with 20 buildings in Houtan with an aggregated GFA of 412,000 sq m. Kerry Properties made the RMB2.4 billion purchase with the plan to convert the land into mixed-use commercial and residential usage, pending approval from the municipal government.

Land market

Total land sale considerations reached RMB69.8 billion in Q3/2016, up 96% YoY. Commodity residential and commercial sectors accounted for 68% and 30% of total sales, respectively. Commercial and residential AVs averaged RMB13,847 per sq m and RMB45,689 per sq m, respectively.

Land supply improved in Q3/2016, with the total buildable GFA amounting to 5 million sq m, up 83% YoY. Nevertheless, a lack in supply of residential plots in downtown areas and ample liquidity drove Shanghai's dazzling land sale prices. In August, Rongxin Group purchased a residential land plot with a 10% commercial space allocation located in the Jing'an district for RMB11 billion, or RMB100,218 per sq m, a premium of 139%. The AV broke the national record for residential land transactions.

To share the risk and financial burden, developers are establishing JVs with one another to co-develop land plots after purchasing plots from the public land auction market.

- Jinmao China acquired the entire stake of Yulong Properties (禹隆房产) for RMB1.81 billion. Yulong Properties is a subsidiary of Future Land and owns a 49% stake in a residential plot in the Hongkou

TABLE 2
Key investment deals, Q3/2016

| | Upper Riverside 尚滨江 | SOHO Century Plaza SOHO世纪广场 | Wiselogic International Center 上海科恩国际中心 | 18.90% Houtan Land Plot (Krupp Stainless Co., Ltd.) 后滩地块 (上海克虏伯不锈钢公司) |
|----------------------------|---|---|--|---|
| |  |  |  |  |
| Location | 1288 Puming Road, Pudong | 288 Xiangcheng Road, Pudong | 66 North Shanxi Road, Jingan | 21 Tong Yao Road |
| Date | Jul, 2016 | Jul, 2016 | Jul, 2016 | Aug, 2016 |
| Property type | Serviced apartment (Commercial title) | Office | Office | Factory, industrial |
| Transacted price (RMB mil) | 1,400 | 3,221 | 829 | 2,414 |
| Above-ground GFA (sq m) | 19,307 | 42,522 | 31,393 | 412,000 |
| Vendor | Nan Fung International & Wing Tai Property | SOHO China | China HuaRong | Shanghai Krupp Stainless Co. Ltd |
| Purchaser | Jingrui Holdings | Guohua Life Insurance | Sino-Ocean Land | Kerry Properties |
| Transaction method | Equity | Asset | Asset | Equity |
| | 80% Jinqiao Life Hub 金桥国际商业广场80%股权 | Haoshi Plaza 好世商业广场 | 70% Starway Parkview South Station Hotel 上海星程天然居南站酒店70% 股权 | 49% SCB Tower 渣打银行大厦49%股权 |
| |  |  |  |  |
| Location | 3611, Zhangyang Road, Pudong | Kangfeng Road, Jiading | 218 Baise Road, Xuhui | 201 Central Avenue, Pudong |
| Date | Sep, 2016 | Sep, 2016 | Sep, 2016 | Jul, 2016 |
| Property type | Retail and Office | Retail | Hotel | Office |
| Transacted price (RMB mil) | 3,412 | 500 | 57.4 | 1,245 |
| Above-ground GFA (sq m) | 114,732 | 32,800 | 7,318 | 38,520 |
| Vendor | Keppel Land Ltd JV Alpha Investment Partners | Mitsui Real Estate and Marubeni | Deson Development International | Lujiazui Properties |
| Purchaser | Chongbang Group | Keppel Land China | Pamfleet | Shanghai Life |
| Transaction method | Equity | Equity | Equity | Equity |

Source: Savills Research

District. This land is zoned for residential use and has a total GFA of 54,889 sq m.

- Xiamen C&D Inc. reached an agreement with Jinmao China and Poly Property to develop a construction site jointly. Jinmao China and Poly Property will each pay RMB446 million, taking a 29.73% share of the project each. The land zoned for residential usage was acquired by Xiamen C&D in June

2016, with a total GFA of 138,597 sq m.

Market news

Property capital raising

A number of funds either launched or closed their Asia Pacific real estate investment funds with China allocations in Q3/2016.

- PAG reached a further closing of its new Pan Asia property fund – PAG Real Estate Partners Fund (PREP) –

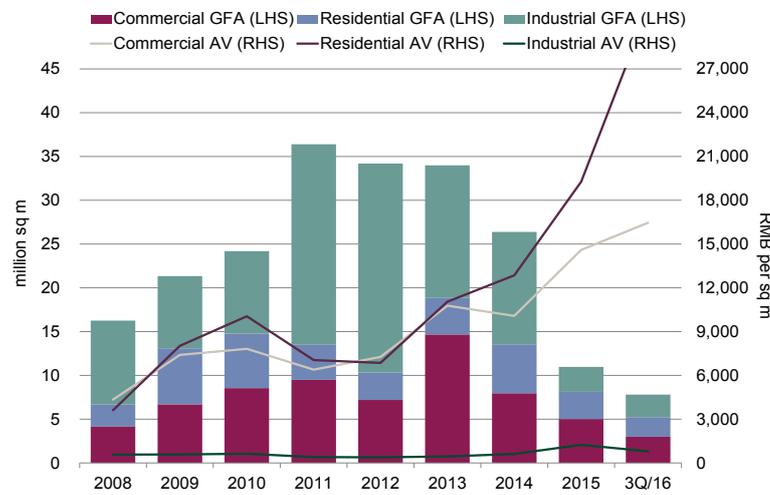
bringing the investment vehicle up to US\$1.3 billion. The closed-end fund will focus on acquiring core-plus assets in nine gateway cities, including China, Hong Kong, Japan and Australia. Nearly 50% of the fund has been deployed, with the vehicle having acquired a major property portfolio from GE Japan in 2015.

- Keppel Capital raised US\$280 million in the first close of its Alpha Asia Macro Trends Fund (AAMTF) III. Keppel is targetting US\$1 billion and will invest the capital in retail and accommodation-related assets that ride on existing trends in Asia, such as consumerism, urbanism, and aging populations. Beyond Singapore, the fund's target markets include China, Vietnam, Japan and South Korea.

- Oceanwide Holdings announced plans to establish a real estate fund named Yuhong Fund (御泓基金). The fund plans to raise RMB1 billion for the purchase and renovation of garden houses and old residential blocks in downtown Shanghai. The holding period is said to be seven years.

- China Redstar and Go High Capital established a joint real estate fund, with a plan to raise RMB5 billion. Both contributed 10% to 15% for the first round of the fund. The fund will be used to invest in retail properties

FIGURE 2 **Land transaction area and AVs, 2008–3Q/2016**



Source: Savills Research

TABLE 3 **Key land deals, Q3/2016**

| Plot | District | Use | GFA (sq m) | Consideration (RMB million) | AV (RMB per sq m) | Buyer |
|-----------------------------|-----------------|----------------------|------------|-----------------------------|-------------------|----------------------------|
| Zhongxin 332-01-a, 333-01-a | Jing'an | Residential & Retail | 109,861 | 11,010 | 100,218 | Rongxin Group |
| Liangcheng 073-06 | Hongkou | Residential | 54,889 | 3,700 | 67,409 | Future Land |
| Gucun 06-01 | Baoshan | Residential | 126,379 | 6,790 | 53,727 | C&D Inc. & COFCO |
| Xinjiangwan a4-01(b3) | Yangpu | Residential | 59,709 | 3,155 | 52,840 | Rongxin Group |
| Pingliang 01c2-02 | Yangpu | Commercial | 19,905 | 967 | 48,582 | Yangpu Venture |
| Xujin 08-04 | Qingpu | Residential | 13,313 | 600 | 45,070 | SCE Property |
| Fangsong b06-06 | Songjiang | Residential | 121,184 | 4,735 | 39,073 | KWG Property |
| Zhuqiao g-10 | Pudong New Area | Residential | 266,480 | 8,800 | 33,023 | Gemdale |
| Xujin 25-01 | Qingpu | Residential & Retail | 50,237 | 2,106 | 41,921 | SCE Property |
| Yingpu 02-01 | Qingpu | Residential | 30,172 | 970 | 32,149 | China Gezhouba Real Estate |

Source: Savills Research

in first- and second-tier Chinese cities.

- LaSalle investment Management is on the fundraising trail for its LaSalle Asia Opportunity V and is targeting a first close of approximately US\$300- US\$400 million by October. The firm also closed the acquisition of the fund's first seed asset in early August. The asset is a retail property in between Osaka City and the international airport. LaSalle Opportunity Fund V will invest in assets with a repositioning and redevelopment potential. The target investment markets include Japan, Australia, China, Singapore and Hong Kong.

- Gaw Capital Partners has raised US\$150 million in an initial capital raise for its first Asian hotels investment fund. The fund is expected to reach US\$250 million with capital raised from as many as five investors. The fund will target hotel properties and has already made its first investment in Singapore. Once fully deployed, the vehicle is expected to hold between seven and ten assets.

China's state-owned enterprises speed up integration

China's state-owned enterprises are speeding up efforts to integrate businesses and resources. The integration effort will enable state-owned enterprises to focus on their core businesses and improve the

performance of their balance sheet. AVIC is expected to transfer its real estate business of approximately 70 projects to the Poly Real Estate Group, totalling around RMB2.3 billion. Early this March, CITIC transferred properties in 25 cities with a total GFA of 2.4 million sq m worth RMB 31 billion to COLI.

Offshore acquisitions remain heated

To mitigate the risks of further RMB depreciations and uncertainties in market policies, domestic investors are increasingly seeking opportunities offshore. Several landmark deals in the third quarter included the purchase of a 42-acre life science complex in California, U.S. by Greenland, Ping An Trust, Agile Group Holdings and Poly Sino Capital Limited for over US\$1 billion. Aqualand also purchased an office building in Sydney, Australia for US\$105.5 million, and Vanke acquired Ryder Court, an office complex, in London, UK for US\$154 million.

Outlook

The investment market is expected to remain active over the coming year as larger players with access to more credit continue to acquire smaller entities for their underlying assets. At the same time, new pools of capital continue to emerge, seeking yield-generating opportunities with the potential for capital value appreciation.

International funds are increasingly sensitive to currency movements and the general market environment when making investments in China. Downtown office assets will remain a top choice thanks to the depth and liquidity of the market, as well as the ease of management and market transparency. A number of office deals are in the offing but have not yet been confirmed or publicly announced.

From September 2016, the China Insurance Regulatory Commission has allowed Chinese mainland insurance companies to invest in Hong Kong shares through a stock link programme. Insurers have to launch wealth management products to make portfolio investments via the Shanghai-Hong Kong Stock Connect. The new access to the Hong Kong market will help China mainland insurance companies improve asset structures, minimise risk and increase returns.

The total land area allocated for construction is to be limited to 3,200 sq km by 2040. By 2014, the city's construction land area had already reached 3,124 sq km. This means that construction land can increase by 76 sq km in the next 26 years or by just 2.9 sq km per year. In 2040, construction land will account for 50.5% of Shanghai's 6,340.5 sq km total land area. ■

Please contact us for further information

Research



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

Agency



Albert Lau
 Chief Executive Officer of Savills China
 +8621 6391 6688
 albert.lau@savills.com.cn



Steve Chen
 Deputy managing director, Shanghai
 +8621 6391 6688
 steve.chen@savills.com.cn

Savills plc

Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 700 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.

This report is for general informative purposes only. It may not be published, reproduced or quoted in part or in whole, nor may it be used as a basis for any contract, prospectus, agreement or other document without prior consent. Whilst every effort has been made to ensure its accuracy, Savills accepts no liability whatsoever for any direct or consequential loss arising from its use. The content is strictly copyright and reproduction of the whole or part of it in any form is prohibited without written permission from Savills Research.