savills
第一太平戴维斯

Savills World Research
Shanghai

Briefing
Investment

February 2017

Image: Nanjing Road

SUMMARY

The Shanghai investment market recorded a very robust year in 2016, as a number of large deals closed in the final quarter.

- Fourteen key deals were concluded in Q4/2016, for a total consideration of RMB44.4 billion, accounting for 62% of the total consideration in 2016.
- Office properties drew the most attention in 2016, accounting for 62% of the total consideration, of which approximately 32% are expected to be purchases by self-users.
- Domestic investors remain the major players in the investment market, accounting for 58% of the total sales consideration in 2016. This number is expected to increase as new sources of domestic capital enter the market in 2017.
- Rising prices of Grade A office assets continue to compress gross yields, which fell by 0.2 of a percentage point (ppt) quarter-on-quarter (QoQ) to 5.0%.

"As policies regarding land bidding and bond issuance continue to tighten, the value of land is expected to deflate, putting downward pressure on property values." James Macdonald, Savills Research

Market commentary

The city's investment market had an active year in 2016, with 35 key sales transactions concluded for a total consideration of RMB72.1 billion, up 34% year-on-year (YoY). The largest deal was the sale of Century Link by Cheung Kong to ARA for approximately RMB20 billion. It is rumoured that China Life provided the capital behind the deal.

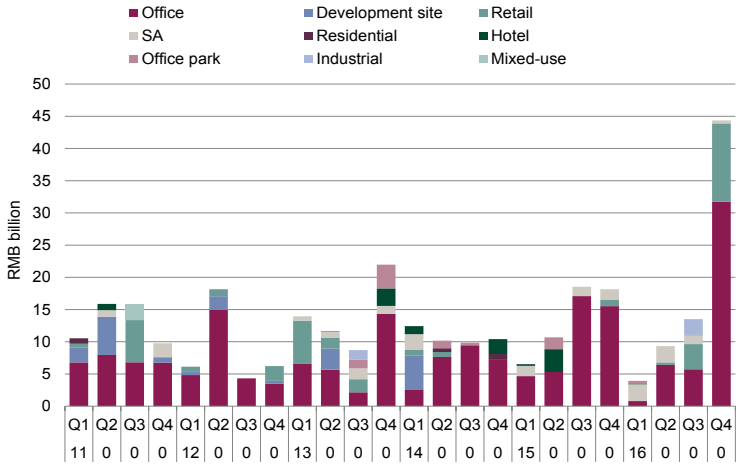
Given the large volumes of capital in the market, combined with limited investment options, the office market, with its relatively good liquidity and transparency, continued to attract the majority of investors. Investments in office assets totalled RMB44.7 billion in 2016, accounting for 62% of the total consideration. End-user purchases are believed to account for nearly one-third of all office investments, with the majority located in emerging business areas such as the Hongqiao Transportation Hub (HTH) and North Bund due to an abundance of supply, enabling companies to find buildings that better meet their specific corporate requirements. For example, State Development & Investment Corporation purchased Star Bund T1 for RMB5.3 billion, while Anhui High speed railway acquired Poly Greenland Plaza Tower A2, located in the Yangpu District, for RMB2.3 billion. Both investments are believed to be for at least partial self-use.

International investors remained bearish due to concerns of further RMB depreciations, high volumes of future supply and slowing economic growth. However, some remain interested in retail assets, which are typically not chased as fiercely by domestic money. International investors aim to leverage their property management capabilities or invest alongside a highly experienced partner to add value on their investments. Chongbang acquired an 80% stake of Jinqiao Life Hub for RMB3.4 billion from a JV between Keppel Land Ltd and Alpha Investment Partners in the third quarter. CSI Properties Limited acquired Rich Gate (Retail podium) for RMB1.35 billion, with an intention to renovate and upgrade the basement level.

In order to control liquidity, the government issued new standards regarding bond issuance. The effect has been felt strongest among small- and mid-sized property developers, with several having already had bond-raising applications rejected. The new regulations prohibit a form of cheap financing used in China to rekindle growth in real estate investment after the market soured in 2014, and are expected to consolidate the market further. At the same time, new policies controlling capital outflows came into effect, such as the restriction of overseas real estate investments in excess of US$1 billion by SOEs, which is expected to direct more investment to the local market.

GRAPH 1

Shanghai large-scale real estate acquisitions, Q1/2011–Q4/2016



Source: Savills Research

Sectors and deals

Fourteen key deals were concluded in Q4/2016, for a total consideration of RMB44.4 billion, up 206% QoQ. Total value of en-bloc transactions in 2016 reached RMB72.1 billion, up 34% YoY.

Office market

Market fundamentals

HKRI Taikoo Hui T1 launched onto the core office market in Q4/2016, adding 95,000 sq m of supply. Annual supply for 2016 totalled 680,000 sq m, remaining flat compared to the previous year, as a number of projects delayed their handovers. Annual net take-up of 2016 totalled 460,000 sq m, lower than last year but on a par with 2014. Vacancy rates in core areas

TABLE 1

Yields and capital values by sector*, Q4/2016

	Grade A Office	Prime shopping mall	Prime retail street store	High-end serviced apartments	High-end strata apartments	5 star hotel	Logistics
Gross reversionary	4.0-5.3%	6.0-7.0%	4.0-5.0%	4.0-5.0%	2.5-3.0%	6.5-8.0%	6.7-7.2%
NOI	3.0-4.0%	3.0-3.5%	2.0-3.5%	2.2-2.8%	2.0-2.5%	1.5-2.0%	6.0-6.5%
Approx. values (RMB per sq m)	50-90,000	60-100,000	150–250,000	55-70,000	100-200,000	40-50,000	6-8,000

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 an Aboveground GFA basis – retail assets will have higher capital values for lower floors.

decreased by 0.6 of a ppt to 8.5%, up 2.4 ppts YoY. Pudong submarkets and prime projects recorded rental growth, which pulled up core market rents by 1.1% QoQ to RMB8.9 per sq m per day.

No new projects entered the decentralised markets in Q4/2016. Vacancy rates fell by 0.5 of a ppt to 22.8%. Rents increased by 2% QoQ to RMB5.5 per sq m per day during the same period, due to high occupancy rates achieved in some projects.

Investor sentiment
Institutional buyers still place a focus on high-quality office properties located in core business areas, because of their resilience to the stagnation of rental growth. End-users or partial end-users remain the main buyers of projects in decentralised locations. Even though interest in added value opportunities remains in the market, few transactions were closed, due to the limited number of such projects available.

Deals
Nine key deals were concluded in the office market in the fourth quarter:
- Cheung Kong Property sold Century Link for RMB20 billion, the largest transaction in 2016. Century Link is a newly-completed, premium-grade integrated commercial property, with an above-ground retail GFA of 90,000 sq m and an office GFA of 130,000 sq m.

- State Development & Investment Corporation acquired Star Bund T1 from China Jinmao for RMB5.3 billion, with a unit price of RMB80,121 per sq m. The company plans to use the building as its second headquarters in China.

- Jiaxing Shengshi Shenzhou, a JV funded by Central China Securities and four other companies, one of which is a subsidiary of Fosun, purchased a 50% stake of BFC for RMB5.3 billion. BFC is an integrated, mixed-use real estate complex, including an office GFA of 190,000 sq m, a retail GFA of 96,000 sq m, and a 4,000 sq m theatre. Fosun still holds the other 50% stake in the project.

- V-Capital purchased Central Plaza from Carlyle for RMB2.4 billion. Central Plaza is a mixed-use project comprised of a 19-floor office building and a three-floor shopping mall, as well as two floors of underground parking space. Carlyle acquired the project from Forterra for RMB1.7 billion in 2012.

- Anhui High Speed Railway bought Poly Greenland Plaza A2 building for RMB2.3 billion from Poly and Greenland with a plan for self-use.

- Red Star Macalline Group acquired two buildings in Hongqiao R&F Center from R&F Properties for RMB2.1 billion, with a plan for self-use.

- Vanke bought A-REIT City from A-REIT for RMB1.1 billion, with a unit price of RMB22,246 per sq m. A-REIT City is a business park located in Jinqiao, and was purchased from Qingjian Int'l (South Pacific) Group by A-REIT with a unit price of approximately RMB11,900 per sq m in 2013.

- China Science & Merchants Investment Management Group purchased JT-Plaza from Xifu Group for RMB660 million in the form of an onshore asset deal. JT Plaza is located on Guoan Road in the Yangpu District.

- Tianli Holdings acquired The Konnect, the former three-star Laurel Hotel, from KaiLong REI for approximately RMB520 million. KaiLong REI bought the building in 2015 for approximately RMB260 million, and converted the 11,000 sq m, 12-storey building into a boutique office. It then leased 10,000 sq m to the world's largest co-working space operator, WeWork.

Retail market
Market fundamentals
Eight retail projects launched in Q4/2016, adding a total retail GFA of 691,120 sq m to the market. Vacancy rates increased by 1.7 ppts YoY in prime areas to 6.6 %, and 0.3 ppt YoY in non-prime areas to 9.8%, in Q4/2016.

First-floor shopping mall rents in prime retail areas increased by 1.1% YoY to an average of RMB49.2 per sq m per day, while non-prime areas increased by 0.5% YoY to RMB16.2 per sq m per day.

Looking forward, 2017 will be another record year for supply, with several large-scale projects to be launched onto the market. The refurbishment of several landmark projects in prime areas will slightly increase vacancy rates, while city-wide rental growth, if any, is expected to remain weak in 2017.

Investor sentiment
While the retail market continues to come under pressure, international investors with ample experience in managing shopping malls are seeking opportunities to acquire retail properties or invest alongside highly-experienced local partners. With less domestic capital chasing retail investment projects, some overseas investors believe that there are better deals to be found. Platform and portfolio purchases, or equity injections into local operators, are currently the preferred investment vehicle.

Deals
Three key deals were concluded in the retail market in Q4/2016:

- Joy City Property Limited purchased Parkside Plaza from Grosvenor Vega for RMB2.2 billion, with a unit price of RMB24,719 RMB per sq m. Parkside Plaza is located on Daduhe Road in the Putuo District, near Changfeng Park, and holds the first Lego Land in Shanghai. Joy City recently sold a 49% stake in six mixed-use projects across China to an investment fund, to be controlled by GIC and China Life, for RMB9.3 billion.

- CSI Properties Limited purchased Rich Gate (Retail podium) from Carlyle for RMB1.35 billion. Carlyle purchased the project from Shanghai Real Estate in 2012 for RMB1.16 billion. After the purchase, CSI Properties Limited announced plans to renovate the basement level of the project to lease out alongside above-ground floors.

- Blackstone purchased Xuebao Mall located on Huaihai Middle Road for RMB610 million, with a plan to convert most of the space into offices.

Hotel market

Market fundamentals

The hotel market in first- and second-tier cities remains one of the most challenging real estate sectors in China. However, In spite of this, Shanghai's hotel market recorded stable growth with a RevPar (Revenue Per Available Room) of RMB664 for five-star hotels, up 5.4% YoY, and RMB348 for four-star hotels, up 3.3% YoY, in December 2016. The increase in RevPar (Revenue Per Available Room) in both markets contributed to the increase of both ADR (Average Daily Rate) and occupancy levels. Mid-level hotels appealing to leisure and family travellers continue to attract more demand than luxury hotels targeting business travellers.

Investor sentiment

The purchases of hotels for the purpose of converting them into other asset classes has led to an increase in hotel sales. However, there are very few projects that meet such investment requirements available in the market. At the same time, domestic developers are seeking opportunities to rebrand and revitalise hotel portfolios.

Residential market

Market fundamentals

The residential sales market has been affected by new policies aimed at tightening Shanghai's housing market. First-hand commodity residential transaction volumes dropped 49.8% in Q4/2016, to 2.1 million sq m. As a result of limited supply, average transaction prices increased 5.4% QoQ to a new high of RMB43,700 per sq m in the fourth quarter.

Vacancy rates increased slightly across the board in the residential leasing market. Serviced apartment vacancy rates increased 0.8 of a ppt QoQ to 11.2%, which pushed average rents for this segment down by 0.5% QoQ to RMB230.6 per sq m.

Investor sentiment

Although investors remain interested in serviced apartment properties, there remains a limited number of opportunities available. Investors will continue to search for opportunities to convert older office buildings into residential or serviced apartments.

Deals

- Lang Xin Investment, a JV of Landsea and CITIC Capital, acquired Huiyin Mingzun from Landsea for RMB471 million, with a plan to upgrade the project. Landsea purchased the project from Yunnan Jingdian for RMB414 million in March, 2016.

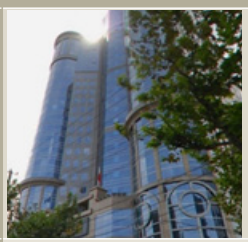
Logistics market

Market fundamentals

Strong demand from third-party

TABLE 2

Key investment deals, Q4/2016

	Central Plaza 中区广场	Century Link 世纪汇广场	The Konnect 朗润商务中心	Parkside Plaza 长风景畔广场	Star Bund T1 星外滩1号楼
					
Location	227 Huangpi Road (N), Huangpu	179 Weifang Road, Pudong	118 Yunnan South Road, Huangpu	196 Daduhe Road, Putuo	170 Huoshan Road, Hongkou
Date	Oct, 2016	Oct, 2016	Nov, 2016	Nov, 2016	Dec, 2016
Property type	Office/ Retail	Office/ Retail	Office	Retail	Office
Transacted price (RMB mil)	2,414	20,000	520	2,200	5,288
Above-ground GFA (sq m)	40,227	220,000	10,127	89,000	66,000
Vendor	Carlyle	Cheung Kong Property Holdings Limited	KaiLong REI	Grosvenor Vega	China Jinmao
Purchaser	V-Capital	ARA Fund Management Limited	Tianli Holdings	Joy City Property Limited	State Development & Investment Corporation
Deal Structure	Offshore equity	Offshore equity	Offshore equity	Onshore equity	Onshore Asset

Source: Savills Research

logistics providers (3PLs), e-commerce and retail companies continues to drive demand in the logistics sector. Government support for cross-border e-commerce is expected to help improve this sector further. Platform and portfolio purchases are preferred investment vehicles.

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

There was no logistics deals recorded in Q4/2016. However, there was much speculation regarding the potential sale of GLP, the largest landlord of premium logistics assets in China.

Land market[1]

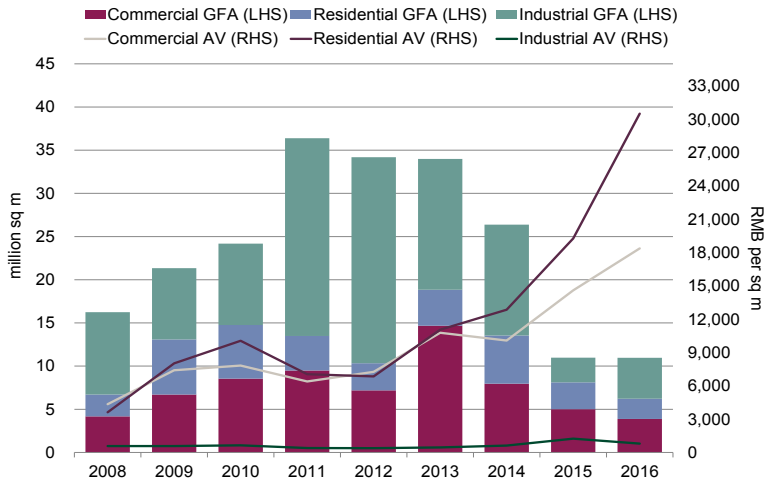
Total land sale consideration reached RMB139 billion in 2016, down 1% YoY. Commodity residential and commercial sectors accounted for 51% and 46% of total sales, respectively, in 2016. Commercial and residential accommodation values (AVs) averaged RMB16,833 per sq m and RMB32,917 per sq m, respectively. Stricter land controls in Q4/2016 helped prevent total buildable GFA from exceeding 11.8 million sq m, up only 0.8% YoY. Two residential-titled land plots in the Fengxian District were the only two auctioned in the fourth quarter, with the AVs averaging only RMB8,531 per sq m.

New rules imposed on land auctions last quarter aim to bring more stability to the market after the sudden rise in asset prices witnessed in the first three quarters. The Shanghai Stock Exchange issued regulations in October forbidding real estate companies from bidding on land plots with the capital raised from issuing bonds. In addition, Shanghai Authority released rules restricting insurance companies from participating in land auctions.

[1] Land sales exclude public and economic housing

FIGURE 2

Land transaction area and AVs, 2008–2016



Source: Savills Research

Market news

Property capital raising

A number of funds either launched or closed their Asia Pacific real estate investment funds with China allocations in Q4/2016.

- D&J Industrial Property (China) Investment Limited, a Shanghai-headquartered firm co-founded by Warburg Pincus, has set up an RMB10 billion industrial real estate fund. The equity raised via D&J Zhiyan Equity Investment Fund will be mainly invested in modern integrated industrial parks in first-tier and select lower-tier cities in China. AVIC Trust also contributed to the fund.

- Angelo Gordon closed fundraising for its AG Asia Realty Fund III, its third Asia opportunistic real estate vehicle, raising approximately $850 million in equity. The capital raised via this vehicle is to be invested in value-add turnaround and development opportunities with a focus on Japan, South Korea, Hong Kong and China. At present, approximately 25 to 30% of the capital has been invested into a total of ten investments in these markets.

- CapitaLand closed its third China-focused development real estate fund, the Raffles City China

TABLE 3

Key land deals, Q4/2016

Plot	District	Use	GFA (sq m)	Consideration (RMB million)	AV (RMB per sq m)	Buyer
Tilanqiao hk322-01	Hongkou	Commercial	56,585	2,555	45,153	Nanjing Fu Mao Real Estate Co., Ltd.
North Sichuan Road hk226-06	Hongkou	Commercial	35,742	1,335	37,351	Shanghai Hong Fang Real Estate Co., Ltd.
Changfeng No10	Putuo	Commercial	195,194	4,410	22,593	YIHE Investment

Source: Savills Research

Investment Partners (RCCIP) III, at $1.5 billion. RCCIP III will be invested in prime integrated developments in China's gateway cities. The vehicle will have a life of eight years.

- Blackstone is said to be planning to raise at least $5 billion for a new Pan-Asia Real Estate fund in the next 12-16 months. The new fund would boost Blackstone's existing bets on warehouses and shopping malls within China, India, Southeast Asia and Australia.

China opens elderly care service market
The State Council published a circular regarding the elderly care service market, introducing private capital and innovating services to benefit a large population of elderly people. The circular helped lower the entry costs by simplifying registration procedures for elderly care institutions, encouraging foreign investment, and putting in place a market pricing mechanism. In October 2016, Temasek entered a half-half JV with Columbia Pacific Management which owns two multi-specialty clinics and three senior living facilities in Shanghai and Beijing.

Co-working market remains popular
Co-working operators and projects continue to attract interest from investors as a supplement to traditional offices. Shanghai Jin Jiang International Hotels invested US$260 million in WeWork in October. Gaw Capital invested US$15M in Naked Hub and Singapore's City Developments Ltd. acquired a 24% stake in Distrii, which already operates nine co-working centres across Shanghai, for US$14.8 million. In December 2016, CapitaLand announced a partnership with Beijing-based shared office provider URWork to provide space for new URWork co-working centres in CapitaLand malls in China.

Outlook

The investment market is expected to remain active over the coming year as the government has issued increasingly tight capital outflow controls, which is likely to lead to more investment focus on the local market. Among property categories, office projects offering mid- to long-term holdings located in centralised areas will continue to draw most of the attention from investors.

Faced with growing financial uncertainty over the next 12 months, some developers and owners are expected to dispose of previously acquired land plots or establish JVs with one another to co-develop land plots in order to spread their risks.

Alternative asset classes, while still a niche, will see their share of total investment increase as investors move up the risk curve in search of higher-yielding opportunities. More platform investments into local experienced operators and owners are expected to occur in the future.

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.