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Savills World Research
Shanghai

Briefing
Investment

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Image: North Bund

SUMMARY

Shimao Property Holdings and Starwood Capital Group announced a US$200 million Joint Venture.

- Ten key deals were concluded in Q1/2017, for a total consideration of RMB13.6 billion, similar to the average quarterly consideration of the past two years.
- Office properties remained the most popular asset type this quarter, accounting for 88% of the total sales consideration, of which 32% were planned for at least partial self-use.
- Domestic buyers remained the most active, representing 69% of total transactions, while international investors continued to focus on value-added opportunities for office properties in centralised locations.
- 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 4.8%.

"The market saw a growing interest in the residential leasing market from both developers and investors, given the decrease in serviced apartment stocks and government controls on residential sales." James Macdonald, Savills Research

Market commentary

The year began strongly, with ten sizeable deals concluded for a total consideration of RMB13.6 billion in Q1/2017, similar to the average quarterly consideration of the past two years.

Softening market fundamentals as a result of ample new supply and slowing economic growth forced investors to search for long-term investments. Demand remains driven by domestic investors and end-users bidding on headquarter locations. Domestic investors remained active in bidding for core assets this quarter, such as the Zhong Rong Trust which acquired Silver Court for RMB3.5 billion. Among end-users, notable deals included Jiangsu Yancheng Investment acquisitions of Poly Greenland Square B1 and C1-C2 buildings for RMB1.6 billion. As regulation for outbound investments grows tighter, more capital is expected to focus on the local market, pushing values higher and yields lower.

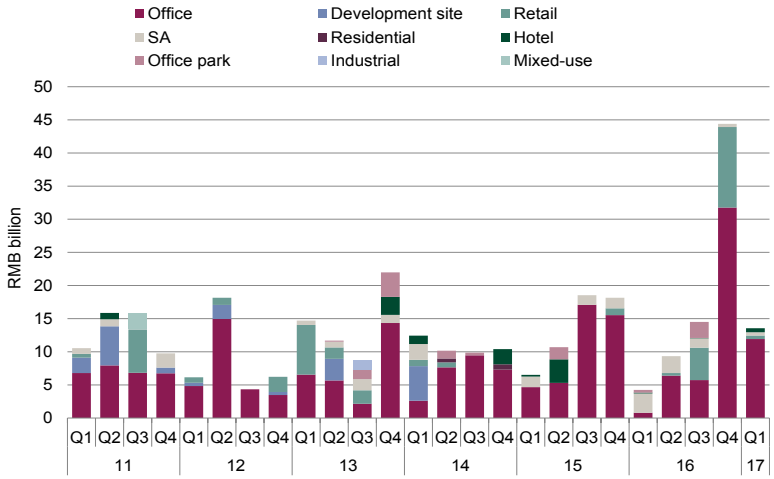
International funds continue to keep a close eye on currency movements as they make selective investments that play to their strengths, with an increasing focus on value-added opportunities. Both BlackRock's purchase of Central Park Tower and Ascendas-Singbridge Group's purchase of the Baolong building fit in this category.

With residential rents expected to continue to increase while a new round of restrictions impact the sales market, the residential leasing market has seen a growing interest from developers and investors. Many investors have been looking for opportunities to purchase and convert old office buildings and hotels into residential units. In this quarter, Nova Property Investment acquired Graceland International Hotel, with the intent to convert the hotel into high-end apartments. Landsea also purchased the Huangxing Building, aiming at converting it into mid-to low-end apartments. However, commercial-to-residential property conversions do present their own set of risks. In some districts, such as Minhang and Jiading, the authorities delivered an ultimatum to developers in February, to tear down apartment partitions and restore original office contours.

The Chinese government introduced both policies welcoming foreign capital and controlling capital outflows this quarter. China moved to globalise its US$9 trillion domestic bond market and allowed foreigners purchasing onshore bonds to hedge currency risks through derivatives trading. The government is expected to further encourage overseas institutions to issue onshore bonds and invest in the domestic market, as well as lower restrictions on foreign investment in banking, securities, investment management, futures, insurance, and some other sectors. Meanwhile, China continues to enforce stricter oversight on companies and individuals looking to move money overseas. The effects of these policies are likely to lead to an increase of onshore capital.

GRAPH 1

Shanghai large-scale real estate acquisitions, Q1/2011–Q1/2017



Source: Savills Research

TABLE 1

Yields and capital values by sector*, Q1/2017

	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%	3.0-4.0%	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.

Sectors and deals

Ten sizeable deals were concluded in Q1/2017, for a total consideration of RMB13.6 billion, on par with the city's average quarterly transaction value over the past two years.

Office market

Market fundamentals

Six projects launched onto the core office market in Q1/2017, adding 380,000 sq m of supply and pushing total core market stock to 7.42 million sq m. Net take-up in core areas totalled 307,000 sq m in the quarter, almost triple that of Q4/2016, driven by strong demand in prime Pudong and the handover of a self-use project.

New supply pushed up the vacancy rates in core areas by 0.6 of a percentage point (ppt) quarter-on-quarter (QoQ), to 9.0%. Supported by rental growth in Pudong, the average core market rent increased by 0.3% QoQ to RMB8.97 per sq m per day, up 2.6% year-on-year (YoY).

Seven new projects launched onto the decentralised market in Q1/2017, adding 470,000 sq m of supply and pushing decentralised market stock to approximately 2.70 million sq m. Vacancy rates in decentralised areas increased by 0.6 of a ppt in Q1/2017, to 23.4%, while rents increased by 2.9% QoQ to RMB5.69 per sq m per day.

The rents of office projects, especially those in Puxi, will come under increasing downward pressure in 2017, as the market adjusts to new supply. The trend of decentralisation is expected to continue as new emerging business areas grow and mature.

Investor sentiment

Domestic buyers remain interested in core assets for long-term hold due to their resilience to rental depreciation. Meanwhile, international funds typically look for scarcer, value-added opportunities due to their shorter life cycle. End-users or partial end-users remain the main buyers of office projects in decentralised locations.

Deals

Eight key deals were concluded in the office market in the first quarter:

-Zhong Rong Trust acquired Silver Court from Mapletree Group for RMB3.5 billion. Mapletree purchased the project from Pacific Esplanade for RMB2.4 billion in 2011. Silver Court is a mixed-use project comprising serviced apartments (26,000 sq m), offices (10,000 sq m) and retail (20,000 sq m).

-The Xuhui Government acquired the Xuhui Vanke Centre Phase 2 for RMB2.7 billion, with a plan for at least partial self-use.

-BlackRock Group bought Central Park Tower from VSC (China) Property Limited for RMB1.4 billion. Central Park Tower is located in Changshou Road, Putuo, with a total GFA of 31,700 sq m.

-Jiangsu Yancheng Investment purchased Poly Greenland Square B1/C1-C2 from Poly & Greenland for RMB1.6 billion. B1 comprises an office building with a GFA of 20,500 sq m, which Jiangsu Yancheng Investment plans to occupy, at least partially. The C1 and C2 buildings comprise 6,500 sq m of retail space.

-Ascendas-Singbridge Group acquired the Baolong Building from AEW Capital Management for RMB1.3 billion, which they intend to renovate. AEW purchased the building from Blackstone for RMB940 million in 2015.

-CDL China Limited purchased Meidao Business Plaza from Shanghai Meidao Investment Co., for RMB900 million. Meidao Business Plaza is located along Lianyou Road in the Minhang district.

-Foresea Life Insurance acquired Hongqiao Green Valley from Shanghai Land (Group) for RMB724 million.

-Landsea purchased the Huangxing Building from CPIC for RMB312 million, with plans to convert the building into apartments for long-term lease. The Huangxing Building is located on Huangxing Road, Yangpu.

Retail market

Market fundamentals

No new retail supply launched in the first quarter of 2017. Vacancy rates decreased by 0.2 of a ppt QoQ to 6.3% in prime retail areas, and 0.5 of a ppt YoY to 9.3% in non-prime retail areas during the period.

First-floor prime shopping mall rents increased by 0.1% QoQ to an average of RMB49.3 per sq m per day, while non-prime rents increased by 0.3% QoQ to RMB16.3 per sq m per day.

1.6 million sq m of new supply is expected to launch in the next three quarters. In addition, the refurbishment of several landmark projects in prime areas will result in elevated vacancy rates, while city-wide rental growth, if any, is expected to remain weak in 2017.

Investor sentiment

A few international investors with experience managing shopping malls remain interested in acquiring retail properties in Shanghai; however, available projects remain limited. Platform and portfolio purchases, or equity injections into local operators, are currently the preferred investment vehicle.

Deals

No purely retail project was transacted this quarter.

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, despite this, Shanghai's hotel market recorded stable growth, with a RevPar (Revenue Per Available Room) of RMB705 for five-star hotels, up 4.7% YoY, and RMB366 for four-star hotels, up 0.2% YoY, in December 2016. This is attributed to an increase in occupancy rates and a decrease in Average Daily Revenue. Mid-level hotels appealing

to leisure and family travellers continue to attract more demand than luxury hotels targetting 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. In addition, investments in hotels for non-conversion purposes are mostly platform investments because the industry requires a high economy of scale and management expertise. For example, Shimao Property Holdings and Starwood Capital Group announced a US$200 million JV.

Deals

Nova Property Investment purchased Graceland International Hotel for RMB610 million, with plans to convert the hotel into for-lease residential units.

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 decreased 29.6% in Q1/2017, to 1.5 million sq m, the lowest level in five years. Yet average transaction prices increased 7.9% QoQ to a new high of RMB47,400 per sq m in the first quarter.

The traditionally quiet first quarter saw all three markets (serviced apartment, strata-title apartment and villa markets) record a decrease in vacancy rates. Average city-wide serviced apartment rents fell by 0.2% QoQ and 0.6% YoY, to RMB 230.0 per sq m. Meanwhile, strata-title market rents saw an increase of 1.0% QoQ to RMB 182.8 per sq m.

Investor sentiment

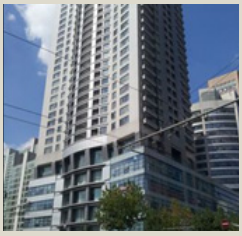
Although investors remain interested in serviced apartment properties, there remains a limited number of opportunities available for en-bloc sales. Investors will continue to search for opportunities to convert older office buildings into residential or serviced apartments. However, government restrictions on converting commercial and office properties into residential units generates risk for such investment.

Deals

CSC Group purchased Rainbow City-Hall of the Moon from Shui On Land for RMB498 million. The newly-built serviced apartment building is located

TABLE 2

Key investment deals, Q1/2017

	Silver Court 永银大厦	Xuhui Vanke Centre Phase2 徐汇万科中心2期	Poly Greenland Square B1/C1-C2 保利绿地广场B1/C1-C2	Rainbow City – Hall of the Moon 瑞虹新城服务式公寓	Graceland International Hotel 格澜国际大酒店
					
Location	218 North Xi Zang Road, Huangpu	55 Ding'an Road, Xuhui	368 Changyang Road, Yangpu	383 Ruihong Road, Hongkou	567 North Xi Zang Road, Huangpu
Date	Mar, 2017	Feb, 2017	Feb, 2017	Mar, 2017	Mar, 2017
Property type	Mixed-use	Office	Office/Retail	Serviced apartment	Hotel
Transacted price (RMB mil)	3,500	2,716	1,600	498	610
Above-ground GFA (sq m)	58,278	57,779	27,000	12,455	16,300
Vendor	Mapletree Group	Vanke	Poly & Greenland	Shui On Land	InfraRed NF
Purchaser	Zhong Rong Trust	Xuhui Government	Jiangsu Yancheng Inv	CSC Group	Nova Property Investment
Deal Structure	Offshore equity	Asset	Asset	Asset	Offshore equity

Source: Savills Research

near the Hongkou district's North Bund business area and includes 106 units.

Logistics market

Market fundamentals

Strong demand from third-party 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 the 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 platform equity injections. Many new investors who do not have on-the-ground leasing experience or resources usually seek safer income producing products, while major players account for the bulk of new development supply.

Deals

No logistics deals occurred in Q1/2017.

Land market[1]

The total land sales consideration reached RMB15.7 billion in Q1/2017, down 12% QoQ. Commodity residential[2] and commercial sectors accounted for 44.6% and 53.8% of total sales, respectively. Commercial and residential AVs averaged RMB18,859 per sq m and RMB13,916 per sq m, respectively.

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

All residential land transacted this quarter was located in suburban and outlying areas.

Prime Minister Li Keqiang said during a conference that cities under pressure from soaring home prices need to boost land supply. In response, the Beijing municipal government increased future land supply, though not at a level that is expected to be sufficient to rein in home prices. Shanghai is expected to follow Beijing by increasing its land supply as a method to curb residential property prices.

Market news

Property capital raising

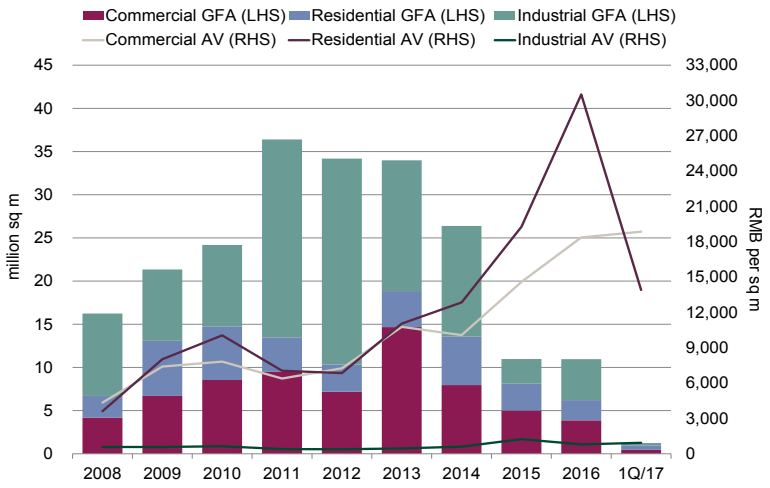
Several funds either launched or closed their Asia Pacific real estate investment funds with China allocations in Q1/2017.

- Gaw Capital reached US$1.3 billion in capital for the final close of its Gaw Capital Real Estate Fund V, which first launched in November 2015. The fund is a pan-Asian fund opportunity, and approximately 70% of the funds raised are likely to be directed at retail and office assets in China. Around US$300 million of the capital is said to have already been deployed.

- PAG has raised US$1.2 billion in capital for its recently established Secured Capital Real Estate Partners VI (SCREP VI) fund. The fund is expected to invest in some of Asia's largest real estate markets, including

FIGURE 2

Land transaction area and AVs, 2008–Q1/2017



Source: Savills Research

TABLE 3

Key land deals, Q1/2017

Plot	District	Use	GFA (sq m)	Consideration (RMB million)	AV (RMB per sq m)	Buyer
Huangpu River South extension, 188s-c-4, 188s-e-1	Xuhui	Commercial	89,571	2,330	26,013	Henderson
Shi Bei business park n070501	Jing'an	Commercial	43,841	1,060	24,178	Shi Bei
Luo Jin Zhen bsp0-1701	Baoshan	Commercial	100,556	2,360	23,469	Shi Mao

Source: Savills Research

Japan, China, South Korea and Australia.

Further consolidation and platform investment in the hotel industry
The hotel industry saw further consolidation this quarter. China Lodgings Holdings acquired Carlyle-backed Crystal Orange Hotels for RMB3.65 billion. Shimao Property Holdings and Starwood Capital Group announced a US$200 million JV. Vanke entered into a RMB2 billion JV with Banyan Tree Holdings, which operates 15 resorts on the mainland.

Outside the traditional hotel market, US room-sharing company Airbnb announced its own China expansion plan, having obtained US$100 from China Investment Corp.

China conducts securitisation of PPP projects
Chinese regulators approved several infrastructure projects funded by public-private- partnerships (PPP) to raise funds through securitisation, aiming to attract private investment to such projects. The approved projects include a RMB1.2 billion tunnel construction project. The securitisation of PPP-funded projects can help expand funding channels, lower financing costs and better attract private capital.

Outlook

The investment market is expected to remain active over the coming year, as the government has issued increasingly tight capital outflow controls, which are likely to direct more investment towards 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.

Diminishing returns in the buy-to-let and added-value markets are encouraging some investors and developers to explore opportunities in adaptive reuse schemes and niche sectors.

Please contact us for further information

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