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Savills World Research
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Briefing
Investment

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Image: Yangpu Binjiang

SUMMARY

Deleveraging is expected to remain the major priority for both the Chinese government and developers in 2018.

- 23 key deals were concluded in Q4/2017, for a total consideration of RMB36.9 billion, accounting for 36% of the total consideration in 2017.
- Office properties drew the most attention in 2017, accounting for 66% of the total consideration, of which approximately 13% were purchased for self-use.
- International players accounted for 31% of the total consideration. The restriction on outbound investment has increased competition in the mainland's investment market from domestic investors.
- Gross yields for Grade A office assets stayed stable at 4.8% in Q4/2017, while net yields were at around 3.4%.

"Yangpu District and fringe locations attracted a growing amount of investment interest in 2017, taking up 19% of the total consideration. Investors were attracted to the district by the perceived capital value growth potential." James Macdonald, Savills Research

Market commentary

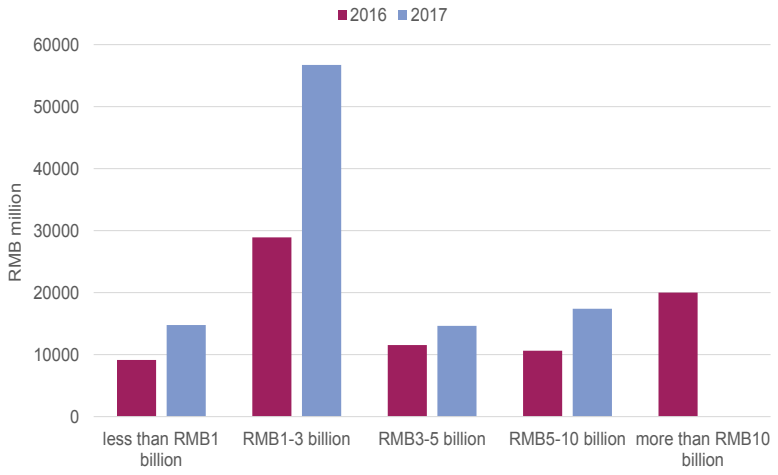
The city's investment market had an active year in 2017, with 66 key sales transactions concluded for a total consideration of RMB103.5 billion, up 29% YoY. Investors are chasing after value-added opportunities where yields for core-assets continue to fall.

While core office buildings in prime business areas are still targeted by local institutional buyers, both domestic and international investors are paying increasing interest to assets in non-prime and emerging areas. In 2017, office park transactions reached a total consideration of RMB9.8 billion, about one and half times the amount in 2016. More affordable transaction prices, coupled with greater room for value appreciation, provided opportunities for investors. Hongqiao Transportation Hub (HTH), North Bund, Wujiaochang, Yangpu and business park areas, such as Zhangjiang and Caohejing are popular investment destinations.

2017 saw investor interest in purchasing hotels with the intention to convert into rental housing units. Five hotel deals were concluded in 2017 for a total consideration of RMB5.1 billion, while only two hotel deals were concluded in 2016 for a total consideration of RMB186 million. Hotels with conversion potential are generally located in areas with easy access to public transportations. Graceland International Hotel, Shanghai Min Yue Hotel, Puxi New Century Hotel and Changfeng International Building all transacted in 2017, are considered in this category.

GRAPH 1

Shanghai Large-scale Real Estate Acquisitions Breakdown by Transaction Volume of Single Deal, 2016-2017



Source: Savills Research

2017 has been a hard year for developers in terms of financing. Onshore corporate bond issuance was on pace to drop in 2017 for the first time in four years. In addition, the National Development and Reform Commission eased the approval for offshore bond deals from 2H/2017 offshore bonds bear higher yields and are easier for big developers. In addition, Chinese real estate developers are currently paying the highest bond coupon in almost three years and are also facing a looming wall of debt repayments—both onshore and offshore—in the next four years, peaking in 2020. The financing challenge will inevitably pressure developers to review their business holdings and explore new means of financing, such as asset-backed securities (ABS) or quasi-REITs.

Sectors and Deals

23 key deals were concluded in Q4/2017, for a total consideration of RMB36.9 billion, up 66% QoQ. Total value of en-bloc transactions in 2017 reached RMB103.5 billion, up 29% YoY.

TABLE 1

Yields and capital values by sector*, Q4/2017

	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%	2.3-3.0%	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, and 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.

Office Market

Market fundamentals

No new projects were launched onto the core office market in Q4/2017. Annual supply for 2017 totalled 1.1 million sq m, up by 56.6% YoY. 2017 annual net take-up totalled 710,600 sq m, up by 54% YoY. As demand in the core market continued to focus on existing stock, vacancy rates fell by 0.7 percentage point (ppt) quarter-on-quarter (QoQ), to 11.8%, but remained up 3.4 ppts year-on-year (YoY). Core market rents remained flat in Q4/2017 at RMB9.0 per sq m per day, up 1.5% YoY.

Five new projects were launched in Q4/2017, bringing 378,400 sq m of supply (Full-year (FY) 2017: 1.4 million sq m). New supply pushed vacancy rates in decentralised areas up a further 1.7 ppts in Q4/2017 to 37.4%. Rents remained flat, averaging RMB5.7 per sq m per day up 6.4% YoY.

Vacancy rates are forecast to rise further in 2018 as 1.2 million sq m (core) and 1.3 million sq m (decentralised) of new supply are scheduled to hand over. Landlords will be forced to provide further incentives to attract and retain tenants, and the competition not only came from other landlords but also from intermediary service providers, such as co-working spaces.

Investor sentiment

Given its market transparency, high liquidity, and comparative ease of management, office properties are still the most chased-after asset type for investors. As the core office buildings are limited in the market and have a continuously compressed return, projects with value-added potential gain most of the attention from investors. The search for properties with capital value increase potential has pushed the investment destination further into decentralised areas.

Deals

15 key deals were concluded in the office market in Q4, including:

- World Union acquired Cross Tower for RMB2.66 billion from Gaw Capital. Cross Tower located in Huangpu district, comprised of 22 floors of office space above a two-storey retail podium is 85% occupied. Gaw capital acquired the building in April 2013 for RMB1.67 billion.

- Gaw Capital purchased Sky SOHO from SOHO China for RMB5.0 billion. Sky SOHO has an office GFA of 103,014 sq m and retail GFA of 25,161 sq m. Sky SOHO was launched in November 2014 and had an occupancy rate of 97% by October 2017. SOHO China sold 100,167 sq m (GFA) of the project to Ctrip for RMB3.05 billion in 2014 for which Ctrip used for office use.

- Five Bulls Fund purchased ZRT Tower from ZR Capital for RMB1.5 billion. ZRT Tower is located in Jing'an district with a total GFA of 41,200 sq m.

- Shanghai Life Insurance purchased a 44% stake of Standard Chartered Building from Lujiazui Properties for RMB1.36 billion. Standard Chartered Building is located in Lujiazui and has a total GFA of 46,100 sq m.

- Shui On Land sold a 49.5% stake in a portfolio of commercial developments in the Rui Hong Xin Cheng Project to China Life Group for RMB3.87 billion. The portfolio includes two existing projects—Hall of the Moon and Hall of the Stars—with a saleable GFA of 110,795 sq m, and an under-development site (Hall of the Sun), with an aboveground GFA of 282,665 sq m as well as 562 car parking lots.

- Shui On Land purchased Jianfa Junyi Building from China C&D for RMB1.14 billion. The project is located in New Jiangwan City, Yangpu District, and is in close proximity to the KIC project of Shui On Land. The project is comprised of two office buildings with a total saleable GFA of 45,298 sq m and 418 underground car parking lots. The project was completed in September 2017.

- BlackRock acquired Waterfront Place Towers E & G from PGIM Real Estate for RMB1.2 billion. Waterfront is located in Changfeng area, Putuo District which will have a nearby metro line 15 opening in two years. Block E is 15-storey office building with an aboveground GFA of 21,193 sq m while Block G has an aboveground GFA of 6,643 sq m. PGIM purchased the project from ARA in 2016 for RMB800 million.

- China Jinmao sold a 50% stake in Harbour 55 to SIPG for RMB6.0 billion. Harbour 55 comprises of retail GFA of 123,000 sq m (from underground Floor 3 to aboveground Floor 3), office GFA of 313,500 sq m and serviced apartment GFA of 48,000 sq m.

Retail Market

Market fundamentals

A total of 966,500 sq m of retail space launched onto the market in 2017, 18% lower than 2016. Despite new supply, vacancy rates continued to fall in all four quarters of 2017, reaching to 7.0% by end of year, 2.0 ppts lower than the end of 2016.

First-floor shopping mall rents increased 1.4% YoY to an average of RMB27.4 per sq m per day. Nanjing Road (W) remains the most expensive location in the city at RMB68 per sq m per day, while Little Lujiazui saw highest growth in 2017 of 7.4%.

14 new projects or a total of 1.37 million sq m of retail space is expected to launch in 2018; therefore, supply levels will continue to be the biggest challenge for the retail market in Shanghai. The significant new supply will keep restraining rental growth; however,

growing demand from new concept retailers and the F&B sector, as well as high margin cosmetic brands, will sustain reasonable rental growth for leading projects.

Investor sentiment
Investors with ample experience in managing shopping malls are still interested in retail investment projects as retail properties see less competition from domestic capital. However, there is a lack of available projects in the market. Platform and portfolio purchases, or equity injections into local operators, are currently the preferred investment vehicle.

Deals
No pure retail project was transacted in Shanghai in Q4/2017. However, in January 2018, China Vanke acquired a portfolio of 20 shopping malls across China from CapitaLand for RMB8.36 billion. Vanke purchased the retail platform SCPG from Blackstone in 2016.

Hotel Market

Market fundamentals
The hotel markets in first-and second-tier cities remain one of the most challenging real estate sectors in China. Despite various challenges, Shanghai's hotel market has recorded stable growth. Shanghai's five-star market ended November with Average Daily Rates (ADRs) of RMB1,010 and an average occupancy rate of 78%, the four-star market stood at RMB552 and 77%. Revenue per available room (RevPar) for five-star and four-star hotels remained stable at RMB791 and RMB423 in November. Mid-scale hotels appealing to leisure and family travellers continue to attract more demand than luxury hotels targeting business travellers.

Investor sentiment
The interest of purchasing hotels located in core areas for the purpose of converting them into other asset classes, mostly for-leasing apartments, still remains the main purchasing purpose for hotels in China. Meanwhile, some domestic developers are seeking opportunities to rebrand and revitalise hotel portfolios.

Deals
- Everbright Ashmore purchased Shanghai Ming Yue Hotel from Shanghai Ming Yue Group for RMB1.32 billion and intend to convert the hotel into for-leasing apartments. The hotel is located on Gushan Road, Pudong.

- Nova & InfraRed Nan Fung acquired Puxi New Century Hotel for RMB680 million with an intention to convert it into for-lease apartments. The hotel is located in Xinjiang Road, Jing'an district.

Residential Market

Market fundamentals
New commodity residential supply fell by 64.5% in Q4/2017, down by 77.4% YoY. The limited supply resulted in first-hand commodity residential transaction volumes falling by 29.0% to their lowest levels in Q4/2017, totalling only 1.2 million sq m, down 44.5% YoY. Average transaction prices increased by 4.6% QoQ to a new high of RMB48,900 per sq m.

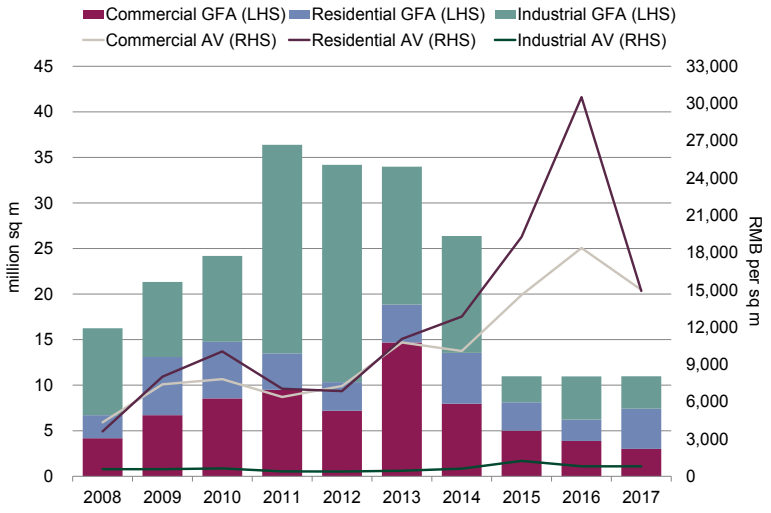
Average vacancy rates declined by 0.7 ppt in the residential leasing market. Pudong serviced apartments saw a 2.2 ppts QoQ increase in vacancy rates, while Puxi serviced apartments saw a 1.5 ppts QoQ decrease in during Q4/2017. Rents in all residential subcategories recorded declines in Q4/2017.

Investor sentiment
Although investors remain interested in serviced apartment properties, there remains a limited number of opportunities available for en-bloc sales.

Q4/2017 continued to see investors' growing interest in the for-leasing market as the government continued supporting this market's development. In January 2018, Shanghai Municipal Government together with China Development Bank, China Construction Bank and other SOE developers, issued cooperation agreements emphasising financial support for the for-leasing market.

Deals
Warburg Pincus together with Sequoia and Tencent, led the RMB4 billion investment in Ziroom, a rental housing firm in China. Founded in 2011, Ziroom, the Beijing-based

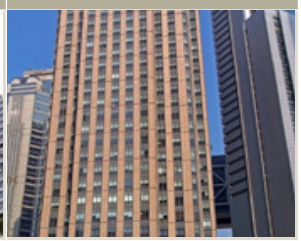
FIGURE 2
Land Transaction Area and AVs, 2008–2017



Source: Savills Research

TABLE 2

Key investment deals, Q4/2017

	Cross Tower 浦汇大厦	Sky SOHO SOHO凌空	50% Harbor 55 50% 星港国际中心	44% Standard Chartered Building 44% 渣打银行大厦
				
Location	318 Fuzhou Road, Huangpu	968 Jinzhong Road, Changning	55 Haimen Road, Hongkou	201 Century Avenue, Pudong
Date	Dec, 2017	Oct, 2017	Dec, 2017	Dec, 2017
Property type	Office	Office	Mixed-use	Office
Transacted price (RMB mil)	2,660	5,008	5,998	1,360
Above-ground GFA (sq m)	41,662	128,175	313,500 (including underground retail GFA	46,100
Vendor	Gaw Capital	SOHO China	China Jinmao	Lujiazui Properties
Purchaser	World Union	Gaw Capital	SIPG	Shanghai Life Insurance
Deal Structure	Onshore equity	Offshore equity	Onshore equity	Onshore equity
	49.5% Rui Hong Xin Cheng Project 49.5% 瑞虹新城项目商业组合	Jianfa Junyi Building 建发君逸大厦	Waterfront Place, Tower E&G 北岸长风E栋G栋	Shanghai Ming Yue Hotel 上海明悦大酒店
				
Location	383 Ruihong Road, Hongkou	386 Guoan Road,	Da du he Road, Putuo	500 Gushan Road, Pudong
Date	Dec, 2017	Dec, 2017	Dec, 2017	Dec, 2017
Property type	Mixed-use	Office	Office	Hotel
Transacted price (RMB mil)	3,869	1,144	1,167	1,315
Above-ground GFA (sq m)	393,460	45,298	27,805	36,235
Vendor	Shui On Land	China C&D	PGIM Real Estate	Ming Yue Group
Purchaser	China Life	Shui On Land	Blackrock	Everbright Ashmore
Deal Structure	Onshore equity	Onshore equity	Offshore equity	Onshore equity

Source: Savills Research

rental service provider, currently operates in nine top-tier cities in China, managing 500,000 rooms and serving 1.2 million tenants.

Vanke plans to issue up to RMB35 billion of direct debt financing instruments to boost the liquidity of financing projects, such as long-lease apartments.

Logistics Market

Market fundamentals

The rapid growth of e-commerce combined with tight supply in first- and second-tier cities continues to draw investors to logistics assets. Industrial land supply has been low since 2015. From 2015 to 2017, a total buildable area of 11 million sq m of industrial land was sold in Shanghai, while a total buildable area of 12.8 million sq m was sold in 2014. The lack of supply results in rising rents for logistics properties.

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. Properties located in the satellite cities of Shanghai are very popular among investors.

Deals

Goodman Group sold a portfolio of seven Chinese logistics assets to the real estate private equity arm of China Everbright Limited in January 2018. The portfolio has a total leasable area of over 320,000 sq m and is spreading across the cities of Kunshan, Jiaxing, Wuxi, Qingdao, Xi'an and Shenyang. Goodman is estimated to be the second-largest warehouse provider in China, behind GLP. Canadian Pension Plan Investment Board (CPPIB) owns 80% of the Goodman's China ventures.

Land Market[1]

Total land sale consideration reached RMB102 billion in 2017, down 26% YoY. Commodity residential and commercial sectors accounted for 31% and 66% of total sales, in 2017. Commercial and residential accommodation values (AVs) averaged RMB15,006 per sq m and RMB14,922 per sq m, respectively. Within the commodity residential sector, AV for residential for sale and residential for lease averaged at RMB20,540 per sq m and RMB6,896 per sq m, respectively.

For-leasing residential land supply continued to increase in Q4/2017 with 15 land plots sold for a total consideration of RMB7.05 billion at an AV average at RMB6,630 per sq m. All 15 plots were attained by local SOEs and are spread across Huangpu, Pudong, Minhang and Changning Districts.

[1]Land sales exclude public and economic housing

Market News

Healthcare market is gaining attention

China's healthcare market, despite being relatively immature, is the fastest-growing healthcare market of all large emerging economics. Moreover, in the Chinese government's recent five- year plan, public healthcare has been listed as one of the priorities alongside environmental protection and food security. Under such conditions, the market saw growing interest from investors. HK's Shun Tak teamed up with Perennial Real Estate, and other firms in Singapore and Thailand to jointly invest up to US$1.2 billion in healthcare-related property projects in China. In addition, in December, China Minsheng Investment Group (CMIG) announced plans to introduce new technologies, raise fresh funds and expand its service network to build a chain of elderly care businesses.

Vanke joins the search for bad assets

In December, China Vanke set up a

TABLE 3

Key land deals, Q4/2017

Plot	District	Use	GFA (sq m)	Consideration (RMB million)	AV (RMB per sq m)	Buyer
Xinqiao c-2地块	Songjiang	Residential	62,124	1,854	29,843	Jindong Business (金栋商务)
Luodian new town bsp0-2202单元h-02地块	Baoshan	Residential	89,011	2,585	29,045	Shanghai Yingpu Trade (盈扑贸易)
Expo a02b-01、a02b-02地块	Pudong	Commercial	65,765	1,876	28,531	Zhonghe Development (中核发展)
Hangtou town b1-02地块	Pudong	Residential	123,500	3,436	27,824	CR Land
Nanqiao new town 06a-03a、10a-03a区域地块	Fengxian	Residential	184,025	4,233	23,000	Chongqin Longfor

Source: Savills Research

fund in collaboration with ICBC to invest in distressed assets. Vanke will invest RMB5 billion and the fund will target opportunities in restructuring, mergers and acquisitions and investment in distressed assets. In addition, Blackstone has acquired a portfolio of Chinese non-performing loans (NPLs) for US$200 million in August 2017. Bain Capital Credit also announced plans to tap into maturing distressed debt investment opportunities in Asia.

Outlook

Based on the Communist Party Politburo's statement in December, deleveraging will be the top priority for 2018, signalling the potential for a tighter monetary policy environment. This could encourage developers to review their business holdings and dispose of non-core assets and liquidating portfolios to pay off old debt. Meanwhile, some investors would also pay more attention on the distressed assets sector.

Investors are expected to migrate to more niche asset classes, where there is less competition and higher yields. Alternative asset classes could include logistics, data centres and elderly housing. Bigger players are expected to buy at the entity level or partner with local government in urban regeneration or new township developments.

A policy U-turn on curb investments by Chinese companies overseas is rumoured to be unveiled in 2018 as the strengthening of the yuan reduces the need for administrative curbs on capital outflows. Additional merger and acquisition activities are expected as more Chinese companies compete to invest in infrastructure projects related to the One Belt One Road initiative. ■

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