Briefing
Investment

July 2018

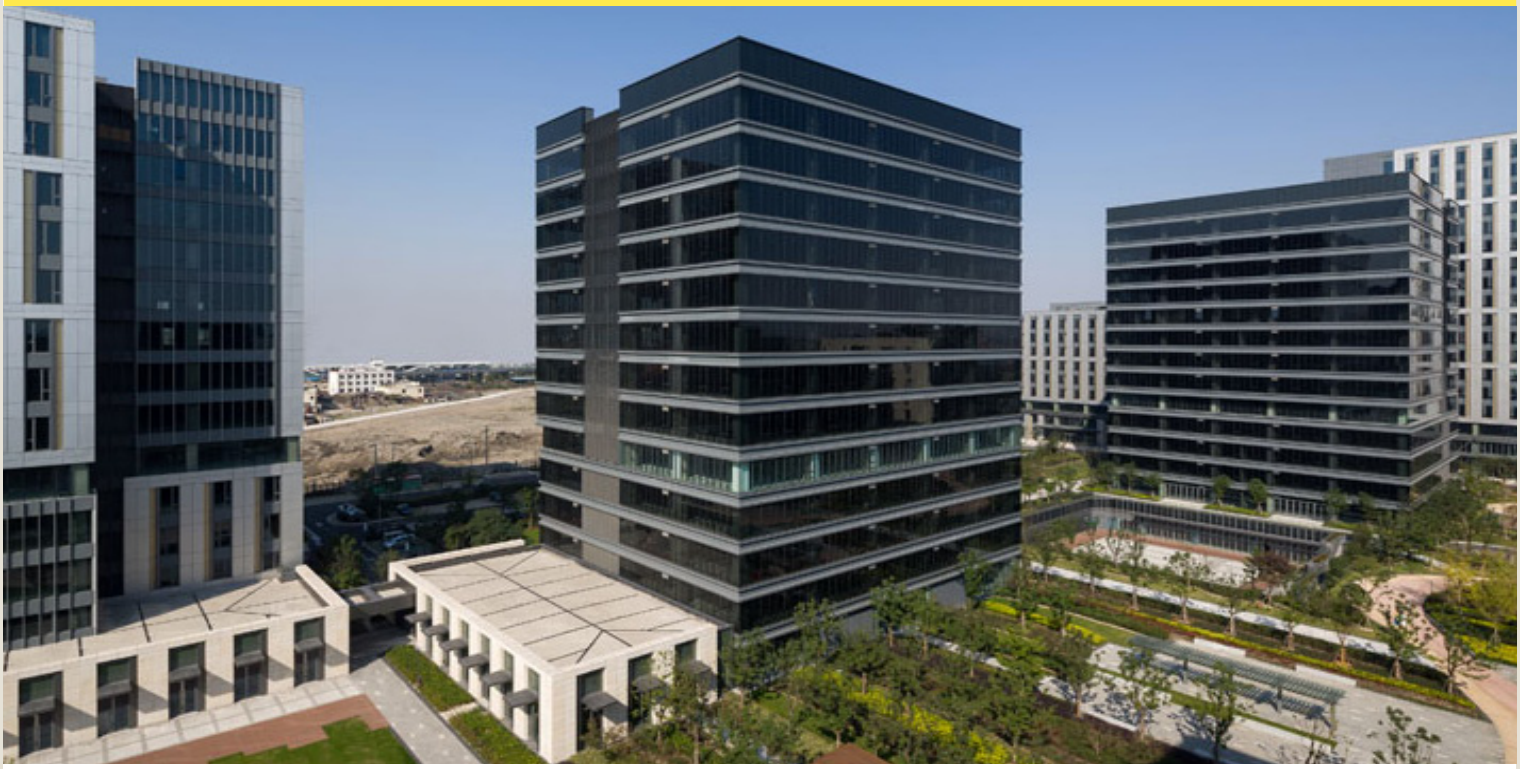


Image: Bay Valley, Yangpu district

SUMMARY

Shanghai's investment market saw only RMB24.2 billion deals concluded in 1H/2018, around half that of 1H/2017, due to a slowdown in transaction volume due to the lack of debt availability and rising costs.

- 13 key deals were concluded for a total consideration of RMB15.7 billion in Q2/2018, down by 34% year-on-year (YoY).
- The market saw more transactions concluded for office properties located in decentralised locations with a low accommodation value (AV) as there is a price gap between buyers and sellers concerning core assets.
- Shui On Land sold 49.5% of the Ruihong Xincheng Project that comprises of two land plots with a total buildable GFA of 269,000 sq m to Joy City Property for RMB4.59 billion. In early July, Shui On Land, in partnership with China Pacific Life Insurance and Shanghai Yongye Enterprise, acquired three land plots in Xintiandi for over RMB13.6 billion.
- Gross yields for Grade A office assets stayed stable at 4.8% in Q2/2018, while net yields were around 3.4%.

"Insurance funds were allowed to invest in the for-leasing market in large and medium-sized cities such as Beijing and Shanghai. The increasing injection of capital will further grow the sector." James Macdonald, Savills Research

Market commentary

Shanghai's investment market remained slow in Q2/2018, with a total consideration of RMB15.7 billion, down by 34% YoY.

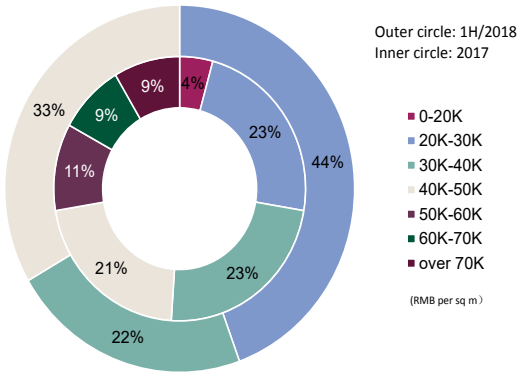
Though office properties located in core areas are considered to be more insulated from downward rental pressure, the compressed yields they offer do not make sense for investors, especially when financing cost increase. Meanwhile, limited available core office properties have also contributed to the low transaction volume of such assets. Many investors have changed tack, seeking opportunities in more decentralised office markets as well as in business park areas where per sq m valuations are lower and there are still perceived chances for value growth. In Q2/2018, IDG Capital acquired Bay Valley B7 for RMB726 million and Gopher Asset purchased Qibao Powerlong Building T2 for RMB452 million.

Retail properties are offering more value-added opportunities and remain popular among investors, especially international investors who have the expertise to upgrade and manage retail malls or convert retail properties into other asset types. Such retail properties usually are underperforming but located in central locations. Five retail properties that fall in this category were transacted in Q2/2018 with a total consideration of RMB4.4 billion. For example, Nova and InfraRed NF acquired Hongkou Bailian Shopping Mall with plans to convert it into a rental apartment complex supported by retail amenities.

The year 2018 saw the government's continued effort to deleverage the property sector, including a crackdown on M&A loans used to buy land, a ban on non-bank financial institutions from channelling funds into the property and infrastructure sectors via entrusted loans, and restrictions on real estate developers from using funds raised via international debt for real estate investments or for working capital. Unable to access previously plentiful sources of financing, some highly leveraged Chinese borrowers are under significant stress, especially when they are also facing large amounts of debt coming due.

GRAPH 1

Number of office transactions by unit price range 1H/2018 vs.2017



Source: Savills Research

Sectors and deals

The second quarter saw 13 key deals concluded for a total consideration of RMB15.7 billion.

Office market

Market fundamentals

Five new projects were launched onto the core office market in Q2/2018, adding 426,300 sq m of new office space and bringing the core Grade A office stock to 8.7 million sq m. Net take-up picked up, totalling 369,500 sq m in Q2/2018. The growth in demand was largely driven by pre-commitments in new supply and strong take-up in Puxi non-prime areas. Strong market absorption offset the pressure from large supply, resulting in stable vacancy rates at 12.4%. Core market rents remained flat in Q2/2018 with

TABLE 1

Yields and capital values by sector*, Q2/2018

	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%	5.5-6.5%	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%	5.0-6.0%
Approx. values (RMB per sq m)	50-90,000	60-100,000	150–250,000	55-70,000	100-200,000	40-50,000	6-8,000

Source: Savills Research
Note: Yields refer to stabilised assets in downtown locations free of any impediments and with a clean holding structure owning 100% of the building and assuming 100% occupancy. Capital values refer to the average for the building on an above-ground GFA basis – retail assets will have higher capital values for lower floors.

rents currently averaging RMB9.0 per sq m per day.

The second quarter saw 563,400 sq m of new office space added to the decentralised market with five new projects being handed over. Total decentralised stock, as a result, was pushed up to 4.1 million sq m by the end of Q2/2018. Due to the large supply, vacancy rates in decentralised areas continued to rise 1.7 percentage points (ppts) in Q2/2018 to 35.5%, the highest level over the last three years. Rents remained flat, averaging RMB5.8 per sq m per day.

A total of nearly 1.4 million sq m of Grade A office space (including core and decentralised locations) is scheduled to launch in 2H/2018. Vacancy rates, as a result, are forecasted to rise.

Investor sentiment

Given its market transparency, high liquidity, and comparative ease of management, office properties are still the most sought-after asset type for investors. Potential buyers and sellers of core assets continue to have a difference of opinion on the prospects of the market and current market values. Meanwhile, properties in decentralised areas that offer higher yields and have more capital value appreciation potential are popular among investors. In addition, business parks are drawing a lot of investment interest because of the growing rental projection, which is driven by demand from R&D and tech companies and higher yields.

The co-working market is still seeing an injection of capital and the industry is going through rounds of consolidation as the market matures. Sino-Ocean Capital and Huarong Rongde Asset Management led a RMB500 million round of financing in Beijing-based flexible office operator Nashwork that was founded in 2013 and operates more than 800,000 sq m of properties across Beijing, Tianjin, Shanghai and Shenzhen.

Deals

Three key deals were concluded in the office market in Q2/2018, including:

- IDG Capital purchased Bay Valley B7 from Shanghai SMI Holding for RMB726 million. Bay Valley is located in the New Jiangwan Town submarket of Yangpu District, and Building 7 has a total GFA of 28,000 sq m. The building was vacant when sold. Top Spring purchased Bay Valley A4/C4 and C7 buildings with a total GFA of around 100,000 sq m for RMB2.4 billion in Q3/2017.

- Gopher Asset purchased Qibao Powerlong Building T2 from Powerlong Property for RMB452 million. Qibao Powerlong Building is located in HTH submarket and is adjacent to Hangzhong Road Metro Station (Line 10) and Qibao Metro Station (Line 9). T2 has a total GFA of 14,583 sq m. Qibao Powerlong Building T3/4/5 have a total GFA of 40,400 sq m and were sold for RMB1.1 billion in Q1/2017.

- Cura Investment acquired Hongqiao World Centre F4-10 with a total GFA of 9,589 sq m from Greenland Holding for RMB403 million. Hongqiao World Centre is located in HTH submarket next to National Exhibition Centre

Retail market

Market fundamentals

Three new projects launched onto the market in the Q2/2018, adding a total retail GFA of 314,380 sq m, while two projects completed renovation and upgrading. Vacancy rates increased by 1 ppt in Q2/2018 to 6.2% in prime retail areas, while they fell by 0.2 ppts to 6.6% in non-prime retail areas. Overall rent on the first floor space increased 0.4% QoQ to RMB27.9 per sq m per day.

New retail and new innovations are expected to stimulate both leasing and consumption demand. However, overall rent and vacancy rates are expected to be adversely affected by the launch of several new projects in the second half of the year.

Investor sentiment

A few international investors with expertise in managing shopping malls and converting retail properties are interested in acquiring underperformed retail properties that are located in core locations. Such investments traditionally offer higher yields and face less competition from domestic capital.

Deals

Five key retail deals were concluded in Q2/2018, including:

- A joint venture of Sunac, Nova, Metro and Hualing purchased a portfolio from Honglou Group which included a 90% stake in Shanghai Plaza for RMB2.5 billion and Fudu Plaza for RMB700 million. Shanghai Plaza is located in Middle Huaihai Road with a total saleable GFA of 40,693 sq m from B1 to F6. In 2005, Morgan Stanley purchased the property for RMB928 million and refurbished the mall's interior, renaming the building Infiniti Plaza before reopening it in late 2007. At the end of 2009, Honglou Group acquired the mall for RMB1.42 billion and managed to boost its occupancy rate to around 90% over the past decade. The Sunac/Nova/Metro/Hualing JV plans to convert the upper floors of the mall into co-working space with retail facilities on the lower floors. Fudu Plaza is located near Yu Garden in Huangpu District with a total saleable GFA of 16,783 sq m.

- Morgan Stanley purchased the 608 Xikang Road project for RMB260 million and Jinkaili Square for RMB430 million. 608 Xikang Road has four floors with a total GFA of 6,662 sq m and is located in Jing'an District close to Changping Road Station (Metro Line 7). Jinkaili Square has five floors with a total GFA of 10,513 sq m and is located in South Xizang Road, Huangpu District.

- Nova and InfraRed NF purchased Hongkou Bailian Shopping Mall for RMB465 million with plans to convert the property into a rental apartment complex supported by retail amenities.

Hotel market

Market fundamentals

The hotel market in first-and second-tier cities remains one of the most challenging real estate sectors in China. Shanghai's five-star market ended May with Average Daily Rates (ADRs) of RMB992 and an average occupancy rate of 70.7%, while four-star hotels achieved ADRs of RMB541 and an average occupancy rate of 69.7%. The revenue per available room (RevPar) decreased by 2% and 3% YoY respectively for five-star and four-star hotels. The market saw retail brands such as Muji and BVLGARI get involved in hotel business by promoting their brand image, culture and unique experience. Baidu also cooperates with hotels to promote their smart home devices.

Investor sentiment

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

Deals

There were no hotel transactions in this quarter. Shimao Group unveiled two select service hotel brands, MiniMax Hotel and MiniMax Premier, as two "inspirational" hotel brands of Shimao Star Hotels Group.

Residential market

Market fundamentals

New commodity residential supply rebounded by 110.5% in Q2/2018 to 1.42 million sq m. First-hand commodity residential transaction volumes increased by 21.4%, totalling 1.45 million sq m, down 30.1% YoY. Average transaction prices rebounded by 12.9% QoQ to RMB49,800 per sq m, an increase of 4.8% YoY.

Citywide high-end residential rents remained virtually flat, declining just 0.6% QoQ to an average RMB198.6 psm pmth but were up 0.8% YoY. Overall vacancy rates fell 1.5 ppts QoQ.

Investor sentiment

Although investors remain interested in serviced apartments, there remain a limited number of opportunities available for en-bloc sales. Investor interest in the long-term rental apartment market continued in Q2/2018 on the back of the government's sustained support for the sector's development.

Deals

Joy City Property purchased a 49.5% stake in a land project that includes two land plots under the Ruihong Xincheng project from RMB4.59 billion. Land plot No.1, with a total buildable GFA of 110,000 sq m, will feature high-end residential apartments while No. 7, with a total buildable GFA of 159,000 sq m, is expected to finish relocating the current occupants of the land by the end of 2018. In the end of 2017, Shui On Land sold 49.5% stake in the retail portion with a total saleable GFA of 393,460 sq m in Ruihong Xincheng for RMB3.87 billion to China Life.

The market saw continued growth in the for-leasing sector. Singaporean sovereign wealth fund GIC established a joint venture with Nova to invest up to RMB4.3 billion in acquiring, renovating and operating rental apartment projects in major cities in China. In addition, Shanghai-based co-living operator Harbour Apartments is setting up a US$1 billion fund with Gaw Capital dedicated to buying existing properties for conversion into for-leasing apartments. Also, Harbour Apartments partnered with Far East Horizon to create a RMB10 billion fund that will acquire land plots for developing for-leasing apartments. Moreover, Canada Pension Plan Investment Board (CPPIB) and Longfor Group announced an agreement to jointly invest at least US$817 million in building rental housing projects in China.

Industrial market

Market fundamentals

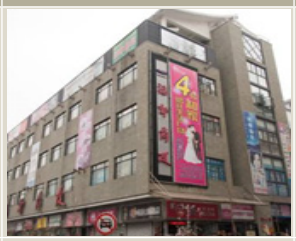
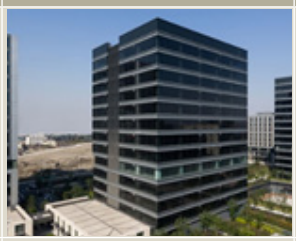
The rapid growth of e-commerce combined with tight supply in first and second-tier cities continues to draw investors to logistics assets. Rising demand, together with the lack of supply, has resulted in increased rents for logistics properties.

Shanghai has been striving to develop into an advanced manufacturing centre in response to the government's Made in China 2025 initiative. Demand is on the rise for manufacturing centres that combine multiple functions under one roof, such as manufacturing, R&D and logistics. Tesla will establish its first overseas Gigafactory at Lingang, Shanghai. The wholly foreign-owned plant will also be the largest overseas manufacturing investment in China. The lifting of foreign ownership limit is expected to pave the way for global companies to set up their own production plants in Chinese cities.

Data centres have experienced a surge in demand as China continues to be one of the world's leading countries for new technology developments; in addition, cyber security regulations require companies to store all Chinese customers' data within China. The strong underlying fundamentals of data centres – higher yields and typically longer lease terms– are motivating asset owners to redevelop existing properties into data centres. However, the fact that heavy capital expenditure needed to set up the facilities requires longer investment

TABLE 2

Key investment deals, Q2/2018

	90% of Shanghai Plaza 上海广场90% 股权	Fudu Plaza 福都商厦	Bay Valley B7 湾谷科技园 B7	Qibao Powerlong Building T2 七宝宝龙2号楼
				
Location	138 Middle Huaihai Road, Huangpu	399 Renmin Road, Huangpu	1688 Guoquan North Road, Yangpu	1399 Xinzhen Road, Minhang
Date	May, 2018	Jun, 2018	Apr, 2018	Q2/2018
Property type	Retail	Retail	Office	Office
Transacted price (RMB mil)	2,500	700	726	452
Sellable GFA (sq m)	40,693	16,783	28,042	14,583
Seller	Honglou Group	Honglou Group	Shanghai SMI Holding	Powerlong Property
Purchaser	JV (Sunac, Nova, Hualing, Metro)	JV (Sunac, Nova, Hualing, Metro)	IDG Capital	Gopher Asset
Deal Structure	Onshore equity	Onshore equity	Asset	Asset
	Hongqiao World Centre 虹桥世界中心 4-10层	608 Xikang Road Project 西康路608号项目	Jinkaili Square 金开利广场	Hongkou Bailian Shopping Mall百联虹口购物中心
				
Location	1588 Zhuguang Road, Qingpu	608 Xikang Road, Jing'an	758-2 South Xizang Road, Huangpu	699 Tongfeng Road, Hongkou
Date	Apr, 2018	Q2/2018	Q2/2018	Jun, 2018
Property type	Office	Retail	Retail	Retail
Transacted price (RMB mil)	403	260	430	465
Sellable GFA (sq m)	9,589	6,662	10,513	31,645
Seller	Greenland	Individual	Individual	Ping'an Bank
Purchaser	Cura Investment	Morgan Stanley	Morgan Stanley	Nova and InfraRed Nan Fung
Deal Structure	Asset	Onshore equity	Onshore equity	Onshore equity

Source: Savills Research

timelines might be an issue for some short-term funds.

Investor sentiment

The market is dominated by a handful of players, such as GLP and E-shang, who are responsible for most investment deals. These players typically look for acquisitions of individual assets and development sites or opportunities for platform equity injections. Properties located in the satellite cities of Shanghai are very popular among investors. Overall, the market saw sustained international demand as well as domestic institutional investors' growing appetite for high-quality core logistics assets.

Deals

Hong Kong-based logistics firm Tigers acquired two-warehouse sites with a combined 3,779 sq m in Shanghai in order to increase its capacity by 34 percent.

There are also a couple of funds specifically raised for logistics investment. GLP set up a RMB10 billion property equity fund in China to invest in logistics-related businesses with a focus on companies employing technology to enhance logistics efficiency. The announcement of the new fund comes three months after GLP teamed up with China Life to form a US$1.6 billion value-add fund focused on logistics opportunities in China. In addition, logistics developer ESR joined with Beijing Properties to set up a US$1 billion offshore fund that would acquire logistics projects in China.

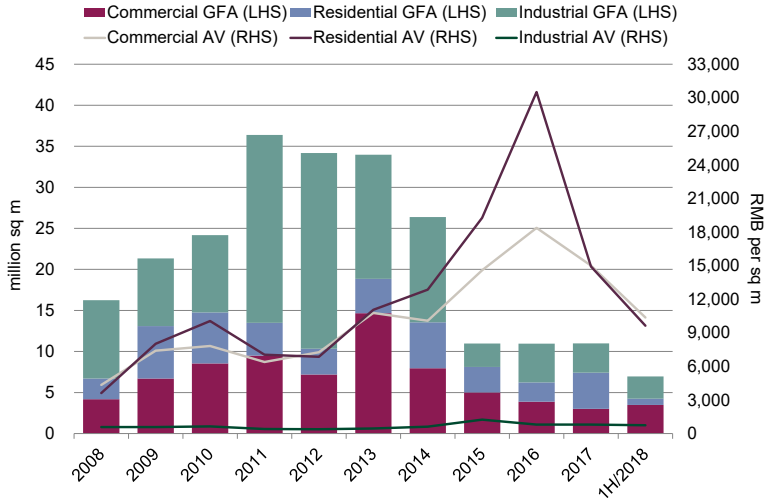
Land market [1]

Total land sale consideration reached RMB13.9 billion in Q2/2018, down by 21% YoY. Commodity residential and commercial sectors accounted for 40% and 49% of total sales in Q2/2018. Residential[2] and commercial AVs averaged RMB22,898 per sq m and RMB12,640 per sq m, respectively. There was one for-leasing land sold in Q2/2018.

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

FIGURE 2

Land transaction area and AVs, 2008–1H/2018



Source: Savills Research

This quarter saw an increasing supply of industrial land as the total industrial land sales consideration reached RMB1.44 billion in Q2/2018, up by 67% QoQ. The supply was focused in Songjiang, Minhang, and Fengxian districts.

Market news

Australia's largest senior housing provider Lendlease entered the Chinese market

Lendlease, which manages more than 70 senior living communities totalling 12,500 retirement living units with 16,500 residents in Australia, signed a contract with the Qingpu government for 50-year land-use rights to develop a RMB1.9 billion senior-living community in Zhujiajiao, Qingpu. The construction work is expected to start early next year and provide approximately 900 living units.

HNA offloaded another project

HNA offloaded another project in Q2/2018 with the sale of a mixed-use project (currently under construction by local developer Fusheng Group) for RMB2.9 billion. The project, comprising a pair of 20 floor residential towers and a 24 floor office building, is located in Qiantan.

Outlook

Highly capitalised investors, such as insurance companies, SOEs and pension funds are expected to take up more transactions in the market in the coming years as financing remains a challenge for developers and domestic funds.

Developments tied to the sharing economy, such as co-working and co-living, are expected to continue to draw interest from investors. PEs and VCs continue to back these companies in the uncompromising bid to claim market share.

Given limited supply and growing demand, the logistics market will remain attractive to many investors. Yields of such investments are expected to continue to compress as value growth continues to exceed rental growth.

TABLE 3

Key land deals, Q2/2018

Plot	District	Use	GFA (sq m)	Consideration (RMB million)	AV (RMB per sq m)	Buyer
Dinghai c2-2a	Yangpu	Commercial	27,001	810	30,000	Yangpu Binjiang Investment and Development
Huangpujiang South Extension ws5/188s-q-1	Xuhui	Commercial	76,894	1,961	25,500	163.com (网易)
Meilong mhp0-0307/07-03	Minhang	Commercial	42,584	429	10,081	Linteng Investment (上海林腾投资)
Xinjiangwan n091104/a3-05	Yangpu	For lease	84,515	676	8,000	Shanghai City Land

Source: Savills Research

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