savills
第一太平戴维斯

Savills China Research
Shanghai

Briefing
Investment

November 2018

Image: Bay Valley, Yangpu district

SUMMARY

Investors are raising capital for the China logistics market given its strong fundamentals, which are supported by a big expansion in the consumption base, rising incomes, controlled supply and higher yields.

- Seven key deals were concluded for a total consideration of RMB5.2 billion in Q3/2018.
- Tough credit conditions make it hard for domestic funds to secure deals, thus giving international investors more opportunities.
- The market still sees interest in purchasing underperforming hotels and retail assets in core areas for conversion purposes. However, such opportunities remain limited.
- Gross yields for Grade A office assets remained stable at 4.8% in Q3/2018, while net yields were around 3.4-3.6%.

"The investment market continues to slow with a total consideration of only RMB5.2 billion in Q3/2018—the lowest levels in six years. Investors' concerns about market fundamentals and the difficulty in accessing debt attributed to the slowdown."
James Macdonald, Savills Research

Market commentary

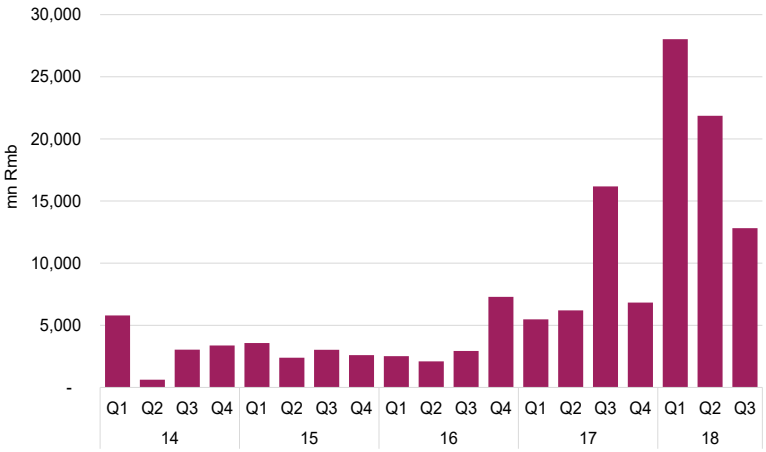
Shanghai's investment market remained slow in Q3/2018, with a total consideration of only RMB5.2 billion in Q3/2018.

Since the end of 2016, the Chinese government has been working on deleveraging the economy including cracking down on shadow banking. The real estate industry, which relied heavily on debt, has been hit badly. Domestic funds and developers are faced with rising financial costs and tight credit access. However, this is giving international investors—who tend to be more fiscally conservative—more opportunities to secure deals due to the lack of competition from domestic investors. Generally speaking, international pension funds and sovereign wealth funds have an interest in core assets given their long investment cycles, while private equity funds remain interested in platform investments and value-added opportunities. Alpha and Allianz acquired Bay Valley C6, a business park asset located in Yangpu in Q3/2018. It is rumoured that several deals are in the closing phases with international funds as buyers. Currently, active international investors include Kailong REI, Gaw Capital, Keppel Capital, Allianz, and CapitaLand.

Faced with high repayment pressure and the government's requirement to lower debt levels, we see domestic buyers—who made news by purchasing trophy assets overseas a couple of years ago—are making the headlines again by scaling back their overseas holdings. High profile investors who have seen pushback from Chinese authorities include HNA, Anbang Insurance, and Dalian Wanda.

GRAPH 1

Volume of overseas properties sold by Chinese sellers,2014-Q3/2018



Source: Savills Research

Moreover, Greenland Group sold three development sites at its Pacific Park Brooklyn project four months after a Greenland-led consortium disposed of a San Francisco Bay Area site. Many of the projects that Chinese investors developed overseas are experiencing construction delays and overestimations on sales projections. Together with the currency fluctuation risk, after this wave of clean-up, it is expected that Chinese investors will become more cautious about investing overseas.

As the real estate industry faces price restrictions and credit controls, we see real estate developers expanding their business scope to related industries and moving from a development focus to asset management and operation. Most real estate developers tend to branch out into finance, tourism, education and elderly care, where they can form synergies with residential developments and cultivate new profit growth points. Sunac recently launched the "Taoyuan+" strategy, which will gradually extend to the fields of culture, entertainment, tourism, sports and leisure, education, health and elderly care. In addition, Vanke has been expanding its position from a real estate developer who mainly focuses on residential and office development to a well-rounded player who also operates in retail, logistics and hotels by purchasing SCPG from Blackstone and GLP cold chain from Swire, and setting up a JV partnership with Banyan Tree Holdings.

Sectors and deals

Office market

Market fundamentals

Three new projects launched onto the core office market in Q3/2018, adding 127,000 sq m of new office space and bringing the core Grade A office stock to 8.8 million sq m. Net take-up totalled 132,600 sq m in Q3/2018, down 65% from a high base.

TABLE 1

Yields and capital values by sector*, Q3/2018

	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%	6.2-6.7%
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%	4.5-5.5%
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 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.

Non-prime areas saw strong demand, while prime areas (Lujiazui, West Nanjing Road and Middle Huaihai Road) all recorded negative take-ups, indicating a decentralization trend. Demand outstripping new supply resulted in a decline of 0.2 of a percentage point (ppt) in vacancy rates, to 12.2% in Q3/2018. Core market rents remained flat on an index basis in Q3/2018, currently averaging RMB9 per sq m per day.

There was no new supply in the decentralized market in Q3/2018. Total decentralised stock remained at 4.1 million sq m at the end of Q3/2018. As the market continued to absorb current stock, vacancy rates in decentralised areas fell by 2 ppts in Q3/2018 to 33.8%. However, rents remained flat on an index basis averaging RMB5.8 per sq m per day.

A total of 784,000 sq m of Grade A office space (including core and decentralized locations) is scheduled to launch in Q4/2018. Judging from the looming new supply, Shanghai office rents are likely to adjust downwards in the next 12 months.

Investor sentiment

Given its market transparency, high liquidity, and comparative ease of management, office properties are still the most sought-after asset class for investors. However, business parks are drawing investment interest because of the growing rental projections, driven by demand from R&D and tech companies. Investors are showing concerns that the negative impact from oversupply, an ongoing trade war, slower economy, and financial deleveraging could result in slower lease take-ups in the office market.

Deals

Three key deals were concluded in the office market in Q3/2018, including:

- Alpha Investment Partners and Allianz purchased Bay Valley C6 from Citic Capital for RMB554 million. Bay Valley is located in New Jiangwan Town submarket in Yangpu, and Building C6 has a total GFA of 19,800 sq m. IDG Capital acquired Bay Valley B7, which has a total GFA of 28,000 sq m, from Shanghai SMI Holding in Q2/2018 for RMB726 million.

- Comac acquired one of Crystal Plaza's towers from Tishman Speyer for RMB1.5 billion. The building has a total GFA of 23,600 sq m. Crystal Plaza is a mixed-use project developed by Tishman Speyer and includes 194,300 sq m of Grade A office, 52,800 sq m of retail and 109,200 sq m of high-end apartments

- Poly and Greenland sold another building in its Poly Greenland Plaza project for RMB850 million. The total GFA of the building sold was 14,500 sq m. Also in Poly Greenland Plaza, Anhui High-speed Railway purchased the A2 Building, which has a total GFA of 45,100 sq m, for RMB2.3 billion in Q4/2016. Jiangsu Yancheng Investment acquired B1/C1-C2 for a total office GFA of 20,500 sq m and a total retail GFA of 6,500 sq m for RMB1.6 billion in Q1/2017.

Retail market

Market fundamentals

Two new projects launched in the market in Q3/2018, contributing a total retail GFA of 206,000 sq m. Vacancy rates increased by 0.1 of a ppt in Q3/2018 to 6.3% in prime retail areas, while they fell by 0.2 of a ppt to 6.4% in decentralised retail areas. Overall, average rent on first floor levels increased 0.4% QoQ to RMB28 per sq m per day.

637,400 sq m of new supply is expected to open in Q4/2018. Growing demand from co-working spaces will help increase the sector's market share in the shopping mall market to around 0.6% by the end of 2018.

Investor sentiment

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

Deals

There were no retail deals in Q3/2018. It is rumoured that KaiLong is in the closing phase of purchasing the retail podium of JAJE Plaza (嘉杰国际广场), located in Sichuan Road, for RMB700 million, and that the company intends to convert part of the retail space into co-working facilities.

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 August with Average Daily Rates (ADRs) of RMB918 and an average occupancy rate of 72.3%, while four-star hotels achieved ADRs of RMB529 and an average occupancy rate of 70.2%. The revenue per available room (RevPar) remained stable compared to the same time last year for five-star and four-star hotels.

Investor sentiment

Interest in purchasing hotels located in core areas for the intent of converting them into other asset classes—mostly for-leasing apartments—remains the main purpose for purchasing hotels in China. Meanwhile, some domestic developers are seeking opportunities to rebrand and revitalise hotel portfolios. Investors are starting to look at this submarket with more interest, given the strengthening domestic tourism sector and expected travel demands.

Deals

There were no hotel transactions in Q3/2018. It is rumoured that an international fund is in the process of purchasing Xin Chang Run Hotel located in Yangpu for RMB212 million with a plan to convert it into for-leasing apartments.

Residential market

Market fundamentals

New commodity residential supply rebounded by 116.4% in Q3/2018 to 3.1 million sq m, up 281% year-on-year (YoY). First-hand commodity residential transaction volumes increased by 58.6%, totalling 2.3 million sq m, up 38.7% YoY. Average transaction prices rebounded by 9.6% QoQ to RMB54,600 per sq m, up 17% YoY.

Q3/2018 saw two new serviced apartment projects launch onto the market, both in Puxi and both from developer Sincere, for a total of 494 units. Serviced apartment rents saw a decrease of 0.6% QoQ on an index basis, to RMB244.9 per sq m per month. The serviced apartment vacancy rate fell by 2.4 ppts QoQ to 4.9%.

Investor sentiment
Although investors remain interested in serviced apartments, there are a limited number of opportunities available for en-bloc sales. Investor interest in the long-term rental apartment market continued in Q3/2018 on the back of the government's sustained support for the sector's development. As the rental apartment market grows, the government is also working out policies and guidelines to regulate the market, which could improve quality control in the market.

Deals
There were no residential transactions in this quarter.

The market saw continued growth in the for-leasing sector. 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 steady rental growth 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 purchased an 860,000 sq m land plot in Lingang, Shanghai for RMB973 million for building its first overseas Gigafactory.

Data centres have experienced a surge in demand as China continues to be one of the world's leading countries for big data and cyber security. 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 heavy capital expenditure needed to set up the facilities, which requires longer investment timelines, and ongoing regulatory hurdles might be issues for some short-term funds.

Investor sentiment
The market is dominated by a handful of players, such as GLP and ESR, who are responsible for most of the investment deals. These players typically look for acquisitions of individual assets and developments while PE funds look for big platform investment. Investors are also looking for opportunities to acquire more advanced assets, such as cold chain, which can create barriers for other investors to entry. Properties located in the satellite cities of Shanghai are very popular among investors.

Deals
China Vanke acquired Swire's cold chain logistics unit for RMB2 billion. The transaction gives Vanke seven facilities covering 290,000 sq m in Shanghai, Guangzhou, Nanjing, Chengdu, Xiamen, Langfang, and Ningbo.

Warburg Pincus and NewEase China injected US$800 million into launching a logistics platform, with the plan to realize a layout of 10 million sq m of logistics facilities in the next three years.

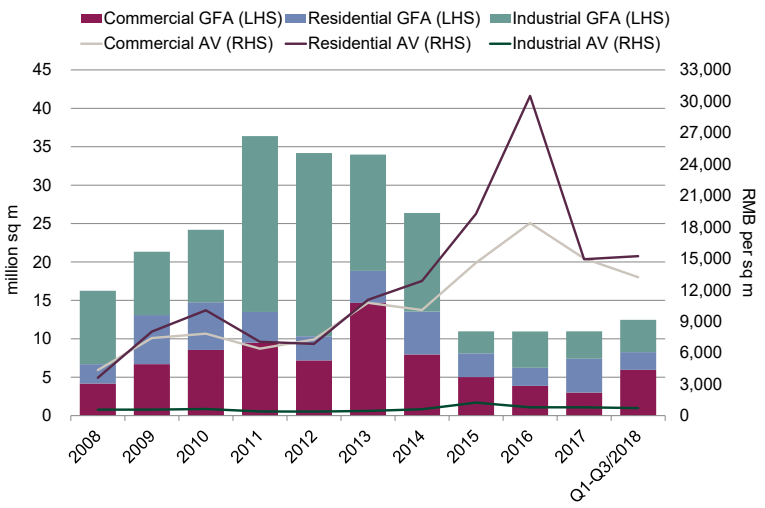
A couple of funds have been raised specifically for logistics investment. ESR set up an offshore fund with Beijing Properties to buy US$1 billion in China logistics projects; CPPIB and Goodman added US$1.75 billion to their China Logistics Fund, aiming to double their mainland portfolio; and GLP and GIC established a US$2 billion China logistics fund.

Land market[1]
Total land sale consideration reached RMB81.7 billion in Q3/2018. Commodity residential and commercial sectors accounted for 39% and 59%, respectively, of total sales in Q3/2018. Residential for sale and residential for lease AVs averaged RMB24,243 per sq m and RMB6,300 per sq m, respectively. Commercial AVs averaged 16,311 per sq m. The market saw an increase in supply when compared with the previous three years. Most of the land was transacted at reserved pricing.

Outlook
The investment market has been in a state of imbalance for a long time, with financing costs exceeding yields and sluggish rental growth. Investment was being made on the basis of continued cap rate compression under the weight of capital. Investors remained active but vigilant for potential triggers of a correction in the market. Slower economic growth and tighter financing are now forcing investors to reassess expectations.

[1] Land sales exclude public and economic housing

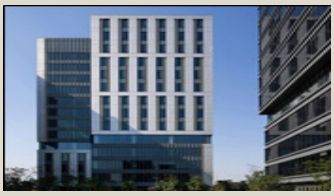
FIGURE 2
Land transaction area and AVs, 2008–Q3/2018



Source: Savills Research

TABLE 2

Key investment deals, Q3/2018

	Bay Valley C6 湾谷科技园C6	Crystal Plaza one building 晶耀前滩一栋
		
Location	1688 North Guoquan Road, Yangpu	276 Yaoti Road,
Date	Q3/2018	Pudong
Property type	Business park	Aug, 2018
Transacted price (RMB mil)	554	Office
Sellable GFA (sq m)	19,768	1,517
Seller	Citic Capital	23,548
Purchaser	Alpha Investment Partners and Allianz Insurance	Tishman Speyer
Deal structure	Onshore equity	Onshore equity

Source: Savills Research

TABLE 3

Key land deals, Q3/2018

Plot	District	Use	GFA (sq m)	Consideration (RMB million)	AV (RMB per sq m)	Buyer
Mid Huaihai road 123, 124, 132 plot	Huangpu	Commercial	343,370	13,610	39,637	CPIC, Shui On Land, Yongye Group
Hongmei street xh240a plot	Xuhui	Commercial	390,330	9,863	25,269	Vanke and Huaxin (华鑫)
North Sichuan street hk194-01plot	Hongkou	Commercial	194,930	7,100	36,423	Chongbang Group
Gucun district 16-02 plot	Baoshan	Residential	203,725	4,278	21,000	Dahua Group (大华集团)
Jinshan new town sc1-0701 plot	Jinshan	Residential	234,545	3,917	16,700	NGS Property (农工商)

Source: Savills Research

Please contact us for further information

Research

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

Agency

Siu Wing Chu
Managing Director
Central China
+8621 6391 6688
siuwing.chu@savills.com.cn

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

Please contact us for further information

Research

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

Agency

Siu Wing Chu
Managing Director
Central China
+8621 6391 6688
siuwing.chu@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 600 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.