Buyers await discounted buying opportunities

With yields in primary locations remaining stubbornly low, international investors focused their attention on secondary locations amid a forecast of significant new supply for decentralised areas.

- There was a total of sixteen deals concluded in Q2/2019, totalling around RMB21.3 billion and pushing the total consideration for the first half of 2019 to RMB73.5 billion.
- Brookfield’s acquisition of Greenland Huangpu Centre was the largest deal of the quarter, totalling more than RMB10 billion.
- Though the market remained active, the distinct difference in price expectation between buyers and sellers, equivalent to 50 bps in yield terms, has led to protracted deal negotiations.
- International investors remain interested in Shanghai’s investment market, accounting for around 70% of total consideration in Q2/2019.
- The business park market remained attractive with popular target areas including Zhangjiang, Lingkong, Jinqiao, Caohejing and Caohejing Pujiang.
- Total primary land sale consideration reached RMB61.3 billion in the first half of 2019, up by 68% year-on-year (YoY). The land market has remained relatively stable in terms of volume and pricing.

- Gross yields for recently-traded Grade A office assets continued to increase by 10 bps quarter-on-quarter (QoQ) to 5.0% in Q2/2019, while net yields were around 3.6-3.8%.

“Investors rethink the feasibility of converting properties to alternative uses as approval and construction delays hamper earlier investments. The market saw fewer deals for conversion purposes in the first half of 2019.”

JAMES MACDONALD, SAVILLS RESEARCH
MARKET COMMENTARY
Shanghai’s investment market remained active in Q2/2019, with sixteen deals concluded in Q2/2019 for a total consideration of RMB21.3 billion.

Business parks continued to garner attention from investors with a total consideration of RMB5.7 billion traded in 1H/2019—compared to RMB5.4 billion for the whole of 2018. Popular business park areas include Zhangjiang, Lingkong, Jinqiao, Coahejing and Coahejing Pujiang. Business park transaction unit prices ranged from RMB20,000 to RMB30,000 per sq m. With deal sizes for individual blocks being relatively low, the sites have garnered significant attention from domestic buyers who accounted for most of the business park transactions. For example, Vantone Group purchased Coahejing Pujiang Hi-Tech Centre Block No. 21 for RMB483 million.

Over the past two years, there has been significant interest in retail or hotel assets for conversion to multifamily and office spaces. However, several projects are seeing approval and construction delays greatly impact the investments’ rate of return; consequently, investors are now reconsidering the wisdom of this strategy—especially as sellers are seeing increased interest from domestic buyers and have started to increase prices. Investors have, in many cases, reverted to more traditional add-value plays such as renovating dilapidated buildings and taking on lease-up risk.

OFFICE MARKET
One project launched onto the core office market in Q2/2019, adding 70,500 sq m of new office space into the core market, while three projects were handed over in the decentralised market adding 171,200 sq m of new office space. Thanks to strong take-up in the core market, vacancy rates fell by 0.5% of a percentage point (ppt) in Q2/2019 to 11.9%. Vacancy rates in decentralised areas also saw a drop of 3.6 ppts QoQ to 30.3%. In terms of rent, core market rents decreased by 0.2% to an average of RMB89.66 per sq m per day and rents remained flat for the decentralised market to an average of RMB85.82 per sq m per day. The office market is expected to receive about 1.5 million sq m of new supply in the second half of 2019, of which 40% is expected to be launched in decentralised areas.

Office properties remain highly sought-after assets with the market being one of the more transparent and liquid of the key sectors. Investors are focused on office properties in secondary locations which have slightly higher yields and more room for negotiation than developments in primary locations, where sellers are typically only willing to part with their asset at a premium to market. At the same time, investors remain cautious about investing too much in decentralised markets where supply levels remain high, business communities are still immature, and values have already seen some significant uplift. While some deals have managed to make it across the finish line, the more traditionally traded assets in core locations are seeing prolonged deal negotiations. There remains a distinct difference in price expectation between buyers and sellers, equivalent to 50 bps in yield terms, given the uncertainty in market conditions and questions over the strength of the economy.

RETAIL MARKET
The retail market saw rents increase by 0.4% QoQ in Q2/2019 to an average of RMB27.8 per sq m per day along with a slight decrease in vacancy rates in both prime and non-prime retail areas. The luxury market still looks

TABLE 1: Yields And Capital Values By Sector*, Q2/2019

<table>
<thead>
<tr>
<th>Sector</th>
<th>Grade A Office</th>
<th>Prime Shopping Mall</th>
<th>Prime Retail Street Store</th>
<th>High-End Serviced Apartments</th>
<th>High-End Strata Apartments</th>
<th>5-Star Hotel</th>
<th>Logistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross reversionary</td>
<td>4.3-5.4%</td>
<td>5.5-6.5%</td>
<td>4.0-5.0%</td>
<td>4.0-5.0%</td>
<td>2.3-3.0%</td>
<td>5.5-7.5%</td>
<td>6.2-6.7%</td>
</tr>
<tr>
<td>NOI</td>
<td>3.5-4.0%</td>
<td>3.0-4.0%</td>
<td>2.0-3.5%</td>
<td>2.2-2.8%</td>
<td>2.0-2.5%</td>
<td>1.5-2.0%</td>
<td>4.5-5.5%</td>
</tr>
<tr>
<td>Approx. values (RMB per sq m)</td>
<td>50-90,000</td>
<td>60-100,000</td>
<td>150-250,000</td>
<td>55-70,000</td>
<td>100-200,000</td>
<td>40-50,000</td>
<td>6-8,000</td>
</tr>
</tbody>
</table>

* Yields refer to stabilised assets in downtown locations free of any impediments with a clean holding structure owning 100% of the building, and assuming 100% occupancy. Capital values refers to the average for the building on an aboveground GFA basis – retail assets will have higher capital values for lower floors.

Source: Savills Research
positive, with leading landmark projects welcoming new brands, although
the market size remains limited, as only a few retail developers are able to
successfully capitalise on the luxury market. Around 800,000 sq m of new
supply is expected to open in 2H/2019.

Investors are reconsidering the feasibility of converting smaller
underperforming retail centres into co-working or for-leasing apartments.
Investor interest has instead shifted to larger community malls as they look
to capitalise on the superior retail performance achieved by community
malls, which are benefitting from rising consumer demand from people in the
neighbourhood.

OTHER MARKETS
Supported by the sector’s strong demand and limited land supply, logistics
properties remained a key target for investors; they also enabled investors to
diversify their portfolios and gain exposure to rising consumerism in China
both online and offline. Investors are continuing to raise logistics funds with
a target on China assets. Allianz recently invested US$660 million into China
and Japan real estate investment funds managed by GLP. In addition, it was
reported that LaSalle is planning for a US$1 billion China logistics fund debut.
Investors are keen to develop and invest in assets that adopt the latest industry
technologies—hoping not only to lower operating costs, but also stay ahead of
the industry.

Pricing in the residential sales market remained stable in the first half of 2019
amid a relatively steady policy environment. As China’s housing sales cool the
market, it is expected that more investors will explore the rental sector, which
has received a lot of support from the government. Cifi and Ping’an Real Estate
recently teamed up to establish a RMB10 billion rental housing investment and
management platform with their maiden project being a 2,100 unit development
in Pujiang Town.

KEY DEALS
- Brookfield purchased Greenland Huangpu Centre from Greenland for
RMB10.57 billion. Located in South Huangpu submarket, the project is a mixed-
use project with three office buildings and a retail podium with combined total
GFA of 154,500 sq m. The office part of the project is still under construction
and is expected to launch at the end of the year while the retail component
is expected to open in 2020. Greenland originally bought the land parcel for
the project in 2013 for RMB5.95 billion. The large mixed-use development also
includes another office tower (previously sold to an end-user) and two residential
towers (sold strata title for RMB170,000 per sqm in 2016).
- CDL purchased a 70% stake in Shanghai Hongqiao Sincere Centre Ph2 for
RMB1.2 billion. The mixed-use complex has 11 buildings that include offices,
serviced apartments, a retail component and a basement car park with a total
GFA of around 34,800 sq m. CDL also plans to take a 24% stake in Sincere
Property Group, making it the mainland developer’s second-largest shareholder.

LAND MARKET
Total primary land sale consideration reached RMB61.3 billion in 1H/2019, up
by 68% YoY. Commodity residential¹ and commercial sectors accounted for
42% and 17% of sales, respectively. Residential for-sale and residential for-lease
accommodation values (AVs) averaged RMB20,500 per sq m and RMB5,600 per
sq m, respectively. Commercial AVs averaged RMB16,400 per sq m. Most of the
land was transacted at reserve pricing. The land market has been relatively stable
in 1H/2019 in terms of transaction volume and pricing.

OUTLOOK
Yields could soften further in 2H/2019 as market fundamentals remain
challenging because of significant supply and uncertainty surrounding demand—
partially a result of the ongoing trade dispute, but also domestic issues.

More funds are expected to be made available for the eldercare sector as the
government pushes to accelerate the development of the industry to ensure the
needs of an ageing population are met.

China REITs are once again being discussed as a possibility in China, with
expectations that legislation in support of the REIT market could be announced
in the coming quarters. REITs still face many regulatory and market challenges
in China, but ongoing developments—namely a push to increase transparency,
a shift from debt to equity, improved management standards and REIT
legislation—will help alleviate many of these issues.

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

TABLE 2: Key Investment Deals, Q2/2019

<table>
<thead>
<tr>
<th>PLOT</th>
<th>DISTRICT</th>
<th>USE</th>
<th>GFA (SQ M)</th>
<th>CONSIDERATION (RMB)</th>
<th>AV (RMB PER SQ M)</th>
<th>BUYER</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jiangpu Shequ b2-03</td>
<td>Yangpu</td>
<td>Residential</td>
<td>77,724</td>
<td>4,179</td>
<td>53,772</td>
<td>Poly Group</td>
</tr>
<tr>
<td>Shabei Gaoxin n070501 18-03</td>
<td>Jing’an</td>
<td>Residential</td>
<td>69,522</td>
<td>3,432</td>
<td>49,365</td>
<td>Yanlord Land Group</td>
</tr>
<tr>
<td>Tianshan 115-9/2 b7-2</td>
<td>Changning</td>
<td>Commercial</td>
<td>53,578</td>
<td>2,421</td>
<td>45,178</td>
<td>Jinheng Group</td>
</tr>
<tr>
<td>Chengjiaqiao 249-5/1</td>
<td>Changning</td>
<td>Commercial</td>
<td>22,405</td>
<td>706</td>
<td>31,489</td>
<td>Chunqiu Airline</td>
</tr>
<tr>
<td>Dachang e1-13a, e1-14a, e1-14b</td>
<td>Baoshan</td>
<td>Residential</td>
<td>174,127</td>
<td>4,212</td>
<td>24,192</td>
<td>Dahua Group</td>
</tr>
</tbody>
</table>

Source: Savills Research