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Investment

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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 RMB61.3billion 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."

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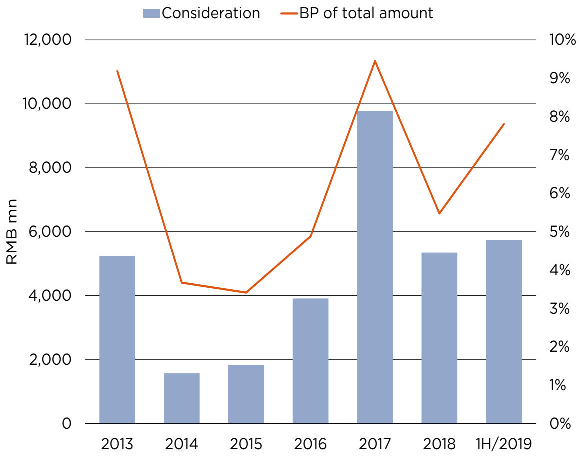
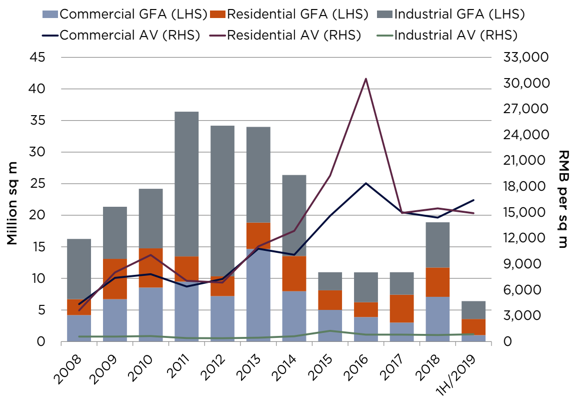
GRAPH 1: Business Park Consideration And Ratio, 2013-1H/2019



Source Savills Research

GRAPH 2: Land Transaction Area And AVs, 2008 to 1H/2019



Source 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, Caohejing and Caohejing 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 Caohejing 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 in these asset classes 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 70,300 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 RMB8.96 per sq m per day and rents remained flat for the decentralised market to an average of RMB5.82 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 are 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

	GRADE A OFFICE	PRIME SHOPPING MALL	PRIME RETAIL STREET STORE	HIGH-END SERVICED APARTMENTS	HIGH-END STRATA APARTMENTS	5-STAR HOTEL	LOGISTICS
Gross reversionary	4.3-5.4%	5.5-6.5%	4.0-5.0%	4.0-5.0%	2.3-3.0%	5.5-7.5%	6.2-6.7%
NOI	3.5-4.0%	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

* 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$600 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[1]

Total primary land sale consideration reached RMB61.3 billion in 1H/2019, up by 68% YoY. Commodity residential[2] 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.

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

TABLE 2: Key Investment Deals, Q2/2019

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

Source Savills Research