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Savills China Research

SPOTLIGHT
China 10 Residential Cities 2017

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 700 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.

Contents

SEU* Residential Value Ranking

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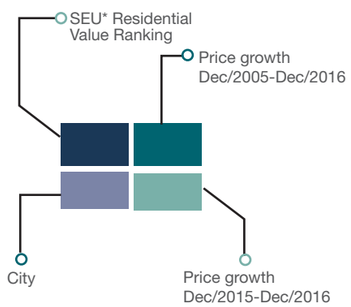


*SEU = Savills Executive Unit, a seven-person group that might start up or expand a global business in any country, which comprises of one regional CEO, one senior expat director, a locally employed director and four locally employed administrative staff.

Source: Savills Research

10 cities average growth	263% (2005-16)
	18% (2015-16)

3	363%
Beijing	21%

8	216%
Tianjin	17%

4	201%
Nanjing	18%

10	175%
Chongqing	2%

9	204%
Wuhan	18%

2	404%
Shanghai	19%

7	130%
Chengdu	22%

6	183%
Hangzhou	18%

5	101%
Guangzhou	16%

1	923%
Shenzhen	17%

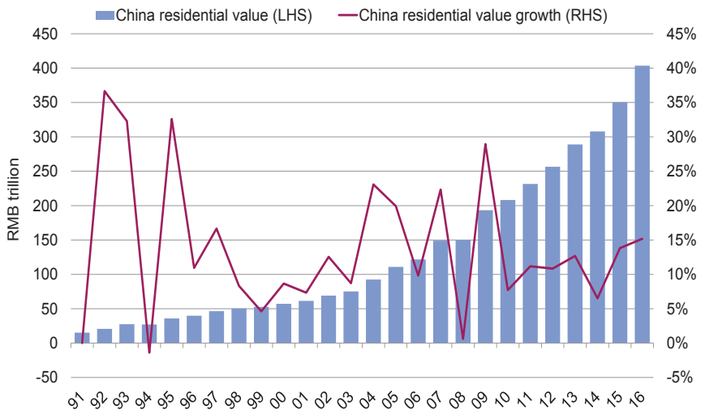
Introduction

The foundation of China's current residential real estate market was laid in 1998 when the central government privatised the housing sector. Prior to this, the majority of China's urban population lived under a welfare housing system in which the government provided low-cost accommodations. In August 1999, the Ministry of Housing and Urban-Rural Development of China (MOHURD) declared that all residential units were to be bought rather than allocated, thereby setting China's private residential market in motion.

To kick-start growth in the residential market, state-owned company employees were allowed to buy their units at a fraction of the cost, resulting in one of the largest transfers of wealth in history. Subsequent policies included tax rebates between 1998 and 2003.

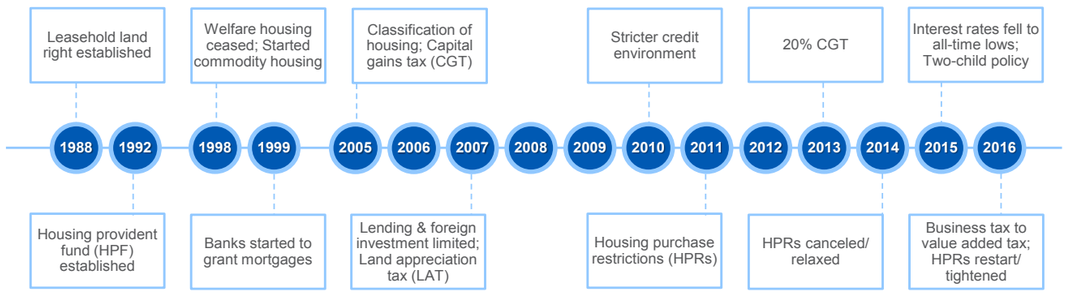
Following the reforms, China's housing market experienced tremendous growth, becoming an important driver for the Chinese economy. In 1999 investment in real estate development (REI) was just RMB410 billion, by 2016 this figure had risen 25-fold to RMB10.3 trillion, the equivalent of 15% of China's GDP. Among all types of REI, the residential sector accounted for 67%.

FIGURE 2: China residential value



Source: National Bureau of Statistics, Savills Research
NB: Residential value is estimated by using per capita residential GFA × population × average first-hand residential price.

FIGURE 1: China residential policy timeline



Source: Government announcement, Savills Research

Chinese property has been one of the biggest wealth generators in the world. The estimated value of China's residential market was RMB350 trillion (US$54 trillion) in 2015, which is 5.4 times larger than the GDP (RMB68 trillion or US$10 trillion) and roughly 33% of global residential values[1].

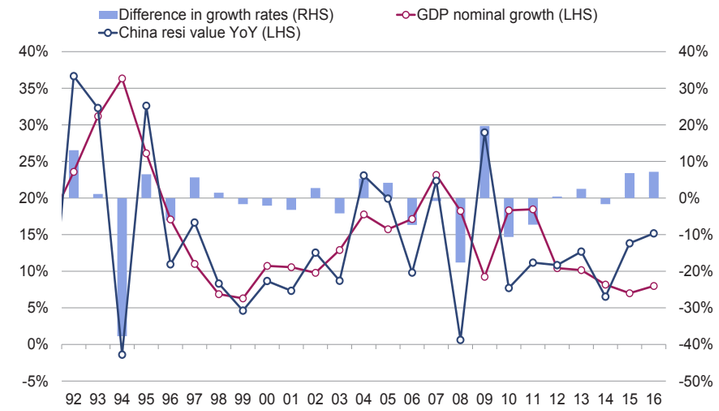
The commodity housing market in China has reached a period of peak development, with the slowing pace of urbanisation, oversupply in lower-tier cities and rising lending and construction costs reducing the number of new starts from a peak in 2011 of 1.47 billion sq m to 1.16 billion sq m in 2016. However, significant improvements in building technologies and standards have increased the quality of new housing stock.

With increased income levels, many home purchasers are typically no longer buying to reach their basic living standards but buying larger-sized units that fit their lifestyle needs. These units will often be located in more suburban locations that, because of extensive investment in city infrastructure and public transportation, have become increasingly accessible and convenient for city workers. According to MOHURD, living space per capita for urban residents reached 33.5 sq m in 2015, compared to 26.1 sq m a decade ago. Many individuals also own multiple properties either in the same city or throughout the country.

In response to rising house prices and increasingly speculative buying, especially in first-tier and hot second-tier cities, the government has repeatedly emphasized supporting end-use demand, whilst also curbing speculating activities by instituting new Housing Purchase Restrictions (HPR), stricter lending requirements and rigid tax regimes.

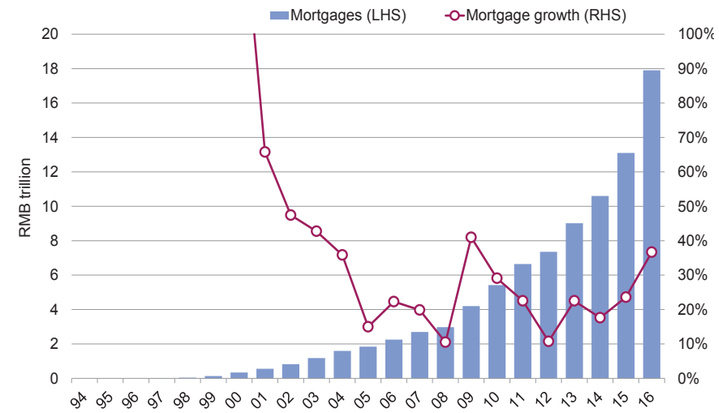
[1] Savills World Research estimated global residential asset valued US$162 trillion in 2015.

FIGURE 3: China residential value growth vs. GDP growth



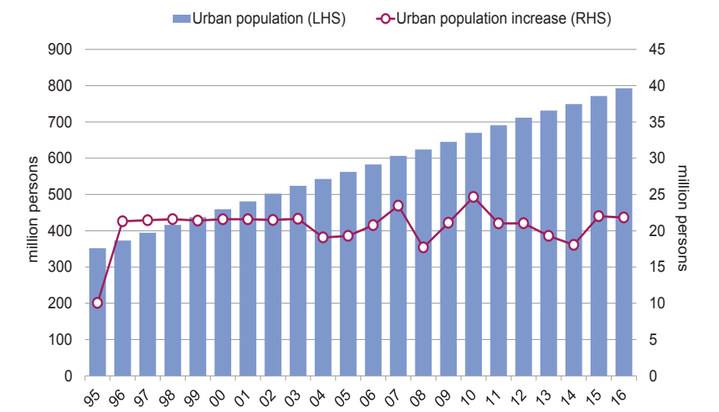
Source: National Bureau of Statistics, Savills Research

FIGURE 4: China mortgages



Source: People's Bank of China, Savills Research

FIGURE 5: Urban population



Source: National Bureau of Statistics, Savills Research

Savills Executive Unit (SEU)

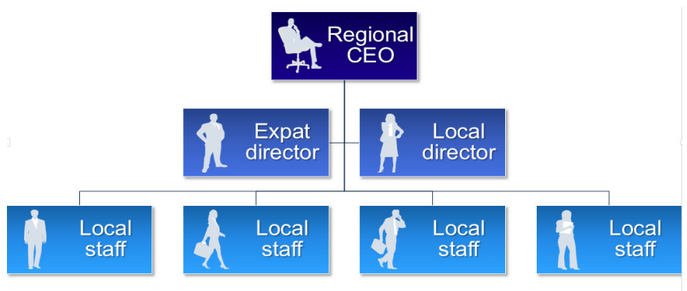
In order to compare the costs of residential properties across different Chinese cities, a typical 'executive unit', a group of people that might start up or expand a global business in any country, is taken and then compared with the residential accommodation they would likely inhabit in each Chinese cities. This methodology has been used by World Research to enable global comparisons.

Savills Executive Unit (SEU) includes one regional CEO, one senior expat director, a locally employed director and four locally employed administrative staff. They each live in different types of households, some with children, some with partners and some without. Each member of the group lives in a different location and type of property.

The following ten Chinese cities lead their respective regions economically, politically, commercially and/or in liveability. The list includes the four first-tier cities of Beijing, Shanghai, Guangzhou, Shenzhen and six second-tier cities: Chengdu, Chongqing, Tianjin, Nanjing, Hangzhou and Wuhan. These ten cities form an index of residential price movements since 2005. An index is used as it is more important to see the trend and relative cost of buying/renting, rather than absolute values.

By comparing the accommodation costs of SEU, the cost of residential property across different Chinese cities and its impact on local businesses and the economy can be truly compared. This analysis will hopefully shed light on the market from a different perspective, helping to generate important insights.

FIGURE 6: Savills Executive Unit



Source: Savills Research

Sales Market

Overall price movements

The average value of SEU properties rose by 207% from 2005 to 2015, for a compounded annual growth rate (CAGR) of 12%. The growth rate stood at 18% in 2016, whilst the index is expected to slow or trend down in 2017 as further restrictions by local governments have started to take effect in cooling down the overheated residential market.

1st-tier cities vs. 2nd-tier cities

There are big differences in the performance of individual cities: Shenzhen recorded the strongest growth of 923% over the past 11 years, whilst Guangzhou has only doubled over the same period. As a result of their lower base of comparison, as well as stronger migration and faster economic growth, first-tier cities grew on average by 380% since December 2005, whilst second-tier cities averaged 200% growth over the same period. The difference is not as significant as expected, partly as a result of Guangzhou's high base and slower pace of growth.

The second-tier cities to record the fastest price growths included Tianjin (216%), Wuhan (204%) and Nanjing (201%). Nanjing also recorded some of the most aggressive price increases over the last two years. Large price growth in Tianjin and Wuhan resulted primarily from their low bases in 2005.

FIGURE 7: SEU residential price index, 2005-2016

Source: Savills Research

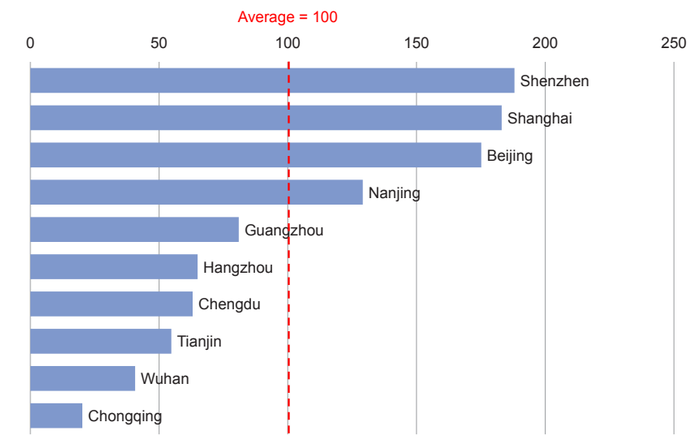
Price ranking

Shenzhen is the most expensive city in which to house the SEU, followed by Shanghai and Beijing, respectively.

After a decade of exponential price growth, Shenzhen is now significantly more expensive than the other nine selected cities, with housing prices in Qianhai close to prices in some areas of the world's most expensive city – Hong Kong. Apart from a beneficial location just across the border from Hong Kong, the city's residential market is supported by a vibrant economy that recorded GDP growth rates of 9.0% in 2016, versus the 6.7% national average. The city has found itself at the forefront of both the finance and IT/hi-tech sectors, generating job opportunities and demand for homes and offices as well as retail spaces. Unsold inventory levels in the city remain one of the lowest among leading cities, standing at 3.6 million sq m by the end of 2016, encouraging developers to set aggressive prices.

The most expensive second-tier cities are Nanjing, Hangzhou and Chengdu. Chongqing is the least expensive market, costing 80% less than the average of all ten cities.

FIGURE 8: Relative cost of buying, Dec/2016



Source: Savills Research

TABLE 1: Price-growth ranking, 2005-2016

Source: Savills Research

Rental Market

China's residential leasing market has gone through many changes over the last 20 years in terms of both supply and demand. High-end residential leasing started off in the hotel market, with business travellers staying in four- and five-star hotels. In the early 1990s, developers began to offer serviced apartments, providing larger units and more privacy at lower prices than star-rated hotels. In the 2000s, a number of international-branded serviced apartment operators entered the China market, and have been expanding rapidly ever since.

Since 2008, an increasing number of strata-title properties have joined the leasing market, increasing the variety of accommodation available. In recent years, the increase in secondary landlords, selected-service residences and co-living spaces has offered tenants a wider range of accommodation types at different price points and service levels, while also further blurring the lines between serviced apartments, strata-title apartments and hotels.

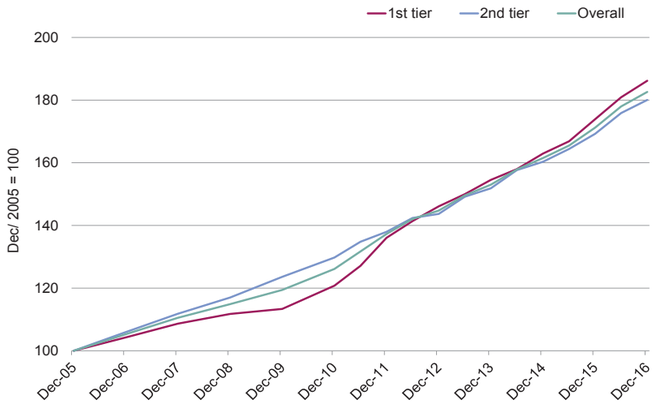
High-end leasing and serviced apartment market

The main driver of many high-end residential leasing markets in China has been expatriates working for large multinational corporations (MNCs). Expatriates working for MNCs have historically received large housing budgets in US dollars, allowing them to rent at the top end of the market. However, a weaker global economy and the strengthening of the Renminbi has led to reductions in housing budgets and the replacement of expatriate employees with the improving local talent pool. While demand for serviced apartments primarily still comes from expatriates, westerners and families make up a smaller and smaller proportion. The number of domestic tenants has also increased as people become more mobile and demand better quality accommodation.

Nascent leasing market

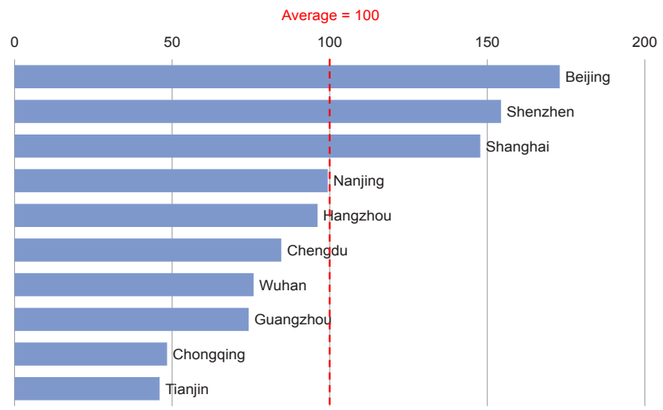
As Chinese people regard properties as "safe havens" in which to store wealth, most people prefer to buy rather than rent a house. According to the People's Bank of China (PBoC), China's home ownership is over 89%, significantly higher than the global level. Due to this traditional attitude, the residential leasing market remains relatively immature compared to the residential sales sector. According to the sixth national population census, 89.5% of rental houses come from private housing and 100 million people still live in rental houses. With rising residential prices, the leasing market is expected to benefit from the clampdown in the sales market as would-be buyers, who are unable to scrape together the inflated down payment requirement, turn to the leasing market.

FIGURE 9: SEU rental index, 2005-2016



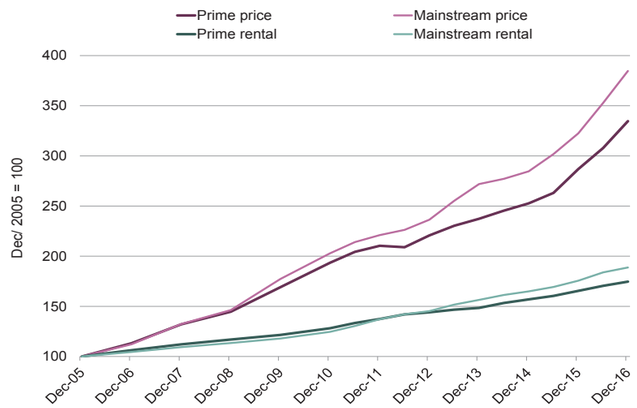
Source: National Bureau of Statistics, Savills Research

FIGURE 10: Relative cost of renting, Dec/2016



Source: National Bureau of Statistics, Savills Research

FIGURE 11: Mainstream premises seeing higher growth than prime



Source: Savills Research

Overall rental movements

The total annual cost of renting all the accommodations needed by the SEU for one year averaged RMB1.1 million in 2016, ranging from RMB491,000 in Tianjin to RMB1.8 million in Beijing. For any business, these are sums worth noting as in addition to office costs employees will need to be paid a package allowing them to cover their costs of living in their respective cities.

The average rental value of all SEU properties rose by 71% from 2005 to 2015 or a CAGR of 5.5%, approximately one-third the pace of price growth over the same period. Rental growth in 2016 reached only 7%, despite an 18% increase in prices.

Rental value ranking

Beijing achieved the highest rents among the ten tracked cities, supported by greater job opportunities (more non-locals), higher incomes and higher residential prices. Many would-be home purchasers who can no longer afford or are no longer allowed to buy have been pushed into the leasing sector.

Shenzhen and Shanghai rank second and third after Beijing, followed by Nanjing and Hangzhou, which sit close to the ten cities average. Chongqing and Tianjin were the least expensive cities, with rents nearly 50% below the average of all ten cities.

Government support

The central and local governments both have lent their support to the leasing market. In 2016, the State Council announced plans to encourage the residential leasing market, including allowances for individuals who qualified for low-income housing, encouraging them to lease from the open market, and promoting the conversion of commercial-use properties to residential leasing use. While encouraging the conversion for residential leasing, the government has recently cracked down upon the sales of commercial zoned residential development and commercial properties converted to residential usage. This was previously used as a loophole to circumnavigate house purchase restrictions in many cities.

Aside from that, a new regulation in the residential land market requires a percentage of the holding area designated for self-use or lease only, which also will encourage developers to enter the leasing market (e.g. via developing talent housing as proposed by the government) and thus adding accommodation types to the residential leasing market. Some cities have gone further, Shanghai recently announced their 13th five year urban planning plan for 2015-2020, which in addition to increasing the targeted number of units to be develop called for the development of 700,000 units of residential leasing stock.

Future scope

Other types of leasing accommodations include student housing and senior housing, whose markets are mature in overseas countries but which remain in very early stages of development in China.

TABLE 2: Ultra-luxury residential properties in ten Chinese cities

One Sino Park Lufthansa, Beijing	Tomson Riviera Lujiazui Riverside, Shanghai
	
Portofino OCT, Shenzhen	The Bayview Zhujiang New Town, Guangzhou
	
Zhongshan International Golf Villa East City, Nanjing	The One Hushu, Hangzhou
	
Yintai Huayue Penthouses Financial City, Chengdu	The Skyline Nanbin Road, Chongqing
	
Yanlord Riverside Plaza Laochengxiang, Tianjin	Wuhan Tiandi Hankou Riverside, Wuhan
	

Source: Savills Research

Yields

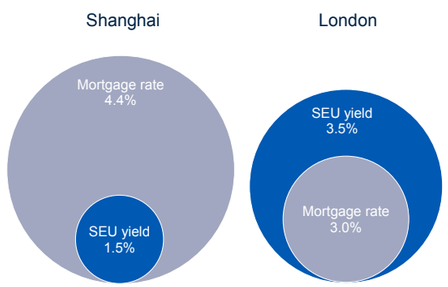
Residential property sales prices over the last ten years have easily outstripped rental growth, suppressing yields. Compared with world cities such as London (3.5%) and New York (4.5%), the rental yield is relatively low in Chinese cities, with an average gross yield of 2.4% in December 2016[1]. This is a result of the volume of investors buying for capital gain or to store wealth, which has caused prices to rise significantly quicker than rents.

[1] Yields all refer to SEU properties.

Given lower prices, Chongqing recorded the highest rental yields among all ten cities at 4.8%, followed by Chengdu (3.4%) and Wuhan (3.0%). Shenzhen and Shanghai, unsurprisingly, recorded the lowest yields due to their high price levels and rapid price growth.

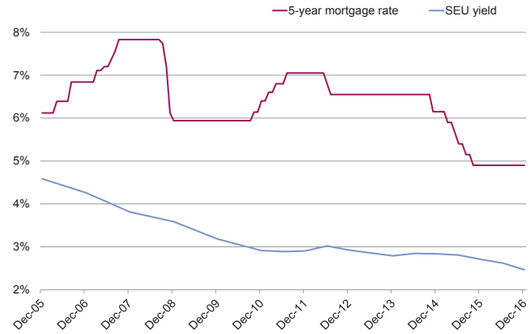
In many international markets, leasing a property typically achieves a yield between 4-6%, which in many cases is enough to cover the cost of a mortgage, especially given record low interest rates since the 2008 Global Financial Crisis (GFC) began almost a decade ago. However, this is not the case in China, where rental yields are as low as 1-3%.

FIGURE 12: Mortage rate vs SEU yield, Shanghai vs London



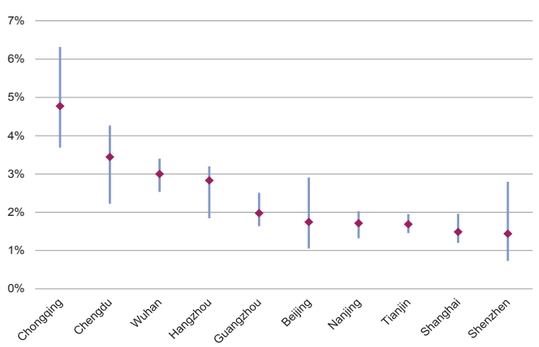
Source: Savills Research

FIGURE 13: Historical SEU gross yields vs. mortgage rates, 2005-2016



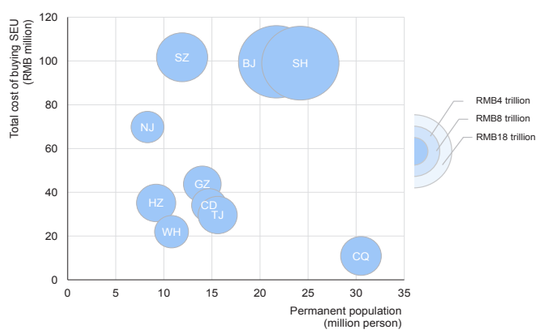
Source: People's Bank of China; Savills Research

FIGURE 14: SEU gross yields, Dec/2016



Source: Savills Research

FIGURE 15: Estimated total value of ten cities' residential markets



Source: National Bureau of Statistics, Savills Research
NB: City value is estimated by using per capita residential GFA × population × average first-hand residential price.

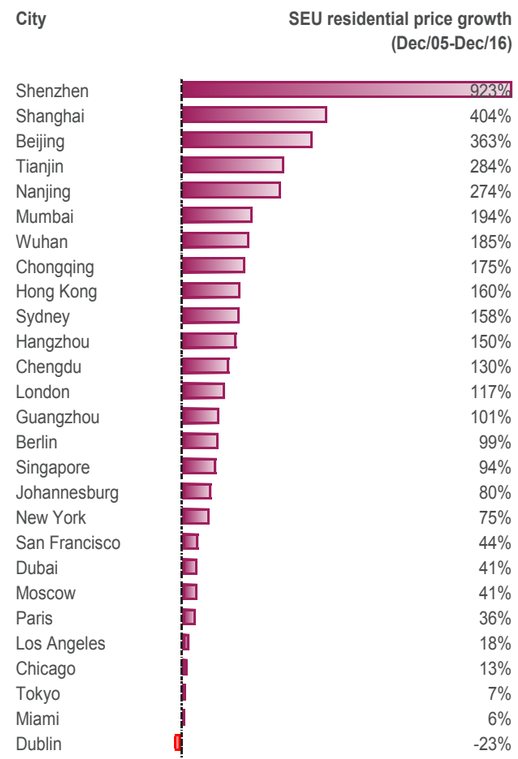
When comparing to the world cities…

Housing prices in many of China's big cities have increased as much as or even more than those in developed countries over the last decade (see Figure 13). However, even as some cities begin to reach international pricing, the incomes of residents lag far behind those of developed countries.

Despite this sharp contrast, millions of Chinese homebuyers with different goals and savings continue to rush into the housing market as leading Chinese cities remain significantly cheaper than Hong Kong/London properties, increasing speculation over further price increases. Meanwhile, high net-worth individuals (HNWIs) who made up the original cohort of investors in the early 2000s have begun to trade in and upgrade their properties. These factors, combined with a lack of alternative investments, a belief that home prices will not fall and the traditional Chinese attitudes towards property, make the real estate market the darling of Chinese investment portfolios and drive China's home ownership rates to one of the highest levels in the world.

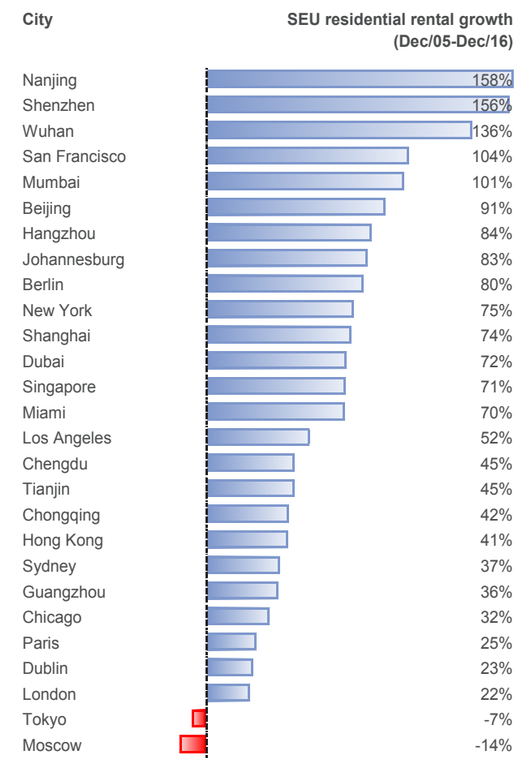
Despite the differences, Chinese cities still share some similarities with world cities, including suburbanisation, lower yields in prime locations, highly sought-after school districts, gentrification and displacement, and non-local HNWIs buying up central locations.

FIGURE 16: Global SEU residential price growth



Source: Savills World Research

FIGURE 17: Global SEU rental growth



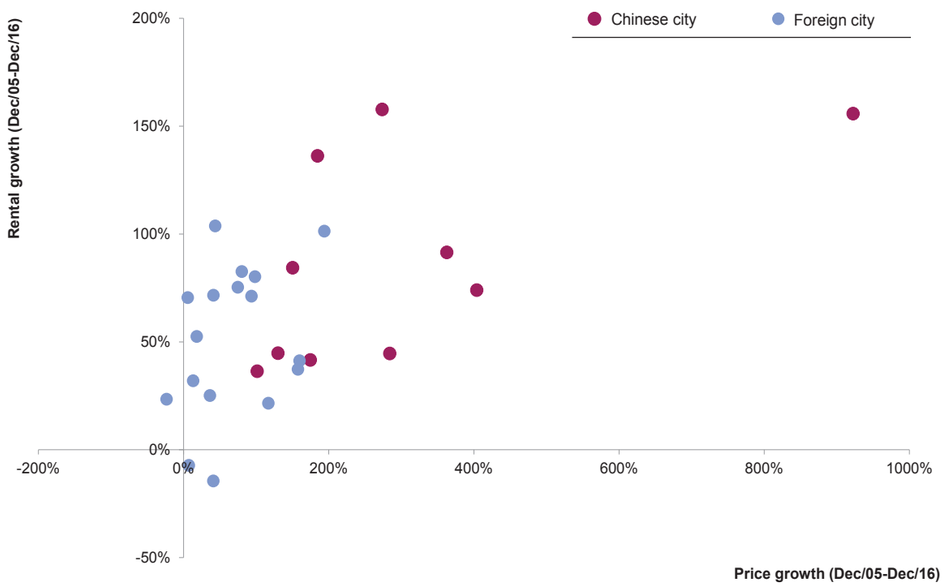
Source: Savills World Research

Final thoughts

While rising home prices have made home owners wealthier, they have also made it more difficult for young and low-income people from getting on the property ladder, which decreases a city's equality and social mobility. At the same time, rising property prices require employers to match these rises with commensurate increases in wages to maintain affordability for staff, placing an additional burden upon corporations.

The debate over China's rising residential prices has been a key concern for policymakers for many years. Initially price growth was encouraged as a way to generate private wealth, increase investment as well as stimulate economic growth and job creation as developers and investors piled into the market. Now policymakers are trying to tread a fine line between cooling the market but also increasing affordability and maintaining investment levels, economic and developer confidence.

FIGURE 16: Global SEU residential price and rental growth



Source: Savills World Research

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