Community retail garners attention

Smaller lump sums, lower price points and higher yields, as well as the potential for increased operational efficiencies, have attracted investors to the community retail space.

- Only six deals were concluded in Q3/2020 for a total consideration of RMB4.5 billion, down 60% YoY.
- A fall in activity in the third quarter reflects the lack of deal origination in the first two quarters as a result of COVID-19 as well as continued market uncertainty and price disparities.
- End-use buyers remain active in the office and business park markets with three deals concluded in Q3/2020, accounting for more than half of the office and business park transactions.
- The commercial land transaction volume in the first three quarters of 2020 has already exceeded 2019 full-year volumes by 70%.
- Driven by the rapid expansion of the digital economy, growing use of cloud services and the dawn of 5G mobile data networks, investors are actively exploring opportunities to invest in data centres.
- Gaw Capital US$1.3bn fund backed by ADIA recently announced a JV with Beijing-based data centre operator Centrin Data to acquire, develop and operate hyperscale facilities in China.

- Transaction volumes could pick up in Q4/2020 as buyers pull the trigger on deals and sellers seek to meet sales targets and continue to feel financial pressure.

“Tighter control over developer financing with the announcement of the 3-4-5 policy will mean that many companies will have to focus on monetising assets and attracting new equity investments while continuing to roll over debt commitments.”

JAMES MACDONALD, SAVILLS RESEARCH

Savills Research
MARKET COMMENTARY

Only six deals were concluded in Q3/2020 for a total consideration of RMB4.5 billion, bringing the YTD consideration to RMB43.8 billion, down 50% YoY (albeit from a high base of comparison). Three deals were concluded by end users, including two offices and one business park, with less price-sensitive buyers seizing the opportunity to secure ideal projects at a reasonable price while the market is quiet. The other three are retail, serviced apartment and mixed-use properties.

The investment community has taken a significant interest in community retail centres with several en-bloc deals closed over the last year or in the final stages of closing, including Zhangjiang Jade Park, Yuqiao Haishang Chuanqi, Sanlin Vanke Wujiefang and a small retail asset on Baotou Road. Community retail has proved resilient in 2020 with changes in consumer behaviour prove positive as individuals stay closer to home and avoid more crowded city centres. Community retail's comparatively low capital value, stable cash flow and relatively high returns are all key selling points. City-centre shopping mall cap rates in first-tier cities stand at roughly 4.0-4.5% while community retail is typically 50 bps higher at 4.5-5.0% (while cap rate for logistics properties stand at 5.5-6%). The drawback, however, is that given the location and nature of the asset there is little tenant reconfiguration that can be done to increase revenues, and each asset is a relatively small lump sum making it challenging to deploy significant capital.

The PBOC and MOHURD announced in August that they were drafting new financing guidelines for real estate developers, assessing companies against three key ratios, namely liabilities to asset, net debt to equity and cash to short-term debt. Though there has no clear timetable when the rules will be enforced yet, according to some media, a pilot program was instigated where a dozen key developers were selected to submit a three-year debt-reduction plan, and other developers may have to follow suit in 2021.

While the government has attempted to curb excesses in the past, the current policy seems to be a more concerted, transparent, long-term and broad approached to forcing heavily-indebted developers to deleverage. Heavily indebted developers will likely need to speed up monetisation of assets by cutting home prices to boost sales, sell equity stakes or spin off non-core businesses and assets. More market consolidation is expected, with more fiscally conservative developers able to gain market share over their more cavalier peers.

OFFICE MARKET

Three new projects, including One Financial Street, the Edge and the Huatai Financial Building were handed over in Q3/2020, adding a total office GFA of 105,700 sq m. Net take-up totalled 168,200 sq m in Q3/2020, compared to just 14,200 sq m in Q2/2020. Rising net take-up resulted in the citywide Grade A office vacancy rate declining by 0.5 ppt in Q3/2020 to 16.9%. The effective rent continued to decrease in Q3/2020, but at a slower rate of 1.4%, to an average of RMB7.4 per sq m per day.

End-user buyers were the most active office buyers in 2020 accounting for more than half of the office and business park transactions to date compared to just one-sixth of deal in 2019. Funds on the other hand have remained cautious due to market uncertainties and softening fundamentals. Core area assets have few discounts, with owners often, if possible, holding onto the assets until the market picks up. Nevertheless the market is expected to see more highly motivated sellers and an
increase in NPL in response to owners cash crunch and restricted financing channels, such as the Tomorrow Square’s scheduled online auction.

RETAIL MARKET
Retail sales totalled RMB966 bn in the first eight months of 2020, down 6.4% YoY despite a return to growth in May. No new projects were launched onto the market in Q3/2020 or indeed for the whole of 2020. Overall shopping mall vacancy rates fell by 0.2 ppt QoQ to 11.5%. Fashion retailers were more positive in the third quarter with many young brands helping to drive footfall and consumption to malls. First-floor rents fell 0.2% in Q3/2020 at an average of RMB26.5 per sq m per day.

Appetite for shopping centres remains limited to a handful of investors given the high demands on management and operational experience and structural oversupply and competition from online platforms. Nevertheless, community retail projects have won many investors’ attention given their stable cash flow even during the pandemic and relatively high returns compared to city centre malls. Some developers are looking to sell these non-core assets to generate short term capital and may offer discounts to market to dispose. Assets however are relatively smalls and larger investors will require a portfolio of assets to make it worth their time.

OTHER MARKET
Niche sectors
Driven by the rapid expansion of the digital economy, growing use of cloud services and the dawn of 5G mobile data networks, investors are actively exploring opportunities to investment in data centres.

High barriers to entry including licencing, electricity supply, environmental controls and land usage rights make it challenging for international funds to go it alone with many partnering with local operators. Gaw Capital US$1.3bn fund back by ADIA recently announced a JV with Beijing-based data centre operator Centrin Data to acquire, develop and operate hyperscale facilities in China.

Others are going solo, Keppel invested RM1.5 billion to purchase a greenfield area located in Tonghu Smart City in Huizhou from Country Garden with a plan to develop a data centre of 45,215 sq m.

Meanwhile, big high-tech companies are also building their own data centres. For example, Alibaba Cloud has put three new hyperscale data centres located in Hangzhou, Nantong and Ulanqab, with a combined capacity of over one million servers. The hyperscale data centres are said to use self-developed, state-of-the-art servers and artificial intelligence chips.

KEY DEALS
- Guohai Securities purchased Greenland Bund Centre C1 for RMB3.8 billion intended for self-use. Located in Dongjiadu, Greenland Bund Centre is expected to be completed in 2021, has a total lettable GFA of 15,209 sq m and is one of 11 buildings in the complex. Together with Guohai Securities’ purchase, seven of the planned 11 commercial buildings in the complex have been sold, including one building to Bank of Shanghai, two buildings to PICC and three buildings to Haitong Securities.
- Blackstone acquired Central Garden for RMB1.0 billion from Sunac. Central Garden is a serviced apartment project located in Putuo district with a total GFA of 42,600 sq m. Blackstone is said to have appointed Funlive, a apartment platform run by SCE Real Estate, to be the operator.

LAND MARKET
Primary land sales totalled RMB24.4 billion in the first three quarters in 2020 with commodity residential and commercial sectors accounting for 50% and 44%, respectively. Residential for-sale and for-lease land plot AVs averaged RMB26,350 per sq m and RMB5,750 per sq m, respectively. Commercial land plot AVs averaged RMB10,780 per sq m.

Many local governments have sped up land sales to generate more revenues and attract increased investment in recent months, with Shanghai being no different. Commercial land transaction volume for the first three quarters of the year is already over 70% higher than the total transacted volume for FY2019, including a number of high profile plots such as Lujiazui Development’s purchase of a mixed-use land site in Qiantan for RMB4.9 billion and New World Development’s purchase of a commercial land site on Huaihai Road for RMB4.1 billion.

OUTLOOK
Transaction volumes are expected to pick up in the final quarter as buyers look to deploy allocated dry powder, sellers look to hit sales targets and the near term outlook becomes clearer allowing for better price discovery. End-users and long-term investors, however, are expected to remain the major buyers in the market in the near future.

With more people going into the logistics sector, yields are expected to compress further. As online groceries and pharmaceutical sectors expand rapidly, the cold chain segment of logistics is expected to become more popular.

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*LAND sales exclude public and economic housing*