MARKET IN MINUTES
Savills Research

Investment

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Investors opinions on the best asset class start to diverge

Despite weak consumer sentiment, supportive policies and new exit channels attract investor interest to the retail sector.

- Nine deals were concluded in Q3/2023 for a total consideration of RMB6.9 billion, down 44.0% QoQ.
- Serviced apartment/residential assets remain a key focus for investors with two en-bloc transactions taking place in Q3/2023.
- Investor inquiries have increased as office asset owners adjust their price expectations. More family offices are considering investing in the office sector for the first time as asking prices fall.
- Demand for quality retail has increased since the March announcement of their inclusion in the REIT regime. Some insurers and domestic funds have started looking for suitable investment targets, and large-scale retail assets with stable tenant profiles and cash flows are favoured.
- Hotel owners and managers have found the last three years incredibly challenging with several hotels up for auction nationwide this year.

> "As sellers start to price assets more realistically under current market conditions, investors are taking another look at the sector that many have forgone in recent years."
>
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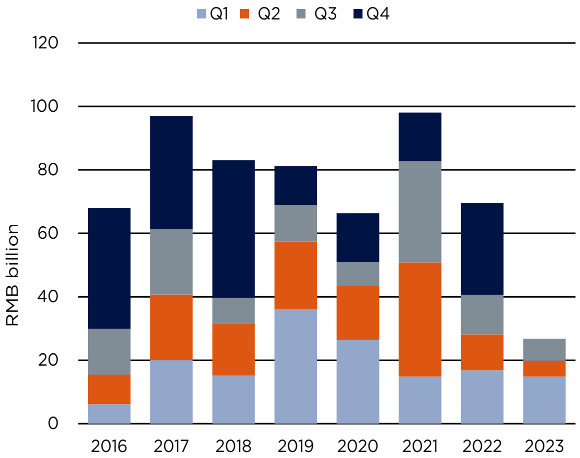
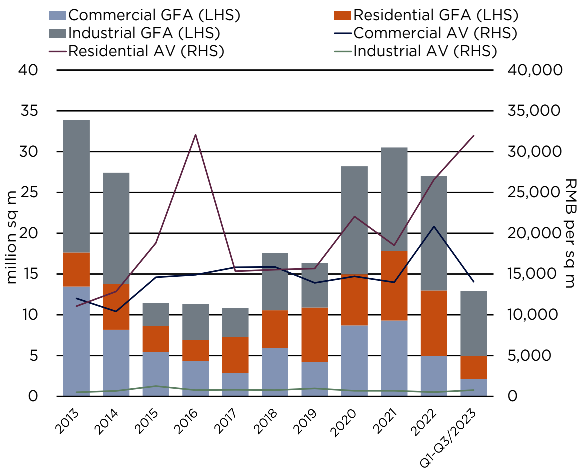
GRAPH 1: Shanghai En-Bloc Transaction Volume By Quarter, 2016-Q3/2023



Source Savills Research

GRAPH 2: Land Transaction Area And AVs, 2013 to Q3/2023



Source CREIS, Savills Research

MARKET COMMENTARY

Nine deals were concluded in Q3/2023 for a total consideration of RMB6.9 billion, up 40% QoQ. However, total transaction volume in the first three quarters of 2023 accounts for only 38% of FY2022 volumes.

Family office acquisitions of business parks and warehouses accounted for most deals in Q3/2023. Despite a higher number of inquiries for office assets this quarter, investors still require more significant discounts. However, most assets that are willing to discount tend to have shortcomings, namely remaining land tenures of less than 25 years, poor building quality and/or location.

Hotel owners and managers have found the last three years incredibly challenging whether it be reduced demand, last-minute cancellations, or quarantine requisitions. Partly because of this, and the ongoing developer debt crisis, several hotels have been put up for auction this year, especially luxury hotels. Sheraton Shanghai Hongkou Hotel was put up for auction by the creditor bank after seizing the asset from the previous owner. The asset was originally valued and put up for auction at RMB2.3 billion, Jinfeng Group eventually acquired the asset after the third round, at a reserve price of RMB1.6 billion.

Office/Business Park Market

Nine new Grade A office projects, 1.07 million sqm, were handed over in Q3/2023, driving the city's total stock to 17.9 mn sqm by the end of the quarter. In large part due to self-use developments and pre-leasing, net take-up totalled 351,700 sqm in Q3/2023. Excluding owner-occupied projects, non-prime areas contributed 70% of total net take-up. New supply and weak demand pushed the citywide vacancy rate up to 19.1%, up 3.1 ppts QoQ. Grade A office rental declines accelerated, with rents falling 1.8% QoQ to an average of RMB6.9 psm pday.

Four office/business park deals were concluded in Q3/2023. Transaction volume fell 50% QoQ to RMB573 million. The sector has the most transparent pricing and high liquidity, along with relatively simple asset management. More family offices are considering investing in the office sector for the first time as asking prices fall. Faced with weak leasing demand, investors are finding it increasingly difficult to underwrite short-term rental growth and are more concerned with an asset's ability to retain existing tenants/occupancy levels.

RETAIL MARKET

Four new projects within the Outer Ring Road were launched in Q3/2023, adding a total GFA of 272,000 sqm. The citywide vacancy rate fell 0.4 ppt QoQ to 12.3%, down 0.4 ppt YoY. Prime retail area vacancy rates fell 0.9 ppt QoQ to 10.2%, while non-prime retail areas were down 0.3 ppt QoQ to 12.8%. First-floor rents remained flat in Q3/2023 at an average of RMB25.8 psm pday, down 0.5% YoY; prime area rents grew by 0.1% QoQ, after five consecutive quarters of decreases, while non-prime areas' rents kept flat.

Demand for quality retail has increased since the March announcement that retail assets would be included in the REIT regime. Some insurers and domestic funds have started looking for suitable investment targets, and large-scale retail assets with stable tenant profiles and cash flows are favoured. Wanda sold four Wanda Malls to Dajia Insurance in 2023, including Shanghai Songjiang Wanda Plaza

TABLE 1: Yields And Capital Values By Sector[1], Q3/2023

	GRADE A OFFICE	BUSINESS PARK	PRIME SHOPPING MALL	PRIME RETAIL STREET STORE	HIGH-END SERVICED APARTMENTS	LONG-TERM LEASING APARTMENTS	HIGH-END STRATA APARTMENTS	5-STAR HOTEL	LOGISTICS
APPROX. GROSS TO NET RATIO[2]	70-80%	75-85%	55-65%	70-80%	50-60%	70-80%	80-90%	35-45%	80-85%
NOI	3.5-4.75%	4.0-5.0%	3.5-4.5%	3.0-3.5%	3.5-4.0%	4.0-4.5%	2.5-3.0%	2.0-3.0%	4.75-5.25%
APPROX. VALUE (RMB PER SQ M)	40-90,000	20-40,000	50-80,000	80-150,000	55-70,000	20-40,000	100-200,000	30-50,000	7-11,000

[1] 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.
[2] Takes into consideration the costs, including taxes, fees, and other miscellanies.

Source Savills Research

and Shanghai Zhoupu Wanda Plaza. Wanda still maintains the management rights.

INDUSTRIAL AND LOGISTICS MARKET

Shanghai's non-bonded Grade A warehouse market remained stable in Q3/2023. Two new projects were recorded in Jinshan, totalling about 93,000 sqm of new supply, and pushed the city's non-bonded Grade A warehouse stock to 7.41 million sqm. Rents fell by 0.2% QoQ to an average of RMB49.7 psm pmth, up 0.5% YoY. The citywide vacancy rate increased by 1.5 ppt QoQ to 16.3%, impacted by weak demand and new supply. Fengxian and Jinshan submarkets witnessed a slight decline in demand, as 3PLs adjusted storage networks to improve efficiencies.

The logistics market remains attractive to investors; however, they have become more conservative in recent quarters. GLP Capital Partners closed the latest tranche of its China Revenue Fund VIII for nine logistic parks in China in July, with a size of RMB5.2 billion. The Fund's investors are five domestic insurance companies. Shortly afterwards, it announced the close of its China Value-Added Fund for four logistic parks located in Beijing, Shanghai and the Greater Bay area, with a size of RMB3.5 billion.The investor is an international institution.

SERVICED APARTMENT

Four new serviced apartment projects were launched onto Shanghai's serviced apartment market in Q3/2023, adding 1,070 units. A soft residential sales market supported demand for the leasing market as potential buyers waited on the sidelines. Meanwhile, a pickup in tourism numbers supported short-term stays. The citywide serviced apartment vacancy rate grew by 0.3 ppt QoQ to 18.7%, down 2.0 ppts YoY. Rates increased largely because of new supply with the occupancy rate of many existing projects recording an improvement. Serviced apartment rents increased 0.2% in Q3/2023 to an average of RMB268.8 psm pmth.

Serviced apartment/residential assets remain a key focus for investors with two en-bloc transactions taking place in Q3/2023. Developers and insurers are the main investors. Insurers are more likely to purchase quality assets with stable cash flow. CCB Trust purchased Pujiang Center Vlinker Youth Community in Q3/2022 for over RMB1 billion. Vlinker purchased this asset in 2021 for RMB520 million and reopened in October 2022 after renovation. CCB Trust announced in October that their application for C-REIT issuance with three affordable rental housing projects located in Beijing, Shanghai and Suzhou had been accepted by the National Development and Reform Commission (NDRC).

KEY DEALS

• Huineng Group purchased three buildings (49,000 sqm) in Ocean One (previously Fraser Suites Top Glory) for RMB4.1 billion with a unit price of RMB84,000 psm.

• Jinfeng Group purchased Sheraton Shanghai Hongkou Hotel at auction at a reserve price of RMB1.6 billion, which was originally valued at RMB2.3 billion.

• Haihua and Uster purchased the 101,000 sqm Tomson Waigaoqiao Industrial Park (one office building and three industrial buildings) for RMB404 million with a unit price of RMB4,000 psm.

• Yuanlong Yato, a listed marketing company, bought China Overseas Centre (Block E F6-9) for RMB306 million with a unit price of RMB40,000 psm.

LAND MARKET

Primary land sales totalled RMB126.2 billion in the first three quarters, down 58% YoY. Commodity residential and commercial land accounted for 71% and 24% of the transaction consideration, respectively. Residential for-sale plots accommodation values (AV) averaged RMB31,968 psm while commercial land plot AVs averaged RMB14,044 psm.

Shanghai's second batch of land auctions were held in July/August involving 24 residential plots with a buildable area of 2.63 million sqm. They were sold for a total consideration of RMB64.4 billion, with an average accommodation value (AV) of RMB24,500 per sqm. A Pingliang sub-district (平凉街道) plot in Yangpu District had the highest reserve AV of RMB67,500 per sqm and eventually sold for RMB74,250 per sqm.

More sustainability requirements are being added to new residential plots, while auction prices that reach price ceilings will now go to a lottery system.

OUTLOOK

Shanghai's Grade A office yields remained unchanged at 4.75% in Q3/2023, but the continued weak demand is affecting investor expectations and yields could rise further in the coming quarters. The market is expected to see more developers selling assets to pay back liabilities, as well as an increase in activity in state-led asset restructuring and disposal of non-performing loans by banks.

TABLE 2: Key Land Deals, Q3/2023

PLOT	DISTRICT	USE	GFA (SQ M)	CONSIDERATION (Million RMB)	AV (RMB PER SQ M)	BUYER
松江区洞泾镇SJS30006单元04-04、05-01、05-05号地块	Songjiang	Residential	273,238	7.1	25,850	Huafa Industrial Share
闵行区梅陇社区MHP0-0304单元02-07-07地块	Minhang	Residential	129,054	6.2	47,853	Greentown
闵行区华漕镇MHP0-1402单元16-05、17-04地块	Minhang	Residential	150,234	6.1	40,920	CRCC
嘉定区南翔镇JDC2-0203单元13-02、16-01地块	Jiading	Residential	143,291	4.9	34,100	Greentown
闵行区浦江镇浦江拓展大型居住社区44-01、45-01地块	Minhang	Residential	190,259	4.7	24,888	Dahua Group
自贸区临港新片区PDC1-0103单元B05-01、DSH-04单元C07-01地块	Pudong	Mixed use	517,832	3.9	7,481	Shanghai Lingang, Zhejiang Rongsheng

Source CREIS, Savills Research