China Real Estate Market - 2021

SPOTLIGHT
Savills Research

Finding The Way Forward

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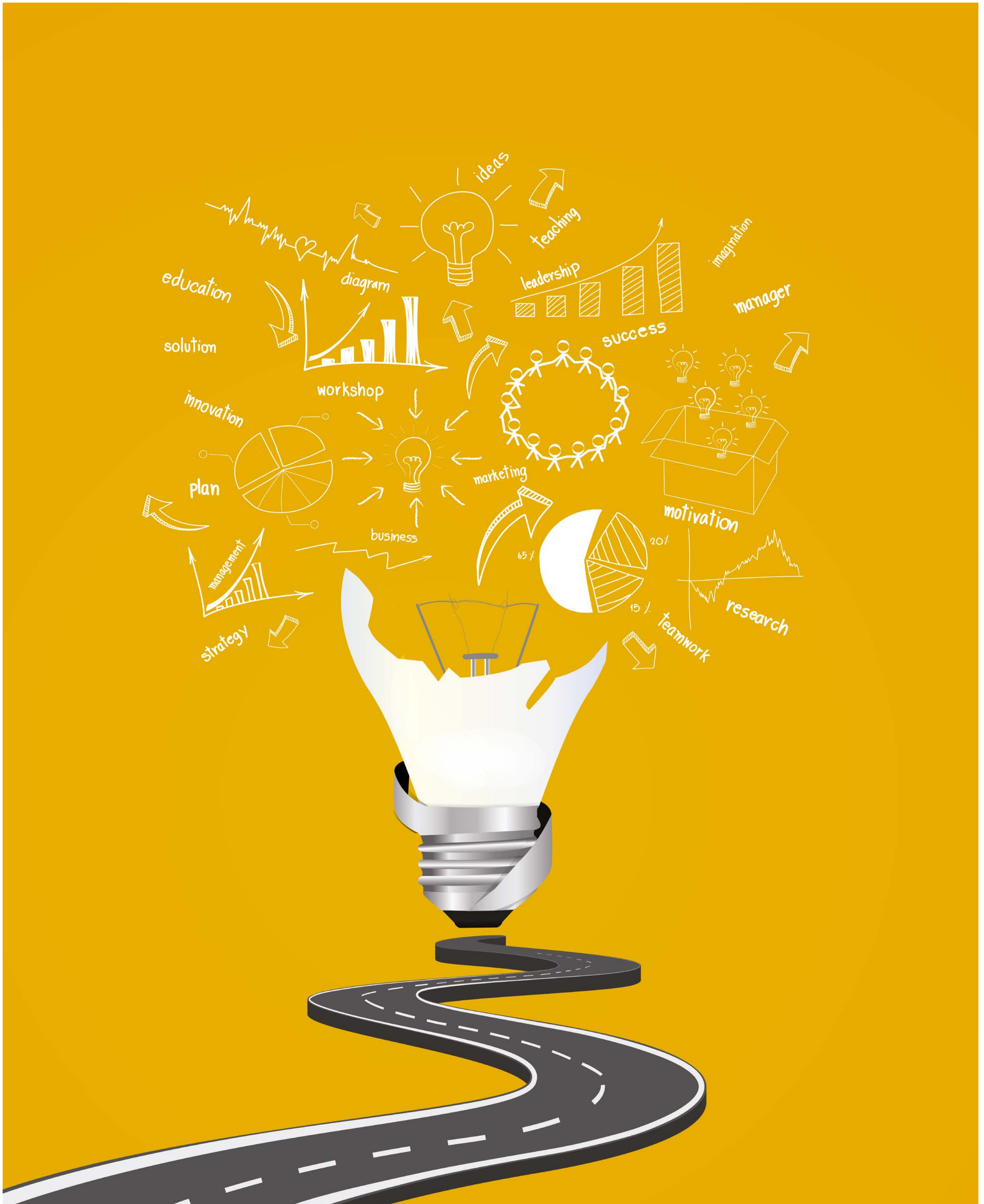

Foreword

No country has been left unscathed by COVID-19, though the extent and duration that it has impacted individuals, communities and businesses have varied significantly. China was the first country to detect the virus and, with measures that were some of the toughest in the world, they proved successful in curbing the spread of the virus within China's borders. In the weeks and months of disruption following the outbreak, businesses went into crisis mode in order to continue operations and eventually resume operations, with many hoping that business and life would return to normal relatively swiftly as it had done in the case of SARS in 2003-2004. This proved correct to a certain extent, with life for most of the country returning to a degree of normality by April/May within China, though, unfortunately, not for the rest of the world.

Faced with the prospects of prolonged lockdowns, social distancing, the rise of working from home and home deliveries services, many in the developed world are questioning whether there is still the need for the more traditional office or retail centres. China, on the other hand, with a relatively short lockdown period, has seen the usage of these spaces largely revert to normal, albeit with contactless touchpoints, extra health checks and raised hygiene standards.

In the short term, the shift in working, consumer and lifestyle habits is likely to be more profound in developed western countries where longer commute times, larger personal residences, independent work styles and suburban/country living may be better suited to remote working and the impact that has for other real estate sectors. Nevertheless, in the mid to long run, China may also selectively adopt and adapt aspects of this new built environment, whether that be more agile workspaces with more hot desking, flex space and work from anywhere, which will influence people's connection and understanding of the built environment. Retail spaces will have to be more dynamic and experimental, homes will have to more comfortable and less utilitarian, logistics will need to be smarter and faster and investment will need to become more strategic, adaptive and additive.

The residential sector has proved surprisingly resilient in 2020 with first-hand sales volumes recovering swiftly in several cities and prices holding firm with new measures to control debt levels within the real estate market. However, this has forced some developers to accelerate sales through discounts in the final months of the year. The retail and hospitality markets were heavily impacted by the pandemic, though they have seen a recovery in the second half of the year, with monthly retail sales recording positive year-on-year (YoY) growth in August, domestic flights down just 2% in September and hotel occupancy rates recovered to 60-70%. The office market is a bigger question; it wasn't immediately impacted in a significant way, but looming supply has encouraged developers to discount rents despite relatively stable occupancy rates and future demand expectations may have to be revised down with economic growth forecasts moderated.

There are three key trends to watch for in 2021:

Niche sector
The build-out of the commercial real estate sectors has gotten ahead of itself—GDP and disposable income growth have traditionally expanded at a rate of 8-10%, so city planners and developers have extrapolated forwards at similar rates. Investors have largely stepped back from the more traditional commercial market to take aim at sectors that have been historically underinvested. Many of these sectors have higher entry yields and are also experiencing structural demand drivers which should result in strong multi-year growth. There are challenges in finding suitable investment opportunities, local partners and business models, and these sectors may be prone to regulatory changes as the sectors grow in importance and complexity. By their nature, they are small and cannot accommodate large amounts of fresh capital, while pricing remains opaque and established exits are limited.

Digitalisation
The pandemic has accelerated the digitalisation of the built environment. New retail touchpoints continue to emerge online and, while e-commerce penetration rates have been climbing for a long time, they reached new highs during the lockdown. Office spaces have installed new filtration systems, contactless controls and monitoring technologies which have created new data sets to improve operational efficiency and future designs. Property management, especially in the context of residential developments, was on the front line of the pandemic and the main conduit for communication and contact with the rest of the world. Realising the potential business opportunity, investment in property management digitalisation looks to increase standardisation and professionalisation, improve operational efficiencies and economies of scale and create a platform for other service providers.

Experience
With online platforms able to fulfil an ever-growing range of needs, the bricks-and-mortar retail market must double down on consumer engagement through additional touchpoints and more meaningful experiences. During the lockdown, community retail stood out in the market thanks to its convenience and familiarity with neighbourhoods. But as social life largely returns to normal, retail experience plays a more important role in capturing consumer attention. Stores need to be interactive in their design as well as their consumer service, and they must provide consumers with greater insights into the product or brand.

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The big debate: Niche or traditional

Investors, looking to find the right balance between niche and traditional, are exploring opportunities within more niche subsectors of traditional asset classes

2020 has been an incredibly challenging year for everybody as COVID-19 increased uncertainty and rattled markets that were already weakened by financial de-risking and ongoing trade disputes. The China investment market has seen a fall in activity in 2020 with total consideration at RMB178 billion, down by 36% YoY. While life is getting back to normal and the economy is once again expanding, the impact of the virus will most likely still be felt in many tenant and landlord financials in 2021. To get through the difficult time, some investors are switching their attention to niche asset classes, while others are delving deeper into the subcategories of more traditional asset classes in search of tenant strength, untapped value and growth opportunities.

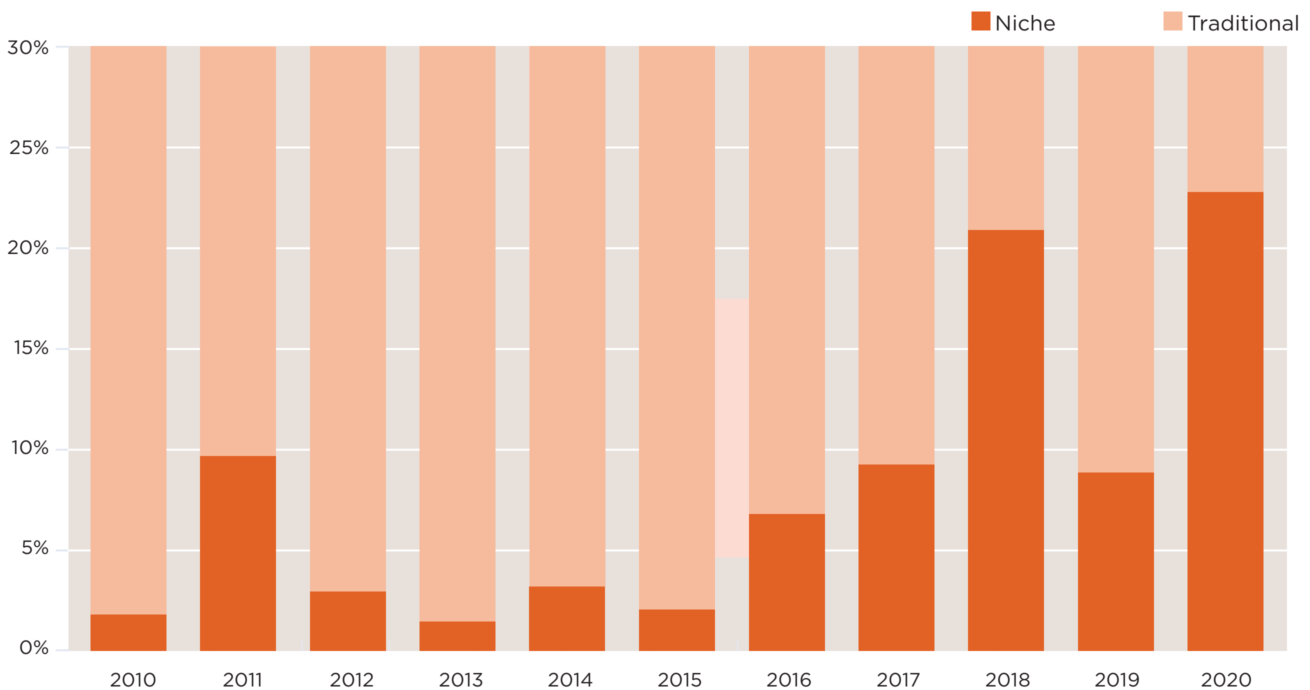
22.8%

Share of niche assets in total investment value in 2020

Traditional assets have the advantage of being comparatively easy to manage and having high liquidity and adequate options. When acquiring traditional assets, fund investors are expected to keep taking defensive strategies by focusing on stabilised assets with longer weighted average lease expiries (WALEs) while also staying in first-tier cities and fast-growing second-tier cities such as Hangzhou and Chengdu. On the developer side, debt repayment pressure, such as the US188 billion of bonds that will expire in 2021 (up 23% YoY), will push some owners to dispose of assets to pay down debt or recycle capital. Buyers and sellers are likely to find price gaps narrowing as both parties come under more pressure to get a deal done, resulting in a pickup in transaction volumes for traditional assets in 2021.

However, traditional assets have their limits. Many cities are already faced with oversupply as local authorities continue to release new land plots, and demand has weakened given the economic headwinds and uncertainties. On top of that, yields often remain below borrowing costs and the potential for capital value growth is less certain

FIGURE 1: China Traditional And Niche Asset Class Investment Ratio



Note Only includes deals over RMB100 million, and excludes self-use deals. Traditional assets include: office, retail, hotel and apartment; niche assets include: industrial, senior housing, manufactured housing and self-storage

Source Real Capital Analytics; Savills Research

> Fund investors are expected to maintain defensive strategies by focusing on stabilised assets with longer weighted average lease expiries

than before. Traditional asset classes also face potential disruptions resulting from changing consumer and occupier habits.

Therefore, investors are paying increasing attention to niche asset classes. In 2020 niche assets accounted for 22.8% of total en-bloc transaction value, the highest on record, and deals included several data centre purchases, with GDS in Beijing for RMB3.8 billion as an example, and many purchases by PE and logistics facilities funds including the RMB8 billion acquisition of R&F's logistics park in Guangzhou. Niche assets tend to have structural growth potential—growth in e-commerce, 5G and an explosion in connected devices, ageing societies, elective and specialised healthcare and privatised education. Until recently, the sectors were not exceptionally competitive and enjoyed higher yields.

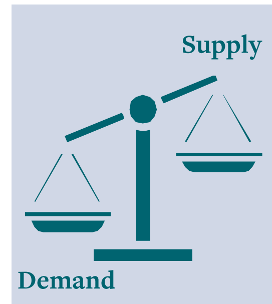
However, niche sectors, by their nature, are less liquid with fewer exit options. Opportunities to buy stabilised assets are few and far between, forcing investors with higher return expectations into development partnerships with local firms where investment periods are longer and returns are less certain. Additionally, regulatory environments are constantly changing, and investor/managers will sometimes require whole new skill sets, lexicons and tenant relationships.

Some investors, looking to find the right balance between niche and traditional, are exploring opportunities within more niche subsectors of traditional asset classes, such as community retail centres, outlet malls, business parks, R&D facilities, co-living and multifamily properties. These sectors share a degree of familiarity with more mainstream assets and similar management skills while being different enough to not face direct competition for tenants from more mainstream assets.

KEY TRENDS

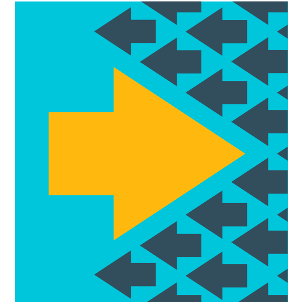
REITs bringing liquidity to illiquid markets

Infrastructure and related assets tend to be illiquid, requiring heavy capital injection and long-term holding periods. REITs will offer an additional exit strategy for developers and investors, making it more attractive and encouraging additional investment in the sector while allowing developers to recycle capital.



Niche buy-sell imbalance

Niche sectors are the flavour of the decade with every investor wanting to get in on the action but nobody selling. The nature of the asset class is owner-operator, long-term holds and stability. Additionally, the current market sees a lack of reinvestment opportunities if owners were to sell down. Currently, investors can only get into these markets by partnering up with local developers with a pipeline of assets and building to core.



Countercyclical opportunities

Despite Covid-19 impacts on domestic tourism, a lack of outbound travel, a swift recovery in the domestic market, significantly improved infrastructure and continued government support could provide growth opportunities for correctly positioned projects. Rather than chain hotels, investors may focus on boutique hotels in popular tourist areas such as Qiandaohu and Moganshan or resorts in Sanya and Badaling.

IPOs create more end-users

End-users were the biggest contributor to the market in 2020 and they are expected to remain active in 2021, especially with the number of IPOs increasing. Many projects have also been specifically designed with single tenants and end-users in mind with office GFA split between high-rise towers and several low-rise HQ spaces.

Debt dilemma

The renewed focus on debt levels, especially in the real estate market, means challenges for developers, encouraging them to proactively offload non-core assets. At the same time, the removal of loan forbearance may trigger a wave of defaults, causing a steep rise in non-performing loans often secured against real estate. This may increase real estate trades and place downward pressure in certain markets.

Investors jump into the debt market

As access to traditional financing is restricted, real estate private debt funds are stepping in to provide not just mezzanine debt but also senior debt. Some may even take over loans from commercial banks in the hope that they can access the underlying assets should the borrower default.

Demand dynamics

2021 is expected to build upon the recovery in the second half of 2020, with dynamics largely characterised by increasing demand from domestic tech firms, digitalisation of workplaces as well as cost-saving considerations

2020 proved another challenging year for the Chinese office market that has been struggling for several years with excess supply and weakening demand as financial de-risking and a slowing economy limit the growth of companies from more traditional sectors. Increased uncertainty about the short-to mid-term outlook forced some companies to pair back expansion plans and reduce operational costs. As the economy recovers, leasing activity has started to recover, though the loss of the first half year will mean that full-year figures in many cities will be significantly below five-year averages. 2021 is expected to build upon the recovery in the second half of 2020, with dynamics largely characterised by increasing demand from domestic tech firms, digitalisation of workplaces and cost-saving considerations.

140%

Office net take-up recovery in Q3/2020 in ten leading cities

Domestic

Exports as a percentage of GDP have been falling steadily over the last decade from 23.5% to 17.4% in 2019. Despite maintaining a trade surplus of RMB2.9 trillion, and seeing a swift recovery after controlling the spread of COVID-19, China is on the path to self-reliance and native innovation, especially in critical new economy sectors. Information technology led growth across all sectors in the first nine months of 2020, growing by 15.9% YoY. Tech companies, mostly domestic, accounted for 28.8% of new leased office space in Beijing, up 3.6 percentage points (ppts) YoY.

China's online economy grew to RMB5.4 trillion by 2019, primarily propelled by online consumption (44.2%). 2020, however, has also seen the rapid expansion of other online segments, most notably entertainment and education, with those sectors expected to achieve 23.9% and 21.3% CAGR between 2019-2022. The growth of these sectors could provide a much-needed boost in office demand from industries that were not necessarily key occupiers in the past. Online businesses are not only large leasing tenants but firms such as Bytedance, Tencent, and Meituan are also buying or developing their own headquarter buildings or campuses.

Digitalisation

Digitalisation is changing nearly every aspect of office space as PropTech changes the design, construction and management of buildings, and cloud computing tools enable different ways of working.

PropTech has been focused on ensuring health standards and guaranteeing the efficiency of resumption, such as the contactless calling of lifts. The digitalisation of these processes, as well as the adoption of 5G and IoT devices, have generated a wealth of information about how users interact with projects, redefining office buildings' design and management for decades to come. The forced closure of offices has posed the question of whether it might be possible to have employees work from

TABLE 1: Selected Leasing Deals, 2020

Tenant	Industry	City	From	To	Area (sq m, approx.)
OPPO	Retail & Trade	Shenzhen	Houhai	Qianhai	96,000
China Galaxy Securities	Finance	Beijing	Multiple areas	Lize	35,000
PwC	Professional Services	Shanghai	Huaihai Road (M)	Qiantan	30,000
AstraZeneca	Healthcare	Guangzhou	Tianhe Bei	Bio Island	18,000
Lvzhou Insurance	Finance	Xi'an	City Centre	City North	4,500
Deloitte	Professional Services	Nanjing	Xinjiekou	Hexi New Town	4,000
China Railway Construction	Real Estate	Wuhan	Jianshe Avenue	Wuhan CBD	4,000
Ronglian Petro	Energy & Raw Material	Chengdu	CBD	Dayuan	2,000
ICBC-AXA Life	Finance	Hangzhou	Huanglong	Yunhe	2,000

Note Transactions information subject to final contracts

Source Savills Research

> Companies still see tremendous growth opportunities in China, but the elevated uncertainty has encouraged many to look at controlling fixed costs while still investing in strategic sectors

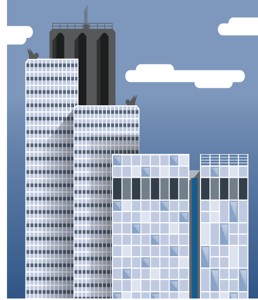
home (WFH) for more sustained periods of time. However, domestic companies, especially SOEs, still tend to prefer traditional working styles with headquarter spaces and fixed desks, and homes are typically smaller than in western countries, making WFH less appealing. What is more likely is an accelerated evolution of office spaces, with private firms and MNCs leading the charge, looking at a range of solutions for different teams and personnel whether that be hot desking, flexible space or intermittent WFH, helping reduce costs while also providing a degree of personal freedom and creating a more resilient company structure.

Cost saving

The economic fallout of the pandemic and subsequent business disruption has forced occupiers to look at reducing costs wherever possible. Cities, having invested heavily in infrastructure and encouraging the construction of emerging business areas to shore up tax and employment bases, are now seeing companies more willing to relocate to these new areas in search of operational cost reductions, with some of them also buying properties, consolidating premises or even building their own headquarters.

For key cities like Shanghai and Beijing, companies are often large enough to have several office locations, creating opportunities for cost reductions and efficiencies across portfolios. For some, this may entail bifurcation, leaving front office operations in the city centre and relocating larger back-office operations to low-cost locations. For others, it may entail consolidating disparate offices to generate operational efficiencies and stronger bargaining power into new, largely-vacant premises. In Shanghai, for example, prime locations saw vacancy rates increase 0.8 of a ppt in the first three quarters of the year while emerging locations saw vacancy rates fall by 6.5 ppts.

KEY TRENDS

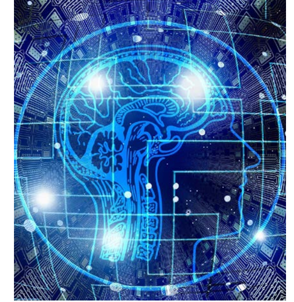


Leasing or sales

Recently IPO-ed and cash-rich companies, as well as those looking to establish regional or national headquarters, are seeking to acquire office developments. Recent developments are increasingly a composition of smaller standalone towers that would give owners signage rights and private entrances.

Secondary landlords

Landlords looking at elevated vacancy rates and happy to accept lower rents for a more assured income stream are turning to secondary landlords. Operators and investors, on the other hand, unable to justify stubbornly high capital values, see this as an opportunity to turn an operational profit, especially if the leasing market and rents pick up faster than is currently expected.



Data and technology

The adoption and development of new technologies have accelerated in the past year, though nothing comes close to the potential opportunities unlocked by 5G and the array of low-power, wide-area network IoT devices that will enable more efficient, sustainable and secure management of facilities while also allowing iterative space design enhancements.

Incentives

This current cycle in the office market has seen a significant increase in tenant incentives (TI) in recently completed projects as landlords seek to entice tenants away from more mature developments. TIs typically come in the form of extended fitout and rent-free periods but also fitout subsidies with some TIs rising from approximately 8-10% to 20-25% for some anchor tenants.

Agility and flexibility

While prolonged work from home initiatives seem unlikely in China in the short term, a degree of space flexibility is likely to accelerate—many people work with cloud tools and messaging platforms already. Continued uncertainty and cost control will also mean that corporates are likely to adopt lean but flexible space solutions, having hybrid office spaces utilising both traditional, hotdesking, flex space, memberships and work from home.

Services on demand

In addition to rental concessions, landlords must pay more attention to value-added services, public spaces and PropTech offerings to attract tenants. Tech-enhanced property management platforms with mobile access integration can improve customer experience and guarantee the sustainable development of the industry.

Discovering new depth

Retailers embracing online platforms are not necessarily scaling back their physical store networks but are changing the function and purpose of their bricks-and-mortar locations and, in doing so, are reshaping the nature of the retail industry

The online retail market has been elevated to new highs due to COVID-19, with online sales now accounting for approximately 25% of retail sales in China. Retailers, recognising the increasing importance of e-commerce, continue to invest in digitalisation and innovation, providing a seamless experience to consumers through omnichannel strategies.

Retail brands that are thriving in the China market tend to be those who reign supreme on both online and offline markets. Successful skincare and cosmetics brands are actively expanding in the offline market, despite online penetration as high as 27%. Uniqlo, who has seen phenomenal sales on Tmall, has opened over 780 stores around China, even surpassing the store count in Japan, its home market.

25%

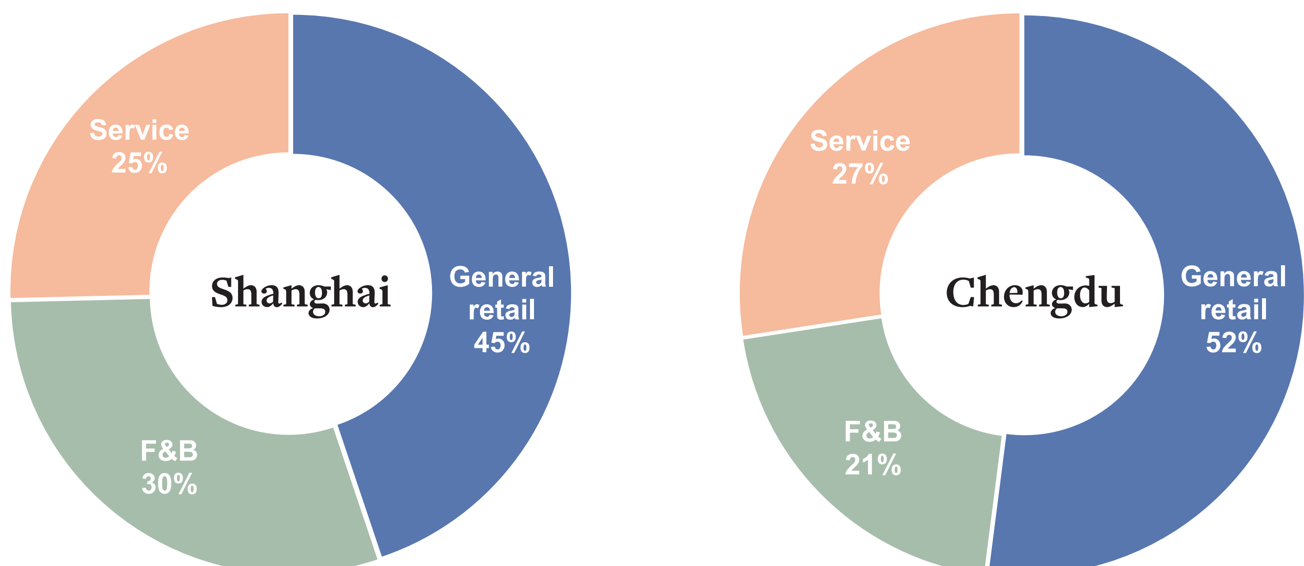
Share of leisure tenants in Shanghai shopping malls

Retailers embracing online platforms do not necessarily scale down their physical store network but are changing the function and purpose of their bricks-and-mortar stores. According to a recent BCG report, 62% of consumers preferred to “Research Online, Purchase Offline” (ROPO). With online purchasing just a click away, there must be a reason why these consumers are still choosing to acquire products offline. Are they looking for something more than just buying? That final touchpoint before making the purchase? To ensure the eventual purchase, retailers, in order to strengthen the connection between the brand and consumers, need to ensure the store design is original, instagrammable and interactive, while the service is knowledgeable, flawless and exceptional.

The entertainment sector was already recording stronger growth before COVID-19 with mall owners welcoming new categories such as indoor skiing, escape rooms and pet playgrounds to attract footfall and social media attention. In Shanghai, entertainment tenants increased their share in shopping malls from 18% to 25% in 2020, while in Chongqing their share reached 31%. With the pandemic largely under control in China, consumers are coming back to retail spaces to reinvigorate their social life, and the demand from leisure and entertainment operators is expected to be even stronger than before.

Though it remains the foundation of many malls and is decisive in determining project positioning and catchment, general retail faces more challenges. In Chengdu, general retail

FIGURE 2: Tenant Mix Of Shopping Market In Shanghai And Chengdu, 2020



Source Savills Research

> “Leisure and entertainment operators are reinvigorating malls and drawing in consumers, eager to return and embrace normal life and social ties”

tenants still account for over 50% of shopping mall space. Burberry’s new store in Shenzhen has incorporated dining areas, art and digital interfaces to enhance the consumer experience, while Lululemon has opened stores in 19 cities, creating communities and forming stronger bonds with consumers. Harmay is an online brand investing heavily in its physical store rollout for tailor-made, social-media ready locations to attract customers to explore and engage with both online and offline channels. Experiential retail encourages consumers to find and discover something unique, bringing excitement and footfall to the space.

Owners need to work together with tenants to create a unique experience for consumers while staying true to their brands’ values, image and overall positioning. Online platforms can already deliver highly personalised and responsive environments to their users, so physical stores will have to expand their design to target different consumers through different experiences. While some brands are reducing store numbers, they are still willing to invest in higher-profile flagship stores, making benchmark projects, as well as niche or boutique projects, more sought after and irreplaceable.

During the past decade, international retailers have expanded aggressively in China’s lower-tier cities. However, the pandemic and proliferation of e-commerce channels have convinced retailers to double down on core cities. While many brands have scaled back expansion plans in 2020, Shanghai and Shenzhen still saw significant increases in new store openings. Being at the vanguard of the consumer markets, these cities could also be test beds for new concept stores and flagship stores that may remain exclusive to these cities, testing new products, services, store designs and client engagement approaches.

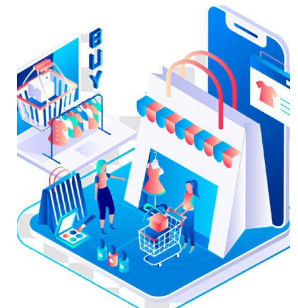
KEY TRENDS

Green retail

The retail industry is increasingly embracing sustainability. From material procurement to waste recycling to low-carbon storage space, retailers continue to invest in sustainability to reduce energy consumption. The number of LEED-certified retail spaces has notably increased, bringing health and safety to consumers while also establish green and sustainable developments.

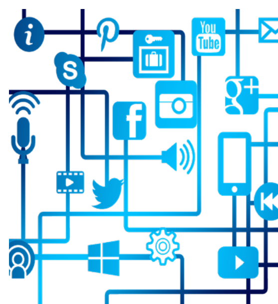
Designed by China

Consumers are embracing Chinese designs. Chinese brands have gained more attention in recent years from young consumers due to their rapidly improving quality, traditional elements combined with localised tastes and their familiarity with digital marketing. More emerging brands are expected to come to market, bringing cooperation opportunities for international brands.



Blurring lines

Traditional retail stores are expanding their business scope, introducing more experiential spaces to attract consumers and get them to stay longer while also building a stronger brand image through more interactions. The addition of F&B offerings is the most common, but art exhibits and interactive gaming zones are becoming more popular.

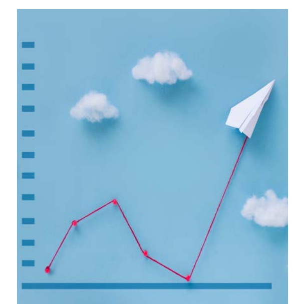


Multi-channel

Online content channels, such as short videos and live streaming, have grown in popularity in recent years. Retailers and landlords are exploring new ways to leverage and collaborate with these new channels to reach out to consumers. Retailers and products that lend themselves to impulse purchases are particularly popular.

Reshoring

The virtual elimination of overseas travel has meant a reshoring of Chinese luxury consumption. This had been a growing trend in recent years as import tariffs fell, price disparities narrowed and customer experience and product ranges improved. The pandemic has accelerated this shift, and the growth of the luxury sector is expected to continue in 2021, especially with the expansion of duty-free policies in Hainan.



Rebound

With retailers revisiting their expansion plans, landlords have become more confident, and rent incentives have shrunk in the second half of 2020. However, new supply is expected to increase in 2021 as delayed projects are released. With the luxury and mass-market sectors having largely recovered to pre-pandemic levels, the extent to which the mid-range market can do the same will play a decisive role in the market’s full recovery.

Getting back to living

Deferred purchases, upgrade demand and confidence in the strength of the property market have supported the residential market post-COVID

Sales
Stability and growth have been guiding principles for the residential market over the last decade, especially over the last 12 months. China's residential market led the post-pandemic recovery with sales volumes for many cities returning to and then exceeding pre-COVID levels in the second quarter. Volumes were driven by deferred purchases, upgrade demand and confidence in the property market.

First-tier cities showed a swift rebound in activity levels and prices in the second quarter, while some of the lower-tier cities saw volumes recover but price growth slow. Northern and Central China, whose economies have been struggling for several years, remained weak. The high-end market has outperformed the mass market in both transaction volumes and pricing. These variations are likely to persist for most of 2021 as the factors dictating them persist.

57%

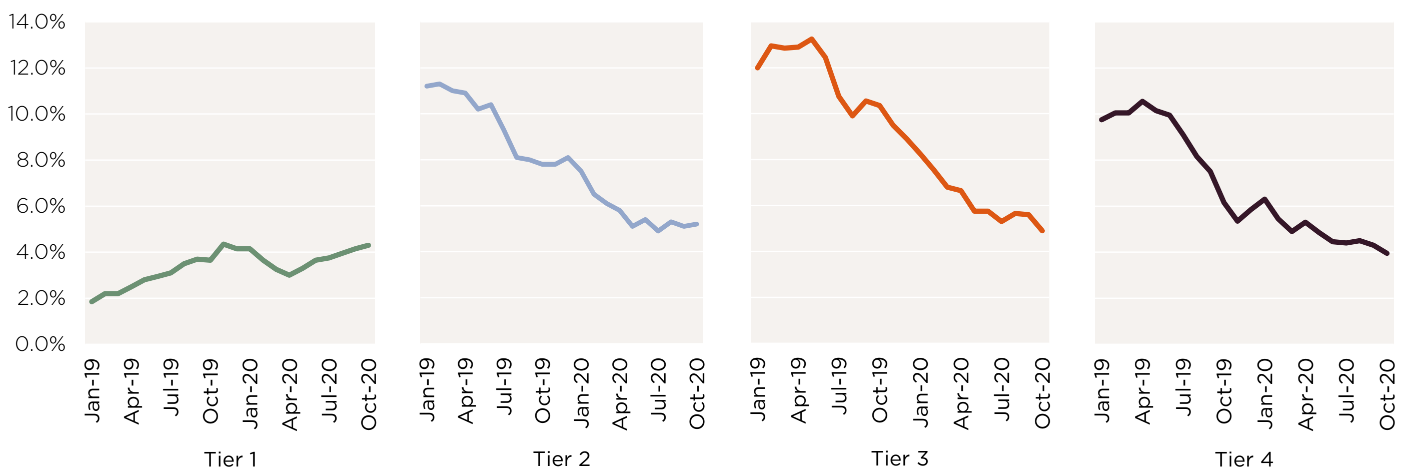
Household debt to GDP in China

The key factor to consider for next year will be the debt markets. To reduce systemic risk, the government has adopted a much more proactive and aggressive approach to the sector's debt levels. Authorities have developed a simple and broad method to assess developers' debt levels relative to their assets, the "345 rule", limiting developers' ability to take on additional debt depending upon how many red lines they cross. This is expected to encourage developers to push sales through the promotion of new land acquisitions and potentially accelerate consolidation in the market as better-financed developers steal market share. Tighter financing will also apply to individuals. Household debt has increased rapidly in recent years, reaching 57.2% of GDP by Q1/2020 from just 25.6% a decade ago, with mortgage financing accounting for a significant proportion of this. While commercial mortgage loan-to-values (LTVs) are below 70% (30-40% for second homes), homebuyers have been known to take on supplemental financing with higher interest rates and higher prices to increase income rates, meaning mortgage payments can still pose a significant burden for individuals.

A healthy housing market has always been a key goal for regulators; now, homebuyers are taking this literally into the home itself. Compared with first-time homebuyers, households looking to upgrade tend to be in a stronger financial position and are clear on what they want from their new home. Larger houses mean that family members can enjoy more independent space and the demand for a study room created by working from home can also be met. Property services have also become a key selling point, ensuring resident safety, a comfortable community environment and an ever-increasing range of value-added services.

Leasing
Serviced apartments have had to pivot ever more towards the domestic market in recent years, and 2020 could prove a watershed moment, with many

FIGURE 3: First-hand Median Price Growth Rate YoY By City Tiers, 2019 To Jan-Oct/2020



Source National Bureau of Statistics; Savills Research

> “The divergence in city market performance is likely to continue to 2021, while a hot land market in 2020 is expected to lead to a supply surge in the coming years”

international travel restrictions hindering a large tenant pool from returning to their leases across China. Many operators, however, will find it challenging to fully offset the shortfall in demand and will be eagerly anticipating a recovery in secondments that may accompany vaccine rollouts.

Aside from the high-end segment, the broader leasing market in China also sees dramatic challenges. The intermediary apartment leasing market has been thrown back into controversy with stories of tenant evictions and failure to pay landlords. The market is likely to see operator consolidation as well as increasing regulatory oversight in the coming year, with operators required to set aside greater rent provisions. Intermediaries may also become more like managers with contracts signed directly between landlords and tenants. Authorities are likely to bolster tenant rights, landlord accountability and increase market transparency while centrally registering leases.

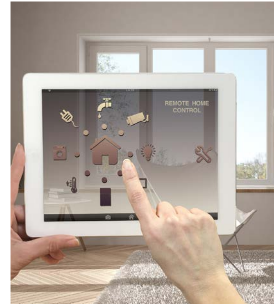
Investment firms and developers are expected to increase their exposure to the market by converting commercial properties and the introduction of leading service providers to fill in the mid-range segment. Notably, Greystar, an American real estate developer with more than 500,000 units under management in America, has ambitious China plans. The developer launched its first project in Shanghai at the end of 2020 and has further expansion plans with a new site acquisition in August.

Many cities are launching preferential talent-attraction schemes to bring in both domestic and international high-level employees. With many cities still enforcing policies that limit the ability for non-locals to buy properties, the leasing market is expected to benefit from the high-level talent filtering into these cities.

KEY TRENDS

Managing debt risks

While 2020 was about shoring up market sentiment, transaction volumes and prices in the residential market, 2021 will be focused on reducing systemic risks that have grown over the last decade, especially the levels of debt that developers and households have built up during that time. The announcement of the three red line policy was a wakeup call for the market.

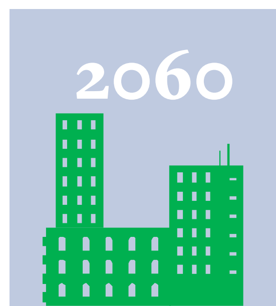


Property management revolution

Several developers have separately listed their property management services over the last year, raising over US$3.5 billion on the Hong Kong market as of November 2020. The sector is going through a transformation as new IT tools enable greater efficiencies, economies of scale, standardisation, transparency, accountability and monetisation of additional value-added services.

Renovating old properties

To improve living standards while preserving historical architecture and communities while also create jobs and fiscal stimulus, authorities have embarked upon a plan to renovate 39,000 old urban residential communities, with RMB1.0 billion earmarked for elevator installation in ageing projects in Beijing alone.



Bolstering building standards

China has pledged to be carbon neutral by 2060, and the property sector is a significant contributor to greenhouse emissions both embodied and operational. Greater adoption of modern construction methods are reducing embodied carbon costs while that of LEED, BREEAM and three-star are reducing operational carbon costs. These practices are likely to see further adoption going forwards.

Multi-family housing

Despite the recent bad press, the residential leasing market and particularly the multi-family market will continue to grow by offering better quality housing to tenants. Regulations are likely to be stricter, and growth likely slower. Developers and investors with ownership over the buildings are likely to be better stewards of the market.

Online home sales

If listings on Alibaba and JD.com are anything to go by, bank home foreclosures have increased significantly in 2020. Tmall had around 800,000 homes on sale with discounts reaching up to RMB1.0 million by Q4/2020. Online platforms not only list foreclosed properties but also first-hand developer sales, with some even participating in the Double 11 e-commerce extravaganza with special discounts.

Levelling up logistics

In addition to the new infrastructure initiative, the adoption of new technologies has the possibility of changing the game

Despite some supply chain disruption at the start of the year, the logistics market has proved to be one of the most resilient sectors in 2020 with a surge in e-commerce sales and a recovery in international imports and exports increasing demand for logistics space. The government has initiated further investment to develop modern infrastructure and new economy sectors as part of a fiscal stimulus package. In addition, the promotion of the Dual Circulation System, which emphasises domestic consumption and self-reliance in critical industries, should further spur demand for quality logistics space. Industrial/logistics land sales increased 19% YoY in the first three quarters of 2020.

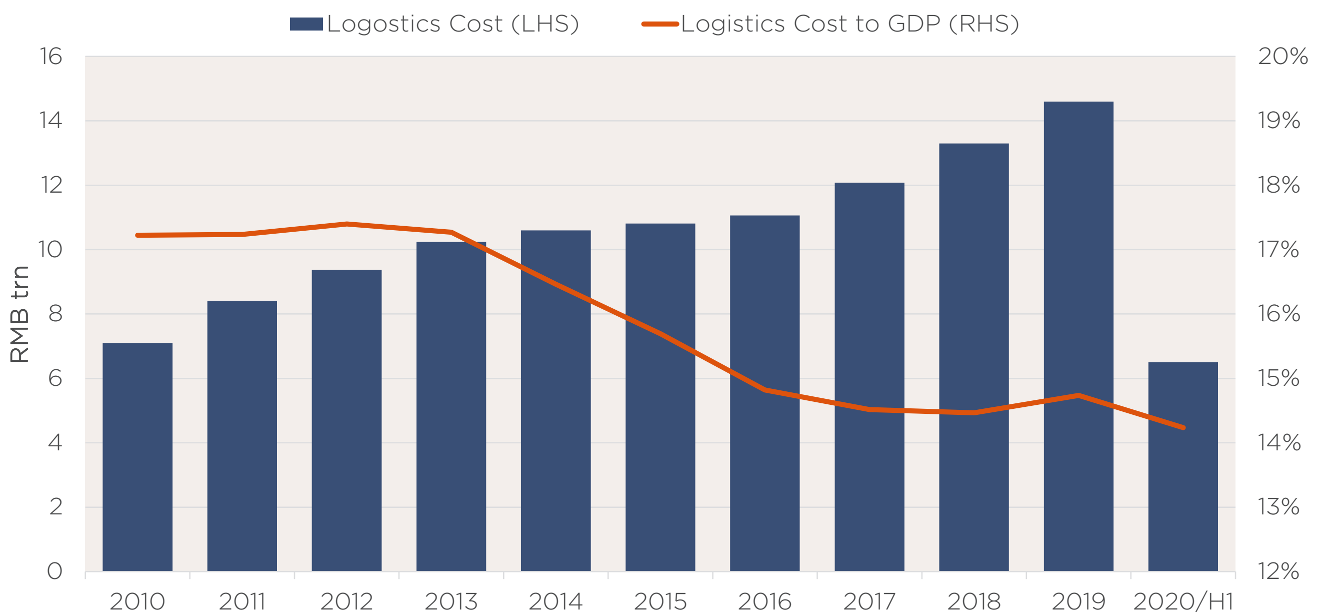
19%

YoY increase of industrial land supply in Q1-Q3 2020

Logistics costs having fallen for several years, and are now the equivalent of roughly 14.5% of GDP. The ratio is still higher than developed markets where they are closer to 8-10% of GDP. In addition to increased investment in the country's infrastructure, which will create greater access to emerging rural consumption bases, the adoption of new technologies has the possibility of being a game-changer. The 5G rollout will level up automation and sensor networks in industrial and warehouse spaces, creating more efficient and reliable storage while also enabling the adoption of autonomous trucking, which has the potential to open new geographies for logistics expansion further away from population centres.

China's Grade A warehouse stock stands at roughly 60-80 million sq m with the majority of this located in proximity to densely populated areas such as Beijing-Tianjin-Hebei (JJJ), the Yangtze River Delta (YRD), the Greater Bay Area (GBA) and the Chengdu-Chongqing Metropolitan Area (CCMA). Markets like Shenzhen and Shanghai have limited land supply and strong demand, which keeps rents up, though if they rise too much, demand tends to spill over to neighbouring cities where land is more plentiful, rents are cheaper and authorities more accommodating. Suzhou, for example, has just marginally less logistics stock than Shanghai. Occupancy rates closer to the larger cities and their immediate

FIGURE 4: Logistics Cost To GDP



Source China Federation of Logistics & Purchasing; Savills Research

> The window of opportunity for new start-ups is narrowing as the market consolidates, and established players have national and regional networks to fulfil all their clients' needs

periphery typically fall within the range of 90-95%, though markets further afield can fall to 75-80%. Demand comes mainly from third-party logistics (3PLs), e-commerce platforms, traditional retailers and advanced manufacturing companies.

The key players in the logistics space continue to shift from the initial handful of international operators and small-scale regional domestic firms to a now-established roster of experienced national developers that originated from private equity-backed domestic firms. Another wave of developers is now emerging as international investors look to enter the market by providing seed capital to a number of new start-ups from the management ranks of established firms. They have the potential to add their names to the likes of GLP, CNLP, ESR, Blogis and others, but their window of opportunity is closing as the market matures and barriers to entry rise as the market consolidates and established players have national and regional networks to fulfil all their clients' needs.

Investment interest in the logistics market is unlikely to wane in the short term as it has several advantages over other asset classes, namely, strong demand growth fundamentals, stable tenants, higher yields and restricted land supply near large population centres protecting markets from supply competition. Additionally, there are new growth sectors at the higher-end of the market which has the potential for higher returns; the growth of the pharmaceutical sector and chilled foods will require an extensive network of professionally-managed cold chain storage facilities. Investors will also be eagerly anticipating the arrival of REITs, which will bring a new pot of cash to the market, increase transparency and professionalise the sector.

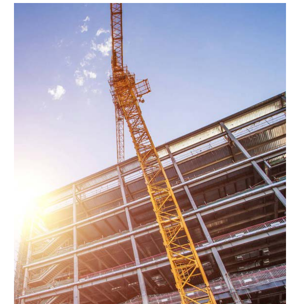
KEY TRENDS

Public REITs

Several public REITs with warehouse and logistics parks as the underlying assets are expected to be issued in 2021, providing an additional exit strategy for investors.

Cold chain

There is a rising need for international-standard cold chain storage facilities in China to meet the demand from pharmaceutical companies and online grocery retailers. Such investment-grade logistics warehouses will also be sought after by investors looking to create a more defensible portfolio of properties and point of differentiation from competitors.



Self-built warehouses

As e-commerce companies continue to grow at phenomenal rates and see their valuations rise, they are looking to secure key infrastructure footholds in critical markets and mitigate potential future cost increases. Traditional landlords may lose out on this key occupier base in the future and see an increase in competition for future site acquisitions.

Space fit for purpose

In addition to purpose-built logistic facilities to reduce delivery times, 3PLs and e-commerce players are looking to get ever closer to the end consumers. Fresh Hippo spearheaded this initiative by utilising supermarkets as hybrid logistics depots, shortening delivery times to 30 minutes. Vacant office and retail spaces could also be repurposed for similar uses.

Future-proofing facilities

As technological innovation marches on and real estate costs rise, it is essential that developers and investors future proof their investments, either by ensuring maximum GFA, adequate column spacing for wide-berth vehicles, proximity to new infrastructure arteries, and utilisation of the latest construction materials, tools and sensors as well as meeting sustainability ratings.

Reducing red tape

Cross border e-commerce is one of the fastest-growing segments of the online market; efficient, reliable and cost-effective processing of goods is essential for this sector's growth. Cities and logistics parks that can work with authorities to ensure efficient customs clearance will be at a significant advantage going forwards. This is especially true given expanding trade relations, such as the recently signed Regional Comprehensive Economic Partnership.

Property management outperforming

Managers have the opportunity to significantly increase the scale of their businesses while also enhancing efficiencies through tech adoption and boosting revenues through value-added services

Property management has been a long-overlooked, unglamorous and undervalued segment of the property market. It has been low-margin, labour-intensive and incredibly difficult to standardise and upsell to clients. At the same time, as property prices and rents have continued to rise, residential management fees have largely been stuck in neutral while commercial management fees have failed to keep pace.

25.1 bn sq m

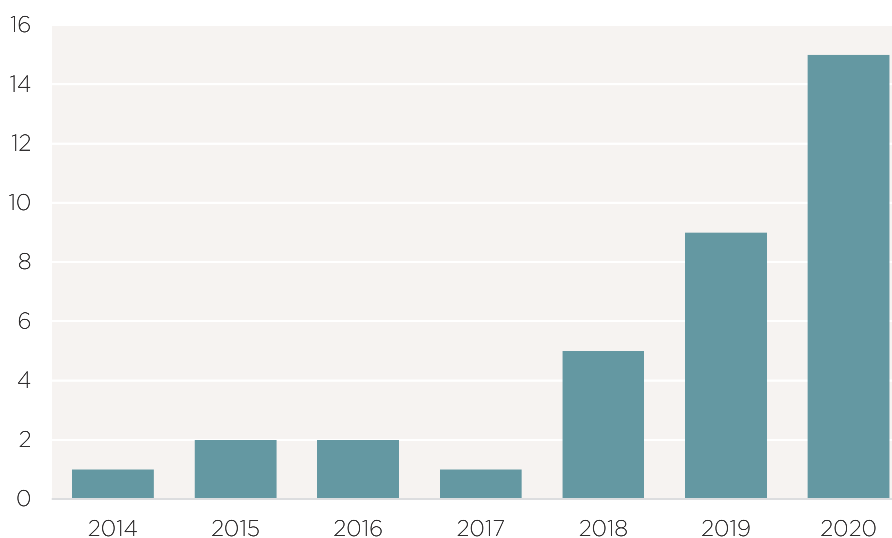
Area currently professionally managed in China

Safety and security
As the pandemic hit China in early 2020, it was the property managers that were called upon to protect communities and work with public health authorities. Owners and tenants, who previously may have looked to squeeze financing for property managers and cut costs, are now unlikely to be as quick to dismiss the valuable service that property managers provide. As property prices rise, developers are having to justify their price tags with an international standard of service to meet homeowners wants and needs while also protecting their investment through proactive management and preventative care.

Scale
The market scale is growing and, while we are starting to see some consolidation in the market, there is still a long way to go. Some estimates put the total scale of the Chinese property management market at 25.1 bn sq m by the end of 2020, while the top 100 managers have less than 50% of the market share. Property management companies can often be no bigger than one or two developments, making it incredibly difficult to regulate and a real challenge to improve service quality, consistency, accountability and transparency. It also means there are tremendous savings and real value to be generated through sector consolidation and with more specialised resources spread over several projects.

Leading PM companies are also looking to partner with local authorities to bring their expertise and resources to bear on public services and utilities, especially in the more under-resourced third-and fourth-tier cities. Different cooperation models are evolving but tend to contain a specific management contract for a predetermined scope of service, a joint venture or more advisory services, especially for more specialised or advanced tools and processes.

FIGURE 5: Number Of Chinese Property Manager IPOs By Year



Source Various news sources; Savills Research

If stock investors are right, then property management firms are in for a period of extraordinary growth, with valuations of some of the companies reaching 50-60 times earnings, valued on a par with tech heavyweights Tencent (x49) and Alibaba (x37). Even without these valuations, the property management arm spin-offs will allow firms to go after third-party projects and enable them to concentrate on improving property management services and operational efficiencies.

Service
As competition for commercial tenants intensifies, landlords are turning to the property managers to raise their standards as they look to transition to “Workspace as a Service” (WaaS), not only providing space, security, cleaning and maintenance but a community and menu of additional services. While each

> If stock investors are right, then property management firms are in for a period of extraordinary growth

service may seem trivial, the combined impact can be quite meaningful, whether it be shuttle bus services, smart parking, priority lift access, food delivery lockers/robots or one of the many other services that make individuals lives a bit more convenient.

Sustainability
Two other hot topics in the property space have been the rise of PropTech and a greater awareness and demand for ESG strategies. These two goals can often go hand-in-hand. The more sensors installed within buildings, the greater ability to track energy usage, which is essential in quantifying and understanding where efficiency gains can be generated. Additionally, these sensors are also necessary for sustainability certification of existing buildings. Sensors can also control the internal environment, ensuring correct humidity levels, adjusting light settings in response to natural light availability and a range of other criteria to ensure the best working environment for staff.

Sensors also provide property management teams with valuable information about how different approaches may affect a building, automate more mundane processes and highlight when parts of the building are not functioning properly. The utilisation of rapidly developing artificial intelligence or machine learning can enable incremental gains over the lifecycle of a building as well as the rapid adaption to changes in the building's usage or external environment. Green certification is increasingly becoming a must-have as investors, regulators and tenants demand more from their buildings.

KEY TRENDS

Public listing
This year has seen a record number of listings of Chinese property firms as developers look to generate much-needed capital. Investors are going crazy for tech-enabled recurrent income streams with valuations of some firms reaching 40 times price to earnings.

PropTech
Property management is an incredibly labour-intensive industry. In some cities, it can account for as much as 5% of the entire workforce, equating to hundreds of thousands or even millions of jobs. As wages continue to rise, automation of certain processes is essential and will provide consistency, transparency and accountability.

Value-added services
Profit margins for property management firms can be very thin, with input costs rising and firms looking to add additional services. Managers have direct contact with a large captive market and can offer a range of specialised services, especially if they can build economies of scale.

Consolidation
The property management sector is incredibly fragmented and inefficient. As the sector professionalises and becomes more profitable through additional revenue streams, operators will more pro-actively expand market share. Likewise, landlords will increasingly see differentiation between firms, choosing best-in-class operators to retain asset values and tenants.

Frontline
Property management firms played a critical role in preventing the spread of COVID-19, whether it be the enforcement of quarantines, parcel delivery, disinfection of public spaces or monitoring/coordinating screenings. The importance of quality property management services has been elevated significantly over the last 12 months.

Sustainability
Ambitious targets for carbon neutrality by 2060 will need all sectors of the economy to pull together, not least the property market with GHG emissions from the operation of buildings contributing a significant chunk. In the future, certification and recognition of sustainability within the sector will be essential.

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