MARKETBEAT

Investment Snapshot Q4 2015

China

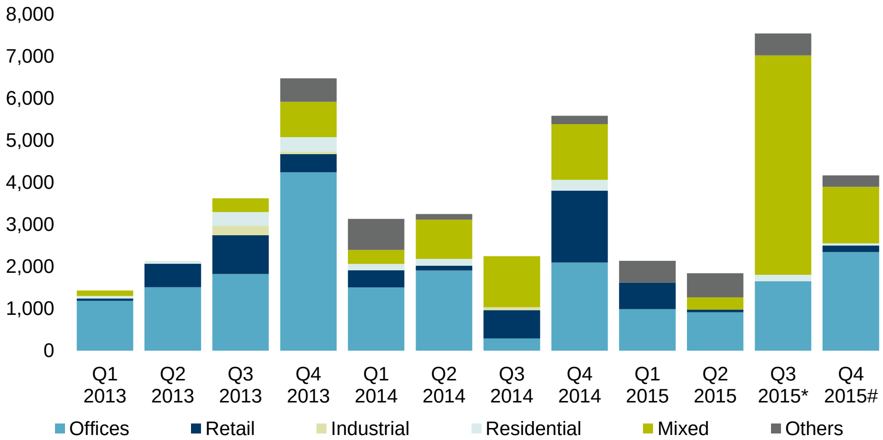
24 February 2016

Contents

- Following a historical high Q3, building transaction in 16 Chinese cities slowed down with 27% decline q-o-q to USD 4.17bn in Q4 2015, but the volume was still higher than the combined activity in H1 2015. Viewed from the perspective of the entire year China's US$15.7bn total building transaction registered 10.4% annual increase (Figure 1). And this was achieved despite the macro headlines about China's economic slowdown, currency outflows, volatility of the domestic bourses weakening trend in the RMB.
- Shanghai continued to be China's most active market with a total of RMB 58.4 billion transacted in commercial property investment rising 50 percent y-o-y. Volumes have been driven by domestic corporates, financial institutions as well as PEREs. Robust performance was highlighted by a few high profile transactions including Beijing Guosheng Plaza (RMB10.5bn, US$1.7bn) and Shanghai Corporate Avenue Block 1 & 2 (RMB 6.6bn, US$1bn) in Q3, followed shortly thereafter by Lee Kum Kee and China Vanke jointly acquiring Corporate Avenue Block 3 for RMB 5.7bn (US$892mn) and Carlyle purchasing Manpo International Tower for RMB 1.46bn (US$230mn).
- Despite the recent volatility of China's equity market and currency fluctuation, Hong Kong and international investors actually increased their asset holdings in China. Despite international media headlines about China's capital outflows, when taken together with a strong Q3, the full year offshore investment into standing building properties in China amounted to US$5.5bn, marking highest level in history and making China the second hottest spot for non-domestic investors in APAC in 2015, following Australia. This continued influx of capital reflected investors' confidence in Chinese major cities where high end commercial properties suitable for core or core plus investment plays are now in increasingly short supply.

Figure 1

Total building purchasing activity by sector (US$mn)



Source: DTZ/Cushman & Wakefield Research
*Note: *Revised figure; #Preliminary figure*

Authors

Andrew Ness
Head of Greater China Research
+852 2507 0779
andrew.ness@dtzcushwake.com

Catherine Bai
Manager, Greater China Research
+852 2250 8227
catherine.xl.bai@dtzcushwake.com

Contacts

Francis Li
Investment and Advisory Services
+852 2992 4321
francis.cw.li@dtzcushwake.com

Building transactions

The level of transactional activity in Q4 2015 was relatively flat, declining by 44.8% measured q-o-q, and dropping by 25.4%, y-o-y, to the level of US $ 4.2 billion (See Chart No.1). Following the disposition of Corporate Avenue Towers 1 and 2, which marked the largest transaction in Q3, the disposal of Corporate Avenue Tower 3, for US$892 million marked the largest transaction in Q4.

Hong Kong capital was active in the China investment market in standing commercial buildings. In addition to Lee Kum Kee teaming up with China Vanke to acquire Corporate Avenue Tower III, Hong Kong based ARA acquired the Bank of East Asia Building for US$470 million, marking the second largest standing building transaction of the quarter. In addition, PAG was involved in the acquisition of Ciros Plaza (Table 1).

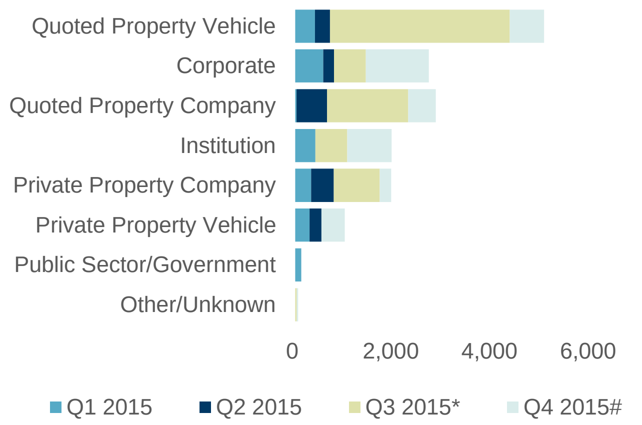
In the fourth quarter, investment interest in acquiring hospitality assets remained strong, with two hotels having been sold in Shanghai, for US$198 million US$720 million, respectively.

Analysing market activity from the perspective of the identities of the buyers, corporate acquisition of real estate represented the main thrust of purchasing activity within the quarter. In Beijing, the largest transaction of this type was the purchase of Kuntai Garry Center by Alibaba for US$390 million. In Shenzhen, several floors of the China Front Center building in Shenzhen were acquired by a corporate purchaser for US$81.87 million. These two deals, when lumped together with purchase of the Corporate Avenue Tower 3 accounted for more than 30% of all transaction turnover within the quarter.

From the perspective of analyzing the identities of the vendors, within the quarter, traces of listed company dispositions became harder to find, but the slack which this created was taken up by the disposals of unlisted real estate companies. One example would be the disposal of the Chang'an Metropolis Center in Xi'an by the local developer Chang'an Holding Group for US$250 million, the highest paid ever paid for an office building in Xi'an, to date.

Figure 2

Total building purchasing activity by purchaser type (US$m)

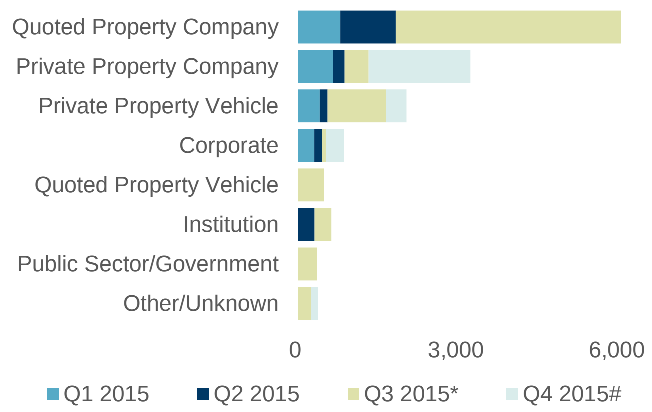


Source: DTZ/Cushman & Wakefield Research

Note: *Revised figure; #Preliminary figure

Figure 3

Total building disposal activity by vendor type (US$m)



Note: *Revised figure; #Preliminary figure

Source: DTZ/Cushman & Wakefield Research

Table 1

Significant building deals

ADDRESS/PROJECT NAME	CITY	SECTOR	GFA(SQ M)	PRICE(RMB BILLION)	PRICE(US$M)
Corporate Avenue Block 3	Shanghai	Mixed-use	87,295	5.7	891.9
Bank of East Asia Building	Shanghai	Office	42,500	3.0	469.4
Ciros Plaza	Shanghai	Mixed-use	70,398	2.9	453.8
Kuntai Garry Centre	Beijing	Office	51,499	2.5	394.3
Kingkey Timemark	Shenzhen	Office	24,000	2.0	312.9

Source: DTZ/Cushman & Wakefield Research

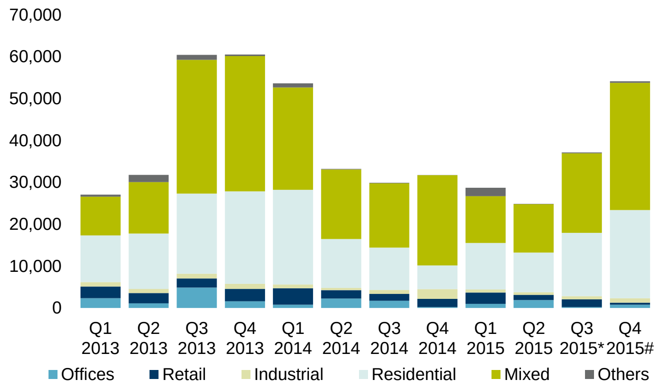
Land Transactions

Within the fourth quarter, investment in development continued to grow at the same fast pace as the previous quarter, growing by 45.9% q-o-q, or the equivalent of a 70.7% jump y-o-y to US$54.2 billion. The sale of land zoned for mixed use developments was most prominent, representing 56.1% of all land sales within the quarter, but also growing by 60%, y-o-y and rising by 40% q-o-q to US$30.4 billion. The majority of mixed use sites sold were zoned for development of mixed office/retail complexes, but some mixed use development sites also contained residential elements as well. Apart from this, sales of land zoned for development of offices, residential and industrial property grew by 257.5%; 39.2% and 43.7%, compared q-o-q. But the sale of sites zoned for pure retail developments dropped dramatically by 74% to US$478 million.

Analysing those cities which were the subject of major land sales transactions, the value of sites sold in Beijing and Shanghai accounted for more than 50% of the total value of land sales across all 16 cities, accounting for 32% and 21% of total transactional turnover in development land sales. Amongst Tier II cities, only Nanjing was relatively active, with its land sales accounting for 10% of the total.

Figure 4

Total land purchasing activity by sector (US$m)



Note: *Revised figure; #Preliminary figure

Source: DTZ/Cushman & Wakefield Research

Table 2

Significant building deals

ADDRESS/PROJECT NAME	CITY	SECTOR	GFA(SQ M)	PRICE(RMB BILLION)	PRICE(US$M)
Beijing Shijingshan District, North Xin'an	Beijing	Residential	404,589	18.53	2898.8
Lot no. 1404-657, 659 & 1401-607, Nanyuan, Huaifang village & Xingong village	Beijing	Mixed-use	132,433	8.60	1344.9
1404-669, 670, 665, 666 & 668, Nanyuan, Xianghuaifang village & Xingong village	Beijing	Mixed-use	117,633	8.34	1305.0
Lot no. 2015G61, Jianye District	Nanjing	Mixed-use	477,090	8.30	1298.7
No.6, No.12, No.2, Huaxiang, Fanjia village	Beijing	Mixed-use	104,578	4.95	774.5

Source: DTZ/Cushman & Wakefield Research

Table 3
Investment Market (US$m) (deals over US$10m)

		Q4 2014	Q1 2015	Q2 2015	Q3 2015*	Q4 2015#	YR TO Q2 2015	YR TO Q3 2015	YR TO Q4 2015#
Total investment volume		37,313	30,855	26,691	44,676	58,333	127,005	139,535	160,555
TOTAL REAL ESTATE PURCHASING ACTIVITY BY SECTOR									
Office	Land	223	973	1,872	217	777	4,782	3,285	3,840
	Building	2,097	989	916	1,651	2,343	4,292	5,653	5,899
Retail	Land	1,958	2,725	1,238	1,843	478	7,558	7,763	6,283
	Building	1,706	625	64	0	159	3,070	2,395	848
Industrial	Land	2,309	719	672	758	1,090	4,654	4,458	3,239
	Building	0	0	0	0	0	68	0	0
Residential	Land	5,679	11,089	9,431	15,117	21,047	36,290	41,316	56,684
	Building	257	0	0	153	48	257	410	201
Mixed	Land	21,539	11,199	11,569	19,019	30,405	59,705	63,326	72,191
	Building	1,329	0	290	5,214	1,346	2,832	6,833	6,850
Others	Land	20	2,012	67	180	370	2,205	2,279	2,629
	Building	197	524	572	524	270	1,293	1,817	1,889
TOTAL REAL ESTATE PURCHASING ACTIVITY (DOMESTIC VS. FOREIGN)									
Domestic	Land	31,021	27,948	24,681	37,045	54,152	113,509	120,696	143,826
	Building	4,281	1,259	959	5,787	2,162	8,322	12,286	10,167
Foreign	Land	706	769	168	89	15	1,684	1,732	1,040
	Building	1,305	879	883	1,755	2,004	3,491	4,822	5,521

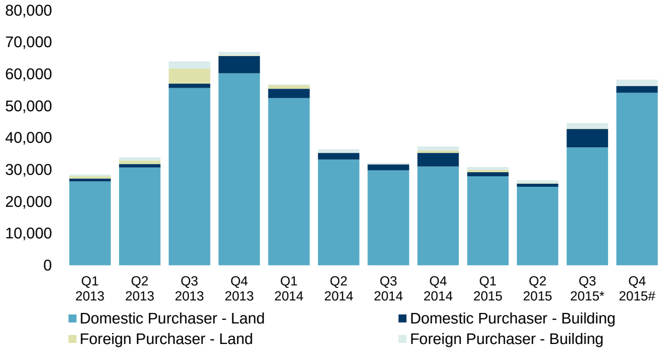
*Note: *Revised figure; #Preliminary figure*
Source: DTZ/Cushman & Wakefield Research

Source of capital

Within the fourth quarter, overseas capital investment in buildings and land increased by 9.5% to rise to the level of US $2.02 billion. Further analyzing this activity, the level of investment activity in standing buildings increased by 14% to US $2 billion, whereas interest in land acquisition turned markedly weaker. Viewing investment activity in 2015 as a whole, the total scale of investment surpassed the level of 2014. But within this rising trend, the tendency to switch from acquiring land to rather acquiring buildings became pronounced. Besides the very active investors from Hong Kong, within the quarter, the Carlyle Group invested US$229 million in the acquisition of the Manpo International Tower.

Figure 5

Investment volume by domestic and foreign purchaser (US$m)

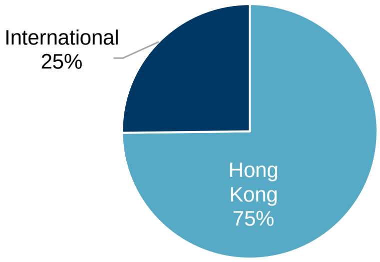


*Note: *Revised figure; #Preliminary figure*

Source: DTZ/Cushman & Wakefield Research

Figure 6

Cross-border investment in China by source of capital



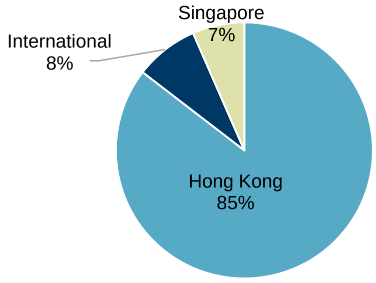
Source: DTZ/Cushman & Wakefield Research

Outflow of capital

Based on DTZ/Cushman&Wakefield data, in 2015 the pace of capital outflow from the China commercial building market slowed down to US$1.9 billion, a sharp drop from the outflow of US $ 5.8 billion which was recorded in Q.3. Of this total, US $ 800 million was triggered by one Hong Kong company's acquisition of an asset owned by another. However, the net effect was the influx and outflow of overseas capital became much more nearly balanced within the quarter. From the perspective of identities of companies making dispositions within the quarter, disposition activity was dominated by Hong Kong property owners. The only other overseas party which was active making dispositions within the quarter was one Singaporean company, which disposed of the No.5 building of Guoson Centre, and another multinational corporation, which disposed of the Mall 818 on Nanjing Road West, this one deal accounting for 25% of foreign capital outflow within the quarter.

Figure 7

Cross-border investment in China by outflow of capital



Source: DTZ/Cushman & Wakefield Research

Outlook

Under new laws, initiated in 2014 China decided to re-open the domestic debt bond market to developers as of end of 2014. This is already having a huge impact on cost chain for larger developers, whose access to funding will remain healthy, due to benign onshore lending conditions. Domestic liquidity is more than sufficient to support new domestic developer's bond market, and will remain open in 2016 as the domestic development industry is still on the path to recovery. As a consequence of abundant liquidity in China, we do not expect any shortages of fund availability in the commercial investment market as domestic corporate buyers, private equity funds and institutional investors and HNWIs will remain quite active.

Right now, the major theme, for overseas funds, is "flight to quality." Shanghai will continue to be China's most active market, and the city has strong pipeline of deals going forward in 2016. There is a very clear trend towards trying to do core plus investment in Tier I cities. Flavor remains acquiring commercial assets. Main strategies being used are core plus and repositioning or value add. Looking towards the future, we would expect that amongst the Tier I markets Beijing, Shenzhen and Guangzhou markets to be somewhat more driven by corporate occupational investment as well as increasing diversity of asset classes traded as well as the types of investors engaged in deals.

However, overseas players face increasing difficulty doing core plus in Tier I cities generally, because of the weight of capital brought to bear by domestic corporates, institutions and PE funds is large, and growing larger, as income producing commercial real estate appears to be an increasingly attractive safe haven for investment funds in China . Hence, value add opportunities have become harder to come by, over the past year and situation will further tighten going forward. Opportunistic investment is a strategy which is more suitable for Tier II cities, but Tier II cities plays are more suitable for specialized domestic investors, who are more sensitive to local market conditions.

Hence the influx of capital which is expected to continue in 2016 is, in effect, a vote of confidence in the economic resilience of China's major cities where commercial property suitable for core or core plus investment plays will remain in increasingly short supply.

Contact

Francis Li
Head of Investment and Advisory Services, Greater China
+852 2992 4321
francis.cw.li@dtzcushwake.com

Alvin Yip
Managing Director,
Investment and Advisory Services, China
+852 2507 0716
alvin.kp.yip@dtzcushwake.com

Jim Yip
Managing Director,
Investment and Advisory Services, China
+8621 2208 0250
jim.ks.yip@dtzcushwake.com

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Global Headquarters
77 West Wacker Drive
18th Floor
Chicago, IL 60601 USA
phone +1 312 424 8000
fax +1 312 424 8080
email info@cushwake.com