

“The market experienced a significant fall in transaction volume in the third quarter as government restrictions remain in place and banks find it increasingly difficult to lend. Sales incentives are expected to become more common in the future as developers look to encourage buyers.”



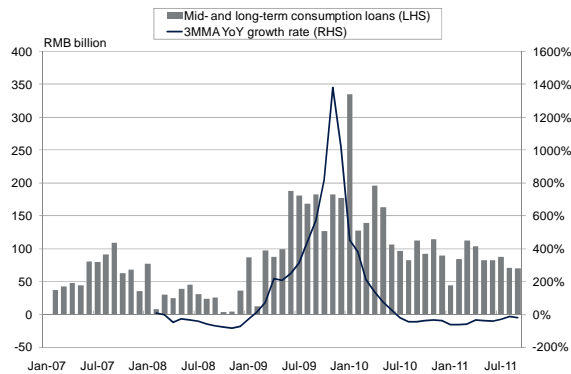
Image: The Palace, Xuhui district

- First-hand commodity residential transaction volume fell by 12.9% quarter-on-quarter, while transaction prices remained stagnant at an average of RMB22,100 per sq m.
- First-hand high-end villa transaction volume (villas priced more than RMB40,000 per sq m) fell by 38.5% year-on-year to 107 units.
- The first-hand residential price index increased by 3.0% in the first three quarters, while the average year-on-year growth rate in the third quarter of 2011 amounted to just 3.3%, illustrating developers' resilience towards regulations.
- Second-hand residential transaction volume fell by 14.4% year-on-year to 2.5 million sq m in Q3/2011.
- First-hand high-end apartment transaction volume (units priced more than RMB40,000 per sq m) fell by 5.3% year-on-year to 656 units.
- Second-hand residential transaction prices fell by 4.2% year-on-year to RMB16,400 per sq m.
- Fourteen residential land plots were transacted in the third quarter with the average mark-up over the reserve price falling to 15.4%.

Market overview

The People's Bank of China (PBoC) kept interest rates and bank reserve ratio requirements unchanged in the third quarter, at their elevated levels. Mid- to long-term consumption loans, a proxy for mortgage lending, fell steadily over the last seven months as a result of stricter bank lending quotas. Newly added mid- to long-term consumption loans for the first three quarters of the year fell to RMB735 billion, down 45.9% year-on-year.

China's mid- to long-term consumer loans and growth¹, Jan 2007–Sep 2011



Source: PBoC, Savills Research & Consultancy

Monetary tightening and home purchase restrictions have had a profound impact on both supply and transaction volume in the third quarter. The decline in transaction volume has led to price growth slowing but has not yet led to a notable fall in prices in either the first- or second-hand markets.

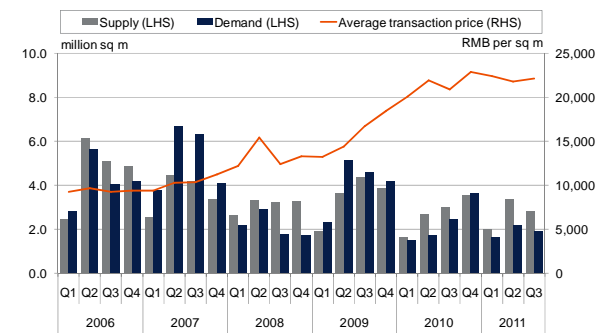
First-hand commodity² residential market

First-hand commodity residential transaction volume fell by 12.9% in Q3/2011, down 22.9% year-on-year. Supply volume is also significantly depressed, having fallen 16.3% quarter-on-quarter, and 6.9% year-on-year.

¹ Mid- to long-term consumer loans are a proxy for mortgage loans, accounting for approximately 95% of total loans.
² Commodity housing excludes residential properties designated for relocated residents under urban redevelopment plans, as well as economical housing.

Mediocre transaction volume is likely to remain until there are signs of a relaxation of policies, with buyers expecting better sales prices in the coming year. Protests outside developer offices and reports of substantial discounts, even if they are not indicative of the wider market, do nothing to encourage buyers.

First-hand commodity residential market, Q1/2006–Q3/2011

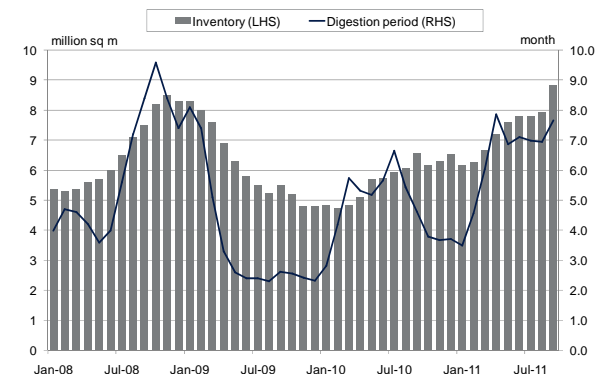


Source: SRETC, Savills Research & Consultancy

First-hand commodity housing transaction prices recorded only a 1.7% growth in the third quarter to an average of RMB22,148 per sq m, up 5.7% year-on-year.

According to the National Bureau of Statistics of China (NBS) the price index of a basket of properties rose 0.1% in the third quarter, supporting the conclusion that discounts are not widespread, but that at the same time there is very little upward movement in prices.

First-hand inventory and digestion period, Jan 2008–Sep 2011



Source: SRETC, Savills Research & Consultancy

As demand continued to fall short of supply in the third quarter, the first-hand residential unsold inventory level increased to 8.8 million sq m in September, exceeding the high of 8.4 million sq m seen in October 2008, the last time the market was cooled by government policies. It is believed that approximately three-quarters of the new stock added to the unsold inventory is from the commodity market, with the remainder accounted for by economical housing.

At current transaction volume levels (for the preceding three months) it will take 7.7 months to absorb the outstanding inventory.

A similar situation is seen in the second-hand market where the unsold inventory level increased to 18.5 million sq m and the digestion period climbed to 21.9 months, largely due to a fall in transaction volume.

First-hand high-end residential sales market

First-hand high-end apartment transaction volume (priced more than RMB40,000 per sq m) fell by 5.3% year-on-year to 656 units. Meanwhile, first-hand high-end villa transaction volume (priced more than RMB40,000 per sq m) fell by 38.5% year-on-year to 107 units.

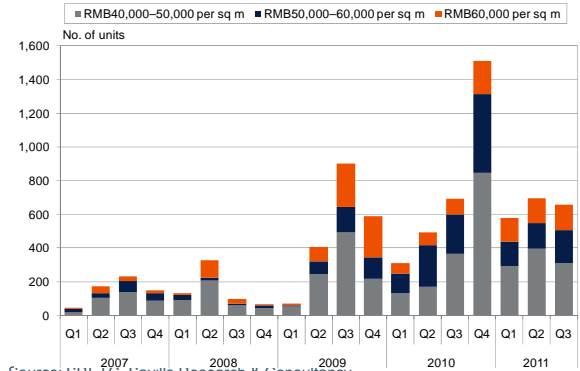
First-hand high-end commodity residential transaction volume and prices both recorded a fall in the third quarter. This was particularly true for the villa market which saw a drop in supply of 61.8% quarter-on-quarter and consequently, weakened sales volume.

High-end apartment supply, 2011

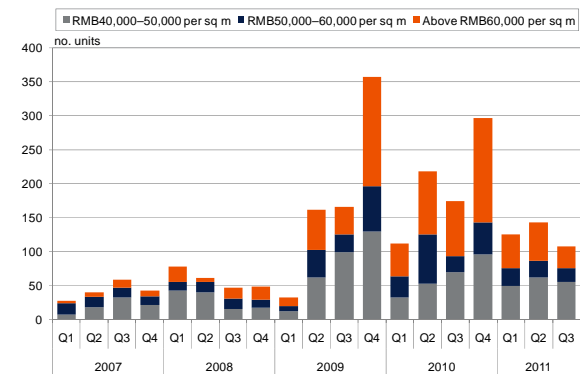
	Developer	District	Launch date	Price range (RMB per sq m)	No. of units	No. of units sold (by Q3/2011)
City Castle (Ph II)	Farglory	Jing'an	Q2	60,000–90,000	186	56
The Bay	Guoxin Real Estate	Pudong	Q2	70,000	204	33
The Palace	K. Wah	Xuhui	Q3	80,000–100,000	514	33
Star River (Ph II)	Star River	Pudong	Q3	70,000	209	49
Grand Summit	K. Wah	Jing'an	Q4	80,000–100,000	387	N/A
Weifang Project	SHK	Pudong	Q4	150,000–200,000	200	N/A
Paragon	CapitaLand	Luwan	Q4	100,000–150,000	300	N/A

Source: Savills Research & Consultancy

Transaction volume of first-hand apartments by price, Q1/2007–Q3/2011



Transaction volume of first-hand villas by price, Q1/2007–Q3/2011



Source: SRETC, Savills Research & Consultancy

Developers seem to be reluctant to launch new properties onto the market as originally scheduled, with many deciding to postpone launches until the market picks up. This has had a notable impact on supply levels.

Residential Sales

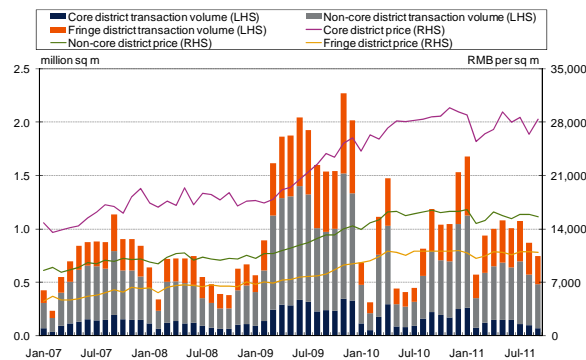
Developers have been able to employ such a strategy as many are well capitalised. This allows them the ability to wait through what many of them believe to be a short-term slump in the market. Additionally, new project launches are still recording lacklustre (although better than expected) interest from buyers and many market watchers expect regulations to start being relaxed in the second half of 2012. If correct, transaction volume is expected to reach pre-regulation levels, which will encourage developers to start re-launching their idle projects.

Transaction volume also recorded a slight fall as growing uncertainty about the state of the residential markets in the current regulatory environment forced buyers to reassess the likelihood that prices would remain firm.

Second-hand overall residential market

Second-hand residential transaction volume fell by 17.8% quarter-on-quarter and by 14.4% year-on-year to 2.5 million sq m in the third quarter. Second-hand residential transaction prices fell by 1.5% quarter-on-quarter and by 4.2% year-on-year to RMB16,400 per sq m.

Second-hand residential sales market³, Jan 2007–Sep 2011



Source: SRETC, Savills Research & Consultancy

³ Core districts: Changning, Jing'an, Xuhui and Huangpu (new)
Non-core districts: Hongkou, Putuo, Zhabei, Yangpu, Minhang and Pudong
Fringe: Baoshan, Fengxian, Chongming, Jinshan, Jiading, Qingpu, Songjiang and Nanhui

Low leverage, high employment levels and rising incomes all indicate that home owners are not under pressure to sell. Owners placing their property on the market are reluctant to lower prices, and so there has not been a significant correction in the second-hand prices to-date.

Property owners are also of the belief that, as the current lull in the residential market was induced by government regulations, the government still exerts a lot of control in the market, and as a result, is also able to engineer a recovery in the market through a loosening of restrictions. Given that the government does not want to see a hard landing in the market, the chance of this happening is relatively low and so home owners are waiting for the recovery, whether it be in 2012 or later, before selling their property.

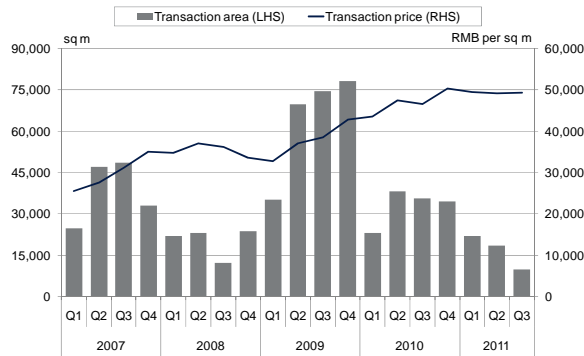
Some owners, however, do not have the luxury of keeping so much capital tied-up in properties and should other investments turn sour, such as their own businesses, they may need to cash-out of the market in a hurry so there may be the chance that some properties will be sold at discounted levels.

Second-hand high-end residential market

Second-hand high-end residential prices remained fairly stable in the third quarter, increasing by 0.2% to RMB49,328 per sq m, up 5.9% year-on-year. Trading activity in the monitored basket continued to fall in the third quarter to just 9,779 sq m, the lowest level recorded for over five years, as uncertainty over the future of the market and discrepancies over the true worth of properties created a divide between buyer and seller pricing.

Residential Sales

Second-hand high-end apartment prices⁴, Q1/2007–Q3/2011



Source: SRETC, Savills Research & Consultancy

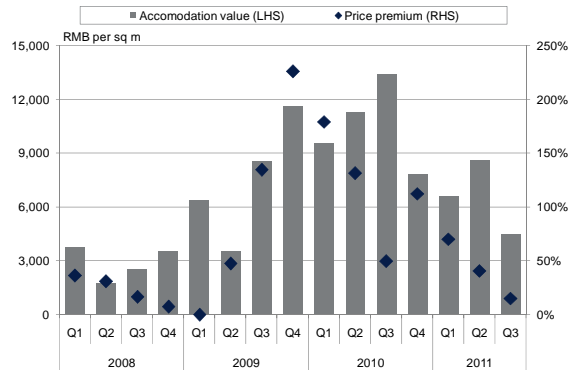
Developers continue to face liquidity issues, with weak residential transaction volume limiting their ability to convert stock to cash, and greatly restricted financing channels, namely bank and trust-fund lending and corporate bond issuing. The vast majority of developers, aside from those which are well capitalised, are unwilling to overstretch by bidding on new land plots when there are already development schemes in the pipeline. As a result, competition for new land had been less fierce over the last twelve months, with the average land accommodation value falling and the price premium shrinking.

Commodity residential land market

Fourteen residential-zoned land plots were transacted in the third quarter, with an average accommodation value of RMB4,479 per sq m and a total buildable area of 2,325,000 sq m.

The fourteen land plots transacted in the third quarter were bought at an average premium above reserve price of 15.4%, considerably lower than the 41.0% and 70.2% in the second and first quarters respectively.

Commodity residential accommodation value and its premium above the reserve price, Q1/2007–Q3/2011



Source: Shanghai Municipal Bureau of Planning and Land Resources, Savills Research & Consultancy

The rise of New Jiangwan Town



The New Jiangwan Town, covering an area of 9.45 sq km, is located in the north of Yangpu district in the northeast of Shanghai, between the city centre and Baoshan district.

Top land sales, Q3/2011

Location	District	Site area (sq m)	Buildable area (sq m)	Total value (RMB million)	Accommodation value (RMB per sq m)	Price premium	Developer
West to Qiujiagang, Zhujiajiao Town	Qingpu	107,954	107,954	826	7,651	1.5%	Shanghai Jiuqing Real Estate
South to Zhangyu Road, Zhujiajiao Town	Qingpu	68,860	68,860	520	7,545	0.0%	Shanghai Jiangong and Shanghai Xiandai Architecture Design

Source: Savills Research & Consultancy

⁴ Based upon a basket of 13 high-end properties

New Jiangwan Town is a new entrant to the mid- to high-end residential market, after a decision was made to redevelop and masterplan the area around five years ago. The old army airport was demolished and Fudan University relocated their main campus to the area and numerous residential plots were auctioned, attracting a number of high-profile international developers, including Tishman Speyer, Hines, CR Land, Wharf and Yanlord.

New Jiangwan Town is planned to accommodate between 60,000 and 80,000 households. Residential developments are relatively low density, with average plot ratios of 1.0 and an average greenery ratio of more than 50%. Between Q1/2006 and Q3/2011, 1.10 million sq m of residential property was transacted on the first-hand market in New Jiangwan Town, at an average transaction price of RMB46,240 per sq m in Q3/2011.

Between Q1/2006 and Q3/2011, 480,000 sq m of residential-zoned land was transacted at an average accommodation value of RMB16,385 per sq m with a total buildable area of 619,000 sq m. The area has significant potential for further development over the coming years, with more land plots expected to come to the market.

New Jiangwan Town has proved hugely successful for a number of reasons: the ability to masterplan a large area in a relatively central location, the close proximity to one of Shanghai's emerging sub-business districts, Wujiaochang, and the pleasant surroundings afforded by the leafy Fudan campus, tree-lined streets and cultural, art and sports centres, to name a few.

Selected residential projects in New Jiangwan Town

	Developer	Type	Residential GFA (sq m)	Completed date	Sales price (RMB per sq m)	Unit type
The Springs	Tishman Speyer	Mixed-use	180,250 (Phase 1)	2014	--	--
California Place	Hines	Mixed-use	84,051	2010	33,000–50,000	3 beds (160 sq m)
Yanlord Townhouse	Yanlord	Residential	65,073	2010	50,000–80,000	3–4 beds (209–342 sq m)
Wharf Xiyuan	Wharf	Residential	100,472	2012	40,000–70,000	2–4 beds (147–334 sq m)
Oak Bay	CR Land	Residential	153,644	2009	36,000–70,000	1–6 beds (86–280 sq m)

Source: Savills Research & Consultancy

Residential sales market outlook

Regulations and monetary restrictions

The central government made it clear in September and October that their stance on regulations will remain unchanged, and this was highlighted by the tussle between the local government of Foshan and the central government on loosening restrictions. In September 2011, Foshan's Bureau of Housing and Urban-Rural Development announced that they would relax the home purchase curbs by allowing people to buy a second home if priced under RMB7,500 per sq m, but within two days, the central government stopped the plan.

Financing is also expected to remain an issue, both for developers and purchasers, with many of the large banks having already reached their loan quotas for the year and others increasing mortgage rates above the base lending rate for first-home purchases for the first time in recent history.

Shrinking land transaction volume and local government financial pressure

The weakening residential market and worsening financial positions of a number of developers, and their reluctance to buy new land, are having a notable impact on local government revenues. This position is limiting the ability of the local government to support the new social housing schemes, despite promotion of the scheme by the central government.

The slowdown in land sales and construction pace are not expected to have a significant impact on the residential market but they could cause issues in the long term as supply shortages may appear in two to three years. Demand should hopefully have picked up by that point, putting upward pressure on prices.

Developer consolidation

A slowing down of the market should prove positive for the long-term sustainability of the market. Over the last 15 years, the success of the market has encouraged a number of companies not specialising in property to enter the market. The current cooling of the market is making this a less attractive proposition for many, and these companies are starting to leave the market. Meanwhile, the larger, better capitalised and more fiscally responsible developers are able to pick up cheaper land to replenish land banks and will benefit from the recent downturn once the market picks up again.

Conclusion

Under the assumption that regulations will remain unchanged for the next 9 to 12 months and interest rates and bank reserve rates stay at their current levels as the government tackles inflation, the residential market is expected to remain weak for at least the next year, possibly flattening out in the second half of 2012.

The general consensus among market watchers and analysts is that the central government needs to see a meaningful correction in prices, possibly 10% to 20%, in order to prove its property price fighting credibility. While it may be painful in the short term, it should, with hindsight, prove to be a much better choice than leaving price growth left unchecked.

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