 Bubble Threat Rises as GDP Growth Slows

Every year since around 2005 foreign media have been predicting an imminent and giant crash in the China housing market. The crash will be so severe, they say, that it will drag down other segments of the nation's economy with it. Yet aside from some minor price drops we saw in 2014-2015 in many cities, the market continued to rise, with average home prices increasing over the last decade by some 700% in total.

Now, after further dramatic rises in home values in the nation’s first-tier cities in the first three quarters of 2016, pundits are again talking about a real estate apocalypse. While we believe they are likely underestimating the market's resilience once again, it's worth noting that there are some differences in the situation this time around.

New Voices and New Numbers

One difference is that it is not only foreign commentators who are now acknowledging the potential for a market crash, but also some of China's own experts, including the country's wealthiest person, Dalian Wanda owner Wang Jianlin. In a recent CNN interview he referred to the national housing market as "the biggest bubble in history".

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"I don't see a good solution to this problem," Wang said, noting that all the government’s measures to limit home purchases or credit have ultimately failed.
Our sense is that the government’s attitude towards controlling the market has also changed. With its many levers — $3 trillion in foreign exchange reserves, ability to instantly implement new policies, strong control over media, banks and state-owned enterprises — the China government used to exude absolute confidence about its ability to steer markets. But events such as the June 2015 stock market crash that wiped away some 40% of the value of the nation’s listed companies have made it clear that when a China market turns into a bear market, it’s not always possible to control how far downward it spirals.

A changed economic environment also suggests real estate investments may now be in a more precarious position. When China’s home prices rose by some 100% between 2008 and 2012, an accompanying furious rate of economic growth made the increase at least somewhat sensible. During those years, yearly GDP growth averaged 9.44%* and export growth averaged 12% **. In contrast, GDP is expected to expand by only 6.5-7.0% in 2016, and export growth, like last year, will most likely be negative.

Potential Shape of a Crash

What would a China real estate market crash look like? While it’s impossible to say with certainty, we can at least identify some conditions that would influence the development of events, one being the bifurcated nature of the China property market.

China’s property market has evolved into two fairly distinct markets in recent years, with strong demand for homes and tight supply in upper-tier cities, and the reverse situation (soft demand and excess supply) characterizing the markets of most lower-tier cities. To an extent, the pattern holds for commercial real estate as well. The upper-tier metropolises have the largest numbers of affluent individuals, and are widely perceived to hold the best career and lifestyle opportunities — they are where most Chinese want to be.

All this would seem to suggest that the second-, third- and fourth-tier cities are the most exposed to risk of a swift and large-scale drop in home prices.

In terms of magnitude: In many cities around the world, a 20% to 30% drop in home values might be shocking and labeled a ‘crash’. But given how ridiculously high home prices have become relative to resident’s income in Shanghai, the term ‘market correction’ seems more appropriate for a 20-30% drop. From the government’s point of view, such a drop may even be welcome.

The government would surely not want to see, however, prices spiraling downward by 50% or more, which could create a negative domino effect on the overall economy and possibly even lead to protests and social unrest. We don’t see that apocalyptic scenario as very likely to occur, but home price drops of 15% to 35% in many areas of the country in the not-too-distant future appears well within the realm of possibility.

*Based on China Bureau of Statistics data.

**China Customs Bureau data.

The Scene

[Image of a cartoon scene showing a street with people discussing real estate and market conditions.]
Property Snapshots

### Plaza 66
With its high-end mall replete with the world's leading luxury brands, Plaza 66, or Henglong Guangchang, is widely viewed as one of the most prestigious office addresses in Shanghai. The development includes a 288-metre tower that opened in 2001 and a 228-metre tower that opened some years later. Its Hong Kong based developer Hang Lung is also the company behind Grand Gateway in Xujiahui.

**Building quality:** Grade A+
**Address:** 1266 Nanjing West Road
**Ceiling height:** 2.7 meters
**Recommended Floor/Area:** 1,780 sqm
**Rental/sq.m/day:** RMB 12
**Total Floors:** 66
**Metro:** 10 min walk to line 2 (Nanjing West Road)
**Location:** Jingan
**Availability:** Limited space available

### Hong Kong Plaza
Completed in Q1 1998 by Hong Kong’s Lai Sun Group, Hong Kong Plaza includes an office tower, an Ascott serviced residence and a shopping mall that boasts Apple and Cartier among its anchor tenants. One of the early properties of the Huaihai Middle Road CBD, the property has a central location close to South Huangpi Road station, Xintiandi and other prestigious office towers.

**Building quality:** Grade A
**Address:** 283 Huaihai Middle Road
**Ceiling height:** 2.4 meters
**Recommended Floor/Area:** 1,211 sqm
**Rental/sq.m/day:** RMB 9.0-9.5
**Total Floors:** 38
**Metro:** 2 min walk to line 1 (Huangpi South Road)
**Location:** Huangpu
**Availability:** Limited space available

### Central Park Pudong
This property was developed by the Shanghai Electric Group and completed in 2014. Hong Kong Shanghai Alliance Holdings Limited (a HK-listed firm) acquired the property in June of 2016, announcing that it intended to change the name of the tower to "Central Park - Pudong" and perform renovations to make the building more attractive to prospective tenants. The 12-story property has a total gross floor area of approximately 33,191 sqm and is divided into 75 office units.

**Building quality:** Grade A
**Address:** 2399 Zhangyang Road
**Ceiling height:** 3.0 meters
**Recommended Floor/Area:** 2,002 sqm
**Rental/sq.m/day:** RMB 6.8-7.2
**Total Floors:** 12
**Metro:** 10 min walk to line 6 (Beiyangjing Road)
**Location:** Pudong
**Availability:** Many options

Contact NAI Sofia Group Shanghai at 021-6230 1919 for further information on the three office building properties listed above, or for information on any other commercial property in the city.
Events – Art at 11th Shanghai Biennale, West Bund Fair

The third edition of the West Bund Art + Design Fair runs from November 9th to 13th and features 30 contemporary galleries from China and abroad, several of whom are organizing events in conjunction with the Shanghai Biennial 2016. Visit westbundshanghai.com for details.

The China Sustainable Building Forum & Expo takes place 13th - 15th November at Shanghai New International Expo Centre (SNIEC). More about this event can be found at www.csbexpo.com.cn.

The 11th Shanghai Biennale, or Shanghai Biennale 2016, takes place from November 11th to March 12th, 2017 and has some definite connections to India: The curator of the main show inside the Power Station of Art is the Delhi-based Raqs Collective, and the event’s main theme, “Why Not Ask Again? Arguments, Counter-arguments and Stories”, is inspired by a 1974 Bengali movie that centers on a debate between an intellectual and a group of peasant and student rebels. The Peace Hotel, the Good Choice Bakery and Shanghai Concert Hall Square are among other venues hosting Biennale events. www.shanghaibiennale.org

Ukrainian-born pianist Inna Faliks has been described in major media as a "concert pianist of the highest order" possessing "remarkable insight", "poetry and panoramic vision". She performs on December 2nd at Shanghai Oriental Art Center. Call 4006-466-406 for tickets.

New Year’s concerts in Shanghai will include England’s National Symphony Orchestra playing works of Glinka, Dvorak and Strauss on December 31st at Shanghai Oriental Arts Center, and the German Radio Orchestra playing pieces by Beethoven, Brahms, Glinka and Strauss on January 1st at Shanghai Symphony Hall. Tickets for both concerts can be booked on the website culture.sh.cn.
Tech Tip — Speeding Up Your Website in China

Many foreign companies that host their website on a server outside of China find that it takes users within the country a frustratingly long time to open their site pages.

One way to solve this problem is to set up a mirror site hosted on a server within China, perhaps with a new "cn" website address. This will require a little work: You will need to obtain an ICP (Internet Content Provider) license from the Chinese Ministry of Industry and Information Technology, pay hosting and domain name registration fees, and figure out a way to synchronize updates between the China and overseas servers. We recently discovered a neat and simpler solution and would like to share it with our readers.

"Chinaware" is a service offered by the firm PTL Group. It uses proprietary technology developed by an Israeli IT engineer and can increase the loading speed of your website for users within China. The solution does not involve the hosting of a China mirror site, and you do not need to obtain an ICP license.

The company offers three different Chinaware packages and the basic package costs $50 / month plus set up fees. For more details, contact PTL Group directly:

PTL Group
Telephone: +86-21-64453190
jun@ptl-group.com

Dining Suggestion – The PHÉNIX Eatery & Bar

Last month France’s famous Michelin guide released its first ever Shanghai edition, granting globally coveted Michelin stars to 26 local chefs and their restaurants. A recent lunch at one star-winner, chef Michael Wilson's PHÉNIX eatery & bar, has convinced us that when it comes to recommending great restaurants, Michelin knows what it is doing.

The PHÉNIX offers ‘intuitive’ French cuisine that embodies simplicity and authenticity, with a focus on using only the finest and freshest quality ingredients. Set lunches of 2 or 3 courses are just a little over 200 RMB. Ours, which included an outstanding Beef Bourguignon, was prepared to perfection, and the service was on a similarly stellar level.

The PHÉNIX eatery & bar
Level 2, The PuLi Hotel & Spa1 Changde Road, Jingan District
Telephone: (21) 2216 6988
Property for Sale — Versatile Warehouse in Fengxian District

62,785 sqm High Quality Logistics Warehouse

An international-standards logistics warehouse in Fengxian District is available for purchase. Location is within the 15 km² Shanghai Seaport Comprehensive Development Zone.

All official land certificates and property certificates are in place for the property, which is situated on a plot of more than 95mu with 15% green area, and has a main building of size 62,400 sqm. Suitable for use as an international logistics operation, bonded warehouse, international enterprise warehouse, distribution center, or advanced manufacturing.

Main Building:
- Warehouse Area: 2 Floors (61,175 sqm)
- Warehouse Ceiling Height:
  - 1st Floor: 7.9 m, 2nd Floor: 8.9 m

Market Notes

The average occupancy rate for the main business districts in Puxi decreased slightly during recent months as a large amount of new supply entered the market. New openings include Century Link Phase II, Gopher Center, and Raffles City Changning Building 2. Average rent also inched down slightly to around CNY 9.8 / sqm / day.

Significant recent tenant moves include new space occupation in Plaza 66 Phase II by Guotai Junan, one of China’s major securities brokerages, and a move by Japanese firm Kobelco from K11 to Gopher Center.

Office Building Rental Rates by CBD Area: CNY / sqm / day

Shanghai Office Occupancy in Percentage
Our consultants will be delighted to personally assist you at any time. You may call our main Shanghai office number, (86 21) 6230 1919, or contact directly a consultant who handles your specific concern:

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