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RESEARCH REPORT
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Assessing investment opportunities in the Chinese Real Estate (Industrial) Logistics and Warehouse sector

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This report

Our research report looks at the investment potential of Chinese Logistics and Warehouse space. Investment opportunities lie in areas where there is consistent long-term growth within cycles, and in this paper, we examine such a scenario. As usual, our report looks at the historic cycle and then provides forecasts the future trends in the cycle for the next five years. We analyse the results and provide reasons thoroughly. Our focus is on four major cities: Beijing, Guangzhou, Shanghai and Shenzhen.

Summary

The warehouse sector in parts of China contains what is commonly referred to 'Old Stock'. This does not mean that they are not being used, rather, they are not being used efficiently and estimates suggests that numbers of old stock are over the 95% level, with only less than 5% being stock which has either been newly built or undergone modernisation. With China continuing its economic growth predominantly led by e-commerce activities, this demand for warehousing is driving the Real Estate logistic sector - more specifically the need for modernised warehousing to propagate China to higher levels of growth. China's Real Estate sector accounts for a significant part of its GDP, and personal consumption reaches new levels each year. The focus on our four chosen cities show that the year on year average annual growth forecasts for the five year cycle (2020 - 2024) are much higher than the previous three years (2017 – 2019). We show the full figures later in this report.

What are we measuring?

In order to assess the potential of any Real Estate sector, we choose a measurement for growth. In this case, we choose rents charged by landlords for warehouse in the four cities and we track the growth rates. Health growth rates are a good indicator of good returns on investment, but firstly, in figure 1 below, we chart the historic percentage change in rental growth for the 4 cities. We show the rental change versus GDP and examine the shape of the cycle. Our data is taken from 2007 to the end of 2019.

Figure 1

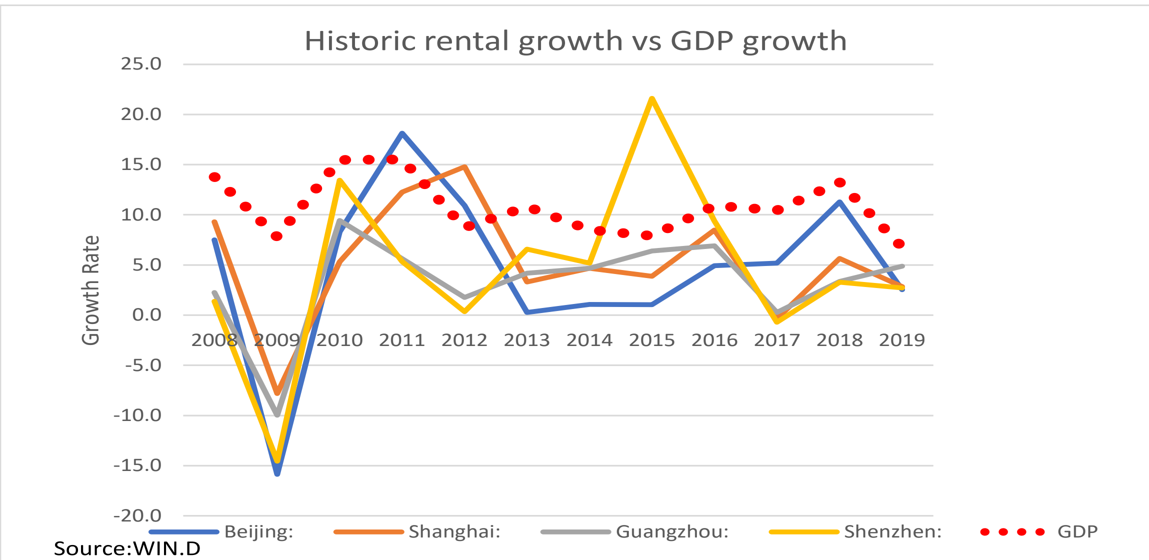


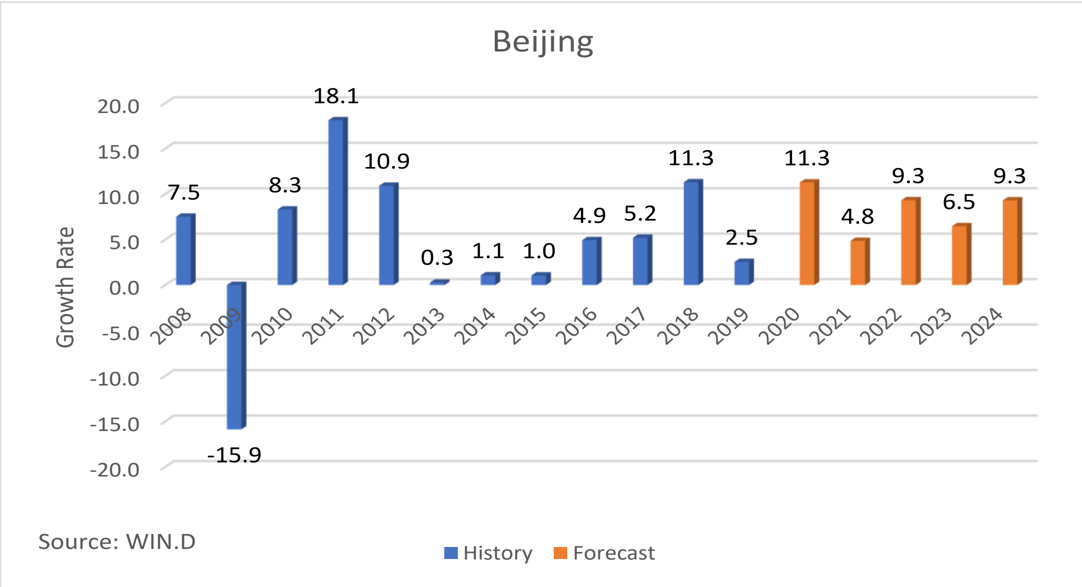
Figure 1 shows the four cities differentiated by their perspective colours. We have added a final 'dotted red' line which shows the percentage change in GDP over the same period, that is GDP growth. The shape of the graph is similar to the change in rents for warehouses. The sharp decrease in 2009 is prevalent to all four cities and is shown by the corresponding decrease in GDP before a sharp rise thereafter leading into 2010. There are then a series of peaks and troughs until 2018, after which there is another sharp decrease. The graph illustrates that GDP growth is highly correlated to rental growth.

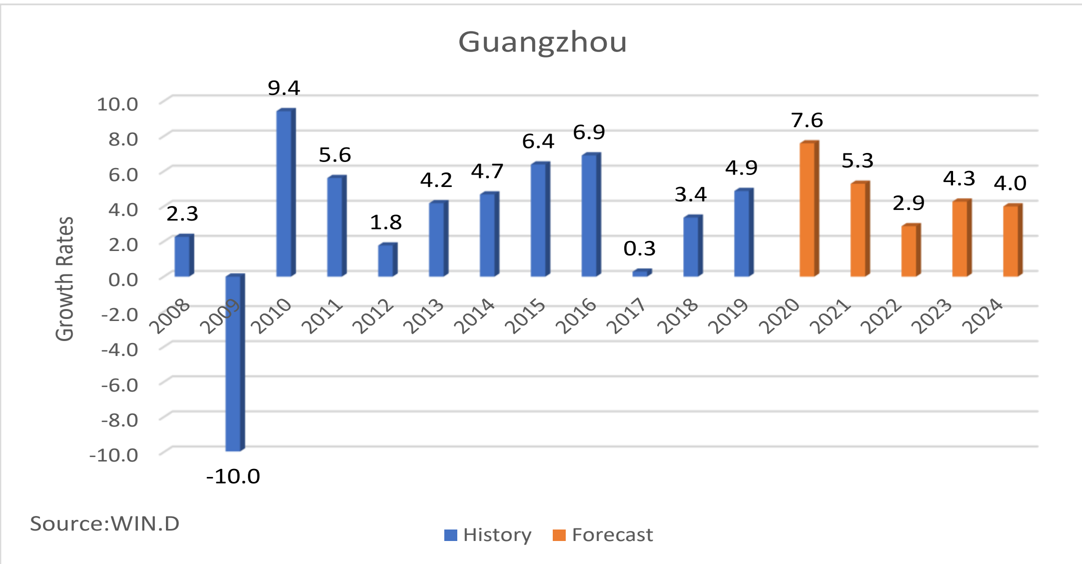
Our aim is to forecast rental growth in four of China's cities. Warehouses are currently drastically underdeveloped and this report aims to show(i): The rent forecasts under a scenario which includes China's growing use of e-commerce particularly in the retail sector; (II) GDP which is a highly correlated economic indicator and; (iii) an index of Warehouse Usage, constructed to reflect the historic use and the forecasted use which assumes that modernisation takes place and hence adequate storage space increases. Therefore, this report is a hypothetical scenario created to understand the current situation with underdeveloped warehousing known as 'old stock' and it is not a real situation currently existing. Warehouse Usage (our supply economic indicator) includes, space, the desire to use the warehouse itself and the rent charged based on the condition of the warehouse. In order to ensure that the index is realistic, we assume that the warehouse usage grows only 5% every year from the end of 2019 until the end of 2024. The 5% annual growth rate represents a hypothetical average rate of growth if warehouses were modernised and capacity added. And Hence, we assume that the total growth between this period (2020 and 2024) is approximately 28%. It is totally possible that due to the expansion of e-commerce activities, warehouse usage may grow at a much faster rate. We measure all indicators in real terms which takes inflation into account. In table 1 below, we show a summary of historic growth rates and our forecasted growth rates from our calculations.

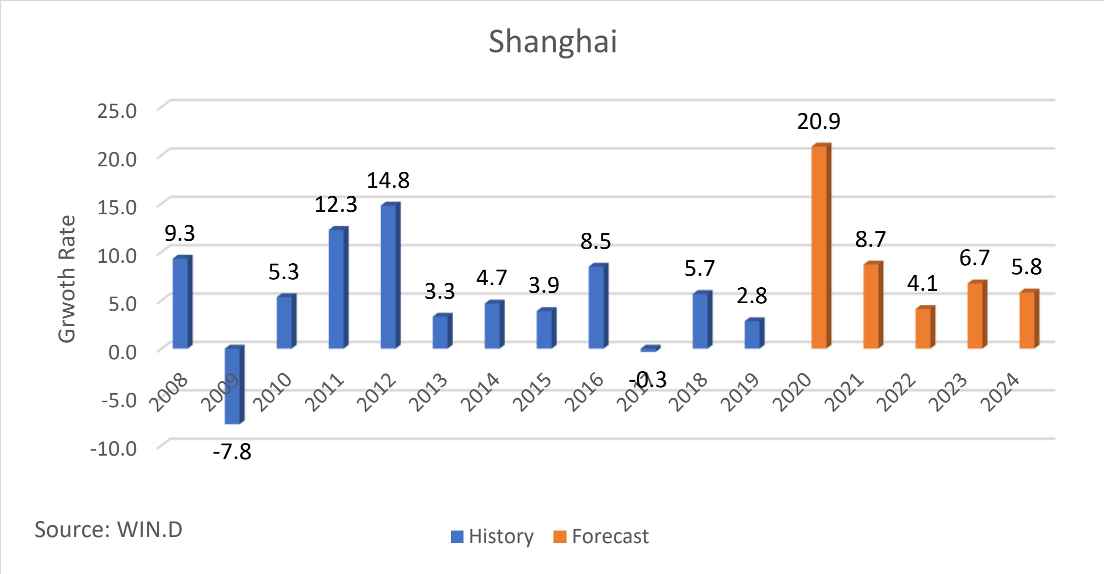
Table 1

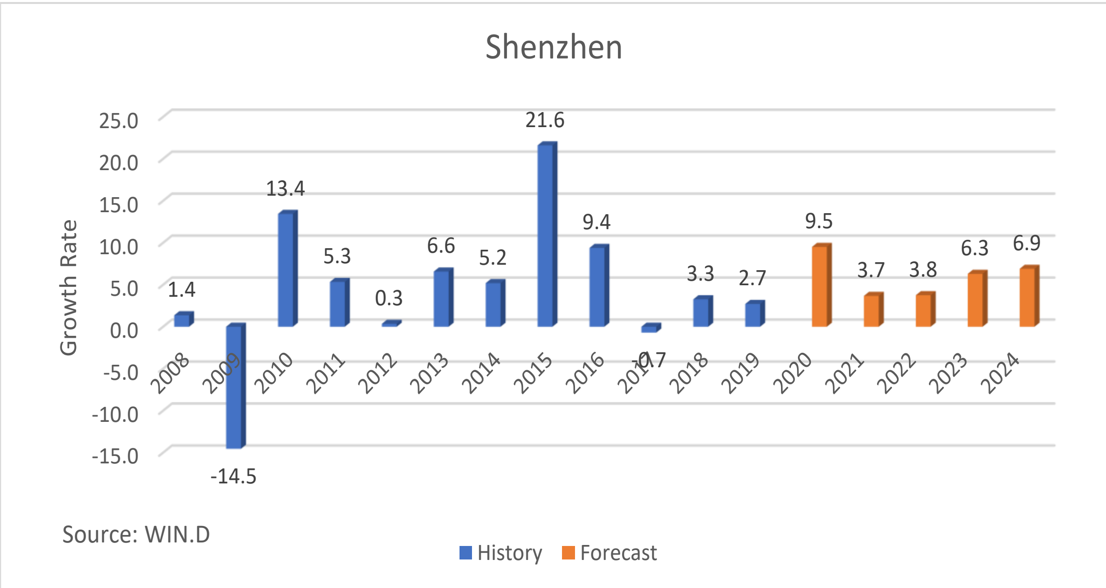
Year	Beijing	Guangzhou	Shanghai	Shenzhen
2008	7.5	2.3	9.3	1.4
2009	-15.9	-10.0	-7.8	-14.5
2010	8.3	9.4	5.3	13.4
2011	18.1	5.6	12.3	5.3
2012	10.9	1.8	14.8	0.3
2013	0.3	4.2	3.3	6.6
2014	1.1	4.7	4.7	5.2
2015	1.0	6.4	3.9	21.6
2016	4.9	6.9	8.5	9.4
2017	5.2	0.3	-0.3	-0.7
2018	11.3	3.4	5.7	3.3
2019	2.5	4.9	2.8	2.7
2020	**11.3**	**7.6**	**20.9**	**9.5**
2021	**4.8**	**5.3**	**8.7**	**3.7**
2022	**9.3**	**2.9**	**4.1**	**3.8**
2023	**6.5**	**4.3**	**6.7**	**6.3**
2024	**9.3**	**4.0**	**5.8**	**6.9**

Our forecast results for the four cities show a significant increase in rental growth rates from the first forecasted year, 202, this being the year following a redevelopment unused space by 5%. More importantly, we note the steady growth rates as shown by the forecasts as opposed to the varied and volatile nature of some of the historical growth rates. Growth rates in Shanghai in the 2020 stand at 20.9% before a return to 8.75 the year after. Indeed, the first year growth for all cities show a sharp rise and before a decrease the year after, and this decrease is explained by the competitive element as cities in China realise the potential of the warehouse/logistics space and begin their own redevelopment programmes therefore increasing the supply of warehouse usage. The value of upgrading existing stock is paramount as the increase in e-commerce activity in China continues at a rapid pace. We graphically illustrate the different cities below separately.









It can be said that the industrial distribution space and logistics sector is being partly driven by the rise in e-commerce activity and the very nature of the underdeveloped warehouse space suggests that improvements are required to meet this demand. Major cities like Beijing, Shenzhen and Shanghai do not simply need to add capacity to existing warehouses, but they need to upgrade to an industrial space sophisticated enough to meet the demands of the China's growth plans. These cities are experiencing a major demand for this type of space. Beijing is a hub for international transport and the centre for e-commerce activity with a highly educated consumer class comprised of nearly 21 million residents. Beijing has a logistics and distribution area with a large number of warehouses. We see steady growth from 11.3% in 2020 and a year on year growth rate of 8.2% between 2020 to 2024.

Likewise, Guangzhou is a booming city which has benefitted from a large amount of investment and this has resulted in a vast amount of prosperity for Chinese GDP. E-commerce is rising significantly which results in the requirement for adequate warehousing. Most of the demand is in consumer goods, and with Guangzhou being the centre of manufacturing, numerous foreign companies have established a presence there. This has led to a rise in demand for warehouse usage, making the city a major centre for economic activity. We see the five year average annual growth of 4.8%, the lowest measure of our chosen cities, however, the growth potential in this city is significant.

Shanghai is the epicentre to the world and is the largest city in China with a growing middle class. Shanghai's location, consumer population and transport network mean that the warehouse modernisation and usage requirement become paramount. With the port of Shanghai being a constant and growing area of economic activity, the network ecosystem comprising of transport, distribution and warehousing must work efficiently in order to fulfil the requirement of the growing e-commerce demand. We forecast the five year average annual growth cycle to be 7.7%. Shanghai's real income levels are higher than the national average, and this assists in driving up e-commerce in that city and together with international trade, this growth provides a real opportunity for China's Real Estate investors.

Shenzhen does not escape the notice of investors looking at opportunities in the warehouse investment space. Shenzhen is a city of innovation over the last forty years having been transformed form a small fishing village to a major finical hub specialising in technology. Shenzhen, like the other cities has a significant logistics space and the rise of e-commerce has meant that the area has experienced unprecedented growth. We forecast the five year average annual average growth rate to be 5.1% with 2020 forecast at 8.2%.

Next 5 years versus previous 3 years

Finally, we assess the five year average annual growth rate for each city and compare them with the previous three years in table 2 below. All the cities show the rental growth rates' their respective five growth cycles to be higher than the previous three years. Moreover, we forecast steady growth for the full period in all cities, and this is how we assess relative stability in the market. It is important to note that the report in a hypothetical situation which assumes that underdeveloped warehouse space will be developed at a rate of 5% each year between 2020 and 2024.

Table 2

	Beijing	Guangzhou	Shanghai	Shenzhen
Next 5 years (2020 - 2024)	8.2	4.8	7.7	5.1
Last 3 years (2017 - 2019)	6.3	2.8	2.7	1.8