2022-2023

MAINLAND CHINA INVESTOR INTENTIONS AND CAP RATE SURVEY

In collaboration with:

CREITs论坛 China REITs Forum

北大光华 中国REITs研究中心

中联基金 GSUM FUND MANAGEMENT

CUSHMAN & WAKEFIELD 戴德梁行

FOREWORD

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As China continues to optimize its COVID-19 control policies in an effort to re-energize economic growth, commercial real estate (CRE) investors are reacting quickly to the changing environment. In response, as a joint undertaking of our Valuation & Advisory, Capital Markets, and Research teams, in late 2022 we conducted an investor intentions and cap rate expectations survey, collecting valuable responses from mainland China's largest CRE investors, both domestic and international.

The survey results revealed strong investor interest in China's Tier 1 cities —— especially in office assets in Beijing and Shanghai, as well as growing interest in alternative assets such as business parks, life sciences and multifamily. In contrast, at the time of the survey, investor interest in retail and hotel assets had declined significantly compared to two years ago, as a result of increasing pressures in the retail and tourism markets. However, with the most recent relaxation of COVID-19 control measures, we do expect investor interest in retail and hotel properties to pick up in 2023. Perhaps unsurprisingly, the majority of survey respondents also demonstrated interest in logistics, cold storage and data centers in Tier 1 and surrounding satellite cities. In addition, among the major Tier 2 cities, Hangzhou — China's rising tech city and provincial capital city of Zhejiang — remained as the top choice, followed by Suzhou and Chengdu.

In terms of interest rate moves, although mainland China's 10-year treasury yield was relatively stable in 2022 overall, overseas markets saw a stronger interest rate hike policy, with the U.S. 10-year Treasury Rate rising by around 225bps over the year. Hong Kong SAR followed the same rise as in the U.S. market. Based on historical experience, the commercial real estate investment market tends to be under greater pressure in an interest rate hike

environment, since 1) higher interest rates dampen global economic sentiment; 2) higher risk-free interest rates lead to a reduction in the present value of cash flows; and 3) higher financing costs raise investors' expectations for cap rate returns.

In the context of this environment, our survey revealed that for 2023, the majority of respondents expressed a relatively prudent attitude towards the cap rate trend of the three traditional asset classes, namely Grade A offices, retail properties, and hotels; presenting an upward trend in most cities. For business parks and apartments, investors suggested an overall flat trend on the cap rate change. For industrial assets, the majority of surveyed institutions suggested the cap rate trend for the coming year would remain flat, reflecting investors' greater recognition of the anti-risk capacity of industrial assets against the backdrop of COVID-19 and economic uncertainty.

This report is an extract from the China REITs Index report series. The full Chinese language report includes further information on the REITs performances of major Hong Kong and Singapore CRE investors with a presence in mainland China. The Chinese language report is also produced in collaboration with the China REITs Forum, the China REITs Research Center of Guanghua School of Management of Peking University, and GSUM Fund Management.

Finally, we'd like to offer our sincere thanks to all the CRE investors who participated in our survey. We hope this report provides beneficial insights to interested individuals and organizations. To find out more about Cushman & Wakefield's capital markets research and services in Asia Pacific, please visit our APAC Real Estate Investment Hub webpage.

Sincerely,

Catherine Chen
Head of Capital Markets Research
Greater China

INTRODUCTION TO THE SURVEY

This is the third annual China REITs Index: Real Estate Yield Survey conducted by Cushman & Wakefield to gauge investment intentions and expected cap rates within the mainland China real estate market. Institutions and experts in the field of real estate investment were invited to participate in the survey by responding to questionnaires. By analyzing respondents' judgements on asset types in the en-bloc market in different cities, the survey provides a reasonable benchmark index for building a pricing system for REIT assets in China. The survey was completed in Q4 2022, with questionnaire responses received from more than 50 real estate investment institutions. Respondents included domestic and foreign real estate private equity funds, insurance companies, developers, and Singapore, Hong Kong SAR, and China-listed REIT managers. Real estate private equity funds represented the majority of participants, at nearly 60%, followed by insurance companies at close to 20%. The ratio of domestic capital to foreign capital was approximately two to one. In terms of the investment period requirement, institutions holding assets for less than 3 years, 3–6 years, 6–9 years, and 9 years or more accounted for 6%, 71%, 15% and 8% respectively.

The survey comprised three categories of question: Institution Background, Investment Preference, and Cap Rate. The institution background section aimed to glean information on the interviewees and their institutions, such as past investment projects, city levels and investment experience. The investment preference section focused on the degree of attention that interviewees expected to pay to city levels and asset types in 2022, while the Cap Rate questions aimed to learn of reasonable cap rate levels identified by participants for different assets, both from the buy-side and from sell-side.

METHODOLOGY

Firstly, to take account of the different expectations of buyers and sellers on asset pricing in the real estate block trading market, the questionnaire set up three types of roles: buyer, seller, and both. Interviewees could give their reasonable cap rate ranges for various assets from the perspectives of buyer and seller. Our analysis tracks the overlapped cap rate recognized by both buyer and seller.

Secondly, the major Tier 2 city category refers to the eight major cities of Hangzhou, Nanjing, Suzhou, Chongqing, Chengdu, Tianjin, Wuhan, and Xi'an. In addition, considering the characteristics of the Beijing and Shanghai Grade A office markets, the survey subdivides these city markets into CBD and non-CBD submarkets for the purposes of studying the Grade A office cap rate. By definition, the Beijing CBD submarket includes the China World Trade Center area, Beijing Financial Street, East Second Ring Road, Lufthansa Area and Zhongguancun. The core-submarket for Grade A offices in Shanghai includes Lujiazui CBD, People's Square, Nanjing West Road, Xuhui District, Zhuyuan, Xintiandi, and Changning Zhongshan Park.

Finally, for logistics storage and data center assets, the surveys were performed across the two categories of city: 1) Tier 1 cities and the surrounding satellite cities, and 2) all other cities.

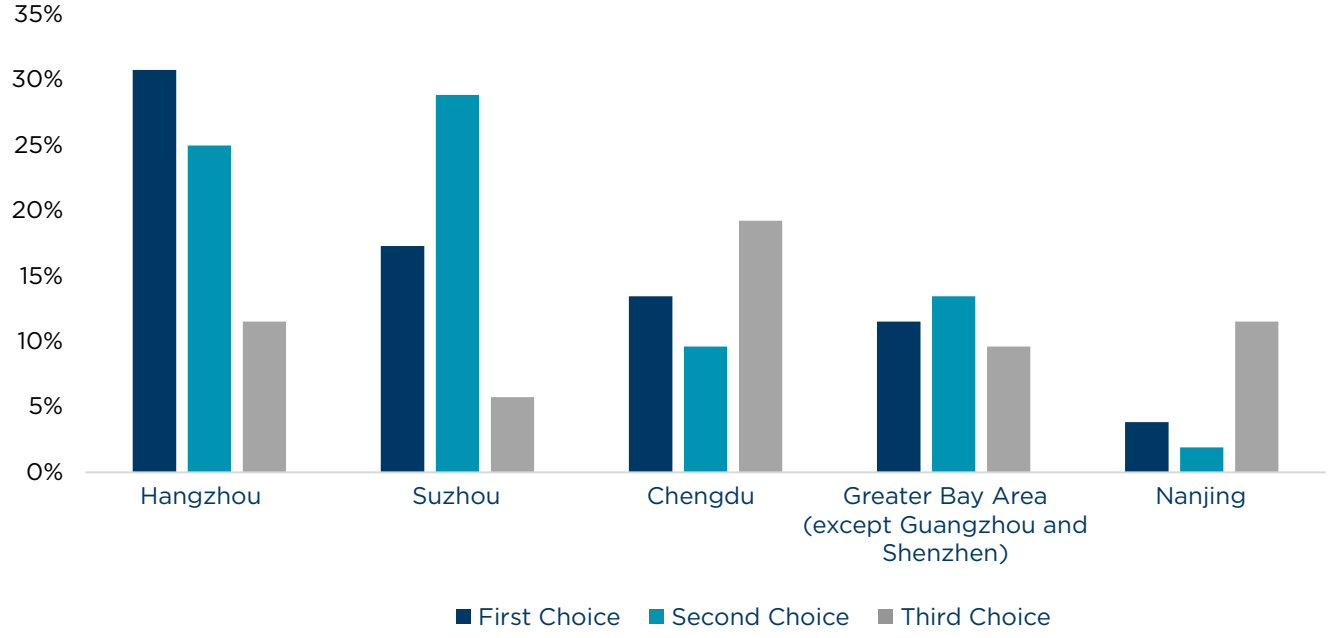
SURVEY FINDINGS

Investment intentions

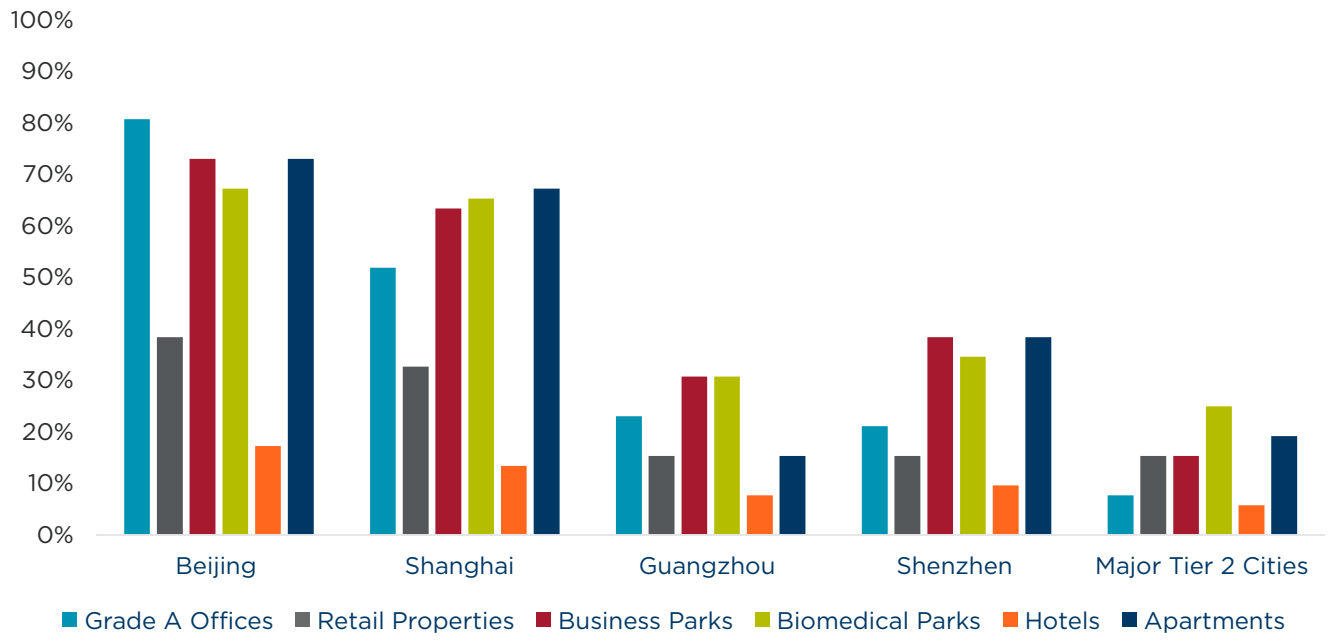
In terms of cities, Beijing and Shanghai assets received the highest degree of attention from investors, reflecting the market's investment preferences and these cities' superior asset liquidity. Guangzhou and Shenzhen were next, followed by major Tier 2 cities. In response to the impact of the overall economic uncertainty caused by COVID-19 and the tightening of the domestic real estate financial market in recent years, many investors tended to choose more stable markets in Tier 1 cities as investment destinations, seeking to reduce investment risks. Investors in China are still concerned about the impact of potential COVID-19 related control measures when selecting real estate investment opportunities.

The rapid growth of non-Tier 1 cities and their relatively higher investment returns have also attracted the attention of real estate investment institutions. Of them, the five cities or regions attracting the most attention are Hangzhou, Suzhou, Chengdu, the Greater Bay Area (not including Guangzhou and Shenzhen) and Nanjing. Approximately 67% of survey respondents chose Hangzhou as an investment destination, including 31% of investors who selected Hangzhou as their first preference location for investment. In recent years Hangzhou has held most attention among non-Tier 1 cities, thanks to its well-developed industry clusters.

Top Five Tier 2 Cities/Regions



2022 Investment Intentions



Note:
1) Tier 1 cities: Beijing, Shanghai, Guangzhou, Shenzhen
2) Major Tier 2 cities: Hangzhou, Nanjing, Suzhou, Chongqing, Chengdu, Tianjin, Wuhan, Xi'an
Sources: Cushman & Wakefield Research

Grade A Offices Still Hold Most Investor Attention, With Beijing and Shanghai Projects Favored

The office leasing market in Tier 1 cities came under evident pressure in 2022, with the resurgence of COVID-19 restraining enterprises from releasing office space demands, coupled with market factors such as rising supply within a short period. However, in general, Grade A offices remained investors' most favored asset when compared with other commercial transaction formats. Respondents also displayed marked city preferences when selecting investment opportunities, with Beijing and Shanghai their first choices. More than 80% of investors considered Grade A offices in Beijing, making this asset class the most preferred by investors among all commercial asset classes. More than 50% of respondents expressed interest in investing in Shanghai office properties, while around 20% showed intent in Guangzhou and Shenzhen. In contrast, only 8% of investors showed interest in offices in major Tier 2 cities, a marked fall from past years.

In terms of investor type, Grade A office investors are primarily insurance funds. Insurance funds prefer core assets or core value-added assets with stable cash flow, high maturity and low risk. The survey indicates that almost all insurance fund respondents expressed willingness to invest in Grade A offices. Against the backdrop of an expected market price pullback, and with due diligence for investment by foreign funds facing increasing difficulty, the trading volume of office assets was curtailed to some extent. However, numerous investors still consider office property an indispensable part of their asset allocation due to stable rental income, easier operation, fairly good asset liquidity, and the category's role as an inflation hedge. The prevailing market price pullback trend will also bring more access opportunities for investment institutions paying attention to this sector.

Strong Demand Emerging for Business Parks, Investors Prefer Biomedical Parks

The survey results show that more than 60% of respondents would consider investing in business park assets in Beijing and Shanghai, markedly higher than in Guangzhou and Shenzhen (at approximately 30%) and major Tier 2 cities.

However, unlike office investments which focus more on the building's location relative to the urban core areas, business parks are usually located in the non-CBD area of a city, and investors tend to pay more attention to the industrial orientation and development in the region. Parks with distinctive industrial characteristics and higher agglomeration rates, such as Shangdi in Beijing, Zhangjiang in Shanghai, Shenzhen Nanshan Science and Technology Park, and Suzhou Industrial Park, are more attractive to investors because the industrial support will bring more stable rental incomes and value growth performance to the real estate. At the end of November 2022, there were five industrial park infrastructure REITs holding 10 business park projects in mainland China, mainly located in the industry cluster districts of Tier 1 cities and their neighboring areas, as well as major Tier 2 cities. The launch of infrastructure REITs will help industrial parks complete the "investment, financing, management and exit" process, thus driving up investors' interest in industrial park deals.

Thanks to positive factors such as healthcare policy reform, talent returning to China, and financial capital inflows, China's biomedical industry has been developing fast, and many cities have built biomedical industry clusters supported by incentives and promotional policies, in turn attracting investors to pay more attention to investment opportunities in biomedical parks. At present, a framework with the Yangtze River Delta, Bohai Rim, Guangdong–Hong Kong–Macao Greater Bay Area, and other city clusters as the core has been formed in China. The survey results show that more than 60% of respondents expressed willingness to consider investing in biomedical parks in Beijing and Shanghai, significantly more so than for Guangzhou and Shenzhen. For the latter, approximately 35% of respondents showed a preference for Shenzhen, slightly higher than for Guangzhou at 31%. About 25% of respondents expressed their willingness to invest in biomedical parks in major Tier 2 cities.

In recent years, asset acquisitions of biomedical parks in mainland China have been mainly value-add strategic investments, mainly engaged in by foreign institutions. The strong leasing demand, multiple entry strategies, and established exit channels have made current institutional investors more willing to pursue investment in this area. The survey findings also indicate that foreign institutions showed broader investment attention than their domestic peers to the biomedical park category. When considering investment in biomedical parks, investors also target the exit channels of infrastructure REITs. In November 2022, the Huaxia Hangzhou Heda Hi-Tech Industrial Park public REIT was approved, with underlying assets encompassing two projects: the Heda Medicine Valley Phase I, and the incubator at the Hangzhou Economic and Technological Development Zone. The market expects infrastructure REITs to further enrich biomedical park transaction opportunities.

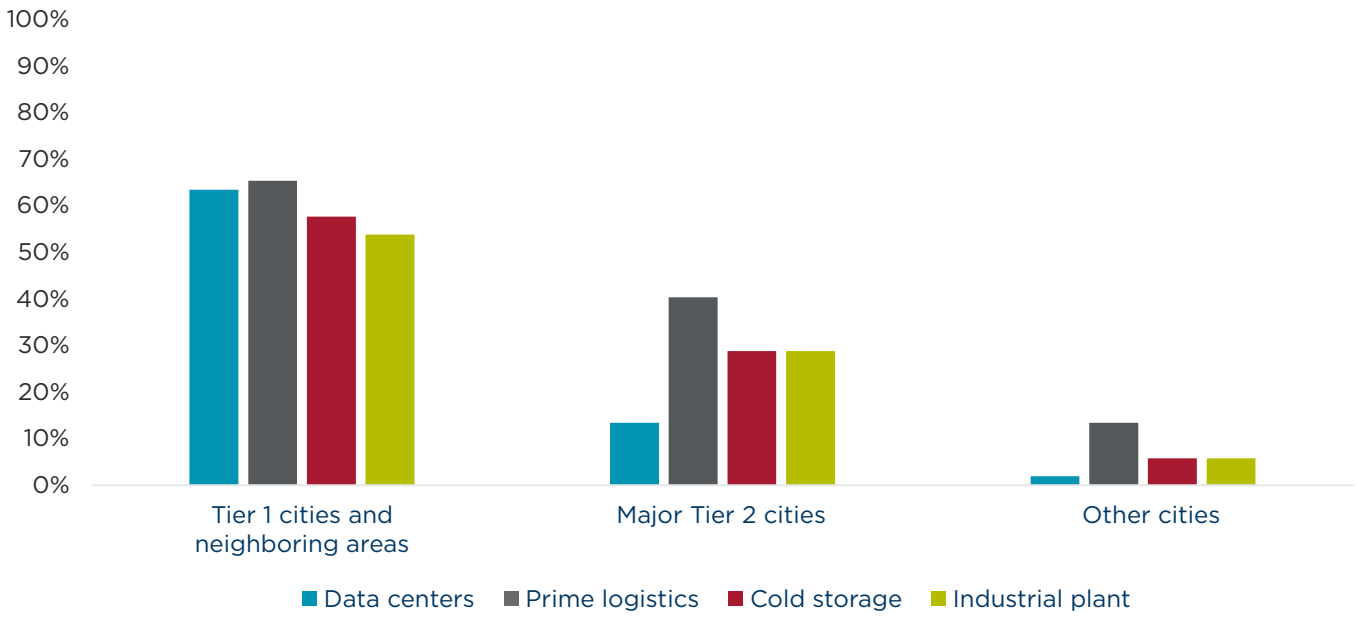
Retail and Hotel Sectors Are Under Pressure, While the Long-Term Leasing Residential Apartment/Serviced Apartment Investment Sector Sees Growth

With the negative impacts of COVID-19 and the economic downturn, rising living costs have curtailed consumption expenditure, while human resources costs and other factors have pushed up operational costs in the retail industry. When the pandemic fully broke out across China in 2020, nearly 50% of investors were still willing to invest in retail properties in Beijing and Shanghai. In 2022, that investment preference for retail properties has fallen significantly, with just 38%, 33%, 15% and 15% of respondents considering investment in retail properties in Beijing, Shanghai, Guangzhou and Shenzhen respectively.

Unlike the apparent recovery of major deals in the overseas hotel sector, COVID-19 still exerts multiple impacts on mainland China's hotel industry, causing the institutions in our survey to remain cautious about hotel investments. In Tier 1 and major Tier 2 cities, investment preference for hotel assets is the lowest among all asset classes, with just 17% of respondents considering opportunities in Beijing, the highest, and 6% percent focusing on opportunities in major Tier 2 cities.

In contrast, the overseas long-term leasing residential apartment/serviced apartment investment market expanded in 2022. More investment giants have entered the overseas apartment market due to demand for improved living conditions and the return of international students to school in the post-pandemic era. In the mainland China market, investors are also seeking value-add investment opportunities, mainly in Shanghai and Beijing, with more people moving to the big cities and their metropolitan areas, coupled with changing consumption concepts around housing. The survey findings show that nearly 70% of respondents would consider investing in long-term leasing residential apartment/serviced apartment assets in Beijing and Shanghai, and nearly 40% would look at such opportunities in Shenzhen. Specifically, long-term leasing residential apartments/serviced apartment assets are the most popular asset class in Shanghai for investors. The results also indicate that domestic institutions showed broader investment interest in the long-term leasing residential apartment/serviced apartment investment track than foreign institutions. In 2021, the National Development and Reform Commission included affordable rental housing in the pilot program of public REITs. By the end of 2022, four different affordable rental housing REITs have been successfully offered, bringing good news to the long-term leasing residential apartment/serviced apartment market in mainland China.

2022 Investment Intentions — Industrial Assets



Industrial Assets: Warehousing Logistics Facilities Remain the Mainstream Option, While Investors Are Relatively Cautious With Investment in or Around Non-Tier 1 Cities.

The survey investigated respondents' preferences for investment opportunities in industrial assets. The results show that warehousing logistics are still the most favored asset class within the industrial assets category. In and around Tier 1 cities, 65%, 63%, 58% and 54% of respondents considered investing in dry warehousing logistics, data centers, cold chain logistics and industrial plants respectively, indicating that they recognized the resilience and growth of new economy assets under the pandemic environment. In addition, warehousing logistics, industrial plants and data centers have been included in the pilot scope of the infrastructure REITs policy, providing a stable equity financing channel for such real estate investments and indirectly promoting investors' enthusiasm for such assets.

From the city-level perspective, investors' attention to industrial assets focused on Tier 1 cities and their neighboring areas, broadly consistent with the results of our research in late 2020 in terms of the degree of attention. This is closely linked to the short supply of industrial land in and around Tier 1 cities in recent years, indicating that the scarcity of industrial assets is an important factor in investors' decision-making.

Institutional investors have higher compliance requirements for data center assets, and projects in and around Tier 1 cities can better meet their investment screening requirements. On the other hand, the oversupply of data center projects in some areas of non-Tier 1 cities in recent years has also prompted capital to favor projects in and around Tier 1 cities, with the objective of enjoying more stable investment returns with lower risks.

In recent years, with rising income levels in China, the increasing scale of the fresh food e-commerce industry, and the growing demand for transportation, storage and distribution of drugs/vaccines driven by the pandemic, the level of institutional investors' attention to cold chain logistics assets has gradually elevated. The survey results show that nearly 60% of the institution respondents are interested in investment opportunities in cold chain logistics. And due to the high professional requirements of cold storage operations, and the low transparency of cold chain en-bloc transactions and low liquidity, the degree of attention paid to cold chain logistics still lags that of dry warehousing logistics.

Driven by the demands of the high-end manufacturing industry, industrial plants have become the new economic asset type favored by investment institutions, of whom 54%, 29% and 6% considered investing in industrial plant projects in and around Tier 1 cities, major Tier 2 cities, and other cities, respectively. 2022 saw the successful listing of two infrastructure REITs, the D&J New Economy Industrial Park and Lingang Innovative Intelligent Manufacturing Park, with the underlying assets comprising four standard plants for production and processing in East China and two in Shanghai, respectively. The launch of infrastructure REITs may produce a positive impact on improving liquidity in the en-bloc trading market of industrial plants.

Cap Rates of Different Assets in Different Cities

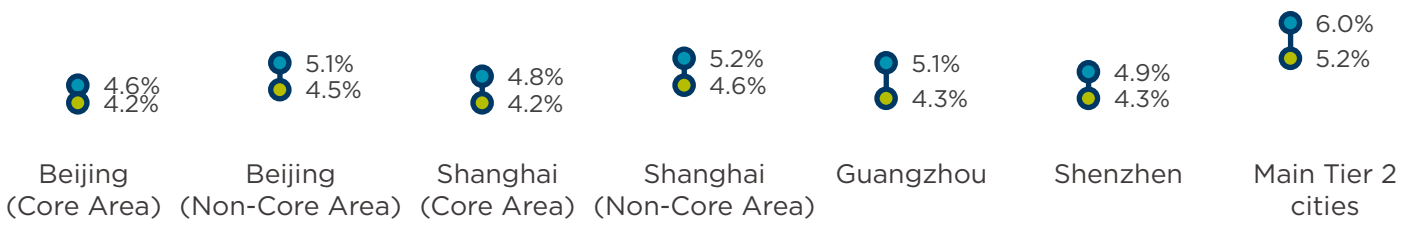
The survey observed the reasonable cap rate range of various assets in transactions from the perspectives of buyer and seller, and developed the following conclusion based on the consensus of the range.

Yield levels of assets in different cities

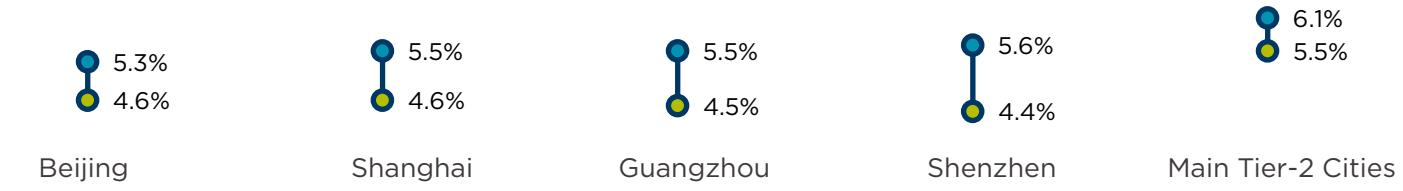
City	Grade A Offices	Retail	Business Parks	Hotel	Apartment
Beijing	Core area: 4.2%%–4.6% Non-core area: 4.5%-5.1%	4.6%–5.3%	4.8%–5.3%	5.1%–5.9%	4.6%–5.1%
Shanghai	Core area: 4.2%-4.8% Non-core area: area4.6%-5.2%	4.6%-5.5%	4.7%-5.6%	5.1%-6.0%	4.5%-5.3%
Guangzhou	4.3%-5.1%	4.5%-5.5%	5.1%-5.5%	5.4%-6.0%	4.8%-5.3%
Shenzhen	4.3%-4.9%	4.4%-5.6%	4.9%-5.6%	5.2%-5.9%	4.6%-5.3%
Major Tier 2 cities	5.2%-6.0%	5.5%-6.1%	5.6%-6.1%	5.8%-6.3%	5.4%-6.3%

City	Logistics	Cold Storage	Industrial Plant	Data Center	Apartment
Surrounding areas of first tier cities	4.6%-5.3%	4.8%-5.5%	5.3%-6.1%	7.5%-8.5%	4.6%–5.1%
Other cities	5.4%-6.0%	5.5%-6.0%	6.1%-6.8%	8.5%-10.0%	4.5%-5.3%

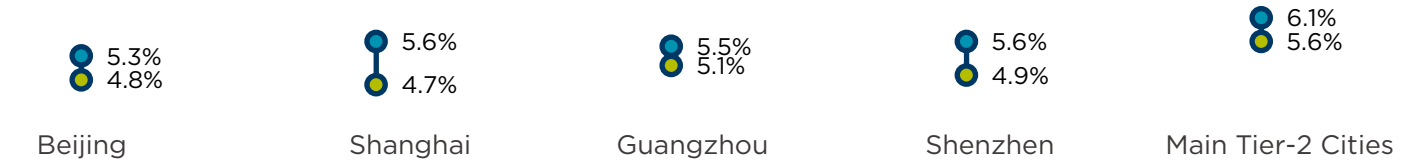
Grade A Office Cap Rate



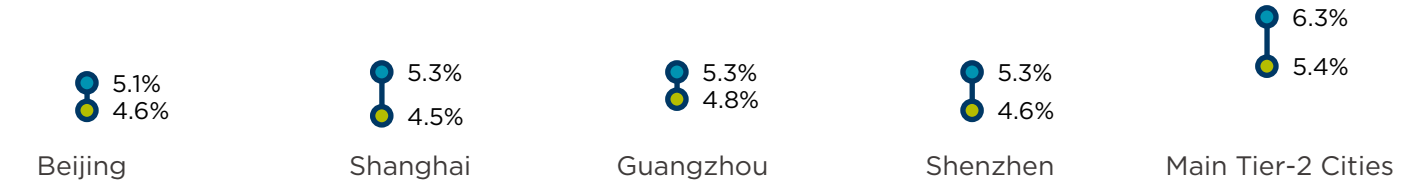
Retail Cap Rate



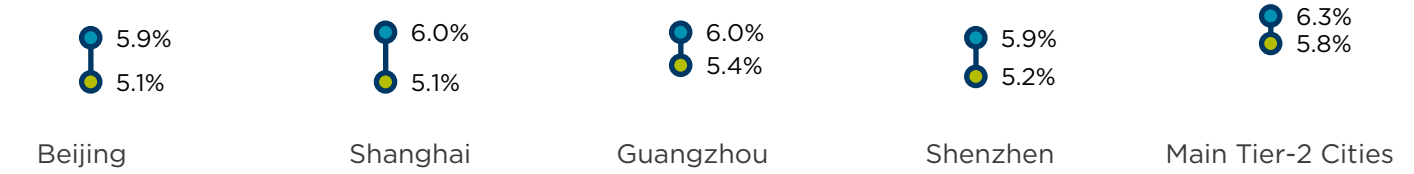
Business Park Cap Rate



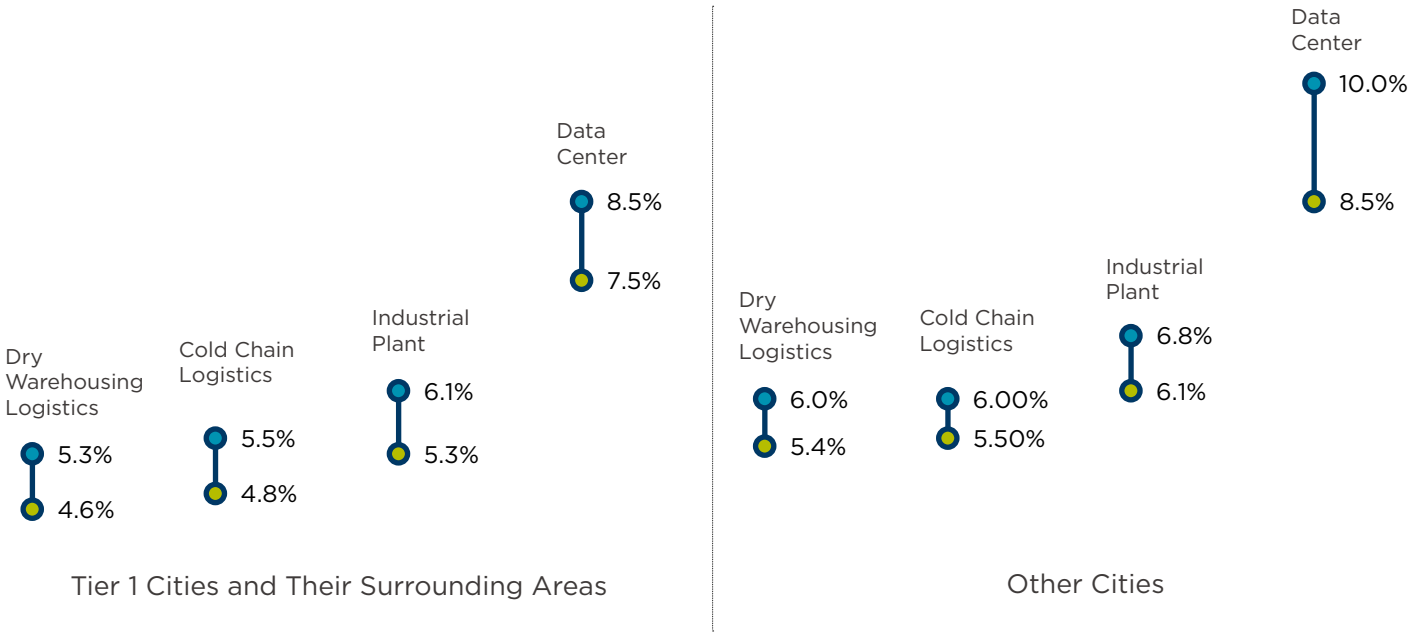
Apartment Cap Rate



Hotel Cap Rate



Industrial Asset Cap Rate



Grade A Offices

The survey results show that market players have reached a basic consensus on the pricing of office property, an asset class with the strongest liquidity that has received the highest attention in the domestic real estate en-bloc trading market. Investors often take it as a benchmark to compare the yield with that of other types of property so as to mirror investment risks and returns requirements brought by different asset classes.

Of all the cities and regions, the cap rates of Grade A offices in the core area in Beijing and Shanghai are the lowest, and close to each other, in a range of 4.2%–4.6% and 4.2%–4.8% respectively, while the cap rates in the non-core area in the same city is around 30bps–50 bps higher. Grade A offices in the core area in Beijing received a yield range of 4.2%–4.9% from buyers and 3.9%–4.6% from sellers. There is a clear distinction between two ranges. Most buyers are holding a prudent wait and see attitude. Meanwhile, the yield range of Grade A offices in the core and non-core area in Shanghai are about 30bps higher than that at the end of 2020. Influenced by both the COVID-19 shocks and more new supply in the short term, investors now have less confidence in Grade A office assets in Shanghai.

Grade A offices in Guangzhou and Shenzhen saw a yield range of 4.3%–5.1% and 4.3%–4.9% respectively, which stood between that of the core and non-core area in Beijing and Shanghai. Respondents showed a clear city-level generated risk premium in terms of yield requirement on Grade A offices in major Tier 2 cities, as represented by yield range of 5.2%–6.0%, at 1.0pps–1.4pps higher than that of assets in the core areas in Beijing and Shanghai.

Retail

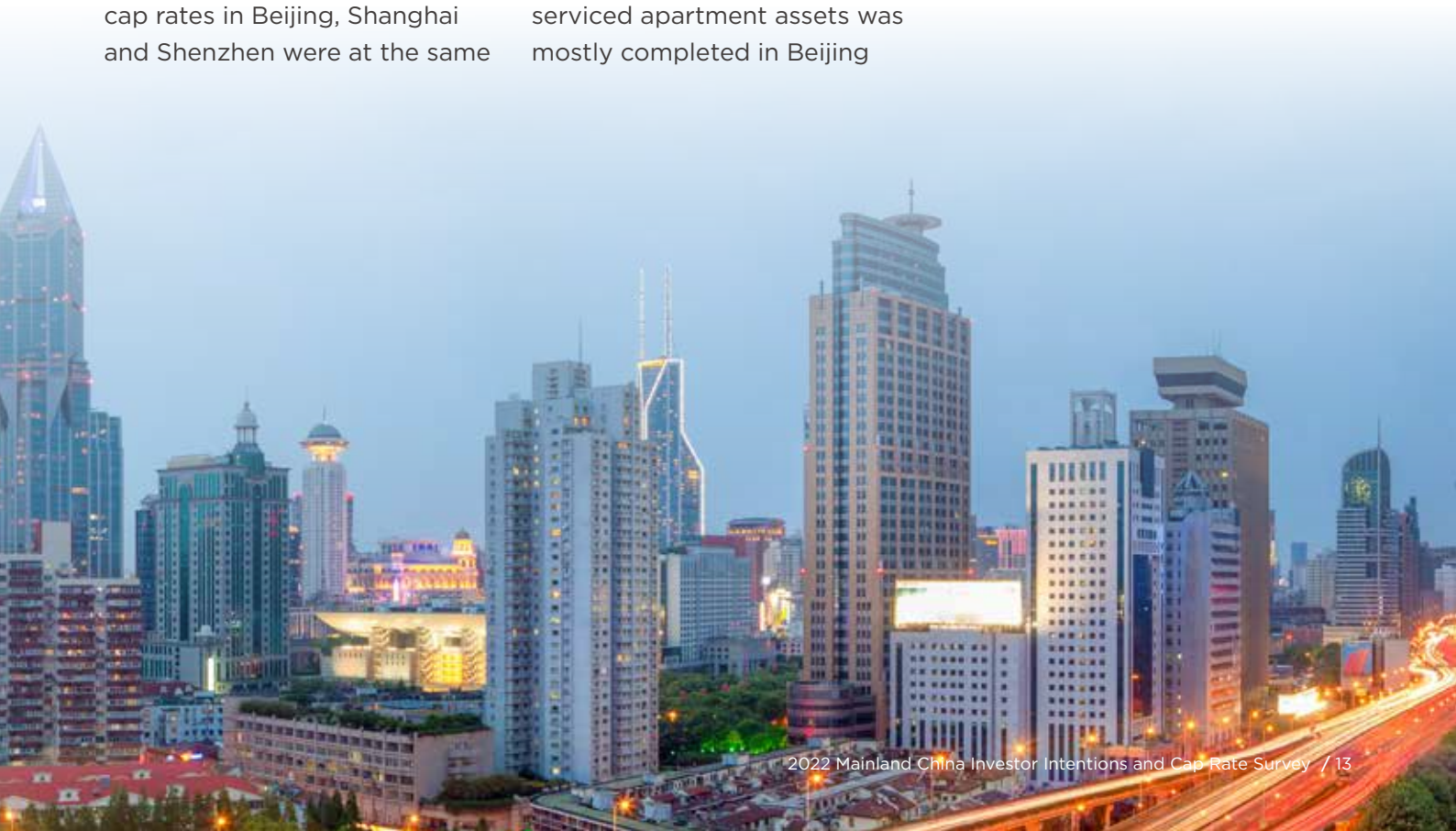
The cap rates of retail properties in Beijing, Shanghai, Guangzhou, Shenzhen and major Tier 2 cities largely rose in 2022 when compared with the end of 2020. The cap rates of retail properties in Beijing, Shanghai, Guangzhou-Shenzhen and major Tier 2 cities were at about 20bps, 40bps, and 30bps higher than those at the end of 2020 respectively. The yield spread between retail properties in Tier 1 cities and Grade A offices in the core area expanded, as demonstrated by 2022 data that the cap rates of retail properties in Beijing and Shanghai were at 40bps–70bps higher than those of Grade A offices, 10bps–70bps higher in Shenzhen, and only 20bps–40bps higher in Guangzhou and major Tier 2 cities.

Business Parks

The cap rates of business parks in Beijing, Shanghai and Shenzhen were similar, represented at approximately 4.7%–5.6%. The cap rates of business parks in Beijing and Shanghai were 10bps–40bps higher than those of Grade A offices in non-core areas. This spread has narrowed from Q4 2020, arising from the current high investor interest in business park assets. Although the overall market requirements for the yield of business parks were higher than those for Grade A offices, investors were willing to accept a lower yield for some core assets located in industrial clusters, even close to the level of Grade A offices in core areas, due to their stable rental income and expected value growth. In addition, infrastructure REITs have provided a platform for withdrawal from listing of the assets of the industrial parks, which drove their fund building and asset trading to maintain movement.

Apartments

Long-term leasing apartments and serviced apartments presented robust leasing fundamentals and strong risk resistance against the macro background of repeated COVID-19 and economic fluctuations in mainland China, becoming an asset type favored by investors. Of Tier 1 cities, their cap rates in Beijing, Shanghai and Shenzhen were at the same level, ranging at 4.5%–5.3%, and at 4.8%–5.3% in Guangzhou. It was widely thought by investors that cap rates in Guangzhou were about 10bps–20bps higher than those in Beijing, Shanghai and Shenzhen. After the outbreak of COVID-19, the en-bloc trading of long-term leasing residential apartment/ serviced apartment assets was mostly completed in Beijing and Shanghai, while investors expressed 80bps–120bps for yield spreads between Tier 1 and Tier 2 city assets. The market also demanded hotel asset cap rates to be roughly 50bps–70bps higher than that of long-term leasing residential apartments/serviced apartments.



Logistics

The stable lease demand, limited land supply for warehouse logistics, and the establishment of exit channels for infrastructure REITs in surrounding areas of Tier 1 cities in China enabled the popularity of warehouse logistics assets to keep rising in the real estate investment market. The extensive attention and increasing transaction cases led to the gradually transparent pricing basis and yield level. Compared with Q4 2020, cap rates of high-quality logistics (dry warehouse) in Tier 1 cities and their surrounding areas dropped by about 30bps, indicating that investors preferred the core location. The survey showed that the cap rates of high standard logistics (dry warehouse) demanded by buyers and sellers were 4.6%–5.5% and 4.6%–5.3% respectively in Tier 1 cities and their surrounding areas, exhibiting a spread of 0.2% and an overlap of 4.6%–5.3%, revealing consistent judgment on asset pricing from both sides.

In the en-bloc trading market, the cap rates of Shanghai logistics asset package transactions approached those of business parks and Grade A offices transactions in non-core areas. Investors' pricing of warehouse logistics in cities surrounding non-Tier 1 cities formed a distinct gradient compared with that in Tier 1 cities. Cap rates of logistics in other cities were about 75bps higher than those in Tier 1 cities and their surrounding cities.

Cold Storage

According to the survey, the cap rates of cold storage facilities in Tier 1 cities and their surrounding areas were at 4.8%–5.5%, and at 5.5%–6.0% in other cities. Due to factors such as the high requirements for operational professionalism, low transaction activity, and complex asset portfolios, professional institutional investors generally held that the yield of cold chain logistics was about 50bps higher than that of dry warehousing logistics with active transactions in the same geological location. However, the yield ranges of dry warehouse and cold chain assets in this survey were rather close, highlighting the scarcity of cold chain assets.

Industrial Plants

The study on the yield of industrial plants was added in this year's survey. The yield range of industrial plants in Tier 1 cities and their surrounding areas was at 5.3%–6.1%, while those in other cities varied at 6.1%–6.8%. Industrial plants, in comparison with warehouse logistics assets with a higher degree of product standardization, usually possessed a higher degree of customization, which made their liquidity lower than warehouse logistics in the en-bloc trading market. As a result, the cap rates of industrial plants at the same city level were about 30-50bps higher. In 2022, two infrastructure REITs that held productive industrial plant assets were listed for the D&J New Economy Industrial Park and Lingang Innovative Intelligent Manufacturing Park. In the future, as the infrastructure REITs market matures, their transaction pricing will play a certain role in value discovery when industrial plant assets are priced in the primary market.

Data Centers

The survey finds that institutions clearly had different views on the yield of data centers. As an emerging real estate investment area, few transactions of mature data centers are yet available in China. M&A or acquisition cases of data centers were mostly projects that acquired energy indexes or projects in the process of development and construction, with transaction information disclosure incomplete or where consideration included non-asset elements. All of this contributed to an overall lack of a transparent basis for pricing of data centers, and was the key reason for the wide variation in respondents' opinions. Currently, there is almost no en-bloc trading of mature operating data centers in mainland China.

The yield range expressed by buyers and sellers in the survey mainly reflected their psychological expectations for future transactions. In terms of the buyer, investment institutions required a high rate of return on data center transactions, mainly considering risk factors such as the high complexity of acquiring data center assets, the difficulty of post-acquisition operations, low transaction dynamics, and difficulty in assessing risk in the project compliance. As for sellers, the rising share price multiples of listed data center companies in the past often led them to expect higher valuations in the assets traded compared with buyers, resulting in the difference in the yield range expressed by buyers and sellers.

Overall, the yield range of data centers expressed by buyers and sellers was evidently closer to each other in 2022 compared with 2020, indicating a significant boost in willingness to make deals. To ensure the reliability of the findings in this survey, the yield range of data centers included only the questionnaires of respondents with previous investment experience as statistical samples. After data analyzing, we found that the yield of data centers in Tier 1 cities and their surrounding areas identified by both buyers and sellers was at 7.5%–8.5%, down on the results from the survey completed at the end of 2020, mainly because it was more difficult for the Tier 1 cities and their surrounding areas to obtain energy consumption indexes, and that the core area assets were most favored by capital. Investors were still cautious about investing in data centers in cities surrounding non-Tier 1 cities, and the yield of data centers in other cities was approximately 1.0%–1.5% higher than that in Tier 1 cities and their surrounding cities.

In this survey, we also calculated the difference in the yield spread between data center assets and actively traded dry warehousing logistics assets viewed by the same institutional investor. Both buyers and sellers generally agreed that the yield of data centers was about 2.6pps–3.2pps higher than that of actively traded prime logistics assets. From the perspective of transaction difficulty, operational difficulty, and investors' challenges in fully understanding such assets, investors required a higher rate of return on data centers than on dry warehousing logistics, which are relatively simple to operate and actively traded. When compared with the U.S. market, where data center transactions are more active, according to Cushman & Wakefield's study of U.S. data centers and high-quality logistics facilities transactions over the past five years, the average yield of data center transactions in the U.S. was approximately 1.65pps higher than that of high-quality logistics transactions. As the data center asset transaction market gradually matures in mainland China, the difference in the yield spread between the two in mainland China may trend downwards in the future.

2023 CAP RATE OUTLOOK

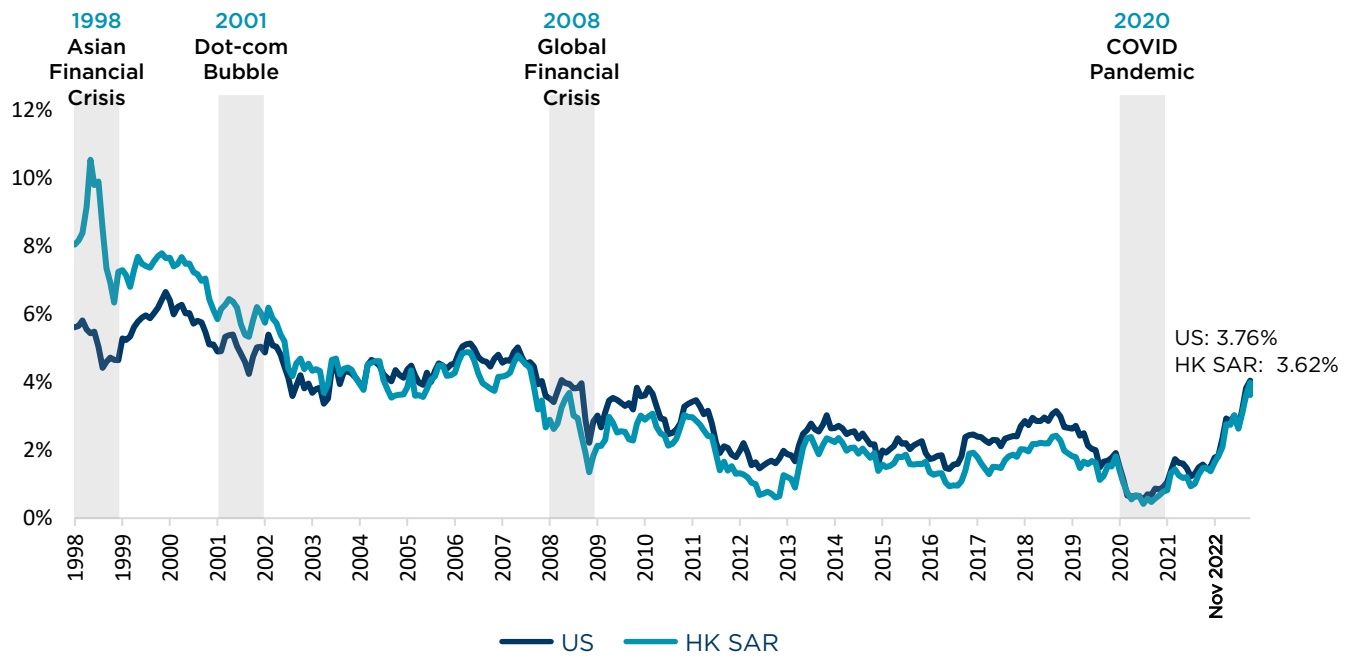
Mainland China's 10-year Treasury Yield was relatively stable overall in 2022, with only a small uptick of around 20bps in the second half of the year. In contrast, overseas markets saw a stronger interest rate hike policy, with the U.S. 10-year Treasury Rate rising by around 225bps over the year. Hong Kong SAR's 10-year Treasury Rate followed the same rise as in the U.S. market. Based on historical experience, the en-bloc real estate trading market tends to be under greater pressure in an interest rate hike environment that generates influence from the following three factors:

1. Higher interest rates affect global economic sentiment, leading to weaker demand for real estate leasing, which in turn affects the profitability of properties, such as with rents and occupancy rates.

2. Higher risk-free interest rates lead to a reduction in the present value of cash flows, putting pressure on property valuations.

3. Higher interest rates raise financing costs and reduce the difference between the loan cost of asset acquisition and merger, and asset cap rates, leading investors to take a wait-and-see attitude. Overseas funds show an obvious withdrawal trend due to the rising cost of overseas capital.

U.S. and HK SAR 10-year Treasury Yield



Source: Investing.com

The survey findings show that for the coming year, the majority of respondents expressed a relatively prudent attitude towards the cap rate trend of the three traditional asset classes, namely Grade A offices, retail properties, and hotels; presenting an upward trend in most cities. For business parks and apartments, investors suggested an overall flat trend on the cap rate change.

For industrial assets, the majority of surveyed institutions suggested the cap rate trend for the coming year would remain flat, reflecting investors' greater recognition of the anti-risk capacity of industrial assets against the backdrop of COVID-19 and economic uncertainty. As for the dry warehousing logistics facilities in other cities, respondents showed a more prudent attitude towards the upward trend, mainly due to the major inputs of funds and land in high standard logistics in recent years, which resulted in weak absorption of new supply in some areas, in turn pushing up the vacancy rate in the regional markets. As a result, oversupply has now emerged in central and southwest China.

Cap Rate Trend in 2023

	Beijing	Shanghai	Guangzhou	Shenzhen	Major Tier 2 Cities
Grade A Offices	↑	↑	→	↑	↑
Retail Property	↑	↑	→	↑	↑
Business parks	→	→	→	→	→
Hotels	↑	↑	↑	↑	↑
Long-term Leasing Residential Apartments/ Serviced Apartments	→	→	→	→	→

	Tier 1 Cities and Their Surrounding Areas	Other Cities
Dry Warehousing Logistics	→	↑
Cold Chain Logistics	→	→
Industrial Plants	→	→
Data Center	→	→

Note: ↑ refers to increased yield; → refers to flat yield; ↓ refers to decreased yield

CONCLUSIONS

1. From the city perspective, all asset types in Beijing and Shanghai attract the highest level of investor attention, reflecting the market's investment preference for the two premier cities. In non-Tier 1 cities, Hangzhou, Suzhou, Chengdu, the Greater Bay Area (not including Guangzhou and Shenzhen) and Nanjing are the cities that enjoy the most attention.

2. In terms of asset types, Grade A offices are still most favored by investors, and the market has a clear investment preference for projects in Beijing and Shanghai. Investment opportunities in business parks and long-term leasing residential apartments/serviced apartments attract high attention across cities, while biomedical industrial parks in Beijing and Shanghai are also in high demand.

3. Long-term leasing residential apartments/serviced apartments are highly favored by investors, especially in Shanghai and Beijing. In the industrial categories, incentive policies and support from the new economy mean that dry warehousing logistics, cold chain logistics, industrial plant and data center projects are sought after by the market, but attention is focused on Tier 1 cities and their surrounding areas.

4. For 2023, the majority of respondents expressed a relatively prudent attitude towards the cap rate trend of the three traditional asset classes, namely Grade A offices, retail properties, and hotels; presenting an upward trend in most cities. For business parks and apartments, investors suggested an overall flat trend on the cap rate change.

5. For industrial assets, the majority of surveyed institutions suggested the cap rate trend for the coming year would remain flat, reflecting investors' greater recognition of the anti-risk capacity of industrial assets against the backdrop of COVID-19 and economic uncertainty.

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