

# THE RISE OF QIANHAI, CHINA: AN OPPORTUNITY OR A CHALLENGE?

## EXECUTIVE SUMMARY

There is no doubt China has the world's fastest-growing economy and its currency (RMB) has grown significantly over the past years in terms of the volume utilised for trade settlement, finance and investment. According to the latest survey compiled by the Society of Worldwide Interbank Financial Telecommunications (SWIFT), a global provider of secure financial messaging services, RMB payments worldwide have almost tripled in value over the past two years. As of September 2014, the RMB was ranked seventh in the top 20 global payments currencies. Looking forward, due to the increasing usage in Hong Kong, China and other offshore centers, it is predicted to be mature enough to become a reserve currency within the next five years.

In order to cater for expanding settlement volumes, and support the future development of new products and services denominated in RMB, Qianhai in Shenzhen will play a unique role in fostering RMB internationalisation by accelerating the circulation of RMB funds across the border.

In an effort to explore the opportunities and challenges Qianhai poses, Colliers will comment on the positioning of Qianhai in relation to Hong Kong and other factors, such as the Shanghai Free-Trade Zone (SHFTZ), and the latest development policies, such as the newly announced 15% corporate tax and its subject beneficiaries.

Competition is inevitable but characterised by the Central Government supported incentives and policies, Colliers believe the position of Qianhai as a "special zone", will provide more opportunities rather than challenges in and beyond the Pearl River Delta region.

## QIANHAI IS ON TRACK

Qianhai, seeking to transform itself into Asia's 'Manhattan' by 2020, is intended as a test field for Renminbi (RMB) internationalisation and financial reforms. The development scope was outlined in the Overall Development Plan for Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Area (The Plan), approved by the State Council in August 2010, and was included in China's 12th Five-Year Plan released in March 2011. The government is set to inject RMB390 billion (USD63 billion) over The Plan's duration, and aims to achieve RMB150 billion (USD24 billion) of Gross Domestic Product (GDP) by the end of 2020.



Source: Colliers

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According to The Plan, Qianhai's development is designed to take place in three stages:



**Colliers View:** Though it seemed aggressive four years ago, Qianhai's ambitious concept has proven successful. During the last decade, several infrastructure developments have been completed or are currently under construction. The Hong Kong-Shenzhen Western Corridor, connecting Tuen Mun and Shekou, was completed in October 2006 and has been in use since July 2007. The building of the Shenzhen Metro Line 1 (Luobao Line), connecting Luohu and Airport East, commenced in 2004 and was completed in June 2011. Line 5 (Huanzhong Line), connecting Qianhaiwan and Huangbeiling, was also completed in June, 2011, and the Shenzhen Metro Line 9 (Meilin Line), which will connect Hongshuwan and Wenjin, commenced in August of 2012 and is scheduled for completion in 2016. There will be three stations on the line through Qianhai; Shenzhen Metro Line 11, which connects the Central Business District (CBD) of Futian, Nanshan and Qianhai to Shenzhen Bao'an International Airport and further extends to Fuyong, Shajing and Songgang suburban areas, is still under construction and is due to completion in late 2015. Most of Qianhai's infrastructure is in the final stage of construction, making the completion of stage two very promising.

In addition, Excellence Group's commercial development — One Excellence (前海壹號) — was the first land plot auctioned off for office use, and will be launched for sale by the end of 2014 and ready for occupation by mid-2016. Though short development cycles are common in China, the fact that this project started construction only three short months after the auction and is scheduled for completion in roughly three years has amazed the people in Hong Kong.

Since the overall infrastructure construction process is progressing well, the Authority of Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone (the Authority) has further detailed the infrastructure investment plan from an annual to quarterly-basis breakdown, and introduced an incentive-based supervision mechanism. Colliers is optimistic that the target of RMB4 billion (USD642 million) for basic infrastructure in 2014 will be met. The total budget for infrastructure over the three stages is RMB68.2 billion (USD11 billion).

## POLICIES DESIGNED TO ENCOURAGE INNOVATION

The policy-making process in Qianhai has proven to be an ongoing endeavor for the Authority. Seventeen out of twenty-two pilot policies have been implemented since The Plan was first published. It remains a challenge, however, for most overseas enterprises — including Hong Kong-based firms — to operate in China due to policy risks. For example, details of the tax rate incentive, which is an essential item of the twenty-two pilot policies, were recently announced, revealing that the finance industry won't be allowed to benefit from the 15% corporate tax rate, despite the fact that up to 60% of the 6,000 registered firms in Qianhai are finance-related as of the end of April 2014.

**Colliers View:** As the Central Government continues to transform its structure, risk-takers seem to be benefiting the most. The concept of Qianhai has been supported by the government and The Plan has, for the most part, been followed. Whether the finance industry has been singled out appears doubtful. In fact, the sector has benefitted from a variety of 'innovation incentives' which were released at the beginning of 2014. It is believed that the finance industry's exclusion from the tax benefit is intended to encourage the formation of an alliance between the finance industry and other sectors, such as I.T. If such a mechanism works, the 15% corporate tax rate would benefit the finance industry indirectly.

In January 2014, China issued the first batch of private banking licenses. Tencent, the largest Internet service company listed on the Hong Kong Stock Exchange, was one of the enterprises approved for the license. The company is expected to combine its current popular app 'WeChat' and its online payment system to provide clients with easier and faster transactions. So far, this model is experimental, but it indicates the government's intention of encouraging corporate innovation.

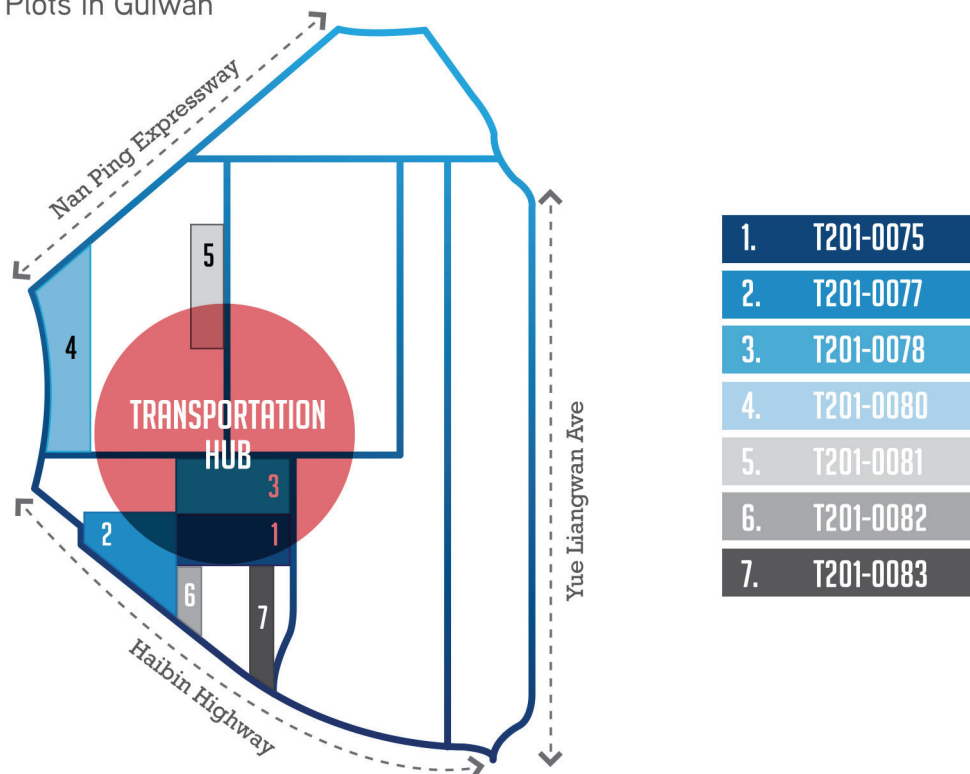
Additionally, the fact that the finance industry was not mentioned at all when Qianhai released the list of industries entitled to the preferential corporate income tax, may imply that the Authority could introduce more preferential policies for the sector at a later stage. Colliers believes more government incentives are certain to follow as the Central Government works to bolster this pillar industry and develop a channel allowing RMB to easily flow to and from on and offshore markets.

### WHAT'S NEXT?

Following the sale of six commercial land plots in July 2013, another four commercial plots were auctioned off on 22 May 2014. The sale prices for the first six plots span a wide range from RMB16,000 (USD2,600) psm by Excellence Group to an astonishingly high RMB28,000 (USD4,500) psm by the joint venture of Silverstein Properties and Qianhai International Energy Financial Center (QIEFC). However, the transacted prices for four recently sold plots dropped to a record-low, plummeting to a range of RMB8,077 (USD1,298) to 13,935 (2,240) psm. What led to this significant price gap? What potential do investors see for active participation in the auctions?



## Land Plots in Guiwan



Source: Colliers; the Authority of Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone

**Colliers View:** Colliers have identified two factors that led to the price differential. Firstly, a building's location is key. Secondly, the restrictions on applicants regarding their asset value and the future use of the properties built indicated that the Authority was creating a 'branding' effect by selecting big name brands with deep pockets.

It is believed that Silverstein Properties, a privately-held real estate management firm based in New York, has acquired the premium plot in the designated business centre, Guiwan, thus driving the rocket-high bidding price. Tencent succeeded in acquiring a plot at a reserve price of RMB8,138 (USD1,308) psm mainly due to the stringent conditions. For example, bidders had to be internet companies with operating revenue of not less than RMB40 billion (USD6.4 billion) in 2012 and 2013. This limited the prospective bidding pool to Tencent alone, thus providing them with a competition-free bidding environment.

Investors bet on higher-than-average yields. According to Colliers, the first low-rise office project developed by China Vanke, namely the Enterprise Dream Park, adopted a build-operate-transfer (BOT) investment model and achieved full lease-out with an average rental of RMB260-280 (USD42-45) psm per month. The Park will provide a gross floor area of 60,000 sq m for 46 low rise office buildings which are expected to be ready for occupation around March 2015. An average rental of RMB260-280 psm per month (representing the lower end of office rental prices in Qianhai) and an estimated sale price of RMB65,000 (USD10,400) psm (representing the higher end of the price range for Grade A office space in the traditional CBD Futian, next to Nanshan), translate into a conservative indicative yield of around 5% which is still higher than an average yield of 4% in Futian.

*Colliers believes that this figure is supported by the rent and price potential in Qianhai and will attract investors aiming for long-term rental income and strong capital gains.*

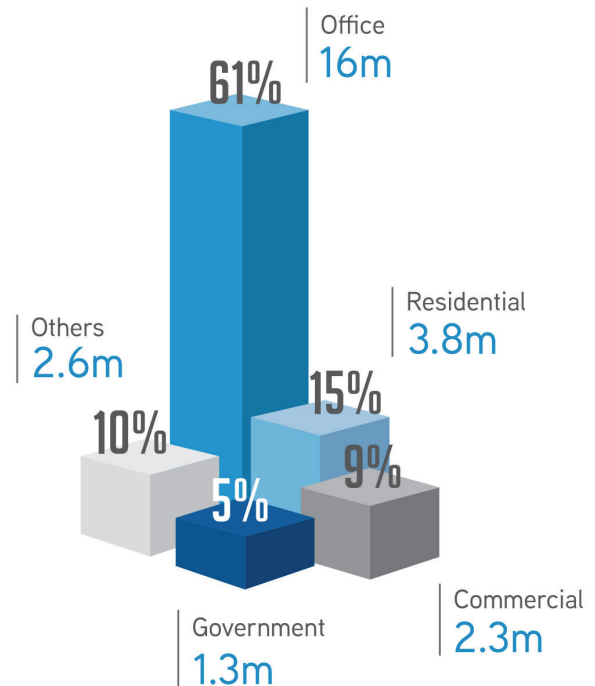
## QIANHAI'S POSITION WITHIN THE PEARL RIVER DELTA

### • Hong Kong

Qianhai benefits from its proximity to the major international financial centre of Hong Kong. By 2015, when construction of the Express Rail Link is completed, it will take only 14 minutes to travel from West Kowloon to Futian. By the time Qianhai reaches its completion stage, a massive office space supply will have entered the pipeline, eliminating the obstacle (lack of space) that has hindered development in Hong Kong's commercial real estate market. At the same time, Grade A average office rent in the Futian district is about RMB204 (USD33) psm per month, less than one-fourth of the cost of central Hong Kong's Grade A office rent, and lower than the average rent in Hong Kong's Kowloon East area.

*With lower costs and the convenience of traveling in the Pearl River Delta region, where will companies and talent be going?*

Floor Usage Planning (sq m)



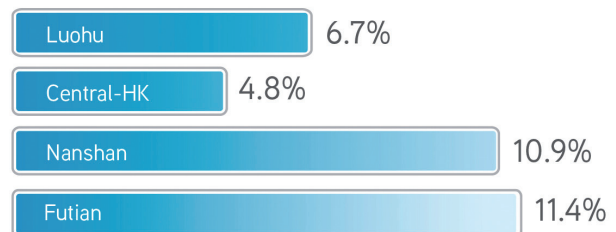
Source: Colliers; the Authority of Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone

**Colliers View:** According to Colliers, based on the 26 million sq m of total floor area to be developed in Qianhai, approximately 16 million sq m is planned for office use, reflecting an amount almost three times the size of Hong Kong's existing Grade A office market today (approximately 7 million sq m). Colliers believes this additional office supply could alleviate the severe shortage in Hong Kong and complement the city in terms of land resources. In addition, Hong Kong will benefit from the rise of RMB businesses with the establishment of Qianhai as a test field for RMB internationalisation. Essentially, instead of a posing a potential threat, Qianhai provides Hong Kong with an exceptional opportunity in an environment where strong collaboration is key.

### • Shenzhen

Qianhai will become a major supplier of offices in Shenzhen over the next few years, thus increasing the overall vacancy rate and driving down average rents. According to Colliers, Shenzhen's annual office supply is expected to rise by 200% to 1.06 million sq m per year by 2015. The average vacancy rate in Shenzhen is anticipated to rise as well, but vacancy levels in the order of 10-15% are considered healthy in the context of supply-and-demand dynamics in Shenzhen.

Grade A office Vacancy Rate Comparison - 2Q 2014



Source: Colliers

The major distribution of office stock will be allocated in Qianhai (16 million sq m), Nanshan (0.8 million sq m in addition to the stock in Qianhai), Futian (2 million sq m) and Luohu (0.6 million sq m) in the near future.

**Colliers View:** A positive spill-over effect is expected over the next few years in Futian's high-quality office sector before Qianhai is completed. There are a number of new tenants — representing a variety of backgrounds — who need space at least 1,000 sq m or larger.

## LOOKING BEYOND THE PEARL RIVER DELTA

Shanghai officially launched its Pilot Free-Trade Zone at the end of September 2013 and is the first Hong Kong-like free-trade area in Mainland China. Together with at least two other special zones in the Pearl River Delta — namely Nansha in Guangzhou and Hengqin in Zhuhai — it has been hotly debated as to whether the other free-trade zones in China would underplay the role of Qianhai in regards to attracting foreign companies.

**Colliers View:** Competition is inevitable, but the target customers are notably different. Whilst serving as a financial innovation free-trade zone like Shanghai, Qianhai will focus more on the Pearl River Delta region and serve the needs of local state-owned enterprises (SOEs) and Hong Kong-based companies. While China's economic growth remains the most robust in the world, tertiary industry (finance as the major part) contributed 45% of the approximate RMB52 trillion (USD8 trillion) GDP in 2012. Colliers believes that as the second largest economy in the world, China is capable of allocating resources amongst various free-trade zones.

## COLLABORATION: THE KEY TO SUCCESS

Qianhai has attracted wide attention for its strategic location and its mission of internationalising Renminbi.

In view of Qianhai's current progress, Colliers observes that despite the factor of uncertainty regarding the policy details, the Authority is endeavouring to promote innovation and is leaning on a reinforced and transparent legal system to provide a sound business environment for state-owned and Hong Kong-based enterprises.

*As Qianhai continues its rise, Colliers believes collaboration between Qianhai, Hong Kong, and Shanghai is vital for their mutual success.*

Despite its similar position as a financial centre, Qianhai presents an opportunity for Hong Kong's future development, as it alleviates the office space shortage and makes increased tenant flow possible. Preferential policies, such as a 15% corporate tax for various sectors in the zone have been devised to benefit and cater to both local and Hong Kong-based enterprises, while Shanghai targets more international enterprises. With different roles and associated functions, the special zones will achieve synergy through close collaboration and continued self-development.

DATE	PLOT NO.	SUCCESSFUL BIDDERS	SITE AREA (SQ. M)	DEVELOPABLE AREA (SQ. M)	RESERVE PRICE (RMB MILLION)	AUCTION PRICE (RMB MILLION)	ACCOMMODATION VALUE (RMB / SQ. M)	CRITICAL LAND SALES CONDITIONS
Jan-2014	T201-0080	Silverstein and QIEFC	51,416	477,000	—	13,410	28,113	<ul style="list-style-type: none"> <li>40% of office area for self-use for no less than 10 years</li> <li>Tax revenue to the Qianhai government no less than RMB1 billion after the second year of the completion of property</li> <li>No company shares transfer within 3 years after the completion of the property</li> </ul>
May-2014	T201-0081	Tencent Holdings Limited	24,948	190,000	1,546	1,546	8,138	<ul style="list-style-type: none"> <li>Self-use</li> <li>Tax revenue to the Qianhai government no less than RMB500 million after the second year of the completion of property for no less than 10 years</li> <li>Listed Internet companies;</li> <li>Revenue no less than RMB40 billion in 2012 or 2013</li> </ul>
May-2014	T201-0082	Hony Capital Management Limited	15,063	80,000	646	646	8,077	<ul style="list-style-type: none"> <li>60% Self-use</li> <li>Headquarter to move in within one year of completion</li> <li>Total assets no less than RMB500 billion for ten years after the completion of the property</li> </ul>
May-2014	T201-0083	Minsheng E-commerce	24,317	172,000	1,574	1,574	9,15	<ul style="list-style-type: none"> <li>Self-use</li> <li>Tax revenue to the Qianhai government no less than RMB500 million after the second year of the completion of property for no less than 10 years</li> </ul>
May-2014	T102-0253	Shenzhen Qianhai Hengchang	9,985	140,000	1,950	1,951	13,935	<ul style="list-style-type: none"> <li>Self-use</li> <li>Tax revenue to the Qianhai government no less than RMB500 million after the second year of the completion of property for no less than 10 years</li> </ul>

Source: Colliers International, Shenzhen Land and Real Estate Exchange Centre

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