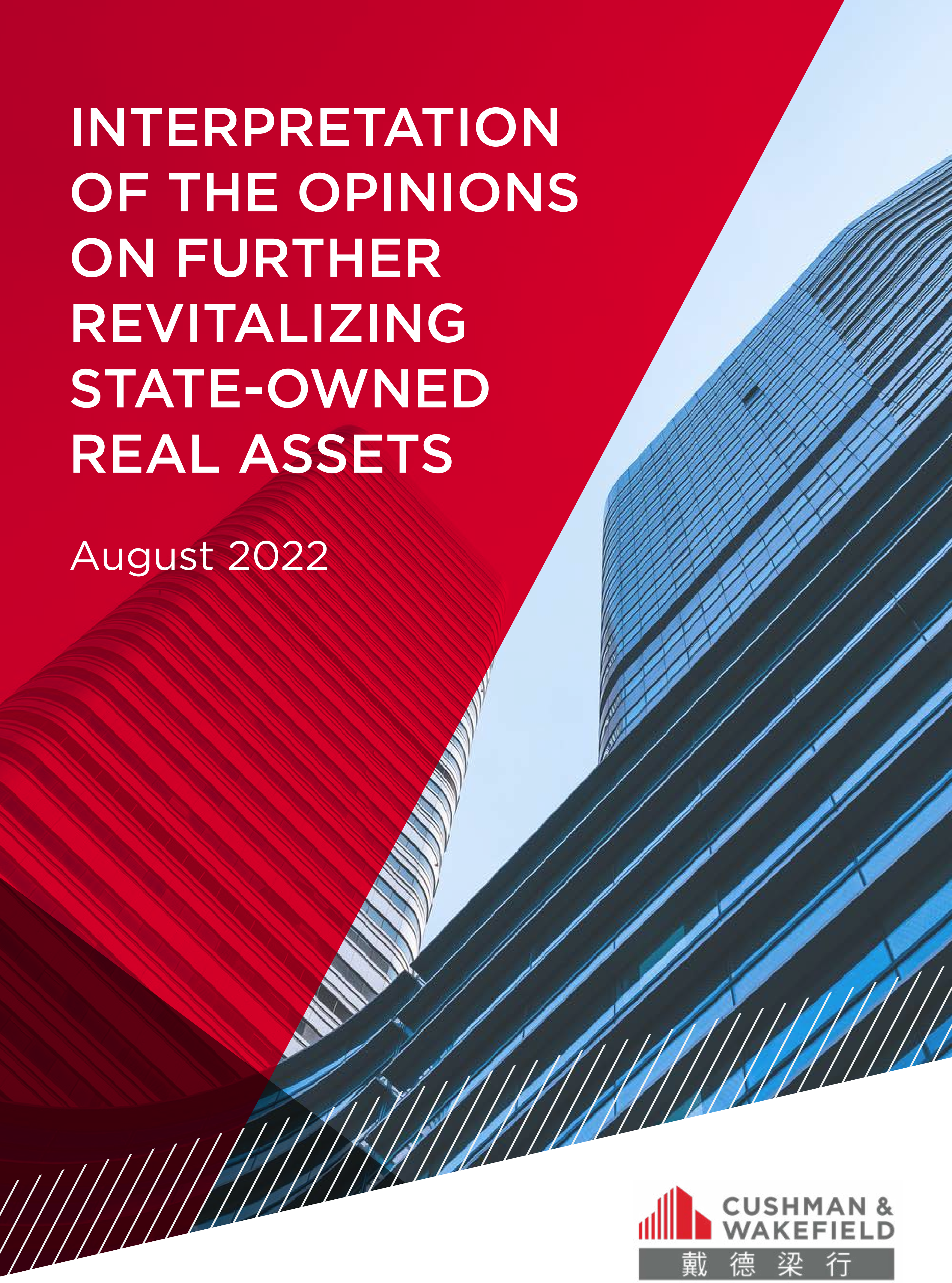
INTERPRETATION OF THE OPINIONS ON FURTHER REVITALIZING STATE-OWNED REAL ASSETS

August 2022



CUSHMAN & WAKEFIELD
戴德梁行

INTRODUCTION

On May 25, 2022, the General Office of China's State Council issued *Opinions on Further Revitalizing Real Assets to Expand Effective Investment* (the *Opinions*), providing clear policy direction on the background, objectives, methods, and policy support for investment of available capital in revitalizing state-owned real estate assets.

Against the backdrop of a complex international environment, ongoing domestic pandemic containment measures, and the priority of sustaining stable economic growth, the release of the *Opinions* is a significant step towards effectively revitalizing existing real estate assets. We anticipate that the policy has the potential to jumpstart and invigorate a cycle of new investment into existing assets, improve infrastructure operation and management, broaden societal channels for investment, and expand effective investment. In turn, the strategy should aid in reducing both government debt risks and corporate debt levels.

The *Opinions* also represent a positive signal for the development of China's commercial real estate market in the second half of 2022, creating new possibilities for rapid development of infrastructure REITs, promotion of government-subsidized housing programs, participation of private funds in urban renewal and TOD construction, and effective disposal of inefficient state-owned assets.

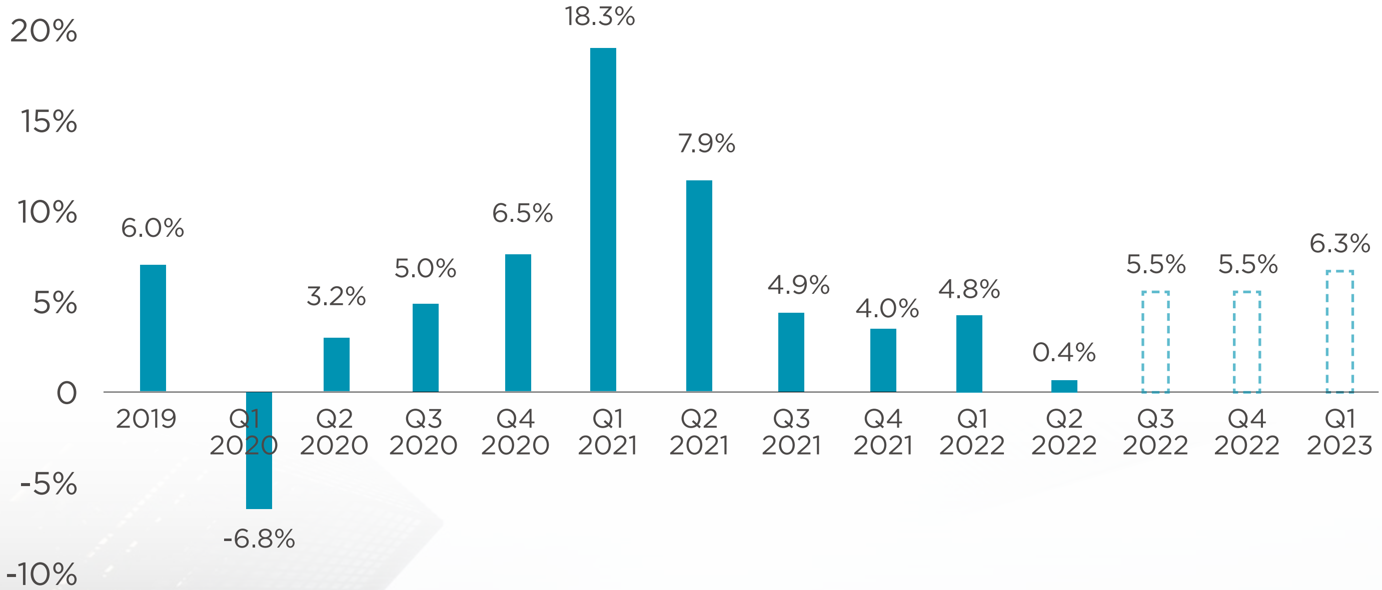
BACKGROUND

The recurrence of COVID-19 in areas of China earlier in 2022 impacted many of the nation's key cities, including Beijing, Shanghai, and Shenzhen; and consequently slowing social and economic activities. China's GDP growth was recorded at 2.5% for 1H 2022. This signals a challenge for China to reach its stated annual GDP growth rate target of 5.5% (Figure 1). As a result, strong economic growth performance in the second half of 2022 is now even more important.

Of the available tools to boost economic growth, infrastructure investment is generally considered the most effective in the short-term, with the intensity of infrastructure investment being directly related to government financial input. In China, the response to COVID-19 has seen the government inject considerable funds into the economy, but the authorities have also implemented further actions to reduce taxes and fees to help mitigate the financial burden on business. According to the State Council, tax refunds and reductions will come to an estimated RMB2.64 trillion for the year. The central government is also taking measures to more closely control local government debts to guard against systemic risks. Reduced fiscal revenues, coupled with a rise in spending, and greater caution in issuing bonds, have created financial pressures.

In this context, the disposal of inefficient or ineffective real estate assets from state-owned stockholdings has become an important means of introducing private capital to help revitalize and develop higher-quality assets. And in turn, this will assist the government to raise funds for further investment in new infrastructure construction. The operational management of state-owned assets, and the efficiency of resource allocation, should also be improved — releasing new dynamism for economic growth, creating employment, and enabling private capital to obtain preferred assets and to operate and gain returns from high-quality projects, thus achieving mutual benefits.

Figure 1: GDP Growth Trend (2019-2023)



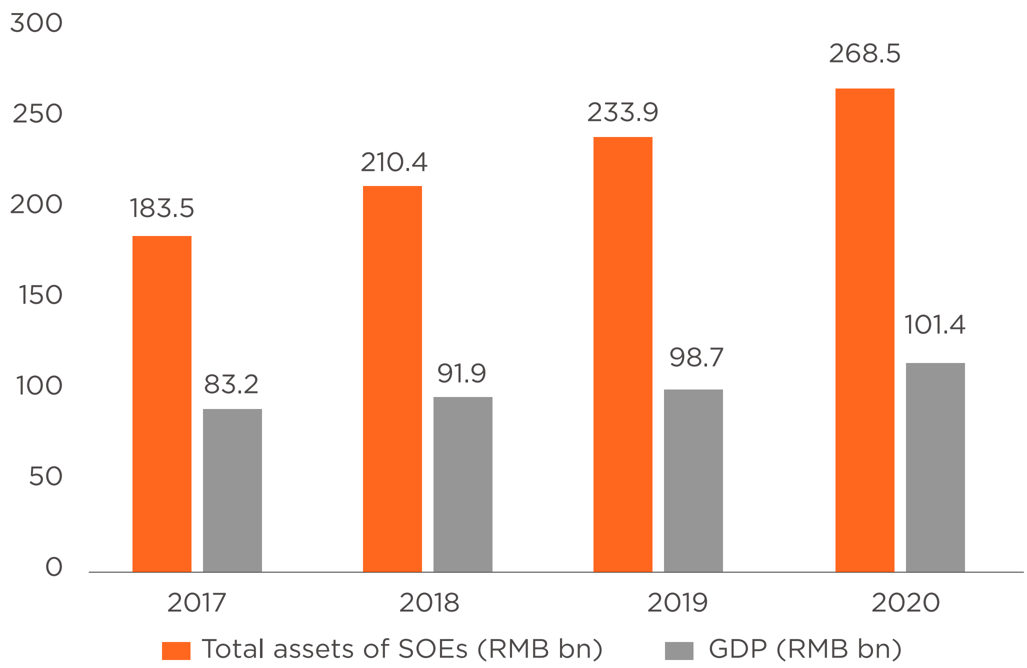
Sources: Moody's Analytics, National Bureau of Statistics, Cushman & Wakefield Research

The primary areas mentioned in the *Opinions* are large-scale assets relating to infrastructure projects with strong revenues or high growth potential, including industrial parks, warehousing, and logistics facilities. Secondary business assets such as older factories, cultural and sports venues, and SOE-managed hotels, restaurants, and care homes are also listed.

EVALUATION

China's government-linked entities have accumulated a significant stock of real assets in infrastructure and other fields following decades of investment and construction. State ownership of such facilities has steadily risen, with the total assets of SOEs nationwide reaching RMB268.5 trillion by 2020 (Figure 2).

Figure 2: Total State-Owned Assets and GDP Trend (2017-2020)



Sources: National Bureau of Statistics, the Comprehensive Report of the State Council on State-owned Assets Management

These accumulated state-owned assets are concentrated in infrastructure construction, public livelihood projects, emerging industries, and other areas where SOEs have historically been engaged. However, after years of operation, some of these assets have now become inefficient or even ineffective. Examples include:

- Facilities or industrial land located in core city areas, hence underutilizing valuable land resources
- Facilities with high operating capacities which are running at a loss due inadequate operations, or a lack of commercially minded management
- Port facilities requiring industrial reallocation or upgrades to better align with current urban development
- Olympic Games and National Games venues requiring revitalization and renovation to meet current and future demands in use and function
- Under-utilized factory facilities engaged in lower-end manufacturing in cities which are moving up the value chain and transitioning to serve tertiary industries

Consequently, in recent years local governments have been strongly motivated to promote planned urban renewal programs, with the aim of revitalizing existing real estate assets. However, local governments alone may struggle to meet the high funding requirements of big urban renewal projects. Instead, it has become increasingly important to introduce private capital as a major component of such investment. In recent years there have been many cases of successful participation by private capital in urban transformation projects. Such participation in these projects has often enhanced land values, or project quality or function, while others have successfully introduced new industries or supported upgrading of incumbent industry sectors. In these situations, SOEs also then have an opportunity to further rationalize their business by divesting non-core assets, enhancing cash flow and improving asset efficiency.

In the past, some SOEs may have lacked the expertise, resources or motivation to reorganize, upgrade or dispose of their own asset portfolios. In the context of policy, we see the *Opinions* opening a new window to private capital for state-owned assets, providing greater impetus for SOEs to involve private capital in the revitalization of assets or to seek such participation in urban renewal projects.

In terms of pathways to revitalizing assets, the *Opinions* highlight a need to promote the sustainable development of real estate investment trust funds (REITs) in the infrastructure sector, and to further improve the recommendation and review process, so that greater numbers of qualified infrastructure REIT projects can be encouraged to go public.

Traditional urban renewal projects have required large upfront investments, high operational capacity requirements, and long profitability cycles. Furthermore, projects associated with property rights disputes may also need to undergo a complex liquidation process, furthering lengthening the project cycle. Consequently, projects that offer stable returns have become the first choice for SOEs to revitalize their stock of real estate assets through the securitization process.

The issuance of infrastructure REITs can reduce corporate funds tied up in real assets and accelerate the return of funds for use in new projects, thus enhancing the cycle of investment and financing. This approach can also help to reduce debt risks, especially in the prevailing environment where local government debt is under scrutiny and financing is difficult. By revitalizing existing assets, governments can both expand effective investment and at the same time seek to control unchecked expanding debt levels, as have sometimes been seen in the past.

The *Notice on Work in Relation to Advancing the Pilot Project for Infrastructure Real Estate Investment Trusts* was officially published on April 30, 2020. Following the publication, by May 2022, a total of 12 public listed domestic infrastructure REITs had been successfully issued, with a combined market value of RMB45.8 billion, generating a strong capital raising. Listed asset types have included industrial parks, warehousing and logistics, highways, and ecological and environmental protection infrastructure. The total number comprises 29 underlying assets, including eight industrial parks, and eight warehousing and logistics facilities, all coming under the category of real property rights.

On May 30, 2022, the National Development and Reform Commission and the China Securities Regulatory Commission (CSRC) issued the *Notice on Regulating Work Related to the Pilot Issues of Infrastructure REITs for Affordable Rental Housing*. It calls for the promotion and orderly development of REIT practices relating to the affordable rental housing market, confirming that the REIT pilot for affordable rental housing has now been officially launched, and signaling a further substantial step in the diversified expansion of infrastructure REITs. In addition, sectors such as clean energy and new infrastructure are now actively participating in infrastructure REIT pilots, and the potential for REITs covering sectors such as industrial parks, highways, warehousing and logistics, together with ecological and environmental protection projects, continues to expand.

These moves demonstrate strong policy support for the development of infrastructure REITs. We expect that further public infrastructure REITs will be approved for marketing this year.

“Exploration should be pursued to revitalize the existing stock of assets through renovation and expansion. Private capital needs to be attracted to support in the revitalization of older and dated urban assets and resources via metro rail infrastructure, development of above-ground and underground spaces in transportation hubs, government-subsidized rental housing communities, and the development of public space. Such endeavors can effectively re-activate older assets such as railway stations, and adjacent developable sites, with the aim of increasing project revenues. Full consideration should also be given to relocation or functional upgrading of older port areas in national land planning, at all levels and with relevant dedicated planning.”

According to the *Guidelines on Developing a Comprehensive Transport Network* released by the State Council in February 2021, efforts should be made to advance Transit-Oriented-Development (TOD). TOD principles stress the key role of public transportation and seek to expand the value of adjacent properties and revenue via the interconnection and linkage of transportation facilities.

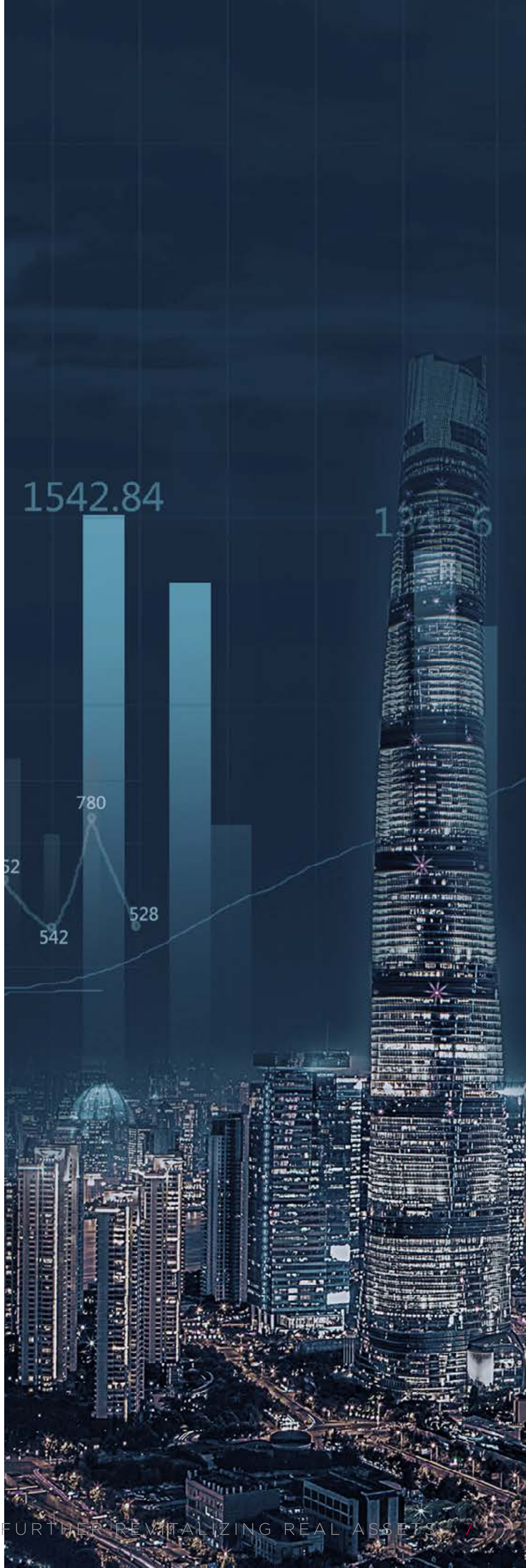
Currently, the major investors in rail transit projects are central SOEs, local SOEs and financing platforms. There are few opportunities available for private capital participation. The quality of developable land around railway stations varies considerably, and as the most attractive sites are often reserved for government development, the remaining assets available for private capital participation tend to be more challenging to develop and are generating less attractive returns.

Despite the fact that private capital is keen to develop land around rail transit stations, there are currently limited channels for participation, and such investors are often deterred by the challenges of project profitability. Against the background of constrained government finance, the introduction of the *Opinions* is now expected to facilitate private capital's greater participation in TOD projects, with a view to forming a multi-win situation for the government, the rail transit groups, investors, and citizens.

Data from the National Bureau of Statistics shows that, as of 2020, China had a total of 2,592 ports capable of handling 10,000 tons. However, many port facilities need to be relocated or upgraded to achieve functional and industrial improvements.

Some ports which have been operating for a long time have already fully integrated with their city's overall development, or are located in central city areas. Consequently, considerable effort is needed to relocate such older ports, or to construct new towns around newly established port facilities.

Older ports also often need to be fully upgraded in terms of their industrial focus, moving from legacy manufacturing to service industries. The process of revitalizing these existing assets requires considerable investment, with the aim of achieving an overall improvement in land value. Private capital will normally be rewarded with development opportunities in the later stages of upgrading, and the introduction of the *Opinions* has new created new possibilities for such investors to take part in the relocation and functional upgrading of old port areas.



CONCLUSION

The priority for China's central government today is to stabilize the nation's economic fundamentals. A primary challenge in achieving this objective is local governments' funding requirements. The *Opinions* provide a policy direction and strategic pathway to help local governments stabilize economic growth, and to pursue employment objectives, while avoiding expansion of debt.

From the market perspective, the implementation of the *Opinions* has the potential to effectively promote the development of publicly offered infrastructure REITs, allowing SOEs to broaden their mindset in revitalizing their stock of real estate assets. By shifting away from traditional models of asset management, in favor of entering the capital markets, SOEs have the opportunity to raise funds more quickly, resolve debt issues, and redeploy this capital in new investments.

In the case of inefficient or ineffective assets, the implementation of the *Opinions* will help encourage further transfers of such state-owned assets, enabling SOEs to generate greater cash flow while providing private investors with a wider array of project options.

Finally, we can expect that infrastructure projects previously largely unavailable to private capital, such as TOD initiatives, new town construction in port areas, and industrial upgrading, will now become further liberalized and accessible to private capital, achieving positive outcomes for all participants.

BUSINESS CONTACTS

Francis Li
International Director
Head of Capital Markets, Greater China
francis.cw.li@cushwake.com

Alva To
Vice President
Head of Consulting, Greater China
alva.yh.to@cushwake.com

Andrew Chan
Managing Director
Head of Valuation & Advisory Services, Greater China
andrew.kf.chan@cushwake.com

RESEARCH CONTACTS

James Shepherd
Head of Research
Greater China
james.shepherd@cushwake.com

Shaun Brodie
Head of Research, East China
Head of Occupier Research
Greater China
shaun.fv.brodie@cushwake.com

Xiaoduan Zhang
Head of Research
South China
xiaoduan.zhang@cushwake.com

Ivy Jia
Head of Research
West China
ivy.jia@cushwake.com

Wendy Hsueh
Head of Research
Taiwan
wendy.hj.hsueh@cushwake.com

Rosanna Tang
Head of Research
Hong Kong
rosanna.tang@cushwake.com

This summary report was edited by Simon Graham, Editor, Business Development Services, Greater China, from an original Chinese language research report authored by Sabrina Wei, Chief Policy Analyst and Head of North China Research Team. Sabrina also leads the Research Centre of Excellence for Government Policy. If you have any queries related to North China or Government Policies, please contact:

Sabrina Wei
Chief Policy Analyst
Head of Research, North China
sabrina.d.wei@cushwake.com

About Cushman & Wakefield

Cushman & Wakefield (NYSE: CWK) is a leading global real estate services firm that delivers exceptional value for real estate occupiers and owners. Cushman & Wakefield is among the largest real estate services firms in the world, with approximately 50,000 employees in over 400 offices and 60 countries. In Greater China, a network of 23 offices serves local markets across the region, earning recognition and winning multiple awards for industry-leading performance. In 2021, the firm had revenue of $9.4 billion across core services including valuation, consulting, project & development services, capital markets, project & occupier services, industrial & logistics, retail and others. To learn more, visit www.cushmanwakefield.com or follow @CushWake on Twitter.

Disclaimer

This report has been produced by Cushman & Wakefield for use by those with an interest in commercial property solely for information purposes. It is not intended to be a complete description of the markets or developments to which it refers. The report uses information obtained from public sources which Cushman & Wakefield believe to be reliable, but we have not verified such information and cannot guarantee that it is accurate and complete. No warranty or representation, express or implied, is made as to the accuracy or completeness of any of the information contained herein and Cushman & Wakefield shall not be liable to any reader of this report or any third party in any way whatsoever.Cushman & Wakefield shall not be held responsible for and shall be released and held harmless from any decision made together with any risks associated with such decision in reliance upon any expression of opinion in the report. Our prior written consent is required before this report can be reproduced in whole or in part.