

Government may relax curbs on property investment by foreign entities as housing market faces slump

China poised to ease investment rules as property crisis looms

The Chinese government's tough approach to the real estate sector looks set to soften, as the credit crunch really begins to bite into Asian real estate markets.

Agents have begun to talk up the possibility of falling rents in Hong Kong, Singapore and Japan, to add to faltering capital values. Development land prices are falling in China and India and agents predict a rental slowdown in Beijing and Shanghai (see page 3).

In the past three years, China's government has introduced restrictions on the property sector, often focusing on overseas speculative investors rather than developers.

The moves were intended to protect the Chinese economy and people from a property price bubble, especially in the residential sector.

But the market is convinced that China will soon use targeted measures and interest-rate cuts to revive its property market and sustain economic growth.

China has been caught between the government's proposals and the effects of the credit crisis, which have put a brake on lending and prevented developers from raising cash through flotations.

A JPMorgan Chase report last week said: "China can't afford a housing-market slump because the property sector accounts for a quarter of fixed-asset investment and 10% of employment."

Head of China equities Jing Ulrich said: "Expectations are

building for the government to introduce policies supporting lower-income home buyers and a selective easing of credit for some developers."

Last month, developers China Vanke, Hengda Real Estate and Shimao Property Holdings cut apartment prices by up to 35%.

Ulrich said possible measures could include lower interest rates (China cut borrowing costs last month for the first time in six years) and lower bank reserve requirements; reduced down payment requirements; and allowing more bond sales to finance property developers. Land appreciation tax could also be reduced or eliminated.

At a local level, restrictions have begun to ease. One Hong Kong-based banker said: "In Xi'an the local government is offering tax breaks and other incentives to developers. Tier-two cities in western China are also looking at such measures."

In June, China's Ministry of Commerce made it easier for foreign companies and funds to access the country's property market with an amendment to its Circular 50 investment rules.

The amendment removes a requirement for foreign property buyers to file with the Ministry of Commerce at a national level after filing at provincial level and receiving local approval.

While the move was seen as a measure to make the commerce ministry's work easier, it will also speed up the investment process for overseas entities.

3 NEWS

Share price plunge forces CapitaLand to scale back expansion in China

7 ANALYSIS

Asia feels force of financial crisis as capital markets freeze following Lehman's collapse

18 PROFILE

MGPA turns its attention to real estate opportunities in Australia's depressed market

23 SURVEY: INDIA

Long-term market prospects remain good, despite slowdown caused by credit squeeze

34 RESEARCH

Key data on the region's occupational, non-listed and listed property sectors

Mall mania leaves India overstocked

Developers are struggling to find tenants to fill the plethora of shopping schemes that have sprung up across the country in the past three years, while retailers are holding out against high rents

On MG Road, the leading shopping street in Gurgaon, India's burgeoning new business centre outside Delhi, there are 15 mall developments, all of which were originally planned as purely retail schemes. Today, only four have stuck to the original plans. The rest have gone mixed-use, switching their third, fourth and fifth floors to office space and even apartments.

It's a story repeated across India, as the higher potential rents that malls offer developers are offset by the difficulty of finding retailers to take the space.

At the end of July, Akruiti City, one of Mumbai's leading developers, said it had converted seven of its mall developments into office space over the past year. Delhi-based DLF now plans to develop 40% of its planned malls as mixed-use developments.

"They were hoping that retail would catch on, but there just aren't enough operators in the country," says Shubhranshu Pani, head of retail at Jones Lang LaSalle. "Every major retailer in India probably already has two outlets on MG Road."

Pani says vacancy rates in some malls are above 50%. Cushman & Wakefield reports an average vacancy of 18% across the 3.75m m² of retail developments in India's eight leading cities. The vacancy rate could have been even higher, but only 185,800m² of a planned 557,400m² of new mall supply expected to come onto the market this summer has actually been completed.

Vacancy rates to worsen

Rajneesh Mahajan, director of retail services at C&W, says he expects the situation to get worse. "The vacancy level reported is a result of inappropriate supply, poor mall management and consolidation of retailers," he says. "We expect vacancy rates to go even higher in the short term."

Mahajan expects to see more retail developments converted into commercial space: "The modern retail spaces developed in recent times will find other commercial uses and get occupied."

Retail was India's next business growth

story two to three years ago, with most of India's big business groups – Reliance Industries, Tata Group, Aditya Birla Group among them – launching chains. Foreign companies, from niche fashion players to supermarket chains such as Tesco, Wal-Mart and Metro, were also queuing up to launch stores in the country.

The lure was a retail industry worth \$350bn and set to grow even faster than India's 9% GDP growth, 95% of which was still in the hands of small 'ma and pa' retailers.

"DEVELOPERS ARE GOING TO HAVE TO INVEST IN ESTABLISHING STRONG MALL BRANDS TO DIFFERENTIATE THEMSELVES AND STAND OUT FROM THE CROWD"

Dominic Twyford, Cord

But even Reliance – famed for its ability to carry out its plans – has failed to fulfil the ambitious roll-out strategy for its retail operation. While Tesco and Wal-Mart have announced joint ventures, neither has yet opened a store.

Indians starved of clean public spaces in which to hang out have flocked to its new malls in the past decade, but they have spent far less than projected. As a result, retailers are now refusing to pay the high rents – in excess of 100 rupees/sq ft (\$2.11/sq ft) – they were willing to pay a year ago.

"They were anticipating that business would be better," says Pani. "In the absence of organised retailers, they were predicting sales from population figures. A reality check came when they opened the stores. Now they know what their affordability is, they're not jumping at rents."

As a result, many retailers are delaying openings in anticipation of a correction in retail rents over the next few quarters.

"We are experiencing a cut in the demand for store space, or clients not taking up the spaces they booked earlier," says Mahajan.

Retailers continue to pay high rents for space in good-quality, well-designed developments that pull in customers.

However, they are deserting the many

Indian malls that fall short of the mark in terms of location and quality.

"Certain kind of catchment areas have also not lived up to retailers' expectations, hence they do not want to repeat mistakes," says Mahajan.

This means that it is crucial for developers to ensure that their malls stand out from the others that are springing up across India's cities.

Standing out from the crowd

"Developers are going to have to invest in establishing strong mall brands to differentiate themselves and stand out from the crowd," says Dominic Twyford, a partner at Cord, a London-based agency that advises on mall developments.

On the face of it, looming oversupply could mean that even well-thought-out malls suffer. Some 10.4m m² of retail space is expected to be completed in the next three to four years, with 250 new malls expected in India in the next two years.

JLL projects that in cities such as Gurgaon, Bangalore and Ludhiana, the amount of retail space will balloon from 1 sq ft per person to as much as 5 sq ft per person – far beyond what is justified by the projected growth in Indian spending habits.

However, Pani predicts that only around 50% of the announced developments will actually be built.

One model that is becoming more common is rental deals where the retailer receives a lower rent, but agrees to share revenue beyond a certain level with the mall-owner, thus giving the landlord a bigger stake in the store's success – a similar practice to the turnover rents common in European retail. Big Bazaar, India's low-cost retail success story, has pioneered this approach.

But the fundamental demographic and growth statistics that created such fevered interest in India's retail remain. Pani believes that, as India's corporate retailers gain the sort of market understanding a company such as Tesco has in the UK, the mall rental market will become more stable.