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Article 1: EG China Special – 2015 a year of promise and prosperity.

Estates Gazette's China special issue, published in February 2015, identified the biggest story which would impact global markets this year and explored it in depth. Attached is the full 17 page special issue which was entirely researched and written by Jack Sidders during a three day trip to China in late January. The particular article to be judged is the opening feature (p62-65) which sets out the macro prospects for China, probing the early warning signs which would lead to a full scale market shock later this year. The piece includes the voices of key players including China's largest developer, China Vanke (whose key executives were separately profiled in the special issue on p70-73), who gave Estates Gazette their first ever UK interview. The full special issue is attached to put the piece in proper context and demonstrate the depth and breadth of coverage generated in a few short days in what remains a thoroughly opaque market to which few journalists manage to gain in depth access.

Article 2: The Grater Good

This in depth profile of the Leadenhall Building – aka the Cheesegrater – marked the launch of one of the most significant London office developments in several years with an innovative commercial review of the scheme. The article provides a vital insight for Estates Gazette's highly knowledgeable readership into how the building as performed as an investment, something most development reviews entirely overlook, demonstrating in depth knowledge and understanding.

Article 3: Trade Secrets

This article investigates one of the most significant real estate deals of this cycle, the acquisition of Hammerson's London office portfolio by Brookfield. Brookfield disclosed extremely limited information on the details of its acquisition so Estates Gazette conducted its own detailed financial examination of the deal, revealing the huge profits generated by Brookfield and raising serious questions about the decision of one of Britain's largest property companies to exit the office market when it did.

A LITTLE TROUBLE IN BIG CHINA

As its economic miracle starts to wobble, Jack Sidders visited China to find out how worried the world should be and to assess Chinese firms' appetite for London property

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2015: A YEAR OF PROMISE AND PROSPERITY

On the face of it, China is on the verge of a slowdown. But property performance in top-tier cities, quick fixes to prevent loan defaults, and a flood of overseas investment dissipate the gloom. Jack Sidders investigates

On 19 January China's two main stock exchange index values fell by 7.7%, wiping $315bn (£209bn) off the Shanghai exchange in a day – their biggest losses since June 2008.

Less than 24 hours later the government confirmed it had missed its official annual growth target for the first time in 15 years, with 2014 GDP coming in at 7.4%, the lowest annual growth rate since 1990 when the country was suffering from the economic sanctions imposed after the Tiananmen Square massacre.

Markets were already nervous from the news a fortnight earlier that Kaisa Group, a Shenzhen-headquartered developer listed in Hong Kong, had apparently become the first Chinese propco to default on overseas debt obligations when it missed interest payments due on its $500m (£331.9m) foreign-held bonds (Finance, p50). Then DTZ released a report showing that commercial real estate investment volumes in Shanghai had fallen by 54% in 2014 and the proportion of deals carried out by overseas investors had dropped by 80%.

The driving force behind much of this grim reading has been the Chinese government's attempt to rebalance the economy away from the state-led capital expenditure and grand construction projects that have powered China's expansion for the past 20 years in favour of more consumption-led growth.

But how much of the story do these figures actually tell? How worried should the rest of the world be? And what will be the impact of the reported end of the country's economic miracle on the Chinese appetite for London property?

Alarm bells in the West

The headline GDP numbers might have prompted alarm on the western news bulletins but the Chinese media was reasonably upbeat about the announcement.

President Xi Jinping reiterated his view ahead of the latest numbers that the slowdown represented a "new normal" for the maturing Chinese economy, which was perfectly healthy. After all, a growth rate of more than 7% is still comfortably above that of most developed nations, even if it falls short of the 10%-plus average for the two decades up to 2010.

And the facts beyond the headline numbers suggest that there are still plenty of reasons for optimism. The latest release by the National Bureau of Statistics showed

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One of China's partially completed residential 'ghost cities'

that the service sector, which overtook the industrial sector as the largest part of the Chinese economy in 2013, was up by 8.1%, indicating that consumer spending is expanding more rapidly than the economy as a whole.

One of the biggest drags on the headline GDP numbers is the property market, which accounts for 15% of GDP, and in particular the residential sector, which accounts for 67% of Chinese real estate investment. The speed at which residential prices are falling accelerated in the last four months of 2014, reaching 4.3% by December.

But there are huge regional variations in a country that contains more than 600 cities, 160 of which have a 1m-plus population.

Unsold residential space might have increased by 26.1% nationally by the end of December but prices in top-tier cities have performed much better. Shanghai luxury residential even registered modest growth in the final quarter, according to Knight Frank.

"Oversupply is dependent on local government," says

CORRUPTION CRACKDOWN: THE REAL ESTATE IMPACT

What was most shocking about the apparent overseas debt default by Shenzhen developer Kaisa is that its last reported results for 30 June 2014 appeared to show reasonably healthy finances.

The company's net profit was up by 30% to RMB1.3bn (£140m) on revenues of RMB 6.8bn while its gearing was relatively modest with RMB6bn of debt compared to cash reserves of RMB9.4bn.

Instead, the company's problems have stemmed from the fact the local Shenzhen government has blocked sales at some of its developments after it got caught up in president Xi Jingping's widespread corruption crackdown.

JLL east China managing director Anthony Couse says the news may have been "jumped on internationally but we see that as an isolated case" that is unlikely to be the first of a series of major propco defaults.

But the corruption crackdown is having a significant impact on the property market nevertheless.

"The luxury retail sector was crazy several years ago because you had government officials purchasing luxury goods with gift cards," says Joe Zhou, JLL's head of research for east China.

"Then all of a sudden this anti-corruption campaign started and the luxury retailers stopped their expansion, which affected the shopping malls."

According to Bain & Company, sales of luxury goods in mainland China fell by 1% to RMB115bn in 2014, compared with a year earlier, the first time the consultant has detected a decline since it first began monitoring the market in 2000.

The result, according to JLL Shanghai head of retail leasing Rebecca Tibbott, is that rental growth has slowed markedly to around 3-5%, with mid-market brands and fast fashion now driving demand and many luxury brands considering portfolio consolidation in China for the first time.

The result has also been felt in the Hong Kong market, according to Tom Gaffney, JLL's regional head of retail.

"The years 2011 and 2012 were when the luxury retail market in Hong Kong posted an increase in take-up from watch and jewellery makers of 300%," he says.

Those shops are dependent on demand from the 54m-plus predominantly Chinese tourists visiting Hong Kong every year, attracted by the lack of VAT and sales taxes that makes luxury goods around between 17% and 40% cheaper than across the border, he said.

"During 2011-12 we saw growth of around 45% in luxury good sales," Gaffney says.

"In 2014 we saw our slowest year in terms of overall sales growth, which was only 0.6% and that was led by fast fashion and cosmetics.

"In 2011 overall growth was 25% and in 2012 it was 15%," he adds.

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the market is still growing despite the slowdown in the rate of growth, means that distressed developers, encouraged by their lenders, have so far been able to sell excess inventory even if it has meant cutting prices and therefore accepting that some schemes will not make a profit, limiting the risk of overexposure by the banks.

Rebalancing act

So if the real picture is not as alarming as first appearances suggest, does that mean the government's rebalancing act is working? What will it mean for the property market?

"In order to boost consumption in the short term you need a lot of things to happen," says Zhou.

These include consistent income growth, increased consumer confidence, lower taxes on goods to discourage Chinese consumers from doing all of their shopping overseas, and a strong social safety net to change attitudes towards savings and debt.

"The good thing is that all of these things are happening," he says, pointing to social security reforms, uplifts in the minimum wage and rapidly rising real incomes for the ever-expanding middle class.

Thus far China's jobs market has remained strong, which is helping consumers break with traditional attitudes towards credit and savings. "The young middle class spends much more and saves much less," adds Zhou. "And they know how to use credit cards."

But does this new-found fondness for credit mean that the banks are likely to see a repeat of the US subprime crisis if property prices continue to fall? No to both, according to Zhou.

The government placed tight restrictions on mortgage availability in early 2013 to head off the threat of a property bubble and the effect was felt almost instantly.

The new rules prohibited borrowing more than 30% of the value of a second home and said that consumers could use only a maximum of 50% of their household income to service mortgage interest payments.

"That killed speculation pretty quickly," says Anthony Couse, managing director for JLL East China.

"There is little risk of consumers being in negative equity. Some developers might be overleveraged, but consumers are not," he adds.

Outbound boom

With oversupply causing falling prices in lower-tier cities, many Chinese consumers and property developers have sought to diversify geographically.

Overseas real estate investment by Chinese firms rocketed by 46% to $16.5bn in 2014, according to JLL, surpassing the volume of domestic investment for the first time and accounting for 52% of total commercial spend.

London topped the list of destinations for this exodus with $4bn of investment out of a total $5.5bn spent in Europe, the top region.

"Chinese real estate investors used 2014 to strategically internationalise their investment portfolios," said Darren Xia, the head of JLL's International Capital Group, China.

"At a time when macro concerns around developers and residential prices dampened the market, diversification into international markets allow Chinese investors to continue to grow sustainably and ensure long-term returns."

So while the headlines for China might appear negative, the outlook for the UK and other beneficiaries of the country's international expansion is anything but.

And even within China, the picture is complicated. As well as diversifying offshore, major developers are refocusing on core cities. And for places such as Shanghai (see overleaf), the effect on commercial property could be unprecedented.

Charles Ma, head of global strategy, investment and new business at China Vanke, the country's largest residential developer (Profile, p70).

"Some local governments do a good job of planning their city in a sustainable and logical manner," he says. "Some cities haven't done such a good job. They think they can build New York city in the middle of nowhere."

Despite being the largest developer in the country, China Vanke is active in only around 10% of Chinese cities, with a strong bias towards tier-one and tier-two locations. As a result it has, like most of the biggest listed developers, avoided the worst of the pain.

In fact, rating agency Moody's has forecast that China's top 20 rated property developers will continue to outperform the market. They achieved 17.1% growth in 2014 compared with a 7.8% average decline in the wider market.

"Their strong execution, reputable brands, and solid financial and liquidity position them to benefit amid the industry consolidation," said Moody's vice president Kaven Tsang in a January 2015 update.

The slowdown has hit developers active in the lower-tier cities much harder however; some companies have been forced to cut prices on schemes in oversupplied areas by as much as 30%, says JLL's head of research in east China, Joe Zhou.

But while that has caused some developers to show serious signs of distress, there has not yet been widespread defaulting on loans in the real estate sector.

The high-profile Kaisa case, which attracted attention globally, actually has more to do with the government's corruption crackdown than with the overheating property market (see box).

Instead, companies such as China Vanke have been willing to step in and snap up distressed operators, before they get a chance to default. And that consolidation has been widely welcomed in a heavily oversupplied market.

And for Zhou, the fact that

> "The middle class spends more and saves less. They know how to use credit cards"

SHANGHAI

Just as China is slowing down, Shanghai is speeding up. But can the city survive its next unprecedented supply boom? asks Jack Sidders

SURPRISE

The hazy view from the 26th floor of the Plaza 66 skyscraper puts Shanghai's exponential growth into context.

The vista takes in a panoply of towers, from the wedding cake peak of the Stalinist Shanghai exhibition centre across the street, to the forest of concrete and glass polygons beyond it.

It is easy to believe JLL's managing director for east China, Anthony Couse, when he says the city's office stock has roughly doubled over the past five years. But his next statement stretches credibility.

"It is going to double again in the next five," he says. "I doubt any city on earth has ever done that."

Like the rest of China, Shanghai is a city of dizzying superlatives and numbers so large they are hard to comprehend. In the time between the UK introducing

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the first Crossrail Bill in 1991 and starting construction in 2010, Shanghai built the world's longest metro network from scratch. And when that process first started, the whole of Pudong (pictured on the previous page) was just mudflats.

But even in a city where incredible stories are scribbled on every wall, the tale of Shanghai's office market stands out.

So with China now experiencing a slowdown, can this city cope with a another doubling of its office supply by the end of the decade?

A tale of high demand

While most cities in China will measure rents on a per square metre per month basis, in Shanghai they are quoted in square metres per day.

This is a legacy from when occupiers used to lease hotel rooms when they could not find enough office space.

And despite the boom in development, commercial space remains a real problem.

Although the city's skyline suggests a vast office market, most of the towers that form it are either blocks of flats or comprise office space that is a long way from grade A.

"The story in Shanghai is one of demand," says Couse. "Shanghai's total grade-A office space is still only 70m sq ft. And yet it has a population of 23m. Compare that with London and New York [and those cities' populations] and it is minuscule."

Domestic occupiers have driven the market since the 2008 financial crisis, boosted by the RMB4tn (£430bn) government stimulus that triggered expansion even as the multinationals that had previously dominated the office market were retrenching.

"Shanghai is on a journey, going from 80% international to 80% domestic, so there is massive untapped demand," Couse says.

"It's not that domestic occupiers are not here, they are just not in grade A."

The government's shift to a consumer-led economy is expected to drive take-up, as all effort is now directed at expanding the service sector.

James Allan, national director and head of tenant representation for JLL in Shanghai, says: "The tertiary sector outperformed other sectors if you look at the latest GDP numbers. And that push towards the tertiary sector will push office demand."

Free trade zone opens

A key part of the government's attempt to stimulate the service sector in Shanghai has been to introduce a free trade zone that opened officially in 2013, initially covering 11 square miles in the Pudong area, the home of the iconic skyscrapers that face the historic Bund across the Huangpu River.

The launch of the free trade zone was a statement of intent from the local and national government about the planned road to financial reform.

At present the big banks are relatively modest occupiers of Shanghai office space, with US and European institutions typically preferring to base themselves in financially liberalised Hong Kong rather than on the mainland.

Goldman Sachs, for example, occupies just 30,000 sq ft in Shanghai, a fraction of its footprint in other major financial centres.

But the government is now firmly on the path to financial reform and the Shanghai free trade zone is expanding, raising the prospect of increasing demand from financial occupiers.

"A year ago the free trade zone was just a little area. Today it is a big area and before you know it, it will be all of

Shanghai," says Couse. "That will be when the big tenants such as Goldman Sachs actually have something to do in Shanghai."

That is why JLL is forecasting that, despite the unprecedented wave of office development planned mainly in areas outside the city centre, vacancy rates will rise only marginally, from 7.8% today to roughly 10% by 2020, and rents will continue to rise modestly over the next two years.

"We have a strong belief that net take-up will balance with new supply, which means that demand will double," adds Allan.

Developers gear up

Developers have responded to the prospect of a rapidly expanding financial services sector with relish.

Fosun Property, part of the largest privately owned company in China (company profile, p74), is under way with a gargantuan mixed-use scheme on Shanghai's Bund designed to tap into the forecast surge in financial occupier demand.

The 4.4m sq ft Bund Finance Center is an office-led mixed-use scheme that Fosun believes will create a banking cluster on the opposite side of the river from the prominent Lujiazui financial district, home to the city's tallest skyscrapers.

The scheme reflects how Fosun is "adapting its domestic business" to tap into the pockets of demand in China's patchy real estate market, according to the company's executive president Alex Gong.

"For Fosun Property, our domestic strategy includes Hive City [public-private partnerships designed to create mixed-use clusters, of which the Bund scheme is an example] and to focus on tier-two and tier-one cities like Shanghai," Gong says.

While the occupational markets might be in rapid expansion mode in Shanghai, the same cannot be said of the investment market.

Spending on commercial property in the city dropped by more than 35% last year, from RMB65bn in 2013 to RMB 42bn in 2014, according to JLL.

The city's investment market remains immature and can fluctuate significantly on local factors such as fund expiries. But despite this there has been a clear knock to sentiment caused by the economic slowdown – and in a market that lacks transparency, shifts in investor mood are often amplified. With the government spending much of the past two years downplaying expectations for growth, investors took time to readjust.

"Imagine being so used to double-digit growth that it is the only environment you have ever operated in, and suddenly you have a new government saying, 'we are in contraction mode'," says Couse. "What transpires is businesses do nothing, which in the real estate world translates to low volume, which affects sentiment and pricing."

Key deals boost investment

But just as sentiment can trigger a sudden drop in activity, so it can just as suddenly return.

A couple of key transactions in the final quarter of last year – including the RMB3.1bn purchase of Suntown Plaza by Gopher Asset Management, and a few trophy assets being lined up for sale in Q1 this year, and suddenly sentiment is on the up.

"This year will be a bumper year again," says Couse. "We are already seeing major transactions in Q1 and because it is so sentiment-led, we see a flock mentality."

As with leasing demand, investment activity is likely to be led by domestic players, according to JLL.

Chinese insurance companies, which were permitted to start investing in real estate in 2009, have huge sums at their disposal but thus far they have been more active overseas than at home. This is because the government has restricted them to buying buildings with yields of no less than 6% domestically.

With prime Shanghai office yields well below this they have not yet had a huge impact on the market.

But as with the gradual reform of the banking sector, analysts are expecting a gradual relaxation of the rules governing insurance companies. And should that be the case, there will likely be a significant surge in demand.

"My view on Shanghai from an office standpoint is that it is an investor's dream. Because there is no land, there is a massive emergence of domestic consumption, which is like oil under the ground just flowing into the marketplace. And," adds Couse, "you have a government that is hell bent on making Shanghai a world city."

ALAMY

LONDON'S LARGEST

The biggest residential developer in mainland China is preparing to make its UK debut. In their first UK interview, Jack Sidders spoke to the China Vanke executives tasked with leading the company's charge on London

China Vanke built roughly 150,000 houses in mainland China last year. That's comfortably more than 10 times the annual number of houses sold by Britain's biggest house builder, Barratt Developments, in 2013-14. In fact, it exceeds the total number of houses completed in the whole of the UK last year – 141,000, according to the Office of National Statistics. But the company isn't just big by UK house building standards. It is the biggest China has ever seen.

Despite the sharp slowdown in the country's housing market, China Vanke's interim results for 2014 showed it had become the first Chinese developer to top RMB100bn (£10.8bn) of sales in half a year.

FIRST-TIME BUYER

And now the group wants to enter the UK market. In the company's first UK interview, head of global strategy, investments and new business development Charles Ma and the company's newly appointed managing director for the UK Lily Lin explain the plan for London expansion and reveal why the company will do things differently to the Chinese developers that have already broken ground on British soil.

Grand-scale growth

Founded in 1984 by chairman Wang Shi in the south China city of Shenzhen, China Vanke's rise has been relentless. Like many Chinese property companies, it started out as a conglomerate, selling everything from men's suits to bottled water. But in the mid-1990s it began to specialise in property development, riding the wave of capital investment that fuelled China's long real estate boom over the past two decades.

Today its market cap is RMB140bn and it has a presence in several overseas markets, including Hong Kong, Singapore and the US. The overseas expansion began in 2013 when the company signed a joint venture agreement with US investor and developer Tishman Speyer to build a pair of residential

towers comprising 655 flats at 201 Folsom Street in San Francisco.

It has since begun work on a second US residential project at 610 Lexington Avenue in New York with partners RFR Holding and Hines.

"The approach to London and the UK will be similar to what the company has done in the US, at least in the beginning," says Lin, who joined China Vanke from UBS in London at the start of this year.

In broad terms, that will mean seeking out residential and mixed-use development opportunities, initially in central London, that offer a reasonable scale – at least £40m-plus, according to Lin.

So far, so similar to the Chinese developers already building houses in London, such as Greenland or Dalian Wanda.

The most eye-catching contrast to how its homeland competitors have approached the market will likely be in the company's sales strategy.

"If you look at our Singapore, Hong Kong or San Francisco projects, we have been selling them mostly to local clientele," says Ma, who heads China Vanke's international business. "Around 90% of our San Francisco project was sold to local clients instead of overseas clients."

And that is entirely deliberate.

Ma says the company is aware of the political rhetoric in the UK, where the sale of London flats to overseas buyers has become a contentious issue.

But he says the planned domestic sales strategy is about good business much more than it is about good politics.

"The reason is we want to have a very sustainable strategy in the long term and that means we want to create a product that works well in that local market.

"From our perspective, selling local developments all to international buyers is just not a sustainable strategy in any market."

He cites the experience of developers from other Asian countries, such as Japan and Korea, that have based their overseas business models on selling flats in various markets to their native clients.

"They have all tried appealing to their local home buyers, but that trend typically drops off after five to seven years, so if you are looking to stay in the market for a long time, you need to establish a local reputation and really become a localised player," adds Ma.

That long-term approach is reinforced by the company's view that the London market is currently expensive.

On London time

While the timing of the US entry proved fortuitous, with China Vanke and Tishman underwriting the San Francisco scheme at $900 per sq ft (£592 per sq ft) and achieving sales at as much as $1,500 per sq ft, it is under no illusions that such IRR-busting deals are easy to find in London.

But as with its China business, it intends to avoid the worst of the toppy conditions by keeping clear of the oversupplied and overinflated super-prime end of the market.

Domestically, China Vanke is very much a mid-market player: while catering to all forms of buyer, given its enormous scale, it sells most of its houses to the middle classes.

Although developing in central London is not exactly "middle income" development, the company would be more comfortable underwriting schemes off values in the region of £1,000 per sq ft than it would be those in super-prime areas such as Belgravia, SW1, where prices now top £4,000 per sq ft, according to Lin, who refuses to be drawn on the exact parameters for the deals it would consider.

"The question to ask," says Lin, a former banker who grew up in Los Angeles but has lived in London for the past eight years, "is, 'could I afford to live here myself?'"

Yu Liang, president of China Vanke (left), speaks to Wang Shi, chairman, during the company's listing in Hong Kong last year

China Vanke's Shenzhen HQ

China Vanke's Beijing Hills residential development in Beijing

Prudence and price drops

Such prudence has served China Vanke well. The red-hot Chinese residential market has long topped lists of the biggest threats to the global economy and towards the end of 2013 it began to contract sharply after five years of astronomic growth.

The rate of contraction, which hit 4.3% in December, according to data from China's National Bureau of Statistics, prompted the government to ease lending rules in the second half of last year in a bid to prop up the faltering market, which has been plagued by oversupply in many second- and third-tier cities.

Vanke has not been immune to the price drops and while its share price has taken a hammering in line with most listed Chinese developers – the company's dual Shanghai and Hong Kong-listed shares typically trade at around a 30% discount to NAV – it is one of the few Chinese developers to boast an investment-grade credit rating, thanks to its efforts to reduce its debt burden and cut back on land acquisitions. As of September 2014, its debt-to-equity ratio was 46%, compared with an average of 67% in its peer group, according to Bloomberg.

And that comparatively conservative gearing, paired with its cash reserves of more than RMB50bn mean it is well placed to ride out the downturn.

"The market is definitely stabilising," says Ma. "Continuous 30% growth year-on-year is not sustainable and it is actually not a healthy market state.

"In a healthy market you really want it to go through the regular cycles because that is natural. So, I think what we are seeing is the market becoming more natural, and from our perspective we actually welcome it."

While China Vanke may have the balance sheet to withstand falling house prices, many of the thousands of real estate developers registered in China are much more reliant on bank debt and therefore at far greater risk of default.

"I think we will continue to see some smaller real estate developers get into distress because they have overleveraged and overextended themselves," Ma says. "There shouldn't be thousands of real estate developers, even in a country as big as China."

But rather than posing the perceived systemic risk to the banks that financed them, these struggling developers will be a source of opportunity for China Vanke, says Ma.

Recent cases such as that of Kaisa, which defaulted on its overseas bond obligations after it became embroiled in the government's corruption crackdown, suggest this may well be the case (Finance, p50).

Sunac China Holdings stepped in to rescue the company after it teetered on the brink, demonstrating the appetite for the company's landbank despite the slow down in the regional housing market.

"What we have seen in the past is that there is always someone who is willing to gobble up these assets, including us," Ma adds.

In some ways it might be surprising that China Vanke has not yet entered the UK market, given the Chinese downturn has prompted so many of its peers to diversify in London.

And it is not because the company has suffered from a paucity of opportunity. It has already held meetings with several major UK developers with a view to establishing local partnerships.

And there has been "no lack of shiny PDFs" for London development sites presented to the business either, according to Lin.

In true oil tanker fashion, the giant company has simply taken its time to prepare to enter the UK market.

But with a London representative now in place and a UK company already established, China Vanke is finally set to make a splash in London and, given its size, it is reasonable to expect it to be a big one.

THE ALL INCLUSIVE INVESTOR

Fosun's takeover of Club Med shows how Chinese investors are diversifying. Jack Sidders met the president of the company's property division in Shanghai to find out just how far its ambitions extend

On 15 January this year one of China's biggest real estate investors emerged victorious in the longest-running takeover battle in French corporate history.

Some 18 months after making its initial €17 (£14.45) per share approach to buy the company credited with inventing the all-inclusive holiday, Club Mediterranée, Fosun's final (and eighth) €24.60 offer was recommended to shareholders by the company's board. The 45% premium on Fosun's original offer values Club Med at €939m, a price that rival suitor, the Italian financier Andrea Bonomi, just could not justify.

Fosun bought its initial stake in the Club Med business five years ago, at the time its first deal outside China. That early international expansion reflected Fosun's entrepreneurial spirit. The company prides itself on being the largest private investment firm in the People's Republic and one whose strategic growth has mirrored the economic opening up of the world's most populous country.

Against the backdrop of a slowing Chinese economy, which the government is furiously attempting to rebalance, what does Fosun's determination to secure Club Med tell us and what will that mean for the company's real estate ambitions globally?

Responsibility

Alex Gong is executive president of Fosun Property

ALAMY

Fosun's Atlantis resort on Hainan Island, China, is due for completion in 2016

Holdings, the real estate arm of Hong Kong-listed Fosun International, with responsibility for the group's overseas business. The former Bank of Shanghai and Standard Chartered banker is in no doubt about the merits of the Club Med acquisition, even if it came at a hefty price.

"We firmly believe there is a huge synergy to be generated if we work with Club Med by combining our tourism business, China International Travel Services," he says, in his first UK interview.

"We have already helped Club Med to open three resorts in China and between the size and depth of the Chinese market we believe three is just the beginning."

CITS is one of China's largest travel agencies and Fosun plans to use the platform to sell Club Med holidays to the country's burgeoning middle class.

According to the China Outbound Tourism Research Institute, there were 102m border crossings by Chinese citizens between April 2013 and March 2014, a 15% increase on the previous year, despite the slowing economy.

This rapidly growing international demand, coupled with a lack of quality domestic supply, creates a compelling opportunity, according to Gong.

And the synergies do not stop there.

It is common in China for companies to buy package holidays for loyal employees. Given Fosun's conglomerate structure – it has interests in everything from mining and menswear to jewellery and pharmaceuticals – Gong believes the company is well placed to leverage its diverse corporate relationships to the benefit of Club Med.

Beyond the beach clubs

And the Club Med deal bears a wider significance for Fosun. The group has for the past 20 years invested in Chinese businesses which it believes are best placed to take advantage of the government's economic policy.

"Fosun has seized the opportunities in different phases of China's development. For example, in the era of state-owned enterprise reform, we invested in Yuyuan Tourist Mart, the first commercial company listed in China and an undisputed cultural icon in Shanghai," says Gong.

With Club Med, the group is seeking, in part, to diversify its interests away from the capital investment that has fuelled China's growth for the past 20 years, towards the more consumer-led growth the Chinese government is trying to stimulate.

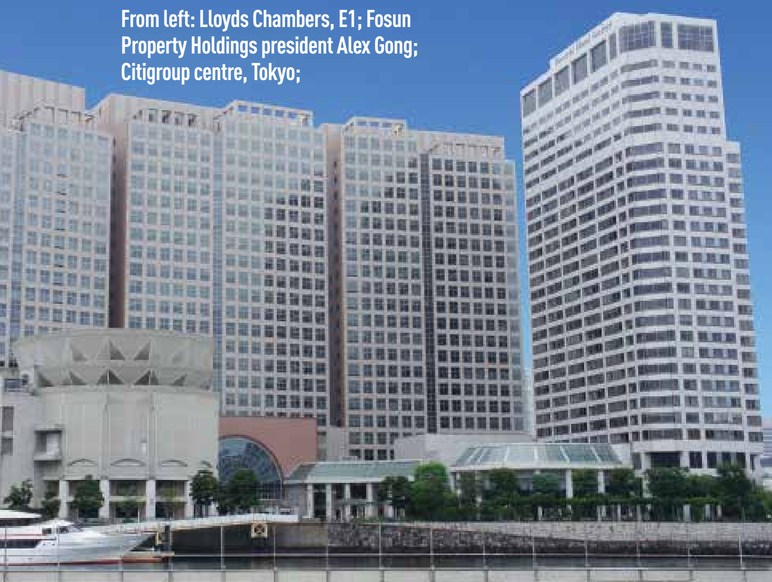
For Gong, this desire to diversify will have major implications for the group's real estate investment activities, as it looks to increase the pace of its international expansion.

"We started investing in real estate outside China at the end of 2013 with two deals; one in London and one in New York. I would say these two deals are just the beginning," he says.

Fosun has four "workstreams" for its international real estate business, according to Gong.

The first is to acquire platforms in various gateway cities around the world.

Instead of simply sending Chinese employees to cities including London, Tokyo or New York, Gong says Fosun will acquire experienced local



From left: Lloyds Chambers, E1; Fosun Property Holdings president Alex Gong; Citigroup centre, Tokyo;

businesses in each of its chosen markets, providing fast and informed access to the best deals.

Gong points to the company's May 2014 acquisition of Japanese real estate investment firm Idera as an example.

Idera employs around 70 staff and has assets under management of ¥160bn (£900m). The purchase immediately gave Fosun access to the notoriously insular Tokyo market.

In the five months since taking over Idera, Fosun has bought the 25-storey Citigroup centre for an undisclosed sum well in excess of $100m (£65m) and the 23-storey Shinagawa Seaside Park Tower Building.

The second workstream involves direct real estate deals for buildings, portfolios, or development sites. Fosun's first UK deal, the acquisition of Lloyds Chambers, E1, fits into this strategy.

The third strand of work will see Fosun buying into listed real estate companies. There is money to be made "from the fluctuations of undervalued securities", says Gong.

The company has an experienced listed real estate team in China, but its international expansion is in its infancy and Gong is willing only to say Fosun is "looking at some opportunities" in London, as well as in Russia.

The final pillar of the company's international expansion is its private equity and venture capital arm.

Fosun wants to invest in start-ups both in and outside China where it sees an opportunity to add value to various of its existing businesses.

Gong cites AirBnB, the website that lets people rent out their spare rooms, as an example of the kind of company in which Fosun would like to invest.

But such grand ambitions take serious firepower. And Fosun's multi-billion pound overseas spending spree began to attract concerns among analysts last summer, amid fears the company might be borrowing excessively.

Burgeoning borrowing

Ratings agency Moody's has put Fosun's Ba3 credit rating – three rungs below investment grade – on negative outlook, suggesting it may soon downgrade the company.

"Fosun's financial profile has remained weak because of its large debt-funded investments," read the Moody's report. "Its investments have exceeded its internally generated cash. For instance, its recurring EBITDA (earnings before interest, tax, depreciation and amortization) is barely enough to cover its interest expenses and tax payments," the May 2014 note added. Moody's suggested that if the company made further investments using its own resources, the impact on its finances would be negative.

But while its initial forays into international real estate have been funded from internal financial resources, Gong said Fosun's ambitious future plans will leverage the group's insurance subsidiaries instead.

In May 2014 Fosun completed the €1bn acquisition of 80% of Portuguese state-owned Caixa Seguros, the country's largest insurance group. This, in turn, gave it control of Portugal's largest insurance company, Fidelidade which includes health insurer Multicare, and travel and transport insurer Cares.

The purchase of the €13bn AUM Fidelidade, as with Fosun's $433m (£282m) deal to buy US insurer Meadowbrook in December, gives the Chinese conglomerate access to quality long-term capital to finance its acquisitions.

"Our focus now we have bought Fidelidade is to optimise the allocation of its real estate portfolio," says Gong.

"The allocation is flexible, but we would say, given our understanding of real estate, we probably tend to take a more progressive attitude towards it as an asset class."

Western Europe, and particularly London, will be the focus for Fosun's Fidelidade real estate allocation, which will be weighted towards core and core-plus assets.

Fosun is in the process of establishing an office in the UK capital to help channel its investment.

The strategy has been met more favourably by analysts, with Standard & Poor's now predicting a stable outlook for the company after downgrading it from BB-plus to BB in April 2014, saying it will benefit from cashflow from its Portuguese acquisitions.

A Fosun future

It is clear that the company is delicately balanced at a time when the economy of its main domestic market is similarly finely poised.

Should it succeed, the global potential could be huge, but if it stumbles the shockwaves will also be widely felt.

Does Gong believe China could yet be in for a hard landing, or is it over the worst of the readjustment?

"China is not a single economy so any one single statement is not going to be accurate," he says.

Perhaps the same could be said for Fosun and its ever-expanding portfolio.

As British Land and Oxford Properties prepare to launch the Cheesegrater, Jack Sidders meets the men responsible for delivering the City's newest icon and weighs up the scheme's commercial merits. Portraits by Tom Campbell

THE GRATER GOOD

Architecture critics have opined on its hi-tech style. Documentary makers have explored its innovative construction. Politicians and the public have debated its impact on the skyline. And on Wednesday night the City of London's agency community will finally get its chance to give its verdict on the completed offices inside the Square Mile's newest – and tallest – skyscraper, when British Land and Oxford Properties host the building's launch party.

The distinctive cheesegrater-like outline of the Leadenhall Building may already be familiar to the party guests. But for the vast majority of them this will be the first opportunity to assess the merits of what is arguably the most significant office development ever completed by the UK's second-biggest property company. Ahead of the party, *EG* looks behind the hoardings to offer its own view of the building's commercial credentials.

The launch party will be a celebration for the joint-venture developers, marking the end of what, for British Land, has been a decade-long project. But it is also an important marketing opportunity. Forty-four per cent of the 610,000 sq ft speculative office development remains unaccounted for at launch, meaning it still has 21 of the 45 floors left to let (see box overleaf). Agents en route to the party will arrive via the building's recently opened public square, effectively a seven-storey open-air lobby carved out beneath the overhanging floor plates above. The cavernous space makes an impressive impression.

But it also poses the first question for the guests and the prospective tenants they represent. The lobby is dominated by two enormous escalators. The second of these, which is set slightly back from the first, will exclusively service Aon, the building's largest tenant. One of the main challenges for British Land and Oxford Properties is to reassure prospective tenants that this remains the Leadenhall

Building – or, at a push, the Cheesegrater – and that it will not be known as the Aon tower. No signage has yet been erected when *EG* visits, so how prominent will it be?

"We're not going to be flashing anybody's logo all over it," says Oxford Properties' executive vice-president and senior managing director for Europe, Paul Brundage.

"Not even our name is on the top of the building. It's the Leadenhall Building," he says.

"We're cool about all of that," adds British Land's head of offices, Tim Roberts. "Aon will have some branding because it is going to be one of the major occupiers of this building and, of course, it has its own entrance.

"But if you think about Amlin [another major tenant that agreed a prelet a year after Aon], it is a top 100 insurance company and it has looked at what the branding of the Leadenhall Building will be and it signed up to take just under 100,000 sq ft."

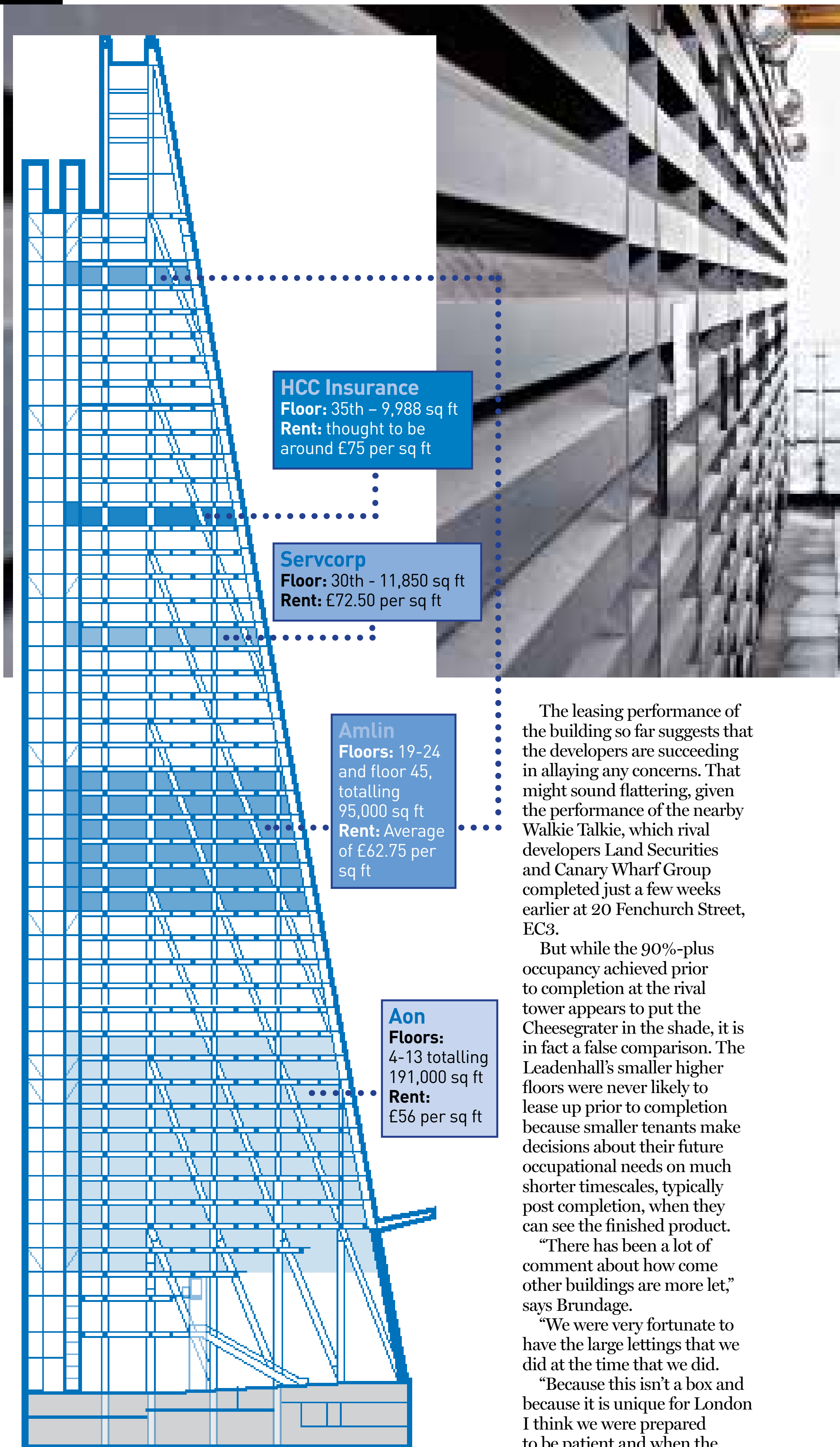
In fact Aon's signage will be internal and though it will be visible from Leadenhall Street, it will be no more prominent than that on show at any other modern multilet office block in the City of London, according to Roberts.

Tenant concerns about a building's branding might seem trivial. But Heron's decision to sell the naming rights at its formerly eponymous City skyscraper to occupier Salesforce provoked outrage in some quarters and debate among agents about the effect the move might have on the building's attractiveness to prospective tenants in future.

But both men are clear that there is no danger of such a rebrand here.

"We call it the Leadenhall Building," says Roberts. "We like the fact that someone has given our building a nickname. Usually nicknames happen because people are fond of you.

"What we're not going to do is give away the branding rights of a building to an occupier, because that's going to be to the detriment of the rest of the building."



The leasing performance of the building so far suggests that the developers are succeeding in allaying any concerns. That might sound flattering, given the performance of the nearby Walkie Talkie, which rival developers Land Securities and Canary Wharf Group completed just a few weeks earlier at 20 Fenchurch Street, EC3.

But while the 90%-plus occupancy achieved prior to completion at the rival tower appears to put the Cheesegrater in the shade, it is in fact a false comparison. The Leadenhall's smaller higher floors were never likely to lease up prior to completion because smaller tenants make decisions about their future occupational needs on much shorter timescales, typically post completion, when they can see the finished product.

"There has been a lot of comment about how come other buildings are more let," says Brundage.

"We were very fortunate to have the large lettings that we did at the time that we did.

"Because this isn't a box and because it is unique for London I think we were prepared to be patient and when the

"This isn't a box and because it is unique for London I think we were prepared to be patient... to not rush to knock the other floors off until there was something really special that occupiers could see"

market was improving we were prepared.

"We had a lot of discussions about this, to not rush to knock the other floors off until there was something really special that occupiers could see."

The developers haven't held floors back as such, but they haven't blown the budget on an enormous marketing campaign for them yet either. That's what the launch party is for.

And ultimately that is likely to be a shrewd move.

"I don't think holding floors back is ever a smart thing to do," says Brundage.

"But I think we were patient and I think we've been rewarded so far and that we're going to continue to be rewarded for taking that approach."

Prime City rents dragged along at £55 per sq ft – with a slight premium for tower space – during the first 18 months of the Cheesegrater's construction. But in the past 18 months rents have begun to rise, with Knight Frank forecasting that they will hit £65 per sq ft by the end of this year and could reach an all-time high of £75 per sq ft by 2018, owing to the lack of new office space being delivered.

Tower floors are already reaching and exceeding these levels, with the most recent letting confirmed at the Cheesegrater – the 13,500 sq ft 25th floor – agreed with Goldman Sachs-owned insurer Rothesay Life for close to £70 per sq ft.

And the joint venture partners are now offering terms on the best space in the building at rents that start with an eight.

The other unflattering comparison with the Walkie Talkie that is often drawn is the perceived inefficiency of the Cheesegrater's higher floorplates.

By expanding as it rises the Walkie Talkie increases its lettable area and offers the highly efficient floors that most appeal to big insurers – and to prospective investors.

But while the sloping outline required of the Leadenhall Building to preserve views of St Paul's has clearly shaved off a chunk of rental income that a comparable square building would have achieved, the striking design has turned constraint into compliment, Roberts believes.

"It's not designed like this because we've got egos and we want to create a weird shaped building, it's designed like this because of the view corridor and St Paul's," he explains.

"And actually that gives it some context and some integrity, doesn't it?"

In fact the gross-to-net ratios for the vast majority of the office floors are above 70%, well above what skyscrapers typically achieve.

That's largely thanks to the steel frame of the building and lack of a central core.

That might add depth to the floor plates but a tour of the higher floors at least reveals them to be bathed in natural light.

"Look at the Heron Tower," adds Roberts. "It has not, God bless it, had a great leasing campaign, because it's competing with itself.

"I think the constraint was really turned into an opportunity because that view corridor created this multi-floorplate, distinctive piece of architectural design."

To reinforce the point, he nods in the direction of the neighbouring development site where a consortium of Arab investors' plans to build the Pinnacle skyscraper have stalled.

"There is a million square foot building behind us that's too big right now for the marketplace and having a hard time of making it to this point," he adds.

Standing on the 40th floor of the building, it is easy to forget that at one stage it looked like it might never happen.

In 2008 British Land put the brakes on the scheme as the world's financial markets went into meltdown.

Two years later, when it announced it would build the scheme speculatively in a joint venture with Oxford Properties, it was still a very brave call.

But with rents now rising in perfect time for the smaller higher floors and the hard work of securing a pair of blue-chip anchor tenants long completed, it is increasingly clear that decision was absolutely the right one.

The Cheesegrater represents just under 30% of British Land's 2.1m sq ft 2010 development pipeline, which has already accrued profits for the company of £640m.

In 2013 alone its balance sheet benefited from a £64m development profit at the building.

So while its leasing performance might have attracted fewer headlines than that of its nearby rival – much as its architecture has done – it is clear the building has been a phenomenal success.

The only problem for the developers now is where to find the next development opportunity that offers the same sort of potential.

Brookfield's deal for Hammerson's London office business is paying dividends, not that you will hear Martin Jepson shout about it. Jack Sidders seeks to worm the details out of the firm's president and chief operating officer for European offices. Portraits by Tom Campbell

TRADE SECRETS

Martin Jepson is keeping schtum. He refuses to divulge how much Brookfield paid for each of the assets when it bought the bulk of Hammerson's London office business in June 2012.

And without breaking down how each of the three large offices, the Principal Place development site and a handful of smaller ownerships were valued, it is hard to pin down precisely how the £518m deal has performed.

But consider this: in the two-and-a-half years since the portfolio changed hands, City yields have compressed by more than 100 basis points. Then factor in that Brookfield has let more than 1m sq ft across the portfolio.

That's when you start to get an inkling of just how good a deal this has been. So good that even Jepson, Brookfield's chief operating officer and president for Europe, admits that "it sounds slightly arrogant", as he bats off another attempt to worm out more detail on how much was paid for each of the component parts.

"I think the headline is that we are well above our returns on each individual property and, therefore, obviously combined as a portfolio, performance has been well above expectations," he says.

The fact that Jepson may not wish to shout about precisely how much value has been created will be of little comfort to Hammerson's shareholders. The reason behind the sale of the portfolio was the result of a strategic decision by the REIT to become a retail specialist, a move designed to create better returns for its investors.

In light of the returns that Brookfield now appears to be achieving, Hammerson has come in for a pasting from some City commentators. Mike Prew, head of real estate at Jefferies, believes the deal has "gone against Hammerson, big time".

After Blackstone's smash-and-grab raid of British Land's Broadgate jewels, is this another example of how UK REITs have been on the wrong side of the best deals during the cycle?

The ground work

North American giant Brookfield arrived in London in 2010 when it entered a joint venture with Great Portland Estates, giving it a 50% stake in the 900,000 sq ft 100 Bishopsgate development, EC2.

Jepson was still at Hammerson at the time and the deal was led by Brookfield's chief executive, Ric Clark.

"Having made the joint venture with GPE to develop 100 Bishopsgate, Ric made it clear that he wanted to find a London platform," says GM Real Estate founder Tony Gibbon, who advised GPE on the jv and then Brookfield on the Hammerson purchase.

With retail man David Atkins having taken over as chief executive of Hammerson in 2009, questions arose around whether the idea of REIT specialisation – abandoned by Land Securities during the crisis in 2008 – could be back on the agenda.

Brookfield made an initial approach to Hammerson regarding a potential jv. That deal didn't happen, but neither was it immediately rebuffed.

In July 2011 when Hammerson announced London boss Jepson was leaving the business to pursue new opportunities, Brookfield hired him, well aware of his unrivalled knowledge of the platform it coveted.

"Having identified Hammerson, [Ric Clark] had real conviction to get a transaction done and to put together a team that could execute its business plan," says Gibbon.

The deal

At the start of 2012 Hammerson confirmed it wanted to sell its London business, prompted by a story in *The Times*.

Several other bidders came out of the woodwork including LandSec – which wanted to trade its stake in Bristol shopping centre Cabot Circus for some of the London developments – and Oxford Properties.

But Brookfield got its deal, after executing due diligence with remarkable speed, agreeing to pay £189m for Leadenhall Court, EC3, and a half stake in 125 Old Broad Street, EC2, and £329m for 99 Bishopsgate, EC2, the Principal Place development site and a couple of neighbouring buildings, plus an interest in the complex lease structure of the Puddle Dock site, EC4.

A couple of weeks later Hammerson allowed its development option agreement with the City of London for the 500,000 sq ft London Wall Place, EC2, scheme to expire, stating the development did not meet its return requirements.

Brookfield stepped in and, for £20m, secured a new option from the City for the site, in a joint venture with Oxford Properties.

"[David] Atkins said that Hammerson had decided to focus on retail assets because they generated higher returns than London offices, which was

right, up until then," Prew wrote in an analyst note earlier this autumn. "But the past isn't always an accurate guide to the future."

With the second phase of the deal finally completed in June 2013, Brookfield immediately set about proving there was value to be had in the City.

The aftermath

Its first significant deal was in July 2013, when it sold a stake in the residential element of the Principal Place, EC2, scheme, a 50-storey Foster+Partners-designed tower to be built next to the proposed 600,000 sq ft office block.

Based on *Estates Gazette*'s estimates, Principal Place represented about £50m of the total portfolio price, a figure Jepson declines to comment on. After 12 months of soaring residential values, a jv agreement with Concord Pacific went a long way to recouping this cost, meaning Brookfield was left with a massive office development for which it had paid very little.

This summer Amazon agreed to prelet 430,000 sq ft of the development, with options on the other 170,000 sq ft, which expire in phases up until the anticipated completion in 2017.

The agreed rent was not disclosed but the price quoted to prospective tenants was £50 per sq ft.

That means the office development could have a rent roll of around £30m. Once complete, and assuming a relatively conservative 5% yield, it could be valued at £550m. Take out the £250m it will cost to build and Brookfield will be sitting on a substantial profit.

As well as preletting at least 70% of Principal Place, Amazon also signed a short-term deal at Leadenhall Court, agreeing to rent the entire 108,000 sq ft building from Brookfield at least until Principal Place is complete, but with the option to stay there longer. Long-term, Jepson says Brookfield may look to develop a tower on the Leadenhall site, with Ken Shuttleworth's Make Architects

"The headline is that we are well above our returns on each individual property"

appointed earlier this year to see what may be possible.

The other big letting Brookfield has secured was to Schroders, which prelet all 310,000 sq ft of One London Wall Place at the end of last year. With US law firm Cleary Gottleib now under offer for around 60,000 sq ft in Two London Wall Place, Brookfield and Oxford Properties are circa 75% prelet across the 500,000 sq ft development.

With rents at London Wall over £60 per sq ft, the final rent roll of the building will be in excess of £30m, implying a GDV of more than £550m against development costs of around £150m.

There have been fewer headline-grabbing lettings too. At 99 Bishopsgate, 100,000 sq ft of vacancy has been let at rents of £50 per sq ft in the podium and more on the upper floors, while at 125 Old Broad Street almost 40,000 sq ft of vacant space was filled.

This has allowed Brookfield to take advantage of an investment market that has also been moving in its favour.

The original half-stake in 125 Old Broad Street was acquired together with Leadenhall Court for £189m, suggesting it cost something like £130m. Brookfield then bought in the other half of the building in late 2013. Given the way the market moved, the second 50% cost the company more like £140m. Jepson won't comment on the figures, but he is happy to confirm that the eventual sale of the building in July this year to Blackstone, for £320m, crystallised a "considerable" profit for Brookfield – around £50m, according to *Estates Gazette*'s estimates.

The returns

So how well has the deal performed for Brookfield?

"Brookfield has probably extracted north of £1bn pre-financing costs," Prew concluded in a note on the merits of REIT specialisation earlier this autumn.

Either way, for Brookfield the decision to pounce on the City of London has been more than vindicated.

Which raises the question about what the company does next. Its debut London deal – 100 Bishopsgate – is now its only site that is not committed.

GPE assembled the site before entering a jv with Brookfield in 2010, a decision it made because the scheme was too large for a company of its size to pursue on its own.

With a brimming West End development pipeline, GPE then sold down a further 37.5% stake in the scheme in October 2012. The deal put Brookfield in control, allowing it to call the shots on how much of the scheme should be prelet before construction could start. At that point its appetite for risk was tempered by the fact it was sitting on 2m sq ft of unlet City development – around half of the total pipeline in the Square Mile.

Chief executive Toby Courtauld said: "We didn't sell out entirely then because we wanted some effective hedging against that prelet materialising, with the hope that they would prelet the building."

However, last month GPE did exercise its right to exit entirely, selling its final 12.5% stake for £15.7m.

That decision could be read in one of two ways. Either GPE believes there is little prospect of a prelet kicking the scheme off any time soon. Or, as now seems more likely given the lack of space available in the City, because Brookfield is looking to get going on the scheme with a less substantial level of prelets than GPE feels comfortable with.

While Jepson is clear Brookfield would never speculatively build such a large development, the company's early success in the City is clearly increasing its appetite for risk.

Normally, says Jepson, a 40% prelet would be enough to justify kicking off such a major scheme. But instead of looking at each development in isolation, Jepson says Brookfield will assess its appetite for risk across the entire portfolio.

"I think it's the one building where we may be a little bit more flexible," he says.

So will 100 Bishopsgate be the next big City tower to come out of the ground, ahead of rivals such as the Scalpel, the Pinnacle, Gotham City or the Can of Ham?

"I would hope so," says Jepson. "I think frankly my task – and this is probably putting my neck on the block now – is to make sure that it is."