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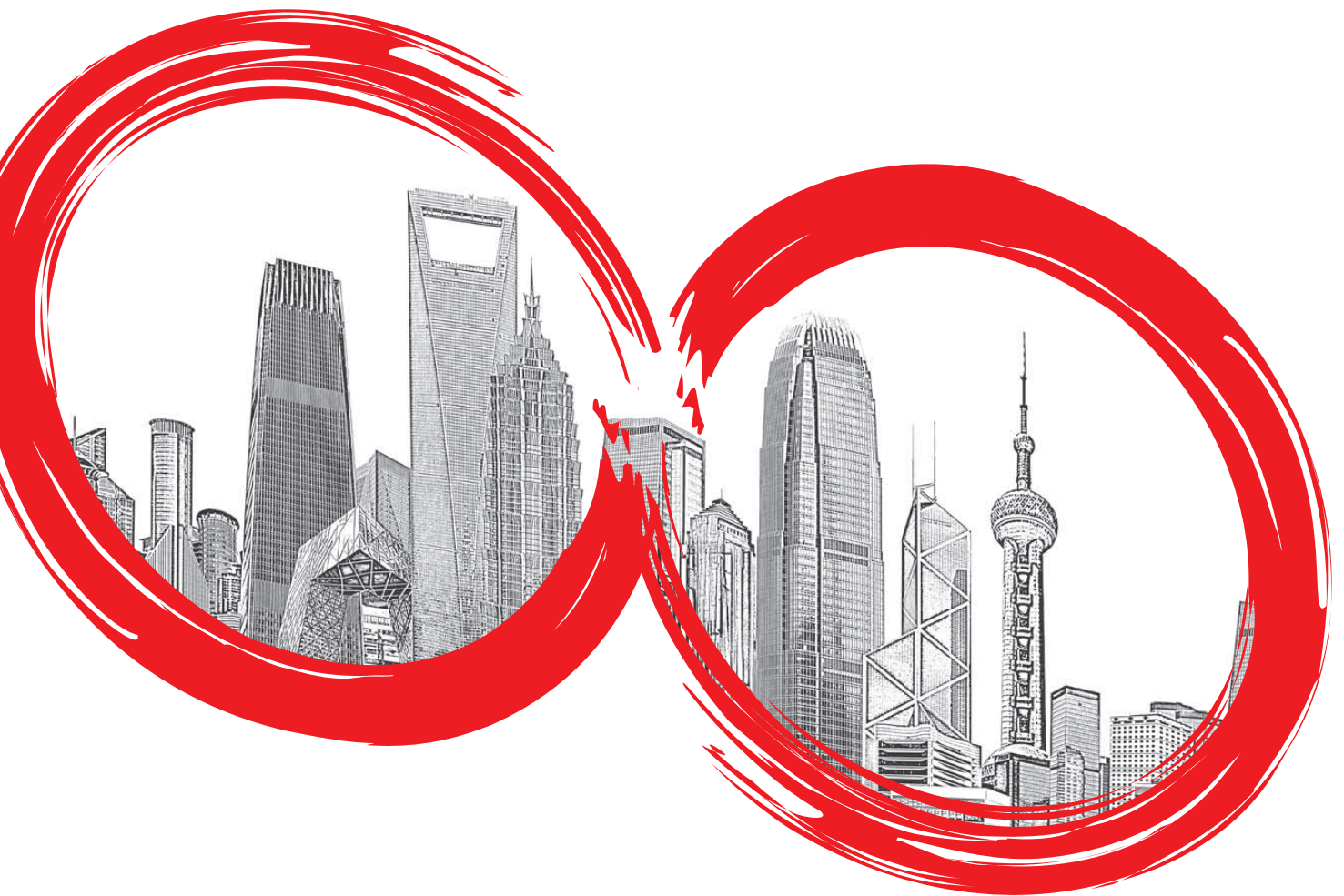
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World Winning Cities

Global Foresight Series

# China 2020: The Landscape of Change



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## Looking to the Future

China is different. Despite much international commentary and agreement around the sources of China's dramatic growth, its rise as a superpower, its influence on world trade, its urbanisation rates and plans for harmonious development, there is little consensus around the shape of China's future. Typical scenarios revolve around three potential outcomes for China: as a successful and integrated superpower; as a regional powerhouse which challenges the world order; or as a nation overcome by internal challenges and environmental degradation.

It would be easy in all of these mega issues and uncertainties to lose sight of the fact that real estate will play a major part in determining not just the physical, but the social and economic landscape of China 2020. Property is vital to China's progress through its contribution as an investment, a home, and as a driver of city growth. In this note we offer some thoughts about the key drivers and trends for the future and point to some of the likely city winners.

## The Shape of New Urban China—Super Cities?

The Shape of New Urban China—Super Cities?

Flash Urbanisation and 200 new cities?

For the past 8 years China loses rural areas equating to Holland & Belgium

Source: Jones Lang LaSalle



### Evolution of the Super City?

Concentrate urbanisation, minimise footprint, create magnets for growth



Source: Jones Lang LaSalle

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An enduring truth about property is the importance of location and the macro question of urbanisation in China underpins the potential and future shape of the commercial city network. The government's vision of the urbanisation process is a broad network of liveable cities each with their specific specialisms and strong intraregional or even international trading connections. They see the second tier cities guiding the progress of the third tier cities and so on.

To meet the government's target of creating a million jobs a year and to cope with the

subsequent rural to urban migration, China could have up to 400 cities with over one million people by 2020. This compares to 40 in the USA.

The landmark and highly significant announcement to liberalise farmers' land use rights in October 2008 will further positively influence the growth of China's cities, particularly those with large agricultural economies such as Nanning. We expect to see at least 40 secondary and tertiary cities on the core international real estate agenda by 2020 with a further 10 attracting substantial interest.

# The 'China 30'

Our evidence suggests that China's second and third tier cities are mobilised and that their 'destination is growth'. In our first analysis we consolidated our intelligence, information and views we have on the cities in order to create a city evolution curve and categorised the cities into tiers.

Our 30 city winners included cities like Tianjin, the economic centre of North China, Suzhou, Shanghai's overspill city, and Dalian, a target for Japanese and Korean investors. All of these cities have lived up to expectation.

## China 30 Updated

Even over the last three years there has been a noticeable movement in our hierarchy as a number of determined cities have successfully carved out their niche. For example, Hefei's economy has nearly doubled in just two years and is now known as one of China's four main 'Science and Education Bases'. Ningbo is now the 6th wealthiest city and is set for further success as a key port in China's world trade strategy and Nanchang, a transport and manufacturing hub, has doubled its economy in less than five years and is set for further growth.

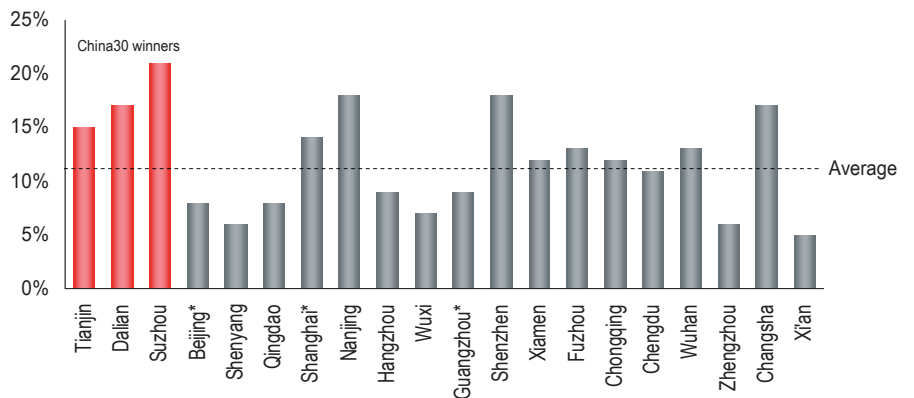
## Geography of Education

For many of these cities their skill base has underpinned their attraction to multinational companies. The geography of education is vital to China's domestic future and the health of many international academic institutions who rely on Chinese student numbers.

The collaboration between Chinese and foreign universities will strengthen as will the connection between academia and the private sector with corporates universities, such as the Motorola University in Beijing, showcasing the value of partnerships. Over the next 15 years China will need to build at least 800 colleges to meet increasing demand according to the president of the Shanghai Academy of Educational Sciences. We will undoubtedly see strong growth in the 'corporate or affiliated' universities, science parks and campuses throughout the top 40 cities in the country.

### Office Capital Values

Compound Annual Growth Q305-Q308

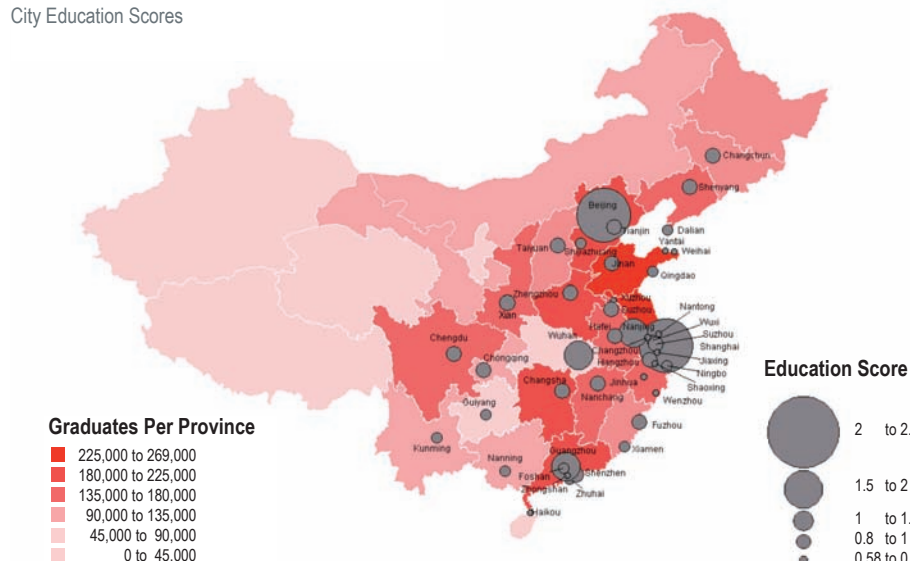


Source: Jones Lang LaSalle's Real Estate Intelligence Service

\* Grade A only

### China's Skills Bases

City Education Scores

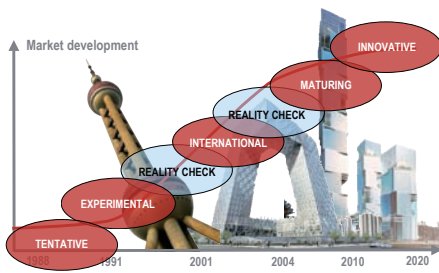


Source: Jones Lang LaSalle and government figures

## Stepping into 2011

### The Office Market Moves Further to Internationalisation

China Office Market : Phases of Evolution



Source: Jones Lang LaSalle

We believe that by 2011 the office environment will be well into its 4th phase of development – from its tentative beginnings in the late 1980's to its experimental phase in the 1990's, to the more dynamic markets of this decade and finally to further internationalisation and its maturation stage.

We forecast that by 2011 in the 20 cities we cover in detail – the stock of grade A offices will have risen to a total of 24 million sq m – equivalent to the total stock of a city like Washington DC. While cities like Hangzhou – now in 4th place in the Economist ranking for business environment – and Dalian – the emerging Bangalore of China – are currently gaining headlines, other cities are creating enviable reputations for innovation in real estate format and type.

accessibility to this campus style format means the sector is moving into lift off – the current 17 million sq m of space is expected to double by 2010 as a result of strong demand from R&D, BPO (business process outsourcing) activities and cost reduction allied to corporate expansion. With this backdrop in recent work we identified 15 cities that will be the focus of business park activity in the next 3 years including Shanghai, Beijing, Dalian, Guangzhou and Tianjin.

### Retail Futures

Retailing, the great moderniser of China's future, continues to show impressive growth. Total retail sales in the first ten months of 2008 jumped to RMB 8.8 trillion (US\$ 1.29 trillion), a 22% increase over the same period last year, close to the fastest period of growth in a decade. This is being driven by increasingly wealthy Chinese with a strong appetite for shopping. Disposable incomes which today are about RMB 13,058 (US\$ 1,920) per person are forecast to reach around RMB 15,872 (US\$ 2,334) in 2011.

The big stories have been about shopping malls and big box formats. We estimate that China has around 450 shopping centres, built over the past 10 years, including 10 of the worlds largest malls in which international retailers are now very well represented. Going forward, we expect the total amount of retail space to almost double from 26 million sq m to 45 million sq m by

### The Nascent Business Parks Market

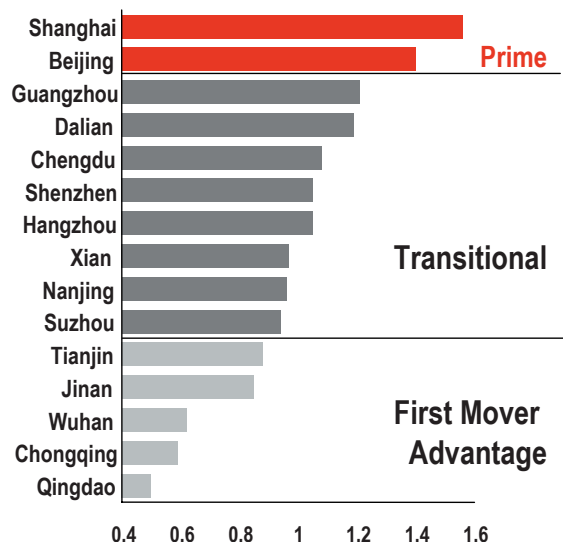
Business Parks are speaking to the needs of a nation which is up skilling and moving their economy up the value chain. Space, costs, design, facilities, and increasingly,

15 Business Park Hotspots



Source: Jones Lang LaSalle China Business Parks report

Business Park Activity



2011. However, we believe that many of the country's malls will struggle as a result of poor management, over specification, and a limited understanding of shopping behaviour.

The other growth sector is airport retailing – according to Verdict research passenger numbers will rise by almost 250million by 2012 and spend by approximately US\$ 300 million. Land side and air side retailing will be one to watch over the next few years as, even though passenger numbers are in a short term decline, the airport operators and retailers will be looking at the longer-term potential.

## Forecast of Logistics Space 2011

The success of the logistics market will underpin much of China's economic progress. The modern logistics sector in China has largely emerged over the last four years. While we talk of 30 and 40 cities on the offices and retail radar screen, there are really only 6 cities that have made an impact so far in this very young but frantically growing market.

Currently, there are around 6-7 million sq m of modern logistics space in China. More than half of this space is located in three regions: Greater Shanghai/Yangtze River Delta, Bohai Bay (Beijing-Tianjin) and Pearl River Delta (Shenzhen-Guangzhou).

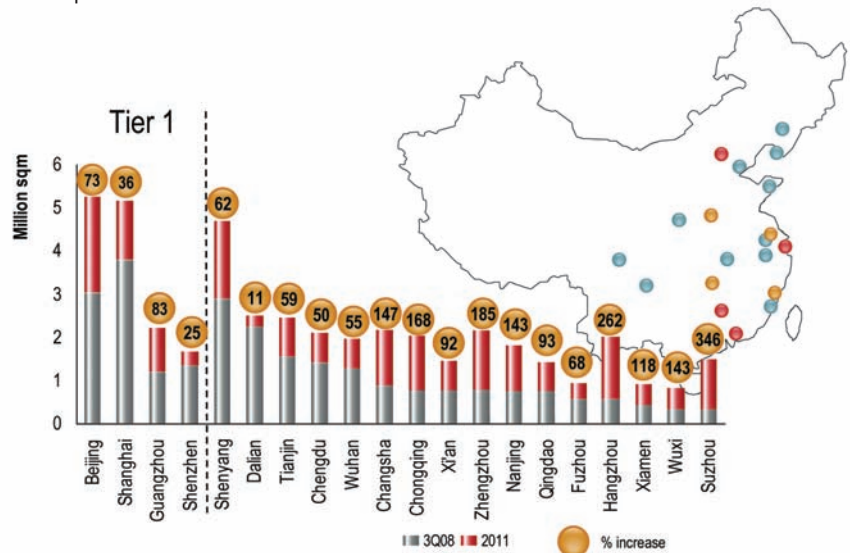
The economic growth drivers underpinning the logistics market are all familiar and the need for increasing efficiencies will force the introduction of modern logistics infrastructure. The sector is currently growing at around 20% per year – aided by the growth in 3PLs (third part logistics), deregulation and increasing sophistication of warehousing and more international operators and foreign investment.

Going forward, the market will witness continuing consolidation, particularly in the 20 primary, secondary and emerging logistics hubs we have identified.

## Future Stock

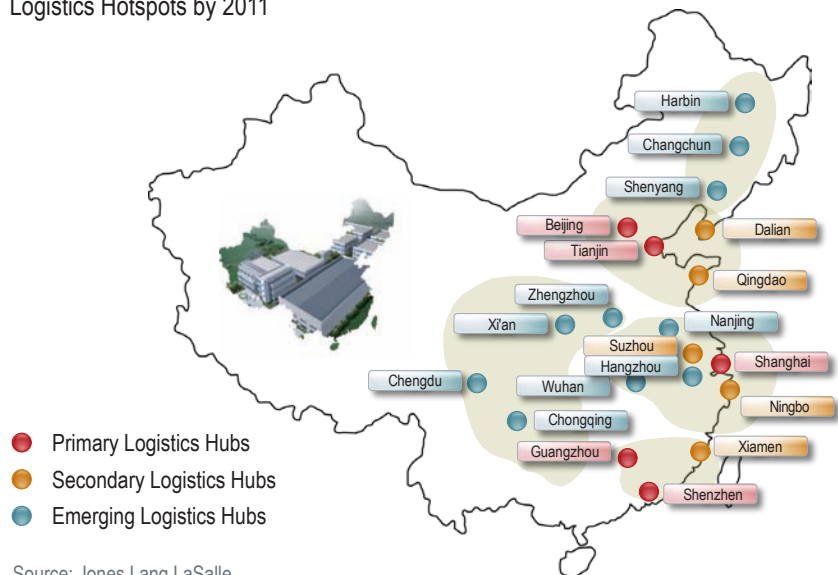
The sector is poised for lift-off and the total prime logistics stock in China is expected to more than double to 15 million sq m by

## Retail Space Available: Now and Future



Source: Jones Lang LaSalle's Real Estate Intelligence Service

## Logistics Hotspots by 2011



Source: Jones Lang LaSalle

2011. In Central China, the government of Chengdu is aiming to create one of the largest logistics hubs in China by 2010.

To back up its pledge the government has invested US\$286 million to construct a massive railway station centre that will be the largest in Asia when complete. Further north, Tianjin's manufacturing sector is showing robust growth – as witnessed by the recent establishment of the large Airbus factory in TEDA – on the back of already superior and expanding port facilities, high speed railways, highways and airport capacity. Tianjin is a city to watch.

Transparency Level	Market	2008 Composite Score	2008 Global Rank
<b>High Transparency</b>	Australia	1.20	2
	New Zealand	1.21	4
<b>Transparent</b>	Hong Kong	1.55	11
	Singapore	1.55	11
	Malaysia	2.25	23
	Japan	2.39	26
<b>Semi Transparent</b>	Taiwan	3.07	41
	South Korea	3.15	44
	Thailand	3.16	45
	Philippines	3.23	47
	<b>China Tier 1 Cities</b>	<b>3.33</b>	<b>49</b>
	India Tier 1 Cities	3.34	50
	India Tier 2 Cities	3.38	52
<b>Low Transparency</b>	Indonesia	3.51	55
	Macau	3.54	57
	India Tier 3 Cities	3.65	62
	<b>China Tier 2 Cities</b>	<b>3.68</b>	<b>65</b>
	<b>China Tier 3 Cities</b>	<b>3.97</b>	<b>72</b>
	Vietnam	4.29	77
<b>Opaque</b>	Cambodia	4.67	79

Source: Jones Lang LaSalle Middle Kingdom Transparency report

## Transparency

Real estate transparency is fundamental to the investors view of a market and according to our latest global transparency survey, China now ranks 49th out of the 82 countries we survey. In the last two years it has improved from a low to semi transparent market. Globalisation has been the main driving force behind transparency improvements in China. The movement of capital and companies around the world has led to a growing requirement for accurate market information (published in English) and the increasing adoption of global practices. This in turn has encouraged governments to streamline bureaucratic practices.

We anticipate further transparency improvements in China's real estate market over the coming years with its transparency score improving to 2.7 from 3.1 by 2010. This will raise China's position to the upper end of the 'Semi Transparent' category, equivalent to current transparency levels in Russia and Brazil.

So we have seen which cities are moving up the value chain and the medium term prospects for sectors. Now we get to the greater challenge of 2020.

## Stepping Into 2020

If we assume the continuation of a globalising economy, an improving regulatory framework and a relatively steady trend line of growth of China's economy, then the potential growth across our 20 cities could see a total of 23 million sq m of grade A office space, almost a doubling of residential space, and an increase in retail space to almost 44 million sq m. We also see an urban backdrop of a growing number of mega cities and the movement up the hierarchy of secondary and tertiary cities with now 'dormant cities' having appeared on the radar screen of investors, occupiers and developers.

## Drivers of the 2020 Landscape

The successful cities will be those that anticipate and act on the growing market trends and the signals of change.

**2 pockets 7 mouths** – 'China will get grey before it gets rich'. Ten years from now, today's twenty something does and will be faced with the rising costs of child rearing and retiring parents. Today's Little Emperors will feel the financial squeeze. China may develop the care home concept, but more likely it will re-assess its house building programme to allow for bigger residential space to accommodate three generations.

**Feeding the Dinosaur** – Tens of millions of people are still employed by the government in jobs that are becoming less productive and who have limited skills to survive or prosper in an increasingly competitive job market. Will such jobs be protected at the expense of real productivity? Will the existing concerns about limited talent pool turn the multinationals away from China?

**The Green Revolution** – If the government creates good plans for more eco cities, continues to implement green building codes, squeezes out polluting factories and puts financial and regulatory pressure on city mayors; if urbanisation takes place in a sympathetic fashion learning the lessons about transport and energy from Finland and sustainable city design from Sweden – then by 2020 China may be on its way to being a world leader.

**Mass Tourism:** Official industry figures from the Chinese National Tourism Administration show domestic tourism is flourishing. During the National Holiday week, 178 million Chinese travelled within China, up 22.1 percent from the same period last year. Will we see Sun Belt leisure developments that model themselves on Western developments and mock cultural experience?

**Floridisation:** A winter migration of the wealthy northerners to the warmer climates of the south will greatly benefit seaside cities such as Xiamen, Qingdao and Dalian.

**Value Chain – The Golden Link:** As heavy industry is slimmed and off shored the golden link will be the creation of a new generation of innovative businesses linked to new product delivery. This will be seen in diverse industries from telecoms to airlines and from nanotechnology to education.

## Concluding Observations

Any or all of these trends may occur and will variously affect the market. By 2020 real estate players could be working in:

- a new democratic China – a democracy with Chinese characteristics, according to Zhou Tianyong
- a country of dense mega cities
- a market with very different and higher spending consumer psychology
- pollution and burgeoning health care costs
- a legal framework with strict policies on green building
- a huge internet, media and film sector
- the largest laboratory capacity in the world
- the most extensive rail and road network on the planet
- a maturing market with good real estate transparency
- and as either a regional or even world super power

## The 2020 Winners

### Office Market:

**Tianjin's** prospects remain bright, even through 2020 with vice mayor Cui's commitment to turn the city into a financial centre, port and an innovation hub.

**Chongqing's** office market will undergo renewed growth on the back of a strengthening local economy, business friendly government and cheaper costs that will continue to attract foreign investors.

**Nanjing** may prove increasingly popular as a regional HQ location for large domestic firms. This city will develop better grade office space and differentiate itself as a local capital.

### Retail Market:

**Changsha's** development into a transportation hub of Hunan Province will be a boost to retail activity in the city as a result of increased traffic flows. Other cities in Hunan Province, such as Zhuzhou and Xiangtan, will also contribute to retail spending in the city.

**Wuhan** already possesses one of the largest populations in China and its plan to be the centre of 8 surrounding cities will ensure this capital city becomes a regional shopping destination. Compared to other Tier II cities retail stock is low and has significant room to grow.

**Wenzhou**, surprisingly unsophisticated in retail given its market size of 7.6 million wealthy people, will rethink its retail strategy and is well placed to do something stunning.

### Logistics:

**Chengdu** plans to become the largest logistics sector in Western China and its new railway container station currently under construction, which will be the largest in Asia, is one step in that direction.

**Qingdao's** port is one of the largest and fastest growing ports in China. Logistics will undoubtedly benefit from the latest rural reforms as increased agricultural productivity results in higher volumes of food processing and refrigerated container shipments.

**Zhengzhou** plans to be the centre of a new city cluster in Henan province and with its significant position as a railway hub is one to watch.

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