Villas in Shanghai

Straits Partners finds rare colonial-era gems in a fragmented residential market

BY CECILIA CHOW

If you're a Singaporean seeking exposure in China's real estate market and still like the buzz of Shanghai but do not want the hassle of managing an overseas investment property, here's a solution: You can invest in a private equity fund that acquires niche properties in Asia. Due to scarcity, such properties are less vulnerable to market vagaries.

There's just such a fund in Singapore. It's called the Straits Shanghai Property Fund and is headed by Straits Partners Pte Ltd, whose three partners are: "head honcho" Dominic Andria (a British citizen with 15 years' experience in corporate finance in London, Hong Kong and Singapore); Ricardo Villanueva ("a third-generation Singaporean" with 10 years in equity research, corporate finance and capital raisings); and Rila Zhang (a Chinese citizen who has 10 years of experience in foreign direct investment and corporate strategy consulting, and speaks fluent English and German).

The fund, which was started last August, has raised more than US$7 million to date, which is close to its targeted US$10 million. It specializes in acquiring and restoring colonial-era manors and villas in Shanghai's Old French and international concession areas. Subsequently, these villas are leased out primarily as residential homes to multinational corporations to house expatriate staff and their families, or for commercial use.

More than half of the investors in the fund are Singaporean professionals and business owners who are high-net-worth individuals, while the rest are other Southeast Asian investors, Europeans and wealthy Shanghai Chinese, says Andria. "The investors are individuals who see the potential in Shanghai, and given our local presence and the size of the fund, a lot of investors tend to be from the region, particularly Singapore and Southeast Asia."

And depending on when the investor enters the property fund, returns on their investment so far have been "at least 20%", says Villanueva.

Focus on colonial villas
A Singapore equivalent of such colonial villas would be the black and white bungalows owned by the government and managed by Frasers and The Ascott Group, both part of CapitaLand.

Colonial villas are popular in Shanghai — both for sale as well as for lease, and whether for owner-occupiers or investors, says Larry Hu, senior manager for residential department at Jones Lang LaSalle, Shanghai.

The majority of the colonial-era houses are around 70 years old, having been built between 1920 and 1940 by foreigners, and are primarily in the Old French and international concession areas. Many of these villas were bought over by local business owners and families in the 1930s and 1940s, when foreigners began withdrawing from China.

These villas were seized by the Chinese government following the Communist rule in 1949.

In the late 1970s and early 1980s, the government returned these properties to their last registered private owners (provided they were Chinese citizens and had retained their old title deeds). Historically, in China, most of the colonial villas in the former French concession or international concession areas are owned either by several individual owners, who are normally the relatives or the next generation of the original owner, or by the government," says Hu of Jones Lang LaSalle.

The villas have since then been either occupied by, or leased to, several families who have carved them up into separate residences. "Thus tracking the transaction of sales and leasing activity is comparatively difficult on this type of property," says Hu. "In addition, some areas, especially those close to governmental offices, have restrictions on disclosing the buyer's identity."

In most cases, the land still belongs to the government while the house belongs to the owner, and there are therefore two separate titles. In some instances, the owners of the house who have been living there for many years are not the owners, and under certain regulations, the rightful owners are not allowed to evict them, says Zhang.

Since April 1986, the government has allowed the transfer of land-use rights for "value". And for most residential properties including the colonial villas, the land-use right is for 70 years. The fund usually pursues

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A fresh title deed of 70 years to cover the house and land of its newly acquired villa, says Andida.

Scarcity factor
To date, Straits Partners has acquired six colonial villas for the fund, primarily in the French concession area, which is right smack in Puxi and regarded as the prime residential location in Shanghai. It sold one villa at the end of last year and has leased out the other five. "It really depends on what is most suitable for the fund." says Zhang. "Basically, we just want to accrue a higher return for investors. For some [villas], we feel that it's better to sell it right now, and to purchase a better property given the limited fund size."

The main attraction of colonial villas is the "scarcity factor" that ensures the preservation of their value, says Villanueva. There are probably only 500 such villas in the French concession and an equally limited number in the international concession area. "At one stage, a lot of these houses were demolished to put up newer buildings," he adds. "But of late, the government realised the value of these houses, and is adopting a preservation stance towards them."

Of the 500 villas, fewer than 100 are available in the market. And of these, there are many complications, making it difficult to complete a transaction. "It's a very inefficient market, but our advantage is that we know how to get the right sources of information," says Zhang.

The fund acquired its villas for US$500,000 to US$1.5 million each, and budgets another 10% to 20% of the purchase price to renovate and restore the villas. Typically the land area of a villa is 350 sq m to 600 sq m, while the built-up area is 400 sq m and upward.

The market price for colonial villas that are in prime city areas such as Suzhou, Liwan District and Huashan Road ranges from 30.000 to 60.000 renminbi psn, depending on the location and garden size, says Hu of Jones Lang LaSalle. So a 350 sq m villa costs between 10.5 million and 21 million renminbi (US$1.3 million to US$2.5 million), while a 600 sq m villa will be in the region of 18 million to 36 million renminbi (US$2.2 million to US$4.3 million). Villas are very popular with the expatriates and the only concern is management, for most of the villas are well maintained and lack security systems," he adds.

New luxury villas are developed in suburban areas in the districts of Minhang, Qingpu, Songjiang, Pudong and Nanhui. The price of these villas ranges from 20,000 to 35,000 renminbi psn, says Hu.

Government regulations
Currently, there is some negative perception of the villa and luxury apartment market because they are regarded as the root cause of speculation and the run-up in the Shanghai residential market prices, admits Hu of Jones Lang LaSalle.

"We also noticed that a lot of local banks have decreased the proportion of loans for [these] properties," he adds. "It is hard to say how strong the negative impact will be, for based on our study of the buyers' profile of luxury properties, the local (Shanghai) buyers and those from other provinces rely less on bank financing than overseas buyers. It is now a very crucial time in Shanghai and a lot of developers are still expecting a price hike for this market sector even after the next two to three months, when intensive governmental policies will be applied to the market."

"We haven't been significantly impacted by the perceived timing of regulations," says Andida. "We do carefully manage our banking relationships."

Given that the fund is very niche, the value of the properties at the moment is very low-risk for the banks," says Zhang. "During this period of time, when the Chinese government is tightening on approval of property loans, it takes a longer time to get approvals. It does slow it down a little, but typically, our houses take two to six months to clear."

The Shanghai residential market is very fragmented, and buying a colonial villa is not as easy as buying an apartment, where one can see the prices advertised, says Zhang. "Returns on these colonial villas cannot be pegged to the new villas, which should be lumped together with new apartments," says Villanueva. "The colonial villas are a totally different breed of animal [compared to the new villas]."

Moreover, given the complexities "it's extremely difficult for someone to just go in and buy [a colonial villa]," says Andida. "A lot of the foreigners who buy these colonial villas are not foreigners per se, but are overseas Chinese from Taiwan and Hong Kong, and they [tend to] purchase in cash," he adds.

The fund is looking to acquire a few more villas. "From our perspective, the colonial houses are a scarce resource, and we believe that they would be more robust if there's any downturn in the market," says Andida.