

A woman with dark hair tied back, wearing glasses and a grey patterned sweater, is sitting on a long, low, grey rectangular bench. She is looking up at a large, colorful abstract painting on the wall. The painting features bold, geometric shapes in red, yellow, blue, and pink. The gallery has white walls with several other framed artworks, including a black and red abstract piece to the left and a blue and white abstract piece above. The floor is made of light-colored wood in a herringbone pattern.

E-House

# Baoku China: An Art-centric Real Estate Platform

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China's real estate sector is finding robust growth increasingly hard to come by. As such, many real estate companies now find it necessary to adopt more innovative approaches in order to sustain property values and revenue growth. Among them, art-centric real estate is gaining increasing traction. This business model seeks to increase property values by integrating art venues into a given property. Such an inclusion helps drive foot traffic, which raises the value of a commercial property while simultaneously providing cultural enrichment to residents and the wider community. Baoku China, a subsidiary brand of E-House China, is a major player in this art-centric business segment. It offers a one-stop service that includes art storage, as well as the development of private museums and art galleries — thereby creating an art ecosystem that has great appeal to China's increasingly sophisticated and wealthy urban population.

## E-House Platform at a Glance

Founded in 2000, E-House China Holdings is a leading real estate services company in China. The company offers a variety of real estate-related services, including real estate online services, brokerage and marketing, information and consulting, financial services as well as community value-added services, covering the full spectrum of the real estate service value chain.<sup>1</sup> In 2007, E-House went public on Nasdaq to access international capital and facilitate its global expansion, raising over \$200 million. After approximately a decade as a public

company, E-House management took the company private in 2016 for approximately \$1 billion.<sup>2</sup>

E-House does not own real estate properties, and instead pursues an asset-light strategy that focuses on value creation opportunities in real estate-related service industries. Its platform growth and product line expansion are centered on end-user demand. In 2017, E-House published its strategic business plan (Exhibit 1), which can be categorized as three stages of corporate development.<sup>3</sup>

<sup>1</sup> "E-House China Website." Accessed February 9, 2018. <http://www.ehousechina.com/index.htm>.

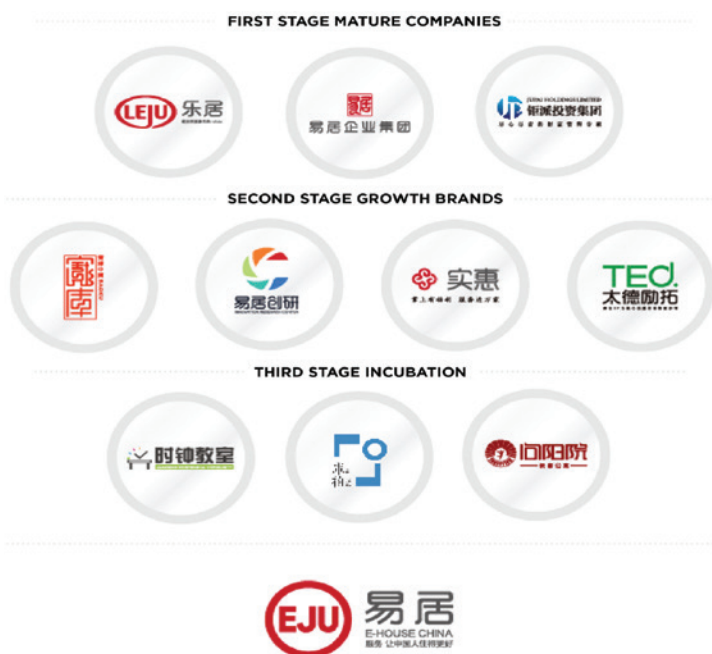
<sup>2</sup> "E-House Enters into Definitive Agreements for Going Private Transaction." April 15, 2016. Accessed February 9, 2018. <https://www.prnewswire.com/news-releases/e-house-enters-into-definitive-agreement-for-going-private-transaction-300252143.html>.

<sup>3</sup> "E-House China's 10 service-focused brands" Accessed February 9, 2018. <http://www.ehousechina.com/cn/service/index.html>.



The first category includes relatively mature brands such as E-House Corporate (a leading real estate transaction services provider leveraging big data analytics), LEJU (NYSE: LEJU), a leading online-to-offline or O2O real estate services provider in China, and Jupai Holdings (NYSE: JP), a wealth management product and advisory services provider. The second category is comprised of brands experiencing rapid growth, such as Baoku China, the E-House Innovative Research Center (an organization dedicated to internet-based innovative product research and development), EJU-Shihui (a one-stop service platform for residential communities) and EJU-Ted (an integrated public relations and media services platform for real estate). The last category includes companies that are still in incubation, including 51 Shizhong (an educational service platform for the sharing economy), Ku Pai (an interactive auction platform focused on creating a transaction ecosystem), and Sunny View (a high-end senior living facility).

**Exhibit 1: E-House Strategic Positioning 2017**



## Baoku China Business Overview

Founded in 2012, Baoku China has three pillars of value creation. The first pillar, Baoku Treasury, provides the world's largest private vault for customers to store their fine art in safe boxes ranging from small to high-end spaces. Its storage facilities are certified by UL or Underwriter Laboratories Inc. The second pillar, Baoku Museum, is a private museum format showcasing traditional Chinese art. The third pillar, Baoku Art Centers, are experiential art spaces designed to accommodate gallery exhibitions and private parties.<sup>4</sup> The platforms where Baoku products can be found are divided into two types: Baoku in Landmarks, referring to its art partnership with landmark buildings, and Baoku in Communities, which refers to art galleries, storage facilities, and event spaces embedded in local communities.

Baoku is an important part of E-House's strategic plan, which aims to diversify revenue streams, while continuing to pursue new ground for the real estate services industry. An art-centric platform is certainly one way to do so.

## Market Overview: The Evolution of Cultural Integration in Real Estate

Cultural integration in Chinese real estate can be traced back to the late 1990s. Initially, the concept referred to a promised lifestyle rather than to the provision of art, and its aim mostly was to facilitate real estate sales and marketing. It came on the heels of the housing market crash in the early 1990s. Housing demand in China, in turn, went through fundamental changes, shifting from narrowly focusing on future living needs to focusing on the amenities of the building and the quality of its surrounding neighborhood. Against this macro market backdrop, real estate developers thus shifted towards 'lifestyle creation' to promote their projects, predominantly in residential properties. To attract potential buyers, these developers positioned their properties as more than just a home purchase. It became a 'lifestyle' choice.

<sup>4</sup> "Baoku China Website." Accessed February 10, 2018. <http://www.baokuchina.com/en>.

Developers subsequently built upon this cultural concept and further explored value creation opportunities through deeper cultural integration in areas such as urban planning and design, construction, amenities and services as well as community development. The evolution of cultural integration in real estate, as such, was driven by the need of developers to differentiate.

The development of cultural integration in real estate projects is comprised of three distinct stages.<sup>5</sup> In the first stage of the development, consumer needs were primarily focused on space. Development projects during this stage were more focused on scale and quantity, and lacked comprehensive planning and post-sale services. The residential properties developed during this period tended to have virtually the same architectural styles and fewer amenities. The second stage of development focused on the quality of living through the creation of multi-functional lifestyle communities, but remained predominantly in residential. Developments during this stage sought unique architectural styles and building layouts as well as differentiated functions and amenities.

The last stage of the development moves past the basic needs for space and amenities, and focuses on cultural aspects beyond building design and development. Faced with increasingly fierce competition, developers adapted their development approach to differentiate against one another and began to incorporate cultural elements to satisfy customer demand beyond the material level. This is the latest form of ‘cultural integration’ in real estate, and has been applied to all major property types. These projects generally have a very clear cultural concept, a well-developed service system and an active ‘eat-live-play’ community. Through the integration of culture, real estate, and productivity, these projects help create a mutually beneficial relationship between businesses and the underlying real estate.

## Forms of Culture-driven Real Estate Development

Over the past decade, there have been plenty of cases successfully integrating culture and real estate, especially in the last stages. They have distinct business models that involve different resources and product types. From a business model perspective, there are primarily four types of culture-driven real estate projects. They are (1) art-driven; (2) commerce-driven; (3) cultural heritage-driven and (4) innovation-driven.

### Art-driven business model (or the museum model).

Dilapidated factory buildings are converted into galleries, creative spaces, offices and restaurants based on functional needs. These developments are anchored in art and elevate consumer demand from ordinary shopping and entertainment to the need for art and culture, thereby transforming the corresponding neighborhood and increasing the underlying property value. The success of this business model is predicated on the idea that the presence of art will enhance the overall project value so as to subsidize the cost of operations and initial capital investment.

This type of business generates profit through real estate development, property management, commercial business development and corporate sponsorship. A good example of this business model is the 798 District in Beijing. It fully leveraged the unique architectural style of the original German Bauhaus-style factories and converted them into a contemporary art district with creative studios, galleries, fashion shops, restaurants and bars. Over 300 artists live in or near the district and the agglomeration effect has further improved the desirability of the community, creating a virtuous cycle. Baoku China falls squarely into this art-driven model.

**Commerce-driven business model.** Often seen in creative businesses and tourism, such projects generally have a development and operational model of ‘streets + culture + commerce + leisure’ to convert

5 谢成龙《文化地产的定位与规划》2015年三月一日 Xie Chenglong “The Positioning and Planning of Culture-Driven Real Estate.” March 1, 2015. Accessed February 10, 2018. <https://cread.jd.com/read/startRead.action?bookId=30201960&readType=1>.

an entire building complex and to stimulate commercial development. The core of this business model is striking the right balance between historic building preservation and commercial development. A representation of this business model is the City God Temple of Shanghai. Other similar projects include Xintiandi in Shanghai, and the Wide and Narrow Alley in Chengdu. Profits from these large-scale development projects not only come from real estate capital appreciation and tourism consumption, but also from value creation through the transformation of the entire neighborhood.

### Cultural heritage-driven business

**model.** Seeking to integrate local cultural traditions and heritage into real estate development, this business model focuses on preserving historically significant towns and leveraging historic resources to enhance value proposition of development projects. Successful projects in this category include Liangzhu Cultural Village in Hangzhou and Lijiang Old Town in Yunnan.

### Innovation-driven business model.

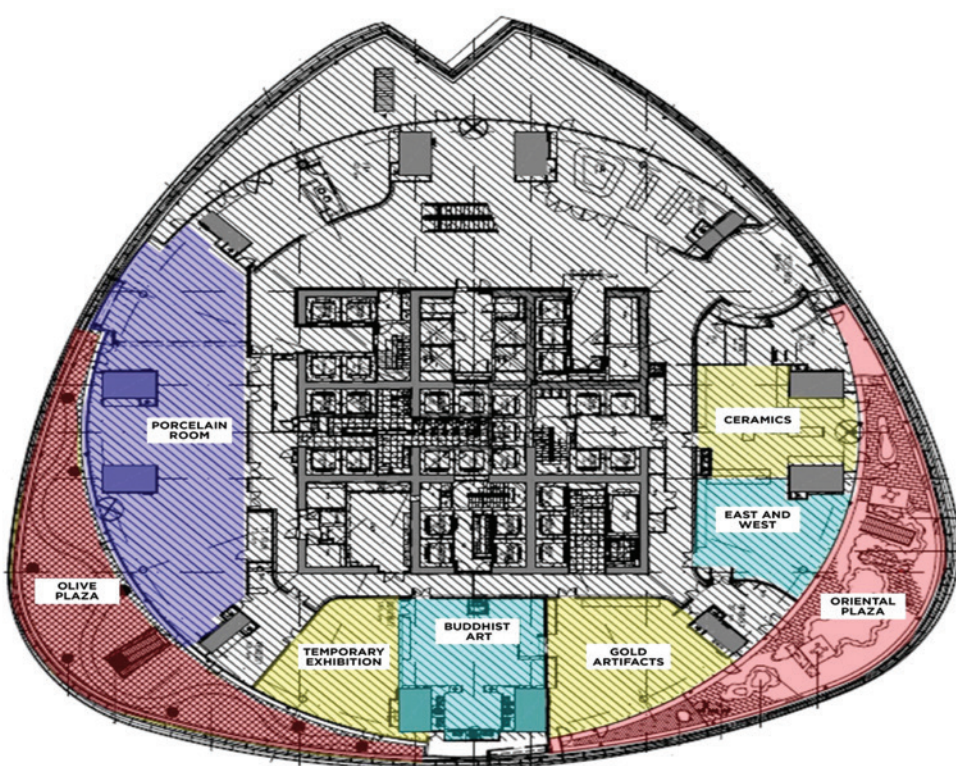
This business model focuses on discovering creative elements in the value chain and positioning a real estate project based on these specific cultural themes. For example, the Overseas Chinese Town in Shenzhen is an entertainment destination that features four theme parks including Splendid China, Fold Culture Village, Window of the World and Happy Valley, each with a unique cultural angle.

## Analysis of Baoku's Business Model: The Case of the Shanghai Tower Project

Any art-centric platform faces two core operational challenges: high initial capital investment and the

likelihood of low profit margins at the outset. To address this dilemma and generate additional revenue stream, Baoku China decided to include professional storage services along with its art offerings. To explore this value-creation strategy, we examine its flagship project, Baoku Shanghai Tower, which officially launched in mid-2016. The project has three components: Baoku Treasury #1 (its storage facility), Baoku Art Center, and the private Shanghai Guanfu Museum (Exhibit 2).

Exhibit 2: Baoku Shanghai Center Layout



- **Baoku Treasury #1** is the brand name for Baoku's underground vault for high-end storage services, and is located in basement level 5 in Shanghai Tower. By converting space traditionally used for parking into a more profitable storage facility, Baoku was able to maximize the real estate value of the underground space in a creative way. Moreover, the physical qualities of the Shanghai Tower's mat-slab foundation — which is six meters thick — signals to consumers the resiliency of the facility protecting their



valuables.<sup>6</sup> Additionally, the storage facility is certified by UL (Underwriter Laboratories Inc.), and has been designed and continues to be managed according to museum standards. As such, it is one of the few places in China where a growing community of high-net worth individuals can store their art collections when they are not on display. To accommodate different needs for storage services, Baoku offers five different sizes of storage products to its members (Exhibit 3).

Membership, however, is by no means inexpensive. To start, customers need to pay an upfront 15-year membership fee and additional annual management fees. The smallest safe box, measuring 127 x 286 x 600 millimeters, costs 68,888 RMB (about USD \$10,300) for 15 years.<sup>7</sup> In addition to Baoku Treasury's storage facilities, members are also eligible for free museum visits and exclusive cultural events.

**Exhibit 3: Baoku Treasury Storage Product Offerings<sup>8</sup>**

MEMBERSHIP	COMPARTMENT SIZE (height x width x depth in millimeters)	MEMBERSHIP FEE (RMB)	ANNUAL MGMT FEE (RMB)
Gold	127*286*600	68,888	480
Platinum	256*286*600	98,888	660
Black	388*286*600	148,888	1,000
Diamond	740*385*600	268,888	2,400
VIP	1,160*385*600	398,888	3,000

Besides serving as an additional revenue stream, Baoku Treasury is also a means of attracting a specific type of clientele. Most high-end auction houses, for example, also have storage facilities. As such, having a storage facility as part of an art-enabled real estate services platform enables Baoku to continue to develop its brand through related activities, such as auctioning. From a market-entry perspective, a recent

survey on storage inventory in Shanghai's Lujiazui Financial District shows that there are fewer than 30,000 storage boxes in the area, of which more than 20,000 are owned by large institutional banks with a relatively high occupancy rate.<sup>9</sup> Given growing wealth in this major metropolis, there is likely pent-up demand for this service. Indeed, within a week of launching its private vault, Baoku sold one third of its 10,000 safety boxes.<sup>10</sup> Baoku markets itself as safer than bank storage facilities, and is unmatched in the distinctive features of its location and security protocols.

Baoku is not the only player in this market, however. There are a handful of better-known brands, such as Trojans Art, Helu-Trans, BA Culture and Crown Relocations, but the market remains highly fragmented with different brands operating in some locations but not others. Baoku is no different. It launched in Shanghai, and intends gradually to expand to other Tier 1 cities. But given the nature of the business, it is not likely that a national player will emerge anytime soon. At least, Baoku is different from its competitors in that it is able to leverage the E-House platform to acquire new customers, identify locations for expansion based on data analytics, and ultimately take advantage of market fragmentation.

- **Baoku Art Center** is an experiential art space located on the 37th floor of Shanghai Tower. The space is designed to house art exhibitions and parties. The center has two rooftop gardens — one cultivated in the traditional Chinese style and the other in the European style — and also a porcelain room with the largest cloisonné floor in the world. The Chinese garden is a representation of the Ming Dynasty Gardens and showcases traditional Chinese landscape architecture. The European-style garden, also called the Olive Plaza, combines eight different stone columns with eight different ancient languages

<sup>6</sup> E-House Internal Report, Baoku Appendix - Page 3.

<sup>7</sup> <http://www.sixthtone.com/news/1040/what%20s-lurking-vaults-beneath-shanghai-tower>

<sup>8</sup> E-House Internal Report, Baoku Appendix - Page 3.

<sup>9</sup> E-House Internal Report, Baoku Appendix - Page 2.

<sup>10</sup> [http://usa.chinadaily.com.cn/business/2016-03/19/content\\_23957481.htm](http://usa.chinadaily.com.cn/business/2016-03/19/content_23957481.htm)

to represent the lost civilizations of the world. The porcelain room has a cloisonné floor that measures more than 480 square meters — a Guinness World Record — and is a critical piece in Baoku's cultural innovation.

The Baoku Art Center is an important medium for Baoku's integration within the Shanghai Tower. The rooftop gardens showcase distinct architectures and cultural heritages, while the porcelain room has become an event space for cultural events, fashion shows and gallery exhibitions, all of which generate revenue.

- **The Guanfu Museum** was founded in 1997 in Beijing and is the first private museum in China. In 2016, it opened an outpost in the Shanghai Tower. The Baoku team selected the museum for its flagship project in the tower largely due to the arts collections, which are primarily traditional Chinese artifacts and quite fitting for the company's cultural themes. Moreover, the choice of the Guanfu Museum links Baoku to the strong, and well-established personal brand of Ma Weidu, a well-respected Beijing-based art collector.<sup>11</sup> He founded the Guanfu Museum, which now has several branches across China.

The museum is also located on the 37th floor of Shanghai Tower, and shares some amenities with the Baoku Art Center. Visitors can enjoy five distinct galleries of Chinese antiquities: ceramics, gold, Buddhist art, furniture and silk. In the adjacent and separately managed café, which is set in a huge atrium, visitors can sit back and enjoy the entire Shanghai skyline through Shanghai Tower's 'double-skin façade' after the exhibitions. Guanfu Museum, together with the Baoku Art Center, provide a diverse set of art forms and help position Shanghai Tower as a multi-functional center for commerce, culture and leisure. The museum is the first step of Baoku's push for collaboration with more private museums in its other landmark projects. Through its private museum business, Baoku generates revenue from exhibition

tickets, guided tours, souvenir sales as well as Baoku membership fees.

The success of Baoku in the Shanghai Tower has demonstrated the viability of its three-pronged business model: Baoku Treasury serves largely as a commercial line of business, with confirmed revenue streams from the 15-year contracts its members must pay outright; the Baoku Art Center and Guanfu Museum represent the cultural aspect of the business — they are the core of Baoku's operations. As these are available for public use, they help to advance the real estate value of the Shanghai Tower. They also generate revenue streams, inclusive of space rental fees, museum exhibitions fees, and management fees.

## Risk and Challenges

Excitement aside, Baoku China is still a young enterprise and may face some operational and growth challenges ahead. To start, the entire business model is predicated on not only the integration of art and culture into physical spaces, but also the assumption that doing so will add value to a property. In other words, the value-add of Baoku is closely linked to some level of pre-existing demand for the services that it provides. Creating new gallery and museum space, moreover, requires a large upfront capital investment with no promise of profit in the short-term. A recent survey conducted by Magnus Resch, author of the book *Management of Art Galleries*, found that 55% of galleries make less than USD \$200,000 in revenue per year, with an average profit margin of 6.5%.<sup>12</sup> Additionally, 30% of the surveyed galleries actually lose money. As such, the burden on Baoku is not only to turn a profit but to increase demand so as to ensure some capacity for scale and sustainable growth.

At present, Baoku Treasury represents the company's largest revenue stream, but barriers to entry in the

<sup>11</sup> <http://www.scmp.com/news/china/article/1266815/curator-ma-weidu-rich-source-antiques>

<sup>12</sup> "Why do So Many Art Galleries Lose Money" July 31, 2015. Accessed February 9, 2018. <https://www.bloomberg.com/news/articles/2015-07-30/why-do-so-many-art-galleries-lose-money->

professional storage service is not high. To be sure, Baoku does have an advantage with regard to the location of its flagship project, the Shanghai Tower. But the company's more profitable clientele are in the arts and culture space, which is a niche market with demanding consumers who expect a top-notch customer experience. As such, there is some risk to brand value if Baoku cannot meet expectations or continues to welcome members from outside this community to sustain its storage business. One alternative might be to split the storage segment to distinguish its art and culture identity further. Another avenue for growth might be to use its own event spaces for art education as a means to build up its customer base and generate additional revenue.

Finally, there are always regulatory risks in dealing with Chinese antiquities and the provision of security services for some of China's ancient treasures. As a hedge, Baoku has aligned itself with entities or people with the best reputations in the business, opting, for example, for UL certification, as well as affiliation with the Guanfu Museum's founder. Neither, however, will matter much should there be more restrictions on private businesses operating in this sector or there arises a failure to protect the goods that Baoku's members have chosen to store with this young enterprise. All to say this: The prospects for Baoku are promising, as long as the company attends to potential threats to its reputation and ability to grow early on. ■