Savills World Research
China

Asian Cities Report
Beijing Office

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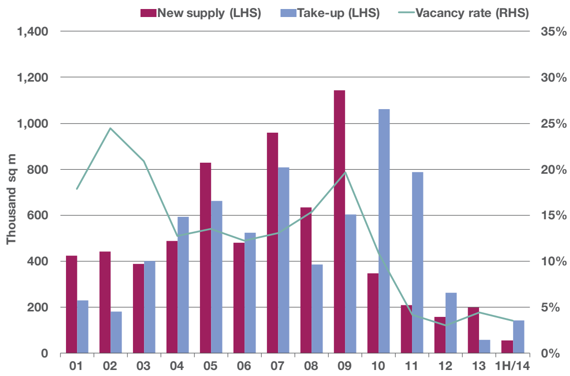
GRAPH 1

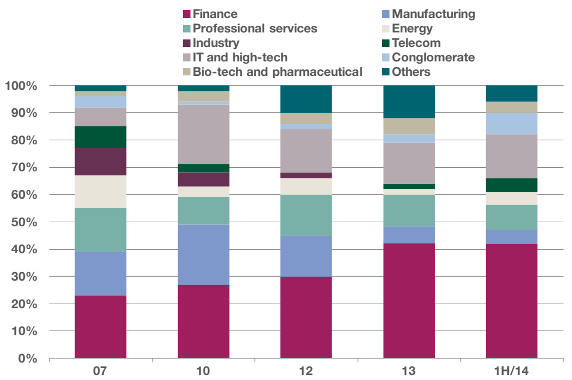
Grade A office supply, take-up and vacancy, 2001–1H/2014



Source: Savills Research & Consultancy

GRAPH 2

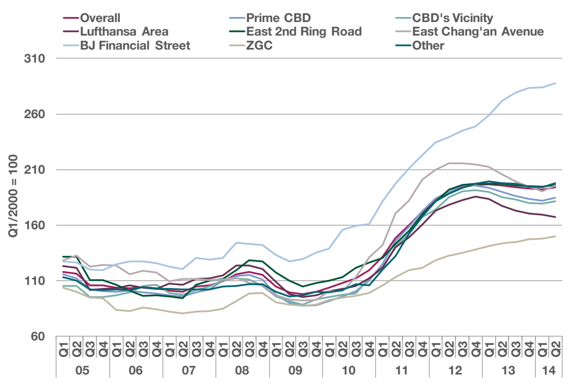
Grade A office leasing transactions by industry, 2007–1H/2014



Source: Savills Research & Consultancy

GRAPH 3

Grade A office rental index by submarket, Q1/2005–Q2/2014



Source: Savills Research & Consultancy

Supply and demand

Following a similar trend witnessed over the past three years, Beijing's Grade A office market continued to receive limited new supply in the second half of 2014. Only one new project was handed over adding an office GFA of 56,000 sq m to the market. As a result, Beijing's Grade A leasable office stock grew to around 9.4 million sq m, remaining the largest market in mainland China.

After a slowdown over the past year, demand began to pick up in 1H/2014 as the stabilised local economy created growing demand from domestic companies, particularly private companies. This was evidenced by net take-up rising significantly to 141,000 sq m in 1H/2014, nearly 2.5 times that of 2013.

Insurance, investment companies and funds were the strongest demand drivers. Meanwhile, due to a promising prospective market performance, e-commerce enterprises showed a greater appetite for expansion. Domestic enterprises continued to dominate market demand, accounting for 77% of the recorded transactions, while demand from overseas companies has been slower in the past few quarters due to tightened budgets for both office rents and headcount.

Consequently, positive net absorption led to city-wide vacancy rates falling a further 0.8 of a percentage point (ppt) year-on-year (YoY) to 3.5%, still the lowest level in the country. Overall, 80% of Grade A office buildings in the city boasted occupancy rates of over 95%.

Rent

Rising demand combined with limited leasable area in the majority of projects reinforced landlords' bargaining power, allowing overall rents to rebound. After consecutive declines over the past 12 months, rents rose by 0.7% half-on-half (HoH) to RMB314.7 per sq m per month, still the highest level in China.

The eastern market[1] witnessed positive performance in 1H/2014. East Chang'an Avenue registered the largest rental appreciation of 3.0%, largely due to the improved performances of certain projects. Meanwhile, CBD rents increased after declines in the past five quarters as this continues to be a major location for the relocation, renewal and initial offices of many overseas and domestic enterprises. The Lufthansa area was the only exception, falling 1.8% despite improved occupancy rates. This was mainly the result of overseas companies with tightened rental budgets accounting for a larger share of tenant profile than any other submarket.

The western market[2] remained stable in the first half of 2014. Beijing Financial Street (BFS) continued to outperform the overall market by commanding the highest rents (RMB510.0 per sq m per month) and occupancy rates (95.0%) in the city while ZGC rental rates were the lowest of any submarket. This was mostly due to the clustering of IT companies and education institutes, all of which have much lower spending power than financial and professional services companies.

Similarly, non-prime markets, such as the Asian and Olympic Games Village, North Third Ring Road and Wangjing areas, also witnessed a rebound in performance after consecutive rental declines over the past four quarters, with rents rising to an average of RMB259.0 per sq m per month. Despite financial and professional services companies staying keen on traditional business districts, many manufacturing, IT and high-tech, e-commerce, and media and cultural enterprises with weaker spending power and stronger consolidation demand continued to look for cost-advantageous offices in non-prime markets.

Leasing market outlook

In the second half of 2014, the Grade A office market is expected to see a surge in supply, with six projects scheduled for handover, adding a total leasable office GFA of 428,000 sq m to the market.

Core business areas are still the preferred locations for expected growing demand. Thus, landlords in prime business districts are expected to continue to hold stronger bargaining power than tenants, allowing rents to largely stabilise in the second half of the year. Projects in non-prime areas, however, will face challenges in terms of both rents and occupancy rates. As a result, city-wide vacancy rates are expected to witness only a moderate rise to about 5%, while overall rents are expected to remain flat at the current high level until the market witnesses another supply peak after 2015.

Investment market

Limited investment stock combined with high rental levels compared to other cities and a large pool of potential tenants continued to strengthen landlord price expectations when disposing of assets. As a result, Grade A office capital values appreciated by 3.5% HoH to RMB63,300 per sq m. Despite rents growing by 0.7% HoH in the first half, Grade A office gross reversionary yields compressed by 6.0 bps HoH to 5.96% by the end of 1H/2014.

The en-bloc sales market was quiet compared with the same period of 2013. Only two en-bloc deals – Pacific Century Place and Tianhe Plaza – were concluded in 1H/2014 for a total consideration of RMB6.1 billion. As a result, total transaction volumes for 1H/2014 only accounted for approximately one-fifth of the total in 2013.

Investment market outlook

Despite several projects currently under negotiation, the en-block sales market is expected to be calm for the rest of 2014 due to the higher than expected prices delaying the process.

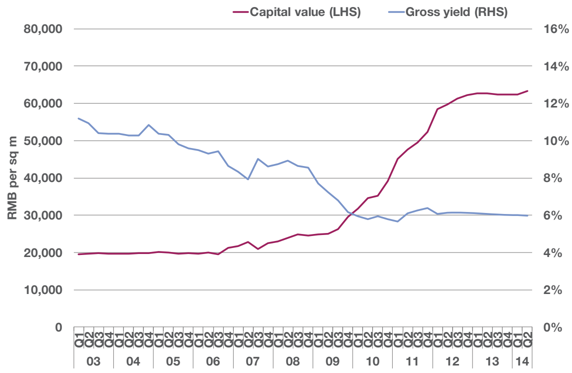
Limited prime investment stock and strong demand from investors are expected to support Grade A office capital values as they continue to grow. Meanwhile, rents are expected to largely stabilise in the second half of 2014, and Grade A office gross yields, as a result, are anticipated to continue to decline moderately to 5.8% to 6.0% by the end of 2014.

Despite this lack of prime investment stock, investors are expected to continue seeking investment opportunities. Several projects are under negotiation; however, the higher than expected prices may delay the process. As a result, the en-block sales market is expected to be calm for the rest of the year.

1 Eastern market refers to CBD, CBD vicinity, East Second Ring Road, East Chang'an Avenue and Lufthansa.
2 Western market refers to BFS and ZGC.

GRAPH 4

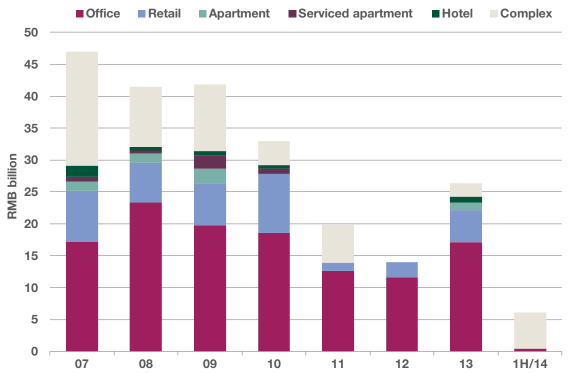
Grade A office price vs yield, Q1/2003–Q2/2014



Source: Savills Research & Consultancy

GRAPH 5

En-bloc sales transaction volumes by property type, 2007–1H/2014



Source: Savills Research & Consultancy

TABLE 1

Major en-bloc transactions,1H/2014

	Pacific Century Palace (盈科中心)	Tianhe Plaza (天和大厦)
Buyer	Gaw Capital	Fangheng Properties
Seller	PCPD	Jing Gong Real Estate
Property type	Complex	Office
Location	CBD vicinity	CBD vicinity
Purchased area (sq m)	169,916	10,079
Sales volume (RMB million)	5,710	400
Unit price (RMB per sq m gross)	33,000	40,000
Purchaser nationality	Overseas	Domestic
Usage	For lease	For lease
Deal structure	Offshore equity	Asset

Source: Savills Research & Consultancy

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