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Savills World Research
China

Asian Cities Report
Dalian Office

2H 2015

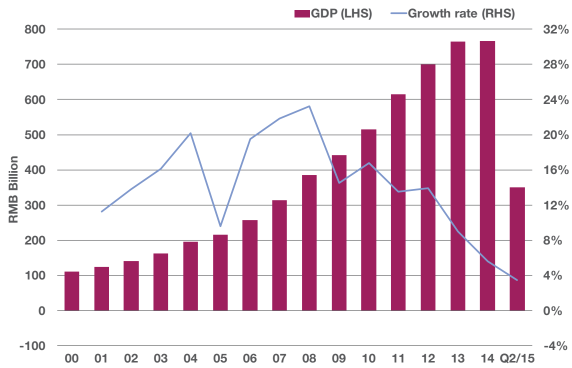
MAP 1

Major business districts in Dalian

Source: Savills Research & Consultancy

GRAPH 1

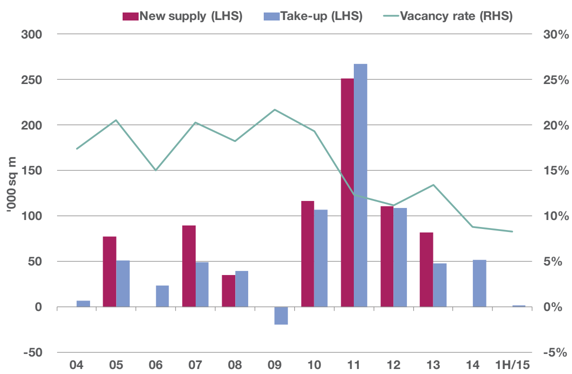
GDP and GDP growth rate, 2000–Q2/2015



Source: Savills Research & Consultancy

GRAPH 2

Supply, take-up and vacancy rates, 2004–1H/2015



Source: Savills Research & Consultancy

Market overview

Dalian is a major seaport city, located on the southern tip of the Eastern Liaoning Peninsula. It is one of northeast China's most important financial and transportation (particularly shipping and logistics) hubs. Due largely to its proximity, Dalian has strong ties to other East Asia countries, such as South Korea and Japan.

Mirroring China's economic slowdown, Dalian's GDP growth also slowed to just 3.5% (RMB350.1 billion) in the first half of 2015. This is 3.5 percentage points (ppts) lower than the national level.

Dalian is the financial centre of northeast China. The Grade A office market of Dalian took off in the mid-1990s to meet the need for high-quality office space from overseas financial, transportation & logistics, IT and trading companies, primarily from South Korea and Japan.

The Dalian Grade A office market is currently divided into four areas, including two traditional business areas and two emerging areas:

Traditional business districts – Renmin Road

As the majority of office stock in this area is out-dated and offers lower-quality facilities, landlords continued to hold less bargaining power in terms of rental negotiations. This was reflected in the area rents remaining largely stable. Renmin Road rents increased 0.2% half-on-half (HoH) to an average of RMB84.0 per sq m per month, up 1.5% year-on-year (YoY). Renmin Road continued to offer the lowest rents in the city but saw strong demand from domestic companies with tighter rental budgets. As a result, vacancy rates in the area were recorded at 1.8% by the end of 1H/2015, remaining the lowest in the city.

Traditional business districts – Qingniwa

Qingniwa area, home to numerous prime office buildings such as the Senmao Building and Xiwang Tower, continued to attract a number of overseas companies. However, amid the local economic slowdown, several landlords of older projects in the area have begun to offer rental incentives to retain and attract tenants. As a result, Qingniwa area rents fell 4.1% HoH to an average of RMB144.9 per sq m per month, down 1.6% YoY. Vacancy rates remained stable at 5.3%, although this is down 0.9 of a ppt YoY.

Emerging markets–Xinghai Square

With new supply for the area in the pipeline, landlords continued to lose bargaining power over tenants. Xinghai Square rents fell 1.3% HoH to an average of RMB152.5 sq m per month, a decrease of 2.8% YoY. Meanwhile, vacancy rates remained relatively stable at 14.3%.

Emerging markets–East Harbor

East Harbor is the eastern extension along Renmin Road and is positioned as a new CBD in Dalian. Given the project's high-quality facilities and services, coupled with the strong affordability of tenants, East Harbor continued to command the highest rents in the city, averaging RMB164.3 per sq m per month, an increase of 7.9% YoY. Strong demand saw vacancy rates continue to drop, down 4.3 ppts YoY to 9.4%.

Stock, supply & demand

No new supply was handed over in the first half of 2015, marking the eighth consecutive quarter of no supply. Consequently, Grade A office stock remained unchanged at 1.1 million sq m. The remainder of the year, however, is scheduled to welcome two new projects with a combined office GFA of approximately 160,000 sq m, the highest half-yearly supply peak since 2012.

The lack of supply in the market continued to place a downward pressure on city-wide vacancy rates, which dropped 0.5 of a ppt HoH to 8.3%, down 1.6 ppts YoY. As a result, Dalian remains the tightest office market among all major second-tier cities.

Given the local economic slowdown, companies continued to remain cautious in terms of expansion plans, resulting in net-take up falling 56.6% HoH to 5,500 sq m.

Rents

Although Dalian Grade A office effective rents bottomed out in 2010, supported by the Chinese economic recovery they increased by an average of 10% per annum to RMB125.0 per sq m per month (exclusive of management fees) by the end of 2012, surpassing pre-crisis levels. This growth was largely supported by the steady expansion of overseas enterprises and domestic companies.

Given weaker demand from company expansions, several landlords offered rental incentives to attract or retain existing tenants, leading to Grade A office rents falling 1.7% in Q4/2013, to an average of RMB123.2 per sq m per month (excluding property management fees), with YoY growth slowing to just 2.5% from the compound annual growth rate (CAGR) of 10.0% between 2010 and 2012.

A shortage of Grade A office supply throughout 2014 has resulted in an upward trend of rents, especially in prime buildings. However, in 1H/2015, slowing demand under economic uncertainties has forced landlords to offer rental discounts to retain tenants. As a result, Grade A office effective rents dropped 1.4% in 1H/2015 to an average of RMB124.8 per sq m per month (exclusive of property management fees). However, this is up 0.5% YoY.

Outlook

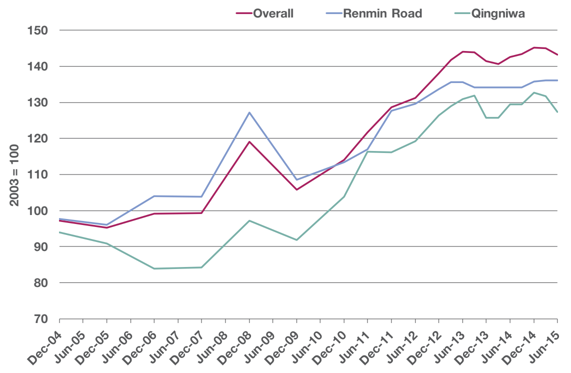
With Eton Centre choosing to continue to postpone its completion date, the second half of 2015 is now scheduled to welcome two new projects with a combined GFA of approximately 160,000 sq m to the market. All of the new supply will be located in Qingniwa area, a traditional business district. With the market experiencing slowing demand, this significant influx of new supply is expected to take a longer period of time to be absorbed, leading to an expected decline in both city-wide occupancy rates and rents in the short term.

The oversupply situation in the office market is expected to be further exaggerated over the next few years, with 12 new projects scheduled to be launched by the end of 2017, pushing total stock to approximately 2.3 million sq m. New supply will be distributed throughout emerging markets, with Xinghai Square and East Harbor accounting for 32% and 68%, respectively, turning them into the largest business areas in the city.

This substantial level of new supply is expected to increase competition in the market, pushing landlords to offer rental incentives. As a result, the market is expected to see continued downward pressure on rents over the next five years until vacant space is sufficiently digested.

GRAPH 3

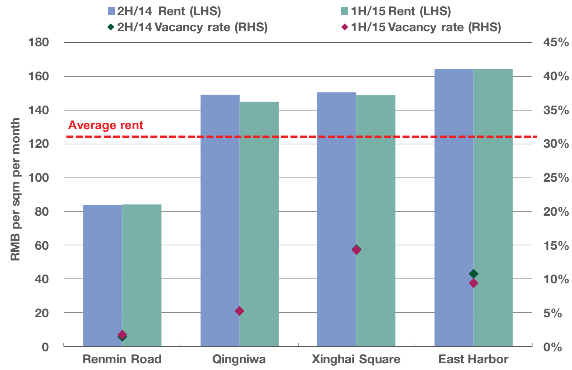
Grade A office rental index, Dec 2004–Jun 2015



Source: Savills Research & Consultancy

GRAPH 4

Grade A office submarket vacancy rates and rents, 2H/2014 vs 1H/2015



Source: HVS Research, Savills Research & Consultancy

TABLE 1

Future supply, 2H/2015

Project	Completion date	Grade	District	Office GFA (sq m)
Eton Center Dalian	2015	A	Qingniwa	80,000
Dalian World Trade Centre	2015	A	Qingniwa	86,000

Source: Savills Research & Consultancy

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