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Savills World Research
Beijing

Briefing
Office sector

December 2013

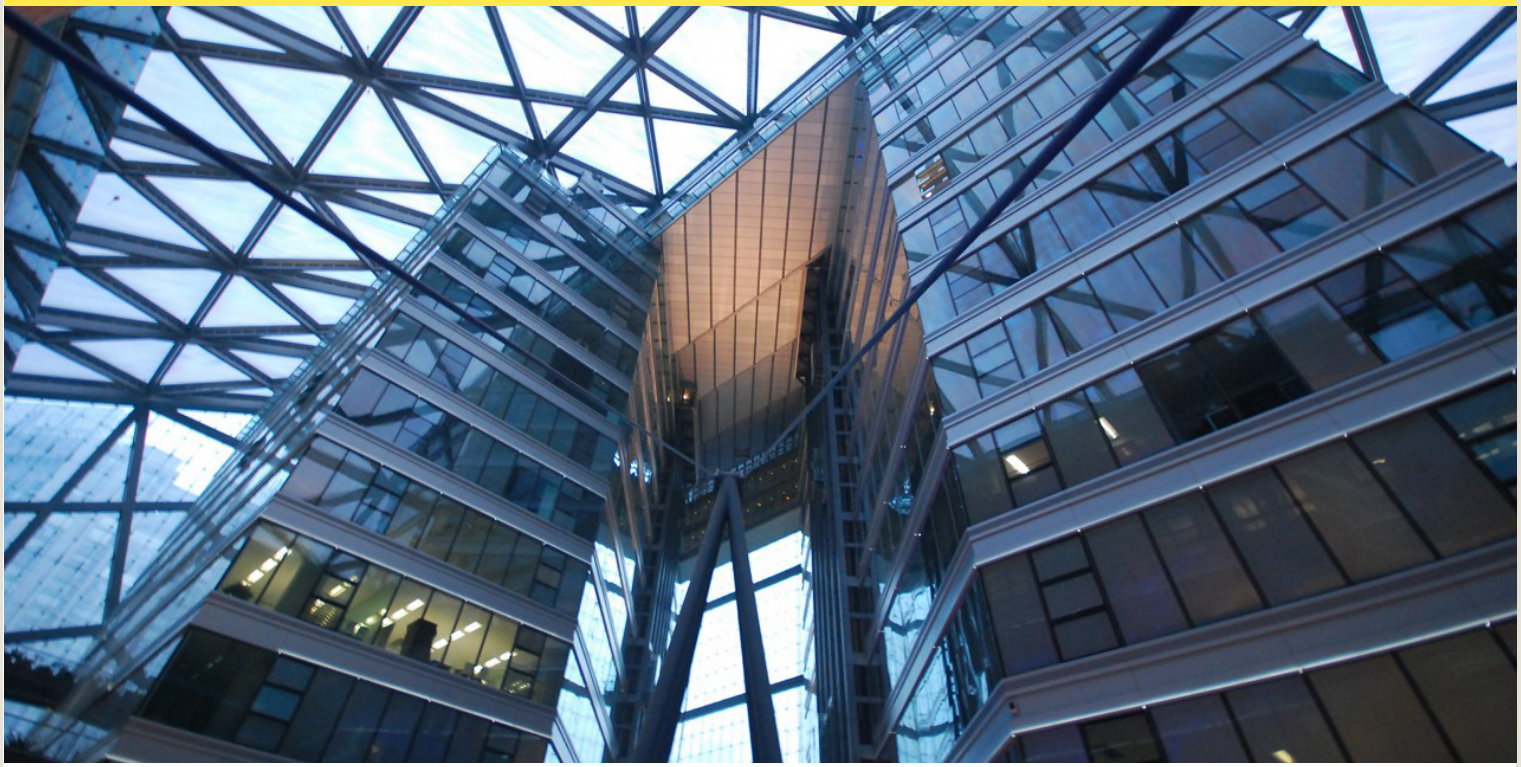


Image: Parkview Green, CBD vicinity, Chaoyang district

SUMMARY

Beijing's CBD welcomed its first leasable supply in over three years, pushing the city-wide vacancy rate up to 4.4%. Effective rents continued to fall as landlords applied discounts in response to weak demand.

- One new project, the 150,000-sq m Fortune Financial Centre, was handed over in Q4/2013, bringing city-wide leasable stock to 9.34 million sq m.
- Net take-up totalled 54,000 sq m in Q4/2013, mainly resulting from pre-leasing activity at the new project. Weak take-up over the rest of the year, however, has led to full-year take-up of only 58,000 sq m, the lowest level seen in a decade.
- Despite stable occupancy rates in existing buildings, the sizable new supply pushed the city-wide vacancy rate up by 0.9 of a percentage point (ppt) quarter-on-quarter (QoQ) to 4.4%.
- Grade A office rents fell for the third consecutive quarter by 0.6% QoQ to an average of RMB313.0 per sq m per month, down 1.6% year-on-year (YoY).
- Nine projects are scheduled to launch in 2014 adding nearly 600,000 sq m of leasable office GFA. The ensuing rise in the city-wide vacancy rate and stronger landlord competition is expected to force rents down by more than 2% by year's end.

"High rents, a slowing economy, and weak demand for expansions and new leases resulted in net take-up falling to a decade low in 2013." Joan Wang, Savills Research

Market commentary

Beijing saw one new project completed in Q4/2013, representing the first leasable supply in the CBD since 2011. The 150,000-sq m Fortune Financial Centre is an international Grade A project. Despite this, leasable supply for the full year of 2013 totalled less than 200,000 sq m, the second lowest level in a decade.

Renewals continued to account for the majority of leasing activity as companies remained conservative about moving or taking on more space which would result in not insignificant capital expenditure. As a result, net take-up in 2013 fell to just 58,000 sq m from an annual average of 705,000 sq m between 2010 and 2012.

Despite the sizable supply launched in Q4, the city-wide vacancy rate remained the lowest in mainland China with nearly 80% of Grade A office buildings boasting occupancy rates of over 95%.

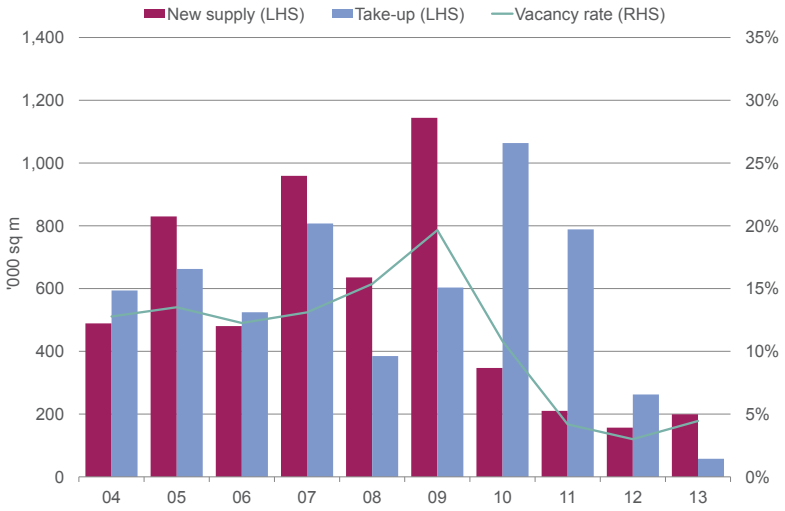
Supply, net take-up and vacancy rate

One new project, Fortune Financial Centre, was handed over in Q4/2013, adding 150,000 sq m of leasable office space to the market, bringing total leasable stock to 9.34 million sq m, up 2.2% YoY. Despite this, limited new supply and tight vacancy rates remained an issue, with only 199,000 sq m handed over for the full year, the second lowest level in a decade.

GRAPH 1

Supply, net take-up and vacancy rate, 2004–2013

Net take-up shrank to a ten-year low due to limited supply combined with slow demand.



Source: Savills Research

TABLE 1

Grade A office leasing market key indicators, Q4/2013

	Stock (sq m)	Vacancy rate (%)	Take-up (sq m)	Supply (sq m)	Rent (RMB per sq m per month)
Q4/2013	9,335,000	4.4	54,000	150,000	313.0
QoQ change (%/ppts)	+1.6	+0.9	-	+206.0	-0.6
YoY change (%/ppts)	+2.2	+1.4	+1.7	+135.1	-1.6

Source: Savills Research

TABLE 2

Major renewal transactions, Q4/2013

Company	Building	Location	GFA (sq m)
Caterpillar	LSH Centre	Wangjing	20,000
Sina	Ideal International Plaza	ZGC	8,000
Samsung Investment	The Exchange	CBD	5,800
Sunshine Insurance	Kuntai International Building	CBD vicinity	4,000
AVL List GMBH	Gateway Plaza	Lufthansa	2,300
Sumitomo Pharma	Raffles City	East Second Ring Road	2,200

Source: Savills Research

Fortune Financial Centre

Fortune Financial Centre, also known as Fortune Centre Phase 3, was developed by HKI China Land to international Grade A standards and was handed over in October 2013. The project, with a total office GFA of 150,000 sq m, was the first leasable supply in the CBD for three years. Given its prime location and high-quality specifications, several large tenants, such as HSBC, DBS, CDH Investments and China Zhongwang Holdings, have pre-committed at Fortune Financial Centre.

Net take-up rose to 54,000 sq m in Q4/2013, up from the 18,000 sq m handed back to the market in Q3/2013. Net take-up primarily resulted from pre-commitment in the newly completed project. Consequently, net take-up totalled 58,000 sq m for the full year of 2013, just 29% of supply and the lowest net take-up seen for a decade.

Given that many leases were signed in 2010 and 2011 just when rents were starting to rise rapidly, and that the typical lease is three years, many of these leases are now expiring. The majority of tenants are deciding to renew their existing premises as there are few alternative options, current landlords are willing to offer discounts to market rent to retain key tenants, and tenants are averse to spending on new fit-outs at a time of market uncertainties. Several prime buildings located in core business areas, such as CBD, Lufthansa and Beijing Financial Street (BFS), have been able to retain

more than 80% of tenants whose leases have expired in recent quarters.

Financial, manufacturing, IT and high-tech, and professional services companies were the major demand drivers in Q4/2013, collectively accounting for over 80% of recorded transactions. Overseas companies accounted for a higher proportion (46%) of transactions compared with the previous three quarters, although domestic companies continued to account for the lion's share of leases.

The city-wide vacancy rate rose by 0.9 of a ppt QoQ to 4.4%, as newly completed projects recorded lacklustre pre-commitment levels. Despite this, Beijing still has the lowest vacancy rates among any city in mainland China, leaving many tenants with no choice but to renew.

Rent

Landlords offered either a discount to face rents or longer rent-free periods to compete for or retain quality tenants. Effective Grade A office rents fell for the third consecutive quarter, decreasing by 0.6% to RMB313.0 per sq m per month, down 1.6% YoY.

Eastern markets[1] continued to take a lead in rental declines, with CBD and its vicinity recording the largest falls of 1.6%. In contrast, western markets[2] continued to see rental appreciation, with BFS and Zhongguancun (ZGC) – the most and least expensive submarkets respectively – recording a growth in rents of 1.4% and 1.8% respectively.

1 Eastern markets include the CBD, CBD vicinity, Lufthansa, East Second Ring Road and East Chang'an Avenue.

Submarket rents and vacancy rates

Traditional business districts

The CBD welcomed its first new project for three years concurrent to a peak in lease expiries, forcing landlords in the vicinity to offer rental incentives to retain their tenants. As a consequence, CBD rents fell by 1.6% QoQ to RMB355.7 per sq m per month, down 6.2% YoY. Given a relatively low occupancy in Fortune Financial Centre, the CBD vacancy rate climbed by 4.6 ppts QoQ

2 Western markets include BFS and ZGC.

TABLE 3

Major new-lease transactions, Q4/2013

Company	Building	Location	GFA (sq m)
Renren.com	Eagle Run Plaza	Lufthansa	7,000
Sino Hydro Group	Hanwei Plaza	CBD	2,600
Stryker	Ping'an IFC	Lufthansa	2,500
Minsheng Financial Leasing	Office Park	CBD	2,500
Beijing Bank	China World Tower	CBD	2,100
Maslink	Oriental Plaza	East Chang'an Avenue	1,700

Source: Savills Research

TABLE 4

Future supply, 2014

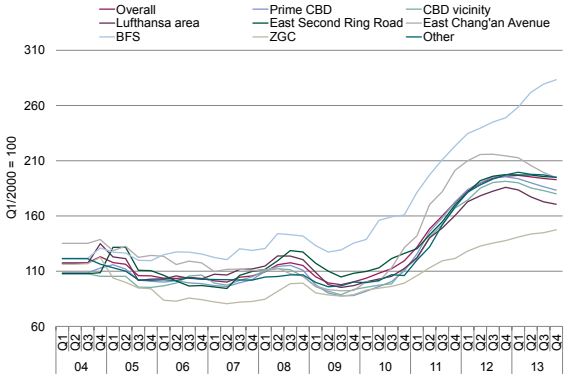
Project	Completion	Submarket	Leasable office space (sq m)	Self-use space (sq m)
ZGC Internet Financial Centre 中关村互联网金融中心	Q1	ZGC	51,000	-
Ocean International Centre II Tower 1 远洋国际中心二期1座	Q1	CBD vicinity	33,000	-
Ocean International Centre II Tower 2 远洋国际中心二期2座	Q1	CBD vicinity	22,000	-
Posco Centre 浦项中心	Q4	Wangjing	89,000	15,000
Raycom Infotech Park - Tower B 融科资讯中心B座	Q4	ZGC	58,000	-
SOHO Peaks Tower 3 银峰SOHO3座	Q4	Wangjing	124,000	-
Guanghualu SOHO II 光华路SOHO2号	Q4	CBD	63,000	-
Plot E9 金融街E9	Q4	BFS	57,000	-
Plot E9A/B 金融街E9A/B	Q4	BFS	74,000	-

Source: Savills Research

GRAPH 2

Grade A office rental indices, Q1/2004–Q4/2013

Eastern market rents continued to fall while western market rents largely stabilised.

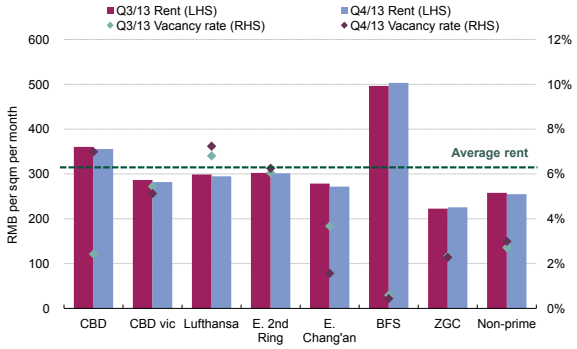


Source: Savills Research

GRAPH 3

Submarket rents and vacancy rates, Q3/2013 vs Q4/2013

Most submarkets witnessed stable or improved occupancies except for the CBD.



Source: Savills Research

to 7.0%, up 4.5% ppts YoY, despite occupancy rates remaining largely unchanged in existing buildings.

BFS continued to outperform the market in both rents and occupancy rates as a continuous shortage of supply was combined with strong demand from domestic financial enterprises. BFS rents grew by 1.4% QoQ to RMB503.1 per sq m per month, up 13.9% YoY, while vacancy rates fell by 0.2 of a ppt to 0.4%, the lowest in the city.

Non-prime markets

Landlords in non-prime markets have been losing their cost advantage in recent quarters as their counterparts in traditional business districts have become more flexible on rents. Non-prime rents fell for the third consecutive quarter by 1.2% QoQ to RMB254.8 per sq m per month, down 1.2% YoY. Meanwhile, non-prime vacancy rates rose 0.3 of a ppt QoQ to 3.0%, as fewer leading companies are considering relocating, given the 10% to 30% rental discounts by prime landlords, fit-out/relocation costs and staff turnover.

Wangjing rents fell for the first time in the past three and a half years by 2.9% QoQ to RMB228.4 per sq m per month, although still up 3.2% YoY. Over the next two years, annual supply is expected to be close to 195,000 sq m, with nearly half of projects launching on the strata-title sales market which will result in rising competition going forwards. With some tenants moving to lower grade projects, vacancy rates rose by 1.2 ppts QoQ to 1.5%, but this was still the second lowest level in the city.

Despite falling occupancy rates and rents, Wangjing is still one of the most highly sought-after business areas in the city by many manufacturing, IT and high-tech, and telecom companies, given its mature infrastructure, residential communities and retail ambiance, as well as the 16% to 36% rental discounts to Beijing's other eastern submarkets. This was evidenced by the fact that Hewlett-Packard, the American IT and high-tech giant, pre-committed to 50,000 sq m in an under-construction development, with the company expected to relocate from the CBD in 2016 once the project is completed. ■

OUTLOOK

Supply is expected to pick up in 2014, putting downward pressure on both occupancy rates and rents.

■ The under-supply situation seen in the past three years (with annual supply averaging just 189,000 sq m) is expected to end in 2014, as nine projects are scheduled to be handed over to the market, bringing with them a total leasable supply of 571,000 sq m. Sixty percent will be in the eastern markets, with Wangjing accounting for nearly 40% of this amount.

■ Given the continuing economic uncertainty, rental budgets are expected to remain tight and headcount expansion conservative, resulting in weak demand. This, combined with a pick-up in supply, is expected to push the city-wide vacancy rate up to between 5% and 8%, while effective rents should fall by more than 2% as landlords continue to offer rental discounts.

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