Briefing
Office sector

July 2015

Image: ZGC core area, Haidian District, Beijing

SUMMARY

Grade A office rents began to fall though city-wide occupancy rates largely stabilised, with eastern markets taking a lead in rental compression.

- One new project entered the market in Q2/2015, contributing an additional 61,000 sq m of office GFA to the market. As a result, Grade A office leasable stock increased to 9.94 million sq m, remaining the largest office market in Mainland China.

- Despite new supply, net take-up decreased to 68,500 sq m in Q2/2015, just half of that seen last quarter.

- City-wide vacancy rates fell 0.1 of a percentage point (ppt) to 4.1% quarter-on-quarter (QoQ), largely attributable to the further digestion of vacant space in recently-launched projects, combined with landlords continuing to offer rental incentives to both attract and retain tenants.

- Grade A office rents witnessed a decline after four consecutive quarters of growth. Overall rents were down 0.3% to RMB319.1 per sq m per month by the end of Q2/2015.

- The Grade A office market will welcome an influx of supply, with seven new projects scheduled for handover in the second half of 2015, adding a total leasable office GFA of 360,000 sq m. With non-prime locations scheduled to receive approximately half of this new supply, it is expected to further fuel the decentralisation trend of the market.

"With the remainder of 2015 scheduled to welcome seven new projects, city-wide occupancy rates and rents are both anticipated to continue to fall." Jack Xiong, Savills Research & Consultancy

Supply, net take-up and vacancy rate

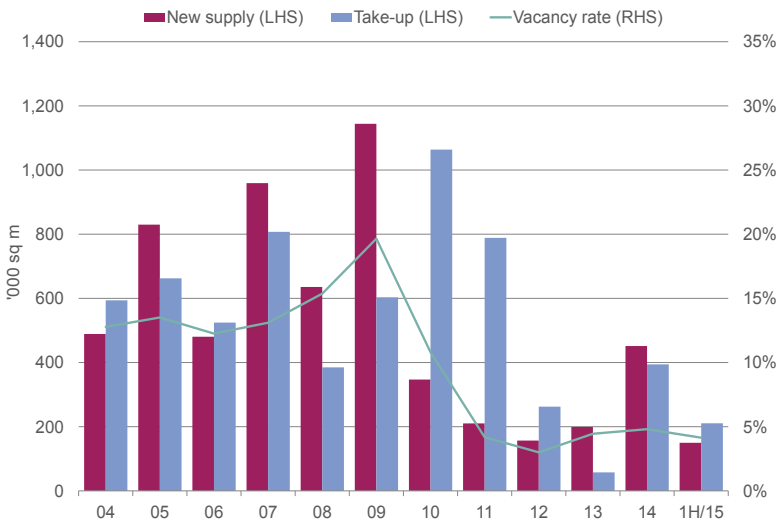
Poly International Plaza T1 (保利国际广场塔1), developed by Poly Real Estate, is located in Wangjing and launched in late June 2015, contributing 61,000 sq m to the market. As a result, Grade A office leasable stock increased to 9.94 million sq m, remaining the largest office market in mainland China.

After consecutive growth over the last three quarters, net take-up fell 51.8% QoQ and 21.8% year-on-year (YoY) to 68,5000 sq m in Q2/2015, despite new supply. This is a reflection of slowing demand under economic uncertainties. Non-prime markets contributed the largest net absorption volume in the last four quarters, accounting for 55% of the total in this quarter.

Financial and IT & High-Tech companies continued to be the strongest demand drivers for Grade A office space, accounting for 48% of all recorded transactions. After the manufacturing industry experienced a period of contraction, companies posted positive growth this quarter, registering 11% of the total demand. This was largely attributable to a number of large-sized transactions, of which food and electrical manufacturing companies dominated. Domestic companies continued to dominate demand, contributing 63% of recorded transactions in Q2/2015.

GRAPH 1

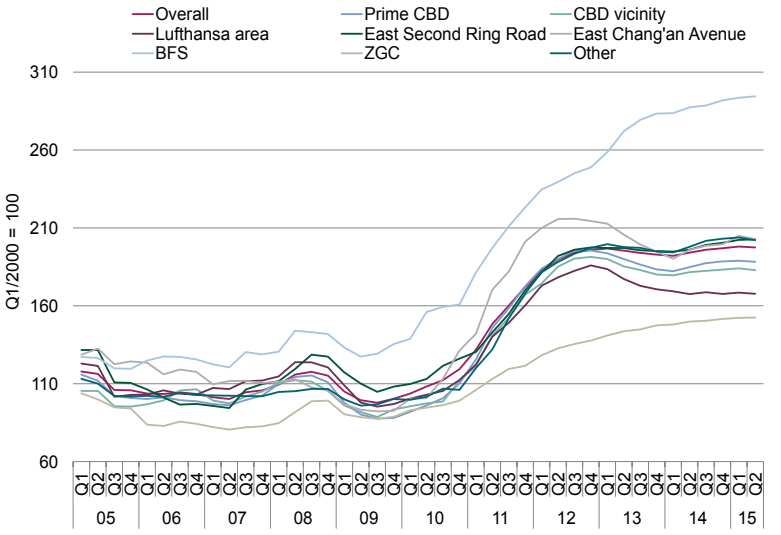
Supply, net take-up and vacancy rate, 2004–1H/2015



Source: Savills Research

GRAPH 2

Grade A office rental indices, Q1/2005–Q2/2015



Source: Savills Research

TABLE 1

Grade A office leasing market key indicators, Q2/2015

	Stock (sq m)	Vacancy rate (%)	Take-up (sq m)	Supply (sq m)	Rent (RMB per sq m per month)
Q2/2015	9,936,000	4.1	68,500	61,000	319.1
QoQ change (%/ppts)	+0.6	-0.1	-51.8	-31.1	-0.3
YoY change (%/ppts)	+5.8	+0.6	-21.8	+9.4	+1.7

Source: Savills Research

City-wide vacancy rates stabilised at 4.1%, despite new supply entering the market. This was largely attributable to a further digestion of vacant space in recently-launched projects, highlighted by transactions with Fortune Financial Centre in the CBD area, World Profit Centre in Lufthansa, Dreamfont 35th in BFS and Posco Centre in the Wangjing area. Beijing Financial Street is still host to the lowest vacancy rate in the city at just 1.9%, while other traditional business areas also recorded low vacancy rates ranging from 2.2% to 6.3%.

Rents

Grade A office rents fell after witnessing four consecutive quarters of moderate growth, with overall rents down 0.3% QoQ to RMB319.1 per sq m per month by the end of Q2/2015. Most traditional areas in eastern markets witnessed rental declines ranging from 0.3% to 1.1%, while BFS and ZGC, located in western markets, saw stable rents.

By submarket, East Chang'an Avenue rents dropped 1.1% in the second quarter of 2015, the largest decline across all submarkets. BFS and the CBD continued to command the highest rents at RMB523.0 and RMB363.4 per sq m per month, respectively.

Submarket rents and vacancy rates

Traditional business districts

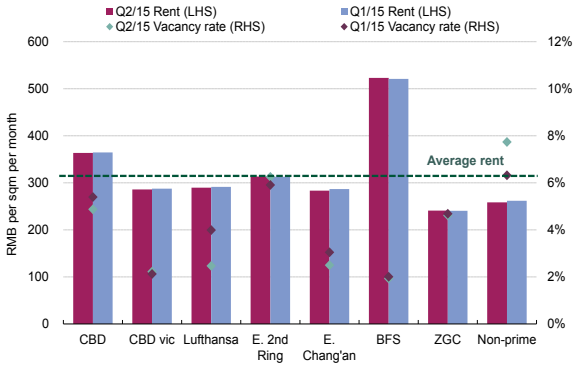
There was no new supply in traditional business districts in Q2/2015, with the total GFA remaining at 8.5 million sq m. As a result, the majority of the traditional business districts experienced a drop in vacancy rates, with the exception of CBD Vicinity and East Second Ring Road, which posted slight increases of 0.1% and 0.3% respectively. With two new projects scheduled to enter into the CBD Vicinity in Q3/2015, vacancy rates are expected to increase in the short term.

The CBD continued to remain one of the most popular locations for many overseas corporations and leading domestic companies, due to a clustering effect and ease of access. However, CBD rents fell 0.3% QoQ to RMB363.4 per sq m per month due to landlords offering rental incentives to retain quality tenants. Vacancy rates witnessed a decrease of 0.5 of a ppt QoQ to 4.9%.

In contrast with the rental declines of most traditional business areas in eastern markets, both rents and occupancy rates remained stable in western markets due to a continued lack of new supply combined with stable demand.

GRAPH 3

Submarket rents and vacancy rates, Q1/2015 vs Q2/2015



Source: Savills Research

TABLE 2

New supply, Q2/2015

Project name	Poly International Plaza T1
	
Location	Wangjing
Completion date	Q2/2015
Landlord	Poly Real Estate
Grade	Grade A
Leasable office GFA (sq m)	61,000
Floor plate (sq m)	2,000
Asking rent (RMB per sq m per month)	300
PM fee (RMB per sq m per month	33

Source: Savills Research

TABLE 3

Major leasing transactions, Q2/2015

Company	Building	Location	GFA (sq m)	New lease/renewal
EPSON	China Central Place	CBD	7,000	New lease
Yucheng Group	World Finance Center	CBD	4,400	New lease
SUMITOMO	China World Tower 3	CBD	3,400	Renewal
Koolearn	Metropolis Tower	ZGC	2,800	Renewal
Huarong Rongde Asset	Winland Intl Financial Centre	BFS	2,400	Expansion
CFLD	Gateway Plaza	Lufthansa	2,300	Renewal

Source: Savills Research

Specifically, BFS saw rents continue to increase by 0.3% QoQ to an average of RMB523.0 per sq m per month by the end of Q2/2015, while vacancy rates stabilised at 1.9%, still the lowest among each submarket. With the completion of the Asian Infrastructure Investment Bank (AIIB) Headquarters Building in the second half of 2015, and limited leasable supply over the next three years, it is expected that BFS will see continuous growth in both rents and occupancy, supported by sustained demand from financial companies.

Meanwhile, ZGC continued to show a positive trend, with rents growing 0.1% QoQ to an average of RMB241 per sq m per month, representing a 1.7% YoY appreciation. Strong government support for the IT and high-tech sector has fuelled strong demand for the area, resulting in vacancy rates dropping 0.1 of a ppt QoQ to 4.6%.

Non-prime markets

Along with the continuous supply from the Wangjing area, vacancy rates in non-prime markets rose 1.4 ppts QoQ to 7.7% by the end of Q2/2015, up 5.2 ppts YoY. Meanwhile, given the rental decreases in traditional business areas,

TABLE 4

Future project focus, Q3/2015

Project name	AVIC Plaza I	Air China Century Plaza	Damei Central Plaza Tower 1	Borui Building II
				
Location	ZGC	Lufthansa	CBD's Vicinity	CBD's Vicinity
Owner	AVIC	Air China Group	Damei Investment	Yongjia Group
Office GFA (sq m)	52,000	78,000	39,000	19,000
Floor plate (sq m)	Approx.3,000	3,260	2,000	1,679
Asking rent (RMB per sq m per month)	270	TBC	360	450
Management fee (RMB per sq m per month)	30	TBC	32	32

Source: Savills Research

TABLE 5

Future supply, 2H/2015

Project (EN)	Project (CN)	Completion	Submarket	Leasable office space (sq m)
AVIC Plaza I	中航广场一期	Q3	ZGC	52,000
Air China Century Plaza	国航世纪大厦	Q3	Lufthansa	78,000
Damei Central Plaza Tower 1	达美中心广场一座	Q3	CBD Vicinity	39,000
Borui Building II	博瑞大厦二期	Q3	CBD Vicinity	19,000
Greenland Centre	绿地中心	Q4	Wangjing	61,000
CCT Centre	诚盈中心	Q4	Wangjing	53,000
New Times Square – CSC Land Building	开元国际广场-中建大厦	Q4	Asia-Olympic	60,000

Source: Savills Research

some landlords of quality buildings in non-prime markets also began to offer incentives to compete for tenants, resulting in rents decreasing 0.8% QoQ to an average of RMB258.5 per sq m per month.

Wangjing area welcomed new supply this quarter, with Poly International Plaza T1 adding 61,000 sq m of Grade A office space to the market. This addition led to vacancy rates increasing 3.2 ppts to 12.7%. The new project has seen the Wangjing office market continue to mature, with prime office stock now reaching 875,000 sq m, 9% of Beijing's total.

Given sustained supply from Wangjing area over the year, combined with 400,000 sq m of new supply in the pipeline for the next three years, Wangjing rents largely stabilised at RMB244.4 per sq m per month by the end of Q2/2015, up 0.4% QoQ. However, upon release of the new supply, Wangjing is likely to see vacancy rates rise in the short term, as well as a decline in rents as landlords are placed under increasing competition to attract tenants.

Market outlook

The second half of 2015 will see the Grade A office market receive an influx of supply, with seven new projects scheduled for handover, adding 360,000 sq m of leasable office space. Annual supply is expected to be 510,000 sq m, 91% higher than the average over the past three years. Meanwhile, China's economic growth is forecasted to further slow between 2015 and 2016 (according to several worldwide economic institutes), which will likely result in overall demand continuing to weaken. As a result, it is anticipated city-wide vacancy rates will increase to approximately 7-8%, while rents will fall to around an average of RMB310-320 per sq m per month by the end of 2015 as competition intensifies

Non-prime markets, namely Wangjing and Asian & Olympics, are scheduled to receive approximately half of the new supply coming onto the market by the end of 2015. This, combined with the limited availability of new supply in core locations, is expected to further fuel the decentralisation trend in the market. While non-prime markets are expected to witness decreases both in rents and occupancy rates in the short term, they are quickly accelerating towards maturity.

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