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**Savills World Research**
Beijing

# Briefing
# **Office sector**

October 2016


Image: Financial Street International Center, BFS, Xicheng district

## SUMMARY

Landlords in the CBD and its vicinity remain cautious towards internet financing companies, namely peer-to-peer (P2P) lenders, as tenants. Looking to mitigate risk, some landlords have pushed to remove such tenants from their projects, causing vacancy rates to rise in the precinct.

- Three new projects entered the Grade A office market in Q3/2016, contributing a total office GFA of 211,600 sq m.
- The overall vacancy rate continued to rise during the period, up 0.5 of a percentage point (ppt) to 4.9% (including self-use office GFA).
- Grade A office rents edged down 0.2% quarter-on-quarter (QoQ) to RMB337.8 per sq m per month by the end of Q3/2016.
- One new project will come onto the market in Q4/2016, with an office GFA of approximately 47,000 sq m.
- As landlords further strengthen their efforts on tenant adjustment, average rental growth is expected to be further constrained.

"Landlords are expected to further adjust their rents and offer more incentives in order to remain competitive. As a result, average rental growth is forecast to shrink in the mid- to short-term." Jack Xiong, Savills Research & Consultancy

## Supply, net take-up and vacancy rate

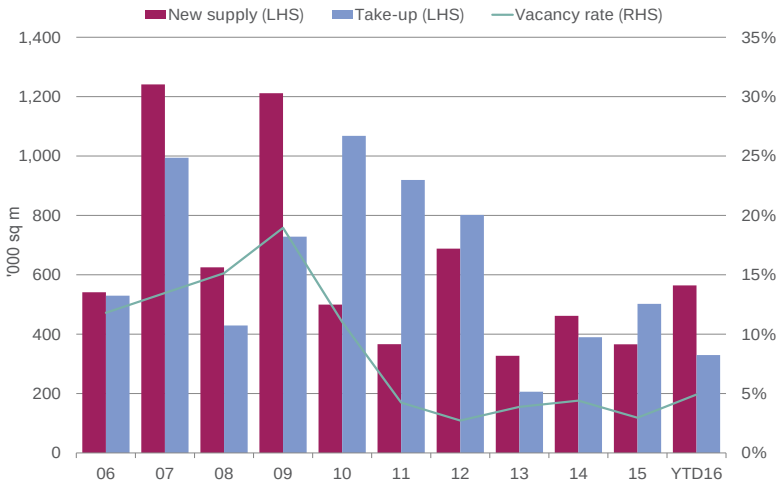
Three new projects totalling 211,600 sq m entered the Grade A office market in Q3/2016, raising overall stock to approximately 9.8 million sq m (including self-use office GFA). The majority of new supply was located in the Asia-Olympic district, namely the Sinotrans Building (外运大厦) and CSCEC International Centre Tower A (中建国际中心A座). BFS also welcomed new supply, with the recently closed InterContinental Hotel renovated and re-launched as the Financial Street International Center (金融街国际中心).

The overall Grade A Office market vacancy rate further edged up by 0.5 of a ppt to 4.9% during the period. Relatively high vacancy levels in new projects such as the Sinotrans Building pushed up the market average. At the same time, landlords in the CBD and its vicinity remained cautious towards introducing internet financing companies, especially those from the P2P lending sector, to their projects. Some landlords actively sought to remove existing P2P tenants from their projects, which contributed to the higher vacancy levels witnessed over the past quarter.

Finance, IT & Hi-Tech and the Cultural & Media sectors were the major demand drivers for Grade A office space during the period. The traditional financial sector, including insurance and investment firms, continued to display robust demand for Grade A office space in the CBD and BFS areas. Demand from emerging industries and "internet plus" companies remained strong, albeit unstable, with favouritism for

GRAPH 1

### Supply, net take-up and vacancy rate, 2006–Q3/2016




Source: Savills Research & Consultancy

TABLE 1

### New supply, Q3/2016

| Project Name EN | Project Name CN | Location | Grade | Office GFA (sq m) |
|---|---|---|---|---|
| Sinotrans Building | 外运大厦 | Asia-Olympic | Grade A | 83,300 |
| CSCEC International Centre Tower A | 中建国际中心A座 | Asia-Olympic | Grade A | 94,300 |
| Financial Street International Center | 金融街国际中心 | BFS | Grade A | 34,000 |

Source: Savills Research & Consultancy

TABLE 2

### Major leasing transactions, Q3/2016

| Company | Industry | Nationality | Project | Location | GFA (sq m) |
|---|---|---|---|---|---|
| Tian'an Insurance | Finance | Domestic | WFC | CBD | 6,800 |
| Pernod Ricard | Commercial and Trading | Overseas | China Central Place | CBD's Vicinity | 1,100 |
| TE Connectivity Ltd | IT and Hi-Tech | Overseas | New China Insurance Tower | CBD's Vicinity | 1,400 |
| CFC Group | Other | Domestic | Fortune Financial Center | CBD | 6,000 |
| Ausin | Professional Service | Overseas | Fortune Financial Center | CBD | 1,800 |

Source: Savills Research & Consultancy

traditional IT and Hi-Tech clusters, namely Zhongguancun (ZGC) and the quickly maturing Wangjing area. Demand from professional service firms, co-working space operators and the manufacturing sector also remained relatively stable.

## Rents

Grade A office rents continued to edge down by 0.2% QoQ to RMB337.8 per sq m per month by the end of Q3/2016. Some high-quality projects with good occupancy rates maintained relatively high rental levels. However, overall market demand continued to weaken as companies become more sensitive towards price and office location. Many landlords have actively targeted medium- and large-sized tenants by extending rental discounts. Whilst this helped secure a comparatively stable tenant mix and fill up vacant space in some projects, it also impacted rent levels.

## Submarket rents and vacancy rates

**Traditional business districts**

The CBD saw vacancy rates increase by 0.6 of a ppt QoQ to 4.4% during the period. This is largely attributable to companies adopting more cautious expansion strategies, combined with landlords continuing to undertake tenant adjustment strategies in order to remove dubious internet financing and P2P companies from their projects. Average rental for the precinct further edged down 0.5% QoQ to RMB368.2 per sq m per month. However, Grade A office buildings with high building specifications and tight vacancy rates were able to maintain rental performance. An increasing number of projects in the precinct have started showing a preference for securing a healthy tenant profile by introducing medium and large tenants by extending rental discounts and incentives rather than leasing a project more quickly to tenants of high-risk industries.

Supported by stable demand, vacancy rates in BFS and ZGC remained at a relatively low level during the quarter, registering 2.2% and 3.7%, respectively. Given this, the average rents in these two precincts were largely flat compared with the previous quarter, registering RMB541.3 and RMB274.4 per sq m per month, respectively.

**Non-prime markets**

Wangjing witnessed further strong performance during the quarter, backed by the ever-increasing demand from IT & High-Tech, high-end manufacturing and e-commerce industries. A rapidly maturing business environment driven by the entry of large enterprises such as Alibaba has seen Wangjing grow in attractiveness to the start-ups sector. Meanwhile, the emergence of high-quality buildings and competitive rental levels has also boosted the demand within the precinct and encouraged relocation demand from other precincts such as ZGC. As a result, the vacancy rate of Grade A offices in Wangjing significantly declined, down 7.8 ppts QoQ to 7.1%, while average rental trended up 0.6% QoQ to RMB257.8 per sq m per month.

With new self-use and partial self-use projects entering the market, the Asia-Olympic area saw a decline in the overall vacancy rate. Primarily fuelled by growing demand for space in Panggu Plaza, average rents in the Grade A office market in the precinct edged up 0.3% QoQ. The recent announcement by Asian Infrastructure Investment Bank to relocate its new headquarters to the area is expected to further the development of the areas maturing office market.

Other precincts, namely Lufthansa, East Second Ring Road and East Chang'an Avenue, were largely stable during the same period.

## Market outlook

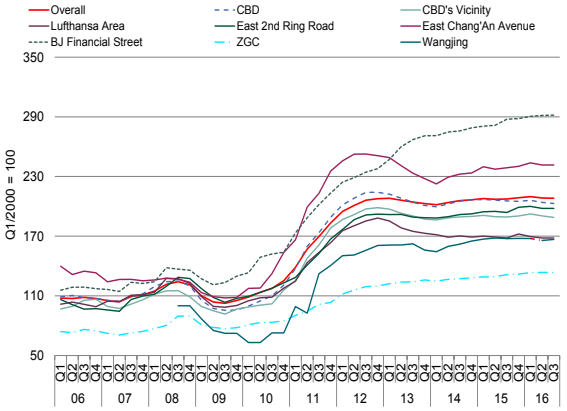
With several projects delaying their delivery, the fourth quarter of 2016 is expected to see only one new project enter the market, contributing approximately 47,000 sq m. Emperor Group Centre, which will be partially used as the landlord's new regional headquarters, is expected to raise the profile of the area with its high-quality building specifications.

While the city's economic growth is anticipated to further slow alongside the national trend and the "New Normal" economic environment, the Tertiary industry is expected to maintain its prominent role in the city's development. Demand for the Grade A office market is expected to derive largely from this rapidly growing sector, namely from financial services, IT & Hi-Tech, and professional services companies.

At the same time, increasing cost sensitivity from companies is likely to

GRAPH 2

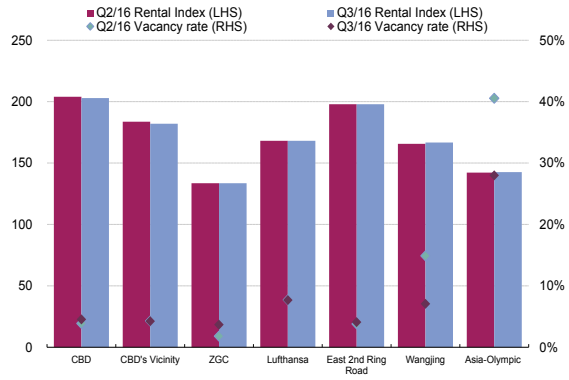
### Grade A office rental indices, Q1/2006–Q3/2016




Source: Savills Research & Consultancy

GRAPH 3

### Submarket rents and vacancy rates, Q2/2016 VS Q3/2016




Source: Savills Research & Consultancy

further hinder expansion plans. With this in mind, the CBD and its vicinity may continue to see rents edge down. However, the relatively high rent levels of new projects, as well as emerging industry clusters, will stabilise city-wide rents. In addition, new demand may be generated from tenants looking to upgrade and relocate from traditional business districts to emerging areas, further narrowing the gap between the two.

As city-wide Grade A office supply is expected to peak in the next five years, older projects with a lower building quality will accelerate the pace of tenant adjustment. Some projects will strengthen efforts on attracting medium- and large-sized tenants to stabilise their tenant profile mix. Other landlords are likely to adjust their rents and offer more incentives in order to remain competitive. As a result, average rental growth is expected to shrink in the mid- to short-term.

TABLE 3

## Future supply focus, Q4/2016

| Project name | Emperor Group Centre (英皇集团中心) |
|---|---|
| |  |
| Location | CBD's Vicinity |
| Owner | Emperor Group |
| Office GFA | 47,000 sq m |
| Typical floor plate | 2,239 sq m |
| Typical clear ceiling height | 3.1m |
| Office stories | F5 – F25 |
| Completion date | Q4/2016 |

Source: Savills Research & Consultancy

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