

Briefing Office sector

July 2017



Image: Junhao Central Park Plaza, CBD's Vicinity

SUMMARY

Grade A office vacancy rates edged up, while average rent declined for the fourth consecutive quarter. Landlords increased the commission levels of agents to stimulate leasing demand.

- Three new projects entered the Grade A office market in Q2/2017, contributing a combined GFA of 114,000 sq m. As a result, total Grade A office stock increased to 10.2 million sq m (including self-use GFA).

- Affected by new supply, citywide vacancy rates increased by 0.5 of a percentage point (ppt) quarter-on-quarter (QoQ) and 3.1 ppts year-on-year (YoY), to 6.5%.

- Faced with greater competition, landlords continued to extend more flexible rental strategies to tenants. As a result, overall average rental posted a decline for the fourth consecutive quarter, down by 0.2% QoQ and 0.7% YoY to RMB338.1 per sq m per month.

- The Grade A office market is scheduled to welcome five new projects in 2H/2017, increasing overall stock by 337,000 sq m.

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 “Time will be needed for demand to absorb both existing stock levels and future supply. Landlords will need to have an accurate grasp of market trends in order to devise a reasonable leasing strategy and mitigate risk.” Jack Xiong, Savills Research & Consultancy

→ **Supply, net take-up and vacancy rate**

Three new projects – Central Park Plaza, China World Trade Center III Tower B and ZRT Tower Beijing, entered the Grade A office market in Q2/2017. In addition, CSCEC International Centre also released some floor area to the leasing market during the quarter. As a result, total

Grade A office stock increased to 10.2 million sq m (including self-use GFA).

ZRT Tower Beijing, which was previously positioned as the New Century Grand Hotel, was closed for renovations and relaunched as an office building after being acquired by ZRiver Capital in 2016.

Despite the second quarter historically being viewed as the most active of the year, leasing demand was relatively weak, recording only a marginal increase during the period. Affected by the new supply, citywide vacancy rates increased by 0.5 of a ppt QoQ to 6.5%, up by 3.1 ppts YoY.

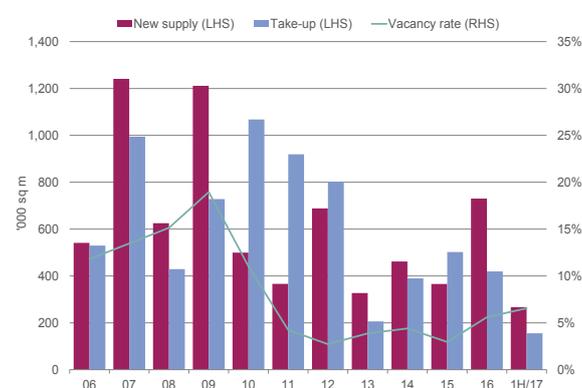
Site inspections conducted by Savills have revealed vacancy rates in some existing projects in the CBD district have far exceeded the average level in the precinct. Concerned with potential negative effects, landlords have shown a tendency to publicise their vacancy rates at levels lower than actual figures.

The financial sector, in particular non-banking functions such as investment and insurance companies, continued to be the dominant demand driver in the city, accounting for 36% of all transactions during the quarter. Notable transactions witnessed Efunds lease 4,700 sq m in Tai Kang International Building in BFS district and Guanghai Longxin Asset Management lease 3,400 sq m in LSH Centre in Wangjing district.

Meanwhile, demand continues to grow from the IT and High-Tech sector, with robust expansion deriving from industries that merge the internet and traditional sectors, such as the new manufacturing and new media fields. During the quarter, KDX leased 5,500 sq m in the CCT Centre and ZTE, a communication company, committed to 15,000 sq m in Sinotrans Plaza, located in Asia-Olympic district.

The Wangjing and Asia-Olympic areas continue to meet the demand from tenants requiring large space and cheaper rents. Consequently, the two precincts accounted for

GRAPH 1 **Supply, net take-up and vacancy rate, 2006–1H/2017**



Source: Savills Research & Consultancy

TABLE 1 **New supply, Q2/2017**

Project Name EN	Project Name CN	Location	Grade	Office GFA (sq m)
Central Park Plaza	骏豪中央广场	CBD's Vicinity	A	40,000
China World Trade Center III Tower B	中国国际贸易中心三期B座	CBD	A+	41,000
ZRT Tower Beijing	中融信托大厦	Others	A	33,000

Source: Savills Research & Consultancy

TABLE 2 **Major leasing transactions, Q2/2017**

Company	Industry	Nationality	Project	Location	GFA (sq m)
ZTE	IT and High-Tech	Domestic	Sinotrans Building	Asia-Olympic	15,000
Longfor	Real Estate	Domestic	CSCEC International Centre Tower A	Asia-Olympic	9,200
KDX	IT and High-Tech	Domestic	CCT Centre	Wangjing	5,500
Efunds	Finance	Domestic	Tai Kang International Building	BFS	4,700
Anbang Insurance Group	Finance	Domestic	China Overseas Plaza	CBD	1,500
Hongkun Group	Real Estate	Domestic	World Finance Centre	CBD	930

Source: Savills Research & Consultancy

40% of citywide demand during the quarter. Aware of the heavy future supply pipeline in the CBD Core Plot, landlords in these precincts have been working actively to boost occupancy levels before entry of the new projects. Meanwhile, as the economy continues to undergo its transformation and companies take greater note of their operating costs, these precincts will continue to stand out as desirable choices for numerous tenants.

Rents

Faced with greater competition, landlords continued to extend more flexible rental strategies to tenants. As a result, overall average rental declined for the fourth consecutive quarter, down by 0.2% QoQ and 0.7% YoY, to RMB338.1 per sq m per month.

Submarket rents and vacancy rates

Traditional business districts

The CBD and CBD's Vicinity welcomed two new projects in Q2/2017, and consequently vacancy rates increased by 1.1 and 1.6 ppts to 6.8% and 9.1% QoQ, respectively. Cost sensitivity has seen a number of tenants relocate or terminate their tenancy agreements. Faced with this situation, landlords have been under pressure to decrease their asking rents during negotiations in order to secure occupancy in their projects. Meanwhile, landlords of some high quality Grade A projects have made the move to increase commissions for agents to incentivise them in their search for new tenants. Average rents in the precincts continue to decline, down by 0.7% and 0.5% QoQ to RMB379.1 and RMB297.9 per sq m per month, respectively.

The Grade A office market in BFS area continues to remain saturated, with demand far outstripping supply. Some landlords have looked to consider upgrading their tenant mixes as they have concerns that current occupants may not be able to afford rental increases in the future. Overall vacancy rates in BFS remained at 2.0% by the end of the quarter, while average rents edged up 0.5% QoQ to RMB547.4 per sq m per month.

Demand in ZGC remained stable during the quarter, largely driven by

expansions and renewals. The overall vacancy rate in the precinct was down by 0.1% QoQ to 2.9%, while rental held stable at RMB274.8 per sq m per month.

Non-prime markets

Outside of the traditional business districts, the Wangjing and Asia-Olympic areas continue to grow in popularity as destinations to fulfil large-scale leasing area requirements. A recent improvement in supporting facilities, as well as rental discounts in the range of 15%-30% over traditional business districts, has seen Wangjing continue to rise in prominence and outperform some of the core business areas.

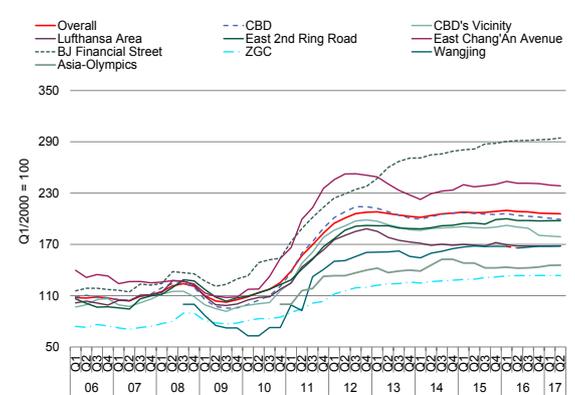
Strong leasing activity in the CCT Centre witnessed the project achieve full occupancy, and consequently the overall vacancy rate in Wangjing precinct declined by 2.0 ppts to 10.9%. Meanwhile, average rental held stable at RMB255.0 per sq m per month.

Asia-Olympic area has seen the majority of existing projects developed by SOEs and has witnessed average rentals trade at a premium over Wangjing. Thus the precinct has seen strong leasing demand from tenants with high rental affordability, such as SOEs, real estate and finance firms. Average rents edged up by 1.4% to RMB340.0 per sq m per month, while average occupancy rates also increased during the period.

Aging projects along East Chang'an Avenue have begun to lose their appeal to tenants. As a result, overall vacancy rates increased by 0.6 of a ppt to 5.8%. Looking to retain tenants, some landlords have considered upgrading or converting their projects. For example, last quarter's recent retail-to-office conversion of COFCO Plaza Tower C has already achieved an occupancy level of 30%. Meanwhile, Beijing International Hotel, which is currently being converted to an office project, has already received some pre-commitment on leases.

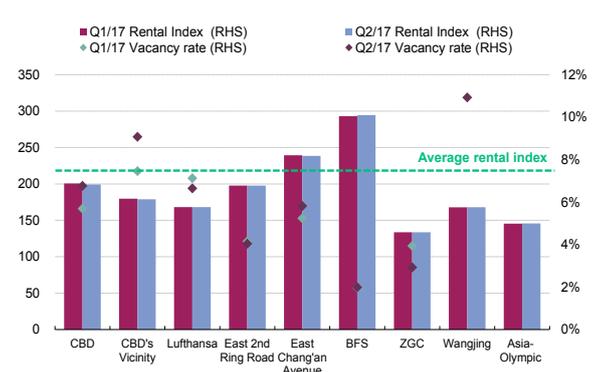
The overall vacancy rate in Lufthansa area declined by 0.5 of a ppt to 6.7% during Q2/2017, largely driven by strong leasing activity in The Genesis. Meanwhile, average rental

GRAPH 2
Grade A office rental indices, Q1/2006-Q2/2017



Source: Savills Research & Consultancy

GRAPH 3
Submarket rents and vacancy rates, Q1/2017 VS Q2/2017



Source: Savills Research & Consultancy

held stable at RMB298.5 per sq m per month.

Market fundamentals in East Second Ring Road area remained largely stable during the period. In May, Shenzhen Yitian Group announced its intention to acquire the Guosen Centre in Dongzhimen district from China Cinda Asset Management through a partial equity transaction with the plan to relaunch the project soon.

Market outlook

The Grade A office market is scheduled to welcome five new projects in the remainder of 2017, increasing overall stock by 337,000 sq m. Emerging business districts, such as Lize and Tongzhou, are expected to see their first project deliveries before the end of the year, and consequently the list of location options for tenants will expand.

Urban regeneration and stock transformation will play an increasingly prominent role in the future. Relatively stable demand and rental income levels in the office market will see institutional investors pay greater attention to commercial properties on the second-hand market.

Overall office supply in Beijing will increase as a growing number of retail-to-office and hotel-to-office conversions occur in the future.

As the transformation and upgrading of China's economy continues, it is anticipated that domestic demand, particularly from the financial sector, will play a major role in absorbing stock levels. Foreign companies will become increasingly cautious in terms of expansion plans. ■

TABLE 3 **Future supply focus, Q3/2017**

Project name	Hatemen Plaza East Tower (哈德门广场东塔)
	
District	Chongwenmen
Developer	Glory Group
Office Stories	10 (over ground)
Office GFA	48,500 sq m
Typical floor plate	3,000 – 4,500 sq m
Typical ceiling height	4.45 m
Estimated completion date	Q3/2017

Source: Savills Research & Consultancy

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