

Briefing Office sector

January 2018



Image: Glory Star Financial Towers, Lize Financial Business District

SUMMARY

The Grade A office market received an influx of new supply in Q4/2017, all of which is located in non-prime and emerging business districts. Weak absorption in the new projects located in emerging markets, saw the vacancy rate rise sharply to 7.6%.

- Five new projects entered the Grade A office market in Q4/2017, contributing a total of approximately 453,000 sq m GFA. As a result, total Grade A office stock increased to 10.74 million sq m (including self-use GFA).

- Overall leasing demand in the Grade A office market remained strong in Q4/2017. The addition of new projects helped to satisfy demand in the non-prime markets, in particular for tenants with large space requirements.

- Large vacancies in the newly launched projects in Lize Financial Business District saw the vacancy rate rise sharply by 2 percentage points (pts) quarter-on-quarter (QoQ) and year-on-year (YoY) to 7.6%.

- Active demand continued to see overall average rents rise, up by 1.3% QoQ and 1.1% YoY to RMB340 per sq m per month.

- The Grade A office market is scheduled to welcome two new projects in Q1/2018, increasing citywide stock by 110,000 sq m.

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“The CBD Core Plot Area and Lize Financial Business District will provide a majority of the new supply in the near future. Combined with the effect of ongoing relocation of government offices to Tongzhou District, Beijing’s new business districts will form and mature rapidly.” Jack Xiong, Savills Research & Consultancy

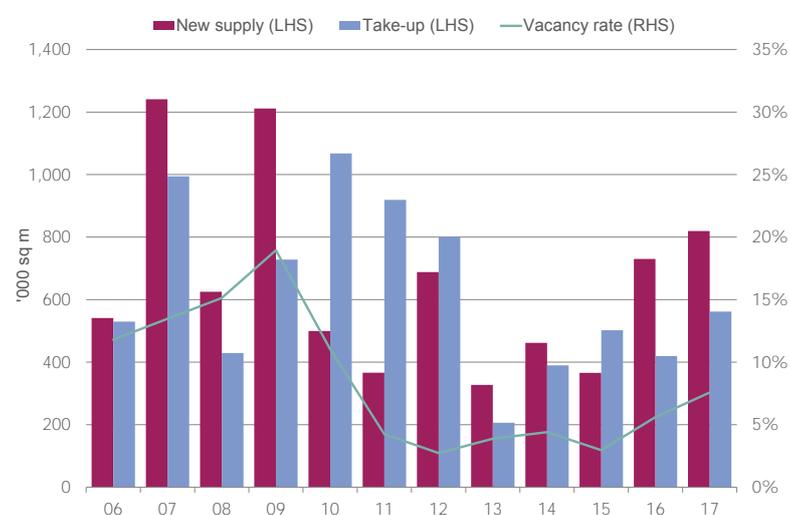
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➔ **Market Overview**

A small supply peak in Q4/2017 saw the citywide vacancy rate increase by 2 ppts QoQ and YoY to 7.6%. The market has seen an overall rise in leasing demand throughout 2017, largely driven by strong performance from the IT & Hi-Tech fields. Stable leasing demand has seen citywide average rent increased, for two consecutive quarters, to RMB340 per sq m per month.

In total, the Grade A office market received 14 new projects in 2017, contributing approximately 819,000 sq m GFA and marking the highest level of supply since 2010. More than half of the new supply entered into non-prime markets. Total Grade A office stock therefore increased to

GRAPH 1 **Supply, Net Take-Up and Vacancy Rate, 2006–2017**



Source: Savills Research & Consultancy

TABLE 1 **New supply, Q4/2017**

Project Name EN	Project Name CN	Location	Grade	GFA (sq m)	Usage
China Overseas International Centre	中海国际中心	Asia-Olympic	A	48,800	Leasing
Ronsin Technology Centre	融新科技中心	Wangjing	A	115,700	Leasing
JS Business Combination Building	晋商联合大厦	Lize	A	36,000	Leasing
Glory Star Financial Towers	聚杰金融大厦	Lize	A	125,000	Leasing
AZIA Centre	汇亚大厦	Lize	A	126,800	Leasing

Source: Savills Research & Consultancy

TABLE 2 **Major leasing transactions, Q4/2017**

Company	Industry	Nationality	Project	Location	GFA (sq m)
CNPC	Energy / Chemical	Domestic	Hengyi Plaza	Asia-Olympic	67,000
Google	IT & High-Tech	Foreign	China Overseas International Centre	Asia-Olympic	6,000
Playcrab	IT & High-Tech	Domestic	China Overseas International Centre	Asia-Olympic	5,500
Beijing Zhumeng Information Technical	IT & High-Tech	Domestic	HNA Tower	CBD	3,800
Sitong Network Service	IT & High-Tech	Domestic	The Genesis	Lufthansa	2,500
Lewan.cn	IT & High-Tech	Domestic	Cameo Center	Wangjing	2,200

Source: Savills Research & Consultancy

10.74 million sq m (including self-use GFA) in 2017.

Supply, Net Take-Up and Vacancy Rate

The Grade A office market received an influx of supply in Q4/2017, with five new projects contributing a combined GFA of 453,000 sq m and increasing total stock to 10.74 million sq m (including self-use GFA). All new supply are located in non-prime and emerging business districts, including China Overseas International Centre in the Asia-

Olympic district; Ronsin Technology Centre in the Wangjing district; and JS Business Combination Building, AZIA Centre and Glory Star Financial Towers in the Lize district.

Overall leasing demand in the Grade A office market remained strong in Q4/2017. The addition of new projects helped to satisfy demand in the non-prime markets, particularly for tenants with large space requirements. However, high vacancy rates in the newly launched projects in Lize Financial Business District

caused citywide vacancy rates to rise sharply by 2 ppts QoQ and YoY to 7.6%. Nevertheless, average citywide vacancy rates, excluding the Lize Financial Business District, continued to trend downwards, reaching 5.1% in Q4/2017.

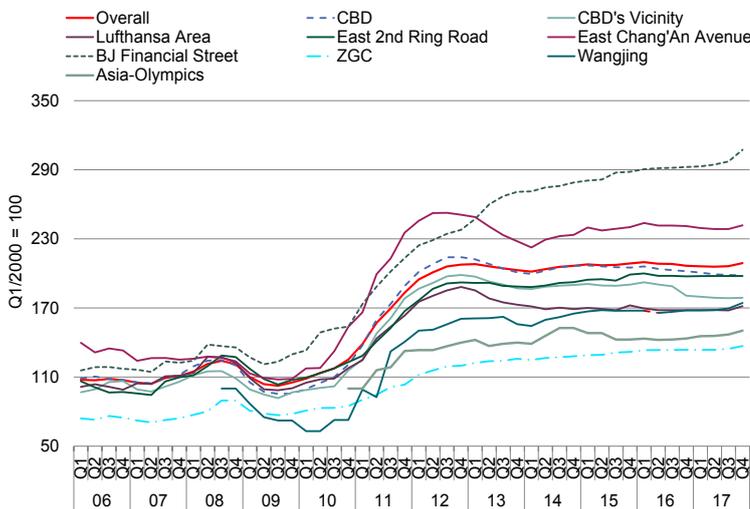
The ongoing development of technology innovation and artificial intelligence (AI) and continuous active expansion of tech giants, contributed significantly to deals in Q4/2017. A notable leasing example was Google's lease of 6,000 sq m in China Overseas International Centre in the Asia-Olympic district. In addition to this, the company announced that they will be opening an AI Centre in the city. This project marks the first of its kind in Asia and site selection is already underway.

Start-up companies have developed rapidly, following successful fundraising, and are consequently contributing to an increase in upgrading demand, in terms of both location and project quality. Zhongguancun (ZGC), Asia-Olympic and Wangjing submarkets continue to be favourable sites among all submarkets. Key leasing activity during the quarter included Playcrab, a tech firm focused on mobile games and innovative product development, leased 5,500 sq m in China Overseas International Centre in the Asia-Olympic district.

The traditional financial segment (particularly investment and fund companies), professional services and energy/chemical companies also continued to be key drivers of leasing demand. Transactions during the quarter included: China National Petroleum Corporation (CNPC) leasing 67,000 sq m in Hengyi Plaza in the Asia-Olympic district; Fujian Fuchun Investment leasing 1,170 sq m in Sinotrans Building in the Asia-Olympic district.

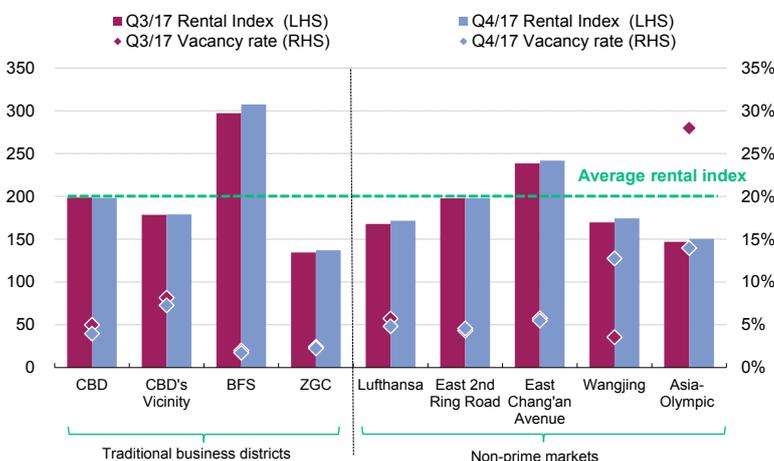
Active leasing demand and stable rental returns in the office market is expected to continue to attract the investors' interests. Retail and hotel projects which offer the potential for transformation will stand out and the market is anticipated to see a growing number of new launches

GRAPH 2
Grade A Office Rental Indices, Q1/2006–Q4/2017



Note: The Lize Financial Business District is not included in the graph as there is no historical data available. Source: Savills Research & Consultancy

GRAPH 3
Submarket Rents and Vacancy Rates, Q3/2017 vs Q4/2017



Note: The Lize Financial Business District is not included in the graph as there is no historical data available. Source: Savills Research and Consultancy

moving forward. Relevant deals during Q4/2017 included: Joy City Property's disposal of the W hotel (whole block to be converted to office use) on Chang'an Avenue to a domestic based fund for a total of RMB1.98 billion; Yintai In88 Shopping Mall also announced their intention to convert some of the higher floors into office space. Limited available supply in Business Financial Street (BFS) and ZGC has instigated growth in the surrounding precincts from tenants looking to expand. This scenario has prompted some landlords of older office projects in the precincts to plan for renovation in order to continue attracting high quality tenants and improve rental performance.

Rents

Active leasing demand has increased citywide average rents rise, up by 1.3% QoQ and 1.1% YoY to RMB340 per sq m per month.

Submarket Vacancy Rates and Rents

Traditional Business Districts

Vacancy rates for the CBD and its vicinity decreased by 1 ppt and 0.7 of a ppt to 4.0% and 7.3% QoQ respectively. Meanwhile, average rents were down by 0.2% QoQ to RMB375 per sq m per month in the

CBD area, while average rents in the CBD's vicinity increased by 0.2% QoQ to RMB298.2 per sq m per month.

The first round of new supply for 2018 in the CBD Core Plot Area received moderate pre-commitment by several clients with large space and central location requirements. However, it is expected that as a greater number of future projects enter the market, large vacant spaces will see average rents come under downwards pressure.

Demand in the BFS area continues to remain stable. The overall vacancy rate in the best performing area decreased slightly by 0.2 of a ppt QoQ to 1.7%. Average rent edged up 3.4% QoQ to RMB570.9 per sq m per month. China Overseas Property Mansion, which is currently fully leased by ICBC until March 2018, will undergo renovation when lease expires and then relaunch in June 2018.

The overall vacancy rate in ZGC precinct declined by 0.2 of a ppt QoQ to 2.2% in Q4/2017, ranking second after the BFS area. Limited vacancy in Grade A office buildings has pushed a number of tenants looking to expand in Grade B

projects. Demand continued to rise from financial and professional services tenants with higher rental affordability. As a result average rent increased by 1.8% QoQ to RMB 282.2 per sq m per month.

Non-Prime Markets

The overall vacancy rate in the Lufthansa area declined by 0.9 of a ppt to 4.8% during Q4/2017. However average rent in the precinct was up by 2.2% QoQ to RMB305 per sq m per month. As the landmark project in the district, the occupancy rate of The Genesis has risen steadily since launch in 2016. The project continues to command a rental premium over other projects in the precinct, signifying willingness of tenants to pay a premium for quality projects.

Leasing demand in East Chang'an Avenue area remained stable during Q4/2017, with the overall vacancy rate decreased slightly by 0.3 of a ppt QoQ to 5.5%. Average rent in the precinct went up 1.4% QoQ to RMB 295.7. Based on the plan announced by the Beijing Municipal Committee, the majority of the municipal government will move to Tongzhou. Therefore more leasing space will open up in the precinct. For example: the Beijing Municipal Political and Legal Committee, which currently leases space in Tower E of Minsheng Financial Centre, plans to vacate the property in 2018. Thus, the landlord is currently seeking replacement clients with large space requirements.

The overall vacancy rate in Wangjing district increased significantly by 9.2 ppts QoQ to 12.7% in Q4/2017, largely due to vacant space in the newly launched Ronsin Technology Centre. Pre-leasing activities in Radiance attracted quality clients with large space requirements, with Alibaba as one of the notable tenants. This scenario prompted a number of landlords in the precinct to raise their asking rents. As a result, average rents in Wangjing increased 2.8% QoQ to RMB260 per sq m per month.

Leasing activities in the Asia-Olympic precinct remained active during the

TABLE 4

Future Supply Focus, Q1/2018

Project name	ZRT Plaza Beijing	AVIC Capital Tower
		
District	Others (Sanyuanqiao)	Wangjing
Developer	ZRiver Capital	AVIC Capital
Office Floors	7 (Above Ground)	34 (Above Ground)
Office GFA	30,700 sq m	79,900 sq m
Typical Floor Plate	3,000 – 4,000 sq m	1,972 sq m
Typical Ceiling Height	3.2 m	3.0 m
Estimated Completion Date	Q1/2018	Q1/2018

Source: Savills Research & Consultancy

quarter with new tenants brought along by the entry of a new project entry. The large lease by CNPC in Hengyi Plaza and other large space deals significantly reduced average vacancy rate by 14 ppts QoQ to 14%. Average rents in the area increased by 2.6% QoQ to RMB 338.3 per sq m per month.

Emerging Business Districts

The Lize Financial Business District, one of the emerging business districts in the city, welcomed its first wave of deliveries with three new projects making their debut. Despite having good building quality, an immature business environment, along with weak transportation links and amenities resulted in poor pre-leasing performance. Nevertheless, metro line 14 which is expected to start operating in 2019 will likely drive relocation demand.

Market Outlook

The Grade A office market is scheduled to welcome two new

projects in Q1/2018 – ZRT Plaza Beijing (中融信托广场) located in Sanyuanqiao and AVIC Capital Tower (中航资本大厦) in Wangjing.

Around two million sq m of new supply is expected to enter the Grade A office market in 2018. As a result citywide occupancy rates and average rents will face downwards pressure. It is anticipated that some landlords will adjust the timing of their launch dates to avoid direct competition from the supply wave. The CBD Core Plot Area and Lize Financial Business District will become the major sources of new supply in the near future. This, combined with the ongoing relocation of government offices to Tongzhou district, will continue to accelerate the formation and development of new business districts in Beijing.

Limited vacancy and high rents in prime areas will see tenants with expansion appetite and limited rental budgets expand their site

selection to Yizhuang Economic and Technical Development Area, Fengtai Advanced Business Park and other business parks located in Wangjing and Shangdi. As a greater number of tenants enter these submarkets, it is expected the commercial atmosphere in these markets will mature rapidly, further diversifying Beijing's office market.

The People's Bank of China and China Banking Regulatory Commission jointly announced new guidelines to clean up the controversial cash loan and online micro lending market on 1 December 2017. Announced guidelines look to control the online micro-lending sector, tighten and halt new approvals of online micro lenders and cross-region lending businesses. It is expected that huge numbers of micro-lending companies and other relevant institutions will close offices, and some owners and landlords will tighten their lease procedures. ■

Definitions

Rent: Achievable effective rents for a 500-sq m unit in the mid-zone of an office building signed for a three-year lease.

Rental index: A reflection of rental movement of a representative sample of projects.

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