

Briefing Office sector

April 2018

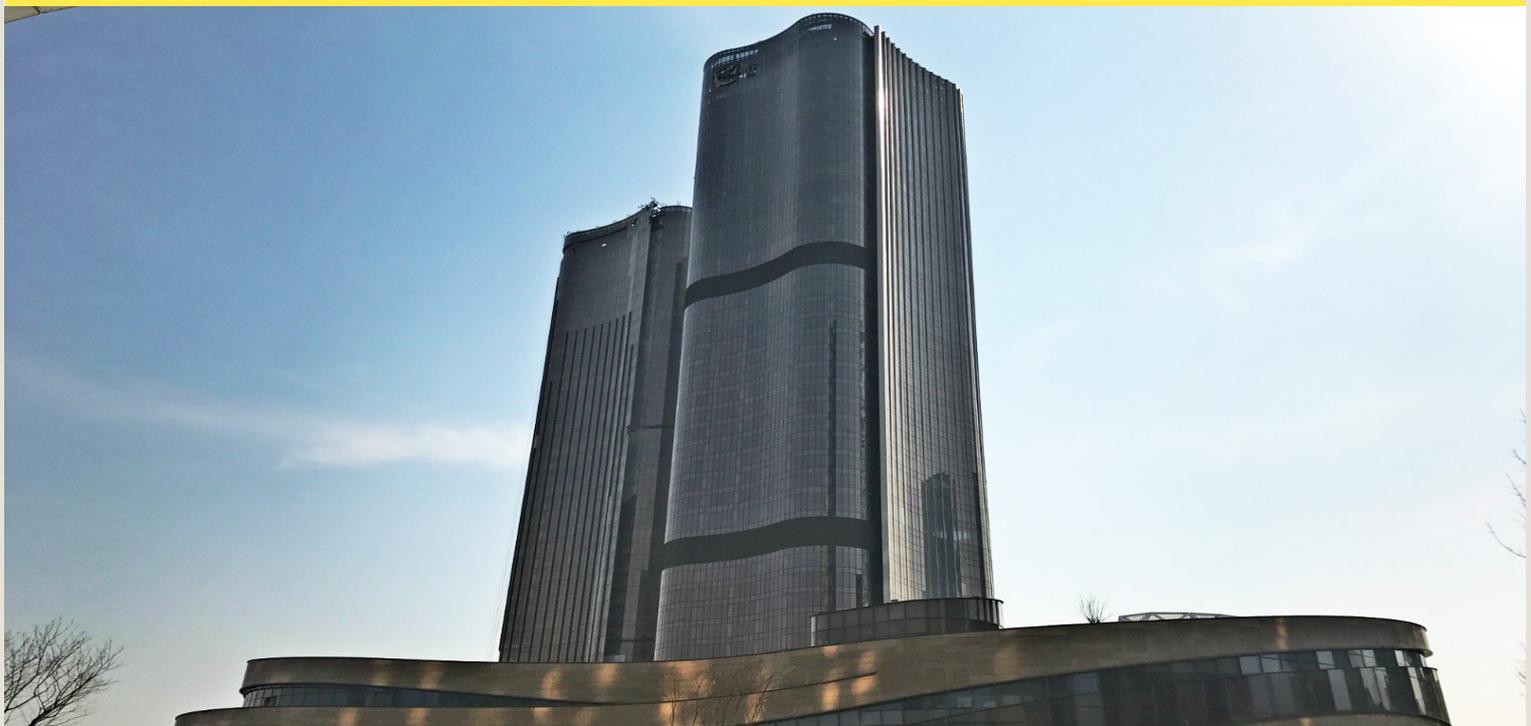


Image: CIVIC Capital Tower, Wangjing

SUMMARY

Strong leasing demand in the capital city saw the average Grade A office rent rise for a third consecutive quarter.

- Two new projects entered Beijing's Grade A office market in Q1/2018, contributing a total of approximately 145,000 sq m GFA. Total Grade A office stock increased to 10.65 million sq m (including self-use GFA).
- Strong leasing demand saw the overall vacancy rate fall by 0.8 of a percentage point (ppt) quarter-on-quarter (QoQ) to 6.8% in Q1/2018. However, the figure increased by 0.7 of a ppt year-on-year (YoY).
- Active demand continued to spur an overall average rent rise, up by 2.4% QoQ and 4% YoY to RMB345.3 per sq m per month.
- The Grade A office market is scheduled to welcome four new projects in Q2/2018, which will increase city-wide stock by 220,000 sq m GFA.

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 “Non-prime areas continued to gain momentum at the start of 2018, with many well-known companies choosing to locate in areas such as Wangjing and Asia-Olympic, helping to fuel growth and improve the business environment of non-prime markets.” Jack Xiong, Savills Research & Consultancy

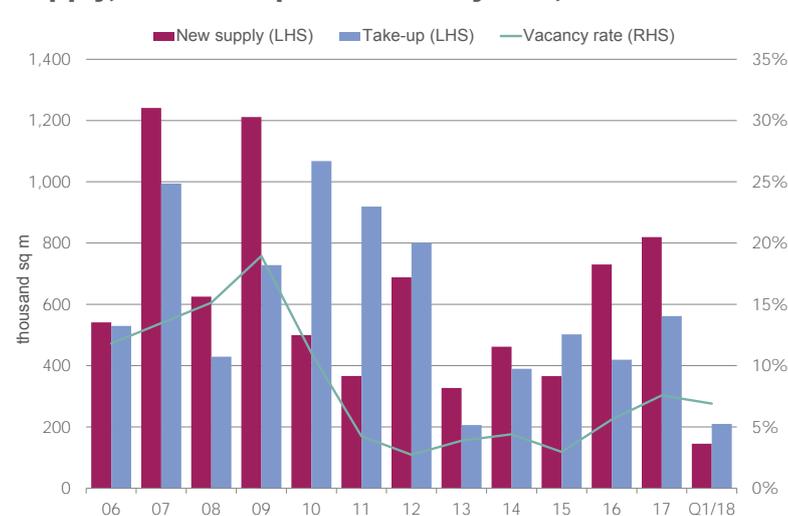
→ Supply, Net Take-Up and Vacancy Rate

The Grade A office market added two new projects in Q1/2018 – CIVIC Capital Tower in Wangjing and ZRT Plaza in Sanyuanqiao – which contributed a combined GFA of 145,000 sq m. Total Grade A office stock (including self-use) increased to 10.65 million sq m.

ZRT Plaza, originally the Parkson Department Store (Taiyanggong), was acquired by ZRiver Capital in 2016 and subsequently converted to an office tower. The project is largely leased to Volkswagen. CIVIC Capital Tower was partially launched to the leasing market in Q1/2018. Floors 27 to 43 – 45% of the project’s total office GFA – are zoned for self-use.

Overall leasing demand in the Grade A office market remained strong in Q1/2018. The city-wide vacancy rate decreased by 0.8 of a ppt QoQ to

GRAPH 1 Supply, net take-up and vacancy rate, 2006–Q1/2018



Note: Downgrading of projects and a readjustment to the stock basket in January 2018 has resulted in changes to historical supply, take-up and vacancy rate figures. Source: Savills Research & Consultancy

6.8% in Q1/2018 but increased by 0.7 of a ppt YoY.

The government’s support of technology innovation continues to see IT companies thrive and thereby contribute significantly to

TABLE 1 New supply, Q1/2018

Project Name EN	Project Name CN	Location	Grade	GFA (sq m)	Usage
ZRT Plaza	中融信托广场	Others (Sanyuanqiao)	A	65,300	Lease
CIVIC Capital Tower	中航资本大厦	Wangjing	A	79,900	Lease / Self-use

Source: Savills Research & Consultancy

TABLE 2 Major leasing transactions, Q1/2018

Company	Industry	Nationality	Project	Location	GFA (sq m)
Volkswagen	Manufacturing	Foreign	ZRT Plaza	Others (Sanyuanqiao)	N/A
Xiaokaxiu	IT & High-tech	Domestic	CIVIC Capital Tower	Wangjing	20,000
Toutiao.com	Cultural & Media	Domestic	Internet Financial Centre	ZGC	7,000
Black & Veatch	Professional Services	Foreign	Ronsin Technology Centre	Wangjing	4,000
Google	IT & High-tech	Foreign	Raycom Infotech Park	ZGC	3,450
China Urban Construction International Investment	Finance	Domestic	LG Twin Towers	CBD's vicinity	1,700

Source: Savills Research & Consultancy

leasing demand. Notable leasing deals in Q1/2018 included Google's expansion of 3,450 sq m in Raycom Infotech Park-Tower B in Zhongguancun (ZGC).

The continuing digitalisation of other industries, such as entertainment and media, has prompted an increase of mobile application and software development companies. Key leasing activity in 2018 included: Xiaokaxiu, a video filming app, leased 20,000 sq m in CIVIC Capital Tower in Wangjing; Toutiao.com, a news

sharing platform, committed to 7,000 sq m of office space in Internet Financial Centre in ZGC.

Stricter regulations on the financial sector have slowed expansion amongst companies in traditional banking, insurance and securities sectors. The majority of leasing demand from the financial industry stems from funds and investment companies. Transactions during the quarter included: Zhong Shang Ji Wealth leased 1,740 sq m in IFC in the CBD; China Urban Construction

International Investment agreed to 1,700 sq m in LG Twin Towers in the CBD's vicinity.

The professional services and manufacturing industries also showed a strong leasing appetite in Q1/2018. Notable transactions were: Black & Veatch, an American engineering company, leased 4,000 sq m in Ronsin Technology Centre in Wangjing; Volkswagen leased considerable floor space in ZRT Plaza.

Co-working spaces continue to grow in popularity. Being aware of this, developers are entering the sub-sector through partnerships and by creating their own brands. Major activity in Q1/2018 included:

- MyDream+ signed leasing contracts with both Glory Star Financial Towers and AZIA Centre in Lize Financial Business District.
- Kr Space leased 6,000 sq m in Junhao Central Park Plaza in the CBD's vicinity.
- China Overseas Holdings' own brand name – Office Zip – will launch another branch in China Overseas Property Mansion in BFS. The space is currently under renovation, scheduled to open in September 2018.

- Jingrui Holdings acquired a retail property located in ZGC precinct in March 2018. They plan to convert the building into a co-working space under its "Distrii" brand.

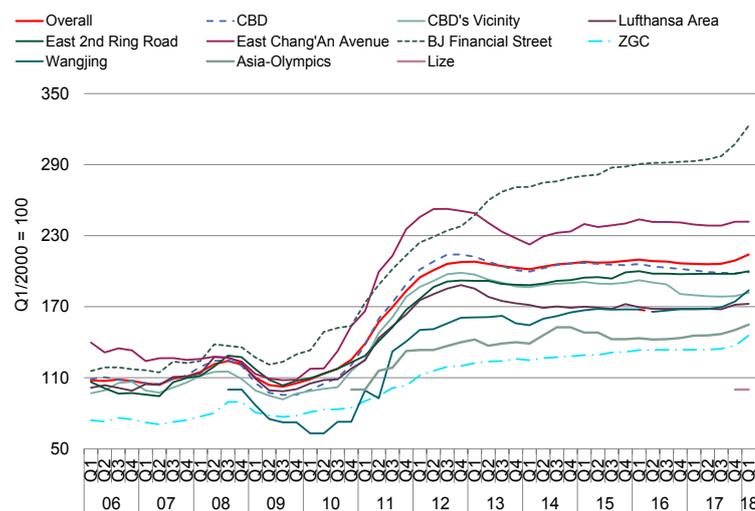
Rents

Active leasing demand continued to spur an average rent rise, up by 2.4% QoQ and 4.0% YoY to RMB345.3 per sq m per month.

Submarket Vacancy Rates and Rents

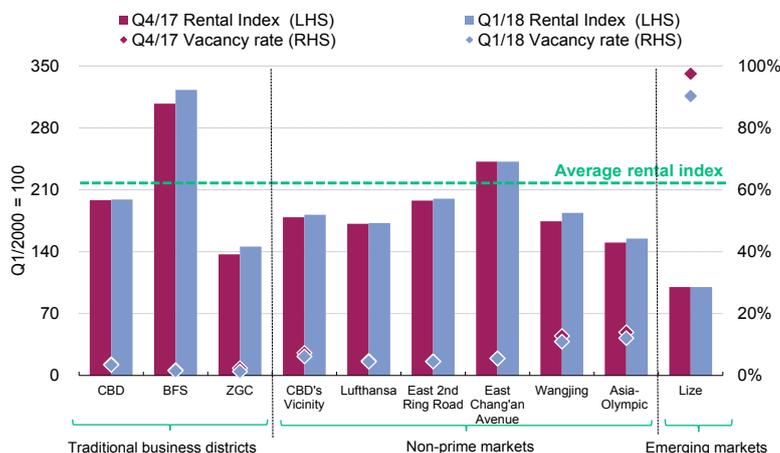
Traditional Business Districts
A rebound in leasing activity after the Spring Festival Holiday saw the average vacancy rate in the CBD

GRAPH 2 **Grade A office rental indices, Q1/2006–Q1/2018**



Source: Savills Research & Consultancy

GRAPH 3 **Submarket rents and vacancy rates, Q4/2017 vs Q1/2018**



Source: Savills Research and Consultancy

decrease by 0.3 of a ppt QoQ to 3.4%. Meanwhile, average rent in the precinct increased by 0.4% QoQ to RMB376.6 per sq m per month.

Affected by the winter construction ban and the government's recent policy to reduce plot ratio, construction progress in the CBD Core Plot Area (CBD) has slowed, and the first two projects of the year are now scheduled to make their debut in 2H/2018.

The first projects to launch in 2018 in the CBD are now actively looking for potential tenants. Due to their high building quality and prime location, they have received a number of pre-commitments, the majority of which involve relocation and upgrading demand. Some existing tenants in the surrounding areas have shortened their lease terms during contract renewal negotiations as they are actively looking to relocate to the CBD. Thus the future market supply is anticipated to change the dynamics in the area.

Beijing Financial Street (BFS) remains the most stable precinct and continues to post steady rental growth. The average vacancy rate continued to decline, down by 0.2 of a ppt QoQ to 1.5% during Q1/2018. Average rent edged up 5.9% QoQ to RMB600.9 per sq m per month. The debut of the Huajia project, which is expected to be pre-leased in 2019, will help ease the precinct's supply shortage.

Moving forward, the slowly maturing business environment in Lize Business District and the ripple effect of AIB's headquarters opening in Asia-Olympic, may divert some demand away from BFS. Meanwhile, escalating supervision of the financial sector is likely to slow the expansion of banks and securities companies.

Strong leasing demand from the IT & high-tech sector saw the average vacancy rate in ZGC decline by 1.1 ppts QoQ to 1.3% in Q1/2018, overtaking BFS for the first time in terms of lowest vacancy. As a result, average rent increased by 6.5% QoQ to RMB299.6 per sq m per month. A

scarcity of developable land will see future supply in the precinct limited to buildings converted from other usage.

Non-Prime Business Districts

The vacancy rate in the CBD's vicinity decreased by 1.1 ppts QoQ to 6.1%. Meanwhile, average rent increased 1.6% QoQ to RMB302.2 per sq m per month.

The average vacancy rate in Lufthansa area declined by 0.3 of a ppt to 4.5% during Q1/2018. Average rent in the precinct grew 0.4% QoQ to RMB309.5 per sq m per month.

Sluggish leasing demand in East Chang'an Avenue area saw its average vacancy rate remain stable at 5.5%. Average rent in the precinct went up 1.4% QoQ to RMB295.7 per sq m per month.

The overall vacancy rate in Wangjing district dropped by 1.8 ppts QoQ to 10.9% in Q1/2018, largely due to the quick absorption rate of its new project. This situation prompted a number of landlords in the precinct to raise their asking rents. As a result, average rent increased by 5.5% QoQ to RMB271.5 per sq m per month.

The majority of new deals in Asia-Olympic during Q1/2018 focused on the China Overseas International Centre. The average vacancy rate decreased by 1.9 ppts QoQ to 12.1%, while average rent in the area increased by 3.0% QoQ to RMB348.3 per sq m per month.

BIG Financial Centre in Asia-Olympic is scheduled to debut in 2019 and is likely to attract a number of state-owned enterprises and financial institutions. The project has a total GFA of 380,000 sq m, of which 80,000 sq m will be leased for AIB's headquarters.

Emerging Business Districts

An immature business environment in the Lize Financial Business District

TABLE 4 **Future supply focus, Q2/2018**

Project name	Meritus Tower	COFCO Landmark
		
District	Wangjing	Others (Andingmen)
Developer	Beijing Meritus Properties Limited	COFCO Group
Office Floors	40 (Above Ground)	13 (Above Ground)
Office GFA	70,220 sq m	52,120 sq m
Typical Floor Plate	1,956 sq m	1,965-3,046 sq m
Typical Ceiling Height	3.3 m	2.9 m

Source: Savills Research & Consultancy

continues to dampen the absorption of its large supply. The vacancy rate in the area was high at 90.3%, and average rents in the precinct stood at RMB195.0 per sq m per month.

Market Outlook

The Grade A office market is scheduled to welcome four new projects in Q2/2018, adding a total of 220,000 sq m of GFA to the leasing market. With new supply concentrated in non-prime areas, the office market will continue to decentralise.

Wangjing and Asia-Olympic areas will see vacancy rates decline as tenants with large space requirements continue to fuel absorption rate. Rental growth is expected to maintain its current momentum. Meanwhile, landlords in the CBD will continue to actively look for potential tenants to alleviate the pressure from a huge incoming supply wave.

As revealed during the 2018 Two Sessions, the central government will place technology innovation as the new driver for economy growth and will look to upgrade traditional

industries through technical and mechanical innovation. Thus future leasing demand in the office market is expected to stem primarily from technology companies and other industries at the forefront of this policy focus.

The Government Work Report announced that the manufacturing, communications, medical care, education and new energy industries will become more open. As a result, it can be expected that these industries will also contribute to leasing demand in the near future. ■

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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