

Briefing Office sector

July 2018



Image: Meritus Tower, Wangjing

SUMMARY

Limited Grade A office supply in 1H/2018 matched with steady demand growth from the financial, IT and professional services sectors continued to see the city-wide average vacancy rate decline. Average rents also increased for a fifth consecutive quarter.

- Only one new project entered Beijing's Grade A office market in Q2/2018, with Meritus Tower in Wangjing district contributing a total of 70,200 sq m GFA, all of which was positioned for self-use. As a result, total Grade A office stock increased to 10.72 million sq m (including self-use GFA).

- Strong leasing demand saw the overall vacancy rate decrease by 0.9 of a percentage point (ppt) quarter-on-quarter (QoQ) to 5.8% in Q2/2018.

However, the figure is still higher by 0.7 of a ppt year-on-year (YoY).

- Active demand continued to fuel an overall rise in average rent, up by 3.6% QoQ and 7.5% YoY to RMB355 per sq m per month.

- The Grade A office market is scheduled to welcome eight new projects in 2H/2018, increasing city-wide stock by 575,000 sq m GFA.

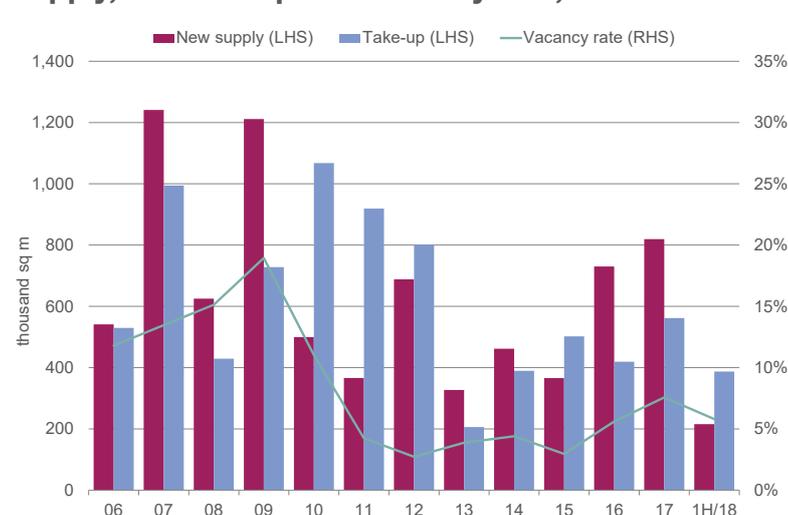
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 "The Grade A office market is expected to see a supply peak in 2H/2018. As the majority of new supply is located in favourable locations, it is forecast that the projects will be welcomed by expansion and upgrade demand." Jack Xiong, Savills Research & Consultancy

→ Half-year summary

Three new projects with a combined GFA of 215,400 sq m (including self-use) were launched onto the Grade A office market in 1H/2018, all of which were located in non-prime areas. Active demand saw net absorption outstrip supply and reach 387,000 sq m, and as a result the average vacancy rate declined by 1.8 ppts half year-on-half year (HoH) to 5.8%.

No new supply in prime areas saw demand concentrated on the absorption of existing stock, therefore the average vacancy rate in prime areas fell to below 2%. Among non-prime areas, Wangjing accounted for the largest proportion of leased space during the period as new supply in the precinct satisfied the needs of tenants looking for large space requirements. Meanwhile, Lize Financial Business District continued to be plagued with a high vacancy rate, a dynamic which is not expected to change in the short term due to ongoing infrastructure construction and an immature business environment.

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



Note: Downgrading of projects and a readjustment to the stock basket in January

Supply, net take-up and vacancy rate

Only one new project – the 70,200 sq m GFA Meritus Tower in Wangjing district solely for self-use – entered Beijing’s Grade A office market in Q2/2018. Thus, total Grade A office stock increased to 10.72 million sq m (including self-use GFA).

Overall leasing demand in the Grade A office market remained strong in Q2/2018. The city-wide vacancy rate decreased by 0.9 of a ppt QoQ and 0.7 of a ppt YoY to 5.8% in Q2/2018.

The majority of leasing demand stemmed from the financial sector during Q2/2018. Transactions during

TABLE 1 **New supply, Q2/2018**

| Project Name EN | Project Name CN | Location | Grade | GFA (sq m) | Usage |
|-----------------|-----------------|----------|-------|------------|----------|
| Meritus Tower | 美瑞泰富大厦 | Wangjing | A | 70,200 | Self-use |

Source: Savills Research & Consultancy

TABLE 2 **Major leasing transactions, Q2/2018**

| Company | Industry | Nationality | Project | Location | GFA (sq m) |
|----------------------|------------------------------------|-------------|-------------------------------------|----------------------|------------|
| AIA | Finance | Foreign | China Merchants Tower | CBD | 10,000 |
| Changsheng Fund | Finance | Domestic | CSCEC International Centre Tower A | Asia-Olympic | 5,000 |
| Jie Yue United | Commercial / Professional Services | Domestic | COFCO Plaza | East Chang’an Avenue | 5,000 |
| BDO LLP | Commercial / Professional Services | Domestic | China Overseas International Centre | Asia-Olympic | 5,000 |
| All View Cloud | Information Technology | Domestic | R&F Centre | CBD | 2,400 |
| Chukong Technologies | Information Technology | Domestic | AVIC Tower | Wangjing | 2,000 |

Source: Savills Research & Consultancy

the quarter included AIA's lease of 10,000 sq m in China Merchants Tower in CBD and Changsheng Fund's commitment to 5,000 sq m in CSCEC International Centre Tower A in Asia-Olympic district.

The professional services sector, particularly consultancy, law and accounting firms, showed strong demand for both expanding and upgrading office space. Notable transactions included Jie Yue United, a domestic finance and consultancy company, expanding its operations by 5,000 sq m in COFCO Plaza in

East Chang'an Avenue area, BDO LLP relocating to China Overseas International Centre in Asia-Olympic area and leased approximately 5,000 sq m, and the Zhonglun and Yingke law firms signing pre-commitment contracts with CP Centre in CBD. They will relocate when the project launches in the next six months.

Demand from the IT sector maintained momentum during the quarter and contributed to a large number of deals. Deals of interest included All View Cloud leasing 2,400 sq m in R&F Centre in CBD's vicinity

and Chukong Technologies, a mobile entertainment platform, leasing 2,000 sq m in AVIC Tower in Wangjing area.

Rents

Active demand continued to fuel an overall rise in average rent, up by 3.6% QoQ and 7.5% YoY to RMB355 per sq m per month.

Submarket vacancy rates and rents

Traditional Business Districts

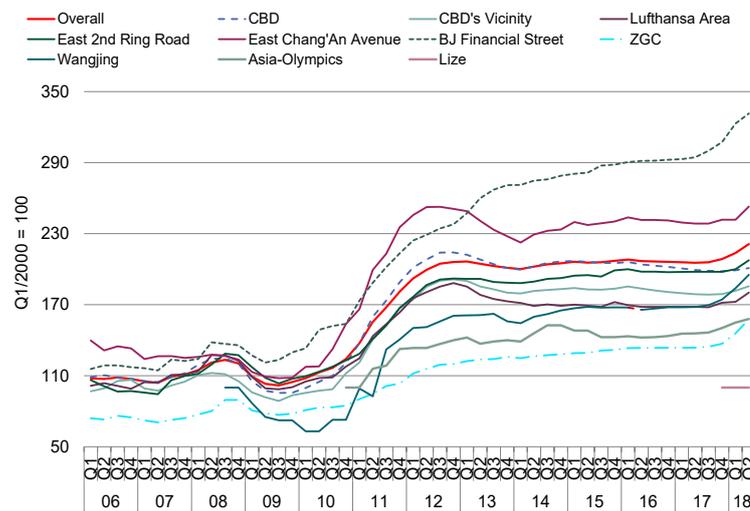
CBD remains the most favoured choice for office location. The average vacancy rate in the CBD decreased by 0.8 of a ppt QoQ to 2.6% in Q2/2018. Meanwhile, average rent in the precinct increased by 0.9% QoQ to RMB379.5 per sq m per month.

It is rumoured that the CBD Committee plans to establish a mechanism that will link building management with a tenant credit-review system. The initiative aims to provide landlords with stricter selection criteria and allow greater supervision of their tenants so as to avoid potential contract breaches, in particular from financial companies.

The CBD Core Plot Area will witness the first two projects launch in 2H/2018, with China Life Financial Centre and CP Centre scheduled to make their debut. The projects have embarked on early pre-leasing campaigns and have been able to secure several renowned international and domestic tenants. Large space requirements from these tenants, often above 15,000 sq m, have alleviated pressure on landlords.

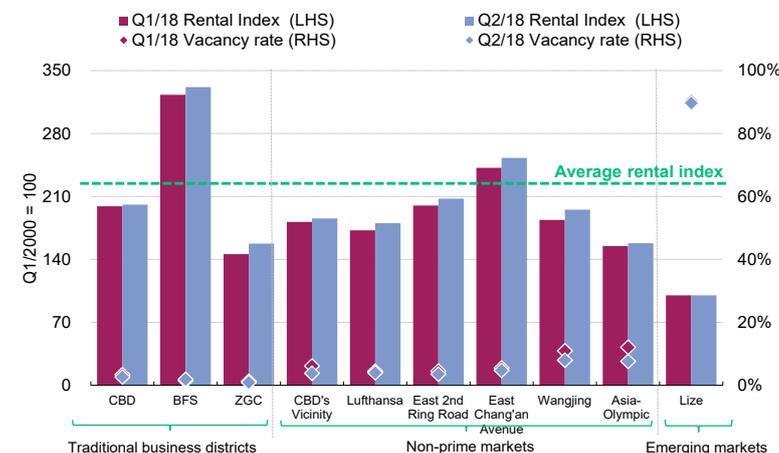
A recent roll-out of regulations in the banking industry has seen stricter requirements placed on banks in terms of setting up branches. As a result, some projects in Beijing Financial Street (BFS) saw tenancy terminations from non-local banks. Consequently, the average vacancy rate in the precinct has increased by 0.4 of ppt to 1.9%. While the regulations may contribute to a slight adjustment in the tenant mix, sustainable and strong demand from funds and investment companies will give landlords the confidence to raise

GRAPH 2 **Grade A office rental indices, Q1/2006–Q2/2018**



Source: Savills Research & Consultancy

GRAPH 3 **Submarket rents and vacancy rates, Q1/2018 vs Q2/2018**



Source: Savills Research and Consultancy

rents. Average rent in the precinct rose by 2.6% QoQ to RMB617.3 per sq m per month in Q2/2018.

Limited historical supply in Zhongguancun (ZGC) has resulted in the average vacancy rate in the precinct to fall to below 1% in Q2/2018. Tight vacancy levels in Grade A office projects have caused some tenants to begin exploring space in both Grade B office projects and in surrounding industrial parks. Strong leasing demand and increasing rental affordability from the IT and high-tech sector saw average rent increase substantially by 8.1% QoQ to RMB321.3 per sq m per month in Q2/2018.

Non-Prime Business Districts

The vacancy rate in the CBD’s vicinity decreased by 2.3 ppts QoQ to 3.8%. The improvement in performance was largely driven by Junhao Central Park securing several large deals and achieving an occupancy rate of 90%. Meanwhile, average rent in the precinct increased by 2.1% QoQ to RMB308.2 per sq m per month. Lufthansa area has seen a number of premium office projects aiming to achieve rental growth through the provision of value-add services and

by paying heightened attention to the improvement of project management. During Q2/2018, The Genesis signed a deal with a domestic financial company at a significantly higher price than the market average. The high-priced deal prompted a number of landlords in the precinct to also raise their asking rents. As a result, average rent in the precinct increased by 4.6% QoQ to RMB325.5 per sq m per month. Meanwhile, the average vacancy rate declined by 0.5 of a ppt to 4.0% during Q2/2018.

East Chang’an Avenue area saw its average vacancy rate decline by 0.8 of a ppt to 4.7%. Meanwhile, average rent in the precinct increased by 4.6% QoQ to RMB308.6 per sq m per month. The Beijing International Club Tower, which is scheduled to launch in 2H/2018, has already achieved a pre-commitment rate of 98%.

Wangjing area has seen the majority of existing projects in the precinct maintain high occupancy rates. The overall vacancy rate in Wangjing district dropped by 3 ppts QoQ to 8% in Q2/2018, largely due to fast absorption in recently launched projects. Average rent in the precinct

increased by 6.2% QoQ to RMB288 per sq m per month.

The average vacancy rate in Asia-Olympic area decreased by 4.4 ppts QoQ to 7.6% during Q2/2018, largely due to relocation and upgrading demand. The majority of deals transacted in the precinct occurred in China Overseas International Centre and CSCEC International Centre Tower A, with space demands ranging from 2,500 to 5,000 sq m. Average rent in the area increased by 2.0% QoQ to RMB355 per sq m per month.

Emerging Business Districts

Lize Financial Business District will receive a large level of new supply over the next five years as 1.37 million sq m is forecasted to enter the market. Among the new supply, approximately 68% or 934,000 sq m is for lease. Lize Financial Business District continued to be plagued with a high vacancy rate, a dynamic which is not expected to change in the short term due to ongoing infrastructure construction and an immature business environment. The average vacancy rate in the area stands at 89.7%, while average rent sits at RMB193.3 per sq m per month.

Tongzhou Canal Core Area is seeing good progress in terms of construction. The precinct is expected to see its first project launch in 2H/2018, with Trade Finance Centre Building #3 scheduled to make its debut on the leasing market. Huaxia Insurance acquired Trade Finance Centre Building #3 in 2016 and Trade Finance Centre Building #2 in 2017 on the en-bloc market. Huaxia has indicated the majority of the projects will be placed on the leasing market, with a minimum ratio of space reserved for self-use.

Market outlook

The Grade A office market is expected to welcome a supply peak in 2H/2018, with eight new projects scheduled to bring an additional 575,000 sq m GFA. As the majority of the new supply is located in favourable locations, it is forecasted this peak will not change much of

TABLE 4 **Future supply focus, Q3/2018**

| Project Name | COFCO Landmark |
|------------------------|---|
| |  |
| District | Others (Andingmen) |
| Developer | COFCO Group |
| Office Floors | 13 (Above Ground) |
| Office GFA | 52,120 sq m |
| Typical Floor Plate | 1,965 – 3,046 sq m |
| Typical Ceiling Height | 2.9 m |

Source: Savills Research & Consultancy

the dynamic of supply-demand equilibrium.

The Beijing Municipal Commission for City Planning and Land Resources Management issued a "Positive and Negative List of the Nature of Use of the Planning for Construction Projects". The directive has placed limitations on the use of land plots in the city, causing a decline in future commercial-zoned land in urban core areas. The limitation is expected to provide existing premium office projects strong potential for further asset appreciation.

The central government issued dozens of policies aimed at opening up the financial sector in 1H/2018, including lifting the limitation on the equity share of banks held by foreign capital and expanding the business scope of foreign banks. Thus it is expected that there will be a rise in leasing demand from foreign financial companies.

The IT and high-tech sector is expected to maintain strong momentum and continue to demand more for-lease space, especially from companies undergoing new rounds of financing and IPO activities.. ■

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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