

Briefing Office sector

March 2015



Image: CD IFS, Dongda Street, Chengdu

SUMMARY

Vacancy rates have increased as a result of new supply and suppressed demand. As property owners continue to decrease rents city-wide, average rents fell to the lowest level seen in eight years.

- Only one Grade A office, Tongwei International Center, was handed over in Q4/2014, adding a total GFA of 68,300 sq m. Consequently, total leasable stock expanded to 1.93 million sq m.
- As a result of weakened demand and several tenants breaking leases early, city-wide net take-up was negative for the first time in two years, totalling -2,700 sq m.
- Vacancy rates climbed 2.7 percentage points (ppts) to 30% quarter-on-quarter (QoQ).
- Grade A office rentals fell for the third consecutive quarter, down 4.2% QoQ to RMB100.16 per sq m per month, down 7.2% year-on-year (YoY).
- Seven projects are expected to be launched in 2015, adding over 480,000 sq m of new leasable space to the market – the highest annual supply on record. As a result, city-wide vacancy rates are expected to increase, leading to intensified competition amongst projects.

“Market supply pressure will be significantly higher in the coming year than in previous years. The continued falling rents and downturn pressure on the national economy has exacerbated the market’s pessimistic expectations.”
Dave Law, Savills Research

➔ **Market overview**

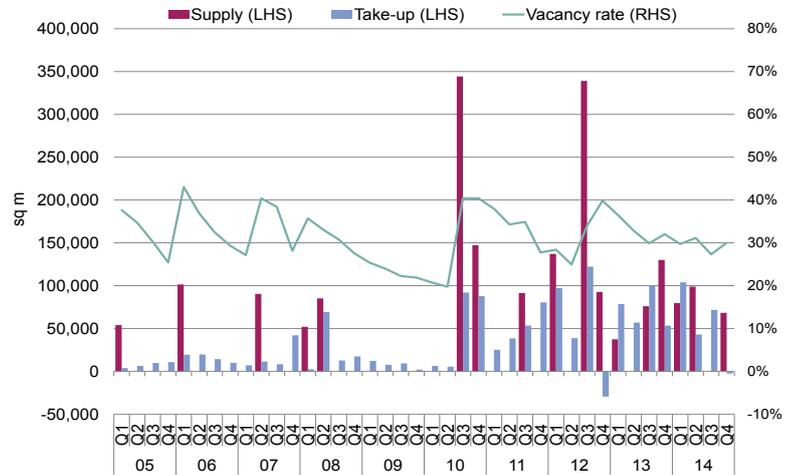
City-wide GDP reached RMB732.06 billion, representing a YoY growth of 8.7% in the first three quarters of 2014. Driven by the development of the automotive industry and electronic information industry, the secondary industry GDP reached RMB335.7 billion, up 10% YoY. Meanwhile, affected by the cooling of the financial industry and real estate industry, the tertiary industry GDP reached RMB367 billion, up 7.8% YoY.

Due to project schedules and market pressure, several projects which were scheduled to be launched this quarter have been delayed. Only one Grade A office, Tongwei International Center, located in Tianfu New City, entered the market, bringing a new supply of 68,000 sq m. City-wide Grade A office market reached 1.93 million sq m in total, still the largest in western China.

Due to the cooling of the national economy, small- and medium-sized,

GRAPH 1

Grade A office supply, take-up and vacancy rates, Q1/2005–Q4/2014



Source: Savills Research

privately-owned finance companies, particularly microcredit companies, began breaking their leases. Although part of the vacant space has been taken over by other tenants, city-wide Grade A office net take-up was still negative. As a result of both new projects and tenants vacating projects, city-wide vacancy rates increased 2.7 ppts QoQ to 30%.

Continued rental discounts and extended rent-free periods, in order to attract new tenants and secure existing high quality tenants, has led effective rents in the Chengdu Grade A office market to trend downward for three consecutive quarters, decreasing 4.2% QoQ to RMB100.16 per sq m per month, falling 7.2% YoY.

CBD

Several incomplete projects were launched onto the market in an effort to beat competition, resulting in projects with unfinished facilities such as lifts and parking areas. Additionally, several new projects are now providing tenants with more rental discounts as well as rental-free periods, resulting in some projects experiencing a period of tenant adjustment.

Although no new projects entered the market this quarter, CBD area witnessed the highest Grade A office vacancy rates in Chengdu, up 3.5 ppts QoQ to 36.1%, surpassing the Dongda Street vacancy rates. In an effort to boost occupancy rates in the area, certain projects are making rental

sacrifices leading to an 8.5% QoQ decrease in rents for Grade A offices to RMB103.75 per sq m per month. Rents in CBD, however, remain the highest in Chengdu.

SBD

A lack of new supply in the last two years has resulted in a stable SBD office market and allowed the area to achieve the lowest city-wide vacancy rates in Q4/2014.

Though the mature business atmosphere and high-quality facilities keep vacancy rates relatively low, certain buildings have been showing signs of aging. This quarter, SBD Grade A office average rents declined 3.1% to RMB95 per sq m per month.

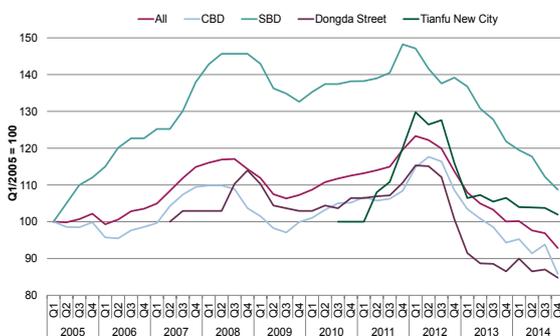
Dongda Street

The fourth quarter saw several privately-owned finance companies, particularly microcredit companies, break leases in a number of Grade A offices in the Dongda Street area. Nevertheless, with the support of CD IFS, net take-up of Grade A office space exceeded 3,000 sq m, with vacancy rates falling 0.7 of a ppt QoQ to 33.5%.

Most Grade A office projects in the area were launched after 2010 and provided excellent facilities, prompting property owners to be hesitant in providing tenants with rents below the average. Dongda Street area Grade A office rents decreased 2.5% QoQ to RMB107.86 per sq m per month

GRAPH 2

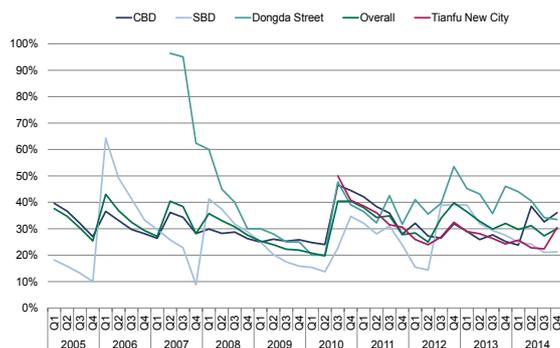
Grade A office rental indices, Q1/2005–Q4/2014



Source: Savills Research

GRAPH 3

Grade A office vacancy rates, Q1/2005–Q4/2014



Source: Savills Research

→ In the coming year, 270,000 sq m of new supply will enter the market in this area – 60% more than the existing market stock. Consequently, vacancy rates are expected to fall and landlords will be offering rental incentives to ensure high occupancy rates in the face of heightened competition.

Tianfu New City

With the Tongwei International Center entering the Grade A office market, available stock in this area became the highest city-wide, climbing to over 530,000 sq m and pushing vacancy rates up 8.0 ppts QoQ to 30.4%. Consequently, due to increasing vacancy rates, property owners reduced rents in the area to boost occupancy, allowing rents to fall 1.7% QoQ to RMB95 per sq m per month – the lowest in the city-wide Grade A office market.

In the long term, Tianfu New City, being one of the state-level new areas, will see a period of sustained growth of office net take-up. In the short term, however, property owners are expected to face pressure to lower rents due to the large influx of supply. Grade A office vacancy rates in this area are expected to increase further in conjunction with the remaining COLI Int'l Center offices scheduled to be launched onto the market in the future. However, most new projects being launched are expected to be high-quality projects under single ownership and are unlikely to provide rental discounts.

TABLE 1
Key leasing deals, Q4/2014

Tenant	Project	Location	Surface area (sq m)
EOG	Square One	CBD	850
CNTV	Square One	SBD	850
Kohler	Square One	CBD	230

Source: Savills Research

Market Outlook

Due to an influx of supply and the current weakened economic conditions, the Chengdu Grade A office market is expected to face tougher challenges. Vacancy rates are expected to increase significantly over the coming year despite landlords extending rent-free periods and introducing a number of discounts.

- Several projects which were scheduled to be launched in 2014 were postponed and are now expected to enter the market in 2015. Seven projects, over 480,000 sq m, are scheduled to be launched over the coming year. Dongda Street will witness a supply peak with the launch of several projects including CD IFS, WIFC and Pinnacle One. However, the traditional commercial districts, such as CBD and SBD, lack sizable Grade A office projects entering the market.

- Property management of future projects is improving significantly, alongside commercial and public

facilities, allowing new business districts, such as Tianfu New City and Dongda Street, to mature. As a result, large-scale tenant adjustment is expected to occur in the near future. In addition, a number of high-quality companies, which have the financial ability to afford renovation costs, will upgrade existing office space step by step in order to upgrade the overall property image.

- In the short term, the Chengdu office market is facing an issue of oversupply. Continuously high vacancy rates and consistently declining rents will deepen the pessimistic outlook on the market. However, with the freeing of the supply of land plots for sale within core areas and the optimistic outlook of the Chengdu economy, Grade A office vacancy rates, rents and tenant structure are expected see a tentatively positive outlook. ■

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