

Briefing Office sector

October 2015

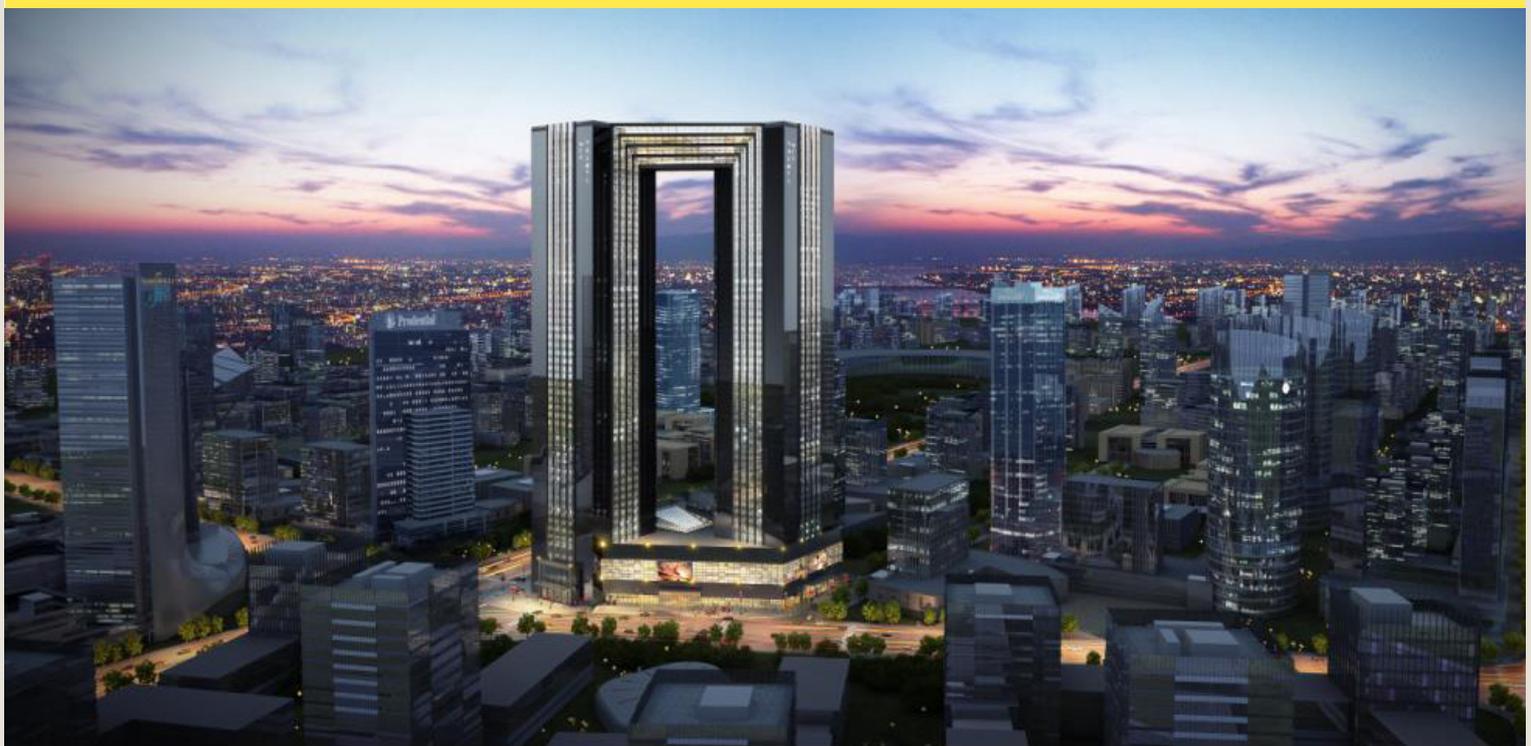


Image: World Financial Center, Tianfu New City, Chengdu

SUMMARY

Due to the current economic downturn, a number of projects witnessed tenants relocating, resulting in high, city-wide vacancy rates. As a result, many landlords continued to lower rents amid the increasing competition.

- In Q3/2015, no new supply entered the Grade A office market, with overall stock remaining at 2.16 million sq m.
- Although no new supply entered in Q3/2015, some tenants decided to break their leases early due to the economic downturn, leading to vacancy rates remaining high – down 0.3 percentage points (pts) to 40.5%. Only 6,000 sq m of net take-up was recorded in the third quarter, despite the market remaining active.
- Due to the increasing competition in the market, a number of landlords reduced rents in the hope of attracting and retaining tenants, leading to overall city average rents falling 1.8% quarter-on-quarter (QoQ) to RMB98.6 per sq m per month.
- The Sichuan Airlines Center is expected to enter the market in the next quarter, adding 80,000 sq m to the market.

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 “Due to the combination of pressure from market supply and the current economic downturn, the office market is beginning to see increasing competition among developers and landlords.” Dave Law, Savills Project & Development Consultancy

➔ **Market overview**

In the first half of 2015, Chengdu's GDP reached RMB513.61 billion, with a growth rate of 8.0% year-on-year (YoY), 0.7 of a ppt lower than the same period last year. The structure of the economy continues to change, with the service industry achieving the fastest growth rate among the three industries at 10.0% YoY, adding RMB278.45 billion to the economy. City-wide fixed asset investment growth also performed strongly, reaching RMB350.29 billion – up 8.7% YoY. Real estate development investment reached RMB122.91 billion, up 16.2% YoY.

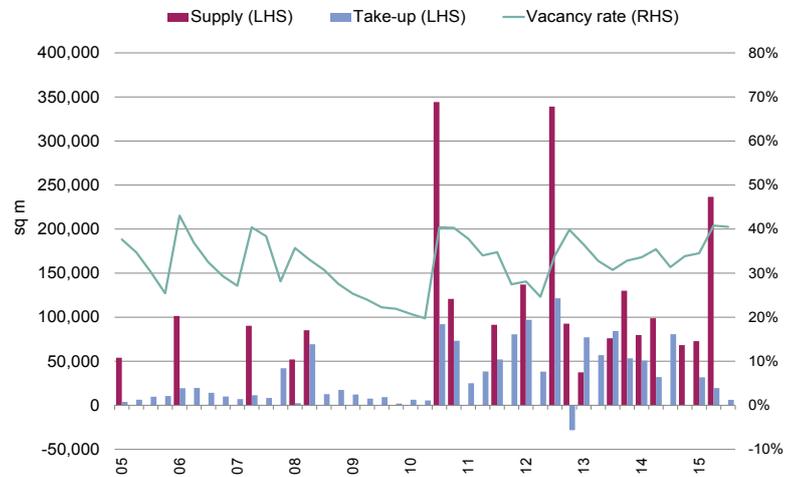
Although a number of projects had initially postponed their launch dates to this quarter, no new supply was seen. Chengdu Grade A office leasable stock remained stable at 2.16 million sq m. At the same time, a number of tenants decided to break their lease early due to the current economic downturn, leading to vacancy rates remaining high – down 0.3 pts to 40.5%. At the same time, only 6,000 sq m of net take-up was recorded in the third quarter, despite the market remaining active.

Due to the expected influx of supply and increasing competition in the market, a number of landlords reduced rents in the hope of attracting and retaining tenants, leading to overall city average rents falling 1.8% QoQ to RMB98.6 per sq m per month – down 7.7% YoY

Tianfu New City saw the highest decrease in rents at 3.1% QoQ. A number of projects widened their target audience for spaces within their developments in order to improve the occupancy rate, such as by cooperating with the government and providing a higher commission to stimulate the enthusiasm of third parties.

GRAPH 1

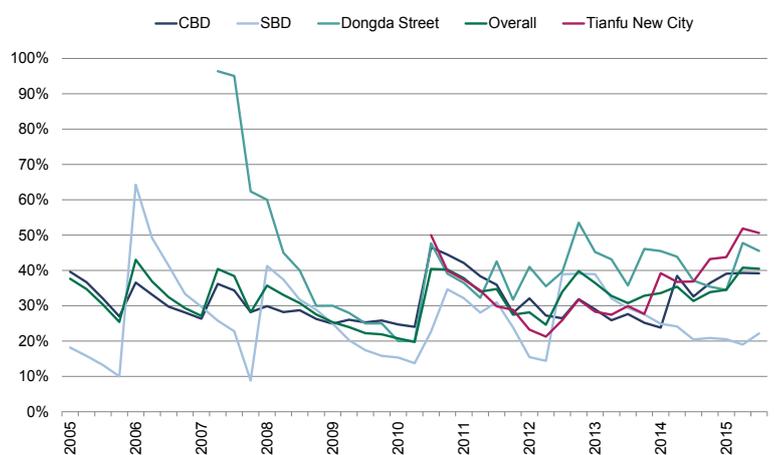
Chengdu Grade A office supply, take-up and vacancy, Q1/2005-Q3/2015



Source: Savills Project & Development Consultancy

GRAPH 2

Chengdu Grade A office vacancy rates, Q1/2005-Q3/2015



Source: Savills Project & Development Consultancy

Financial service companies remain the demand drivers of the leasing market, however, IT and e-commerce companies were also active, which could mean the city is going through a period of transition.

CBD

The CBD area was stable this quarter, with rent remaining at RMB111.43 per sq m per month – continuing to be the highest in the city. The vacancy rate fell to 39.2%, reversing the upward trend

witnessed since the beginning of the year.

Although the area had a stable performance overall, a number of buildings did better than others due to the large range of project quality, developers' operating ability and other factors. Handian Financial took-up 2,000 sq m in Yanlord Landmark, while Maoye World and Chinese Estates Plaza also saw occupancy rates increased slowly.

→ In the fourth quarter, the 80,000 sq m Sichuan Airlines Center is expected to be launched in this area.

SBD

During this quarter, the SBD saw a dip in performance compared to Q2/2015. Net take-up was recorded as negative as vacancy rates increased 3.2 ppts to 22.2%. Although vacancy rates increased, the SBD still has the lowest vacancy rates in the city. As a result, SBD average rents dropped 1.9% to RMB90.00 per sq m per month.

Influenced by the current economic environment, local micro-credit financial companies accounted for the largest proportion of tenant relocations in the area, followed by retail/trade and medical related companies.

The SBD is not expected to see any new supply over the next two years. However, due to the current project characteristics and tenant structure, the vacancy rates of this area are expected to continue to fluctuate in the future.

Dongda Street

In this quarter, due to take-up in The Atrium and International Financial Square I, Dongda Street had the best performance in the city, with vacancy rates decreasing 2.3 ppts to 45.5%. Averages rents saw the lowest decrease, down 0.6% to RMB106.88 per sq m per month.

Dongda Street remains the first choice for financial services companies, while many professional services companies are also relocating to the area. As a result, Dongda Street may have the potential to take over the most attractive area status from the CBD. As the Atrium and International Financial Square I are within the core area of Dongda Street, the advantageous location and high-quality projects will

attract many well-known companies, helping to increase occupancy rates.

During the next two years, Pinnacle One and Western International Financial Centre are expected to be handed over, likely causing increasing competition between landlords in the long term.

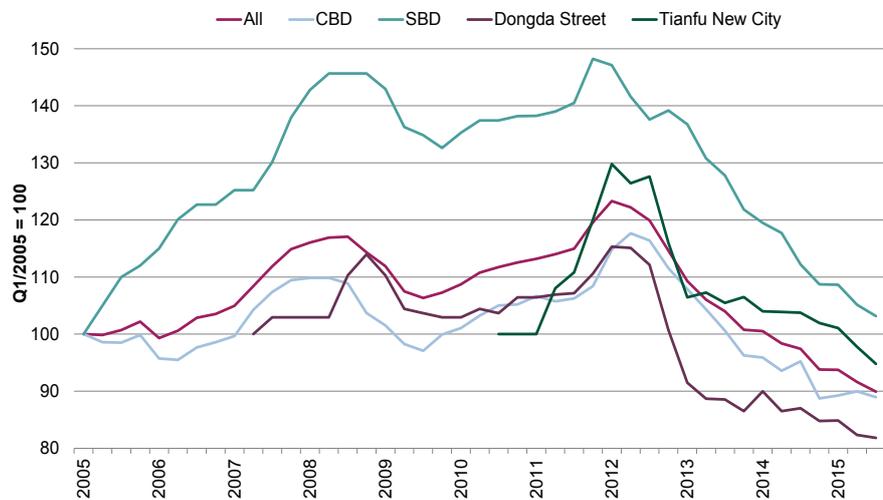
Tianfu New City

In the third quarter, due to Chengdu International, COLI Int'l Center and other projects increasing their lease numbers, vacancy rates decreased 1.3 ppts to 50.6%. However, due to the large amount of competition from Grade B office buildings, absorption of the new projects will take a longer period of time than previously seen. As

a result, landlords are opting to reduce rents, leading to the lowest rents of the city, down 3.1% QoQ to RMB91.8 per sq m per month. In addition, landlords are also providing added incentives to attract tenants in order to increase occupancy rates, such as offering higher commission rates to third party agents.

Chengdu International showed high take-up levels as a result of its environmentally-friendly design, cost-effective pricing levels and industrial development benefit policies. As the main tenants of Sichuan Investment Plaza are financial services companies (who have been affected by the current economic environment), many tenants decided to break their leases early,

GRAPH 3 Chengdu Grade A office rental indices, Q1/2005-Q3/2015



Source: Savills Project & Development Consultancy

TABLE 1 Selection of leasing transaction, Q3/2015

Tenant	Project	Location	Surface area (sq m)
The Biomobie Corp.	Int'l Financial Square	Dongda Street	2,800
Lafarge Shui On	Chengdu International	Tianfu New City	2,000
The Czech Consulate	The Atrium	Dongda Street	500

Source: Savills Project & Development Consultancy

leading to increasing vacancy rates. During the next two years, four projects, including Yintai Centre and World Financial Center, are expected to enter the market, placing an increasing pressure on landlords.

Market outlook

The Chengdu Grade A office market is expected to continue to receive new supply over the next two years, however, due to the combination of the current economic downturn and the increasing competition between projects, a number of projects are

considering postponing their launch dates.

Another result of this increasing competition between projects is the fact that many tenants are relocating to find office space at a more cost-effective price; others are becoming more cautious about expansion plans or even closing down completely. As an influx of supply is due to be seen over the next two years, average rents are expected to witness a downward trend, while vacancy rates are expected to remain high.

In the current market, landlords will be forced to shift focus and adapt strategies to ones other than lowering rents, such as providing innovative services and products targeting a wider audience of tenants and providing further value-added services to tenants. ■

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