

Briefing Office sector

October 2015



Image: Zhongyu International, Xinpaifang

SUMMARY

The third quarter of 2015 saw city-wide vacancy rates reaching 51.9%, the highest ever recorded, due to an influx of supply achieving low pre-commitment rates.

- Three new projects, located in the Jiangbeizui and Xinpaifang areas, were launched onto the market in Q3/2015, adding 175,000 sq m and pushing total Grade A office stock up to 1.52 million sq m.
- Net take-up totalled 41,420 sq m in Q3/2015, a significant increase compared with the first two quarters of 2015.
- City-wide vacancy rates rose 3.2 percentage points (ppts) to 51.9%

quarter-on-quarter (QoQ), the first time that vacant space exceeded occupied space in the market.

- As high vacancy rates have led to fierce competition, rents of Grade A office space witnessed a decline of 1.5% QoQ to an average of RMB105 per sq m per month.
- Strata-title transaction prices decreased 0.9% QoQ, averaging RMB20,000 per sq m.

"The downward trend of occupancy rates and rents is expected to continue due to a huge volume of supply combined with weaker demand levels."

Dave Law, Savills Research

→ **Forecast**

Four new projects, totalling approximately 120,000 sq m (excluding self-use space), are expected to be launched onto the market during the next quarter.

Market commentary

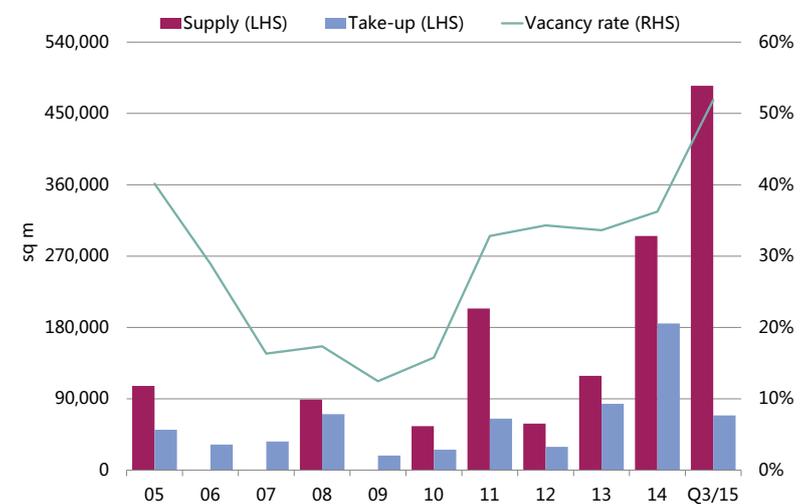
New supply was seen in the Xinpaifang and Jiangbeizui areas this quarter, adding 175,000 sq m to the market and increasing city-wide stock to 1.52 million sq m. With the successive handover of the second and third Grade A office buildings in the Xinpaifang area, a new business centre is emerging in Yubei. According to the Chongqing Commerce Commission in Yubei, the development of the Xinpaifang area is regarded as promising even though Guanyinqiao, a mature business centre, is nearby. As a single business centre is not able to meet the large demand in this area, the emergence of a further business district is needed for city development.

Net take-up increased significantly in Q3/2015, reaching a total of 41,420 sq m, double that seen in the last quarter. The increase of take-up was attributed to the absorption of new supply in the Xinpaifang and Jiangbeizui areas due to the competitive strategies adopted within these emerging areas. The Xinpaifang area benefits from its advantageous location and transportation links, while Jiangbeizui benefits from the commercial cluster and supporting facilities.

Vacancy rate

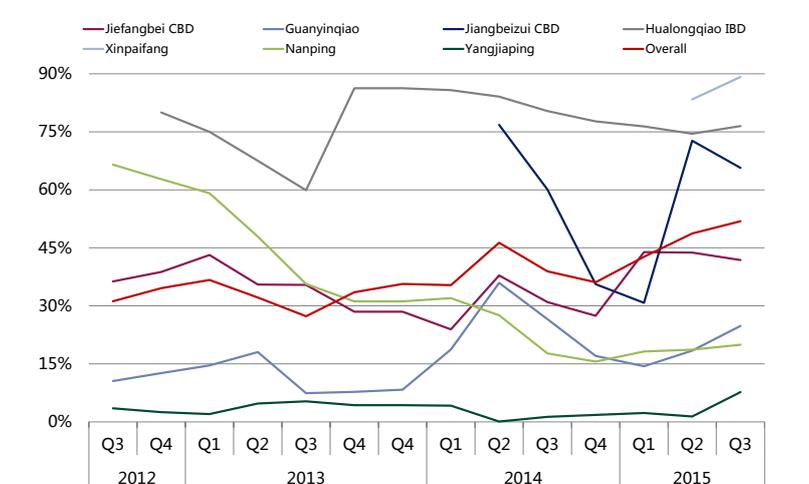
City-wide vacancy rates rose 3.2 pts QoQ to 51.9% in Q3/2015 – the first time that vacant space exceeded occupied space. This

GRAPH 1 **Grade A office supply, take-up and vacancy rates, 2005–2015 YTD**



Source: Savills Research

GRAPH 2 **Vacancy rates by area, Q3/2012–Q3/2015**



Source: Savills Research

is a result of demand levels being unable to sustain supply levels. New business districts (Hualongqiao, Xinpaifang, Jiangbeizui) witnessed increased vacancy rates due to the handover of new projects. Vacancy rates in the Xinpaifang area remained the highest at 89.2%, increasing 7.0% QoQ. Traditional areas (Nanping, Yangjiaping, Guanyinqiao) vacancy rates remained flat.

The total number of organisations in all industries recorded an increase of 10.5% QoQ, contributing to a growth in occupied space. Among these firms, financial companies grew at the highest rate of 20% QoQ – adding 50 companies and leading to city-wide occupied space increasing by 50,470 sq m. In addition, company expansions also contributed to the growth of occupied space – Nanyue Bank

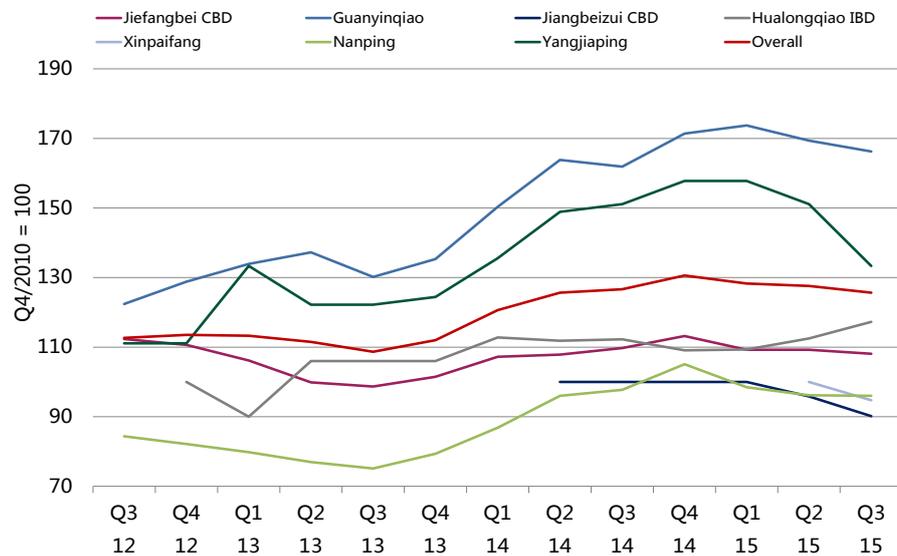
entered into Lifan Centre T1, occupying 10 floors (21,625 sq m). The rapid expansion of the financial industry is related to government policies offering financial support for encouraging entrepreneurship and the development of small enterprises. As a result, the total occupied space across the city rose to 735,410 sq m, up 6% QoQ, as the amount of companies relocating was relatively small.

However, even though net take-up increased significantly QoQ, supply volumes still exceeded the expected demand levels, contributing to high vacancy rates.

Rents

Grade A office rents fell 1.5% QoQ to an average of RMB105 per sq m per month in Q3/2015. All districts saw rents decrease, albeit to different extents, with the exception of an increase in the Hualongqiao area. This increase can be attributed to the beneficial factors within new markets, including advantageous supporting facilities and industry clustering effects. Since the Hualongqiao area has already attracted several Fortune 500 companies, such as Deloitte and Sony, the prospects look good for the area. The current downward trend in overall rents resulted in an increase in vacancy rates. The Xicheng International building in the Yangjiaping area reduced rents due to fierce competition from new surrounding Grade B office buildings. Emerging business areas find it harder to attract large amounts of international, well-known companies with lower budget constraints. In the Jiangbeizui area, the decline of rents resulted from increased market competition caused by the large supply.

GRAPH 3 Rental indices by area, Q3/2012–Q3/2015



Source: Savills Research

Office strata-title market

City-wide strata-title transaction prices fell 0.9% QoQ to an average of RMB20,036 per sq m. Jiefangbei area prices rose 0.8%, while the traditional districts of Nanping and Yangjiaping fell 4.4% and 13.9% QoQ respectively. Other business centres remained flat. The reason for these price adjustments is that the comprehensive competitiveness of traditional business districts is declining in anticipation of new emerging markets.

Market outlook

Four new projects are expected to be handed over in the last quarter of 2015, adding 120,000 sq m of leasable office space. The total supply for 2015 is likely to reach over one million sq m, six times higher than the average supply over the past five years.

According to the Chongqing Commerce Commission, 50 core business areas will be completed

up to 2020, with a further influx of supply expected to continue. Although the Grade A office market in Chongqing is increasingly driven by financial and IT industries, overall demand is expected to be inadequate to sustain the large amount of supply. As a consequence of this excess supply and weak demand, as well as fierce competition, a downward trend of rents and occupancy rates is expected.

However, the People's Bank of China has cut interests for the third time in 2015. Thus, reduced costs of real estate purchases can be expected, which could stretch to the recovery of the market. In addition, the CPPCC (Chinese People's Political Consultative Conference) economic committee is determined to encourage the development of small- and medium-sized banks in Chongqing. As a result, an increased demand from banks for high-quality office space is expected. ■

Project focus

Zhongyu International #1

Zhongyu International #1, located in Xinpaifang, was developed by Chongqing Zhongyu Development Co. Ltd, which was acquired by the Evergrande Real Estate Group Limited this year. This project was handed over in Q3/2015, with an office GFA of 69,000 sq m, spanning floors 5 to 36. The project is serviced by 20 passenger lifts and offers 2,200 car parking spaces. The project also benefits from direct access to the Jiazhou metro station (line 3). The asking rent is RMB100 per sq m per month, and management fees are RMB25 per sq m per month.

Zhongyu International #1 is one of the Grade A office buildings within the Zhongyu International project, which will consist of Grade A office space, a five-star hotel and retail components – phases two and three are currently under development and planning. This mixed-use development intends to be the new centre of Chongqing, aiming to meet the increasing needs of the market.

TABLE 1
Zhongyu International #1

Location	Xinpaifang	
Developer	Chongqing Zhongyu Development Co. Ltd	
Office GFA	69,000 sq m	
No. of office floors	36	
Standard floor height	4.35 m	
Number of lifts	20	
Floor plate	2,000 sq m	
No. of parking spaces	2,200	
Handover date	Q3/2015	
Asking rent	RMB100 per sq m per month	
Management fee	RMB25 per sq m per month	

Source: Savills Research

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