

# Briefing Office and retail sectors

August 2015



Image: Pavilion, Zhongshan District

## SUMMARY

The Grade A office market saw declines in both rents and net take-up in 1H/2015, while the mid- to high-end retail market witnessed a positive performance, with moderate growth in both rents and occupancy rates.

■ No new supply entered the Grade A office market in 1H/2015, marking the eighth consecutive quarter of no supply, leaving stock unchanged at 1.1 million sq m.

■ City-wide vacancy rates fell 0.5 of a percentage point (ppt) half-on-half (HoH) to 8.3% by the end of 1H/2015, a result of the lack of new supply. Despite this, net take-up totalled just 5,500 sq m during the first half of 2015, down 85.7% year-on-year (YoY).

■ Grade A office rents declined 1.4% to an average of RMB124.8 per sq m per month (exclusive of property management fees), but up 0.5% YoY.

■ One retail project was handed over in 1H/2015, adding 130,000 sq m to

the market. As a result, total retail stock expanded to 2.4 million sq m.

■ As a result of high pre-commitment rates in a newly launched project, combined with the stable performances in existing projects, city-wide vacancy rates in the retail market decreased 0.3 of a ppt HoH to 4.1% by the end of 1H/2015.

■ Mid- to high-end shopping mall first-floor rents grew 1.7% HoH to RMB407.9 per sq m per month, representing a 6.0% YoY growth.

■ Both the Grade A office and mid- to high-end retail markets are expected to welcome the highest supply peaks recorded to date in the second half of 2015, with two new office buildings

and five retail projects scheduled to be launched. The influx of supply is expected to place a downward pressure on both occupancy rates and rents in both markets.

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“Strong performance in the retail market saw Dalian become the only city among all major first- and second-tier cities in Northern China to experience growth in occupancy rates in 1H/2015.”

Jack Xiong, Savills Research

### → Economic overview

Dalian's GDP grew at a real rate of just 2.0% to RMB148.4 billion in Q1/2015. This was 5.4 pts lower than the national level and marked the slowest period of growth in the past decade. Fixed-asset investment (FAI) totalled RMB43.8 billion in the first three months of the year; however, the growth rate was down 27.2% YoY, posting the first ever negative growth in the past decade. Meanwhile, both urban disposable incomes per capita and retail sales grew during the period, up 7.7% and 6.0% YoY respectively.

### Office market

#### Supply, take-up and vacancy rates

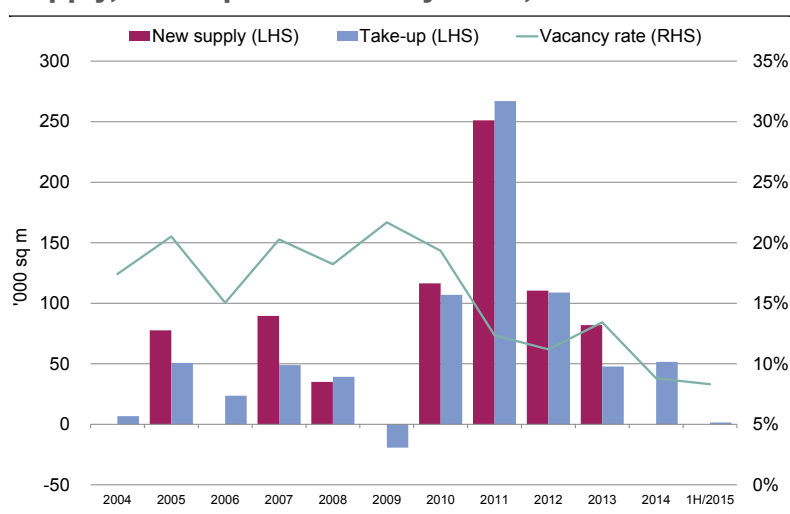
No new supply was handed over in the first half of 2015, marking the eighth consecutive quarter of no supply. Consequently, Grade A office stock remained unchanged at 1.1 million sq m. The remainder of the year, however, is scheduled to welcome two new projects with a combined office GFA of approximately 160,000 sq m, the highest half-yearly supply peak since 2012.

The lack of supply in the market continued to place a downward pressure on the city-wide vacancy rates, which dropped 0.5 of a ppt HoH to 8.3%, down 1.6 pts YoY. As a result, Dalian remains the tightest office market among all major second-tier cities.

Given the local economic slowdown, companies continued to be cautious with expansion plans, resulting in net-take up falling 56.6% HoH to 5,500 sq m.

Financial, E-commerce and IT & Hi-Tech companies continued to be the strongest demand drivers for Grade A office space. Recently launched projects, namely the Wanda Centre, Modern Service Headquarter Building and Jinlian International Mansion, continued to be popular leasing options for many companies. Given these projects offer prime locations and higher-quality building standards, accelerated absorption rates were witnessed compared to other projects over the same period.

GRAPH 1 **Supply, take-up and vacancy rates, 2004–1H/2015**



Source: Savills Research

TABLE 1 **Key economic indicators, Jan–Mar 2015**

Indicator	Units	Value	YoY growth rate (%)
GDP	RMB billion	148.4	2.0
FAI	RMB billion	43.8	-27.2
Retail sales	RMB billion	69.7	6.0
Disposable income per capita (urban)	RMB	9,398	7.7
Consumer price index (CPI)	Previous year = 100	101.4	1.4

Source: Dalian Statistics Bureau, Savills Research

TABLE 2 **Northern China Grade A office market main indicators, 1H/2015**

	Beijing	Tianjin	Shenyang	Dalian	Qingdao
<b>Stock (million sq m)</b>	9.94	0.61	1.40	1.10	1.53
HoH change (%)	2%	-	57%	-	4%
YoY change (%)	5.8%	18.8%	88.7%	-	10%
<b>New Supply (sq m)</b>	150,000	-	510,000	-	58,000
HoH change (%)	-62.2%	-	237.8%	-	-27.8%
YoY change (%)	168.2%	-	1,460%	-	-
<b>Vacancy rate</b>	4.1%	24.0%	47.7%	8.3%	19.3%
HoH change (%ppts)	-0.7	-3.9	18.0	-0.5	1.5
YoY change (%ppts)	0.6	5.9	30	-1.6	1.9
<b>Rents (RMB per sq m per month)</b>	319.1	141.9	135.8	124.8	102.8
HoH change (%)	0.2%	-0.2%	-1.6%	-1.4%	-0.1%
YoY change (%)	1.7%	0.8%	-1.7%	0.5%	1.4%

Source: Savills Research

➔ **Grade A office rents**

Slowing demand under economic uncertainties has forced landlords to offer rental discounts to retain tenants. As a result, Grade A office effective rents dropped 1.4% in 1H/2015 to an average of RMB124.8 per sq m per month (exclusive of property management fees). However, this is up 0.5% YoY.

**Submarket vacancy rates and rents**

*Traditional business districts*

Renmin Road rents increased 0.2% HoH to an average of RMB84.0 per sq m per month, up 1.5% YoY. With the majority of office stock in this area being rather old and offering lower-quality facilities, landlords continued to not hold any significant bargaining power in terms of rental negotiations, reflected in the area rents remaining largely stable. Renmin Road, continuing to offer the lowest rents in the city, saw strong demand from domestic companies with tighter rental budgets. As a result, vacancy rates in the area were 1.8% by the end of 1H/2015, remaining the lowest in the city.

Qingniwa area, home to numerous prime office buildings such as the Senmao Building and Xiwang Tower, continued to attract a number of

overseas companies. However, amid the local economic slowdown, several landlords of older projects in the area have begun to offer rental incentives to retain and attract tenants. As a result, Qingniwa area rents fell 4.1% HoH to an average of RMB144.9 per sq m per month, down 1.6% YoY. Meanwhile, vacancy rates remained stable at 5.3%, although this is down 0.9 of a ppt YoY.

*Emerging markets*

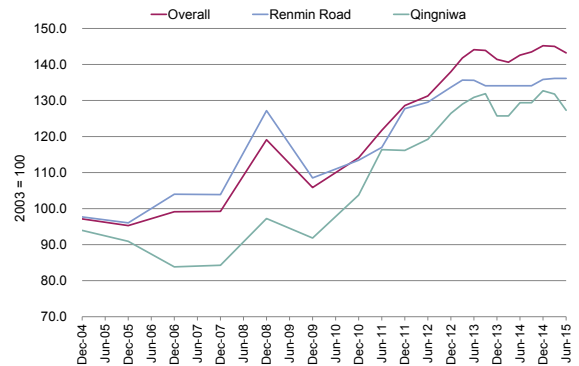
Xinghai Square rents fell 1.3% HoH to an average of RMB152.5 per sq m per month, a decrease of 2.8% YoY. With new supply for the area in the pipeline, landlords continued to lose bargaining power over tenants. Meanwhile, vacancy rates remained stable, down 0.1 of a ppt to 14.3%.

Active performances from financial companies saw East Harbour rents remain stable and still the highest in the city, averaging RMB164.3 per sq m per month, an increase of 7.9% YoY. Strong demand saw vacancy rates continue to drop, down 4.3 ppts YoY to 9.4%.

**Office market outlook**

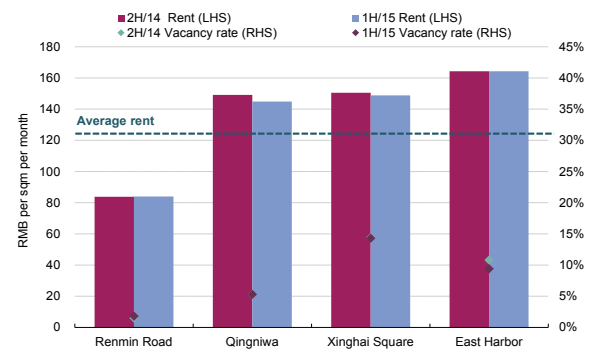
With Eton Centre choosing to continue to postpone its completion date, the

GRAPH 2 **Grade A office rental indices, 2004-1H/2015**



Source: Savills Research

GRAPH 3 **Grade A office submarket vacancy rates and rents, 2H/2014 vs 1H/2015**



Source: Savills Research

TABLE 3 **Selected office leasing transactions, 1H/2015**

Company	Project	Location	GFA (sq m)	New lease/renewal
CEC China	Tian An International Tower	Qingniwa Area	360	New lease
Jinjia Investment	Tian An International Tower	Qingniwa Area	380	New lease
Soufun	Jinlian International Mansion	Qingniwa Area	450	New lease
Qunar	Modern Service Headquarter Building	Others (Xi'an Road)	500	New lease
PublicRevenue	Tian An International Tower	Qingniwa Area	540	New lease
Mingjie Investment	Tian An International Tower	Qingniwa Area	560	New lease
Shan Lin Financial	Modern Service Headquarter Building	Others (Xi'an Road)	700	New lease
Heng Chang Wealth	Modern Service Headquarter Building	Others (Xi'an Road)	700	New lease
58.com	Modern Service Headquarter Building	Others (Xi'an Road)	1,000	New lease
Dalian Huizhong Fisheries	Tian An International Tower	Qingniwa Area	1,330	New lease
Zhongjin Hengjun	Wanda Centre	East Harbour	1,600	New lease
StarsWealth	Wanda Centre	East Harbour	1,600	New lease

Source: Savills Research



second half of 2015 is now scheduled to welcome two new projects with a combined GFA of approximately 160,000 sq m to the market. All of the new supply will be located in the traditional business district, Qingniwa area. With the market experiencing slowing demand, the significant influx of new supply is expected to take a longer period of time to be absorbed, leading to both city-wide occupancy rates and overall rents anticipated to decline in the short term.

The oversupply situation in the office market is expected to be further exaggerated over the next few years, with 12 new projects scheduled to be launched by the end of 2017, pushing total stock to approximately 2.3 million sq m. New supply will be distributed throughout emerging markets, Xinghai Square (32%) and East Harbour (68%), turning them into the largest business areas in the city.

The substantial level of new supply is expected to increase competition in the market, pushing landlords to offer rental incentives. As a result, the market is expected to see continued downward pressure on rents over the next five years until vacant space is sufficiently digested.

### Retail market

#### Supply and stock

Dalian welcomed one new retail project to the market in the first half of 2015. Pavilion (柏威年) shopping mall launched in the Qingniwa district, contributing 130,000 sq m to the market. As a result, total mid- to high-end retail stock expanded to 2.4 million sq m, 75% of which now comprises shopping malls.

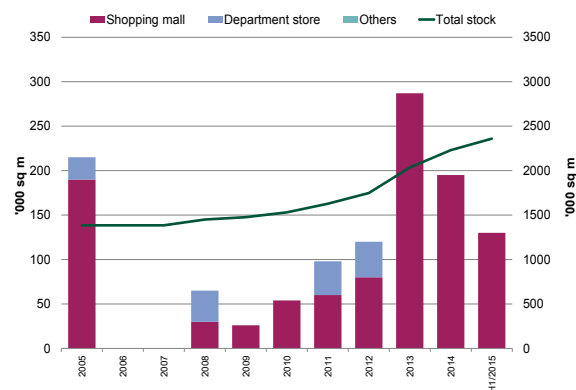
- Pavilion (柏威年)  
Pavilion (柏威年) is a high-end shopping mall located in the downtown Qingniwa district. Developed by the Pavilion Group, a

Malaysia-based property developer, this project marks the company's entrance into the China market. Spanning six floors, the project aims to offer a comprehensive shopping experience, introducing a diverse tenant mix including a variety of luxury, fashion, F&B, entertainment and lifestyle retailers. Located in the Eton Centre office building, which is scheduled to launch in the second half of the year, the project has allocated 35% of the tenant mix to F&B retailers. Anchor tenants include CGV Cinema, Ole Supermarket, Vivienne Westwood and Dunhill. Given the project's prime location, strong pre-commitment levels were attained which have seen occupancy rates already reach approximately 85%.

#### Demand and vacancy rates

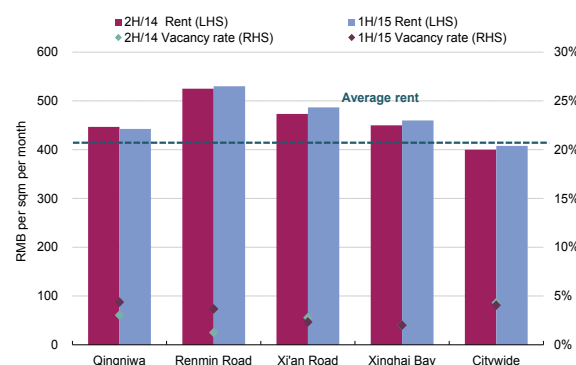
Landlords continued to feel pressure from the increasing popularity of e-commerce. As a result,

GRAPH 4 Mid- to high-end retail supply and stock, 2005-1H/2015



Source: Savills Research

GRAPH 5 Rental ranges and vacancy rates of major retail areas, 2H/2014 vs 1H/2015



Source: Savills Research

TABLE 4 Future project focus

Project name	Eton Centre - Dalian	Dalian World Trade Centre
		
Location	Qingniwa	Qingniwa
Owner	Eton Properties	Dalian World Trade Centre Co. Ltd
Office GFA (sq m)	80,000	86,000
Floorplate (sq m)	1,700-1,800	2,700
PM company	Eton	TBC
Asking rent	180	TBC
Management fee	TBC	TBC

Source: Savills Research

TABLE 5 Future office supply, 2H/2015

Project (EN)	Projects (CN)	Office GFA (sq m)	Submarket
Eton Center Dalian	大连裕景中心	80,000	Qingniwa
Dalian World Trade Centre	大连国贸中心大厦	86,000	Qingniwa

Source: Savills Research

they remained eager to attract entertainment and F&B retailers to their projects, known for their ability to attract higher footfall. Supported by rental incentives from landlords, entertainment and F&B retailers continued to show the most aggressive expansion activities of all retailer categories. Given slowing demand and an ongoing anti-graft campaign by authorities, luxury and fashion retailers continued to remain hesitant in terms of expansion plans. Notable transactions of the period included:

- Bona Cineplex opened a 5,000 sq m cinema complex in Yi He City in Ganjingzi district.
- Wanda Cinemas launched a 7,000 sq m cinema complex in Grand Gateway in the Qingniwa area.
- Five Plus Fitness opened a 2,000 sq m gym in The Metropolis in Qingniwa area.

City-wide vacancy rates dropped 0.3 of a ppt HoH to 4.1% by the end of 1H/2015, up 1.1 ppts YoY. This can be largely attributed to the successful pre-leasing activity of the new project and stable performances in existing projects. As a result, Dalian has become the only city among all the major first- and second-tier cities in Northern China to experience growth in occupancy rates in 1H/2015.

**Rents**

Prime shopping mall first-floor rents recorded steady growth, driven by both domestic and international retailers competing for limited prime retail space in downtown areas. Mid- to high-end shopping mall first-floor rents grew 1.7% in 1H/2015, to RMB407.9 per sq m per month (excluding property management fees), up 6.0% YoY.

**Retail market outlook**

Five new retail projects are scheduled to launch onto the market in the remaining half of 2015, adding a total retail GFA of 624,000 sq m and enlarging total stock by 26%. The market is expected to be further upgraded with the debut of several high quality projects, all of which

TABLE 6 Northern China mid-to high-end retail market indicators, 1H/2015

	Beijing	Tianjin	Shenyang	Dalian	Qingdao
<b>Stock (million sq m)</b>	10.10	3.30	5.70	2.40	3.05
HoH change (%)	1%	6%	2%	6%	18%
YoY change (%)	12%	4.2%	2%	16%	22%
<b>New Supply (sq m)</b>	140,000	200,000	110,000	130,000	460,000
HoH change (%)	-84.7%	33.3%	-	-33.3%	247.7%
YoY change (%)	208.7%	124.2%	-48.0%	-	-
<b>Vacancy rate</b>	5.6%	17.2%	18.4%	4.1%	22.2%
HoH change (%ppts)	1.1	1.4	1.6	-0.3	0.8
YoY change (%ppts)	0.4	0.5	1.5	1.2	1.3
<b>Rents (RMB per sq m per month)</b>	902.4	398.6	367.0	407.9	431.3
HoH change (%)	-0.5%	-1.1%	-0.9%	1.7%	1.6%
YoY change (%)	0.3%	-5.9%	1.0%	6.0%	1.9%

Source: Savills Research

TABLE 7 New retail supply, 1H/2015

Project name	Pavilion (柏威年)
	
Location	Qingniwa, Zhongshan district
Opening date	Q2/2015
Retail GFA (sq m)	130,000
Retail type	Shopping mall
Floor	B3-F6
Tenant mix	Luxury, fashion, F&B, entertainment and lifestyle retailers.
Major tenants	Dunhill, Vivienne Westwood, BOSS, Starbucks, Blue Frog, Karl Lagerfeld, Daniel Hechter, CGV international cinema, Ole supermarket.

Source: Savills Research

TABLE 8 Selected retail leasing transactions, 1H/2015

Tenant	Trade	Project	Location	GLA (sq m)
Charle s& Keith	Accessories	Roosevelt	Xi'an Road	100
DNCY	Fashion	Roosevelt	Xi'an Road	150
G.Revive	Fashion	Roosevelt	Xi'an Road	150
BalaBala	Kids Fashion	Roosevelt	Xi'an Road	200
Bally	Luxury	Times Square	Renmin Road	200
Five Plus Fitness	Entertainment	The Metropolis	Qingniwa	2,000
Bona Cineplex	Entertainment	Yi He City	Others	5,000
Wanda Cinemas	Entertainment	Grand Gateway	Renmin Road	7,000

Source: Savills Research

are to be operated by experienced operators. These projects include Galleria Dalian (大连凯丹广场) and Olympia 66 (恒隆广场), which are also expected to bring a more diversified tenant mix to the city.

Given the large volume of supply entering non-prime areas, leading to increasing competition, city-wide vacancy rates are expected to rise. At the same time, landlords in traditional areas are likely to continue applying rental increases due to the lack of supply expected. However, this will be offset as average city-wide rents are expected to remain stable as landlords in non-prime areas continue to offer rental incentives to secure healthy pre-leasing/occupancy rates. ■

TABLE 9 **Future project focus**

Project name	Galleria Dalian	Olympia 66
		
Location	East Harbour	Shahekou district
Retail GFA (sq m)	101,000	222,000
Retail type	Shopping mall	Shopping mall
Opening date	Q3/2015	Q3/2015
Major tenants	CGV, BHG supermarket, Kingsport gym, Yuyuto	Luxury, Fashion, Cinema, F&B, lifestyle retailers

Source: Savills Research

TABLE 10 **Future retail supply, 2H/2015**

Project (EN)	Project (CN)	GFA (sq m)	Location	Expected Launch
Gateway Plaza	国泰港汇广场	40,000	Renmin Road	Q3/2015
Galleria Dalian	大连凯丹广场	101,000	East Harbour	Q3/2015
Olympia 66	恒隆广场	222,000	Shahekou district	Q3/2015
Dalian International Business Centre	大连国际商业中心	21,000	Qingniwa	Q4/2015
Central Avenue Shopping Centre	中央大道购物中心	240,000	Xi'an Road	Q4/2015

Source: Savills Research

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