

# Briefing Office and retail

August 2016



Image: Davos Dalian Convention Centre, Zhongshan District

## SUMMARY

Driven by the development of the Huanan area, average rents in the mid- to high-end retail market continued to climb in 1H/2016. During the same period, the Grade A office market saw net-take up and rents fall across the board.

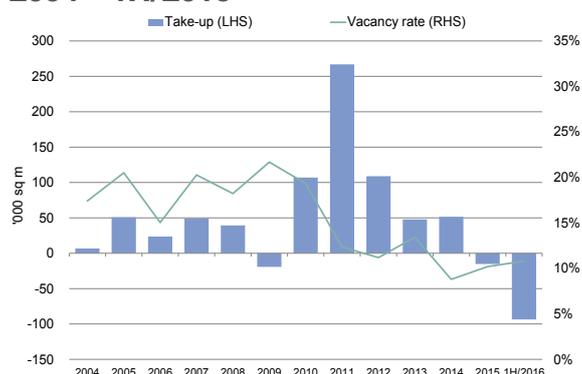
- No new supply was handed over in the Grade A office market in 1H/2016, marking the third consecutive year of no new supply. Total leasable stock stands at 1.1 million sq m.
- In response to current economic uncertainty, take-up levels have decreased, increasing the city-wide vacancy rate 0.6 of a percentage point (ppt) half-on-half (HoH) to 10.8% in 1H/2016.
- Grade A office rents declined 5.6% HoH and 6.1% year-on-year (YoY) to an average of RMB112.2 per sq m per month (exclusive of property management fees) by the end of the period.
- Total retail stock remained unchanged at 2.96 million sq m as no new retail projects launched onto the market in 1H/2016.
- City-wide vacancy rates increased 1.1 pts HoH to 9.5% by the end of 1H/2016, largely due to the poor performance of the real economy and the impact of fierce competition from e-commerce.
- Mid- to high-end shopping mall first-floor rents increased to RMB420.0 per sq m per month.

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 “Project delays have created a serious supply bottleneck that will push a large volume of new office space onto the market over the next three years. With demand already strained, vacancy rates are expected to rise.” Jack Xiong, Savills Research & Consultancy  
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### ➔ Economic overview

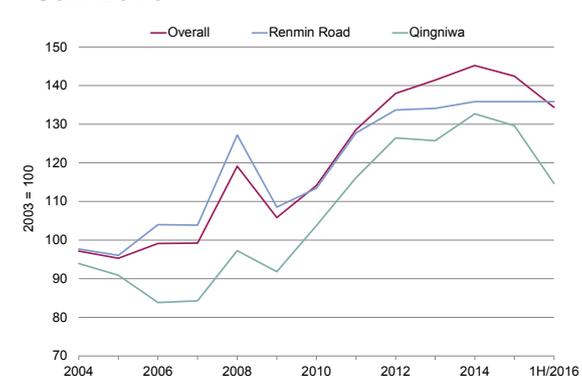
Dalian's GDP grew 5.0% YoY to RMB363.4 billion in 1H/2016. Fixed-asset investment (FAI) totalled RMB101.1 billion in the first half of 2016, down by 64.2% YoY. Urban disposable incomes per capita and retail sales grew by 5.8% YoY and 9.8% YoY, respectively.

GRAPH 1  
**Supply, take-up and vacancy rates, 2004 – 1H/2016**



Source: Savills Research

GRAPH 2  
**Grade A office rental indices, Dec 2004 – Jun 2016**



Source: Savills Research

### Office market

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

No projects were handed over in 1H/2016, marking the third consecutive year of no new supply. City-wide Grade A office stock continues to stand at 1.1 million sq m, with the Xinghai Square and the Renmin Road areas remaining the largest submarkets, accounting for 34% and 28% of the total stock, respectively.

Though no new supply entered the market in 1H/2016, a weaker economic environment saw investors and companies scale back their expansion plans. Rising overheads and decreasing revenues have led to an increasing number of company relocations from Grade A to Grade B office buildings, or an exit from the market entirely. The sudden collapse of some financial investment companies has also led to a decline in occupancy rates in a number of projects. As a

result, the city-wide vacancy rate rose 0.6 of a ppt HoH and 2.5% YoY to 10.8% during the period. Meanwhile, the majority of demand continued to stem from financial companies, who account for approximately 80% of all recorded transactions.

#### Grade A office rents

The continued economic downturn, combined with weakening demand, has caused more landlords to offer rental incentives in order to fill vacant space in their projects. As a result, Grade A office effective rents declined 5.6% in 1H/2016, to an average of RMB112.2 per sq m per month (exclusive of property management fees), down 6.1% YoY.

#### Submarket vacancy rates and rents Traditional business districts

Rents in the Renmin Road area remained stable at an average of RMB83.8 per sq m per month during the first half of 2016. As the majority of office buildings located in this area

TABLE 1  
**Key economic indicators, Jan – Jun 2016**

Indicators	Units	Value	YoY growth rate (%)
GDP	RMB billion	363.4	5.0
FAI	RMB billion	101.1	-64.2
Retail sales	RMB billion	157.2	9.8
Disposable income per capita (urban)*	RMB	19,310	5.8
Consumer Price Index (CPI)	Previous year = 100	101.9	-

\* Annualised figure  
Source: Dalian Statistics Bureau, Savills Research

TABLE 2  
**Selected office leasing transactions, 1H/2016**

Company	Project	Location	Office GFA (sq m)	New lease/renewal
Yunji Business	Xiwang Tower	Qingniwa Area	400	New lease
Ping An Insurance	Nuode Building	Xinghai Bay	3,000	New lease
Xiangyu Group	Wanda Centre	East Harbour Area	800	New lease
Uber	Xiwang Tower	East Harbour Area	400	New lease

Source: Savills Research

→ are under strata-title management, tend to be older and offer lower-quality facilities than many other projects in the city, rents in this area are relatively lower than other submarkets. However, given its central location, the area remains a popular office destination among domestic companies with lower rental budgets. As a result, the Renmin Road area maintains the lowest vacancy rate in the city, at 4.0%.

The Qingniwa area is host to a number of prime office projects, such as the Senmao Building and Xiwang Tower, and continues to attract interest from multi-national companies (MNCs). Beginning in 2014, the proportion of financial companies in the tenant mix of many projects rose, including Xiwang Tower. In light of the recent retreat of the peer-to-peer (P2P) lending industry, overall vacancy rates in the area have increased 0.7% HoH to 11.9% during 1H/2016. Looking to attract more stable tenants, landlords have begun to extend rental discounts and incentives. As a result, rents in the area declined by 11.5% HoH to an average of RMB127 per sq m per month in 1H/2016.

Emerging markets

The Xinghai Square area saw rents decline 14.4% YoY to an average of RMB126.7 per sq m per month. This was largely due to slowing demand and the anticipation of future supply, which has seen landlords lower asking rents. Vacancy rates increased 0.6 of a ppt to 16.5% by the end of the period. The East Harbour area saw a number of early lease terminations in key projects, namely Wanda Centre and Shangfang Mansion, as the economic downturn causes more tenants to leave the market. As a result, vacancy rates in the area grew by 0.6 of a ppt to 8.1% in 1H/2016. Although landlords slashed rents in the hope of attracting and retaining tenants, the area remained the most expensive in Dalian, averaging RMB142.5 per sq m per month, down 13.3% HoH.

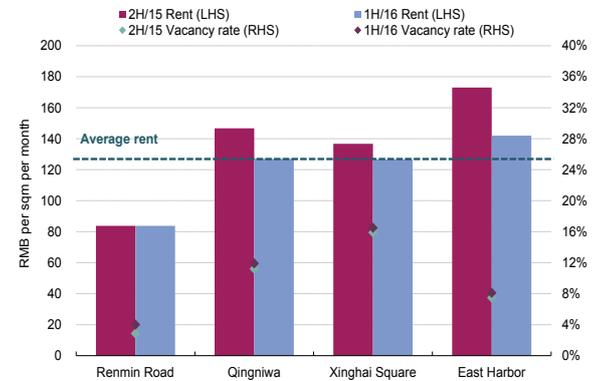
**Office market outlook**

The Grade A office market is expected to see an influx of supply in 2H/2016. Three new projects are scheduled

to be handed over to the market, contributing a combined leasable supply of 170,000 sq m. As all new supply is to be concentrated in prime areas (Qingniwa and the Xi'an Road Commercial Zone), the market is expected to have difficulties absorbing the stock. As a result, both city-wide occupancy rates and average rents are expected to face downward pressure in the short- to mid-term.

After past delays in project delivery, the city's office market has accrued a bottleneck of supply which is expected to enter the market over the next three years. With demand already strained, an oversupply of new office space

GRAPH 3 **Grade A office submarket vacancy rates and rents, 2H/2015 vs 1H/2016**



Source: Savills Research

TABLE 3 **Future project focus**

Project name	Eton Centre - Dalian	NOVA International Centre
		
Location	Qingniwa	Zhongshan Square
Owner	Eton Properties	Xinxing Group
Office GFA (sq m)	89,726	37,408
Floor plate (sq m)	1,700-1,800	1,968
PM Company	Eton	Savills
Asking Rent	RMB 140 / sq m / month	RMB 105 / sq m / month
Management Fee	RMB 1 / sq m / day	RMB 1 / sq m / day

Source: Savills Research

TABLE 4 **Future office supply, 2H/2016**

Project (EN)	Projects (CN)	Office GFA (sq m)	Submarket
Central Avenue	中央大道	39,749	Xi'an Road
Eton Centre - Dalian	大连裕景中心	89,726	Qingniwa
NOVA International Centre	新星国际中心	37,408	Qingniwa

Source: Savills Research



is forecast to raise vacancy rates. Landlords of new projects will be wary of their timing when it comes to entering the market, resulting in more handover delays.

The Xinghai Square and East Harbour areas are scheduled to receive the majority of high quality supply, which should help them transition rapidly into mature business environments. However, the substantial level of new supply is expected to outstrip demand, causing landlords to extend rental discounts in order to attract and retain tenants. As a result, the market will experience continuous decline in rents until the vacant space is absorbed.

### Retail market

#### Supply and stock

No new projects were handed over in 1H/2016. As a result, mid- to high-end retail stock remained unchanged at 2.96 million sq m, of which shopping malls now account for 80%.

#### Demand and vacancy rates

Luxury retailers continued to scale back expansion plans, given the slowing national economy and the government's ongoing anti-graft campaign. Meanwhile, fast-fashion, entertainment and lifestyle retailers expanded aggressively. Major leasing transactions included:

- Apple leased approximately 2,400 sq m in Olympia 66.

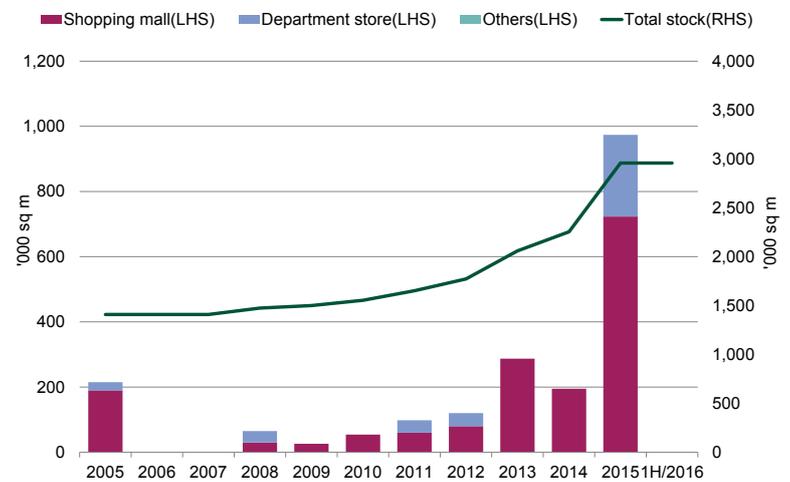
- Ole' Supermarket leased approximately 5,000 sq m in Olympia 66.

- Decathlon leased approximately 2,000 sq m in Galleria, the third store in the Dalian market.

The growth of the e-commerce sector and on-going tenant adjustment strategies in some projects increased city-wide vacancy rates by 1.7 ppts HoH and 5.5 ppts YoY to 9.6% during 1H/2016. The Xinghai Bay area, one of the oldest prime retail locations, maintained the lowest vacancy rate of just 2.0% at the end of the period.

GRAPH 4

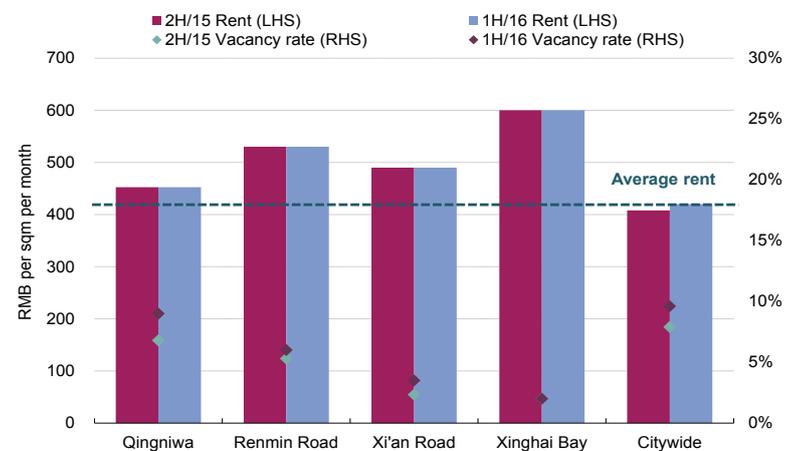
### Mid- to high-end retail supply and stock, 2005 – 1H/2016



Source: Savills Research

GRAPH 5

### Rental ranges and vacancy rates of major retail areas, 2H/2015 vs 1H/2016



Source: Savills Research

TABLE 5

### Selected retail leasing transactions, 1H/2016

Tenant	Trade	Project	Location	GLA (sq m)
GODIVA	Retail	Olympia 66	Others	100
Ole'	Supermarket	Olympia 66	Others	5,000
Apple	Retail	Olympia 66	Others	2,000
Decathlon	Retail	The Galleria	East Harbour	1,600
Will's Fitness	Leisure	The Pavilion	Qingniwa	2,000

Source: Savills Research

**Rents**

Retail sales in the Huanan area, including Yihe City, Ansheng Plaza, Walmart, Huanan Decorative and Furniture Mall, and Water, have been strong, promoting rental growth in the area. Dalian’s mid- to high- end shopping mall first-floor rents grew to RMB420 per sq m per month (excluding property management fees) in 1H/2016.

**Retail market outlook**

Retail supply is expected to increase in 2H/2016, as one new project is scheduled to enter the market, contributing a total retail GFA of 240,000 sq m. Given the large volume of new supply and existing competition, city-wide occupancy rates are expected to decrease over

the remainder of the year. Despite rising vacancy rates, established landlords in traditional retail areas are expected to increase rents as there is no shortage of demand in these areas. However, newer developments in non-prime locations will have to offer rental incentives in order to attract tenants. As a result, overall city-wide rental growth is expected to remain flat. ■

TABLE 6

**Future retail project focus**

Central Avenue	
	
Location	Xi'an Road
Retail GFA (sq m)	240,000
Retail type	Shopping mall
Opening date	Q4/2016
Major tenants	TBC

Source: Savills Research & Consultancy

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