

Briefing Office and retail

August 2017



Image: Qingshiwa Area, Zhongshan District

SUMMARY

The Grade A office market experienced declines across the board, with both rental and net take-up down in 1H/2017. Average rents in the mid- to high-end retail market also saw declines during the same period.

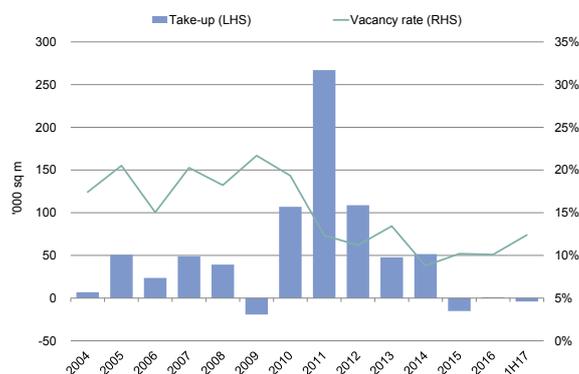
- No new supply was handed over in the Grade A office market in 1H/2017. As a result, overall stock remained unchanged at 1.15 million sq m.
- A prolonged period of economic downturn has seen the office market continue to perform poorly. Weak leasing demand saw net take-up decline during the quarter. As a result, city-wide vacancy rates increased by 0.4 of a percentage point (ppt) half-on-half (HoH) to 12.4% during the period.
- Grade A office rents declined by 0.8% HoH and 1.8% year-on-year (YoY) to an average of RMB106.6 per sq m per month (exclusive of property management fees) by the end of 1H/2017.
- No new retail projects launched onto the market in 1H/2017, leaving total retail stock unchanged at 2.92 million sq m.
- City-wide vacancy rates increased 1.3 ppts HoH to 12.3% by the end of 1H/2017, largely due to the poor performance of the economy and the impact of online retail.
- Average mid- to high-end shopping mall first-floor rents fell to RMB416.7 per sq m per month, representing a decline of 0.4% HoH and 0.4% YoY.

“Due to delays in project launches in 1H/2017, the Dalian office market is expected to face an influx of new supply over the next two years.” Jack Xiong, Savills Research & Consultancy

➔ Economic overview

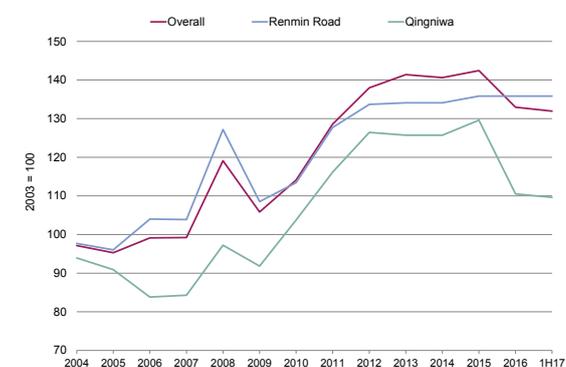
Dalian's GDP grew 6.7% YoY to RMB134.2 billion in Q1/2017. Urban disposable income per capita and retail sales grew by 6.0% YoY and 8.9% YoY, respectively. Fixed-asset investment (FAI) totalled RMB56.4 billion during the first five months of 2017, down by 26% YoY.

GRAPH 1
Supply, take-up and vacancy rates, 2004 – 1H/2017



Source: Savills Research

GRAPH 2
Grade A office rental indices, 2004 – 1H/2017



Source: Savills Research

Office market

Supply, take-up and vacancy rates

No new projects were handed over to the market in 1H/2017. As a result, city-wide Grade A office stock remained unchanged at 1.15 million sq m. The Xinghai Square and Renmin Road areas continued their reign as the largest submarkets, accounting for 32% and 27% of total stock, respectively.

A generally weak economic environment saw investors and companies scale back their expansion plans, and in some cases choose to downsize or even exit the market entirely. Consequently, city-wide vacancy rates continued to face downwards pressure, declining 0.4 of a ppt HoH and 1.6 ppts YoY to 12.4%. The majority of demand continued to stem from financial companies, which collectively accounted for approximately 40% of all recorded transactions during the period.

Grade A office rents

The ongoing economic downturn continues to weaken leasing demand, and consequently landlords remain under pressure to extend rental discounts and incentives in order to fill vacant space in their projects. As a result, Grade A office effective rents declined 0.8% HoH to an average of RMB106.6 per sq m per month (exclusive of property management fees), down by 1.8% 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 1H/2017. As the majority of office buildings located in this area are under strata-title management, they tend to be older and offer lower-quality facilities compared to many other projects in the city. Consequently, rents transact at a level significantly lower than other areas, and approximately 20% below the market average. However, given its central

TABLE 1
Key economic indicators, Jan – March 2017

Indicators	Units	Value	YoY growth rate (%)
GDP	RMB billion	134.2	6.7
FAI	RMB billion	56.4*	-26.0
Retail sales	RMB billion	83.1	6.0
Disposable income per capita (urban)**	RMB	1064.1	8.9
Consumer Price Index (CPI)	Previous year = 100	101.1	-

Source: Dalian Statistics Bureau, Savills Research
* Data as of May 2017
** Annualised figure

TABLE 2
Notable office leasing transactions, 1H/2017

Company	Project	Location	Office GFA (sq m)	New lease/renewal
Yeyun Investment	Modern Services Headquarters Building	Huanghe Road	400	New lease
Pharmeyes	Nuode Building	Xinghai Bay Area	1,000	New lease
Hengli Petrochemical	Wanda Centre	East Harbour Area	1,000	New lease
Neo Wealth	Senmao Building	Qingniwa Area	200	New lease

Source: Savills Research

→ 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 6.3%.

The Qingniwa area is host to a number of prime office projects, including the Senmao Building and Xiwang Tower, and continues to attract interest from MNCs. However, some early lease terminations during the period caused the vacancy rate in the precinct to spike up 1.7 of a ppt HoH to 21.1%. Looking to attract more stable tenants, landlords have begun to extend rental discounts and incentives, and as a result rents in the area declined by 0.8% HoH to an average of RMB115.8 per sq m per month by the end of 1H/2017.

Emerging markets

The Xinghai Square area saw rents decline 5.3% HoH to an average of RMB118.3 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. A number of tenants terminated their leases early in the Nuode Building during the period, thus the vacancy rate in the precinct increased by 1.5 ppts to 13.4%.

The East Harbour area witnessed a number of early lease terminations in key projects during the period, namely Wanda Centre and Shangfang Mansion, as the economic downturn causes more tenants to exit the market. As a result, vacancy rates in the area grew by 0.6 of a ppt to 12.2% during 1H/2017. Despite landlords slashing rents in the hope of attracting and retaining tenants, the area remained the most expensive in Dalian, averaging RMB130.0 sq m per month, although down by 3.7% HoH.

Office market outlook

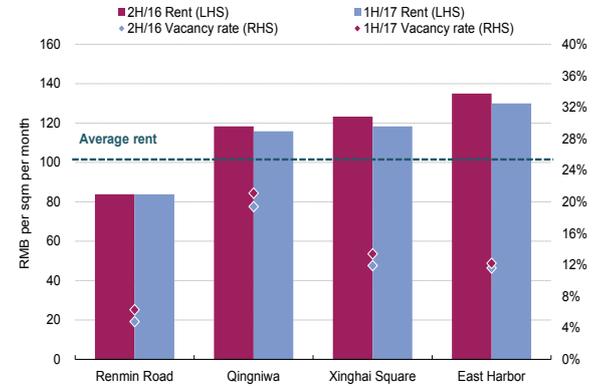
The Grade A office market is expecting two new projects with a combined leasable office GFA of 130,000 sq m to be handed over in 2H/2017. As all new supply is to be concentrated in the prime areas of Qingniwa and the Xi'an Road Commercial Zone, the market is expected to have difficulties absorbing the stock. As a result, both city-wide occupancy rates and average rents are

expected to face downwards pressure in the short- to mid-term.

Following a series of delays in project delivery, the city's office market has accrued a bottleneck of supply which is expected to flood the market over the next three years. With demand already strained, the oversupply of new office space is forecast to push up vacancy rates. However, landlords of new projects will be wary of their timing when it comes to entering the market, which is likely to result in more handover delays.

The Xinghai Square and East Harbour areas are scheduled to receive the majority of high-quality supply, which

GRAPH 3
Grade A office submarket vacancy rates and rents, 2H/2016 vs 1H/2017



Source: Savills Research

TABLE 3
Future project focus

Project name	Eton Centre - Dalian	Central Avenue
Location	Qingniwa	Xi'an Road
Owner	Eton Properties	Yongjia Group
Office GFA (sq m)	89,726	39,749
Floor plate (sq m)	1,700 – 1,800	2000
Asking Rent	RMB130 per sq m per month	RMB105 per sq m per month
PM Fee	RMB 30/ sq m / month	RMB 30/ sq m / month

Source: Savills Research

TABLE 4
Future office supply, 2H/2017

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

Source: Savills Research



should help them transition rapidly into mature business centres. 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, it can be expected that the market will experience a continuous decline in rents until the vacant space is absorbed.

Retail market Supply and stock

No new retail projects launched onto the market in 1H/2017. As a result, total retail stock remained unchanged at 2.92 million sq m, of which shopping malls accounted for approximately 80%.

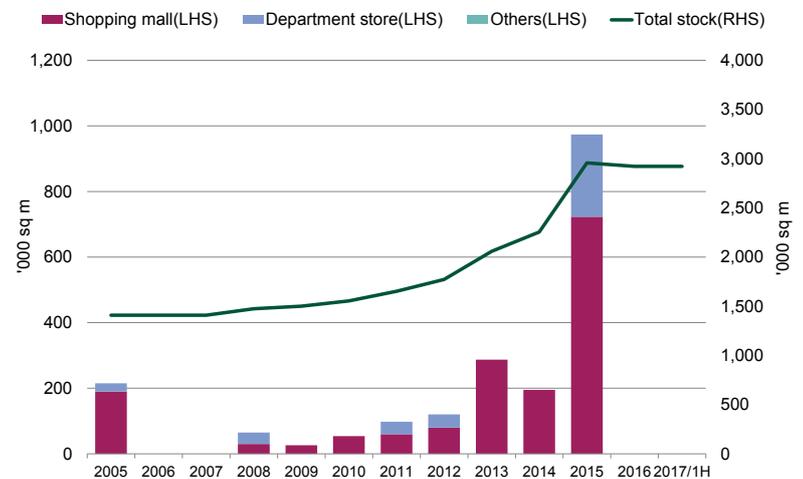
Demand and vacancy rates

Fast-fashion and F&B retailers expanded aggressively. Major leasing transactions of the period included:

- Leo Young Market, a speciality supermarket, leased approximately 2,000 sq m in Parkland in the Qingniwa district.
- Haidilao Hot Pot, a famous domestic restaurant chain, leased around 2,000 sq m in CapitaLand in the Xinghai district.
- GANT, an international clothing brand, leased approximately 200 sq m in Mykal in the Qingniwa district.

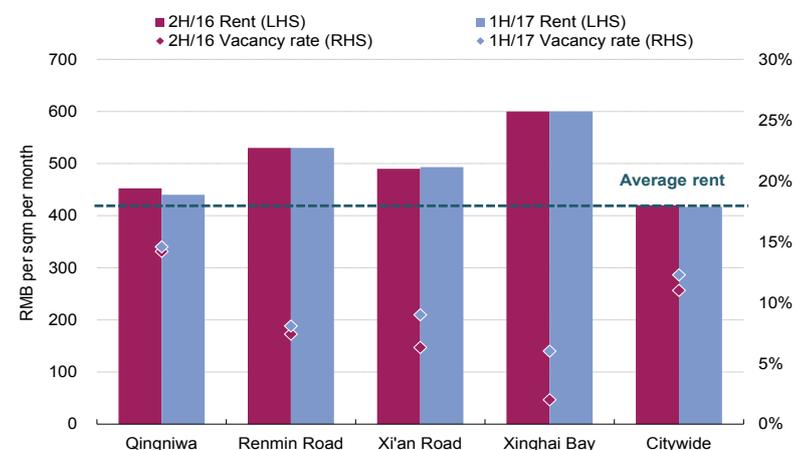
Competition from the growth of the e-commerce sector, and ongoing tenant adjustment strategies in some projects, saw city-wide vacancy rates increase by 1.3 ppts HoH and 2.7 ppts YoY to 12.3% during 1H/2017. The Xinghai Bay area, one of the oldest prime retail locations, maintained the lowest vacancy rate of just 6.0% at the end of the period. The Qingniwa area, a traditional business district, is host to a number of prime shopping mall and department store projects, such as New-Mart, Mykal, Parkland and Victory Plaza. However, the ongoing tenant adjustment strategy in Victory Plaza and Mykal, has seen the average vacancy rate in the area rise by 0.4 of a ppt HoH and 5.6 ppts YoY to 14.6% during 1H/2017.

GRAPH 4
Mid- to high-end retail supply and stock, 2005 – 1H/2017



Source: Savills Research

GRAPH 5
Rental ranges and vacancy rates of major retail areas, 2H/2016 vs 1H/2017



Source: Savills Research

TABLE 5
Selected retail leasing transactions, 1H/2017

Tenant	Trade	Project	Location	GLA (sq m)
KidsLand	Children's	Parkland	Qingniwa	500
CITIC Books	Culture	CapitaLand	Xinghai Bay	1000
Pandora	Fashion	Mykal	Qingniwa	800

Source: Savills Research

The Renmin Road area is host to a number of well-known mid- to high-end shopping malls, such as Friendship Shopping Center, Times Square and Galleria. However, ongoing anti-corruption efforts by the local government continue to see local luxury brands exit the market. Average vacancy rates in the precinct

have increased 0.7 of a ppt HoH and 2.1 ppts YoY to 8.1% during the period.

The Xi'an Road area, billed as the second largest commercial centre in Dalian, is host to a number of prime shopping mall projects, most notably Roosevelt Plaza and Fujia Plaza. Due

to the adjustment of Fujia Plaza, the average vacancy rates in the area increased 2.7 ppts HoH and 5.5 ppts YoY to 9.0% during 1H/2017.

Rents

Dalian's average mid- to high-end shopping mall first-floor rents fell to RMB416.7 per sq m per month, representing a decline of 0.4% HoH and 0.4% YoY.

Retail market outlook

Retail supply is expected to increase in 2H/2017, with one new project, Central Avenue in the Xi'an district, scheduled to enter the market and contribute a total retail GFA of 240,000 sq m. Given the large volume of new supply and existing competition, the city-wide vacancy rate is expected to increase 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	2H/2017
Major tenants	TBC

Source: Savills Research & Consultancy

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