

Briefing Office and retail sectors

February 2015



Image: YiHe City, Ganjingzi district

SUMMARY

A shortage of Grade A office supply throughout 2014 has resulted in an upward trend of both rents and occupancy rates. The mid-to high-end retail market witnessed moderate rental growth while occupancy rates fell as two retail projects opened in 2H/2014.

■ No new supply was handed over in 2014, leaving Grade A office market leasable stock unchanged at 1.1 million sq m.

■ Net take-up dropped to 12,700 sq m in 2H/2014, bringing annual take-up to 51,500 sq m, up 7.7% year-on-year (YoY). City-wide vacancy rates fell 1.2 percentage points (ppts) half-on-half (HoH) to 8.8% by the end of 2014, supported by the lack of new supply.

■ Grade A office rents grew 1.8% in 2H/2014 to an average of RMB126.4 per sq m per month (exclusive of property management fees), up 2.7% YoY.

■ Two retail projects were launched onto the market in 2H/2014, adding 195,000 sq m of leasable retail space to the market and expanding total retail stock to 2.23 million sq m by the end of 2014.

■ City-wide vacancy rates rose 1.4 ppts HoH to 4.3%, due to the low pre-commitment rates seen in newly handed over projects.

■ Mid-to high-end shopping mall first-floor rents grew 4.3% HoH to RMB400.0 per sq m per month, representing a YoY growth of 8.7%.

■ Both Grade A office and mid- to high-end retail markets are expected

to witness the highest supply to date in 2015, with four office buildings and another six retail developments scheduled to be launched, placing downward pressure on both occupancy rates and rents in both markets.

“Emerging China markets are expected to witness an acceleration in maturity given the influx of high quality supply expected in 2015.”

Joan Wang, Savills Research

→ Economic overview

Echoing the general economic slowdown in China, Dalian's GDP grew at a real rate of 6.3% YoY to RMB575.1 billion in Q3/2014, the slowest growth in the past five years. Fixed-asset investment (FAI) totalled RMB549.5 billion in the first nine months of the year, up 4.2% YoY, while urban residents' disposable income per capita and retail sales grew by 9.8% and 12.3% YoY respectively during the same period.

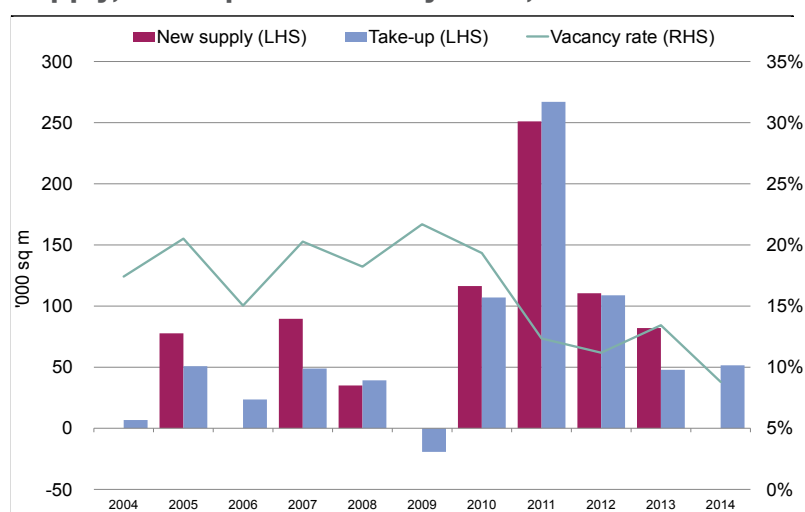
Office market

Supply, take-up and vacancy rates

With the Eton Centre – Dalian electing to postpone its completion date to 1H/2015, no new supply entered the market in 2H/2014, resulting in 2014 being the only year in the past five without new supply. As a result, Grade A office stock stabilised at 1.1 million sq m, with Xinghai Square and the Renmin Road area continuing to remain the largest submarkets, accounting for 34% and 28% of total stock respectively.

The lack of new supply, combined with companies maintaining a conservative stance towards expansion plans due to a slowing economy, resulted in net-take up declining 67.1% HoH to 13,000 sq m. By the end of 2014, net take-up reached 52,000 sq m, only 36% of the annual average take-up between 2011 and 2013.

GRAPH 1
Supply, take-up and vacancy rates, 2004–2014



Source: Savills Research

The majority of demand continued to stem from two industries – real estate companies and financial firms (particularly investment firms) in 2H/2014. These industries were responsible for approximately 80% of all recorded transactions. Due to their prime locations, Wanda Centre, Tian An International Tower and Modern Service Headquarter Building witnessed accelerated absorption rates of vacant space.

Despite the slowing of demand, a lack of supply led city-wide vacancy rates

to further decline, down 1.2 ppts HoH to 8.8%, and 4.6 ppts YoY. This is the lowest vacancy rate witnessed in the past ten years in Dalian, as well as the lowest among other major second-tier cities.

Grade A office rents

Limited leasable office space in prime buildings, coupled with strong demand, allowed landlords to continue increasing rents. However, projects located in areas forecasted to see growing supply in the coming year, such as Xinghai Square, saw landlords forced to offer rental discounts to retain quality tenants. As a result, Grade A office effective rents grew 1.8% in 2H/2014 to an average of RMB126.4 per sq m per month (exclusive of property management fees), up 2.7% YoY.

Submarket vacancy rates and rents

Traditional business districts

Renmin Road rents increased 1.3% HoH to an average of RMB83.8 per sq m per month, up 1.3% YoY. Given the majority of office buildings located in this area are under strata-title management, are over ten years old and offer lower-quality facilities than many projects within the city, landlords are generally limited in their ability to apply rental increments. However, given the core location, the area continues to prove popular with domestic companies with lower budgets. As a result, the Renmin Road area witnessed the lowest vacancy rates in the city, stabilising at 1.5%.

TABLE 1
Key economic indicators, Jan–Sep 2014

Indicator	Units	Value	YoY growth rate (%)
GDP	RMB billion	575.1	6.3
FAI	RMB billion	549.5	4.2
Retail sales	RMB billion	206.1	12.3
Disposable income per capita (urban)*	RMB	30,238	9.8
Consumer price index (CPI)	Previous year = 100	102.1	2.1

Source: Dalian Statistics Bureau, Savills Research

*Annualised figure.

TABLE 2
Grade A office market main indicators, 2H/2014

	Stock (sq m)	Vacancy rate (%)	Net take-up (sq m)	Supply (sq m)	Rent (RMB per sq m per month)
2H/2014	1,115,000	8.8%	13,000	-	126.4
QoQ change (%/ppts)	-	-1.2	-67.1	-	+1.8
YoY change (% ppts)	-	-4.6	-8.0	-	+2.7

Source: Savills Research

→ Steady performance of several quality buildings, particularly Xiwang Tower (希望大厦) and Senmao Building (森茂大厦), saw Qingniwa area rents increase to an average of RMB149.1 per sq m per month, up 2.6% HoH and 5.5% YoY. Meanwhile, steady demand from companies for prime office space in this business district resulted in vacancy rates falling 0.9 of a ppt HoH to 5.3%.

Emerging markets

Xinghai Square rents remained unchanged HoH, remaining at an average of RMB150.5 per sq m per month. However, this is a decrease of 8.0% YoY, resulting in landlords losing bargaining power due to slowing demand and the anticipation of new supply in the coming year. Vacancy rates witnessed a decline of 1.8 ppts to 14.4%. As an emerging market with a cluster of several high-quality projects and domestic financial companies, Xinghai Square now commands the

second most expensive rents in the city, followed by East Harbour,

East Harbour rents increased 7.9% HoH to an average of RMB164.3 per sq m per month, up 19.3% YoY. Rental appreciation can be attributed to recently launched projects having high absorption rates, including Wanda Centre (万达中心) and Shangfang Mansion (上方大厦). With the area generally comprising high-quality projects and tenants with strong affordability, East Harbour now commands the most expensive rents in the city, while vacancy rates dropped 20.3 ppts YoY to 10.8%.

Office market outlook

Given Eton Centre – Dalian postponed its completion date to 2015, the Grade A office market is expected to witness an influx of supply in 2015. Four new projects are scheduled to be handed over to the market, contributing a total

leasable supply of 450,000 sq m, four times the average over the past five years, enlarging total stock by 40%. As all new supply is to be located in the prime areas such as Qingniwa and sought-after emerging areas such as Xinghai Square, both city-wide occupancy rates and average rents are expected to increase.

The oversupply situation will continue to be aggregated between 2016 and 2018, with 21 projects expected to be handed over during this period. Completion of these projects will raise total office GFA to 1.6 million by the end of 2018, nearly triple the current stock. Emerging markets, Xinghai Square and East Harbour, will take 36% and 61% of the new supply respectively, leading them to be the largest business areas in the city.

With Xinghai Square and East Harbour witnessing both high-quality, newly-

TABLE 3
Selected office leasing transactions, 2H/2014

Company	Project	Location	GFA (sq m)	New lease/renewal
Tairan Wealth	Wanda Centre	East Harbour	800	New lease
SilverCapital	Tian An International Tower	Qingniwa Area	600	New lease
SenHao Investment	Tian An International Tower	Qingniwa Area	500	New lease
Pusense Wealth	Tian An International Tower	Qingniwa Area	430	New lease
Yitian Real Estate Group	Modern Service Headquarter Building	Others (Xi'an Road)	350	New lease
GuanQun Chi Cheng Investment	Modern Service Headquarter Building	Others (Xi'an Road)	300	New lease

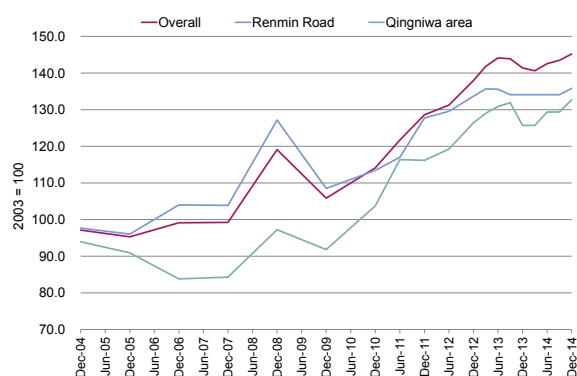
Source: Savills Research

TABLE 4
Future office supply, 2015

Project	Office GFA (sq m)	Submarket
Trust Building 信托证券大厦	160,000	Xinghai Square
Eton Center Dalian 大连裕景中心	120,000	Qingniwa
Dalian World Trade Centre 大连国贸中心大厦	86,000	Qingniwa
CNP Building 中国石油大厦	80,500	Xinghai Square

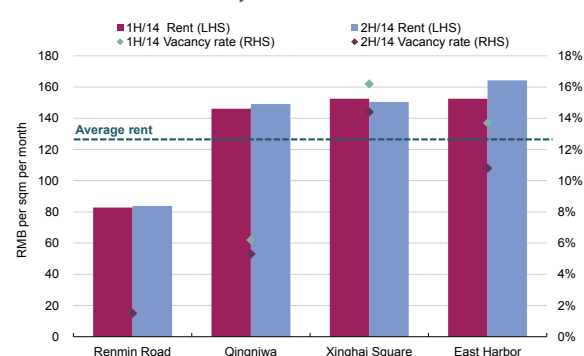
Source: Savills Research

GRAPH 2
Grade A office rental indices, 2004–2014



Source: Savills Research

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



Source: Savills Research

completed projects and projects in the supply pipeline, both areas are poised to transition quickly into mature business environments. However, the substantial level of new supply is expected to force landlords to offer rental discounts under fierce competition. As a result, it is forecasted the market will see a continuous decrease in rents over the next five years until vacant space is largely digested.

Retail market

Supply and stock

The Dalian mid-to high-end retail market welcomed its first batch of supply for the year in 2H/2014. Two shopping malls, YiHe City (亿合城) and Sunrise Shopping centre (锦辉购物广场高新店), were launched onto the market, adding a total retail GFA of 195,000 sq m. As a result, mid-to high-end retail stock expanded to 2.23 million sq m by the end of 2014, with 74% positioned as shopping malls.

YiHe City (亿合城)

YiHe City, developed by the Ansheng Group, is located in the non-prime retail area of Huanan in the Ganjingzi district. Served by Zhonghua Square Station (metro line 1), the project comprises residential apartments, a shopping mall a pedestrian street and more than 1,400 parking spaces, covering a total GFA of 230,000 sq m. The retail component of the project is positioned as a regional mid-to high-end shopping mall, offering a GFA of 120,000 sq m. The tenant mix comprises a variety of F&B, fashion, entertainment and lifestyle retailers. Anchor tenants include Carrefour, H&M, and Bona International Cinema. Given the project's non-prime location, the occupancy rate has achieved a level of approximately 80%

Sunrise Shopping Centre High-tech Zone Store (锦辉购物广场高新店)

Sunrise Shopping Centre High-tech Zone Store, developed by the Jin Hui Group, is located in the

core area of the Dalian High-tech Zone. It is the third shopping mall launched in Dalian by the group, and is comprised of retail, leisure, entertainment and F&B components, covering a total retail GFA of 75,000 sq m. The project has achieved pre-commitment rates of almost 80%, with anchor tenants including the first 4D cinema in Dalian, MGM International Cinema and Ding Long Total Fitness.

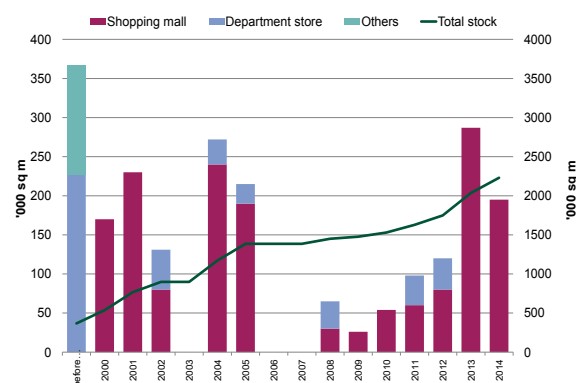
Demand and vacancy rates

With landlords looking to compete with the fierce competition of online retail platforms, F&B retailers have featured heavily in expansion plans in an effort to attract higher footfall.

Meanwhile, child-related retailers and new fashion entrants continued to show strong interest in the Dalian market, while the slowing of the economy and the government's corruption crackdown saw luxury and popular fashion retailers continue to be cautious of expansion. Major leasing transactions included:

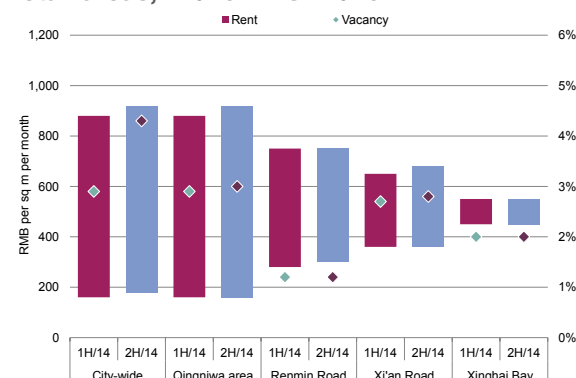
- Mr. Pizza, a well-known Korean pizza

GRAPH 4
Mid- to high-end retail supply and stock, pre-2000–2014



Source: Savills Research

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



Source: Savills Research

TABLE 5
Future office supply, 2015

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)	120,000	86,000
Floorplate (sq m)	1,700-1,800	2,700
PM company	Eton	TBC
Asking rent	6.5	TBC
Management fee	TBC	TBC

Source: Savills Research

TABLE 6
Mid- to high-end retail market indicators, 2H/2014

	Stock (sq m)	Vacancy rate (%)	Supply (sq m)	Rent (RMB per sq m per month)
2H/2014	2,2 million	4.3	195,000	400.0
HoH change (%/ppts)	+9.6	+1.6	-	+4.3
YoY change (%/ppts)	+9.6	+1.1	-	+8.7

Source: Savills Research

brand, opened a 300 sq m store in Peace Plaza in Xinghai Bay.

- Toys"R"Us, the leading children's toy store, opened its first store in Dalian, debuting in Tianxing Roosevelt International Center (天兴罗斯福国际中心) with an GFA of 400 sq m.

- Roosevelt Center, located in Shahekou district, also introduced the city's first Gap store, leasing a GFA of 400 sq m.

A large amount of new supply, coupled with relatively low pre-commitment rates, saw city-wide vacancy rates increase 1.4ppts HoH to 4.3% by the end of 2014, up 0.9 of a ppt YoY. The Renmin Road area, one of the oldest and most prime retail catchments, witnessed the lowest vacancy rates of just 1.2% by the end of 2014.

Rents

Largely a result of positive rental increments of projects located in core areas, such as Qingniwa and Renmin Road, Dalian's mid-to high-end shopping mall first-floor rents grew 4.3% in 2H/2014 to RMB400.0 per sq m per month (excluding property management fees), up 8.7% YoY.

Retail market outlook

Retail supply is expected to increase significantly in 2015 as six new projects are expected to be launched, bringing a total retail GFA of 760,000 sq m to the market. This will enlarge total stock by one third of its current level. The market is expected to be further upgraded with the debut of several high quality projects which will be operated by experienced operators. These are to include Pavilion Shopping Centre (柏威年购物中心), Galleria Dalian (大连凯丹广场) and Olympia 66 (恒隆广场), which are expected to bring a more diversified brand mix to the area.

Given the large volumes of new supply and intense competition, city-wide occupancy rates are expected to decrease in 2015. Despite rising vacancy rates, established landlords in traditional retail areas are likely to continue applying rental increases as there is no shortage of demand in these areas. However, newer developments in non-prime locations may have to offer rental incentives in order to attract tenants. As a result, there is a relatively flat outlook for city-wide rents. ■

TABLE 7
New retail supply, 2H/2014

Project name	YiHe City (亿合城)	Sunrise Shopping Centre High-tech Zone Store (锦辉购物广场高新店)
		
Location	Ganjingzi district	Dalian High-tech Zone
Retail GFA (sq m)	120,000	75,000
Retail type	Shopping mall	Shopping mall
Opening date	Q4/2014	Q4/2014
Major tenants	Armani Jeans, Calvin Klein, H&M, C&A, Carrefour, Bona international cinema	MGM cinema, Ding Long Total Fitness, Maan Coffee, Starbucks


Source: Savills Research

TABLE 8
Selected retail leasing transactions, 2H/2014

Tenant	Trade	Project	Location	GLA (sq m)
Gap	Fashion	Tianxing Roosevelt Int. Center	Xi'an Road	400
Toys "R" Us	Kids	Tianxing Roosevelt Int. Center	Xi'an Road	400
85 café	F&B	Tianxing Roosevelt Int. Center	Xi'an Road	100
Papa Johns	F&B	The Metropolis	Qingniwa	200
Meet Fresh.	F&B	New-Mart Shopping Mall	Qingniwa	100
BalaBala	Kids Fashion	New-Mart Shopping Mall	Qingniwa	400
Mr. Pizza	F&B	Peace Plaza	Xinghai Bay	300
CACHITO	F&B	Peace Plaza	Xinghai Bay	150
TRENDIANO	Fashion	Peace Plaza	Xinghai Bay	200

Source: Savills Research

TABLE 9
Future retail project focus, 2015

Project name	Pavilion Shopping Centre	Galleria Dalian	Olympia 66
			
Location	Qingniwa	East Harbour	Shahekou district
Retail GFA (sq m)	135,000	101,000	222,000
Retail type	Shopping mall	Shopping mall	Shopping mall
Opening date	Q2/2015	Q2/2015	Q4/2015
Major tenants	Ole' supermarket, CGV	CGV, Tesco supermarket, Kingsport gym, Yuyuto	TBC

Source: Savills Research

TABLE 10
Future retail supply, 2015

Project (EN)	Project (CN)	GFA (sq m)	Location	Expected Launch
Galleria Dalian	大连凯丹广场	101,000	East Harbour	Q1/2015
Guotai Ganghui Plaza	国泰港汇广场	40,000	Renmin Road	Q1/2015
Pavilion Shopping Centre	柏威年购物中心	135,000	Qingniwa	Q4/2015
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
Olympia 66	恒隆广场	222,000	Shahekou district	Q4/2015

Source: Savills Research

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