

Briefing Office and retail sectors

March 2015



Image: Olympia 66, Xigang District

SUMMARY

The Grade A office market experienced declines across the board, with both rental and net take-up down in 2H/2015. While the mid- to high-end retail market saw moderate rental growth, the launching of four new retail projects saw overall occupancy rates fall during the period.

- No new supply was handed over in the Grade A office market in 2015, marking the second consecutive year of no new supply. As a result, total leasable stock remained unchanged at 1.1 million sq m.

- Amid the economic downturn, the office market performed poorly, with net take-up declining. As a result, city-wide vacancy rates increased 1.9 percentage points (ppts) half-on-half (HoH) to 10.2% by the end of 2015.

- Grade A office rents declined 0.6% HoH to an average of RMB124.3 per

sq m per month (exclusive of property management fees) during the period, down 1.9% year-on-year (YoY).

- Four new retail projects launched onto the market in 2H/2015, contributing a combined GFA of 593,000 sq m. As a result, total retail stock expanded to 2.96 million sq m.

- City-wide vacancy rates increased 3.6 ppts HoH to 8.4% during the period, largely the result of the low pre-commitment rates achieved in the newly handed over projects.

- Mid- to high-end shopping mall first-floor rents grew to RMB407.8 per sq m per month.

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 “Due to delays in project launches in 2015, the Dalian office market is expected to face an influx of new supply in the next three years.”

Jack Xiong, Savills Research

➔ **Economic overview**

Echoing the general economic slowdown in China, Dalian's GDP grew at a real rate of 4.2% YoY to RMB773.2 billion for 2015. Year-to-date (YTD) fixed-asset-investment (FAI) totalled RMB455.9 billion by the end of 2015, down 32.7% YoY. Meanwhile, both urban disposable incomes per capita and retail sales grew during the period, up 6.8% and 8.5% YoY, respectively.

Office market

Supply, take-up and vacancy rates

No new supply entered the market in the second half of 2015, thus marking the second consecutive year of no new supply. With total Grade A office stock unchanged at 1.1 million sq m, Xinghai Square and the Renmin Road area continued to remain the largest submarkets, accounting for 34% and 28% of the total stock, respectively.

Despite no new supply entering the market in 2015, a generally weak economic environment saw poor appetite from investors and companies in terms of expansion plans. Rising costs, income decreases and pressure factors such as the exchange rate are causing more and more foreign companies to move out of Dalian, especially Korean and Japanese enterprises. As a result, the city-wide vacancy rate rose 1.9 ppts HoH to 10.2%, up 1.4% YoY.

The majority of demand continued to stem from financial companies in 2H/2015, accounting for approximately 80% of all recorded transactions.

Grade A office rents

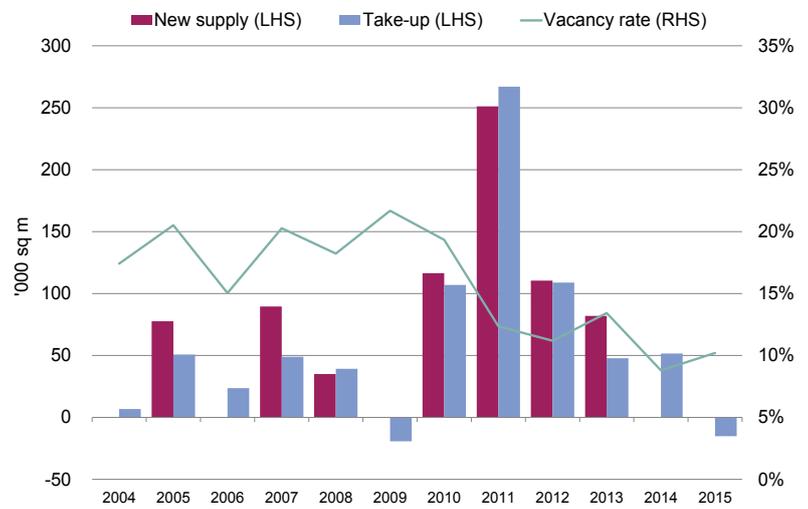
The continued economic downturn, combined with weak demand from tenants, saw landlords forced to offer rental incentives in order to fill vacant space in their projects. As a result, Grade A office effective rents declined 0.6% in 2H/2015 to an average of RMB124.3 per sq m per month (exclusive of property management fees), down 1.9% YoY.

Submarket vacancy rates and rents

Traditional business districts

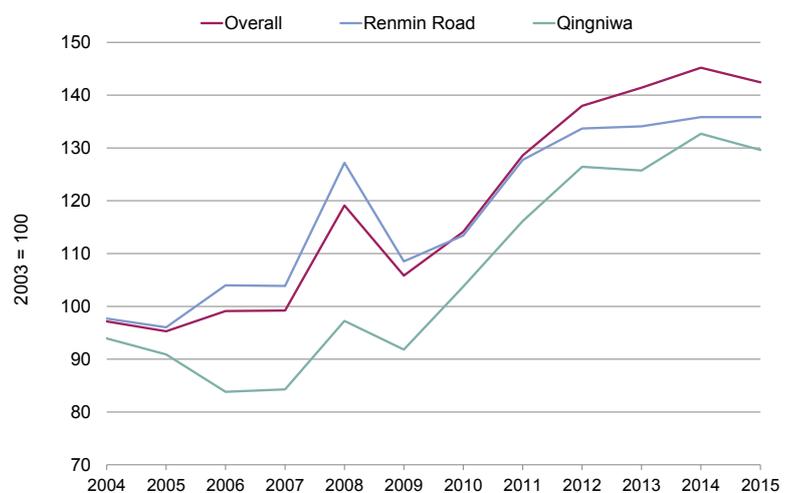
Renmin Road rents declined 0.2%

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



Source: Savills Research

GRAPH 2 **Grade A office rental indices, 2004–2015**



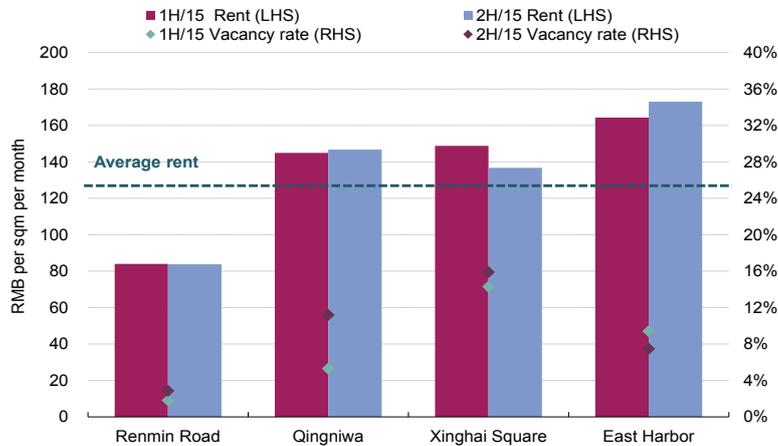
Source: Savills Research

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

Indicator	Units	Value	YoY growth rate (%)
GDP	RMB billion	773.2	4.2
FAI	RMB billion	455.9	-32.7
Retail sales	RMB billion	308.4	8.5
Disposable income per capita (urban)*	RMB	35,889	6.8
Consumer price index (CPI)	Previous year = 100	101.6	1.6

Source: Dalian Statistics Bureau, Savills Research
*Annualised figure

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



Source: Savills Research

TABLE 2 **Selected office leasing transactions, 2H/2015**

Company	Project	Location	GFA (sq m)	New lease/renewal
Quark Finance	Xiwang Tower	Qingniwa Area	800	New lease
Whale Wealth	Wanda Centre	East harbour Area	600	New lease
Nuoyuan Capital	Xiwang Tower	Qingniwa Area	500	New lease
Dongxing Securities	Xiwang Tower	Qingniwa Area	400	New lease

Source: Savills Research

TABLE 3 **Future project focus**

Project name	Eton Centre - Dalian	Dalian World Trade Centre
Location	Qingniwa	Xi'an Road
Owner	Eton Properties	Yongjia Group
Office GFA (sq m)	89,726	39,749
Floorplate (sq m)	1,700-1,800	1,450
PM company	Eton	TBC
Asking rent	195	TBC
Management fee	TBC	TBC

Source: Savills Research

HoH to an average of RMB83.8 per sq m per month, keeping rental levels in line with those of the same period last year. Given that 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 other projects in the city, rents stayed at low level in this area. However, given the core location, the area continues to prove popular with domestic companies with lower rental budgets. As a result, the Renmin Road area continued to have the lowest vacancy rate in the city, holding stable at 2.9%.

The Qingniwa area is home to numerous prime office buildings such as the Senmao Building and Xiwang Tower, and as a result continued to attract interest from a number of overseas companies. Consequently, rents in the area increased by 1.8% HoH to an average of RMB146.7 per sq m per month during the period. Meanwhile, due to the cancellation of some major leases in the two projects, vacancy rates in the area grew 5.9% HoH to 11.2%.

Emerging markets

Xinghai Square rents declined 10.5% YoY to an average of RMB136.7 per sq m per month. Vacancy rates grew 1.6 pts to 15.9%, as a result of landlords losing bargaining power in rental negotiations amid slowing demand and the anticipation of new supply in the future.

East Harbour rents increased 6.3% HoH to an average of RMB173.0 per sq m per month, up 6.3% YoY. Rental appreciation can be attributed to the strong performance of recently launched projects – namely the Wanda Centre (万达中心) and Shangfang Mansion (上方大厦). With the area generally comprising of high-quality projects and tenants with strong affordability, East Harbour now commands the most expensive rents in the city and boasts a vacancy rate of 7.5%, down 3.3 pts YoY.

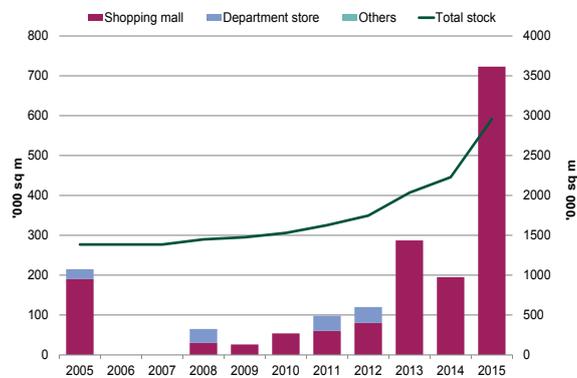
Office market outlook

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

to be handed over to the market, contributing a combined leasable supply of 250,000 sq m. The new supply is three times the average supply of the past five years, and will enlarge total stock by 23%. As all new supply is to be concentrated in prime areas (Qingniwa and 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.

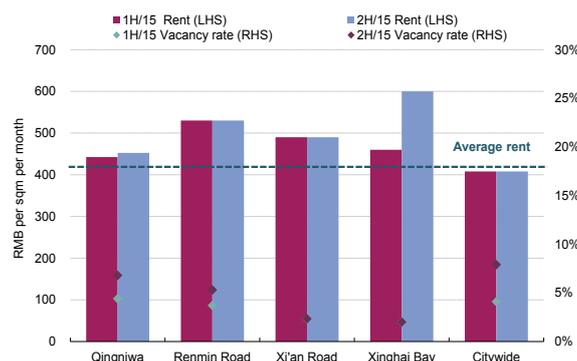
As part of the project's delay into the market in 2015, the Dalian office market will face a larger amount of new supply in the next three years. At some point, the oversupply will be even more severe, the vacancy rate will be higher, and some of the projects will likely consider delaying their launch into the market due to the pressure.

GRAPH 4
Mid- to high-end retail supply and stock, 2005 – 2015



Source: Savills Research

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



Source: Savills Research

With the Xinghai Square and East Harbour areas scheduled to receive an influx of high quality supply, the areas are both poised to transition rapidly into mature business environments. However, the substantial level of new supply is expected to outstrip demand, which is expected to see landlords forced to extend rental discounts amid fiercer competition. As a result, it is forecasted that the market will see a continuous decrease in rents until the vacant space is largely digested.

Retail market Supply and stock

The Dalian mid- to high-end retail market welcomed a large supply in 2H/2015, with four shopping malls – Galleria(凯丹广场), Wanda Plaza (开发区万达广场), Olympia 66 (恒隆广场) and The Grand Gateway (国泰·港汇中心) – contributing a combined retail GFA of 593,000 sq m to the market. As a result, mid- to high-end retail stock expanded to 2.96 million sq m by the end of 2015, of which now 80% is comprised of shopping malls.

- Galleria (凯丹广场)
Galleria Dalian has strong mix of fast-fashion tenants, including ZARA, H&M, C&A and Uniqlo, as well as five brands from the Inditex Group which opened for the first time in Dalian. CGV Studios from South Korea entered Galleria with a 4DX IMAX and a special effects hall. BHG Market place which is a luxury subsidiary of BHG launched in the project.

- Wanda Plaza (开发区万达广场)
Wanda Plaza is the only urban complex in the Dalian development

zone. It has a total construction area of 728,600 sq m, of which an area of 230,000 sq m is dedicated to the shopping centre. The Plaza will offer catering, culture, entertainment and other multi-function integrated services, including Wanda IMAX International Studios, Wanda King Baby, Youhome supermarket, Sugar Tide KTV, Dragon Fitness, Gome Electrical Appliances, Uniqlo and MJstyle.

Olympia 66 (恒隆广场)

Olympia 66 launched onto the market in the core business district of Xigang, contributing a total retail GFA of approximately 221,900 sq m. The project has the capacity to hold approximately 300 tenants, and already has a diverse tenant mix covering the clothing, F&B, accessories, children's, entertainment, lifestyle and leisure categories. Approximately 30% of the diverse tenant mix is international brands, of which approximately 40 brands are making their first entrance into the Dalian market.

- The Grand Gateway (国泰·港汇中心)
The Grand Gateway is a shopping mall project located in the Youhao Square area. Developed by the Guo Tai Group, the project has contributed an additional 40,000 sq m of retail GFA to the market. The project offers a diverse tenant mix covering retailer categories including leisure, entertainment and F&B. The pre-commitment occupancy rate is around 70%. Anchor tenants in the project include the Wanda Cinema and Haokang Fitness.

TABLE 4
Future office supply, 2016

Project (EN)	Projects (CN)	Office GFA (sq m)	Submarket
Central Avenue	中央大道	39,749	Xi'an Road
Eton Center – Dalian	大连裕景中心	89,726	Qingniwa
Dalian World Trade Centre	大连国贸中心大厦	85,907	Qingniwa
NOVA International Centre	新星国际中心	37,408	Qingniwa

Source: Savills Research

Demand and vacancy rates

Amid a slowing retail market and intense competition from online retailers, landlords have continued to encourage F&B retailers to their projects in the hopes of boosting footfall. Luxury retailers continue to exhibit caution about expansion plans, given the slowing national economy and the government’s ongoing anti-graft campaign. Meanwhile, fast fashion, entertainment and lifestyle retailers continue to aggressively expand. Major leasing transactions including:

- Blue Ice Skating Rink leased approximately 1,400 sq m in Olympia 66.
- Broadway Palace Cinemas opened a cinema complex of ten theatres in Olympia 66, the largest of which can accommodate 400 viewers.
- LINE FRIENDS are to open their first store in Dalian in Olympia 66.

A large amount of new supply, coupled with relatively low pre-commitment rates, saw city-wide

vacancy rates increase 3.6 ppts HoH to 8.4% by the end of 2015, up 3.3 ppts YoY. The Xinghai Bay area, one of the oldest and most prime retail catchments, witnessed the lowest vacancy rates of just 2.0% by the end of the period.

Rents

Dalian’s mid- to high-end shopping mall first-floor rents grew to RMB407.8 per sq m per month (excluding property management fees).

TABLE 5
New retail supply, 2H/2015

Project name	Galleria (凯丹广场)	Wanda Plaza (开发区万达广场)	Olympia 66 (恒隆广场)	The Grand Gateway (国泰·港汇中心)
				
Location	Donggang	Development Zone	Xigang district	Youhao Square
Retail GFA (sq m)	101,120	230,000	221,900	40,000
Retail type	Shopping mall	Shopping mall	Shopping mall	Shopping mall
Opening date	Q3/2015	Q3/2015	Q4/2015	Q4/2015
Major tenants	CGV, H&M, Uniqlo	Wanda Cinema Dragon Fitness	Emporio Armani, Hugo Boss, Vero Moda, H&M, Blue Ice, Broadway Palace	Wanda Cinema, Haokang Fitness

Source: Savills Research

TABLE 6
Selected retail leasing transactions, 2H/2015

Tenant	Trade	Project	Location	GLA (sq m)
Blue Ice	Entertainment	Olympia 66	Others	1,400
Y-3	Fashion	Olympia 66	Others	400
Line Friends	Retail	Olympia 66	Others	400
Jiaodian	F&B	Parkland	Qingniwa	600
Chongqing Little Swan Hotpot	F&B	Jiu guang	Qingniwa	500

Source: Savills Research

Retail market outlook

Retail supply is expected to increase in 2016, as one new project is expected to be launched onto the market and bring a total retail GFA of 240,000 sq m. Given the large volumes of new supply and intense competition, city-wide occupancy rates are expected to decrease over the coming year. 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 **Future retail project focus**

Project name	Central Avenue
	
Location	Xi'an Road
Retail GFA (sq m)	240,000
Retail type	Shopping mall
Opening date	Q2/2016
Major tenants	TBC

Source: Savills Research

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