

Briefing Office and retail sector

August 2014



Image: Qianjiang New City

SUMMARY

Several department stores in primary areas began repositioning in order to differentiate themselves and attract higher footfalls to compete with e-commerce and new supply in non-primary areas.

- One Grade A office building, Wulin Times Square (武林时代商务中心), was handed over to the market in the first half of 2014, adding 23,000 sq m to the market and bringing total stock to 914,000 sq m.

- Net take-up totalled 83,900 sq m in 1H/2014, largely attributed to stable demand in Qianjiang New City.

- City-wide Grade A office vacancy rates fell 7.3 percentage points (ppts) half-on-half (HoH) to 25.4% in 1H/2014.

- Grade A office rents fell to an average of RMB4.62 per sq m per day, down 0.7% HoH and 2.3% year-on-year (YoY).

- Two shopping malls, Bridge Water Mall (运河上街) and Rainbow Park (天虹购物中心), were handed over in the first half of 2014, bringing total supply to 150,000 sq m.

- City-wide shopping mall vacancy rates increased 0.7 of a ppt HoH to 5.4% in 1H/2014.

- City-wide shopping mall first-floor rents increased 0.6% HoH to RMB17.36 per sq m per day.

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 “More companies are relocating from prime areas to Qianjiang New City due to its close proximity to the city centre and its competitive rents.” James Macdonald, Savills Research

➔ **Office market**

Market commentary

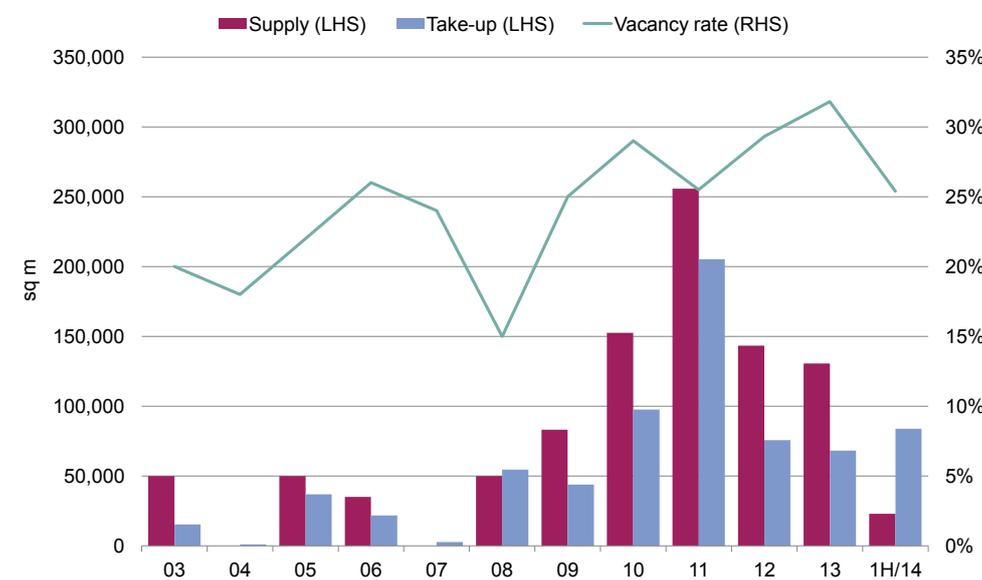
Hangzhou's GDP amounted to RMB393.8 billion in the first half of 2014, with a real growth rate of 7.7%, which is higher than the nationwide figure of 7.4%. Utilised foreign direct investment increased 16.1% to US\$3.9 billion. Although the economy grew at a slower pace, improved infrastructure and business

environment helped Hangzhou attract both overseas and domestic investments. Cisco relocated its Chinese headquarters from Shanghai to Hangzhou in March, the first Fortune 500 company to locate their headquarters in Zhejiang.

Due to a slowing economy and substantial amount of stock in non-prime and decentralised areas,

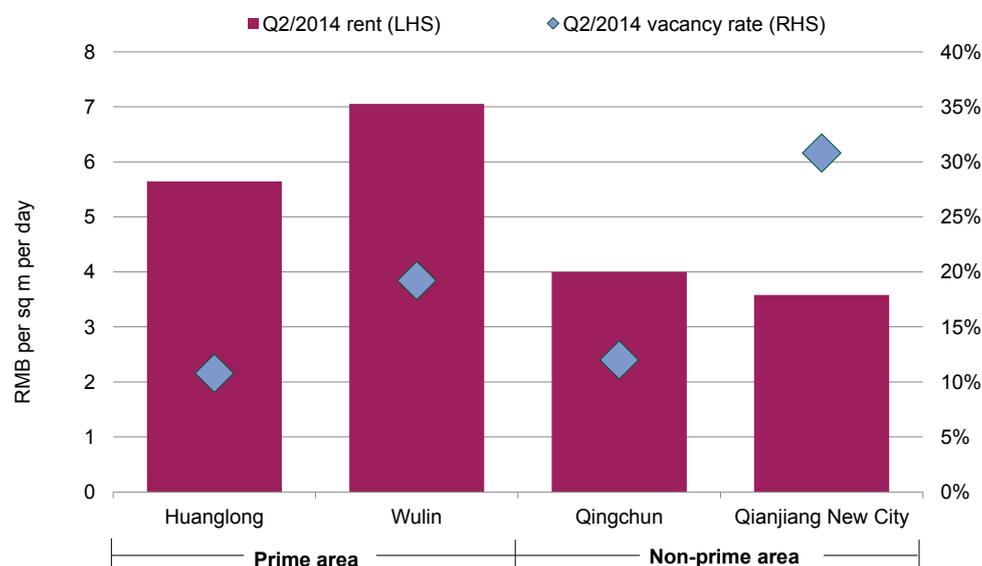
landlords of non-prime projects have lowered their asking prices or compromised further to ensure higher occupancy rates and to compete with prime projects. More companies are relocating from prime areas to non-prime areas, given the competitive rents (nearly 40% lower than prime areas). However, prime areas, such as Wulin and Huanglong, remain top choices for overseas companies. Domestic banks continue to establish their regional branches in Qiangjiang New City, including Huaxia Bank and Mintai Bank, which purchased office space for self use.

GRAPH 1 **Grade A office supply, demand and vacancy rate, 2003–1H/2014**



Source: Savills Research

GRAPH 2 **Grade A office rents and vacancy rates, Q2/2014**



Source: Savills Research

Supply and demand

One Grade A office project, Wulin Times Square (武林时代商务中心), was handed over to the market in 1H/2014, adding a total office GFA of 23,000 sq m and bringing total stock to 914,000 sq m.

Wulin Times Square, a lease-only Grade A office project in Wulin area, is the office component of mixed-use development Wulin Palace (大家武林府) and is a five-minute walk to Xihu Culture Square Metro Station on line 1. It is the first new supply seen in Wulin in the past four years, and as a result, this project achieved good leasing activity, with Alcatel Lucent and Teltou Group both renting a whole floor (1,200 sq m).

Huaxia Bank took up 47,700 sq m of office space in Qianjiang New City for self-use purchase. Landlords of non-prime projects have lowered their asking prices or compromised further to ensure occupancy. As a consequence of both, the first half's net take-up totalled 83,900 sq m, exceeding 2013's total of 68,200 sq m.

Grade A office rents and vacancy rates

As landlords of non-prime projects compromised further to ensure occupancy, Grade A office rents fell to an average of RMB4.62 per sq m per day in Q2/2014, down 0.7% HoH and 2.3% YoY. City-wide Grade A office vacancy rates decreased 7.3 ppts HoH to 25.4% in the first half of this year, largely attributed to strong leasing demand from domestic companies in Qianjiang New City.

Due to very tight Grade A office space in Wulin area, landlords increased asking rents at the beginning of the year, resulting in rents increasing 1.7% HoH. Wulin remained the city's most expensive area with an average rent of RMB7.05 per sq m per day in Q2/2014 (subtracting new supply). Due to Wulin area receiving its first supply in the past four years, vacancy rates rose by 14.2 ppts.

Huanglong area remained stable, recording a moderate rental growth of 0.8% to RMB5.64 per sq m per day in the second quarter. More companies are relocating from Huanglong to Qianjiang New City, given the competitive rents (nearly 40% lower than prime areas). Additionally, companies tend to choose Qianjiang New City to expand their office space due to a tight availability in prime areas. As a result, vacancy rates of older projects fell 0.5 of a ppt. Despite this, Huanglong's vacancy rates were down 4.2 ppts to 10.8%, with strong demand in Delixi Building offsetting negative net take-up in older projects.

As landlords lowered their asking rents and compromised further to ensure occupancy, a 2.1% HoH decrease in Grade A office rents and a 11.4-ppt HoH fall in vacancy rates was recorded in Qianjiang New City. Domestic banks continue to establish their regional branches in Qianjiang New City. Huaxia Bank and Mintai Bank purchased office spaces for self use in Oceanwide International Centre (泛海国际中心) and Hanjia International (汉嘉国际). High-quality projects continue to receive large occupier demand of over 800 sq m from leading companies. BMW opened its southeast regional office in Tower B, Uncommon District Centre in June, occupying nearly 1,500 sq m.

Office strata-title market

Office transaction volumes in downtown districts¹ amounted to roughly 129,000 sq m in 1H/2014. Excluding the en-bloc deal of Oceanwide International

¹ Hangzhou has six downtown districts: Xiacheng, Shangcheng, Gongshu, Xihu, Jianggan and Binjiang.

Centre, Wanda Plaza (North City) and Zheshang Fortune Centre (West City) collectively took-up approximately 40% of total demand, with transaction prices of nearly RMB18,000 and RMB24,000 per sq m respectively. Transaction prices in downtown districts remained stable at RMB23,000 per sq m, with Qianjiang New City still recording the city's highest price. For Grade A office projects, transaction prices will reach RMB31,000 to RMB37,000 per sq m.

With subdued rental growth and value appreciation, yields for strata Grade A offices remained stable at 3.5% to 4.5%.

Office market news

Cisco has relocated its Chinese headquarters from Shanghai to Hangzhou in March 2014, occupying a total office GFA of over 30,000 sq m (one block) in Wangjiang International (望江国际). This is the first Fortune 500 company to be headquartered in Zhejiang.

Huaxia Bank acquired Tower B in Oceanwide International Centre for a total consideration of RMB1.3 billion in January 2014. This asset deal represents a unit price of RMB27,400 per sq m. Located in Qianjiang New City, this office building was completed in Q2/2012. This investment deal followed the Bank of Beijing acquiring office space in Oceanwide International Centre Tower C. Until now, nine domestic banks have purchased their regional headquarters in Qianjiang New City.

Hangzhou Financial City Development (杭州金融城建设发展有限公司) acquired Qianjiang Financial City development site (钱江金融城) for a total consideration of RMB8.6 billion, representing an accommodation value of roughly RMB10,600 per sq m. Qianjiang Financial City site is designated as the expansion area of Qianjiang New City, the city's newly planned CBD. It plans to attract finance related sectors, providing support to banks, financial institutions and regional headquarters in Qianjiang New City. The buyer is a government-subsidised developer and the

construction work is expected to start this year.

Office market outlook

Four Grade A office projects are scheduled to be handed over to the market in the second half of 2014, adding a total office GFA of 226,000 sq m and bringing city-wide stock to 1.2 million sq m.

Qianjiang New City is expected to receive two new projects, MixC Tower A (万象城二期A塔) and Huangfeng International Business Plaza (华峰国际商务大厦). MixC phase 2 has two office buildings, with Tower A and Tower B completing in 2014 and 2015 respectively. Tower A has been completely sold. Huangfeng International Business Plaza is a lease-only project and has a total office GFA of 44,000 sq m. Grade A office GFA is expected to reach 760,000 sq m, contributing 67% of the city's total office space at the end of this year.

Metro line 2, connecting Qianjiang New City and Xiaoshao, is expected to open in November 2014 and line 4, passing through Qianjiang New City, is to be in operation in January 2015. By then, Qianjiang New City will become the only business area to enjoy the benefits of access to all metro lines. As all new projects are located in non-prime areas, city-wide rents will continue to soften during the remainder of this year.

Retail market

Market commentary

Hangzhou's retail sales reached RMB176.6 billion in 1H/2014, up 10.0% YoY. The growth rate has slowed 3.1 ppts compared with last year, representing weak consumption confidence. Urban disposable income per capita recorded stable growth, increasing by a rate of 9.9% YoY to RMB24,733.

Following a shopping mall boom in 2013, all future projects are expected to be shopping malls. According to the half-year report of Intime Group, all their department stores in Hangzhou saw turnover decrease in the first half, while an outlet in Wulin recorded a 20% increase in half-year turnover. Operators of department

stores, in prime areas in particular, have begun to take measures to survive the weak consumption and fierce competition from shopping malls and e-commerce. Approaches include: 1) converting existing department stores into shopping malls; 2) tenant adjustments by

decreasing women's fashion retailers and increasing lifestyle and leisure services; 3) combining small department stores into one and diversifying tenant mix; 4) opening large-sized shopping malls anchored by self-operated department stores in decentralised areas; and 5)

establishing online stores integrated with physical stores.

Supply and stock

Two shopping malls were launched onto the market in the first half of 2014, namely Bridge Water Mall (运河上街) and Rainbow Park (天虹购物中心), adding a total of 150,000 sq m to the market and bringing total retail stock to 1.5 million sq m.

The 77,000-sq m Bridge Water Mall held its soft opening in March 2014. This enclosed shopping mall is positioned as a community centre and has introduced mid-end retailers and Chinese restaurants, including McDonalds, Maxwin, Eland Group and Xinbailu restaurant.

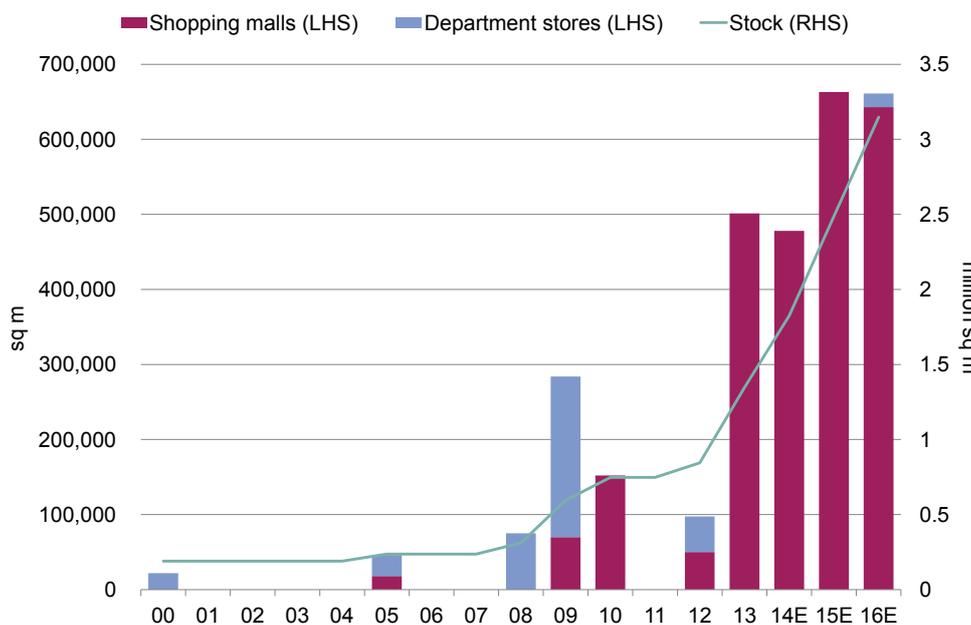
Rainbow Park, the second shopping mall to be operated by Shenzhen-based Rainbow Department Store in the country, is located in Qingchun, Jianggan district. It has two blocks and a total retail GFA of 73,000 sq m. Anchor tenants include a 17,000-sq m Rainbow Department Store, a 4,000-sq m Jinyi Cinema, a 1,700-sq m LSE supermarket, Shen Cai Fei Yang and In Love KTV. In order to attract more footfall from families living nearby, operator facilitates include a children's play area in Block B. Nearly 20% of retail space is allocated to F&B, leaving only 40% occupied by fashion retailers.

Rents and vacancy rates

City-wide first-floor rents recorded a mild YoY growth of 1.5%, reaching RMB17.36 per sq m per day. Rental increases have been mainly driven by strong demand and good business performance in non-prime projects including Xixi Incity Plaza and Intime City.

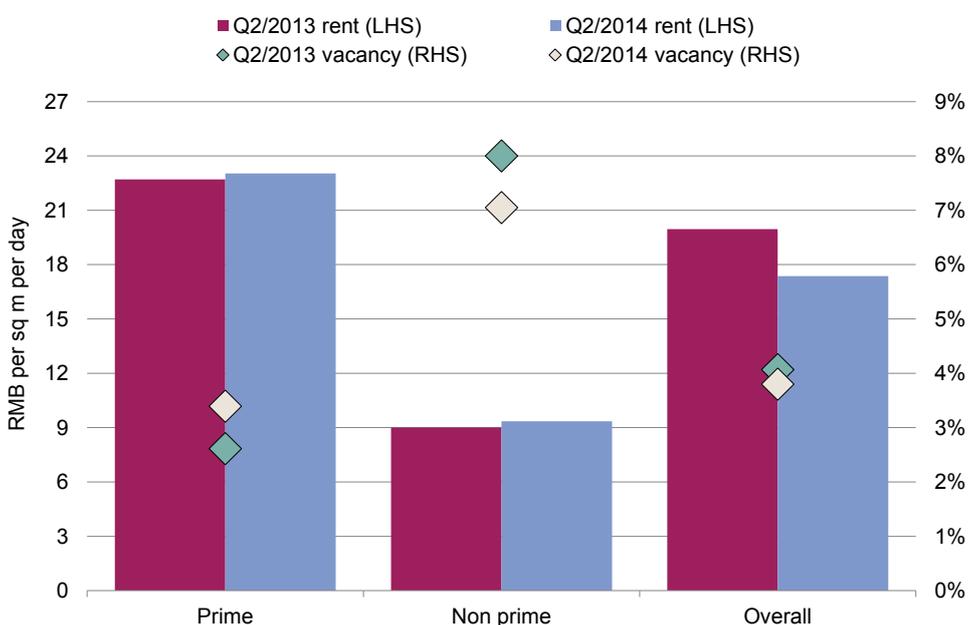
Owing to a relatively small market size of 900,000 sq m compared with Shanghai (6.8 million sq m) and Nanjing (1.4 million sq m), vacancy rates of Hangzhou's shopping malls remained low at 5.4%, up 0.7 of a ppt HoH. Prime vacancy rates increased to 3.4%, up 0.8 of a ppt YoY, due to tenant adjustments in MixC Mall. All key projects in non-prime areas were completed in the past year and recorded high footfall with diversified retailers and nearly 90% occupancy.

GRAPH 3 Prime retail supply and stock, 2000–2016E



Source: Savills Research

GRAPH 4 Retail rents and vacancy rates, Q2/2013 vs Q2/2014



Source: Savills Research

Primary area – Wulin

Hangzhou Tower continues to adjust retailers in Tower D, by relocating luxury accessory brands from Tower A to the first floor of Tower D. Omega and Rolex are expected to expand their retail space to 120 sq m to 150 sq m from 90 sq m after reopening. Stuart Weitzman, a high-end ladies' shoes maker, opened a new store in B1/F, Tower A.

Hangzhou Department Store and the underground floor of Wulin Intime Department Store have closed and started their renovations in July. The two projects are expected to be merged into a bigger store in order to attract higher footfall. Underground spaces are to be connected and a bridge is to be added to the 3/F, making it more convenient for customers to walk through. Construction is expected to finish by the end of this year.

Primary area – Lakeside

New Look debuted in Hangzhou by opening its first store on the 1/F of Yuanhua Building, Jiebai Plaza (解百新元华), following openings in Shanghai and Beijing.

Xihu Intime Department Store will close on 1 August and will be converted into a shopping mall after six years of operation. It has seven floors (B2/F to 5/F) and a total retail GFA of 76,000 sq m. Nearly 40% of women fashion retailers are to be removed and the amount of F&B, lifestyle and services will be

increased to 40% from 18%. The new shopping mall is planned to reopen in November.

GDA Plaza also plans to close on 1 August and is expected to reopen together with its second phase in 2015. Retail GFA will be increased from 6,000 sq m to 60,000 sq m. Zara, the anchor store of GDA Plaza, has moved to the podium of Hangzhou Hotel occupying roughly 3,000 sq m of retail space.

Emerging area – Qianjiang New City

With improved business environment and convenient accessibility, more luxury retailers began looking at MixC Mall to open new stores or expand their retail space. Verri opened a 100-sq m store on the 2/F and Marni expanded its retail space by occupying a further retail GFA of 200 sq m on the 2/F.

Retail market news

Golden Rice, a subsidiary of Great Star Group (巨星集团), bought Xihu Tiandi from Shui On Land, with a total retail GFA of approximately 6,000 sq m. The transaction price has not been disclosed. With a total retail GFA of 20,000 sq m, the second phase began its construction in June 2013 and is expected to be completed in three years.

Intime Group has signed to operate two retail projects in decentralised areas, Xihu and Xiaoshan districts. The Xiaoshan project was acquired

by Greenland for RMB331 million this May. This mixed-use site benefits from metro lines 2 and 5 and has a total GFA of 130,000 sq m.

SCP Group has bought a commercial land plot in Hangzhou Economic and Development Area (Xiasha) for a total consideration of RMB527 million. The city's third Incity Plaza has a total retail GFA of 100,000 sq m and will open in 2016.

In order to address oversupply concerns, Hangzhou's government has released new regulations to prohibit new retail plans in Canel area (运河新城) and East City (城东新城), and promoted the development of community centres in Xixi (西溪), Binjiang (滨江) and Xiasha (下沙) in June.

Retail market outlook

Four new shopping malls are expected to debut on the market in the second half, adding 328,000 sq m and bringing overall stock to 1.8 million sq m. As future supply is expected to double current stock, concerns of oversupply will continue to put pressure on city-wide rents and occupancy rates.

Non-primary areas are expected to remain healthy this year with a limited retail stock, while competition in primary areas will continue as renovations of key department stores are completed during the remainder of this year. ■

TABLE 1

Selected retail leasing transactions, 1H/2014

Tenant	Trade	Project	Location	GLA (sq m)
PurCotton	Lifestyle	Mingde Plaza	Lakeside	378
Secret Recipe	F&B	MixC Mall	Qianjiang New City	171
Sieg Fahrenheit	Fashion	MixC Mall	Qianjiang New City	114
It Machaa	Fashion	MixC Mall	Qianjiang New City	110

Source: Savills Research

TABLE 2
Upcoming retail projects in downtown districts, 2H/2014

Project	Retail GFA (sq m)	Area	Retail type
Crystal City Mall 水晶城购物中心	88,000	North City	Shopping mall
Hubin Yintai Phase 4 湖滨银泰四期	20,000	Lakeside	Shopping mall
Wanda Square 万达广场	130,000	North City	Shopping mall
Zhongda Intime City 中大银泰城	90,000	North City	Shopping mall

Source: Savills Research

Please contact us for further information

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