

Briefing Office and retail sector

August 2015



Image: MixC Phase 2

SUMMARY

The opening of the new metro line 4 has greatly improved the accessibility of Qianjiang New City area, resulting in flat rents and decreasing vacancy rates after eight consecutive quarters of rental decline.

- One Grade A office building, Jintou Financial Plaza (金投金融大厦), was handed over to the market in the first half of 2015, bringing total stock to nearly one million sq m.
- Net take-up totalled 53,500 sq m in 1H/2015, largely attributable to strong demand from financial companies.
- City-wide Grade A office vacancy rates fell to 21.5% in 1H/2015, down 7.0 percentage points (ppts) year-onyear (YoY).
- Grade A office rents recorded an increase of 4.0% YoY to an average of RMB5.01 per sq m per day.
- MixC Street was the only new retail project launched in 1H/2015, adding 16,000 sq m onto Hangzhou's retail market and bringing downtown stock to 1.9 million sq m.
- City-wide shopping mall vacancy rates increased 1.7 ppts half-on-half (HoH) to 10.4% in the second guarter of 2015.

■ City-wide shopping mall first-floor rents recorded a mild growth of 0.7% HoH to RMB18.1 per sq m per day.

"All business areas have received strong demand from financial industries, internet financial companies in particular, accounting for over 60% of total leasing activities in 1H/2015."

James Macdonald, Savills Research

→ Office market

Market commentary

Hangzhou's GDP amounted to RMB450 billion in 1H/2015, with a real growth rate of 10.3%. This is the first time that Hangzhou has witnessed a double-digit growth rate since 2012. The tertiary industry output increased 15.4% and accounted for 57.8% of the total output. The information industry reached RMB102 billion and has

become an important driver for the transformation of Hangzhou's economy.

Mirroring the hot stock market during the first half and easing monetary policies, the financial industry witnessed the most leasing activity and dominated the majority of Grade A office demand across all sectors. Net take-up totalled 53,500 sq m, while vacancy rates decreased 7.0

ppts YoY in 1H/2015. The Huanglong area continued to witness companies giving back space to the market, especially within older projects, due to high rents and a lack of new high-quality supply in the area.

Supply and demand

One Grade A office building, Jintou Financial Plaza, was handed over to the market in the first half of 2015, adding a total GFA of 57,100 sq m. This 36-storey office building is located in the non-prime area of Qingchun and was developed by the Hangzhou Financial Investment Group (杭州市金融投资集团), a stateowned financial company based in Hangzhou. The majority of office space is occupied by subsidiaries of the Group for self-use.

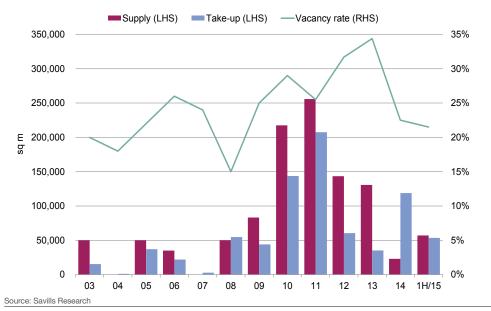
Despite a rebound in GDP growth rate, foreign companies remain conservative about expanding in Hangzhou and are relocating to non-prime areas, such as Qianjiang New City, to upgrade office facilities and cut overhead costs. Huanglong was the only area that witnessed companies giving back space to the market, especially within older projects, due to high rents and a lack of new high-quality supply in the area

Domestic companies continued to provide the majority of total leasing demand. Meanwhile, all business areas have received strong demand from financial industries, internet financial companies in particular, accounting for 60% of total leasing activities in 1H/2015. This can be mainly attributed to the easing monetary policies and other stimulus regulations. Quark Finance (夸客投 资) and Hangzhou Tourong Puhua (杭州投融谱华) have each occupied one floor (1,800 sq m) in Wulin Times Square (武林时代中心); Minsheng Wealth (民生财富) has taken up 600 sq m in EAC, in the Huanglong area; and Chuangdao Capital (创道资本) has occupied 1,500 sq m in UDC, Qianjiang New City.

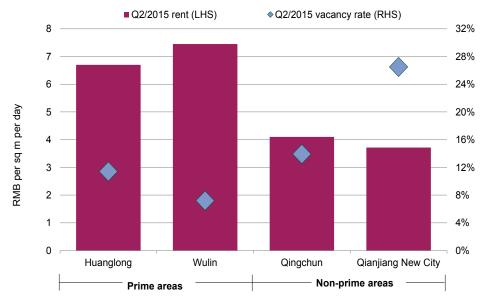
Grade A office rents and vacancy rates

Grade A office rents recorded a moderate increase of 4.0% YoY to an average of RMB5.01 per sq m per

GRAPH 1 Grade A office supply, demand and vacancy rate, 2003–1H/2015



GRAPH 2 Grade A office rents and vacancy rates, Q2/2015



Source: Savills Research

Notes: Rents are calculated six months after launch.

day. The divergence in rents between prime and non-prime areas continued in the first half, with prime rents increasing 10.4% YoY and non-prime rents growing 0.3% YoY.

Net take-up totalled 53,500sq m in 1H/2015, largely attributable to strong demand from financial companies. City-wide Grade A office vacancy rates fell to 21.5% in 1H/2015, down 7.0 ppts YoY.

As new supply was absorbed quickly, landlords of new projects continued to increase asking rents throughout the first half of the year, leading to Wulin area's rents growing 11.5% YoY to RMB7.45 per sq m per day in 1H/2015. Meanwhile, Wulin has the lowest stock among all business areas and continues to receive strong demand, leading to the city's lowest vacancy rates at 7.2%.

Huanglong rents grew 9.0% YoY to an average of RMB6.7 per sq m per day in Q2/2015. As no new projects launched and many companies relocated from old projects to newer office facilities to cut overhead costs, Huanglong was the only area to witness companies giving back space to the market in the first half of 2015.

Grade A office rents in Qianjiang New City remained flat in 1H/2015, after eight consecutive quarters of rent decreases. Accessibility has greatly improved with the opening of metro line 4, and Qianjiang New City has become the only business area to benefit from all three metro

lines. Nevertheless, Qianjiang New City continued to record the highest vacancy rates, at 26.5%, in the second half.

Office strata-title market

Office transaction volumes in downtown districts amounted to roughly 112,500 sq m in 1H/2015, representing an average price of RMB20,000 per sq m.

Non-prime areas, such as Qianjiang New City and Canal City, have the largest stock of Grade A office strata projects. As these areas face fierce competition from surrounding projects and substantial new supply, landlords tried to find en-bloc purchasers to adsorb large amounts of space by providing a nearly 10% discount for these buyers.

Bank of Shanghai purchased 10,560 sq m (equalling six floors) in Huafeng International Plaza (华峰国际大厦) for a total consideration of RMB285 million. A local company, 杭州乾构 实业投资有限公司, bought 86 units (13,000 sq m) in Greenland Central Plaza (绿地中央广场) in Canal City.

The strata Grade A office market remains stable with transaction prices stabilised at RMB31,000 to RMB37,000 per sq m, and yields unchanged at 3.5% -4.5%.

Office market outlook

Four Grade A office projects are expected to launch in the second half of 2015, adding a total office GFA of 275,000 sq m, and pushing city-wide stock up to 1.21 million sq m. Qianjiang New City and Qingchun are expected to account for 85% and 15% of overall supply, respectively.

Three projects in Qianjiang New City, Huarun Towers A and B and Huafeng International Plaza, are scheduled to be handed over in the second half. Nearly 50% of total office space in Huafeng International Plaza has been sold to end-users. Huarun Towers A and B will be the first international Grade A office buildings in Hangzhou, attracting premium companies relocating from the city centre. This is the first time in two years that Qianjiang New City has received a large amount of supply, placing an upward pressure on vacancy rates in this area.

Retail market

Market commentary

Hangzhou1's retail sales reached RMB213.7 billion in the first half of 2015, up 7.0%. Online sales recorded a high growth rate of 42.7%, 35.5 ppts over city-wide retail sales growth rate.

Intime Retail has continued its "Online+Offline" scheme by deepening its cooperation with the Alibaba Group. As Shen Guojun, the former chairman of Intime Retail, transferred 18% of his company's shares to his relatives this July, Alibaba has become Intime Retail's biggest shareholder, holding 32%. Alibaba will continue combining online and offline shopping through Intime Retail's platform. As the home of these two retailer giants,

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

TABLE 1 Selected office leasing activities, 1H/2015

Tenant	Project	Location	GLA (sq m)
Quark Finance	Wulin Times Square	Wulin	1,800
Hangzhou TourongPuhua	Wulin Times Square	Wulin	1,800
Chuangdao Capital	UDC	Qianjiang New City	1,500
CIFI	UDC	Qiangjiang New City	1,500
Texas Instruments	Delixi Tower	Huanglong	520

Source: Savills Research

Hangzhou is expected to lead this experimental scheme.

Slowing retail sales, together with fast growing online shopping, are shaking up the physical retail markets and have forced operators, and department stores in particular, to find new ways to attract higher footfalls.

- Most downtown projects have continued their tenant mix

adjustment during the first half of 2015.

- By the end of June, three department stores had begun renovations and are scheduled to reopen in the fourth quarter.
- Intime Retail continued its "online+offline" trial scheme with Alibaba Group by utilising online shopping analysis and bringing more online consumers into physical

stores. The first offline store operated by the Alibaba Group opened on the B1/F of the Wulin Yintai Department Store.

Supply and stock

MixC Street was the only new project launched in the first half of 2015, adding 16,000 sq m onto Hangzhou's retail market and pushing downtown stock up to 1.9 million sq m.

Suburban areas' retail stock stayed unchanged at 282,000 sq m in the second quarter.

MixC Street, the second phase of MixC Mall, opened in May. This new shopping mall benefits from direct connectivity to Qianjiang station (metro lines 2 and 4). It has introduced the second Apple Store in Hangzhou and other retailers include Godiva, Haglofts, Turlhatti, Element Fresh and Cold Stone.

Following a shopping mall boom in 2013, Hangzhou's retail market has witnessed a supply glut during the past two years, especially in decentralised areas. Due to the rapid growth of online shopping and slowing retail sales, many projects have delayed their launches to secure higher occupancy rates upon launch.

Rents and vacancy rates

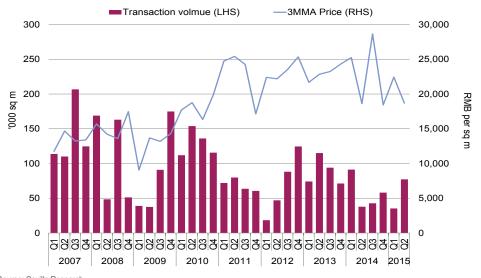
City-wide first-floor rents grew 5.7% YoY to RMB18.1 per sq m per day, mainly driven by strong demand and good business performance within non-prime projects. Prime rents stayed unchanged at RMB24.2 per sq m per day in the second quarter, compared with the last quarter of 2014. Non-prime rents recorded a 1.7% HoH growth to RMB10.5 per sq m per day.

Vacancy rates of Hangzhou's shopping malls increased 1.7 ppts to 10.4%, largely owing to the tenant adjustments in prime projects. As the space occupied by Central Department Store remains vacant since its closure, Qianjiang New City recorded the highest vacancy rates at 26.4% in the second quarter.

Prime area - Wulin

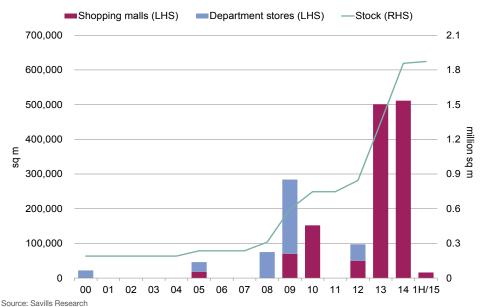
The acquisition of Hangzhou Tower has made the Jiebai Group

Downtown office sales market, Q1/2007 - Q2/2015



Source: Savills Research

Downtown retail supply and stock, 2000–1H/15



NB: Prime areas include Wulin and Lakeside.

go through a period of tenant adjustment by differentiating positions of all downtown retail projects. Hangzhou Tower continues to focus on introducing high-end retailers, particularly in Tower B. Prada opened its third store in Hangzhou, taking up two floors nearly 700 sq m. Other new retailers include Sandro, Club Monaco, Loro Piana, and Peuterey.

"Choice" hypermarket debuted in the B1/F of Wulin Intime Department Store Tower C, occupying 1,200 sq m. This is the first physical store opened by the Alibaba Group and Intime Retail Group. Only 70% of goods can be purchased within the store and customers can buy the remaining 30% of goods by scanning a code and ordering online.

Prime area - Lakeside

Jiebai Xinyuanhua (解百新元华) has closed for repositioning and the other two buildings, Tower B and Jiebai Xinshiji (解百新世纪), will also

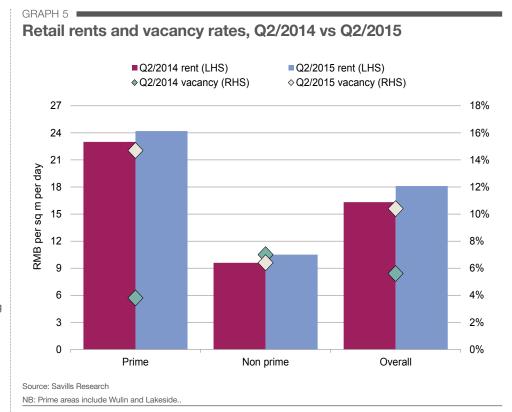


TABLE 2

Selected retail leasing transactions, 1H/2015

Tenant	Trade	Project	Location	GLA (sq m)
Choice	Hypermarket	WulinIntime Department Store	Lakeside	1,200
Louis Vuitton	Accessory	In 77 phase 1	Lakeside	717
Marina Rinaldi	Fashion	MixC Mall	Qianjiang New City	112
Hui Lau Shan	F&B	MixC Mall	Qianjiang New City	85

Source: Savills Research

TABLE 3

Upcoming retail projects, 2H/2015E

Project	Retail GFA (sq m)	Area	Retail type	Retail type
Jinsha Paradise Walk 金沙龙湖天街	86,100	Xiasha	Suburban	Shopping mall
AEON Mall 永旺梦乐城	100,000	Liangzhu	Suburban	Shopping mall
Lixing 1157 利星1157	80,000	South City	Downtown	Shopping mall
Star Avenue 2 星光大道二期	87,000	Binjiang	Downtown	Shopping mall

Source: Savills Research

continue their tenant adjustments. Jiebai Xinyuanhua will target middle-income and fashion-conscious female customers aged between 20 to 35 years old, by introducing bars, female-focus facilities and regular exhibitions. Jiebai Xinshiji will position as a female-dedicated store and Tower B will focus on men's fashion and fast-fashion retailers, with a 3,000sq m H&M flagship store and a 1,400sq m UR store scheduled to open later this year.

Louis Vuitton opened its fourth store in In 77 Zone A(湖滨银泰 1期) in July after five years of construction. The new store has two floors and takes up over 700 sq m. Also, Jimmy Choo will launch its first store in Hangzhou in the project.

Non-prime area - Qingchun

By the end of June, both Qingchun Intime Department Store (庆春银泰百 货) and Rainbow Shopping Mall Zone A (天虹A座) had closed to reposition and introduce more F&B retailers and other entertainment facilities. Both are expected to reopen in October.

Suburban area - Qiaosi

Ikea debuted by opening its first store in the Qiaosi area, within 30 minutes of the city centre by metro line 1. It has a total GFA of nearly 43,000 sq m, taking up three floors and offering 953 car parking spaces. Ikea Group acquired this land plot in 2013 for RMB137 million.

Retail market outlook

Four new shopping malls are expected to launch onto the market in the second half of 2015, with two located in downtown districts and another two in suburban districts.

All new supply is to be located in non-prime areas, which currently lack high-quality retail projects, helping to address strong demand from surrounding areas.

The extension of metro line 1 is scheduled to open in October with an additional length of 5.6 km, passing through the Xiasha Higher Education Zone. There are over 180,000 students studying and living in this area. The opening of the extension of the metro line and Jinsha Paradise

Walk (金沙龙湖天街) will improve the commercial environment and accessibility of this suburban area.

Due to concerns about economic uncertainties, fierce competition from ecommerce and new projects, both retailers and operators remain conservative about expansion plans. Most department stores have renovated or introduced more lifestyle retailers to provide a better shopping experience and to differentiate from competitors. Despite this, the lack of experience and talent, as well as the high cost of renovations, may impose more pressure on the weak physical retail

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