

# Briefing Office and retail sector

August 2013



Image: Omega flagship store at Hubin Yintai 1

## SUMMARY

The Grade A market is characterised by flat rents and high vacancy rates, while the retail market remains healthy with both developers and retailers seeking opportunities to enter the market.

- Two Grade A office projects with a total GFA of 119,600 sq m were handed over in 1H/2013.
- The city-wide Grade A office vacancy rate increased by 7.6 percentage points (ppts) year-on-year (YoY) to 26.7% in Q2/2013.
- Grade A office rents fell to an average of RMB126.0 per sq m per month in 1H/2013, down by 0.1% compared with 2H/2012.
- Three shopping malls were handed over in the first half, adding a total of 331,000 sq m of supply to the retail market.
- Prime shopping mall vacancy rates increased by 1.1 ppts to 2.9% in 1H/2013.
- Prime shopping mall first-floor rents increased by 0.6% half-on-half (HoH) to RMB26.2 per sq m per day.
- One department store and three new shopping malls are expected to be launched onto the market in 2H/2013, adding a total of 446,500 sq m, roughly doubling the current retail stock.

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 “Non-prime Grade A office and retail projects are likely to dominate future supply in the next two years, putting pressure on both rents and the city-wide occupancy rate.” James Macdonald, Savills Research  
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→ **City overview**

Hangzhou's GDP totalled RMB363.2 billion in 1H/2013, with a real growth rate of 8.0% year-to-date YoY, which is higher than the nationwide figure of 7.6% but still represents a slowdown from 2012.

The Nanjing–Hangzhou–Ningbo high-speed rail began its official operation on 1 July. The newly opened rail line

has helped to reduce travel times between the cities by half, making it more convenient for business people commuting in the Yangtze River Delta. The new line may also help to increase regional integration between Jiangsu and Zhejiang provinces, both of which are renowned for their flourishing small and medium enterprises.

**Office market**

**Supply and demand**

Two Grade A office projects, Jinlong Fortune Centre (金龙财富中心) and Zhejiang Fortune Financial Centre West Tower (浙江财富金融中心西塔), were handed over to the market in 1H/2013, adding a total office GFA of 119,600 sq m and bringing total stock to 2.0 million sq m. Both of these two new projects were sited in the non-prime areas of Qingchun Road and Qianjiang New City respectively.

Jinlong Fortune Centre, a lease-only Grade A office building on Qingchun Road, has a total office GFA of 29,000 sq m from the 6/F to 19/F. Located on the traditional financial street, this project received demand mainly from financial service providers, including domestic insurance companies and fund management firms.

Located in Qianjiang New City, Zhejiang Fortune Financial Centre comprises two towers, of which, East Tower was purchased by China Construction Bank in 2006 and was handed over in 2011. The 90,600-sq m West Tower was launched in Q2/2013. The developer is only entertaining the sale and lease of larger units (more than 1,000 sq m), leading to a 20% sell-through rate and an 8% occupancy by the end of 1H/2013.

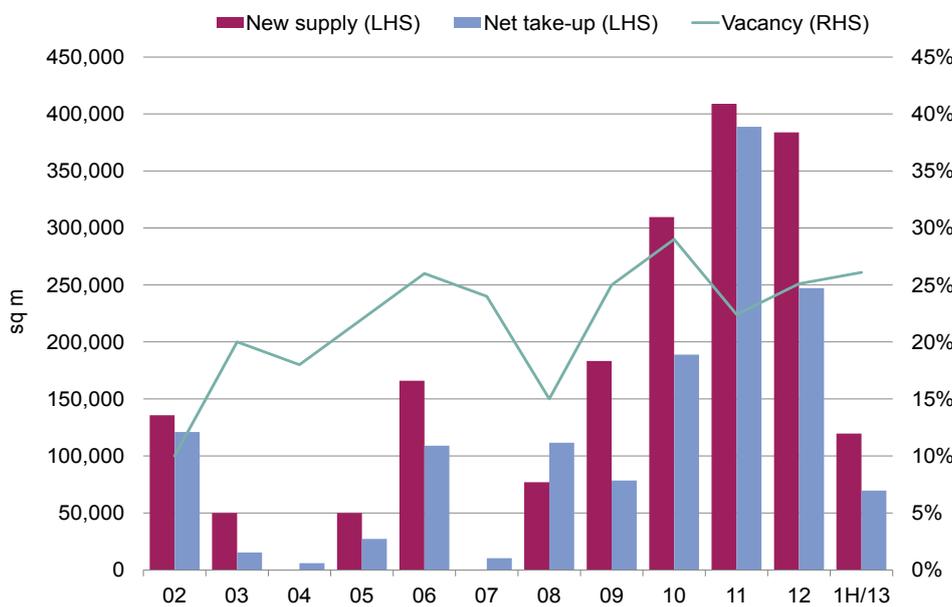
Because of the slowing economy and weak business confidence, net take-up fell by 9% to 61,416 sq m in 1H/2013, compared with 67,859 sq m in 2H/2012.

**Grade A office rents and vacancy rates**

Grade A office rents fell to an average of RMB126.0 per sq m per month in 1H/2013, down 0.1% YoY. Due to sluggish demand and ample supply, the city-wide Grade A office vacancy rose to 26.7% in 1H/2013, up 7.6 ppts YoY.

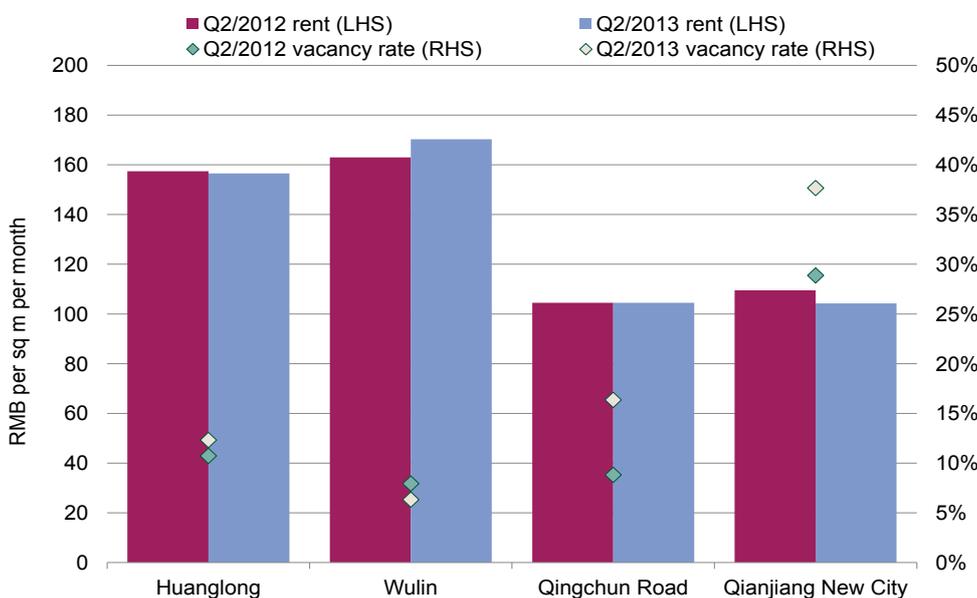
Because of limited supply and strong demand, prime areas Wulin and Huanglong remained relatively healthy.

GRAPH 1 **Grade A office supply, demand and stock, 2002–1H/2013**



Source: Savills Research

GRAPH 2 **Grade A office rents and vacancy rates, Q2/2012 vs Q2/2013**



Source: Savills Research

→ Wulin became the most sought-after location for both multinational and domestic companies, especially those in the financial sector, this year with the completion of Hangzhou's first Metro line (line 1) in November 2012 which passes through the Wulin area. Wulin rents increased to an average of RMB170 per sq m per month while the vacancy rate fell to 6.3%. Canhigh Centre, the best office building in Hangzhou, witnessed a record low vacancy of 1%.

Huanglong also received strong demand. Delixi Tower (德力西大厦), an unfinished office project, achieved roughly a 1,300-sq m pre-commitment from a serviced office provider, while Bulthaup, a German kitchen manufacturer, occupied 400 sq m in Gongyuan Mansion (公元大厦) as an exhibition space.

Both Qingchun Road and Qianjiang New City received new projects in 1H/2013, resulting in a rise in vacancy rates in these non-prime areas. Multinationals and domestic real estate companies and banks seeking large-sized units (over 1,000 sq m) are relocating or establishing new offices in Qianjiang New City. This is largely attributed to limited leasable office space in prime areas, reasonable rents and a gradually improving business environment. Nevertheless, Qianjiang New City continued to record Hangzhou's highest vacancy rate, at 37.7%.

#### Office strata-title market

Three Grade A office projects, namely Vantone Centre (万通中心), Matrix International (矩阵国际) and Zhejiang Fortune Financial Centre (West Tower), received pre-sale permits in the first half of 2013, adding a total office GFA of roughly 191,000 sq m to the strata market. Vantone Centre and Matrix International are located in decentralised areas, West City and North City, and achieved LEED gold certification in 2011 and 2012 respectively. Upon completion, they will represent the first LEED certified office projects in Hangzhou's decentralised areas. All three projects are selling large-sized units (750

sq m to 1,500 sq m), leading to a comparably low sell-through rate of roughly 18%. Additionally, the poor business environment and the imbalance between supply and demand are likely to increase competition for tenants, suppress rents and subsequently compress rental yields. Asking prices for high-quality office projects in non-prime areas currently hover around RMB35,000 sq m. Based on estimated rents and transacted prices, yields for strata-title Grade A offices are approximately 3.8% to 4.5%.

#### Office market news

A joint venture between The Bank of Ningbo and two other financial firms acquired a commercial land plot, Plot A-01-2 in Qianjiang New City, for a total consideration of RMB1.56 billion. This represents an accommodation value (AV) of RMB14,527 per sq m and a 0% premium over the reserve price. The plot has a site area of 16,781 sq m and a plot ratio of 6.4. This development is expected to start construction in 2015 and be completed by 2018. By the end of Q2/2013, nearly 900,000 sq m of office space in Qianjiang New City (both space purchased and developed for self use) was occupied by 15 domestic banks and financial institutions.

#### Office market outlook

Four Grade A office projects are scheduled to be handed over to the market in 2H/2013, adding a total of 262,000 sq m of office GFA and bringing city-wide stock to 2.3 million sq m.

Delixi Tower (德力西大厦), a lease-only project located in Huanglong area, is the only new supply in the last two years in the area and has so far recorded a 70% pre-commitment.

Intime City (银泰城), located in West City, is a 400,000-sq m mixed-use project with five office towers and a total of 76,000 sq m of office space. Nearly 50% of units purchased to date were bought by companies

in the trading, IT, energy and pharmaceutical industries for self use.

Qianjiang New City is expected to receive two new projects in 2H/2013 with a total office GFA of 101,000 sq m, bringing the total stock in the area to 1.24 million sq m, accounting for 55% of city-wide stock and imposing significant downward pressure on rents and occupancy rates.

Prime areas, Wulin and Huanglong, are expected to remain relatively healthy with reasonable demand and limited supply. Qianjiang New City is likely to continue having high vacancy rates and flat rents. Meanwhile, owing to the opening of Metro line 2 (end of 2013E) and Hangzhou Raffles City (2014E), the improvement in accessibility and business environment will help Qianjiang New City develop into a new CBD.

## Retail market

### Supply and stock

Three shopping malls were launched onto the market in 1H/2013, Hubin Yintai Phase 2 (湖滨银泰二期), City Mall Phase 1 (西田城一期) and Xixi Incity Mall (西溪印象城), adding a total of 331,000 sq m to the market and bringing total retail stock to 1.4 million sq m. All three projects achieved high commitment rates prior to soft opening (over 90% occupancy) and received high footfall upon opening.

Hubin Yintai Phase 2, the first shopping mall operated by Yintai Group in Hangzhou, is located in the Lakeside retail area and has a total GFA of 100,000 sq m. Targeting young and fashion-conscious consumers, this four-storey building introduced a number of new retailers to Hangzhou. New entrants include Hedgren, LAFEE, BELFE, Claire's, Cachet, Crozza, SIU, Miss Patina and J. Lindeberg. Gap also occupies nearly 1,500 sq m in this project.

North City, the non-prime retail area, received its first shopping mall (City Mall Phase 1). This 61,000-sq

m shopping mall is anchored by Yonghui Supermarket and Hangzhou Cinema, and also managed to introduce fashion, F&B, leisure and children's products to attract residents from the surrounding area. On the soft-opening day, City Mall Phase 1 recorded a high footfall of roughly 140,000 individuals.

XiXi Incity Mall, the first retail project in West City, the non-prime retail area, held its grand opening in May. The project has a total GFA of approximately 170,000 sq m. Sam's Club occupies 20,000 sq m in the mall, their first store in Hangzhou. Additionally, fast-fashion retailers including H&M, Inditex Group and Uniqlo occupy nearly 5,000 sq m. Developed by SZITIC Commercial Property (SCP), Xixi Incity has been well received by nearby residents and college students.

**Rents and vacancy rates**

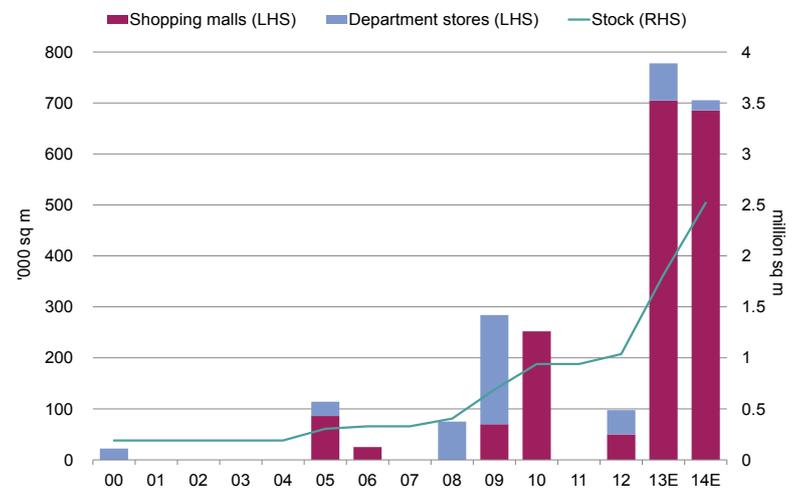
Prime rents increased by 0.6% YoY to RMB26.2 per sq m per day, while the city-wide prime vacancy rate increased slightly in the first half of the year, from 1.8% in 2H/2012 to 2.9%, largely attributed to the new supply of Hubin Yintai Phase 2.

**Primary area – Wulin Hangzhou Tower**

Hangzhou Tower, where most of the luxury brands are concentrated, continues to attract world-famous luxury retailers. Louis Vuitton completed its renovation in July 2013 and opened its women's store occupying the 1/F to 3/F in Tower B, with an operating area of 921 sq m. This is the largest fashion store in Hangzhou Tower. Roger Vivier, a French footwear retailer, debuted in Hangzhou occupying a GFA of 80 sq m in Tower B. This store represents the retailer's fourth in China.

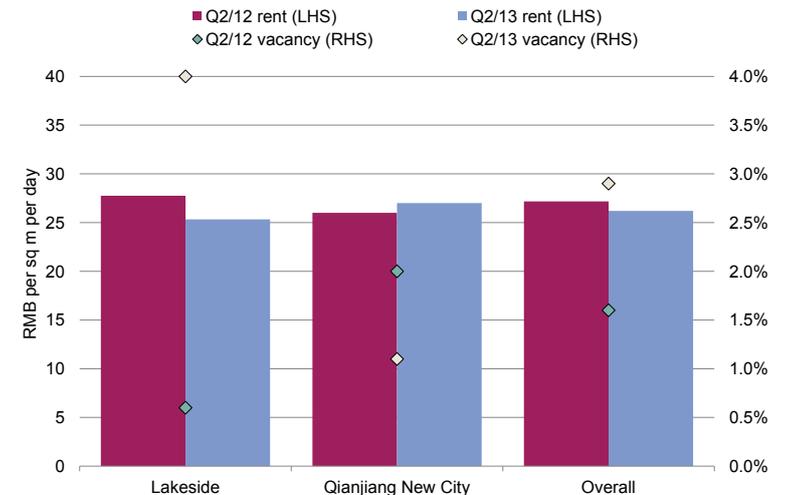
Following the completion of tenant adjustments and facade renovations in Towers A and B in 2012, Towers C and D began facade renovations and tenant adjustments on the first two floors. Tower D will introduce a

GRAPH 3 Prime retail supply and stock, 2000–2014E



Source: Savills Research

GRAPH 4 Retail rents and vacancy rates, Q2/2012 vs Q2/2013



Source: Savills Research

number of fine jewellery brands on the 1/F.

Hangzhou Tower Corporation (杭州大厦有限公司) entered into a lease agreement with the owner of San Li Building (三立大厦) to lease 26,600 sq m (including an 8,000-sq m basement) within the project. San Li Building, located next to Hangzhou Tower B, was previously a hotel development but will be converted into retail and office space. The ongoing renovation work is scheduled to be completed

in 2016, with the building being directly connected to Hangzhou Tower B. The lease is negotiated to start in 2016 and expire in 2034. It has been suggested that the new San Li Building, after renovation, will introduce a number of boutique luxury retailers.

**Primary area – Lakeside**

Construction work along Yan'an Road, including widening the roads and building underground passages, was completed in 1H/2013. Jiebai Plaza (Tower B), taking advantage of

improved accessibility, introduced a number of retailer flagship stores with street frontages along Yan'an Road after reopening. One of the more significant stores is the 2,000-sq m flagship Adidas store which opened in April 2013, while Esprit opened a 1,100-sq m flagship store on the first two floors of Xihu Intime Department Store (西湖银泰百货).

#### Hubin Yintai Phase 1

OMEGA, a Swiss watch brand, opened its largest worldwide flagship store in Hubin Yintai Phase 1 in May. The store has a total GFA of 668 sq m covering three floors. In addition to crafted watches, the store will offer fine jewellery and leather collections produced by OMEGA, and a maintenance and repair centre for after-sales service.

Hermes started renovations and store upgrading in January 2013, committing to an additional 434 sq m adjacent to its existing store.

#### Hubin Yintai Phase 4

Apple signed an agreement with Hubin Yintai to open a 2,000-sq m store in the fourth phase of the project. The store is expected to officially open in August 2014.

#### Emerging area – Qianjiang New Town

##### MixC Mall (万象城)

MixC Mall started its first tenant adjustment since opening in 2010. The repositioning is focused on the 1/F and 2/F. The mall is intending to become more international and diverse by introducing Givenchy, Loewe, Hollister, J. Lindeberg and Diesel.

#### Retail market news

Wanda Group secured a commercial land plot in Gongshu district for a total consideration of RMB1.43 billion in March 2013. This is Wanda's first project in Hangzhou. The plot has a total buildable GFA of 254,312 sq m and an AV of RMB5,608 per sq m. The development includes a 90,000-sq m shopping mall, four office towers and a 53,500-sq m open-air retail street. Hangzhou Wanda Plaza is scheduled to open in Q4/2014.

Gang Long Holdings (港龙控股) secured a commercial land plot in Jianggan district for a total consideration of RMB966.6 million in March 2013. The plot has a total buildable GFA of 148,533 sq m and an AV of RMB6,508 per sq m. The development, once completed,

TABLE 1

### Selected retail leasing transactions, 1H/2013

Tenant	Trade	Project	Location	GLA (sq m)
Gap outlet	Fashion	Xiasha Outlet	Xiasha	900
Hollister	Fashion	MixC Mall	Qianjiang New City	825
Initial	Fashion	Queen's Park	Wulin	500
Harbour House	Furniture	Xixi Incity Plaza	West City	411
Diesel	Fashion	MixC Mall	Qianjiang New City	212
Loewe	Accessories	MixC Mall	Qianjiang New City	198
Miss Patina	Fashion	Hubin Yintai Phase 2	Lakeside	170

Source: Savills Research

TABLE 2

### Upcoming retail projects, 2H/2013E

Project	Retail GFA (sq m)	Area	Retail type
Hangzhou Intime City 杭州银泰城	289,000	West City	Shopping mall
North Centre 北城天地	50,000	North City	Shopping mall
Bridge Water Mall 运河上街	34,500	North City	Shopping mall
Rainbow Department Store 天虹百货	73,000	Qingchun	Department store

Source: Savills Research

will have direct access to Peng Bu Station (Metro line 1).

Carlyle Group announced a strategic partnership with SCP in May, acquiring a 49% stake in Suzhou Incity Mall and Hangzhou Gudun Incity Mall. Hangzhou Gudun Incity Mall, located in the northwest part of Xihu district, has four aboveground floors and two basement floors for car parking with a total GFA of 52,000 sq m.

Greentown entered into an agreement to acquire a 45% stake in the Wulin Square project from Hangzhou Metro Real Estate Ltd in July 2013 for a total consideration of nearly RMB1.4 billion. The development site is designated for

commercial use and will be directly connected to Wulin Square Station (Metro line 1). The project will have an aboveground GFA of 148,936 sq m and an underground GFA of nearly 87,000 sq m. The mixed-use development will include a five-star hotel, an office tower and a 100,000-sq m shopping centre. Construction started in May 2013 with the retail section expected to open in 2016.

Hangzhou Jiebai (杭州解百) announced its acquisition of a 60% stake in Hangzhou Tower Corporation for a total consideration of RMB2.3 billion. Hangzhou Tower Corporation is a leading domestic luxury retail operator and owns the city's most profitable department store – Hangzhou Tower. The

remaining 40% will still be owned by Nam Kwong Group, a state-owned entity based in Macau.

**Retail market outlook**

Four new projects are expected to debut on the market in 2H/2013 adding 446,500 sq m and leaving the overall stock at 2.5 million sq m.

Taking into account the fact that all these projects have already recorded very healthy levels of pre-commitment (over 80%) and the locations where the new supply is expected have a dearth of stock, the retail market should be able to digest the new supply and remain healthy for the remainder of the year. ■

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