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Savills World Research
Hangzhou

Briefing
Office and retail sector

February 2014

Image: Qianjiang New City

SUMMARY

Hangzhou's Grade A office market saw slowing demand, decreasing rents and increasing vacancy rates. Meanwhile, prime retail rents and vacancy rates remained stable.

- Two Grade A office projects were handed over in 2H/2013, adding a total GFA of 120,000 sq m to the office market.
- Net take-up totalled 124,835 sq m in 2013, down 44% from 222,369 sq m in 2012.
- City-wide Grade A office vacancy rates rose 3.0 percentage points (ppts) year-on-year (YoY) to 26.0% in Q4/2013.
- Grade A office rents fell to an average of RMB126.8 per sq m per month in Q4/2013, down 1.7% YoY.
- Three shopping malls were handed over in the second half of 2013, bringing total supply of 204,500 sq m.
- City-wide shopping mall vacancy rates increased by 0.4 of a ppt to 4.5% in 2H/2013.
- City-wide shopping mall first-floor rents increased by 0.9% half-on-half (HoH) to RMB19.14 per sq m per day.

"Hangzhou's retail market witnessed a shopping mall boom in non-prime areas this year, helping to address robust demand and reshaping the market." James Macdonald, Savills Research

Office market

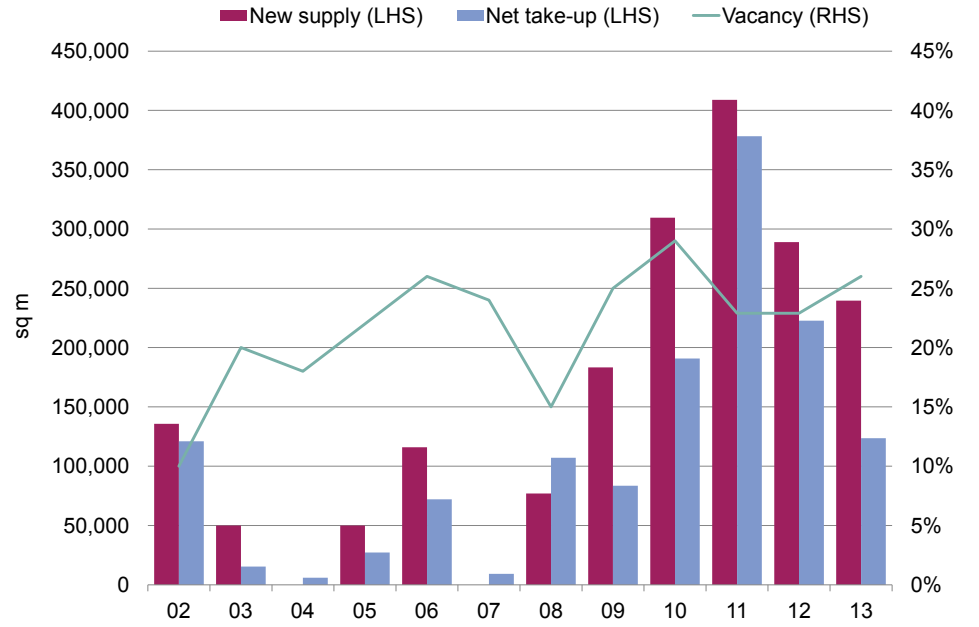
Market commentary

Hangzhou's GDP totalled RMB834.4 billion in 2013, with a real growth rate of 8.0% year-to-date YoY, which is higher than the nationwide figure of 7.7%, but still represents a slowdown from 2012. Utilised foreign direct investment grew by 6.3% YoY to US$5.3 billion. The manufacturing, biochemical and computer software sectors continued to attract overseas investment.

Domestic companies remained the primary drivers of demand in the leasing market. More privately-owned companies are purchasing office space in the West and North of the city, and relocating their businesses to such decentralised areas. Supply levels in 2013 were 30% less than the average over the past three years, giving the market time to absorb the substantial supply from years past. Due to weak demand and upcoming ample supply, more landlords are compromising to ensure occupancy, leading to somewhat lower rents and a mild increase in vacancy rates. Subdued rental growth and excess future supply will continue to place pressure on Hangzhou's office market.

GRAPH 1

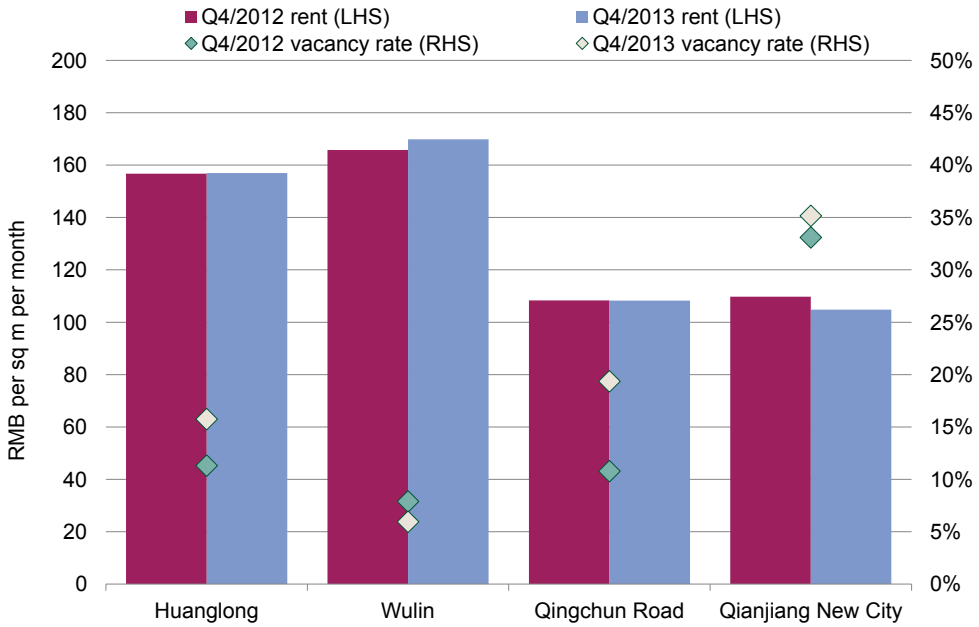
Grade A office supply, demand and vacancy, 2002–2013



Source: Savills Research

GRAPH 2

Grade A office rents and vacancy rates, Q4/2012 vs Q4/2013



Source: Savills Research

Supply and demand

Two Grade A office projects, Delixi Building (德力西大厦) and Di Kai Yin Zuo (迪凯银座), were handed over to the market in 2H/2013, adding a total office GFA of 120,000 sq m and bringing total stock to 2.0 million sq m.

Delixi Building, a lease-only Grade A office project in Huanglong area, has two office towers and a total office GFA of 64,950 sq m. As it is the first new supply in a prime business area in the last two years, this project achieved good leasing activity, with its North Tower fully occupied at the end of 2013. Multinational companies, such as Air Liquide and Regus, occupied whole floors in this project, while the investor, Delixi Group, took up some office space for self use.

Located in Qianjiang New City, Di Kai Yin Zuo is the second office project developed by the Dikai Group (迪凯集团) following Dikai International Business Centre. With the launch of this 55,000-sq m office building, Qiangjiang New City's Grade A office stock amounted to 1.1 million sq m, accounting for 56% of the city-wide total by the end of 2013.

As prime areas received the first new supply since the end of 2011 and landlords of new buildings tend to offer lower than market average rents to attract tenants, the second half's net take-up totalled 83,696 sq m, up 103% HoH. Nevertheless, net take-up decreased 44% YoY to 124,835 sq m in 2013, largely attributed to the slowing economy and weak business confidence.

Grade A office rents and vacancy rates

Grade A office rents fell to an average of RMB126.8 per sq m per month in Q4/2013, down 1.7% YoY. With flat demand and a supply glut in non-prime areas, the city-wide office vacancy rate grew to 26.0% in Q4/2013, up 3.0 ppts YoY.

Considering the slowing demand and impending supply glut, the landlords of both new projects in the second half took steps to achieve a satisfactory occupancy by offering discounted rents of 5% to 10% to potential tenants.

Due to a lack of supply in the last three years and very limited leasable Grade A office space in Wulin, this prime area outperformed, with rents increasing by 1.9% YoY and vacancy rates falling by 1.9 ppts YoY in Q4/2013. Additionally, the opening of Metro line 1 in December 2012 and improved transportation in the surrounding area have both induced strong demand from multinational manufacturers and domestic service providers.

Huanglong area remained stable, recording a mild rental growth of 0.4% from RMB128.3 per sq m per month in Q4/2012. Some tenants are relocating from this area to emerging areas, such as Qianjiang New City and West City, given the close proximity to the main business district, competitive rents and the high-quality office environment. Grade A office vacancy rates were up 4.6 ppts to 15.7% in the fourth quarter.

Due to several municipal administrative functions relocating from the city centre to Qianjiang New City, along with an improved business environment, more companies are considering relocating to or expanding in this newly planned city centre. As nearly 70% of current Grade A office space in Qianjiang New City was strata sold, and individual landlords have more flexible leasing strategies and respond quickly to weak demand, a 3.1% HoH decrease in Grade A office rents and a 0.8 of a ppt HoH fall in vacancy rates was recorded in this area. Despite this, Qianjiang New City continued to hold Hangzhou's highest vacancy rate, at 35.2%.

Office strata-title market

Office transaction volumes in downtown districts[1] amounted to roughly 353,000 sq m in 2013, increasing from 321,000 sq m in 2012. Qianjiang New City saw the most transactions of all areas in 2013. Meanwhile, emerging areas, particularly the West and North of Hangzhou, started to have high-quality projects handed over in 2013 and record good performances.

Average prices in downtown Hangzhou fell 9.2% YoY to RMB22,181 per sq m. This is largely attributed to internal deals in Qianjiang New City and large transactions in emerging areas. MixC Tower and Di Kai Yin Zuo, located in Qianjiang New City, were largely transacted internally, with an average price of approximately RMB22,600 per sq m and RMB18,900 per sq m respectively. Excluding these internal sales, Xizi International Centre (百大绿城•西子国际) ranked first in terms of transaction value in 2013. This project was jointly developed by Greentown and Bai Da Real Estate (百大置业), and a 40% interest was sold to Hangzhou Tower Corporation (杭州大厦有限公司) in 2012. With the advantages of developer reputation, convenient accessibility to the Metro and a planned shopping mall within this compound, Xizi International Centre recorded a total revenue of over RMB1 billion and an average price of RMB36,000 per sq m.

With slowing rental growth and value appreciation, yields for strata Grade A offices remained stable, at 3.6% to 4.2%.

Office market news

Cisco started to relocate its Chinese headquarters from Shanghai to Hangzhou, occupying one block of Wangjiang International (望江国际) in 2H/2013. Prior to this, Cisco established its R&D centre in Binjiang district in November 2011.

Alibaba Group, a privately-owned Hangzhou-based e-commerce company, relocated to its newly built Taobao Town Phase 1 (淘宝城一期) in August 2013. Nearly 10,000 people are moving from Xihu International Tower (西湖国际大厦) and Chuang Ye Building (创业大厦). Taobao Town has three phases, the first two phases of which are for office and R&D use. The second phase is expected to be completed in December 2014. Upon its completion, there will be over 15,000 people working there.

Office market outlook

Five Grade A office projects are scheduled to be handed over to the market in 2014, adding a total of 257,000 sq m of office GFA and bringing city-wide stock to 2.2 million sq m.

All business areas are expected to receive new projects in the next year. Hangzhou Intime City (杭州银泰城), Vantone Centre (万通中心) and Xizi International Centre are strata office projects, and an estimated 60% of buyers are acquiring for self use. Located in Wulin area, Wulin Times Square (武林时代商务中心) is the only new supply expected in the area in the next four years, with a total office GFA of 24,000 sq m. Tower A, Wan Yin International Phase 2 (万银双子中心A座) is expected to be handed over in Qianjiang New City in the next six months. It was purchased by Agriculture Bank of China (ABC) for a total consideration of nearly RMB1.3 billion in November 2009. The whole block is expected to be occupied as ABC's headquarters in Zhejiang province.

Wulin and Huanglong districts are expected to remain healthy, with reasonable demand and limited supply. New supply in decentralised areas, particularly in the West and North of the city, will compete for private companies that are already operating in prime areas. Metro line

1 Hangzhou's downtown districts include Shangcheng, Xiacheng, Xihu, Gongshu, Jianggan and Binjiang.

2 is scheduled to open in the first half of 2014. By then, Qianjiang New City will become the only business area that enjoys the benefits of two Metro lines. With an uncertain business environment, the Grade A office market will continue to soften in 2014.

Retail market

Market commentary

Hangzhou's retail sales reached RMB353.1 billion in 2013, with a growth rate of 13.0% YoY. The growth rate has slowed 2.5 ppts compared with last year, representing weak consumption confidence. Urban disposable income per capita recorded stable growth, increasing by a real rate of 7.4% YoY to RMB39,310.

Hangzhou's retail market witnessed a shopping mall boom in 2013. All retail projects launched this year were shopping malls, with a total retail GFA of 535,700 sq m. Shopping malls accounted for 60% of all retail space at the end of 2013, up from 34% in 2012. Except for Hubin Yintai Phase 2, all malls are located in non-prime retail areas, the North and West of the city. With a large population living in the aforementioned decentralised areas and very limited retail facilities, the opening of these projects helped to address robust retail demand and reshape the city's retail market.

Supply and stock

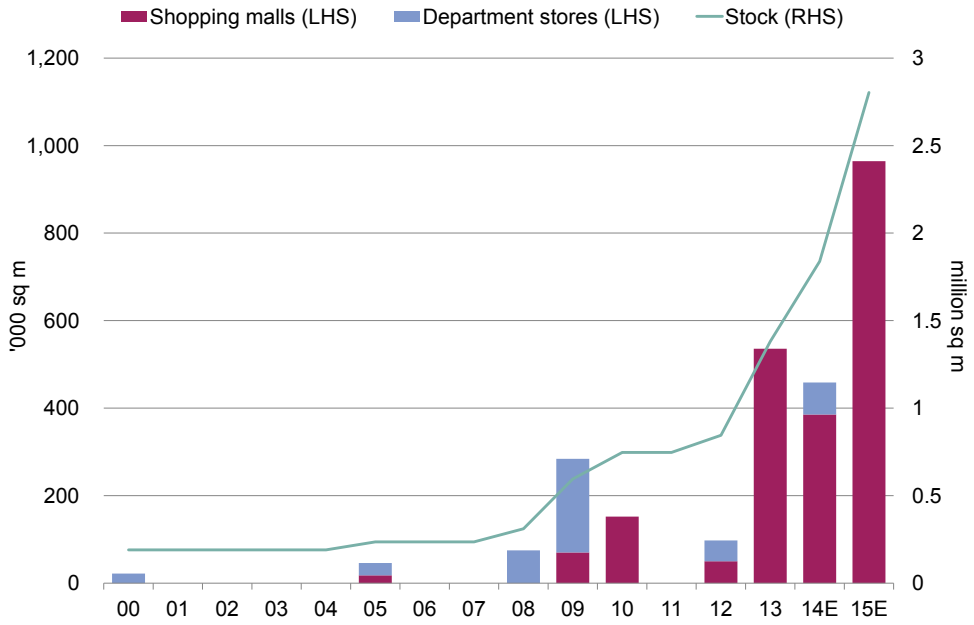
Three shopping malls were launched onto the market in the second half of 2013, namely North Centre (北城天地), Hangzhou Intime City (杭州银泰城) and Bridge Water Mall (运河上街), adding a total of 204,500 sq m to the market and bringing total retail stock to 1.4 million sq m. All three projects were located in decentralised retail areas, in the West and North of the city, achieving high commitment rates of over 90% upon opening.

North Centre, located in the North of the city, held its grand opening in September. Targeting local residents in surrounding communities, this 50,000-sq m project is anchored by a 13,000-sq m Century Mart (世纪联华), a 3,000-sq m Kids Want (孩子王), a 3,000-sq m Yin Le Di (银乐迪) and a 1,500-sq m Ku Wan Ba (酷玩吧). Over 50% of the retail space is occupied by F&B and leisure retailers.

The 35,000-sq m Bridge Water Mall opened in December 2013. This open-air mall introduced many domestic brands, including Ochirly, AMASS and several Chinese restaurants.

GRAPH 3

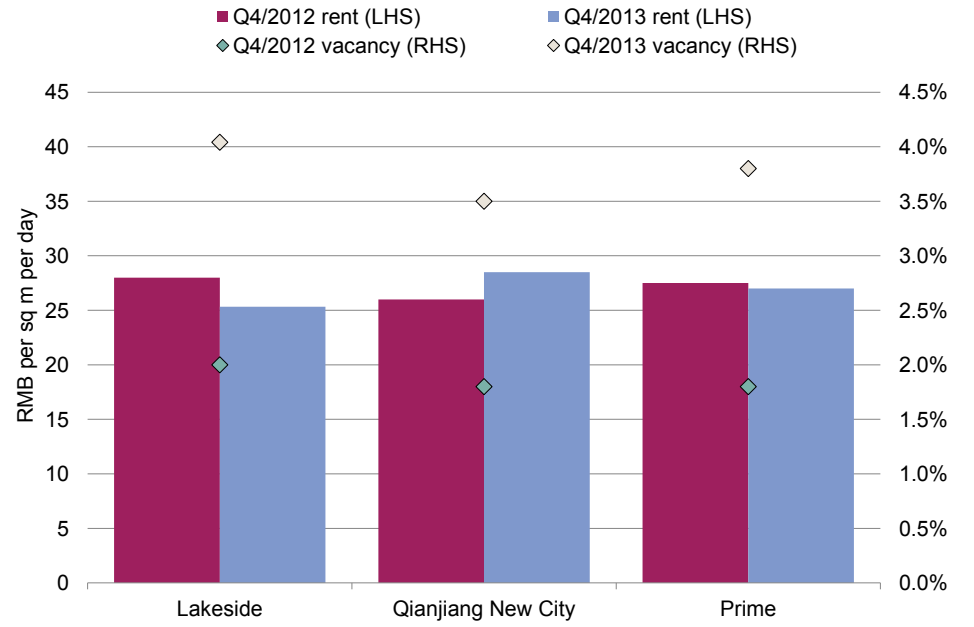
Prime retail supply and stock, 2000–2015E



Source: Savills Research

GRAPH 4

Retail rents and vacancy rates, Q4/2012 vs Q4/2013



Source: Savills Research

Hangzhou Intime City, the second shopping mall operated by Yintai Group in Hangzhou, is located in the West of the city and has a total retail GFA of 120,000 sq m. As many universities are concentrated in the West of the city, Hangzhou Intime City has a large catchment covering the whole district and enjoys a broad customer profile. In order to attract more footfalls during a slowing economy, nearly 20% of retail space is allocated to F&B and facilities, leaving only 37% occupied by fashion retailers. In addition, 43% of space is taken up by ten anchor tenants, including Intime Department Store, blt supermarket, SAGA Legend Cinema, Kids Want, ToysRUs, Maige KTV, Shen Cai Fei Yang, Physical, Xiyo indoor rink and Real Style Sports.

Rents and vacancy rates

City-wide first-floor rents recorded a mild YoY growth of 1.6%, reaching RMB19.1 per sq m per day. Although new retail projects are emerging in non-prime areas and competing for retailers and consumers with prime projects, prime areas remained the top choice for retailers to expand in Zhejiang and attracted all residents in the wealthy province with a diversified retailer profile.

Owing to a supply glut this year, the city-wide vacancy rate rose by 2.6 ppts to 4.5% in the fourth quarter of 2013, yet still remained very low among all key cities in China. MixC Mall continued its tenant adjustment on the 2/F and 3/F in the second half, and prime vacancy rates grew to 3.8%, up 2.0 ppts YoY. As many landlords delayed their launches to ensure satisfied commitment rates upon opening, the vacancy rate for non-prime areas reached 5.1%.

Primary area – Wulin

Hangzhou Tower

Hangzhou Tower Corporation has been renovating Towers A and B and completing a tenant adjustment over the last two years, in order to offer more space for luxury retailer expansions. Dior opened its boutique store in Tower B with a GFA of 504 sq m.

Additionally, Towers C and D began renovations and tenant adjustments in 2H/2013. Tower C plans to introduce designer brands on the

TABLE 1

Selected retail leasing transactions, 2H/2013

Tenant	Trade	Project	Location	GLA (sq m)
COS	Fashion	Hangzhou Intime City	West City	330
By Creations	Fashion	Hangzhou Intime City	West City	200
Tory Burch	Accessories	Tower C, Hangzhou Tower	Wulin	200
LONGINES	Accessories	Hubin Yintai	Lakeside	128
Kate Spade	Fashion	MixC Mall	Qianjiang New City	100

Source: Savills Research

TABLE 2

Upcoming retail projects in downtown districts, 2014E

Project	Retail GFA (sq m)	Area	Retail type
Rainbow Department Store 天虹百货	73,000	Qingchun	Department store
Crystal City Mall 水晶城购物中心	89,000	North City	Shopping mall
Hubin Yintai Phase 4 湖滨银泰四期	20,000	Lakeside	Shopping mall
Go Go Park 五洲国际广场	33,000	North City	Shopping mall
Wanda Square 万达广场	153,500	North City	Shopping mall
Zhongda Intime City 中大银泰城	90,000	North City	Shopping mall

Source: Savills Research

first two floors, including Moncler, Michael Kors and Philipp Plein. Tory Burch debuted in Hangzhou, occupying a GFA of 200 sq m in Tower C. This store represents the retailer's sixth in China. All jewellery and watch brands are scheduled to be moved to the 1/F of Tower D.

San Li Building (三立大厦), a hotel was leased by Hangzhou Tower Corporation (杭州大厦有限公司) at the end of 2012, is scheduled to be converted into retail and office space. The ongoing construction work is expected to be completed in 2016.

Primary area – Lakeside
Building B, Jiebai Plaza (新解百B座) reopened with a leasable GFA of 22,000 sq m after a year of renovation work. The first four floors are occupied by men's fashion and accessory retailers, including Lottusse, 7 Camicie, Sieg, Masahito Oji, CK Jeans and Bean Pole. Building A is expected to reopen in the next six months, introducing mid- to high-end women's fashion retailers.

Mclaren, a British automotive manufacturer of high-performance vehicles, debuted in Hangzhou opening a retail store on the 1/F of Yuan Hua Buildings, Jiebai Plaza (解百新元华) in January 2014.

Hubin Yintai Phase 1
Hermes completed a store renovation and expansion in November 2013, occupying three floors and committing to an additional 434 sq m adjacent to its existing store. The first two floors of the new store have a total retail GFA of 652 sq m, and the third floor is a 243-sq m function room for customer service and crafts display.

Emerging area – Qianjiang New Town
MixC Mall (万象城)
MixC Mall continued its tenant adjustment in 2H/2013, introducing luxury brands on the 1/F and repositioning on the 2/F and 3/F. Having operated one store in Hangzhou Tower, both Givenchy and Van Cleef & Arpels opened their second store in MixC Mall, occupying 296 sq m and 130 sq m of retail space respectively.

Retail market news
SCP Company (深国投商置) secured a commercial land plot in Hangzhou Economic and Technological Development Area for a total consideration of RMB527 million in January 2014. It is rumoured that it will be developed into the third Incity Plaza in Hangzhou, following Gudun Incity Plaza and Xixi Incity Plaza. The plot has a total aboveground GFA of 106,300 sq m and an accommodation value of RMB4,960 per sq m. This development site is directly connected to Gao Sha Station (高沙站) of Metro line 1.

Retail market outlook
Six new projects are expected to debut on the market in 2014, adding 458,500 sq m and bringing overall stock to 1.8 million sq m. Hubin Yintai Phase 4, a high-end shopping mall located near West Lake, is expected to open next year with many luxury retailer tenants.

Taking into account the fact that new decentralised malls have started to compete for retailers and customers, city-wide average rents will soften in 2014. Nevertheless, Hangzhou remained the top choice for both developers and retailers seeking opportunities in the China's retail market. ■

Please contact us for further information

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