

Briefing

Office and retail sector

March 2015



Image: Hangzhou Apple Store

SUMMARY

Hangzhou's Grade A office market is expected to witness a continued divergence in rental movement between prime and non-prime areas.

- No new office projects were handed over to the market in the second half of 2014, leaving total stock at 1 million sq m.
- Net take-up totalled 63,000 sq m in 2H/2014, largely attributed to stable absorption in Qianjiang New City.
- City-wide Grade A office vacancy rates fell significantly to 19.6% in Q4/2014, down 12.1 percentage points (ppts) year-on-year (YoY).
- Grade A office rents recorded a mild increase of 1.0% YoY to an average of RMB4.75 per sq m per day.
- Four shopping malls were handed over in 2H/2014, bringing total supply to 361,500 sq m.
- City-wide shopping mall vacancy rates increased 4.0 ppts to 8.7% in Q4/2014.
- City-wide shopping mall first-floor rents increased 5.5% YoY to RMB18.0 per sq m per day.

“Due to weak consumption confidence and difficult financing conditions, several retail projects have delayed their launches until 2016.” James Macdonald, Savills Research

➔ **Office market**

Market commentary

Hangzhou's GDP amounted to RMB920 billion in 2014, with a real growth rate of 8.2%, 0.8 of a ppt higher than the nationwide figure of 7.4%. This is the first rebound in GDP growth rate for the past four years. The information industry generated a total output of RMB166 billion, up 20% YoY and contributing 18% to the total industrial

output. Meanwhile, the output of e-commerce reached RMB56 billion, representing the highest growth rate among all industries at 30.1%.

Hangzhou's Grade A office market continued to record a divergence in rental movement between prime and non-prime areas. With strong demand from domestic companies in the financial and e-commerce sectors, prime area rents recorded

an increase of 7.4% YoY. Meanwhile, certain developers have delayed the launches of non-prime projects and landlords have lowered prices further to ensure higher occupancy rates and to compete with prime projects. As a result, non-prime areas rents fell 2.5% YoY while vacancy rates fell 16.6 ppts.

Supply and demand

As no new projects were launched onto the Hangzhou Grade A office market in the second half of 2014, total stock remained at 1 million sq m. Wulin Times Square (武林时代商务中心) was the only Grade A office project launched in 2014, with a total office GFA of 23,000 sq m.

As Wulin Times Square was the first new supply seen in the Wulin area in the past four years, the project attracted high leasing demand, with a satisfactory occupancy rate of 65% by the end of 2014. Certain developers have delayed the launches of non-prime area projects to avoid intense competition and allow more time for the high level of current stock to be absorbed.

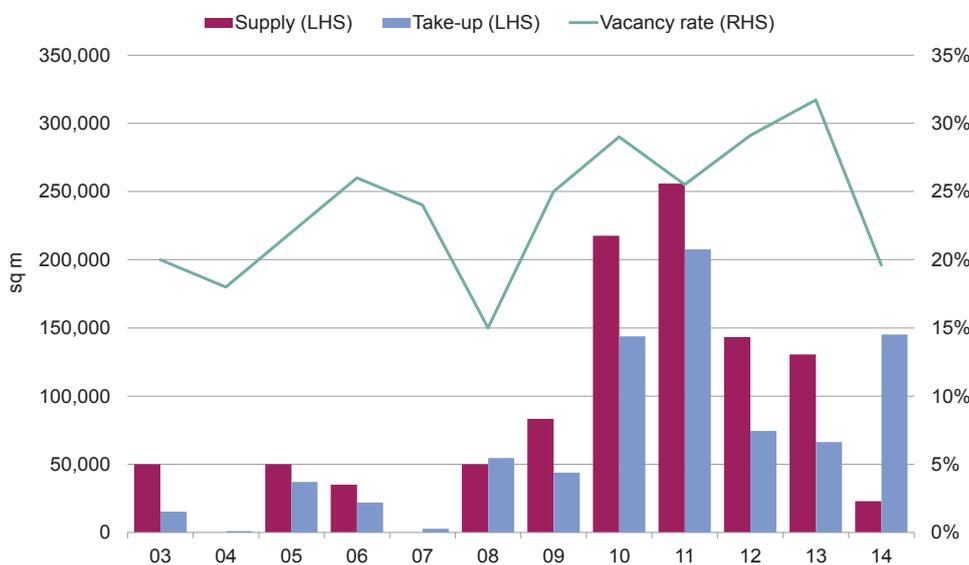
Projects in prime areas, namely Huanglong and Wulin, continued to receive strong demand from domestic companies, mainly concentrated in new projects. Both Ctrip and Hangzhou Tianque Technology have relocated from Grade B office buildings in non-prime areas to occupy 1,800 sq m in Delixi Tower and 1,000 sq m in Wulin Times Square, respectively.

Due to the weak investment sentiment and slowing economy, companies are becoming more price-sensitive, particularly multinational companies (MNCs). Qianjiang New City has benefited from this trend with competitive rents and high-quality premises. Microsoft relocated from Lakeside area to lease over 700 sq m in Uncommon District Centre (UDC).

Grade A office rents and vacancy rates

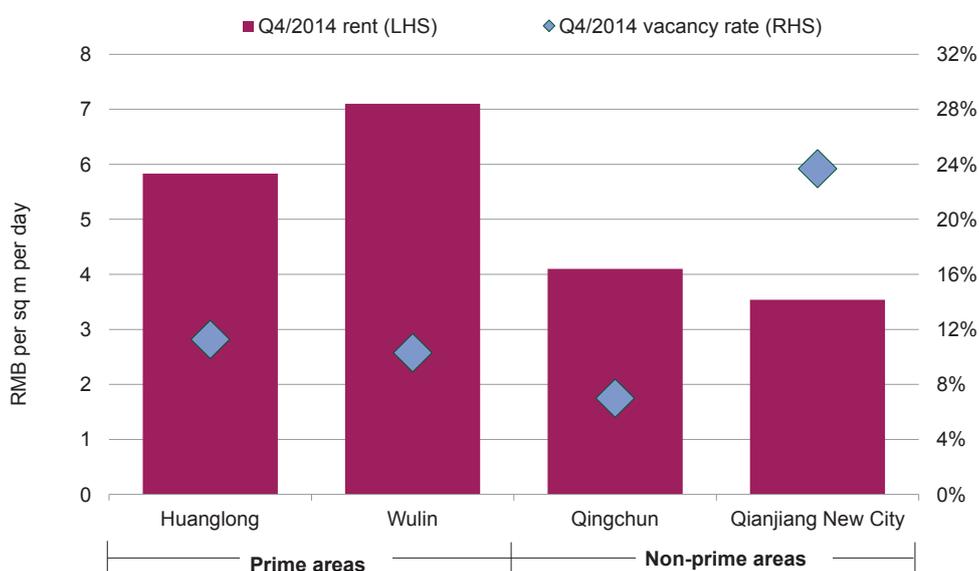
Grade A office rents recorded a mild increase of 0.95% YoY to an average of RMB4.75 per sq m per day. The divergence in rental movement

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



Source: Savills Research

GRAPH 2 **Grade A office rents and vacancy rates, Q4/2014**



Source: Savills Research

Notes: Rents are calculated six months after launch.

between prime and non-prime areas continued in the second half, with prime rents growing 7.4% YoY and non-prime rents falling 2.5% YoY.

City-wide Grade A office vacancy rates fell significantly to 19.6% in the fourth quarter, down 12.1 ppts YoY, largely attributed to strong leasing activity in Qianjiang New City.

As new supply was absorbed quickly, landlords of new projects continued to increase asking rents throughout the year, leading to rents growing 10.3% YoY. Wulin remained the city's most expensive area with an average rent of RMB7.1 per sq m per day in Q4/2014.

Huanglong rents grew 3.9% half-on-half (HoH) to an average of RMB5.8 per sq m per day in the last quarter, up 4.8% YoY. Due to strong leasing activity in Delixi Tower, vacancy rates fell 3.7 ppts to 11.3%. Nevertheless, old and low-quality projects saw more tenants moving out to non-prime areas.

As landlords in Qianjiang New City lowered their asking rents and compromised further to ensure occupancy, Grade A office rents registered at RMB3.5 per sq m per day, down 2.5% YoY and vacancy rates fell 17.4 ppts to 23.7% in Q4/14. Net take-up in the area reached 121,000 sq m, the highest in the past three years. Microsoft opened its office in UDC Tower B, occupying over 700 sq m.

Office strata-title market

Office transaction volumes in downtown districts¹ amounted to roughly 370,000 sq m in 2014, representing an average price of RMB22,000 per sq m. Purchasing demand in the Grade A office market remained concentrated in Qianjiang New City, mainly for self use. Raffles City (来福士广场) has launched 131,800 sq m onto the first-hand sales market, with asking prices ranging from RMB30,000 to RMB35,000 per sq m. Eight floors (22/F to 29/F) in Huafeng International Plaza (华峰国际大厦) sold en-bloc for a total consideration of RMB160 million. In Hangzhou (杭州印·摩中心) in Binjiang district, also received a large-scale purchase agreement from MAI Fund, a real estate fund based in Beijing.

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% to 4.5%

Office market news

As the home of Alibaba Group, Hangzhou is well known for its prosperous e-commerce businesses and continues to attract companies to locate headquarters in the city. By the end of 2014, leading e-commerce and related companies, such as Cisco, had established their Chinese headquarters in Hangzhou. Amazon has also signed agreements with Xiaoshan district government to establish an Amazon China Payment Centre in Qianjiang Century City in January 2015.

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

Hangzhou Ping An Financial Centre (杭州平安金融中心) is expected to launch two office towers onto the sales market in 2015. The land was acquired by Ping An Real Estate for RMB2.3 billion in 2012. Although this project consists of three office towers and a retail podium, the major tower will be held by Ping An Group for self use, while the remaining two towers are scheduled for en-bloc sale. The whole project is expected to be completed in 2017.

Office market outlook

Since developers of several projects have delayed their launches until 2015, there will be several projects with a total office GFA of 531,700 sq m added to the market, pushing up city-wide stock to 1.55 million. Qianjiang New City and Qingchun are expected to account for 73% and 27% of overall supply, respectively.

Qianjiang New City is expected to receive five new projects, including MixC Towers A and B (万象城二期 A/B塔), Huangfeng International Business Plaza, Raffles City, Winning Plaza Phase 2 (万银国际二期) and West Tower of Global Packaging Centre (世界包装产业中心西塔). Two new projects, Jintou Financial Tower (金投·金融大厦) and Xizi International Plaza (西子国际), in the Qingchun area will be handed over in 2015, adding a total office GFA of 145,000 sq m.

Although vacancy rates in non-prime areas fell significantly in the second half of 2014, the substantial supply will place greater pressure on Qianjiang New City and Qingchun,

TABLE 1
Selected retail leasing transactions, 1H/2014

Tenant	Project	Location	GLA (sq m)
Ctrip	Wulin Times Square	Wulin	1,800
Tairan Wealth	Jiahua International Plaza	Huanglong	1,400
Getop Investment Management	Wulin Times Square	Wulin	1,200
Hangzhou Tianque Technology	Delixi Tower	Huanglong	1,000
Microsoft	Hualian UDC	Qianjiang New City	730

Source: Savills Research

resulting in increasing vacancy rates and softening rents. Hangzhou's Grade A office market is expected to witness a divergence in rents between prime and non-prime areas, with a moderate increase in prime rents and softening rents in non-prime areas.

Retail market

Market commentary

Hangzhou's retail sales reached RMB383.9 billion in 2014, up 8.7%

YoY, but 4.3 ppts lower than previous YoY growth. Retail sales (excluding auto consumption) will generate a growth rate of 12.0%. Meanwhile, online consumption reached RMB90 billion, up 38.5% YoY. Urban disposable income per capita recorded a real growth rate of 7% to reach RMB44,632.

Due to weak consumption confidence and difficult financing conditions, several retail projects

decided at the end of 2014 to postpone the launch of projects expected in 2015 to 2016, including Raffles City (来福士广场), GDA Plaza (国大城市广场) and Xizi International Plaza (杭州大厦西子国际广场).

Supply and stock

Four shopping malls were launched onto the market in the second half of 2014, namely Zone B of Yintai In77 (湖滨银泰四期), Crystal Mall (水晶城购物中心), Wanda Plaza (万达广场) and Zhongda Intime City (中大银泰城), adding a total of 361,500 sq m to the market.

The 40,000 sq m Zone B of Yintai In77 held its soft opening in September 2014. Over 60 popular retailers marked their debuts in this open-plan shopping mall targeting young and fashion-conscious consumers. New entrants include Forever 21, Apple, i.t, Chocolate, Aape, D2C, Stayreal and Millions of Milkshakes.

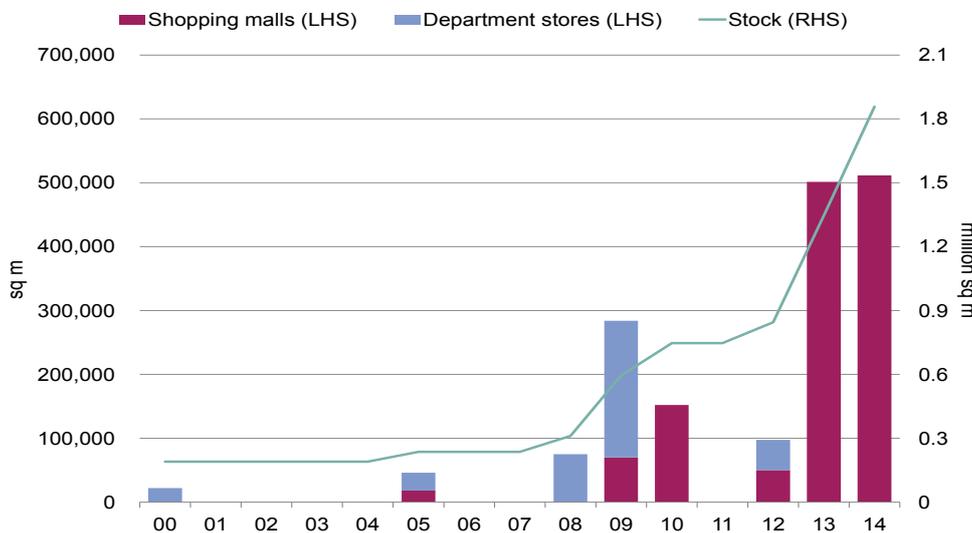
Crystal Mall opened in December, adding a total retail GFA of 88,000 sq m to the North City submarket. It is anchored by the 2,000 sq m H&M store, Wanda Cinema, InLove KTV and Xinhua bookstore.

Wanda Plaza debuted in North City, comprising a 90,000 sq m shopping mall and a 53,500 sq m open-air retail street. Anchor stores include Wanda Department Store, Mu Ma Wang Guo (木马王国), Wanda Cinema, Da Wan Jia (大玩家), Dagexing KTV and Wumart. F&B retailers take up 35% of total retail space. This is Wanda's first project in Hangzhou and was acquired for RMB1.43 billion in 2013.

Zhongda Intime City, the second shopping mall in Hangzhou operated by Intime Retail Group, held its opening in December 2014. It was developed by Zhongda Real Estate (中大地产) and Intime Retail Group and has a total GFA of 330,000 sq m, comprising offices, SOHO apartments and a 90,000 sq m shopping mall. Anchored by Uniqlo, GAP, Kids Want, Yinlang KTV, Aurora International Cinema and Mu Ma Wang Guo, it has also introduced Bose, Caffe Bene and many Chinese restaurants.

GRAPH 3

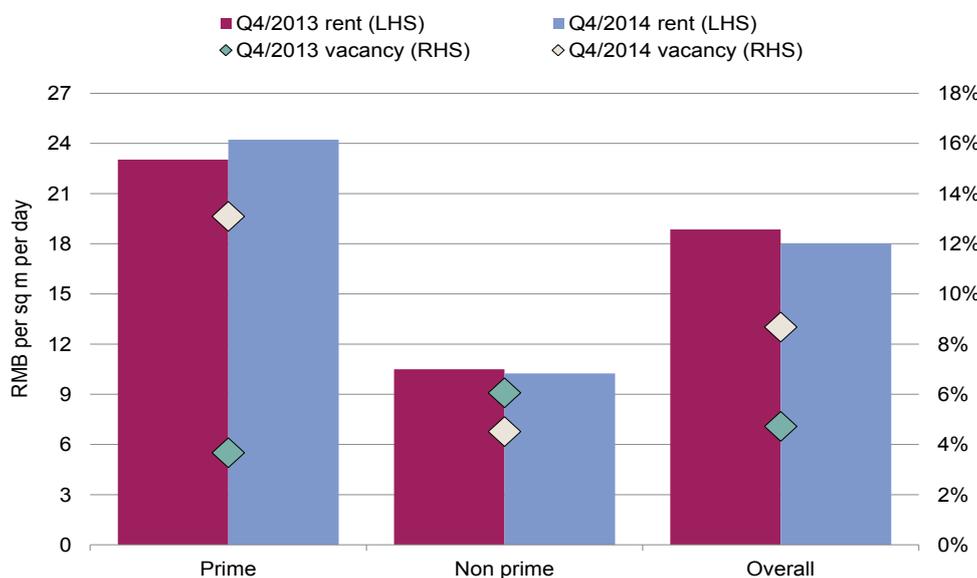
Prime retail supply and stock, 2000–2014



Source: Savills Research

GRAPH 4

Retail rents and vacancy rates, Q4/2013 vs Q4/2014



Source: Savills Research

NB: Prime areas include Wulin and Lakeside.

Rents and vacancy rates

City-wide first-floor rents grew 5.5% YoY to RMB18.0 per sq m per day, mainly driven by strong demand and good business performance in non-prime projects. Prime rents reached RMB24.2 per sq m per day in the fourth quarter, up 4.1% YoY, whilst non-prime rents recorded a YoY growth of 7.2% to RMB10.3 per sq m per day.

Vacancy rates of Hangzhou's shopping mall increased 4.0 ppts to 8.7%, largely owing to the closure of Central Department Store in MixC Mall. All key projects in non-prime areas were completed in the past year and recorded high footfall with diversified retailers and over 80% occupancy. Since non-prime areas West City and North City have witnessed a supply boom for the past two years, developers will face a greater challenge to secure high occupancy and footfall.

Primary area – Wulin

Hangzhou Tower, one of the most profitable luxury stores in China, continues to attract the debut stores of high-end brands, including Bao Bao Issey Miyake, Stuart Weitzman, Fresh, P-plus and Steinway & Sons. Asics has also committed to launching its first concept store here, occupying 200 sq m in Hangzhou Tower, Tower D.

Hangzhou Jiebai (杭州解百) concluded the acquisition of 60% stake in Hangzhou Tower in August 2014. Tenant adjustment will continue in Hangzhou Tower with more distinctive positioning of the four towers and diversification of tenants to achieve high footfall.

Prime area – Lakeside

Xihu Intime Department Store reopened as a shopping mall in November and was renamed Xihu Intime City. In order to provide a

better shopping experience, a third of the fashion brands have been removed, a 960 sq m public resting area has been added and charging stations and iPads have been installed for public use. A 4,000 sq m City Life supermarket has also been added. The conversion aims to attract more young families with children.

Apple committed to opening its first store in the city in Zone B, Yintai In77 in January 2015. This 3,000 sq m store is the 14th Apple store in China.

Zone C3, Yintai In77 opened by introducing 28 retailers targeting families with children. Retailers include Mothercare, New Balance Kids, Zoo Coffee and Thank U Mom. Longines unveiled its first directly-owned store in Zhejiang district in Zone C, Yintai In77 in September. This 126 sq m store has the biggest floor area among all directly-owned stores in China.

TABLE 2

Selected retail leasing transactions, 2H/2014

Tenant	Trade	Project	Location	GLA (sq m)
Uniqlo	Fashion	Wanda Plaza	North City	700
Tiffany	Accessory	MixC Mall	Qianjiang New City	250
StayReal Café	F&B	Zone B, Yintai In77	Lakeside	200
Longines	Accessory	Yintai In77	Lakeside	126

Source: Savills Research

TABLE 3

Upcoming retail projects in downtown districts, 2015E

Project	Retail GFA (sq m)	Area	Retail type
VV Park 西溪海港城	70,000	West City	Shopping mall
Image of Canal 运河印象	50,000	North City	Shopping mall
Star Avenue Phase 2 星光大道二期	87,000	Binjiang	Shopping mall
Lixing 1157 利星1157	80,000	South City	Shopping mall

Source: Savills Research

Longines also opened a flagship store in Lixing Plaza, occupying 80 sq m, while Zara expanded to the third floor, taking up the first three floors.

Non-prime area – Qianjiang New City

Central Department Store, the anchor store of MixC Mall, closed in November. As a result, vacancy rates in Qianjiang New City decreased significantly to 25%, up 21.5 ppts YoY. Department stores within shopping malls are facing more competition from online retailers and similar retailers within the shopping malls. In spite of this, tenant adjustments continued on the third and fourth floors with the introduction of new brands. Key new retailers include Iceason, L'Occitane, Jurlique, Tiffany & Co and Escada Sport. The city's second Apple store is expected to launch in MixC Street in 2015.

Emerging area – West City

COFCO is expected to open Joy City in West City, after acquiring two development sites from Hebei Tiancheng (河北天成). The total consideration of the two land plots was RMB2.78 billion, comprising a

buildable commercial GFA of 283,400 sq m and a residential GFA of 23,700 sq m. The retail part, Joy City, is expected to open in 2017.

Yintai Group secured a commercial land plot in Xixi area for a total consideration of RMB772 million, representing an accommodation value of RMB4,511 per sq m. With a total buildable GFA of roughly 170,000 sq m, it will be the seventh Intime City project operated by Intime Retail Group in Hangzhou.

Due to financing problems being faced by the developers, VV Park has delayed its launch. PKU Resources Group (北大资源集团) has acquired major stakes from Lande Real Estate (蓝德置地), which helps to address these financing problems. This new shopping mall in West City is expected to launch in 2015.

Emerging area – South City

Lixing Group has announced its second project, Lixing 1157, in South City area. This new shopping mall has four floors, comprising nearly 80,000 sq m of retail space. 35% of total space will be allocated to fast-fashion brands, 30% to F&B and entertainment, and 30% to culture-

related sectors. The mall is expected to open by the end of 2015 with anchor stores including a 5,000 sq m bookstore on the third floor, Muse Bar and Poly Cinema.

Retail market outlook

Four new shopping malls are expected to debut on the market in 2015, adding 287,000 sq m and bringing overall stock to 2.1 million sq m. By the end of 2015, 70% of downtown retail stock will be located in non-prime areas, increasing from 34% in 2012. All new supply is to be located in non-prime areas, placing pressure on rental appreciation and occupancy rates in those emerging areas.

Metro line 4, passing through Qianjiang New City, is expected to begin initial operation in February 2015. Combined with line 2, which opened in November 2014, Qianjiang New City has become the only business area to enjoy the benefits of access to all three metro lines. The opening of the Apple store in MixC Street will also attract higher footfall to the city's new business centre, and in turn, help improve the business environment, attracting more high-profile companies. ■

Please contact us for further information

Savills Research



James Macdonald
Director, China
+8621 6391 6688
james.macdonald@savills.com.cn

Savills China



Albert Lau
Head & Managing Director, China
+8621 6391 6688
albert.lau@savills.com.cn

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