

Briefing

Office and retail

March 2014



Image: Tsingtao Centre

SUMMARY

Grade A office supply reached a ten-year peak in 2013, with three new projects handed over in the second half of the year. This pushed city-wide vacancy rates up and restrained rental growth, despite stable demand.

- In 2H/2013, three Grade A office projects were handed over, adding a total office GFA of 230,000 sq m to the market and expanding stock to 1.39 million sq m by the end of 2013.
- City-wide vacancy rates rose by 3.4 percentage points (ppts) half-on-half (HoH) to 19.2% due to new supply, representing a year-on-year (YoY) increase of 0.7 of a ppt.
- Grade A office effective rents appreciated by just 1.0% compared with 1H/2013 to RMB98.1 per sq m per month, up 2.8% YoY.
- Only one mid- to high-end retail project debuted in the second half of 2013, adding a retail GFA of 46,000 sq m to the market and enlarging total stock to 2.49 million sq m.
- City-wide shopping mall vacancy rates increased by 9.3 ppts in 2H/2013 to 22.0% despite prime retail area rates being just 1.4%.
- Mid- to high-end shopping mall first-floor rents were up 1.5% YoY to RMB414.5 per sq m per month by the end of 2013, due to several underperforming projects lowering rents.

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 “Several underperforming shopping malls located in secondary and emerging markets experienced tenant mix adjustments, which led to a rise in city-wide vacancy rates.”
 Joan Wang, Savills Research

➔ **Economic overview**

Qingdao's economy maintained double-digit growth rates in 2013, with GDP real growth reaching 10.0%, while China's other major northern second-tier cities saw GDP growth slowing to below 10%. Additionally, fixed-asset investment totalled RMB503.8 billion in 2013, up 21.1% YoY, while urban residents' disposable incomes per capita and retail sales grew by 9.6% and 13.3% YoY respectively, during the same period.

Grade A office market Supply, net take-up and vacancy rate

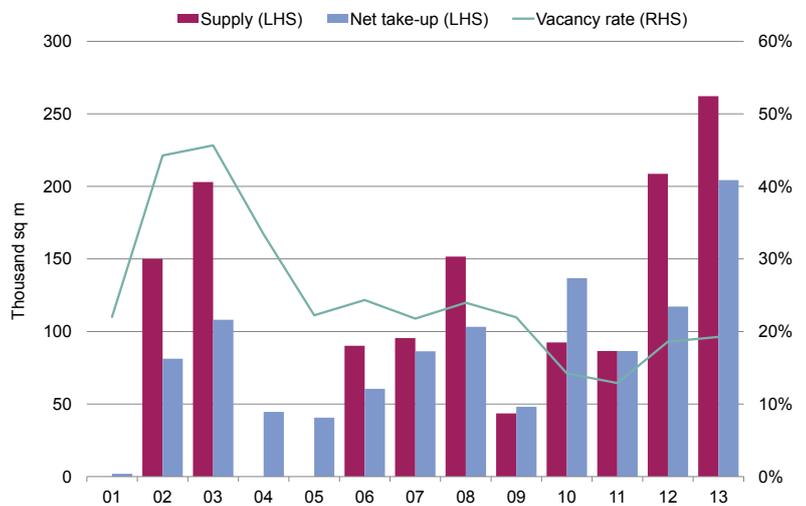
In the second half of 2013, three Grade A office projects, namely Eurasian Centre (欧亚中心), Noble Plaza (诺德广场) and Tsingtao Centre (青岛中心), were handed over, adding a total office GFA of 230,000 sq m to the market. As a result, Qingdao's Grade A office market witnessed a supply peak of 262,000 sq m in 2013, expanding total stock by 23.2% compared with 2012 to 1.39 million sq m by the end of 2013, and becoming the largest market among second-tier cities in north and northeast China.

Located in the Shibei CBD area, Eurasian Centre has an office GFA of 66,000 sq m. This project has attracted several state-owned enterprises and domestic financial enterprises to establish their regional headquarters. The majority of tenants leased at least a whole floor and Eurasian Centre achieved an occupancy rate of approximately 65% by the end of 2013.

Located in the same area as Eurasian Centre, Noble Plaza comprises two

GRAPH 1

Grade A office supply, net take-up and vacancy rate, 2001–2013



Source: Savills Research

towers with a total office GFA of 97,000 sq m. This project has a different tenant profile compared with Eurasian Centre, as the majority of tenants are small and medium enterprises from the manufacturing and trading industries with smaller space requirements. Noble Plaza achieved an occupancy rate of approximately 30% at the end of 2013.

The Hong Kong Middle Road area welcomed its second Grade A office project in 2013, with the handover of Tsingtao Centre in the second half of the year. Developed by CREC Group, this is a landmark project in the local market with an office GFA of 67,000 sq m. By the end of 2013, Tsingtao Centre achieved an occupancy rate of approximately 50%.

Given the large amount of supply in the second half of 2013 and steady demand in the local market, net take-up rose significantly to 146,000 sq m from 58,000 sq m in the previous half-year. As a result, net take-up in 2013 accumulated to 204,000 sq m, accounting for 78% of annual supply and an historical high in the past decade. Despite stable demand, city-wide vacancy rates rose 3.4 ppts HoH to 19.2% due to new supply, representing a YoY increase of 0.7 of a ppt.

Rents

Due to the large amount of supply handed over in the second half of 2013, combined with future supply expected in the next two to three years, market competition is

intensifying. Consequently, many landlords are losing the momentum to apply further rental increases, as evidenced by approximately one-third of landlords offering rental discounts to attract new clients as well as retain existing tenants.

As a result, Grade A office effective rents appreciated by just 1.0% compared with 1H/2013 to RMB98.1 per sq m per month, up 2.8% YoY and down 0.9 of a ppt compared with the CAGR between 2010 and 2012.

Submarket rents and vacancy rates

Hong Kong Middle Road
Hong Kong Middle Road is the oldest, largest and most mature business district in Qingdao, enjoying a cluster of prime retail, five-star hotels, serviced apartments and high-end residences, as well as attracting a number of overseas companies. As a result, Hong Kong Middle Road continued to command the highest rents in the city at RMB111.3 per sq m per month, a 13% premium compared with the city's average and an over 40% premium compared with the other two business districts. Vacancy rates in Hong Kong Middle Road rose by 0.7 of a ppt to 13.8% compared with 1H/2013 due to the handover of Tsingtao Centre, down 0.4 of a ppt YoY.

Haier Road

Supported by steady demand from domestic energy, IT and high-tech, manufacturing, and commerce and trade companies, Haier Road vacancy rates dropped by 3.1 ppts HoH to 10.4%, the lowest in the city. Although

TABLE 1 **Macro economic indicators, 2013**

Indicators	Unit	Value	YoY growth (%)
Gross domestic product (GDP)	RMB billion	800.7	10
Fixed-asset investment	RMB billion	503.8	21.1
Real estate investment	RMB billion	104.9	12.7
Retail sales	RMB billion	290.4	13.3
Disposable income per capita (urban)	RMB	35,227	9.6
Consumer product index (CPI)	PY = 100	102.5	2.5

Source: Qingdao Statistics Bureau, Savills Research

→ the lower quality office buildings located in this area limit demand from overseas companies, Haier Road rents appreciated by 1.7% HoH to RMB77.9 per sq m per month, representing YoY growth of 5.9%, and still remain the lowest in the city.

Shibei CBD

As the government-planned CBD, Shibei CBD welcomed its first batch of Grade A office supply since 2012. In 2013, this area witnessed two projects handed over with a total office GFA of 163,000 sq m. Despite the relatively high-quality specifications of these projects, the large amount of supply in a short period led to vacancy rates as high as 52% by the end of 2013, down 23 ppts YoY, but still 33 ppts higher than the city's average. As a result, Shibei CBD rents stood at a relatively low level of RMB80.4 per sq m per month by the end of 2013, up 5.4% YoY.

Market outlook

Qingdao's Grade A office market is expected to continue to witness growing supply in 2014, with eight projects scheduled to be handed over offering a total office GFA of 488,000 sq m, increasing total stock by 35% by the end of 2014. Nearly half of the new supply will be clustered in Shibei CBD area, while new supply located in Hong

Kong Middle Road area and Haier Road accounts for 28% and 27% of the total respectively. Shibei CBD area is accordingly expected to be further upgraded with the completions of these projects.

Given that this large amount of new supply will be difficult for the market to digest in a short period of time, we expect city-wide occupancy rates and overall rents to be driven down as intensified competition forces landlords to offer rental discounts to compete for new clients and retain existing tenants.

Mid-to high-end retail market

Supply and stock

In contrast to the Grade A office market, Qingdao's mid- to high-end retail market witnessed limited supply in the second half of 2013, with only one mid- to high-end retail development, Tsingtao Centre Plaza, opening and injecting a retail GFA of 46,000 sq m onto the market. Consequently, annual supply in 2013 was only 167,000 sq m, a five-year low. Total stock reached 2.49 million sq m by the end of 2013, over 60% of which was shopping centre space.

Located in Hong Kong Middle Road area, Tsingtao Centre Plaza opened in

December 2013 and is positioned as a mid- to high-end shopping centre. The 46,000-sq m project is anchored by the 1,500-sq m Maxvalu supermarket, Qingdao's second, and the 2,172-sq m Golden Jaguar store. Tsingtao Centre Plaza also introduced a series of luxury, fashion, accessories, jewellery, household and lifestyle, healthcare and beauty, and F&B retailers, including Balmain, Furla, Diesel, Maria Luisa, Xi Yue, Jil Sander and Da Vincil. By the end of 2013, this project achieved a pre-commitment rate as high as 100%.

Another four projects scheduled for launch by the end of 2013, namely IMC Centre (海航万邦中心), Liqueur Department Store – Shibei store (利群百货市北店), Capland Centre (凯悦中心) and Farglory International Plaza (远雄国际广场), postponed their debut dates to 2014. As retail operators became more cautious due to the aggregating competition between projects, Rainbow Department Store, which planned to open in 2013, quit Noble Plaza.

TABLE 2 **Grade A office market key indicators, 2H/2013**

	Stock (sq m)	Supply (sq m)	Net take-up (sq m)	Vacancy rate (%)	Rent (RMB per sq m per month)
2H/2013	1,394,000	230,000	146,000	19.2	98.1
HoH change (%/ppts)	19.8	619.3	151.0	3.4	1.0
YoY change (%/ppts)	23.2	252.8	169.2	0.7	2.8

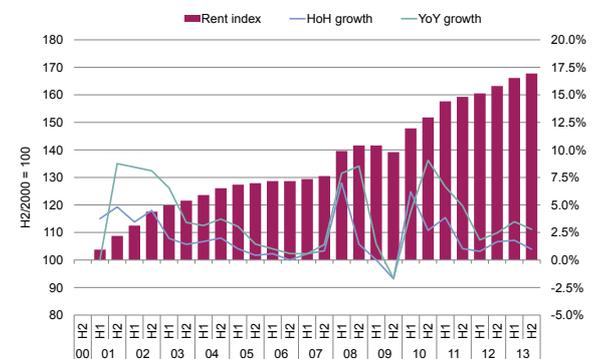
Source: Savills Research

TABLE 3 **Selected office leasing transactions, 2H/2013**

Company	Project	Location	Office GFA (sq m)	New lease/renewal
Zhongyuan Lai Bao Steel	HNA IMC Centre	Hong Kong Middle Road	2,000	New lease
Deutsche Bank	HNA IMC Centre	Hong Kong Middle Road	1,000	New lease
Cengfeng Asset Management	Far Glory	Hong Kong Middle Road	1,000	New lease
JHJ International Transportation	Cosco Plaza B	Hong Kong Middle Road	650	New lease
Huayi Jindian Trading	Far Glory	Hong Kong Middle Road	300	New lease

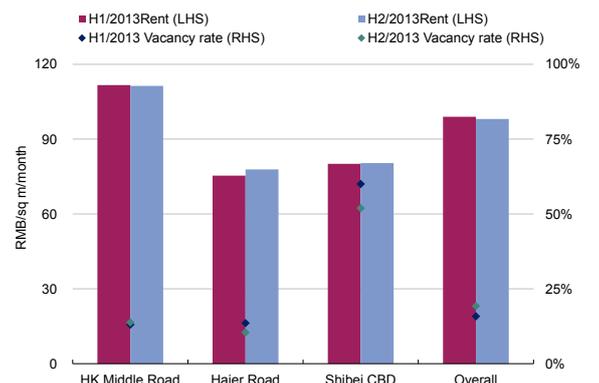
Source: Savills Research

GRAPH 2 **Grade A office rents and rental growth, 2H/2000–2H/2013**



Source: Savills Research

GRAPH 3 **Submarket rents and vacancy rates, 1H/2013 vs 2H/2013**



Source: Savills Research

➔ **Demand and occupancy rates**

Luxury, fashion (including fast fashion), and household and lifestyle retailers expanded steadily in the locality to capture market share from a tourist city with an expanding pool of affluent consumers and sustained economic growth. Most of these retailers took-up space in prime retail areas such as Hong Kong Middle Road, Taidong and Zhongshan Road to launch new stores. Meanwhile, F&B, children's and entertainment retailers expressed an increased interest in the local market due to landlords' eagerness to introduce them to attract heavier footfall.

Due to the tenant mix adjustments in some shopping malls in secondary and emerging retail areas, such as Chengyang Powerlong City Plaza in Chengyang area, Licang Powerlong City Plaza in Licun area and Zendai Thumb Plaza in Laoshan area, city-wide shopping mall vacancy rates increased by 9.3 ppts in 2H/2013 to 22.0%, up 8.0 ppts YoY. Shopping mall vacancy rates for prime, secondary and emerging retail areas were 1.4%,

16.9% and 31.9% respectively, by the end of 2013.

Rents

In the second half of 2013, several underperforming shopping malls located in secondary and emerging markets adjusted their tenant mixes, resulting in rising vacancy rates and rental discounts in an attempt to attract more popular retailers to improve their performance. This led to overall shopping mall first-floor rents standing at RMB414.5 per sq m per month, with YoY rental growth constrained to just 1.5%, from the CAGR of 5.4% in the past five years.

Hong Kong Middle Road area continued to command the highest rents in the city at RMB646.3 per sq m per month by the end of 2013, a 56% premium on the city's average. The majority of luxury, secondary luxury and designer labels, fashion and fast fashion, accessories, and jewellery and watch retailers took-up space on Hong Kong Middle Road due to the mature retail environment combined with a more affluent population.

Market outlook

Six shopping malls and two department stores are expected to debut in 2014, adding a total retail GFA of 644,000 sq m and enlarging total stock by 25%.

Eighty percent of new supply will be clustered in Hong Kong Middle Road area, the most mature retail catchment in Qingdao. Most projects will be developed/operated by experienced developers/operators with strong retailer relationships, such as China Resources Land, Hisense Group and Liqun Group, which should largely stabilise city-wide shopping mall occupancy rates, given the high pre-commitment rates expected to be seen in the aforementioned projects.

However, overall shopping mall rental growth is expected to be restricted further as landlords compromise on rents to attract suitable retailers and secure healthy pre-commitment rates amid fierce competition between projects. ■

TABLE 4 **Future supply, 2014**

Project	Completion	Submarket	Office GFA (sq m)
Glory Centre (大荣中心)	Q1	Haier Road	61,000
Celebrity International (名汇国际)	Q1	Haier Road	26,000
Yongxin International Centre (永新国际广场)	Q2	Haier Road	45,000
Yinhai Building (银海大厦)	Q2	Hong Kong Middle Road	20,000
Fortune Centre (财富中心)	Q4	Hong Kong Middle Road	45,000
China Resources Building (华润中心)	Q4	Hong Kong Middle Road	70,000
Kaijing Famous Plaza (凯景广场)	Q4	Shibei CBD	141,000
Fortune Zone (青房财富地带)	Q4	Shibei CBD	79,000

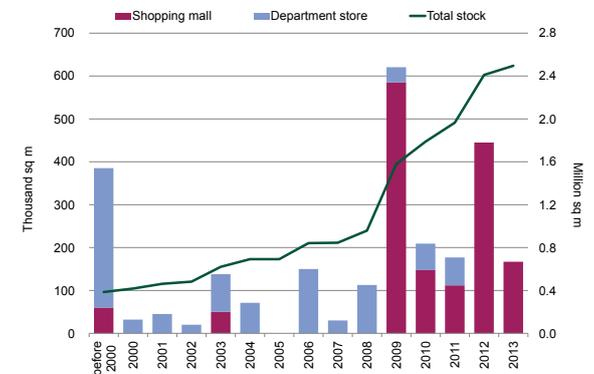
Source: Savills Research

TABLE 5 **Mid- to high-end retail market indicators, 2H/2013**

	Stock (sq m)	Vacancy rate (%)	Supply (sq m)	Rents (RMB per sq m per month)
2H/2013	2,495,000	22.0	46,000	414.5
HoH change (%/ppts)	1.9	9.3	-61.9	0.1
YoY change (%/ppts)	3.5	8.0	-87.8	1.5

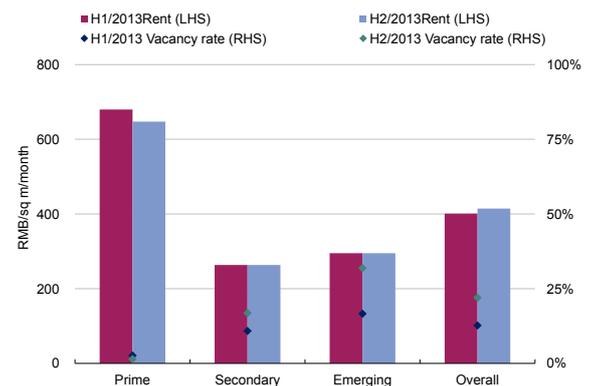
Source: Savills Research

GRAPH 4 **Mid- to high-end retail supply and stock, pre-2000–2013**



Source: Savills Research

GRAPH 5 **Submarket rents and occupancy rates, 1H/2013 vs 2H/2013**



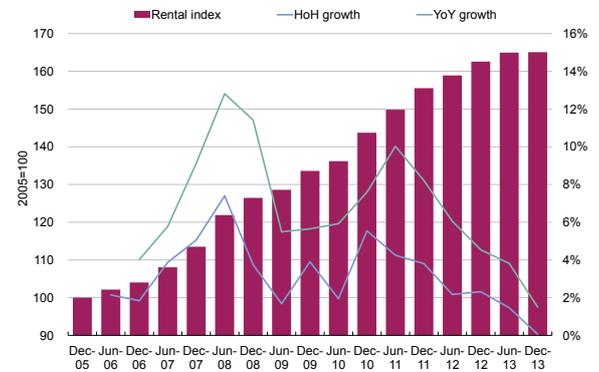
Source: Savills Research

TABLE 6 Selected retail leasing transactions, 2H/2013

Tenant	Trade	Project	Location	GLA (sq m)
Gap	Fashion	Marina City	Hong Kong Middle Road	400
Burger King	F&B	Marina City	Hong Kong Middle Road	200
Kenzan Japanese Restaurant	F&B	Hisense Plaza	Hong Kong Middle Road	200
Yoshinoya	F&B	Jusco	Hong Kong Middle Road	150
Yipinxiang Restaurant	F&B	Hisense Plaza	Hong Kong Middle Road	150
Heine	Fashion	Marina City	Hong Kong Middle Road	100
Rolex	Jewellery and watch	Hisense Plaza	Hong Kong Middle Road	50

Source: Savills Research

GRAPH 6 Shopping mall first-floor rental index, 2H/2005–2H/2013



Source: Savills Research

TABLE 7 Future key projects, 2014

Project	Location	Retail type	Retail GFA (sq m)
IMC Centre 万邦中心	Hong Kong Middle Road	Shopping mall	40,000
Liqun Department Store 利群百货	CBD	Department store	47,000
Capland Centre 凯悦中心	Hong Kong Middle Road	Shopping mall	19,000
Farglory International Plaza 远雄国际广场	Hong Kong Middle Road	Shopping mall	44,000
Central International Mansion 中央国际	Hong Kong Middle Road	Shopping mall	33,000
Yongxin Plaza 永新国际广场	Laoshan	Shopping mall	80,000
The MixC 华润万象城	Hong Kong Middle Road	Shopping mall	300,000
Hisense Plaza Expansion Project 海信广场扩建	Hong Kong Middle Road	Department store	80,000

Source: Savills Research

Please contact us for further information

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