

Briefing Office and retail

February 2015



Image: HK Middle Road area, Shinan district, Qingdao

SUMMARY

The primary source of new demand stemmed from financial and professional services firms in the second half of 2014; this trend is expected to become more evident in 2015.

■ Two Grade A office projects were handed over in 2H/2014, adding a total office GFA of 80,000 sq m to the market. As a result, office stock reached 1.47 million sq m by the end of 2014.

■ Net take-up increased 126.3% half-on-half (HoH) to 60,000 sq m. The new supply in 2H/2014 mildly impacted the city-wide vacancy rate, up 0.5 ppts HoH to 17.8%.

■ Grade A office effective rents increased 1.5% HoH to RMB101.1 per sq m per month, up 1.9% year-on-year (YoY).

■ Two mid to high-end retail projects debuted in the second half of 2014, contributing a retail GFA of 133,000 sq m to the market and enlarging total stock to 2.62 million sq m.

■ City-wide shopping mall vacancy rates increased 0.5 of a ppt to 21% in 2H/2014. Vacancy rates in prime retail areas increased 2.5 ppts to 4.3%. Mid- to high-end shopping mall first-floor rents increased 1.5% YoY to RMB422.3 per sq m per month by the end of 2014.

■ Both Qingdao's Grade A office and mid- to high-end retail markets are expected to witness a significant influx of new supply in 2015, with eight office

projects and 13 retail developments scheduled to enter the market, contributing a total office and retail GFA of approximately 430,000 sq m and 1.4 million sq m respectively.

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 “The retail market is expected to experience further divergence, with location-dependent project positioning becoming increasingly apparent.” Joan Wang,
 Savills Research

➔ **Economic overview**

Qingdao's macro economy operated steadily in 2014, with GDP real growth reaching 8%. Fixed-asset investment maintained rapid growth reaching RMB576.6 billion, up 16.1 ppts YoY, while real estate investment growth continued to slow down, falling to 6.6% from 13% in 2013 and 19% in 2012. Urban residents' disposable incomes per capita and retail sales maintained stable growth, by 8.7% and 12.6% respectively, while CPI YoY growth reached 2.6% during the same period.

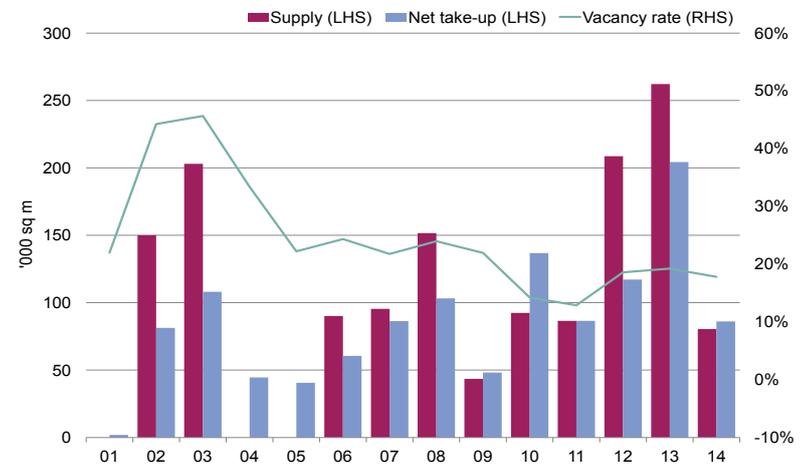
Grade A office market Supply, net take-up and vacancy rate

The Haier Road area market welcomed its first office supply since 2011 with two projects, Darron Center (大荣中心) and Celebrity International (名汇国际), adding a total office GFA of 80,000 sq m in 2H/2014. As a result, leasable Grade A office stock expanded to approximately 1.47 million sq m. Darron Center (大荣中心) offers two towers and a total office GFA of 54,000 sq m. Sold by strata title, the project enjoys the highest rent levels in the Haier Road area. Positioned nearby, Celebrity International(名汇国际) contributes 26,000 sq m of office space to the area and has witnessed strong demand from financial, IT & hi-tech and trading companies. Darron Center and Celebrity International, both launched in Q4/2014, have achieved occupancy rates of around 15% and 30% respectively.

Other projects, namely Yongxin International Centre (永新国际广场), Kaijing Plaza (凯景大厦) and Fortune Zone (青房财富地带), scheduled to be

GRAPH 1

Grade A office supply, net take-up and vacancy rate, 2001–2014



Source: Savills Research

launched onto the market in 2014 have postponed their completion dates to 2015.

Steady demand from financial and professional services companies combined with a preference for self-use occupancy within the new projects, saw net take-up increase 126.3% HoH to 60,000 sq m, up from 26,000 sq m in 1H/2014. The new supply in 2H/2014 mildly impacted city-wide vacancy rates, up 0.5% HoH to 17.8%. However, net take-up for 2014 totalled 86,000 sq m, exceeding annual supply by 7%, and resulted in city-wide vacancy rates decreasing 1.4% YoY.

Rents

No new supply in the Hong Kong Middle Road and Shibei CBD areas in the past 12 months, combined with a growing demand from finance and professional services companies with high affordability, has led to an upward trend in city-wide average rents. As a result, Grade A office effective rents appreciated 1.5% HoH to RMB101.1 per sq m per month, up 1.9% YoY.

Submarket rents and vacancy rates

Hong Kong Middle Road
Hong Kong Middle Road, the largest business district in the city in terms of GFA, continued to enjoy the highest rents at RMB116.9 per sq m per month, up 2.0% HoH and 2.7% YoY. Strong demand for the area resulted in vacancy rates dropping 3.0% HoH to 10.8%.

Known as the “Wall Street of Qingdao”, Hong Kong Middle Road is considered a priority location for financial and foreign companies in the city. Reflecting the strong demand, over 90% of foreign companies in Qingdao have chosen to locate their premises in this area. Emphasising the demand from the financial sector, HNA IMC Center (海航万邦中心) and Far Glory International Plaza(远雄国际广场), both launched in 2012, now see 48.5% and 60% of their tenant mix comprised of financial companies respectively.

Haier Road

Haier Road witnessed two projects handed over in 2014, contributing a total office GFA of 80,000 sq m. However, given the area's non-prime location and subsequent lack of demand, the new supply did not have sufficient time to be absorbed by the market, resulting in vacancy rates rising 11.7% HoH to 21.7%. Competition between old and new landlords in the form of rental discounts saw Haier Road rents decrease 1.3 ppts YoY to RMB78.8 per sq m per month, the lowest level in the city.

Shibei CBD

While the Shibei CBD area is positioned as the city's new business district, recent traffic disruptions due to construction in the area have seen newly launched projects, particularly Noble Plaza (诺德广场), experience low occupancy rates. On the other hand, projects such as China Overseas Plaza (中海大厦), Xiwang Building

TABLE 1

Macro economic indicators, 1Q/2014-3Q/2014

Indicators	Unit	Value	YoY growth (%)
Fixed-asset investment	RMB billion	869.2	8.0
Real estate investment	RMB billion	576.6	16.1
Retail sales	RMB billion	111.8	6.6
Disposable income per capita (urban)	RMB	326.9	12.6
Consumer product index (CPI)	PY = 100	38294	8.7

Source: Qingdao Statistics Bureau, Savills Research

→ (西王大厦) and Excellence Building (卓越大厦), which entered the market earlier and have an established tenant base, have all achieved relatively high occupancy rates of over 79%. As the area continues to mature, the drag owing to Noble Plaza's low occupancy is expected to subside, and occupancy rates are expected to rise district-wide.

Vacancy rates decreased 4.9 ppts to 36.4% in the second half of 2014, down 15.6% YoY. Rents continued to increase, up 2.2% to RMB84.3 per sq m per month, representing a 4.5% YoY growth

Market outlook

As several projects have delayed their launch dates, a large influx of supply is expected in 2015, with eight Grade A office buildings scheduled to hand over a total stock of 431,000 sq m. As all three business districts are due to welcome new projects, the completion of these projects is expected to result in an upgrade of the office market overall.

The market is anticipated to experience difficulties absorbing the large amount of supply expected

in 2015. As a result, the market is expected to see declines in city-wide occupancy rates. Fierce competition between landlords for tenants is expected to result in overall rents experiencing a drop.

Mid-to high-end retail market

Supply and stock

Two new retail projects positioned at the mid- to high-end were launched onto the market in 2H/2014, adding a total GFA of 133,000 sq m. September witnessed the closure of one mid- to high-end department store, which reduced stock by 40,000 sq m. Overall total stock grew to 2.62 million sq m by the end of 2014.

The IMC Centre (海航万邦购物中心), a mid- to high-end shopping centre located in Hong Kong Middle Road held its soft opening in November 2014. The 40,000 sq m project offers a strong tenant mix covering fashion, children-related, entertainment, jewellery, healthcare & beauty and F&B retailers. Anchor tenants include French Pavilion taking 1,000 sq m, You Pin Mei Zhuan Buffet occupying 1,100

sq m and D-House Gym leasing 2,100 sq m. By the end of 2014, the project achieved a pre-commitment rate of 78%; however, only approximately 40% of the retail stores had opened for business. Japanese retailer MaxValu, having operated its debut store in the basement of the project for over a year, closed its doors one month after IMC's launch due to the low opening rates, increasing vacancy space in the project by 1,500 sq m.

Hefei Road Aeon, a mid-end shopping centre located in Laoshan district, commenced its soft opening in December 2014. While this will be the third shopping centre operated by Aeon Group in Qingdao, at 93,000 sq m this will be its largest shopping centre in not only Qingdao but the whole of Shandong province. While the official opening is scheduled in 2015, the operator's extensive experience and successful track record has seen the project reach nearly full occupancy.

TABLE 2 **Grade A office market key indicators, 2H/2014**

	Stock (sq m)	Supply (sq m)	Net take-up (sq m)	Vacancy rate (%)	Rent (RMB per sq m per month)
2H/2014	1,474,000	80,000	60,000	17.8	101.1
HoH change (%/ppts)	5.7	-	126	0.5	1.5
YoY change (%/ppts)	5.7	-65	-59	-1.4	1.9

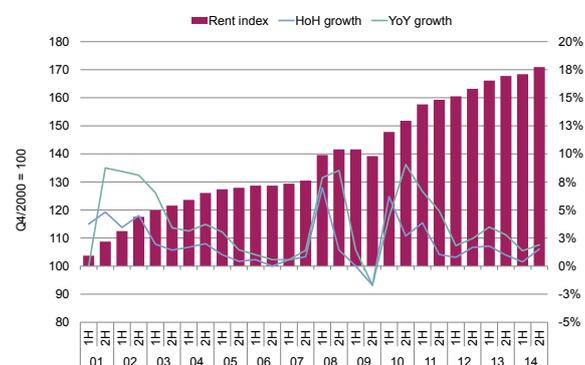
Source: Savills Research

TABLE 3 **Selected office leasing transactions, 2H/2014**

Company	Project	Location	Office GFA (sq m)	New lease/renewal
All Bright Law Offices	Hua Ren International Building	Hong Kong Middle Road	1,000	New lease
Zhong Lun Law Firm	Cosco Plaza A	Hong Kong Middle Road	1,300	New lease
AC Nielsen	Sunshine Building	Hong Kong Middle Road	500	New lease
Yunda Petrochemical	Zhonghai Building	Shibei CBD	500	New Lease
SEDL Group	Darron Center	Haier Road	1,200	New lease
Longway Group	Celebrity International	Haier Road	500	New lease

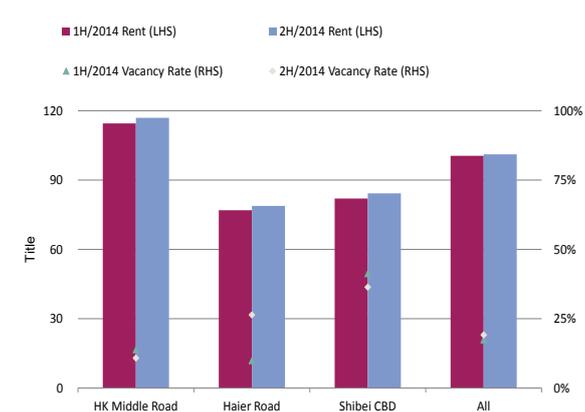
Source: Savills Research

GRAPH 2 **Grade A office rents and rental growth, 1H/2001-2H/2014**



Source: Savills Research

GRAPH 3 **Submarket rents and vacancy rates, 1H/2014 vs. 2H/2014**



Source: Savills Research

→ Aggregating competition among projects has made retail operators increasingly selective as to when they launch projects onto the market. Adopting a cautious attitude, six projects scheduled for launch by the end of 2014, Liqun Shopping Center (利群百货市北店), Licang Inzone Plaza (李沧银座广场), Nanhua Shopping Center (南华购物中心), Hisense Plaza Phase II (海信广场二期), Rio Carnival In Qingdao (海上嘉年华) and Inzone Center (银座商城香港中路店), all postponed their debut dates until 2015.

With the Beijing Wangfujing Department Store Group Co., Ltd (北

京王府井百货) having taken over PCD Department Group (春天百货), the group has since been repositioning the acquired departmental stores to deal with the downturn in the retail market. After 17 years of operation, Plaza Printemps(巴黎春天广场), the first high-end department store in Qingdao saw its doors close in August 2014, with a re-launch date yet to be announced.

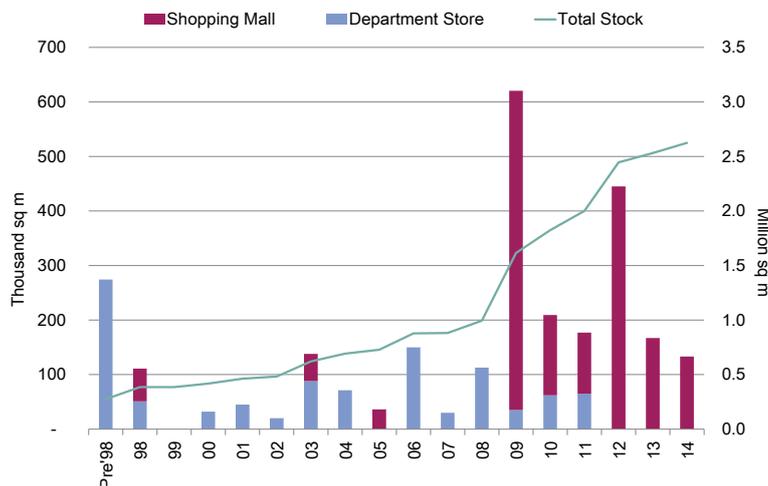
Demand and occupancy rates

The two newly launched shopping malls witnessed strong demand from F&B retailers, which comprised a greater portion of tenant mix than

fashion retailers. F&B retailers also showed the strongest demand within the city-wide Qingdao market in 2H/2014, a trend expected to continue within most new projects. With two new projects, Hisense Plaza Phase II and The MixC, scheduled to be opened in 2015, the anticipation of fiercer completion in the luxury market has seen some existing luxury brands in Qingdao expand their store space and add category lines in response.

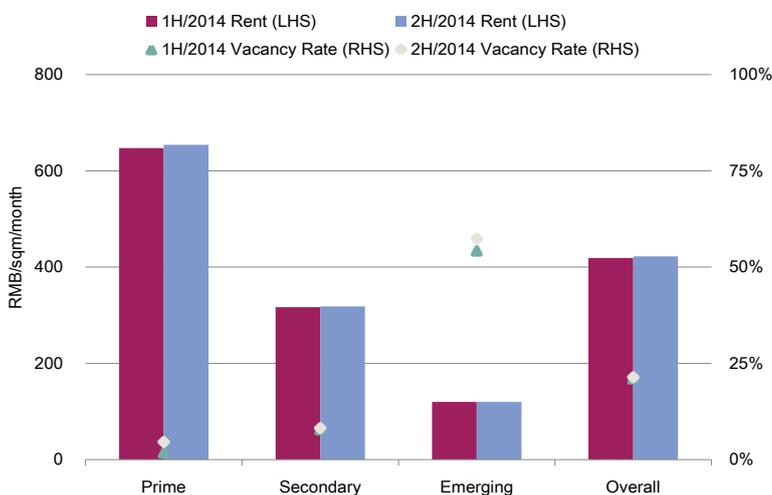
The downturn in Qingdao's retail market in 2H/2014, combined with the influx of supply expected in 2015 has seen city-wide vacancy rates increase 0.4 of a ppt to 21.4%. By the end of 2014, shopping mall vacancy rates for prime, secondary and emerging retail areas were 4.6%, 8.2% and 57.3% respectively.

GRAPH 4 Mid- to high-end retail supply and stock, pre-1998-2014



Source: Savills Research

GRAPH 5 Submarket rents and occupancy rates, 1H/2014vs 2H/2014



Source: Savills Research

Rents

Despite many retail projects engaging in tenant mix adjustment in anticipation of the upcoming supply peak, rents have remained relatively stable over the past six months. Overall shopping mall first-floor rents stood at RMB422.3 per sq m per month by the end of 2014, a YoY rental growth of 1.5%.

Hong Kong Middle Road area continued to command the highest rents in the city at RMB655 per sq m per month by the end of 2014, a 55%

TABLE 4 Future office supply, 2H/2014

Project	Completion	Submarket	Office GFA (sq m)
Baijin Plaza (白金广场)	Q3	Haier Road	55,000
Yongxin International Centre (永新国际广场)	Q3	Haier Road	45,000
Fortune Zone (青房财富地带)	Q4	Shibei CBD	79,000
China Resources Building (华润中心)	Q4	Hong Kong Middle Road	70,000
Kaijing Buidin (凯景大厦)	Q4	Shibei CBD	28,000
Q.1 (财富中心)	Q4	Hong Kong Middle Road	34,000
Ginza Centre (银座中心)	Q4	Hong Kong Middle Road	40,000
Minjian Building (民建大厦)	Q4	Shibei CBD	80,000

Source: Savills Research

premium on the city's average. Rents in emerging areas remained the lowest at RMB120 per sq m per month, largely due to the quality and instability of the tenant mix.

Market outlook

Nine shopping malls and five department stores are expected to debut in 2015, adding a total retail GFA of 1,573,000 sq m to the mid-to high-end retail market, enlarging total stock by 60%. The new supply is expected to be located in multiple retail markets, including Hong Kong Middle Road, Licun, Laoshan, Chengyang, Qingdao Development Zone, Renmin Road, Zhongshan Road, Shibei CBD, New Urban Center and Taidong.

Luxury and secondary luxury brands, boutique brands and high-end restaurant retailers are expected to continue to show a strong preference for the Hong Kong Middle Road area when first entering the market. This is expected to further strengthen Hong Kong Middle Road's reputation as the high-end shopping location of Qingdao.

A growing number of mid-end positioned retail projects in secondary retail areas are expected to see a large grouping of similar brands and product choices, likely leading to fiercer competition among retailers in these catchments.

As the population continues to grow, the retail ambience in emerging areas is expected to be strengthened. However the distance from prime locations and lack of purchasing power of residents is expected to see the gap in asset performance of projects continue to widen.

The opening of Qingdao's metro in the second half of 2015 will provide better accessibility to prime retail areas, and is expected to result in an increase both in rents and occupancy rates. Meanwhile, the downturn in the retail market is likely to see secondary and emerging areas face greater downward pressure both in terms of rents and occupancy rates. ■

TABLE 5

Mid- to high-end retail market indicators, 2H/2014

	Stock (sq m)	Vacancy rate (%)	Supply (sq m)	Closing (sq m)	Rents (RMB per sq m per month)
2H/2014	2,624,000	21	133,000	40,000	422.3
HoH change (%/ppts)	3.6	-0.5	-	-	0.3
YoY change (%/ppts)	3.6	0.5	189	-	1.5

Source: Savills Research

TABLE 6

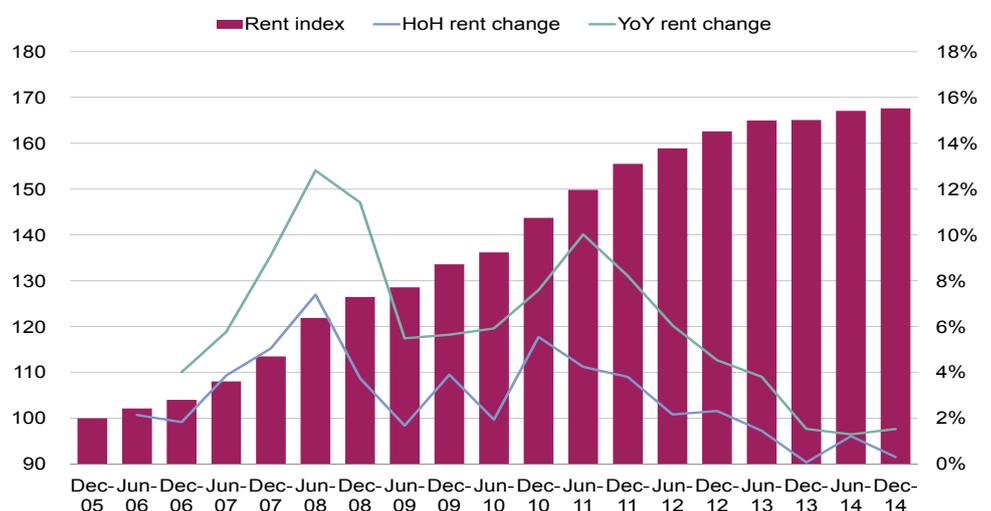
Selected retail leasing transactions, 2H/2014

Tenant	Trade	Project	Location	GLA (sq m)
Bottega Veneta	Luxuries	Hisense Plaza	Hong Kong Middle Road	383
P-Plus	Fashion	Hisense Plaza	Hong Kong Middle Road	150
Raki Restaurant	F&B	Tsingtao Centre	Hong Kong Middle Road	300
Burger King	F&B	Parkson Department Store	Zhongshan Road	150
Le Living	F&B	CBD Wanda Plaza	Shibei CBD	80
Pony	Shoes	Licang Wanda Plaza	Licun	100
Levis	Fashion	Licang Wanda Plaza	Licun	100

Source: Savills Research

GRAPH 6

Shopping mall first-floor rental index, 2H/2005–2H/2014



Source: Savills Research

TABLE 7

Future retail projects, 2H/2014

Project	Location	Retail type	Retail GFA (sq m)
Licang Inzone Plaza (李沧银座广场)	Licun	Department store	82,000
The MixC (华润万象城)	Hong Kong Middle Road	Shopping mall	450,000
Inzone Centre (银座商城)	Hong Kong Middle Road	Department store	50,000
Nanhua Shopping Center (南华购物中心)	Laoshan	Shopping mall	75,000
AUX Plaza (奥克斯广场)	Licun	Shopping mall	120,000
Flow World (水悦城)	Chengyang	Shopping mall	120,000
Hisense Plaza Phase II (海信广场二期)	Hong Kong Middle Road	Department store	80,479
Rio Carnival in Qingdao (海上嘉年华)	Qingdao Developing Zone	Shopping Mall	140,000
Yuehui Plaza (悦荟广场)	Renmin Road	Shopping mall	73,000
Free Harbour (中联自由港)	Zhongshan Road	Shopping mall	50,000
Liqun Group Shibe CBD Shopping Center (利群百货CBD店)	CBD	Department store	47,000
Tesco Taidong (乐购)	Taidong	Shopping mall	66,000
Lion Square (金狮广场)	Laoshan	Shopping mall	130,000
Mykal II (麦凯乐新都心店)	New Urban Centre	Department store	90,000

Source: Savills Research

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