

Briefing Office sector

June 2014



Image: Zhonglou, Xi'an

SUMMARY

Growing demand from the services sector and expanding prime office stock have accelerated the development of the Grade A office market, although current rents stand at a relatively low level compared with other major second-tier cities.

■ Three new Grade A office developments were handed over in the first five months of 2014, adding a total office GFA of 160,000 sq m. As a result, Grade A office stock rose to 1.06 million sq m.

■ Supply and demand have been relatively balanced over the past decade, with net take-up absorbing over 90% of the new supply. However, in the first five months of 2014, net take-up accounted for just 59% of new supply.

■ Due to the supply-demand imbalance, city-wide vacancy rates rose 3.4 percentage points (ppts) to

22.4% by the end of May 2014.

■ Rents appreciated at a CAGR of 6.2% between 2009 and 2013, and were up a further 2.0% in the first five months of 2014, to an average of RMB99.6 per sq m per month (exclusive of property management fees).

■ Similar to other major second-tier cities, Xi'an is expected to see a total office GFA of 2.39 million sq m enter the Grade A market, increasing current stock 2.3 fold. Both city-wide occupancy rates and rents are expected to drop in the short term as a result.

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"A lack of financial and professional services companies constrained rental growth in the local market. In spite of this, city-wide vacancy rates stood at a healthy level compared with other second-tier cities."
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Joan Wang, Savills Research

➔ **City overview and urban planning**

As the capital city of Shaanxi province, Xi'an is the economic and cultural centre, and transportation hub in northwest China, as well as one of the most popular tourism destinations, enjoying a rich history of more than 3,000 years. Additionally, Xi'an is a primary education hub in China, housing a number of universities and scientific research institutions.

The central government initiated the "Go West" plan in 2000, with Xi'an as one of the key engines fuelling the development of western China. The city witnessed accelerated development in the following decade, with improved economic volumes and structure, and infrastructure, thanks to a series of investment and incentive policies implemented by the government.

Xi'an consists of 13 administrative divisions, including Xincheng, Beilin, Lianhu, Yanta and Weiyang districts, within five main urban areas. Weiyang and Yanta districts contain the city's Economic and Technological Development Zone (ETDZ) and Hi-tech Industries Development Zone (HTIDZ) respectively. Another district, Lintong, is considered a tourism hub due to the number of places of historical interest here.

Infrastructure and transportation

As the main railway hub of Shaanxi province, the city is home to three stations – Xi'an Railway Station, Xi'an North Railway Station and South Railway Station. Xi'an North Railway

MAP 1 **Xi'an's major transportation networks**



Source: Savills Research

Station caters for high-speed trains and was opened in 2010. Currently, the city is connected to Beijing and Zhengzhou through high-speed rail links, and is scheduled to be connected to Datong in 2014 and Chengdu in 2017.

To date, Xi'an is the only city operating an underground railway system in northwest China, with Metro lines 2 and 1 becoming operational in 2011 and 2013 respectively. Line 3 is under construction, with another three lines (4 to 6) in the planning stages, scheduled to be fully operational by 2020.

Xi'an Xianyang international airport ranked eighth in terms of passenger

throughput nationwide in 2013. Moreover, the newly-completed second runway and Terminal 3 is expected to further enhance passenger throughput capability.

Economic overview

Xi'an serves as the engine of economic growth in northwest China, with a strong GDP growth (CAGR) of 18.0% between 2004 and 2013. Despite this, GDP (RMB488.4 billion by the end of 2013) was lower than other major eastern and western second-tier cities such as Tianjin, Dalian, Shenyang, Chengdu and Chongqing.

Pillar industries include automobile, equipment and material manufacturing. Additionally, the city is seeing the beginning of a boom in the IT and high-tech industry, with the fast development of HTIDZ which, so far, has attracted approximately 100 related fortune 500 companies, including Samsung, Bosch, Schneider, IBM and Intel. Finance and professional services companies, however, have a relatively low profile in the locality, resulting in the tertiary industry accounting for just 52% of GDP in 2013.

Grade A office market overview

Market overview

Xi'an is considered one of the most famous and favourable tourism destinations in China and has enjoyed robust economic growth over the past

TABLE 1 **Macro economic indicators, Jan-Mar 2014**

Indicators	Unit	Value	YoY growth (%)
Gross domestic product (GDP)	RMB billion	95.6	9.5
Foreign direct investment	US\$ billion	1.1	90.5
Fixed-asset investment	RMB billion	67.1	21.8
Real estate investment	RMB billion	25	19.4
Retail sales	RMB billion	68.2	12.7
Disposable income per capita (urban, 2013)*	RMB	33,100	10.4
Consumer product index (CPI)	PY = 100	102.4	-

Source: Xi'an Statistics Bureau, Savills Research
*annualized figure

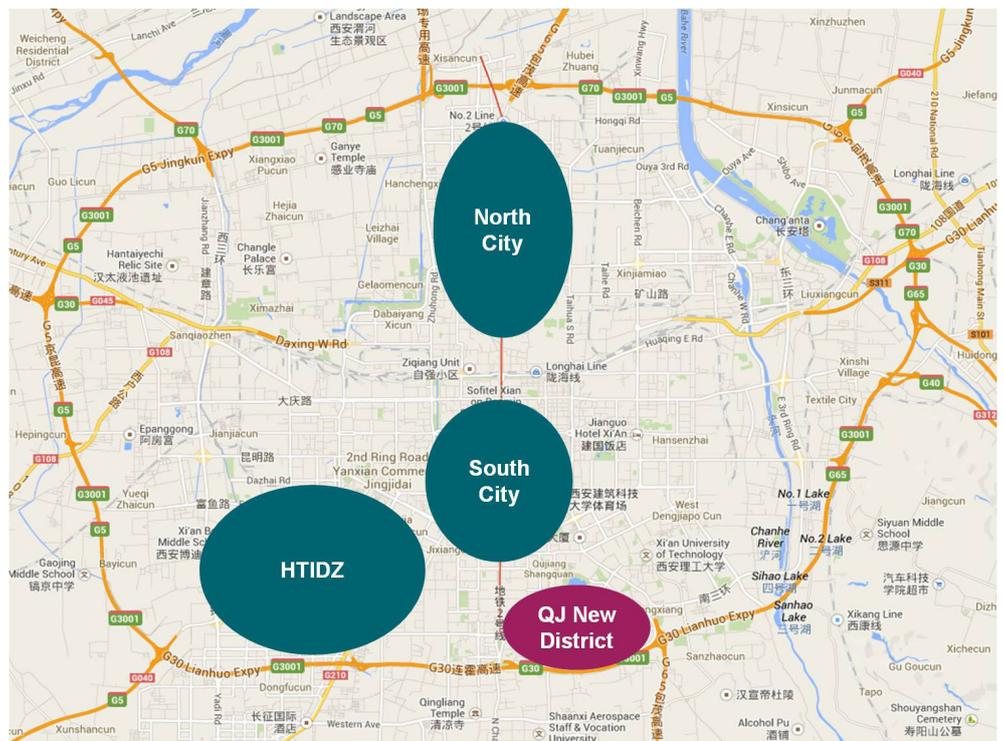
decade. The development of its Grade A office market, however, was slow over the same period, particularly compared with other Chinese regional centres such as Shenyang and Chengdu. The market received its first batch of Grade A office supply between the late 1990s and the early 2000s, with the majority of projects clustered in South City area and HTIDZ. Zhongda International (Tower A) and High-tech International Business Centre were among the first projects launched onto the market in its early stages. As ETDZ and Qujiang Central Cultural Business District developed, North City area and Qujiang New District matured into important business districts, with the clustering of several Grade A office buildings after 2005.

The market experienced a significant imbalance in project distribution, as HTIDZ's accelerated development, on the back of growing demand, saw more than one half of total stock launch here. Three other major business districts, however, accounted for a very small amount of Grade A office stock.

Due to economic growth being led by the industrial, manufacturing, and IT and high-tech sectors, overall demand for Grade A office space in Xi'an was weak, not only compared with first-tier cities but also with leading second-tier cities such as Shenyang, Dalian and Chengdu. This was mainly due to a lack of new financial and professional services companies entering the market (particularly consulting, law and accounting firms). Private domestic and small to medium IT and high-tech, professional services (focusing on small technology consultancies, educational consultancies, and so), and commerce and trade companies, however, which usually boast relatively low rental budgets, were the major demand drivers in the locality. As a result, average leased space by a single company in a Grade A office building was less than 300 sq m.

Additionally, much like other major second-tier cities, the majority of Grade A office projects in Xi'an are strata title, with only three office buildings, namely High-tech International Business Centre, CapitaLand Plaza and China Overseas Plaza, currently held by landlords. The shortage of quality lease-only developments, combined with a lack of demand, particularly from the services sectors, hampered the growth of the market.

MAP 2 Xi'an's major business districts



Source: Savills Research

Nevertheless, the market has changed over the past three years, with the services sectors playing a more important role in the local economy, allowing demand to grow. This demand has ensured that more quality Grade A office developments by leading developers, including CapitaLand and China Overseas Property, are entering the market. Restrictive policies on residential markets since late 2010 also served as an engine to fuel the development of local office market by stimulating developers to diversify and enter into the commercial segments.

Xi'an's Grade A office market is divided into three traditional business districts and one emerging market:

Traditional business districts:
High-tech Development Zone (HTIDZ):

Located in the southwest of Xi'an, HTIDZ was approved and established by the State Council as one of the three state-level development zones in 1991 (the other two are Zhongguancun Park located in Zhongguancun and Suzhou Industrial Zone located in Suzhou). HTIDZ is one of the engines of the city's economic growth, currently housing

more than 1,000 high-tech enterprises, and around 100 Fortune 500 companies and subsidiary R&D centres. Pillar industries of HTIDZ include IT and high-tech, and electronic, equipment and automobile manufacturing, as well as bio-tech and pharmaceutical companies, with representative enterprises that include Oracle, Emerson Electric, Huawei Technologies, SPSS, NTT Data, NEC, New Egg and Fujitsu.

Thanks to government support, a cluster of quality residential communities, established retail facilities, and strong demand from overseas and domestic IT and high-tech manufacturing companies, HTIDZ is currently the largest and most mature business district in the locality, accounting for the more than one half of Grade A office stock.

The majority of office buildings are located in the northern part of HTIDZ, including High-tech International Business Centre, Xi'gang International Building and Linking International, and have high-standard specifications compared with their counterparts in the South City and North City areas.

This, combined with stronger demand than for any of the other three major business districts, allowed HTIDZ to command the second highest rents in the city.

The development of the office market in southern HTIDZ was slow compared with northern HTIDZ. However, the government revealed a plan for a new CBD, HTIDZ CBD, in 2003. HTIDZ CBD is located in the southern area of HTIDZ, with Jinye Road as the axis, a total site area of approximately 2 sq km and a total planned GFA of approximately 2 million sq m.

HTIDZ CBD focuses on business function, with the majority of projects zoned as office buildings. Most land

plots have been successfully transacted since 2004, and a basic business ambiance has come into being, with currently completed office buildings including City Gate (where the HTIDZ Administrative Committee is housed) and Huixin IBC. Residential projects include Greenland Century City, while hospitality projects include Holiday Inn as well as the Xi'an Greenland Pico International Conference and Exhibition Centre. Greenland Group is the largest landlord in HTIDZ CBD contributing approximately 1.2 million sq m of projects.

HTIDZ CBD has attracted a number of renowned developers, investors and four- and five-star hotel operators, such as Greenland Group, CREC Group, China Investment Group and Ramada Hotel Group. Several of their landmark projects, including CREC Xi'an Centre, Greenland Centre (Tower 1 and 2), Greenland Being Funny Shopping Mall and Ramada Hotel, are expected to be completed over the next five years. These projects, combined with the planned Metro line 6 along Jinye Road offering easier access to the downtown area, are scheduled to be completed in 2018. HTIDZ CBD is expected to develop into one of the most mature business districts in Xi'an, with a cluster of high-quality projects and a large pool of quality tenants and end users.

South City area
Located in the southern downtown area which highlights the historical culture of Xi'an, South City area is the oldest

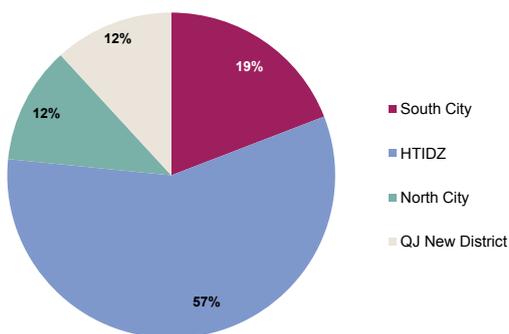
business district in the locality, with its first batch of Grade A office buildings completed between 1998 and 2005 marking the beginning of the Grade A office market. Given the prime location, convenient accessibility, and mature retail and hospitality markets, South City area has attracted a number of international financial, manufacturing and professional services companies, including Kuehne & Nagel, Mitsubishi Electric, Siemens and Casio, to establish their presence in the area since 2000. Landmark projects launched in this period include Zhongda International Tower A (renovated to retail use in 2012), Laosanjie Century Star Plaza and Chang'an International.

This submarket was further upgraded with the handover of CapitaLand Plaza in 2013, marking the first Grade A office project developed by an international developer and currently one of the best office buildings in the locality in terms of specifications. As a result, several internationally renowned companies, such as Danfoss, Leica and EMC, established their presence in Xi'an within this project. Consequently, South City area currently commands the highest rents in the city, enjoying a 19% premium over the city's average.

North City area
North City area is located in the northern part of the urban area of Xi'an, with Weiyang Avenue as the axis road. Its growth was stimulated by the development of ETDZ located in the same area. ETDZ was established by the government in the early 1990s and appointed as a state-level development zone in 2000. As a result, this area attracted several international companies, such as Coca-Cola, General Motors, HP and Mitsubishi Electric, as well as a number of state-owned enterprises (SOEs), such as AVIC Group, Sino Steel Group and China Transportation Group, to establish manufacturing bases, R&D centres or factories.

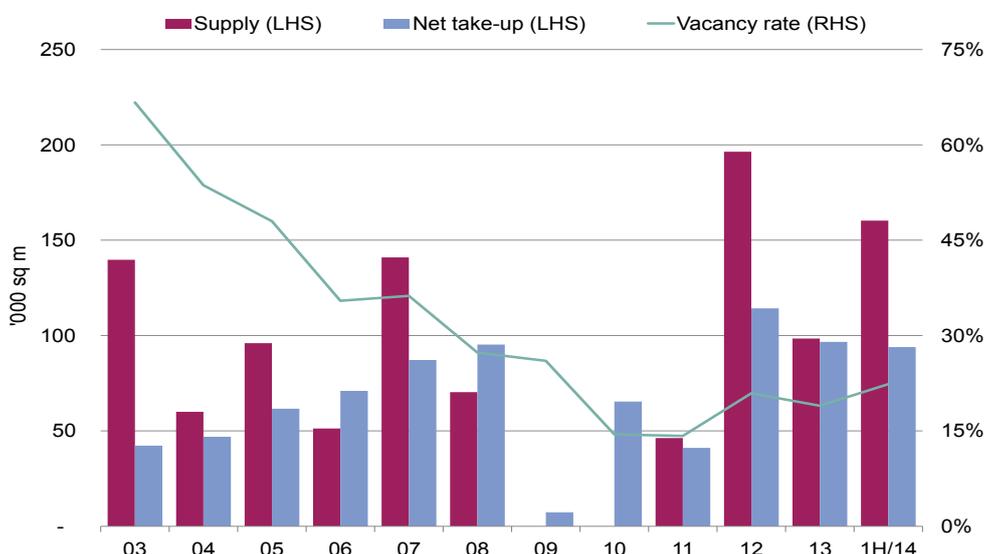
However, this submarket currently focuses mostly on Grade B offices, with only two Grade A office buildings in the area, namely Economic Development Building and Zhongdeng Building, leading to the lowest vacancy rates among any submarket. Domestic manufacturing, property development and energy companies were the major demand drivers, as the aforementioned overseas corporate giants focused

GRAPH 1
Grade A office stock by submarket, 1H/2014



Source: Savills Research

GRAPH 2
Grade A office supply, net take-up and vacancy rate, 2003–1H/2014



Source: Savills Research

on manufacturing and R&D functions, while their state-owned counterparts preferred to buy assets or own offices themselves.

The Xi'an municipal government relocated to the North City area in 2011, leading to more SOEs establishing their presence in this submarket by leasing offices in the past three years. Stimulated by an expected growth in demand, a substantial level of Grade A office supply is scheduled in this area and is expected to enlarge current stock five-fold by the end of 2016.

Emerging markets

Qujiang New District

With a history of more than 1,000 years, Qujiang area is one of the hottest tourist destinations in this ancient city, enjoying several historical landmarks, including Dayan Tower, Qinglong Temple and Qujiang Pool Legacy, along with other tourist sites such as Tang Dynasty Furong Park. As a result, in 2003, the local government established Qujiang New District and appointed it the city's Central Cultural Business District (CCBD), targeting industries including media and cultural, tourism and exhibition services. After a decade of development, Qujiang New District has evolved into a mature area accommodating a number of high-end residences, mid- to high-end retail, and hospitality and exhibition facilities.

Qujiang New District welcomed its first batch of Grade A office supply in 2012, and is currently the smallest business district in the locality. Office buildings in this submarket, highlighted by Qujiang Culture Creative Building, China Overseas Plaza and Qujiang International Building, enjoy relatively high specifications compared with those in South and North City areas. Domestic media and cultural, financial, commerce and trade, and exhibition service companies are the major demand drivers in this submarket. However, rental levels remain the lowest in the city, largely a result of the market being in its early stages combined with weak affordability from media and cultural companies.

Supply, stock and demand

By the end of May 2014, Grade A office stock stood at 1.06 million sq m, larger than Shenyang, Tianjin and Chongqing, but smaller than Chengdu, Qingdao and Dalian. HTIDZ is the largest business

district, accounting for 57% of total stock, followed by South City area accounting for 19% of the total.

The Grade A office market took off in the late 1990s and welcomed its first period of development between 2003 and 2008, with annual supply averaging 93,000 sq m. Several landmark buildings, including Hi-tech International Business Centre and Chang'an International, were handed over during this period.

Market development accelerated in the past three years, with annual supply averaging 114,000 sq m and net take-up absorbing 74% of the new supply in the same period. Despite this, city-wide vacancy rates decreased to around 20% between 2012 and 2013, from an average of over 40% between 2003 and 2008, due to active expansion from IT and high-tech, manufacturing and property development enterprises, as well as growing demand from financial

and professional services companies. In the first five months of 2014, three new projects, namely Linghai Plaza, Zhihai Plaza and Pearl River Times Square, were handed over, adding a total of office GFA of 160,000 sq m to the market, the second highest supply peak over the past decade. Overall demand started to lag behind supply as net take-up accounted for just 59% of new supply in the same period. As a result, city-wide vacancy rates rose 3.4 ppts to 22.4%, although still a healthy level among other major second-tier cities.

By submarket, North City recorded the lowest vacancy rates at just 3.8% by the end of May 2014 due to its small amount of Grade A office stock, while Qujiang New District had the highest vacancy rate of nearly 60%, as the majority of its office projects were handed over in late 2013.

Domestic IT and high-tech, professional

TABLE 2 **Grade A office market key indicators, 1H/2014**

	Stock (sq m)	Supply (sq m)	Net take-up (sq m)	Vacancy rate (%)	Rent (RMB per sq m per month)
1H/2014	1,060,000	160,000	94,000	22.4	99.6
HoH change (%/ppts)	17.8	-	-	3.4	2.0

Source: Savills Research

TABLE 3 **New supply, 2013–1H/2014**

Project	Location	Office GFA (sq m)	Completion date
City Gate (A/B)	HTIDZ	136,000	1H/2013
CapitaLand Plaza	South City	34,000	1H/2013
China Overseas Plaza	Qujiang New District	25,000	2H/2013
Qujiang International Building	Qujiang New District	40,000	2H/2013
Linghai Plaza	HTIDZ	90,000	1H/2014
Zhihai Plaza	HTIDZ	57,000	1H/2014
Zhujiang Times Building	South City	13,000	1H/2014

Source: Savills Research

services, commerce and trade, construction and engineering, and manufacturing companies are major demand drivers in the locality, accounting for 64% of the tenant profile at the end of May 2014. More notable financial and professional services companies witnessed a growing demand in recent years. Meanwhile, domestic companies took the lion's share of demand, accounting for 87% of recorded transactions, with limited demand from overseas companies in terms of Grade A office space.

Grade A office rents

Xi'an office rents are usually paid yearly with one month's rent as deposit, and quoted on a monthly rate, inclusive of tax but exclusive of property management fees. Lease terms range from one to three years. City-wide property management fees averaged

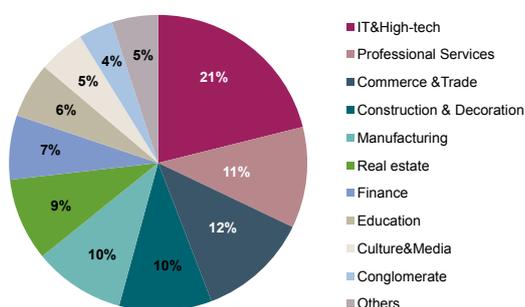
RMB15.1 per sq m per month. At the early stage of the market, Grade A office rents grew slowly, with a CAGR of just 1.0% between 2003 and 2008, largely a result of limited demand from the service sectors. However, rents accelerated to appreciate at a CAGR of 6.2% between 2009 and 2013. This was largely due to the growth in demand from international professional services companies, combined with the maturing of the market, with more Grade A office space and buildings with higher specifications. In spite of this, rental rates fell 6.2% in 2009 due to the global financial crisis suppressing corporate expansions.

At the end of May 2014, Grade A office rents rose a further 2.0% compared with 2013, to an average of RMB99.6 per sq m per month (exclusive of property management fees). Despite

steady growth, the rental level was relatively low compared with other major second-tier cities such as Tianjin, Shenyang, Dalian and Chengdu. Chang'an International (长安国际), Hi-tech International Business Centre (高新国际商务中心) and CapitalLand Plaza (凯德广场) are among the most expensive office buildings in the locality, with their effective rents ranging from RMB120 to RMB150 per sq m per month (exclusive of property management fees).

By submarket, South City rents surpassed HTIDZ rents at RMB118.8 per sq m per month to command the highest rental level in the city by the end of May 2014, largely a result of its core location and a high number of overseas companies, combined with the stagnant rental growth of HTIDZ due to a large amount of supply handed over

GRAPH 3 Demand drivers, end of 1H/2014



Source: Savills Research

TABLE 4 City vacancy rates, 1H/2014

Second-tier city	Vacancy rate (%)	First-tier city	Vacancy rate (%)
Shenyang*	19.8	Beijing	3.9
Tianjin	19.5	Shanghai	6.7
Dalian*	13.4	Guangzhou	14.2
Chengdu	29.3	Shenzhen	12.0
Chongqing	35.4		

Source: Savills Research (*data of 2H/2013)

TABLE 5 Selected office leasing transactions, 2011-1H/2014

Company	Project	Location	GFA (sq m)	New lease/renewal
Shanghai Pudong Development Bank	Greenland Central Plaza	HTIDZ	1,556	New lease
PWC	Changan International	South City	1,400	New lease
HP	Linkai International	HTIDZ	1,360	New lease
Canon	Changan International	South City	830	New lease
EMC	CapitalLand Plaza	South City	600	New lease
Cisco	Zhongda International (Tower A)	South City	591	New lease
Acer	Jinding International	South City	500	Expansion
Sanxia Guarantee Group	Linkai International	HTIDZ	457	New lease
New Oriental School	Zhongda International (Tower C)	South City	400	New lease
Danfoss Heating	CapitalLand Plaza	South City	300	New lease

Source: Savills Research

in the first five months of 2014. HTIDZ is currently the most mature business district in terms of office stock, tenant profile and demand, and commanded the second highest rents of RMB100.7 per sq m per month. Comparatively, rents in North City and Qujiang New District were much lower, reaching RMB81.0 and RMB84.0 per sq m per month respectively.

Market outlook

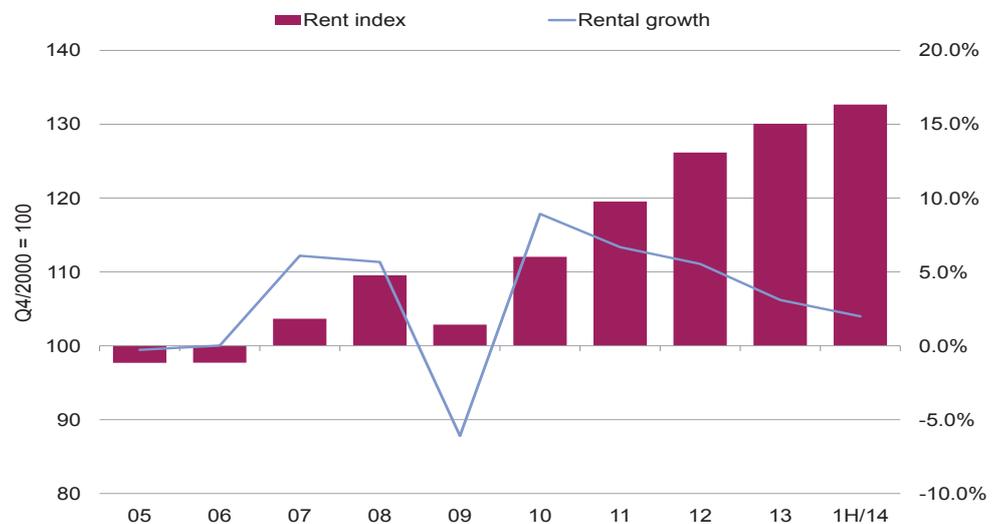
Similar to other major second-tier cities, Xi'an's Grade A office market is expected to welcome a significant growth in supply in the next three years (2014 to 2016), with a total of 27 projects (2.39 million sq m office GFA) scheduled to be handed over, seven times of that in the previous three years. HTIDZ will continue to be the hub of this round of market development, with new supply accounting for 46% of the total over this period.

Sixty percent of future supply in HTIDZ in the next three years will be located in the CBD and most projects are expected to embrace a higher standard of specifications. HTIDZ CBD is expected to welcome the first batch of international Grade A office buildings in the city, when CREC SIAN Centre (中铁西安中心) and Greenland Centre (绿地中心) Tower 1 are handed over in 2016.

Meanwhile, demand is also expected to grow in the next three years, with Xi'an maintaining its leading role in China's IT and high-tech industry, as well as an expectation of improved economic structure. Proof of this, is that the city recently received a series of investments from leading domestic and overseas IT and high-tech (including e-commerce) and related companies, such as 360Buy.com, Thought Works, HopeRun Software, which are expecting to establish their representative offices, R&D centres or logistics bases.

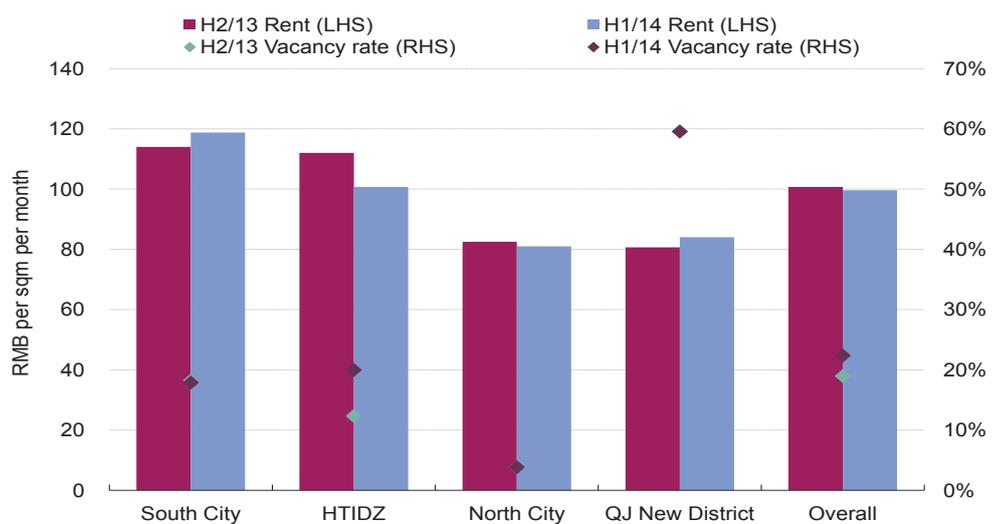
Despite growing demand and a significantly upgraded office market in terms of project specifications and prime stock, it is still expected to be difficult to absorb such a substantial level of new supply in the short term. As a result, both city-wide occupancy rates and rents will fall over the next three years given intensified competition between landlords, which is a common dilemma with other major second-tier cities, such as Shenyang, Qingdao,

GRAPH 4
Grade A office rental index, 2005–1H/2014



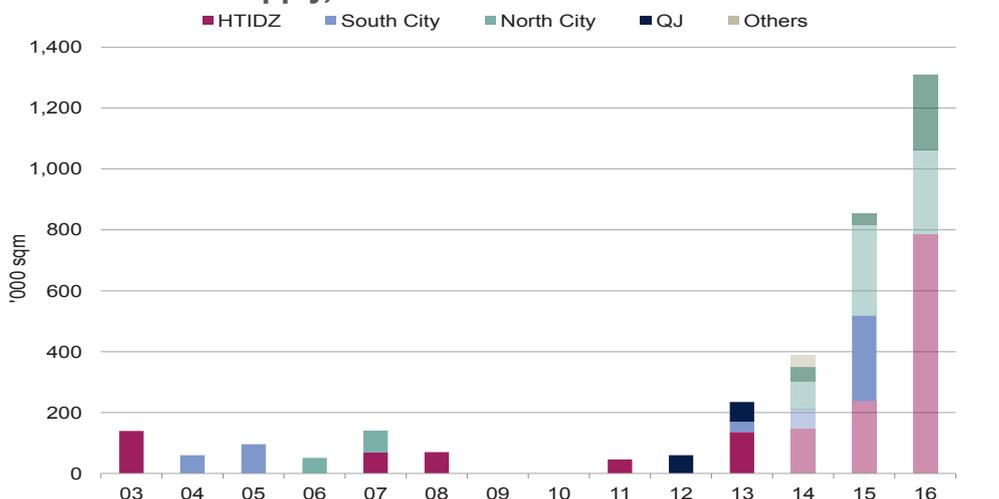
Source: Savills Research

GRAPH 5
Submarket rents and vacancy rates, 2H/2013 vs 1H/2014



Source: Savills Research

GRAPH 6
Grade A office supply, 2003–2016F



Source: Savills Research

TABLE 6
Future office supply, 2H/2014–2015

Project	Business district	Office GFA (sq m)	Expected completion
Tuorui International Centre 拓锐国际	Qujiang New District	46,000	2014
Daming Palace Wanda Centre 大明宫万达中心	North City	91,000	2014
Changan International Phase II 长安国际二期	South City	50,000	2014
Hengtian Caizhi Masion 恒天才智大厦	Others	40,000	2014
Zhengshang International Finance Plaza 正尚国际金融广场	North City	80,000	2015
Quanshi Beiao Center 泉石北奥中心	North City	108,000	2015
Fulton International Fortune Centre 富尔顿国际财富中心	North City	110,000	2015
BHG Plaza Office Building Phase III 华联购物广场三期写字楼	South City	44,000	2015
Xi'an International Centre Phase 1 西安国际中心一期	South City	140,000	2015
Lizihan Palace 利兹瀚宫	South City	67,000	2015
Wangdu City View 旺都城市之窗	HTIDZ	213,000	2015
Fangzhou International 方舟国际	HTIDZ	24,000	2015
Chaoyang New World 朝阳新世界	South City	30,000	2015
Qujiang Dijie International Plaza 曲江谛杰国际广场	Qujiang New District	36,000	2015

Source: Savills Research

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