BEIJING

Grade A Office – Demand Moderated but Market Remained Stable

Beijing’s GDP grew by 6.9% YOY in Q1 2016, on par with 2015, according to the Beijing Statistics Bureau. The tertiary industry growth accelerated by 0.1 percentage point to 8.2% YOY during the same period, supported by the fast-growing finance, technology and IT sectors. Underpinned by the steady growth of the tertiary industry, Beijing’s Grade A office property market was stable in H1 2016, with the average rent remaining the highest in mainland China and the overall vacancy rate staying low at 5.9%.

Two Grade A office properties completed in H1 2016: Genesis Beijing in the Lufthansa submarket and LSH Center Tower A in the Wangjing submarket. These projects added a combined office GFA of approximately 190,000 sq m to the market, leading the total stock to expand by 3.4% HOH to 5.8 million sq m.

Leasing demand for Grade A office space moderated in H1 2016 as a result of tightened corporate budgets and a slowdown in new business setups. Demand primarily came from domestic finance and IT companies, though expansions from the finance sector slowed in the light of stricter government supervision. Net absorption totalled 110,994 sq m, mostly focused on projects completed in the past two years. The overall vacancy rate increased by 1.2 percentage points HOH to 5.9% due to new supply.

The city’s average rent edged down by 0.1% HOH to RMB331.2 per square metre (psm) per month due to the below-average rents at the new projects. Excluding the impact of new supply, the rent increased by 0.5% HOH. In CBD, rent declined by 0.3% HOH to RMB348.8 psm per month as certain landlords offered discounts to attract new tenants. By comparison, limited available space pushed up the rents in Financial Street and Zhongguancun by 0.8% HOH and 2.8% HOH respectively to RMB443.6 psm per month and RMB276.1 psm per month.

Three en bloc transactions were disclosed in H1 2016. Domestic end-users continued to seek office space for owner-occupancy in emerging areas. United Electronics acquired an office building (16,800 sq m) at IT Business Park in Wangjing from Beijing Electronic City for approximately RMB390 million. Inner Mongolia Yili Industrial Group purchased three office buildings (planned GFA of 44,100 sq m) at Dongxu International Centre in Fengtai for approximately RMB1.8 billion. In addition, an undisclosed buyer acquired an office tower (32,000 sq m) at China Overseas Building in Shijingshan for approximately RMB1.5 billion.

The central government expanded the VAT programme to all industries in May, including the real estate sector. Despite the change in taxation, no major impact on tenants was seen in Beijing in the first half of 2016 as many landlords have adopted the 5% tax rate during the transition period.
Eight projects with a combined GFA of approximately 447,000 sq m are scheduled to complete in H2 2016. These projects include Emperor Group Centre in East Chang An Avenue, LSH Centre Tower B in Wangjing and Tianyuan Xiangtai Tower in Asian Games Village. This coming wave of new supply, the largest volume since 2009, will push up the city’s overall vacancy rate and limit average rental growth in the short term.

In the investment market, both domestic and international institutional investors will continue to seek investment targets in Beijing and capital values of Grade A offices should continue to rise, albeit at a slower pace. However, landlords of stabilised properties will continue to hold their properties for long-term gains.

**Retail – Market was Active with Strong Demand**

Beijing’s retail sales of consumer goods grew by 3.1% YOY as of end-May 2016, edging up by 0.9 percentage points compared with Q1 2016, according to the Beijing Statistics Bureau. The Household Income Expectation Index remained strong for the sixth consecutive quarter, increasing by 1.8 points QOQ to 102.7 in Q1 2016. Beijing’s prime retail property market reflected this positive sentiment, as the vacancy rate decreased and rent increased during H1 2016.

Vanke Mall in Daxing District opened in H1 2016. The mass market community mall has a retail GFA of approximately 62,000 sq m. Total stock of prime retail space increased to approximately 4.7 million sq m.

Demand for Beijing’s prime retail space was strong in H1 2016 as retailers from various sectors continued to expand. Many international brands opened flagship stores in the city this half, including British fashion brand Joseph and Swiss watch brand Rado. F&B, fashion, lifestyle and children’s retail sectors were active during this half, as were jewellery, cosmetics and accessories brands. Demand was concentrated at the new supply, which was almost fully occupied at opening, and was further stimulated by trade and brand mix adjustments at mature properties. As a result, net absorption totalled approximately 97,000 sq m and the average vacancy edged down by 0.8 percentage points HOH to 4.4%.

The average ground floor fixed rent in Beijing’s mid- to high-end shopping centres increased by 0.2% HOH to RMB848.7 psm per month in H1 2016. Although rent at the new supply was below average, rents in the prime area increased by 0.9% HOH to RMB1,164.4 psm per month.

Beijing’s retail investment market recorded a headline en bloc sales transaction in this half. LeTV purchased Shimao Department Store from Shimao Group for RMB2.97 billion, or a unit price of approximately RMB72,000 psm. The project is located in the Sanlitun area and has a total GFA of 41,200 sq m.

Three prime retail projects with a total GFA of approximately 480,000 sq m are scheduled to enter the Beijing market in the rest of 2016. All the new supply will have mass market and family-oriented positioning and be located in non-prime areas. Developers of this new supply are domestic companies with national market presence and expertise in the retail property sector. This will translate into high pre-commitment levels, and no major impact on the city’s average vacancy rate is expected. However, rent in non-prime areas is below the level in prime areas, and a decline in the average rent is inevitable. However, on a project basis, rents in prime areas should continue to grow given the unabated demand for prime retail space, which is limited, and low vacancy rates.

In the short to medium term, new supply in Beijing’s retail property market will continue to be concentrated in emerging areas. However, as stock continues to grow in these areas, competition for popular brands will intensify, and homogeneous positioning and brand and tenant mixes will become a challenge for landlords. In the prime area, established high-end properties are expected to further adjust towards a contemporary fashion or mass market positioning to attract a wider range of consumers.
Residential – Buying Sentiment Stabilised, Leasing Demand Rebounded

Beijing’s housing sales volume edged up in H1 2016 compared to the same period in the previous year, as several new stimulus policies came into effect. Noticeably, transaction volume in the high-end market picked up by 39% HOH, or more than 100% YOY. Tongzhou district issued further purchase restrictions on business apartments in May, following on from housing purchases restrictions in August 2015, to further curb speculation in that area. Buying sentiment stabilised toward end-H1 2016.

In the serviced apartment segment, total stock declined by 5.7% HOH or 10.5% YOY to 7,004 units as four projects retreated from the market. Lanson Place in the CBD submarket and Ariva Beijing in the Jianguomen submarket were strata-titled sold as residential projects. Embassy House in the Lufthansa & Chaoyang Park submarket and Somerset Serviced Residence in the Zhongguancun & Wanliu submarket were sold en bloc and withdrew from the market. However, 158 units at The Ascott Beijing returned to the market following renovations.

Leasing demand for high-end properties rebounded moderately in H1 2016 as seasonal tenants returned. In the villa and luxury apartment sectors, average rental values increased by 2.4% and 1.5% HOH to RMB84.2 psm per month and RMB136.3 psm per month, respectively. In the serviced apartment sector, due to the continuous reduction of market stock, most landlords with stable occupancy maintained their existing rents while certain projects in CBD and Jianguomen submarkets raised rents. As a result, the average vacancy rate edged down by 0.8 percentage points HOH to 19.9% and the average rent edged up by 1.4% HOH to RMB226.5 psm per month.

The en bloc sales market was active with two sales transactions concluded during H1 2016. CITIC purchased Embassy House for approximately RMB2.28 billion and Hong Kong Qianhai Zhongjin Group purchased Somerset Zhongguancun Serviced Residence from CapitaLand for approximately RMB590 million. In the land market, developers sought land plots outside the core area (which are highly limited), as seen in China Merchants Group’s purchase of two sites in Changping District for a total combined consideration of RMB6.2 billion.

In H1 2016, Beijing’s municipal government took further steps to restrict speculation in Tongzhou District. However, speculation here has been related to the city’s government move to the Tongzhou area, and has not spread throughout the city. As such, while Beijing’s purchase restrictions are expected to remain in place for the coming half, no major change is forecast.

In the serviced apartment sector, one project located in Lufthansa & Chaoyang Park submarket is scheduled to complete in H2 2016. The new supply will lead to a temporary increase in the average vacancy rate. Leasing demand is expected to remain stable but soften towards year-end as the low season approaches. A minor rental correction is expected at certain properties, though serviced apartments with prime location, good amenities and convenient transportation are likely to maintain the current rental level.

Industrial (Logistics) – Sustained Demand Supported Rental Growth

Beijing’s online retail sales, a stronger driver of demand for logistics property, grew by 6.0% YOY in the first five months of 2016, 2.9 percentage points faster than its retail sales growth, according to the Beijing Statistics Bureau. Demand from this sector amidst limited stock supported an increase in the average rent, and a decline in the overall vacancy rate on half-year basis in H1 2016.

Two new projects with a combined GFA of 199,200 sq m were completed in H1 2016: Prologis Beijing Capital Airport Logistics Center II and Golden Road Logistics Park, located in Beijing Airport Logistic Park (BALP) and Beijing Tongzhou Logistics Park (BTLP) respectively. As a result, the total stock of Beijing’s logistics property market expanded to 1.76 million sq m.

Demand for Beijing’s quality logistics properties remained strong in the first half of 2016, with net absorption totalling 193,941 sq m. The overall vacancy rate edged down by 0.1 percentage point to 3.3% HOH despite the new supply, which achieved nearly full occupancy upon completion. The e-commerce sector, third-party logistics (3PL) providers
and fast moving consumer goods (FMCG) industry continued to be the major sources of demand. Leasing transactions concentrated on the newly completed projects due to the low vacancy at existing prime warehouses. This was reflected in Cainiao Network’s lease of the entire Prologis Beijing Capital Airport Logistics Center II and food company Sanhui Group’s lease of 74,000 sq m at Golden Road Logistics Park. The average rent increased by 1.6% HOH to RMB39.0 psm per month, primarily driven by buoyant leasing demand and annual rental adjustments.

Although no en bloc sales transactions were concluded in Beijing’s logistics market in H1 2016, the investment sentiment for the logistics sector remained strong, evidenced by the high level of enquiries and deal sourcing activities. Logistics developers e-Shang and the Redwood Group Asia announced that they completed an all-stock merger in January 2016. The combined group was renamed e-Shang Redwood, and has more than 3.5 million sq m of warehouses (completed & under construction) across Asia, including one logistics park in the BTLP submarket.

The future supply of prime logistics warehouse in the medium to long term will be constrained. This was evidenced by Beijing’s reduction of the industrial land supply from 350 hectares in 2015 to 100 hectares in 2016, according to Beijing Municipal Bureau of Land and Resources. Meanwhile the integration of Beijing, Tianjin and Hebei has driven intercity infrastructure development. Several motorways will start construction or upgrade in 2016, including Jingtai Motorway, which will connect Beijing’s new airport, Tianjin and Hebei. As such, price-sensitive tenants are expected to relocate to nearby areas with less expensive rents, benefiting logistics properties beyond Beijing’s city borders.

Three new projects with a combined GFA of approximately 268,000 sq m are scheduled for completion in H2 2016 and 90% of the warehousing space will be located in the BALP submarket. Given strong pre-commitment rates of the future supply and sustained leasing demand from the 3PL providers and e-commerce sectors, these projects will be absorbed quickly and major fluctuations in the overall vacancy rate are not expected upon their completion. However, the average rental growth will slow due to the already-high rental levels in addition to growing competition from surrounding cities such as Langfang and Tianjin. In the investment market, the relatively high yield of industrial property will continue to attract both investors and developers, though opportunities for acquisition will remain limited amidst the tight supply of industrial land in Beijing.

SECOND-TIER CITIES (TIANJIN, SHENYANG, QINGDAO and DALIAN)

Office

Tianjin, Shenyang, Qingdao received a total of four new office developments, one phase of a new project and one phase of an existing project with a total office GFA of approximately 303,600 sq m in H1 2016. No new projects were completed in Dalian.

Tianjin received the most new supply (148,000 sq m), followed by Shenyang (118,000 sq m). The large amount of new supply outpaced the demand in these cities, leading the vacancy rate to increase by 1.4 and 1.2 percentage points HOH to 31.4% and 43.3% respectively. The high vacancy level at existing projects drove competition between landlords. In Dalian, the lack of new supply led the average vacancy rate to edge down by 0.5 percentage points HOH to 17.8%. In Qingdao, the prime office market remained stable during H1 2016, though the temporary effect of the new supply drove the vacancy rate up by 0.4 percentage points HOH to 17.6%.

In all four cities, domestic finance and service enterprises continued to be the key demand generators, though new leases and expansions slowed and some existing tenants retreated due to stricter government and landlord screening supervision of this industry. While in Shenyang, given its economic climate, new business setups were limited and relocations from older buildings to newly completed buildings with higher-standard facilities accounted for a large portion of demand.

The office markets in Tianjin, Shenyang and Dalian continued to favour tenants, given the rental competition among landlords and vacant space. Landlords offered rental discounts or a longer rent-free period to retain current tenants.
and attract new tenants, leading the average rent to edge down by 4.1%, 2.2% and 0.4% HOH to RMB100.4 psm per month in Tianjin, RMB88.9 psm per month in Shenyang and RMB96.8 psm per month in Dalian respectively. By contrast, the average rent of Qingdao’s office market grew by 1.0% HOH to RMB98.0 psm per month, supported by sustained demand.

Two significant sales transactions were concluded in the office investment market. In Dalian, KaiLong Group purchased a 90% equity stake in the 46,400 sq m Senmao Building for RMB700 million. In Shenyang, a subsidiary of China Poly Group, acquired the remaining 20% interest in Central Plaza Phase II from SOCAM Development for RMB305 million. The subsidiary acquired an 80% interest in the project in 2014. However, strata-titled sales and dual lease/sale strategy remained popular.

Fourteen projects are expected to enter these markets in H2 2016, with a total office GFA of approximately 932,000 sq m. In particular, five projects with a combined GFA of 239,300 sq m are scheduled for Qingdao. The new supply will outpace demand in the short term, and landlords are expected to offer rental incentives, constraining rental growth in the short to medium term. The average vacancy rates in all four cities are forecast to increase in the short to medium term due to the large volume of new supply while the average rents will see further corrections amidst increased competition. Landlords will respond in various ways including providing better property management and service to retain tenants in addition to offering rental discounts.

**Retail**

In H1 2016, Tianjin and Qingdao each received one new project; no new supply was completed in Shenyang and Dalian. As a result, the total retail stock in Tianjin and Qingdao expanded by 3.3% and 9.0% HOH to 2.4 million sq m and 1.6 million sq m, respectively, while Shenyang and Dalian’s retail stock remained at 2.9 million sq m and 1.5 million sq m.

Shenyang, Tianjin and Qingdao saw vacancy rates increase during H1 2016, with Shenyang recording the highest increase (1.4 percentage points HOH to 20.0%), primarily due to closures of department store and fashion stores, given their gloomy sales and competition from online retail. The new supply in Tianjin and Qingdao led their vacancy rates to increase by 0.8 and 0.2 percentage points HOH to 8.4% and 9.9%, respectively. By contrast, Dalian’s vacancy rate saw a decline of 1.6 percentage points HOH to 9.4%, supported by brand mix adjustments of certain properties and stable absorption at recently completed projects. All four cities have seen a growing proportion of experience-type brands and strong demand from the F&B sector.

Dalian was the only city to record rental growth in H1 2016, edging up 0.4% HOH to RMB644.0 psm per month. This was attributed to slight rental increases made by landlords of mature properties as well as limited new supply. In Tianjin and Qingdao, below-average rents at the new projects, combined with rental discounts at some projects, led the average rents to decrease. Among the four cities, Dalian recorded the highest rental level, followed by Qingdao (RMB494.9), Tianjin (RMB484.2) and Shenyang (RMB 440.3).

No en bloc sales transactions were concluded in the retail investment markets in any of the cities in H1 2016. Investment opportunities were limited and institutional investors were cautious towards economic uncertainties and rental growth in second-tier cities.

The prime retail property market in these cities will expand further in H2 2016, with the exception of Dalian, which does not have any new projects scheduled. Seven retail properties are expected to enter the markets with a total retail GFA of approximately 650,000 sq m. Tianjin and Qingdao will receive 231,000 sq m and 246,000 sq m of prime retail space respectively. Shenyang is expected to receive one new project with GFA of approximately 170,000 sq m.

In Tianjin and Qingdao, most of the new supply will be located outside of these cities’ core catchments. Given the expected below-average rents and mass market positioning at the new supply, the cities’ rental growth will be constrained. At the same time, these cities have seen an improved transportation network, including partial operation
of Qingdao’s Metro Line 3 and Tianjin’s Metro Line 6. The development in infrastructure will stimulate the integration of urban and suburban areas, further boosting demand for certain retail properties along the metro lines in the medium term. In Dalian, a slight decline is expected in the overall vacancy level due to a lack of future supply. Shenyang’s retail property market will continue to favour tenants, given the intensifying competition among landlords and large volume of vacant stock.