CHENGDU

Prime Office – Rental Correction Amidst Oversupply

Chengdu’s office property market was characterised by a significant oversupply in 2016. While demand picked up and the vacancy rate fell, it remained at nearly 38% by the end of 2016. The market imbalance resulted in an ongoing rental correction, with average rent declining by 12% from 2015. Several investors saw the situation as an opportunity to acquire assets in the city, and four en bloc transactions were announced during the year.

Two new prime office projects (combined office GFA of approximately 175,000 sq m) completed in 2016: Sichuan Airlines Centre and Parkview Plaza Tower A. Separately, three prime office projects were postponed to 2017 due to construction or leasing strategy adjustments. As a result, the total stock increased to 2.2 million by the end of 2016.

Demand rebounded in 2016 after a sluggish year in 2015, with net absorption of approximately 220,000 sq m. Much of this demand can be credited to preferential policies by certain district governments, which encouraged domestic firms, particularly in the finance, trade, technology and professional services sectors to sign new leases or extend existing contracts. Nonetheless, the average vacancy rate was 37.7% by the end of 2016 though this was a decline of 5.5 percentage points from 2015. The oversupply was roughly equal in both mature and emerging submarkets, with the vacancy ranging from 38% in the CBD to 42% in Dayuan.

Demand in the emerging submarkets (Dayuan and Financial Town) continued to be stronger than that in mature submarkets (CBD, East Avenue and Renmin South Road) in 2016, accounting for 62% of net absorption during the year. Reasons for this pattern included: government stimulus at all levels, from district policies to national plans; the improvement of infrastructure and commercial amenities in emerging submarkets, making them more attractive to tenants; and competitive rents compared to the mature submarkets.

A rental correction, started in 2012, continued throughout 2016, with the average rent declining in both mature and emerging submarkets. However, the degree of the correction was strongest in mature submarkets, as landlords in this area competed with buildings in the emerging submarkets. This was seen in the CBD, East Avenue and South Renmin Road submarkets, where rents declined from 11-16% from 2015 levels. On average, the citywide rental rate declined by 12.0% YOY to RMB90 per sq m per month. Notably, a divergence in rental performance between buildings that are held strata-title and buildings held en bloc was seen. In some strata-titled buildings, landlords of individual floors in the same building competed against each other in certain. In buildings with single ownership, the standard of management was often more professional, which many tenants valued.
Chengdu’s office investment market was active in 2016. High-quality buildings with good accessibility and amenities were attractive to institutional investors, especially in emerging markets, where rents are relatively low and have room for growth. This was seen clearly with four en bloc sales transactions completed during the year, all in the Hi-tech Zone. Ping An Life Insurance and Hua Xia Life Insurance acquired Tower 3 (80,000 sq m) and Tower 2 (81,000 sq m) of Chengdu Yintai Centre from Yintai Group in March and June respectively for an undisclosed price. In November, Chengdu Jiayu Investment sold Tower 2 of the China Railway Trust Building, which was under construction, for an undisclosed price. In December, Shenzhen Wongtee Real Estate acquired one bloc of Global Times Centre (52,900 sq m) from Tairan Group, which was under construction, for RMB835 million.

Chengdu should continue to favour tenants for the foreseeable future given the volume of vacant space available and new supply in the pipeline. Seven Grade A office projects are scheduled for 2017, with a total GFA of more than 500,000 sq m. Four of the new projects will be located in the Financial Town submarket, two will be in East Avenue and one will be in Dayuan. As a result, rental corrections and further incentives such as rent-free periods are expected to continue in 2017. The office investment market will continue to attract investors who are confident in the city’s long-term development plans, and use the current situation to enter the Chengdu investment market.

**Retail – Demand continued active, with rental level decline**

Chengdu’s retail sales of consumer goods increased by 10.2% YOY to RMB461 billion in the first ten months of 2016, decelerating 0.3 percentage points compared with the same period of 2015, according to the Chengdu Statistics Bureau. Against this backdrop, Chengdu’s retail real estate market remained active, underpinned by continued demand from the F&B and children’s sectors. The overall vacancy rate decreased despite new supply, though rental discounts pulled down the city’s average rent. One en bloc investment transaction was announced during the year.

Chengdu’s retail property market is dominated by properties outside the traditional prime catchments, as developers focus on under-served suburban areas with available land. This trend continued in 2016, and both new projects were completed in non-prime areas. Vary International, in Wuhou district, and Qingyang Wanda Plaza, in Qingyang district, both opened in the second half of the year, adding a combined retail GFA of approximately 240,000 sq m to the city’s total stock, which increased to approximately 4.4 million sq m. Both projects were positioned as community shopping centres targeting surrounding residents. Following their completion, 87% of Chengdu’s retail property was in non-prime areas.

Demand in Chengdu’s retail property market was robust in 2016, though limited by the lack of new supply. Both new projects achieved an occupancy rate of 95% or above at opening, and dozens of new brands entered the existing projects. As a result, the average vacancy rate decreased by 3.1 percentage points YOY to 5.0% by the end of the year, or 3.3% in prime areas and 5.3% in non-prime areas.
International retailers continued to choose Chengdu as a point of entry for the southwest region. During 2016, wedding dress brand Vera Wang and Japanese designer brand Issey Miyake opened their first stores in southwest China, while Nike Air Jordan chose International Financial Centre for its largest flagship location in Asia, and lingerie brand Victoria’s Secret leased more than 2,300 sq m at The MixC for its fifth global flagship store.

Fast fashion retailers continued to expand during 2016, with new locations for well-established brands as well as emerging domestic brands. H&M’s high-end brand COS opened its second store in Chengdu at The MixC, while Uniqlo launched its 15th store at Sino-Ocean Taikoo Li, and domestic fast fashion brand Mjstyle opened three new stores in the city during 2016.

The F&B sector continued to be dynamic, with expansions by several chains and new stores by international brands. Korean fast food chain Nine Road Pizzeria opened two new locations; Korean bakery chain Paris Baguette and French bakery chain Brioche Doree both opened their first stores in Chengdu. Domestic brands were active as well. Da Niu He, a hot pot chain, opened three new stores, all in non-prime areas, while local chain Yi Ba Gu opened two new locations.

Retailers catering to children were popular with landlords during 2016, especially in non-prime areas. Children’s education and indoor entertainment brands were particularly attractive for their relatively large space requirements and ability to attract neighbourhood families. Six children’s brands opened or leased at CapitaMall Tianfu alone, including Yuyuto, Murphy’s Play House, The Little Gym and Anniekids. Retailers of children’s clothing and toys were also popular, with new openings by Toys ‘R’ Us, Kidsland and Stride Rite at The MixC.

In the supermarket category, Park’n’shop withdrew from the Chengdu market, while Greenland opened its first G-super store in southwest China at Raffles City in November (approximately 6,000 sq m), followed by a 3,000 sq m store in December at The One.

The average ground floor rent in Chengdu’s retail property market declined by 2.2% YOY to RMB499 per sq m (psm) per month, pulled down by rental discounts offered by certain landlords as well as the below-average rents at the new projects. Nonetheless, rental increases associated with internal brand and trade mix adjustments in International Finance Square and Sino-Ocean Taikoo Li pulled up the average rent in the prime area by 1.5% YOY to RMB1,174 psm per month.

In the investment market, Capitaland Retail China Trust purchased Galleria from BlackRock for approximately RMB1.5 billion in August. The 92,000 sq m project is located in the Xinnan Tiandi catchment of Hi-tech zone, with full occupancy, and became Capitaland’s sixth retail project in Chengdu.

Five new projects with a total retail GFA of approximately 379,000 sq m are scheduled for completion in 2017, all in non-prime areas. Most projects will be positioned as community shopping centres targeting surrounding residents, though Yintai Group’s Yintai Centre In99, in the Hi-tech district, will be notable for its positioning as a high-end shopping centre, catering to the growing retail needs of the Hi-tech district and Tianfu New Zone as the city expands southward.
Most landlords are expected to achieve opening occupancy rates of at least 80%, though, given the market’s low vacancy rate, this will result in a temporary increase in the vacancy rate in non-prime areas. In the prime retail market, the vacancy rate is expected to stay at or around its extremely low level, as brands compete for the limited stock in these catchments.

In the non-prime retail area, the below-average rents at several new supplies will pull down the average rent, though the above-average rent at Yintai Centre In99 and the rental growth followed by brand upgrades at several projects in 2017 will moderate this decline. In the prime retail area, the rental performance of stable projects will remain buoyant given the limited amount of retail space in this market.

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