

VACANCY RATE FELL, RENTS STABLE

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Summary & Recommendations

Chengdu's economy remained healthy in Q4 2018, and with no new completions, rent remained stable while vacancy rate declined.

- > Vacancy declined 2.7 pps qoq to 17.3%, and the high demand in the Financial Town submarket gave it the lowest vacancy rate in Chengdu.
- > We expect heavy new supply in 2019 to push up the vacancy rate, before sequential declines in 2020-2022 as supply eases.
- > The new supply in 2019 provides a good opportunity for tenants to upgrade. Landlords should adjust by improving the amenities and services provided to differentiate their offering and cope with competition.

		Q4 2018	Full Year 2019	2019-2023 Annual Average
 Demand	> Leasing demand slowed in Q4 2018, with demand mainly coming from the financial and TMT sectors.	79,904 sq m	400,000 sq m	400,000 sq m
 Supply	> With no new completions in Q4, total new supply in 2018 reached 134,542 sq m, a sharp decline from 2017. From 2019 to 2023, we expect new supply of Grade A office in Chengdu to reach 1.81 million sq m, of which new supply in 2019 should be 520,000 sq m.	0 sq m	522,000 sq m	370,000 sq m
 Rent	> We expect rent to remain stable in 2019 due to the new supply. After the supply peak in 2019, rental growth will probably resume at 2% a year over the next five years.	0.2% RMB106.3	0% RMB106.3	2.0% RMB117.3
 Vacancy	> Due to project delays, we estimate the heavy supply in 2019 will push up overall vacancy in Chengdu. As new supply falls in 2020-2023, vacancy should drop to 12.3% by 2023.	-2.7pp 17.3%	3.9pp 21.2%	-1pp 12.3%

Source: Colliers International

Note: 1 sq m = 10.76 sq ft USD1 = RMB6.85 at end Q4. "PP = percentage point". Rent = Face rent.

LEASING MARKETS AND RENTS

Demand dropped

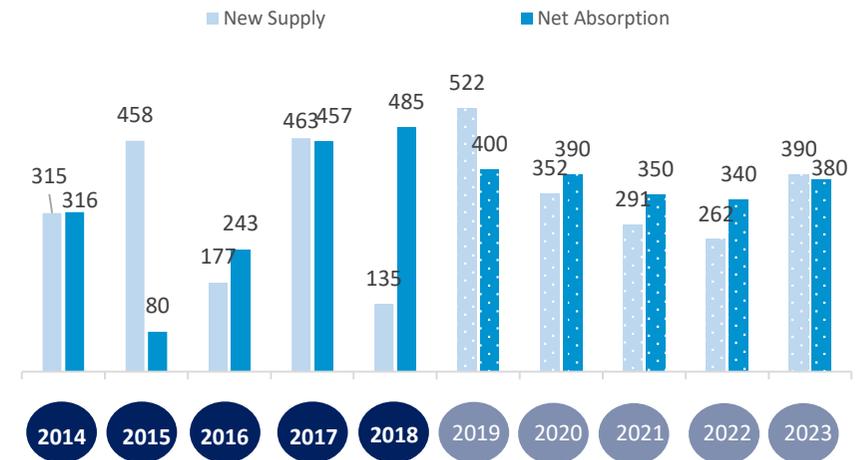
Due to project delays, no new supply was completed in Q4 2018. In 2018, total new supply reached 135,000 sq metres (1.4 million sq feet), a 70.9% yoy decline. Chengdu’s Q4 2018 leasing market slowed, as concerns about macro-economic growth weighed on sentiment, leading to a drop in demand. Net absorption was 79,900 sq metres (860,000 sq feet), which translates to a 22% qoq and a 44% yoy decline. The financial sector slowed its pace of expansion, but together with the TMT sector, remained the main source of office leasing demand in Chengdu.

Demand in the traditional CBD slowed; submarkets south of the city centre led the leasing market

The southern submarkets of Chengdu accounted for 72% of total absorption. The Dayuan submarket continued its recent active performance with the largest amount of net absorption in Q4, recording a total of 30,000 sq metres (323,000 sq feet) of leased space. This net absorption in Q4 has effectively pushed down Dayuan’s vacancy rate by 5.0pps to 22.2%. The Financial Town submarket had net absorption of 27,000 sq metres (290,000 sq feet) in Q4, second only to Dayuan. Thanks to favourable leasing terms from high-quality projects in this submarket, vacancy dropped by 6.2pps qoq to 7.7%, making it the lowest vacancy rate among all submarkets in Chengdu.

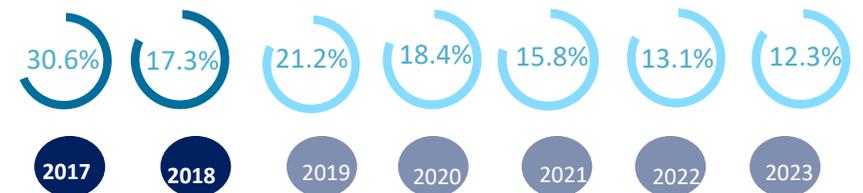
Landlords with low vacancy rates in the traditional CBD are starting to optimise the buildings’ performance by being selective in their tenant mix. The result is a lower net absorption for this area, as it only accounted for 20% of Chengdu’s total take-up. Flexible workspace operators continue to seek space in high-quality office buildings, but after a year of rapid expansion, the pace is slowing due to market saturation and difficulty in finding suitable space to expand into.

New supply & net absorption, 2014-2023F ('000 sq m)



Source: Colliers International

Vacancy rate, 2014-2023F (percentage)



Source: Baidu, Colliers International

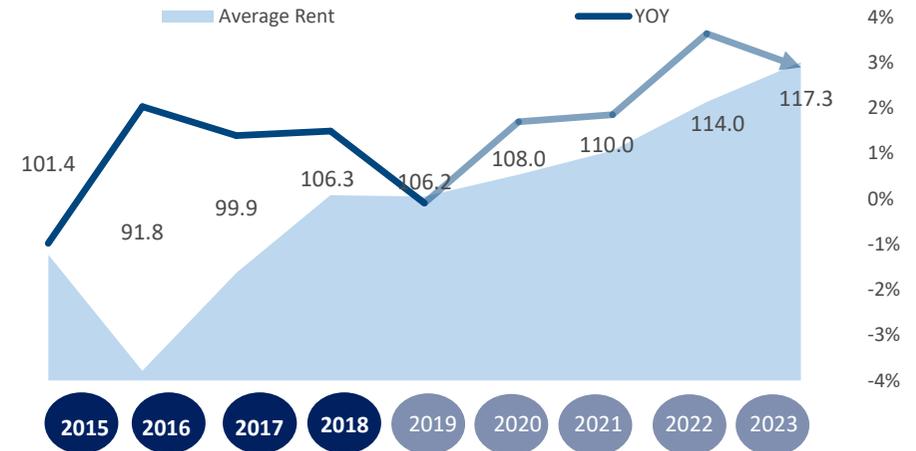
Stabilised rent

In Q4 2018, the Financial Town submarket was the only submarket to see a rental increase, its rent increased 1.2% qoq to RMB110 (USD16.1) psm per month. The city-wide rent remained stable. Considering the slowdown in market demand and the heavy new supply planned in 2019, most landlords have been conservative on rent increases, as the main focus has shifted to maintaining a stable tenant mix.

No en bloc sales transaction recorded

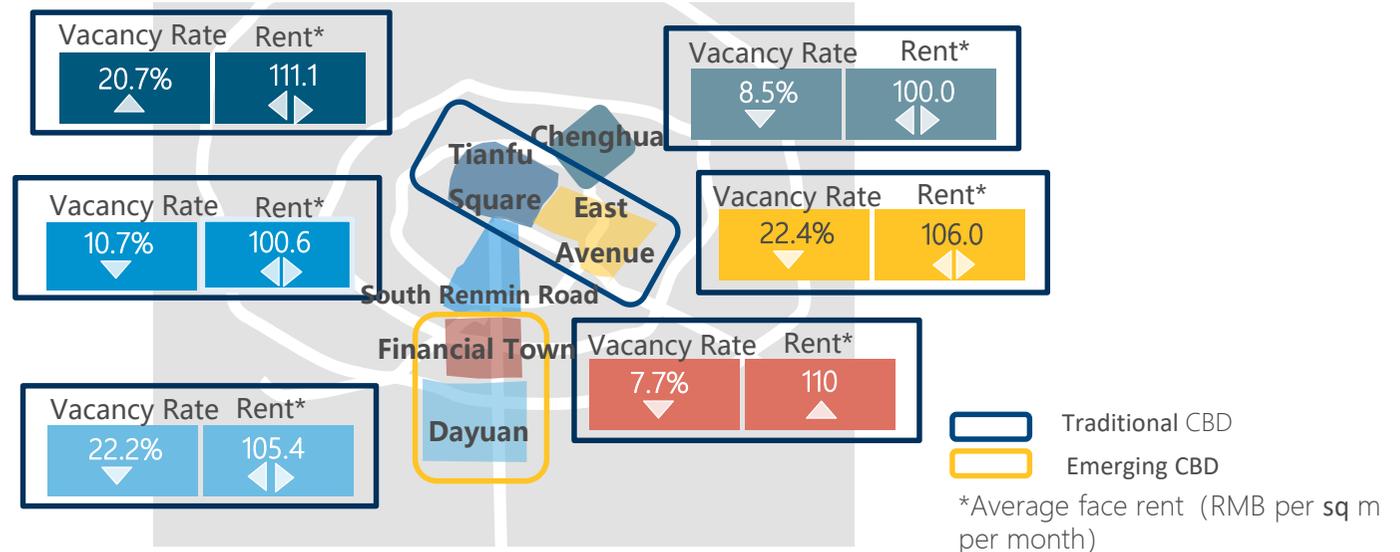
The investment market in Chengdu remained quiet in Q4, as no en-bloc transactions were recorded. However, the substantial new supply in 2019 should not only provide options for tenants, but should also increase the available assets in the market, providing more options for potential buyers. Colliers believe the southern submarkets will become a spotlight in 2019, as an influx of new supply should provide more options for tenants, while the premium rents of the new buildings should offer a higher future yield to investors.

Rent by submarket (RMB psm per month)



Source: Colliers International

Chengdu submarket overview



Source: Colliers International

OUTLOOK

Unicorn enterprises will likely lead the demand

Chengdu has made the cultivation of unicorn enterprises (unlisted startups valued at more than USD1 billion) a priority. Chengdu set the goal of cultivating more than 60 unicorn enterprises by 2022. In May 2018, the Global Unicorn Enterprise Summit Conference was held in Chengdu, meanwhile, Chengdu began to build the world's first unicorn island which shows the government's support for cultivating unicorn enterprises. Moreover, Chengdu is transforming into a cradle and hub for financial and technological innovations in western China. With these positive factors, five unicorn enterprises were born in 2018 alone. In addition, we believe Unicorn enterprises will be a driver to attract the upstream and downstream supply chains of relevant industries to Sichuan, thus providing a solid foundation for future office space absorption.

FinTech and traditional finance

Fintech may be defined as the core competitiveness of internet-based financial enterprises. Fintech is subverting traditional finance, and traditional financial institutions have taken countermeasures. In fact, China's fintech and traditional financial institutions are complementary to each other. Allowing fintech companies to return to science and technology and provide scientific and technological services to traditional financial institutions should promote the rapid and stable development of the financial sector. Since 2017, more than 30 traditional banks have begun to move into the P2P business, and in the future more [commercial banks should establish wholly-owned subsidiaries to start P2P businesses](#), which we estimate will promote Grade A office demand.

New Financial Town supply in 2019

From 2019 to 2022, we expect Grade A supply in Chengdu will reach 1.43 million sq metres (15.4 million sq feet), of which new supply in 2019 alone should be 522,000 million sq metres (5.6 million sq feet), accounting for 38% of the total. After 2019, in the subsequent four years, supply on the south side of Chengdu is scheduled to account for 36% of total supply, with most of the new space in the Financial Town submarket. The vibrant technology and finance sectors, however, should result in healthy net take-up, and rents should, therefore, remain stable.

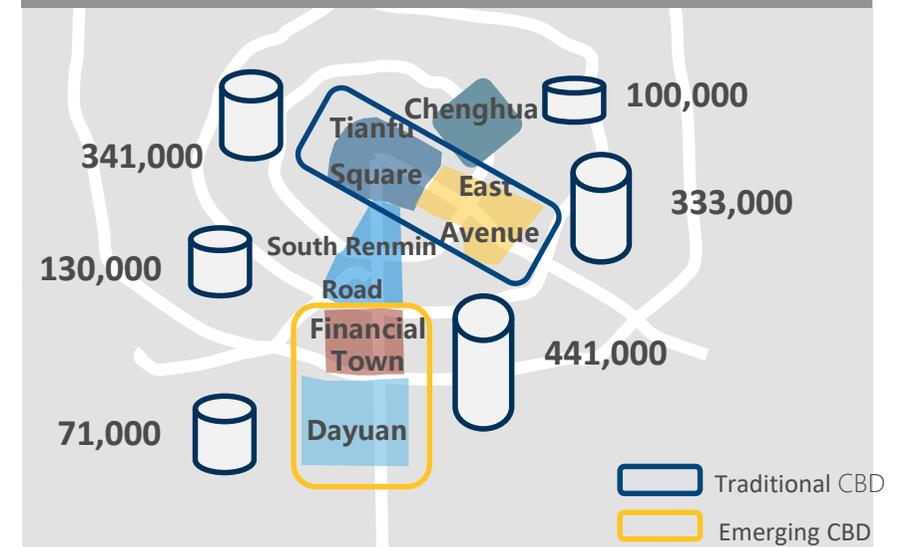
The influx of new supply in 2019 should provide tenants with more options, providing a good opportunity to expand or negotiate favourable terms with landlords. From a landlord's perspective, to stay competitive, adjustments should be made by improving the amenities and services offered.

Chengdu, major leasing transactions, Q4 2018

Property	Tenant	Industry	SQM
Jiachen International	WeWork	Co-working	6,000
Yanlord	Kr Space	Co-working	3,000
OCG	OPPO	TMT	10,000
Yintai	VIPKID	TMT	6,000

Source: Colliers International

Submarket new supply breakdown 2019-2022F (sq m)



Source: Colliers International

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