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DEMAND SLOWING, VACANCY STABLE

Summary & Recommendations

No new projects were completed this quarter. The effects of a macroeconomic slowdown and the trade war led to a drop in demand in Q2 2019. The average rent dropped slightly and vacancy remained stable.

- > In H2 2019, we expect new launches in the Dayuan and Financial City sub-markets which can offer more options for tenants interested in the City South submarket.
- > Competition among landlords should intensify in 2019, and new projects with high quality and moderate rents are likely to be most attractive to tenants. Landlords in Dayuan submarket will likely face pressure due to the huge supply, and should increase incentives to attract tenants, including increasing rent-free periods and upgrading services.

		Q2 2019	Full Year 2019	2018-23 Annual Average
 Demand	> We expect office demand to slow in 2019 as economic uncertainty led to decreased demand for expansion and relocation. We also expect demand in the next five years to come mainly from the finance, technology and real estate sectors.	 570 sq m	 150,000 sq m	 238,000 sq m
 Supply	> We expect 240,000 sq m (2.57 million sq feet) of new supply to be delivered in 2019, of which about 47% is concentrated in the Dayuan and Financial City submarkets.	 0 sq m	 240,000 sq m	 290,000 sq m
		QOQ / End Q2	YOY / End 2019	Annual Average Growth 2018-23 / End 2023
 Rent	> In 2019, we expect slower demand to weigh on the market and lower the expectations of landlords. Rising demand and high-quality new projects are likely to support a recovery in rents from 2022 onward.	 -0.3% RMB106.5	 -0.9% RMB105.8	 0.2% RMB108.0
 Vacancy	> We expect a vacancy rate rise to 18.8% by end-2019 due to the adjustment of leasing strategies. Vacancy rates are likely to peak in 2021 and gradually decline.	 0pp 15.9%	 1.5pp 18.8%	 0.0pp 17.4%

Source: Colliers International

Note: USD1 to RMB6.88 as of end-Q2. 1 sq m = 10.76 sq ft

LEASING AND RENTS

Demand decreased

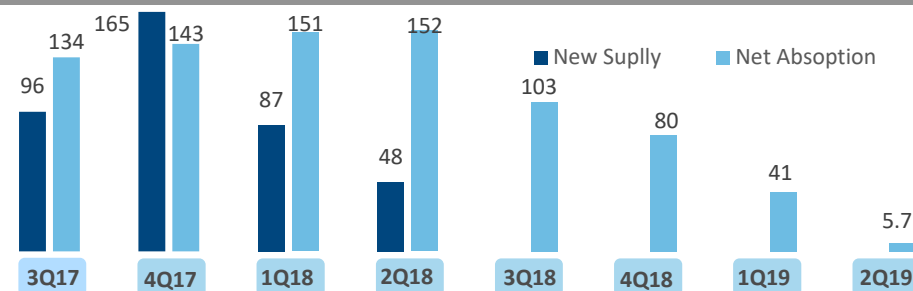
In Q2 2019, we observed a decline in inquiries from Grade A office tenants, with many tenants taking a wait-and-see approach due to economic uncertainty. Also, the effects of the trade war have led some private finance and retail trade enterprises to vacate their offices before lease expiration or reduce their leased area. In addition, we observed that some real estate companies moved to self-owned buildings, resulting in large vacancies. Therefore, net absorption in the second quarter was only 570 sq metres (6,100 sq feet).

Influenced by the macro-economic slowdown, some tenants paid more attention to controlling costs, and showed a preference for lower-rent Grade B offices. Also, flexible workspace operators, who were expanding aggressively in 2017-2018, are no longer expanding as quickly. At the same time some tenants who might have leased Grade A space are now leasing sublet space and flexible workspaces, further reducing Grade A demand. These trends led to a sharp fall in Grade A office demand this quarter. At the end of the second quarter, Chengdu's overall vacancy rate stood at 15.9%, essentially unchanged from the previous quarter.

Rent in South Renmin Road submarket dropped slightly





Some projects in South Renmin Road submarket recorded a significant increase in vacancy. Given the rising vacancy pressure, these landlords reduced their rental expectations, leading to a decline in rent of 1.5% QOQ to RMB98 per sq metre per month (USD14.2), and a city-wide average rent decline of 0.3% QOQ to RMB106.5 per square metre per month (USD15.5).

Chengdu new supply, net absorption & occupancy rate ('000 sq metres)



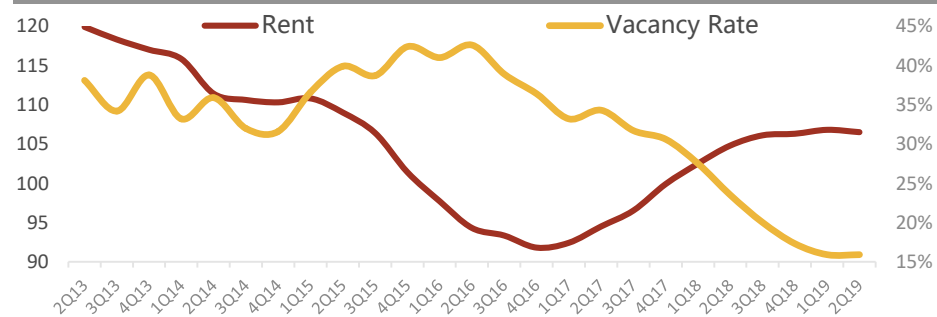
Source: Colliers International

Chengdu major leasing transactions Q2 2019

Project	Tenant	Industry	SQM
			
IFS	TEC	Co-working	2,800
Pinnacle One	Pacific Insurance	Finance	1,000
China Overseas International	AVIC Trust	Finance	720
Ping'an Finance Center	Bestseller	Costume	1,500

Source: Colliers International

Average rent and vacancy rate (RMB per sq metre per month)



Source: Colliers International

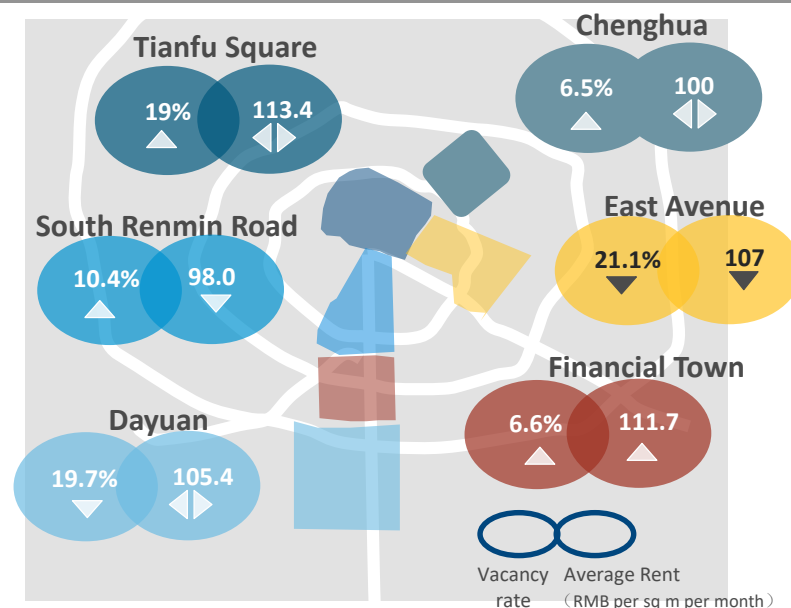
OUTLOOK

In 2019, we expect 240,000 sq metres (2.6 million sq feet) of new supply will complete, pushing the total Grade A stock to 3.2 million sq metres (34.3 million sq feet).

Slowing demand should lead to a vacancy rate of about 18.8% by year-end, leading to more intense competition among landlords and a drop in rent of a half a percentage point YOY to RMB105.8 (USD15.4) per square metre per month. We expect new projects in Tianfu New District to reach completion over the next few years, resulting in a supply peak in 2021, which will likely lead the vacancy rate in Chengdu to rise to 19.8%. Also, we expect falling supply and rising net absorption in 2022-23 to bring down the vacancy rate to 17.4% by the end of 2023.

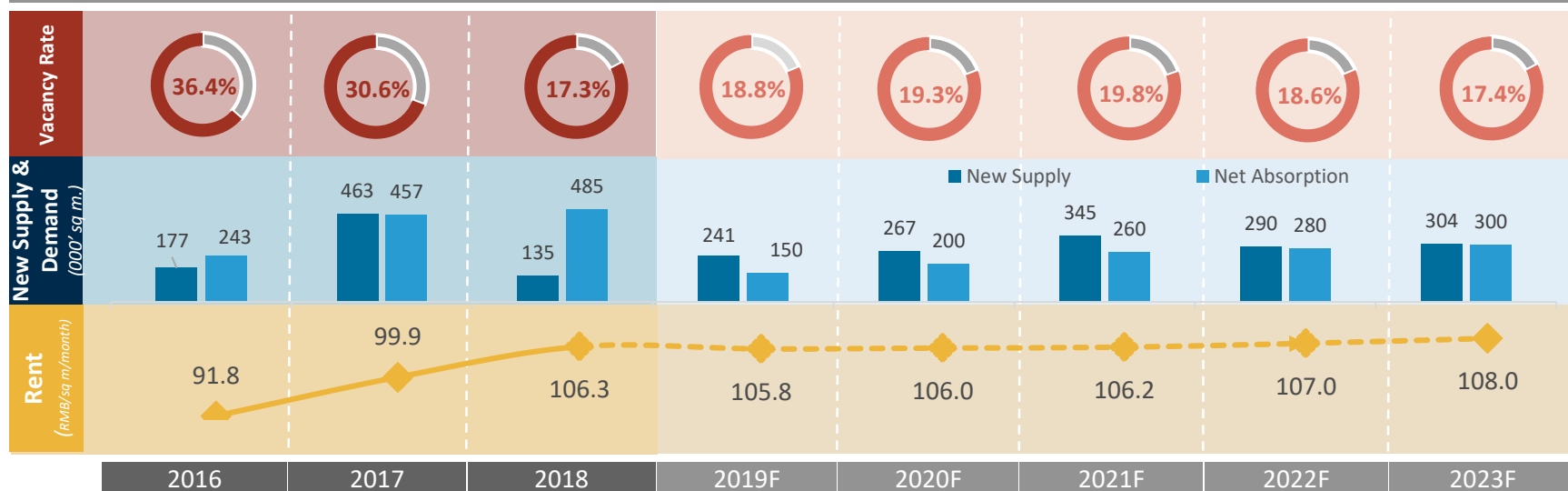
We recommend landlords to offer enhanced incentives to attract or retain tenants, such as increasing the rent-free period or increasing rental flexibility. Therefore, we suggest tenants take advantage of the increased competition in the market and the coming supply peak to obtain better lease terms.

Chengdu submarket overview



Source: Colliers International

Chengdu office market outlook



Source: Colliers International

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