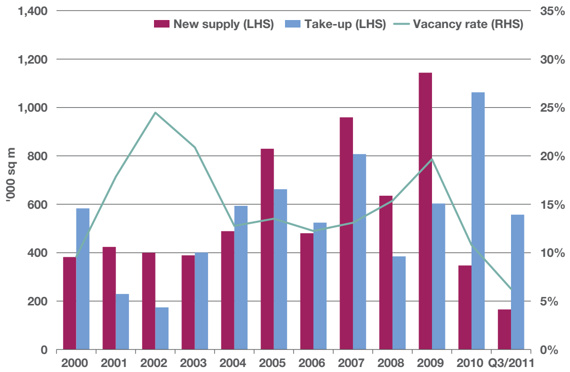
Savills Research
China

Asian Cities Report
Beijing Office

1H 2012

GRAPH 1

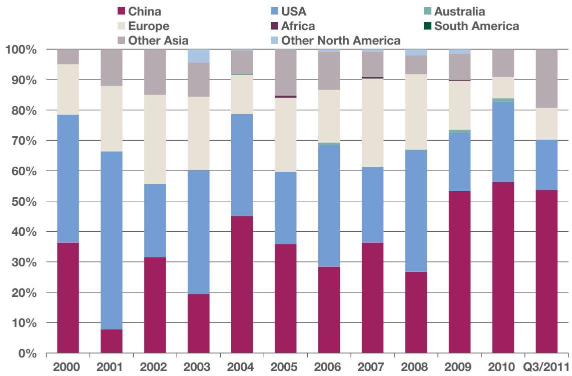
Grade A office supply, take-up and vacancy, 2000–Q3/2011



Source: Savills Research & Consultancy

GRAPH 2

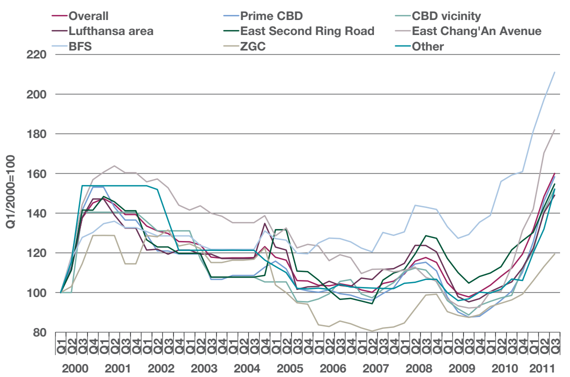
New Grade A office tenants by nationality, 2000–Q3/2011



Source: Savills Research & Consultancy

GRAPH 3

Grade A office rental index by submarket, Q1/2000–Q3/2011



Source: Savills Research & Consultancy

Supply and demand

Beijing's Grade A office market experienced a shift from a tenant-led market to a landlord-led market in 2011 due to limited new supply amid strong demand for office space. Leasable supply for 2010 and the first three quarters of 2011 stood at only 347,000 sq m and 165,400 sq m respectively. Net take-up, on the other hand, reached 1 million sq m in 2010 and 557,300 sq m in the first three quarters of 2011. As a result, the city-wide vacancy rate dropped from 19.6% at the end of 2009 to 6.3% by the end of Q3/2011.

Beijing Financial Street (BFS) represents an extreme example of demand volatility in the office leasing market. The vacancy rate in BFS fell from an eight-year peak of 16.2% in Q2/2009, to 0.5% in Q2/2011 and then climbed by 0.8 of a percentage point to 1.3% in Q3/2011. This was largely a result of tenants having difficulty in finding suitable expansion space and, subsequently, moving out of the area.

Prime CBD, where 24% of total Grade A office stock is concentrated, also witnessed its vacancy rate fall from 30.8% in Q3/2009 to 6.3% in Q3/2011.

The global financial crisis has also transformed typical tenant structures for Grade A office buildings. The share of domestic firms increased from less than 30% in 2008 to over 50% in 2011, with a larger proportion of Chinese companies leasing Grade A office space.

Rent

Rental growth has accelerated since Q3/2009 due to strong demand amid limited new supply being handed over to the market. With increasing bargaining power, landlords have been raising asking rents considerably while reducing rent-free periods and other associated incentives.

City-wide rents increased by 7.9% quarter-on-quarter to RMB258.7 per sq m per month in Q3/2011, representing a 34.1% appreciation for the first three quarters of 2011 and a 42.5% increase year-on-year.

The average rent in submarkets such as BFS and CBD reached RMB346.8 and RMB310.3 per sq m per month respectively. This represents year-on-year rental growth of 32.5% in BFS and 57.2% in CBD. Such high growth rates can be explained by both areas' popularity with firms operating in the financial sector and multinational companies. Excess demand has spilled over from core business areas to emerging districts due to limited available office space and rising rents. As a result, emerging areas have also experienced a sharp rise in rents to RMB204.9 per sq m per month at the end of Q3/2011, representing a 42.4% year-on-year increase.

Investment market

A bullish office market also saw capital values rise by 4.8% quarter-on-quarter in Q3/2011, representing a year-on-year growth of 37.9% to RMB49,575 per sq m. Such growth, however, was not sufficient to offset skyrocketing rents and, as a result, the average market gross yield edged up by 16 basis points quarter-on-quarter to 6.26%, representing a 33-basis point increase year-on-year.

The en-bloc investment sector has traditionally favoured office projects. Seven out of nine en-bloc projects transacted during the first three quarters of 2011 were office buildings, representing an overall transaction value of RMB7.53 billion. The bullish commercial leasing market, however, has lead to the reluctance of landlords to cash-out on projects and, as a result, the total en-bloc office transaction volume has fallen by 29% year-on-year in the first three quarters, while total consideration has dropped by 18.6% year-on-year.

In recent years, domestic companies, especially state-owned enterprises (SOEs), have replaced foreign investors to dominate the office en-bloc sales market. In 2011, however, SOEs closed fewer deals compared with the previous years.

Outlook

In Q4/2011, only one project is expected to be handed over onto the leasing market, adding 44,700 sq m of new supply. Total supply in the Beijing Grade A office market will remain at approximately 1 million sq m over the next three years from 2012 to 2014. The current shortage of supply is expected to ease following the completion of a number of projects located within the CBD extension area after 2014.

According to the Hudson Employment & Market Trends report, permanent hiring expectations in China fell by 8 percentage points quarter-on-quarter but remain relatively high with 64% of respondents across all sectors forecasting headcount growth in Q4/2011. According to the report, financial institutions and firms in the medical and health, high-tech energy and manufacturing industry sectors will constitute a greater share of employment demand in the market. For instance, firms such as Hewlett Packard, Daimler, Benz, General Electric and UBS have all announced intentions of setting up new branches in Beijing, while Microsoft plans to expand on its existing R&D centre.

Due to fast rental growth in the core business areas, tenants with lower budgets and large space requirements may choose to relocate to emerging business districts such as Wangjing and BDA or lower grade buildings. As a result, the Grade A office vacancy rate is expected to drop to around 5.1% then climb slightly to around 5.9% by the end of 2013.

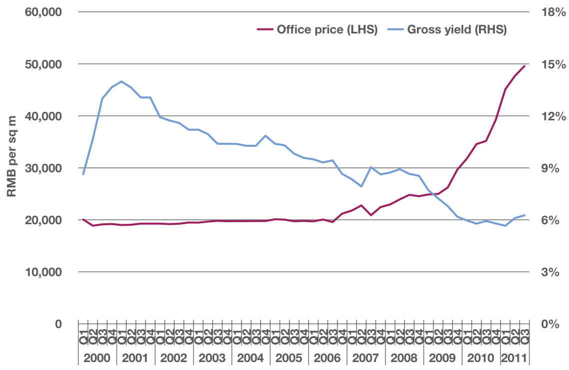
Regardless of expected demand over the next two years, rental appreciation will be supported by scarce supply.

Rental levels by the end of 2013 are expected to lie within a range of RMB335 to RMB379 per sq m per month, representing an expected growth rate of 25% to 35%.

Lack of investment opportunity has been a major feature since the start of 2011 and will continue to characterise the en-bloc sales market in the next year. Insurance companies, a strong source of underlying investment demand, will keep a prudent attitude on prime commercial property investment in Beijing. The tightening of credit and the introduction of residential cooling policies in 2011 also limited credit availability for developers, while a slowdown in the residential market curbed revenue generation putting developers under great financial pressure. This is expected to lead to greater deal availability for opportunistic investors.

GRAPH 4

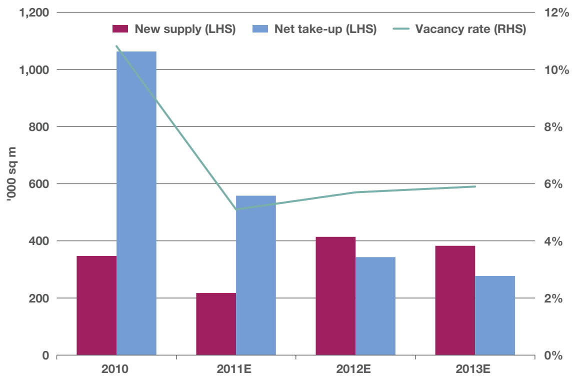
Grade A office price vs yield, Q1/2000–Q3/2011



Source: Savills Research & Consultancy

GRAPH 5

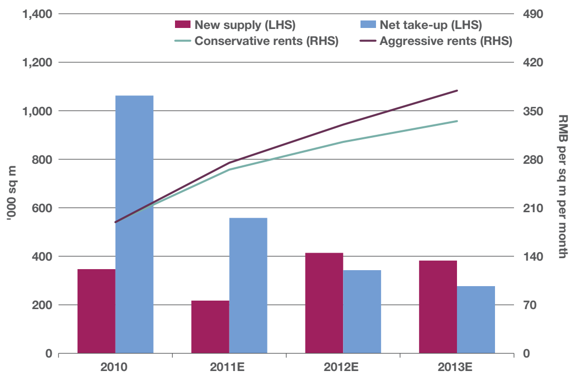
Grade A office supply, take-up and vacancy rate, 2010–2013E



Source: Savills Research & Consultancy

GRAPH 6

Grade A office supply, take-up and rent, 2010–2013E



Source: Savills Research & Consultancy

ASIA PACIFIC HEADQUARTERS

23/F Two Exchange Square, Central, Hong Kong
Tel: (852) 2842 4400   Fax: (852) 2868 4386

Robert McKellar - CEO, Asia Pacific
Raymond Lee - CEO, Greater China
Chris Marriott - CEO, South East Asia
Charles Chan - MD, Valuation & Professional Services, Greater China

HONG KONG SAR

Savills (Hong Kong) Limited
23/F Two Exchange Square , Central, Hong Kong
Tel: (852) 2842 4534   Fax: (852) 2869 6738
Contact: Raymond Lee   E-mail: rlee@savills.com.hk
EA Co. Licence: C-002450

Savills Valuation and Professional Services Limited
28/F Two Exchange Square, Central, Hong Kong
Tel: (852) 2801 6100   Fax: (852) 2501 5810
Contact: Charles Chan   E-mail: ccchan@savills.com.hk
EA Co. Licence: C-023750

Savills Property Management Holdings Limited
8/F Cityplaza One, 1111 King's Road, Taikoo Shing, Hong Kong
Tel: (852) 2534 1628   Fax: (852) 2508 1883
Contact: Johnnie Chan   E-mail: jckchan@savills.com.hk
EA Co. Licence: C-002993

Savills Guardian (Holdings) Limited
7/F Cityplaza One, 1111 King's Road, Taikoo Shing, Hong Kong
Tel: (852) 2512 1838   Fax: (852) 2887 3698
Contact: Peter Ho   E-mail: peterho@savillsguardian.com.hk

MACAU SAR

Savills - Macau
Savills (Macau) Limited
Suite 1309-10, 13/F Macau Landmark, 555 Avenida da Amizade, Macau
Tel: (853) 8506 6288   Fax: (853) 2878 1805
Contact: Franco Liu   E-mail: fliu@savills.com.mo

CHINA

Savills - Shanghai
20/F Shanghai Central Plaza, 381 Huaihai Middle Road, Shanghai 200020, China
Tel: (86) 21 6391 6688   Fax: (86) 21 6391 6699
Contact: Albert Lau   E-mail: Albert.Lau@savills.com.cn

Savills - Beijing
2101 East Tower, Twin Towers, B-12 Jianguomenwai Avenue, Chaoyang District
Beijing 100022, China
Tel: (86) 10 5925 2288   Fax: (86) 10 5925 2299
Contact: Billy Chau   E-mail: Billy.Chau@savills.com.cn

Savills - Guangzhou
Room 906, R & F Centre, 10 Hua Xia Road, Zhu Jiang New Town
Guangzhou, 510623, China
Tel: (86) 3892 7168   Fax: (86) 3892 7030
Contact: Woody Lam   E-mail: Woody.Lam@savills.com.cn

Savills - Shenzhen
Unit A, 5/F, Anlian Plaza, 4018 Jintian Road, Futian District, Shenzhen 518026, China
Tel: (86) 755 8828 5707   Fax: (86) 755 8828 5676
Contact: Woody Lam   E-mail: Woody.Lam@savills.com.cn
Offices in Chengdu, Chongqing, Dalian, Hangzhou, Shenyang, Tianjin, Xiamen, Zhuhai

ASIA

Savills - Japan
Savills Japan Co., Ltd.
CR Kamiyacho Building 10F, 1-11-9 Azabudai, Minato-ku,
Tokyo 106-0041, Japan
Tel: (81) 3 5562 1700   Fax: (81) 3 5562 1705
Contact: Christian Mancini   E-mail: cmancini@savills.co.jp

Savills - Korea
Savills Korea
11/F Seoul Finance Center, 84 Taepyungro-1-ga
Chung-gu, Seoul, Korea 100-768
Tel: (82) 2 2124 4201   Fax: (82) 2 2124 4188
Contact: Moonduck Kim   E-mail: mdkim@savills.co.kr

savills.com

Savills - Malaysia
Savills Rahim & Co
Level 17, Menara Uni. Asia, 1008 Jalan Sultan Ismail, 50250
Kuala Lumpur, Malaysia
Tel: (60) 3 2691 9922   Fax: (60) 3 2691 0096
Contact: Robert Ang   E-mail: robertang@savillsrahim-co.com

Savills - Singapore
Savills (Singapore) Pte Ltd.
30 Cecil Street, #20-03 Prudential Tower, Singapore 049712
Tel: (65) 6836 6888   Fax: (65) 6836 2668
Contact: Chris Marriott   E-mail: cjmarriott@savills.asia

Savills - Taiwan
Savills (Taiwan) Limited
17F-1, Exchange Square, 89 Sung Ren Road
Xin-Yi District, Taipei, Taiwan
Tel: (886) 2 8789 5828   Fax: (886) 2 8789 5929
Contact: Cynthia Chu   E-mail: cchu@savills.com.tw

Savills - Thailand
Savills (Thailand) Limited
26/F Abdulrahim Place, 990 Rama IV Road
Silom, Bangrak, Bangkok 10500, Thailand
Tel: (66) 2 636 0300   Fax: (66) 2 636 0339
Contact: Robert Collins   E-mail: robertc@savills.co.th

Savills - Viet Nam
Savills Vietnam Ltd. Co.
18/F, Fideco Tower, 81-85 Ham Nghi Street
District 1, Ho Chi Minh City, Vietnam
Tel: (84) 8 3823 9205   Fax: (84) 8 3823 4571
Contact: Brett Ashton   E-mail: bashton@savills.com.vn
Office in Hanoi

AUSTRALIA

Savills - Australia
Savills (Aust) Pty Ltd.
Level 7, 50 Bridge Street, Sydney, Australia
Tel: (61) 2 8215 8888   Fax: (61) 2 8215 8899
Contact: Paul McLean   E-mail: pmclean@savills.com.au
Offices throughout Sydney, Parramatta, Liverpool, Canberra, Melbourne, Notting Hill, South East Melbourne, Adelaide, Perth, Brisbane, Gold Coast and Sunshine Coast.

NEW ZEALAND

Savills - New Zealand
Barfoot & Thompson
Level 5, 50 Kitchener Street, Auckland, New Zealand
Tel: (64) 9 307 5523   Fax: (64) 9 303 1689
Contact: Peter Thompson   E-mail: peter@barfoot.co.nz

NORTH AMERICA

Savills - New York
Savills LLC
599 Lexington Avenue, 36th Floor, New York, NY 10022
Tel: (1) 212 328 2800   Fax: (1) 212 328 2828
Contact: John D. Lyons   E-mail: jlyons@savills.com

UNITED KINGDOM / EUROPE / SOUTH AFRICA

Savills - Europe
20 Grosvenor Hill, London W1K 3HQ, U.K.
Tel: (44) 207 499 8644   Fax: (44) 207 495 3773
Contact: Jeremy Helsby   E-mail: jhelsby@savills.com
Offices throughout the United Kingdom, Belgium, France, Germany, Hungary, Italy, Netherlands, Poland, Spain and Sweden. Associate offices in Austria, Greece, Norway, Portugal, Russia, Turkey and South Africa.

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