Leasing and investment fall sharply but recovery already underway

+0.4%

GDP

(Q2 2022, Y-o-Y)

-4.6%

Retail Sales

(Q2 2022, Y-o-Y)

+4.2%

Fixed Asset Investment

(Q2 2022, Y-o-Y)

Source: National Municipal Statistics Bureau, CBRE Research, Jul 2022

Executive Summary

- **Office:** New office supply in the 18 major cities tracked by CBRE reached 627,000 sq. m. in Q2 2022, representing a decline of 56% q-o-q. Lockdowns weighed on leasing activity over the quarter, with nationwide net absorption falling 74% q-o-q and 88% y-o-y to 260,000 sq. m. Weaker demand pushed up nationwide office average vacancy by 0.2 pps to 21.8%. Rents declined in all 18 cities, dragging down the nationwide average rental index by 0.5% q-o-q.
- **Retail:** 850,000 sq. m of new shopping mall supply was completed nationwide in Q2 2022, with most new projects concentrated in tier 2 cities that were relatively unaffected by the pandemic. Nationwide net absorption stood at just 270,000 sq. m, a decline of 44% m-o-m and 87% y-o-y. The overall nationwide retail vacancy rate climbed by 0.4 pps to 7.8%. Ground floor shopping mall rents fell 0.5% q-o-q to RMB 19.4 per sq. m. per day.
- **Logistics:** Logistics net absorption totalled 880,000 sq. m., an increase of 19% q-o-q and well above the 237,000 sq. m. registered at the onset of the pandemic in Q1 2020. The impact of COVID-19-related measures on the logistics sector continued to be limited, ensuring the nationwide logistics rental index edged up by 0.1% q-o-q. With national container throughput reaching new highs in June and express delivery volume rebounding swiftly in May, CBRE expects warehouse demand to pick up rapidly in Q3 2022.
- **Investment:** Commercial real estate investment totalled 49.6 billion RMB in Q2 2022, a decline of 2% q-o-q and 51% y-o-y. During H1 2022, commercial real estate investment exceeded RMB 100 billion, a fall of 35% y-o-y but 4.3% higher than the volume recorded in the same period of 2020.

FIGURE 1: Quick Statistics

Office	q-o-q	y-t-d	y-o-y
Rent	-0.5%	-0.5%	-0.5%
Vacancy	-0.2 pps	-0.3 pps	-0.7 pps
Retail	**q-o-q**	**y-t-d**	**y-o-y**
Rent	-0.5%	+0.2%	+0.2%
Vacancy	+0.4 pps	+0.1 pps	+0.1 pps
Logistics	**q-o-q**	**y-t-d**	**y-o-y**
Rent	+0.1%	+1.0%	+1.3%
Vacancy	+0.7 pps	+1.8 pps	+2.0 pps
Investment	**q-o-q**	**y-t-d total, y-o-y**	**y-o-y**
Total volume	-2.0%	-35.3%	-50.7%

*Transactions include deals above US$10 million in the office, retail, mixed, industrial, hotel and other commercial sectors
Source: CBRE Research, Q2 2022.

Economy

GDP growth slides to 0.4 y-o-y but recovery underway

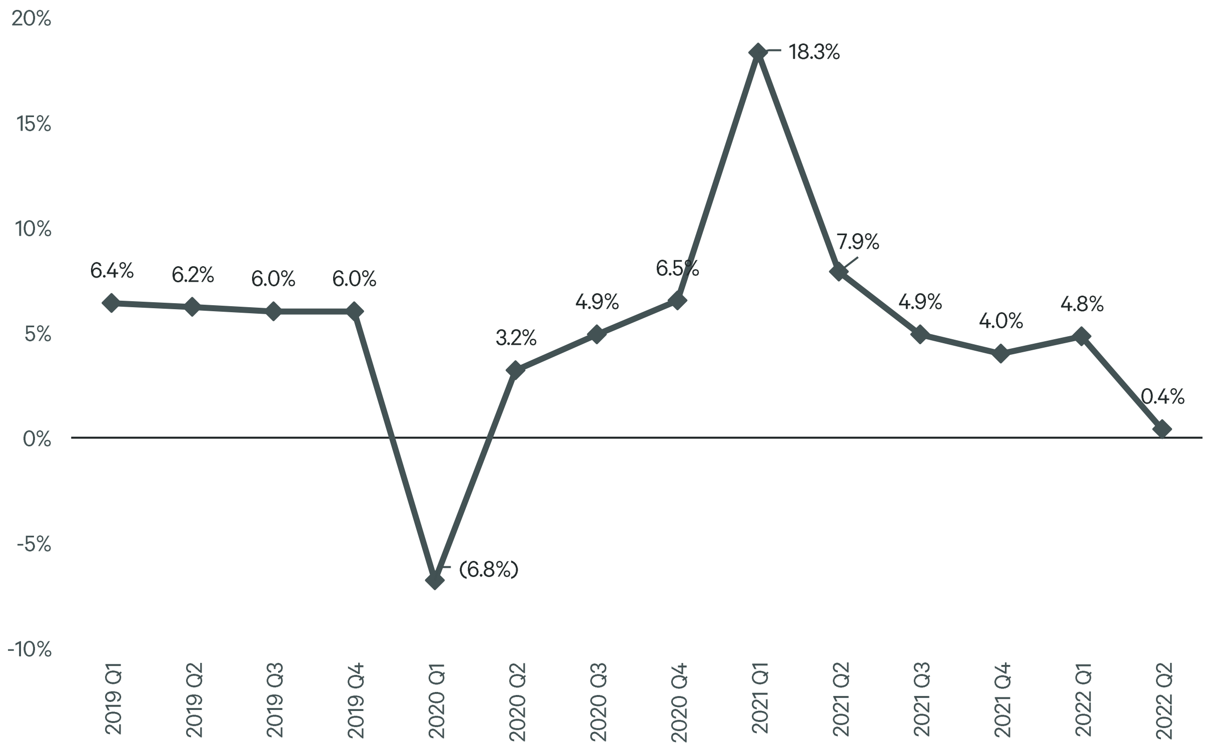
China's Q2 2022 economic data revealed the extent of the impact of the government's lockdown measures in April and May to contain an Omicron-driven surge in COVID-19 infections.

GDP growth slowed significantly to 0.4% y-o-y and fell 2.6% between the first and second quarters, marking the second lowest quarterly output since China instituted economic reforms some four decades ago. GDP in Shanghai and Beijing contracted by 13.7% y-o-y and 2.9% y-o-y, respectively.

With the gradual lifting of lockdown restrictions at the end of May and government incentives taking effect, all key economic indicators registered strong improvement in June. Growth of fixed asset investment accelerated from 4.6% y-o-y in May to 5.6% y-o-y in June; retail sales registered growth of 3.1% y-o-y; and export growth picked up to 17.9% y-o-y.

The recovery of the property development sector lagged the economic rebound, with declines in development investment, new construction starts and land purchasing all widening in June. After local authorities eased curbs in the residential market, sales grew by 65% m-o-m in June but remained 22% below the same period of 2021.

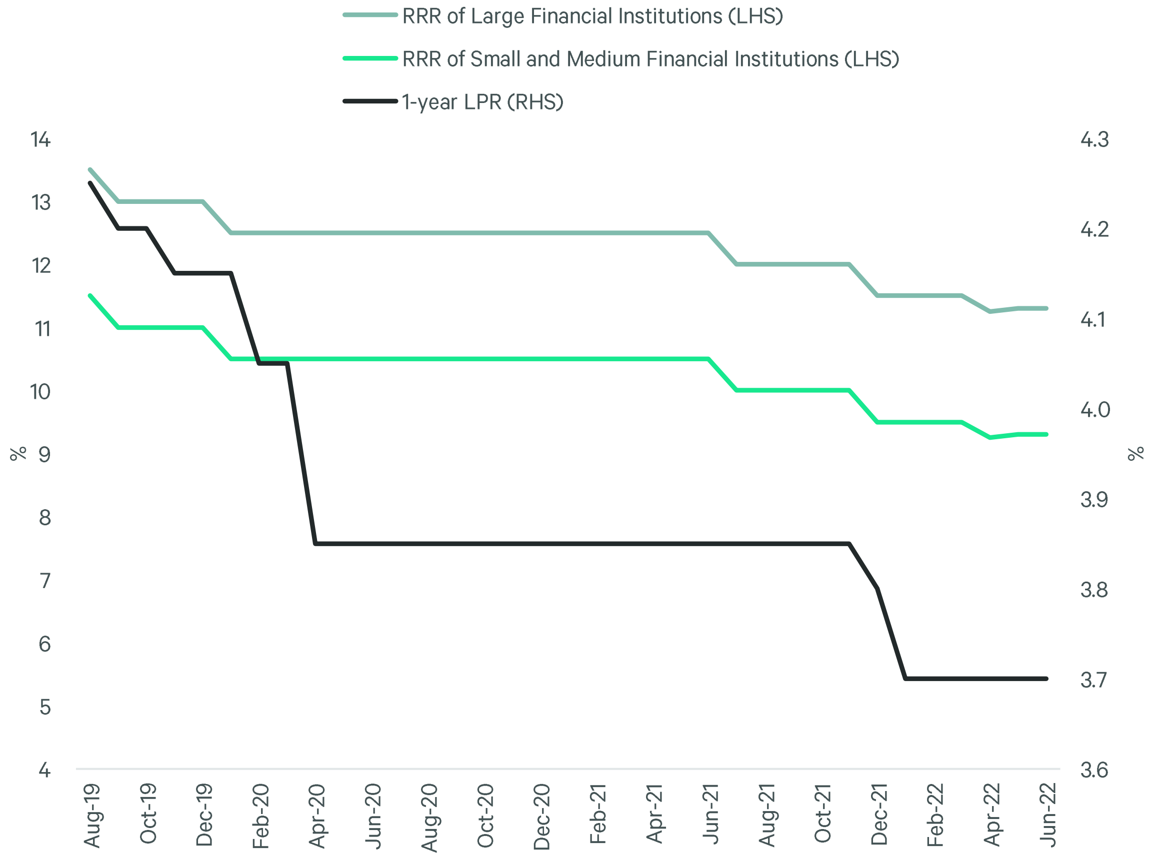
FIGURE 2: China GDP Growth (%, Y-o-Y)



Source: National Statistics Bureau, Q2 2022

The impact of the People's Bank of China's (PBoC) countercyclical measures began to appear towards the end of Q2 2022. The increase in total social financing hit a record high RMB 5.2 trillion in June, including RMB 2.8 trillion worth of new loans, 33% higher than the same period of last year. The volume of new medium-and-long term corporate loans was RMB 610 billion greater than June 2021, reflecting rising confidence among enterprises.

FIGURE 3: Reserve Requirement Ratio (RRR) and 1-year Loan Prime Rate (LPR)



Source: PBoC, CBRE Research, Q2 2022

Office

Net Absorption -87.8% y-o-y

Vacancy -0.7 pps y-o-y

Rent -0.5% y-o-y

Demand slows amid latest COVID-19 wave but performance eclipses 2020

New office supply in the 18 major cities tracked by CBRE reached 627,000 sq. m. in Q2 2022, representing a decline of 56% q-o-q. The fall was primarily a consequence of restrictions to contain the pandemic. Lockdowns also weighed on leasing activity over the quarter, with nationwide net absorption in the 18 major cities registering a decline of 74% q-o-q and 88% y-o-y and falling 260,000 sq. m.

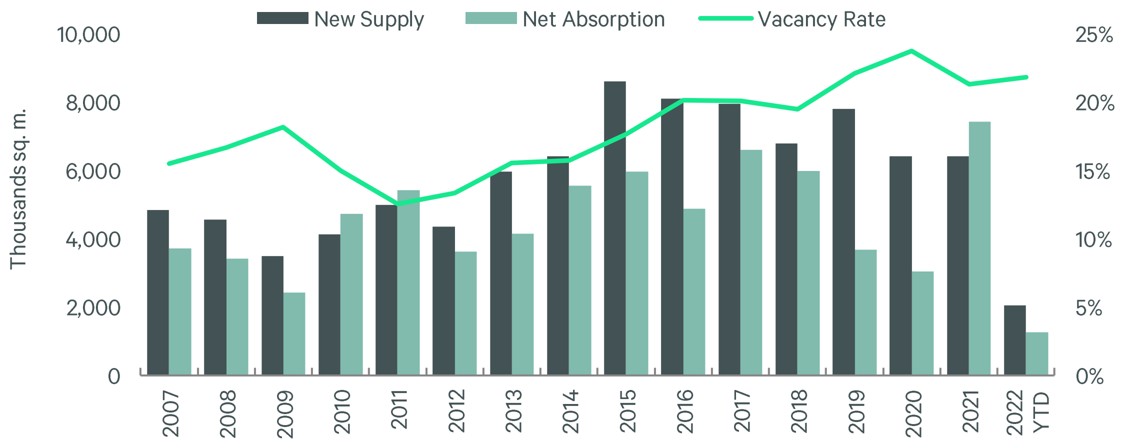
Demand in Beijing and Shanghai decreased significantly due to the impact of strict lockdowns. Net take-up in Beijing turned negative for the first quarter since 2020, while new expansionary demand in Shanghai was less than 20% of the figure for Q1 2022. Compared with the -33,000 sq. m. of net absorption recorded in Q1 2020 following the onset of the pandemic, demand was far more resilient this quarter. Grade A offices outperformed the Grade B segment, contributing 85% of total demand.

Finance emerges as main demand driver; TMT demand expected to rebound

Nationwide office leasing volume shrank by 14% q-o-q and 32% y-o-y in Q2 2022. Demand from non-banking financial institutions including securities firms and funds was resilient, ensuring finance replaced TMT as the largest demand driver, accounting for 26% of leasing volume over the quarter.

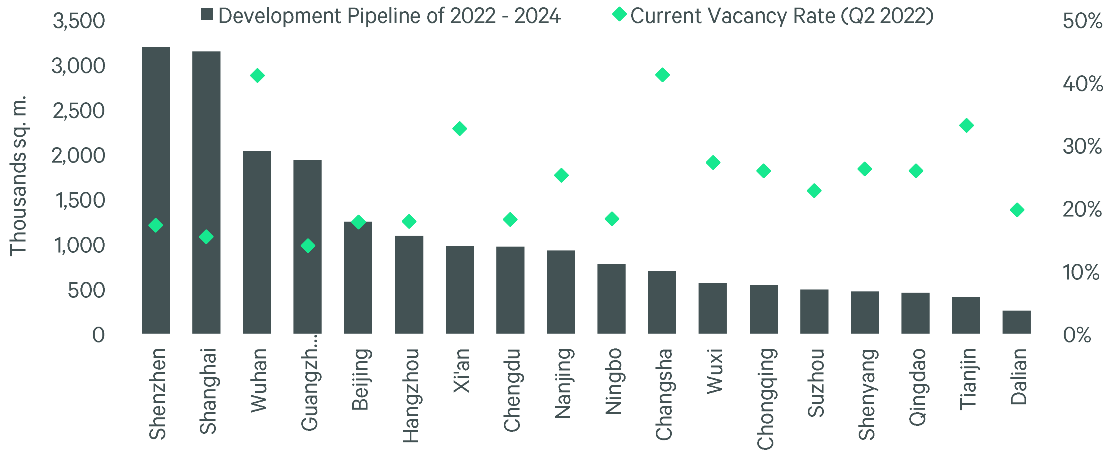
Asset Management Association of China data show the number of institutions that submitted applications for private equity fund manager registration and the institutions for processing approval increased by 64% y-o-y and 36% y-o-y, respectively, in the first five months of 2022. Beijing and Shanghai contributed over 50% of leasing volume from the finance industry, despite both cities having been significantly impacted by the pandemic.

FIGURE 4: China Office New Supply, Net Absorption and Vacancy Rate



Source: CBRE Research, Q2 2022

FIGURE 5: Vacancy Rate and Development Pipeline



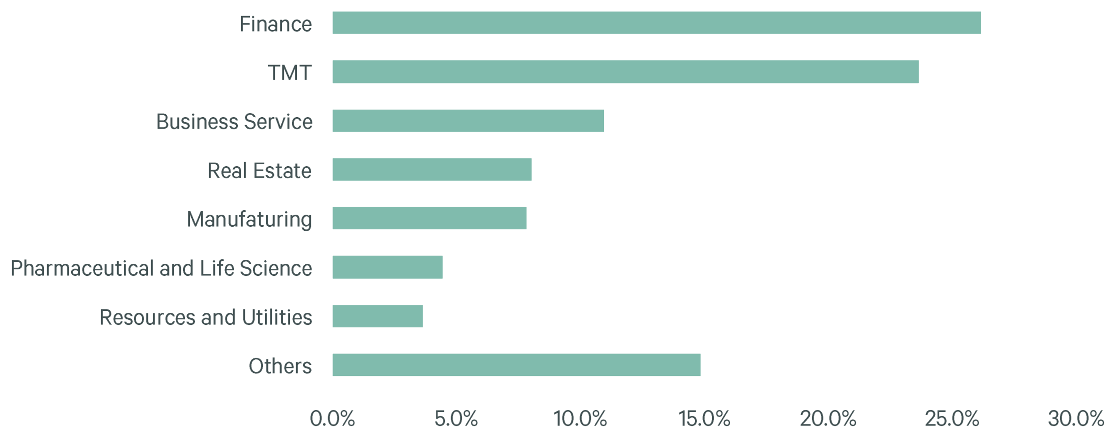
Source: CBRE Research, Q2 2022

TMT leasing demand fell by 21% q-o-q and 49% y-o-y as the industry continued to consolidate. However, a few subsectors including artificial intelligence and enterprise software services displayed some expansionary demand. Since the government announced in April that it would strengthen promotion of the platform economy, several cities have introduced related policies to support the development of the Metaverse. Office leasing demand from the TMT industry is therefore expected to recover and rebound gradually in H2 2022.

Demand from booming industries such as energy and chemicals grew by 50.4% y-o-y in Q2 2022, with pharmaceuticals and life sciences companies especially active.

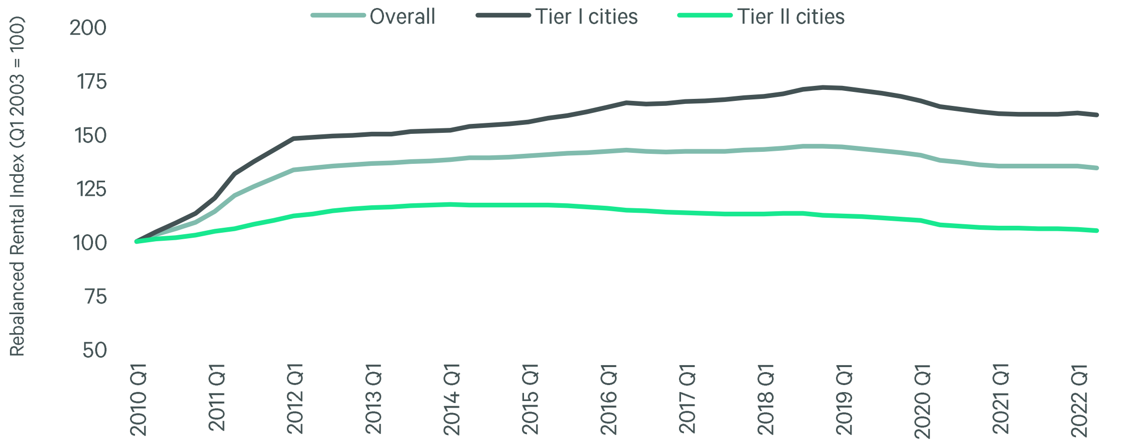
Weaker demand pushed up nationwide office average vacancy by 0.2 pps to 21.8%. Rents declined in all 18 major cities tracked by CBRE, dragging down the nationwide average rental index by 0.5% q-o-q over the quarter.

FIGURE 6: Proportion of Leased Office Space by Industry



Note: Office leasing transactions include new set up, expansion, relocation and upgrading
Source: CBRE Research, Q2 2022

FIGURE 7: China Office Rental Index



Note: Face Rent
Source: CBRE Research, Q2 2022

Retail

Net Absorption -29.8% y-o-y

Vacancy -0.6 pps y-o-y

Rent +0.3% y-o-y

Consumer market feels strain of lockdowns

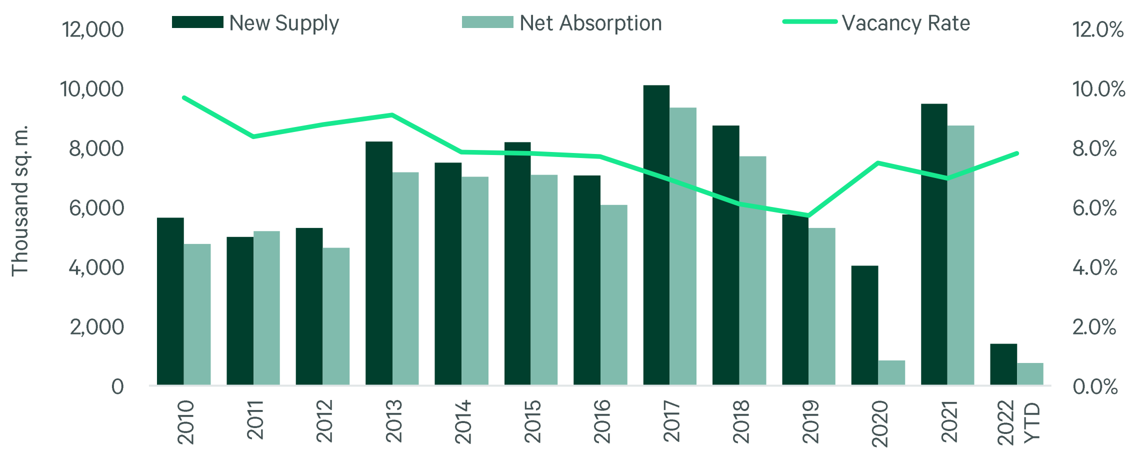
Lockdowns to contain an Omicron-driven surge in COVID-19 infections in several major cities weighed on consumption in Q2 2022, with total retail sales of consumer goods falling by 4.6% y-o-y. However, June brought a strong recovery, with sales rising by 3.1% y-o-y and 0.53% m-o-m.

While F&B revenue fell by 4.0% y-o-y due to rigorous anti-pandemic measures, overall sales eclipsed those for the same period of 2020 by 4.9 pps.

Demand weakens but still better than two years ago

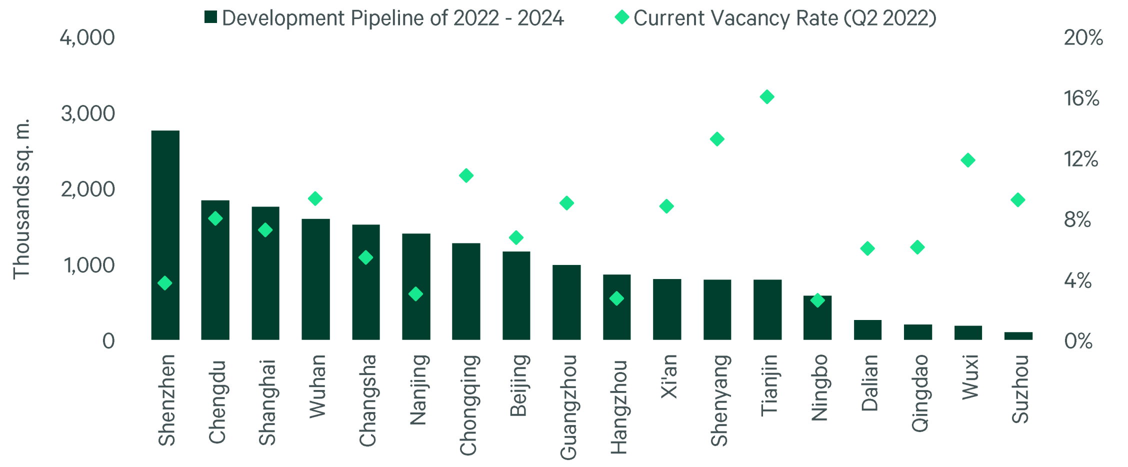
Around 850,000 sq. m of new shopping mall supply was completed nationwide in Q2 2022, with most new projects concentrated in tier 2 cities that were relatively unaffected by the pandemic. Nationwide net absorption stood at just 270,000 sq. m this quarter, a decline of 44% m-o-m and 87% y-o-y. However, this still exceeded levels witnessed at the onset of the pandemic, when two consecutive quarters of net absorption were recorded in H1 2020. Tier I cities that were severely affected by lockdown measures all recorded negative absorption this quarter, with demand in Shanghai contracting the most, falling by -100,000 sq. m. The overall nationwide retail vacancy rate climbed by 0.4 pps to 7.8% in Q2 2022. Ground floor shopping mall rents fell 0.5% q-o-q to RMB 19.4 per sq. m. per day.

FIGURE 8: China Retail New Supply, Net Absorption and Vacancy Rate



Source: CBRE Research, Q2 2022

FIGURE 9: Vacancy Rate and Development Pipeline

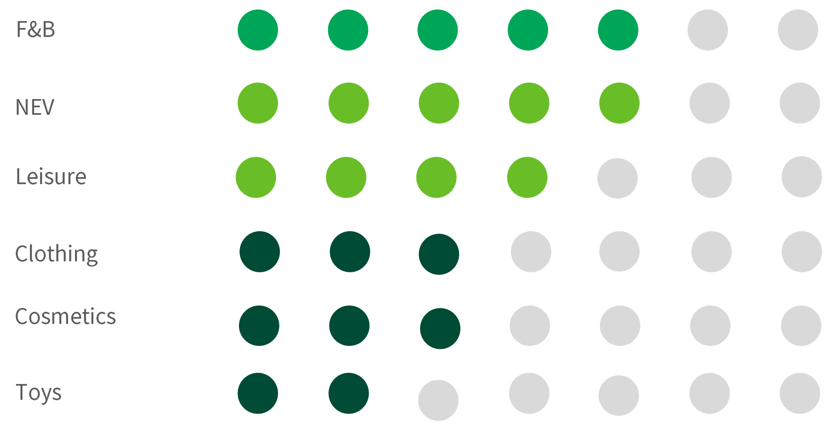


Source: CBRE Research, Q2 2022

NEV, sportswear and beverage retailers continue to expand

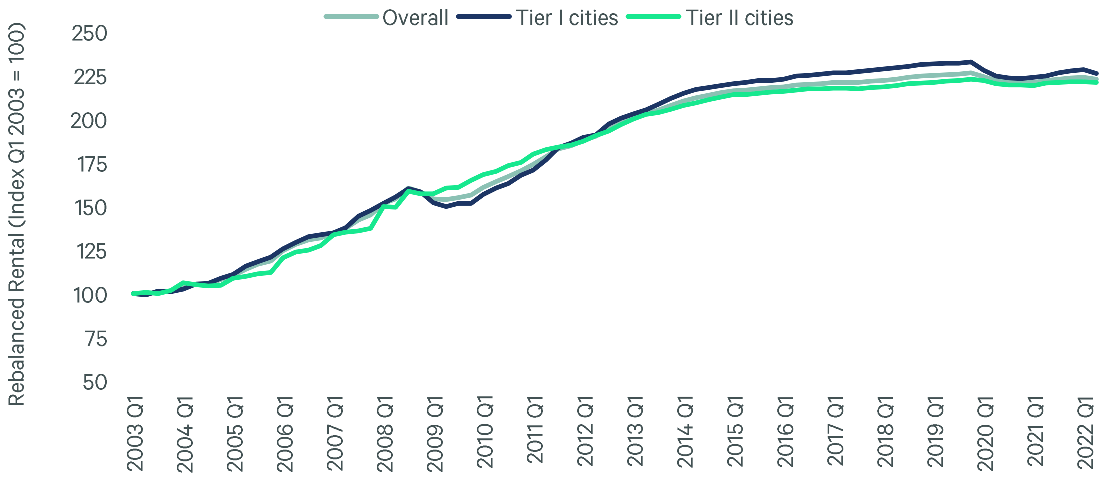
Backed by government incentives, New Energy Vehicle (NEVs) manufacturers displayed solid expansionary demand over the quarter. Strong nationwide NEV sales, which grew by 120% in H1 2022, underpinned the opening of more than 100 new stores across major cities in the first six months of the year. In addition to new NEV brands, legacy car companies such as Ford and Cadillac are also entering the sector. Sports brands continued to open new stores, with many such retailers filling large spaces vacated by departing fast fashion brands. Lululemon opened six new stores in China in June, while outdoor sports brands such as KOLON sport, Burton, and Penfield also launched new shops. Beverage retailers, primarily coffee and tea sellers which continue to attract large sums of venture capital, were also in expansion mode this quarter. Luxury and lifestyle groups continue to open branded cafés to entice consumers with coffee, dessert and a space to socialise. During the quarter, the world's first Maison Margiela Café opened in Sino-Ocean Taikoo Li in Chengdu.

FIGURE 10: New Store Opening Momentum by Trade Category



Source: CBRE Research, Q2 2022

FIGURE 11: China Shopping Mall Ground Floor Rental Index



Note: Asking rent
Source: CBRE Research, Q2 2022

Logistics

Net Absorption
-43.2% y-o-y

Vacancy
+2.0% y-o-y

Rents
+1.3% y-o-y

Demand remains resilient

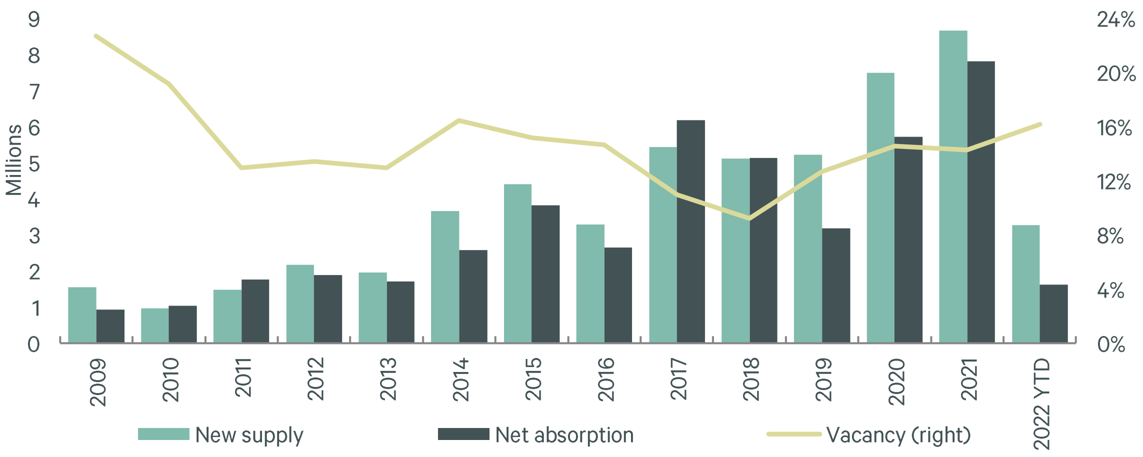
Logistics net absorption totalled 880,000 sq. m. in Q2 2022, an increase of 19% q-o-q and well above the 237,000 sq. m. registered at the onset of the pandemic in Q1 2020. The impact of COVID-19-related measures on the logistics sector continues to be limited.

Foreign trade (import and export) rebounded strongly over the quarter, rising 0.1% y-o-y, 9.6% y-o-y and 14.3% y-o-y in April, May, and June, respectively. Exports increased by 1.9% y-o-y, 15.3% y-o-y and 22% y-o-y in April, May, and June, respectively. Although local outbreaks have occurred in the Yangtze River Delta (YRD), the Pearl River Delta (PRD) and Northeast China since the beginning of this year, all regions displayed an upward growth trend in May and June.

Exports in the YRD, PRD and Northeast China grew by 4.8% y-o-y, 2.8% y-o-y and 12.2% y-o-y, respectively, in May, and rose by a further 14.9% y-o-y, 6.4% y-o-y and 12.8% y-o-y, respectively, in June. Foreign trade in Shanghai, which was most affected by measures to contain the pandemic, returned to growth in June, rising by 9.6% y-o-y and 35.6% m-o-m.

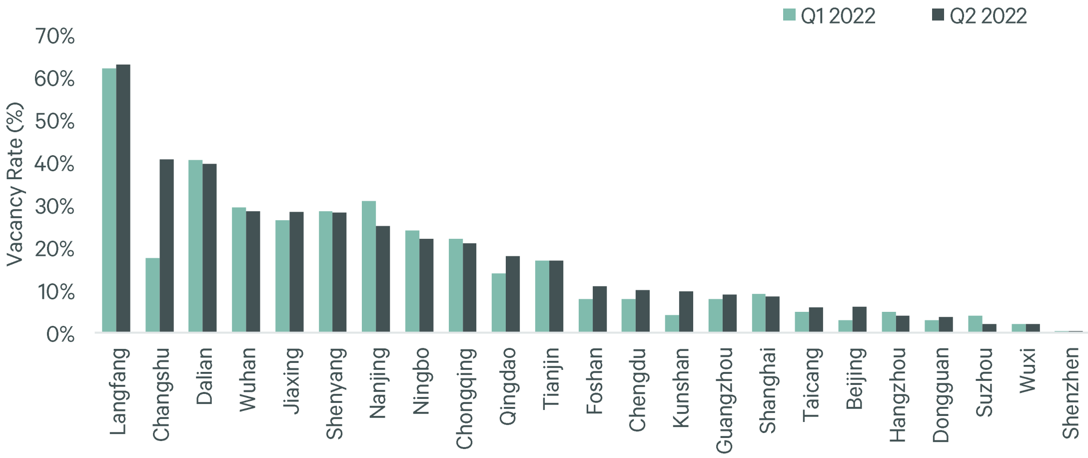
China's online retail sales of physical goods grew by 5.6% y-o-y in H1 2022, comfortably above the 0.7% y-o-y decline in total retail sales. The online share of physical goods sales reached 25.9%, an increase of 1 pps over Q1 2020's figure. Online sales of physical goods grew by 14.3% and 8.2% y-o-y in May and June, respectively, much higher than China's total retail sales of -6.7% and 3.1% y-o-y, respectively.

FIGURE 12: China Warehouse Net Absorption, Completions and Vacancy (million sq. m.)



Source: CBRE Research, Q2 2022

FIGURE 13: Logistics Vacancy Rate



Source: CBRE Research, Q2 2022

E-commerce and 3PLs account for over 70% of new leases

E-commerce and 3PLs remained the major drivers of logistics demand, contributing 41% and 33% of new leases, respectively, in Q2 2022. Online grocery platforms expanded aggressively in Shanghai during the lockdown, mostly via short-term leases, while supply chain re-organisation propelled leasing activity in Ningbo and Jiaxing. Robust demand by manufacturers was observed in Chongqing, Wuhan, Guangzhou and Tianjin.

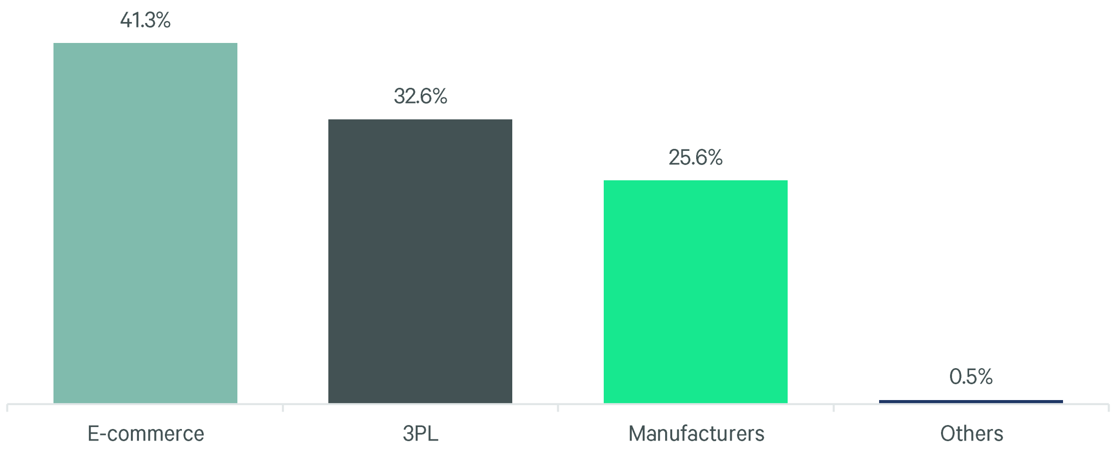
New supply in tier I and satellite cities stimulates demand

New supply totaled 1.62 million sq. m in Q2 2022, a figure on par with Q1 2022's total. New supply rose in tier I markets over the quarter. Two thirds of pipeline projects due to come on stream in Q2 2022 were postponed, leading to a supply peak in H2 2022. Just 15% of new supply this quarter was located in Guangzhou and Shenzhen, which remain short of space. 40% of new stock added in Q2 2022 was located in satellite cities such as Tianjin, Langfang, Jiaxing and Dongguan, driving up demand in these areas. Total vacancy increased 0.7 pps q-o-q to 16.2%, while vacancy in tier I cities remained low at 6.7%.

Nationwide rents increase steadily

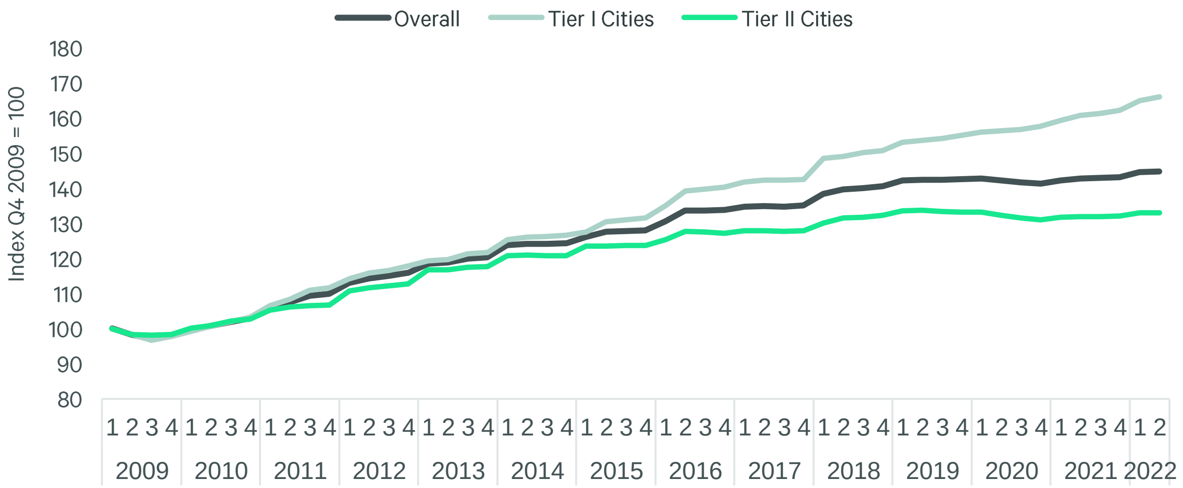
CBRE's China nationwide logistics rental index edged up by 0.1% q-o-q in Q2 2022. Rents in East China continued to rise amid tight availability, while landlords' strategy to prioritise occupancy over rents led to q-o-q rental decline in both Langfang and Wuhan.

FIGURE 14: Proportion of Leased Logistics Space by Industry in Q2 2022



Source: CBRE Research, Q2 2022

FIGURE 15: China Industrial Rental Index



Source: CBRE Research, Q2 2022

Investment

Investment Turnover
-50.7% y-o-y

Investment Turnover
-2.0% q-o-q

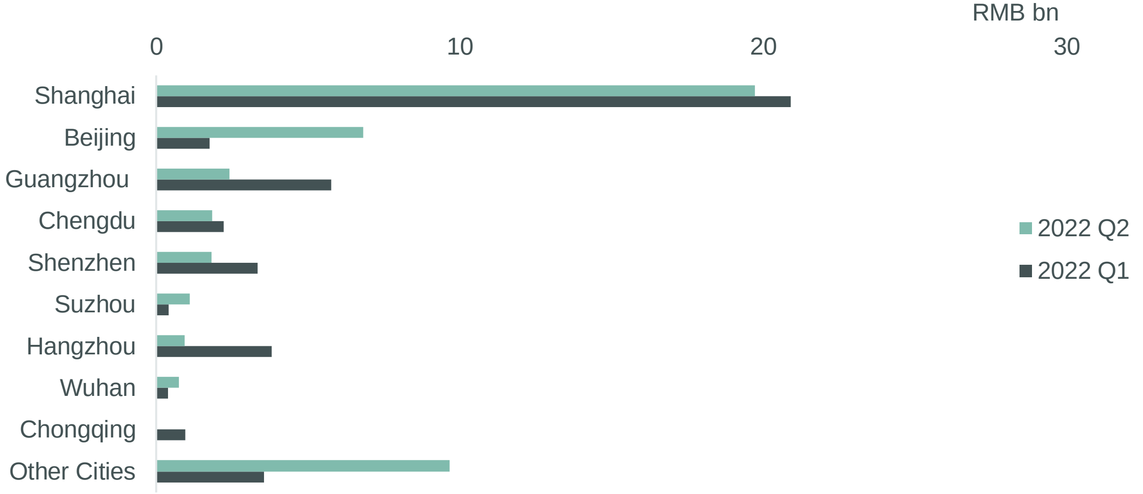
Investors eye new economy real estate; office deals rise in Beijing and Shanghai

Commercial real estate investment totalled 49.6 billion RMB in Q2 2022, a decline of 2% q-o-q and 51% y-o-y. During H1 2022, commercial real estate investment exceeded RMB 100 billion, a fall of 35% y-o-y but 4.3% higher than the volume recorded in the same period of 2020. Despite its prolonged lockdown, Shanghai remained investors' preferred market, with over 40 billion RMB worth of investment deals completed in the first half of the year. The city's high liquidity, large volume of investible assets and robust long-term economic fundamentals continue to attract a broad range of investors.

Cross-border investment spiked by 185% q-o-q in Q2 2022, accounting for 29% of total transaction volume, the highest since the onset of the pandemic in Q1 2020. Stronger inbound investment was accompanied by a rising appetite for sectors associated with the new economy, such as logistics, cold storage, science parks and multifamily, as well as an extension of focus from coastal urban clusters to key hubs in central and western regions. Key transactions this quarter included Link REIT's acquisition of three warehouses in Jiaxing and Changshu; NWS's purchase of a portfolio of six warehouses in Chengdu and Wuhan; and Keppel DC REIT's acquisition of two data centres in Jiangmen.

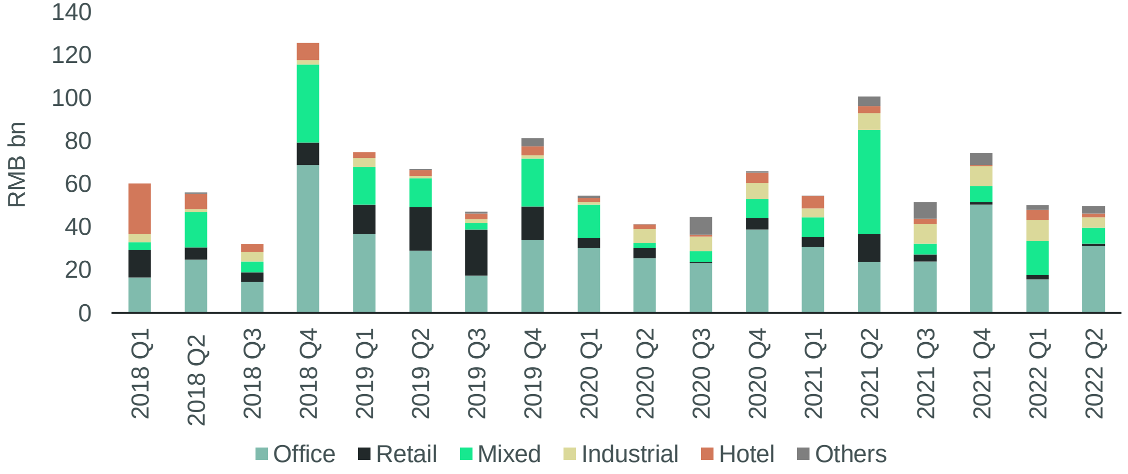
Office transaction volume grew by 70% q-o-q and 15% y-o-y this quarter, 79% of which was contributed by Shanghai and Beijing. During Q2 2022, enterprises from the finance, TMT, logistics and energy industries acquired several prime office buildings in Shanghai for headquarters use. Deals included Erdos Group purchasing Suhe Centre; CZ Bank buying Greenland Chuangyi Building; and Zhonggu Logistics purchasing Shanghai Kaisa Financial Centre. Elsewhere, Ping'an acquired Rayzone, a Grade A office building in Beijing's Lize district.

FIGURE 16: Transaction Volume by Market y-o-y



Source: CBRE Research, RCA , Q2 2022; Transactions include deals above US$10 million in the Office, Retail, Mixed, Industrial, Hotel and Other commercial sectors.

FIGURE 17: Transaction Volume by Sector

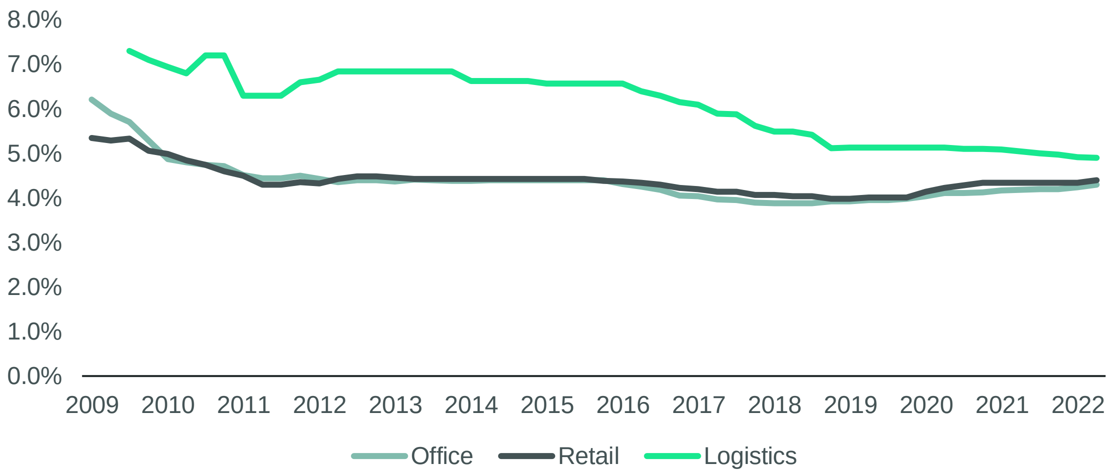


Source: CBRE Research, RCA , Q2 2022

Expiring debt and weak residential sales continued to compel highly-leveraged developers to offload commercial real estate assets during the quarter, with total sales fetching more than RMB 30 billion. Other activity included CDH partnering with Longey to acquire a distressed portfolio from Founder Group, comprising of eight real estate projects in Chengdu, Kunming, Hangzhou and Yancheng.

Owing to short-term weakness in office and retail leasing fundamentals, office and retail cap rates are likely to expand over the next six months, with overall expansion set to be in the range of 5 to 10 bps due to the lower cost of borrowing. In contrast, logistics cap rates are projected to drop further based on the resilient leasing market and strong capital flows.

FIGURE 18: Tier I Cities Average Net Yields



Source: CBRE Research, RCA, Q2 2022

Outlook

OFFICE

China's Service Purchasing Managers Index (PMI) rebounded sharply to 54.3% in June, with 19 of 21 industries surveyed recording higher business activity, indicating a rebound in the service industry. CBRE expects office leasing demand to recover in Q3 2022 as pandemic prevention and control normalises. Nationwide net absorption is forecasted to reach 2.5 - 3 million sq. m. in H1 2022, representing growth of 100% on H1 2022, and approaching 75% of H2 2021's figure.

4 million sq. m. of new supply is expected to come on stream in H2 2022, ensuring the market continues to favour tenants. Rents in most cities will continue to decline in H2 2022, with the nationwide office rental index forecasted to fall by 1.2% for the full-year compared to 3.9% in 2020. Rents in core CBDs are expected to be more resilient.

RETAIL

With daily new nationwide COVID-19 cases falling to less than 1,000 by the end of May, most cities have entered a stage of normalised prevention and control. In June, the passenger flow of the Beijing-Shanghai subway returned to 60% of levels prior to the Omicron-driven surge in infections. CBRE expects retail leasing activity to experience a long and drawn-out recovery, with policies requiring mall capacity to be limited to 50%-75% as well as a 90-minute limit on dwell time set to weigh on retailers' expansion plans in the short-term. Nationwide net absorption in H2 2022 is expected to reach around 2.8 million sq. m, comparable to the same period of 2020. Shopping mall rents will experience downward pressure in the short-term as landlords focus on maintaining and improving occupancy. The bifurcation of rents based on landlords' operational expertise will widen further as the pandemic intensifies a survival of the fittest. CBRE expects nationwide ground floor shopping mall rents to drop by 0.4% in H2 2022.

LOGISTICS

With national container throughput reaching new highs in June and express delivery volume rebounding swiftly in May, CBRE expects warehouse demand to pick up rapidly in Q3 2022. The ever-present threat of a resurgence in COVID-19 cases and related lockdowns will continue to support growth in online shopping, which should translate into more warehouse demand. CBRE expects warehouse demand to surge to 4.5 million sq. m. in H2 2022, an increase of 180% from the first half of the year.

Despite a short-term peak in supply in H2 2022, the strong rebound in demand will continue to drive up rents. CBRE expects nationwide rents to increase by 0.5% h-o-h, with tier I and satellite cities continuing to take the lead.

INVESTMENT

CBRE expects investment volume to increase by 10-15% in H2 2022 compared to the first six months of the year, in line with the economic recovery. Investors' short-term focus will remain on new economy real estate. CBRE advises investors seeking countercyclical opportunities to identify potential office and retail acquisitions in prime locations of tier I cities, as capital values in these areas have now fallen by 15% to 20% from their peak and are likely to bottom out when leasing demand rebounds in 2023.

Rental Cycle

FIGURE 19: China Office Rental Cycle Q2 2022

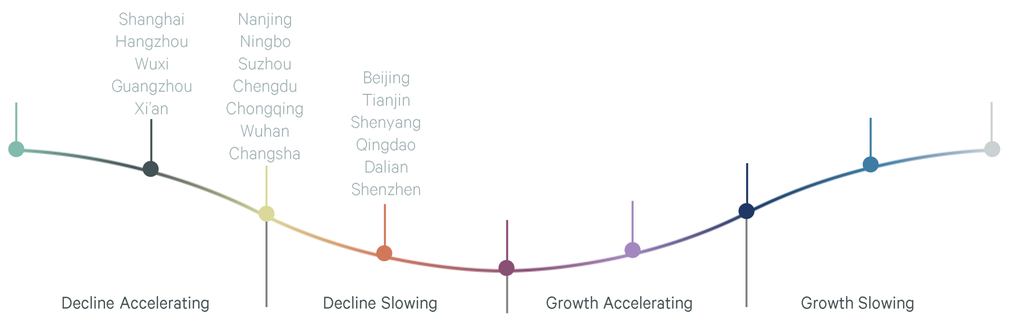
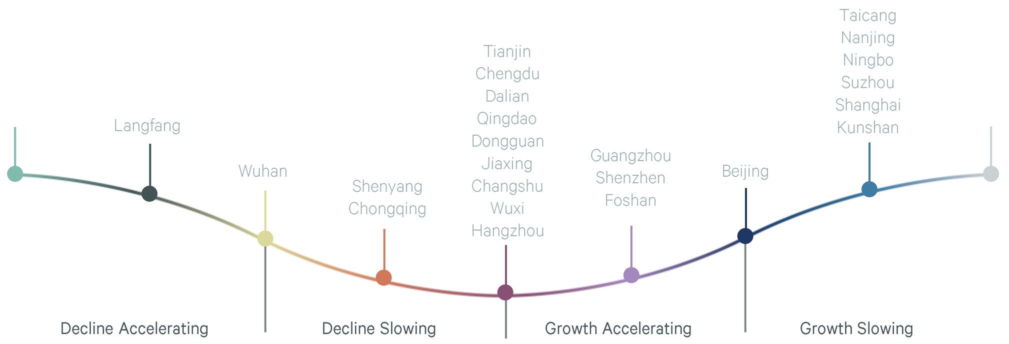


FIGURE 20: China Shopping Mall Ground Floor Rental Cycle Q2 2022

FIGURE 21: China Logistics Rental Cycle Q2 2022



Source: CBRE Research, Q2 2022

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