Q3 2018: China Commercial Property Monitor

Market momentum subdued, but remains positive despite trade concerns

Q3 of 2018 saw momentum across China's commercial property market slow but remain positive. Most cities are still seen as being in the expansionary phase of the current cycle, with the exception of Shanghai. Although concerns over the potential impact of the trade war did not have a substantial impact on the occupier market in Q3, it does appear that tighter credit conditions are taking hold in certain cities such as Beijing.

Occupier Market

- The Occupier Sentiment Index (an amalgamated measure of occupier market indicators) stayed fairly level at +4 in Q3 vs +5 in Q2 (Chart 1), indicating stalled momentum in the occupier market.
- Occupier demand increased at a modest rate for the second consecutive quarter. Like in Q2, this was primarily driven by the office segment as occupier demand for industrial and retail properties was little changed.
- There was a sharp increase in the availability of office properties to rent, particularly in Guangzhou. Shanghai and Beijing both saw an increase in retail space available to let. Given this backdrop, there was a modest increase in inducements at the national level for office and retail properties.
- Headline development starts were flat in Q3 as an increase in office starts was offset by a decline in industrial starts. Nationally, respondents in Beijing reported a sharp drop in development starts while those in Guangzhou reported an increase.
- Chart 2 shows that rents are seen rising over the next three months, though this is largely confined to the office segment. However, rents are still seen rising across all market segments (office, industrial, retail) over the next twelve months.
- As indicated by Chart 6, respondents expect rents on prime properties to increase over the next year. Respondents in Guangzhou had a particularly lofty outlook for rents on prime office and retail properties, which are seen increasing by 12.5% and 6.9%, while in Shanghai prime industrial properties are expected to see a 4.6% increase in rents over the next year.

Investment Market

- The Investment Sentiment Index (an amalgamated measure of occupier market indicators) fell to +8 in Q3 from +15 in Q2 (Chart 1), indicating subdued investment market momentum.
- Investor demand increased in Q3, but at a slower pace than in Q2. Foreign demand was flat for the second consecutive quarter, though contributors did note an increase in foreign interest in Guangzhou office space.
- There was an increase in office and retail properties available for sale at the national level. After posting a sharp drop in availability in Q2, the availability of industrial properties for sale was unchanged in Q3.
- Credit conditions at the national level were evenly distributed, as shown in Chart 3. However, in Beijing, 71% of respondents reported some degree of deterioration in credit conditions.
- Chart 4 shows that valuations were skewed towards being expensive for the second consecutive quarter. This was seen as being slightly more acute in first-tier cities compared to smaller markets.
- Headline capital values are expected to rise across the prime market segments (office, industrial, retail) over the next three and twelve months. Chart 5 shows that contributors broadly revised forecasts over the next year lower in Q3, but still expect prime property values to increase.
- Nationally respondents were split on the phase of the cycle, with 52% signalling that the market was in some phase of a downturn and 44% indicating that the market was in an upturn. At the city level, Shanghai is seen as being at a more mature phase of the cycle, while other cities are still seen as being in an upturn.

Commercial Property Market

Chart 1: Occupier, Investment Sentiment Indexes

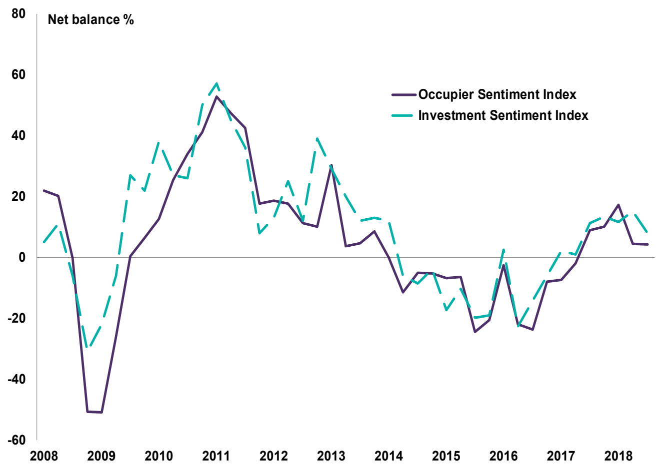


Chart 2: 3-month Rents, Capital Values

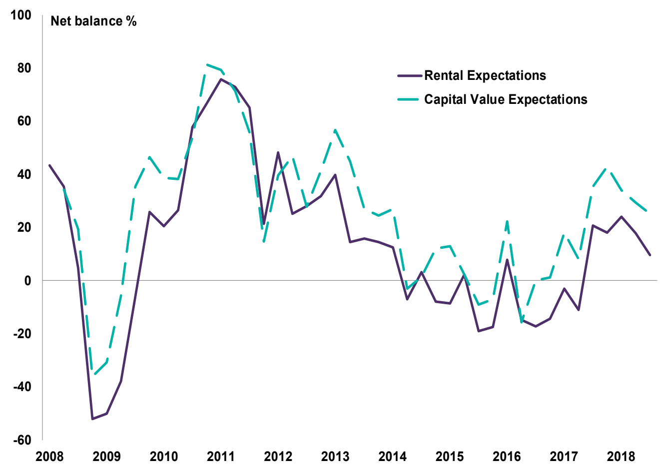


Chart 3: Credit Conditions

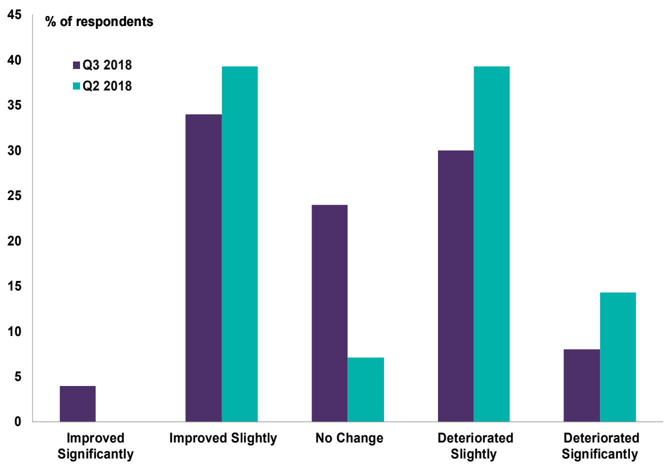


Chart 4: Valuations

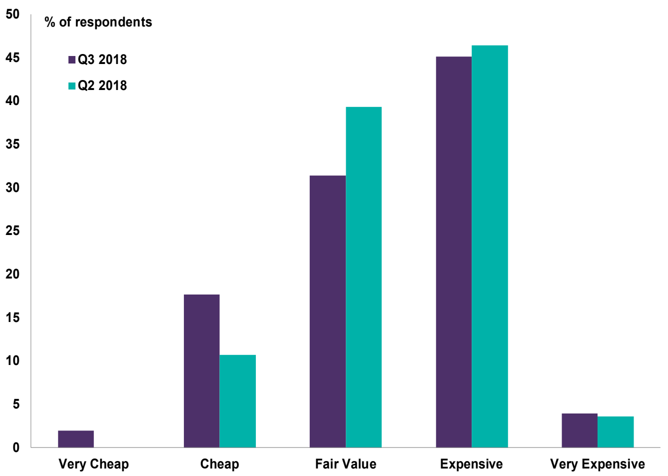


Chart 5: 12-month Capital Values Forecast

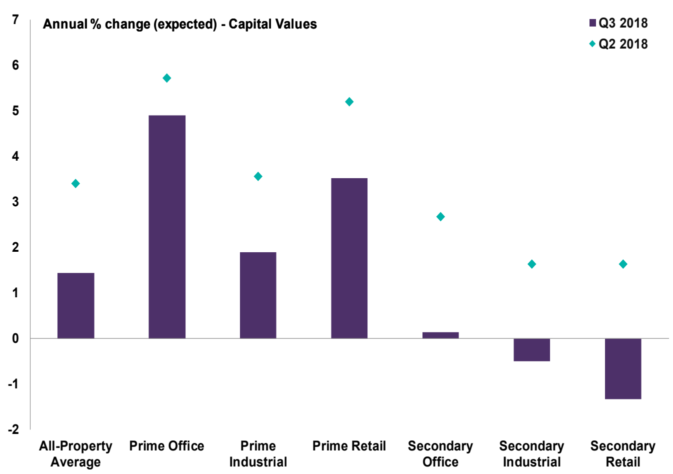
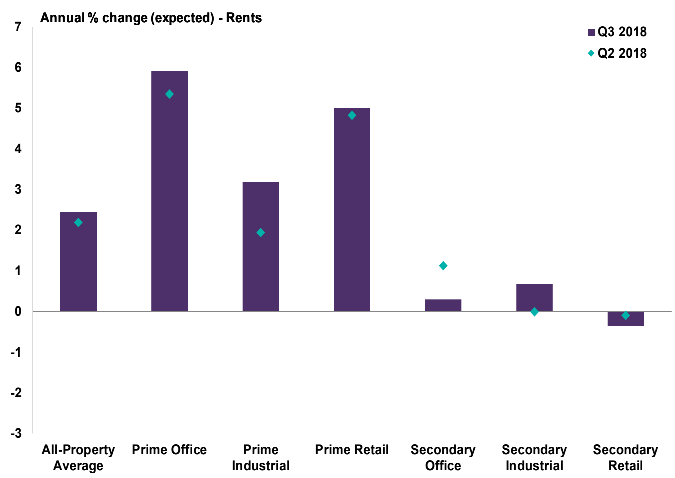


Chart 6: 12-month Rent Forecast



Information

Global Commercial Property Monitor

RICS' Global Commercial Property Monitor is a quarterly guide to the trends in the commercial property investment and occupier markets. The report is available from the RICS website www.rics.org/economics along with other surveys covering the housing market, residential lettings, commercial property, construction activity and the rural land market.

Methodology

Survey questionnaires were sent out on 13 September 2018 with responses received until 14 October 2018. Respondents were asked to compare conditions over the latest three months with the previous three months as well as their views as to the outlook. A total of 1791 company responses were received, with 341 from the UK. Responses for Ireland were collated in conjunction with the Society of Chartered Surveyors Ireland. Responses for Spain and Portugal were collated in conjunction with Iberian Property. Responses for New Zealand were collated in conjunction with Property Council New Zealand. Responses for Malaysia were collated in conjunction with the Royal Institution of Surveyors Malaysia.

Responses have been amalgamated across the three real estate sub-sectors (offices, retail and industrial) at a country level, to form a net balance reading for the market as a whole.

Net balance = Proportion of respondents reporting a rise in a variable (e.g. occupier demand) minus those reporting a fall (if 30% reported a rise and 5% reported a fall, the net balance will be 25%). Net balance data can range from -100 to +100.

A positive net balance reading indicates an overall increase while a negative reading indicates an overall decline. The RICS Occupier Sentiment Index (OSI) is constructed by taking an unweighted average of readings for three series relating to the occupier market measured on a net balance basis; occupier demand, the level of inducements and rent expectations. The RICS Investment Sentiment Index (ISI) is constructed by taking an unweighted average of readings for three series relating to the investment market measured on a net balance basis; investment enquiries, capital value expectations and the supply of properties for sale.

Contact details

This publication has been produced by RICS. For all economic enquiries, including participation in the monitor please contact: **economics@rics.org**

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Economics Team

Tarrant Parsons

Economist

+44(0)20 7695 1585

tparsons@rics.org

Sean Ellison

Senior Economist

+65 68128179

sellison@rics.org

Simon Rubinsohn

Chief Economist

+44(0)20 7334 3774

srubinsohn@rics.org

Jeffrey Matsu

Senior Economist

+44(0)20 7695 1644

jmatsu@rics.org

Kisa Zehra

Economist

+44(0) 7695 1675

kzehra@rics.org

Janet Guilfoyle

Market Surveys Administrator

+44(0)20 7334 3890

jguilfoyle@rics.org

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Americas

Latin America
ricsamericalatina@rics.org

North America
ricsamericas@rics.org

Asia Pacific

ASEAN
ricsasean@rics.org

Greater China (Hong Kong)
ricshk@rics.org

Greater China (Shanghai)
ricschina@rics.org

Japan
ricsjapan@rics.org

Oceania
oceania@rics.org

South Asia
ricsindia@rics.org

EMEA

Africa
ricsafrica@rics.org

Europe
ricseurope@rics.org

Ireland
ricsireland@rics.org

Middle East
ricsmiddleeast@rics.org

United Kingdom RICS HQ
contactrics@rics.org