2022 Market Outlook
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01

**Economy**

Economy expected to normalise in 2022; Counter-cyclical policies and structural transformation to ensure stable growth
Growth set to return to pre-pandemic levels

After GDP expanded by 5.1% in each of 2019 and 2020, China’s economy grew by 8.1% in 2021 owing to a low base effect from the slowdown witnessed following the onset of the pandemic. Growth is expected to normalise this year, with CBRE forecasting expansion of around 5%.

The emergence of new COVID-19 variants such as Omicron and associated measures to contain their spread will pose the biggest risk to the global economy this year. However, given the rapid pace of the vaccine rollout and declining fatality rates, pandemic-related headwinds should be weaker this year compared with those in 2021.

Growth in real estate investment slowed to 4.4% y-o-y in 2021, the weakest rate of expansion since 2015, primarily due to the impact of measures to deleverage the economy. Growth in new construction and land purchasing fell by more than 10% y-o-y following the introduction of the “Three Red Lines” policy to contain developer debt. While weaker investment in real estate is likely to drag on total investment in 2022, CBRE believes property sector risks are manageable as several developers including Greenland, Agile Property and Kaisa Group have already reduced their debt levels. The People’s Bank of China (PBoC) has also accelerated M&A among debt-ridden real estate firms to mitigate risks.

Growth in China’s exports slowed in 2021 due to a high base effect in 2021 and a recovery in competing countries’ production capacity. However, the Regional Comprehensive Economic Partnership (RCEP), which took effect at the beginning of this year, should ensure exports achieve solid growth in 2022.

Source: CBRE Research, January 2022

Figure 1: China and global GDP forecast
Counter-cyclical policies to underpin stable economic growth

The Central Economic Work Conference held in December 2021 focused on formulating expansionary monetary and fiscal policies to ensure sound economic growth. Following the conference, the PBoC immediately cut the reserve requirement ratio by 0.5 percentage points and lowered the loan prime rate for two consecutive months in order to reduce financing costs for the real economy. This year the Ministry of Finance (MOF) plans to issue new special debt of RMB 1.46 trillion to invest in nine key areas of infrastructure development such as transportation, energy and the environment, which will boost growth in infrastructure investment. Consumption stimulus measures such as the extension of the preferential tax treatment for annual one-time bonuses to the end of 2023 will ensure consumption growth rebounds in the second half of the year.

Beyond infrastructure investment and consumption stimulus, the transformation and upgrading of China’s manufacturing industry will provide a new economic growth engine. As the country transforms to a low-carbon economy and upgrades to high value-added technology, growth in investment in the biomedical, electronics and telecoms; integrated circuitry; new energy vehicle; and other high-tech manufacturing industries will accelerate.

![Figure 2: Reserve requirement ratio and one-year loan prime rate (LPR)](chart)

Source: CBRE Research, January 2022
Occupiers and investors adopt ESG metrics; Demand for green buildings set to accelerate
ESG takes on more prominent role

93% of occupiers say they would prefer to lease space in green buildings.
- CBRE 2021 China Office Occupier Survey

55% investors already include ESG criteria in investment decisions
- CBRE 2022 China Investor Intentions Survey

China made steady progress in its carbon reduction initiatives over the course of 2021. In March, the Report on the Work of the Government laid out the country’s ‘dual carbon’ goals for the first time, while July saw the launch of a national carbon emissions exchange. In October, the State Council released a high-level policy framework setting out a roadmap to achieving peak carbon dioxide emissions and carbon neutrality. China’s energy consumption per unit fell by 2.7% y-o-y in 2021, while its utilisation of renewable energy increased by 1pp to 25.3% over the corresponding period.

Leading domestic companies including Alibaba, SF Express and BYD have already outlined objectives and action plans to reduce carbon emissions. This year will see more firms state their carbon emission reduction goals in accordance with China’s “1+1+N” policy framework.

ESG performance is becoming more important

A recent study by the China Energy Conservation Association found that China’s real estate industry accounted for 51% of total national carbon emissions. As one of the largest sources of emissions, real estate plays a critical role in helping China achieve dual carbon goals. Rapid progress in improving environmental performance in the real estate sector has been made in recent years, with more than 40% of newly completed office buildings in China in 2021 being LEED-certified or registered. CBRE data show that green buildings tend to command an advantage in the leasing market.

with net absorption for LEED buildings 2.6x greater than that for non-certified properties. Leading retail developer Beijing SKP recently became China’s first carbon neutral real estate first owner and operator through reducing the emissions and purchasing carbon credits.

The introduction of ESG objectives and tracking of ESG performance is expected to accelerate further in 2022. CBRE’s 2021 China Occupier Survey found that 93% of occupiers stated a preference for green buildings and 33% of logistics occupiers plan to lease warehouse facilities with green certification over the next three years. CBRE’s 2022 China Investor Intentions Survey revealed that 53% of investors already include ESG criteria in their investment decisions.

Occupiers and investors are displaying recognition of a rental and price premium for green buildings. 22% of respondents to CBRE’s 2022 China Investor Intentions Survey said they would be willing to pay more for ESG-compliant assets, while CBRE’s 2021 China Occupier Survey found that 9% of occupiers would pay a rental premium for green buildings.

While older properties may be at risk from the rising focus on ESG, CBRE believes that the coming wave of urban renewal will create huge investment potential.
Tech and finance to remain key drivers of office demand; most cities expected to remained tenant-favoured markets
Net absorption set to weaken but will remain above 6 million sq. m.

China’s ongoing containment of the COVID-19 pandemic and rapid economic recovery ensured the national office market enjoyed a strong cyclical rebound in 2021. Nationwide net absorption in the 18 major cities tracked by CBRE reached 7.43 million sq. m., a record high. Beijing, Shanghai and Shenzhen each recorded over 1 million sq. m. of net absorption for the first time in history, while tech-driven cities including Hangzhou, Chengdu and Wuhan contributed the majority of demand among tier II cities.

Innovative industries retain solid expansionary demand despite ongoing macro risks

China’s office leasing market will experience several macro headwinds and tailwinds in 2022. While slower economic growth and the tighter regulation of fast-growing industries including online education and online gaming will weigh on expansionary demand, the introduction of the RCEP, reform and opening-up of the finance industry and countercyclical financial and monetary policy adjustments are expected to spur new office leasing activity. Strategic emerging industries with government support will continue to grow rapidly, with National Information Centre data showing the national innovation prosperity index of strategic emerging industries reached 130.7 in 2021, remaining at a high level for three consecutive years.

The outlook for office demand in 2022 is positive, with CBRE’s 2021 China Office Occupier Survey indicating that 60% of respondents plan to increase their headcount over the next three years. Amid a stronger focus on workplace wellness and hygiene, 49% of respondents plan to increase their office space per capita. Technology and life science companies exhibit the strongest intentions to expand their office space. CBRE expects nationwide net absorption to reach 6.2 million sq. m. in 2022, a 17% decline compared to 2021’s peak, but well above the five-year average of 5.3 million sq. m.
Major growth engines remain strong; demand underpinned by several sub-sectors

While tech and finance will remain as the primary drivers of office leasing demand in 2022, activity within industry sub-sectors will fluctuate.

Tech firms focus on R&D of base technology and business applications

This year will see companies scale up investment in R&D of base technology and increase their expenditure on business service applications, with Artificial Intelligence (AI) and cloud computing set to be among the most popular areas of focus. Tianyancha data show that more than 86,000 cloud computing-related companies were set up in 2021, while over 300,000 AI-related companies were registered in H1 2021, an increase of 88% y-o-y. Demand from VR/AR companies, which manufacture the devices powering the Metaverse, also increased over the year. CBRE expects the wider adoption of these innovations to spur expansion by relevant companies in 2022.

Finance: reform and opening-up to drive demand from securities and asset management firms

Chinese authorities continued to enhance the reform and opening-up of the domestic financial industry in 2021, with the year witnessing the launch of the Beijing Stock Exchange; the creation of the Guangzhou Futures Exchange; the debut of C-REITs; the acceptance of first batch of financial holding companies’ applications; and the setup of foreign-controlled and wholly-owned insurance securities fund companies. Policy incentives spurred further demand from securities and asset management firms over the course of the year, with data showing that the number of insurance agents of securities firms grew by 17% y-o-y in 2021; the number of investment advisers increased by 12%; and the number of general employees in the securities industry recorded growth of 5%. Office leasing volume by securities firms increased by 163% y-o-y in 2021.

CBRE expects the promotion of a stock issuance registration system and the accelerated deployment of foreign-funded securities and financing companies to drive additional office leasing demand in 2022.

Figure 4: Leasing volume forecast of major drivers of office demand

<table>
<thead>
<tr>
<th>Industry</th>
<th>% of 2021 leasing volume</th>
<th>% of 2022 leasing volume</th>
<th>Expected drivers of demand by subsector</th>
</tr>
</thead>
<tbody>
<tr>
<td>TMT</td>
<td>33.6%</td>
<td>↑</td>
<td>AI, Cloud Computing, Metaverse</td>
</tr>
<tr>
<td>Finance</td>
<td>21.9%</td>
<td>↑</td>
<td>Securities, Funds, Asset Management, Financing</td>
</tr>
<tr>
<td>Business Services</td>
<td>8.8%</td>
<td>↑</td>
<td>Legal and Financial services, Professional Consulting</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>8.2%</td>
<td>↑</td>
<td>Intelligent Manufacturing, Automation</td>
</tr>
<tr>
<td>Real Estate</td>
<td>6.0%</td>
<td>↓</td>
<td>–</td>
</tr>
<tr>
<td>Pharmaceutical and Life Science</td>
<td>4.1%</td>
<td>↑</td>
<td>Vaccine R&amp;D, Medical Equipment</td>
</tr>
</tbody>
</table>

Source: CBRE Research, January 2022

Pharmaceutical and life science: Beijing and Shanghai attract bulk of demand

Robust investment in vaccine R&D and medicines designed to treat China’s ageing population supported rapid growth by pharmaceutical and life science companies in 2021. Pharmaceutical manufacturing value added registered 26.5% y-o-y growth in the first three quarters of 2021, while financing and investment in the pharmaceutical and life science industry increased by 19.3% and 38.6%, respectively in 2021. CBRE expects demand momentum to remain solid in 2022, with Beijing and Shanghai set to attract numerous new headquarters and R&D centresetups.

Supply peak to ensure market continues to favour tenants

After two consecutive years of low supply in 2020 and 2021, new office stock will peak in 2022 along with the completion of around 9.5 million sq. m. of new office space. However, with the prolonged pandemic, Winter Olympics, lockdowns and other factors likely to result in some delays to new projects, CBRE expects full-year new supply to reach 8 million sq. m., which would nevertheless represent a sizable increase of 25% y-o-y.

Market to stay tenant-favoured but individual cities and regions diverge

While overall office vacancy is forecasted to reach 23% at year’s end along with the completion of new supply, this is still lower than the level recorded in 2020. Although overall supply and demand patterns will ensure the market remains tenant-favourable, subtle differences will emerge across cities and regions.

Vacancy in tier I cities is forecasted to fall below 20%, with significant declines expected in Beijing Guomao CBD and Lize, where the recent supply peak ended in 2021 and the pipeline over the next three years is limited. Elsewhere, new supply in Guangzhou will fall by 20% y-o-y in 2022. Among tier II cities, several markets in Eastern, Central and Western China are expected to see a supply peak in 2022, pushing up vacancy in all these locations above 20%, except for Chengdu.

Around 90% of new supply in tier I cities is in decentralised areas including Shanghai Xuhui Riverside, Shenzhen Qianhai and Guangzhou Pazhou. Several high-quality buildings will come on stream in prime locations in tier II cities such as Hangzhou Qianjiang New City, Chengdu Financial City, Dongda Street and Wuhan Zhongnan Road.

Figure 5: Office 2021 net absorption with 2022 new supply forecast by city

Source: CBRE Research, January 2022
Rental decline to lose momentum; rents in core CBDs of tier I cities to rebound first

The influx of new supply will ensure CBRE’s China Office Rental Index covering 18 major cities declines by 0.4% y-o-y in 2022. Weaker demand in Northern China and high vacancy in Central and Western China will exert downward pressure on rents in tier II markets.

Tier I cities will continue to outperform in terms of rental growth. Beijing will become a landlord’s market in 2022, with average rents forecasted to rise by 0.4% y-o-y. With robust supply and demand expected to continue in Shanghai and Shenzhen, rental growth will remain stable. However, Guangzhou’s substantial supply pipeline will lead to weaker growth.

Core CBDs in tier I will experience rental stabilisation and growth over the next 12 months. Leasing volume in Core CBDs of tier I cities surged by 123% in 2021, leading vacancy in most submarkets to fall below 10%. With the exception of Guangzhou Zhujiang New Town, new supply in core CBDs will be extremely limited. Rents will stabilise and continue to increase in Shanghai Nanjing West Road, Beijing Guomao CBD and Zhongguancun, while those in Shanghai Lujiazui and Shenzhen Futian CBD are forecasted to stabilise.

Figure 6: 2022 vacancy rate and rental forecast in tier I and tier II cities

Source: CBRE Research, January 2022
Expansion and flight-to-quality drive demand; stronger focus on workplace wellness

CBRE’s 2021 China Office Occupier Survey found that office occupiers plan to prioritise expansion (24%) and consolidation (20%) over the next three years. Abundant new supply in 2022 will create opportunities for occupiers to implement these strategies. In 2021, leasing volume involving expansion grew by 205% and 318% over 2020 and 2019, respectively.

Flight-to-quality will be another prominent trend in 2022, with investors displaying a strong preference for space in decentralised areas with plentiful new supply, mature infrastructure and comprehensive amenities. In addition to Shanghai Qiantan and Beijing Lize, Shanghai Xuhui Riverside, Shenzhen Qianhai and Guangzhou Pazhou are expected to emerge as preferred locations for occupiers in 2022.

As vacancy continues to fall in tier 1 cities’ core CBDs, occupiers, particularly finance and business services companies planning relocation or upgrading to prime locations, are advised to accelerate decision-making.

Stronger focus on office wellness

The flight-to-quality trend is partly being driven by a stronger emphasis on health and wellness among companies and employees. As the pandemic drags on, occupiers are increasingly prioritising a building’s wellness features when evaluating leasing strategies. 47% of respondents to CBRE’s 2021 China Office Occupier Survey viewed wellness as the most important factor driving building selection, 28pp higher than in the last survey conducted before the onset of the pandemic.

Figure 7: What portfolio strategies are you planning to pursue in the next three years?

Source: 2021 China Office Occupier Survey, CBRE Research, December 2021
Conclusions and recommendations

**Recommendations for occupiers**

01 Abundant new supply in 2022 will facilitate the implementation of occupiers’ long-term corporate real estate strategies. Occupiers should carefully monitor markets expected to see oversupply and rental increases, including Beijing citywide, Shanghai Nanjing West Road, Qiantan and Pudong Expo.

02 Consider pandemic-related contingency plans in their workplace and real estate strategies. Remote working policies and force majeure clauses in leases should be carefully evaluated.

03 Increase emphasis on wellness and safety. Measures can include introducing more wellness facilities in their offices and leasing buildings with green and wellness certification to improve operational capability and attract and retain employees.

04 Re-evaluate short-term and long-term portfolio development strategies to allow for more frequent flexible or remote working.

05 Align corporate real estate strategy with ESG goals.

**Recommendations for landlords**

01 Target occupiers in industries displaying strong growth, such as technology and life science.

02 Raise occupancy by capturing flight-to-quality demand for new buildings, upgrading tenant profiles and improving mid-to-long-term operational performance.

03 Incorporate wellness amenities and services and consider obtaining building certifications such as LEED and WELL. Introduce cleaning robots, touchless facilities, and measures to improve air circulation. Maintain high-frequency disinfection and sterilisation.

04 Incorporate features to facilitate flexible working such as agile workplaces, shared meeting rooms and movable phonebooths.
Retail

Tax reductions and growth of subsidiaries support structural recovery; operational excellence emerges as key differentiator
Retail market expected to see moderate growth in 2022

China’s total retail sales exceeded RMB 44 trillion in 2021, an increase of 12.5% y-o-y, well above the growth rate of 3.9% y-o-y registered over the previous two years. Consumption upgrading underpinned overall retail sales growth during the year, with sales of sports and entertainment products, cosmetics, gold and silver jewellery of units above designated size recording y-o-y growth rate of 22%, 14% and 30%, respectively.

Although the emergence of the Omicron variant of COVID-19 has added another layer of uncertainty to the economic outlook, China’s more active fiscal policy and the implementation of the RCEP will benefit import consumption and support the steady growth of the domestic retail market. Total retail sales are expected to register y-o-y growth of between 5-6% in 2022 and will return to pre-pandemic growth rates of 7-8% from 2023.

Fiscal policy boosts consumption

At its executive meeting in December 2021, the State Council decided to continue the implementation of several individual income tax policies, extending the preferential tax calculation method for year-end bonuses and the tax exemption policy to the end of 2023.

Additionally, the separate tax calculation policy for equity incentives for listed companies was extended to the end of this year. These policies are expected to reduce the tax burden by RMB 110 billion per annum and will help increase disposable income, providing additional support to the domestic retail market. In addition, key consumption centres across the country will introduce upgraded versions of the “first-store” policy this year, which will involve expanding the scope of subsidies and simplifying the approval process. This will promote the market entry of new brands, formats and stores in 2022.

Experiential retail remains essential

Although online retail has grown significantly since the onset of the pandemic, experiential retail in brick-and-mortar stores has become more important than ever before. Restrictions on international and even inter-provincial travel has strengthened the importance of shopping malls, while younger consumers’ demand for a more immersive consumption environment has underlined the key role played by brick-and-mortar stores.
Demand from major retail categories expected to remain stable; Gen Z-related trades and new energy vehicle retailers to see rapid growth

Shopping malls’ key tenants will continue to see steady expansion in 2022. Euromonitor expects clothing retailers to achieve 4.5% annual growth in terms of store numbers, while electronic equipment products that integrate consumer experience and sales will continue to expand. Store numbers of cosmetics and sports products retailers will register annual growth of over 3.5%.

**International brands continue to invest in China**

CBRE’s 2021 Asia Pacific Retail Survey found that China remains the top market for brand expansion. Several major brands are planning market entry or expansion in 2022, led by outdoor sports brands Head Sportswear and Hoka One One; apparel brands Chuu, ARKET, and Other Stories; and toy brand Lego.

**Offline retail financing hits record high; catering and experiential retail to expand rapidly**

A total of 106 venture capital investments in offline retail store expansion were recorded in 2021, a record high. The catering industry, which mainly focuses on coffee, tea and special light meals, attracted nearly 60% of financing, and will continue to expand in the coming year.

Companies receiving investment tend to be linked to Gen Z consumption and include new business formats such as surf halls; secret rooms; Sankengcultural experience stores; and blind boxes. CBRE expects these retail formats to provide new growth engines for experiential retail and enhance the overall appeal of shopping malls.

**Automotive showroom demand poised to accelerate**

China is the world’s largest market for new energy vehicles. The China Association of Automobile Manufacturers projects that sales of new energy vehicles will exceed 5 million in 2022, a y-y-y increase of more than 40%. Showrooms for new energy vehicles have emerged as a new source of leasing demand in recent years, with major brands including NIO, LI, XPENG and HOZON operating a combined total of around 200 showrooms. As more traditional automotive companies and new market entrants increase investment in new energy vehicles, showrooms and multifunctional flagship stores will continue to open in shopping malls. Tier I cities along with major tier II cities such as Hangzhou, Chengdu and Zhengzhou will be the main target markets.
Brands carefully evaluate location and landlord expertise when opening first store

Retailers are adopting a more selective attitude towards location and operator experience when considering opening their first stores in China. CBRE data show that of the first stores that opened in H1 2021, nearly 70% launched in projects owned by experienced operators, an 15pp increase on 2020. At the same time, the proportion of first stores in core locations increased from 44% to 54%.

This trend reflects the more synergistic relationship between retailers and landlords that has emerged in recent years. Retailers increasingly value a landlord's ability to design and operate a property to attract brands to lure target consumers, while landlords are targeting first stores to create social consumption and enhance community management. Success in securing first stores as tenants will emerge as a key differentiator of shopping mall operational performance.

As ESG takes on a more prominent role, stores and shopping malls with environmental features will become the industry standard. A total of 23 new LEED-certified retail property projects were completed nationwide in 2021, an increase of 20%. More than 80% of shopping malls with a GFA greater than 100,000 sq. m. that opened in Shanghai last year, including Shanghai Qiantan Tai Koo Li and Shanghai Ruihong Sun Palace, featured green elements and outdoor space. On the tenant side, Cartier, Tiffany, Lululemon and several other international retail brands all opened green stores in 2021.

Figure 10: Preference for location and operational experience among retailers opening first stores

Source: CBRE Research, January 2022
Ground floor rents of shopping malls to see mild growth in 2022

New shopping mall supply is expected to remain stable in 2022, with around 9 million sq. m. of new space scheduled to come on stream. Although 90% of new projects are in non-prime areas, just over half will be operated by experienced landlords, meaning that vacancy risk should be minimal. Combined with solid demand from new retail trades and policy support from local authorities, this should ensure overall vacancy remains below 10%.

Shopping mall rents will continue to rise steadily in 2022, with average ground floor rents forecasted to increase by 1% y-o-y. Rents in tier I cities and tier II cities in Eastern China are expected to rise by 1.5-2.5% y-o-y as these locations continue to attract retailers seeking offline expansion, but overall rents will remain below pre-pandemic levels. Tianjin will see lower rents due to tenant attrition and high vacancy in old projects in prime areas, while abundant supply in Chongqing will continue to exert downward pressure on rents.

Figure 11: Retail supply and demand forecast

Figure 12: Shopping mall ground floor rental forecast by city in 2022

Source: CBRE Research, January 2022
Conclusions and recommendations

Recommendations for occupiers

01 With space available for lease in retail schemes in core business districts still scarce, brands with flagship store location plans in core areas should speed up decision-making.

02 Consider entering new cities and business districts or create new store formats to capitalise on the expansion of the scope of local authorities’ “first store” policy.

03 Place a stronger focus on precinct, transportation infrastructure and landlords’ operational expertise when evaluating new supply in non-prime areas, which is due to increase in the coming year.

04 Embrace the green consumption trend by strengthening the implementation of environmental protection and integrating ESG criteria into store design and operations.

Recommendations for landlords

01 Provide a healthy and safe retail environment for tenants and shoppers.

02 Consider adding more features and elements catering to Gen Z consumers. Examples include replacing poorly performing businesses such as karaoke halls with experiential offerings such as secret rooms and surf halls.

03 Introduce zoning within malls to meet the location selection criteria of certain business types such as bistros with late opening hours.

04 Add more green or outdoor space.

05 Owners lacking operational staff or expertise can consider asset-light partnerships with experienced shopping mall operators.
Logistics

Solid net absorption to be driven by e-commerce growth, 3PL expansion and policy support
Strong growth in demand to extend into 2022

China’s exports (in USD) and domestic express delivery each achieved growth of around 30% y-o-y in 2021 amid continued strong foreign and domestic demand. This spurred significant growth in requirements for warehouse space from e-commerce platforms, 3PLs and manufacturers. Logistics net absorption in the 19 markets tracked by CBRE reached 6.6 million sq. m. in 2021, a 40% increase on the previous historical high set in 2017.

Net absorption to exceed 6 million sq. m. in 2022

CBRE’s 2021 China Logistics Occupier Survey found that 70% of respondents intend to increase their warehouse portfolios over the next three years. E-commerce and 3PLs, which collectively account for around 80% of total annual leasing volume, are most willing to expand. With demand set to remain strong in 2022, net absorption is expected to exceed 6 million sq. m. for the second consecutive year.

Three major drivers to propel solid growth

CBRE expects rising e-commerce penetration; supply chain logistics demand driven by manufacturing upgrading; and the boost to regional trade and logistics activity from the RCEP to be the main engines of warehouse demand in 2022. Demand will increasingly shift towards newer properties providing more intelligent and efficient space along with larger portions allocated to cold storage.

Figure 13: Projected total net absorption in 19 markets

- **Rising e-commerce penetration**
  - China’s 14th Five-Year Plan on E-commerce projects online retail sales to grow by 44% between 2020 to 2025.
  - Live broadcasting, online groceries and cross-border e-commerce possess the strongest growth potential.

- **Robust logistics financing to spur more warehouse demand**
  - Financing of logistics enterprises increased by 340% y-o-y in 2021 as operators sought to fuel network expansion.
  - Supply chain logistics will emerge as a new source of demand.

- **Policy support**
  - The launch of the RCEP will promote regional trade and cross-border commerce, especially in east and southeast China, and will translate into more warehouse demand.
  - The government plans to establish 120 national transportation hubs and scale-up development in cold chain logistics.
Anti-monopoly laws to support healthy e-commerce development; continuous innovation to spur future growth

Domestic online retail sales reached RMB 10.8 trillion in 2021, representing growth of 12% y-o-y. Authorities have introduced a raft of measures to support the healthy development of the e-commerce sector, including anti-monopoly rules to reduce barriers to entry in the internet industry and stricter laws to prevent industry consolidation in the form of M&A. Other measures include the taxation of live-stream broadcasts and aligning regulations on online sales.

According to China’s 14th Five-Year Plan on E-commerce, domestic online retail sales are projected to grow by 44% between 2020 to 2025. Strong growth witnessed in 2021 means this target is likely to be exceeded. CBRE’s Global E-Commerce Outlook found that for every US$1 billion of e-commerce sales, an additional 1 million sq. ft. or 92,903 sq. m. of logistics space is needed. This means that a total of 70 million sq. m. of additional warehouse space will be required to be constructed from 2021-2025.

Low penetration of online groceries points to large growth potential in warehouse demand

With China’s online grocery industry undergoing a period of consolidation and M&A activity in 2021, customers have received fewer discounts and lower rebates. Leading players such as Alibaba and Pinduoduo are entering rural areas and adopting a stronger agricultural focus, helped by policy support. However, online grocery sales continue to lag those in other categories, with Forrester data showing they accounted for just 9% of online sales, lagging electronics and apparel.

CBRE data show that leasing by online grocery platforms surpassed 400,000 sq. m. in 2021, an increase of 80% y-o-y compared to 2020. Online groceries will continue to expand in major metropolitan areas in 2022, driving a further increase in warehouse demand, particularly for cold storage facilities. CBRE’s 2021 China Logistics Occupier Survey showed that 31% of occupiers intend to increase their use of cold storage space in the coming years.

Other drivers of warehouse demand include live-streaming broadcasters and cross-border e-commerce platforms, which are spurring the emergence of Consumer-to-Manufacturer (C2M) models.

Figure 14: Online penetration rate of individual retail categories

- Electronic products (cell phones & computers)
- Books & videos
- Apparels & accessories
- Personal care
- Home appliances
- OTC medicine
- Jewelry and watches
- Groceries

Source: Forrester, CBRE Research, January 2022
Robust logistics financing to spur warehouse demand; supply chain logistics to emerge as new growth engine

Publicly available information show that logistics financing increased by 340% y-o-y to RMB 180 billion in 2022, driven by 12 IPOs, 15 M&A deals and several private placements. This year will see listings by RRS Supply Chain and Anxun Logistics.

JD Logistics, ANE Logistics and SF Express have committed to spending over 50% of their financing on the construction and expansion of transportation networks. JD Logistics stated in its IPO report that 55% of the funds raised would be spent on expanding its warehouse, logistics (including cold chain logistics), and delivery networks. CBRE expects robust logistics financing to spur more warehouse demand, especially in tier I and satellite cities with strong consumption, as well as national transportation hubs.

Supply chain to become new growth engine; manufacturers seek higher quality warehouses

Integrated supply chain logistics providers are emerging as a new driver of leasing demand amid the upgrading of China’s manufacturing industry and e-commerce players’ initiation of C2M strategies to enhance supply chain efficiency. CBRE expects this to result in more manufacturers upgrading to investment-grade warehouses capable of hosting automation and digitalisation hardware. In 2021, leading online fashion retailer SHEIN, which already operates its supply chain using a leading-edge digital system, leased over 1 million sq. m. of modern warehouse space to facilitate its C2M business operations.

The upgrading of the manufacturing supply chain will improve efficiency by enabling users to purchase raw materials from online platforms. With the penetration of industrial B2B e-commerce standing at less than 5%, there is huge growth potential for warehouse demand.

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Figure 15: Robust financing to spur 3PL expansion

Source: LOG Research, CBRE Research, January 2022

New supply in tier I and satellite cities to release pent-up demand

New warehouse supply in the 19 markets tracked by CBRE is projected to reach a record high 7 million sq. m. in 2022, with tier I and satellite cities expected to account for the bulk of new stock.

With new supply in Guangzhou, Shanghai and Changshu set to exceed 1 million sq. m. each in 2022, CBRE expects the new stock to release pent-up demand that has been building for several years amid the low vacancy environment. CBRE’s 2021 China Logistics Occupiers Survey found that 55% of occupiers intended to increase their warehouse portfolios in tier I cities and satellite cities this year.

In contrast, cities in Western China including Chengdu, Chongqing and Wuhan will experience a drop in new supply this year after witnessing a supply peak from 2019 to 2021.

Overall vacancy in the 19 markets tracked by CBRE is estimated to increase by 0.6% y-o-y to 14% in 2022 before falling to 11% in 2023 along with a sharp decline in new stock.

Strong supply and demand will push up rents by 1.9% y-o-y in 2022, with a further gain of 2.4% y-o-y set to follow in 2023. While average rental growth in tier I and satellite cities will reach over 3%, lower supply in Western cities including Chengdu and Chongqing will also propel overall growth. Rental growth in Wuhan will remain stable over the next three years.

Source: CBRE Research, January 2022
More cities set to become balanced or landlord markets in 2022

Figure 17: More cities will become balanced or landlord markets in 2022

Vacancy

"More cities will become balanced markets in 2022 under strong demand and limited supply."

Source: CBRE Research, January 2022

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Conclusions and recommendations

Recommendations for occupiers

01 Capitalise on the supply window in tier I and satellite cities to expand networks and lower total transportation costs in major markets.

02 With Chengdu and Chongqing expected to turn from occupier to landlord markets in the next two years, occupiers should lock in better locations and longer lease terms before rents start to increase.

03 Adopt warehouse automation, warehouse management systems and other new technologies to optimise labour costs and operational efficiency. New technologies should complement warehouse features such as height, floor loading, loading bays and power supply.

04 Engage developers at an early stage to ensure facilities are customised to their specific requirements.

05 Integrate ESG targets into warehouse site selection and operations.

Recommendations for landlords

01 Pursue new development in tier I and satellite locations along with major logistics hubs such as Chengdu, Chongqing and Wuhan, which are projected to see a rental rebound due to a sharp decline in supply over the next three years.

02 Involve occupiers at the facility design and planning stage to ensure a greater degree of customisation. Alternatively, improve warehouse compatibility to meet occupier requirements.

03 Increase capital expenditure on green energy and optimise business operations to satisfy authorities’ and occupiers’ sustainability targets.

04 To improve tenant retention and income generation, landlords with large-scale networks should consider investing in warehouse management systems; intelligent supply chain systems; warehouse automation; and supply chain solutions to lower tenants’ operational costs and raise efficiency.
06

Investment

Real estate investment forecasted to reach RMB 300 billion in 2022 as buyers look to purchase more and asset availability improves
Real estate investment volume set to reach RMB 300 billion in 2022

China’s real estate investment market enjoyed a solid recovery in 2021, with total transaction volume reaching RMB 273 billion, an increase of 33% y-o-y. With CBRE’s 2022 China Investor Intentions Survey detecting a strong willingness to both purchase and sell over the coming year, annual transaction volume is expected to exceed RMB 300 billion.

The survey found that purchasing intentions reached a new high, with 59% of respondents saying they intend to buy more in 2022. Purchasing intentions among both domestic and foreign investors strengthened from the previous survey. Interest among overseas buyers is especially strong, with Shanghai and Beijing both named among the top five cross-border investment destinations in Asia Pacific.

The proportion of respondents who said they plan to sell more real estate this year increased by 10pp to 51%. Amid debt repayment pressure and the “Three Red Lines” regulation capping debt, around 60% of domestic developers intend to sell more assets this year.

With several funds approaching their expiry date, property funds’ willingness to sell increased by 20pp in this year’s survey. Considering that most assets acquired by property funds between 2017 and 2019 were located in prime locations in Shanghai and Beijing, this year is likely to provide investors with attractive cyclical opportunities to acquire prime assets in these rapidly recovering gateway cities.

CBRE expects commercial real estate investment volume to increase by 10-15% y-o-y in 2022, exceeding RMB 300 billion for the first time.

Figure 18: Domestic commercial real estate transaction volume (2009-2022)

Source: CBRE Research, January 2022
Pace of monetary easing may exceed expectations; cap rates in tier I cities set to remain stable aside from some minor compression

After reducing both the RRR and LPR at the end of 2021, the PBoC once again lowered the one-year and five-year LPR by 10 bps and 5 bps, respectively, in January. With the central bank indicating that it plans to adjust rates more actively this year, the pace of monetary easing may exceed expectations, resulting in a downward trend in market risk-free interest rates and the cost of capital.

Record high net absorption in 2021 has boosted investors’ confidence in the office market, with rents for office buildings in Beijing’s and Shanghai’s core submarkets rebounding. Rents for shopping malls and high-standard warehouses in most cities have bottomed out, while those for high-standard warehouses in tier I metropolitan areas have accelerated. CBRE’s 2022 China Investor Intentions Survey found that investors’ expectations for asset prices have risen significantly, with willingness to acquire Grade A warehouses, business park offices, and stabilised Grade A offices at no discount or at a premium to asking prices accounting for 75%, 56% and 31% of responses, respectively.

Although commercial real estate supply will peak in 2022, stronger leasing and investment demand in tier I cities and the expected loosening of the credit market will result in slight cap rate compression. In the logistics sector, continued solid investment in warehouses will further narrow logistics cap rates in tier I cities by 10-15 basis points.

CBRE advises investors to target real estate benefiting from the new economy and seize cyclical opportunities in the office and retail sectors.

Figure 19: Cap rate for major asset classes in tier I cities

Source: CBRE Research, January 2022
Follow the trend: Target real estate benefiting from new economy

Fierce competition for logistics assets; investors advised to focus on national hubs with improving fundamentals

CBRE expects warehouses to exhibit the strongest leasing fundamentals among major asset classes. The China logistics rental index is forecasted to increase by 1.9% y-o-y and 2.3% y-o-y in 2022 and 2023, respectively, while annual average rental growth for tier 1 and satellite cities will reach 35% y-o-y.

Barriers to logistics investment include the scarcity of and intense competition for high-quality assets. Since 2020, half of China-related real estate private equity fund-raising has been targeted at the industrial and logistics sectors, resulting in a large volume of capital looking for a home. While CBRE advises core and core-plus investors to continue to focus on mature assets in tier 1 metropolitan areas, buyers should be cognisant of the rapid downward trend in market cap rates over the past 12 months, especially in Beijing and Shanghai, where cap rates for high-standard logistics facilities have fallen below 5%.

Investors with a stronger risk appetite are recommended to explore development, renovation and redevelopment opportunities in tier 1 metropolitan areas and closely monitor national logistics hubs with improving leasing performance such as Chengdu and Chongqing. In the former, the overall vacancy rate for high quality warehouses had fallen to 6.4% by the end of 2021, while average annual rental growth is expected to exceed 3% from 2022-2023. Investors are also advised to consider opportunities in cold storage, with eastern coastal metropolitan areas with major ports and large consumer markets most worthy of attention.

Life science parks with industry agglomeration offer opportunities

Investor interest in life science parks has grown steadily since the onset of the pandemic. In 2021, the added value of China’s pharmaceutical manufacturing industry increased by 24.8% y-o-y, the strongest growth among the country’s major manufacturing industries. With China’s population of those aged 65 and older now exceeding 200 million, and health expenditure per capita just 5% of that in the U.S., the biopharmaceutical industry holds significant growth potential.

Given that biopharmaceutical companies possess highly specialised requirements for talent availability; upstream and downstream coordination; regional environmental assessments; and property conditions, investors should focus on cities and science parks with a high industry agglomeration so as to attract and retain high-quality occupiers.

Beijing and Shanghai are the most developed cities in the domestic biopharmaceutical industry. In 2021, newly leased area by biopharmaceutical companies in Shanghai increased by 146% y-o-y. With leading biopharmaceutical parks in China, such as Zhongguancun in Beijing and Zhanjiang in Shanghai, home to a large number of sizable old R&D properties, there are ample opportunities for investors to pursue upgrading and renovation strategies. CBRE data show that the capital values of several recently renovated R&D properties rose by 50% after upgrading works were completed. Investors can also focus on development and investment opportunities for factories and R&D facilities in emerging parks with relatively abundant industrial land supply.

Investing in biomedical real estate can create synergies between investment income and government demand for the industrial economy. Cooperating with enterprises with relevant industrial resources can help unlock investment opportunities and smooth the investment process.
Follow the trend: Strong demand for multifamily real estate

China's seventh census found that the national floating population reached 376 million in 2020. Long-term trends such as urbanisation, consumption upgrading, smaller family sizes, and government's support for the development of a rental apartment market are combining to make multifamily an attractive asset class for investment.

Focus on value-add opportunities in tier I and key tier II cities

Investors can focus on tier I cities and tier II cities possessing continuous population inflows, relatively high per capita income, and involvement in rental housing pilot schemes, such as Hangzhou and Nanjing. According to data from the Weifang Research Institute, residential rents in major domestic cities increased by more than 2% y-o-y in 2021, with those in Shanghai and Beijing rising by 11% y-o-y and 9% y-o-y, respectively.

Value-added approaches involving renovation or upgrading are currently the preferred strategy among investors. Many major cities in China have issued relevant guidance in recent years to support the conversion of commercial offices, hotels or industrial properties into long-term leased apartments, boosting asset availability. After acquiring a hotel in 2016, Pamfleet converted the property into a rental apartment building, subsequently disposing of the asset in Q4 2021 at a capital value gain of nearly 140%.

Pamfleet's successful exit is expected to drive further interest in the long-term lease apartment market. CBRE recommends investors prioritise projects with convenient transportation and living facilities and those close to major commercial areas with a high-density working population. Investors may also consider cooperating with developers or institutions with renovation and operational experience.

Figure 20: Rental growth for residential apartments in major cities in China in 2021

Source: Jingfang Research Centre, CBRE Research, January 2022
Market timing: Core office buildings in Beijing and Shanghai reach price inflection point

In 2021, nationwide office net absorption exceeded 7 million sq. m. for the first time on record, while Beijing, Shanghai and Shenzhen each recorded more than 1 million sq. m. of net absorption, setting new benchmarks. China’s ongoing containment of the pandemic has meant that office demand has been relatively unaffected by the advent of remote working compared to the U.S. or Europe. Strong demand is also a reflection of the economy’s upgrading and transformation, especially in tier I cities where tertiary industry is concentrated.

According to CBRE’s surveys of occupiers and investors over the past six months, occupiers appear to be more optimistic than investors about the outlook for office demand. 60% of occupiers plan to increase their headcount over next three years, while just 33% of investors believe demand for office space will increase over the same period.

As the leasing market continues to strengthen, investors’ price expectations will continue to rise. The current gap in price expectations and positive rental indicators reveal that an investment window for office buildings is approaching. Considering the supply-demand structure in the leasing market and asset liquidity in the investment market, buyers, especially those with a medium- to long-term investment horizon, should focus on office buildings in core areas of Beijing and Shanghai.

Vacancy rates in core areas of Beijing and Shanghai fell below 10% at the end of 2021 amid solid expansion and upgrading demand from financial, technology and professional services companies.

![Figure 21: Divergent attitudes towards office demand among investors and occupiers](image)

With new supply in the core areas of Beijing and Shanghai set to drop to 400,000 sq. m. and 260,000 sq. m., respectively, over the next three years, the stabilisation and recovery of rents will gradually push up asset prices.

**Re-evaluation of retail assets**

Average capital values of shopping malls in tier I cities were still 10%-15% lower at end-2021 compared to pre-pandemic levels.

However, the rental income of major shopping mall operators in H1 2021 was 10% above that in H1 2019, illustrating the premium that can be achieved by high operational capability.

As of November 5, 2021, the weighted average net asset value discount rate of major retail REITs in Asia Pacific was 12%, well below the 34.2% recorded on March 31, 2020, at the onset of the pandemic, and even lower than the 4.3% registered on December 30, 2019. This indicates that expectations towards retail assets among investors in the secondary market have improved rapidly.

CBRE recommends investors focus on value-added opportunities in core areas and on core-plus opportunities involving regional shopping malls. Institutional investors lacking operational expertise should cooperate with relevant retail management companies.
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