Intelligent Investment

2023 China Real Estate Market Outlook

REPORT

CBRE
CHINA RESEARCH

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Economy

Consumption-led growth to help economy bottom out

At a conference of the Joint Prevention and Control Mechanism of the State Council held on January 19, 2023, officials from the National Health Commission (NHC) stated that the latest wave of COVID-19 infections to hit China had peaked in most provinces from late December 2022 to the beginning of January 2023. Cases logged at fever and general clinics in town- and community-level medical institutes nationwide topped out on December 23, 2022, and fell thereafter, with the number treated at fever clinics dropping 96% on January 23, 2023.

With China having now shifted away from its zero-tolerance COVID-19 policy, consumers can travel and shop freely. CBRE therefore expects domestic consumption to help China's economy accelerate and serve as the country's major economic driver in 2023.

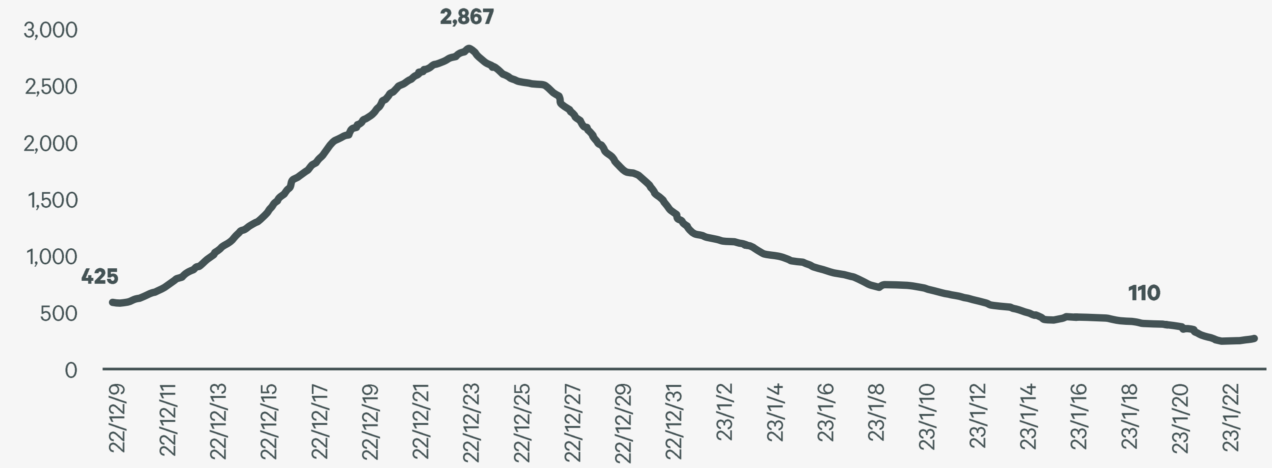
Consumption picks up but recovery will take time

The 2023 Spring Festival in January witnessed a surge in mobility and business activity as China lifted many of its anti-pandemic restrictions. Previously hard-hit service sector industries such as catering, cinemas and travel all registered a strong rebound in receipts during the period, **China's box office and catering revenue surpassed that for the same period of 2019, while the number of passenger trips reached 90% of the total four year ago.**

However, the recovery will take time. While consumer confidence will improve along with the brighter outlook for employment and income, future waves of COVID-19 infections could continue to weigh on consumption in the short term.

CBRE's outlook for domestic consumption in 2023 is cautiously optimistic. Excess savings in 2022 should translate into stronger consumption as the economy picks up, supporting China's economic recovery.

Figure 1: COVID-19 cases treated at fever and general clinics in town- and community-level medical institutes (thousand people)



Source: National Health Commission (NHC) , CBRE Research, February 2023

Figure 2: Headline data for consumption and travel during Spring Festival (compared to 2019)

Catering	Box office revenue	Travelers	Passenger trips
+1.9%	+16%	- 11%	-46%

Source: National Health Commission (NHC),China Film Administration, China Cuisine Association, Ministry of Culture and Tourism, Ministry of Transportation, CBRE Research, February 2023

Expansionary fiscal and monetary policy to support economic recovery; infrastructure investment to stay firm; real estate investment to slowly pick up

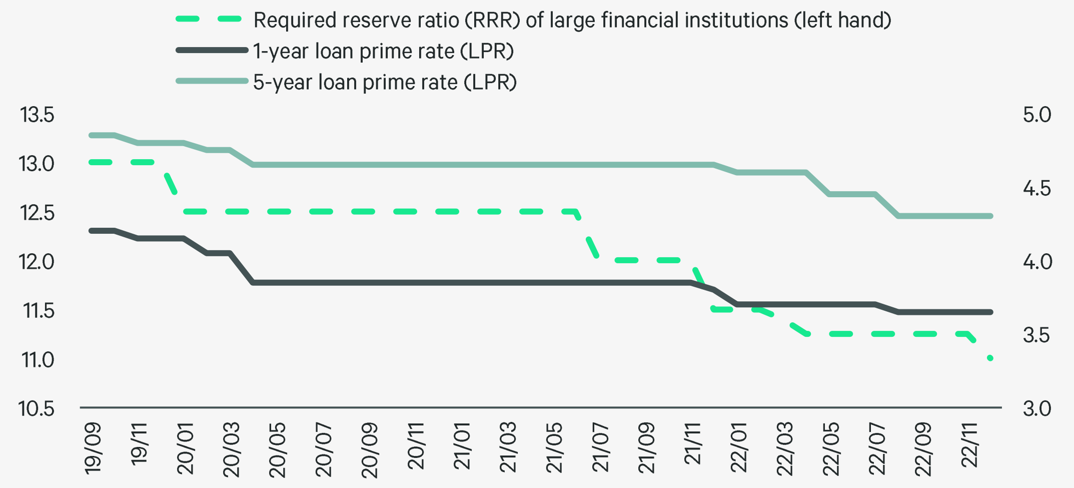
China will adopt a stable and precise approach to monetary policy in 2023. With funding costs and lending rates from commercial banks at historical lows, this will effectively reduce corporates' financing costs in 2023. Further interest rate cuts are also a possibility in the short term.

The People's Bank of China (PBoC) announced on November 25, 2022, that it would cut the Reserve Required Ratio (RRR) by 25bps, in the process releasing RMB 500 billion of additional liquidity for banks to lend. The same month, the PBoC rolled out a package of measures informally referred to as the "three arrows", involving adjustments to bank lending, bond, and equity policies to support financing for real estate enterprises. While housing sales in 2022 slumped by 50% y-o-y, consumers' willingness to buy residential property will strengthen as their incomes and the economy recovers. CBRE expects residential real estate sales and investment to bottom out in 2023.

Data disclosed by multiple provinces show that the issuance of provincial special bonds will increase 35% y-o-y in Q1 2023. Together with the earlier issuance of local government bonds, this will provide further support to China's economy in H1 2023.

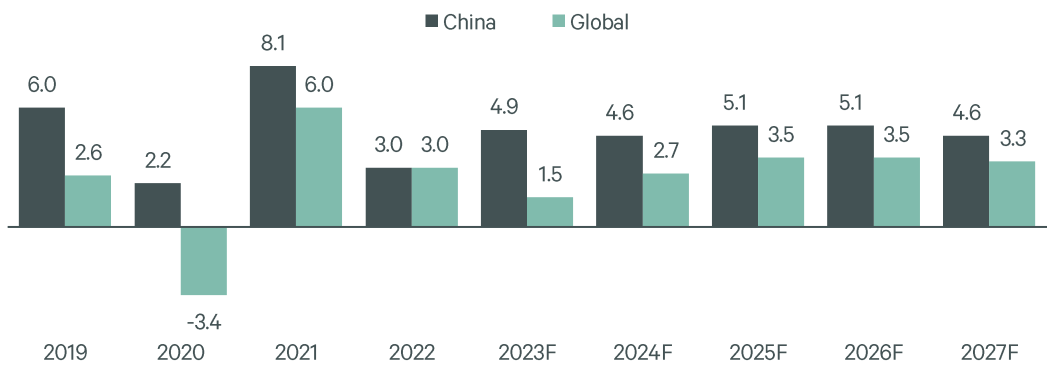
CBRE expects China's GDP growth to rebound to 4.9% in 2023, despite weaker external demand resulting from slower growth in the developed economies of Europe and the U.S.

Figure 3: Required Reserve Ratio (RRR) and Loan Prime Rate (LPR) (%)



Source: Wind, CBRE Research, February 2023

Figure 4: China and global GDP growth forecast



Source: CBRE Research, February 2023

02

Office

Office rental demand to stabilise and recover; net absorption forecasted to reach 5 million sq. m.

Measures to contain the COVID-19 pandemic; the resulting economic slowdown; and tighter regulatory control of the tech sector combined to ensure office net absorption in the 18 major cities in China tracked by CBRE registered just 2.34 million sq. m. in 2022, a decline of 68% y-o-y and the lowest annual total since 2009.

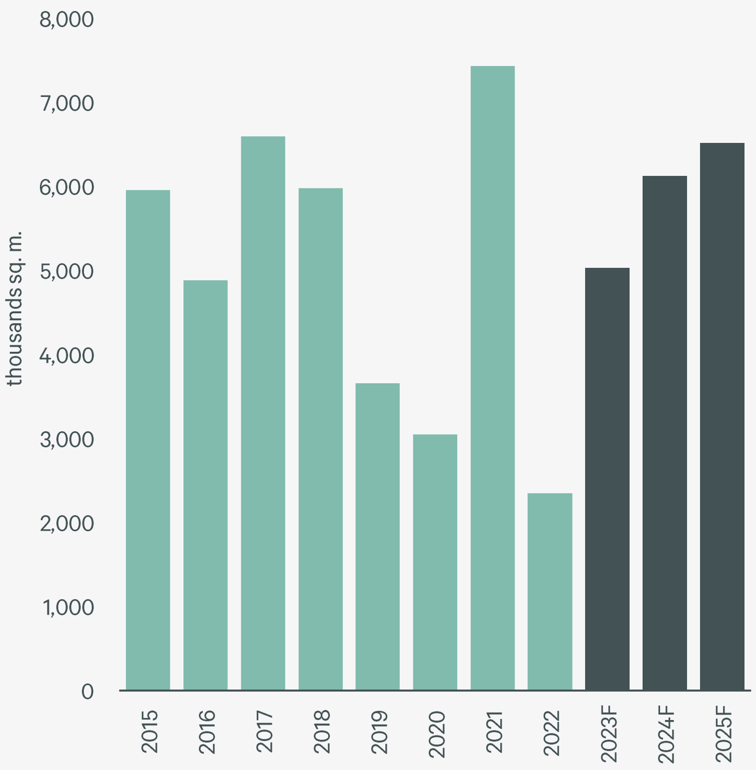
While business activity and leasing demand shrank further following the lifting of the zero-COVID policy and resulting increase in infections towards the end of 2022, economic activity picked up strongly in the opening weeks of 2023. **CBRE therefore expects office leasing demand to stabilise in Q2 2023 and recover thereafter, leading full-year net absorption to approach 5 million sq. m., on par with the past five-year average.**

Offices remain the primary place of work

Although remote and hybrid working policies have been widely adopted by numerous companies since the onset of the pandemic, the office remains the major place of work. **CBRE's 2022 Global Live-Work-Shop Survey found that 90% of China-based respondents still primarily work in offices, 9 pps and 6 pps higher than their Asia Pacific and global counterparts, respectively.**

With the re-designation of COVID-19 to "Category B management (a Class B infectious disease under Category B management)," most companies will return to pre-pandemic office working, while also incorporating remote working into business continuity plans..

Figure 5: Forecasted nationwide net absorption



Source: CBRE Research, February 2023

Brightening economic outlook supports recovery in corporate confidence

With infection rates in major cities thought to have already passed the peak, business activity is now picking up. In January, the manufacturing Purchasing Manager's Index (PMI) returned above the 50 benchmark, indicating expansion and marking an end to three consecutive monthly declines. At the same time, the service sector Business Activity Index registered a sharp increase of 14.6 pps to 54% from December 2022.

A CBRE survey of office occupiers in Q3 2022 shortly before the omicron-driven surge in infections found that 36% of surveyed companies expected to increase their office space in the next 18 months (from H2 2022 to 2023). Considering the recent loosening of pandemic, economic, and macro policies, CBRE expects corporate expansionary demand to increase steadily in the coming months and exceed expectations expressed within the survey.

Office demand among financial institutions is expected to witness a particularly significant improvement thanks to the introduction of macroeconomic incentive policies. Other sources of demand will include the tech and real estate industries, supported by the improved industrial environment, along with the downstream related service industry.

Finance sector to grow steadily; tech demand to rebound; manufacturing momentum to pick up

From the perspective of demand structure by industry, finance and TMT continued to dominate the market in 2022, accounting for a combined 50% of overall leasing volume. These two sectors are expected to continue to drive the leasing market in 2023, with the finance sector set to grow steadily thanks to incentive policies, and expansionary demand from tech companies forecasted to recover after a prolonged period of consolidation.

Capital market reform to generate expansionary demand from non-banking financial institutions

Capital market reforms are expected to benefit the securities sub-industry in 2023, translating to new leasing demand. After a three-year trial period, China's new stock issuance and registration system is likely to be formally adopted, while the pickup in refinancing in the real estate industry along with the expansion of REIT IPOs will also offer new business opportunities to securities companies. The number of securities industry practitioners registered with the China Securities Association reached nearly 380,000 in October 2022, an increase of 5.5% from the end of 2021. CBRE expects the steady growth in headcount among non-banking financial institutions including securities and asset management companies to result in new office leasing demand in 2023

TMT sector to regain momentum as platform economy recovers under looser policy environment

Weighed down by factors such as the slowdown in economic growth and the tighter regulatory environment, new leases contributed by the TMT sector registered a sharp decline in 2022. However, with **"vigorously developing the digital economy, improving normalised supervision, and supporting platform companies to express their talents in leading development, creating employment, and international competition"** having been stated as a key objective at the Central Economic Work Conference at the end of 2022, the policy environment for internet platform companies is expected to be looser in 2023. CBRE expects firms in this sector to focus on growth opportunities tied to integration with the real economy, which should help them regain demand momentum.

Recent years have seen tech companies begin to increase their investment in hard-tech fields. In 2022, Tencent invested in a total of 18 hard-tech companies in the fields of AI, semiconductors, chips and robotics, which accounted for about 21% of the company's total capital outlay.

Alibaba invested in seven such companies, accounting for 23% of its total investment, while ByteDance invested in four firms, representing 21% of its investment[1]. Subsequent months saw several Invested companies including Cloud Whale Intelligence and Black Pebble Cloud start to expand in office buildings.

The advent of the metaverse will also generate new office leasing demand, with authorities in cities including Beijing, Shanghai, Shenzhen, Guangzhou, Hangzhou, Chengdu, Wuhan and Xi'an issuing industrial incentive policies to support the development of the metaverse in 2022.

China's metaverse is expected to maintain a CAGR of 33% from 2022 to 2027[2]. Industry chain related sectors such as AI, 5G, cloud technology software development companies and VR/AR hardware manufacturing companies, are expected to expand continuously.

Note 1: Selected Statistics from Times Finance 2: 'The Market Prospects and Investment Research Report of the 2023 China Metaverse Industry' by the China Business Industry Research Institution

Note 3: Leasing volume includes new set-up, expansion, upgrading and relocation.

Figure 6: Leasing volume forecast for major industries[3]

	% of 2022 leasing volume	Y-o-Y change from 2022 leasing volume	Expected 2023 leasing volume	Growth sub-industry
TMT	24%	-53%	↗	Underlying technology R&D, Metaverse related services, business services
Finance	23%	-19%	↗	Non-banking financial institutions
Manufacturing	12%	-2%	→	New energy vehicles
Business Services	10%	-11%	↗	Law firms, Human Resource, Financial business
Real Estate	8%	-20%	↗	Upstream and downstream sectors such as engineering management
Pharmaceutical and Life Science	4%	-26%	→	Pharmacy R&D, Medical equipment

Source: CBRE Research, February 2023

Long-term confidence of foreign manufacturing companies in China to stay firm; demand from NEV manufacturers to expand

Foreign investment in China increased by 6.3% y-o-y in 2022, with the volume of overseas capital directed into the manufacturing sector rising by an impressive 46.1%, reflecting foreign companies' long-term confidence in China's improving economic prospects and business environment.

Despite the expected slowdown in the U.S. and European economies and possibility of layoffs among multinational corporations, CBRE expects foreign manufacturing companies with a presence in China to expand their R&D and regional headquarters footprint, further benefitting the office market in tier I cities possessing concentrated headquarters economies.

Within the manufacturing sector, New Energy Vehicle (NEV) manufacturers will continue to emerge as a source of office leasing demand. New leases contributed by NEV companies in key markets across the country increased by 250% y-o-y in 2022. In the coming year, rapid growth in both production and sales will push up leasing demand from this segment, along with related upstream and downstream companies, particularly in cities supported by concentrated NEV industry chains, such as Shanghai and Beijing.

New supply expected to match demand in 2023; tier II cities to see improved building quality

Measures to contain the spread of COVID-19 resulted in the suspension of 34% of nationwide pipeline office supply in 2022. With much of this new stock due to come on stream this year, CBRE expects new supply in the 18 major cities to reach 8 million sq. m. in 2023, not far from the pre-pandemic five-year average. New supply in the next three years (2023-2025) is forecasted to reach 21.6 million sq. m., 19% higher than the previous three years, with the bulk of new stock concentrated in tier II cities.

Supply and demand relatively balanced in tier I cities

While new supply in tier I cities will exceed that in tier II cities over the next three years, the former will see a far more equitable supply-demand balance. The ratio of net absorption and new supply in Beijing, Shanghai, and Shenzhen has exceeded 75% in the past three years and is forecasted to continue to do so over the next three years. While the ratio in Guangzhou was lower due to the lack of new supply, the figure for tier II cities was under 65%.

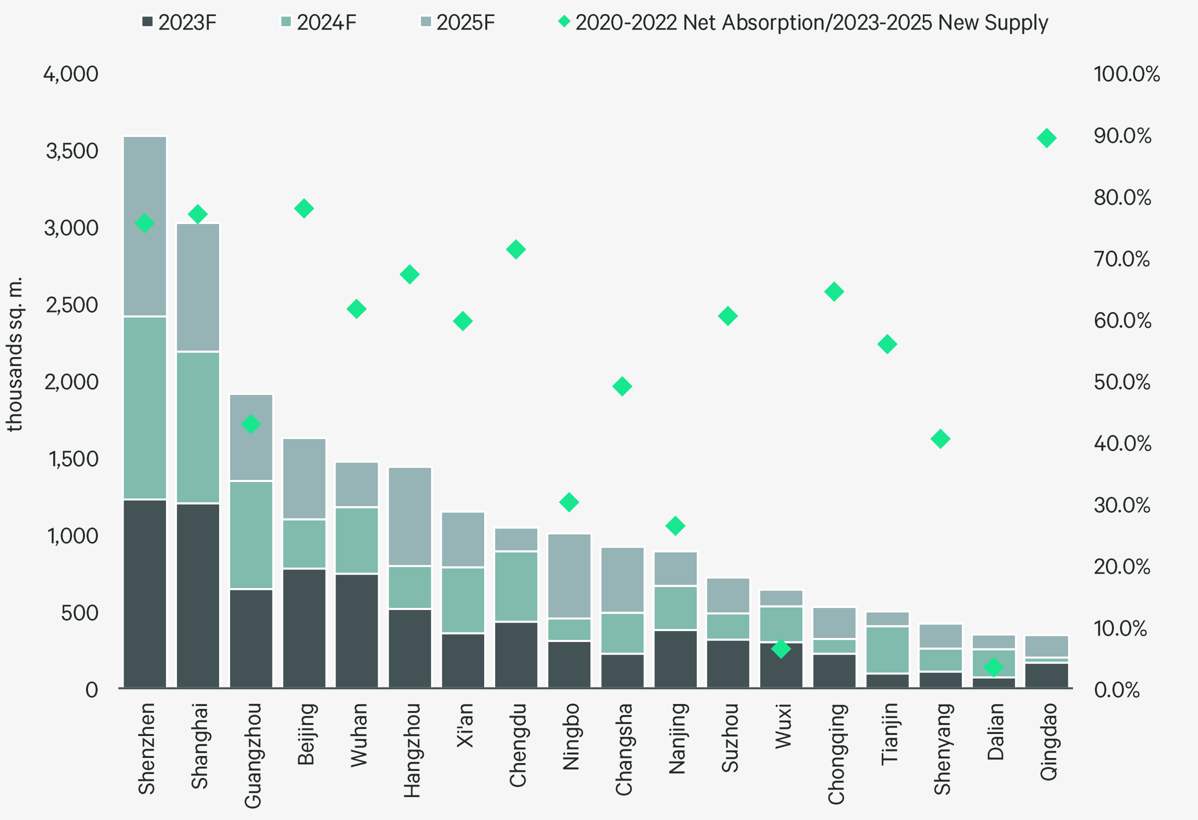
Supply shortage persists in core CBDs of tier I cities

Vacancy and new supply in the core CBDs of tier I cities will continue to exhibit a declining trend. **New completions in core CBDs will account for just 3% of total new supply in tier I cities in the next three years, with leasable space forecasted to decline at a rate of around 10% annually from 2024-2025.**

Tier II cities to see improved building quality

Grade A buildings will account for 81% of the GFA of total new office supply due to come on stream over the next three years, 3 pps higher than that from 2020-2022. The quality of new supply in tier II cities continues to improve and is now not far from standards in tier I markets. With high quality new supply in tier II markets now suited to occupiers' requirements, demand could increase as a result.

Figure 7: 2023-2025 new supply forecast by city



Source: CBRE Research, February 2023

> When asked to identify their preferred real estate strategies over the next 18 months, most occupiers named flight-to-quality and expansion.
>
> CBRE 2022 China Office Occupier Survey
> CBRE Research, August 2022

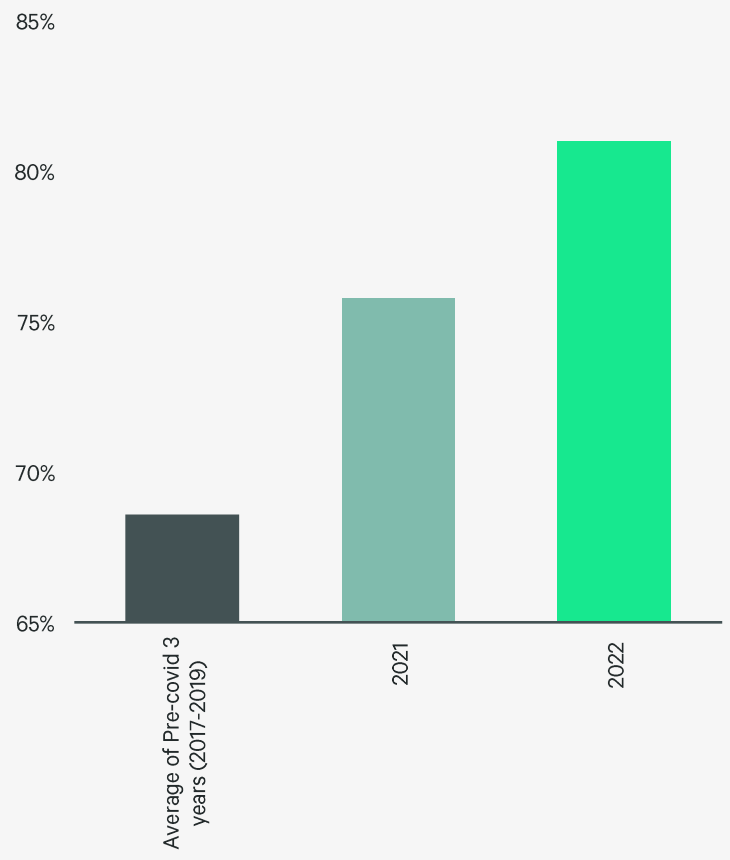
Flight-to-quality demand to accelerate

Recent years have seen flight-to-quality drive office leasing demand in China. Grade A buildings' contribution to total net absorption further increased to 81% in 2022, while Grade B buildings saw negative net take-up in cities including Beijing, Shanghai, Guangzhou, Tianjin, and Hangzhou. The stronger emphasis among both enterprises and employees on health and wellness in the workplace, along with the ample supply of new Grade A buildings, will further accelerate the flight-to-quality trend in 2023.

CBRE's 2022 Global Live-Work-Shop Survey found that 81% of respondents in mainland China believe that the quality of their working environment is more important than before the pandemic, the highest such ratio globally. Employees are now placing a stronger emphasis on the quality of their working environment including air quality, noise control, lighting, space design, multifunctional working spaces and facilities related to health and wellness.

Companies are already responding to their employees' demands. When asked to identify their preferred real estate strategies over the next 18 months, respondents to CBRE's 2022 China Office Occupier Survey named flight-to-quality and expansion as their top choices. Some 40% of respondents expect to increase the use of fresh air circulation and filtering systems, while 30% of respondents plan to include more fitness facilities in their offices in future.

Figure 8: Proportion of net absorption in Grade A buildings



Source: CBRE Research, February 2023

Core CBDs continue to be favoured; Demand growing in emerging CBDs with improved transportation and amenities and sufficient leasable space

Apart from building quality, employers and employees are set to place greater importance on location in 2023.

CBRE's 2022 Global Live-Work-Shop survey revealed a strong correlation between office location and employees' satisfaction. Among China-based respondents, 90% of employees working in city centres and 74% of employees working in emerging CBDs expressed satisfaction with transport and amenities, but this ratio fell to just 17% among employees working in suburbs or other non-business districts.

These findings suggest that as competition to attract talent intensifies, core and emerging CBDs with mature transport systems will be preferred as office locations. However, as previously discussed, new supply and vacant space will be tighter in core CBDs, particularly in tier I cities with stronger demand.

Figure 9: Overall satisfaction with office transportation and amenities

90%	74%	17%
Office in city	Office in established/emerging district	Office in suburbs

The vacancy rate in districts including Beijing Chaoyang CBD and Financial Street, Shanghai Nanjing West Rd and Huaihai Middle Rd, Guangzhou Tianhe Sports Centre and Zhujiang New Town, and Shenzhen Futian CBD, stood at 10% or lower at the end of 2022. With the recovery of the leasing market in 2023, vacancy in these areas will keep decreasing.

New high-quality stock will come on stream in previously undersupplied core CBDs in tier II cities such as Hangzhou and Chengdu, offering flight-to-quality and relocation opportunities.

Cost control and sufficient supply to spur focus on emerging CBDs

Considering the cost of leasing and availability of space, emerging CBDs with mature transportation networks and comprehensive amenities are increasingly favoured by occupiers. Districts with these attributes, such as Shanghai North Bund, Xuhui Riverside, Beijing Lize, Shenzhen Qianhai, Guangzhou Pazhou and International Financial City, Wuhan Optics Valley, and Nanjing Hexi CBD, will command an advantage over other emerging CBDs in 2023.

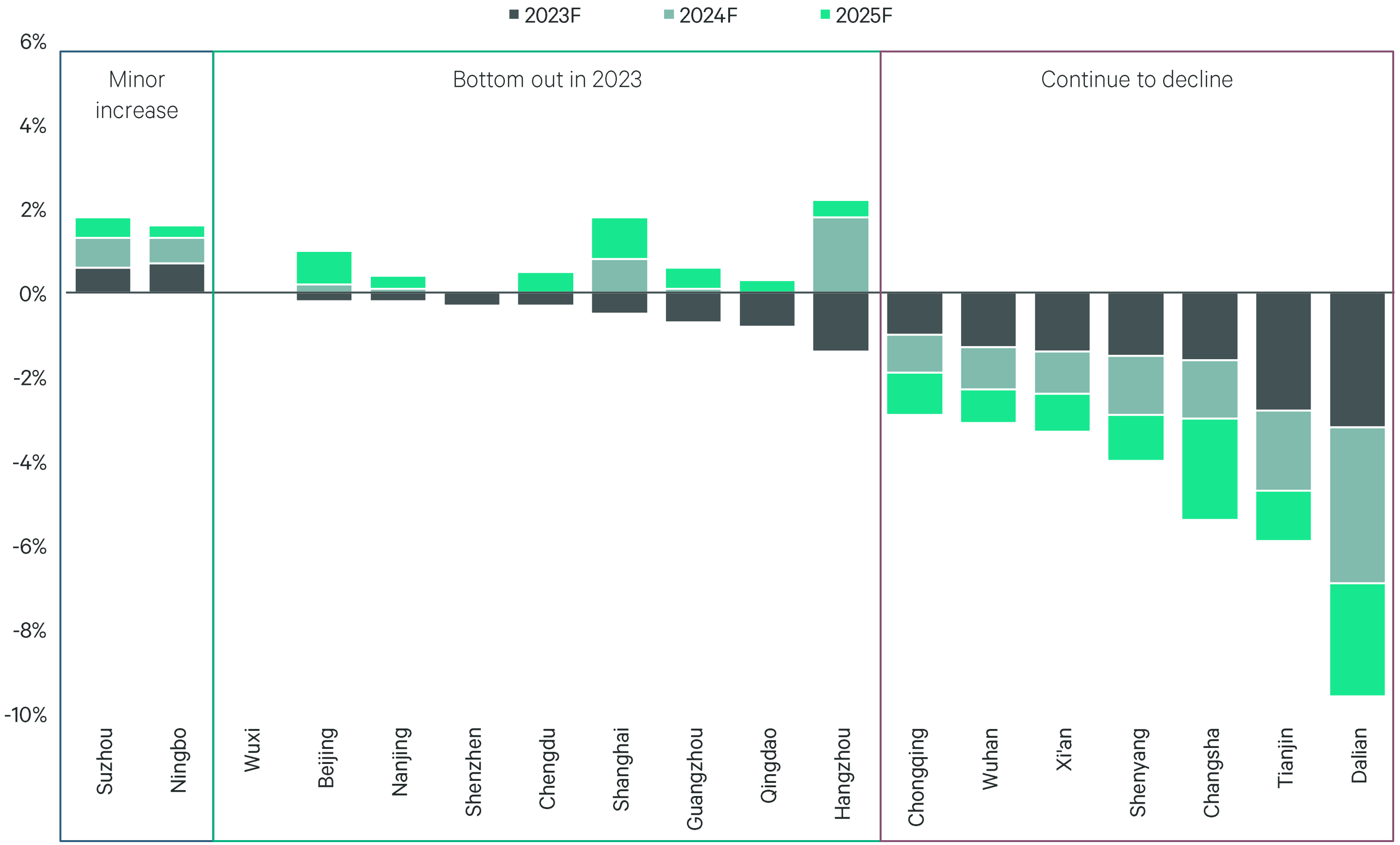
Source: 2022 China Consumer Survey, CBRE Research, February 2023

Rental decline to lose momentum in 2023 but remain favourable to occupier expansion

Along with the recovery of demand, CBRE expects nationwide office average face rents to drop by 0.7% y-o-y in 2023, 1.1 pps less than the fall registered in 2022. However, the influx of new supply will intensify competition among landlords to attract occupiers, ensuring rents continue to experience downward pressure in most tier II cities in North China, Central China and West China. Occupiers' stronger emphasis on the working environment along with location, amenities and quality will strengthen in 2023, leading to relatively poor rental performance for older and less attractive properties.

With the shortage of leasable space set to underpin the rental rebound in core CBDs of tier I cities, overall rents in tier I markets are forecasted to stabilise from H2 2023 to 2024. The outlook for rents in Chengdu, Qingdao and tier II cities of East China is relatively strong, with the average vacancy rate in these markets set to remain below 25% over the next three years, improving the demand-supply balance.

Figure 10: 2023-2025 rental forecast by city



Source: CBRE Research, February 2023

Recommendations

Recommendations for occupiers

– While ample new supply in 2023 will facilitate occupiers' real estate planning, availability in core CBDs in tier I cities will tighten further, pushing up rents. Occupiers targeting space in these areas are therefore advised to hasten decision-making.

– With CBRE's surveys uncovering a correlation between location, amenities and employee satisfaction, occupiers must strike a balance between leasing budgets and building location. For companies with large-scale office requirements, emerging CBDs that are gradually developing will make ideal supplements to core CBD space.

– Although anti-pandemic measures have now been loosened, health and wellness in the working environment will remain a long-term concern. Occupiers are recommended to capitalise on the current supply peak to pursue flight-to-quality moves or relocations to space that can facilitate these criteria.

– As hybrid working featuring mostly office-based work combined with some remote work is here to stay, companies will need to consider this trend in site selection, which could lead to stronger demand for flexible office space, leasable conference rooms, and buildings with high-speed IT networks.

Recommendations for landlords

– Office demand is expected to rebound gradually in 2023, with buoyant industries such as securities, asset management, hard-tech, advanced manufacturing, and business services set to drive leasing activity.

– With flight-to-quality set to be a long-term trend. Landlords are advised to increase their investment in building hardware such as fresh air circulation and filtering systems, lighting, contactless amenities, and commercial service facilities, while enhancing occupiers' experience through building management systems and programmes.

– For comparatively poorly located projects, landlords can offer transport services such as shuttle buses, shared bicycles, charging stations, and facilities related to dining, leisure, and health to attract tenants.

03

Retail

Domestic consumption to recover after pandemic peaks

Retail sales of consumer goods in China decreased by 0.2% y-o-y in 2022 due to the impact of the pandemic, which led to especially sharp declines in contact-based and discretionary consumption. Although the pandemic will continue to impact retail consumption, its magnitude will wane. Following the relaxation of pandemic-related control measures as the end of last year, coupled with the widely anticipated economic recovery and measures to boost consumption, retail sales of consumer goods are expected to grow by 8-10% y-o-y in 2023.

Increase in travel and mobility levels bodes well for consumption market

Shortly after January 1, 2023, authorities in several cities including Beijing, Guangzhou, Shanghai, and Shenzhen, officially announced that they had passed the peak of the latest surge in COVID-19 infections. Mobility in these cities improved shortly thereafter, with subway passenger flows in Beijing and Shenzhen returning to 2021's average level by January 13, and that in Shanghai and Guangzhou rising to around 85%. Data from the Ministry of Culture and Tourism show there were 308 million domestic trips taken during the Spring Festival in 2023, an increase of 23% y-o-y, reaching about 90% of the level during the same period of 2019.

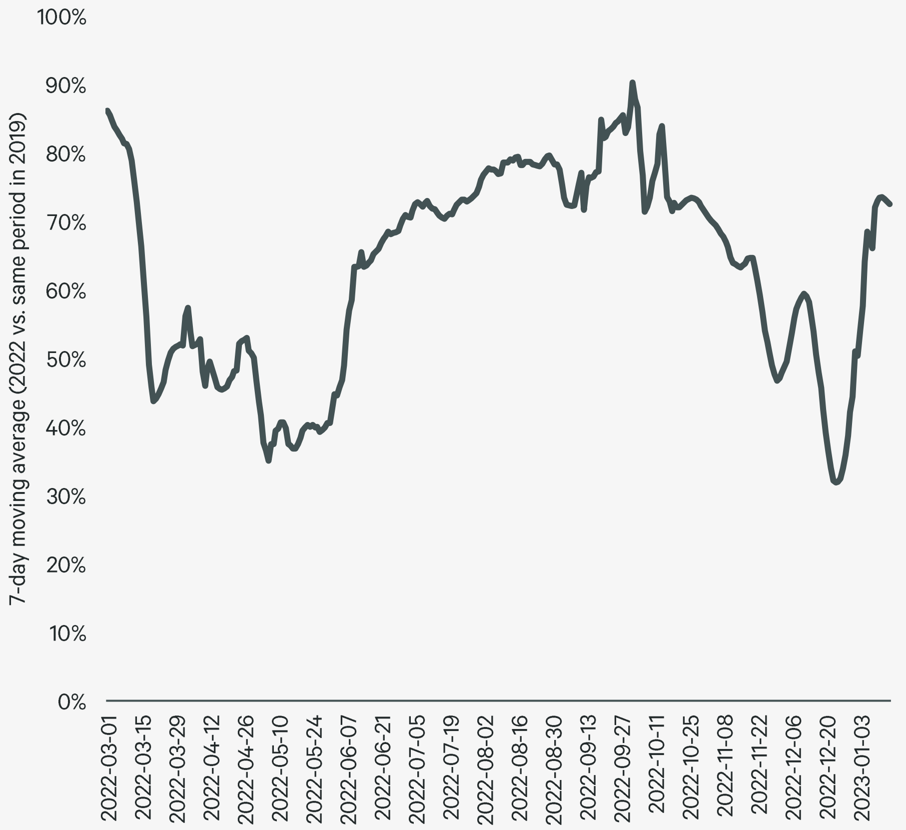
Excess savings set to underpin rebound in consumption

PBoC data show that **household deposits increased by RMB 178.4 trillion in 2022, an historical high, marking an increase of RMB 79.4 trillion over 2021 and RMB 65.4 trillion over 2020**. Chinese consumers' willingness to spend is closely related to the impact of the pandemic on travel and economic employment expectations. During the period from 2020 to 2022, urban residential consumption (per capita consumption expenditure/per capita disposable income) was below 64%, a decrease of about 5 pps from the previous five years. CBRE expects that as consumers become more willing to spend, excess savings may be converted into a driver of a rebound in consumption in 2023.

Shoppers become more willing to consume offline

CBRE's 2022 Global Live-Work-Shop Survey found **that 40% of China-based respondents indicated that they would increase offline consumption after the pandemic was over**. With shopping centres and retail stores having dropped requirements for customers to provide negative nucleic tests and residents' becoming accustomed to living with the virus, shopping mall footfall and consumption will recover significantly, driving a rebound in demand for high-quality retail properties.

Figure 11: Daily subway passenger flow in tier I cities



Source: Wind, CBRE Research, February 2023

Prime locations to benefit from recovery of discretionary consumption and tourism; positive effects of first-store economy set to be further strengthened

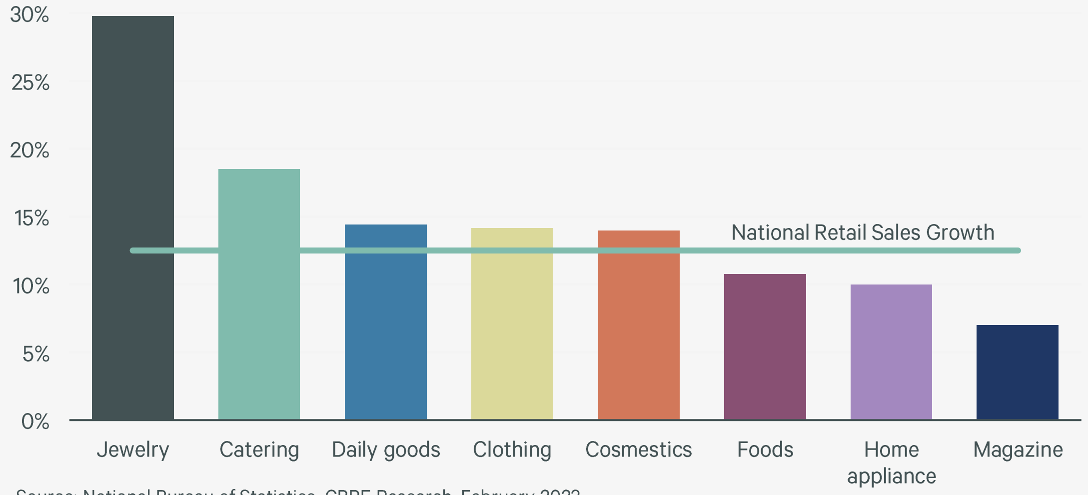
Rebound in optional consumption and tourism to firstly benefit core commercial areas

Based on the annual sales growth across various retail categories seen in 2021, the rebound in optional consumption of items such as jewellery, dining, clothing and cosmetics in 2023 will exceed that of the overall retail sector. This will particularly benefit shopping centres in prime locations which have a higher proportion of these trades in their tenant mix. The recovery in tourism will also boost footfall in core areas. In Shanghai, the Bund and Lujiazui have traditionally been tourist-oriented hubs, typically attracting around one million visitors during the National Day holidays prior to the pandemic. The rebound in foot traffic in these locations should ensure the sales performance of shopping centres in most prime locations outperforms the overall recovery in 2023.

Relaxed border restrictions expected to accelerate the entry of international brands into China, driving demand for prime locations

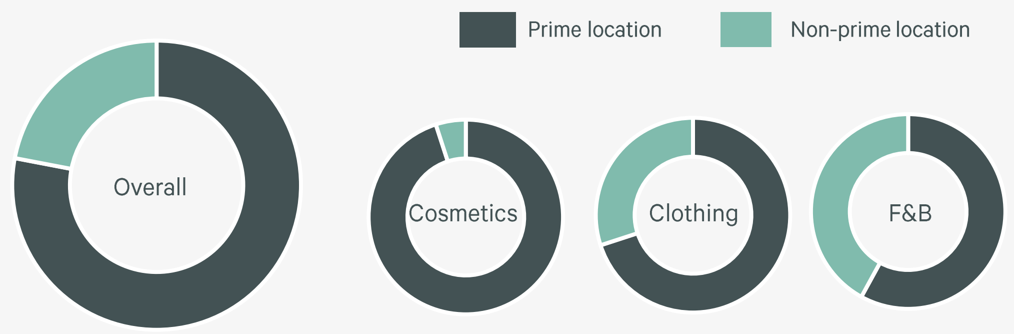
From January 8, 2023, China lifted compulsory nucleic acid testing and centralised quarantine for inbound travelers, and now only requires proof of a negative nucleic acid test within 48 hours of arrival. CBRE expects these looser requirements to help overseas brands speed up market entry and expansion. **CBRE's 2023 Asia Pacific Retail Flash Survey found that tier I cities in mainland China are the top choice in Asia Pacific for overseas market expansion.** In terms of specific location, prime shopping centres have traditionally been favoured by international brands for their first stores. In 2022, 78% of first stores opened by foreign retailers in China were in prime shopping centres. In terms of retail category, cosmetics retailers displayed the strongest preference for core commercial centres, followed by clothing, at around 70%. CBRE's survey also found that **92% of respondents who plan to expand in China said that their first stores would be in a shopping centre or street shop in the city centre.**

Figure 12: Annual sales growth across various retail categories in 2021



Source: National Bureau of Statistics, CBRE Research, February 2023

Figure 13: First store locations of international brands in China in 2022



Source: CBRE Research, February 2023

> Chinese consumers are more willing to buy more expensive brands and go to more expensive locations. Consumption upgrading will therefore remain a key trend in China's retail market.
>
> CBRE's 2022 Global Live-Work-Shop survey, CBRE Research, December 2022

Family and entertainment consumption set to boost regional shopping centres

CBRE's 2022 Global Live-Work-Shop survey found that when personal financial expectations are positive, China-based respondents intend increase their spending on their families, children, leisure and travel. Compared with Asia Pacific consumers, Chinese shoppers are more willing to buy more expensive brands and go to more expensive tourist resorts. This indicates that the trend for consumption upgrading will continue in 2023.

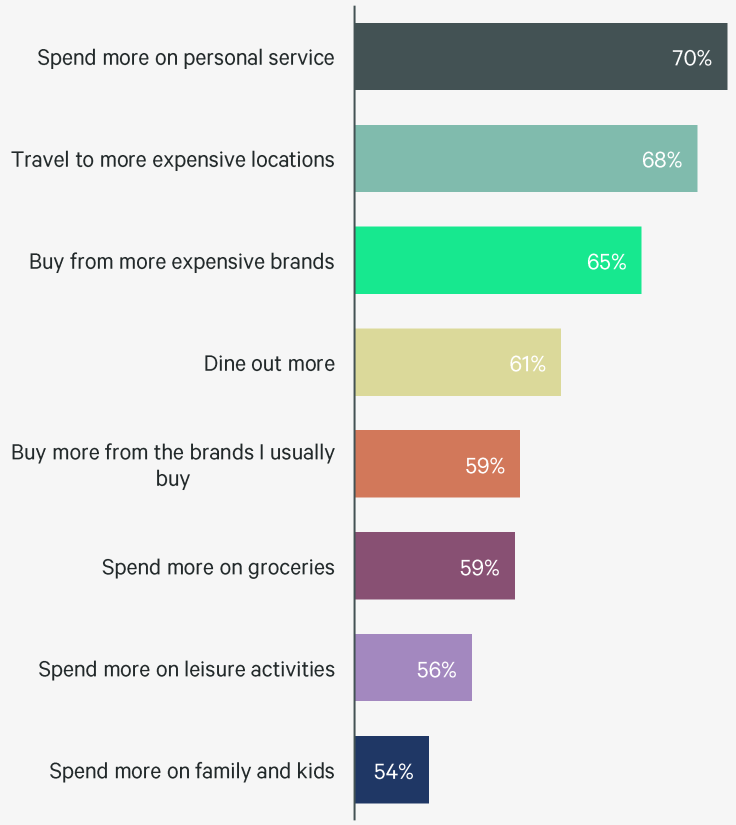
The coming year will see demand from retailers in the family and entertainment categories increase both in terms of quantity and quality. While ever-increasing consumer demand will drive the willingness of existing brands to expand their footprint, consumption upgrading also needs to be facilitated by the emergence of new retail categories.

Taking camping as an example, in November 2022, the Ministry of Culture and Tourism issued the "Guiding Opinions on Promoting the Healthy and Orderly Development of Camping Tourism and Leisure" to support the sustainable development of the upstream and downstream industrial chains of camping tourism and leisure.

Demand from the sector is already on the rise, with the likes of ABC Camping Country and 51Camp setting up camps and opening stores in shopping malls. At the same time, landlords introducing popular outdoor brands have created related themed spaces in their properties. Examples include the starry sky terrace on the fifth floor of Wuhan Joy City, which is the city's first rooftop camp.

CBRE expects the rise of household and entertainment products to greatly benefit regional shopping centres with a one-stop family consumption focus and space to accommodate large-format retailers and activities.

Figure 14: Change in spending habits when people feel positive about their finances



Source: CBRE Research, December 2022

Strong demand to offset impact of large new supply

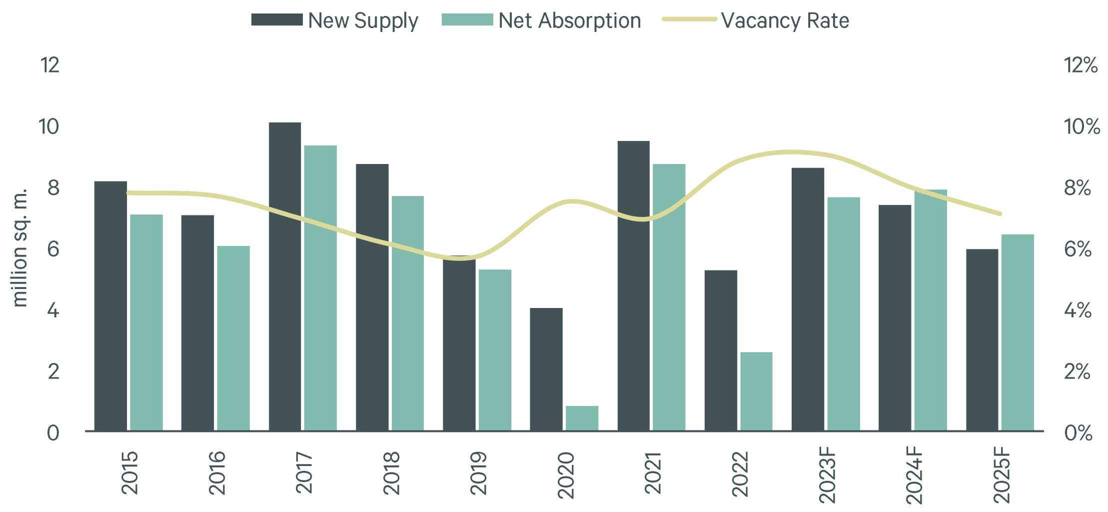
CBRE data show that approximately 8 million sq. m. of new retail stock will come on stream in China's major cities in 2023

The elevated supply pipeline is primarily due to pandemic-related delays to around 30% of last year's retail pipeline. On the demand side, the relaxation of pandemic measures and the recovery of domestic consumption will accelerate retailer expansion. CBRE's 2022 Global Retail Flash Survey found that 71% of respondents from mainland China plan to open new stores in 2023, the highest ratio in Asia Pacific. **CBRE predicts that the vacancy rate for domestic shopping centres will firstly peak and then decline in 2023, falling to around 7% by 2025, a similar level to that observed in 2021**.

Prime locations to drive rental rebound amid robust demand and tight availability

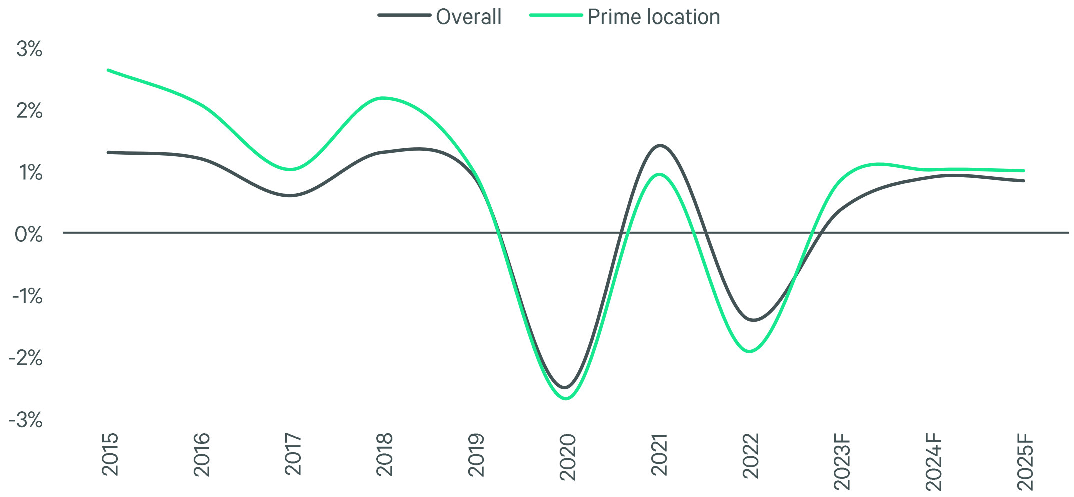
Just 16% of new supply due to be completed from 2023-2025 will be located in the core business districts of the 18 major cities tracked by CBRE. Major new projects include K11 phase two in Shanghai; the Jiari Shanghai Jinling Road project; Beijing Wangfujing Xiyue; Shenzhen Zhuoyue Centre; Hangzhou Henglong Plaza; and Hangzhou K11. Based on the scarcity of leasable area and strong expansionary demand, CBRE expects rents in the core business districts of the 18 major cities to grow by 0.9% y-o-y in 2023, with rents in tier I cities' core business districts forecasted to accelerate by 1.7% y-o-y. As the vacancy rate peaks and then declines in 2023, average shopping centre rents are expected to stabilise and increase slightly by about 1% in 2024, with growth set to continue into 2025.

Figure 15: National retail property market supply and demand forecast



Source: CBRE Research, February 2023

Figure 16: Nationwide Shopping Mall G/F Asking Rental Index (YoY)



Source: CBRE Research, February 2023

Recommendations

Recommendations for occupiers

- The loosening of anti-pandemic restrictions and widely anticipated economic recovery will act as a tailwind for domestic consumption in 2023. Retailers are advised to capitalise on the window of opportunity to expand their footprint, increase brand marketing and regain sales growth.
- While ample new supply will provide room for rental negotiation in 2023, an ongoing scarcity of prime shopping space will require international brands planning to enter the Chinese market to accelerate site selection.
- After reassessing the value and role of both online and offline channels to their brand, retailers are recommended to reshape and strengthen the role of brick-and-mortar stores to meet the needs of the post-epidemic era.
- In response to consumption upgrading, retailers must upgrade and update products and store layouts as well as improve service quality.

Recommendations for landlords

- Landlords should cater to consumers' demand for high-quality shopping environments by improving brand portfolios and services. Healthy and safe shopping will be a long-term requirement.
- With prime locations set to continue to command a significant rental advantage, owners should fully leverage the market recovery to enhance rental performance.
- Landlords of shopping centres in non-prime locations are advised to tap into increased leisure and household spending by introducing high-end supermarkets and family entertainment facilities. Other strategies may include creating micro-vacation destinations and themed events.
- CBRE recommends property owners rigourously evaluate the overall business format of their projects, optimising the balance between floor area and rents while fully harnessing the power of experience-oriented formats.

04

Logistics

2023 to see 30% growth in warehouse demand

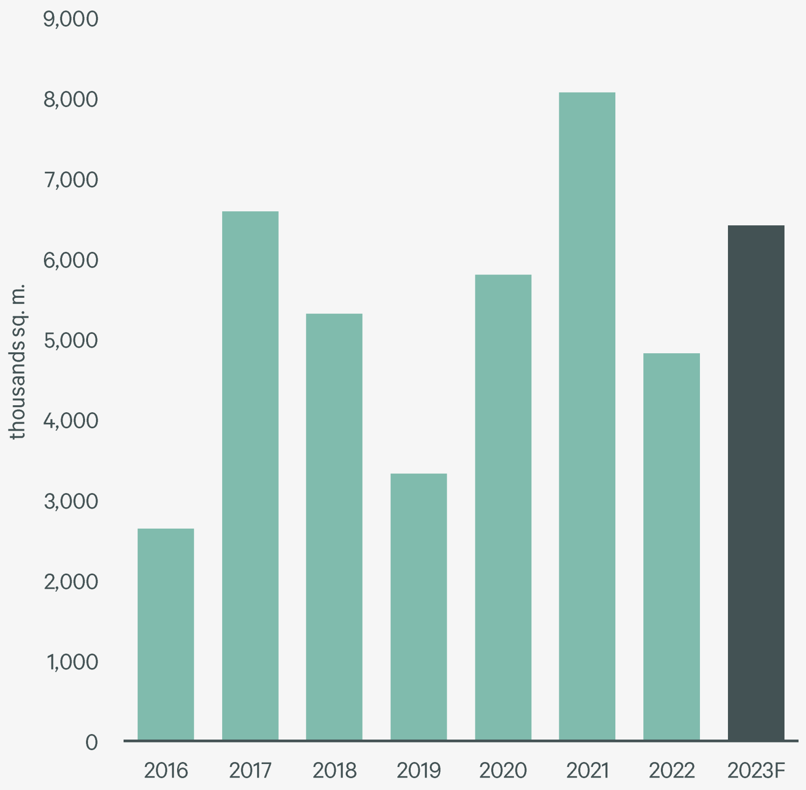
Cargo backlogs, a shortage of truck and delivery drivers, sanitisation requirements and the suspension of operations at distribution centres weighed on logistics and warehouse demand in 2022. Growth in national parcel delivery volume fell significantly from 30% y-o-y in 2021 to 2.1% y-o-y in 2022, the lowest rate of expansion in history. Against this backdrop, national warehouse demand declined by 40% y-o-y to 4.8 million sq. m. in 2022.

This year to see 30% growth in warehouse demand

As set out last year's Central Economic Work Conference, China will be more focused than ever before on economic growth in 2023, with a raft of supportive policies to expand domestic consumption set to be announced in the coming months. Data from The State Taxation Administration show that revenue from domestic consumption related industries increased 12.2% y-o-y in 2022, a rate of growth expected to pick up in the coming year.

Although export growth slowed in 2022, previous limitations that constrained logistics operations and demand are set to dissipate this year, ensuring the rebound in domestic consumption supports the recovery of warehouse demand. In addition, the upgrading of supply chain and logistics outsourcing driven by high-end manufacturing will require more warehouse space. **CBRE expects that warehouse net absorption in China's major cities will increase by 30% y-o-y to 6.4 million sq. m. in 2023.**

Figure 17: Forecast of national logistics net absorption (24 cities)



Source: CBRE Research, February 2023

01 **Online consumption returns to normal**

- Smoother logistics operations and improved consumer confidence will encourage more online consumption
- The economic recovery and stronger housing sales will stimulate a rise in discretionary consumption, including clothing, shoes and hats, cosmetics and household appliances, all of which command a higher share of online sales.

02 **New growth in warehouse driven by live streaming e-commerce**

- As competition intensifies, live streaming e-commerce players will require more efficient supply chains and logistics for a better consumer experience, leading to more demand for warehouse space.

03 **Supply chain to see high growth**

- Industrial upgrading, geopolitics and epidemics will lead to increased supply chain demand from manufacturing companies.
- High-quality warehousing will be key to supply chain operations. Warehousing and value-added services contribute 40% of DHL's supply chain service revenue.

Online retail growth to return to normal; live streaming to emerge as new driver of warehouse demand

Although online retail sales of physical goods rose by just 6.2% y-o-y in 2022, the lowest on record, performance was resilient compared to overall retail sales, which shrank by -0.2% y-o-y. The composition of online retail sales changed substantially compared to 2021, with the consumption of food-related products growing at a rapid pace of 16.1% y-o-y. However, discretionary consumption, including apparel-related and daily use-related products, which constitutes a major part of online retail sales, declined significantly. Economic uncertainty, weaker consumer confidence and logistics bottlenecks all weighed on discretionary consumption in 2022.

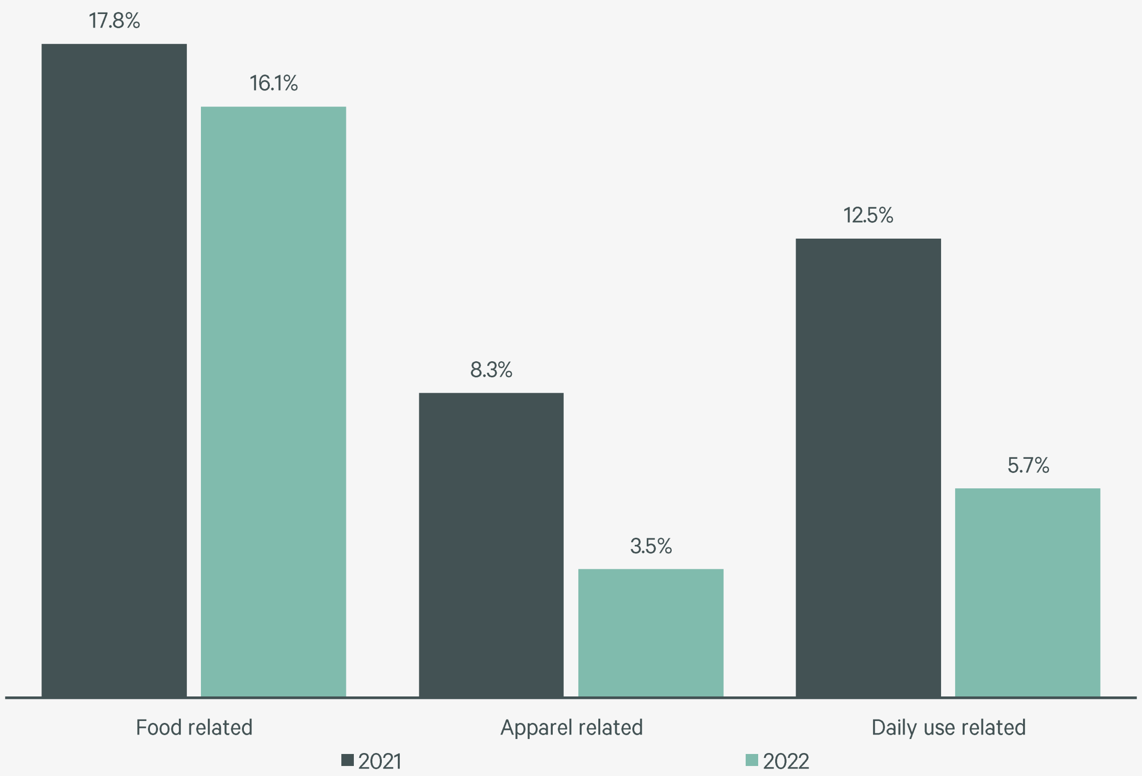
CBRE expects smoother and more efficient logistics networks and improving consumer confidence to support steady growth in online retail sales in 2023. Other supportive factors include a pickup in the residential housing market, which should bring about an improvement in demand for home appliances, and a rebound in domestic travel, which should boost apparel and cosmetics sales. China's State Post Bureau data show that parcel delivery volume increased 13% y-o-y during the Chinese New Year vacation.

Live streaming e-commerce to be new growth driver

By blending entertainment with the ability to purchase items immediately, live streaming e-commerce offers retailers, brands, and digital platforms a new channel for selling goods. Growth has been significant in recent years, with Xingtu data showing the CAGR of GMV for live e-commerce exceeded 100% in the past three years, and growth projected to hit 40% in 2023.

As competition intensifies, live e-commerce players will need more efficient supply chain and logistics networks to provide a better consumer experience – a trend expected to drive new demand for warehouse space. In 2022, Dongfang Zhenxuan (Oriental Selection), New Oriental's live-streaming platform, attracted millions of followers within a very short timeframe. In the six months ending on Nov 30, Dongfang Zhenxuan provided 60 self-run agricultural products, bringing in revenue of over RMB 1 billion. The company reportedly plans to establish 20 warehouses for self-operated products in five cities, namely Beijing, Guangzhou, Hangzhou, Zhengzhou and Chengdu. Douyin, another major live-streaming e-commerce platform, has announced plans to partner with 3PLs to launch services such as "extreme delivery" to improve customers' logistics experience.

Figure 18: Growth and breakdown of online retail sales of physical goods



Source: National Bureau of Statistics, CBRE Research, February 2023

Supply chain gains importance amid China's industrial upgrading

Industrial upgrading, geopolitical tension and the pandemic have led to stronger demand for high quality supply chain networks from manufacturing companies, which require higher inventory while maintaining efficient and cost-effective manufacturing. High-quality warehousing is key to the supply chain. Automotive companies have especially strict supply chain requirements, as the typical vehicle is comprised of over 20,000 individual components, the supply of which must always be ready and available.

The surge in NEV sales and manufacturing is driving demand for more warehouse space to stock components related to production, distribution, sales and after-market care. **CBRE data show that new leases by automotive and parts companies reached a record high 450,000 sq. m. in 2022, representing growth of 86% y-o-y.** Most new leases were signed by NEV firms. The China Association of Automobile Manufacturers expects China's NEV sales to exceed 9 million in 2023, representing growth of more than 30% y-o-y.

3PLs are also enhancing their competitiveness in the sphere of supply chain management, strengthening their planning, sourcing, manufacturing, delivery and return capabilities. 3PLs including JD and SF Express are targeting the supply chain as their key growth driver in 2023 and are already expanding their warehouse footprint, particularly in the high-quality segment. DHL supply chain reported in 2022 that 40% of its global revenue came from warehousing and value-added services, with its business now covering areas such as retail, consumer goods, life sciences & healthcare, auto-mobility, technology, engineering & manufacturing.

Figure 19: DHL supply chain service

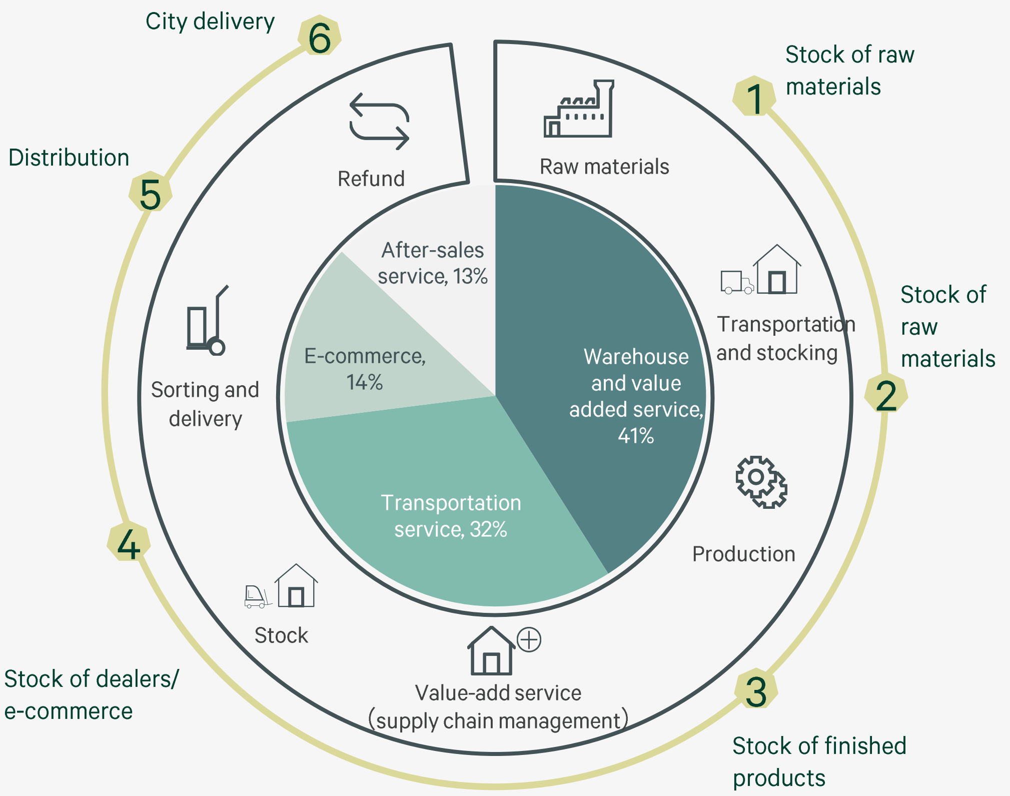
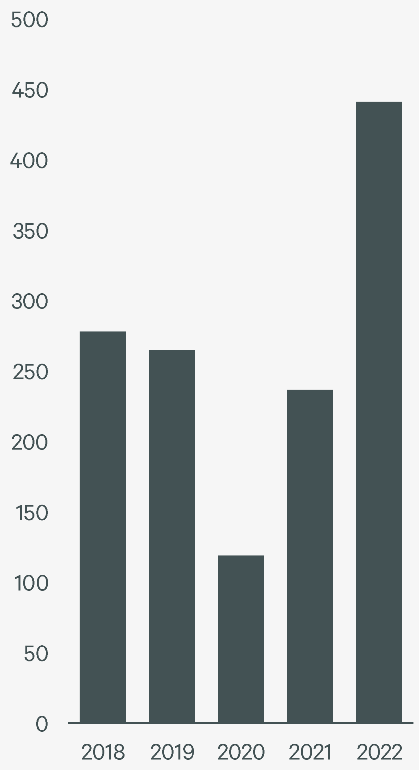


Figure 20: New leases from automotive and parts firms (thousand sq. m.)



Source: DHL annual report, CBRE Research, February 2023

Addition of new supply deferred from 2022 to push up vacancy to five-year high in 2023

The pandemic-driven suspension of business activity for large parts of 2022 resulted in the deferral of over 2 million sq. m. of new logistics supply to 2023. **This will ensure around 10 million sq. m. of new supply comes on stream in 2023, the highest in several years. New supply in tier II markets will account for 83% of the pipeline. However, new supply in 2024 will halve to 5.3 million sq. m.**

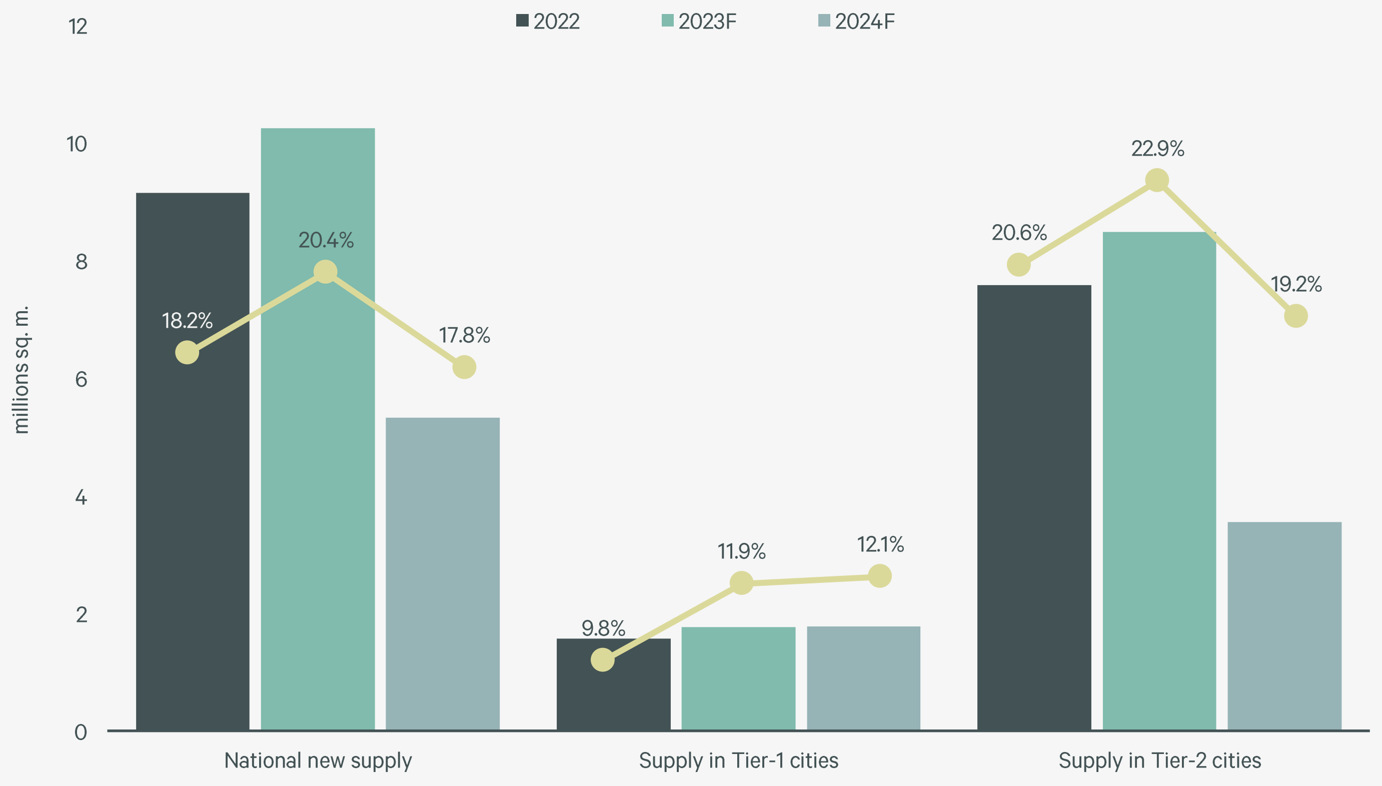
Shanghai and Guangzhou will see the addition of new supply exceeding their respective five-year averages. Supply in Beijing will fall back rapidly after peaking last year, while new stock in Shenzhen will remain extremely limited. Satellite markets around tier I cities will see supply peak in 2023, with new stock in Changshu, Tianjin, Suzhou, Langfang and Huizhou each close to or exceeding 800,000 sq. m., offering occupiers more cost-effective warehouse space close to core cities.

The supply peak in Central and West China, which in recent years led to oversupply in these areas, is about to culminate, with these markets set to be far more balanced in the next three years.

Nationwide vacancy will rise to around 20% in 2023 in face of the supply peak before pulling back to 17.4% in 2024 as supply dries up and demand picks up along with the global economic recovery in 2024.

Nationwide rents will experience minor growth of 0.6% in 2023, before gaining momentum to 1% in 2024. **Cities with tight supply like Dongguan, Hangzhou and Wuxi will continue to see rental growth of 2%-4% in 2023.**

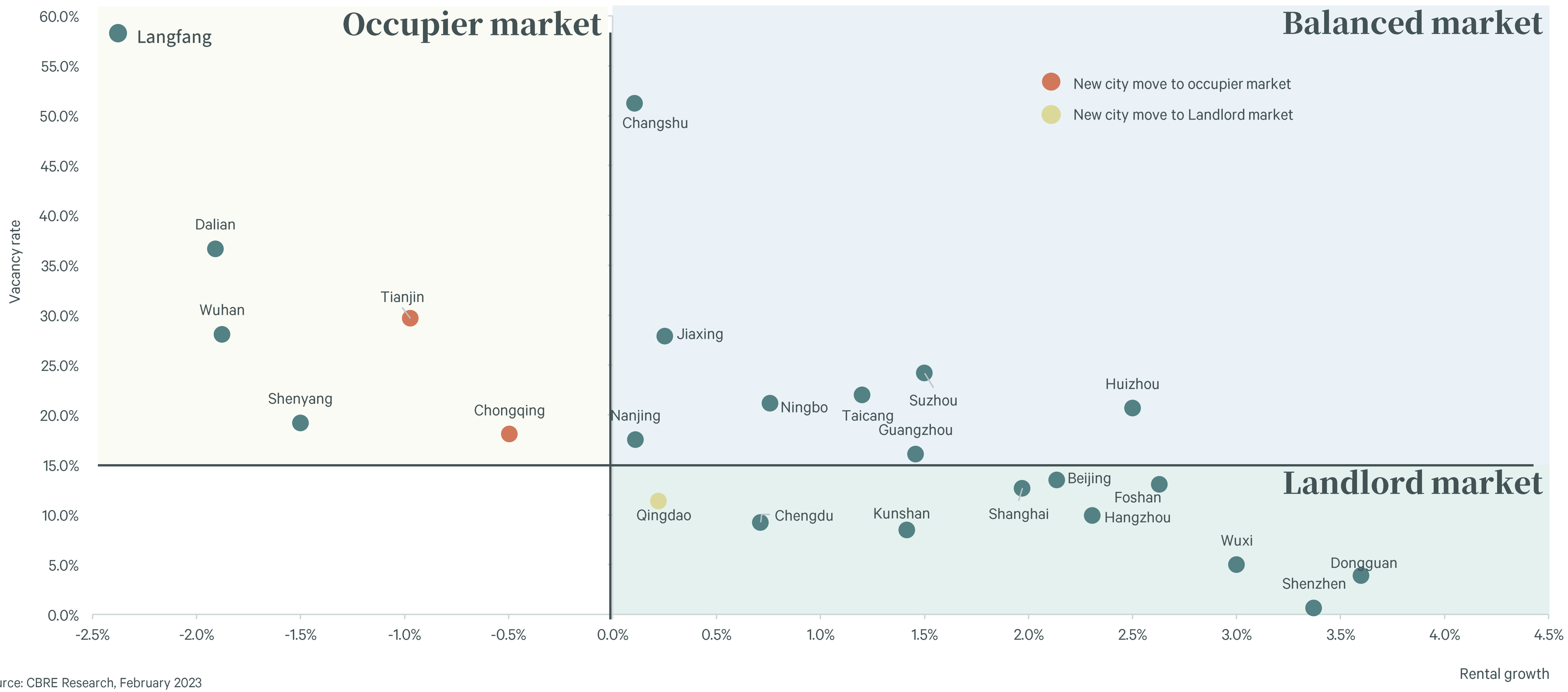
Figure 21: Supply and vacancy forecast from 2022 to 2024



Source: CBRE Research, February 2023

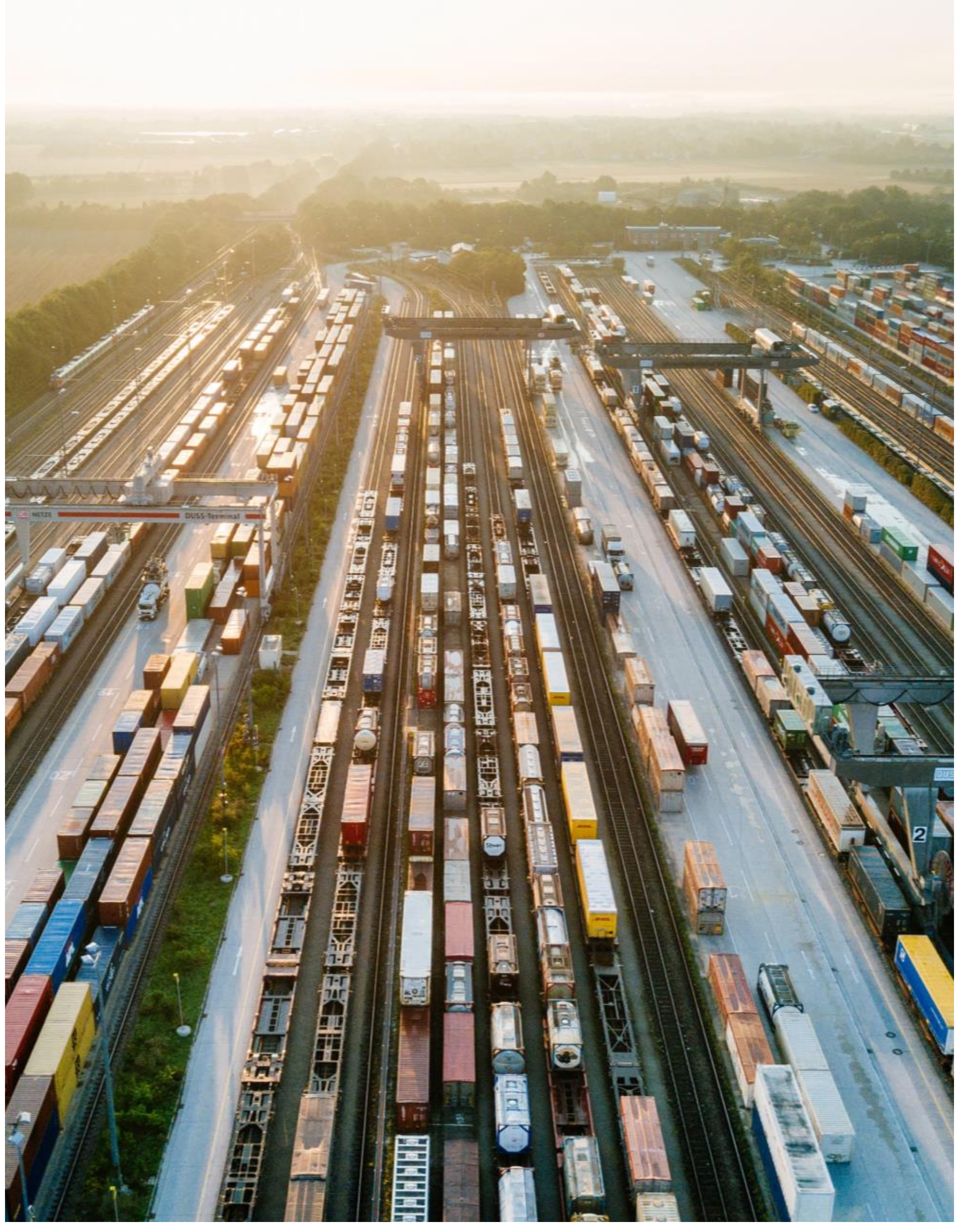
2023 market outlook

Figure 22: Forecasted rental growth and vacancy in 2023



Source: CBRE Research, February 2023

Recommendations



Recommendations for occupiers

- Though abundant in 2023, new supply in tier II cities will be very limited in 2024. CBRE suggests occupiers leverage the opportunities provided by new supply this year to expand in core areas.

- After several years' oversupply, Chengdu, Chongqing and Wuhan will see limited supply in the next three years. With core areas in these cities, such as Shuangliu Airport and Xindu, along with Chongqing airport expected to record lower vacancy, occupiers should lock in leases for properties suitable locations as soon as possible.

- As the relaxation of anti-pandemic policies will greatly reduce uncertainty in logistics and transportation, companies should increase investment in the upgrading and restructuring of warehouses to meet expanding demand.

Recommendations for landlords

- Landlords in cities where supply is peaking, including Langfang, Tianjin and Changshu, should provide favourable leasing terms to attract tenants.

- As China's warehouse per capita will continue to lag advanced markets' in the medium to long term, landlords should seek opportunities to develop and renovate properties in markets with low supply, such as tier I city clusters.

- The pandemic-driven labour shortage has accelerated the application of warehouse automation and robotics. Landlords are advised to incorporate warehouse automation in the planning of physical standards of warehouses and power supply. Other options include investing in smart warehouses or co-operating with third party providers.

- ESG requirements will continue to grow from both governments and occupiers. CBRE advises landlords to add features such as rooftop solar panels on warehouses, enabling them to reduce costs and increase revenue.

05

Investment

Real estate investment volume set to reach RMB 250 billion in 2023

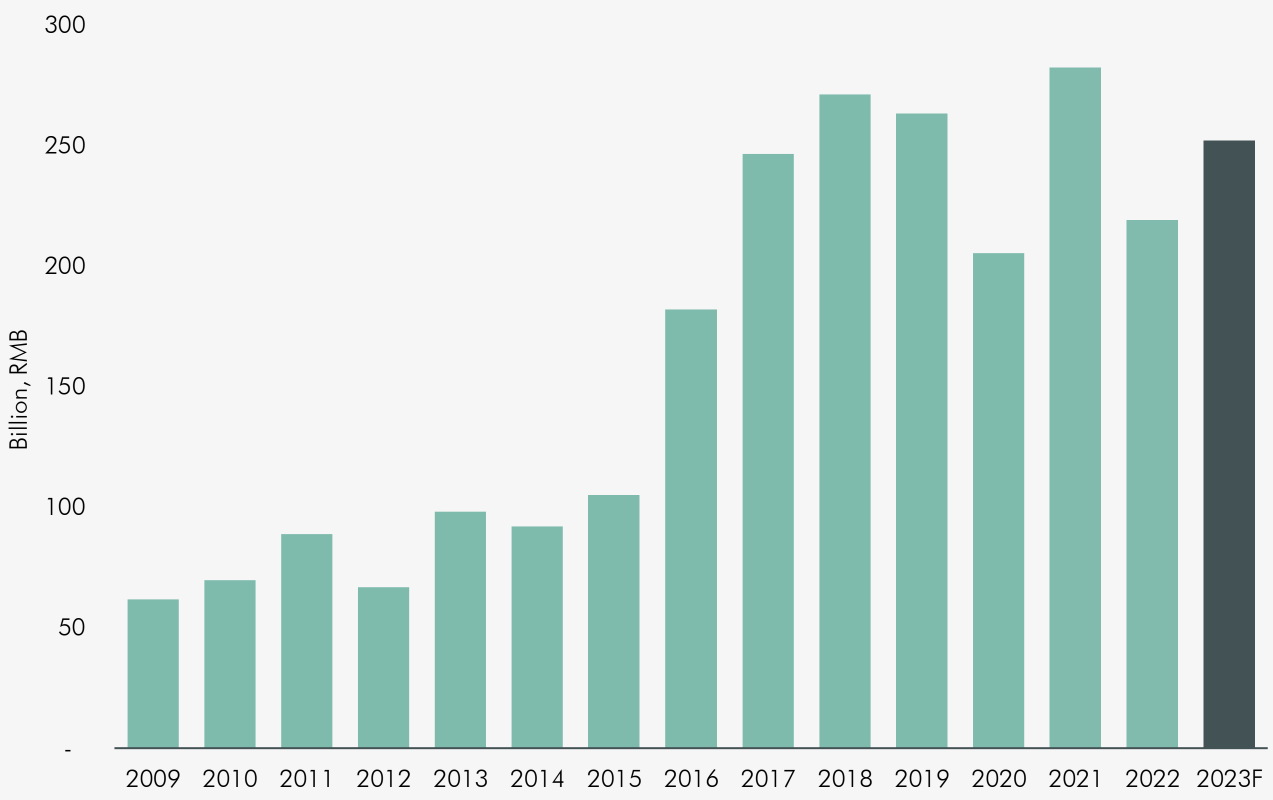
Pandemic-related uncertainty, geopolitical tension, slower economic growth and weaker leasing fundamentals ensured China's total investment volume dropped by 22% y-o-y to RMB 220 billion in 2022. CBRE's 2023 China Investor Intentions Survey conducted between November 8, 2022, and December 2, 2022, reflected the mood of caution, with the proportion of respondents saying they intend to "buy more" in 2023 falling to 34%, and 86% of participants naming "fear of a recession" as their top challenge to real estate investment. However, China's shift away from its zero-COVID policy and introduction of economic stimulus measures has since provided a substantial boost to investor sentiment. CBRE now expects commercial real estate investment demand to exceed the expectations expressed in the survey, pushing up **annual transaction volume in 2023 by 15%-20% y-o-y to RMB 250 billion**.

Low interest rates will provide a sound foundation for a rebound in commercial real estate investment in 2023. Over the course of 2022, the PBoC lowered the five-year LPR three consecutive times by a total of 35 basis points to a record low 4.3%. Even considering recent policy changes, the likelihood of interest rate hikes in 2023 remains low, ensuring investors will continue to enjoy low financing costs. CBRE's 2023 China Investor Intentions Survey found that nearly 50% of investors believe that the PBoC will not raise interest rates this year.

The low-interest environment will promote the allocation of long-term funds from sources such as domestic insurance companies to real estate. CBRE's 2023 China Investor Intentions Survey found that **the proportion of institutional investors planning to increase their allocation to real estate in 2023 reached 50%**, the highest of any buyer type. At the same time, the recovery of economic activity and upturn in the leasing market is expected to create cyclical opportunities for investors such as real estate funds.

Although the introduction of the "three arrows" policy will improve financing for developers, weak residential sales and the expiry of almost RMB 1 trillion worth of debt[4] in 2023 will ensure groups under financial strain continue to offload commercial real estate assets, improving asset availability.

Figure 23: Domestic commercial real estate transaction volume (2009-2023)



Source: CBRE Research, February 2023

Note 4: Sourced from CREIS, covering domestic and overseas bonds (including credit bonks, ABS, etc.) of all real estate related enterprises.

Active fundraising to provide liquidity for commercial real estate investment

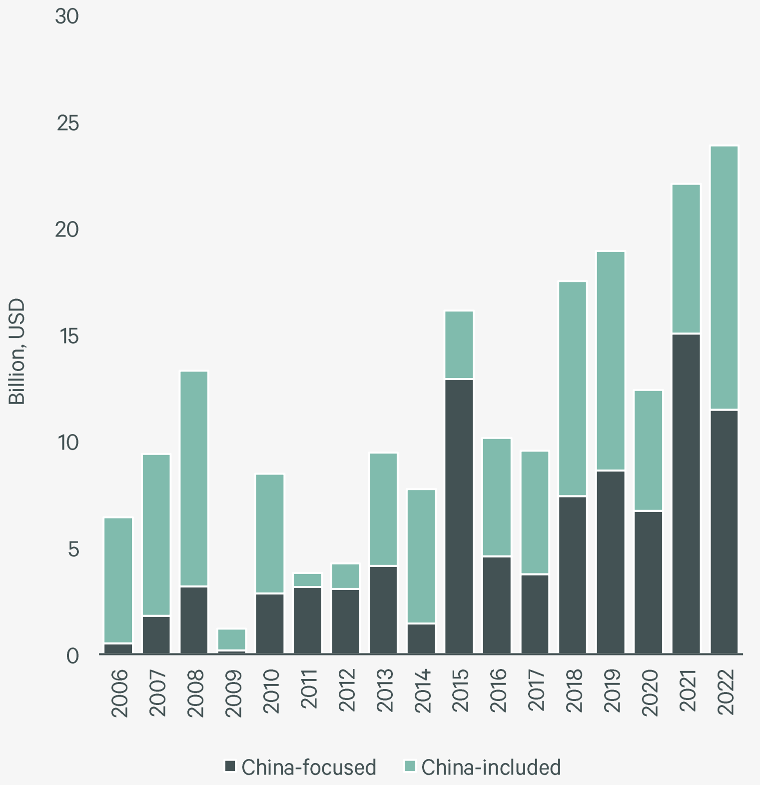
China-related private equity real estate fundraising in Asia Pacific reached nearly US$23.9 billion in 2022, of which about US$11.5 billion was purely focused on the China market, the third largest level in history. Fundraising was led by domestic investors. Following the removal of most anti-pandemic restrictions, and early signs of an economic revival, CBRE expects real estate funds to accelerate their investment in China in 2023, providing liquidity for the recovery of commercial real estate investment volume.

Industrial and logistics will remain the primary focus for China-focused raised funds, which is consistent with CBRE's 2023 China Investor Intentions Survey, which found that 56% of respondents identified this sector as their main target. The volume of capital focused on hotels and mixed-use assets has increased in the past two years, indicating that investors are paying closer attention to counter-cyclical opportunities for assets that were seriously affected by the pandemic.

68%

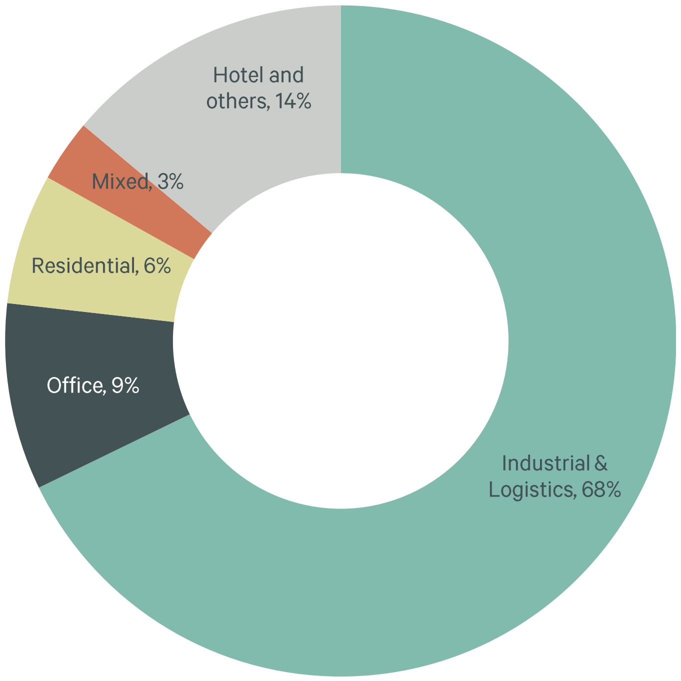
China-focused private equity real estate fundraising targeting industrial and logistics has accounted for 68% of total fundraising since 2020

Figure 24: China-related private equity real estate fundraising[5]



Note 5: The fundraising amount of China-included private equity real estate is the funds' total amount.
Source: Preqin, CBRE Research, February 2023

Figure 25: Target sectors of raised funds of China-focused private equity real estate (2020-2022)



Source: Preqin, CBRE Research, February 2023

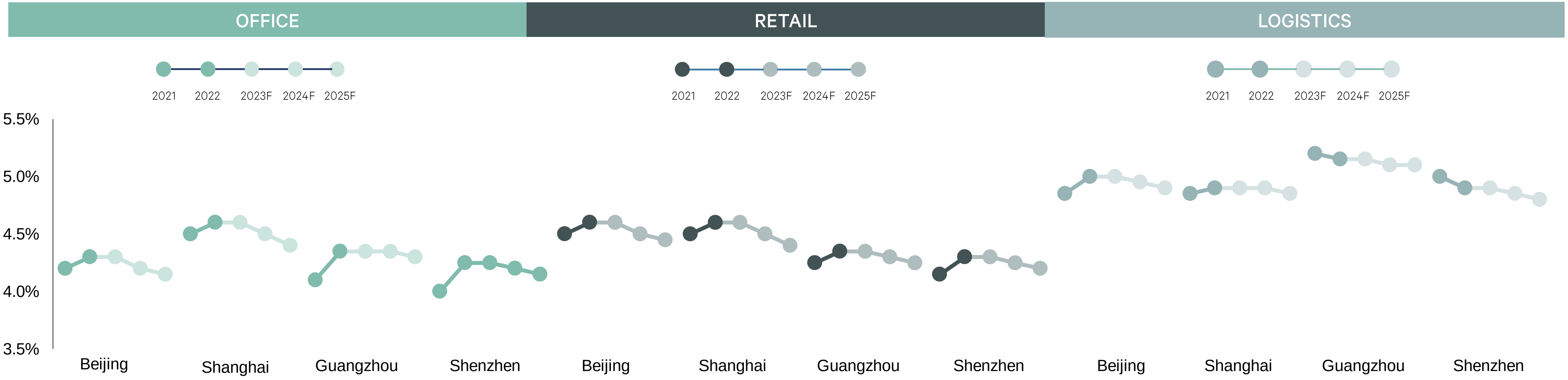
2023 to be a window period for price discovery

Pandemic-related uncertainty, weaker leasing demand and overseas interest rate hikes led to office and retail cap rate expansion and slower logistics cap rate compression in China in 2022. At the same time, however, the PBoC's lowering of the five-year LPR by a total of 35 basis points, ensured the risk-free rate remained low. The spread between 10-year government bond yields and tier I cities' office, retail, logistics net yields reached 154 bps, 162 bps and 215 bps, respectively, in Q4 2022, eclipsing the spread in Q1 2018 (the quarter with the narrowest yield spread in the previous cycle) by 152 bps, 141 bps and 52 bps, respectively.

The relaxation of anti-pandemic measures and accelerating economic growth are expected to significantly boost hotel, retail and office leasing activity in H2 2023. With the U.S. Federal Reserve's interest rate hike cycle expected to peak by the end of H1 2023 as inflationary pressure eases, cap rates of related assets are expected to lift at first and then drop. The first half of 2023 is therefore set to be a window period for price and value discovery.

Industrial and logistics retains its status as the most popular sector, with 46% of respondents to CBRE's 2023 China Investor Intentions Survey stating that they would purchase such assets at a premium or no discount. Considering that the structural growth of China's logistics market remains intact, and pricing of newly issued logistics REITs has been firm, CBRE believes that along with the gradual recovery of leasing demand, logistics cap rates will remain stable in 2023.

Figure 26: Cap rates for major asset classes in tier I cities



Source: CBRE Research, February 2023

Investment recommendations: new economy real estate

Since 2020, new economy real estate such as logistics, multifamily and industrial parks has accounted for 25% of total investment volume. CBRE expects the new economy sector to provide more diversified investment opportunities in the year ahead. Investors are advised to target logistics, multifamily and industrial parks.

Logistics

Weaker leasing demand caused by the pandemic; slower economic growth; and the Fed's sharp interest rate hikes saw logistics cap rates expand in Q4 2022 for the first time in recent years. With these headwinds now gradually subsiding, and new logistics supply falling after reaching the peak, this year will be an ideal window period for investors to acquire high-quality logistics assets in tier I city clusters.

Multifamily

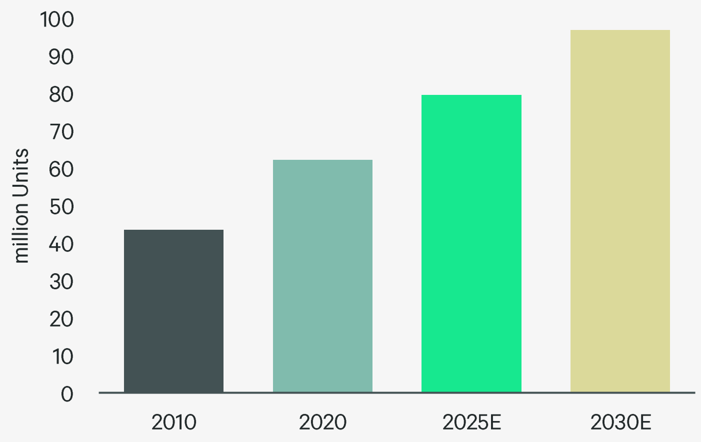
The economic recovery and improving employment outlook will stimulate residential leasing demand in 2023. The inclusion of multifamily assets in C-REITs, along with the introduction of measures to support the conversion of existing non-residential properties into affordable rental houses in major cities, will provide more channels for investors to enter this sector.

CBRE's Investing in China Multifamily Real Estate report released last year forecasted that **nationwide demand for residential rental apartments would reach 97 million units by 2030, a 56% increase from 2020. However, the country's penetration rate of multifamily rental apartments remains low, at under 2%.**

With around three-quarters of urban households in Guangdong, Shanghai, Beijing, Zhejiang and Jiangsu able to afford monthly rents of about RMB 2,000, investors are recommended to target these core markets in the country's three major coastal city clusters.

The main investment approaches to multifamily rental apartments in China include acquisition and renovation of existing assets, and platform collaboration. Investors are advised to consider factors such as accessibility to public transportation, commute time to workplaces and surrounding amenities in site selection, while also gaining a thorough understanding of potential exit channels and investment returns for affordable rental housing.

Figure 27: Demand forecast for rental accommodation in China



Source: CBRE Research, February 2023

Industrial parks

Demand for properties serving sectors in China's new economy such as life sciences, advanced technology and new energy will continue to increase both in quantity and quality. Industrial agglomeration will also see demand for industrial become more sector specific. R&D headquarters in cities such as Beijing and Shanghai and R&D facilities in talent hubs should be investors' main focus. At the beginning of 2023, Ping An Life Insurance announced it would purchase four R&D offices and facilities in Beijing and Shanghai for RMB 7.33 billion.

The launch of Lingang Innovative Intelligent Manufacturing Park REIT and D&J New Economy Industrial Park REIT in Q4 2022 will offer a potential exit route to institutional investors. According to these two REITs' tenant industry profile, their underlying assets are highly attractive to tenants from advanced manufacturing industries such as automobile equipment, precision machinery and life sciences.

CBRE recommends investors focus on properties catering to advanced manufacturing industrial agglomeration within the Yangtze River Delta Area and the Pearl River Delta Area and cooperate with leading industrial park developers to make pre-REIT investments.

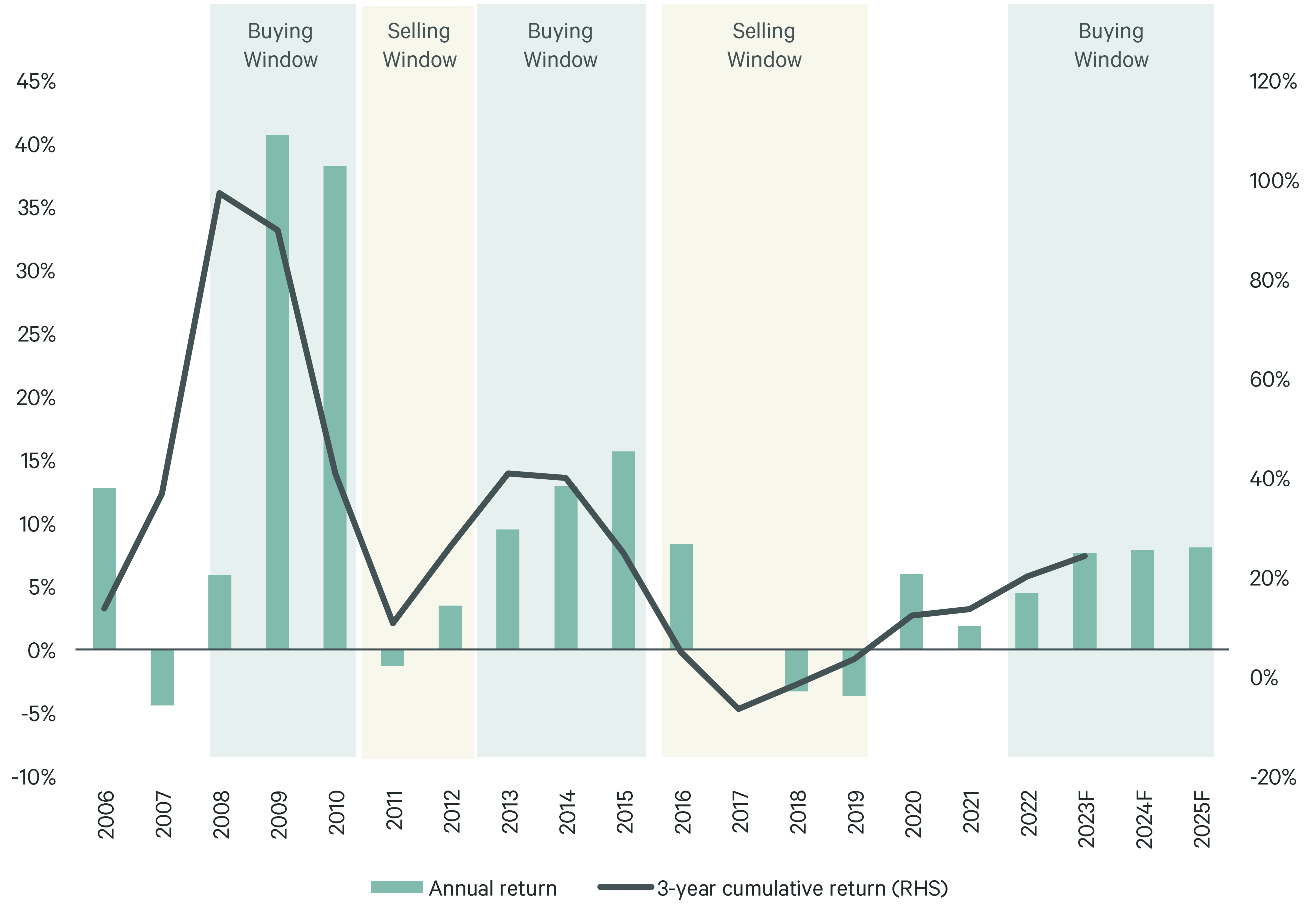
Investment recommendations: Trophy office assets in core locations of tier I cities

Office leasing performance and investment returns are subject to regular cyclical change. Using Shanghai, the most active market for office investment in China, as an example, there have been several buying and selling windows resulting from cyclical fluctuations since 2005.

The relaxation of pandemic-related measures and the expected rebound of the Chinese economy make it likely that office demand will enter a stage of continuous growth in 2023, creating an opportune moment to invest in the sector.

Investors are advised to focus on trophy buildings in core locations of tier I cities, where vacancy remains low and new stock is limited. The completion of the Shanghai SIIC Centre transaction and Beijing GM TIME transaction at the end of 2022 indicate that after several years' downward adjustment, office prices are now sufficiently attractive to institutional investors. The current domestic low-interest environment will also benefit returns for core and core-plus strategies.

Figure 28: Investment returns for Grade A offices in Shanghai[6]



Note 6: Three-year cumulative return assuming investors purchased the asset in the first year and sold it after holding it for three years without leverage
Source: CBRE Research, February 2023

Investment recommendations: Hotel and retail

Focus on cyclical opportunities for value discovery

The strong rebound in domestic consumption and tourism during this year's Spring Festival will significantly boost investor interest in hotel and retail assets in the coming year.

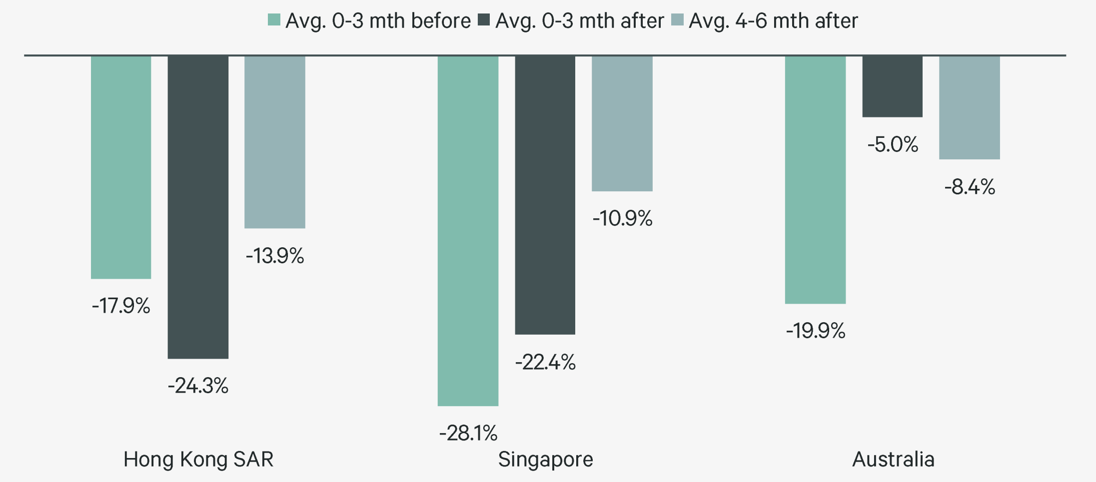
STR Global data show RevPAR and ADR for hotels in mainland China in December 2022 were 41% and 22% lower, respectively, than pre-pandemic levels, lagging every other Asia Pacific market. However, RevPAR for hotels operated by domestic major hotel groups during the Spring Festival holidays grew by more than 100% y-o-y. Meanwhile, the number of star-rated hotels nationwide decreased by 27% from 8,920 in 2019 to 6,505 in Q3 2022, primarily due to pandemic-related closures. With the normalisation of tourism and business travel, hotel asset prices are expected to enter the upward cycle this year.

Similar value discovery opportunities exist in the retail sector. CBRE's 2023 Asia Pacific Retail Flash Survey found that mainland China (tier I cities) was named by retailers as the top destination for cross-border expansion in 2023. Referring to the recovery of retail and recreational activity observed in other Asia Pacific markets following the relaxation of anti-pandemic measures, CBRE expects demand for retail space to pick up significantly from Q2 2023, with shopping centres and high-street shops in core business districts, which attract the bulk of optional and tourist consumption, set to benefit the most. Investors with operational expertise are advised to target investment opportunities based on income improvements in major tier I and tier II cities.

Figure 29: RevPAR & ADR in major Asia Pacific markets (December 2022 vs December 2019)

Source: STR Global, CBRE Research, February 2023

Figure 30: Retail and recreation mobility data before and after COVID-19 policy relaxation (change from pre-pandemic levels)



Source: Google, CBRE Research, February 2023

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