



Donna Zhang

Senior Manager | Research | West China  
+86 28 8658 6288  
[donna.zhang@colliers.com](mailto:donna.zhang@colliers.com)

# CHENGDU'S POST-COVID-19 OFFICE MARKET

Landlords and tenants both optimistic that office market will be stable over 2020 as a whole

## Insights & Recommendations

Chengdu is the top office market in West China. The market has rebounded from the COVID-19 crisis, and we expect office rent to fall by just 1.5% over 2020 ([see our Q1 report of 20 April](#)).

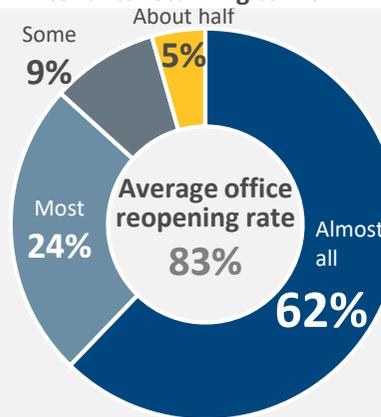
Underpinning our forecast is our assumption of stable supply and firm demand from the finance, TMT, health and infrastructure sectors (though other sectors are weaker). Colliers staged out a big survey in Chengdu in mid-March which supports this outlook. Based on this work, we advise

- Landlords proactively contact clients to review their current business status.
- Offer new tenants incentives including pre-fit units with upmarket decorations and furniture along with more flexible contract periods.
- Consider including a flexible workspace option to avoid large spaces being broken up for small tenants.

Chart 1: Feedback on work resumption



Percent of landlords by proportion of tenants returning to work



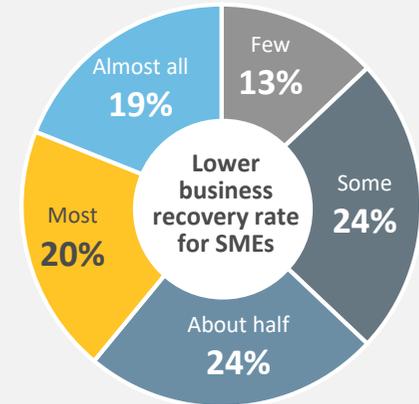
Source: Colliers International. Note: responses are grouped as 0-20%, few; 20-40%, some; 40-60%, about half; 60-80%, most and 80-100% is almost all.

**Differences on work resumption:** based on our survey, in mid-March, over 60% of Grade A office landlords indicated that their buildings were mostly full, and that 83% of Grade A tenants overall had resumed business. The situation should have improved further since then.

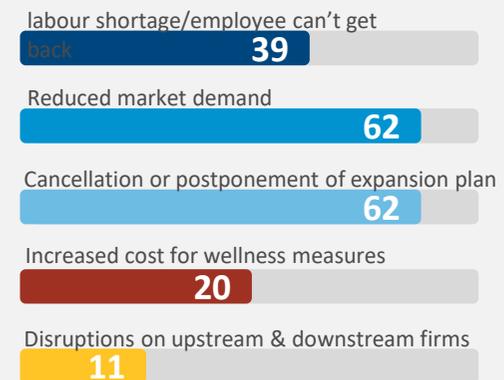
From the perspective of tenants, getting employees back to the office is just a start; it does not imply full business recovery. Based on our survey results, only 19% of tenants had seen revenue recover fully; many small and medium-sized enterprises (SMEs) also reported that revenues had recovered to only about 60% of previous levels. Again, however, the situation ought to have improved more recently.



Percent of tenants by proportion of revenue recovered (mid-March)



Number of respondents reporting negative business impacts



## 2020 DEMAND OUTLOOK

### *Finance: pandemic driving individuals and companies' financing and investment demand*

We expect demand from the finance sector to increase in 2020 in part from money-management companies and foreign financial institutions which are benefiting from China's loosening regulations in this sector. Citizens' increased focus on savings, combined with most enterprises seeing revenues decline, generates large demand for corporate finance and personal investment. We therefore expect a rise in office space demand from the finance sector.

### *TMT and services outsourcing: digital operations becoming the new normal*

Some TMT companies have recorded sales growing against the trend, as COVID-19 has increased telecommuting demand. As seen in our survey, telecommuting, products and services innovation and expansion of online sales channels were the most used strategies to mitigate the impact of COVID-19. We expect information technology companies providing online operations outsourcing and marketing solutions (SaaS) to maintain their growth momentum in 2020. Also, services outsourcing is becoming an important tool for companies to lower costs and improve their balance sheets.

### *Health services companies: increasing launches of internet medical companies*

The COVID-19 outbreak further has exposed the shortage of medical resources while increasing calls for a reasonable allocation of health resources. As one part of tiered medical services system, internet medical services are set to improve medical service delivery. Internet medical services, such as online inquiry or telemedicine, have been widely used and accepted during the outbreak, and we believe this will continue after COVID-19, translating into longer-term demand for office space in this sector.

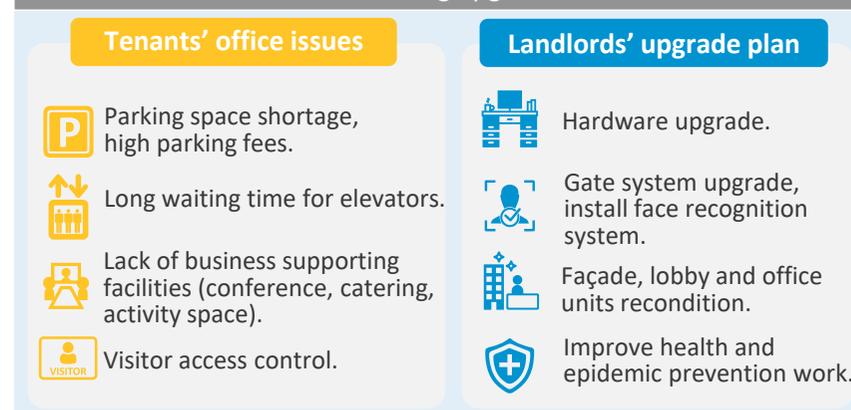
### *Infrastructure project companies: important to stable economic growth*

Public infrastructure investment has long been seen by the government as an essential tool to maintain stable economic growth. In 2020, a new generation of infrastructure (including urban railways, toll roads, airports, electric vehicle charging stations, cold chain logistics infrastructure and natural gas pipelines) is receiving increased attention. Therefore, we expect more office space demand to come from companies involved in this sector.

## RECOMMENDATIONS FOR OFFICE LANDLORDS

- > **Landlords should proactively contact tenants** and understand their current business situation to make good preparations for any lease defaults. Additionally, landlords may offer attractive renewals, to increase tenant retention.
- > **Respond to new office demand.** In response to the current economic uncertainty, a growing number of tenants prefer shorter contract periods (less than three years) but in units with refined decorations and furniture. To cope with those new requests, we suggest landlords shift some rent-free periods to a fit-out budget. This should reduce the risk of shorter leases or defaults by increasing the rent premium or deposit.
- > **Avoid large spaces being leased by a small number of tenants**, by offering tenants a flexible workspace option. This minimizes the risks of industry fluctuations or policy effects on tenants' industries.
- > **To help landlords maintain their revenues despite the uncertainty, focus on improving the building software and hardware management to increase profit margins instead of lowering rents.** And seen in our survey, 44% of landlords indicated upgrades are in progress or under planning over the coming year (see table 6). We suggest landlords prioritize issues raised by tenants, such as a shortage of the parking space and business supporting facilities or long waiting time for elevators.

Chart 6: Feedback on office building upgrade



Source: Colliers International

## TWO PERSPECTIVES ON COVID-19 INFLUENCE

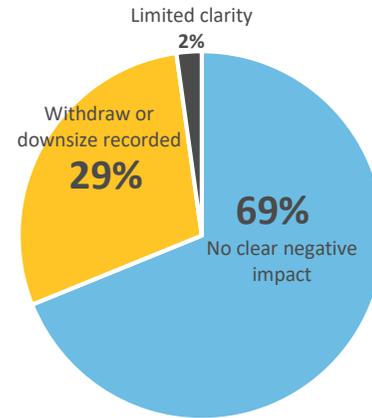
In mid-March, Colliers Chengdu surveyed 54 landlords (in all major office submarkets) and 100 tenants (including 48 large and medium enterprises, 52 small and micro enterprises; of which nine were state-owned enterprises, 25 foreign and joint enterprises and 66 private enterprises).

**Business stability feedback (Chart 2):** around 70% of landlords believed office occupancy had been little affected by COVID-19, as there were very few tenants withdrawing or downsizing through mid-March. The other 30% cited limited instances of tenants surrendering space, including traditional retailers, consumer services and education (tourism, health and beauty, offline education) and the real estate sector; these were the sectors that had been hit the hardest.

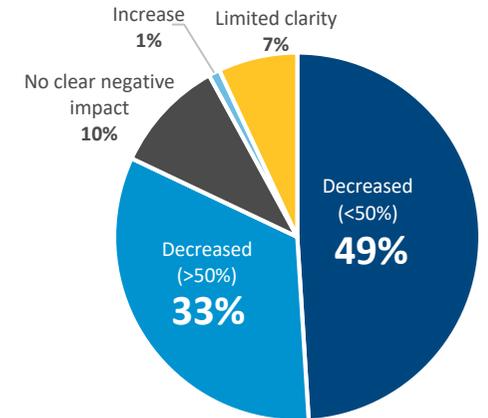
Overall, most landlords saw a stable leasing market. Feedback from tenants was less optimistic, with 82% indicating a clear YOY reduction in revenue, increasing the risk of short-term lease defaults.

Chart 2: Feedback on current business

**Most landlords indicated a stable leasing market**



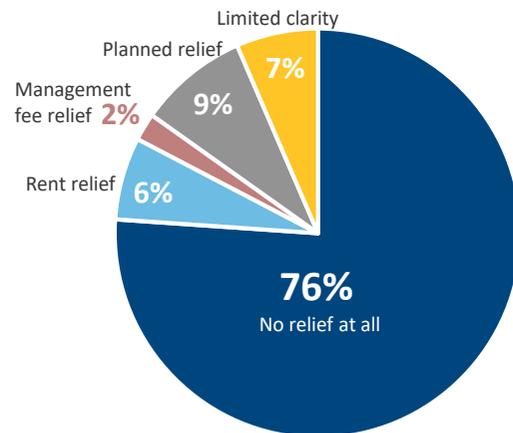
**Over 80% of tenants recorded a YOY revenue decline**



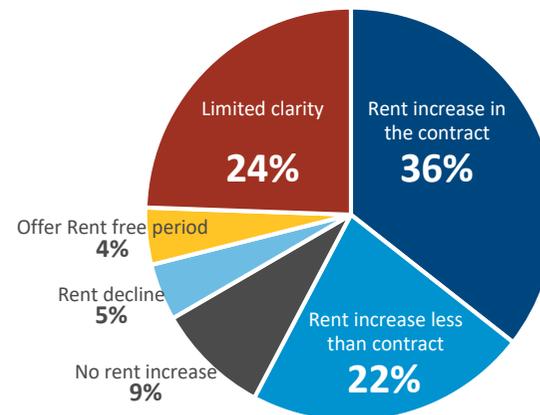
Source: Colliers International

Chart 3: Feedback on current rent/cost

**Small number of landlords offering rent relief...**



**...with inconsistent renewal strategies.**



**Tenants' major COVID-19 concerns (by number of respondents)**



Source: Colliers International.

Our survey shows a clear divergence of view between landlords and tenants, with tenants less optimistic than landlords expected.

However, tenants and landlords both expect the economy to rebound in H2 2020.

**Different measures on rent/cost (Chart 3):** the number of landlords offering rent or management fee relief increased from zero in early February to three in March, with four more landlords planning some preferential measures. Although the proportion of landlords offering rent relief was small, there was greater landlord willingness to offer incentives for renewals (for example, free rent periods, smaller or no rental increases). On the tenant side, to counter the crisis, reducing labour and operating costs has become a crucial tool, just behind telecommuting and expanding online sales.

**2020 expectations (Chart 4):** comparing landlords' occupancy expectations with tenants' full-year revenue forecasts, we believe full-year 2020 office demand will remain stable YOY, as 55% of landlords think occupancy will be flat or increasing by the end of 2020.

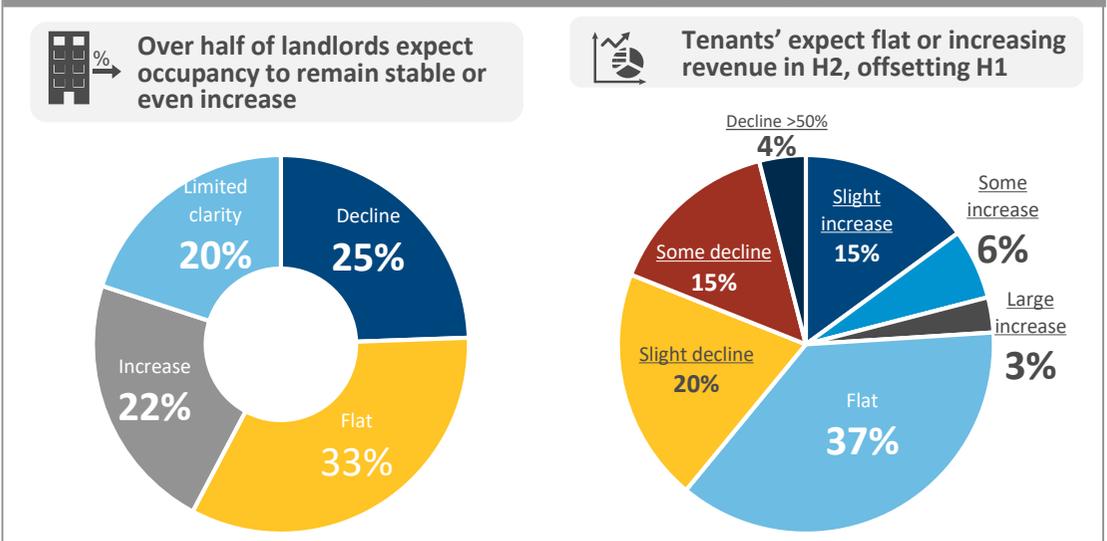
This is largely consistent with tenants' expectations, with 37% of tenants expecting sales to be stable YOY, and 24% expecting sales growth. Some changes in companies' marketing and operating procedures are likely to increase office demand.

**2020 rent/cost expectation (Chart 5):** regarding rents, both landlords and tenants expect conservative rental movements in 2020.

Over 60% of landlords expect to keep rent flat YOY, meanwhile, 13% are expecting rents to decline. This is consistent with tenants' lower budgets and rent affordability in 2020.

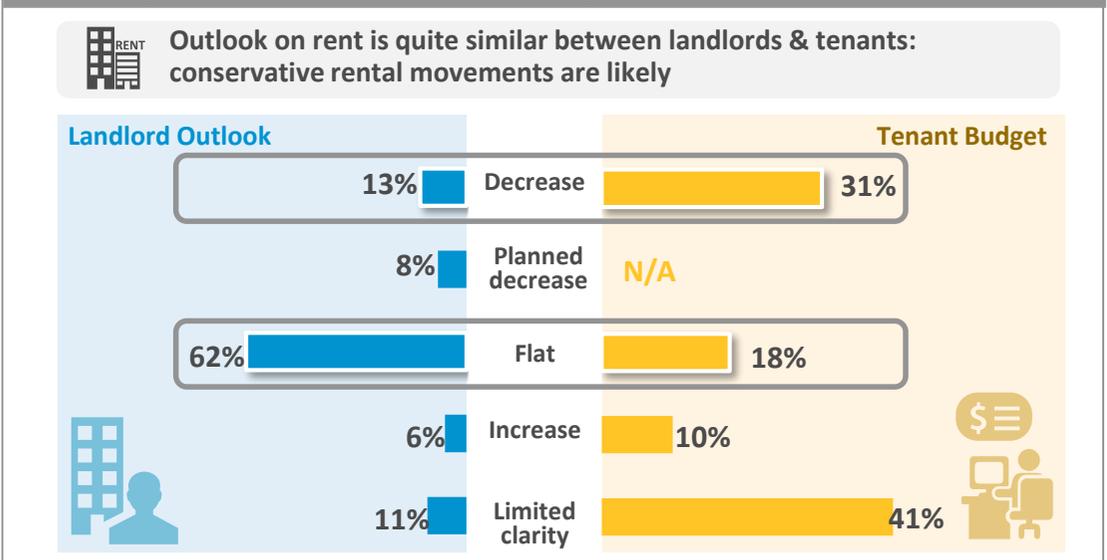
Overall, to counter revenue losses, tenants are more likely to hunt for lease bargains. This will likely bring greater downward pressure on average Grade A office rents, and we believe the reduction of effective rate will be more noticeable. Nevertheless, we expect average rent to decline by only 1.5% in Chengdu over 2020 as a whole. This is a lower rate of decline than for most other large Chinese cities.

Chart 4: Expectations on occupancy / revenue in 2020 (YOY changes)



Source: Colliers International

Chart 5: Expectations on rent in 2020 (YOY changes)



Source: Colliers International

## Primary Author:

### Donna Zhang

Senior Manager | Research | West China  
+86 28 8658 6288  
[donna.zhang@colliers.com](mailto:donna.zhang@colliers.com)

## Contributors:

### Belinda Deng

Analyst | Research | West China  
+86 28 8658 6288  
[belinda.deng@colliers.com](mailto:belinda.deng@colliers.com)

### Kai Lin

Analyst | Research | West China  
+86 28 8658 6288  
[kai.lin@colliers.com](mailto:kai.lin@colliers.com)

## For further information, please contact:

### Andrew Haskins

Executive Director | Research | Asia  
+852 2822 0511  
[andrew.haskins@colliers.com](mailto:andrew.haskins@colliers.com)

### Sean Sun

Managing Director | West China  
+86 28 8658 6288  
[sean.sun@colliers.com](mailto:sean.sun@colliers.com)

### Panny Pan

Senior Associate Director | Office Services-LR | Chengdu  
+86 28 8658 6288  
[panny.pan@colliers.com](mailto:panny.pan@colliers.com)

### Liya Ye

Senior Associate Director | Office Services-TR | Chengdu  
+86 28 8658 6288  
[liya.ye@colliers.com](mailto:liya.ye@colliers.com)

### Fiona Fan

Associate Director | Capital Markets | Chengdu  
+86 28 8658 6288  
[fiona.fan@colliers.com](mailto:fiona.fan@colliers.com)

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