

Redeveloping a Landmark Asset in China's Silicon Valley



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Petiole identified an attractive office real estate opportunity in Beijing, in a region considered as China's Silicon Valley. In our real estate strategy in Asia, we believe this submarket is under-supplied which presents advantages for investors.

A Profit-seeking Opportunity to Redevelop a Landmark Asset in Beijing

The property is a mixed-use asset in the center of Zhongguancun office submarket ("ZGC") of Beijing with direct metro subway line access. It consists of two office towers and a retail podium with a total leasable GFA of c.140,827 sqm. The retail podium used to be the largest consumer electronics market in Beijing, but its trade mix has been gradually shifting towards co-working offices and F&B in recent years through the impact of e-commerce. The property's fit-outs are dated and therefore have not been able to weather the shrinking brick-and-mortar retail sales of consumer electronics, resulting in submarket rental levels.

We have planned a repositioning capex budget to convert part of the retail podium into office space and renovate the property into the most premium office development in ZGC. The property's rents will be reverted to market level and we plan to exit via en-bloc sell to a core buyer. We have planned a repositioning capex budget to convert part of the retail podium into office space and renovate the property into the most premium office development in ZGC. The property's rents will be reverted to market level and we plan to exit via en-bloc sell to a core buyer.

Zhongguancun – the Silicon Valley of China

Zhongguancun is one of the three core office submarkets in Beijing (along with Beijing CBD and Financial Street) and primarily serves high-tech industries. It is regarded as the “Silicon Valley” of China and is the birthplace of China’s IT industry.



Source: Tian zhe/Imaginechina via AP Photo (published in PanDaily.com 24/08/2019)

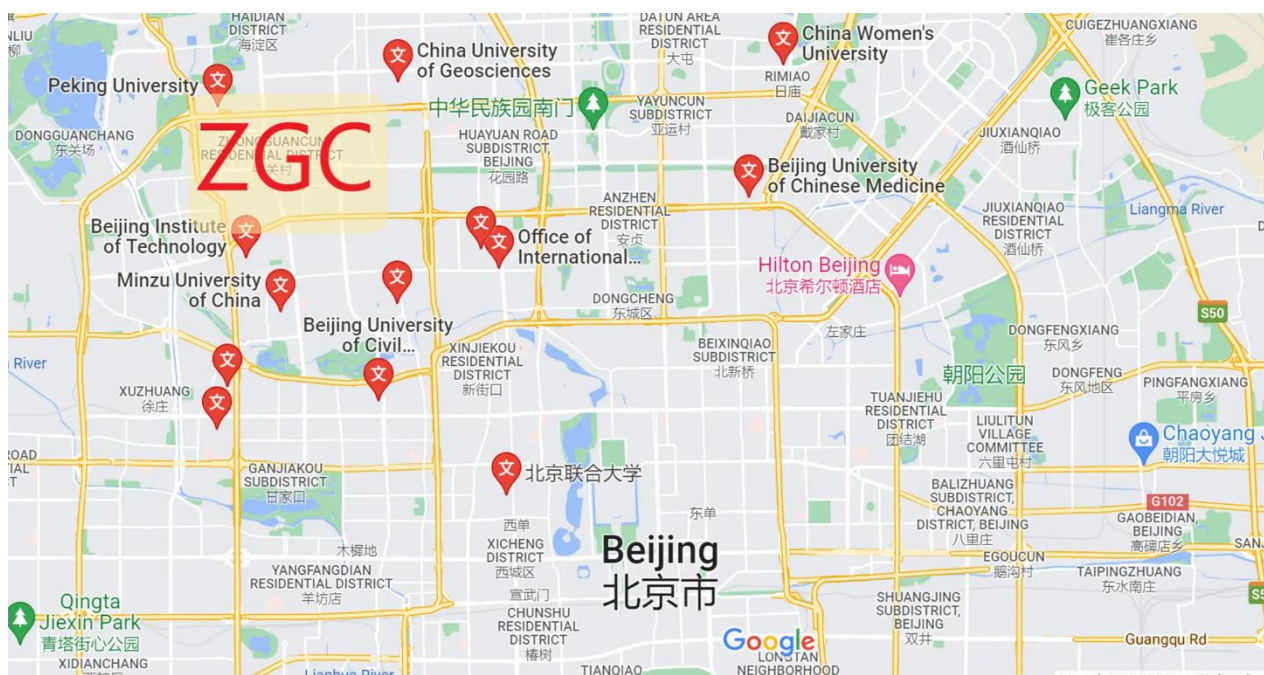
ZGC has many favorable policies for technology ventures and benefits from proximity to the Chinese Academy of Sciences and the two best universities in China – Tsinghua University and Peking University. The area attracts top technology talents from all over China, as well as notable companies like Microsoft, Lenovo, and iQiyi, who established their headquarters in ZGC. With a mature office leasing market, ZGC has remained at a frictional vacancy over the past ten years due to limited supply. The majority of the land in ZGC is owned by academic or research institutions, limiting new development potential.

A Solid Office Submarket under COVID Pandemic

Most of China’s top IT names, such as Lenovo, Baidu, Xiaomi, JD.com, Sina, are headquartered in Beijing, in addition to the North China operations of Alibaba and Tencent. As Beijing became the center of the nation’s IT industry that attracts top talent, IT corporations relying heavily on human capital seek modern, high-quality offices for their operations, favoring open spaces with large floor plates and flexible spatial arrangements rather than traditional offices.

As of the last quarter of 2021, Beijing's citywide rental growth continues to rise amidst a well-contained COVID pandemic in China to c.RMB10.7/sqm/day, increasing by 0.6% quarter-on-quarter. Due to lack of new supply, ZGC has experienced stable rental growth of 0.8% quarter-on-quarter to RMB11.9/sqm/day in 4Q2021, which remained as the second-highest submarket rent in Beijing city and above Beijing CBD rental level.

Moreover, steady strong leasing activities in Beijing keep the vacancy of Grade A offices decreasing by c.1.6% in Q4 of 2021, including the ZGC submarket which enjoys the lowest vacancy in the Beijing office market at 4.6%. Grade A office stock in ZGC stands at c.1,140,000 sqm or merely 9% of the Beijing total stock. Savills is forecasting over 90% occupancy rate in the ZGC submarket from 2019 onwards with leasing activities continuing to be satisfied by the absorption of existing and upcoming inventories.



Source: Google Maps

Repositioning through Value-add Strategy

We intend to reposition the retail podium of the property by converting the higher floors into offices and co-working space, shrinking and upgrading the consumer electronics market, and introducing more lifestyle-oriented retail tenants in the lower floors, while simultaneously refurbishing the common areas and façade of the office towers. The plan involves renovating the office towers to premium Grade-A standards aimed to produce the highest quality office property in ZGC.

The scope of the renovation shall include all interior areas, façade, MEP systems as well as potential relocation of elevator cores. An effort to obtain Leadership in Energy and Environmental Design (“LEED”) entitlement for the Property is also underway.

As ZGC is the “Silicon Valley of China”, large contiguous office space in ZGC is highly sought after by dynamic, fast-growing internet & technology companies who are accustomed to open offices on large floor plates. We intend to revert the office towers rent to market level after completing renovations, with the expectation of absorbing demand from established and leading internet & technology companies.

To date, renovation work has been fully completed in one of the two office towers, which attains a healthy pre-occupancy rate. The first batch of tenants has already commenced moving into this tower to conduct interior adjustments as of January 2022. We expect leasing demand for the remainder of the office towers to be driven by the technology sector enjoying policy tailwinds, and we are in the process of engaging a top-3 TMT conglomerate as an anchor tenant to build up the tenancy profile. The opening of the retail podium of the property is expected by the third quarter of 2022.

To know more about Petiole's real estate strategy in Asia, contact our investment expert team.

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