The Impact of Wenchuan Earthquake on Chengdu’s Property Market

EXECUTIVE SUMMARY

• On 12 May 2008, Wenchuan County in Sichuan Province experienced an 8-magnitude earthquake. As of noon on 5 June, the earthquake has caused 69,127 casualties and 373,612 injuries, with a further 17,918 missing. The Sichuan economy suffered heavy losses.

• Urban Chengdu sits 73 km (45.6 miles) from the earthquake’s epicentre and suffered very slight physical damage due to its stable geological structure. Houses that were affected by the earthquake accounted for only 1% of the city’s total residences. Urban Chengdu is now back on its normal track.

• The earthquake has had a destabilising effect on Chengdu’s economic progression and real estate development. Research has revealed a drop in demand in the real estate market in the short term, as well as a downturn in consumer sentiment and a change in consumer behaviour. However, long-term effects on market performance remain minimal.

• Construction safety and quality have become the focus of home buyers, office tenants and retailers in the aftermath of the earthquake.

• As investors and developers eye long-term investment in Chengdu and Western China, the earthquake has failed to affect long-term plans for corporate investment in the region.

• The dissemination of earthquake knowledge, the effective implementation of an emergency response plan and the introduction of a quality monitoring system are essential steps that must be taken by the municipal government to dispel the psychological shadow that has enveloped the city’s residents.

June 2008
**THE WENCHUAN EARTHQUAKE**

According to the State Bureau of Seismology, at 2:28:01.42 pm (Beijing time), an 8-magnitude earthquake hit Wenchuan County in Sichuan Province (latitude 31ºN, longitude 103.40ºE). Tremors from the earthquake were felt far and wide from Shanghai, Tianjin and Beijing to nearby countries in South East Asia.

According to the Bureau of Civil Administration, as of noon on 5 June, the Wenchuan earthquake has caused 69,127 casualties and 373,612 injuries, with a further 17,918 missing.

The earthquake has also taken a devastating toll on the Sichuan economy. With direct financial losses totalling over RMB 500 billion, the Wenchuan earthquake is considered the most destabilising natural disaster to hit China. Industrial losses have totalled over RMB 200 billion, while losses in infrastructure, transport and communications have totalled about RMB 65 billion. Meanwhile, the tourism industry has witnessed losses of about RMB 60 billion.

Despite these figures, urban Chengdu did not suffer dramatically from the earthquake in comparison with Wenchuan, Mianyang, Deyang and other hard-hit regions. More heavily impacted areas within Chengdu are Dujiangyan and Pengzhou, which lie adjacent to Longmen Mountains. As of noon 24 May, earthquake casualties in Chengdu totalled 4,276, with 26,413 injured and 1,271 yet unaccounted for. The greater Chengdu region has suffered direct financial losses of RMB 95.8 billion.

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1 Source: Government reports
Experts testified that the geological structure of Chengdu Plain remains stable and that the earthquake and aftershocks that occurred along the Longmen Mountain fault zone have not heavily impacted urban Chengdu. The Chengdu Housing Administration has deemed the earthquake’s impact on Chengdu housing to be minimal, with collapsed structures and houses that are in danger of collapsing accounting for not more than 1% of the total residences. As of 27 May, 90% of all upscale industries as well as all stores in Chengdu have returned to normal operations. The city’s residents have also resumed their daily lives.

The Wenchuan earthquake has undoubtedly unseated Chengdu’s economy from its trend of steady growth. With these considerations in mind, this paper will mainly focus on the earthquake’s effects on the Chengdu property market, as well as its implications for the future course of real estate development.

EFFECTS OF THE WENCHUAN EARTHQUAKE ON THE CHENGDU PROPERTY MARKET

Residential market

Although the Wenchuan earthquake has had minimal effects on the overall Chengdu economy, the city’s residential market has seen a sharp drop in demand and sales rate within the short term. According to statistics from the Chengdu Housing Administration, residential housing transactions in May totalled 500,930 sqm (GFA), down 23.4% from that in April. Prices of housing units in urban Chengdu sit at RMB 5,460 per sqm, a slight drop of 2.2%. According to our research of several projects on pre-sale, the price decline was not due to the earthquake. Beginning 2008, housing prices in urban Chengdu has fallen for five consecutive months. The slight decline in prices in May is out of the control of the national macroeconomy as well as the Wenchuan earthquake.

In addition, we have conducted a survey of potential home buyers to gauge the shifts in home purchasing patterns in the aftermath of the earthquake. The pool of potential tenants that were surveyed consists of short-term purchasers (looking to purchase a home within one year), who make up 31.4% of the interviewees; intermediate-term purchasers (looking to purchase in one to three years), who make up 34.3% of the total interviewee pool; and long-term purchasers (looking to purchase in three to five years), who make up 34.3%. Overall, 47% of potential home buyers have indicated that their future home purchase plans were not affected by the earthquake. However, among short-term purchasers, 63.4% indicated a desire to temporarily delay home purchases, while 36.3% remained unaffected by the earthquake due to the urgent nature of their needs.

The Wenchuan earthquake has also shifted consumer preferences for housing. After the calamity, 14.3% of those interviewed indicated a preference for higher floors and tall residential buildings, a sharp drop from 25.7% before the disaster. Moreover, the percentage of potential residents with preference for lower floors and low-rise buildings rose from 34.3% to 60% (Figure 1).

Buyers started to show great concern on building quality and structure after the earthquake. Before the calamity, only 54.3% of interviewees factored in quality into their home-buying preferences. This number rose to 85.7% following the earthquake. Even more significant is that only 10% of those interviewed considered earthquake resiliency into their purchasing factors before the disaster. After 12 May, the figure rose to 65.7%.

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**Figure 1: Preference for Building Type**

Source: Jones Lang LaSalle
The Wenchuan earthquake has also shifted consumer preferences for housing. Buyers also started to show great concern on building quality and structure after the earthquake.

The interviews also indicated that home buyers preferred purchasing in southern (57.5%) and western Chengdu (25.7%) before the earthquake. After the earthquake, home-buyer preference for western Chengdu experienced a sharp drop to 20%, while eastern Chengdu witnessed a slight rise. This may be due to western Chengdu’s location, which is closer to the epicentre of the Wenchuan earthquake (Figure 2).

Compared with the sales market, the leasing market is booming. Owing to the fear of the occurrence of aftershocks and for safety concerns, many tenants wanted to lease lower floors or newly built houses. Part of the demand in the present leasing market is being derived from people in the affected areas, whose houses were damaged due to the earthquake. The limited supply of available houses, in addition to increasing demand, resulted in rental increases.

In the short term, the Chengdu residential market will witness noticeable decreases in demand. Buyers will focus on quality and prefer lower floors and low-rise apartments. In the long run, there will be no great impact on home buyers. Prices will be dependent upon the financial power of developers. Against the backdrop of national macroeconomic control, some small developers will experience a shortage of cash due to decreases in demand. Currently, the major concern for some developers is on how to improve their sales rate to recover capital after the earthquake.

Office market

Since 12 May, the normal operation of offices in Chengdu was disrupted by the Wenchuan earthquake. In the initial period after the calamity, majority of offices were closed for safety concerns. Most corporate tenants began returning to work on 21 May. As of end-May, all Grade A offices returned to their operation, except for a few high-floor tenants. Despite slight damages due to the earthquake, all Grade A offices were classified as safe after the inspection of related authorities.

Although the majority of Grade A office buildings did not suffer great physical damage from the

Interviews conducted with potential office tenants indicated that a portion of businesses that has yet to enter the Chengdu market will temporarily postpone their original plans, leading to a short-term drop in demand. However, businesses that had already decided to enter the Chengdu market will continue to push through with their plans despite the earthquake.
Latest deals indicated a significant increase in moving out of old Grade B offices into high-quality offices, with some tenants hastening their relocations. On the other hand, some tenants on high floors prefer to relocate to lower floors due to psychological shades.

earthquake, a fall in demand in the short term is unavoidable. In 2007, 54,000 sqm of Grade A office space was transacted, half of which came from companies newly entering the Chengdu market. Interviews conducted with potential office tenants indicated that a portion of businesses that has yet to enter the Chengdu market will temporarily postpone their original plans, leading to a short-term drop in demand. However, businesses that had already decided to enter the Chengdu market will continue to push through with their plans despite the earthquake. Some firms also indicated that government-induced measures to stimulate the economy in the post-earthquake period will provide added incentives for their entry into the Chengdu market at the earliest possible opportunity.

While the Wenchuan earthquake has had a very minor physical impact on upper-tier office buildings, older and mediocre structures have suffered significantly. The earthquake has promoted the need for office upgrading. Latest deals indicated a significant increase in moving out of old Grade B offices into high-quality offices, with some tenants hastening their relocations. On the other hand, although high-rise office buildings are indeed safe, some tenants on high floors prefer to relocate to lower floors due to psychological shades.

Generally speaking, tenants have taken safety and earthquake resiliency into greater consideration. The following are the some specific actions taken by tenants:

• Tenants have demanded that they be provided an official building inspection report
• Majority of tenants have indicated a strong desire for new office buildings over older structures
• Majority of tenants have indicated a strong desire for office space on lower floors of buildings
• Tenants have paid strong heed to office buildings’ emergency exits and contingency plans
• Some tenants have started to pay attention on the proximity of offices to emergency exits, which were previously neglected
• Potential tenants have also indicated a strong preference for office buildings under well-known quality management

In the short run, tenants will place emphasis on safety and the psychology of staff. In the long run, tenant requirements for safety will gradually recede from the forefront of rental considerations as the effects of the earthquake fade. It is predictable that tenants will take building quality and safety into consideration. Well-known developers and property management teams are more likely to win the wont of office tenants.

Retail market
The retail sector in Chengdu has witnessed an especially sharp setback in the following week after the earthquake. In Jinjiang district, where most department stores are located, all major retail outlets and shopping malls closed for business on 12 May. However, after quickly ensuring structural integrity, a portion of the stores reopened for business the very next day. As of 28 May, all of the 17 large-scale stores in Jinjiang district returned to normal operations. Nevertheless, the Wenchuan earthquake has had a visible impact on retail revenue in the ensuing period. A number of large-scale department stores such as Wangfujing, Renhe Spring and People’s Department Store reported revenues ranging between 50% and 60% of their total profit recorded in May 2007.

Moreover, government statistics have also revealed a shift in consumer shopping habits in the aftermath of the earthquake. Daily necessities (food and beverages) and emergency-related goods (disinfectants, tents, medicine, etc) have experienced
the Wenchuan earthquake has led to more than RMB 60 billion of revenue loss in the Sichuan tourism industry. This is equivalent to half of the province’s revenue in 2007, which totalled RMB 121.7 billion, accounting for 10% of the total provincial GDP and the largest percentage share of any province in the nation.

Scenery spots have been affected in various degrees. According to the Sichuan Tourism Bureau, 568 of the province’s more than 4,000 tourism sites suffered some degree of damage due to the earthquake. The earthquake has also impacted national cultural heritage sites, with Dujiangyan and Wolong Nature experiencing the most damage. A total of 65 irreplaceable national-level cultural relics and 119 province-level artefacts were damaged in various extents as of 19 May.

Damage to roads caused by the earthquake also affected Sichuan’s tourism industry, making the recovery of related scenic spots more difficult. Roads to Jiuzhaigou, the most popular tourist destination in Sichuan, were greatly damaged.

The occurrence of the Wenchuan earthquake and the damage it caused in infrastructure led to a sheer decline in the number of tourists visiting the region. A significant decrease in the number of tourists will take place in the short term. Tourist confidence in Sichuan tourism will only be restored after a period of time.

The decline in number of tourist visitors in Sichuan directly resulted in a dramatic fall in demand for daily necessities, while luxury goods and non-necessities (clothing, jewellery, cosmetics and electronics) have experienced a movement in the opposite direction. The relatively lower prices of daily necessities led to decreases in revenue. As a result, convenience stores in residential areas saw better performances in the post-earthquake period. Furthermore, consumers have restricted consumption spending to shops on lower levels. In addition, the number of consumers from Chengdu suburbs and other cities was significantly reduced.

Although the Wenchuan earthquake has affected Chengdu’s retail market, we hold that the negative effects are only short-term. Based on our interviews with existing and potential retailers, all of them show strong confidence in the Chengdu retail market as well as in Western China. For retailers looking to enter the Chengdu market in the near future, the earthquake has delayed their initial plans, but has no impact on their long-term agenda. Meanwhile, for retailers looking to enter the Chengdu market in the intermediate time range, the earthquake has had virtually no effect on planning. Existing retailers focus on long-term development and potential are not affected by the earthquake.

Hotels

Tourism in Chengdu suffered great losses due to the Wenchuan earthquake. Immediately following the earthquake on 12 May, the National Tourism Administration sent out an emergency notice mandating the closure of all transport to and through areas impacted by the earthquake. As of end-May,
hotel accommodations. According to government statistics, occupancy rates in hotels (four and five stars) in urban Chengdu were at 56% in May, down 30% from that in April. On the other hand, some hotels closed for several days to undergo safety inspections. The declining number of tourists led to the decline in occupancy rates.

The recovery of the tourism industry relies heavily on the government’s initiative to restore major tourism sites and infrastructure. The short-term outlook on the tourism industry and, likewise, hotel revenues in the greater Chengdu region remain bleak at best. In the long run, the negative impacts being experienced by Sichuan’s tourism are only temporary. As evidenced by the reconstruction of Bali Island and Lijiang, Sichuan’s tourism industry will soon be restored if the government could actively lead and participate in the reconstruction work. At present, tourist sites that relatively suffered less from the earthquake have reopened. Mount Emei and Luodai Town have proposed a series of special activities to attract tourists during the Dragon Boat Festival.

Developers and investors

In the post-earthquake period, tenants, home buyers and retailers have indicated that they will take construction quality and building safety into heavier consideration. The Wenchuan earthquake has led to the destruction of a large number of buildings and has simultaneously highlighted the importance of quality monitoring and the promotion of construction safety.

Based on interviews conducted with existing developers in Chengdu, construction projects were originally built in accordance with national seismic resilience requirements. Therefore, the Wenchuan earthquake should not significantly affect developers’ architectural design or construction methods. However, the post-earthquake period has revealed the previously neglected aspects such as inefficient evacuation, traffic organisation, as well as ineffective emergency alarm facilities.

At present, the earthquake has not led to a significant suspension in development and construction. The construction of projects in Chengdu were initially halted for two weeks after the occurrence of the earthquake, but the majority of those undertakings have resumed normal progress after government inspection confirmed their structural integrity. Nevertheless, the strong demand for construction materials (steel, cement etc) to meet the demand of post-earthquake reconstruction projects could create supply shortages for raw materials in the near future.

In addition to these obstacles, developers may also face short-run financial pressure in the months ahead. The earthquake has temporarily dampened consumer demand for home purchases. Chengdu developers have experienced a sharp drop in sales in the immediate post-earthquake period, and revenue will continue to lag far behind normal levels in the coming months. Simultaneously, national macroeconomic regulation, as well as a tight monetary policy, could lead to further credit shortage for developers in the near future.

Most potential developers have opined that the earthquake has not affected their business outlook or development plans in Chengdu. However, they will have to make necessary adjustments to their projects. A very small number of potential developers have placed their investment in Chengdu on hold. Medium-term and long-term investment will rely on a more stable market. The long-term investment of existing developers was not affected despite the negative impacts of the earthquake.

Market demand remains the major concern of developers. Although the Wenchuan earthquake has not caused heavy property losses in urban Chengdu, it has dealt a heavy blow to consumer confidence. This could lead to reduced short-term demand in the property market. On the other hand, Chengdu still serves as South Western China’s economic and financial centre and thus should continue to enjoy robust demand regardless of the catastrophe. The expedient restoration of the property market, as well as the promotion of robust development, requires a joint effort between the government and developers.

In stark contrast to consumer confidence, which has fallen drastically in the aftermath of the earthquake, investor confidence in Sichuan remained elevated. There has been no diversion of investment from
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Sichuan, and many investors have indicated their desire to join in post-earthquake reconstruction efforts. For example, the Singapore Bureau of Industrial Development has confirmed that Singaporean enterprises will increase corporate investment in Sichuan in the coming years.

IBM, Corning and Carrefour, among other existing foreign enterprises, have expressed their intention to participate in disaster relief efforts. This will establish stronger bonds of co-operation with the Chengdu government, thus opening broader opportunities for development in the future. IBM indicated that it will not only continue to invest in Chengdu, but will also expand its global IT service centre in the city, which will reach an employee base of 1,000 by end-2008. In addition, IBM will donate its Sahana disaster relief management system software to Chengdu. Sahana played a crucial role in the Indian Ocean tsunami disaster. IBM will also provide the corresponding hardware and technical support for Sahana to help Chengdu raise its disaster relief efficiency.

Meanwhile, Carrefour plans to double its investment in Chengdu in three years and will open more stores. In addition, it will step up local sourcing and create more employment opportunities.

The earthquake did not stop enterprises from entering the Chengdu market. On 22 May, Tencent Inc, China’s largest internet service provider, pledged to invest RMB 550 million to establish R&D, data processing and customer service centres in Chengdu. This move made Tencent the first company to invest in the Sichuan Province since the earthquake.

On 4 June, ASM Pacific Technology Co Ltd, the world’s largest assembly and packaging equipment supplier for the semiconductor industry, reached an agreement with Chengdu Hi-tech Development Zone to build a semiconductor seal test facility, as well as an R&D base. ASM, which will invest an initial USD 30 million in the project, will lease office space in Tianfu Software Park beforehand. Within three years, it will build the R&D centre to promote Chengdu’s semiconductor industry.

**HOW CAN THE NEGATIVE EFFECTS OF THE EARTHQUAKE BE FURTHER CONTAINED?**

Although the Wenchuan earthquake has caused limited substantive harm to urban Chengdu’s physical landscape, the short-term fall in demand for Chengdu property remains an irrefutable fact. Restoring market confidence and promoting healthy industrial development currently remain the primary goal.

We believe that disseminating earthquake knowledge and formulating contingency plans are essential steps to be taken by the government. Chengdu has always been known as the ‘land of abundance’ and for the leisurely and carefree lifestyle of its people. The city rarely experiences any natural disasters and even less does it fall victim to earthquakes of such destructive magnitude. The sudden occurrence of the Wenchuan earthquake has placed a ‘psychological shadow’ over the populace, amplifying the effects of the earthquake beyond physical destruction. In order to contain the negative impact of the earthquake, the government must first educate the people about such calamity. It is imperative that people understand the catastrophe that has crippled their lives and comprehend its origins and destructive effects. Additionally, it is vital that emergency procedures and contingency plans be formulated for possible future occurrences. The malevolent effects of this particular earthquake were amplified due to insufficient preparation and prevention measures, coupled with lapses in communication, creating chaotic rescue efforts in the immediate aftermath of the earthquake. Hence, the government should organise training sessions for its citizens to ensure that everybody is prepared for a possible major natural disaster.

Moreover, the government should heighten seismic requirements for buildings in Chengdu and devise
relevant construction standards in the near future. According to expert testimony, houses in Chengdu that were built after the 1980s and comply with the requirement for resilience for earthquakes with a magnitude of 7 should have withstood the Wenchuan earthquake. The fear of high-rise properties is only temporary. In the long run, people will return to reason.

It is also important to tighten the monitoring system through all stages of building construction to ensure the safety of projects. Inspections of buildings can be opened to the public for monitoring.

Lastly, the government could propose favourable policies that promote investment in Chengdu for developers and investors. For potential overseas developers, it will be essential that the government could speed up the approval procedure. In addition, broadened leniency towards foreign investment into Sichuan after the earthquake may provide an invaluable opportunity to enhance the size of foreign investment in the region.

**FUTURE OUTLOOK**

While research has indicated that the Wenchuan earthquake has caused short-term downturns in Chengdu’s property market, we maintain our optimistic outlook on the long-term growth and development of the market.

We believe that the earthquake has left no lasting physical or psychological trace on the Chengdu landscape. Research indicated that the earthquake has not affected the lifestyle of metropolitan residents and has not altered Chengdu’s reputation as a ‘city of leisure’. Chengdu was, and continues to be, one of the most important economic centres of China. The city also serves as one of the nation’s transport and communication hubs and will continue to grow as China develops.

Furthermore, our research has revealed that investors, developers and retailers have not changed their long-term investment plans in Chengdu due to the earthquake. The vast size of Western China’s property market, as well as its growth potential, has worked to bolster corporate investment confidence in Chengdu.

Simultaneously, reconstruction in areas affected by the disaster has provided local industries with numerous opportunities for growth. In addition to the aforementioned retailers of construction materials and industries essential to rebuilding infrastructure, numerous real estate developers have already indicated their desire to quickly join in the reconstruction effort and lead Chengdu above and beyond its former state of glory.
EARTHQUAKE RELIEF AND GOVERNMENT RECONSTRUCTION POLICIES

- Since 12 May, financial inflow into China to aid relief efforts has been on an unprecedented scale. As of 30 May, earthquake relief funds have reached RMB 22.4 billion, RMB 18.1 billion of which came from the central government and RMB 4.3 billion from the local government. As of 4 June, domestic and foreign donations have reached RMB 43.88 billion. China has also diverted over RMB 70 billion to rebuild the devastated region after the earthquake, 5% of which will be used for immediate relief operations.

- The government has taken numerous steps to limit the possible financial fallout from the earthquake. China’s central bank has spearheaded this effort by pledging to keep the reserve ratio constant for banks in the affected regions, thus decreasing pressure on the overtaxed financial system. Districts that will benefit from this policy include Chengdu, Mianyang, Deyang, Guangyuan, Ya’an, A’Ba and six other municipalities in Sichuan. In an effort to increase lenders’ liquidity and support their credit supply, the central bank also increased the amount of credit being lent to financial institutions in the affected regions by RMB 7 billion in the aftermath of the earthquake. Additionally, various Chinese banks have agreed to lend a total of over RMB 83 billion to avoid a credit crunch in the vital relief and reconstruction period.

- Furthermore, government financial authorities have deemed financial debts that are still outstanding after the earthquake as frozen debts to be annulled if the debtor is proven to have died or gone missing as a result of the earthquake. In addition, debt will be annulled if the debtor suffered significant financial misfortune as a result of the earthquake.

- The government has also put into place reductions in property, income, corporate and other taxes for persons or companies that have incurred losses because of the earthquake.

- The overwhelming demand for relief goods following the earthquake has placed heavy inflationary pressure on consumer goods. China’s inflation rate has hovered around a 12-year high in recent months, with inflation in April at 8.5%. In order to facilitate speedy and cost-efficient post-earthquake reconstruction, the government has ordained that prices of food, drugs and construction materials, including steel and concrete, be kept steady by the local commerce ministries to artificially tame the inflationary spiral during the post-earthquake period.

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