Economy

Shenzhen is the second largest economy in Guangdong Province and the fourth largest in China. It is one of two key mainland cities in Guangdong’s Big Bay Area, which includes nine mainland cities and two Special Administrative Regions: Hong Kong and Macau. Shenzhen was granted China’s first ‘Special Economic Zone’ status in the late 1970s. This status, along with Shenzhen’s strategic location, allowed it to become China’s leading manufacturing hub for the next 30 years. In the past several years, the city’s strategic advantages have shifted to high-tech and modern services industries.

Regarding financial performance, Shenzhen’s GDP rose 8.8% year-on-year (YoY) to RMB96 billion in 1H/2017, surpassing nationwide growth rates by 1.9 percentage points (ppts). Shenzhen’s tertiary (modern services) industry has increased its relative proportion of total industry output since 2011, reaching 61.4% in 1H/2017 - higher than the 54.1% national average. Its strategic location and modern services industry advancements have supported development of the Grade A office market.

Office market overview

The Luohu district, which began development back in the 1990s, was Shenzhen’s first Grade A office district. As Luohu district matured, the Grade A office market migrated west toward Futian district. For nearly two decades, Futian has been Shenzhen’s central business district (CBD) for Grade A office space. Commercial development will continue to move to the western edge of the city, and eventually Nanshan will become Shenzhen’s primary CBD.

Futian CBD

Futian is currently the most developed Grade A office district in the city. It was also the primary recipient of city-wide office supply from 2001 to 2011. Since 2011, Futian and Nanshan have alternated Grade A office supply leadership. Futian reclaimed leadership in the second quarter of 2017 by accounting for 60% of new office supply. In the near-term, Futian supply will reach record levels, pushing vacancy rates above historical average. However, land scarcity will limit new supply, hence vacancy rates should mean revert in the longer-term.

Luohu Caiwuwei

Luohu’s Caiwuwei is widely recognised as the birthplace of the city’s office market. Most projects were handed over prior to the year 2000, with new supply continues to be limited thereafter (only one or two projects are launched every two to three years). The area is home to many small- and medium-sized enterprises.

Nanshan

Nanshan’s two key areas that are leading its Grade A office development are Houhai and Qianhai. They will be respective headquarter business areas for top-tier domestic and international companies, and command rents that will challenge and often easily exceed the city average of RMB230.5 per sq m. According to Shenzhen government’s 13th Five-Year Plan, Qianhai will become Shenzhen’s new city centre. Nanshan will therefore receive record levels of new Grade A office supply over the next few years.

Qianhai

Qianhai is a 15 sq km zone dedicated to finance, logistics, and high-tech industries. Planning and construction began in 2010, and are well under way to transforming this area into Shenzhen’s new financial centre. With Qianhai Bay (the largest transportation hub in Asia) under construction, Qianhai will not only be the focal point in Shenzhen, but also the business and transportation nucleus of the 55,000 sq km Greater Bay Area region. The advancement and amalgamation of other cities into the Big Bay Area will also bring more commercial Grade A office opportunities to Qianhai.

Houhai

Houhai is an emerging business area that can be further subdivided into: the Houhai Headquarter Base (HHQB) and the Shenzhen Bay Headquarter Base (SBQB). Although several HHQB projects have already been brought to market, most projects in SBHB have not
begun construction. Houhai land plot accommodation values are now higher than those in Qianhai, indicating developers’ optimistic expectations for the Houhai Bay area.

**Bao’an**
The Bao’an district is directly adjacent to Qianhai and plans to develop nearly 2.5 million sq m of Grade A commercial property. Bao’an Q2/2017 average rent (~RMB150 per sq m) is currently offered at a steep discount relative to the average Shenzhen Grade A rent. Bao’an is therefore expected to become a viable alternative for small- and medium-sized entities that wish to change locations or move closer to Qianhai, without incurring significantly higher rents. Bao’an average rent rose 8.2% YoY in Q2/2017.

**Supply, demand and vacancy rates**
Shenzhen Grade A office market continues to see a surge in new supply, pushing citywide vacancy rates to 12.8% in 1H/2017, an increase of 4.2 ppts YoY. Supply is expected to continue to outpace demand, as Qianhai, Houhai and Shenzhen Bay Headquarter Bases launch new projects over the next two years. Government incentives aimed at attracting international and domestic businesses from key global service sectors will help absorb some of the excess supply during this expansion phase. Thus, vacancy rates should increase in the near-term, but steadily decrease in the longer-term.

**Rents and prices**
Since 2009, Shenzhen Grade A office rents have shown moderate to brisk appreciation, topping RMB231 per sq m per month in Q2/2017. Futian rents rose fastest during this time, increasing from RMB131 per sq m per month in 2009, to RMB266 per sq m per month as of Q2/2017 – an index adjusted increase of 139%. Futian is still Shenzhen’s primary Grade A office area; its mature business atmosphere will continue to attract top companies.

Over the past 8 years, the average Shenzhen office building price grew by 130%, reaching RMB56,000 per sq m in Q2/2017. In terms of average price, Nanshan ranked first followed by Futian, while Luohu ranked last among all business districts (lower than that of Bao’an). Projects in emerging districts that is expected to be the city’s future CBD, such as Nanshan, are relatively new and high-quality. These types of projects are expected to command prices relatively higher compared to the city average.

Shenzhen Grade A office market recorded a sharp yield decline from 2004 to 2006. Since 2006, yields continued to decline at a more moderate pace, reflecting strong and consistent investment demand that has fuelled pricing boom.

**Market outlook**
Shenzhen Grade A office market is expected to receive 1.32 million sq m of new supply in 2H/2017 - Nanshan will receive 51%, and Futian will receive 34%. Land scarcity will ultimately limit new Grade A office supply in Futian, while Nanshan continues to buildout Qianhai CBD. Qianhai’s significance should also positively affect nearby areas, such as Bao’an. Bao’an’s relatively good project specifications and affordable rents make it a viable substitute for the higher priced commercial Grade A offices in Qianhai.

**TABLE 1**

<table>
<thead>
<tr>
<th>Property</th>
<th>Area</th>
<th>GFA (sq m)</th>
<th>Expected launched date</th>
</tr>
</thead>
<tbody>
<tr>
<td>China Resources Headquarter</td>
<td>Nanshan</td>
<td>550,000</td>
<td>Q3/2017</td>
</tr>
<tr>
<td>HFC</td>
<td>Nanshan</td>
<td>54,000</td>
<td>Q3/2017</td>
</tr>
<tr>
<td>Unicentre</td>
<td>Bao’an</td>
<td>115,000</td>
<td>Q4/2017</td>
</tr>
<tr>
<td>Tencent Building of Binhai</td>
<td>Nanshan</td>
<td>200,000</td>
<td>2H/2017</td>
</tr>
<tr>
<td>Central Tower</td>
<td>Luohu</td>
<td>230,000</td>
<td>2018</td>
</tr>
<tr>
<td>One Avenue</td>
<td>Futian</td>
<td>200,000</td>
<td>2018</td>
</tr>
</tbody>
</table>

Source: Savills Research