



Grade A office leasing demand softens

Shenzhen's city-wide vacancy rate increased slightly during Q1/2019.

- Shenzhen's economic growth continued to decelerate in 2018, with the year-on-year (YoY) growth of the local GDP and tertiary industry slowing by 1.2 ppts and 4.2 ppts, respectively.
- The total stock of the Shenzhen Grade A office property market remained unchanged in Q1/2019 as there was no new supply during the quarter.
- Leasing demand softened in Q1/2019, with the city-wide vacancy rate increasing by 0.2 of a percentage point (ppt) quarter-on-quarter (QoQ) to 18.2%.
- By the end of Q1/2019, the city-wide average rent decreased by 1.8% QoQ to RMB227.7 per sq m per month.
- There was no en bloc sales transaction announced in the Shenzhen Grade A office investment market during Q1/2019.
- New supply for 2019 will be significant, with a total GFA of approximately 1.09 million sq m scheduled for completion, the majority of which will be concentrated in the Futian CBD and Qianhai area.
- The city-wide vacancy rate is therefore forecast to increase, leading to a decline in average rent during the rest of 2019.
- With the increasing volume of deal inquiry and due diligence, it is expected that the investment transaction market will become more active during the rest of 2019.

“In response to the softened leasing demand, many landlords implemented leasing strategies such as cutting rents, offering longer rent-free periods or higher leasing commission rates to keep or attract quality occupiers.”

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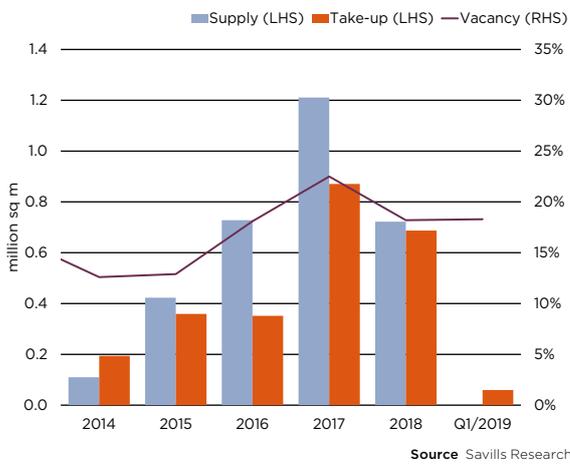
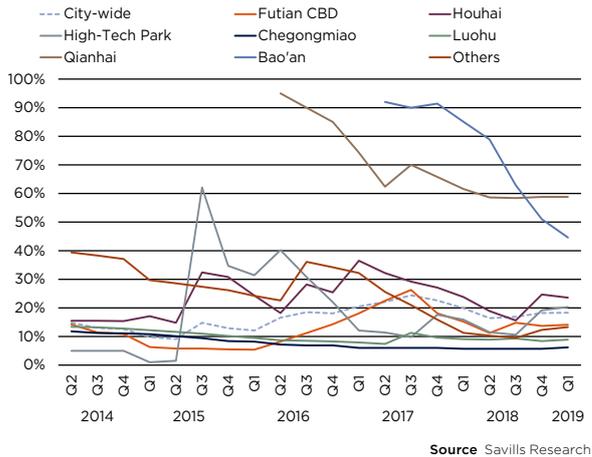
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GRAPH 1: Shenzhen Grade A Office Market - Supply, Take-up and Vacancy, 2014 to Q1/2019**GRAPH 2: Shenzhen Grade A Office Market Vacancy Rate, Q2/2014 to Q1/2019****SUPPLY**

There was no new supply in the Shenzhen Grade A office market during Q1/2019. Consequently, the total stock of the market remained unchanged from Q4/2018, at approximately 6.08 million sq m. By the end of Q1/2019, the Futian CBD, Houhai and High-Tech Park were three largest submarkets in terms of market size, accounting for 45.9%, 14.7% and 13.0% of the total stock, respectively.

DEMAND

As a collective impact of Shenzhen's economic slowdown, the city's ongoing industrial transformation and upgrading and other issues, leasing demand for the Grade A office property market softened during Q1/2019, with the city-wide vacancy rate increasing by 0.2 of a ppt QoQ to 18.2%. Meanwhile, following the elevated financial regulations released by the People's Bank of China, more challenges were brought to the Chinese economic environment, resulting in a further consolidation backdrop for small- to medium-sized companies and more cautious sentiment among them in the industry. This was most apparent in the Futian CBD area. As a result, the vacancy rate in Futian CBD increased by 0.5 of a ppt QoQ to 14.1% by the end of Q1/2019. Overall, new leasing demand was primarily sourced from the finance, IT, professional services sectors, as evidenced by some notable leasing transactions during the quarter. For example, Ping An Bank Card Centre leased approximately 2,000 sq m at Xinlikang Building; Ireader Technology Co. leased approximately 965 sq m at Wilson Software Technology Park; and Bosum Business School leased approximately 1,200 sq m at Xinlikang Building.

RENTS

In response to the softened leasing demand, many landlords implemented leasing strategies such as cutting rents, offering longer rent-free periods or higher leasing commission rates in exchange for more stable occupancy rates. Consequently, the city-wide average rent decreased by 1.8% QoQ to RMB227.7 per sq m per month by the end of Q1/2019. This was most obvious in

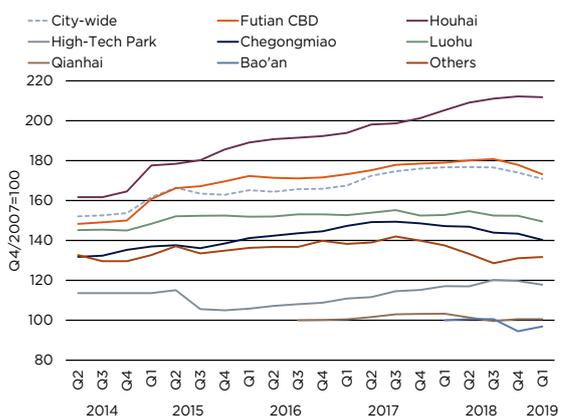
the Futian CBD area where the average rent for the submarket decreased by 2.6% QoQ to RMB253.4 per sq m per month, followed by the Chegongmiao and Luohu submarkets, where rents decreased by 2.15% QoQ and 1.94% QoQ to RMB250 per sq m and RMB199 per sq m per month, respectively.

INVESTMENT

There was no en bloc sales transaction announced in the Shenzhen Grade A office investment market during Q1/2019. With the Guangdong-Hong Kong-Macao Greater Bay Area (GBA) being elevated and integrated to the long-term strategic development plan at the state level, and the formal release of the Outline Development Plan for the GBA, international and domestic institutional investors showed growing interest in investing in the local office property market. Additionally, the investor profile in the market became more diversified compared to the previous years. In particular, insurance companies demonstrated their acceleration plans of sourcing and acquiring deals in the Shenzhen office property market.

MARKET OUTLOOK

Looking forward, 15 new projects with a total combined GFA of approximately 1.09 million sq m are scheduled for completion in the rest of 2019. The Futian CBD and Qianhai are expected to be the largest contributors, with their new supply accounting for 28.8% and 25.5% of the annual new completion, respectively. The leasing competition is expected to be fiercer as demand is forecast to be sluggish during 2019. The excessive new supply will put growing pressure on many landlord's shoulders for letting, and many will have to offer more financial incentives to counter the challenges. Office occupiers will have a lot more choice, yielding them stronger bargaining power during leasing negotiations. The city-wide vacancy rate is therefore forecast to increase, leading to a decline in average rent in the rest of 2019. With the increasing volume of deal inquiry and due diligence, it is expected that the investment transaction market will become more active during the rest of the year.

GRAPH 3: Shenzhen Grade A Office Market Rental Index, Q2/2014 to Q1/2019**TABLE 1: Notable leasing transactions, Q1/2019**

TENANT	TENANT INDUSTRY	PROJECT	SUBMARKET	LEASING AREA (APPROX. SQ M)
Unionpay Information Centre (银联信息中心)	IT Software & Services	China Life Building	Futian	4,200
Ping An Bank Card Centre (平安银行卡中心)	Bank	Xinlikang Building	Qianhai	2,000
Bosum Business School (博商学院)	Education Services	Xinlikang Building	Qianhai	1,200
China Trust (中国信托)	Trust	Shenzhen Kerry Plaza	Futian	1,000

Note: The Shenzhen office database was revamped and updated to reflect market changes during Q1/2019.

Source: Savills Research