MARKET IN MINUTES

Savills Research

Office

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Leasing activity increases

Most landlords offered financial incentives in exchange for higher occupancy during Q3/2019.

- Shenzhen's GDP grew by 7.4% year-on-year (YoY) during 1H/2019, with the tertiary industry accounting for 60.8%, up 0.7 of a percentage point (ppt) YoY.
- By the end of July 2019, the number of registered enterprises in Shenzhen increased to 1.95 million, up 3.3% YoY.
- With nine new completions during Q3/2019, the total stock of the Shenzhen office market expanded to 6.8 million sq m, up 11.4% quarter-on-quarter (QoQ).
- The citywide vacancy rate increased to 22.4%, up 4.3 ppts QoQ, as a result of the new completions.
- The citywide average rent continued downward, declining by 5.2% QoQ and 10.2% YoY to RMB208.3 per sq m per month
- A plethora of new supply, with a total combined GFA of approximately 461,049 sq m, is expected to launch onto the market in Q4/2019, with Nanshan district accounting for more than 70% of the total.
- With all the new projects in 2019, the citywide vacancy rate should inevitably spike, leading to more pressure on rental growth.
- Investment demand should continue to be subdued as a result of the tightened financing environment in China.

"Vacancy is anticipated to increase as new supply surges. Landlords offering more rental concessions or financial incentives to prospective occupiers should continue to be the norm, at least within the next six months. Rents are therefore forecast to edge down in Q4/2019."

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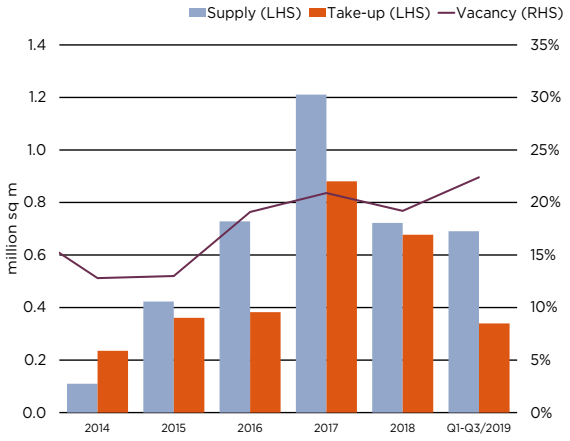
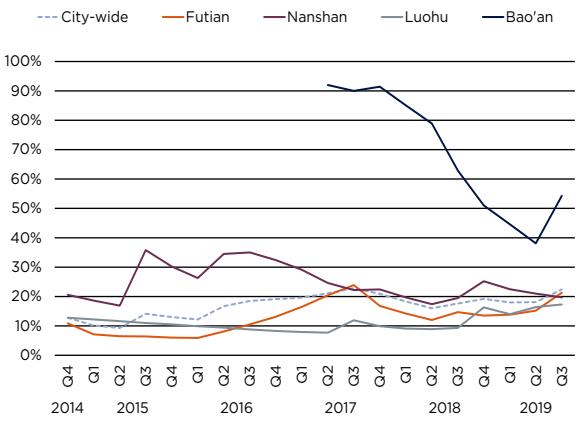
GRAPH 1: Shenzhen Grade A Office Market New Supply, Net Take-up and Vacancy Rate, 2014 to Q3/2019



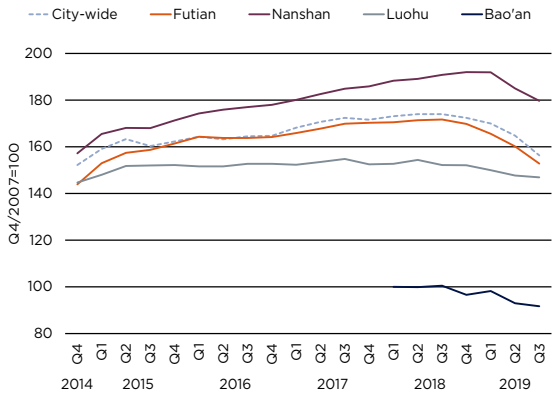
Source Savills Research

GRAPH 2: Shenzhen Grade A Office Market Vacancy Rate, Q4/2014 to Q3/2019



Source Savills Research

GRAPH 3: Shenzhen Grade A Office Market Rental Index, Q4/2014 to Q3/2019



Note Calculation of rental indices for all submarkets starts from Q4/2007 except for: Bao'an—Q1/2018

Source Savills Research

SUPPLY

Nine new Grade A office projects, with a total GFA of 690,553 sq m, were completed during Q3/2019—the first quarter to receive new supply in 2019 and an unprecedented amount for quarterly new supply. As a result, the total stock of the market expanded by 11.4% QoQ to approximately 6.8 million sq m. By the end of Q3/2019, Futian, Nanshan and Luohu as the core areas, accounted for 51.6%, 33% and 9.3% of the total stock, respectively.

DEMAND

As a collective impact of strong pre-leasing commitments at new completions and the leasing strategies of lowering rentals for higher occupancy by most landlords of existing projects, the overall Grade A office leasing market rebounded from the Q2/2019 with the net absorption turning positive at 275,458 sq m in Q3/2019. Demand mainly sourced from the TMT and finance sectors, evidenced by several notable leasing transactions concluded during the quarter. For example, Dianmao Tech leased approximately 13,000 sq m at Sinlikon Centre, and a hedge fund leased 3,000 sq m at Baidu International Building, with both in Nanshan. The surge of new supply resulted in a QoQ structural increase of 4.3 ppts in the citywide vacancy rate, resting at 22.4% by the end of Q3/2019. The Nanshan submarket outperformed other peers, with net absorption increasing by 310% QoQ to 133,448 sq m and the vacancy rate decreasing by 1.2 ppts QoQ to 19.7%, thanks to its sophisticated infrastructure, business environment and quality of offices

RENTS

Considering global and local economic uncertainties, the rental thresholds of prospective occupiers and the challenges posed by the new supply, the majority of landlords saw fierce leasing competition on the market and, therefore, continued to offer more aggressive financial concessions, e.g., direct rental cuts, longer rent-free periods and higher commission rates. Consequently, the citywide average rent fell to RMB208.3 per sq m per month, down 5.2% QoQ—the largest quarterly plummet in history. The growth in demand was unable to keep up with the pace of the new completions in Futian, leading to a decline of 4.6% QoQ to RMB230.3 per sq m per month at the end of Q3/2019—the largest rental decline among all submarkets during the quarter.

INVESTMENT

The overall investment market landscape remained unchanged relative to the prior quarter with no en-bloc sales transaction announced during Q3/2019. On the back of the establishment of Shenzhen as the 'Pilot Demonstration Area of Socialism with Chinese Characteristics' and the current uncertainties in Hong Kong, some family-owned investment funds and small- to medium-sized institutional investors from the city showed growing interest in Shenzhen's office investment market. However, capital value expectations between buyers and sellers were not aligned, with most investors requiring a longer time to understand the local market to scrutinise deals.

Some overseas institutional investors and developers continued to observe, seek and access market entry opportunities through acquiring investment vehicles during this quarter. In consideration of the tightened financing environment, the requirement of paying dividends due by the end of the year and other issues, the pressure on cash flows among some property owners should narrow down price gaps and help close deals in the next quarter.

MARKET OUTLOOK

Five new projects comprising a total of 461,049 sq m are expected to launch onto the market, with Nanshan accounting for over 70% of the total during Q4/2019. With the prior new completions, the plethora of new supply should lead to mounting pressure on most landlords' shoulders and a continued increase in the citywide vacancy rate. In response to the fierce competition, landlords offering more rental concessions or financial incentives to prospective occupiers should continue to be the norm during lease negotiations at least within the next six months. Rents are therefore forecast to edge down in Q4/2019.

TABLE 1: Major Leasing Transactions, Q3/2019

TENANT	TENANT INDUSTRY	PROPERTY	SUBMARKET	LEASING AREA (APPROX. SQ M)
Dianmao Technology (点猫科技)	TMT	Sinlikon Centre	Nanshan	13,000
The Executive Centre (德事商务中心)	Business Centres & Co-working Spaces	GEM Tower	Nanshan	3,600
A Hedge Fund	Finance	Baidu International Building	Nanshan	3,000
Yuyan E-cigarette (驭烟电子烟)	Retail & Trade	Foresea Life Centre	Bao'an	1,300

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