SPOTLIGHT

Savills Research

China Office - September 2022

The Greater Bay Area Grade A Office Index

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INTRODUCTION & GLOSSARY

Background

- Savills's Greater Bay Area Grade A Office Index (GBA Grade A Office Index) aims to provide market players, investors, developers, landlords and office occupiers with a reliable benchmark for the GBA office markets.

Sampling, Timing & Delimitation

- The report covers nine mainland cities and Hong Kong within the GBA, selecting different base years according to each city's market development record. Hong Kong, Shenzhen and Guangzhou have the base year of 2009, while the other cities have the base year of 2013. Macau is temporarily omitted from the report.

Rental Index

- The rental index reflects the change in rents over a six-month period of a basket of properties on a like-for-like basis.

Price Index

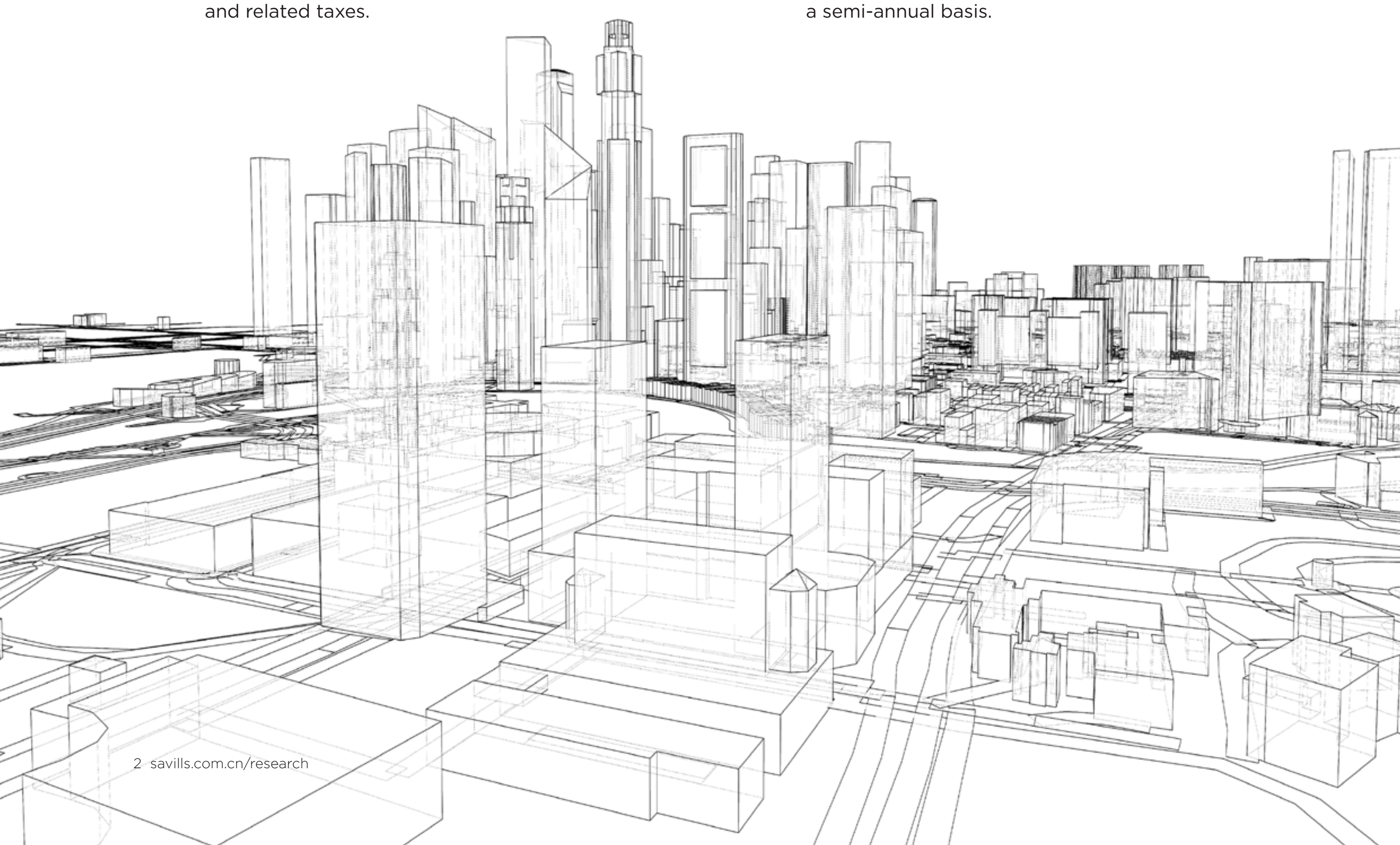
- The price index reflects the change in price over a six-month period of a basket of properties on a like-for-like basis.

Total Occupancy Cost

- The total occupancy cost includes the net effective rent, property management fees and related taxes.

Frequency of Update

- The GBA Grade A Office Index was first published in October 2019 and is updated on a semi-annual basis.



KEY FINDINGS

The GBA Grade A Office rental and price indexes decreased by 0.9% and 0.8% in 1H/2022, simultaneously, under global and domestic economic headwinds, the covid recurrences in multiple cities, and the temporary oversupply issues.

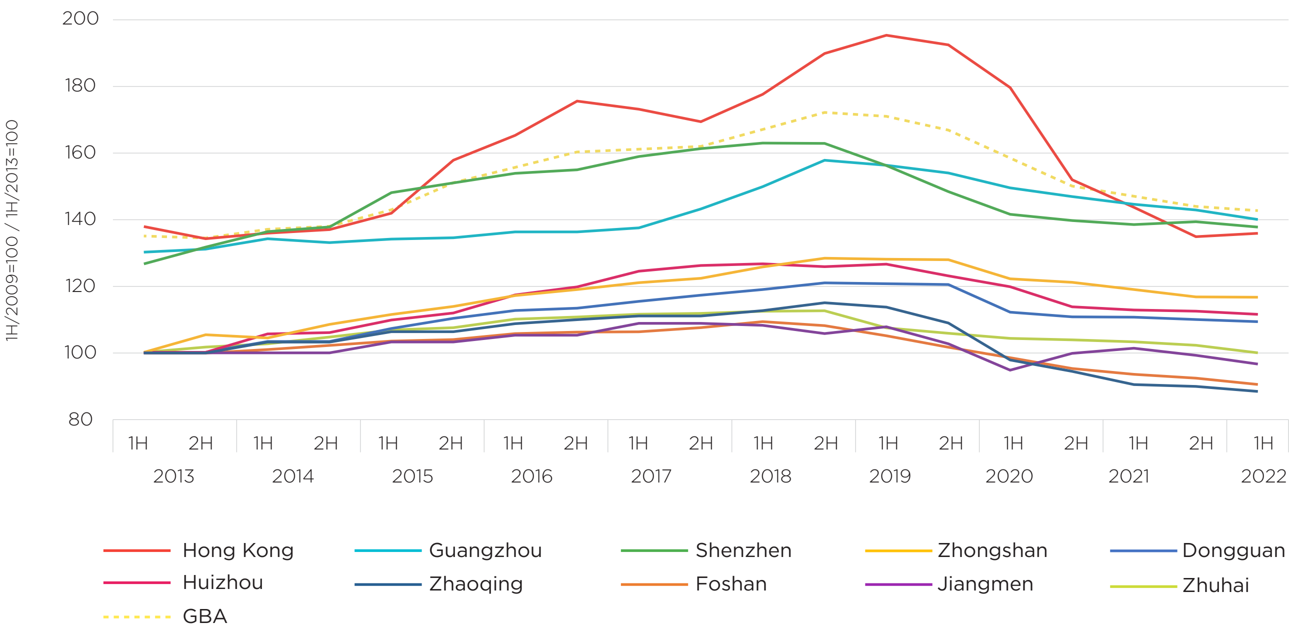
Despite the current challenges affecting the office leasing and sales market, the GBA saw a continuous flow of new supply, adding up to the disequilibrium of supply and demand which persisted during the first half. The overall leasing market across the GBA region slowed, relative to 2021, with most office occupiers showing more prudent corporate real estate strategies and decisions for office requirements. The regional net take-up slumped while the vacancy rate increased. By end-1H/2022, the regional semi-annual net take-up decreased by 77.1% HoH and 72.4% YoY to 268,609 sqm and the regional average vacancy rate increased by 1.0 ppt HoH and 1.1 ppts YoY to 22.4%.

While more market choices and reduced total occupancy costs (because of excessive new supply and decreased rents) came as good news to office occupiers, landlords on the other hand saw it as bad news. Yet most occupiers still need to take the CAPEX into consideration when calculating corporate real estate costs, which hindered possible expansions or relocations given the current economic and financial backdrops. Investors were also widely holding up their acquisition plans during 1H/2022 given the covid outbreak in multiple cities and its impacts on the literal market behaviour, e.g., the difficulty of undertaking site visits, deal scrutiny, negotiations and so on. Meanwhile, the tough financing environment along with undermined asset performance pushed many landlords to list their assets for sale, reducing their price expectations and putting all cities in an early downswing market cycle in due course.

The GBA office leasing and investment markets should continue to see unabated challenges associated with the global and national economic development, stringent covid regulations, cautious real estate strategies among businesses, as well as a plethora of new supply in most cities, if not all, during 2H/2022. However, there is plenty of room for policies that could lead to a bolstered economy and market confidence after Q4/2022. On the other hand, new supply is yet again likely to become a significant factor in the decrease of the Grade A office rental and price indices in 2H/2022.

The Greater Bay Area Grade A Office Index

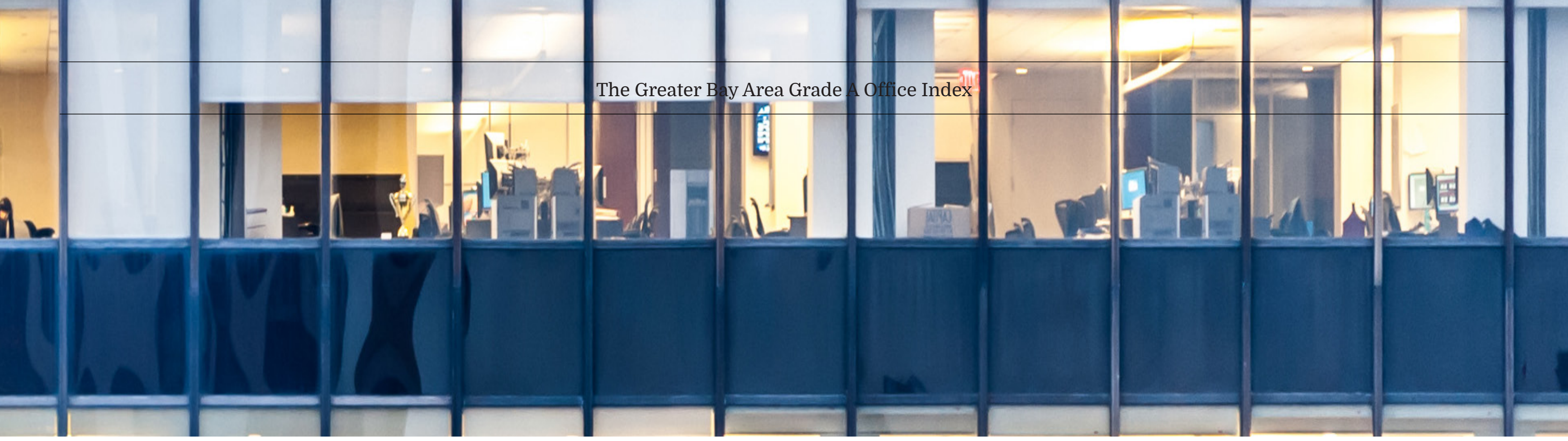
GBA Grade A Office Rental Index, 1H/2013 - 1H/2022



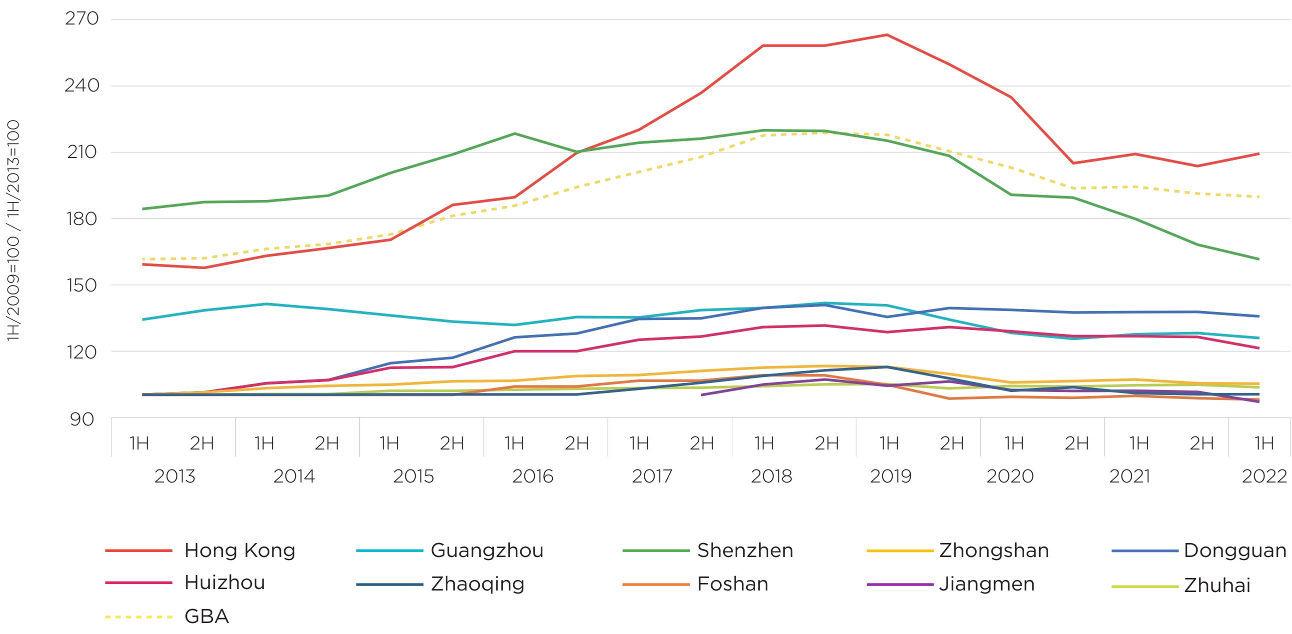
Source: Savills Research, 2022

Rental Index

- In response to the economic backdrop and softened leasing demand across the board, most landlords in almost all cities chose to offer more elasticity on rentals and remain flexible in contract term negotiations and clientele. Hence, the GBA Grade A office rental index decreased by 0.9% HoH and 2.8% YoY to 142.6 as of end-1H/2022. Nonetheless, the decrement narrowed 1.0 ppt HoH and 1.3 ppts YoY. Hong Kong was the only city registering positive growth in the rental index, up 0.7% to 135.7 in 1H/2022, owing to the increase in the exchange rate of the Hong Kong dollar to the Chinese Yuan. In reality, the rental index denominated in the local currency actually decreased by 3.8% HoH. The rental index for all other cities in the GBA decreased, with their HoH decrements ranging from 0.1% to 2.8%.



GBA Grade A Office Price Index, 1H/2013-1H/2022



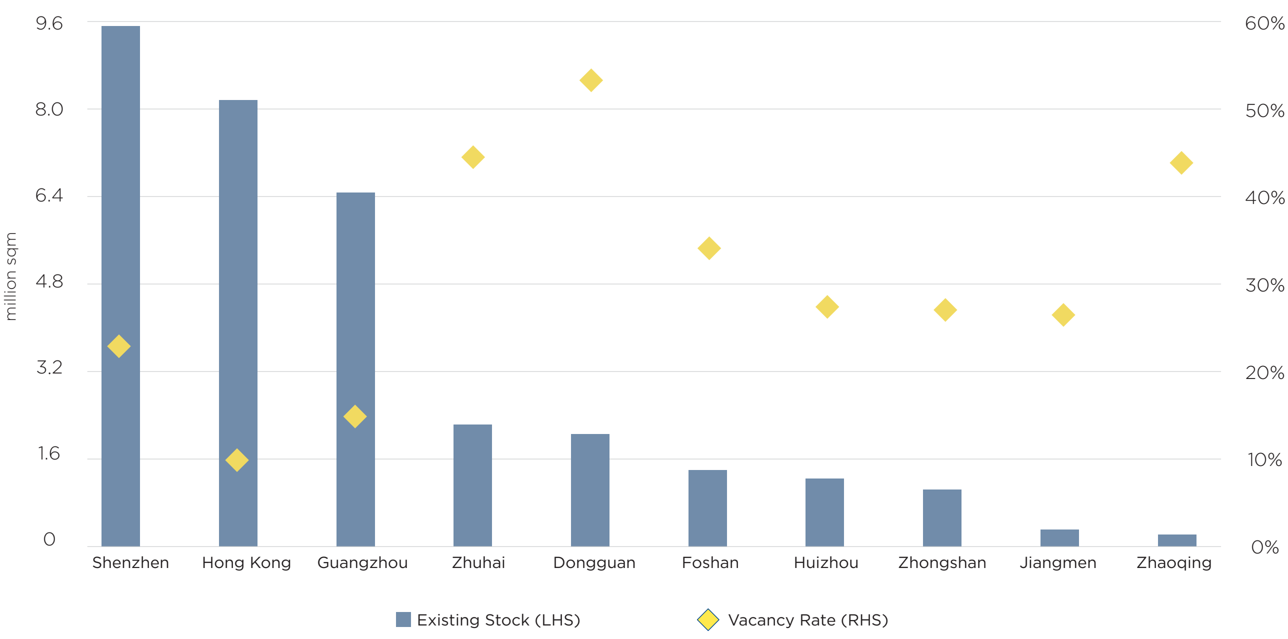
Source: Savills Research, 2022

Price Index

- Financing difficulties and debt risks increased among many highly geared large-scale developers or landlords that pushed them to list their assets for sale with softening price expectations, in a bid to strengthen their liquidity and loan payback capability. On the other hand, some investors continued to show interest in acquiring quality projects with potential upsides but at competitive prices to meet their requirements of raised hurdle rates in the key markets. Correspondently, the GBA Grade A office price index decreased again by 0.8% HoH to 189.8 in 1H/2022, following the downward trend in 2021. Eight out of the ten GBA cities, including Guangzhou and Shenzhen, recorded an HoH decrease in the price index, with their decrement ranging from 0.2% to 4.6%. Hong Kong recorded an HoH increase in its price index again, due to the currency exchange rate issue as touched on above.

The Greater Bay Area Grade A Office Market Supply & Demand Analysis

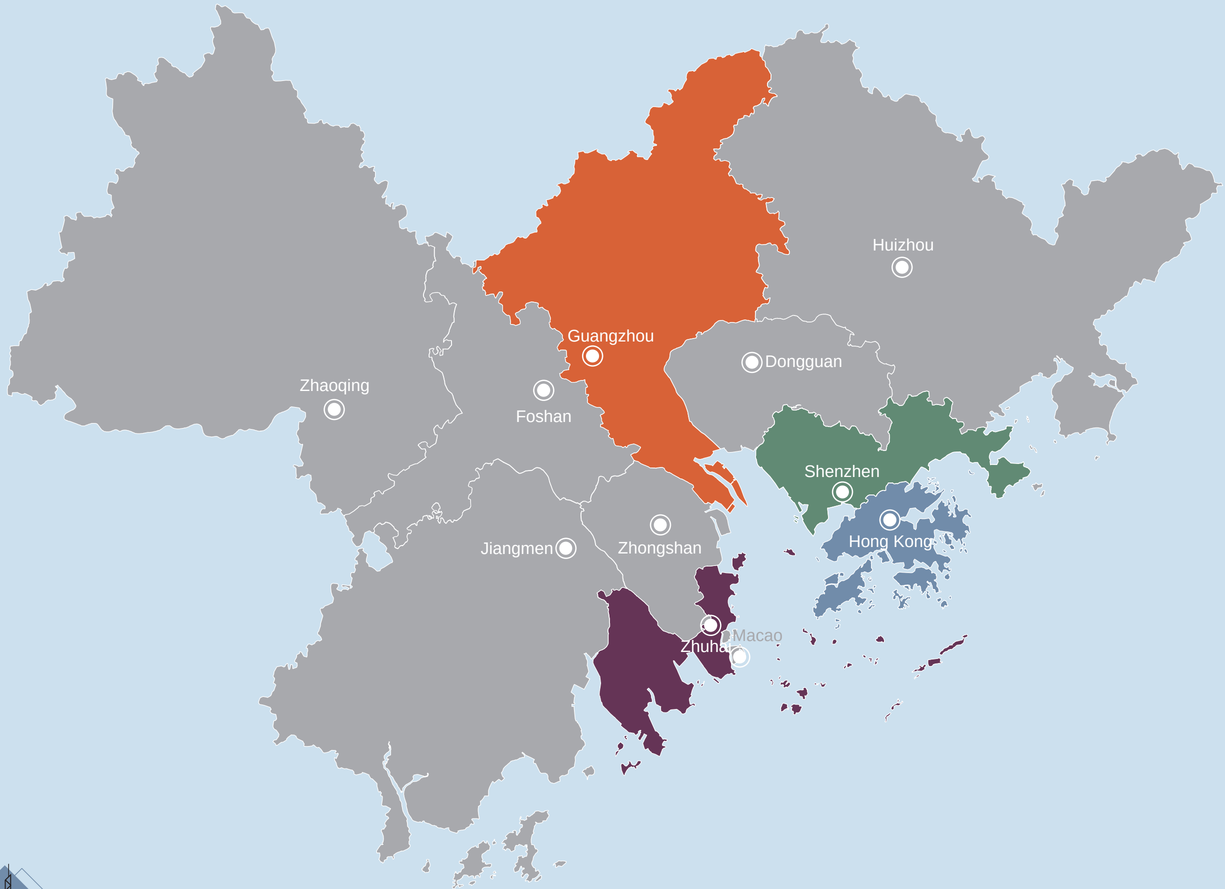
Stock and Vacancy Rate By City, 1H/2022



Source: Savills Research, 2022

A total of 677,017 sqm new supply was completed within the GBA in 1H/2022, expanding the regional stock by 2.6% HoH to 32.7 million sqm by end-1H2022. The combined stock of Shenzhen, Guangzhou, and Hong Kong accounted for 75.9% of the GBA's total stock. As markets in the mainland developed rapidly, the citywide stock of Shenzhen turned out to be 1.2 times larger than that of Hong Kong as of end-1H/2022.

Considering various circumstances including the current macroeconomic environment, covid recurrences and related lockdowns impacting business operations as well as prudent leasing strategies among most occupiers with tightened corporate real estate budgets, the overall GBA leasing market slowed in 1H/2022, especially during Q2/2022. This could be reflected in the slump in the regional net take-up and increase in the vacancy rate. By end-1H/2022, the regional semi-annual net take-up fell 77.1% HoH and 72.4% YoY to 268,609 sqm and the regional average vacancy rate increased 1.0 ppt HoH and 1.1 ppts YoY to 22.4%.



Hong Kong

The Hong Kong office leasing market faced multiple challenges including the continued downsizing activities of MNCs and diminishing demand from mainland companies, on top of related economic issues in the region. However, these were partly offset by a surge in demand from the latest generation of new economy companies, particularly in the blockchain, cryptos and NFTs sectors. All the more, the loosening of various social distancing measures also helped to revive the market sentiment. Collectively, the city's vacancy rate remained unchanged over the past six months, standing at 9.9% by end-1H/2022.

Guangzhou

While the city's total stock continued to increase, Guangzhou's office leasing market sentiment softened during 1H/2022. Leasing activities decreased and demand from multiple economic industries showed a downward tendency. Some tenants in prime submarkets even chose to withdraw their leases. Correspondently, the city's semi-annual net take-up hit a four-year low, registering at 22,000 sqm while its average vacancy rate spiked to a five-year high of 14.9% as of end 1H/2022.

Shenzhen

Shenzhen's economy and business operations were affected by several rounds of covid outbreaks and small-scale neighbourhood lockdowns in the locality and other cities having close economic ties with Shenzhen. In addition, office leasing demand from TMT companies was reduced as some business units were affected by policy adjustments. As a result, the city's semi-annual net take-up decreased significantly by 179% HoH to 156,000 sqm as of end 1H/2022, albeit Shenzhen's semi-annual net take-up remained the highest among all GBA cities due mainly to the contribution of some notable leasing transactions concluded during 1H/2022.

The Greater Bay Area Grade A Office Total Occupancy Cost

Total Occupancy Cost, 1H/2022

City	Total Occupancy Cost	Net Effective Rent	Related Tax	Management Fee
Hong Kong	611.2	498.6	39.9	72.7
Shenzhen	214.6	182.1	Inclusive	32.5
Guangzhou	185.6	154.3	Inclusive	31.3
Zhuhai	114.0	88.6	Inclusive	25.4
Foshan	76.4	53.8	Inclusive	23.7
Dongguan	76.3	56.9	Inclusive	19.4
Zhongshan	76.2	61.7	Inclusive	14.5
Huizhou	68.5	56.6	Inclusive	11.9
Jiangmen	59.7	45.6	Inclusive	14.1
Zhaoqing	51.2	40.9	Inclusive	10.4
Beijing	372.2	337.5	Inclusive	34.7
Shanghai	257.6	222.3	Inclusive	35.3

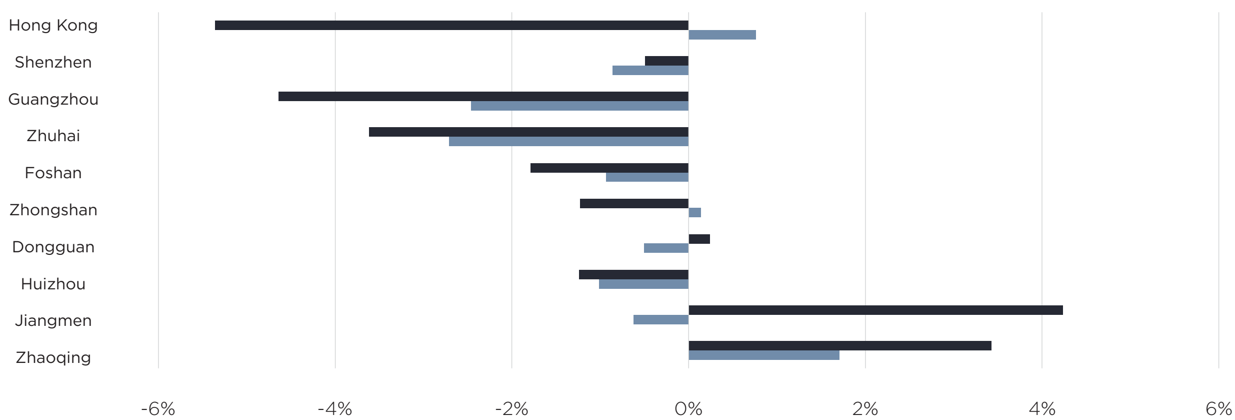
Net Effective Rent (RMB psm pmth)

Related Tax (RMB psm pmth)

Management Fee (RMB psm pmth)

Note: The total occupancy cost is a lump sum cost of net effective rent, property management fee, and related taxes.
Source: Savills Research, 2022

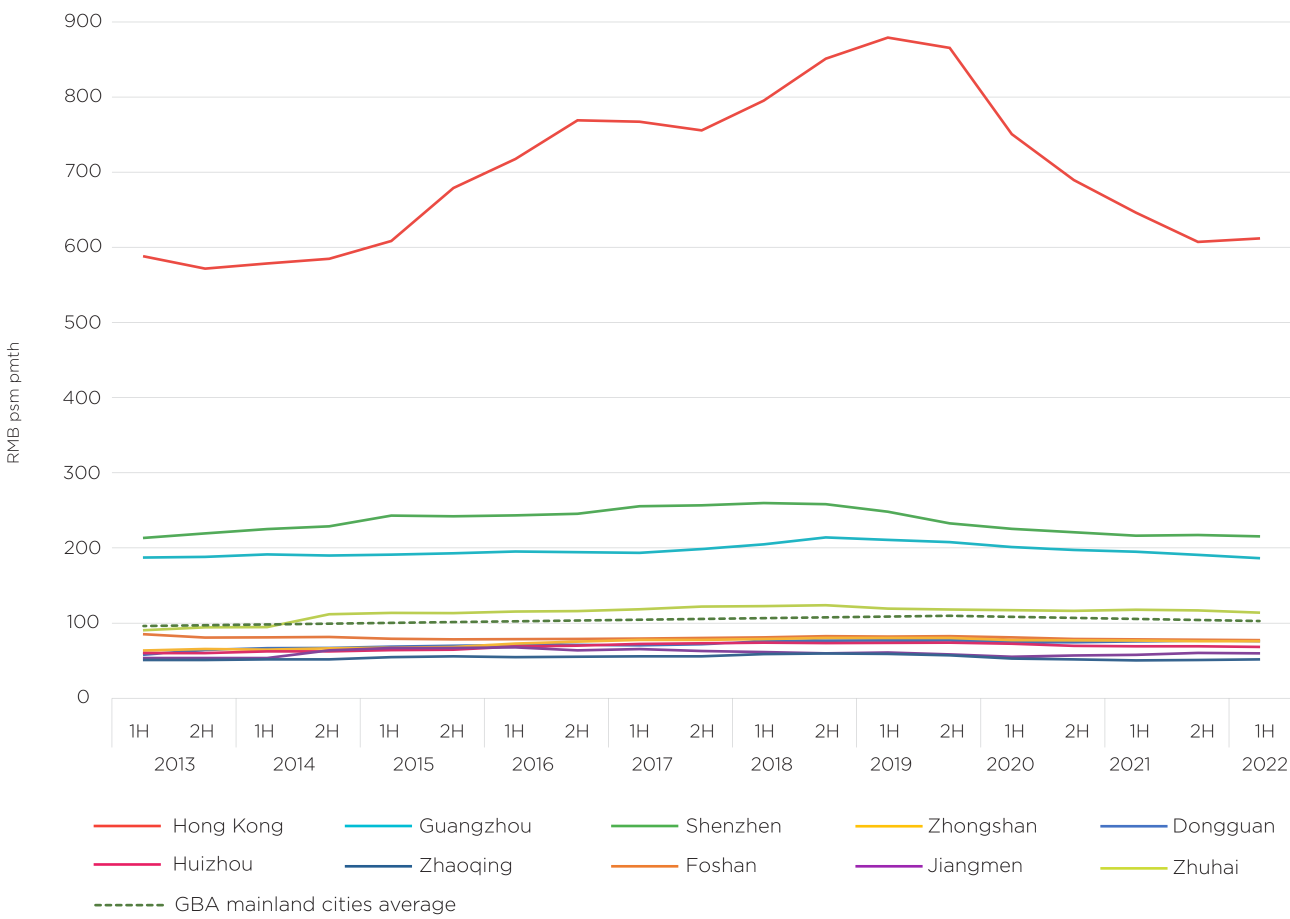
Total Occupancy Cost Change By City, 1H/2022



Source: Savills Research, 2022

As of end-1H/2022, occupancy costs of seven GBA cities recorded an HoH decrease, including Zhuhai (-2.7%), Guangzhou (-2.5%) and Shenzhen (-0.9%). On the contrary, the occupancy costs of Hong Kong, Zhongshan and Zhaoqing increased, and their HoH growth rates ranged from 0.1% to 1.7%. The increase in the occupancy cost in Zhongshan and Zhaoqing resulted from the hike in property management fees; while notably, the increase in occupancy cost in Hong Kong was based on the increase in the currency exchange rate of the Hong Kong dollar to the Chinese Yuan, otherwise the occupancy cost decreased (-3.7%) if it was based on Hong Kong's local currency.

Total Occupancy Cost By City, 1H/2013 - 1H/2022



Source: Savills Research, 2022

Occupiers Lowered Rental Affordability

Broadly speaking, rental thresholds decreased in sync with reduced leasing demand among most office occupiers during 1H/2022 because of continually tightened corporate real estate cost control among most office occupiers amidst the current economic backdrop. In addition, occupiers tended to be more cautious in reviewing financial terms and outcomes, addressing the concerns of CAPEX, when facing with options of either relocation or renewal. These left a limited room to most landlords for holding up their rents at lease and rental negotiations and adversely, resulted in a decrease in occupancy cost in most markets in the region.

Landlords Faced With Reduced Demand and Increased Competition

In addition to the widely employed leasing strategy in all city markets, viz direct cut on face rent and increase in rent-free period, some landlords in lower tier city markets, such as Huizhou, became even more aggressive in retaining occupiers who were struggling financially and had plans to down-grade their offices by extremely lowering their rents. These markets other than Hong Kong, Guangzhou and Shenzhen needed a lot more support from city economy industry development and better planning of office supply pipelines.

The Greater Bay Area Grade A Office Market Cycle Analysis

GBA Grade A Office Market Cycle, 1H/2022

Early Downswing

Most mainland cities in the GBA were witnessing a rapid development of the office property market, inevitably resulting in a strong supply pipeline over a short period as currently faced by most landlords and will likely continue till the midterm (2-3 years). This, along with the weakened leasing demand and reduced rental thresholds amidst the current economic contexts had forced all cities within the GBA in the early downswing market cycle in 1H/2022.

Outlook

The GBA office market should continue to face multiple challenges in the short term (6-12 months) involving global and national economic development obstacles, stringent covid regulations, cautious real estate strategies among businesses, as well as a plethora of new supply in the rest of the year in most cities (if not all). It is hoped however that China will employ policy incentives which are expected to boost the economy and market confidence after Q4/2022. With the injection of a significant amount of new supply in most of the GBA cities, including Hong Kong, Guangzhou and Shenzhen, a structural decrease in both occupancy and rental rates will be likely, and the GBA Grade A office rental index and price indexes are forecast to edge down in 2H/2022.

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