SPOTLIGHT
Savills Research

China Office - July 2021

The Greater Bay Area Grade A Office Index

INTRODUCTION & GLOSSARY

Background

Savills' Greater Bay Area Grade A Office Index, hereinafter referred to as the 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 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 market appeared to be on its way to recovery in 1H/2021. Many market players were increasingly confident with rental decreases slowing (down just 1.6% half-on-half(HoH)), and prices once again rising (up 0.2% HoH)

The pace of projects completions almost recovered to pre-COVID levels. Total GBA Grade A office stock therefore increased to 30.4 million sq m by the end 1H/2021, up 5.0% HoH and 9.0% year-on-year (YoY).

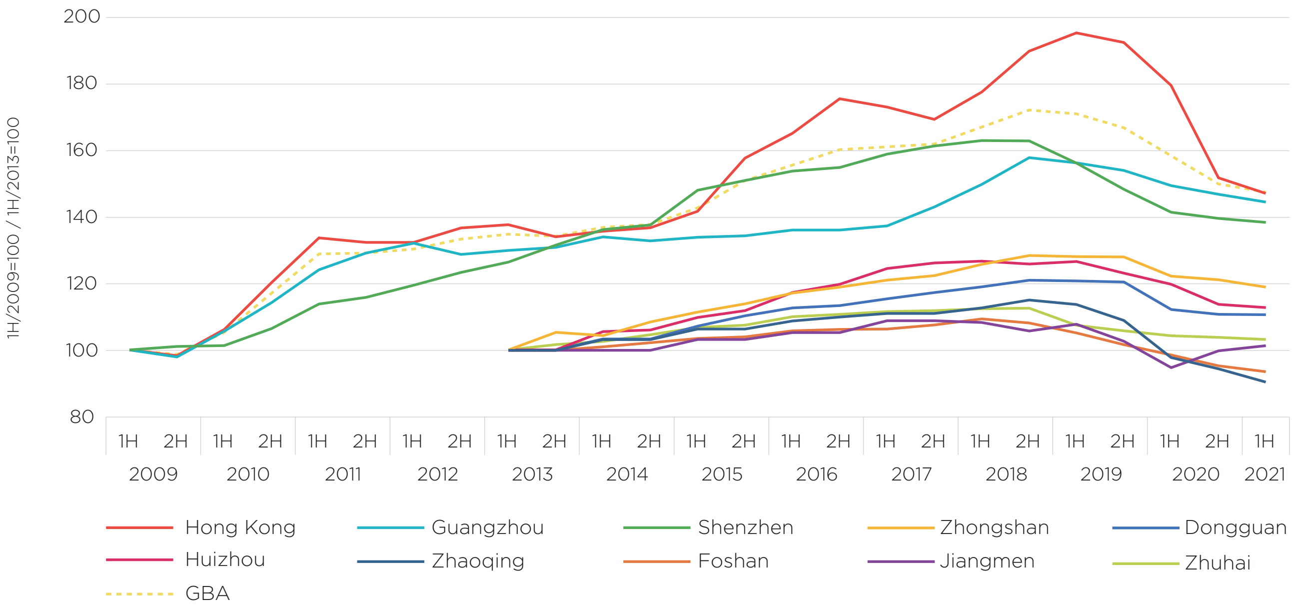
Leasing demand also picked up, with seven out of ten cities recording a decrease in vacancy rate in 1H/2021 and take-up totalling 972,000 sq m. However, Dongguan, Zhuhai and Foshan still faced with oversupply and weak demand. The regional vacancy rate consequently increased 0.6 of a ppt in 1H/2021 to 21.2% and up 2.2 ppts YoY.

Most landlords remained willing to extend incentives to qualified tenants. This is not only because of the business disruption caused by the pandemic but also the lingering oversupply issue in many cities. Total occupancy costs fell in seven out of ten cities within the GBA, including Hong Kong, Shenzhen and Guangzhou, down 2.2%, 2.2% and 1.0% in 1H/2021, respectively. Zhuhai, Jiangmen and Dongguan witnessed increases of 1.7%, 1.3% and 1.1% thanks to new completions of superior quality.

Nine out of 10 GBA cities, including Hong Kong, Guangzhou, Shenzhen and Foshan, etc entered the late downswing cycle in 1H/2021, except for Jiangmen. This was a notable improvement, compared to 1H/2020.

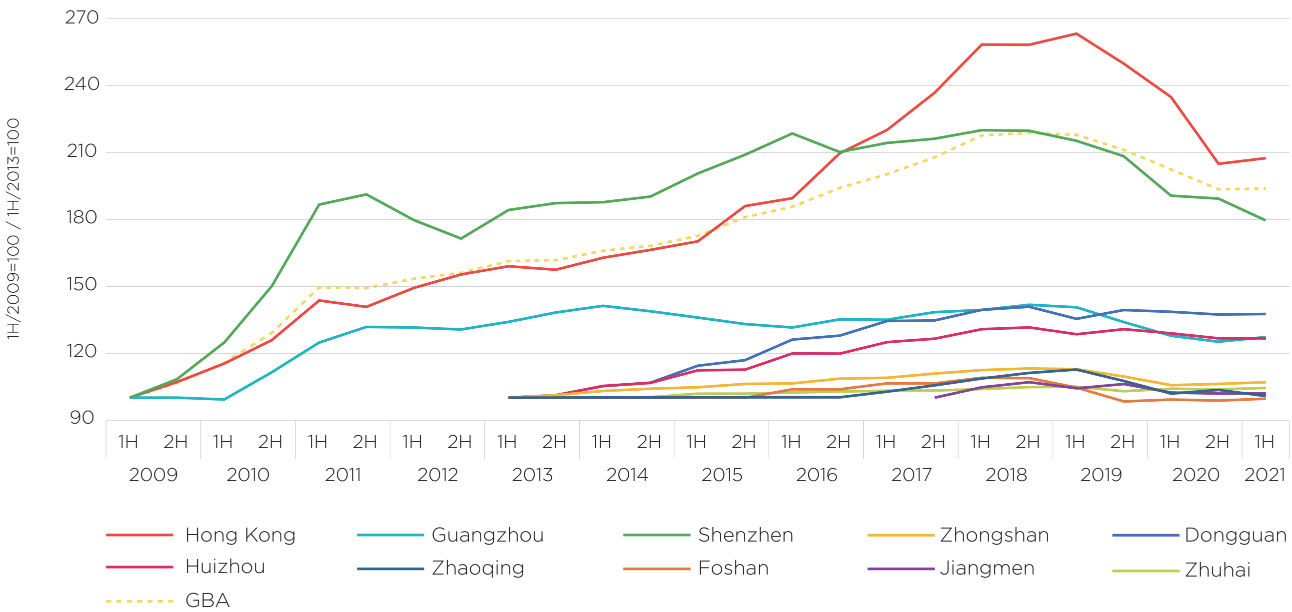
The Greater Bay Area Grade A Office Index

GBA Grade A Office Rental Index, 1H/2009 - 1H/2021



Note: The calculation of the indices for Hong Kong, Shenzhen and Guangzhou starts from 2009. Others start from 2013.
Source: Savills Research, 2021

GBA Grade A Office Price Index, 1H/2009 - 1H/2021



Note: The calculation of the indices for Hong Kong, Shenzhen and Guangzhou starts from 2009. Others start from 2013.
Source: Savills Research, 2021

The impact of COVID-19 has swept across the globe in all aspects, including the GBA Grade A office market. In 1H/2020, many enterprises in the GBA postponed their office relocations or expansions, producing pent-up demand that was collectively released in the 2H/2020 and 1H/2021. Benefited from a series of positive impacts, market players' confidence picked up amid the COVID-19 pandemic. The GBA Grade A office market, therefore, appeared to be on its way to recovery, as reflected in the smaller HoH decrement in the GBA rental index and the HoH uptick in the GBA price index by the end of 1H/2021.

Rental Index

By the end of 1H/2021, the GBA Grade A office rental index fell by 1.6% HoH to 147.6, with the decrement being 4.0 ppts smaller than that in 2H/2020.

In 1H/2021, Work-From-Home policies continued to be implemented or extended by many MNCs in Hong Kong, which subdued the demand for office space markedly. Nonetheless, Chinese companies became the major source of the leasing demand in the locality, which took up considerable space in core areas during the pandemic period. Overall, the limited increase in demand resulted in a rather competitive market, leading to a further drop in the Hong Kong rental index, down 3.1% HoH to 147.2.

Shenzhen's office property market was under the mounting pressure of the long-existing oversupply issue in recent years. Echoing this, the leasing strategy of rental concessions in exchange for higher occupancy became the norm among many landlords in the market during 1H/2021. Shenzhen's rental index has remained on a downswing since 1H/2018, however, the city's rental index decreased marginally HoH by 0.9% to 138.5, which appeared to bottom out as most of the unfavourable notes of the market have been priced in.

In consideration of the influx of new supply in 2021 and the budget control requirements among many SOEs and private enterprises, most landlords in the Guangzhou office market remained prudent in retaining or attracting tenants with lower rents trading for higher market digestion as part of their ongoing leasing strategies. The Guangzhou rental index decreased by 1.6% HoH to 144.6 as a result.

Dongguan, Zhuhai and Huizhou, saw an HoH rental decrease below 1% in 1H/2021. These cities enjoyed the benefits of their proximity to core cities such as Shenzhen and Macau and highlighted their comparable advantages in lower rentals, thus attracting many small-to medium-sized enterprises to move in and expand.

Jiangmen was the only GBA city that recorded a rental increase in 1H/2021 as a few projects reverted rents to the norm after a slump of 2020. By contrast, the office leasing demand in Zhaoqing remained fragile due to the drawbacks of the city's economic structure and its limited support to market recovery. Its rental index plummeted by 4.3% HoH to 90.3.

Price Index

The GBA Grade A office price index edged up by 0.2% HoH to 194.0 by the end of 1H/2021, implying that the office investment market appeared to have successfully weathered the COVID-19 storm.

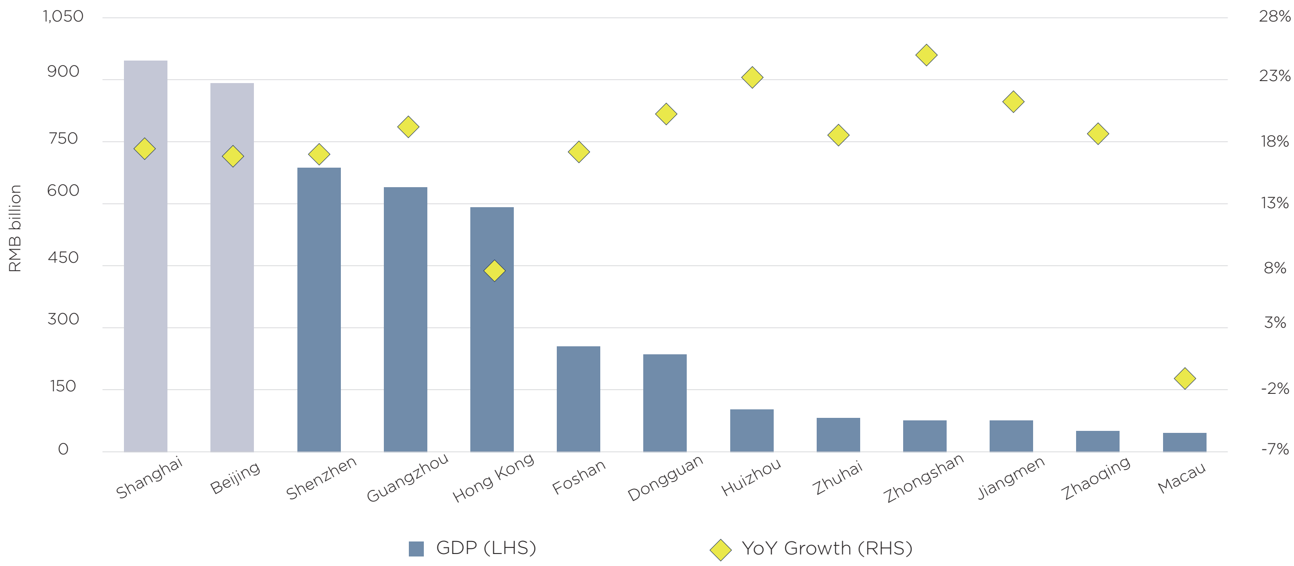
The office investment market in Guangzhou continued to be active, particularly in the strata-title sales market. The asset performance in Guangzhou's office market has proved relatively resilient in light of the lowest average vacancy rate among its peers in the GBA and its comparably stable yield expectations. In addition, many landlords' confidence was restored due to fewer worries about their personal liquidity conditions on the back of the economic recovery. The Guangzhou price index rose by 1.7% HoH to 127.5 in 1H/2021 after four conservative HoH declines and posted the best increment among all GBA cities.

The oversupply concerns lingering in Shenzhen's Grade A office market inevitably diluted the positive sentiment brought by the economic rebound. Shenzhen's landlords continued to show great flexibility in price negotiation and correction in the office investment markets, which led the price index to decrease by 5.2% HoH to 179.7—the most significant HoH decrease among all GBA cities.

Cities such as Foshan, Zhongshan and Dongguan are manufacturing dependent, indicating a more diversified office investor profile, with not only individuals but also many local manufacturers. As many manufacturers qualified with relatively stable cashflows amid the COVID-19 pandemic their willingness to sell the asset was less apparent in 1H/2021. Given this, five out of seven GBA key node cities witnessed an HoH price uptick, such as Foshan (+0.9%), Zhuhai (+0.7%), Zhongshan (+0.7%), Dongguan (+0.1%) and others.

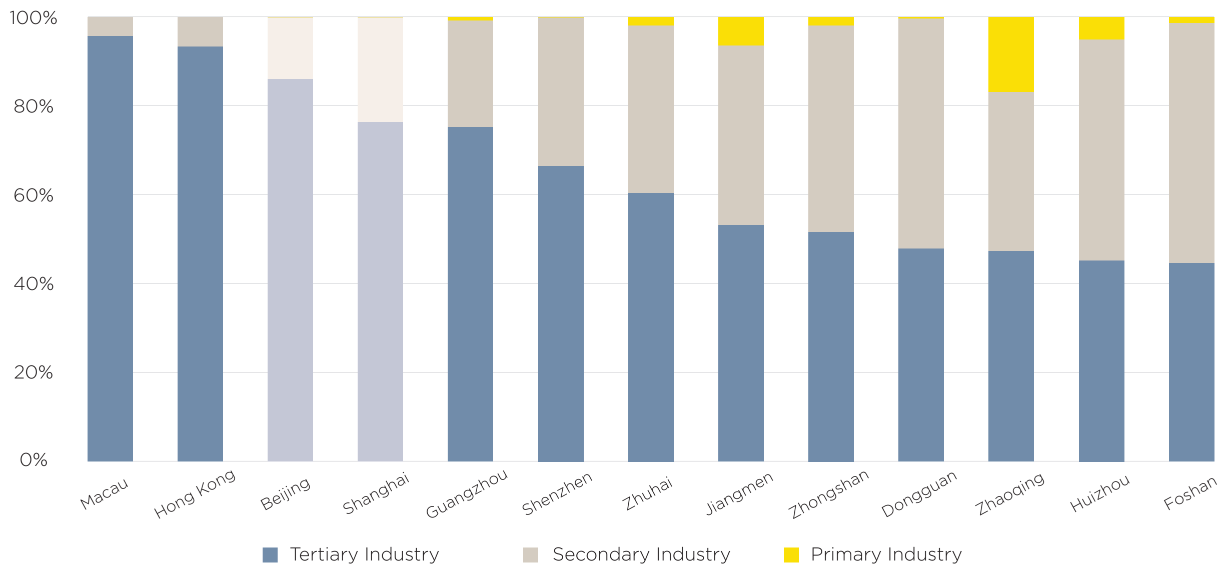
The Greater Bay Area
GDP & Economic Structure By City

GDP and YoY Change By City, Q1/2021



Note: Beijing and Shanghai's data is presented for reference; Hong Kong and Macau's GDP has been calculated under the exchange rate as of March 2021.
Source: Local Bureau of Statistics, Census and Statistics Department, HKSAR, Statistics and Census Service, Macau SAR, Savills Research, 2021

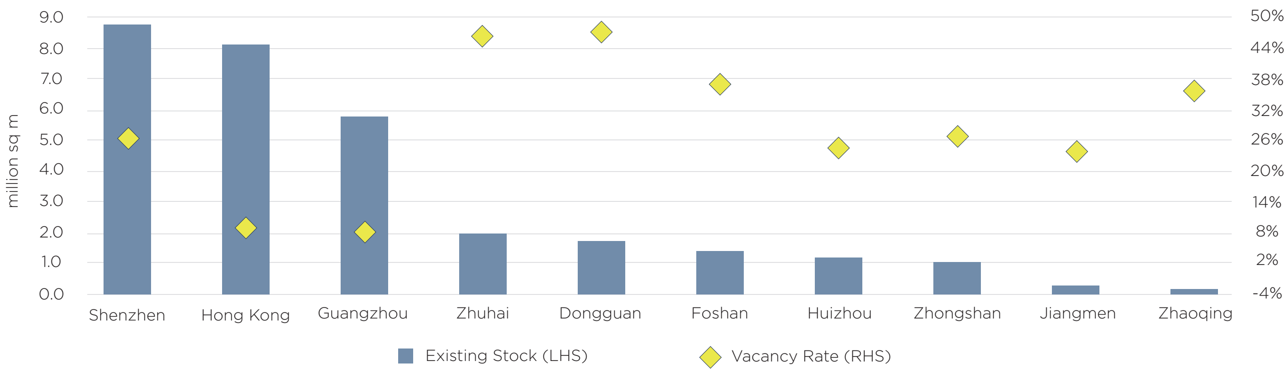
Economic Structure Comparison By City, Q1/2021



Note: Beijing and Shanghai's data is presented for reference; Hong Kong and Macau's GDP has been calculated under the exchange rate as of March 2021.
Source: Local Bureau of Statistics, Census and Statistics Department, HKSAR, Statistics and Census Service, Macau SAR, Savills Research, 2021

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

Stock and Vacancy Rate By City, 1H/2021



Source: Savills Research, 2021

Developers in the GBA (except for Hong Kong) gradually resumed their pace of completing new supply since 2H/2020. In 1H/2021, the regional total new supply reached 1.4 million sq m, almost recovering to the pre-COVID level. With these new injections, the total stock of the regional Grade A office property market increased to 30.4 million sq m, expanding by 5.0% HoH and 9.0% YoY. Among all these ten cities, Shenzhen, Hong Kong and Guangzhou continued to dominate the market share by collectively taking up 74.4% of regional total stock. Meanwhile, Shenzhen has exceeded Hong Kong to rank first in the GBA in terms of the citywide total stock.

Overall, the regional office leasing demand has shown some recovery during the post-pandemic period, with seven out of ten cities recording a HoH decrease in vacancy rate in 1H/2021 and the regional semi-annual net take-up increasing to 972,000 sq m, 3.7 and 2.4 times higher than that of the 1H/2020 and 2H/2020, respectively. However, oversupply situation continued in Dongguan, Zhuhai and Foshan due to the relatively fragile momentum in leasing demand in these cities. Collectively, the regional average vacancy rate increased by 0.6 of a ppt HoH and 2.2 ppts YoY to 21.2% by the end of 1H/2021.

Hong Kong

Due to the uncertainty of the global economic environment and the implementation of Work-From-Home policies since the outbreak of COVID-19, many financial institutions began to downsize their working space in Hong Kong. By contrast, Chinese companies showed strong leasing demand and became the demand driver since 2020, evidenced by a 4.0% YoY increase in new lettings from Chinese companies. While the performance of leasing demand from different companies was mixed, the citywide vacancy rate increased by 0.6 of a ppt HoH to 8.9% by the end of 1H/2021.

Shenzhen

In 1H/2021, supported by the strong rebound of the local economy and the rapid development of New Economy in the city, leasing demand of the Shenzhen Grade A office market remained robust, as it has since end-2020. As a result, the citywide semi-annual net take-up hit a new peak in the post-pandemic period, increasing from 369,062 sq m in 2H/2020 to 447,022 sq m in 1H/2021 and contributing 46.0% to the regional market digestion. During 1H/2021, TMT, finance, professional services and retail and trade continued to be the demand engines. By the end of 1H/2021, the citywide vacancy rate decreased by 1.5 ppts HoH to 26.4%.

Guangzhou

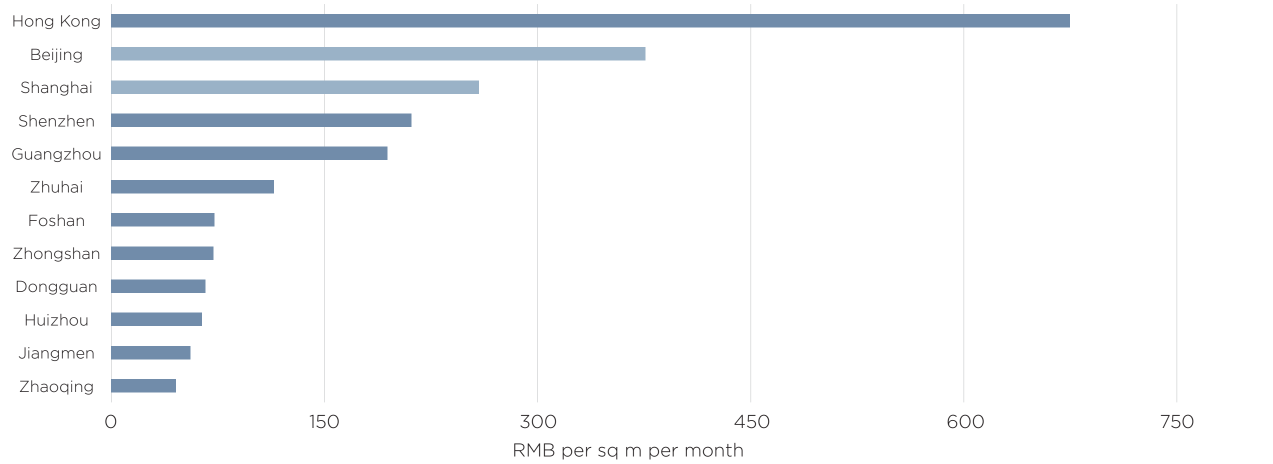
The Guangzhou office leasing market has experienced a significant rebound since the beginning of 2021 as it continued to see an increasing volume of new setup and expansion demand from multiple industries. In 1H/2021, TMT giants, foreign and domestic financial institutions and some domestic leading retail and trade companies all showed strong commitments in taking up office space in Guangzhou, particularly in Pazhou and Zhujiang New Town. Although the market was disrupted again by a small outbreak of COVID-19 in June, the semi-annual net take-up still aggregated to a three-year peak of 264,203 sq m, and the citywide vacancy rate decreased by 0.5 of a ppt HoH to 8.2%, the lowest in the GBA.

Foshan

Foshan's GDP reached RMB1 trillion for the first time in 2020, and manufacturing still contributed most to the local economy. This shaped the financial and real estate enterprises-led characteristics of its office market tenant profile as local manufacturing companies were more likely to set up offices in their factories. However, many local manufacturing companies chose to set up or relocate their headquarter offices in Grade A office buildings to attract high-quality employees recently. This, in turn, generated some new leasing demand for the Grade A office leasing market. Partly benefitting from this and a mild recovery of other demand generators, the citywide vacancy rate edged down 0.7 of a ppt HoH to 36.9%.

The Greater Bay Area Grade A Office Total Occupancy Cost

Economic Structure Comparison By City, Q1/2021



Note: Shanghai and Beijing's data is presented for reference; Hong Kong's total occupancy cost has been calculated under the exchange rate as of March 2021.
Source: Savills Research, 2021

Total Occupancy Cost, 1H/2021

City	Total	Net Effective Rent	Related Tax	Management Fee
Hong Kong	674.2	557.0	44.6	72.7
Shenzhen	211.3	183.6	Inclusive	27.6
Guangzhou	194.2	163.6	Inclusive	30.7
Zhuhai	114.6	93.2	Inclusive	21.4
Zhongshan	71.9	62.8	Inclusive	9.2
Dongguan	66.4	57.0	Inclusive	9.4
Foshan	72.6	54.6	Inclusive	18.0
Huizhou	63.9	57.4	Inclusive	6.5
Jiangmen	55.7	46.1	Inclusive	9.6
Zhaoqing	45.4	40.2	Inclusive	5.3
Beijing	375.7	341.3	Inclusive	34.4
Shanghai	258.8	223.5	Inclusive	35.3

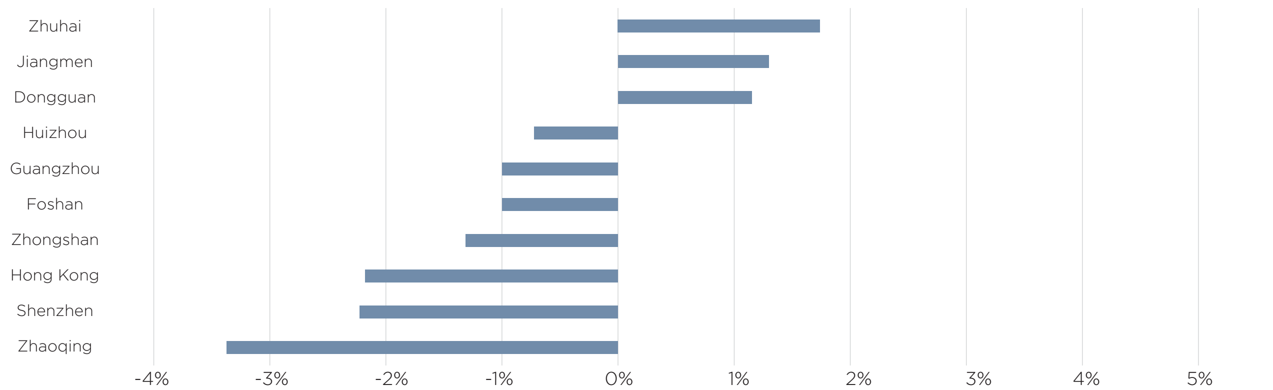
Net Effective Rent (RMB per sq m per month)

Related Tax (RMB per sq m per month)

Management Fee (RMB per sq m per month)

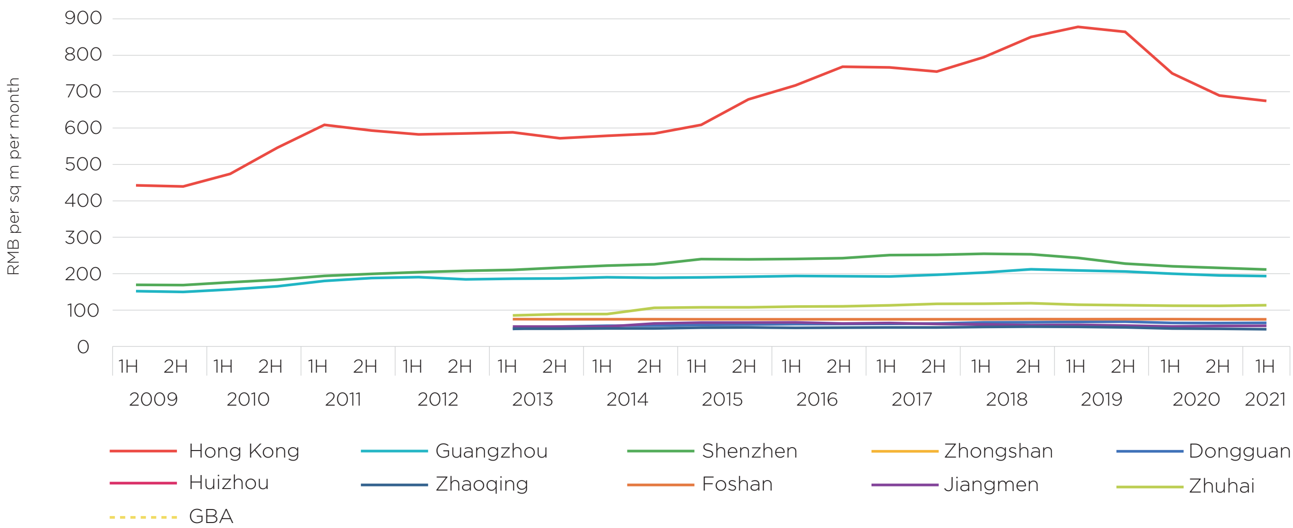
Note: The total occupancy cost is a lump sum cost of net effective rent, property management fee, and related taxes. Hong Kong's total occupancy cost has been calculated under the exchange rate as of March 2021.
Source: Local Bureau of Statistics, Census and Statistics Department, HKSAR, Statistics and Census Service, Macau SAR, Savills Research, 2021

Total Occupancy Cost HoH Change By City, 1H/2021



Source: Savills Research, 2021

Total Occupancy Cost By City, 1H/2009 - 1H/2021



Source: Savills Research, 2021

In the context of the lasting COVID-19 pandemic, most landlords in the GBA were willing to make compromises to qualified from the tenants' perspective, it was a good time for them to optimise their leasing strategies by reviewing the total occupancy costs and site selections.

The total occupancy costs in seven cities out of ten within the GBA, including core cities of Hong Kong, Shenzhen and Guangzhou, fell by 2.2%, 2.2% and 1.0%, respectively, during 1H/2021. By contrast, the three cities of Zhuhai, Jiangmen and Dongguan witnessed a respective increase of 1.7%, 1.3% and 1.1% in total occupancy costs, mainly resulting from the new supply with higher building specifications asking higher rents amid positive economic prospects and pushing average rents up as a consequence.

Tenant's Cost-saving Intention Continued Amidst Global Economic Uncertainties

Given that the global marketplace is still full of uncertainties and midway through an economic recovery, many enterprises across the GBA called for an optimisation in budget control and internal resource allocation, either by reducing their rental thresholds or downsizing leasing areas. The economic recovery in the GBA is still shaky considering the ongoing COVID-19 pandemic. For example, the new wave of COVID-19 infections that occurred in Guangzhou, Shenzhen, Foshan and Dongguan from May to June temporarily stalled the market recovery. Tenants preferred to remain cautious and risk-averse in hopes of juggling quality office building and affordable rents when selecting a new office site.

Quality Tenant Took More Advantages in Lowering Occupancy Cost

Many landlords, realising the importance of tenant portfolio management for improving asset performance, became increasingly selective on tenants. Therefore, despite most landlords continuing their existing strategies of lowering rents in exchange for occupancy, they were inclined to provide more flexibility and concessions in rental negotiation with quality tenants, including bellwether companies and unicorn start-ups.

The Total Occupancy Cost Gap Between Hong Kong and Other Cities Narrowed

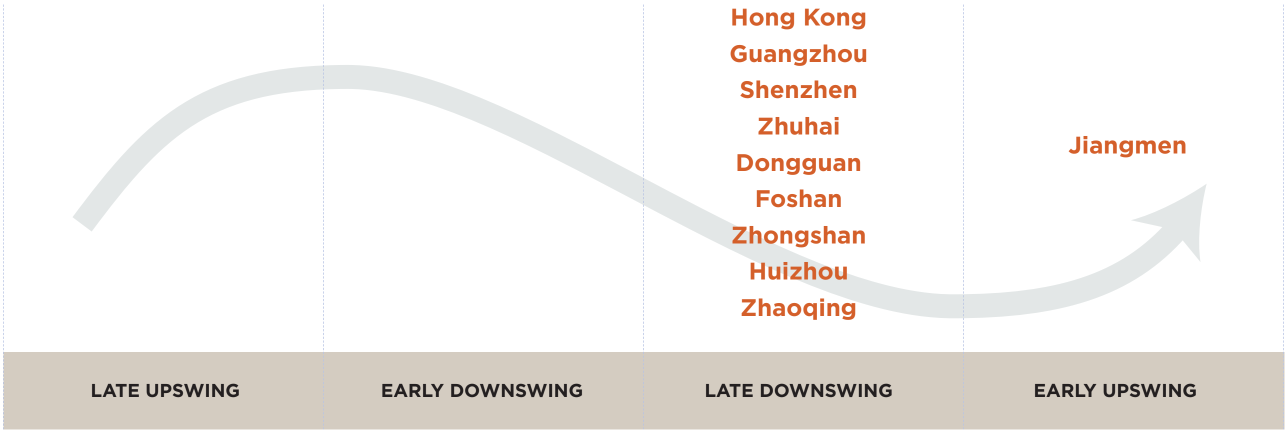
Despite that Hong Kong continued to lead the GBA in terms of the total occupancy cost by the end of 1H/2021, the gap between Hong Kong and other GBA mainland cities narrowed significantly as Hong Kong's overall rent has been on a downward trajectory from the start of 2019. Against the backdrop of COVID-19, the total occupancy cost in Hong Kong was 3.0 times higher than Shenzhen and 13.9 times higher than Zhaoqing by the end of 1H/2021, smaller than the results from two years ago of 3.6 times and a full 16 times, respectively. On a positive note, however, occupancy costs of Hong Kong's prime office projects still led the GBA and even the Asia Pacific region.

Emerging Submarkets Became Many Tenants' Popular Cost-effective Alternatives

Emerging submarkets appeared to be an ideal and rational option for enterprises seeking a balance between quality office building and cost-saving rental expectations, especially in core cities. This was best exemplified by Qianhai in Shenzhen and Pazhou in Guangzhou, both of which saw a surge in the leasing demand during 1H/2021 with a net take-up of more than 100,000 sq m. Another example was Kowloon West in Hong Kong, which saw relatively cheap rent and more stable market performance as it reported fewer corporate closures or downsizings in 1H/2021 compared to that in core submarkets..

The Greater Bay Area Grade A Office Market Cycle Analysis

GBA Grade A Office Market Cycle, 1H/2021



Late Downswing

Nine out of 10 GBA cities entered the late downswing cycle in 1H/2021, except for Jiangmen. This was a notable improvement, compared to 1H/2020, mainly attributed to the recovering economics and the resilience of market development. Although most cities were still facing oversupply and subdued rental growth, office landlords' sentiments improved, and rents stabilised.

Early Upswing

Contrasting to the above cities, Jiangmen was the only city within the GBA that moved into the early upswing cycle. This was largely because of the higher building specifications of new projects, the recovering economy and office leasing demand in the locality.


Jiangmen


Zhaoqing


Huizhou


Zhuhai


Shenzhen

Outlook

The economic outlook for China and the GBA is expected to remain cautiously optimistic. Despite the disruption of COVID-19, the GDP of China (excluding Hong Kong and Macao) managed to grow by 2.3% YoY in 2020 and is expected to rebound by approximately 8.5% YoY in 2021, according to the National Statistics Bureau and the Chinese Academy of Sciences. Meanwhile, the GDP of the GBA also increased by 3% in 2020. More importantly, the regional GDP is projected to expand by 1.8 times from 2020 to 2030. Despite the small outbreak of COVID-19 in several areas in Guangzhou, Shenzhen, Dongguan and Foshan during Q2/2021, the pattern of economic recovery is expected to remain undisturbed, supported by the strong resilience of the Chinese economy and, more fundamentally, the rapid development of the New Economy.

The GBA office market, in general, continues to see growth in leasing and purchasing demand. While this should, to a greater extent, render extra support to the leasing market, oversupply remains a concern as the GBA office market will continue to expand sizably in 2H/2021. The GBA office rental index is anticipated to edge down continually in 2H/2021.

The positive economic performance and the resurgence of investment activities in the mainland have enhanced most landlords' confidence, in turn strengthening the growth in sales prices. The trend will be solidified further, with a continued increase in the volume of investment inquiry and project scrutinising, and the overall GBA price index is expected to maintain its upward trend in the next six months.

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