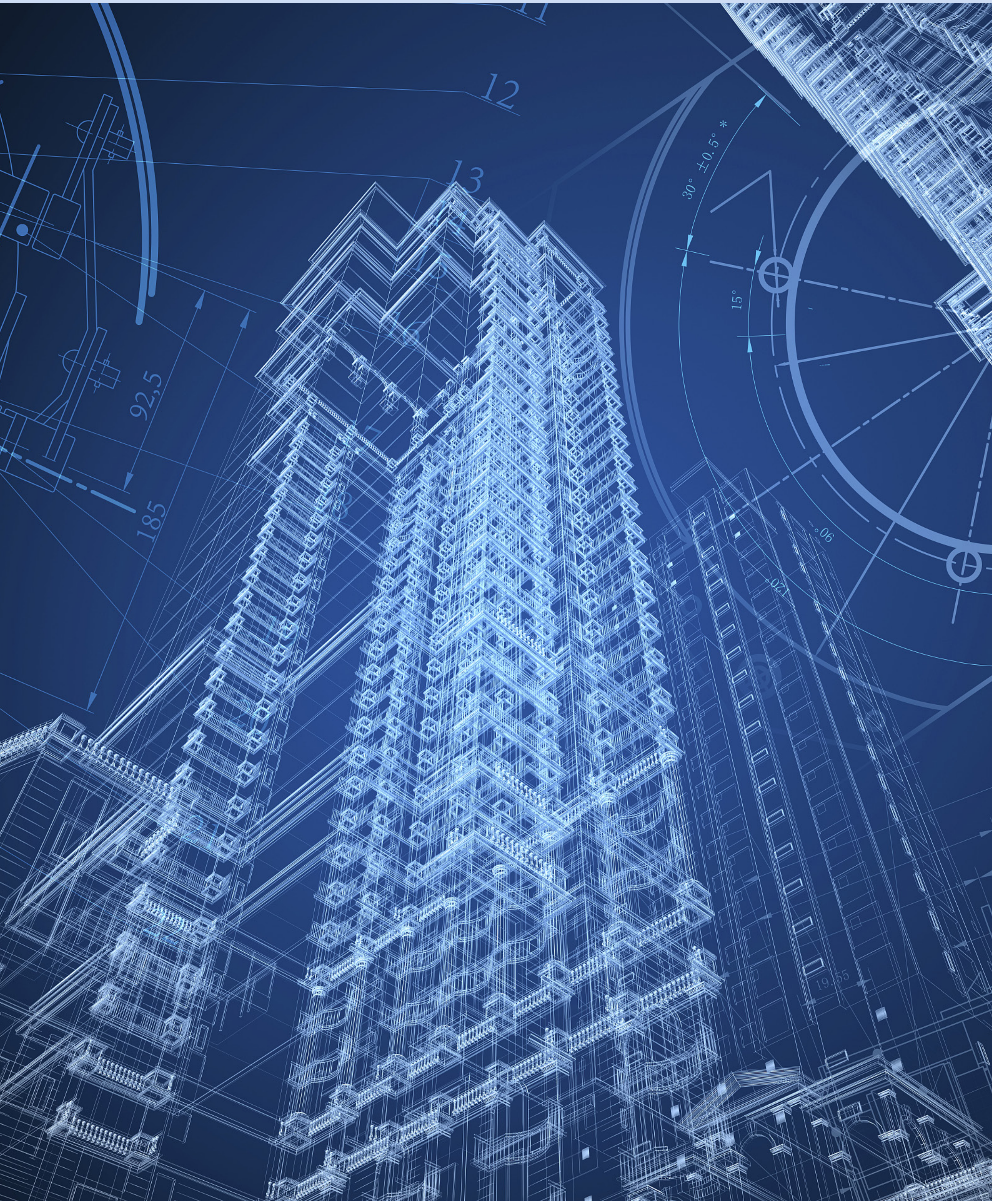
SPOTLIGHT

Savills Research

China Office - March 2020

# The Greater Bay Area Grade A Office Index

savills 第一太平戴维斯



# INTRODUCTION & GLOSSARY


Hong Kong


Foshan


Dongguan

## Background

Savills Research has launched its Greater Bay Area Grade A Office Index, hereinafter referred to as the GBA Grade A Office Index. It aims to provide market players, such as investors, developers, landlords and office occupiers, with a reliable benchmark for the GBA office markets on a city-by-city basis.

## Sampling, Timing and Delimitation

The research exercise delimits a geographic coverage, encompassing the nine mainland cities and Hong Kong within the GBA, and selects different base years for different cities in accordance with the differences in city and market development stages for compatibility and accountability. The calculation of the indices for Hong Kong, Shenzhen and Guangzhou start from 2009, while other cities start from 2013. In this exercise, the city of Macau is temporarily excluded.

## Rental Index

The rental index reflects the trends of rental changes among different cities and indicates the commonalities and divergences of the office markets in different cities.

## Price Index

The price index reflects the trends of price changes among different cities and indicates the commonalities and divergences of the office markets in different cities.

## Total Occupancy Cost

The total occupancy cost is a lump sum cost of 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 semiannual basis.



# KEY FINDINGS

The Greater Bay Area Grade A Office rental and price indices decreased to 166.6 and 209.2, down 2.5% Half-on-Half (HoH) and 3.6% HoH, respectively, during 2H/2019.

Over the same period, new supply of the Grade A offices in the 11 GBA cities totalled 1.4 million sqm, with the majority accounted for by Shenzhen and which represented 75.4% of the total. Meanwhile, the average vacancy rate of the GBA cities increased by 2.5 ppts HoH to 16.3% but Hong Kong and Guangzhou continued to hover at single digit levels, resting at 4.7% and 4.8%, respectively.

Eight cities out of 11 within the GBA witnessed a decrease in total occupancy costs while three cities registeredan increase during 2H/2019. Among all GBA cities, Shenzhen recorded the largest fall of 6.7% HoH while Dongguan logged the largest increase of 2.1% HoH.

The substantial gap in total occupancy costs between Hong Kong, Macau and the mainland cities remained one of the key features of the GBA office property market. By the end of 2H/2019, Hong Kong continued to lead all the cities within the GBA in terms of total occupancy cost, which totalled RMB866.0 per sq m per month and was 3.8 and 4.2 times higher than that of Shenzhen and Guangzhou, respectively.

As forecast in our last report, the spill-over and relocation office leasing demand for establishing back offices in Zhuhai, Shenzhen and Guangzhou from both Hong Kong and Macau has risen in appeal compared to 1H/2019, as enquiry volumes and leasing transactions of this type rose during 2H/2019.

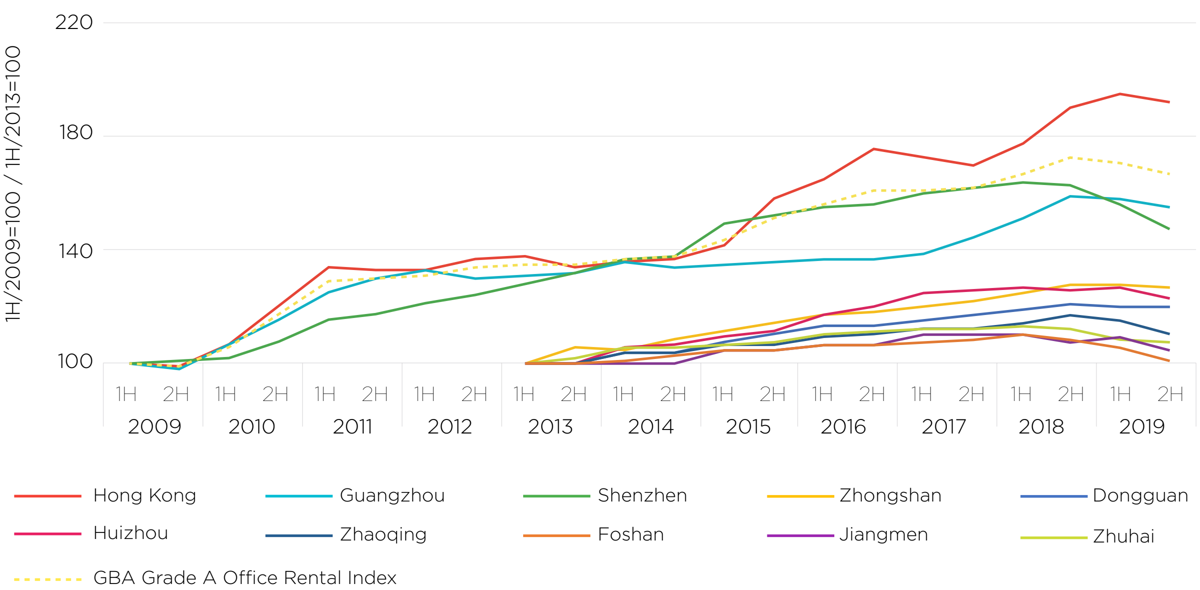
Supported by the geographic advantage of close proximity to Shenzhen, improving infrastructure development and connectivity, and relatively lower occupancy costs, Dongguan has gradually become more competitive compared with other cities in the GBA and one of the alternative site selection options for occupiers from Shenzhen.

Eight out of 11 GBA cities have entered different market cycles, reflecting wide ranging rates of change in a number of areas including broader city economies, and specific supply and demand dynamics. At the end of 2H/2019, Hong Kong, Shenzhen and Guangzhou were in an early downswing while Zhuhai and Dongguan were in a late downswing.

The China market remains largely supported and directed by policies, incentives and subsidies, as in the case of Shenzhen and Zhuhai where both the central and city governments have provided policy support to attract enterprises and subsequently incubate more office leasing demand, and to strengthen market confidence.

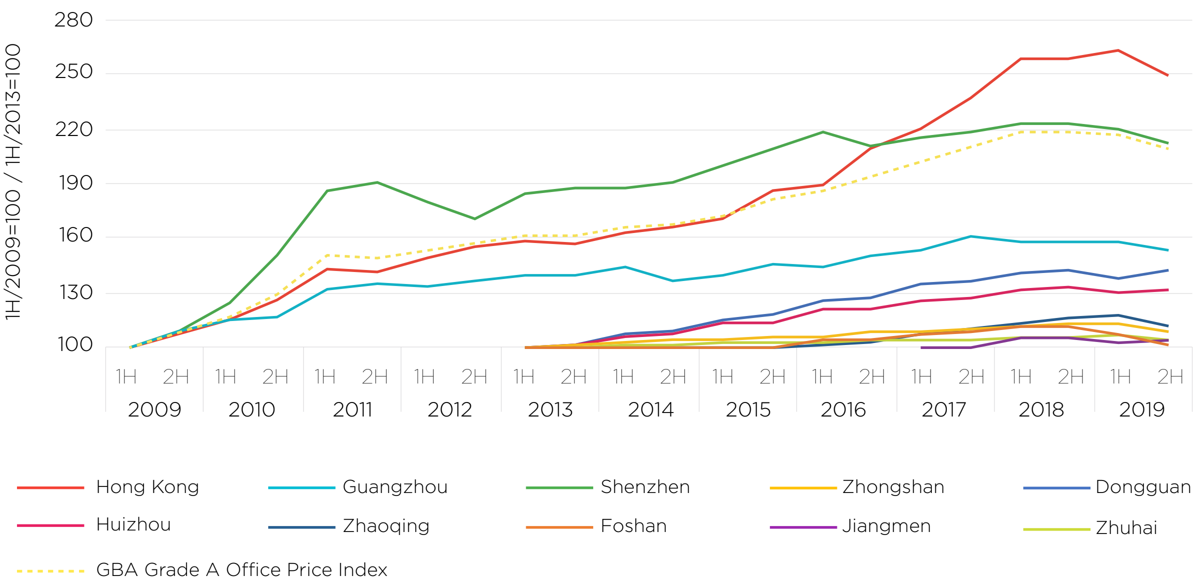
# THE GREATER BAY AREA GRADE A OFFICE INDEX

**GBA Grade A Office Rental Index, 1H/2009 - 2H/2019**




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

**GBA Grade A Office Price Index, 1H/2009 - 2H/2019**




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

The GBA office market rental and price indices declined during 2H/2019 reflecting a number of factors including China's continued decelerated economic growth, the Sino-US trade dispute, excessive new supply in most major cities within the region, and the social unrest in Hong Kong.

By the end of 2H/2019, the rental index of the GBA Grade A office market fell by 2.5% HoH to 166.6 but was still 66.6% higher than 1H/2009. Most noteworthy is that the rental index for Hong Kong remained top among all the GBA cities even though it fell by 1.5% HoH to 192.6 due mainly to the social unrest and its impact on the local economy throughout the period.

The intensified oversupply in Shenzhen, coupled with the domestic economic backdrop, triggered a rental decrease over a period of four consecutive quarters and resulted in a 5.4% HoH drop in the city's rental index to 147.6 – the largest fall among its peers. The office market in Guangzhou remained stable, relative to Shenzhen, although most landlords started to take action during 2H/2019, with many offering more flexibility in financial and tenancy agreement terms during contract negotiations, to counter the decelerating economics, subdued office leasing demand and the scheduled influx of new supply in 2020. As a result, Guangzhou's rental index edged down by 1.5% HoH to 155.5.

On the other hand, leasing demand in Zhuhai and Dongguan picked up during 2H/2019, as enquiry volumes and leasing activity from Hong Kong, Macau and Shenzhen enterprises for cost-saving relocations increased.

The GBA office price index fell by 3.6% HoH to 209.2 at the end of 2H/2019, for many of the same reasons that our rental indices softened over the period.

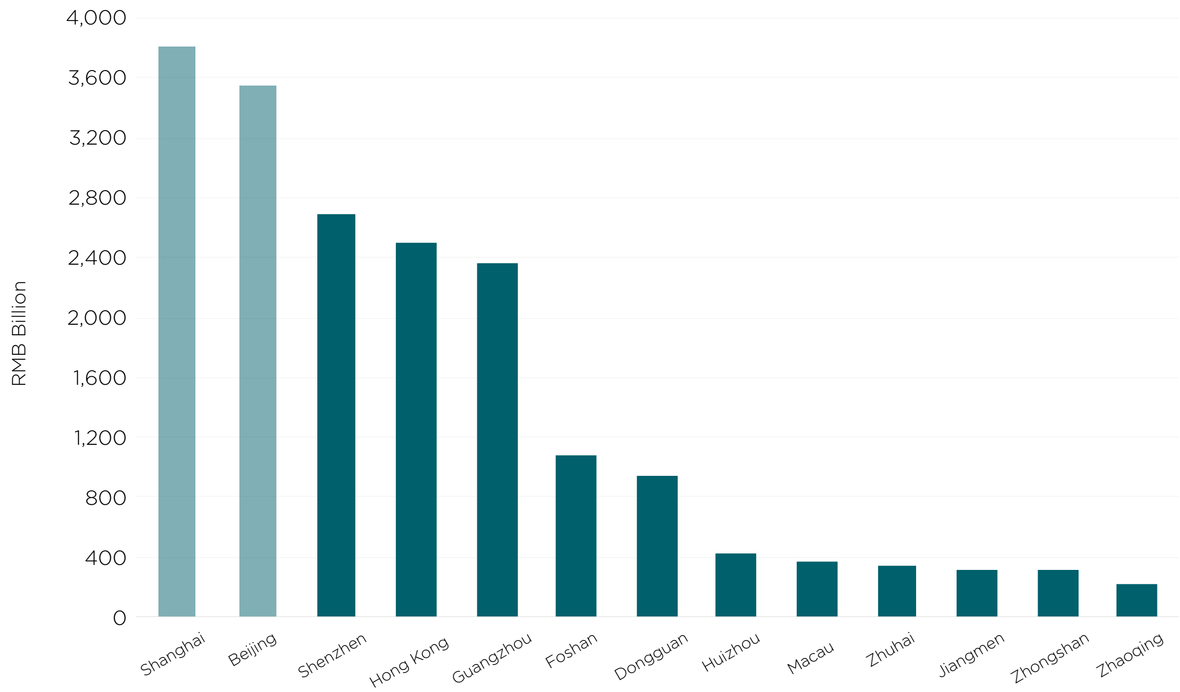
The social unrest and weaker market outlook resulted in a HoH decrease of 5.1% in the office price index in Hong Kong.

The slowing economics and deficient liquidity caused by tightened financing channels collectively brought about a HoH decrease of 3.2% and 3.1% to the price indices of Shenzhen and Guangzhou, resting at 213 and 154, respectively.

Dongguan and Huizhou The improving infrastructure, new completions of high-quality projects and policy support strengthened landlord market confidence in Dongguan and Huizhou, pushing up price indices by 3.5% and 1.4% HoH to 142.5 and 132.4, respectively.

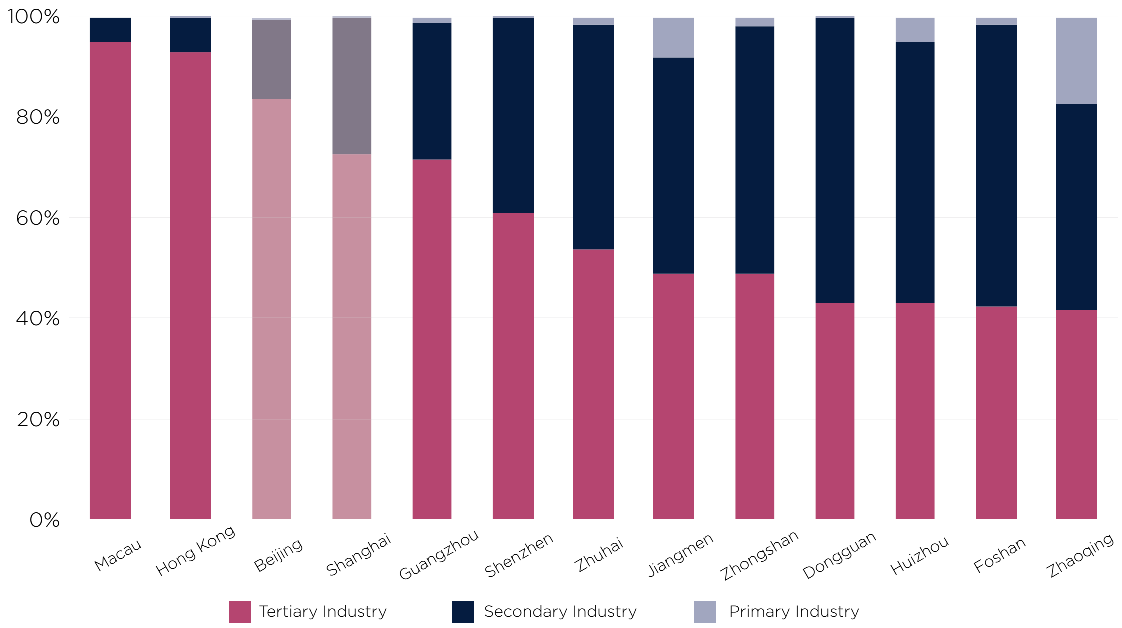
# GDP & ECONOMIC STRUCTURE BY CITY

## GDP Comparison by City, 2019




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 end-2018. Hong Kong and Macau's data is updated as of end-2018.
Source: Local Bureau of Statistics, Savills Research

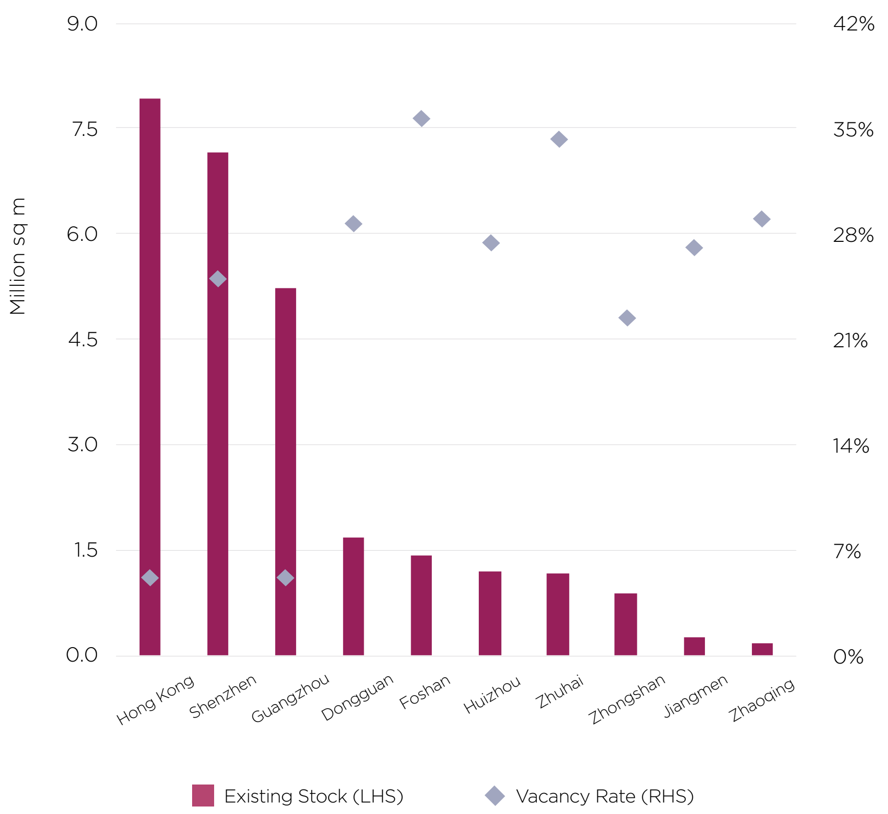
## Economic Structure Comparison by City, 2019




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 end-2018. Hong Kong and Macau's data is updated as of end-2018.
Source: Local Bureau of Statistics, Savills Research

# SUPPLY & DEMAND ANALYSIS

**Stock and Vacancy Rate by City, 2H/2019**




Source: Savills Research

New supply in the Grade A office property markets in the 11 GBA cities totalled 1.4 million sqm, with the majority coming from Shenzhen which accounted for 75.4% of the total. Meanwhile, new supply in Guangzhou and Dongguan totalled 94,000 and 122,000 sqm, accounting for 6.6% and 9.6% of the total, respectively. The total stock of offices in the region therefore increased to 27.3 million sqm at the end of 2019.

The average vacancy rate of the GBA office property market increased by 2.7 ppts HoH to 16.3%. Office occupiers in Hong Kong became more wary of expansion and preferred to seek cost-savings, leading to a 1.6% HoH increase in the vacancy rate to 4.7%. Vacancy rates in most of the mainland cities increased as the impact of the continued oversupply in addition to the slowing economy dragged on the Shenzhen, Foshan and Zhaoqing markets in particular. However, leasing demand in Zhuhai, Dongguan and Huizhou picked up as touched on above, accelerating market take-up.

The spill-over and relocation office leasing demand for back offices in Zhuhai, Shenzhen and Guangzhou from both Hong Kong and Macau became more obvious compared to 1H/2019 as enquiry volumes and leasing transactions of this type rose during 2H/2019. This primarily resulted from the increasing concerns over cost control, the social unrest in Hong Kong, limited supply in Macau, an improving policy and business environment in the mainland cities, lower human resource costs and the convenient transportation between the mainland cities and the two SARs.

**Shenzhen**

The central government published a policy note in August 2019, aimed at building Shenzhen into a Demonstration Pilot Zone with Chinese characteristics. The act raised the city positioning of Shenzhen, strengthening the long-term prospects of the local office property market with additional preferential policies and potentially helping incubate more leasing demand. Nonetheless, with new supply reaching 1.08 million sqm during 2H/2019, oversupply became one of the key concerns for many lessors and investors, causing the citywide vacancy rate to increase by 6.5 ppts HoH to 24.6% at year-end.

**Guangzhou**

Over the same period, leasing demand in Guangzhou remained stable and diversified. A handful of notable leasing transactions by well-known international and domestic financial institutions were concluded, demonstrating resilient leasing demand for expansion and relocation from the financial sector. Combined with the limited new supply, the vacancy rate of the city's office property market continued to hover at a single digit level, resting at 4.8% at year-end.

**Dongguan**

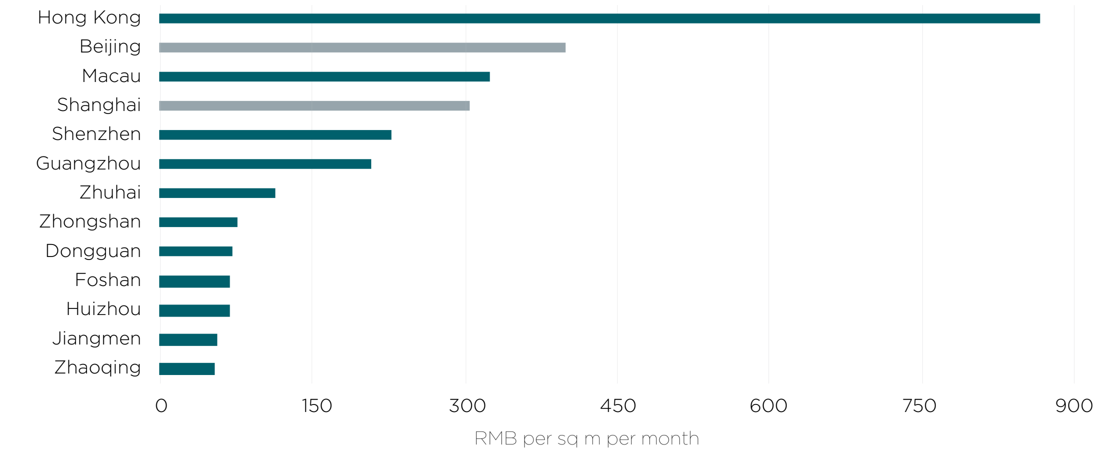
Supported by the geographic advantage of close proximity to Shenzhen, improving infrastructure development and better connectivity between Shenzhen and Dongguan, and the increasing number of enterprises relocating from Shenzhen to Dongguan in order to make cost savings, office landlord sentiment in Dongguan improved. New completions structurally raised the vacancy rate to 28.9%.

**Zhuhai**

Policy support became one of the main drivers helping to propel and sustain the growth of office leasing demand in the region, especially in Zhuhai and Shenzhen. For example, the financial subsidies provided by the local government in Hengqin, Zhuhai enticed some enterprises from the real estate, healthcare and financial sectors to set up their back offices in the locality. Consequently, the vacancy rate of Zhuhai decreased by 3.2 ppts HoH to 34.1% at the end of 2H/2019.

# TOTAL OCCUPANCY COST

## Total Occupancy Cost, 2H/2019




Note: Shanghai and Beijing's data is presented for reference
Source: Savills Research

## Total Occupancy Cost, 2H/2019

| | | | | |
|---|---|---|---|---|
| Hong Kong | 866.0 | 736.1 | 58.9 | 71.0 |
| Macau | 324.8 | 295.4 | Inclusive | 29.4 |
| Shenzhen | 228.3 | 202.6 | Inclusive | 25.7 |
| Guangzhou | 207.6 | 177.4 | Inclusive | 30.2 |
| Zhuhai | 113.8 | 93.4 | Inclusive | 20.4 |
| Zhongshan | 76.6 | 67.8 | Inclusive | 8.8 |
| Dongguang | 70.6 | 61.6 | Inclusive | 9.0 |
| Foshan | 69.5 | 52.8 | Inclusive | 16.7 |
| Huizhou | 67.8 | 62.6 | Inclusive | 5.2 |
| Jiangmen | 56.5 | 46.9 | Inclusive | 9.6 |
| Zhaoqing | 53.5 | 48.2 | Inclusive | 5.3 |
| Beijing | 397.9 | 364.9 | Inclusive | 33.0 |
| Shanghai | 305.4 | 268.6 | Inclusive | 36.8 |

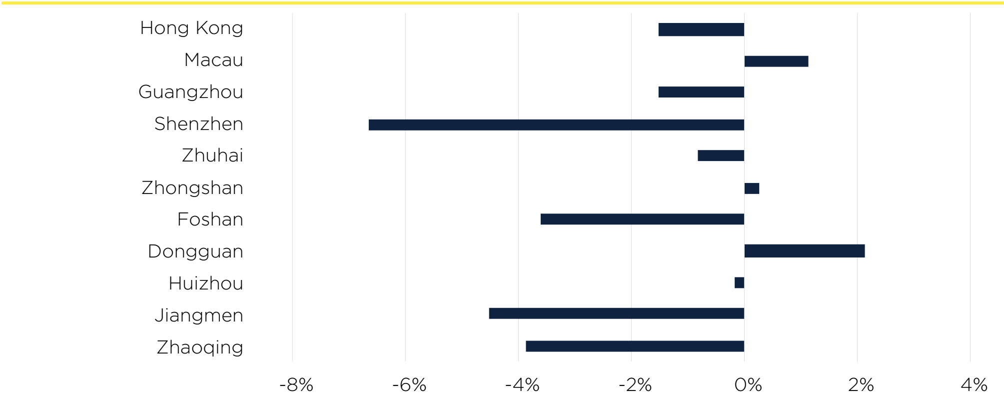
**Net Effective Rent** (RMB per sq m per month)

**Related Tax** (RMB per sq m per month)

**Management Fee** (RMB per sq m per month)

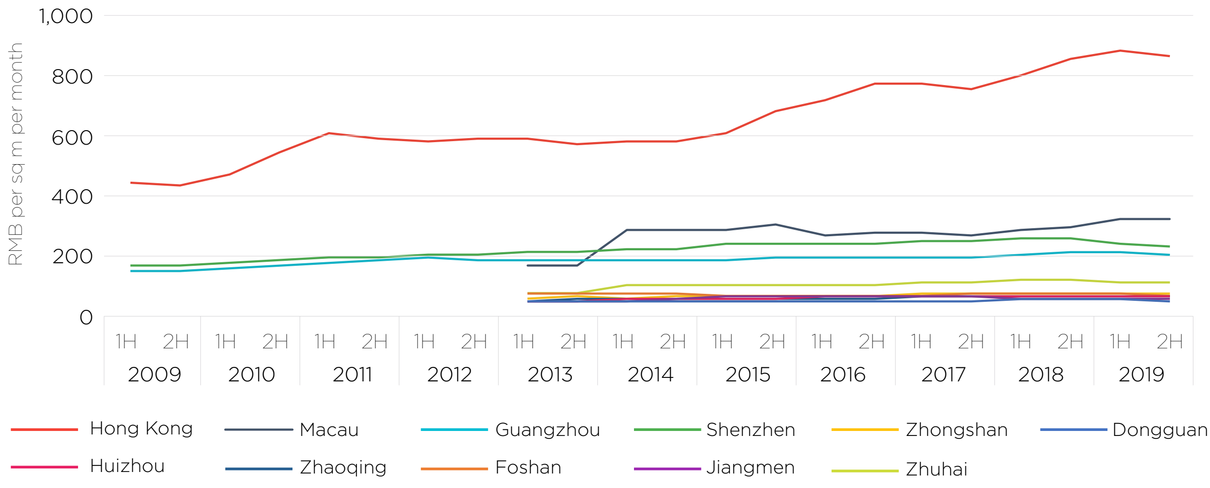
Note: The total occupancy cost is a lump sum cost of net effective rent, property management fee, and related taxes.
Source: Savills Research

## Total Occupancy Cost Change (HoH)




Source: Savills Research

**Total Occupancy Cost, 1H/2009 - 2H/2019**




Source: Savills Research

## Total Occupancy Cost

The total occupancy costs in eight cities out of 11 within the GBA, including Hong Kong, Guangzhou, Shenzhen and Zhuhai decreased during 2H/2019. This resulted from a number of factors including social and economic uncertainties, a disequilibrium of supply and demand, as well as seasonal factors. By contrast, the cities of Dongguan, Macau and Zhongshan witnessed an increase in occupancy cost, resulting from either rental increments or the exchange rate. Persistently, the gap in total occupancy costs between Hong Kong and Macau, and the mainland cities remained significant albeit rental decreases were predominant in most cities.

### Hong Kong

With its unique city positioning, despite all the social and economic uncertainties inevitably undermining market confidence in the locality, Hong Kong continued to take the lead among all the cities within the GBA in terms of its total occupancy cost. Although the total occupancy cost fell by 1.6% HoH to RMB866.0 per sq m per month at the end of 2H/2019, it was 3.8 times higher than Shenzhen and 4.2 times higher than Guangzhou.

### Guangzhou

Mainly driven by seasonal factors, the total occupancy cost of Guangzhou edged down by 1.5% HoH to RMB207.6 per sq m per month, 9.1% lower than that of Shenzhen at the end of 2H/2019.

### Foshan

Because of the collective impact of underdeveloped tertiary industry, excessive supply and fierce leasing competition among many individual landlords, the total occupancy cost for Foshan continued to decline by 3.7% HoH to RMB69.5 per sq m per month.

### Dongguan

Dongguan has become more competitive compared with its peers because of its lower occupancy cost and as an obvious site selection option for occupiers from Shenzhen with cost-saving requirements. With its improving economy, intra-city infrastructure development and good connectivity with Guangzhou and Shenzhen, the occupancy cost of Dongguan increased by 2.1% HoH to RMB70.6 per sq m per month.

### Shenzhen

As a consequence of the growing economic uncertainties, the continued tenant-friendly market conditions and more importantly, the excessive supply, total occupancy cost for Shenzhen fell to RMB228.3 per sq m per month, down 6.7% HoH — the largest decline among all GBA cities. On a positive note, the decreasing occupancy cost is expected to help Shenzhen retain enterprises and stimulate new demand in the leasing market.

### Zhuhai

The implementation of incentive policies and financial subsidies for businesses establishing themselves in Zhuhai was one of the most effective in the region during 2H/2019. It generated a pick-up in office leasing demand. Although the total occupancy cost for Zhuhai fell by 0.8% HoH to RMB113.8 per sq m per month, the decrement was contracted by 4.7 ppts HoH.

### Macau

The total occupancy cost of Macau increased 1.1% HoH to RMB324.8 per sq m per month — the third highest among all the major Chinese cities after Hong Kong and Beijing and the second within the GBA. The increase was primarily attributable to the weakened Chinese Yuan against local currencies (MOP & HKD) during 2H/2019.

# MARKET CYCLE

### Early Downswing

Hong Kong, impacted by the social unrest since mid-2019 and more lately COVID-19, moved into an early downswing, with an expected rental decline in the next six months. In the same market cycle, Guangzhou and Shenzhen were also included because both markets are facing an influx of new completions in 2020 in addition to the existing pressure generated by a weaker economic backdrop, subdued office leasing demand and softening landlord sentiment. Foshan, Huizhou, Zhongshan and Jiangmen entered this cycle as oversupply and fierce leasing competition continued to weigh on their market rental performance and this should remain so for at least the next six months.

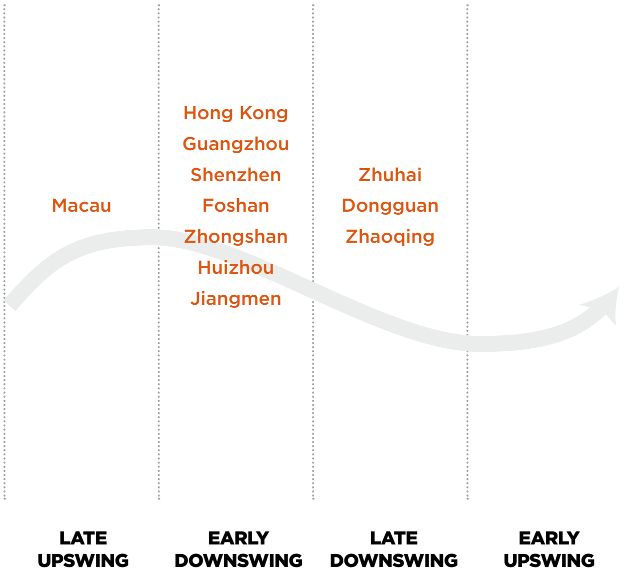
### Late Upswing

Macau continued to be in the late upswing market cycle due to its limited supply and relatively stable asset performance.

### Late Downswing

Zhuhai remained in a late downswing, compared to 1H/2019, and Dongguan and Zhaoqing entered the cycle during the same period. Notably, governments' incentives and policy support in Zhuhai and Dongguan was effective and resulted in strengthened market take-up and decreases in both vacancy rates and rental decrease rates in existing buildings during 2H/2019. The office market in Zhaoqing remained at an early stage of development, with rental growth on a par with the development of the tertiary industry in the locality.

**GBA Grade A Office Rental Market Cycle, 2H/2019**




Source: Savills Research

Huizhou

Jiangmen

Zhongshan

Zhuhai

Guangzhou

# SUMMARY

With China's decelerating economic growth, the Sino-US trade dispute, and excessive new supply in most cities within the GBA, several mainland office markets within the region continued to undergo a temporary period of adjustment during 2H/2019 and accordingly, rental and price indices of most office markets fell to different extents. Meanwhile, Hong Kong's social unrest, as expected, undermined its market confidence and put its rental and price indices under pressure.

By the end of December 2019, vacancy rates of Hong Kong and Guangzhou continued to hover at a single digit level, resting at 4.7% and 4.8%, respectively, although both inched up during 2H/2019. By comparison, vacancy rate of Shenzhen soared to 24.6%, fuelled by the influx of new completion during over the same period. In addition, vacancy rates of Dongguan continued to increase due mainly to the new supply. But that of Zhuhai and Foshan decreased, with government supporting policies being one of the important drivers for the former and the perfectly competitive market being the reason for the latter, respectively, during 2H/2019.

The gap in total occupancy costs between Hong Kong and Macau, and the mainland cities remained significant albeit rental decreases were predominant in most cities. This enticed some cost-sensitive enterprises from Hong Kong and Macau to relocate their back offices to or establish new branch offices in the mainland cities, especially those enjoying the combined advantages of effective policy support, improved transportation accessibility, relatively low human resource costs, and a sophisticated business environment, such as Guangzhou, Shenzhen and Zhuhai.

The intensifying oversupply resulted in the largest rental fall in Shenzhen within the GBA. The expected influx of new supply in 2020 should put more pressure on rents in the city. The lower occupancy cost is expected to help Shenzhen retain enterprises and stimulate the growth of new demand in the leasing market, however.

The asset performance of the GBA office property markets is expected to remain dependent on longer term market fundamentals such as economic restructuring and local market supply and demand dynamics rather than the outbreak of the COVID-19, even though it has already had a short-term impact. At the time of writing, the outbreak has caused some landlords to offer rent-free periods or direct rental cuts to tenants in order to alleviate business conditions during the outbreak. In terms of its impact on the economy and real estate market we are hopeful things will return to normal by summer as they did during SARS and expect a limited downturn and a modest correction in real estate markets from values which in many instances are at historical highs. Savills will continue to monitor the disruption, addressing its implications for office markets in our next publication "The GBA Grade A Office Index" report.

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