Impacted by COVID-19, the decline of the vacancy rate in the Shenzhen Grade-A office market slowed down as compared to the previous quarter

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Shenzhen Office Market Report

Q1 2020

THE ABUNABCE OF NEW SUPPLY AND COVID-19 EXERTED DOWNWARD PRESSURE ON THE RENT OF SHENZHEN GRADE-A OFFICE MARKET

In Q1, the new supply in the Shenzhen Grade-A office market was 42,690 sqm and pushed up the stock to 7.41 million sqm. Affected by the COVID-19 pandemic, the decline of the vacancy rate of the Shenzhen Grade-A office market slowed down.

Q1 2020, Metro Technology Building was delivered to the market and brought 42,690 sqm of space to the Shenzhen Grade-A office market. Although the vacancy rate of the Shenzhen Grade-A office market declined slightly by 0.8 percentage points to 19.5% QoQ, due to the impact of COVID-19, the decline of the vacancy rate slowed down as compared to the previous quarter.

In Q1, the average rents in the Shenzhen Grade-A office market fell 3.2% QoQ to RMB 212 per sqm per month. The COVID-19 outbreak in 2020 further weakened the demand side of the Shenzhen office market, which has already been out of balance between supply and demand. Many companies have put their expansion plans on hold or cancelled them due to economic uncertainty and financial pressures. In order to alleviate the impact of the outbreak on enterprises, Shenzhen government has launched relevant policies to support enterprises to tide over the difficulties. On February 7, 2020, the Shenzhen government released 16 measures, including deferring tax payment or deducting tax, financial subsidies, deducting the rent for enterprises and reducing financing costs, etc., so as to support enterprises.
In the aspect of rent reduction and exemption for enterprises, the Shenzhen government waives the rent for two months for non-state-owned enterprises, scientific research institutions, medical institutions and individual industrial and commercial households that rent properties owned by the municipal government, district government, municipal or district state-owned enterprises.

Although the COVID-19 outbreak has negatively affected many industries, it has also accelerated the development of some industries, such as e-commerce and healthcare. It is expected that relevant enterprises that are benefiting from the epidemic will have plans to upgrade and expand their offices.

It is expected that the surge in new supply of the Shenzhen Grade-A office market in 2020 will exert more downward pressure on the rent. However, that could be good news for many tenants who are facing cash flow pressure. Meanwhile, the vacancy rate in the Shenzhen Grade-A office market remained relatively high, which also means that tenants will have more options when relocating their offices.

Shenzhen Grade-A office market indicators

	NEW SUPPLY	RENT	VACANY RATE	PRICE
Q1 2020	42,690 sqm	RMB 212 / sqm / month	19.5%	RMB 53,976 / sqm
QOQ CHANGE	↓ 61.1%	↓ 3.2%	↓ 0.8 percentage points	↑ 0.6%
FORCAST (Q2 2020)	↗	↘	↗	↘

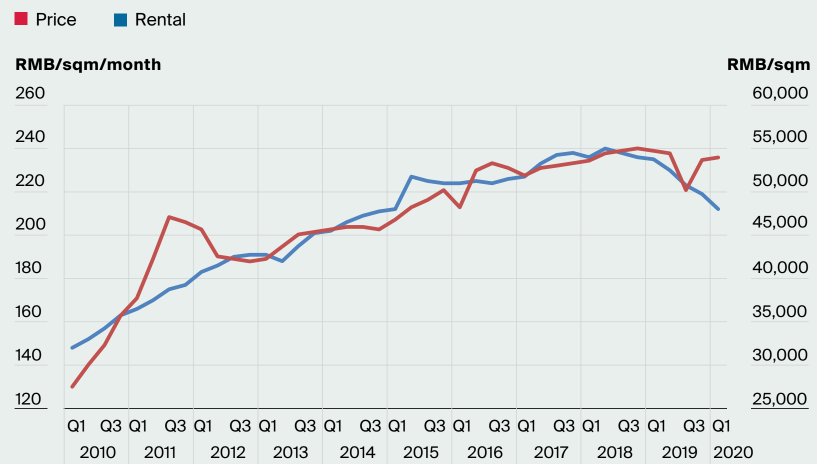
Source: Knight Frank Research

RENTS AND PRICES

In Q1, the average rent for Grade-A office space in Shenzhen was RMB 212 per sqm per month, down 3.2% QoQ. Affected by the epidemic, various business and production activities have not fully recovered to the level before the outbreak in the short term, resulting in the weak demand for office buildings. In addition, the new supply to the market during the year also forced office owners to lower rents to attract more tenants. Therefore, it is expected that the downward trend of the Shenzhen Grade-A office market's rent will continue for some time.

In Q1, in terms of the business district, the average rent in the core business district dropped the most, down by 3.8% QoQ to RMB 225 per sqm per month, while the average rent in the secondary

Fig 1. Shenzhen Grade-A office rental and price



Source: Knight Frank Research

business district dropped the least, a decline of 2.2% QoQ to RMB 193 per sqm per month.

In terms of sub-market, the owners of the Grade-A office buildings in Caiwuwei sub-market offered more favorable rents in order to attract more tenants to settle in their properties, resulting in a QoQ drop of 13.3% to RMB 208 per sqm per month. Rent subsidies introduced by the Qianhai authority last year have encouraged a large number of companies to return to the Qianhai sub-market. The increased leasing demand of Qianhai sub-market led to a slight increase in rent by 0.7% QoQ to RMB 154 per sqm in this quarter.

For the strata-title market, the average selling price of the office buildings in Shenzhen during Q1 was RMB 53,976 per sqm, slightly up 0.6% QoQ. But due to the epidemic, the strata-title market in Q1 was stagnant, selling price fell by 6.3 percentage points QoQ and no transaction of office buildings were recorded in the market in Q1.

Table 1. Shenzhen Major Grade-A office sub-market indicators, Q1 2020

Submarket	Rent (RMB / sqm / month)	Rent Change QoQ	Vacancy Rate	Vacancy Rate Change QoQ
Caiwuwei	208	↓13.3%	15.0%	↑1.6
Futian CBD	247	↓1.2%	13.5%	↓0.9
Houhai	224	↓3.9%	12.7%	↓2.3
Qianhai	154	↑0.7%	32.2%	↓2.4
Huaqiang North	188	↓2.6%	32.5%	↔
Chegongmiao	221	↓4.3%	26.5%	↓2.6
Shekou	200	↔	42.2%	↑0.4
Nanyou	170	↓2.9%	4.4%	↔
High-tech Business Park	183	↓1.1%	23.1%	↑0.1

Source: Knight Frank Research

Table 2. Shezhen Major Grade-A office leasing transactions, Q1 2020

District	Building	Tenant	Area (sq m)
Qianhai	Building T5, China Resources Qianhai Building	Datang Smart Energy	4,000
Chegongmiao	Xinian Center	Meituan	3,000
Baoan	COFCO Core R&D Center	ANA	700

Source: Knight Frank Research
Note: all transactions are subject to confirmation

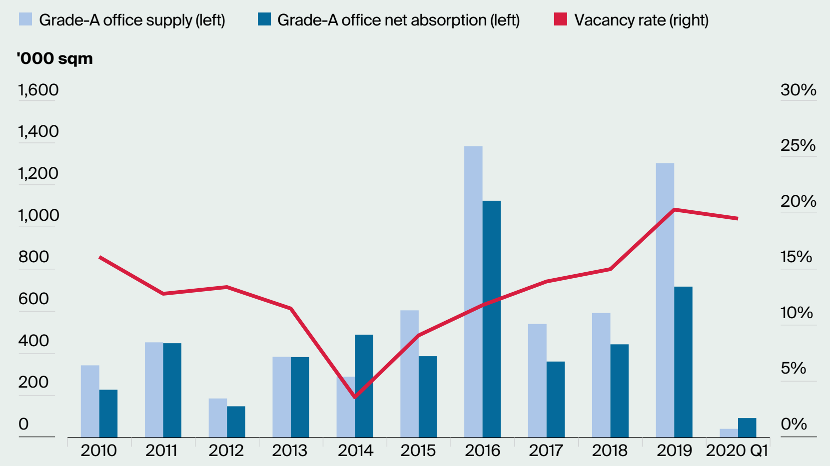
SUPPLY AND DEMAND

In Q1, there was one new Grade-A office project completed and delivered in Shenzhen, bringing 42,690 sqm new supply to the market. Therefore, the stock of Grade-A office market in Shenzhen drove up to 7.41 million sqm and net absorption was 93,000 sqm.

Despite the oversupply situation in the Shenzhen office market, and the epidemic has brought a certain negative impact on its leasing market, lease transactions with large area were still recorded in Q1. The major tenants were from the energy and TMT industries. Typical transaction cases include: Datang Smart Energy rented a 4,000 sqm of office space in Building T5, China Resources Qianhai Building; Meituan rented a 3,000 sqm of office space in Xinian Center.

In Q1, the vacancy rate in the Shenzhen Grade-A office market declined by 0.8 percentage points from the previous quarter to 19.5%. In this quarter, three office sub-markets in Houhai, Qianhai and Chegongmiao all performed relatively well in this quarter. The vacancy rate declined by more than 2 percentage points QoQ.

Fig 2. Shenzhen Grade-A office supply, take-up and vacancy rate



Source: Knight Frank Research

INVESTMENT MARKET

In Q1 2020, no en-bloc transactions were recorded the investment market of the Grade-A office market in Shenzhen, and the market was quiet.
Affected by the epidemic, the activities of en-bloc transaction market in many parts of China has slowed down, but international institutional investors are still actively seeking investment opportunities in office buildings, especially those in Singapore, and their focus on the Chinese real estate investment market have increased. However, due to the epidemic, the investment decision-making process of overseas investors was forced to be delayed.
Nevertheless, on March 15, 2020, the Federal Reserve announced an emergency rate cut to zero and launched a massive US$700 billion program of quantitative easing. The policies from the Federal Reserve are expected to accelerate the liquidity and flexibility of the capital of foreign investors.
According to RCA, in the past decade, the average proportion of foreign buyers' investment amount in Shenzhen real estate market accounted for 33% of the total investment value and the amount increased to about 69.4% in 2019. In the whole year of 2019, office transactions accounted for 39.7% of the total real estate transactions in Shenzhen.
Therefore, at the backdrop of the interest rate cut by the Federal Reserve, it is expected that the office projects located in the core area of Shenzhen will enjoy huge potential for rising capital value and attract more overseas capital to invest in high-quality office

39.7%
office transactions in 2019

Foreign buyers accounted for
69.4%
of total Investment in 2019

properties in Shenzhen.

China has made significant progress in its fight against the COVID-19. With the gradual recovery of China's economy, society and production activity, high-quality assets in China are expected to become a "safe haven" for foreign investors. As a national economic center in the Guangdong-Hong Kong-Macao Greater Bay Area, Shenzhen is expected to attract the investment from foreign investors.

MARKET OUTLOOK

In the short term, due to increasing economic uncertainty, it is expected that the demand side of the office market will continue to be subdued. The financial pressure of small and medium-sized enterprises will increase, and the expansion demand of most enterprises will decline. In addition, the Shenzhen office market will have a large amount of new supply in 2020, the high level vacancy rate is expected to persist throughout the year.

At present, the state strongly promotes the development of high-tech enterprises, which are the important tenants for Shenzhen office market. On March 4, 2020, the Standing Committee of the Political Bureau of the CPC spent a meeting to speed up the construction of 5G networks, data centers and other new infrastructures. It is expected that with the gradual implementation of "New Infrastructure", the leasing demand of related enterprises will increase in the long term.

Meanwhile, in February 2020, the Shenzhen Development and Reform Commission announced the 'Major Project Plan in Shenzhen, 2020'. The plan involved a number of projects in Nanshan District, including the Shenzhen Bay headquarters of China Electronics, innovation headquarters of DJI, Vanke headquarters building, Shenzhen Bay super headquarters of Evergrande, global headquarters building of China Merchants Bank, etc, with total 30 headquarters projects.

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Although the outbreak of COVID-19 has caused a certain disturbance to the Grade-A office market in Shenzhen in the short term, the robust economic structure, industrial composition that meets market demand and the high-quality population structure of Shenzhen will be favorable to the long-term development of the Shenzhen Grade-A office market.

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By April 2020, there were five metro lines in Nanshan District, with seven lines to be commenced by the end of 2020 and nine lines to be commenced by 2030. In the future, with improved traffic networks, it is expected to effectively connect the new business districts such as Qianhai area in Nanshan District, Shenzhen Bay super headquarters base and other emerging business districts with the mature business districts such as Houhai and Futian central district. The capital value for the Grade-A office buildings in Nanshan District will therefore be enhanced.

The long-term performance of the assets in the Shenzhen Grade-A office market will depend on the key development foundation of the city, such as economic development, industrial composition and population structure in Shenzhen. Although the outbreak of COVID-19 has caused a certain disturbance to the Grade-A office market in Shenzhen in the short term, the robust economic structure, industrial composition that meets market demand and the high-quality population structure of Shenzhen will be favorable to the long-term development of the Shenzhen Grade-A office market.

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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