

GUANGZHOU | 2018 MARKET OUTLOOK

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Accelerating success.

Innovation, the new engine for growth

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Guangzhou witnessed firm economic growth and active investment activity in 2017. Given robust leasing demand, we have recorded decreasing vacancy rates and rising rents in both the Grade A office and prime logistics markets. Looking forward to 2018, we believe Guangzhou's economy will continue to thrive especially in the context of further intra-regional integration within the Greater Bay Area (GBA). Despite new supply, we expect a growth in rents in the Grade A office with steadily decreasing vacancy rate and a modest rent increase in prime logistics warehouse with stable vacancy rates. Investment market activity should remain dynamic as we predict strong demand for prime offices and industry projects in 2018.

Collaboration and upgrading

With the government deepening the supply-side structural reform and accelerating industrial transformation and upgrade, Guangzhou's economy grew smoothly in 2017. Guangzhou's industrial production climbed modestly, supported by higher efficiency and rising profit margins. Investment in industry and real estate sectors increased steadily while investment growth in infrastructure exceeded 15% YOY. Guangzhou's GDP is believed to have surpassed RMB2 trillion (USD308 billion) in 2017 (Source: Guangzhou Municipal Statistics Bureau). By successfully hosting the Guangzhou Fortune Global Forum, Guangzhou has presented itself as a national major city, international business centre and comprehensive transportation hub in front of global business leaders.

Given strong government support, continuous economic growth, and innovation and industrial upgrades, the Greater Bay Area of South China (including Guangdong,

Hong Kong and Macao) should develop into one of the most dynamic regions in the world. Infrastructure construction has accelerated and new traffic network will further integrate different cities closer to one another. Individual cities will maximise their advantages in finance, technology, manufacturing capacity and urban development to achieve long term growth.

The released provincial government report "Guangzhou-Shenzhen Scientific and Technological Innovation Corridor Planning", covering different innovation zones in Guangzhou, Dongguan and Shenzhen, should further promote Guangzhou's development as a future innovation centre. Innovation and industrial R&D should fuel Guangzhou's economic growth and the high technology sector should also drive future leasing and investment demand in the office and industrial property markets.

Office: flexible working, innovation

By Q3 2017, Guangzhou's GDP reached RMB1.55 trillion (USD233 billion), up by 7.3% YOY with service industry added value accounting for 82% of the increase in total GDP (Source: Guangzhou Municipal Statistics Bureau). Due to strong economic growth and the expansion of the service industry, demand for Grade A office space in Guangzhou witnessed a robust increase, with 497,600 sq m (5,356,100 sq ft) of net absorption in 2017. We noticed a distinct difference in the source of new demand between 2017 and 2016. The finance and technology sectors used to be the dominant tenant groups, but the real estate services sector emerged in 2017 as an additional important tenant sector.

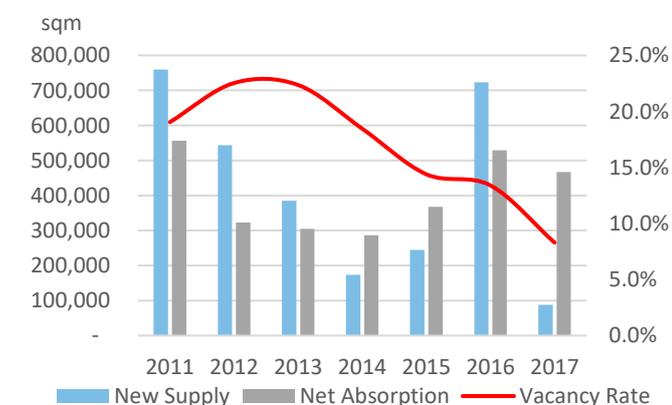
Based on Colliers' records, the real estate services sector overtook technology last year to rank second behind the finance sector and accounted for 21% of total leased office space in Guangzhou. In addition to major office sublessors taking up large amounts of office floorspace directly from the landlords, flexible workspace operators were very active in 2017. Pearl River New City (PRNC), the most expensive submarket in Guangzhou, is the preferred choice of flexible workspace operators. Atlas, World Union Space, Bee Plus all have a presence in PRNC. By the end of 2017, average rent in PRNC grew by 6.1% YOY to RMB 183 per sq m per month (USD2.6 per sq ft per month). We expect new international flexible workspace operators will enter

Guangzhou in 2018 while domestic operators will continue to expand and differentiate to maintain market share. Moreover, we think flexible workspace will enter the fringe CBD and emerging business districts where costs are lower in order to expand their footprint and capture different user bases with better service.

Taking advantage of Guangzhou-Shenzhen Scientific and Technological Innovation Corridor Planning as a new development initiative, we believe that the Pazhou E-commerce Zone will be the focus of activity in the Guangzhou office market over the next few years. With Tencent, Alibaba and Vipshop establishing their regional HQs in Pazhou in the coming years, more downstream companies should also choose Pazhou, forming a new internet and e-commerce business ecosystem. The Pazhou submarket leasing market was very active in 2017 with average rent growing by 8.6% YOY to RMB125 per sq m per month(USD1.8 per sq ft per month). This was the fastest rate of increase among all Guangzhou's submarkets. In addition, total leased space in Pazhou accounted for 19% of total leased space in Guangzhou, ranked second among all submarkets. Improving business amenities and the gathering of more IT talent should increase Pazhou's appeal to the innovation industry.

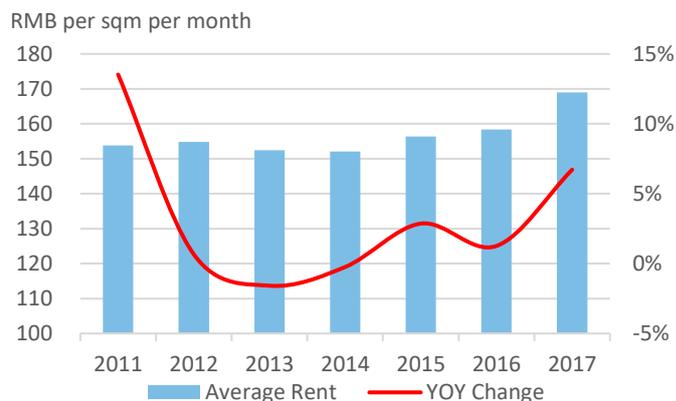
Overall, we predict that there will be 376,900 sq metres (4,056,800 sq ft) of new Grade A office supply in Guangzhou in 2018, about 7.3% of existing stock. We expect a steadily decreasing vacancy rate and a modest growth in overall rent. Government's strong support of innovation industry and the spreading of flexible working spaces will add new demand for office space.

Figure 1: Guangzhou Office Annual New Supply, Net Absorption & Vacancy Rate



Source: Colliers International

Figure 2: Guangzhou Office Average Rent & Change



Source: Colliers International

Logistics market: e-commerce-drive, demand spill-over

Reflecting global economic acceleration, a 16.9% YOY increase in total value of export and import and an 8.8% YOY growth in port cargo throughput were recorded in Guangzhou from January to November in 2017(Source: Guangzhou Municipal Statistics Bureau). By the end of 2017, Guangzhou had become the seventh largest international port with container throughput exceeding 20 million TEUs, a new record.

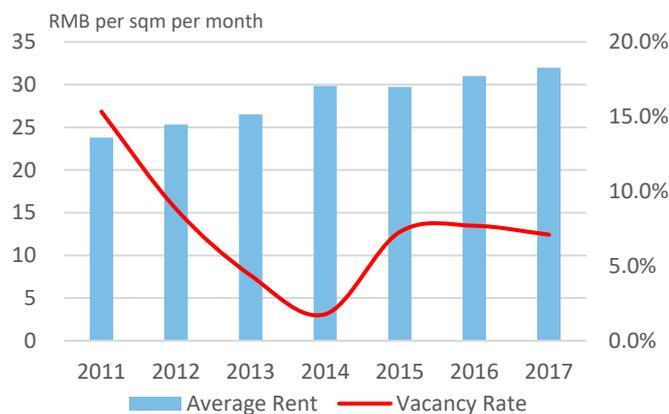
Total retail sales of consumer goods also rose by 8.2% YOY from January to November in 2017(Source: Guangzhou Municipal Statistics Bureau). Continuous growth in trading and e-commerce fuelled the demand for prime non-bonded logistics warehouses in Guangzhou, with 53,100 sq m(571,600 sq ft) of annual net absorption.

As the local government has restricted new land supply for warehouses in recent years within the Guangzhou city boundary, there was only 50,000 sq metres(538,200 sq ft) of new supply of prime non-bonded logistics warehouses in 2017. The vacancy rate dropped by 0.6 percentage points to 7.1% while average rent grew by 3.8% YOY, reaching RMB32 per sq m per month(USD0.5 per sq ft per month).

The promotion of the GBA has boosted the development of intra-regional traffic networks and will further support the logistics industry. As new supply of quality warehouses fell short of demand in Guangzhou and against the background of a steady increase in average rent, new supply in nearby lower cost cities, such as Foshan, Qingyuan, Dongguan and Huizhou, has absorbed the overflowing demand. We estimate that about 146,000 sq m(1,571,500 sq ft) of new supply will be launched in the next two years to satisfy the buoyant

demand and release the pressure on the growing warehouse rent in the short term. However, unless the issue of shortage of land supply can be resolved, rent for prime non-bonded logistics warehouses will keep rising over the long term.

Figure 3: Guangzhou Logistics Average Rent & Vacancy Rate



Source: Colliers International

Investment market: opportunities despite restrictions

The Guangzhou office and retail property investment market saw impressive growth in 2017. Institutional investors and owner-occupiers were the key players in the market. The amount of property transactions exceeded USD2 billion and grew by 136% YOY in 2017, according to Real Capital Analytics' (RCA) data.

Figure 4: Total Value of Property Investment in Guangzhou in 2017

Property	Transaction Value (USD billion)	YOY Change
Office	0.67	112%
Retail	1.3	1779%

Source: Real Capital Analytics

Compared to 2016, retail property investment grew 18x to USD1.30 billion in 2017. This huge increase reflected three large en-bloc transactions in 2017: Metropolitan Plaza in Liwan, Rock Square in Haizhu and Happy Valley in PRNC. We believe institutional investors will still be interested in prime retail mall investment in 2018 due to more considerable yields compared with office property.

On the other hand, institutional investors and owner-occupiers also demonstrated strong interest in the office sector in 2017. The total value of office property

investment reached USD0.67 billion and grew by 112% YOY. Institutional investors and owner-occupiers are searching for opportunities in emerging business districts due to limited supply in the core CBD. There were six whole floor and en-bloc transactions located in the International Financial City, Pazhou, Panyu and Huadu. We expect investors will keep looking for more en-bloc acquisition opportunities in these areas.

It is well known that South China's commercial property market is dominated by local investors and SMEs. The presence of large international institutional investors is small compared to Hong Kong and Shanghai. In recent years, the local government has inserted terms in commercial land sales to encourage single and long-term ownership and restricted the involvement of individual investors in the purchase of office properties in order to attract larger companies and institutional investors into the market. In March 2017, the Guangzhou government released a new report about "Enhancing Regulation and Control in the Real Estate Market", which further restricted individual investors' investment activities. Only institutional investors or corporates can now invest in commercial and office properties.

In the context of the GBA project which should facilitate the increasing exchange of capital among the GBA's major cities, Guangzhou should be able to attract more foreign and large institutional investors to accelerate the development of Real Estate Investment Trusts (REITs). Additionally, the national and local policy to emphasise the long-term residential leasing market should provide new opportunities for investors interested in residential leasing properties.

Regarding industrial land, the Department of Land Resources of Guangdong Province released the "Guidance for Improving Industrial Land Supply System and Accelerating Supply-Side Structural Reform" in July 2017. The guidance highlighted the flexibility in industrial land uses and limited the length of industrial land lease to 20 years in principle, with the aim of lowering initial land cost and improving land use efficiency. It has boosted secondary industrial land prices indirectly due to the great difficulty in securing new industrial land.

There was only one land transaction for prime non-bonded logistics warehouses in 2017 due to limited land supply for warehouses: Ping An Real Estate purchased a warehouse site in Nansha for RMB84.7 million (USD 13.0 million) or RMB265 per sq m (USD3.8 per sq ft). With a shortage of new warehouse land supply and government efforts to redevelop old warehouse and logistics parks, we expect active transaction activity and increasing prices in the secondary market for warehouse land.

2018 Guangzhou market outlook

We expect the overall vacancy rate of Grade A office properties will decrease steadily in 2018. Despite a total of 376,900 sq m (4,056,800 sq ft) of new supply, we predict that the average rent will grow by 5% YOY due to strong net absorption.

Although there should be a total of 166,400 sq m (1,791,100 sq ft) of new office in PRNC, we expect rent will continue to increase by 5%, due to mature developed and robust demand in PRNC. With limited new supply, rent in NTSC and Yuexiu should grow by 6% and 5% YOY respectively. There will be 180,000 sq m (1,937,500 sq ft) of new supply in Pazhou. However, average rent should increase by 8% YOY as Pazhou continues to attract companies to establish there.

Over the next five years, we expect 2.97 million sq m (32.0 million sq ft) of new office space to enter Guangzhou market. We believe the vacancy rate will peak at 19.0% in 2020 and then decrease steadily to 13.0% by 2022. We expect overall average rent to grow by 5% in 2018, and increase smoothly by 2% each year until 2022.

Regarding the warehouse market, we predict nearly 146,000 sq m (1,571,500 sq ft) of new supply in the prime non-bonded warehouse market in 2018, equivalent to 12.9% of existing stock. Warehouse rent will probably face pressure with a higher vacancy rate in H1 2018. However, strong take-up should reduce the vacancy rate in H2 and allow rent to move up further by the year-end. We estimate that warehouse rent will grow by 3% YOY by the end of 2018.

Only 146,000 sq m (1,571,500 sq ft) of new supply will enter the warehouse market over the next five years. We believe the vacancy rate will peak at 12.0% in 2018 and then decline steadily to 1.8% by 2022. We expect overall average rent to grow by 3% in 2018, and increase

steadily by 5% each year until 2022.

Figure 5: 2018 Rental Market Outlook

Property	Submarket	YOY Change
Office	PRNC	5%
	NTSC	6%
	Yuexiu	5%
	Pazhou	8%
Industrial		3%

Source: Colliers International

For the capital market, we expect the increasing volume of transactions in 2017 will carry into 2018. The market should be dominated by institutional investors and owner-occupiers, especially in the emerging office districts. Overall, we foresee a 5% YOY increase in office prices in 2018.

We also expect dynamic activities in industrial market and a 20% YOY increase in capital value, given the great difficulty of acquiring new industrial land and the increase in prices of secondary market sites for warehouses.

Figure 6: 2018 Capital Value Outlook

Property	YOY Change
Office	5%
Industrial	20%

Source: Colliers International

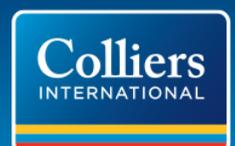
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