SHENZHEN | 2018 MARKET OUTLOOK

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Accelerating success.

2018: embrace new opportunities

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Shenzhen finished 2017 strong with its economic growth leading China. In real estate, Shenzhen's office leasing market was robust and dynamic, while the investment market was also increasingly active. Looking ahead into 2018, we believe that Shenzhen's economy will continue to thrive in the context of Guangdong - Hong Kong - Macao Greater Bay Area project. We expect office rent to maintain its upward momentum despite upcoming new supply. The industrial sector, under the theme of urban renewal, should pivot to a more customized and refined development approach. Finally, the investment sector should see continuous capital inflow and new en-bloc investment opportunities in both the residential and the office market.

Shenzhen's economic growth: leads the nation in 2017

Shenzhen finished 2017 strong in many ways. The city has further refined its economic basis on high value-added industries, such as high-tech, finance, and professional services. Over Q1-Q3 2017, Shenzhen's real GDP growth of 8.8% ranked second among all major Chinese cities and was above all other Tier 1 cities. Moreover, Shenzhen caught up with Guangzhou in terms of total GDP. Industrial added value grew by an impressive 9.3% YOY. The city also continued to attract new capital: total fixed asset investment increased by 31.1% YOY to RMB 350.2 billion (USD 53.8 billion)[1], 23.6% higher than the national average. Investment in infrastructure and construction reached RMB 75.5 billion (USD 11.6 billion), with a 39.5% increment, and investment in the industrial sector reached RMB 59.6 billion (USD 9.2 billion), an annual increase of 55.8%, half of which was geared towards technical innovation.

The tertiary sector also showed healthy growth. The pillar industries have become the key revenue engines. Logistics, IT, and professional services achieved revenue of RMB 147.3 billion (USD 22.6 billion), RMB 214.8 billion (USD 33.0 billion), RMB 93.7 (USD 14.4 billion), showing YOY increase of 19.0%, 26.8%, and 12.1% respectively.

Office leasing: robust demand despite heavy new supply

In Q4 of 2017, five Grade A office buildings with a total GFA of 390,000 sq metres (4.2 million sq ft) were further postponed. Even so, 2017 ended with a strong new supply in total of 1.04 million sq metres (11.2 million sq ft), a new record since 2004. Surprisingly, the market has showed an even strong appetite, with the net absorption of office space exceeding the new supply to leave a lower vacancy rate of 13.5% approaching the year-end, a decrease of 3.4 percentage points YOY. The total net take-up of about 1 million sq metres (10.8 million sq ft) is triple the average absorption of Shenzhen in the past 12 years.

The average rent of Shenzhen's office property market finished strong on RMB231 (USD 35.5) per month per sq m in Q4-2017, showing an increment of 9.6% YOY. At the district level, Luohu District increased by 8.0% to RMB 218 (USD 33.5) per month per sq m; Futian District increased by an impressive 13.7% YOY to RMB 268 (USD 41.2); and Nanshan saw RMB175 per month per sq m, up by 3.0% YOY. As for Qianhai, due to the high vacancy rate, the landlords have adjusted the rent. By end-2017, Qianhai's average rent stood at RMB 150 (USD 23.0) per month per sqm, decreasing by 11.9% YOY.

The dominance of technology and finance as the largest occupier in Grade A office has changed since the second half of 2017. We have discovered that the leasing market has become more diverse and dynamic.

[1] USD exchange rate = 6.51

Domestic and internationally renowned tenants from real estate, professional services, advanced manufacturing, retail, education etc, have generated new demand for office space either for new setup or expansion.

Industrial: property upgrade under urban renewal

While Shenzhen has concentrated its efforts on the creation of a knowledge-based economy, higher costs in Shenzhen have driven more logistics and manufacturing activities into nearby Dongguan and Huizhou. Hence the concept of "Greater Shenzhen" has emerged in the logistics industry. With larger land parcels, a good amount of new supply, and lower prices, Dongguan has become a more appealing logistics destination.

Within Shenzhen City, the average rent for logistics parks wen up 3% YOY to RMB 44.9 (USD 6.9) per sq m per month in Q4-2017. A new project delivered at year end with new supply of 165,000 sq m (1.78 million sq ft) drove the vacancy rate from 6.7% to 10.2%. The gross yield of logistic properties has remained relatively stable within 2017 at 6.7%.

For existing factories and industrial properties within Shenzhen, urban renewal has brought new opportunities. The economic upgrade has raised demand for more intellectual and customised space from sectors such as Big Data (data centre), advanced manufacturing (unpiloted automobile or drones), and intellectual equipment (R&D). The shift in tenants' requirements and demands has encouraged the landlords of industrial properties to collaborate with experienced real estate developers and operators to renovate their property to improve the efficiency of land use and attract new tenants. Some properties may have the opportunity to change usage to more office-oriented functions if located in prime locations.

Investment: inspired by the residential market

During H1 2017, Shenzhen's real estate investment market was slow as investors adopted a wait-and-see approach, concerned about the possible negative impact of the new governmental regulations on real estate market. However, new investment opportunities have emerged following the conclusion of the 19th National Party Congress with both the central and local government encouraging the long-term residential leasing market. This change has further boosted the investment sentiment.

Towards the end of the year, Shenzhen saw increasing en-bloc transactions of smaller sized condominiums (mostly between 30 to 60 sq m) both in prime and emerging locations made by institutional investors, whose confidence is not only driven by the policies, but also by the demand from new talent and young professionals.

The development and investment of the luxury property market has also showed an uptrend. Ranking as China's top location for High Net Worth Individuals(HNWIs), as reported in a recent Hurun report[2], Guangdong province, especially Shenzhen, still has large unmet demand for luxury villas from these wealthy individuals.

Major deals in 2017

Property Name	Type	Price (million RMB)
Fenghui Times Technology Centre	Mix	985
China Merchants Central	Office	1122
COFCO TY One	Residential	990
OCT Oriental Garden	Residential	540
Hongshan 6979	Residential	2500 (est.)
Konka Headquarter Parcel	Land	6980

Source: Colliers International

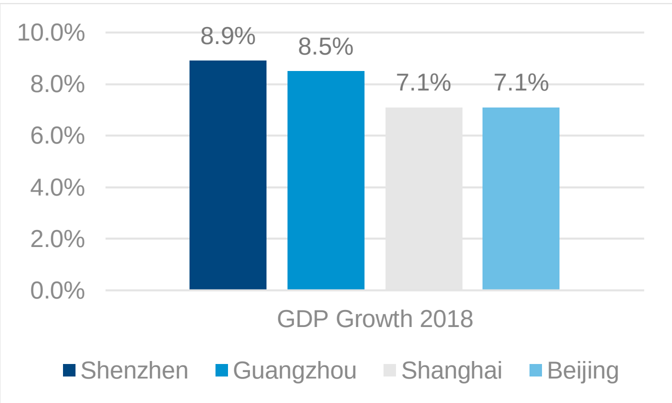
[2] Source: http://www.hurun.net/CN/Article/Details?num=A831ED47918C

Forecasts for Shenzhen for 2018

According to Oxford Economics' latest report[3], Shenzhen's GDP will continue to grow to rank 11th globally in terms of GDP size by 2035, exceeding certain key global cities such as San Francisco, Washington DC, and Boston. As the pioneer city of China, Shenzhen should deepen the reform of industrial structure by encouraging higher value-added industries, helping the city to form a more diverse and healthy industry mix. Therefore, we should expect a more dynamic and various tenant from 2018 onwards.

More investment capital flow both from institution and individuals should enter Shenzhen in 2018. With stable policies Under the guidance of 19th National Congress of the Communist Party of China, we can expect acceleration of Qianhai development, further integration of the Greater Bay Area, and continuous encouragement and inclination of long-term leasing in both residential and office property. Moreover, urban renewal should remain a key theme for the city. Each district government see urban renewal as property. Moreover, urban renewal should remain a key theme for the city, so each district government should see urban renewal as an opportunity to upgrade the industry.

Tier 1 Cities GDP Growth 2018 Forecast



Source: Colliers International

Guangdong-Hong Kong-Macao Greater Bay Area

Following the establishment of the Qianhai and Shekou Free Trade Area, the further integration of Guangdong-Hong Kong-Macao into one Greater Bay Area should launch the region into a key player in the new economy on a global scale. The polycentric nature of the GBA, with Hong Kong, Shenzhen, Guangzhou and Macao each acting as a key economic development engine, yet complementing one another, will maximise future growth potential.

We anticipate the GBA's economic growth will resemble that of the major other bay areas of the world such as Tokyo Bay and San Francisco Bay. In line with the expansion, large sums of personal wealth should be generated through a vibrant private sector economy. As a result, new property investment opportunities should proliferate in different sectors.

Global Cities' GDP ranking by 2035

City	Change since 2016
1 New York-Newark-Jersey City (US)	0
2 Tokyo (JPN)	0
3 London (UK)	1
4 Los Angeles - Long Beach - Anahein (US)	-1
5 Shanghai (CHN)	5
6 Beijing (CHN)	9
7 Paris (FR)	-2
8 Guangzhou, Guangdong (CHN)	14
9 Chicago - Naperville - Elgiin (US)	-3
10 Tianjin (CHN)	17
11 Shenzhen (CHN)	14
12 Dallas - Fort Worth - Arlington (US)	-4
13 Chongqing (CHN)	17
14 San Francisco - Oakland - Hayward (US)	-2
15 Washington - Arlington - Alexandria (US)	-6
16 Houston - The Woodlands - Sugar Land (US)	-5
17 Osaka - Kyoto (JPN)	-10
18 Suzhou, Jiangsu (GHN)	15
19 Philadephia - Camden - Wilmington (US)	-6
20 Boston - Cambridge - Newton (US)	-6

Chart Source: Oxford Economics

For Shenzhen, the GBA has provides a golden opportunity to run its course on a global playing field along with other major global cities such as San Francisco, Singapore, and Frankfurt. Armed with its robust economic growth and strong technology and innovation capability, Shenzhen has attracted new investment capital from the rest of China.

Office Leasing

In 2018, continuous heavy new supply projects exceeding 1 million sq metres will enter the office leasing market. The focus, however, will shift gradually from Futian to Nanshan. In future, we expect to see a large amount of new supply in Luohu district resulting from recent urban renewal developments. Vacancy rates across different districts will vary significantly. Luohu's

[3] Source: http://workplaceinsight.net/wp-content/uploads/2017/12/Global-Cities_2017_v8_-summary.pdf

vacancy rate should remain low due to a lack of new supply in the upcoming years. As Futian's new supply peak levelling off, along with a solid demand for office space in CBD, we anticipate its vacancy rate will continue to drop from 13.7% to 9.2%. Nanshan, with new supply of approximately 800,000 sq m (8.6 million sq ft), is likely to see its vacancy rate rise towards 16.0% in 2018. Eight new developments with a cumulative area of 360,000 sq metres (3.88 million sq m), should enter the market in Qianhai in 2018. At the end of 2017, Qianhai had an exceptionally high vacancy rate of 83.2%. We expect the new supply will further elevate the vacancy rate level till the infrastructure is further developed, since in our view inadequate infrastructure is one of the key factors behind the high vacancy.

Overall, we expect the average rent for the Shenzhen office property market in 2018 to pick up by about 3%. Luohu District rent should remain stable due to the lack of new supply. Futian, which saw astonishing absorption in 2017, is likely to see a moderate 2-3% increase in rent. Nanshan, excluding the Qianhai area, is likely to see rent rise by about 6% due to the new supply of higher quality office space as well as firm market demand. As for Qianhai, we predict the rent will remain low until the construction of metro link is completed or nearing completion in 2020.

Over the next five years, we expect over 6 million sq m (65 million sq ft) of new office space to enter the overall Shenzhen market. We forecast that the vacancy rate will peak at 28.9% in 2019, and then decline steadily to 17.9% by 2022. We expect the average rent for the whole city to grow by about 3% in 2018, and then to decrease by 4.2% in 2019 due to the heavy new supply in Qianhai, where the infrastructure is yet to be completed. However, the rent should pick up in 2020 and reach RMB 241 (USD 37.0) per month per sq m by 2021.

The flexible workspace (co-working) market has been expanding rapidly since early 2017, and shows no sign of slowing down. Shenzhen's co-working market has further heated up following the entry of major new players: Wework rented approximately 20,000 sq m in Nanshan-High-tech Park, SOHO3Q landed in Nanshan-Shekou area, and Atlas chose to open at multiple locations at around the same time. We believe the market will experience a few adjustments: the most established operators offering a better working environment, a stronger sense of community, and a bigger platform of sharing resources are more likely to win market share and keep their vacancy rate low. We also foresee a clustering of coworking operations in the Futian CBD, High-tech Park, and Shekou. We anticipate that more multi-sector start-ups will move into co-working space as new tenants.

Industrial

Cross-border logistics demand is on the rise. According to the new "Cross-border E-shopping Insight Report"[4] co-released by CBNData and Tmall on 28 December 2017, cross-border E-retail sales (import side) grew by more than 20% YOY in 2017 and accounted for one-quarter of total cross-border E-commerce sales (import side. The report estimated that cross-border sales volume would reach RMB 620.3 billion (USD 95.3 billion) by 2019.

The Greater Bay Area, with three of the top 10 global ports and an improved cross-border infrastructure, should see an increasing demand for quality warehouses and logistics facilities. Shenzhen, despite a lack of new supply of warehouses, should remain an important player in the regional logistics landscape as there will be new expansion at both its seaport and airport.

We expect to see a limited amount of new logistics park supply, about 140,000 sq m (1.51 million sq ft), entering the market in the next five years. Correspondingly, the vacancy rate should go down and reach 5% in 2020, and sustain around 5% till 2022..The rent should continue to go up at a modest speed, and possibly reach RMB 49 (USD 7.5) per month per sq m by 2022.

We expect that factories and industrial activities will continue to be clustered in fringe locations following the current round of urban renewal targeting old manufacturing facilities. Existing factories located within prim locations are prime targets for redevelopment into new urban mixed-use complexes.

Investment

After the 19th Party National Congress, the development of a long-term residential leasing market as the top government real estate development priority has been further confirmed. This has led to recent en-bloc transactions on condominiums and apartments acquired by domestic institutional investors. Meanwhile, the trend has also accelerated the process of asset securitisation.

For the office building market, developers have started to change their strategy gradually from strata-title to en-bloc sales, partially influenced by the fact that the

[4] Source: http://www.sohu.com/a/213764806_355061

government has been encouraging unified ownership. With abundant new supply entering the market soon and demand from individual investors close to saturation, the developers' changing strategy ought to offer more choices to institutional investors, who have been looking for en-bloc acquisition for Grade A office assets.

Due to the self-occupation and long-term leasing requirements for office investment in Nanshan-Houhai area, and the fact that key infrastructure has yet to be completed in Qianhai, investors will find very limited opportunities in these areas. Instead, Shekou and Che Gong Miao area ought to present more opportunities from new supply. For instance, approximately1.7 million square metres (14.0 million sq ft) of business space will be released from Che Gong Miao area in Futian District as part of a larger urban renewal project. The new office space should attract the overflow demand from Futian CBD. The higher average rent in this cluster, currently standing at RMB 308 (USD 47.3) per sq m per month, should also make it more appealing to investors.

2018 projections

Property type	Rental market outlook	Capital value outlook
Office	+3%	2% ~ 3%
Industrial	+5%	5% ~ 10%

Source: Colliers International

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