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MODERATING ECONOMIC GROWTH LIKELY TO DEPRESS RENTAL GROWTH IN 2019





Summary & Recommendations

In 2018, Guangzhou witnessed real GDP growth of 6.2%, versus 7.0% in 2017. Given new supply in Q4 2018, the Guangzhou Grade A office market recorded a mild adjustment in rent and a slightly rising vacancy rate.

In 2019, reflecting the expected launch of new supply and the slower economy, tenants will likely take a wait and see attitude, and demand may be tepid. We expect rising vacancy and slower rental growth.

The vacancy rate should peak in 2020, while rental growth should remain low, before rising from 2021 to 2023.

- > Pazhou's momentum remained strong. With large new supply through 2023, we suggest tenants willing to move to Pazhou should seize this opportunity and sign preferential terms.

	Q4 2018	Full Year 2019	2018-23 Annual Average
 Demand <ul style="list-style-type: none"> > Impacted by slower economic growth, we believe tenants will take a wait and see attitude in 2019 with less willingness to move and expand. 	120,300 sq m	633,900 sq m	547,400 sq m
 Supply <ul style="list-style-type: none"> > In 2019, over 825,000 sq m (8.9 million sq ft) of new supply should enter the market while new supply should peak at 1 million sq m (10.8 million sq ft) in 2020 and slow down gradually from 2021 to 2023. 	180,000 sq m	825,300 sq m	547,900 sq m
	QOQ / End Q4	YOY / End 2019	Annual Average Growth 2018-23 / End 2023
 Rent <ul style="list-style-type: none"> > We believe the Guangzhou market will post slower rental growth of 1.0% yoy in 2019. Rental growth should remain slow in 2020 and pick up gradually from 2021 to 2023. 	-0.6%	1.0%	3.4%
	RMB179	RMB181	RMB212
 Vacancy <ul style="list-style-type: none"> > Vacancy climbed slightly due to new supply in Q4 2018. In 2019, we expect the vacancy rate to rise and peak at 9.0% by 2020 due to scheduled new supply. 	1.0pp	2.5pps	-0.3pp
	4.5%	7.0%	3.0%

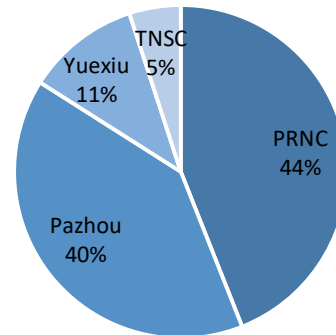
Source: Colliers International
Note: USD1 to RMB6.88. as of end-Q4. 1 sq m = 10.76 sq ft

Average net effective rents and vacancy rates by submarket

	Q4 2018 Average net effective rents (RMB psm pm)	QOQ change (%)	Q4 2018 Vacancy rate (%)	QOQ change (pp)
Pazhou	143	2.7	7.7	4.8
Pearl River New City	197	-0.3	4.7	0.5
Tianhe North-Sport Centre	174	-0.2	2.6	0.7
Yuexiu	131	0.6	1.6	-0.5

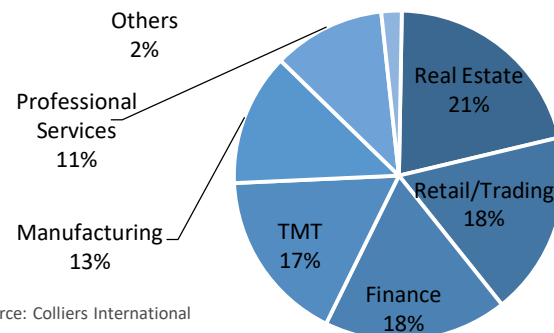
Source: Colliers International

Market share of leased area by submarket, Q4 2018



Source: Colliers International

Market share of leased area by industry, Q4 2018



Source: Colliers International

SLOWER ECONOMIC GROWTH, MINOR ADJUSTMENT IN OFFICE MARKET

In 2018, the ongoing US-China trade dispute and national deleveraging policies continued to impact Guangzhou. This impacted finance, manufacturing, trading and related companies, bringing pressure on Guangzhou's economy. However, Guangzhou's economy still recorded stable performance. In 2018, Guangzhou's GDP and total retail sales of consumer goods grew by 6.2% and 7.6% yoy respectively. Total investment also increased, with fixed asset investment showing an increase of 8.2% yoy¹.

With over 180,000 sq metres (1.9 million sq feet) of new supply, Guangzhou's market recorded a mild adjustment in rents and a slightly rising vacancy rate. At the end of 2018, average rents fell by 0.6% qoq to RMB179 psm per month (USD26.0 psm per month) while the vacancy rate climbed by 1 percentage point to 4.5%.

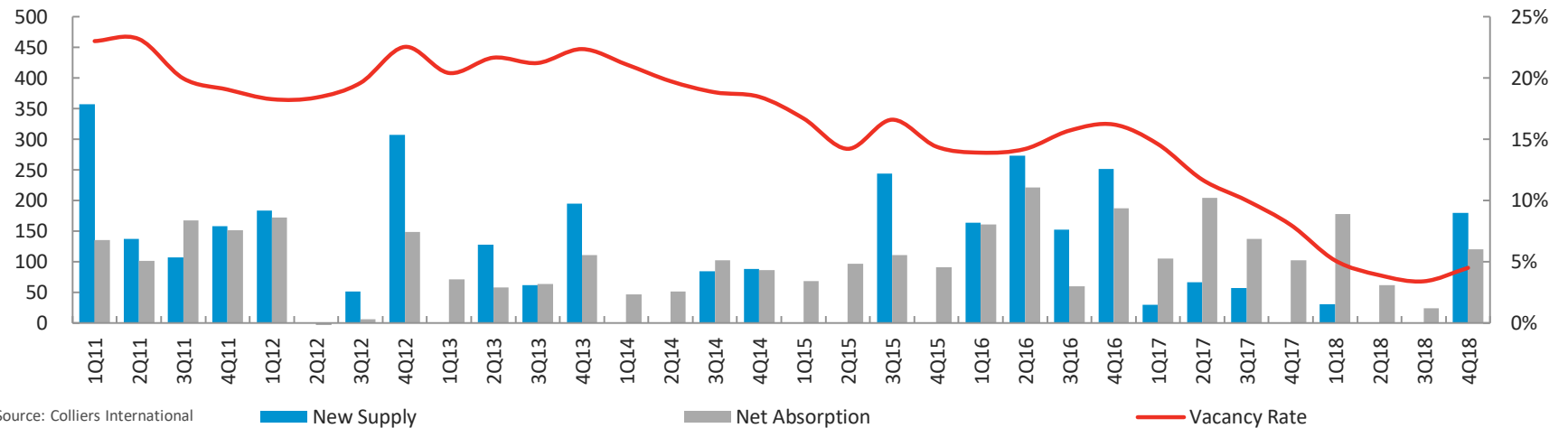
CONTINUOUSLY RISING PAZHOU

In Q4 2018, all new supply was in the Pazhou submarket. This resulted in a 4.8 percentage point qoq increase in the vacancy rate to 7.7%. As the emerging business district, Pazhou saw the fastest rental growth as average rent grew 2.7% qoq to RMB143 psm per month (USD20.8 psm per month). Impact from global economic turbulence and national deleveraging policies emerged in the Guangzhou office market, with both Pearl River New City (PRNC) and Tianhe North-Sport Centre (TNSC) recording slightly decreasing average rents and rising vacancy in Q4 2018.

PRNC dominated the Guangzhou Grade A leasing market in Q4, accounting for 44% of leased space, followed by Pazhou, which accounted for 40%. The leasing market was led by companies in the real estate sector, accounting for 21% of leased space, while the retail/trading and finance sectors both accounted for 18%.

¹Source: Guangzhou Statistical Bureau

Guangzhou office new supply, net absorption and vacancy rate
(Thousands of sq metres)



Source: Colliers International

SLOWER RENTAL GROWTH IN 2019

Given that over 825,000 sq metres (8.9 million sq feet) of new Grade A supply is scheduled in 2019, we expect the vacancy rate of the Guangzhou Grade A market to rise from 4.5% to 7.0%. By our estimate, 38% of the new supply is scheduled in Pazhou. Leasing transactions will likely moderate due to a slowing global economy, and this factor, coupled with the impact of long-standing deleveraging policies, ought to reduce tenants' willingness to move and expand. In 2019, we believe Guangzhou's average Grade A office rental growth will face pressure, increasing by only 1.0% yoy. This is a 2pps downward revision from our Q3 2018 rental growth forecast of 3.0%, and reflects the fact that average rent in the city fell by 0.6% qoq in Q4 2018.

As over 170,000 sq metres (1.8 million sq feet) of new supply in PRNC is scheduled in 2019, rental growth in PRNC should face pressure. In addition to the rebalancing economy, we expect the rental growth in PRNC to slow to 1.0%.

In 2020, the new supply of quality office space will likely surpass 1.0 million sq metres (10.8 million sq feet) and Pazhou, as scheduled, accounts for 73% of the total. We foresee the vacancy rate peaking and rental growth remaining low. With lower new supply from 2021 to 2023, we expect a gradually declining vacancy rate and steadily increasing rents.

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