China's economic downturn hitting luxury commercial property and yachts in wealthy tech hub Shenzhen

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(July 3): In China's hi-tech hub of Shenzhen, a confluence of factors, from over-exuberant commercial property developers, to the US-China trade and tech war, to an exodus of foreign investors, are weighing heavily on what was until recently a booming economy.

The city – just over the border to the north of Hong Kong - is uniquely exposed to the multitude of headwinds facing the Chinese economy, given its track record of luring foreign capital as a special economic zone, and its status as a hotbed of innovation.

The year-long trade war with the United States has made Shenzhen as well as other parts of China less appealing to foreign capital. At the same time, the technology sector is under pressure from the mounting tech rivalry between the world's two modern superpowers.

These are among the factors trickling down to the commercial property sector, where despite steady demand, developers - who have continued to build despite the macroeconomic problems - are facing huge overcapacity. The vacancy rate is now near 10-year high.

This is just one indicator of weakening economic sentiment in China's wealthiest per capita city. A series of interviews with professionals from property sellers to yacht brokers reveals a group of businesspeople struggling with "the toughest year" of their careers.

One of those to feel the brunt is Cindy Huang, a veteran saleswoman of high-end serviced offices in Shenzhen's central business district, who said 2019 has been the worst year on record.

Also of the view is Lan Liu, operations manager of a serviced office firm in the Futian district that is home to Shenzhen's municipal government. "Taking into account tenants' budgets and the increase in new supplies of offices, it can be said that there has been growing pressure for office landlords in Shenzhen to cut rents this year," she said.

"Since last year, it's been common to see companies downsize their office space and send staff to co-working spaces or to work from home office. I heard from most of our tenants that their sales have been suffering since last year, and their views on expansion are very conservative. Everyone is in 'wait-and-see' mode for the economic future of the city and the country."

Part of this trend is due to a shift in the way Shenzhen's tech firms operate. More and more, start-ups and established players prefer co-working spaces, amplifying the characterisation of Shenzhen - home to tech companies like DJI, Huawei and ZTE - as "China's Silicon Valley".

The vacancy situation is most pronounced in the city's Qianhai area near the border with Hong Kong, which has a vacancy rate of 65.7 per cent. Qianhai had hoped to become one of the largest business districts in China and was positioned by Beijing to be a hub for financial and innovation reform, in a bid to lure international companies and start-ups.

In Qianhai and also the Shenzhen Bay area, both of which face south into Hong Kong, the pressure on the commercial property sector will increase, with nearly completed towers due to come online, bringing with them new streams of office space.

Liu said that while she is "not surprised" by the increasing office space capacity in Shenzhen, "the anxiety is amplified when seeing that the boom in Shenzhen's entrepreneurship and innovation is fading", adding that many companies have been hit by the US-China trade war and the domestic consumption slump.

Shenzhen's high-end office buildings currently occupy 5.53 million square metres (59.5 million sq ft), a rise of 19.3 per cent on a year earlier, according to Colliers International, a real estate firm. The firm estimated that an additional 4.37 million square metres (47.39 million sq ft) will be added by 2021.

Speaking at an event on June 18, Alan Fung, Guangzhou managing director at Colliers, said that the vacancy rate for "Grade A" office space in Shenzhen stands at 23 per cent, compared to 13.6 per cent at the end of the second quarter of last year. He blames this on the central authorities' crackdown on peer-to-peer lenders, as Beijing attempted to get a handle on rising debt outside mainstream financing channels. These companies were previously valuable tenants and their troubles resonate throughout the sector, providing another challenge for Shenzhen's economy, the size of which overtook Hong Kong for the first time last year.

The city's latest economic data, however, does not provide much confidence that the issue of overcapacity will improve any time soon.

In the first four months of this year, all of Shenzhen's growth indicators declined, with the exception of fixed asset and infrastructure investment. Total imports and exports fell by 2.3 per cent year-on-year, compared with 16 per cent growth over the same period of 2018.

Retail sales growth in the city slowed to 6.5 per cent over the first four months, down from 8.8 per cent in the year-earlier period, while industrial output from large companies grew by 7.1 per cent, compared to 9.9 per cent for the same period in 2018. Growth in telecommunications equipment, computers and other electronics – key sectors in the nerve centre of China's technology industry – fell to 10.7 per cent, down from 13.7 per cent in 2018.

The downturn is not just being felt in the property sector. A yacht broker in Shenzhen said his team of five sales people once sold 26 imported yachts in a single year, some costing millions of US dollars, to wealthy Chinese buyers earlier in the decade. Last year, they sold fewer than 10.

“We started from a small office unit of three people, but expanded to 12 staff in a 100 square metre (1100 sq ft) office unit priced at 120,000 yuan (US$17,451) a month in 2013. Last year, we downsized to two small office units,” he said.

“The upper-middle class only buy yachts when the economy is seeing stable growth and people are making a good living – not like now. Many rich Chinese people in Shenzhen, either in the tech or finance sectors, are worried that the economic crisis is worsening, asvthe trade war has sharply escalated in recent months. I think our sales will be even worse than last year.”

Industry professionals see a correlation between the drop in luxury office rentals and yacht sales and the slowdown in foreign investors and companies coming to Shenzhen.

“I remember around 2008, most of the office tenants of our serviced office centre were foreign-funded enterprises, especially foreign import and export traders,” said Liu, the operations manager in Futian.

The trend continued until 2015, she said, when service and technology sector firms rushed to Shenzhen, which was booming. After that, the influx slowed, she said, and the number of Chinese firms entering the market increased.

“But to be honest, they were not as stable as the foreign clients,” said Liu, adding that many of the clients now were new Chinese financing companies, who took short-term leases and then disappear.

The boom years of before 2015 feel like a distant memory for one foreign investor too. Homeric de Sarthe, a 31-year old French technology entrepreneur, recalled a time when Shenzhen was jumping with venture capitalists and start-ups. Indeed, he launched his own start-up in an office in Futian, a photo sharing app called Shosha, in 2015.

“Shenzhen is still amazing tech city,” he said. “But the potential for funds, opportunities and talent are not as great as before. If I have a second try to start-up, I will not do it again in Shenzhen, especially not a project focusing on the mainland market. I cannot afford the high talent costs there.”

Zheng Bo, a Shenzhen-based smart device producer, agreed.

“So far this year we have not heard of a hardware tech start-up that has successfully landed a new round of financing. It is the toughest year for Shenzhen’s tech industry, and maybe even tougher in the years to come.”