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EFFECTIVE DEMAND AND OFFICE CYCLES: THE EMERGING GUANGZHOU
OFFICE USER MARKET

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Abstract: This paper examines the conditions of the office user market in Guangzhou, China. Semi-structured interviews were conducted to gain insights of property cycles that are closely related to the social and economic transformation. The analysis of the Guangzhou office user market shows quite different behaviour from typical commercial property markets. It shows the gap between the effective and potential demands as well as the relatively ‘flat’ market condition in the recent office cycle, which is closely associated to the physical and behavioural transformation. The study shows that the structure transformation and the emergence of the office market has been affected by the much slower changes of existing building stock and urban form, which in turn affects office occupancy behaviours and user demand-supply balance. The neglect of these characteristics could mislead the analytical results of office market demand and supply fundamentals in transitional economies, which become a major barrier of investment in emerging property markets. The transition and the mode of economic operation changed the supply of office space, the physical form of commercial districts and behaviours of local office users. However, modern office markets are a complex system. A detailed study of office market cycles requires the simultaneous evaluations of all elements, namely the user, development, investment and land markets in the context of the economic transformation.

Key words: Office; user market; China; economic transition; cycles

1 Introduction

So far, China’s economic performance and the growth of its service-based finance, legal, insurance and property sectors have been very impressive. This has generated considerable potential demand for office in major cities. As the city’s office market started to emerge in the early 1990s, cyclical behaviours were also evidenced. The need for more intensive research into the office user market behaviours should become an important area to facilitate the structure and behavioural changes in the macro-economy. This paper focuses on the demand and supply of office space in the emerging office user market in Guangzhou. It examines the economical and physical structure changes in the city’s office user market and aims to identify and analyse the main reasons for the apparent gap between potential and effective user demands. It addresses the user market cycles by analyzing the balance between effective demand and supply in the context of the unique physical and economic transformation.

2 Office market structure and property cycle theory

The Chinese economic transition is generally a gradualist process, which has achieved impressive performance of the economy (Chai 1997; Jing 2003; Cao 2005). There are the competing views that the structure change in China is a process towards a typical market system or it is an evolving process towards a politico-economical structure that is unfamiliar to current knowledge. The formal is called the economic transition, whereas the latter is called the economic transformation (Chow 2002). Either way has triggered substantial changes in the urban property sector, especially the way office space is supplied and used. On the other hand, typical commercial property cycle theory suggests the direct impact of business cycles on office user and asset markets, which affects both space demand and the level of supply (Barras 1994). However in transitional economies such as China, the past 20 years seem to evident cyclical behaviours that can not be fully explained by standard economic theory. It is important to notice the importance of structure changes in altering market performance, especially the role state plays in the process (Furubotn and Richter 2006). It is clear that understanding the cyclical behaviour of commercial property markets in transitional economy
requires a joint effort from the property cycle theory and the economic transition theory.

3 Research method and data sources

To reach the research aim, surface features of the office market are examined, using historical time-series to reflect the cyclical market behaviours at the surface. The analysis for demand-supply balances is based on the results of the transition process. Supply-demand changes in relation to the emergence and changes of market structure and physical structure factors are the main concerns. The study compared market fundamentals and discusses structure differences between mature and the Chinese office market system, which is further supported by semi-structured interviews with major industry players for more in-depth explanations of the key issues. The special characteristics of the Guangzhou office user market is then linked to the bigger picture of the emerging office market system in the context of the economic transition. Statistical data were collected from government agencies such as the Guangzhou Land and Property Management Department (GLPMD) and the Guangzhou Bureau of Statistics (GZBS), as well as private firms such as DTZ Property Research and My-Top-Home Property Consultants. 40 semi-structured Interviews with major stakeholders were conducted for solid support to the study.

4 Special elements of the emerging office market

The emergence of the office market also shapes the physical office market structure with regards to unique existing stock and supply as well as affects market institutions which are still changing rapidly. It seems there is insufficient reliable data for the Guangzhou office market because the market sector only produces detailed rental data for the high-end and the lower-end sectors, with less detailed data from the Guangzhou Land Management Department (GZLMD) only started in 2001. Hence, there is sufficient evidence to confirm the likelihood of distorted market rental as an indicator of current office demand, which is caused by the ‘hidden’ or unfamiliar office occupancy market – this concept is consistent with the residential leasing market and the ‘free’ non-commercial office stock. Compared to typical ratings in mature office markets, the existing stock in Chinese office sector may be classified into three general categories: a) commercial A grade (high-end) office, B grade office, C grade (low-end); b) residential office space and, c) non-market state-owned-enterprise office space. After more than a decade has elapsed, some early A grade buildings are now being downgraded. Harvey’s general model (2000) of the relation between new supply and total stock and its impact on price level may be applied to large mature office markets, but it is difficult to gain the same credit in emerging office markets. The key difference is the large share of office use under residential office and non-market stocks and the small share of domestic firms in A grade office markets. DTZ maintains A grade stock data (refer to table 1) and My-Top-Home (MTH) give a general count of office buildings in Guangzhou. The current status and the future of the inner-city residential apartments is one of the central issues mentioned by most office users. A common concern is that 40-60% of Guangzhou’s small businesses are renting residential offices (according to interview feedback from a law firm and My-Top-Home). The precise statistics was not available during the fieldtrip; however the influence is clearly significant. Interview with MTH confirms that the focus of office research in the industry is high-end and low-end, which has led to a vacuum of market data in the middle section of the office market. This, of course, does not include the residential and non-market office stocks that are specifically associated with the conditions in Guangzhou, linking to the social and economical transformation and are not included in the current office stock. The MTH estimation of the non-market office stock counts for 40% of Guangzhou’s total office space, which means the GZLMD data only counts for 60% within which the grade-A office has a share. Furthermore, MTH and the property consultant Jones Lang LaSalle predict a future supply of 0.7-1 million sqm in the New Pearl River district and a total of 1.8 million sqm overall by 2010 that could potentially double or even triple the existing office stock in the market.
An imbalance between space demand and supply since the early stage of market emergence has appeared and persisted since the early 1990s. Both the building industry and the amount of existing stock have struggled to meet the potential demand due to the lack of key market institutions, for example property finance, secure property rights, legal structure and so forth, for market-based space supply. It is also important, perhaps essential, to take into consideration the influence of the urban form as a long-term process of transformation resulting from the transition from the planned economy regime reflecting particular socio-economic conditions to a market economy. Existing urban fabric that has been shaped by the planned economic system as well as the politically and economically instable history for almost 150 years makes the emergence of the central business districts under classical urban economic theory too difficult or too costly to realise. Once built, buildings are costly to be altered, removed or demolished (Bon 1989; Raftery 1991). This appears to adversely affect at the aggregate level of cities and their commercial property markets.

Unlike mature office markets where suburban offices may have a large share of the total office stock, there are only a very limited number of office transactions in the peripheral districts of Guangzhou and are normally ignored in aggregate analysis (GZLMD 2005). The majority of office stock is in the inner-city commercial districts. The economic transition seems to result in the emergence of multiple CBDs in a number of cities, for example, Beijing and Guangzhou. The four major office centres in Beijing are defined under their different ‘functions’, featured by the function of each part of the city: for example, the financial, the high-tech, and the central business districts. In Guangzhou, there are also four major office areas, namely Dongshan, Tianhe, Haizhu and Yuexiu Districts (refer to table 1). There has been a continuous changing process of business centres since the early 1980s. According to the feedback during the interviews, it has been suggested by office users and the planning authority that the government could have underestimated or overestimated the level of space required and expansions in association with the change and growth of office effective demands in existing and new business districts. An example for overestimating space demand is the planning and developing of the New Pearl River City CBD, which was formally commenced approximately 10 years ago and has experienced a long delay for solid growth. The continuous creation of new office centres from the old town centres to newer districts, on the other hand, are an example of an underestimation of potential growth in relation to the supporting infrastructure, especially transport systems, built by the government. Matching the State-led reform according to its expectation for market growth and the actual space and infrastructure demands is never a simple task. It is important that the emerging property market system and the State have the ability and capacity to adjust for ‘unexpected’ changes and outcomes. The type and the number of existing office buildings as well as their locations as clusters are an important aspects of the office market emergence. This constrains the level of further changes, hence affecting market demand-supply cycles.

### 5 The gap between potential and effective office demands

The economic transition allows the flourish of market organizations that increase the demand for office space based on the way economic activities are conducted, as well as the market approach of space supply represented by current stock and new supply. Therefore it is important to clearly distinguish between potential and effective office occupancy demands because the actual balance of office user market requires some prerequisites before potential demand becomes effective. The effective absorption in existing stock and new supply of office space should change at a rate below the aggregate rate of new supply minus the depreciation

<table>
<thead>
<tr>
<th>Table 1 A Grade and total office stock in Guangzhou (million sqm)</th>
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</thead>
<tbody>
<tr>
<td><strong>Grade-A office total stock and supply</strong></td>
</tr>
<tr>
<td>average total stock</td>
</tr>
<tr>
<td>new supply</td>
</tr>
<tr>
<td>Dongshan</td>
</tr>
<tr>
<td>Building numbers</td>
</tr>
</tbody>
</table>

Data source: DTZ Property Times (2005) and My Top Home (2005)
rate of existing stock. The actual changing process of effective demand-supply interplay also requires an understanding of the existing city fabric, such as existing buildings and their locational factors, as well as the actual level of wealth of each city or in the local economy. This affects the actual level of office demand and supply, and the state policy in the process of economic transition has a substantial impact in leading into a balanced or imbalanced market condition in a quicker way. The typical market adjustment process reacts at a much slower speed. All of these issues are important for determining office market behaviours in both emerging and mature markets, especially in the actual demand and supply that result in cyclicality in the office user market.

Given potential office demand is directly associated with economic performance i.e. business expansion and recession, and stability i.e. economic cycles, consequently real or effective demand for office space is also affected by the availability of alternative space, such as inner-city residential apartment buildings and office space built and used by State-owned-enterprises (SOEs) or government agencies, and the level of affordability of existing and potential office users. The effective level of office demand in Guangzhou has been relatively flat since the 1990s (see figure 1), therefore it is important to analyse the behaviours of office user groups, such as high-end, small business and those in-between, in relation to existing stocks, new supplies, alternative or potential spaces for office use. It is also important to examine links and interactions between different components in the user submarket, namely the A grade office and lower quality office spaces. This will affect rental levels and space take-up speeds in the office sector as a whole. On the demand side, however, the link in terms of rents seems to be less evident. In other words, demand changes in lower grade or high-end office market seem not to have close link with each others because of distinctive office use preferences between small business firms and those firms where reputation or corporate image is their key concern. There is a consensuses in the mainstream property cycle theory that the level of effective demand in office user market (referred to as a man-made conceptual division as to simplify and to enable the analysis of general equilibrium in office market systems) is directly associated with rental levels in user submarket, which then affects the level of investment return in office investment submarket as well as supply of new space and the release of land. This theory, in emerging markets, should be treated with caution.

![Figure 1 Office user demand and supply in Guangzhou – data source: GLPMD (2005)](image)

Until recently, the concept of CBD in large Chinese cities was vague. Therefore statistics such as CBD employee numbers are not available. However, general city employment statistics have shown a continuous growth of office-based employee numbers since the late 1980s. It has a similar function in reflecting potential office demand. As shown in table 2, the number of office-based employees in Guangzhou has increased by 124.8% over a ten year period (1992 – 2002) – in contrast the Melbourne CBD has experienced a 22.7% increase during the same period (Robinson 2005). The rapidly growing office-based employee number shows a vast potential demand in Guangzhou. Data from the Guangzhou Land Management Department (GZLMD) shows a fairly stable effective demand (annual absorption) since the early 1990s (refer to Figure 1). Although the high-end office demand data (Figure 2) suggests a peak in the early 1990s and the second peak in the early 2000 (DTZ, 2005), it seems the overall office user market has not produced the sort of effective demand that...
matched the potential ‘needs’ indicated in table 2.

Table 2 Potential office demand in Melbourne and Guangzhou

<table>
<thead>
<tr>
<th></th>
<th>Melbourne CBD</th>
<th>Guangzhou city</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>total employee</td>
<td>selected typical office user</td>
</tr>
<tr>
<td>1992</td>
<td>143,252</td>
<td>211,000</td>
</tr>
<tr>
<td>1997</td>
<td>152,989</td>
<td>292,700</td>
</tr>
<tr>
<td>2000</td>
<td>170,353</td>
<td>387,800</td>
</tr>
<tr>
<td>2002</td>
<td>175,735</td>
<td>474,400</td>
</tr>
<tr>
<td>1992-2002</td>
<td>22.7%</td>
<td>124.8%</td>
</tr>
</tbody>
</table>


Figure 2 Guangzhou high-end office rental market - data source: DTZ (2005)

The issue of potential and effective office demand gap is also evidenced in one of the ‘by-product’ observations in the data collection process. Most high-end office users seriously concerned about space efficiency and have been remained in their current office, including A grade buildings, using the same floor space since the initial moving-in. Many of them have had business expansion, both in terms of employee number and new office establishment in other cities. Unchanged office space and the increased employee numbers have resulted in crowded office working environment. This may have something to do with local business culture, for example Beijing grade-A office users looks have much more spacious floor space than their Guangzhou counterparts, and a low effective supply of the right type with the right prices. Among these high-end office users are successful law firms, major consultancy firms, one of the largest property development firms, most influential property agency, and the local office of multi-national firm. Although almost 100% of high-end office users indicated in their interviews the concern of corporate image, but that mainly referred to specific landmark building at a specific primary location, not actual office occupancy quality such as working quality and its associated environment. Their behavior is consistent with the market data, based on which several concerns are raised:

- User behaviour appears to be comparatively rational;
- Many firms are still at the early stage of business expansion;
- Most office users are especially sensitive about space efficiency, despite what grade office are occupied, as well as ‘extra’ payments for common area or ‘non-productive’ space;
- At the high-end market, the expansion of foreign firms were delayed by the financial crisis in the late 1990s and in association with their growth priority such as growths in cities such as Beijing and Shanghai; and
- The macroeconomic and planning policies also created uncertainties that restrict effective office demand.
It seems all these behaviours have affected the effective demand or actual absorption. The relatively flat effective demand since the mid-1990s has resulted in a solid space market with less speculative or ambitious occupancy behaviours. Compared with Beijing and Shanghai, the office user market in Guangzhou is much quieter in terms of annual absorption and new supply. This makes it a more stable market among those three cities. The gap between the potential and the effective office demands has also affected the level of new supply and the speed for absorbing the oversupplied stock in the early 1990s property boom. On the supply side there is the total office stock as well as the development or expansion of new central business districts, for example the New Pearl River City as the proposed new CBD of Guangzhou. This has affected related policy-making and had an impact on the development, investment, as well as new land release and existing city land use patterns in the land market. These features of user demand can assist the following analysis of the overall office market cycles.

6 Supply-demand interplay and user market cycle

This section examines the interplays of effective demand and supply as the actual changes of balance over time in generating cycles, such as rental fluctuations, using data from statistical office and commercial sources. The market rental cycles have also affected the investment and development sectors. Of course, the actual level of impact needs to rely on the transitional economy in how the user market is driven by or relative to the transition and the importance of the state’s role. This requires further analysis of the interviews and related office data. Regarding business cycles, Sir John Keynes (1936) pointed out the misconception of oversupply in absolute terms. It was argued that the Great Depression was due to the lack of effective demand, and the structural imbalance on the supply side or the inappropriate investment as suggested by Rothbard (1963) when quoting the comment of professor Ludwing von Mises on the same issue. This insight on demand and supply interplays in business cycles is important when explaining the office cycle since the early 1990s in the Guangzhou commercial property market. In terms of office supply, for example, until the late 1990s, 86% of vacant space in Hainan was luxury residential building and office, which is a clear structural mismanagement (BSHN 1999). The overbuilding of high return commercial property in Guangzhou had also led to abandoned projects and had caused government control on planning permits for this project type and project loans. The State policy control on property supply structural balance and project finance has become apparent in various national government policies and legal documents. At the practical level, interviews suggest that foreign commercial banks had be very cautious about lending to commercial property development; major SOE banks such as the Bank of Construction has in recent years restricted their commercial building project lending to a restrictive level following the centre bank’s lending policy as a reflection of the national macroeconomic control policy on the property market.

Data availability and reliability in immature markets is a major problem. In the context of Guangzhou, office supply-demand data compiled by the GZLMD is based on office transaction information, such as presale contract registration, construction completion and so forth (see figure 1). The GZLMD treats the total project area that have obtained office presale permit as effective supply and the area that has registered as presale contracts as effective demand. In the commercial marketplace, the effective demand or absorption is normally counted when office users started to occupy building space. According to Mr. Li, an associate director of DTZ Guangzhou (2005), there exists a time-lag between registration for presale and the commencement day. For data from the statistical department, they have been criticized by some scholars, such as Yin (2005), as being submitted directly by developers, hence not reliable. Although a solid response for this criticism still need to be confirmed by responsible authorities, the possibility of moral hazards does reduce the credibility of the data source. In contrast, the GZLMD transaction data is considered more reliable due to the more rigid legal and administrative procedures involved in the data collection process. Table 3 shows the correlations of office demand and supply data from the bureau of statistics, the GZLMD and DTZ respectively over various time periods are generally not strong, and are negatively correlated in several occasions. However, the grade-A new office supply and take-up since 1996 as well as the overall demand and supply appear to have relatively strong correlations. The test also shows that the A grade office market tends to move
independently from the overall market, which is further confirmed by interviews with A grade office users that their occupancy priority is quite different from normal office users.

Table 3  Correlation coefficient of office demand-supply data from different sources

<table>
<thead>
<tr>
<th></th>
<th>Total supply (GZLMD)</th>
<th>office sold</th>
<th>take-up</th>
<th>DTZ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total demand</td>
<td>0.72</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>(GZLMD)</td>
<td>1993-05</td>
<td>-0.42</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>office completion</td>
<td>0.19</td>
<td>-</td>
<td>0.43</td>
<td>-</td>
</tr>
<tr>
<td>new supply</td>
<td>0.02</td>
<td>-</td>
<td>0.91</td>
<td>-</td>
</tr>
<tr>
<td>take-up</td>
<td>1.00</td>
<td>-</td>
<td>-0.23</td>
<td>-</td>
</tr>
</tbody>
</table>


The scope of the early 1990s office building boom and the lack of effective demand is evidenced in figure 2. Interviews with practitioners and users about the low effective demand in the user market context shows the insight that the residential office is so popular that it counts at least 40% of small business firms who have office demands. It was also suggested that industry types, especially the move of IT and financial centre from Guangzhou to Shenzhen, could have substantially reduced the effective user demand. After all, service and IT industries are the most important source of office demand where a simple calculation can highlight the ‘oversupply’ problem. Given the relatively stable effective demand in the past ten years and the fact that the demand and supply were generally in balance since 1998 (R=0.72), it is assumed that the number of years to absorb the ‘oversupply’ in the early 1990s is equal to the total supply (1993-1998) minus the total effective demand over the same period – this is then divided by the average effective demand from 1998 to 2004, assuming no new oversupply occurs and the demands can absorbed annual new supplies. This gives the result of a total of nine years. This could be a main reason for the three government attempts, with the latest in the mid-2005, to drive inner city residential office users into B or C grade offices. Given all these concerns, during the economic transition the physical obsolescence and economic depreciation of the earlier over-supply or the incomplete office projects together with the flat effective demand had made the state the extra pressure for strong interventions: 1) government-led revitalizations for idle projects to facility new supplies; 2) the attempts to discourage office use in inner city residential apartments to realize the existing demand for lower grade office stocks; and 3) the removal or renewal of old districts and the planning of new CBD to accommodate future potential demand in the economic prosperity. Overall, office development is under rigid control by the planning authority (GZLMD 2005) and the typical approach for the above attempts is a mixture of direct orders and market solutions, being a typical feature in a transition economy.

Given annual supply (\(\dot{e}_i\)) and effective demand (\(\mu_i\)), as well as the assumption of one year for presale and normal sales, the balance of real demand and supply is expressed by: \(\dot{a}_i = ((\dot{e}_{i-1} + \mu_i) \times 0.5)/\dot{e}_i\). The analytical results of the demand-supply interplays using data from Guangzhou Land and Property Management Department (GLPMD) and the DTZ are shown in figure 3. It can be observed that the DTZ A grade market and the GZLMD overall office new supply-demand are negatively correlated. For the overall office market, the structural oversupply in early 1990s and the relatively stable and low effective demand has significantly affected new supply since the late 1990s and is currently triggering a new supply upswing. The early office boom in the 1990s and the current upswing highlight not only different cycles but also the transition of market fundamentals: the recent upswing has been backed by consistent supports from market demands. For high-end offices, the initial speculation driven office over-demand was ended by the joint force of the government macro-economic control and the Asian Financial Crisis, which Paul Krugman (1999) called “the Great Recession”. The lack of new supply of A grade buildings and the prosperities of foreign and domestic firms have kept the vacancy level close to the ‘natural rate’ of around 10% (DTZ 2005). The
majority of interviews with property consultants and researchers confirmed that there will be a major supply boom around the corner. All of these facts appear to be clear and are consistent with the user demand-supply interplay analysis. Overall, the A grade office sector behaves more balanced than the overall office market in the past 5 years. However it is also more volatile before 2000, which reminds the fact that the high-end office sector in Guangzhou has been driven mainly by international users.

7 CBD residential office demand and supply

To analyse the reason for relatively low effective office demand-supply interplays and the relatively stable prices and rents since the late 1990s, three issues deserve particular attention, namely inner city apartment office buildings, the wealth of city and the nature of office users in the context of the economic transition. The effect of the economic transition in relation to the emerging office occupancy behaviours and the historical characteristics of the central city building conditions are both affecting the balance of commercial office demand and supply. Table 4 highlights an example when comparing the estimated monthly cost for lower-grade office and commercial district residential properties. Assuming 50,000 median/small firms are currently in Guangzhou and 40% of them occupy inner-city apartments, the total potential demand for office will be two million square meters, equating to an average rented area of 100 square meters. By turning effective, this can almost take up the entire oversupplied stock estimated previously. In mature markets, CBD residential spaces used for commercial purposes is much less common. However, it is a typical phenomenon in transitional economies such as China, which has had significant impacts on the emerging office supply and prices, hence draws greater government policy and administrative attentions. CBD residential building becomes office use is often the natural process of the competition of land (building) use in a specific location (CBD). This happens in most market economy and is not unique in China. Whether the current policy is effective is another issue, and is not the subject of discussion. The key is the demand and supply equilibrium.

With the much more ‘economic’ option of apartment office being available, the wealth of the city or its business community and the nature of office users have determined the rental behaviour. Rental expenses are a major part of business expenditure, and for the majority of small local firms that are in the early growth stage, the reason for apartment office use can explain the persistent flat effective demand for lower-end office. An interesting comment from an interviewee who worked in the Guangzhou property market since its infancy further demonstrated this insight: “Sometimes experience from mature property markets could not be directly applied to China because Chinese cities are still poor. The wealthy and the poor often have different approaches in dealing with life. The office market has been accumulating for less than 20 years, but the funding provided by the state on urban development and redevelopment are insufficient (the state is not wealthy too), and developers, especially local developers, could not access sufficient source of fund – the finance system is immature. Compared to housing expenditure, the general income level is low. And if sufficient funding source is available, the way these things are being done will be changed. Conflicts and
disputes about urban development are closely associated with socio-economic conditions. My opinion is that the low level of social wealth is at the heart of the issue we are discussing here.” (11/2005, legal practitioner interview: Ms Ding)

Table 4 A comparison of office and apartment user costs

<table>
<thead>
<tr>
<th></th>
<th>Office</th>
<th>Residential office</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grade</td>
<td>n/a</td>
<td>B and C inner city high-rise apartment</td>
</tr>
<tr>
<td>Rental</td>
<td>_ /sm/mth</td>
<td>80  60  100</td>
</tr>
<tr>
<td>Opex</td>
<td>_ /sm/mth</td>
<td>10  2  3.5</td>
</tr>
<tr>
<td>shared area</td>
<td>30%</td>
<td>10% 10% 10%</td>
</tr>
<tr>
<td>Effective area</td>
<td>sqm</td>
<td>100 100 100</td>
</tr>
<tr>
<td>taxations</td>
<td></td>
<td>compulsury hard to administer</td>
</tr>
<tr>
<td>total monthly cost</td>
<td>_</td>
<td>11,700 6,820 11,385</td>
</tr>
</tbody>
</table>

Data source: GZLMD (2005), interviews and the author’s estimate in the Tianhe district

Guangzhou is the largest commercial centre in southern China, except Hong Kong, but is not a major financial centre. The financial and IT sector has been growing less strongly since the 1990s with the rise of the nearby city called Shenzhen being the new IT centre as well as one of the two (with Shanghai) central stock exchange markets. This implies a substantial reduced of high-end office demand due to the state decision to develop a new city. The political and economic cost-benefit analysis of Shenzhen development and its impact on the Guangzhou economy and its property market is another complicated issue, which is beyond the scope of this study. This divergence effect of demand source for office from local finance and IT industries may explain the flat effective supply in the high end market. Currently Guangzhou’s small business and trade related firms play a major role in the city’s office market. Their occupancy preferences are driven by cost and flexibility. Therefore the total user cost for existing low-end office and the existence of alternative low cost space, namely city centre apartments, become a key factor to determining the effective market demand. However, the same condition seemed to have much less impact on the high-end sector as most established firms prefer offices that can reflect or improve their corporate images.

The reaction from the supply side is slow since the fact that the transformation of the existing stock takes time, and there was the structural supply imbalance at the early stage of the economic transition. Due to high economic and social costs, the existing central city apartment blocks that are built since the late 1980s are not easily replaced by new office developments. Then it is not surprising to see firms find themselves in central city apartments. Even in cities such as Hong Kong where local/foreign capital and source of finance are plentiful, inner-city redevelopment or change of land use needs to take on board substantial costs for rebuilding itself and the relocation of current residents. Thus the total cost together with the government low rent housing policy have boosted the cost of inner city land use competition or ‘Brownfield’ development through the market force. It is a similar case in the commercial property market in Guangzhou, if not in a worse state. In the context of the Chinese property market system, both the State and the market are lack of capital funding for supplying the required type of space regarding the rapid short run demand changes. In the longer term, the policy impact of driven office users into the low-end office market from their residential offices could impose demand pressure in the lower-end office rent, which, if not properly handled, could impose direct or indirect impacts on office demand and supply in both the high-end and the low-end sectors.

8 Economic transition and the change of built form

At a deeper level, this phenomenon in Guangzhou reflects the basic conflicts between the social and economic transition and the physical built form. The former changes relatively rapidly and with volatility whereas the latter is costly to alter hence changes relatively slowly. This feature is unique for explaining property cycles, especially in transitional economies because it is the economic structure that effectively shapes the urban built
form – this then constrains the emergence of the office market system and its associated economic structure. The lack of effective demand for commercial office since the 1990s has been closely associated with the economic transition in its impact on the wealth or affordability of typical office users, and the changing urban form and building distributions in the city. The state is represented by central and local government where urban planning decisions for city centre redevelopment or new development, commonly known as ‘greenfield’ or ‘brownfield’ development, are difficult tasks to do. The transformation in the economic system or profound change in the business structure requires an accompanying change in the urban form (see Ma and Wu 2005). However, the associated costs for doing so have been assessed by the government as too high, as suggested by local legislative council and planning authorities in the interviews. Redevelopment or renovation processes at city or district scale are often too costly to do in the short run, especially when solely conducted by the state. When the conflict between space demand or potential office space demand, and existing office residential building stock become apparent, the difficulty due to time delays and costs involved for converting existing CBD spaces into commercial buildings forces the market to respond by adopting innovative short-cuts. In Guangzhou, this has blurred the boundary between residential and commercial office spaces; the short-run needs of the local economy and the problem of supply constraints is important driver in explaining the cyclical behaviour of the office user submarket.

However these forces are not working alone. The government’s reaction and managerial approach, including the legislative control of such occupancy behaviour in the user market as well as its decision in designing/planning new CBD as Greenfield urban development such as the New Pearl River central business district, have either destabilized or smoothed the user demand in terms of office supply, as well as office rental and prices. Given the slow inner-city transformation of building stock and the associated constraints, the state has played an essential role in formatting the office market system. This has had and is likely to have substantial impact on the middle and lower end office rent and capital value, hence a key driver of the office building cycle. The ‘policy cycle’ in the space market can be clearly observed in the process of transition. The existence and behaviour of central city apartment office sector, the business base, the wealth of firms and the policy reaction for replace or expansion plans have shown the power of the economic transition as a solid and powerful driver for Guangzhou’s commercial property users market. The economic transition and the existing settings of the central city built area have affected user choice and behaviour, as well as the existing office stock and government’s response to user demands. The economic transition is directly linked to the flat effective demand. The economic transition is also directly linked to the structural imbalance of building stock that is difficult to alter in the short run. The Guangzhou office user market cycles are closely associated with these issues.

9 Conclusive remarks

The analysis in this paper forms part of a broader picture of the study of the emerging office market system in Guangzhou. Office cycles are related to business activities that are conducted in cities. Notably, cities are complex systems within which the general welfare can hardly be purely measured by its material output as is usually the case for business cycle studies. This reality is firmly linked to the element of office space demand, namely the actual requests and the potential needs. Under the classical theory of demand, human needs are affected by various factors, which make it a subjective matter and hard to be measured with precision. The actual request, on the other hand, often represents the actual level of take-up or absorption, which can be measured and analysed more solidly. The changing gap over time is due to the combined force of the structural change, the increased wealth of cities as well as the physical fabric of cities. In a sense, the imbalance of transition is not only the imbalance among different sectors and institutional structures, but also that between market activity and the physical urban form. Market rules and behaviours may be changed rapidly whereas the physical city form is much more costly to be altered in the short run. The mechanism described above explains the gap between potential and effective demand cycles in the user market. Similarly, through the transition process, state policies have affected supply of land via primary land market, buildings via planning rules and regulations, and capitals via fund and interests. Although control of office user demand is passive and office occupancy activities generally encouraged, there are however examples of direct
occupancy control, namely the continuous attempts to push inner city apartment office users such as small firms to move to office buildings. Rental control is another means; however not often occurring in commercial property markets. Overall, the increasing city wealth has created the base for turning potential demand into effective. City’s physical fabric relates to existing stock, its depreciation and new space supply. The balance between potential and effective demands in the process of transition in changing market behaviours over time is the most effective way to identify and explain cyclicality in the Chinese office user markets.

However, office market system not only involves user market, it also contains the interlinked investment, building and land supply elements. The observed cycles in the Guangzhou office market is largely the result of the interactions at submarket levels. The balance within the office submarket system in relation to the economy is difficult to be maintained, as one of the typical features in emerging property markets is the lack of ‘mature’ stock or secondary markets, which has created substantial conflicts between the existing physical built environment with associated managerial structure and the rapidly emerging needs for commercial space that is featured by the dominance of the primary market for land supply, building construction and capital flows. Economic transition moves the urban property system from the emphasis on planned public ownership to a more market-led private ownership structure, which in the finance sector has been transforming the banking system and foreign investment behaviours, and creating more dynamic financial vehicles. Nevertheless, understanding the derived demand for office space in the user market in relation to the business cycles is the basis for making better investment decisions in emerging property markets.

References


