savills
第一太平戴维斯

Savills World Research
Shanghai

Briefing
Office sector

February 2016

Image: Century Grand Metropolis

SUMMARY

Driven by strong demand in non-prime projects handed over in the past few quarters, quarterly take-up reached highs not seen since 2011.

- Four projects launched onto the core office market in Q4/2015, adding 280,000 sq m of supply, pushing total stock to 6.39 million sq m.
- Net take-up in core areas totalled 325,000 sq m in Q4/2015, with approximately 90% of all transactions seen in non-prime areas, and around 60% of all transactions seen in Pudong.
- As a result of strong take-up in recently handed over projects, vacancy rates in core areas fell by 1.0 percentage point (ppt) quarter-on-quarter (QoQ) to 6.1%, down 2.0 ppt year-on-year (YoY).
- Average rents in core areas increased by 0.5% QoQ to RMB8.70 per sq m per day, representing an increase of 1.4% YoY.
- As a direct consequence of the influx of supply, regardless of the strength of demand, downward pressure is expected to be placed on rents and occupancy rates as new projects compete to attract and retain tenants.
- Six new projects launched onto the decentralised market in Q4/2015, bringing 380,000 sq m of supply to the market and pushing total stock to over 1.88 million sq m.
- Decentralised rents remained flat at an average of RMB4.9 per sq m per day.
- The decentralised market witnessed a fall in vacancy rates to 16.8%, mainly due to pre-leasing of new projects.

"International REITs have focused on stabilised assets and long-term holds. Domestic funds are increasingly seeking value-add opportunities and getting involved in asset management, a divergence from previous opportunistic strategies." James Macdonald, Savills Research

Market commentary

Core market

Thirteen new projects, totalling over 670,000 sq m, launched onto the core market in 2015. Pudong saw prime areas continue to tighten in Q4/2015, while non-prime areas continued to witness rental growth and decreasing vacancy rates. Non-prime areas in both Pudong and Puxi witnessed strong take-up in projects handed over in the past few quarters.

A supply influx of approximately 1.8 million sq m is expected to enter the core office market in 2016. Although the new supply is dispersed throughout the city, approximately 30% is located in prime areas, notably the highly anticipated Shanghai Tower and Taikoo Hui Phase I. In addition, Hongkou is expected to receive its first Grade A office building since 2012. Although no notable examples have been confirmed, developers may be inclined to delay projects as a result of intensifying competition.

The key drivers of demand going forward will continue to be domestic companies, as well as financial and professional services industries choosing to upgrade to larger spaces. Although many multinational corporations (MNCs) are positive about China in the long term and plan to continue investing in the country, high operating costs and the economic slowdown are forcing companies to pay closer attention to their operational costs and capital expenditure. Adjusting to the new norm, companies are looking for productivity improvements to drive growth and expansion. In the office market, this represents a review of business space requirements given the high-quality supply in non-prime areas, the emergence of not only non-prime areas but also decentralised ones, and changes in the way office space is used.

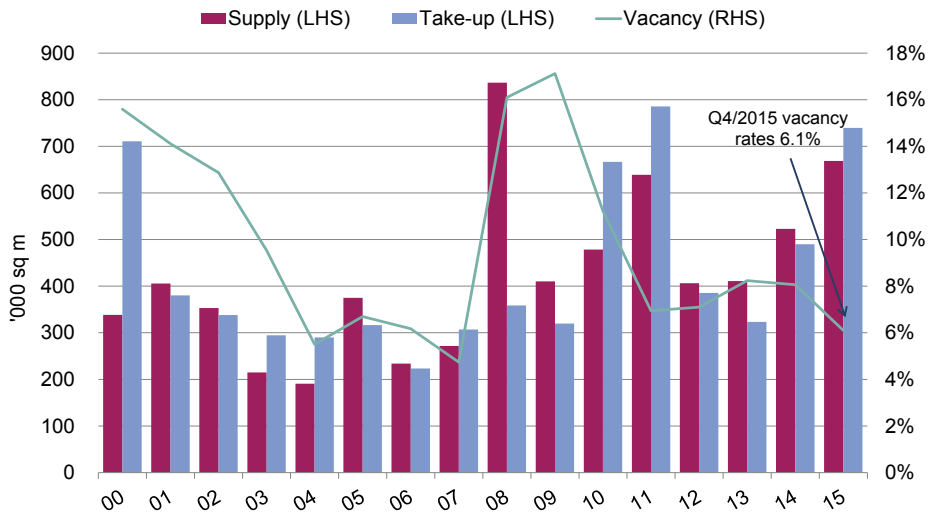
Decentralised

Eleven new projects, totalling over 650,000 sq m, launched onto the decentralised market in 2015. Decentralised rents remained flat, while vacancy rates fell due to projects handed over in the last few quarters.

Supply is expected to total over 2.3 million sq m in 2016, a considerable amount, representing an increase of 278% over the past three-year average annual supply. Half of this will be located in the Hongqiao Transportation Hub (HTH) area.

GRAPH 1

Grade A office supply, take-up and vacancy rate, 2000–2015



Source: Savills Research

Market news

Shanghai 2015 GDP growth stabilised at 6.9%

Shanghai's 2015 GDP amounted to RMB2.5 trillion, an annual growth of 6.9% and the highest in the country. The added-value of the third industry accounted for an historically high proportion (67.8%) of the city's GDP, and 94.9% of the GDP growth. Among the third industry, the added-value of the financial sector increased 22.9% YoY, with an increase of 8.2 ppt YoY. The third industry and financial sector has continued to drive the economic growth of the Shanghai market, which has also impacted on the Shanghai office market. The Shanghai manufacturing industry fell 0.8% in terms of added-value, with a 2.4 ppt decrease in growth rate. The Shanghai government has planned to support the innovation of the industrial sector in order to maintain long-term development. Predicted Shanghai 2016 GDP growth is approximately 6.5% to 7%.

RMB internationalisation positive for Chinese corporations

Continued internationalisation of the Chinese RMB will have long-term positive effects for Chinese corporations, according to Fitch Ratings. The International Monetary Fund (IMF) executive board has decided to include the Chinese currency in its SDR basket, marking a milestone in the currency's global progression and giving a vote of confidence to China's financial reforms. This RMB internationalisation will stimulate China's financial reform and be positive for Chinese corporations in the long term.

Core market

The core office market received four new projects in Q4/2015, adding nearly 280,000 sq m of supply. This included Lilacs International Commercial Centre and Century Grand Metropolis in the Pudong district, Bund IFC north plot in the Huangpu district, and Kerry

Everbright City Phase 3 Towers 1 & 2 in the Zhabei district.

Net take-up reached 325,000 sq m in Q4/2015, which represented highs not seen since 2011. The majority of demand (90%) was in non-prime areas, due to an increasing interest in these areas from cost-conscious tenants. The Pudong non-prime area witnessed particularly high take-up, driven by the active demand from the financial sector, resulting in Pudong accounting for 60% of the city-wide take-up.

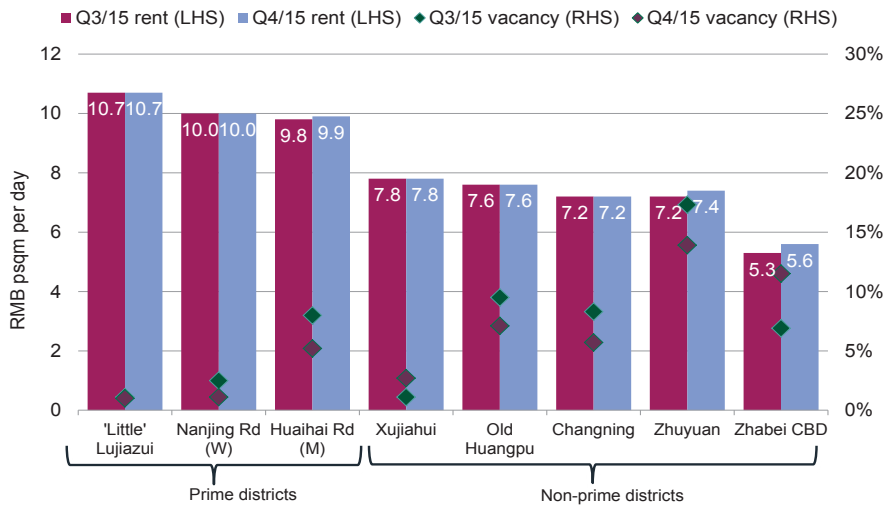
Despite new supply, vacancy rates in core areas fell by 1.0 ppt QoQ to 6.1%, down 2.0 ppt YoY. This fall was a result of strong take-up in non-prime projects handed over in the past few quarters.

Zhabei saw an increase in vacancy rates by 4.6 ppt, resulting from new supply entering the market, but this is expected to be absorbed in the coming quarters. In addition, Xujiahui witnessed a rise by 1.6 ppt this quarter, as a number of tenants relocated from aging buildings to newer projects in emerging areas. Xujiahui has seen no new supply since 2007, leaving limited stock for companies to expand. Apart from Zhabei and Xujiahui, all submarkets saw an overall decrease in vacancy rates.

'Little' Lujiazui continues to be the tightest market due to limited available stock, with vacancy rates at just 1.0%, but Shanghai Tower is expected to provide some relief. Zhuyuan continued to have the highest vacancy rates because of ample supply in recent quarters. The area is currently seeing mixed reviews with some buildings seeing continuously strong take-up levels, while others are yet to see any transactions. It is expected that Zhuyuan will receive a supply influx of around 400,000 sq m in 2016, causing vacancy rates to remain relatively high.

GRAPH 2

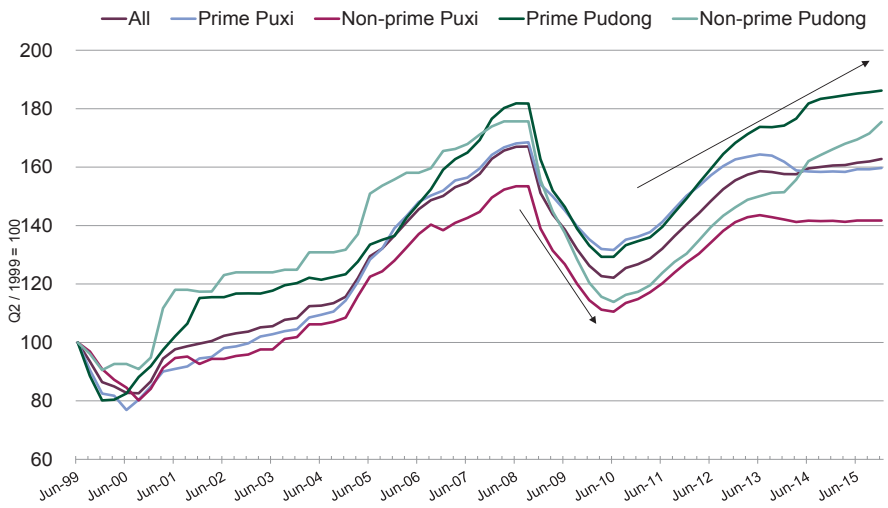
Business district comparison, rent vs vacancy rate, Q3/2015 and Q4/2015



Source: Savills Research

GRAPH 3

Core market Grade A office rental indices, Q2/1999–Q4/2015



Source: Savills Research

TABLE 1

Selection of leasing transactions, Q4/2015

Tenant	Project	Location	Area leased (sq m)
Chrysler	Hongqiao Vanke Center	Minhang	6,000
Industrial Bank	Garden Square	Jing'an	4,200
City Life	BenQ Plaza	Changning	3,100
Beststone	Lilacs International Commercial Centre	Pudong	1,800
Messe Frankfurt	Century Grand Metropolis	Pudong	4,000

Source: Savills Research

➔ Grade A office rents increased 0.5% in Q4/2015, to an average of RMB8.70 per sq m per day, up 1.4% YoY. Puxi rents increased 0.1% this quarter, while Pudong rents increased 1.2%, mainly due to the increasing interest in non-prime areas. Although rental growth has been witnessed in recent months as landlords of newer buildings with healthier occupancy rates increased rents, such a trend has begun to abate this quarter in anticipation of the upcoming influx of supply. This looks set to continue over the next two years.

Both prime and non-prime rents increased 0.3% and 0.7% QoQ to RMB10.3 per sq m per day and RMB7.3 per sq m per day respectively. Non-prime Pudong continues to record the strongest rental growth as strong demand from the financial sector spills over from Lujiazui. The gap between average rents in non-prime Pudong and non-prime Puxi continues to widen, reflected in the 2.3% increase QoQ in non-prime Pudong to RMB7.5 per sq m per day.

Lujiazui, Nanjing Road (W), Huaihai Road (M), and Zhuayuan rents grew by 0.3%, 0.3%, 0.3% and 2.4% QoQ respectively, while other submarkets witnessed flat rents.

Investment market

The Shanghai office investment market was quite active in Q4/2015, with six sizeable sales deals concluded, representing a total consideration of RMB14.97 billion. It is perceived that yields fell to 5.6% on a gross reversionary basis in Q4/2015 (NOI: 4.2%).

The office sector continues to dominate Shanghai's investment market, accounting for 92% of transaction volumes this quarter. This is thanks to the depth and liquidity of the market as well as the ease of management and market transparency. Quality assets in first-tier cities, Shanghai in particular, will continue to attract capital looking for safe havens as investors look to capitalise on the loosening of monetary polices and for protection from the weakening markets in lower-tier cities.

International REITs have concluded three acquisitions of premium office property – 21% of 2015's total considerations – focusing on stabilised rental-generating assets and long-term holds. Domestic funds are increasingly seeking value-add opportunities and getting involved in asset management, a divergence from the previous opportunistic strategies.

International funds will keep an eye on currency movements as they make their future investments in China. Domestic developers and investors will conversely find overseas investments more lucrative should the RMB devalue against the currency of the investment destination country or countries.

Shui On Land sold Corporate Avenue #3 to Lee Kum Kee (90%) & Vanke (10%) for a total consideration of RMB5.7 billion. Corporate Avenue #3 has a total GFA of 87,200 sq m, composed of a 24-floor premium office tower (23 floors leasable), a 5-floor retail podium (7,375 sq m) and basement car parking, and is expected to remain for lease.

China Science & Merchants Investment Management Group (CSC Group) purchased Star Bund #5 from China Jinmao JV Shanghai International Port Group for a total consideration of RMB2.28 billion. Located in the North Bund area, Star Bund, with a total GFA of 24,000 sq m, is expected to remain partly for self-use and partly for lease or sales.

ARA purchased BEA Finance Tower, a 41,000-sq m office tower, for a total consideration of RMB2.7 billion. This is the second deal concluded by ARA in the past six months, following its

TABLE 2

Sizeable sales transactions, Q4/2015

Property	Location	Total (RMB mil)	Price (RMB/sq m)	Buyer	Deal Structure	Usage
Manpo International Plaza 万宝国际广场	Changning	1,466	~46,100	Carlyle	Onshore asset	Lease
One Prime 壹丰广场	Hongkou	2,226	~30,000	Shanghai Chengli Properties	Onshore equity	Lease
#5, Star Bund 星外滩5号楼	Hongkou	2,282	~94,800	China Science & Merchants Investment Management Group (CSC Group)	Onshore asset	Self-use/ lease/ sale
BEA Finance Tower 东亚银行金融大厦	Pudong	~2,700	~66,000	ARA	Offshore equity	Lease
Corporate Avenue 3 企业天地3号楼	Huangpu	5,700	~66,000	Lee Kum Kee (90%) & Vanke (10%)	Offshore equity	Lease
Tower C of Hongqiao Green Valley Plaza 虹桥绿谷广场C幢	Minhang	595	~33,300	Xinhu Zhongbao	Onshore asset	Self-use

Source: Savills Research

acquisition of Platinum Tower in the Huangpu district last quarter, and is expected to remain for lease.

Strata-title market

The strata-title market witnessed a supply decrease, reaching 852,000 sq m in Q4/2015, down 9.5% QoQ, while transaction volumes doubled to 895,000 sq m. The consideration values increased from RMB11.28 billion to RMB38.2 billion in Q4/2015, as more premium projects were transacted this quarter. Self-use demand continues to drive the market, with investors concerned about lower yields and further limited capital value appreciation potential.

Prices based on a basket of around 40 premium quality office projects[1] and analysed on an un-weighted index basis, recorded a more moderate rise of 0.4% QoQ to RMB46,047 per sq m in Q4/2015, down 0.3% YoY.

[1]30 projects in Puxi and 13 projects in Pudong

Over the last 12 months, the HTH in the Minhang district, New Jiangwan Town in the Yangpu district, and Pudong Binjiang have recorded the most amount of new supply. Demand has focused on Pudong Binjiang and Zhangjiang Business Park, HTH, and Everbright City in Zhabei.

Market outlook

2016 is expected to witness a supply influx of around 1.8 million sq m entering the core market, 72% of which is located in non-prime areas, mainly Puxi. Decentralised areas are also anticipated to see a supply influx of around 2.3 million sq m entering the market in 2016, almost half of which is located in the Hongqiao Transportation Hub (HTH). Current forecasts predict that new supply in core areas will reach an all-time high in 2016, with a slight drop in 2017. These estimates may change should developers postpone handover dates.

Demand is expected to remain firm over the next few years, although it is also expected to be inadequate to absorb the majority of the supply entering the market. Key drivers of demand will continue to be from the financial and IT related sectors in Pudong, while Puxi is expected to see demand come from more abundant industries, especially professional services and retail related companies. Several factors will continue to drive demand for various industries in the next few years, including: the deepening of financial reform and innovation; the implementation of policies in the Shanghai Free Trade Zone; the growth of domestic companies; the application of the concept "Internet plus" combined with various industries; the expansion of the middle class; and the upgrading of consumption demand. This will also stimulate demand for office market.

TABLE 3

First-hand strata-title building activity, Q4/2015

Project	District	Transacted GFA(sq m)	Average price (RMB per sq m)
Wentong Tower 文通大厦	Yangpu	912.8	37,888
Xuhui Vanke Centre 徐汇万科中心	Xuhui	1,274.3	37,391
ZJ Railway & Greentown Changfeng Centre 浙铁绿城长风企业中心	Putuo	1,662.3	40,180
CIFI & Henderson Centre 恒基旭辉中心	Minhang	1,250.6	42,834
Sino-Ocean Tower 远洋洲海大厦	District	333.3	39,302

Source: Savills Research

TABLE 4

Key supply, Q4/2015

Project	District	Supply (sq m)	Developer
SOHO Hongkou 虹口SOHO大厦	Hongkou	65,314	Xusheng
Ranking Hongqiao Business Square 融真虹桥商务广场	Changning	60,082	Ranking
Citic Pacific Shipyard Project 尚悦东广场	Pudong	58,565	CSIC
Orstar City Zhabei 绿地星光耀广场	Zhabei	42,247	Greenland & Star Capital

Source: Savills Research

As a direct consequence of the influx of supply, regardless of the strength of demand, downward pressure will be placed on rents and occupancy rates as new projects compete to attract and retain tenants. All areas of the city are expected to feel the pressure of competing projects, albeit to different degrees. Prime business areas with more limited supply, and demand that is less susceptible to cost increases, are likely to see more stable rents. Additionally, projects entering these areas are of a higher quality and therefore will be able to demand higher than average rents, despite the levels of supply seen across the city. For instance, 'Little' Lujiazui, which has kept vacancy as low as around 1-2% for three years, is also expected to feel the pressure, with the launch of 220,000 sq m of leasable area in the Shanghai Tower. Although the project has already reached pre-leasing levels of roughly 50%, the launch of the project and the softening of the market is expected to curb future rental growth. In the context of the wider market, Shanghai Tower is still expected to be one of the most resilient performers.

Landlords of existing buildings within core areas that historically recorded high occupancy rates are expected to feel the pressure. While a number of companies will continue to be in traditional business areas to maintain a certain image, and due to the clustering effect, many may make the decision to move non-client facing departments to more cost effective projects in non-prime areas. On the one hand, some traditional business areas have limited space for companies to expand, like Xujiahui, which witnessed no new supply of Grade A office buildings since 2007. On the other hand, as non-prime and emerging areas can provide more reasonable rents, more abundant space for office design, and improving infrastructure and surrounding amenities, companies may not feel the need to be in traditional business areas, instead opting for larger office spaces elsewhere. As replacement costs begin to increase, landlords will have to pay more attention to the time of renewal, provide various benefits to tenants, and improve the property management level to retain existing tenants as well as attract new ones.

The proportion of decentralised areas in the city-wide Grade A supply will significantly increase, which will challenge landlords. For instance, the HTH will receive a supply influx of over 2 million sq m after all the projects are handed over. Such a large amount of new supply launching in a period of three to four years will bring pressure on the occupancy rates of the area. However, since HTH is an emerging business area and not yet a mature business environment, the take-up of these projects will still be challenging. Landlords will have to differentiate themselves, consider postponing their handovers, or consider strata-title or en-bloc sales.

The Expo, Pujiang Yaohua, Xuhui Bingjiang and Qiantan areas are all anticipated to play an important role in the future decentralisation of Shanghai's office market. Based on master plans provided by the government, these districts will be developed into business centres through the improvement of infrastructure and surrounding amenities such as international schools and hospitals. These areas will also be connected with Puxi and Lujiazui through extensive metro access to improve accessibility. The Pudong master-planned areas plan to attract companies from the financial, consultancy, legal and professional services industries to set up their headquarters, providing a complementary and supportive function for the "Little Lujiazui" area. Xuhui Binjiang is expected to focus on attracting media companies as well as leisure and entertainment operators. A large percentage of the future supply in the Expo area is being developed by state-owned enterprises for self-use. Qiantan has attracted a number of well-known international developers, including Tishman Speyer, Swire and Hong Kong Land, known for their international experience, management quality and reputation. The first projects in these areas will enter the market in the second half of 2016.

For tenants, the influx of supply in the next few years will be a good opportunity to adjust the distribution of resources and optimise office demand. Adjusting to the new norm, companies are looking for productivity improvements to drive growth and expansion. In the office market, this is represented by a review of business space requirements and changes in the way office space is used. Domestic companies will increasingly look at upgrading their office space or purchasing for self-use, leading to demand for quality office space and strata-title projects, while MNCs are beginning to adjust to the new pace and environment of the market. Lower margin operators are expected to relocate to more affordable office premises, while larger occupiers consider bifurcation.

More and more companies are tending towards purchasing en-bloc office projects in non-prime and decentralised areas for self-use, particularly in locations along the North Bund, and in the Xuhui Binjiang, Expo and Qiantan areas. In addition, the emergence of the mobile office and co-working spaces meets the special needs of some start-up companies, showing the diversity of the Shanghai office market.

Future project

Shanghai Landmark Centre

The Shanghai Landmark Centre, developed by HKC (Holdings) Limited, consists of two Grade A office towers. Located in the North Bund area, the development is a five-minute walk from Tiantong Road metro station (lines 10 and 12). The project, which is expected to be launched onto the market in Q4/2016, consists of 110,000 sq m of office space and 72,000 sq m of retail space.

The office component spans 29 floors. Typical floor plates will be around 2,000 – 2,200 sq m, with whole floor efficiency of 70 – 75%. The clear ceiling height is 3.0 m and raised floors are 150 mm. The office buildings will be serviced by 26 'Schindler' passenger lifts and will have around 1022 car parking spaces to support the whole project.

TABLE 5

Shanghai Landmark Centre

Location	Sichuan Rd (N) & Tiantong Rd, Hongkou
Developer	HKC (Holdings) Limited
Handover date	Q4/2016(estimated)
Office GFA	110,000 sq m
No. of storeys	29
Typical floor plate	2,000 – 2,200 sq m
Whole-floor efficiency	70 – 75%
Clear ceiling height	3.0 m
Raised floor	150 mm
Passenger lifts	26 'Schindler' elevators
Car parking spaces	1022

Source: Savills China Research

Please contact us for further information

Savills Research

James Macdonald
Director
+8621 6391 6688
james.macdonald@savills.com.cn

Savills Commercial

Cary Zheng
Senior Director
+8621 6391 6688
cary.zheng@savills.com.cn

Yann Deschamps
Director
+8621 6391 6688
yann.deschamps@savills.com.cn

Project & Development Consultancy

Kitty Tan
Director
+8621 6391 6688
kitty.tan@savills.com.cn

Savills plc

Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 700 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.