

# Briefing Office sector

August 2017



Image: Shanghai Landmark Center, Hongkou

## SUMMARY

The market continues to tilt in favour of tenants, as historical high levels of new supply in both core and decentralised markets increased vacancy rates.

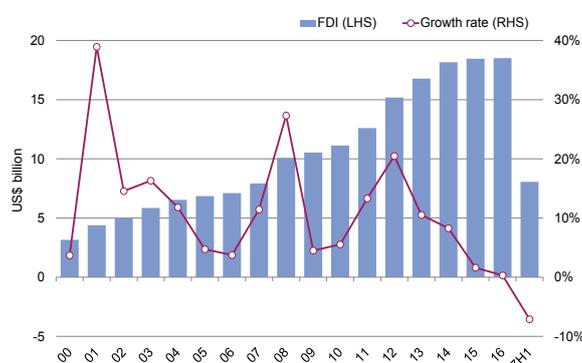
- Four new Grade A projects were launched onto the core office market in Q2/2017, adding 338,600 sq m of supply and increasing core office stock by 4.6% to 7.76 million sq m.
- Demand remained strong in the second quarter, with net take-up in the core market totalling nearly 266,800 sq m (including self-use).
- New supply pushed up vacancy rates in core areas by 0.5 of a percentage point (ppt) quarter-on-quarter (QoQ), to 10.7%, up 3.4 ppt year-on-year (YoY).
- Supported by rental growth in the non-prime Puxi area, average core

market rents increased by 0.5% QoQ to RMB9.0 per sq m per day, up 3.4% YoY.

- Six new projects were launched onto the decentralised market in Q2/2017, bringing 367,700 sq m of new supply and pushing total stock up to approximately 3.1 million sq m.
- New supply pushed up vacancy rates in decentralised areas by 6.3 ppt in Q2/2017 to 33.4%, while rents increased by 3.4% QoQ to RMB5.9 per sq m per day. The growth in rents was not particularly broad based, with a few highly sought after submarkets and projects pulling up the average rents despite generally high vacancy rates for decentralised areas.

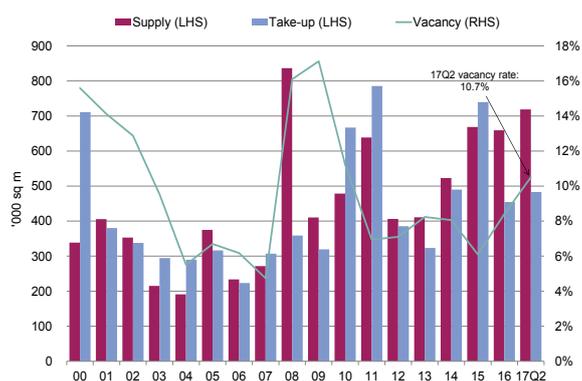
“New projects continue to push up overall vacancy rates, though only marginally as supply is being met with strong demand from various new start-ups, expansions and upgraders, particularly from the Technology, Media, Telecom industry.” James Macdonald, Savills Research

GRAPH 1  
**Shanghai utilised FDI, 2000-1H/2017**



Source: Shanghai Statistics Bureau, Savills Research

GRAPH 2  
**Grade A office core market supply, take-up & vacancy, 2000-Q2/2017**



Source: Savills Research

## Market News

### Foreign Direct Investment (FDI) into Shanghai falls for the first time in over 16 years

Contracted FDI fell 47.1% YoY to US\$18.2 billion in the first six months of 2017, while utilised FDI fell 7.1% YoY to US\$8.1 billion over the same period. The slump in FDI could point to rising costs pushing global companies to look elsewhere. Nevertheless, the potential impact on the city's office market is likely to be limited as office demand is increasingly being driven by domestic companies.

### Shanghai releases plans to increase foreign investment

The Shanghai government released 33 measures on April 2017, to attract more foreign investment. The measures include greater market access in more fields, attracting talent, protecting intellectual property rights, expanding financing channels, and increasing government's inter-agency cooperation. In particular, the government emphasises opening-up in key industries including manufacturing, internet, telecommunications and finance.

These measures hope to encourage more multinational companies (MNC) to enter and expand in Shanghai, generating new occupier demand for the city's Grade A office market.

### Jinmao Holdings buys Hongkou commercial land plot for RMB4.1 billion

China Jinmao Holdings acquired a commercial land plot in the Hongkou district for a total consideration of RMB4.1 billion on 14 June 2017. Given a site area of 22,855 sq m and plot ratio of 5.0, the transaction represented an accommodation value (AV) of nearly RMB36,100 per sq m, or a 0.2% premium over its reserve price.

Located just north of Puxi's landmark project of Sinar Mas Centre in the North Bund, the development is expected to include 90,000 sq m of office space and 60,000 sq m of retail space. The Hongkou government have made it clear that they would like the project to introduce a number of regional headquarters of internet, finance and creative companies once completed.

## Leasing market

### Core market – Supply, take-up & vacancy

The second quarter saw the city's core office market receive four Grade A projects – Bund IFC (S1) in Old Huangpu, HKRI Taikoo Hui T2 in Nanjing Road (W), Sinar Mas Centre in North Bund and Capital Square in North Station – totalling 338,600 sq m of new supply. Pudong recorded no new supply for the third consecutive quarter.

TABLE 1  
**Grade A office core supply, Q2/2017**

Project	District	Business district	Office GFA (sq m)	Developer
Bund IFC (S1)	Huangpu	Old Huangpu	80,500	Fosun
HKRI Taikoo Hui T2	Jing'an	Nanjing Rd (W)	65,000	Swire & HKRI
Sinar Mas Centre	Hongkou	North Bund	138,090	APP
Capital Square	Jing'an	North Station	55,000	CapitaLand

Source: Savills Research

TABLE 2  
**Grade A office core market performance, Q2/2017**

	Supply (sq m)	Take-up (sq m)	Vacancy	Stock (sq m)
Pudong	-	2,600	6.2%	3,587,400
Puxi	338,600	264,200	14.6%	4,170,700
All	338,600	266,800	10.7%	7,758,100

Source: Savills Research

→ While the addition of new supply increased the core market vacancy rate by 0.5 of a ppt in Q2/2017 to 10.7%, the vacancy rate in prime Pudong continued its downward trend due to limited availability, falling 0.2 of a ppt QoQ to 2.7%. Core market absorption remained robust due to strong take-up in non-prime Puxi of 195,200 sq m,

accounting for 73% of the total take-up for the quarter. This was primarily attributable to the availability of new high-quality projects and the rapidly maturing business environment. Nevertheless, as a result of new supply, the vacancy rate in the non-prime Puxi market still witnessed a slight increase of 1.0 ppt QoQ to 20.3%.

**Core market – Rent**

Core office rents continued their moderate growth in Q2/2017, increasing by 0.5% QoQ to an average of RMB9.0 per sq m per day, up 3.4% YoY. Nevertheless, record levels of new supply in 1H/2017 resulted in rents falling in prime markets by 0.8% QoQ, the first decrease recorded by these markets in over three years.

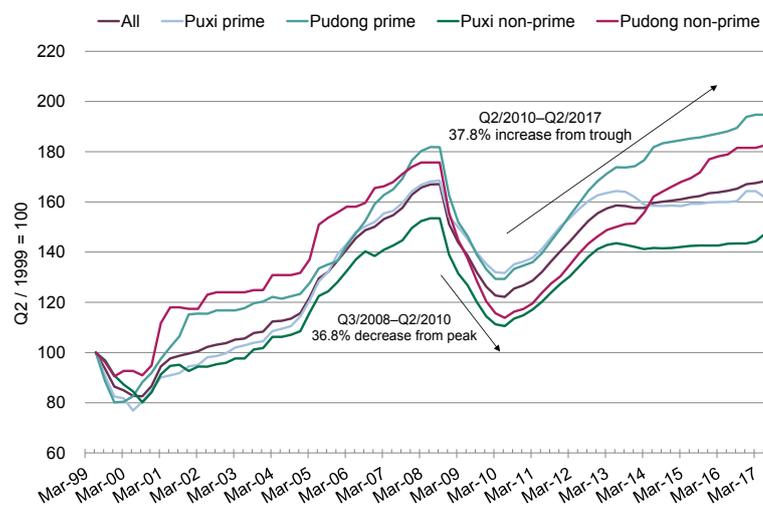
Non-prime Puxi contributed significantly to the city’s overall growth rate in the second quarter, increasing 2.1% QoQ, the fastest rate of growth that submarket has recorded since 2013. Rents eventually ended the quarter at RMB7.4 per sq m per day, up 2.7% YoY. Rental growth in non-prime Puxi was supported by significant tenant interest, as well as the addition of new high-quality projects and a maturing of the business atmosphere.

**Core market – Submarkets**

Lujiazui

Lujiazui continued to see strong demand from financial services and technology companies, maintaining its position as the business area with the lowest vacancy rate in the city at 2.7% in Q2/2017, down 0.2 of a ppt

GRAPH 3 **Grade A office core market rental indices, Q1/1999-Q2/2017**



Source: Savills Research

TABLE 3 **Notable leasing transactions, Q2/2017**

Tenant	Project	District	Business district	Area leases (sq m)	Lease type
3M	Maxdo Centre	Changning	Hongqiao	20,000	Renewal
Changjiang Securities	Century Link	Pudong	Zhuyuan	10,000	Relocation
YKK	Sinar Mas Center	Hongkou	North Bund	4,600	Relocation
Discover	Ocean Towers	Huangpu	Old Huangpu	2,211	Renewal
Kane Matsu	Raffles City	Huangpu	Old Huangpu	700	Renewal

Source: Savills Research

TABLE 4 **Grade A office core market rents, Q2/2017**

Area breakdown	Rent (RMB psm pday)	QoQ change	YoY change
Prime Pudong	11.4	-	+5.1%
Prime Puxi	10.1	-1.5%	+1.2%
Non-prime Pudong	8.0	+0.6%	+3.0%
Non-prime Puxi	7.4	+2.1%	+2.7%

Source: Savills Research

➔ QoQ. Due to limited availability and its prime location, the area remained the most expensive submarket, with average rents remaining unchanged at RMB14 per sq m per day.

**Nanjing Road (W)**

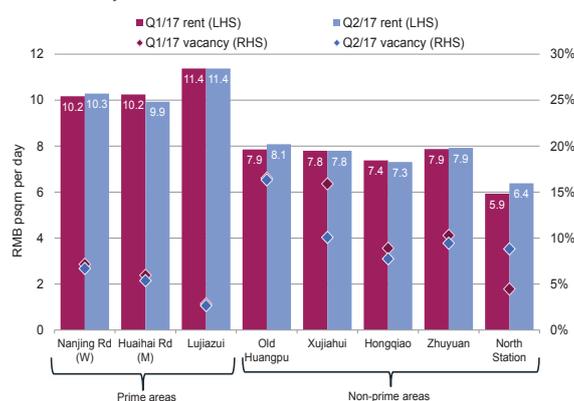
Despite the handover of Swire's Taikoo Hui (Tower 2), Nanjing West

Road saw vacancy rates fall by 0.5 of a ppt to 6.7%, thanks to strong pre-leasing activity in the project. Market absorption remained strong as the area remained popular amongst many MNCs, with approximately 64,900 sq m of net take-up in the second quarter. Rents increased 1.1% in the second quarter to RMB10.3 per sq m per day.

market office rent by 3.4% QoQ to RMB5.9 per sq m per day.

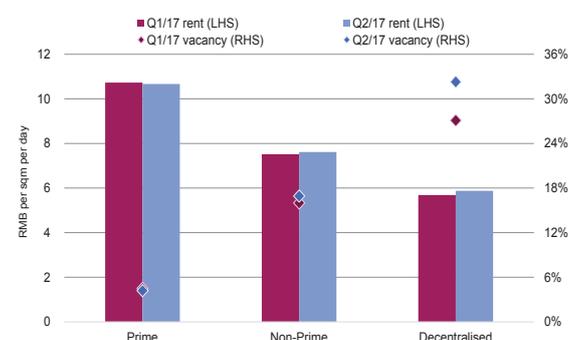
The development of the city's decentralised office market continues to shift towards several master-planned business areas, including the Hongqiao Transportation Hub (HTH) and New Bund areas, which include the Qiantan and Expo business areas. However, judging from the high vacancy rates in newly-handed-over projects in recent quarters, the market needs more time to absorb the large new supply.

**GRAPH 4**  
**Rent and vacancy by business district, Q1/2017 vs. Q2/2017**



Source: Savills Research

**GRAPH 5**  
**Rent and vacancy by submarket, Q1/2017 vs. Q2/2017**



Source: Savills Research

**Huaihai Road (M)**

In contrast to the positive rental performance in the other two prime markets, Huaihai Middle Road recorded a fall in rents of 3.1% in the second quarter to RMB9.9 per sq m per day, down 0.3% YoY. Vacancy rates fell 0.6 of a ppt QoQ to 5.4%.

It has been two years since this area received its last supply (Corporate Avenue T3) in Q2/2015, with no projects expected to enter the submarket until the handover of Capital Tower by CapitaLand in 2019.

**Decentralised market**

The decentralised market continued to see a flood of new office space in Q2/2017. Six new projects were launched onto the market, bringing 367,700 sq m of supply. As a result, decentralised office stock was pushed up to 3.1 million sq m, a 42.1% expansion of the market over the last 12 months.

In response to the new projects, the average decentralised market vacancy rate further increased by 6.3 ppts in the second quarter to 33.4%, up 3.2 ppts YoY. However, improving occupancy rates in some popular projects and submarkets gave some landlords confidence to raise rents in the second quarter, resulting in an increase of the average decentralised

**New decentralised business areas announced**

Despite market concerns about the pace of the development of decentralised markets, the government seems to have no such reservations as they recently announced plans to develop a new business district next to the Longyang Maglev station. The plans, announced on 28 June 2017, call for the development of 19 commercial land plots just to the south of the Longyang Maglev station, which also links to metro lines 2, 7 and 16, and the future line 18. The total buildable area of these 19 plots should be approximately 1.4 million sq m, roughly equivalent to the Grade A office stock in Zhuyuan. Long-term planning may also call for the redevelopment of the Shanghai New International Expo Centre into a 2 million-sq m business district.

The extension of the HTH into the Qingpu District also took another step forward with the auction of plot 42-03 in Xujing Town. This was sold to Zhengrong for RMB1.43 billion, with an AV of RMB8,075 per sq m, site area of 70,857 sq m, and a plot

**TABLE 5**  
**Decentralised office supply, Q2/2017**

Project	District	Business district	Office GFA (sq m)	Developer
China Fortune Plaza	Pudong	Pudong others	33,850	China State Construction
Baosteel Expo	Pudong	Expo	80,750	Baosteel
Orstar City	Putuo	Zhenru	100,000	Star Capital
Chuanfu HTH	Minhang	HTH	62,650	Chuanfu Holding
Longshi HTH	Minhang	HTH	65,000	Longshi
Baochuang HTH	Minhang	HTH	25,470	Baochuang

Source: Savills Research

ratio of 2.5, for 40:60 retail and office use. While most of the projects in HTH are likely to be completed and handed over to tenants in the next 18 months, Qingpu's West Hongqiao business district has just started to kick off. Master planning for the area calls for the development of the 2.5 sq km area between the National Convention & Exhibition Centre and the Shenhai Elevated highway (G15).

## Sales market

### En-bloc

The en-bloc office investment market saw five key deals concluded in Q2/2017, with total consideration reaching RMB8.9 billion, down 25% QoQ.

As the yield for core assets continues to compress, investors, especially core plus funds, increasingly look at value-added opportunities. In the second quarter, AEW Capital Management acquired Innov Tower in Caohejing for RMB1.56 billion from CapitaLand. CapitaLand also announced the acquisition of Guozheng Centre in Wujiaochang for RMB2.64 billion, while Keppel, Alpha and Allianz Insurance purchased SOHO Hongkou in North Bund for RMB3.57 billion.

Limited alternative investment options continued to place downward pressure on yields in

Q2/2017, which fell by 10 basis points (bps) QoQ to 4.8%, while net yields stood at 3.6%.

### Strata-title

No office-titled projects received pre-sales certificates in the second quarter. The near-term is unlikely to see much new strata-title supply as many of the recent land sales prohibit the purchaser from selling them on the strata title market.

Approximately 78,700 sq m of first-hand office space was sold within the Middle Ring Road in the second quarter, down 23% QoQ, while transaction prices averaged RMB66,500 per sq m. There were a number of high-end transactions in prime locations, including Lujiazui and Huaihai Middle Road.

### Market outlook

The city's core office market is expected to receive three new projects in Q3/2017, namely Harbour City (Phase 2) in Lujiazui, and China Overseas International Centre as well as the Haoyuan project in South Huangpu, adding a further 387,500 sq m of office space. However, the new supply is likely to have a limited impact on the area's vacancy rates, due to the high pre-commitment rates and high proportion for self-use.

Office rents are expected to face downward pressure in the coming quarters, with looming supply levels. With an ample selection of new high-quality projects and emerging business areas, as well as a greater variety of flexible office formats for tenants to choose from, landlords will have no choice but to offer rental incentives, more flexible lease terms, or increase agency commissions in order to attract and retain high-profile tenants.

The trend of decentralisation is expected to continue as new emerging business areas grow and mature. Q3/2017 is expected to see more than 602,900 sq m of new Grade A office space handed over onto the decentralised market, of which HTH will account for approximately 60%. The flood of new projects have already, and will continue to cause vacancy rates to increase, limiting future rental growth. However, given the government's support, improving accessibility to the city's more developed office markets, and increasing demand for company headquarter locations and requirements from emerging industries, the long-term development of decentralised areas is positive. ■

TABLE 6  
Notable en-bloc sales deals, Q2/2017

Project	District	Total value (RMB mil)	Unit price (RMB per sq m)	Buyer	Usage
SOHO Hongkou	Hongkou	3,573	51,043	Keppel, Alpha, Allianz Insurance	Lease
Guozheng Centre	Yangpu	2,640	32,713	CapitaLand	Lease
Innov Tower	Xuhui	1,560	38,571	AEW Capital Management	Lease
ASA Building	Jing'an	845	46,827	Cheung Kei Group	Lease

Source: Savills Research

TABLE 7  
Selected first-hand, strata-title sales transactions, Q2/2017

Project	District	Total value (RMB mil)	Transaction GFA (sq m)	Average transaction price (RMB per sq m)
Zhetie Greentown Changfeng Centre	Putuo	Changfeng	2,548	40,500
Greenland Centre, Ph2	Xuhui	Xuhui Riverside	1,043	75,200

Source: Savills Research

## Future Project Highlight

### China Life Insurance Centre (中国人寿金融中心)

China Life Insurance Centre is one of the two Grade A office towers in Harbour City (Phase 2), and is scheduled to hand over in Q3/2017. The project, with an approximate 100,000 sq m of office GFA, was jointly developed by CITIC Pacific and China State Shipbuilding Corporation (CSSC) and bought by China Life in 2015.

Located along the Huangpu River in the city's prime business area of Lujiazui, the project enjoys easy access to the Xinjian Road Tunnel and Lujiazui Metro Station (Line 2).

China Life is expected to use part of the space themselves, though the vast majority will be leased out. Asking rents are estimated to start from RMB12 per sq m per day, while management fees are priced at RMB39 per sq m per month.

Location	Lujiazui, Pudong New Area
Developer	CITIC Pacific, CSSC
Owner	China Life
Handover date	Q3/2017
Office GFA	Approx. 100,000 sq m
Typical floor plate	2,150 sq m
Typical clear ceiling height	Approx. 2.85 m
Asking rent	RMB12-13 per sq m per day
Management company	CITIC Pacific
Management fees	RMB39 per sq m per month



Source: Savills Research

## Definitions

**Core markets:** Prime and non-prime markets.

- Prime markets: Nanjing Road (W), Huaihai Road (M), Lujiazui.

- Non-prime markets: Old Huangpu, South Huangpu, Hongqiao, North Station, North Bund, Zhuyuan, Xujiahui.

**Decentralised markets:** All areas outside of the core markets including: Hongqiao Transportation Hub (HTH), Century Park, Former Expo, Yaohua Pujiang, Qiantan, Xuhui Bingjiang, Minhang, Caojiadu, Zhenru, Wujiachang.

**Rent:** Achievable effective rents for a 500-sq m unit in the mid-zone of an office building signed for a three-year lease.

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