



Office rents fall across the city

Increasing competition from abundant new supply pushed up vacancy rates and convinced landlords to increase concessions.

- Three new office projects were handed over in Q1/2019, two in Pudong plus the ITC phase 2 (G2) in Xujiahui, which was wholly leased to Adidas for its Asia-Pacific and Greater China homecourt office.
- Low pre-commitment rates were recorded in new projects, as economic uncertainties and more availability led to longer decision-making periods from tenants.
- Core and decentralised market rents declined by 0.1% and 0.2%, respectively, in Q1/2019.
- Premium Grade A offices were not immune to rent fluctuations, evidenced by a rental decrease of 0.2% in Q1/2019 to an average of RMB10.68 per sq m per day.
- Tech giants were inclined to relocate staff away from first-tier cities in order to reduce costs and take advantage of the benefit packages that second-tier cities are offering to lure companies.
- As global retail brands continue to expand in the city, so do their office premises. Under Armour leased three whole

office floors in China Overseas International Centre, relocating from a creative park in the same area.

- With several co-working spaces closing locations due to ongoing operational losses or finding it difficult to raise funds, the co-working market is expected to consolidate while newer companies or concepts might rise to the fore.

“Prime Puxi has seen its third consecutive quarter of space being handed back to the market, with landlords losing 12,500 sq m of tenants.”

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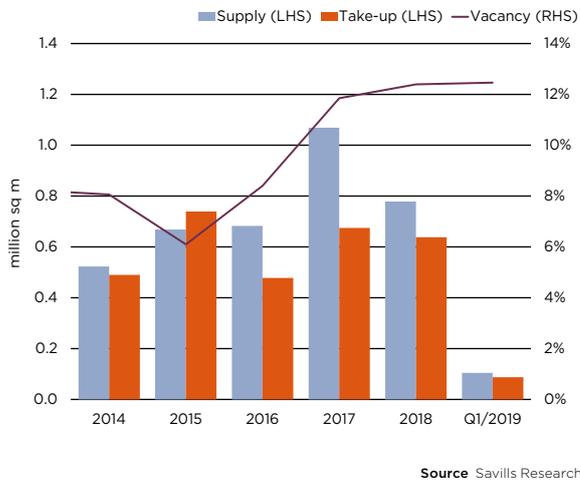
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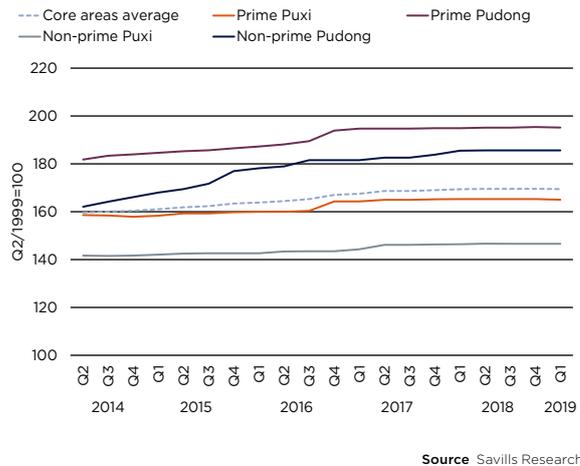
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GRAPH 1: Grade A Office Core Market Supply, Take-up And Vacancy, 2014 to Q1/2019



Source: Savills Research

GRAPH 2: Grade A Office Core Market Rental Indices, Q2/2014 to Q1/2019



Source: Savills Research

CORE MARKET

Three new projects were launched onto the core office market in Q1/2019, adding 104,700 sq m of new office space and pushing the core Grade A office stock up to 8.9 million sq m by Q1/2019. New projects included Ruiming Tower and Foxconn Building in Lujiazui, and ITC Phase 2 (G2) in Xujiahui, which was wholly leased to Adidas.

Net take-up totalled 87,600 sq m in Q1/2019, up 30% quarter-on-quarter (QoQ). Lujiazui contributed over 40% of total market absorption, thanks primarily to two formerly vacant buildings in the Lujiazui Fuhui Tower complex (which was launched in Q3/2018) being leased to Caitong Securities and Essence Securities. By contrast, prime Puxi—including West Nanjing Road and Middle Huaihai Road—saw its third consecutive quarter of space being handed back to the market (-12,500 sq m, Q1/2019) and, consequently, a higher vacancy rate of 11.3%.

Leases from domestic companies accounted for 47% of core transactions recorded in Q1/2019 compared to 60% in Q4/2018, though they still dominated the decentralised market with 56% of leases during the same period. Average vacancy rate rose 0.1 of a percentage point (ppt) in Q1/2019 to 12.5%. Core market rents fell by 0.1% on an index basis in Q1/2019, currently averaging RMB9.01 per sq m per day. Premium Grade A offices, though all are in prime areas, witnessed rental declines of 0.2% in Q1/2019 to RMB11.69 per sq m per day.

DECENTRALISED MARKET

Two new projects were handed over in the decentralised market in Q1/2019, adding 97,500 sq m of new office space. The average vacancy rate in decentralised areas, as a result, increased by 1.9 ppts QoQ to 33.9% in Q1/2019, while rents fell 0.2% on an index basis to an average of RMB5.87 per sq m per day.

Demand was driven mainly by the manufacturing sector, which accounted for 30% of leasing transactions recorded in Q1/2019. Co-working operators continued to expand their businesses but at a slower pace and more

in decentralised areas. Co-working is not only a simple tenant to a landlord but also increasingly a ‘bridge’ between landlord and potential, traditional occupiers. WeWork leased two whole floors in The Springs in Yangpu district, is rumoured as a customised space for Nike, who is a big tenant in this project. Flexible workspace is no longer a disruption; it is a vital part of real estate moving forward.

While most attention in Pudong is focused on Qiantan, the district offers many other master-planned development sites—notably the Former Expo area, just opposite South Huangpu on the other bank of the Huangpu River. Due to limited Grade A office supply, occupancy rates in the area have managed to rise to 88% in Q1/2019, from 69% one year ago. Development of the area is divided into Zone B, as a cluster of central state-owned company headquarters (e.g., COMAC, State Grid, Bao Steel) and where all existing Grade A office stock is located, and Zone A, which targets the financial and power industries. Zone A has around 1.5 million sq m (including above- and underground) of planned GFA, though much of that is likely to be classified as Grade A- or Grade B projects. Three Grade A office projects, totaling 130,000 sq m of new office space, are expected to launch in 2019.

MARKET OUTLOOK

Recent tax reductions (manufacturing industry tax cut from 16% to 13%; transportation and construction industry tax cut from 10% to 9%) will help companies reduce costs and either improve cash flow or allow savings to be passed onto consumers to encourage demand.

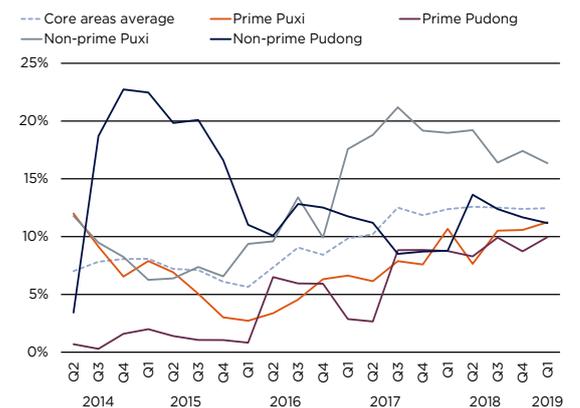
New supply in 2019 is likely to reach the same levels as in 2017, for both core and decentralised markets, with more than one million sq m respectively. Consistently high supply levels have intensified competition for tenants, reduced pre-commitment levels and lengthened the time required for properties to stabilise their occupancy levels. This was evidenced by the relatively low pre-commitment rates seen in most projects launched in the first quarter.

TABLE 1: Notable Leasing Transactions, Q1/2019

TENANT	TENANT INDUSTRY	PROJECT	BUSINESS DISTRICT	LEASED AREA (SQ M)
BD Medical Technology	Healthcare	World Trade Centre	Qiantan	10,000
Under Armour	Retail & Trade	China Overseas International Centre	South Huangpu	6,500
ZC Work	Co-working Spaces	The Gate	HTH	5,200
Farfetch	Retail & Trade	One Museum Place	Nanjing Rd (W)	3,500
ZOJIRUSHI	Retail & Trade	Henderson 688	Nanjing Rd (W)	2,000

Source: Savills Research

GRAPH 3: Grade A Office Core Market Vacancy, Q2/2014 to Q1/2019



Source: Savills Research