



Office rents continue to fall

New supply pushed up vacancy rates to the highest levels in core markets in ten years.

- Two new projects were launched onto the core office market in Q3/2019, adding 227,000 sq m of new office space and pushing core Grade A office stock up to 9.2 million sq m by the end of Q3/2019.
- Net take-up fell by 24% in Q3/2019 to a total of 82,900 sq m, down 32% year-on-year (YoY). Net market absorption in Q1-Q3/2019 totalled 279,200 sq m, down 52% from the same period in 2018.
- Vacancy rates increased by 1.3 percentage points (ppts) in Q3/2019 to 13.2%.
- Core market rents continued to decline, by 0.2% on an index basis in Q3/2019, and currently average RMB8.95 per sq m per day.
- Life Hub @Upbund was handed over in the decentralised market in Q3/2019, adding 14,000 sq m of new office space. Total decentralised stock totalled 4.2 million sq m by the end of Q3/2019.
- Vacancy rates in decentralised areas fell by 1.1 ppts quarter-on-quarter (QoQ) to 28.8% in Q3/2019, while rents fell by 0.7% on an index basis to an average of RMB5.76 per sq m per day.
- Connectivity remains one of the key considerations for tenants seeking office spaces. The divergence in leasing performance between projects with strong transportation connectivity and those without is much more noticeable in decentralised areas.

“Boosted by strong demand from consumer retail companies, West Nanjing Road was the only business area in the city to show rising rents in Q3/2019, up 0.1% to an average of RMB10.24 per sq m per day.”

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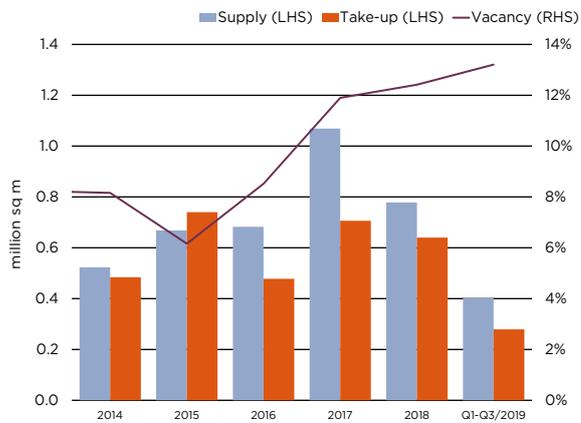
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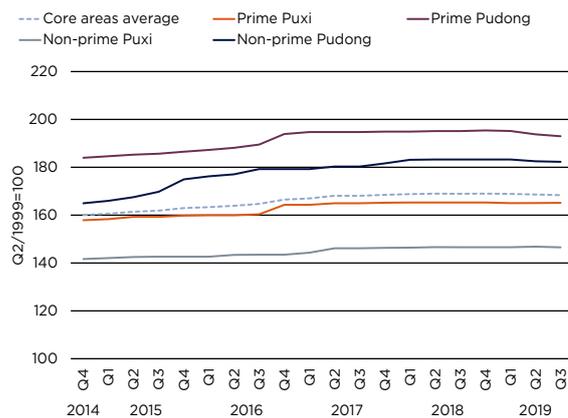
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GRAPH 1: Grade A Office Core Market Supply, Take-up And Vacancy, 2014 to Q3/2019

Source: Savills Research

GRAPH 2: Grade A Office Core Market Rental Indices, Q4/2014 to Q3/2019

Source: Savills Research

CORE MARKET

Two new projects launched onto the core office market in Q3/2019, adding 227,000 sq m of new office space and pushing core Grade A office stock up to 9.2 million sq m by Q3/2019. The new projects were the Kaisa Financial Centre in Pudong and Raffles City The Bund in North Bund, Hongkou.

Net take-up in the core office market fell by 24% in Q3/2019 to 82,900 sq m, of which new projects contributed 16%. Pudong accounted for more than half of the take-up, despite having only a third of the vacant stock.

While the large new supply increased the core market vacancy rate by 1.3 ppts in Q3/2019 to 13.2%, the vacancy rate among existing buildings decreased by 0.8 of a ppt QoQ to 11.2%. This was a result of landlords being forced to adjust rates down to 'rescue' occupancies by offering favourable tenant incentives. With limited office stock, South Huangpu recorded the lowest vacancy rate (3.2%, Q3/2019) in the core market, while North Bund remained the highest (47.9%, Q3/2019) due to increasing stock combined with the slow pace of absorption.

Consequently, core market rents continued to fall by 0.2% on an index basis in Q3/2019, and are currently averaging RMB8.95 per sq m per day. While most core areas were suffering from rental decreases, Nanjing Road (W) was the only business area recording a rental increase of 0.1% in Q3/2019. Huaihai Road (M) and South Huangpu were the other two business areas that managed to escape rental adjustments. Lujiazui, however, recorded the most significant decrease of over 0.4% in Q3/2019 to RMB10.9 per sq m per day—its third consecutive quarterly decline.

DECENTRALISED MARKET

Life Hub @Upbund by Chongbang Group was handed over in the decentralised market in Q3/2019, adding 14,000 sq m of new office space. Total decentralised stock totalled 4.2 million sq m by the end of Q3/2019. Future projects in Q4/2019 will concentrate in the Expo and Houtan areas of Pudong, and Xuhui Riverside in Puxi.

With limited new supply, the decentralised office market continued to absorb existing stock in Q3/2019, though net take-up remained

down YoY by 32%. As demand outstripped supply, the average vacancy rate in decentralised locations fell by 1.1 ppts QoQ to 28.8% in Q3/2019. However, Pudong Expo, East Bund and Changfeng saw tenants move out, with many reductions and relocations recorded during the quarter.

With all landlords aware of the current oversupply situation, they have begun to lower rates and are willing to entertain offers from companies in industries they might not have previously considered. Decentralised office rents fell by 0.7% on an index basis to an average of RMB5.76 per sq m per day.

MARKET OUTLOOK

The city's office market is expected to receive about 1.1 million sq m of new supply in core and decentralised locations in Q4/2019. Ample supply amid weak leasing activity is expected to push vacancy rates up in the remainder of 2019.

Effective office rents will likely continue their downward trend while face rents are expected to remain flat, as landlords tend to offer longer fit-out periods rather than reducing face rents directly.

Although general leasing sentiment is weak, certain sectors such as finance, gaming and specific tech sectors (e.g. AI, 5G, IoT) will continue to fuel demand for office space. There have been several notable leasing transactions in the last couple of quarters from these tenants.

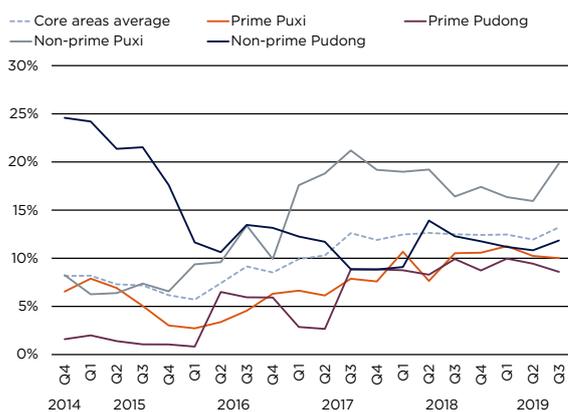
The latest extension of the city's free trade zones to Lingang New Area has brought more preferential policies, including business tax cuts and duty exemptions to attract investments and talent resettlement. Key targeted industries include integrated circuits, AI, biomedicine, civil aviation and smart manufacturing.

As the first Chinese city to introduce guidelines for the Foreign Investment Law, Shanghai will remain a major investment hub in the country.

Definitions

Core prime: Nanjing Road (W), Huaihai Road (M), Lujiazui
Core non-prime: Old Huangpu, South Huangpu, Hongqiao, North Station, North Bund, Zhuyuan and Xujiahui.

Decentralised markets: All areas outside of the core markets including: Changfeng, Hongqiao Transportation Hub, Xuhui Riverside, Xinzhuang, Zhenru, Wujiachang, Former Expo, Qiantan, Houtan and Huamu.

GRAPH 3: Grade A Office Core Market Vacancy, Q4/2014 to Q3/2019

Source: Savills Research

TABLE 1: Notable Leasing Transactions, Q3/2019

TENANT	TENANT INDUSTRY	PROJECT	BUSINESS DISTRICT	LEASED AREA (SQ M)
Union Pay	Finance	Lujiazui Century Financial Plaza	Zhuyuan	20,000
Bayer	Healthcare	New Bund Times Square	Qiantan	12,000
Johnson Controls	Manufacturing	SOHO Gubei	Hongqiao	3,400
Ping An Puhui	Finance	Taikang Insurance Building	Zhuyuan	2,000
Clarins	Retail & Trade	Park Place	Nanjing Road (W)	1,000

Source: Savills Research