MARKET IN MINUTES
Savills Research

Office

Vacancy rates continue to rise

Recovery in net take-up attributed to self-use projects .

- Seven new projects comprising a total of 636,000 sqm were completed in Q1/2024, contributing to a cumulative stock of 19 million sqm by the quarter's end.

- The substantial influx of new supply at the beginning of the year resulted in the citywide vacancy rate increasing 1.0 ppt QoQ to 21.7%. Ten out of the 26 submarkets, however, observed vacancy rate decreases.

- Net absorption reached 300,144 sqm in Q1/2024, up 87.0% from the quarterly average of 2023. Net take-up figures were greatly inflated by the occupation of a 195,000 sqm self-use building.

- There were a number of notable expansion or consolidation deals during this quarter, with some companies prioritizing new projects offering lower prices (same area, building age under five years).

- The office leasing demand from the automobile manufacturing sector, including both cars and parts, remained active in Q1/2024. Car brands consider the proximity to delivery centres, ease of business travel, and ongoing support from authorities when considering office locations. (Notable moves: Li Auto, Changan Auto opening their offices, Volkswagen expanded office space in HTH)

- Grade A office rents declined 2.6% on an index basis in Q1/2024, averaging RMB6.6 per sqm per day. Prime, non-

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 East Bund, Changfeng, Hongqiao Transportation Hub, Xuhui Riverside, Xinzhuang, Zhenru, Wujiaochang, Former Expo, Qiantan, Houtan and Huamu.

> "Incentivized by steeper discounts, hesitant firms are more likely to finalize leasing decisions. Additionally, the expiration of several large tenant leases is expected to boost activity and help clear a backlog of deals."

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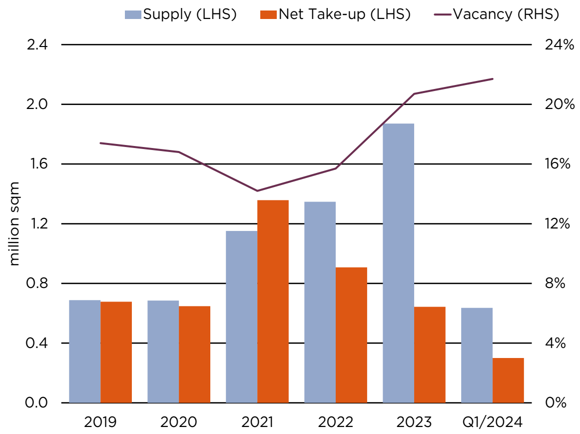
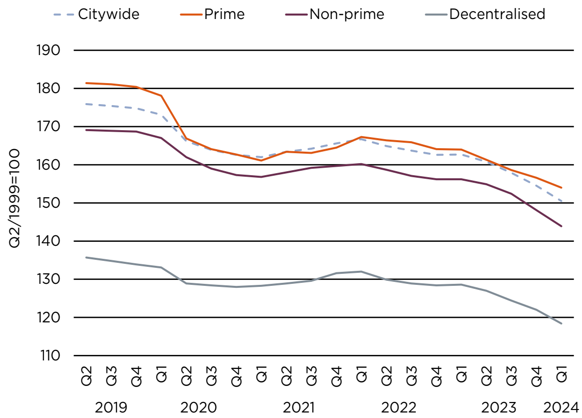
GRAPH 1: Grade A Office Overall Supply, Take-up And Vacancy, 2019 To Q1/2024



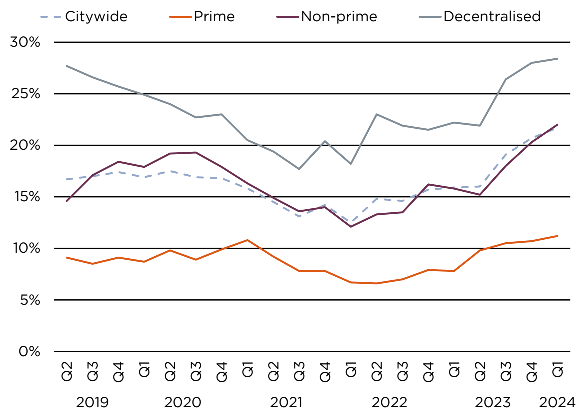
Source Savills Research

GRAPH 2: Grade A Office Rental Indices, Q2/2019 To Q1/2024



Source Savills Research

GRAPH 3: Grade A Office Vacancy, Q2/2019 To Q1/2024



Source Savills Research

MARKET OVERVIEW

Numerous significant leases signed in 2021 are set to expire this year, potentially leading to market disruptions, and prompting landlords to adjust their leasing approaches. Some companies are moving to self-owned properties, while others are consolidating smaller offices scattered across multiple districts into a single central headquarters. Landlords with substantial vacant spaces face considerable pressure and continue to offer rental discounts and tenant incentives to enhance occupancy rates. Landlords in core areas are highly engaged in marketing their properties and are offering significantly more generous discounts than just six months ago.

SUPPLY AND DEMAND

Seven new projects, totalling 636,600 sqm, were launched in Q1/2024, with decentralized areas accounting for 66.0% of the supply. Notable projects launched in Q1/2024 include Golden Square (Nanjing Rd (W)), Greenland Bund Centre T3 (Old Huangpu), TikTok New Jiangwan Square (Self-use), AXIOM T1 (Wujiaochang), Foresea Life Building (North Bund), Yi Fung Centre (Hongqiao), and Vanke Xuhui Ph3 T3-T6 (Xuhui Binjiang).

There has been an increase in site inspections and lease inquiries over the last quarter, although some of these are speculative, and those that are not may still take time to materialize into deals. Many of these transactions are unlikely to result in a net increase in occupied space, as new office spaces tend to be of similar or even smaller size than previous premises. Net take-up totalled 300,144 sqm in Q1/2024, marking an 87.0% increase compared to the quarterly average in 2023, largely due to TikTok's self-use project handover included in the calculations. Excluding self-use take-up, the most active submarkets were Xuhui Binjiang, Zhenru, and the North Bund.

The tenant-oriented market is expected to persist for 2-3 years, with large tenants able to secure significant rental savings through early negotiations, especially in projects expected to be completed in the next year or two and seeking key anchor tenants. Smart landlords of new buildings aim to secure tenants early, as market conditions may take time to improve, and it is advantageous to have a base occupancy rate at handover. The ability to secure contiguous floors in a new building is another advantage, which may not be possible in older developments. However, there is a risk of completion delays, which may necessitate short-term renewals.

Traditional industries continue to dominate the leasing market, with the manufacturing sector accounting for 27.0% of recorded transactions in Q1/2024, followed by finance (17.0%) and healthcare (14.0%). The share of leases signed by multinational corporations (MNCs) was above the average for 2023, accounting for 49.0% of leased area in Q1/2024, mostly as a result of relocations.

VACANCY AND RENTS

Despite an improvement in net take-up, the large new supply in Q1/2024 resulted in the citywide vacancy rate increasing by 1.0 percentage points to 21.7%, up 5.8 percentage points year-on-year. Excluding self-use developments, the vacancy rate would be even higher at 23.0%, with 4 million sqm of Grade A office space currently vacant.

Grade A office rents fell by 2.6% on an index basis in Q1/2024, with rates averaging RMB6.6 per sqm per day. Prime, non-prime, and decentralized markets experienced decreases of 1.6%, 2.8%, and 2.9%, respectively.

MARKET OUTLOOK

An additional 456,000 sqm of new supply is expected to be handed over in Q2/2024, bringing the total new supply in the first half of the year to over one million sqm. Given the lacklustre demand, the citywide vacancy rate is expected to continue to rise with the scheduled handover of new supply.

Average Grade A office rents are now 9.1% lower than three years ago (typical lease tenure). Tenants exploring options are likely to find deals in their current project or nearby for 20-30% less than they are currently paying. The potential savings are now significant enough for tenants to consider relocating to secure the best deal, potentially increasing market activity.

At present, the market is testing the owners' asset management capabilities. Landlords not only need to address vacant spaces returned by tenants, leasing strategies for low zones, and smaller units but also consider value-added services to offer and how to pay for them. Landlords with significant exposure to tenants from a single industry should also be cautious of policy risks affecting their tenants and the potential impact on their leasing outlook.

TABLE 1: Notable Leasing Transactions, Q1/2024

TENANT	TENANT INDUSTRY	PROJECT	BUSINESS DISTRICT	LEASED AREA (SQ M)
Li Auto	Manufacturing	The Hub Ph2	HTH	20,000
HZ Bank	Finance	Sino-American Finance Building	North Bund	15,000
Panasonic	Manufacturing	Corporate Avenue Ruihong	North Bund	10,000
Chagee	Consumer Services	Hongqiao United Centre	Caojiadu	8,800
J Tree Work	Business Centres & Co-working Spaces	Guohua Financial Centre	North Bund	5,700

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