Leasing activities recover

Site inspections pick up in the second quarter, though it will still take time to translate into transactions.

- Shanghai's actual FDI increased by 4.5% year-on-year (YoY) in the first five months of the year, with the city remaining one of the most attractive investment destinations in China.
- Some companies are stepping up cost control measures including layoffs, other fixed cost reductions and surrendering office space.
- Just two projects, 104,800 sq m, were handed over in 1H/2020. However, another 784,100 sq m is scheduled to launch in the remainder of 2020, bringing total Grade A office stock to 14.2 million sq m.
- Leasing activities picked up in Q2/2020, though net take-up totalled just 14,200 sq m, compared to 150,000-200,000 sq m in a typical quarter. Only half of the 25 business areas recorded positive net take-up in Q2/2020.
- Citywide Grade A office rents fell 4.0% in Q2/2020, the worst quarterly performance since the Global Financial Crisis, while the citywide vacancy rate rose by 0.5 of a percentage point (ppt) to 17.4%.
- Demand decentralisation continues as companies look to reduce mid-to-long-term operational costs. Leading decentralised locations saw vacancy rates fall in Q2/2020 due to lack of supply and good demand, such as Qiantan (-1.5 ppts), Houtan (-2.5 ppts), and HTH (-1.6 ppts).

“Despite contracting by 6.7% in the first quarter, the city’s economy has shown signs of a rebound in activity and is still expected to record full-year growth as businesses get back to normal and the government lends a helping hand.”

JAMES MACDONALD, SAVILLS RESEARCH

Definitions
- Core prime: Nanjing Road (W), Huaihai Road (M), Lujiazui.
- Core non-prime: Old Huangpu, South Huangpu, Xujiazui, North Station, North Bund, Zhujian and Xujiahui.
- Decentralised markets: All areas outside of the core markets including Changfeng, Hongqiao Transportation Hub, Xuhui Riverside, Xinzhuang, Zhouzhu, Wujiangchong, Former Expo, Qiantan, Houtan and Huamu.
MARKET OVERVIEW

Two new Grade A office projects, Expo Riverfront Centre (North Tower) and Lujiazui Riverside Centre (Th), were handed over in Q2/2020, adding a total of 104,800 sq m of office space to the market. Several other projects were postponed amid continued uncertainties and weak leasing sentiment. The city’s Grade A office stock totalled 13.4 million sq m by the end of Q2/2020.

The Expo Riverfront Centre is located on the former Puxi Expo site in Huangpu District with easy access to Xizang Road (S) metro station (Line 4, Line 8). The 46,800 sq m North tower was handed over while the South tower is still under construction and scheduled for completion in 2021.

Leasing activity picked up in Q2/2020, though net take-up totalled just 14,200 sq m, compared to 190,000-200,000 sq m in a typical quarter. Prime areas saw 44,100 sq m of space handed back to the market, though financial institutions and law firms continued to expand in Lujiazui, such as Zhenghan Law Firm’s 2,400 sq m in Ruiming Tower. Strong demand from the consumer sector allowed Nanjing Road (W) to record an expansion in demand, such as L’Oréal’s lease of the entire 23,000 sq m of Jing’an Baohua Centre.

Rising demand from certain sectors and companies, unfortunately, was offset by the fact that a number of companies were looking to downsize operations or, in some cases, looking to shut down operations completely, though these were primarily smaller wealth management and consulting enterprises. This, combined with the addition of new space handed back to the market, though financial institutions and law firms continued to expand in Lujiazui, such as Zhenghan Law Firm’s 2,400 sq m in Ruiming Tower. Strong demand from the consumer sector allowed Nanjing Road (W) to record an expansion in demand, such as L’Oréal’s lease of the entire 23,000 sq m of Jing’an Baohua Centre.

As landlords continued to increase rental concessions, Grade A office effective rents fell by 4.0% in Q2/2020 on an index basis, to an average of RMB75 per sq m per day. Face rents remained roughly the same while landlords offered more rent-free and fitout subsidies. Larger anchor tenants, in particular, were offered more favourable terms and bigger discounts.

The last six months have been a challenging time for landlords and tenants alike. Landlords need to prioritise communication and tenant relationships to avoid tenant losses while also working closely with property management teams to ensure health and safety standards and quality services. Landlords that prioritise management abilities should come out of this period in better shape than others. Tenants should take the opportunity to reassess their corporate real estate footprints by identifying new ways of working for their organisation, new opportunities in the market and trying to lock in cost savings for the mid-to-long-term. For some, this may be looking at decentralised locations, consolidation of office locations or adopting more agile workplaces with both core and flex space.

MARKET OUTLOOK

About 784,100 sq m of new office space is scheduled to launch in 2H/2020, including a 260,000- sq m self-use project. Demand is expected to recover as economic clarity and confidence improve, and as government support starts to bear fruit and office costs become more affordable.

Demand from certain sectors such as healthcare, financial and IT/tech sectors will be boosted in the long run, while companies in industries such as mass-market consumer and hospitality prioritise cutting costs, placing downward pressure on occupancy rates and rents in areas where they tend to cluster.

Co-working operators affected by lockdowns in the first quarter are witnessing a rebound in demand as business activity picks up and firms (big and small) look to capitalise on the flexibility of the no-fit-out cost offered by flexible space operators. Stronger operators are also looking to take over space from weaker peers while also reaching out to new landlords that need to fill their office building to secure favourable lease/management/profit share agreements.

Shanghai is stepping up efforts to boost the development of the 873 sq km Lingang Special Area, as evidenced by more favourable measures in recent months, covering talent retention, taxation, housing, land planning, industrial clusters, transportation networks and urban public services. These preferential policies and innovations have already prompted some companies to establish their business in the area, though it may still take years for the area to mature.

Lingang’s development, together with the accelerating expansion of the Yangtze River Delta (YRD) economic cluster, will certainly attract more domestic and international enterprises to establish/expand businesses in the Shanghai market.

TABLE 1: Notable Leasing Transactions, Q2/2020

<table>
<thead>
<tr>
<th>TENANT</th>
<th>TENANT INDUSTRY</th>
<th>PROJECT</th>
<th>BUSINESS DISTRICT</th>
<th>LEASED AREA (SQ M)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PwC</td>
<td>Commercial &amp; Professional Services</td>
<td>New Bund Centre</td>
<td>Qiantan</td>
<td>30,000</td>
</tr>
<tr>
<td>Ningbo Commerce Bank</td>
<td>Finance</td>
<td>Lujiazui Riverside Centre</td>
<td>Yangqiao</td>
<td>10,000</td>
</tr>
<tr>
<td>Takeda</td>
<td>Healthcare</td>
<td>World Trade Centre</td>
<td>Qiantan</td>
<td>8,500</td>
</tr>
<tr>
<td>Yitu Tech</td>
<td>IT</td>
<td>Al Tower</td>
<td>Xuhui Riverside</td>
<td>2,000</td>
</tr>
<tr>
<td>Pop Mart</td>
<td>Retail &amp; Trade</td>
<td>Grand Gateway</td>
<td>Xujiahui</td>
<td>700</td>
</tr>
</tbody>
</table>

Source: Savills Research