Office

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Demand roars back to life in Q2

Net office take-up jumps to 410,900 sq m, the highest in over three years.

- Four new projects (258,300 sq m) were launched onto the market in Q2/2021, bringing the overall stock to 14.3 million sq m. The new projects have attracted a number of high-profile companies covering financial, manufacturing, IT, retail and trade sectors.
- Pent up demand was released in the second quarter with net office take-up more than doubling to 410,900 sq m.
- With demand outstripping supply, the citywide vacancy rate fell 1.3 percentage points (ppts) in Q2/2021 to 14.5%.
- Vacancy rate declines were recorded in the majority of the city's business areas, with the exception of areas where new projects were launched.
- Financial companies remained active, accounting for a third of recorded leasing transactions in 1H/2021. Media and entertainment companies accounted for 14% in the first half, up from just 4% in 2020, as the content creation industry thrives.
- Grade A office rents recovered 0.8% on an index basis in Q2/2021, averaging RMB7.3 psm pday.
- Flexible space providers look to differentiate themselves in an increasingly competitive market, adding amenities and services ranging from relaxation rooms to health clinics and tech support.

"New projects prioritise design, sustainability and wellness as occupiers demand a better environment for their staff and consider business operations' environmental impact."

JAMES MACDONALD, SAVILLS RESEARCH

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, Wujiaochang, Former Expo, Qiantan, Houtan and Huamu.

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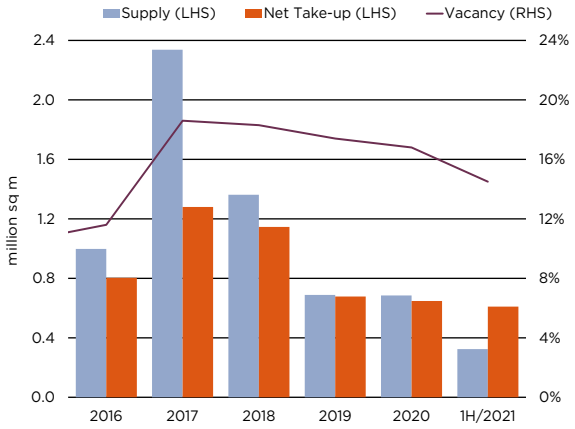
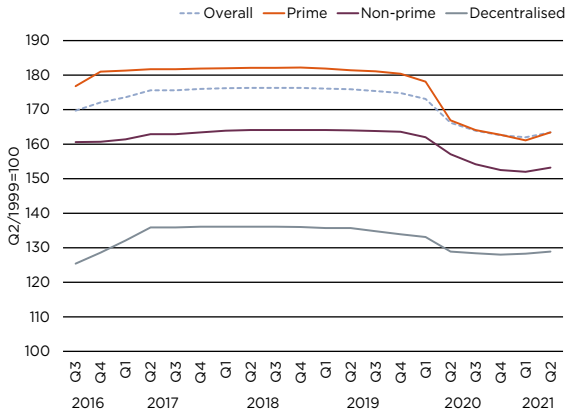
GRAPH 1: Grade A Office Overall Supply, Take-up And Vacancy, 2016 to 1H/2021



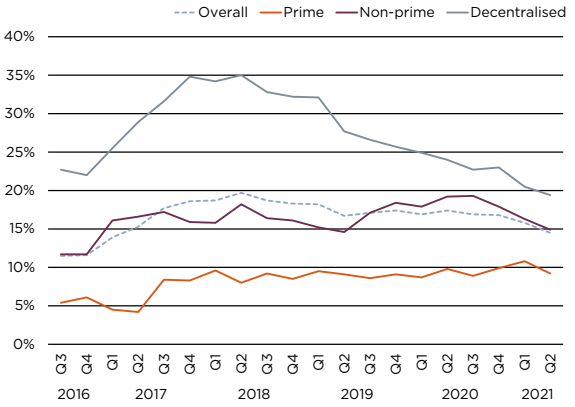
Source Savills Research

GRAPH 2: Grade A Office Rental Indices, Q3/2016 to Q2/2021



Source Savills Research

GRAPH 3: Grade A Office Vacancy, Q3/2016 to Q2/2021



Source Savills Research

MARKET OVERVIEW

Shanghai's economy continued to show signs of improvement from the start of the year, attracting MNCs regional HQs and R&D centres such as ABB and PepsiCo. Shanghai's actual FDI grew by 21.5% in the first five months of 2021, while revenues from services enterprises above designated size (>RMB5-20 mn annual income) grew by 34.8% during the same period.

Four new projects were completed in Q2/2021, namely: JC Plaza in Nanjing Road (W) converted from the JC Mandarin Hotel, The Roof in South Huangpu by Henderson and CIFI, CMG Shanghai (F1&L1) in Xuhui Riverside by China Media Group and the 126,000-sq m SK Tower in Houtan. The new projects have attracted a number of high-profile companies, with Dior occupying 6,000 sq m in the JC Plaza, Hyundai leasing 6,500 sq m in The Roof, Junzheng Group taking up 5,000 sq m in the SK Tower, and Visionary Media leasing 2,300 sq m in the CMG Shanghai (F1).

The office market continued to gain momentum, outperforming expectations in the second quarter. Net take-up, driven by strong demand from financial, retail, tech and commercial services sectors, was double that of new supply in Q2/2021, pushing vacancy rates down to 14.5%. Landlords regained some of their former confidence and have started to increase rents and/or reduce incentives, especially in sought-after locations such as Nanjing Road (W) [+4.5%] where demand was predominantly boosted by consumer goods companies, and East Bund [+2.5%] where occupancy rates continued to improve.

The recent crackdown on the online education sector has been reflected in their office premises. Online education firms such as Tencent-backed Yuanfudao has downsized office spaces in Shanghai while looking to sublet premises in second-and third-tier cities. Meanwhile, Tutor ABC (former Vipabc) handed back 15,000 sq m of space in Yangpu. While several tech-driven companies are slowing their pace of growth due to tightening regulations, many are still aggressively expanding their businesses, and this is translating into new office demand. Latest examples include ByteDance's acquisition of 195,000 sq m of office space in Tishman Speyer's The Springs in New Jiangwan Town, not counting its previous 150,000+ sq m leased office space in the city. Industry clustering, government incentives and access to talent and markets are just some of the reasons why these tech companies are establishing a larger presence in the city, with other recent examples including Meituan and Bilibili.

Grade A office rents recovered 0.8% on an index basis in Q2/2021, with rates averaging RMB7.3 psm pday. The rental increase was primarily driven by Puxi areas (+2.0%, Q2/2021) underpinned by stronger absorption levels. Currently, prime office rents stood at RMB9.6 psm pday, non-prime at RMB7.2 and decentralised at RMB5.5. Nanjing Road (W) remained the most expensive business area in the city standing at RMB10.3 psm pday, followed by Lujiazui (9.4) and Huaihai Road (M) (9.2).

MARKET OUTLOOK

An additional one million sq m of office space is scheduled to launch in 2H/2021, of which three quarters will be in decentralised locations. While core locations remain attractive to high-profile tenants, the decentralised market now accounts for an increasing share of the market. Having a third of total office stock (which might enlarge to 35% by 2023F), decentralised areas contributed nearly 60% of net take-up in 1H/2021, compared to 40% in 2016. Qiantan, Xuhui Riverside and HTH contributed over 60% of decentralised take-up in 1H/2021.

As China enhances supervision of the online services sector, market reshuffles and consolidation are expected in the foreseeable future to guarantee the healthy and orderly growth of the industry. The recent crackdown comes after authorities targeting fintech firms to ensure the stability of the financial system, ecommerce and other platforms for anti-competitive practices, and other firms for poor data practices.

While demand from several tech companies may slow as greater regulatory oversight slows growth rates, the financial sector continues to open up, with the latest example being the launch of Blackrock's first mutual fund product.

TABLE 1: Notable Leasing Transactions, Q2/2021

TENANT	TENANT INDUSTRY	PROJECT	BUSINESS DISTRICT	LEASED AREA (SQ M)
SPD Bank	Finance	Raffles City The Bund	North Bund	25,000
Shanghai Nanhongqiao Investment	Real Estate	Lihpao Plaza	HTH	12,000
Dentons	Professional Services	Shanghai World Financial Centre	Lujiazui	10,000
Amazon	Retail & Trade	New Bund Centre	Qiantan	9,900
Sina News	Media & Entertainment	BFC	Old Huangpu	5,000

Source Savills Research