

**MARKET
IN
MINUTES**

Savills Research

Office

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Vacancy rates fall

Fully occupied new supply drags vacancy down, but general leasing activity remains weak.

- Shanghai University of Finance and Economics (SUFE) Investor Confidence Index continued to fall in Q3/2022 to 102.5, a figure above 100 that indicates optimism and thus signifies that firms remained positive despite challenges.
- Two projects, or 95,900 sqm of office space, were handed over in Q3/2022, pushing the city's stock to 16.0 mn sqm.
- Net take-up totalled 112,900 sqm in Q3/2022, down 58% QoQ and 67% YoY.
- The citywide vacancy rate fell 0.2 ppt in Q3/2022 to 14.6%, thanks to high occupancy in the new projects.
- Grade A office rents fell 0.8% on an index basis in Q3/2022, with rates averaging RMB7.2 psm pday. Prime, non-prime and decentralised rents fell 0.3%, 1.0% and 0.8%, respectively.
- While many companies tend to renew existing leases and are looking to restrict non-essential expenditures, some growth occupier segments continue to expand, such as advanced manufacturing, financial, retail and healthcare.

“While international brands are well established in the China market, the rise of Guochao (国潮) brands represents a change in Chinese consumers' habits that has translated into increasing office demand from these domestic brands.”

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

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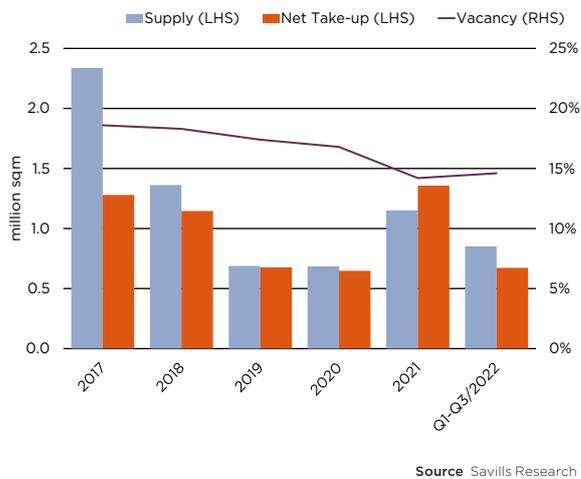
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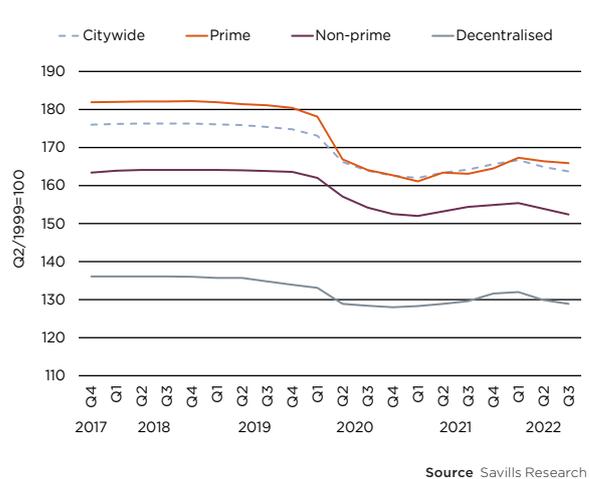
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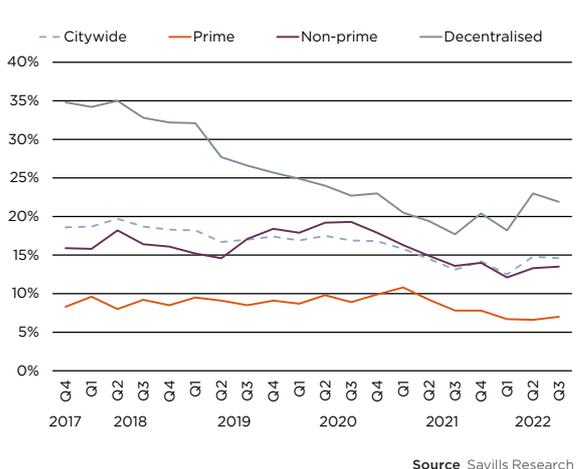
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GRAPH 1: Grade A Office Overall Supply, Take-up And Vacancy, 2017 To Q3/2022

Source Savills Research

GRAPH 2: Grade A Office Rental Indices, Q4/2017 To Q3/2022

Source Savills Research

GRAPH 3: Grade A Office Vacancy, Q4/2017 To Q3/2022

Source Savills Research

MARKET OVERVIEW

The overall leasing sentiment remained weak in Q3/2022 with limited project inspections and a few firms downsizing or terminating leases. Firms are also looking to reduce CAPEX when relocating by considering furnished and fitted-out office space when previously, they would only have considered bare shells. The government continues to do its part in stimulating the economy, including extension or expansions of previous supportive measures (tax relief, subsidies or reward and fee reductions), proactively seeking foreign investment, increasing infrastructure spending and boosting specific industries (e.g. consumer services, aviation, advertising, and advanced manufacturing).

SUPPLY AND DEMAND

Two Grade A office projects were handed over in Q3/2022, adding 95,900 sqm of office space to the market. The 52,900 sqm Bank of Shanghai Building located in the Old Huangpu or Dongjiadu area is currently self-use whilst the 43,000 sqm Norbu Centre in Xuhui Binjiang was wholly leased by Tencent. The overall stock was pushed up to 16.0 mn sqm by the end of the quarter.

Net take-up totalled 112,900 sqm in Q3/2022, down 58% QoQ and 67% YoY. Excluding the 95,900 sqm net absorption contributed by new projects, the market absorbed just 17,000 sqm in the third quarter.

New energy vehicles play an important role in the automobile industry (Sep 2022 sales was 708,000 out of 2.6 mn) and in meeting the city's green goals. Also, homegrown brands are going toe to toe with international firms, with BYD sales exceeding Tesla in China, and plans to increase capacity and expand into overseas markets. This has translated into more demand in the office market, with the latest examples including Zeeker taking up 22,000 sqm in Xuhui Binjiang (Q3/22), and Hozon Auto leasing 40,000 sqm in Changfeng (Q2/22), whilst BYD is said to seek for 10,000 sqm office space in the city.

Another key growth segment is domestic consumer companies, especially in the fashion, cosmetics and food industries. While global retailers have become cautious when it comes to the China market,

emerging and rapidly growing domestic brands which offer value for money and patriotic designs are looking to steal market share by expanding operations, taking more space for workstations, live streaming studios, and others. Notable leases in Q3/2022 included: Team China leasing 1,400 sqm in Yangjing, and Unifon leasing 700 sqm in Huaihai Road (M).

VACANCY AND RENTS

The citywide vacancy rate fell 0.2 ppt in Q3/2022 to 14.6%, thanks to high occupancy in the new projects. However, it will likely trend up again given the 1.9 mn sqm per annum supply in the next three years.

Grade A office rents fell 0.8% on an index basis in Q3/2022, with rates averaging RMB7.2 psm pday. Huaihai Road (M), Nanjing Road (W) and Wujiaochang bucked the trend with rents increasing by 0.1%, 0.1% and 0.3%, respectively. Currently, prime office rents fell to RMB9.8 psm pday, non-prime at RMB7.1 and decentralised at RMB5.4.

MARKET OUTLOOK

As a result of project delays, supply for Q4/2022 is forecast to reach just 142,400 sqm, in three projects: Expo Riverside Dingbo (South Huangpu), New Bund International Square (Qiantan) and IGC Shanghai T3 (HTH).

Companies are likely to prefer renewing existing leases until business leaders have a clearer picture of the future economic situation. Demand from large companies in traditional or pillar industries will remain stable, whilst SMEs are likely to wait and see with less possibility of expanding this year.

Unless demand increases significantly in Q4/2022, rents are unlikely to rebound in the final quarter as vacancy rates remain high.

The government continues to play an active role in industry planning and brokering of real estate deals to create industry clusters and business synergies while also providing support and incentives to key businesses. Many clusters are already well established with submarkets such as Nanjing Road (W) and Wujiaochang, known as retail and IT clusters, recording improving occupancy and rising rents in Q3/2022.

TABLE 1: Notable Leasing Transactions, Q3/2022

TENANT	TENANT INDUSTRY	PROJECT	BUSINESS DISTRICT	LEASED AREA (SQ M)
Jike Offices	Co-working & BC Spaces	Upper West	Zhenru	11,000
Longcheer	IT	Westlink	Xinzhuang	10,000
Zhonghai Trust	Finance	One East	South Huangpu	8,200
Jingsh Law Firm	Professional Services	Financial Street Hailun Centre	North Bund	4,500
Kinlita Enterprise	Manufacturing	World Trade Centre	Qiantan	2,000

Source Savills Research