

**MARKET
IN
MINUTES**

Savills Research

Office

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Leasing activity increases

Market sentiment has improved on the back of more leasing activity but a full recovery in demand will take time.

- The government extends and improves preferential tax and fee policies for smaller companies in an attempt to stabilize business expectations and bolster confidence.
- Three new projects totalling 319,300 sqm were delivered in Q1/2023, pushing the overall stock up to 16.8 mn sqm by the end of the quarter.
- Net absorption totalled 241,800 sqm, down 17% YoY but still higher than 2022's quarterly average (227,000 sqm).
- Ample supply and weak demand in decentralized locations kept the citywide vacancy rate elevated at an average of 15.9%, up 0.2 ppt QoQ and 3.4 ppts YoY.
- Rental increases in leading projects offset declines in underperforming assets, resulting in unchanged Grade A office rents in Q1/2023.
- China's recognition of data as a new factor of production and promotion of data economy has spurred the development of a raft of new companies, resulting in a number of notable leases.

“The removal of zero COVID policies allows local businesses to reconnect regional/global HQs, and to rethink real estate strategies including reviewing existing lease conditions and office reconfiguration.”

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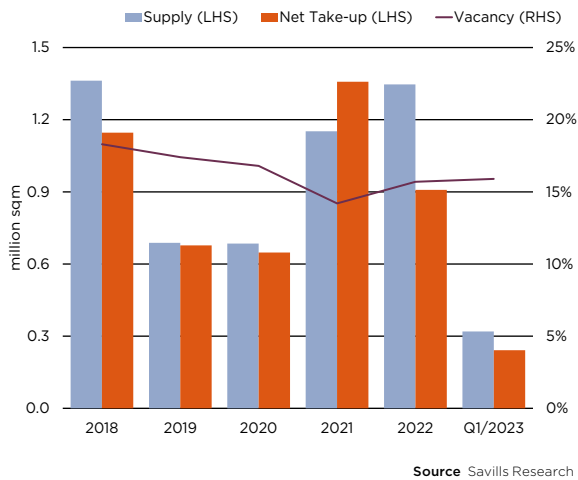
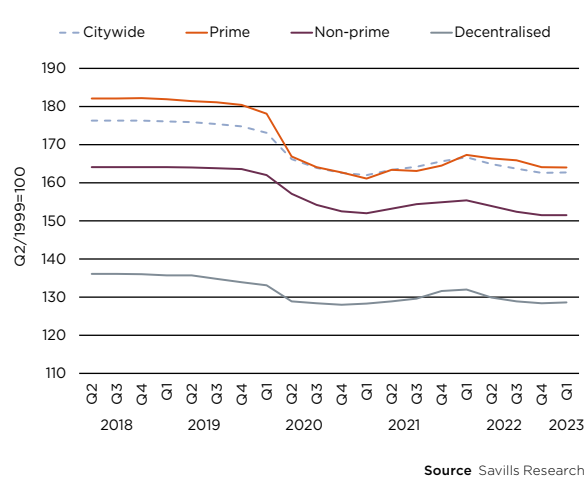
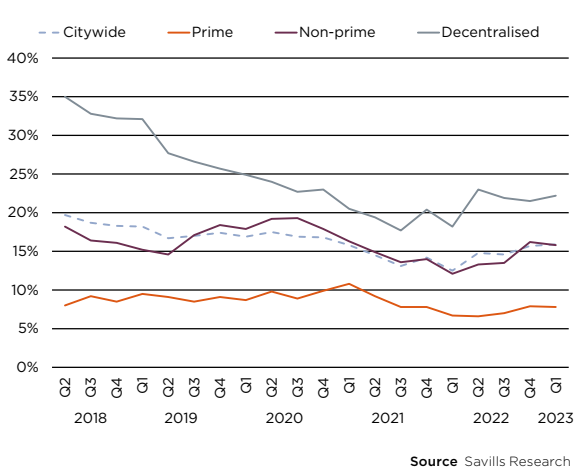
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Definitions

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.

GRAPH 1: Grade A Office Overall Supply, Take-up And Vacancy, 2018 To Q1/2023**GRAPH 2: Grade A Office Rental Indices, Q2/2018 To Q1/2023****GRAPH 3: Grade A Office Vacancy, Q2/2018 To Q1/2023****MARKET OVERVIEW**

As business activities return to normal, office demand starts to pick up. Lease enquiries and site inspections have increased significantly. Firms are now reviewing their real estate needs and strategies, but remain cautious and look to conserve capital, which means it will take time to translate into final transactions. A large proportion of deals concluded in the first quarter involved consumer-focused companies (up 5 ppts) with many being expansions. At the same time, international firms also remained active, accounting for 3 ppts more of recorded lease transactions, particularly from the retail, finance and professional service sectors.

SUPPLY AND DEMAND

Three newly completed projects were handed over in Q1/2023, adding 319,300 sqm of office space to the market. The new projects include Skyline Tower in North Station (a redevelopment project previously known as Zhabei Square), Greenland Bund 1558 in Yangjing (80% occupied by China Zheshang Bank) and T Centre in Zhenru.

Developed by CITIC Pacific Properties, T Centre is a mixed-use complex consisting of five (incl. two high-rises) office towers (186,800 sqm), retail space (60,000 sqm), a business hotel, and 13 business mansions for sale. The project has direct access to Meiling North Road metro station (Line 15) and has attracted both domestic and international firms looking to upgrade their office premises such as eHi Car Services (acquired 16,000 sqm) and Perfetti Van Melle. Retail amenities expected to open in Q3/2023 will improve the overall commercial atmosphere.

Companies are generally waiting to see how quickly and to what extent the economy and their industries recover. Nevertheless, net take-up increased 3% in Q1/2023 to 241,800 sqm but remained down 17% from a year ago.

VACANCY AND RENTS

Due to the supply influx, the citywide vacancy rate increased by 0.2 ppt in Q1/2023 to 15.9%, up 3.4 ppt YoY. Grade A office

rents remained stable, with rates averaging RMB7.1 psm pday. Leading projects that have been able to achieve higher occupancy rates have raised their rental expectations after recording an increase in enquiries. Meanwhile, other landlords are still trying to retain tenants and fill up their buildings by providing greater lease flexibility and offering extra perks such as the use of retail spaces for showrooms.

MARKET OUTLOOK

The beginning of the year saw the resumption of a number of project construction, as the government's priorities shifted from zero COVID to economic growth and business resumption. Supply remains abundant in 2023 with 1.2 mn sqm expected to be handed over in the remainder of the year while averaging 1.6 mn sqm per annum from 2024-2026, bringing total city stock to 23 mn sqm.

As a change in business sentiment and leasing intentions takes time to translate into signed leases, net take-up will likely pick up in the second half of 2023. Nevertheless, the majority of landlords will focus on maintaining/improving occupancy rates given the ample supply this year, with average achievable rents unlikely to record a meaningful recovery in the short term.

Over the last three years (the typical lease term), office rents in highly sought-after locations such as Qiantan and Nanjing West Road will leave the tenants with the prospect of either having to renew at higher rents than what they are currently paying (maybe even reaching the rent growth cap in some cases), or having to find new premises. With citywide vacancy rates at multi-year highs, tenants are not short of options, but it may lead to relocating to another submarket that may be unpalatable for some. Those choosing to stay may be forced to consider implementing space efficiency measures such as hot desking and bifurcation. In some cases, there may be the option of leasing excessive space in owner-occupied buildings where the landlord currently does not require the whole development.

TABLE 1: Notable Leasing Transactions, Q1/2023

TENANT	TENANT INDUSTRY	PROJECT	BUSINESS DISTRICT	LEASED AREA (SQ M)
Heath 100	Consumer Services	Financial Street Hailun Centre	North Bund	6,100
Shanghai Pharma	Healthcare	Lumina Shanghai	Xuhui Binjiang	3,000
Omron	Manufacturing	New Bund Shun Tak Cultural Centre	Qiantan	2,800
Balenciaga	Retail & Trade	One Museum Place	Nanjing Rd (W)	2,270
Cargopro	Transportation	Ruihong Corporate Avenue	North Bund	1,200

Source: Savills Research