



# Office



## Weak office leasing demand

Lacklustre leasing activity needs time to recover.

- One 50,000-sqm project was delivered in Q2/2023. A further 870,000 sqm is planned for the second half of the year, bringing total stock to 17.7 mn sqm by year end.
- Leasing activity was slow in Q2/2023, with 7,400 sqm of space handed back to the market. Non-prime areas however recorded 42,000 sqm of net take-up.
- Despite a recovery in economic activity from the lows seen in 2022, leasing activity hasn't significantly improved. Occupiers are reviewing options, but few of them are converting to new leases or if they are, the process is drawn out. Renewals remain default as companies are now cautious about expansion and focusing on business efficiency and cost control.
- Citywide Grade A office vacancy rate rose 0.1 ppt in Q2 to 16.0%, up 1.2 ppts YoY.
- As landlords become more bearish about short-term prospects and struggle to attract new tenants, Grade A office rents fell 1.2% in the second quarter. While the decline in average rents remains manageable, several deals were recorded at below-market rates, typically through increased tenant incentives.
- Pre-leasing activities remain fraught and drawn out with landlords of existing projects providing fierce competition for new tenants. Landlords are looking for signs of a bigger economic stimulus package to boost demand.

“Business efficiency and cost savings were a key focus for companies in the first half, as conditions stabilise and become clearer in the second half, businesses will become more decisive on office requirements.”

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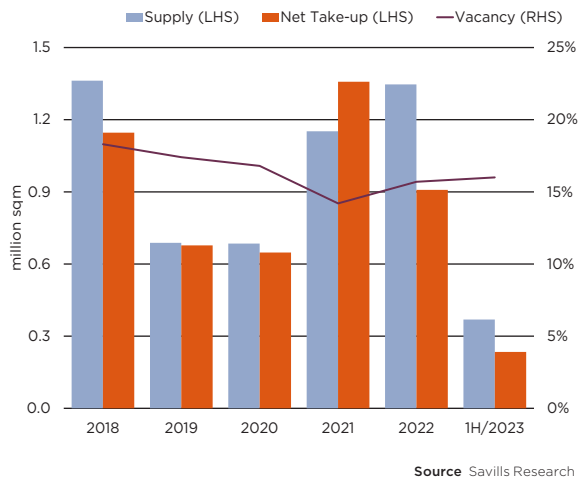
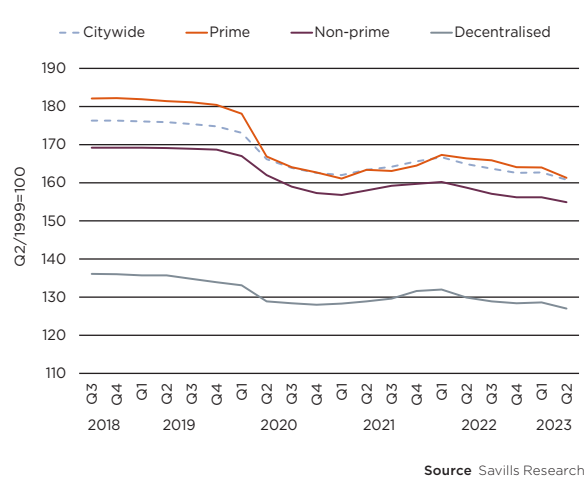
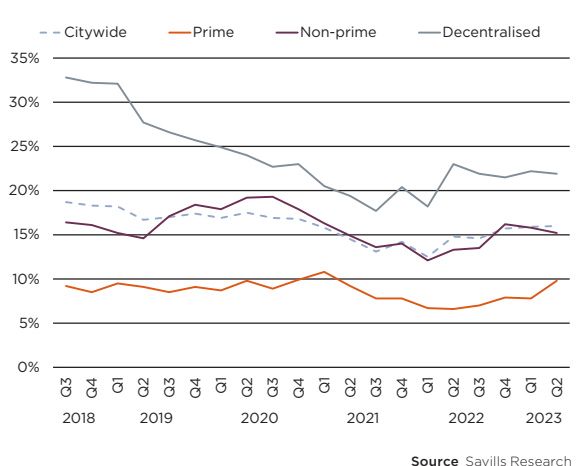
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**Definitions**  
Core prime: Nanjing Road (W), Huaihai Road (M), Lujiazui  
Core non-prime: Old Huangpu, South Huangpu, Hongqiao, North Station, North Bund, Zhuyuan and Xujiahui.  
Decentralised markets: All areas outside of the core markets including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

**GRAPH 1: Grade A Office Overall Supply, Take-up And Vacancy, 2018 To 1H/2023****GRAPH 2: Grade A Office Rental Indices, Q3/2018 To Q2/2023****GRAPH 3: Grade A Office Vacancy, Q3/2018 To Q2/2023****MARKET OVERVIEW**

Leasing demand slowed in Q2/2023 after an initial surge in activity in the first quarter. The authorities however continue to work tirelessly to attract new business investment into the city, working with landlords and other stakeholders to reduce set-up and operational costs through tenant incentives such as extended rent-free periods and rent subsidies. The leasing demand in recent quarters remains below long-term averages while long-term prospects remain intact for many traditional and emerging industries.

Despite short-term challenges like weaker consumer confidence, rising local competition, and increased disruption, some multinational retailers are continuing to expand operations or relocate regional headquarters to Shanghai in response to the market conditions.

Financial companies, a major occupier segment, contributed 18% of office transactions in H1/2023. The financial sector evolves with stricter regulations on private placements potentially leading to a drop-off in PE funds. Fund management companies such as Schroders and Alliance Bernstein have recently been approved to establish public fund businesses in China.

Emerging sectors such as AI, live streaming & social commerce, and NEVs and renewable energy sectors, continue to attract significant investment with intact growth prospects. Some firms have upgraded offices from Grade B projects and business parks in decentralised areas to Grade A office buildings in central locations.

**SUPPLY AND DEMAND**

Only one project, the 50,000-sqm Lee Gardens located by Natural History Museum Station (Line 13), was delivered to the market in Q2/2023, bringing Grade A office stock to 16.86 million sqm.

Weaker demand has resulted in extended pre-leasing periods compared to two years ago. 7,400 sqm of office space was handed back to the market in Q2/2023, compared to 220,000 sqm of absorption in Q1/2023. Non-prime areas maintained positive net take-up of 42,000 sqm, while the prime and decentralized markets underperformed. Most leasing transactions involved finance, manufacturing, and retail & trade companies, with roughly 60.0% involving domestic firms.

**VACANCY AND RENTS**

Citywide vacancy rates rose by 0.1 ppt to 16.0% in Q2/2023 with leasing enquiries down in Q2/2023 compared to the first quarter, despite the continuing recovery in business activity. As some firms look to reduce costs by reducing office space requirements and handing back unused space to landlords, projects previously occupied by whole-floor tenants are seeing partial floor vacancies in their stacking plans. Rents fell 1.2% QoQ to RMB7.1 psm pday, though benchmark projects in core areas saw rents hold up better.

**MARKET OUTLOOK**

A further 870,000 sqm of new supply is planned for the year's second half, bringing Grade A office stock to 17.7 million sqm by the end of 2023. Xuhui Binjiang will see the completion of Yuandian Tower in the second half. The 68,000 sqm project, located above Yunjin Road metro station (Line 11), contains a 29-storey tower office and four detached office buildings.

The demand outlook will be highly dependent on the government's targeted support in the coming months and the monetary environment. The current market momentum is unlikely to be sufficient for.

**TABLE 1: Notable Leasing Transactions, Q2/2023**

TENANT	TENANT INDUSTRY	PROJECT	BUSINESS DISTRICT	LEASED AREA (SQ M)
Swatch	Retail & Trade	ITC Ph3	Xujiahui	6,500
Angel Swan	Consumer Services	BFC	Old Huangpu	4,700
Zhongwen Law Firm	Professional Services	ICBC Tower	Lujiazui	2,700
Taiping Life Insurance	Finance	Raffle City The Bund	North Bund	2,100
Terumo Medical	Healthcare	IM Shanghai	Hongqiao	1,500

Source: Savills Research