The market performance has been divided significantly amid Covid-19

Shanghai Grade-A Office Market Report

Q3 2022

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OVERVIEW AND OUTLOOK

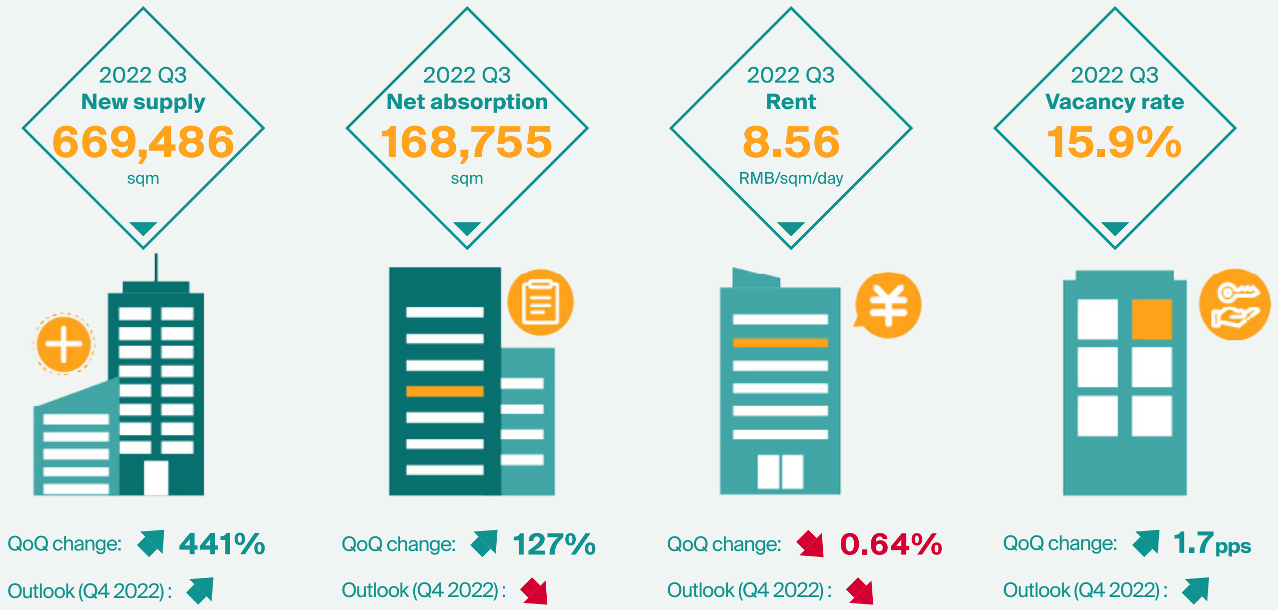
The third quarter in 2022 was the first quarter after the unsealing of Shanghai. Due to the contracting corporate profits and the global economic downturn, rent reduction and downgrading relocation became the office leasing strategy of many companies. As a result, market rents continued to fall and vacancy rates kept surging in Q3. The average rent in Grade-A office market dropped to RMB8.56 per sqm per day, while the average vacancy rate increased to 15.9%. The net absorption reached 168,755 sqm. There were active leasing demand from retail brands, the TMT sector and new energy vehicles.

In Q3, six new office projects were completed in Xujiahui, Xuhui Binjiang and Suhe Creek areas, adding 669,786-sqm office space to the market. The new supply increased significantly by 441% QoQ and increased by 10% YoY.

In Q3, the market saw a significant divergence in market performance. Supported by sectors with high rent affordability, rents in core business districts (Core CBDs) continued its upward momentum. Several emerging business districts saw the rebound in rents, which were mainly driven by the popular industries and the agglomeration effects. However, rents in most submarkets continued to fall, forcing landlords to offer more attractive leasing packages to secure tenants.

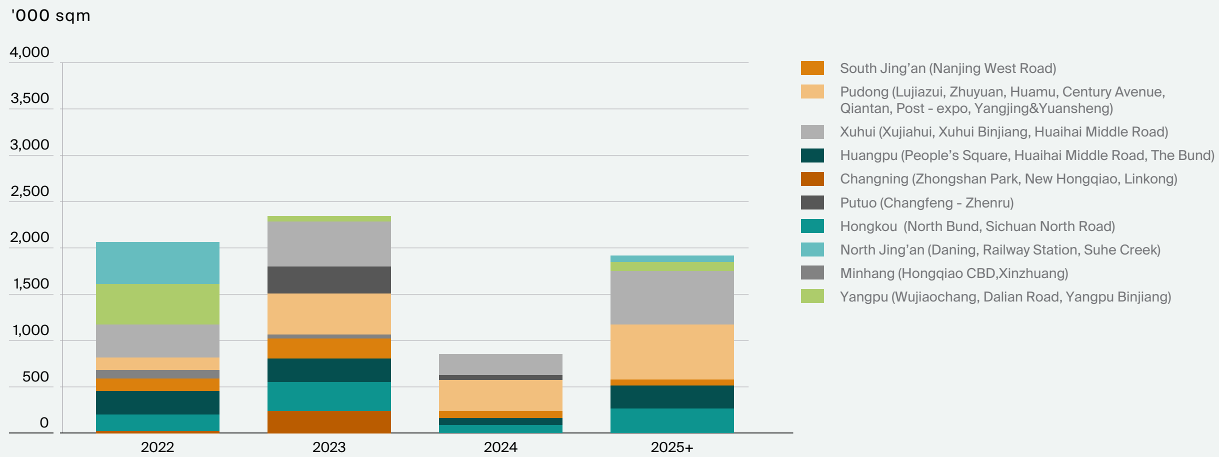
The market continued to be affected by the previous pandemic lockdown. Both landlords and tenants remained conservative given the weak economic environment and market uncertainty. Over the next 12 months, there will be no less than 2 million sqm of new projects entering the market. The landlords will be under further pressure to take up the existing market stock and to face the impact of the new projects entering the market. We expect the office rents to continue to dip in the near term while the vacancy rates to continue to rise due to the abundant new supply.

FIGURE 1: Shanghai Grade-A office market indicators [1]



Source: Knight Frank Research
[1] Rent refers to average effective rent

FIGURE 2: Shanghai office development pipeline by district, 2022-2025+



Source: Knight Frank Research

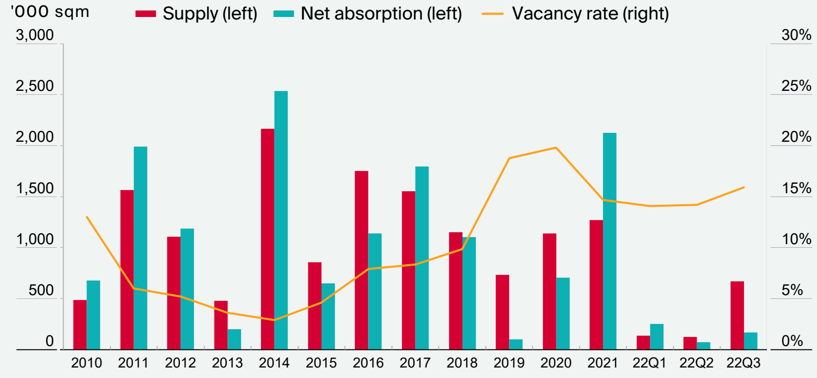
SUPPLY AND DEMAND

The completion of ITC T1 in Xujiahui, developed by Sun Hung Kai Properties, brought nearly 110,000 sqm of office space to the market, which is the major new project launched in Xujiahui recently. Lumina Shanghai in Xuhui Binjiang was also completed and delivered with approximately 170,138 sqm of office space. Additionally, two new projects, Joy Centre and Suhe Centre in Suhe Creek area, were completed in Q3, bringing a total of 193,000 sqm of office space to the market.

In terms of new leasing transactions, nearly 40% of demand came from retail brands and TMT companies. To give an example, an American mid-range luxury brand leased two floors of approximately 4,200 sqm of office space in Suhe Centre. It is worth-noting that the demand for new energy vehicle continues to grow, thanks to the car purchase subsidies. The business expansion of new energy vehicle companies has led to significant growth in demand for office leasing and upgrades.

With strict coronavirus restrictions and uncertain economic performance, the market performance has been largely divided. Some popular industries including intelligent manufacturing, bio-medical and new energy vehicles continued to perform well in leasing in Q3. For examples, Xuhui Binjiang, Post-Expo and The Bund, all of which saw decreases of more than 6% QoQ in vacancy rates in Q3. Some submarkets affected by corporate relocations and demand pullbacks saw an increase in vacant space this quarter. In Q3, the Core CBDs of Nanjing West Road and Huaihai Middle Road were stable, while Little Lujiazui saw a short-term increase in vacancy rate to 11.6%, up 7.6 percentage points from the previous quarter. The rise in vacant space was caused by the moving-out of several companies, which had completed their existing leases recently. The vacancy rate in popular submarkets, such as Xuhui Binjiang, Post-Expo and The Bund had further decreased in Q3, which has been the major reason for a slight decrease of vacancy rate QoQ despite of many new office supplies in the business districts.

FIGURE 3: Grade-A office supply, net absorption and vacancy rate



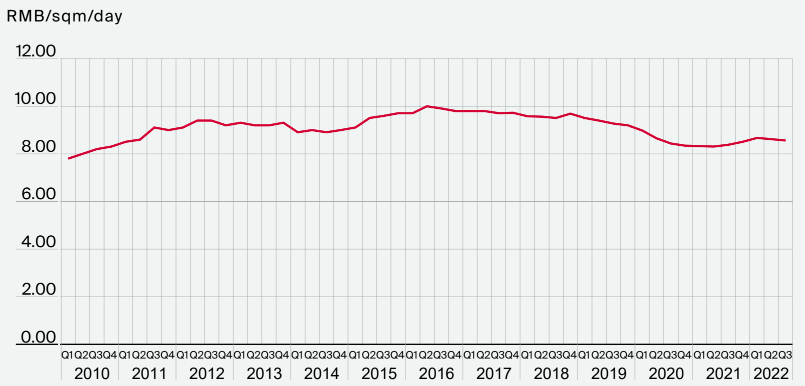
Source: Knight Frank Research

RENTS

In Q3, average rents for Grade-A office continued to drop to RMB8.56 per sqm per day, down 0.64% QoQ. The impact of the pandemic lockdown and the trade war between the U.S. and China continued. Many companies with poor performance had to control their operating costs. Hence, some tenants chose to relocate and terminated their leases, which forced landlords to retain tenants by means of lowering rents, granting discounts and subsidies to avoid the leftovers of a large amount of vacant space.

In Q3, average rents in Core CBDs rose slightly to RMB11.41 per sqm per day. Rents in Little Lujiazui and Huaihai Middle Road performed stable, while rent in Nanjing West Road has increased by 1.33% QoQ, driven by demand of the law firms, consultants, foreign retail brands and investment institutions. Other submarkets with large rent increases in Q3 included Xuhui Binjiang, Qiantan and Xujiahui, with the QoQ increase of 2.43%, 3.08% and 3.45% respectively. Besides of the overflowing demand for financial and medical sectors, Qiantan has also become the place for advanced manufacturing companies as their preferred office location, continuing to push up the office rent in this area. Xujiahui, on the other hand, saw an overall increase in average rents, driven by the new entry of high-rent projects.

FIGURE 4: Grade-A office rental trend



Source: Knight Frank Research

TABLE 1: Major Grade-A office leasing transactions, Q3 2022

Area	Building	Tenant	Area (sqm)	Type
Xuhui Binjiang	Lumina Shanghai Phase Two	ZEEKR	25,000	New Lease
Little Lujiazui	One Lujiazui	Zhonghai Fund	3,500	Renewal
Xuhui Binjiang	Lumina Shanghai Phase Two	Pop Mart	2,500	New Lease
Post-Expo	SK Tower	Tesla	2,470	New Lease
Nanjing West Road	JC Plaza	Fountainvest Partners	2,100	New Lease

Source: Knight Frank Research
Note: all transactions are subject to confirmation

INVESTMENT MARKET

In Q3 2022, the Shanghai's office investment market recorded four en-bloc transactions with a total consideration of over RMB9.0 billion.

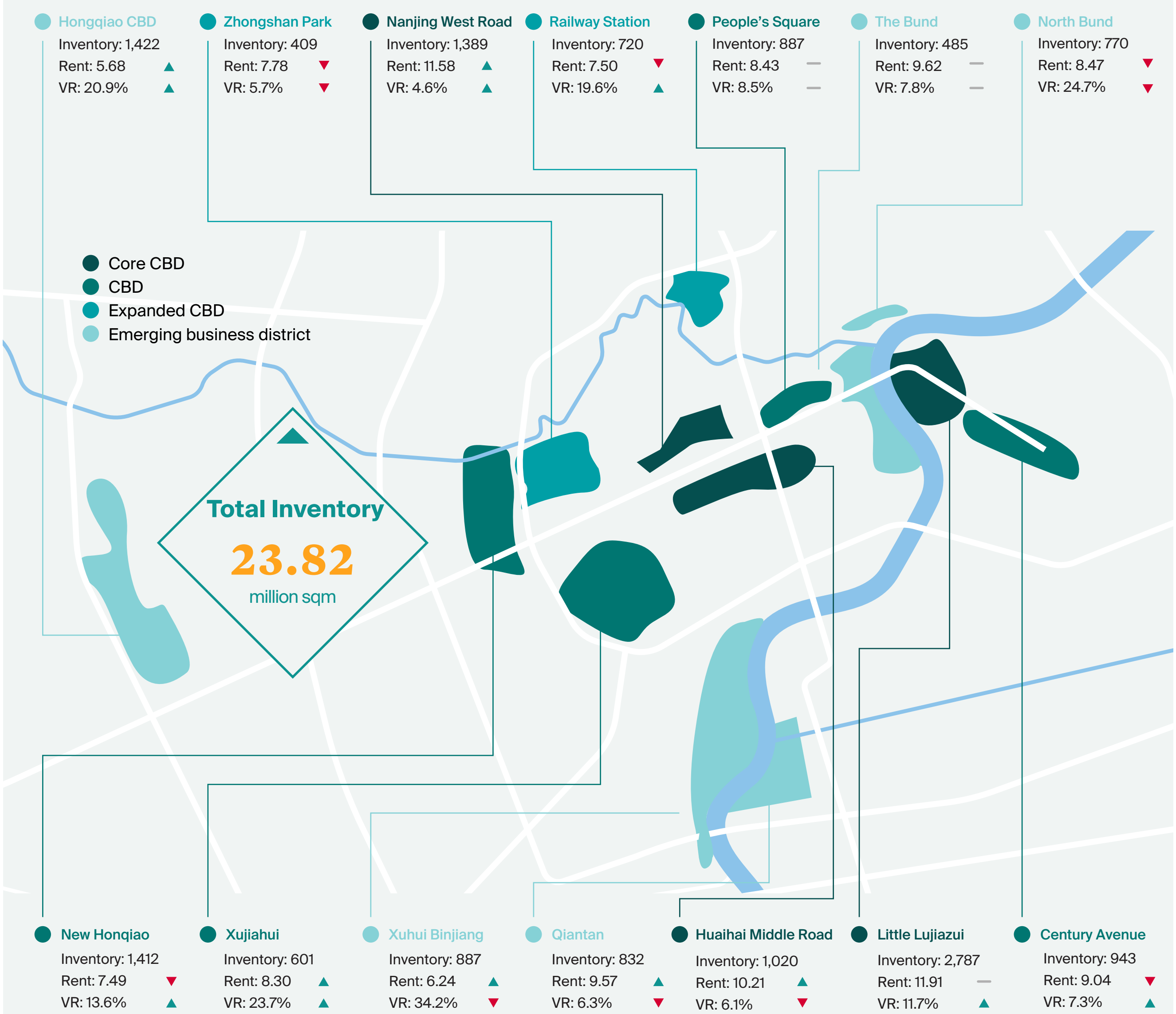
On 25 July, Haitong Unitrust successfully acquired the property located on floors 2nd -12th, No. 599, Zhongshan South Road, Huangpu District, Shanghai, and floors 1st -2nd, No. 666, Zhongshan South Road, for a total consideration of RMB1.673 billion. The GFA of the property which is designated for office use is 13,985.63 sqm.

On 23 Aug, Shanghai Junsheng Tongda Real Estate Co., Ltd. successfully acquired Junkang Financial Plaza with the reserved price of RMB2.52 billion. Junkang Financial Plaza is located in the core area of Pudong Post-Expo and covers a land area of 9,000 sqm with the GFA of 105,400 sqm.

In addition, there were several en-bloc transactions in the market that were in the process of modifying the sale and purchase agreements. In July, Inner Mongolia Huineng Coal & Electrical Group Co Ltd intended to purchase Joy Centre from COFCO Land for RMB5.8 billion, with a total area of 108,602 sqm.

SHANGHAI GRADE-A OFFICE MARKET DASHBOARD (Q3 2022)

Shanghai Grade-A office inventory, rents and vacancy rates of major business districts



Source: Knight Frank Research

Note: unit for market inventory – 1,000 sqm; rents using average effective rent at RMB/sqm/day; VR refers to average vacancy rate.

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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