Average rent and occupancy rate fell due to the Coronavirus outbreak

Knight Frank

Shanghai Grade-A Office Market Report

Q2 2022

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OVERVIEW AND OUTLOOK

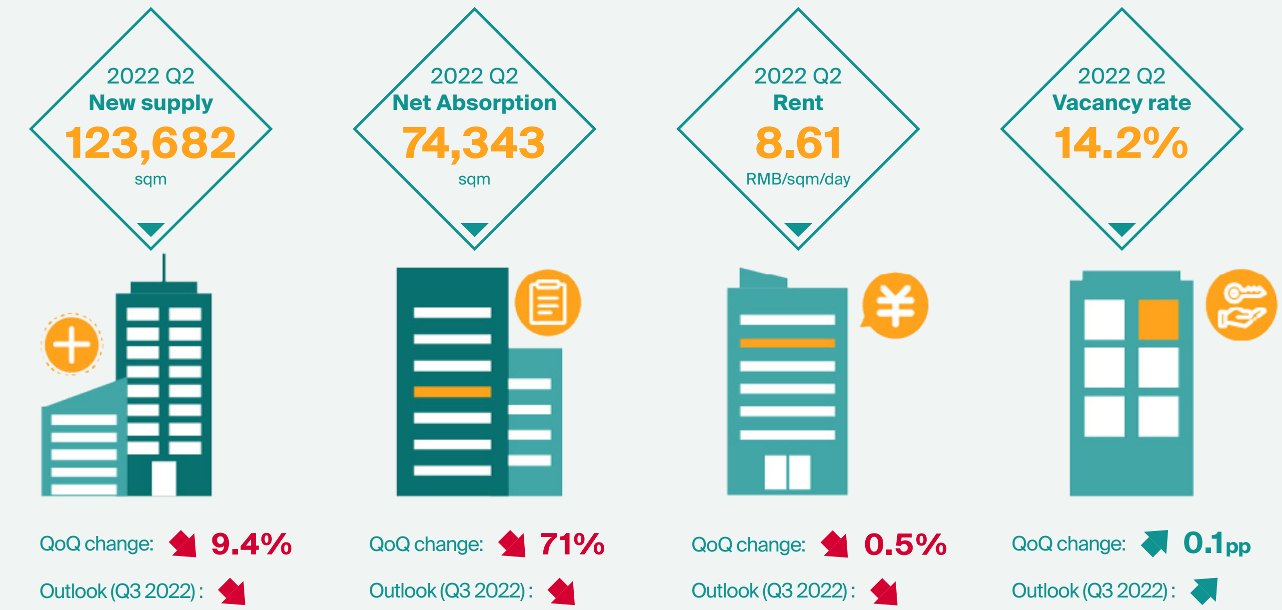
Due to the sudden outbreak of Covid-19, Shanghai implemented a two month lockdown from 1 April to 1 June. During the Covid-19 lockdown, Shanghai has carried out a citywide static management, bringing economic activity to a near-standstill. In June, Shanghai has gradually lifted lockdown and the city's functions started to return to normal. After the easing of lockdown, the government has issued a series of support measures to reduce enterprises' burden, helping them to resume production. Micro and small-sized enterprises (MSEs) and sole proprietorships that engage in production and business activities and rent state-owned property have been exempted from rent payments for a period of up to six months in 2022.

In the second quarter (Q2), affected by the sharp reduction in site inspections and the enterprises' relocation and evacuation, both rent and occupancy rate fell slightly. The average rent of Grade-A office market dropped to RMB 8.61 per sqm per day, while the average occupancy rate decreased to 85.8%. The net absorption in Q2 reached 74,343 sqm, with a YoY decrease of 87%.

During lockdown, electronic signing became a major way to conduct transactions between landlords and tenants. Among those leasing transctions in the market, the leasing demand was still driven by financial, professional services and technology sectors.

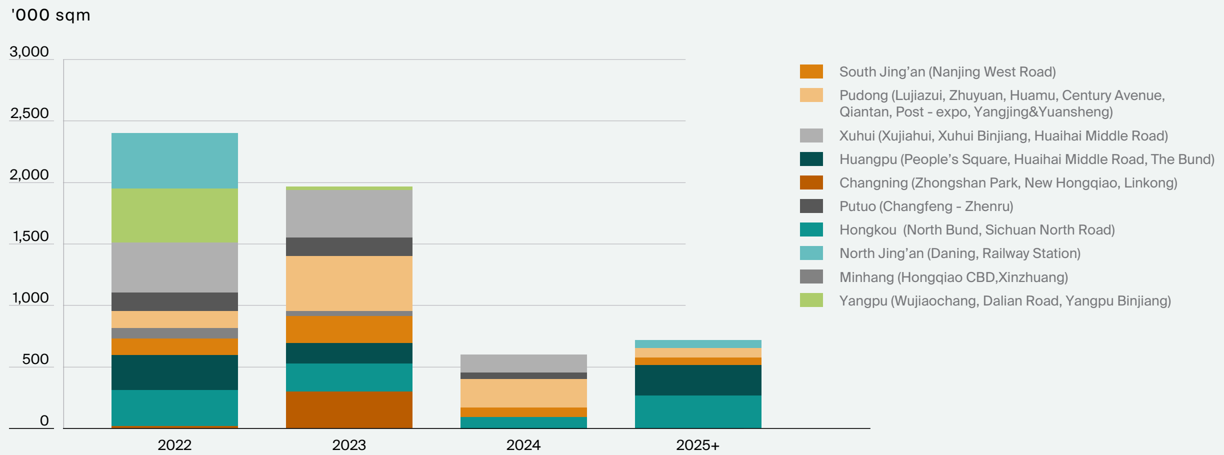
The leasing market is expected to face significant challenges in the coming three or six months. The cost-saving issue will be the first priority for enterprises due to the uncertainty of economic recovery in the short term and the downsizing caused by business shutdown. In the near future, enterprises will choose to renew the lease with lower rent growth or move to buildings with cheaper rents. We expect that in order to avoid the loss of tenants, landlords may offer more fitting-out subsidies and more flexible leasing terms during negotiations. Both rents and occupancy rates will continue their downward trends in the second half of the year.

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, 2022-2025+



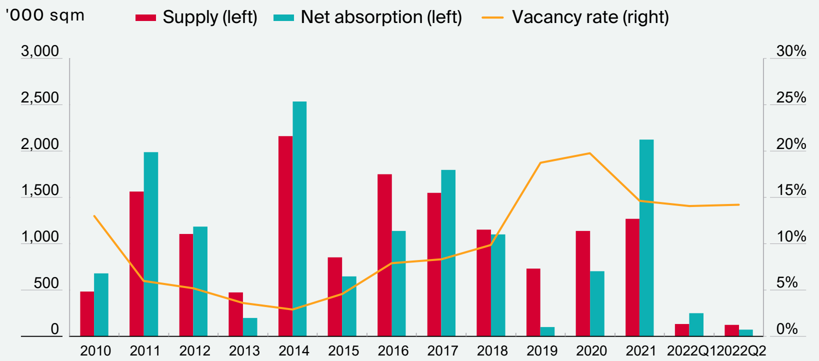
Source: Knight Frank Research

SUPPLY AND DEMAND

In Q2, two new Grade-A office buildings were completed in Shanghai, adding 123,682-sqm office space to the market. In June, Lumina Shanghai Phase Two located in Xuhui Binjiang was completed, adding 80,612-sqm office space to the market. In May, Lonsen Fuxin Hui was completed, adding approximately 43,070 sqm of office space to the market. Affected by the epidemic outbreak, many projects which scheduled to be completed this quarter have been postponed to the second half of the year or the year after. It is expected that the market will see an annual completion of over 1.5 million sqm of new supply, bringing absorption pressure on both the market and landlords.

Among the new leases in Q2, the financial, professional services and technology sectors ranked the top three in terms of the leasing demand and were moderately affected by the Covid-19 outbreak. Based on the confidence of domestic financial market in a long run, foreign financial institutions including banks, asset management companies and hedge funds have still actively expanded their businesses in China. The increasing business volume of foreign law firms and professional consulting companies has boosted the leasing demand for high quality office buildings in core areas.

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



Source: Knight Frank Research

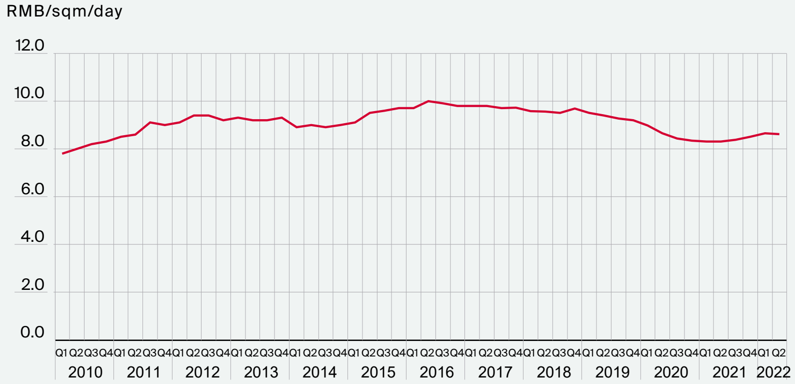
In terms of submarkets, vacancy rates increased in most submarkets due to the dual pressure from suppressed leasing demand and tenants' move-out during lockdown. However, Nanjing West Road and Little Lujiazui performed much better than other submarkets with resillient leasing demand. The vacancy rates of these two areas decreased 0.4 and 0.1 percentage point QoQ to 4.2% and 4%, respectively. More than half of the financial institutions, law firms and professional consulting companies prefer Nanjing West Road and Little Lujiazui as their office locations. With limited supply and favorable geographical location, the Core CBDs will still be the most active area in Shanghai's office market.

RENTS

In Q2, the average rent of Grade-A office market in Shanghai decreased slightly to RMB8.61 per sqm per day, with a decrease of 0.5% QoQ. It was the first rental decline in the past year. As for the enterprises, the uncertainty about the business future and revenue caused by Covid-19 made enterprises become more cautious during leasing neogitiation, reflecting in the strong willingness for enterprises to reduce the increase of renewal rent and downgrade office space. In order to cope with the possible relocation tide and secure tenants, landlords have to offer more attractive asking price and fitting-out subsidies to tenants upon the expiration of their existing tenancy.

In Q2, adversely affected by the epidemic, rents in most submarkets declined in varying degrees from the previous quarter. The market rents in popular areas such as North Bund, Qiantan, Xuhui Binjiang and the Century Avenue recorded an average decrease of approximately 0.6% in Q2. However, Core CBDs performed well with a rental increase of 0.3%, supporting by the high rental affordable sectors including financial institutions, foreign law firms and consulting companies.

FIGURE 4: Grade-A office rental trend



Source: Knight Frank Research

TABLE 1: Major Grade-A office leasing transactions, Q2 2022

Area	Building	Tenant	Area (sqm)	Type
South Jing'an other areas	One Museum Place	Ming Yuan Cloud	2,500	New Lease
Nanjing West Road	HKRI Taikoo Hui T1	Warburg Pincus	2,400	Renewal
The Century Avenue	Century Link T1	Facebook	2,000	Expansion
Little Lujiazui	Shanghai Tower	ABeam Consulting	2,000	New Lease
Little Lujiazui	IFC	Bridge Water	700	New Lease

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

INVESTMENT MARKET

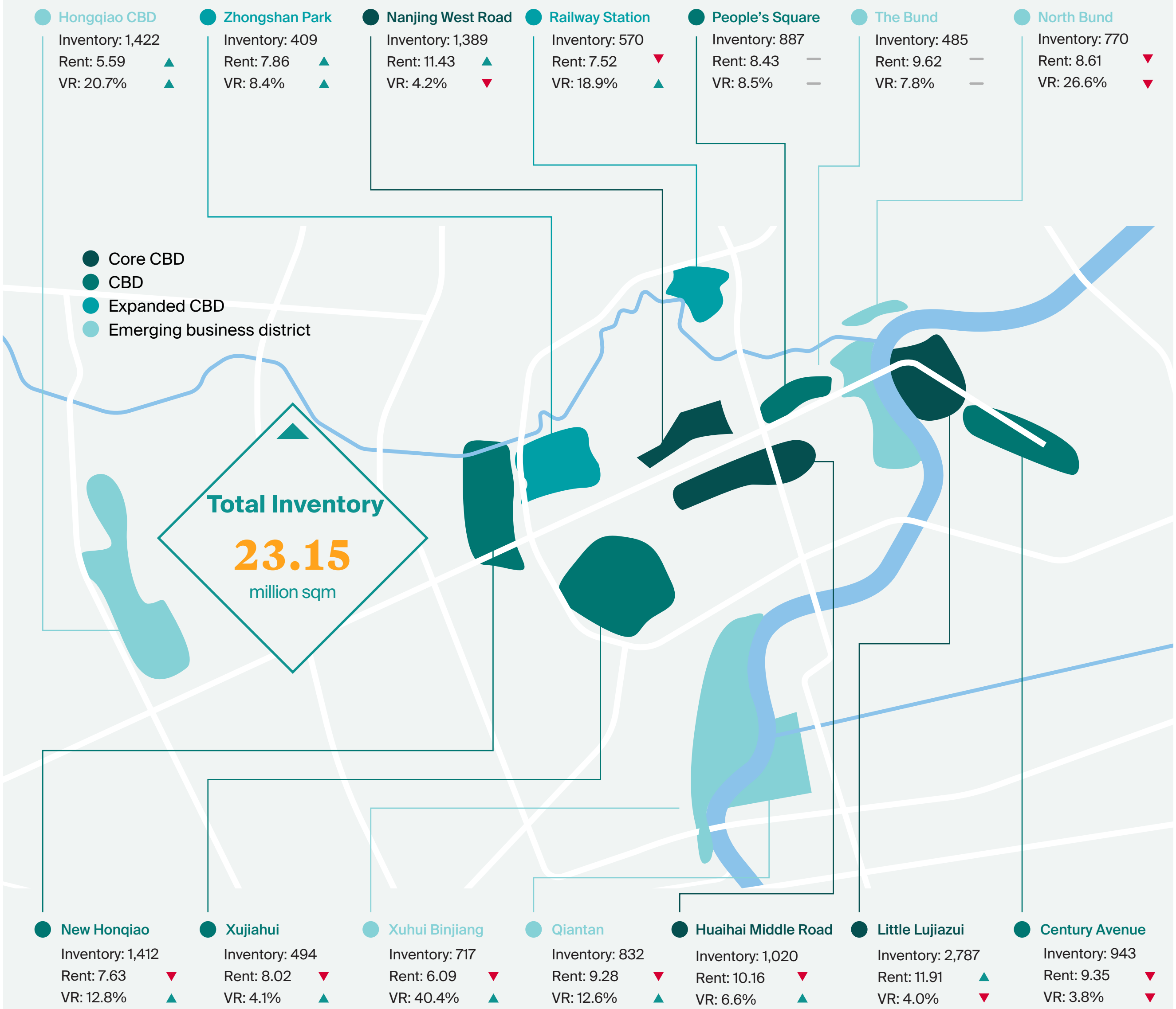
In Q2 2022, affected by the Covid-19 epidemic, the Shanghai's office investment market was not active, recording only one en-bloc transaction.

On 4 April, Shanghai Yingtong Greenland Mansion, the third time on Alibaba Auction was auctioned successfully by Asia Pacific Properties (Shanghai) Ltd for approximately RMB1.4 billion. Located in the south part of Huangpu District and next to Xuhui Binjiang, the building is a mixed-use commercial project with a total GFA of 40,392.62 sqm. By deducting the park lot price of RMB300,000 each, the transacted price of Yingtong Greenland Mansion reached approximately RMB32,665 per sqm.

In addition, there are several en-bloc transactions in the market that are in the process of modifying the sale and purchase agreements. In May, Inner Mongolia Eerduosi Resources intended to purchase Suhe Centre Building 3 for RMB2.673 billion from China Resources Land and Shun Tak Holdings, with a total GFA of 45,394 sqm. In June, Zhonggu Logistics intended to purchase Shanghai Kaisa Financial Centre owned by China Life for approximately RMB2.9 billion. Located in Pudong Huamu, the building has a total GFA of approximately 77,000 sqm.

SHANGHAI GRADE-A OFFICE MARKET DASHBOARD (Q2 2022)

Shanghai 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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