Shanghai Grade-A Office Market Report

Q4 2023

This report focuses on the Grade-A office market in Shanghai, with information about supply and demand, rents, vacancy rates and the office investment market

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Overview and Outlook

Slower-than-expected overall economic recovery, more time required for market recovery

Owing to the slower-than-expected overall economic recovery, leasing demand continued to shrink, leading to a further decline in the Shanghai office market in the fourth quarter (Q4). In Q4, the Shanghai office market experienced a peak in supply, with the completion and delivery of six new projects, bringing a total of 437,177 sqm of new office space to the market, an increase of 7.1% QoQ, pushing annual new supply to 1.369 million sqm.

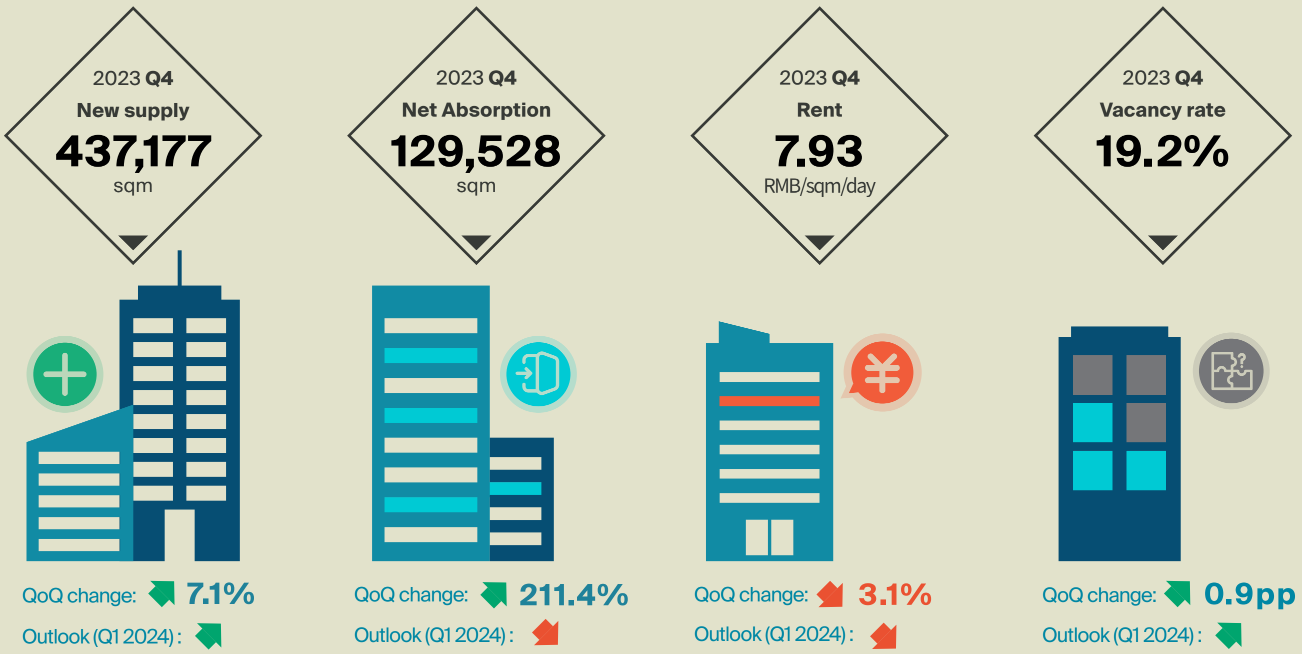
Landlords implemented rent reductions and leasing discounts to retain tenants and attract budget-limited companies, resulting in a significant QoQ decrease of 3.1% in average rent to RMB7.93 per sqm per day. The negotiation space between landlords and tenants further expanded, and lease renewals and corporate relocation activities were very active in Q4.

In Q4, the average vacancy rate increased slightly by 0.9 percentage point to 19.2%. The net absorption area in the market was 129,528 sqm, and annual net absorption reached 509,855 sqm, a decrease of 8.4% YoY.

In Q4, market leasing demand still came mainly from the technology, media, and telecom (TMT), financial and professional services sectors. There were no new industry-driven growth points, so with the influx of many new projects and the departure of major tenants in many office buildings, there was significant pressure on market space absorption.

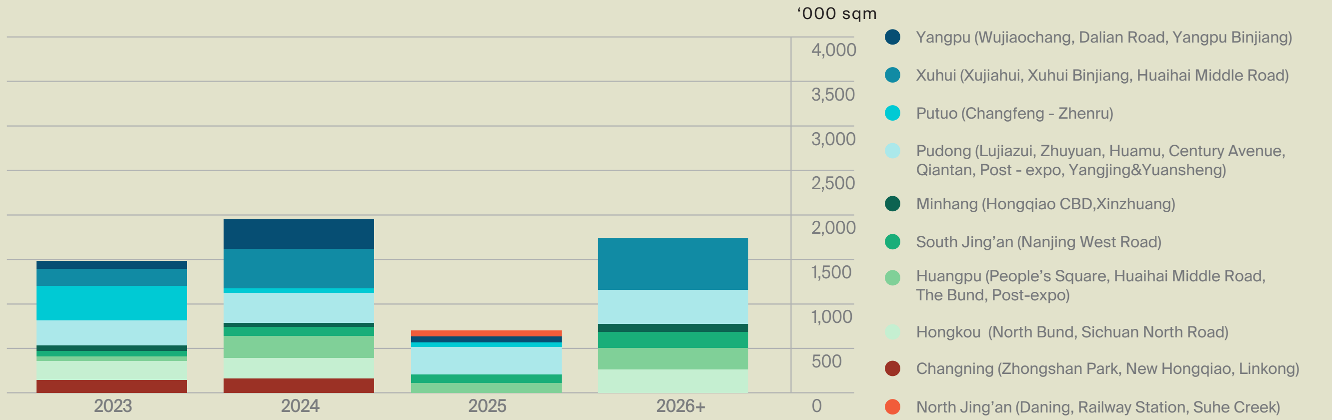
The continued downturn in the leasing market has resulted in uncertainty for both landlords and tenants regarding future market development. With a cumulative project pipeline of nearly 2 million sqm set to enter the market in 2024, the market will face a huge challenge. We expect the ongoing economic weakness to lead companies to emphasize cost reduction, and the trend of lease terminations and downgrading or relocation to continue. With the drive to reduce costs and increase efficiency in many companies, the landlords' strategy of offering quantity over price remains the optimal solution in the market.

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



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

Fig 2: Shanghai office development pipeline by district, 2023-2026+

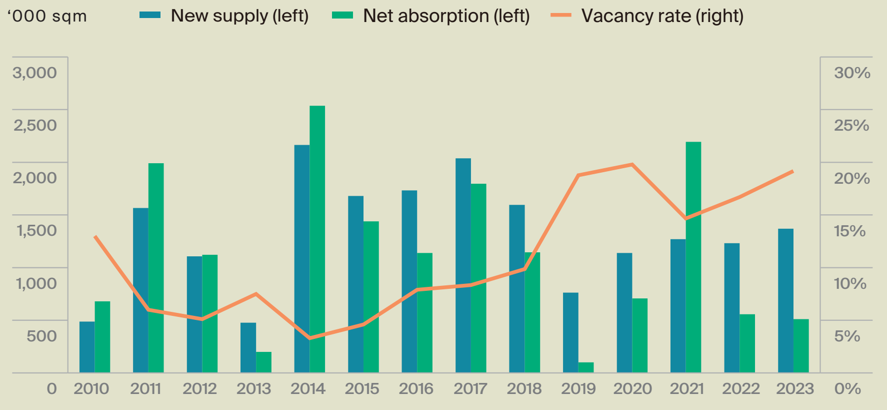


Source: Knight Frank Research

Supply and Demand

Annual new supply reached a near-record high in recent years, but demand remains weak

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



Source: Knight Frank Research

In Q4, six new projects were completed and delivered to the market, resulting in 437,177 sqm of new office space, an increase of 7.1% QoQ, pushing annual new supply in the Shanghai office market to 1.369 million sqm, reaching the pre-pandemic market supply level. The new projects in Q4 were concentrated mainly in emerging business districts, such as the AIA Financial Centre in Hongkou North Bund (126,704 sqm), China Overseas Centre Tower A in Putuo Zhenru-Changfeng (108,088 sqm), Upper West Shanghai T3 (37,754 sqm), and Expo Yaohua Business Centre in Pudong Post expo area (30,608 sqm). Located in the north expansion area of Wujiaochang, the expanded CBD area, AXIOM Tower A was completed and delivered in Q4, providing 91,713 sqm of new office space.

Against the backdrop of a global economic recovery that fell short of expectations, budget-constrained companies with leasing needs tended to prefer lease renewals or downgrading and relocation. In Q4, lease renewals and downgrading or relocation activities accounted for over 70% of leasing transactions. Faced with intense market competition, landlords adopted proactive strategies by offering leasing subsidies and rent reductions, successfully retaining many tenants. This strategy significantly increased the proportion of lease renewals by nearly 20 percentage points in Q4.

In terms of newly signed leases, the TMT, financial and professional services sectors were the main demand drivers in the market in 2023, accounting for over 60% of total leasing demand. In Q4, leasing demand from foreign companies decreased more noticeably and came primarily from the financial, professional services and retail industries. Leasing demand from domestic companies was mainly from the TMT, financial and professional services sectors.

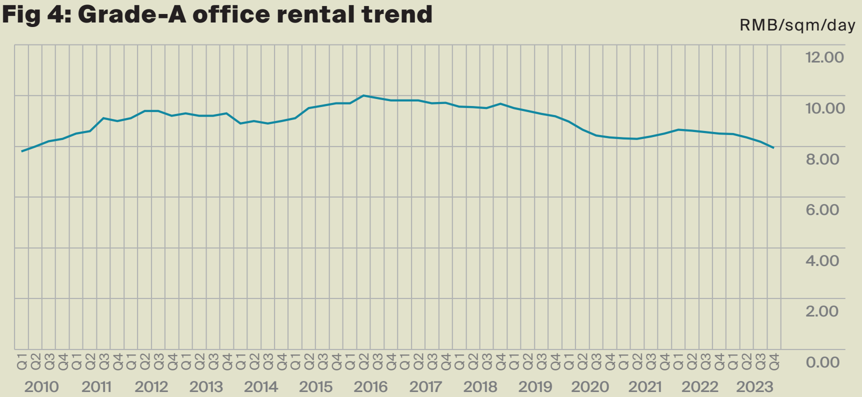
In Q4, limited market demand and the completion of new projects pushed the market vacancy rate slightly higher to 19.2%, for an increase of 0.9 percentage point QoQ. The increased renewal demand in the market effectively offset the negative impact of the constantly increasing new completions and vacant space. In particular, the core CBD areas saw a higher number of lease renewals in Q4, with many landlords offering favorable leasing arrangements to retain tenants, resulting in a slight decline in the vacancy rate to 8.9% QoQ in the core CBDs. Against the backdrop of an overall market decline, emerging business districts, with advantages such as negotiable rental prices, high commuting convenience, and high-quality building facilities continued to attract companies to relocate. Therefore, emerging business districts, represented by the Hongqiao CBD, Xuhui Binjiang and Post Expo, saw a decline in the overall vacancy rate.

Rents

The overall market remained sluggish, with a significant decline in rents throughout the year

In Q4, the overall average rent for Grade A office space continued to decline by 3.1% QoQ to RMB7.93 per sqm per day. The average annual rent also saw a significant decrease of 6.7% compared to that in 2022. Against the backdrop of continued shrinking market demand, companies placed greater emphasis on negotiating rents to control costs and budgets. Additionally, increased transparency between landlords and tenants further expanded the negotiation space. These factors collectively contributed to a substantial decline in market rents in 2023.

Fig 4: Grade-A office rental trend



Source: Knight Frank Research

In core CBDs, the average rent continued to decline, reaching RMB10.86 per sqm per day, representing a QoQ decrease of 2.9%. The Little Lujiazui area experienced a larger decline, with rents falling by 4.9% to RMB11.14 per sqm per day. The key factor behind this significant drop in average rents in Little Lujiazui was landlords offering greater rental concessions and leasing incentives to retain tenants.

In emerging business districts, landlords in many sub-markets faced immense market pressure and were eager to attract tenants by reducing rents. Owing to tight market demand, increased supply, and a large existing market inventory, landlords had to take measures to counter the effects of oversupply. In Q4, the average rent in emerging business districts dropped to RMB6.45 per sqm per day, representing a 3.6% decrease QoQ and an 8.3% decrease YoY. Although the market vacancy rate saw a slight decrease of 0.3 percentage point QoQ, the overall market situation remained unfavorable.

Table 1: Major Grade-A office leasing transactions, Q4 2023

Submarket	Building	Tenant	Area (sqm)	Type
Hongqiao CBD	The Gate	Volkswagen	20,000	New Lease
North Bund	Landmark Centre Shanghai	AIA	13,000	Renewal
Huamu	Kerry Parkside	Greendot	7,400	Renewal
Huaihai Middle Road	Huai Hai International Plaza	Meoffice	6,000	New Lease
Zhenru-Changfeng	China Overseas Centre	JD.COM	5,000	Relocation
Little Lujiazui	IFC	ANLI Partners	1,500	Renewal

Source: Knight Frank Research

Note: All transactions are subject to confirmation

Investment Market

Owner-occupier buyers dominated the market

In Q4 2023, the Shanghai office investment market showed strong activity, with 17 large-scale transactions recorded, for a total value of over RMB15 billion. Throughout the year, there were 61 large-scale office transactions, for a cumulative transaction value of over RMB40 billion. It is noteworthy that owner-occupiers dominated the investment market and became the main driving force behind transaction activity.

Over 60% of the market transactions in Q4 were for office buildings valued at less than RMB1 billion and were located in emerging markets. Projects with the potential for market value appreciation and at a price advantage were highly favored by investors. For example, office buildings with a total gross floor area of less than 30,000 sqm in the Post-Expo Area and Lingang Area were very popular. Mature projects in downtown areas valued at less than RMB2 billion also attracted investor attention.

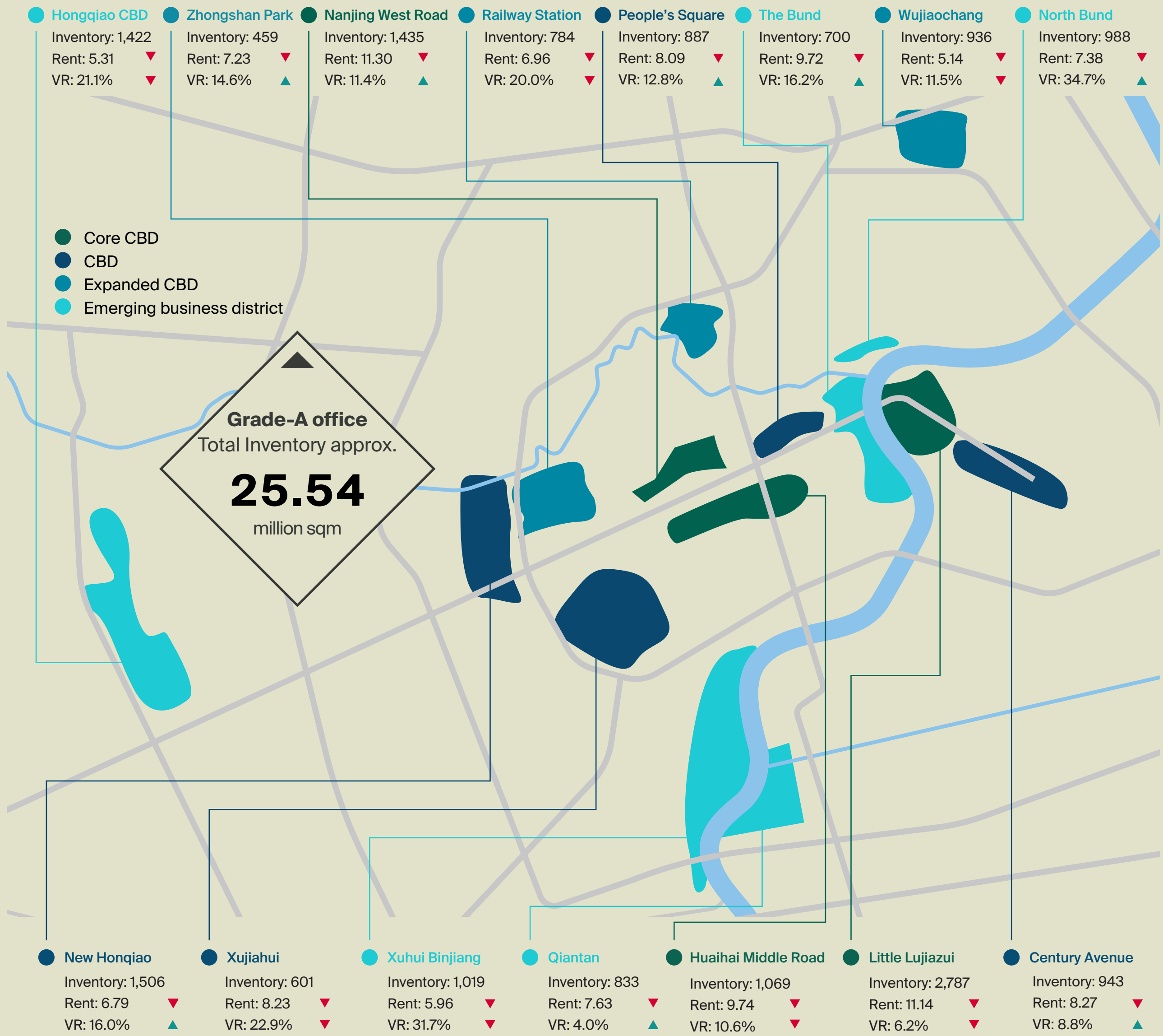
On 20 December, Yonyou Automotive Information Technology (Shanghai) Co., Ltd. announced that it had reached an agreement with Chengling Industrial Group to acquire the office building and associated parking spaces of Shanghai Changfeng Centre Phase 2, Tower 1, located at No. 1 and No. 12, Lane 276, Luding Road, Putuo District, for RMB179 million. The building has a total gross floor area of 4,670.29 sqm. After the acquisition, it will be used primarily for the company's daily operations.

On 22 December, Shanghai Shengxin Investment Management Co., Ltd., a subsidiary of Hong Kong's Gemale Property Holdings, acquired 100% equity and the company debt of Shanghai Junxin Real Estate for a total price of RMB1.32 billion, thereby acquiring Junxin Times Plaza, a mixed-use project located in Yangpu District.

In December, Jinhe Property Management sold Jinhe Centre, located in Caohejing, Xuhui District, to the Catholic Church for a price of RMB1.47 billion. The sold area amounted to 32,625 sqm, highlighting the diversification of market buyers.

Shanghai Grade-A office market dashboard Q4 2023

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/month; 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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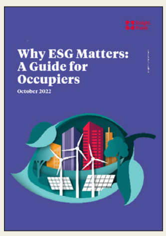

Why ESG Matters for Occupiers

Quantifying ESG in Real Estate