

“Despite concerns arising from uncertainty towards the global economy, companies expanded aggressively in Shanghai, further compressing vacancy rates and hastening rental appreciation.”

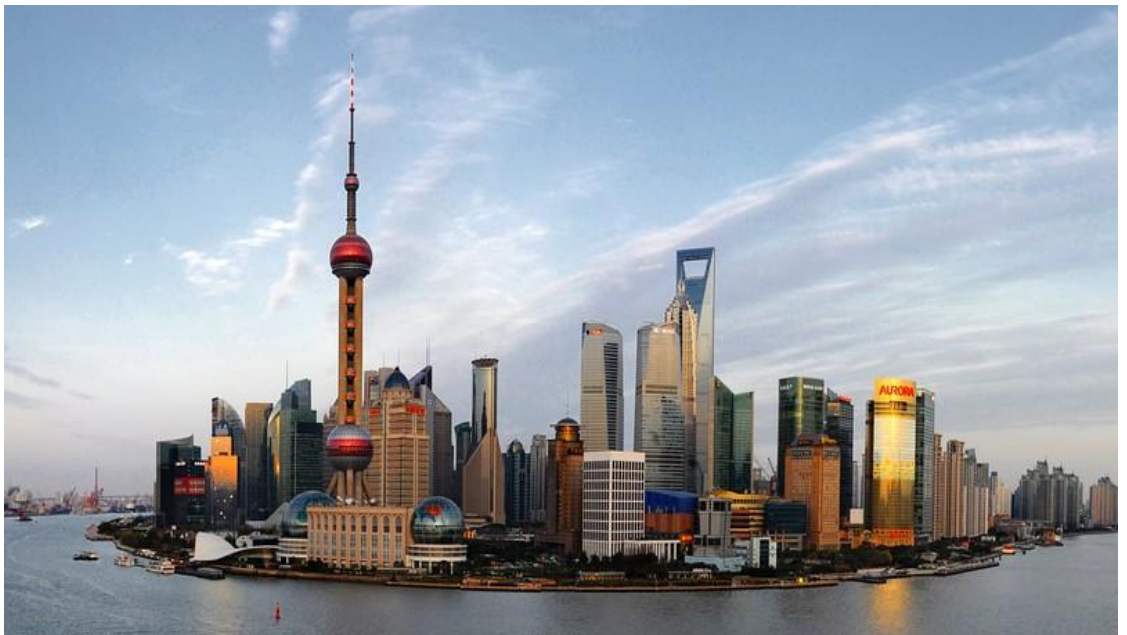


Image: 'Little' Lujiazui, Shanghai

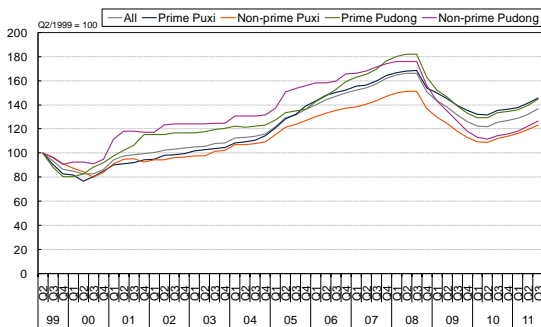
- Four projects were handed over in the third quarter, adding 223,100 sq m to the market.
- Rents rose by 3.3% quarter-on-quarter to an average of RMB7.09 per sq m per day, bringing rental appreciation to 7.6% year-to-date.
- Net take-up totalled 211,400 sq m in the third quarter, with net take-up outstripping supply by 15% year-to-date.
- Seven significant investment deals were transacted in the third quarter for a total consideration of RMB8.3 billion (US\$1.3 billion).
- The city-wide vacancy rate fell by 0.1 of a percentage point quarter-on-quarter to 8.7%.
- Gross yields fell 0.1 of a percentage point quarter-on-quarter to 5.3%, representing a 0.7 of a percentage point decline year-on-year.

### Market commentary

Concerns over the strength of the global economy are being increasingly talked about in China. Anxiety over how the eurozone will handle its debt crisis and the US its unemployment problem may have knock-on effects on China, a country that is expected to see a slight slowdown in 2012 due to its monetary tightening in 2011.

Despite such concerns, companies have been expanding aggressively in Shanghai's Grade A office market, thereby further compressing vacancy rates and hastening rental appreciation. While Shanghai's economy may begin to experience a slowdown next year, it has yet to dampen the prospects of the office market.

#### Grade A office rental indices, Q2/1999–Q3/2011



Source: Savills Research & Consultancy

Overall Grade A office rents increased by 3.3% quarter-on-quarter to an average of RMB7.09 per sq m per day (US\$33.8 per sq m per month), representing an 11.6% increase since bottoming out in Q2/2010.

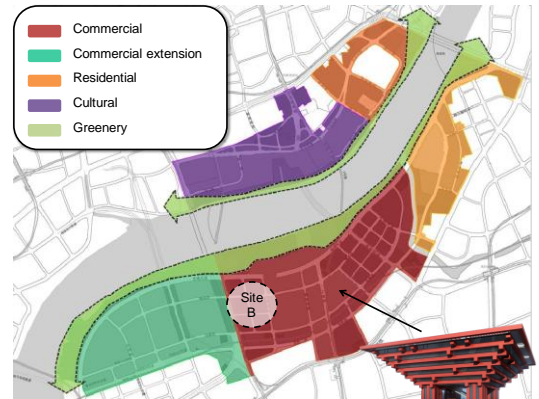
Rental appreciation has been supported by a lack of quality vacant space amid robust demand. Prime buildings have either reached near full occupancy or a level landlords are comfortable applying an increase in rents. Additionally, projects recently handed over to the market are either located in non-prime areas or achieved high pre-commitment levels upon handover.

### Market news

#### Development of the Expo site

Following the success of the 2010 Shanghai World Expo, Shanghai's government quickly began laying the groundwork for the future of the site. While detailed planning has yet to be confirmed, the masterplan currently provides a broad brush stroke for the future direction of the area.

#### Expo site plan



Source: Shanghai Planning and Land Resources Management Bureau, Savills Research & Consultancy

The 6.68 sq km site will be subdivided into five areas, two for commercial use, two for residential and the last as a cultural area. Most areas will keep a handful of structures from the Expo, including the China Pavilion, the Benz Centre, the Expo Centre and the Shanghai Expo Exhibition. In addition, the plan calls for the preservation of a green area, situated along both the north and south banks of the Huangpu river.

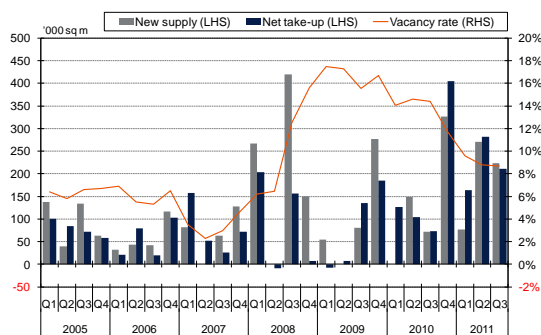
Commercial development will first be focused in the commercial area (labelled red), and more specifically in site B, a 187,200 sq m area with a total planned GFA of 600,000 sq m. Development is then positioned to shift to the remaining portion within the commercial area. Once matured, the commercial extension area will be used for further office and retail development.

Due to height restrictions, site B will see the development of low-rise office buildings which are suitable for headquarter offices. By the end of the third quarter, a total of 14 companies – all of which are state-owned enterprises (SOEs) – inked agreements to build headquarter offices on site B.

The Shanghai Expo Group (SEG) is the governing body responsible for developing the site. Due to close ties with SOEs and increasing demand from such enterprises to acquire en bloc for self use, the SEG is expected to continue to attract SOEs to its commercial area.

Although the area may face difficulties in competing with CBDs such as Nanjing Road and 'Little' Lujiazui in size and overall standing, its central location, access to existing and future metro lines, and nearby residential and future retail zones are all expected to help support its competitiveness against secondary business districts. Moreover, the preservation of Expo structures, a beautified waterfront and cultural elements will undoubtedly help establish a unique character.

#### Grade A office supply, take-up and vacancy rates, Q1/2005–Q3/2011



Source: Savills Research & Consultancy

Four Grade A office buildings were handed over to the market in the third quarter, representing a total of 223,100 sq m, 570,500 sq m year-to-date. This quarterly supply included Lujiazui Fund Tower, Lujiazui Investment Tower, Eco City and Cloud Nine Phase II.

Lujiazui Fund Tower, a 45,000 sq m office project, and Lujiazui Investment Tower, a 29,000 sq m office project, both located in Zhuyuan, were handed over to the market in July. Both buildings managed to secure favourable occupancy rates upon handover primarily by attracting local financial companies.

Also handed over in July, Eco City is a mixed-use project located along Nanjing (W) Road in Jing'an district and is composed of 89,000 sq m of office space and 21,000 sq m of retail in its podium. The project, developed by a local alternative energy company, obtained the LEED Gold Certification, a distinction that sets the project apart from nearby developments.

Cloud Nine Phase II, a mixed-use project located in Changning district, handed over an additional 60,000 sq m of Grade A office space to the market in September 2011. The project was also handed over to the market with satisfactory occupancy rates as it primarily attracted small to medium-sized multinational firms.

Net take-up reached 211,400 sq m in the third quarter, outpacing supply by 15% year-to-date. SOEs represented the largest portion of demand between Q4/2010 and Q1/2011, particularly finance, insurance, telecommunications and petroleum companies developing projects for end use and acquiring projects en bloc for end use.

Most of this year's take-up, however, was accounted for by multinational companies (MNCs) and privately owned domestic companies. Such demand has come from a diversified industry base, including those in the logistics, financial, legal, retail and IT industries. This diversification in the Grade A market's demand base gives weight to the assumption that the market is in a more sustainable recovery.

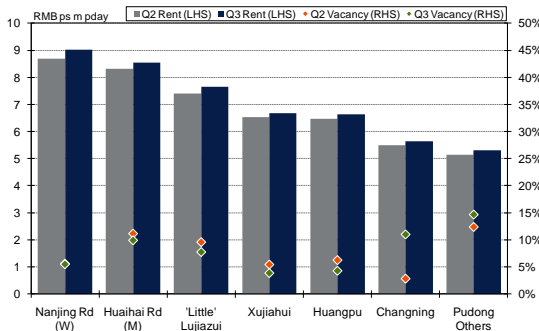
**Selection of leasing transactions, Q3/2011**

Tenant	Project	Location	Area leased (sq m)
Johnson Controls	SOHO Zhongshan	Changning	7,200
Cadence	Kerry Parkside	Century Park	7,000
Samsung Semiconductor	SOHO Zhongshan	Changning	4,400

Source: Savills Research & Consultancy

The city-wide vacancy rate fell by 0.1 of a percentage point quarter-on-quarter to 8.7%. Puxi's vacancy rate increased by 0.3 of a percentage point quarter-on-quarter to 7.6%, while Pudong's fell by 0.6 of a percentage point to 9.8%.

**Business district comparison, rents vs vacancy rates, Q2/2011 & Q3/2011**



Source: Savills Research & Consultancy

PD Others (Pudong excluding 'Little' Lujiazui) and Changning district both witnessed a sizeable increase in their vacancy rates. This increase was due to supply being handed over in those districts. Discounting such supply, vacancy rates in PD Others would have fallen by 3.4 percentage points quarter-on-quarter while vacancy rates in Changning district would have remained unchanged.

**Investment market**

**En-bloc**

Shanghai's office market saw seven significant investment deals concluded in the third quarter, representing a total consideration of RMB8.3 billion (US\$1.3 billion). Transaction volume reached RMB27.0 billion (US\$4.23 billion) year-to-date, representing an approximate 143% increase year-on-year.

Growing interest in the investment market has been attributed to its growing long-term prospects. Foreign and domestic companies acquiring en bloc for self use have been increasingly looking to secure space to avoid the probability of continued rental appreciation.

Meanwhile, institutional investors looking to acquire stabilised assets have begun accepting what have been previously considered to be low yields and IRRs as they lower their risk premiums associated with the market as it increasingly becomes viewed as mature. Nevertheless, expectations for bottom-line IRRs remain promising as capital value and rental appreciation is expected in the long term.

**Selection of en-bloc transactions, Q3/2011**

Property	Location	Price	Buyer
Bund 558	Hongkou	RMB2.7 bil US\$339 mil	Xinhua Insurance
Jiarui Int'l Plaza	Zhuyuan	RMB1.89 bil US\$294 mil	SOHO China
Autumn Building	PD Others	RMB1.10 bil US\$171 mil	Gongyao Industrial
Innov Tower (50%)	Xuhui	RMB599 mil US\$93 mil	CapitaLand

Source: RCA, Savills Research & Consultancy

Gross yields fell 0.1 of a percentage point quarter-on-quarter to an average of 5.3%, representing a 0.7 of a percentage point decline year-on-year.

### Strata title

Shanghai's first-hand strata-title market also picked up in the third quarter as 325,000 sq m was transacted, an increase of 26% over the quarterly average of the past two quarters. Meanwhile, average city-wide prices increased to RMB29,899 per sq m from RMB24,955 per sq m last quarter, largely a result of higher quality buildings being put onto the strata-title market amid robust demand.

Strong interest in the market resulted in the third quarter registering the highest per sq m price to-date. In September 2011, 12 floors were purchased in 21st Century Tower for an average price of RMB102,955 per sq m, beating the high made by a businessman from Anhui in December 2010 when he purchased the top floor of SOHO Exchange for RMB100,400 per sq m. The buyer of the 12 floors in 21st Century Tower remains anonymous however, and it is rumoured that the deal could have been part of an internal restructuring.

#### Selection of strata-title transactions, Q3/2011

Project	Location	Area (sq m)	Price (RMB per sq m)
21st Century Tower	'Little' Lujiazui	22,100	102,955
Shanghai WFC	'Little' Lujiazui	10,400	83,000
CITIC Plaza	Hongkou	3,100	65,900

Source: Savills Research & Consultancy

### Market outlook

Shanghai's Grade A office market is expected to be handed one additional project in the fourth quarter, bringing annual supply to 628,900 sq m in 2011. The project, Merchants Bank Tower, is composed of 58,400 sq m of Grade A office space in 'Little' Lujiazui. It is rumoured that China Merchants Bank plans to use most – if not all – for self use.

Supply pressure is expected to remain constant in the following three years, averaging roughly 543,600 sq m per annum. The majority of such supply is located in Puxi and it is fairly evenly distributed between prime and non-prime areas.

While demand continues to keep pace with new supply, concerns emerging from the eurozone may result in a temporary slowdown of headcount expansion in Shanghai next year. While such concerns should be noted, mid to long-term demand in Shanghai's Grade A office market is expected to be strong as MNCs are likely to place increasing importance on key growth markets such as China, with many choosing their base in Shanghai.

Demand for strata-title space and en-bloc demand for end use is also likely to further absorb future supply. As cash-rich domestic firms increasingly upgrade into the Grade A market, their preference is for purchasing space as opposed to leasing. A number of foreign and domestic companies are still actively seeking to purchase space en bloc for self use, primarily financial companies in 'Little' Lujiazui and Zhuyuan.

City-wide vacancy rates are, therefore, likely to be further compressed in the mid to long term. This compression in vacancy rates is expected to continue to result in rental appreciation. Rents are expected to witness an 11% increase year-on-year by the end of 2011 and the pace of such appreciation is only expected to hasten in subsequent years.

## Future project

### SML Centre



SML Centre is a mixed-use development located in Luwan district. The project is composed of 45,500 sq m of Grade A office space, 120,000 sq m of retail in a mall and serviced apartments.

In addition to the retail offered in the mall, SML Centre is expected to benefit from its close proximity to Tianzifang, a restored enclave composed of boutique retail options.

The project is directly connected to metro line 9 (Dapujiao Station). Its unique location results in the project being the only Grade A office project within roughly a 1.5 km radius.

Current asking rents start at around RMB6 per sq m per day (US\$28.6 per sq m per month), while the management fee is still waiting to be confirmed. The project is expected to be handed over to the market in Q1/2012.

Location:	618 Xujiahui Road, Luwan
Developer:	Advanced Semiconductor Engineering Group
Completion date:	Q1/2012
Office GFA:	45,500 sq m
No. of storeys:	26
Floorplate GFA:	Approximately 1,800 sq m
Efficiency:	70% (whole floor)
Clear ceiling height:	2.95 m
Raised floor:	100 mm
Passenger lifts:	10
Asking rent:	Starting at RMB6 per sq m per day
Management fee:	TBC

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