

Adaptive Space

Domestic Companies in the Grade A Office Market: Four Key Occupier Trends Explained

REPORT

CBRE
CHINA RESEARCH

MAY 2023



Executive Summary

One of the major outcomes of the considerable volatility in China's economy and office market witnessed over the past three years has been the increasing prominence of domestic occupiers. As of the beginning of 2023, Chinese firms occupied 72% of space in Grade A office buildings in tier I cities, 12 pps higher than at the end of 2019.

As domestic companies continue to bolster their presence in the Grade A segment, CBRE's analysis of corporate real estate strategy and leasing activity has identified four distinct trends among domestic occupiers we believe will shape China's office leasing market this year.

1 - Rejuvenated major demand engines

Office leasing demand from technology and finance companies has picked up strongly since the beginning of the year, with momentum expected to grow in the coming months. Industry sub-sectors including securities firms and funds, internet data services and software development companies will be increasingly active.

2 - Robust flight-to-quality activity

The pandemic has prompted domestic companies and their employees to place a far stronger emphasis on workplace quality, leading to accelerated growth in flight-to-quality office demand.

3 - Stronger focus on space efficiency

Domestic occupiers, particularly technology and manufacturing firms, are looking to improve space efficiency to facilitate the adoption of flexible working styles.

4 - Growing requirements for green buildings

China's carbon neutrality goals are driving the increased adoption of sustainability criteria and targets among domestic firms. This is leading to stronger demand for green buildings with features such as high energy efficiency.

Domestic companies increase their presence in the office leasing market

Despite recent consolidation within the technology and real estate sectors, domestic companies have gained a larger share of China's office market over the past three years.

Domestic occupiers accounted for 86% of office leasing volume in the three years from 2020-2022, raising their share of occupied space in 500 Grade A buildings in four tier I cities tracked by CBRE from 60% at the end of 2019 to 72% at the end of 2022 (unless stated, subsequent analysis will focus on office leasing by domestic occupiers.)

The increasing prominence of domestic occupiers is being driven by rapid growth in both the number and scale of high-quality local companies across key industries. In 2022, the total number and market capitalisation of A-share listed companies in China had increased by 35% and 33%, respectively, over 2019 levels.

Recent years have also seen many domestic occupiers previously located in relatively lower-quality office buildings upgrading their working environment. Other factors underpinning growth include the pandemic-driven emphasis on workplace health and wellness, which is driving occupier flight to higher quality buildings. Domestic firms retain a strong appetite for expansion, with CBRE's 2022 China Office Occupier Survey finding that 40% of local companies intend to expand their office footprint in 2023, compared to 28% of foreign firms surveyed.

From a longer-term perspective, the continued innovation and evolution of China's economy will provide a new impetus for office demand, which is set to be driven by **rejuvenated major demand engines, robust flight-to-quality activity; a stronger focus on space efficiency; and growing requirements for green buildings.**

Figure 1: Proportion of total space in Grade A buildings in tier I cities occupied by domestic firms¹

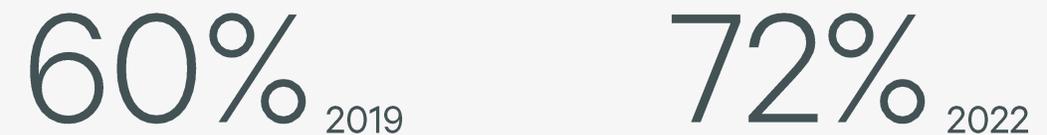


Figure 2: Proportion of leasing volume contributed by domestic occupiers²



Figure 3: Proportion of domestic and foreign companies expected to increase their office space in 2023



Note 1: Calculated based on CBRE's 2019 and 2022 Grade A Office Tenant Profile for Beijing, Shanghai, Guangzhou and Shenzhen in 2019 and 2022.

2: Leasing volume including new set-up, expansion, relocation and upgrading in 18 cities tracked by CBRE
Source: Tier I Cities' Grade A Office Tenant Profile, 2022 China Office Occupier Survey, CBRE Research, April 2023



1

Rejuvenated major
demand engines

As of the end of 2022, the finance and technology sectors accounted for 57% of the total space occupied by domestic firms in Grade A office buildings in tier I cities, 3 pps higher than in 2019. Strong demand growth in sub-sectors including securities and funds, internet data services and software development ensured finance and technology remained the top demand drivers.

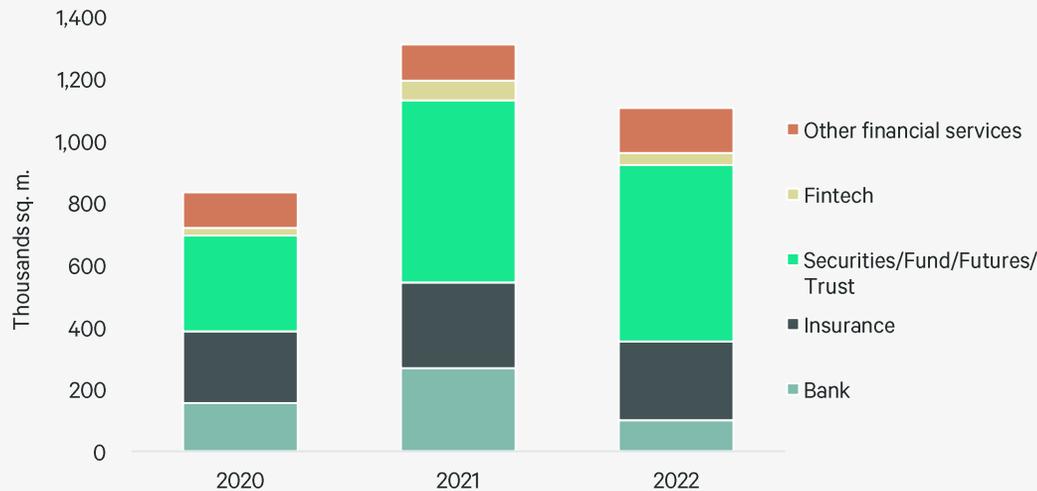
Securities, funds, futures, and trusts (hereafter referred to as securities and funds) accounted for 50% of leasing volume by domestic financial enterprises in 2022, a rise of 14 pps compared to 2020. Within the tech sector, the proportion of leasing volume contributed by internet data services and software development including artificial intelligence and cloud computing companies increased from 45% to 69%.

Figure 4: Finance and technology sector’s proportion of total occupied space by domestic occupiers in Grade A buildings in tier I cities



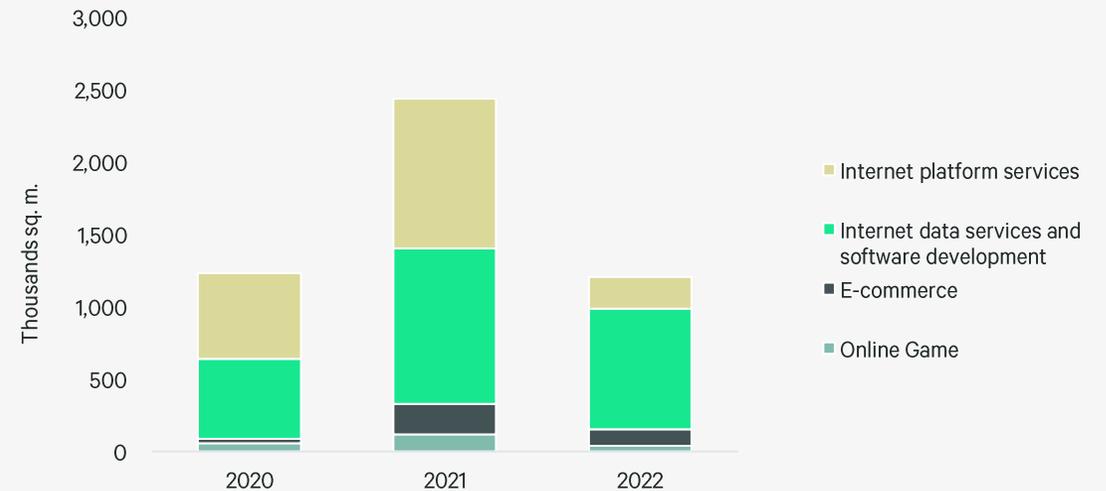
Source: Tier I Cities’ Grade A Office Tenant Profile, CBRE Research, April 2023

Figure 5: Leasing volume by domestic financial enterprises over past three years (by sub-sector)



Source: CBRE Research, April 2023

Figure 6: Leasing volume by domestic technology enterprises over past three years (by sub-sector)



Source: CBRE Research, April 2023

Capital market reform drives expansion of securities and fund institutions

Since 2018, numerous internal reforms, incentives and other initiatives have been introduced to support the growth of China's securities and fund industry. These include the launch of REITs; the opening of the Beijing Stock Exchange; the development and expansion of the stock exchange connect between China and Hong Kong; and the full implementation of a stock issuance registration system.

This has spurred the rapid growth of securities, funds and other businesses within the finance industry. China's A-share market has displayed resilience amid global capital market volatility, with IPO fundraising volume reaching a new record in 2022, growing by 8% y-o-y. The annual number of applications and approvals for private equity fund managers remained the same level as in 2021, ensuring steady expansionary demand among domestic securities and fund institutions. Despite weaker momentum in the overall office leasing market, full-year leasing volume by securities and fund institutions registered 570,000 sq. m. in 2022, on par with the level in 2021 and 84% above that registered in 2020.

With U.S. stock market and private equity investment transactions 3.5x and 6.4x greater, respectively, than China in 2022, China's capital market still has significant growth potential. **CBRE expects the number and scale of companies in industries including securities and funds will continue to grow in the coming years, generating substantial new office requirements.**

Figure 8: Comparison of the scale of the financial industry, stock market, and private equity transactions between China and the U.S. in 2022 (The U.S. versus China)

Financial market size
(Financial Industry Value Added)

> 1.3

Stock market size (total market capitalisation)

> 3.5

Private equity investment market size

> 6.4

Source: National Bureau of Statistics, Preqin, PwC, Sibilisresearch, CBRE Research, April 2023

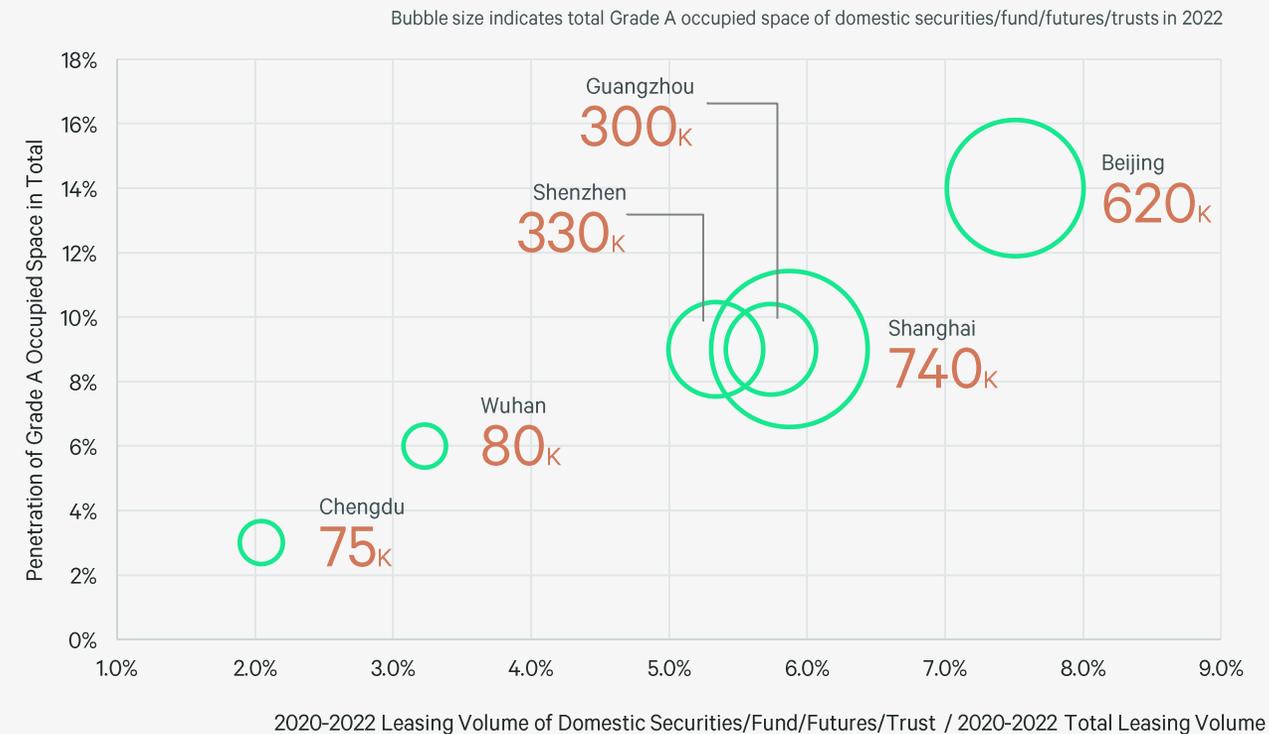
Figure 7: 2017-2023 policy and events timeline related to the reform and opening-up of the securities and fund industry



Source: The State Council, Securities Supervision Commission, and other government agencies public information, CBRE Research, April 2023

Demand from financial institutions continues to be concentrated in tier I cities

Figure 9: Total occupied space by and proportion of domestic securities, funds, futures and trust firms in 2022 and their leasing volume in the past three years



Source: 2022 Tier I Cities; Grade A Office Tenant Profile, CBRE Research, April 2023

Despite the steady increase in the total volume of leasable office stock nationwide, tier I cities, particularly the financial centres of Beijing and Shanghai, retain a distinct advantage in attracting securities and fund institutions.

According to CBRE's 2022 China Office Occupier Survey, of the financial institutions that plan to expand their office space in 2023, 40% of respondents chose Beijing and Shanghai, while 34% of respondents chose Guangzhou and Shenzhen.



Artificial intelligence to spur new technological innovation

Ministry of Industry and Information Technology data show that in 2022, research and development investment by Internet companies above a designated size increased by 7.7% y-o-y, representing an acceleration of growth of 2.7 pps from the previous year. Economic data published in Q1 2023 reveal that the information transmission, software, and information technology service industry's value-added rose by 11.2% y-o-y, with its growth rate ranking second only to the hospitality and F&B industry, which ranked first due to last year's low base.

Recent years have seen the domestic technology industry make significant progress in the field of digital-real integration along with the upgrading of core technology research and development, which has translated to robust requirements for new office space.

Figure 10: Scale and number of enterprises in artificial intelligence sector

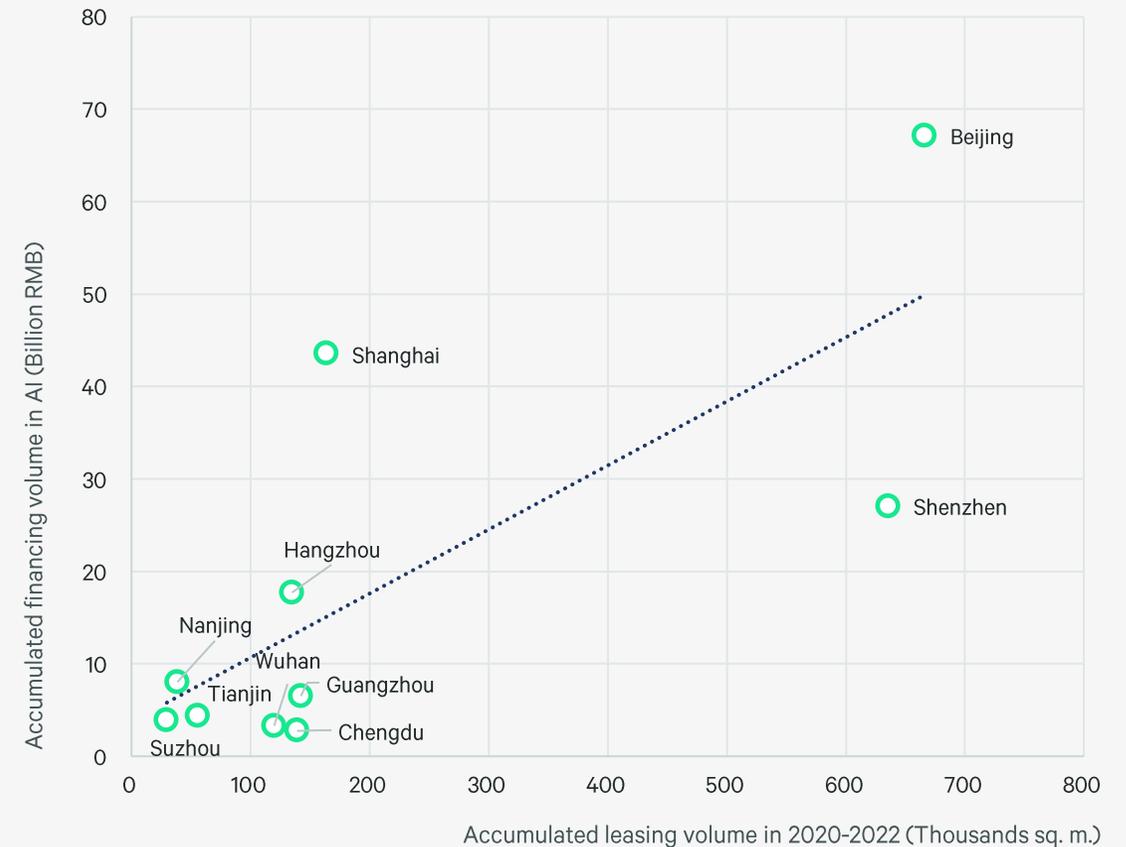
	2020	2021	2022
Industry scale (1 billion RMB)	303	404	508
Number of Enterprises (thousand)	158	338	693

Source: Ministry of Industry and Information Technology, CAICT, QCC, CBRE Research, April 2023

The number of domestic enterprises in the artificial intelligence field tripled from 2020 to 2022, representing an average annual expansion rate of 30% in terms of total industry scale. According to the State Council's New Generation Artificial Intelligence Development Plan, the core industry scale of China's artificial intelligence industry will surpass RMB 1 trillion by 2030, with related industries projected to exceed RMB 10 trillion in scale.

The rapid adoption of ChatGPT and other similar applications is expected to generate a breakthrough in technological innovation, leading to an uptick in office demand from companies associated with these sectors. CBRE believes that leading tech-driven cities including Beijing, Shenzhen, Shanghai, and Hangzhou will continue to hold an advantage in competing to attract these new technology engines.

Figure 11: Financing volume of artificial intelligence firms and leasing volume of internet data services and software development enterprises in major cities



Source: Public information, CBRE Research, April 2023

High-quality economic development spurs growth of business service sector; law firms especially active

Along with finance and technology, CBRE expects the business service sector to remain a key demand driver of the nationwide office market. As China's economy shifts towards more international, specialised, and high-quality development, there has been a corresponding increase in demand for professional services. Domestic law and accounting firms have been growing particularly quickly as they compete and, in some cases, collaborate with their foreign counterparts.

Law firms displayed the strongest demand of any business services sub-sector, contributing 47% of new set-up leasing volume over the past three years. The sector is undergoing rapid growth, with the number of domestic lawyers growing at a rate in excess of 10% annually. Ministry of Justice data show the number of lawyers nationwide reached 575,000 in 2021, giving China about 41 lawyers per 100,000 people. In contrast, the figure in the U.S. is nearly ten times greater. As legal awareness and the social legal environment in China continue to improve, office demand from law firms is expected to accelerate.

Of the total Grade A office space in tier I cities occupied by the business services sector, domestic companies increased their share from 51% as of the end of 2019 to 63% as of the end of 2022. For new set-up leasing volume contributed by business service companies in 2022, domestic occupiers accounted for 91%.

Figure 12: Proportion of total occupied space and new set-up leasing volume by domestic firms in in business service industry³



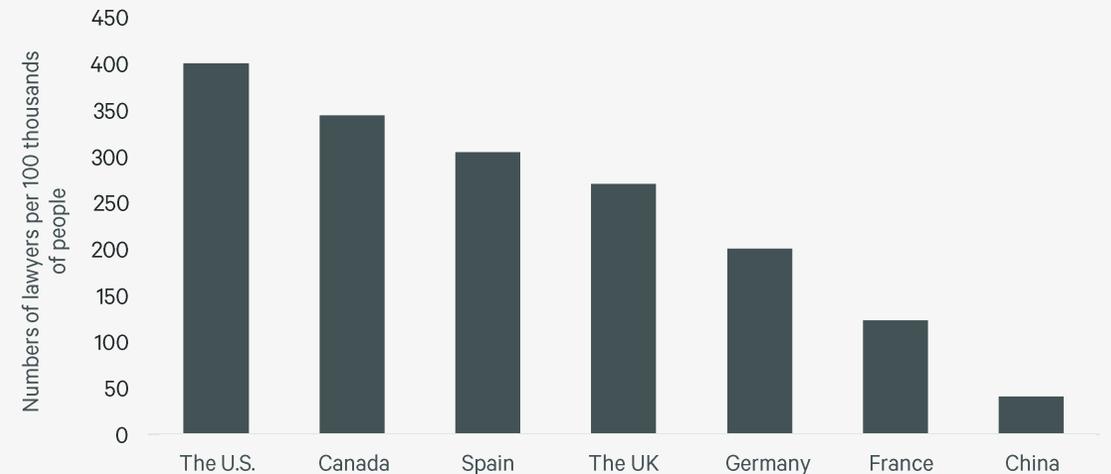
Note 3: The proportion of total occupied space in 2019 and 2022 refers to tier I cities. The proportion of new set-up leasing volume in 2022 is data generated from 18 major tier I and tier II cities tracked by CBRE
 Source: 2022 Tier I Cities; Grade A office tenant profile, CBRE Research, April 2023

Figure 13: Proportion of total occupied space contributed by domestic and foreign occupiers in tier I cities in 2022

	Beijing	Shanghai	Guangzhou	Shenzhen
Domestic	70%	51%	71%	78%
Foreign	30%	49%	29%	22%

Source: CBRE Research, April 2023

Figure 14: Number of lawyers per capita in major countries across the globe⁴



Note 4: Data by country Canada in 2022, the U.S. and China in 2021, Spain, the UK, Germany, and France in 2020
 Source: Ministry of Justice of the People's Republic of China, American Bar Association, Canadian Federation of Bar Associations, Statistica, CBRE Research, April 2023



2

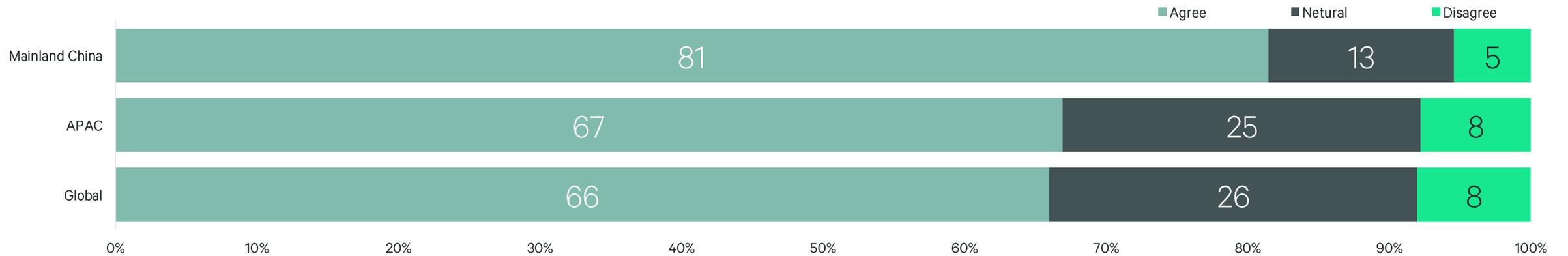
Robust flight-to-
quality activity

Employees increasingly value quality of working environment

Since the onset of the COVID-19 pandemic, office employees have placed a stronger emphasis on the quality of their working environment. CBRE's 2022 Live-Work-Shop Survey found that 81% of Chinese employees believed that the quality of their working environment was more important than before the pandemic, the highest percentage in the world.

Employees are expressing higher expectations for air quality, noise control, daylighting, design, diversity of seating/working areas and leisure facilities in the offices they work in.

Figure 15: Percentage of respondents who thought the quality of their work environment was more important now compared to before the pandemic



Source: 2022 Global Live-Work-Shop Survey, CBRE Research, April 2023

Figure 16: Office features desired by employees and proportion of respondents



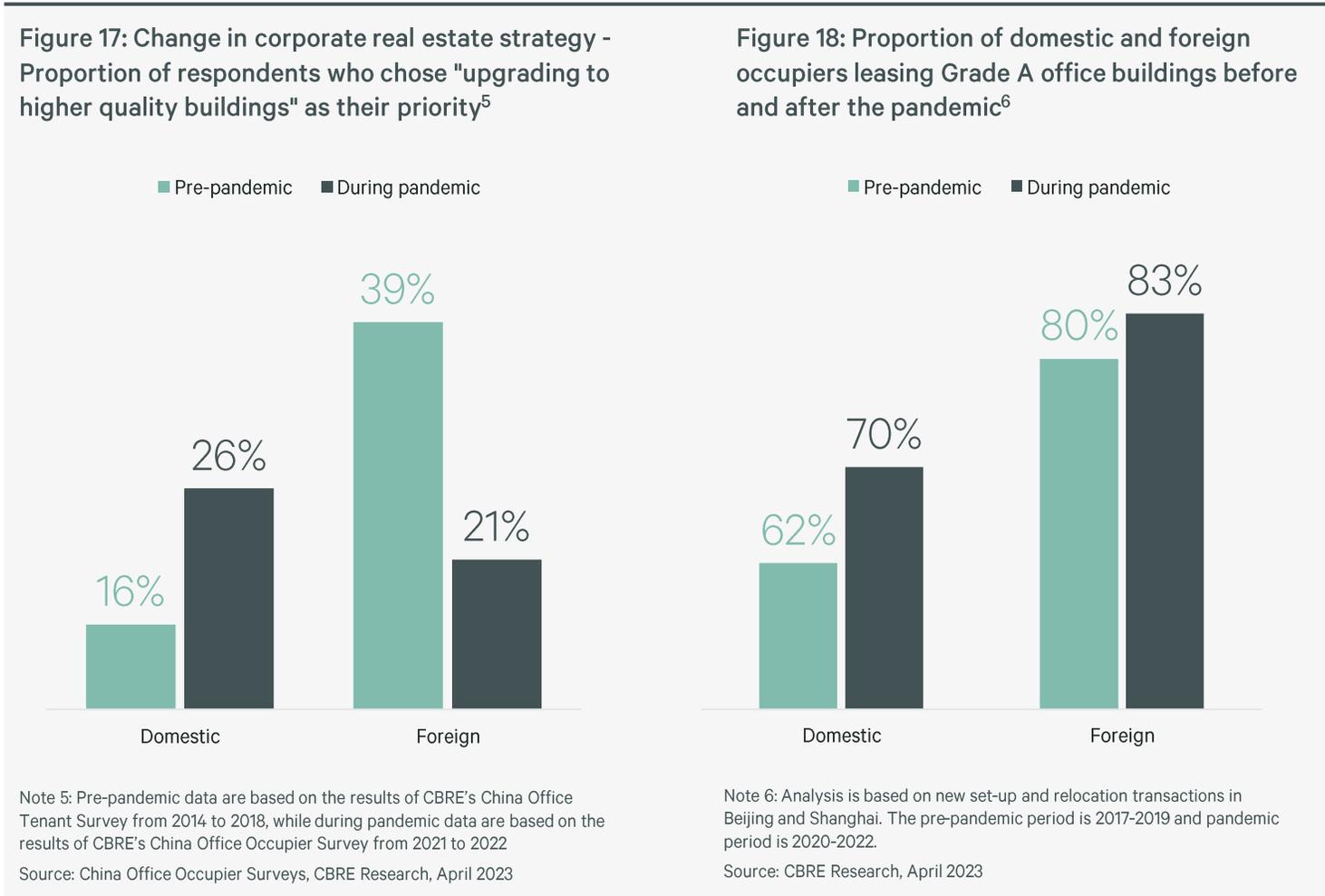
Source: 2022 China Office Occupier Survey, CBRE Research, April 2023

Domestic companies drive upgrading demand

Domestic companies are responding to employees' demands by upgrading their office space. A comparison of recent editions of CBRE's China Office Occupier Survey shows that **domestic occupiers' willingness to upgrade building quality has increased significantly since the pandemic, rising by around 10 pps from 2019 levels.**

CBRE data on new set-up and relocation transactions in Beijing and Shanghai in the three years before and during the pandemic show a significant increase in the proportion of tenants choosing Grade A office buildings. Among these, the proportion of domestic occupiers choosing Grade A buildings increased by 8 pps to 70%. While still lagging foreign companies, the rate of growth was 5 pps faster than overseas firms.

CBRE expects Grade A office space to account for 81% of new office supply in the 18 major cities between 2023 and 2025, with average annual supply projected to reach 5 million to 6 million sq. m. This new stock will provide ample options for domestic occupiers to upgrade, especially in fast-growing new business districts.





3

Stronger focus on
space efficiency

Large and medium-sized manufacturing and tech firms look to consolidate offices

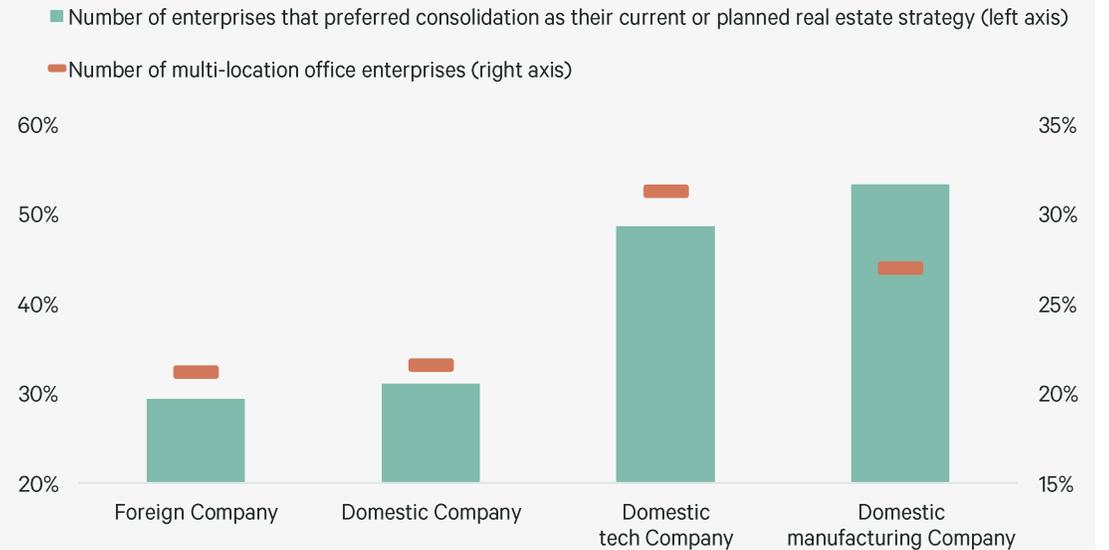
Many large and medium-sized domestic companies are looking to consolidate multiple offices in the same city to a single, usually larger, location. While the main drivers include cost control and business optimisation, enterprises also hope to improve space efficiency and strengthen communication and collaboration among employees.

CBRE’s 2022 China Office Occupier Survey found that 33% of domestic occupiers listed consolidation as their current or planned priority real estate strategy, compared to 29% of foreign companies. Among different industries, domestic occupiers in the manufacturing and technology displayed the strongest intention to consolidate their offices, at 56% and 48%, respectively.

Manufacturing and technology companies’ stronger willingness to consolidate is correlated to the current distribution of their offices. CBRE’s analysis of the composition of occupiers of Grade A office buildings in tier I cities found that among large and medium-sized domestic enterprises with a Grade A office area of 5,000 sq. m. or above in the same city, the overall proportion of enterprises with two or more traditional offices (excluding working points located in shared offices) was 22%. The proportion among manufacturing and technology companies was higher, at 27% and 31%, respectively. CBRE expects potential demand for office consolidation in the future to be even greater if companies’ leased space in Grade B buildings and in business parks that can be integrated into office buildings is considered.

Strong consolidation intentions among domestic companies will translate to stronger demand for full-floor large-areas and single-family headquarters. Over the past three years, around 20% of new leasing transactions of 5,000 sq. m. or more in size in tier I cities involved consolidation.

Figure 19: Proportion of respondents who identified consolidation as their current or planned real estate strategy, and the proportion of large and medium-sized multi-location office enterprises⁷



Note 7: Large and medium-sized multi-location office enterprises refer to enterprises with an office area of 5,000 sq. m. or more in tier I cities

Source: Tier I Cities’ Grade A Office Tenant Profile, 2022 China Office Occupier Survey, CBRE Research, April 2023



Flexible working as a means to enhance spatial efficiency

CBRE expects companies looking to consolidate multiple traditional office spaces into single locations to increasingly utilise flexible working to enhance spatial efficiency while balancing business continuity needs.

Three years of the pandemic and heightened economic uncertainty have had a transformative effect on corporate real estate strategies in China. CBRE’s 2022 China Office Occupier Survey found that nearly 70% of domestic enterprises have incorporated remote/flexible working into their business continuity strategy.

Demand for flexible space solutions, both inside and outside the office, will become more prominent among domestic companies. CBRE’s survey results show that since the onset of the pandemic, the proportion of domestic enterprises setting up flexible seating and collaborative space in their workplaces and including flexible office space as a factor influencing building selection decision has increased significantly.



Figure 20: Proportion of domestic enterprises planning to add flexible seating and collaboration space, prior to and during the pandemic

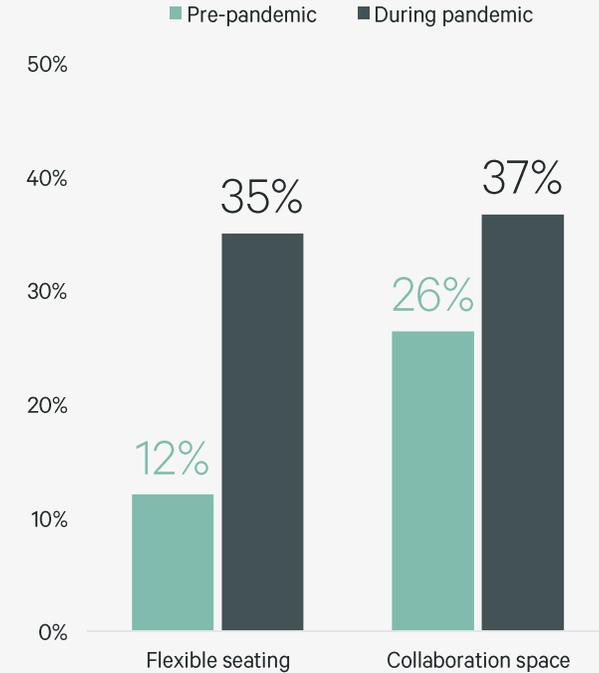
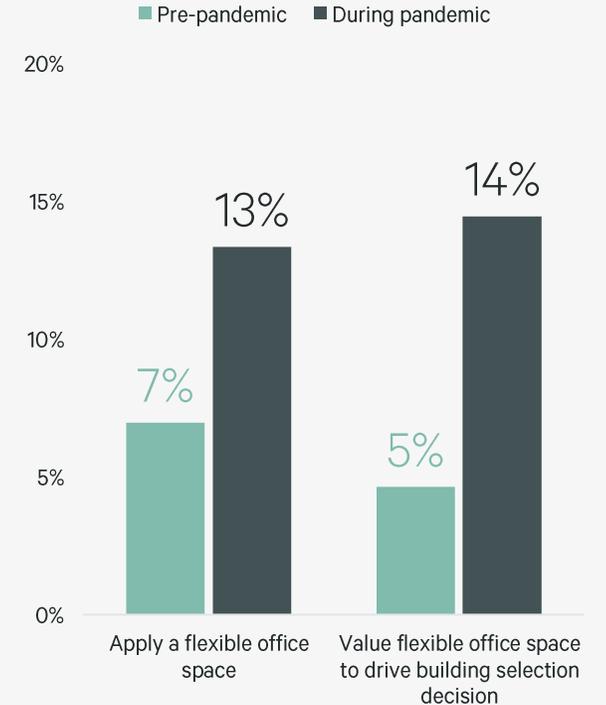


Figure 21: Proportion of domestic occupiers using flexible office space and including flexible office space as a criteria influencing building selection, prior to and during the pandemic



Source: 2020-2022 China Office Occupier Survey, CBRE Research, April 2023



4

Growing requirements for green buildings

As enterprises seek to achieve China's dual carbon goals, green building rental demand will continue to grow

Since China proposed its "3060" carbon goals in 2020, sustainable development and carbon reduction have become important priorities for domestic enterprises.

CBRE's 2022 China Office Occupier Survey found that 10% of domestic companies had set zero-carbon targets, while a large proportion (47%) are considering such a strategy. 54% of domestic enterprises expressed their intention to relocate to green certified buildings.

CBRE's analysis of publicly disclosed carbon neutral targets and relevant ESG information of some leading domestic enterprises show that most corporate real estate including office buildings has been included in the scope of carbon reduction at the level of enterprise operation. Office carbon reduction is crucial to achieving corporate carbon neutrality, particularly for technology and finance companies that use office buildings as their primarily base of operations.

In the short term, domestic enterprises' efforts to reduce carbon emissions at their offices and other workplaces will mainly be focused on self-owned properties, such as by measuring and sharing energy consumption and carbon emission data. As green leases and related metering equipment are more widely adopted, enterprises will be able to include carbon emissions in their assessment of leased buildings, which will continue to promote the growth of green building leasing demand.

Figure 22: Domestic representative enterprise carbon neutral goal and office related initiatives

Enterprise	Main sustainability goal	Statements related to the workplace in ESG reports
Alibaba	<ul style="list-style-type: none"> • Make own operations carbon neutral by 2030 (Scopes 1 and 2) 	<ul style="list-style-type: none"> • By 2025, carbon emissions per unit area of self-owned parks will be reduced by 15% compared with 2021. There will also be a 15% reduction in water consumption per employee
Tencent	<ul style="list-style-type: none"> • Collaborate with upstream and downstream value chains to reduce carbon emission intensity by 50% from 2020 by 2030 	<ul style="list-style-type: none"> • All new own-owned parks will meet LEED (Gold) certification and China Green Building standards
Pingan	<ul style="list-style-type: none"> • Make its own operations and supply chain carbon neutral by 2030, and achieve 100% green electricity 	<ul style="list-style-type: none"> • Encourage low carbon behaviour and low carbon commuting and travel to and in the office
Shanghai Jahwa	<ul style="list-style-type: none"> • A 70% reduction in absolute emissions in areas 1 and 2 and a 30% reduction in absolute emissions in areas 3 by 2030, using 2021 as the base year 	<ul style="list-style-type: none"> • Continue to improve energy and resource efficiency in office operations

Source: Public information of corporate ESG annual reports, CBRE Research, April 2023

Recommendations

- As these four trends come to define China's office leasing market in the coming years, CBRE has identified several strategies for domestic occupiers to consider.
- Real estate planning and business objectives should be closely aligned to ensure enterprises can proactively respond to the rapidly changing economic environment and real estate market.
- As employees attach greater importance to their working environment, occupiers must consider factors such as public transport; building hardware and services; business and leisure facilities when conducting site selection.
- Domestic enterprises are advised to include office utilisation in the cost of real estate appraisal systems; pursue multi-location office consolidation; utilise third-party flexible office space; and increase flexible/remote working to improve space efficiency.
- Although Grade A office supply in tier I cities is expected to be relatively abundant from 2023-2025, occupiers must pay close attention to future development trends to ensure they plan well ahead for office consolidation, relocation and upgrading.
- With real estate set to be at the core of corporate ESG strategy, occupiers are advised to give priority to leasing green buildings; better communicate and cooperate with owners to promote energy conservation and emission reduction in the office; and to prioritise the inclusion of green clauses in leasing contracts.



Contacts

China Research

Sam Xie

Head of Research, China
sam.xie@cbre.com

Joey Wu

Senior Analyst, China Research
joey.wu@cbre.com

Shirley Hu

Senior Director, China Research
shirley.hu@cbre.com

China Advisory & Transaction Services

Rayman Zhang

Head of A&T Office, China
rayman.zhang@cbre.com.cn

© Copyright 2023. All rights reserved. This report has been prepared in good faith, based on CBRE's current anecdotal and evidence based views of the commercial real estate market. Although CBRE believes its views reflect market conditions on the date of this presentation, they are subject to significant uncertainties and contingencies, many of which are beyond CBRE's control. In addition, many of CBRE's views are opinion and/or projections based on CBRE's subjective analyses of current market circumstances. Other firms may have different opinions, projections and analyses, and actual market conditions in the future may cause CBRE's current views to later be incorrect. CBRE has no obligation to update its views herein if its opinions, projections, analyses or market circumstances later change.

Nothing in this report should be construed as an indicator of the future performance of CBRE's securities or of the performance of any other company's securities. You should not purchase or sell securities—of CBRE or any other company—based on the views herein. CBRE disclaims all liability for securities purchased or sold based on information herein, and by viewing this report, you waive all claims against CBRE as well as against CBRE's affiliates, officers, directors, employees, agents, advisers and representatives arising out of the accuracy, completeness, adequacy or your use of the information herein.