



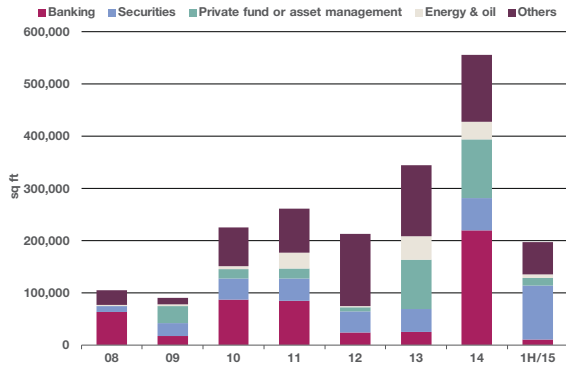
Savills World Research
Hong Kong

Asian Cities Report **Hong Kong Office**

2H 2015

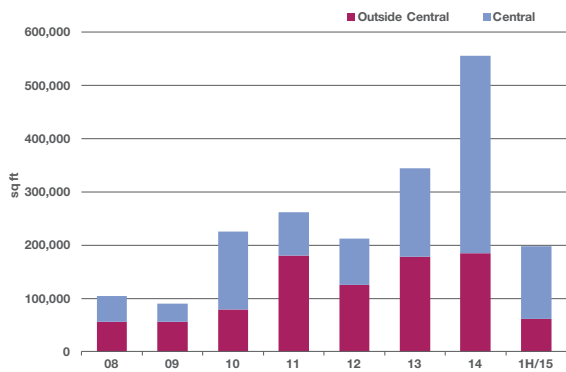


GRAPH 1
PRC office leasing transactions by sector and by year, 2008–1H/2015



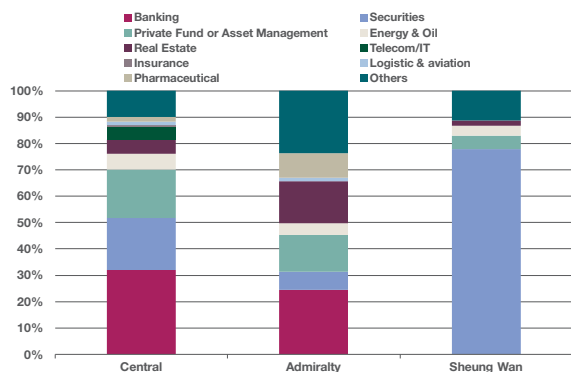
Source: Savills Research & Consultancy

GRAPH 2
PRC office leasing transactions in Central and outside Central by year, 2008–1H/2015



Source: Savills Research & Consultancy

GRAPH 3
PRC office leasing transactions by sector in Central, Sheung Wan and Admiralty, 2008–1H/2015



Source: Savills Research & Consultancy

Market overview

The office leasing demand profile in Hong Kong has been changing quite rapidly in recent years. Although Hong Kong is regarded as an international finance centre which houses various financial institutions, multinational investment banks such as Societe Generale, Credit Suisse, Morgan Stanley and Deutsche Bank, have all recently reduced their office requirements in prime office buildings since 2009, after aggressive expansion in 2008.

Luxury brands such as Prada, LVMH, Richemont and Longchamp, which were actively taking up office space in 2011 and 2012, have slowed their expansion plans since 2013. Apple, Samsung, Facebook and Google were occupying more space in 2013 but this space was still comparatively small and for sales activity rather than product development and research. These trends lasted for only a short period of time.

PRC demand

As the multinationals have downsized new engines of demand are appearing which we believe will make up the shortfall. Since 2008, we have noted a steady but increasing demand from PRC firms. The leasing transactions for office space by PRC firms increased 4.3 times to 556,000 sq ft in 2014. Of this, banks, securities and asset management firms are playing a major role, representing 26.7%, 18.4% and 15.0% of the total by area leased from 2008 to 1H/2015, respectively.

PRC firms tend to stay in Central; from 2008 to 1H/2015 this area accounted for between 31% and 69% of transactions in any given year. Central can be divided into three areas: core Central; Admiralty; and Sheung Wan. In general, securities firms prefer Sheung Wan, possibly due to the more affordable rents there. From 2008 to 1H/2015, 77.8% of the PRC leasing transactions in Sheung Wan were undertaken by securities firms.

Banks prefer to stay in Central as they are less sensitive to the higher rents and recognise the better opportunity for brand building. Many of the larger mainland banks and insurers would ideally purchase en-bloc with naming rights but such opportunities are scarce. According to data from The Banker, PRC banks occupy four of the spots in the list of the Top 10 World Banks by tier-1 capital. Besides leasing, some of them own a number of quality office buildings in Central; only ICBC does not yet have its own building.

Compared with the strong performance of the banking industry in 2014, when they represented 39.6% of total transactions, this year the securities firms are playing a more important role. In the first six months of 2015, securities firms have surpassed banks to become a more significant office demand driver, due to the Stock Connect Schemes and the mutual fund recognition agreement.

Stock Connect

In April 2014, Hong Kong and China made a Joint Announcement to approve the development of the Shanghai-Hong Kong Stock Connect for the establishment of mutual stock market access between Shanghai and Hong Kong. Under this agreement, investors are able to trade shares listed on the other's market. Since the start of the scheme in November 2014, the average daily northbound transaction value (Hong Kong investors buying Shanghai Stocks) increased by 92% to RMB8,921.99 million; average daily southbound trade meanwhile increased by 4.6 times to HK\$4,227.14 million.

As the connect scheme matures, we are seeing more PRC securities firms opening up in Hong Kong instead of Hong Kong securities firms opening up in China. The reason is that as Hong Kong's financial market is more established, PRC investors are eyeing the wider range of financial products on offer, creating a strong demand for the

securities firms to expand in Hong Kong. The Mutual Recognition of Funds, which allows recognised funds to be offered to the public in both markets, will provide further options to investors. This, together with the upcoming Shenzhen-Hong Kong Stock Connect, which allows mutual stock market access between Shenzhen and Hong Kong, will mean a further increase in leasing demand from both PRC securities firms and funds.

Stock market turmoil

Recently, however, the stock markets in China and Hong Kong have been subject to a great deal of volatility. As of 20 Aug 2015, the Shanghai Composite Index and the Hang Seng Index fell by 29% and 17% from their peak in June. The correction in the China stock market was due to the tightening of margin financing in late June, which forced some retail investors to cash in their positions. This popped the bubble created by hot money flows and started the correction in the market.

To stabilise the market the Chinese government implemented a number of measures, including placing limits on short-selling under threat of arrest by the regulator, the stopping of initial public offerings, providing cash to brokers to purchase stocks back, and a six-month ban on stockholders owning more than five percent of a company's stock from selling that stock.

Besides a direct negative impact on the trading volume as fewer stocks have been available for sale, the increased risk of government intervention has made the stock market more unpredictable, suppressing volumes, which is affecting the profits of PRC securities firms. According to the Securities Association of China, total revenue and net profit of the securities firms in July fell by 41.2% and 49.07% month-on-month, respectively. The leasing demand over the remainder of 2015 is therefore expected to soften significantly due to the reduced

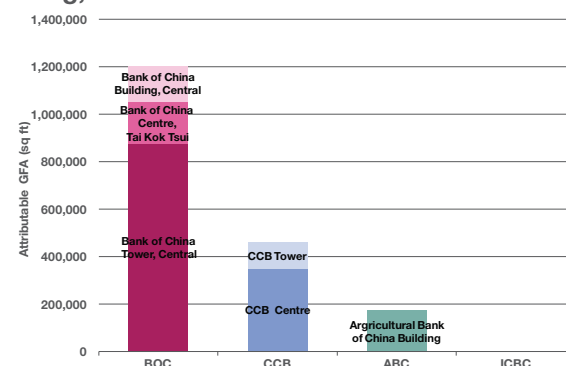
profitability of the securities industry and the poor performance of PRC-related asset management companies and funds.

To make matters worse, in August 2015, two months after the crash, the Central Bank devalued the renminbi by three percent relative to the Hong Kong dollar. The HK dollar is likely to appreciate further with growing expectations of an interest rate rise in the US. This will increase the cost of setting up or expanding offices in the short term. Furthermore, the limited space in Central, where the vacancy rate dropped to 2.0% in July, will also discourage PRC demand.

Conclusion

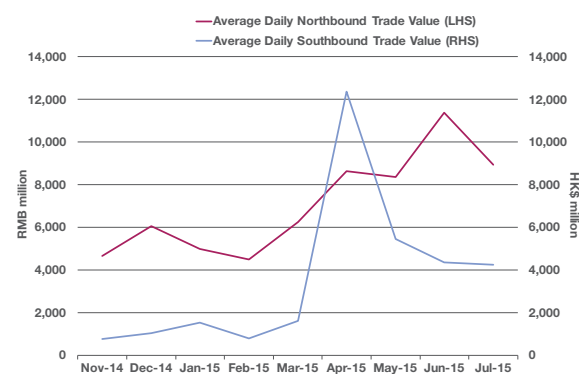
Although we expect a short term slowdown in the take-up of office space by PRC firms, we believe this is still an ongoing demand driver which will support rents over the next 10 years, especially in Grade A office buildings in Central. Despite slower economic growth (at a mid-single-digit level) in China, it will remain one of the largest and fastest-growing emerging economies in the world. As long as Hong Kong is still playing a role which connects the capital markets of the PRC to the outside world, demand for offices will continue. ■

GRAPH 4
Area owned by the 'big four' banks in Hong Kong, 1H/2015



Source: Savills Research & Consultancy

GRAPH 5
Average daily trading volumes of securities under the Shanghai-Hong Kong Stock Connect Scheme



Source: Hong Kong Exchanges & Clearing Limited, Savills Research & Consultancy

TABLE 1
Major PRC transactions in Central, 1H/2015

Name of the firm	Building	Area (sq ft)
Luzheng Futures	33 Des Voeux Road Central	13,500
GF Holdings (Hong Kong)	Wing On Centre	15,355
Huajin Financial (International Holdings)	Citibank Tower	10,528
Fosun	Citibank Tower	25,473
BOCI Securities Ltd	Cosco Tower	19,745

Source: Savills Research & Consultancy

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