Hong Kong – January 2019

Office Leasing

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Office rents hit record highs

Wanchai/Causeway Bay saw displacement demand from Central tenants as average Grade A rents in the CBD reach HK$146 per sq ft per month net effective.

- Wanchai/Causeway Bay rents increased by 2.6% in Q4/2018, making this the business district with the highest rental growth for a third consecutive quarter.
- Causeway Bay and Island East have now emerged as two new financial hubs. Causeway Bay is popular among Asian banks while Island East tends to attract the middle and back offices of multinational financial-institutions.
- Kowloon East, where average rents are HK$35.5 per sq ft net effective, remained the only district where rents were not at an historical high in Q4/2018. Despite this, rents have held up remarkably well considering the high supply volumes in 2018.
- WeWork took over 90,000 sq ft in Hysan's portfolio in Causeway Bay in Q4, continuing the active expansion of their co-working operations in Hong Kong.
- PRC demand has slowed given HNA's surrender of five floors in Three Exchange Square while some PRC firms reportedly walked away from leases in ICC.
- The overall vacancy rate in Hong Kong increased by around 0.5 percentage points during the quarter with a majority of the space located in Kowloon East.
- We expect Grade A rents to continue to make modest gains next year but a protracted trade war and/or a sustained stock market sell off could reverse that.

"Rents continue to test affordability in most districts as tenants search for a dwindling number of decentralised alternatives."

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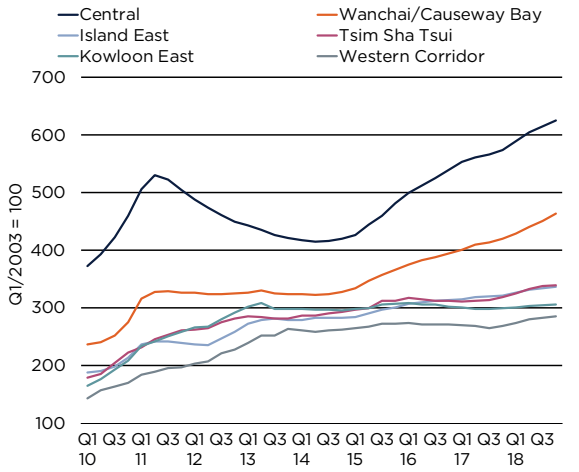
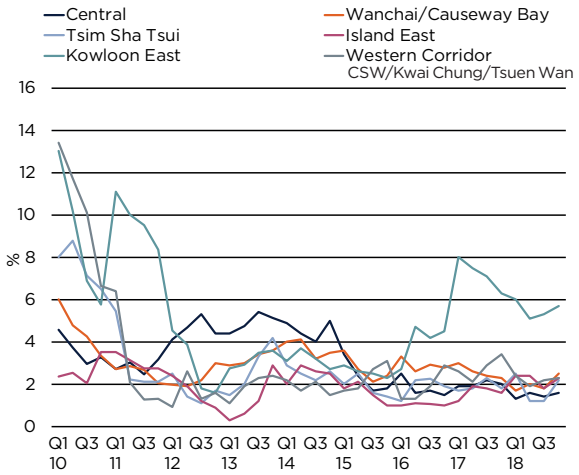
GRAPH 1: Savills Grade A Office Rental Indices By District Q1/2010 to Q4/2018



Source Savills Research & Consultancy

GRAPH 2: Grade A Office Vacancy Rates By District Q1/2010 to Q4/2018



Source Savills Research & Consultancy

MARKET COMMENTARY

During the fourth quarter of 2018, overall Grade A office rents increased by 1.3% while all districts have recorded positive rental growth since Q4/2017. Wanchai/Causeway Bay rents were the main driver, up by 2.6% during the quarter, followed by Central (+1.6%) and Kowloon West (+1.1%). Island rents, which increased by 1.8%, outperformed Kowloon rents, which were up only 0.3% in Q4/2018. During 2018, overall rents were up by 7.8%. The main growth driver was Wanchai/Causeway Bay (+10.2%), which was popular among rent refugees from Central and recorded the highest rental growth among all districts. Central's rents were up 9.0% over the year as a whole.

Looking back at 2018 Central rents hit record levels and even saw an end-of-year spike caused by tenant relocations from the soon-to-be-redeveloped Hutchison House and the newly acquired The Center. PRC demand softened during the year compared with 2017 levels, partly because of a lack of availability (the Hong Kong Island vacancy rate hit 2.0% in December representing only 661,000 sq ft).

As Central rents tested new highs (BitMEX, a cryptocurrency exchange took 21,300 sq ft in Cheung Kong Center in Q3/2018 for HK$225 per sq ft per month) decentralization became a trend. The main beneficiaries were Causeway Bay and Island East which have now emerged as two new financial hubs. Causeway Bay is popular among Asian banks while Island East tends to attract the middle and back offices of multinational financial-institutions.

In Kowloon East rents held up remarkably well in 2018 given elevated levels of new supply (1 million sq ft in total, 60% of which has been absorbed). The area still has availability in new builds such as The Quayside (480,000 sq ft), Kingston International Centre (460,000 sq ft) and NEO (600,000 sq ft). For tenants who require over 50,000 sq ft there is no option other than Kowloon Bay/Kwun Tong.

Co-working demand was evident throughout the year with PRC brands showing some signs of fatigue towards year-end. WeWork on the other hand has shown no signs of flagging (the company now occupies 500,000 sq ft in total, including its pre-commitment in The Quayside). We feel that after two exceptional years, however, 2019 will see some pull back from this particular demand driver. Currently, coworking operators occupy some 2.16 million sq ft in total across major districts in Hong Kong.

The vacancy rate on Hong Kong Island increased slightly to 2.0% in Q4/2018, from 1.9% in Q3/2018. Central's vacancy rate in December 2018 was 1.6%, 0.4 percentage points above the recent low of 1.2% recorded in November 2018. The vacancy rate in Kowloon East rose from 5.3% to 5.7% during the quarter.

What could de-rail the market? Although unlikely, only large scale corporate failure could lead to a correction. PRC firms have been under some pressure recently and most notably, HNA surrendered five floors in Three Exchange Square while other smaller PRC firms have reportedly walked away from leases in ICC. Nothing yet on a scale to warrant concern however (landlords are generally well-protected from such incidents as six to nine-month deposits from less well-known PRC firms are now the norm). A stock market correction is another possibility which could potentially derail what looks to be a promising IPO pipeline this year.

TABLE 1: Grade A Office Rental Growth Q3/2018 VS Q4/2018

DISTRICT	Q3/2018 (%)	Q4/2018 (%)
Central	+1.8	+1.6
Wanchai/Causeway Bay	+2.3	+2.6
Island East	+0.8	+0.9
Tsim Sha Tsui	+1.5	+0.2
Kowloon East	+0.7	+0.2
Kowloon West	+0.8	+1.1

Source Savills Research & Consultancy

TABLE 2: Major New Lettings Q4/2018

TENANT	BUILDING	AREA (SQ FT)
WeWork	Lee Garden One	60,700
L'Oreal Luxe Travel Retail Asia Pacific	Sun Hung Kai Centre	59,300
WeWork	Hysan Place	32,900
Handy Travel	South Island Place	30,000
Milway Development Ltd	Kingston International Centre	28,500
United Overseas Bank Ltd	China Taiping Tower - Phase 1	26,800
HuaTai	The Center	23,500

Source Savills Research & Consultancy