

Briefing Office leasing

February 2018



SUMMARY

All major business districts enjoyed rental growth in Q4 while Kowloon East rents have risen for two consecutive quarters despite elevated supply levels.

- Central and Wanchai/Causeway Bay were again the main drivers of rent increases, up by 1.4% and 1.5% respectively over the last quarter of 2017.

- PRC firms are tending to favour a basket of Grade A offices in Central including IFC One and Two, AIA Central, Cheung Kong Center, Pacific Place One and Two and Exchange Square One, Two and Three where they account for 15% occupancy by floor area.

- Shenzhen is still a preferred location for PRC tech firms, who see Hong Kong more as a platform for fund raising.

- The current rental difference between Kowloon East and locations on Hong Kong Island, such as Wanchai/Causeway Bay and Island East, justifies the cost of relocation, allowing Kowloon East landlords to maintain or even raise rents.

- Vacancy levels in the four traditional core office districts of

Central, Wanchai, Causeway Bay and Tsim Sha Tsui are at, or close to, historical lows.

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 “Central rents are barreling along, driven by PRC financial services demand and vacancy rates near historical lows.”

Simon Smith, Savills Research

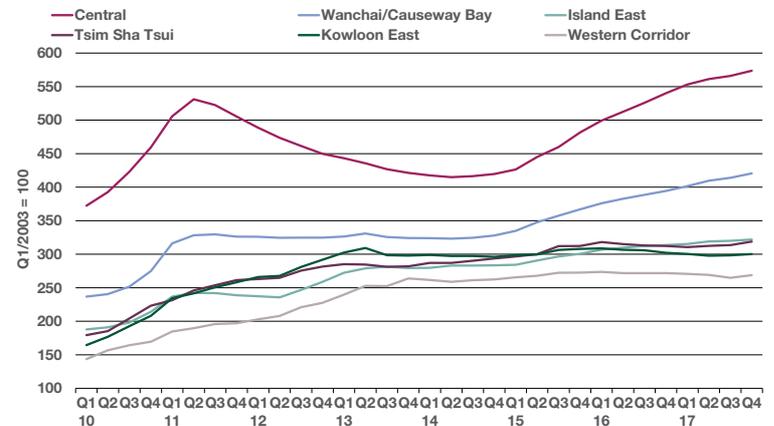
➔ **Market commentary**

Central rents recorded their highest premium over the rest of the market for a fourth consecutive quarter while Kowloon rents grew in line with Island rents for the first time since Q3/2015. Grade A office rents in Central, Wanchai/Causeway Bay, Island East and Tsim Sha Tsui grew by 1.4%, 1.5%, 0.5% and 1.5% respectively over the quarter. Kowloon East enjoyed rental growth for two consecutive quarters, with a rise of 0.7% during the fourth quarter. Kowloon West rebounded by 1.5%, ending three consecutive quarterly drops. Overall Grade A office rents in Hong Kong grew by 1.4%, the highest growth rate since Q1/2016.

In Central transactions volumes continue to hold up well but are increasingly dominated by PRC banks, brokerages and asset managers with the international i-banks firmly in the back seat. PRC firms are tending to favour a relatively niche portfolio of high-profile developments including IFC One and Two, AIA Central, Cheung Kong Center, Pacific Place One and Two and Exchange Square One, Two and Three. We estimate that Mainland firms currently account for around 15% of these buildings by floor area and this can be expected to rise over time. Rents in these prime offices range from HK\$145 to HK\$200 per sq ft net effective. Cross-border trading initiatives, such as the Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect Schemes will continue to attract more PRC financial firms to Central. Landlords in Central are also currently showing a preparedness to churn tenants in the search for better covenants, terminating potential risks in favour of more financially secure options. This is easy to do when newly available space is tending to attract two to three offers at a minimum.

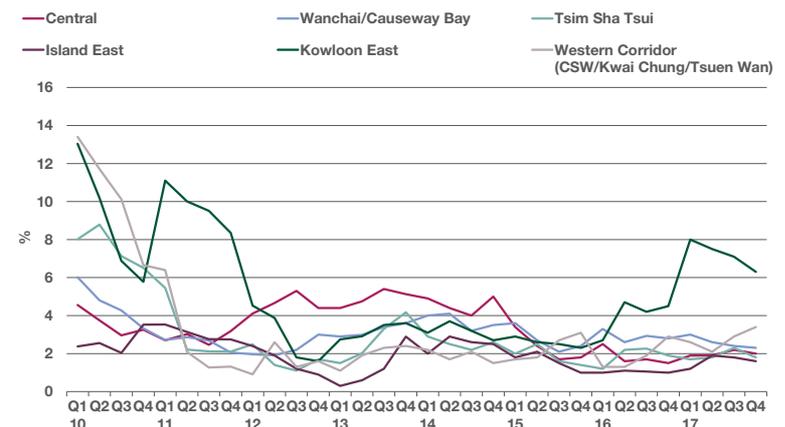
Not surprisingly Central's high rents (the district retains its dubious title as Asia's most expensive office market) and limited availability are driving businesses to decentralised markets. We note that One Taikoo Place with its prime harbour views and high specs is attracting some high-profile movers including Facebook, Baker McKenzie, Simmons and Simmons and JLL, a property services firm. What Island East has not yet succeeded in doing is attracting a banking front office,

GRAPH 1 **Savills Grade A office rental indices by district, Q1/2010–Q4/2017**



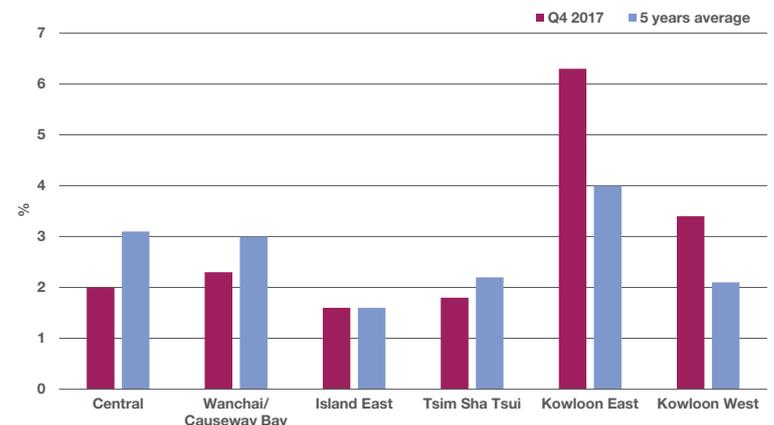
Source: Savills Research & Consultancy

GRAPH 2 **Savills Grade A office vacancy rates by district, Q1/2010–Q4/2017**



Source: Savills Research & Consultancy

GRAPH 3 **Savills Grade A office vacancy rate by district, Q4/2017 vs 5-year average (2013–2017)**



Source: Savills Research & Consultancy

but with improved transport links (the Central and Wanchai bypass will cut travel times from 20 to 10 minutes) and a greater cost consciousness in the industry, such a move seems less unlikely with each passing year.

PRC tech firms perhaps see Hong Kong more as a market to IPO in rather than as a headquarter location as most of the PRC tech giants are fully committed elsewhere. Baidu is headquartered in Beijing, Alibaba in Hangzhou and Tencent in Shenzhen where the company has just completed a vast new headquarters. In fact, all the PRC tech majors have a substantial presence in Shenzhen where Grade A office rents are half those of Hong Kong.

A surprise on the upside for landlords over recent quarters has been the resilience of Kowloon East rents which have largely held up above HK\$30 per sq ft. Vacancy in the area remains relatively low while rents in areas such as Island East and Wanchai/Causeway Bay have remained relatively high allowing Kowloon East to push up rents while maintaining the crucial HK\$20 per sq ft per month plus differential which is the cost of relocation. Vacancy generally is at extremely low levels in the four traditional core office districts and is expected to tighten further into 2018. ■

TABLE 1 Savills Grade A office rental growth, Q3/2017 vs Q4/2017

	Q3/2017 (%)	Q4/2017 (%)
Central	+0.9	+1.4
Wanchai/Causeway Bay	+1.1	+1.5
Island East	+0.5	+0.5
Tsim Sha Tsui	+0.4	+1.5
Kowloon East	+0.2	+0.7
Kowloon West	-1.9	+1.5

Source: Savills Research & Consultancy

TABLE 2 Major new lettings, Q4/2017

Tenant	Building	Size (sq ft)
CNN	41 Heung Yip Road	35,232
China Merchants Securities	Manulife Financial Centre – Tower B	30,985
Regus	700 Nathan Road	23,406
China Fortune Financial Group	Cosco Tower	22,547
5.11 Sourcing Ltd	Goldin Financial Global Centre	17,759

Source: Savills Research & Consultancy

TABLE 3 Major pre-leasing deals, Q4/2017

Tenant	Building	Size (sq ft)
Facebook	One Taikoo Place	109,000
Baker McKenzie		103,500
Pacific International Capital Inc Ltd	K11 Atelier	12,380

Source: Savills Research & Consultancy

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