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Savills World Research
Hong Kong

Briefing
Office leasing

August 2018

SUMMARY

As rents rise to world-beating levels in core locations, decentralization is proving to be the answer for many firms.

- Wanchai/Causeway Bay replaced Central as the main driver of rental increases, up by 2.8% over the second quarter of 2018.
- Besides PRC demand, new economy firms are also beginning to make their presence felt in core areas.
- Grade A office space proved popular among co-working brands who embarked on ambitious expansion plans in Q2/2018.
- Falling vacancy Kowloon-side drove the overall vacancy rate down during the quarter.
- Major pre-leasing commitments from three tenants in One Hennessy, which is now 60% leased, further reduced availability from new buildings on Hong Kong island.
- Kowloon East enjoyed mild rental growth and lower vacancy levels, mainly driven by take-up in high quality and newly developed buildings in Kowloon Bay.

"High quality new builds in decentralized locations are attracting brisk rates of pre-commitment and options for tenants are dwindling rapidly."
Simon Smith, Savills Research

Market commentary

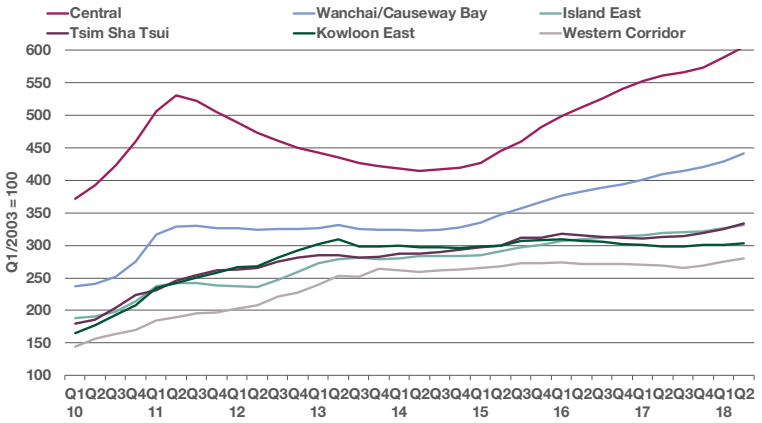
Grade A office rents in all districts recorded positive growth again in Q2/2018, continuing the momentum from Q4/2017. This trend is supported by the change in the overall vacancy rate which fell from 3.6% in Q3/2017 to 2.8% in Q2/2018 representing take-up of 190,000 sq ft. Although vacancy on Hong Kong island was found to increase slightly over the second quarter from 1.7% to 1.9%, leasing activity in Kowloon, which saw vacancy fall by 1.2 percentage points to 3.9%, drove the overall vacancy rate lower.

Overall Hong Kong Grade A office rents rose by 2.4% over the period. Grade A rents in Wanchai/Causeway Bay enjoyed the highest positive growth (+2.8%) among all districts, followed by Tsim Sha Tsui (+2.7%) and Central (+2.5%). Kowloon West's rents have been rising for three consecutive quarters, with 2.1% growth recorded over the second quarter. Island East's rents rose by 1.6%, the highest growth rate since Q2/2016. Rents in Kowloon East grew by 0.9% over the period.

Co-working space operators were highly active in both core and non-core business districts. In the most notable deal of the quarter Kr Space, one of China's biggest co-working operators, pre-leased seven floors (83,000 sq ft) in One Hennessy, which is expected to be completed in 2019, for its first co-working location in Hong Kong. Another China co-working operator, Ucommune, leased a whole floor (22,200 sq ft) in Grand Century Place Tower II in Mong Kok for its second co-working spot in Hong Kong. In another deal the Great Room, an operator from Singapore, pre-leased in One Taikoo Place. We also saw an ambitious expansion from Campfire, a local operator who leased three floors (77,000 sq ft) in the commercial podium of Harbourfront Landmark in Hung Hom. At our last count in May this year there were 72 operators occupying around 2.1 million sq ft.

GRAPH 1

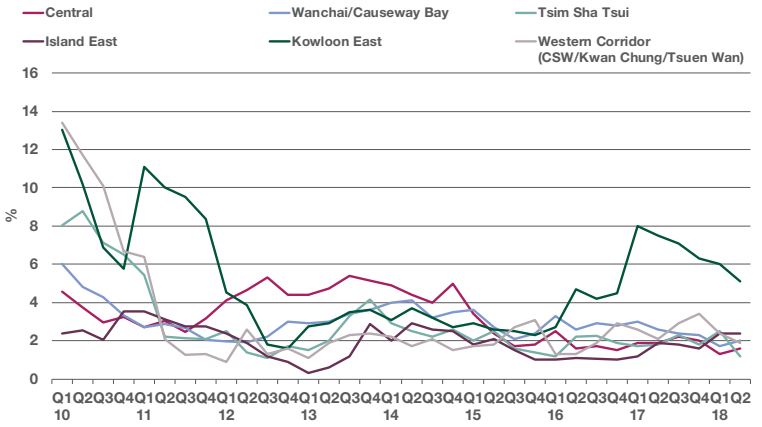
Savills Grade A office rental indices by district, Q1/2010 – Q2/2018



Source: Savills Research & Consultancy

GRAPH 2

Savills Grade A office vacancy rates by district, Q1/2010 – Q2/2018



Source: Savills Research & Consultancy

TABLE 1

Savills Grade A office rental growth, Q1/2018 vs Q2/2018

	Q1/2018 (%)	Q2/2018 (%)
Central	+2.8	+2.5
Wanchai/Causeway Bay	+2.1	+2.8
Island East	+1.6	+1.6
Tsim Sha Tsui	+2.0	+2.6
Kowloon East	+0.1	+0.9
Kowloon West	+2.2	+2.1

Source: Savills Research & Consultancy

TABLE 2

Major new lettings, Q2/2018

Tenant	Building	Area (sq ft)
DBS	Two Harbour Square	197,000
Campfire	Harbourfront Landmark	77,000
Starbucks	Millennium City 5 – BEA Tower	35,100
GIA HK Laboratory Ltd	Goldin Financial Global Centre	34,000
ANX International	Lee Garden One	33,000

Source: Savills Research & Consultancy

TABLE 3

Major pre-leasing deals, Q2/2018

Tenant	Building	Area (sq ft)
Kr Space	One Hennessy	83,000
Pudong Development Bank		73,600
ICAP		24,500
The Great Room	One Taikoo Place	20,700

Source: Savills Research & Consultancy

Besides co-working, demand from the new economy, including firms involved with cryptocurrencies, blockchain and insurtech, is a rising demand factor in the leasing market. Since HKEX permits the listing of companies with a dual-class share structure, we expect to see more leasing demand from such companies which are aiming for an Initial Public Offering in Hong Kong. Although PRC demand is still an important demand driver, we found leasing activity from some PRC corporations was less pronounced this quarter with some even looking to return space if domestic circumstances required it.

In June 2018, Cityplaza Three and Four were sold for HK$15 billion or HK$19,490 per sq ft. En-bloc sales of such major office buildings may further invigorate the leasing market since an ownership change may trigger alternative leasing strategies and tenant mixes. The redevelopment of older stock (Hutchison House has finally been confirmed for redevelopment next year) could also be a factor limiting availability in the near future.

Over the period, we observed active pre-leasing in Wanchai, with three deals accounting for around 60% of One Hennessy, a 300,000 sq ft redevelopment project which is expected to be completed in 2019. During 2018-2019, apart from One Hennessy, we expect to see several new completions on Hong Kong island with One Taikoo Place (1 million sq ft) and South Island Place (380,000 sq ft) in 2018 and 730 King's Road (440,000 sq ft) in 2019. One Taikoo Place is already 75% committed with all remaining space under negotiation while KPMG is said to have taken 150,000 sq ft in South Island Place in July 2018. Of the 2.12 million sq ft of new Hong Kong island supply over 2018-2019, only 800,000 sq ft remains available after high levels of pre-commitment.

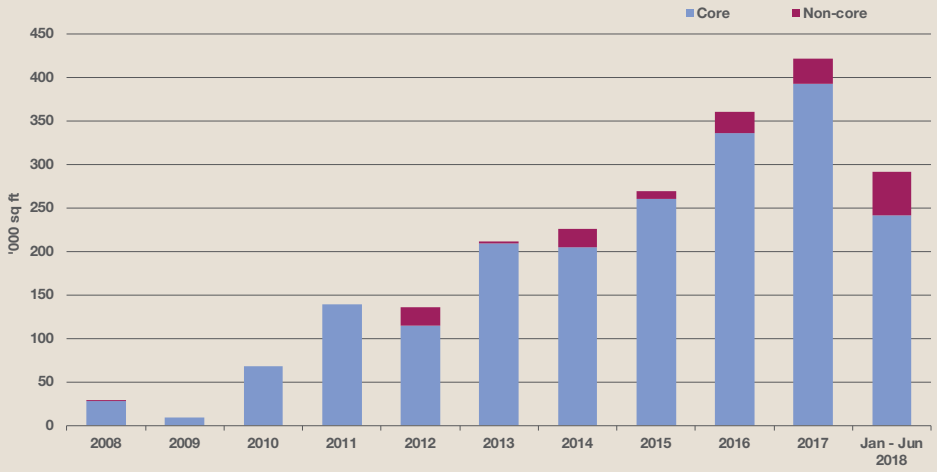
Together with mild rental growth, Kowloon East's vacancy rate fell by 0.9 percentage points to 5.1% in Q2/2018. The main reason behind the decline was take-up in high quality and newly developed buildings in Kowloon Bay and Kwun Tong. After reaching a five year peak in Q1/2017 (8.0%), vacancy in Kowloon East has dropped for five consecutive quarters as corporates who have not traditionally formed part of the local tenant cluster have taken an interest in setting up offices in the area. The latest example is DBS who leased seven floors (197,000 sq ft) in Two Harbour Square in Kwun Tong.

Mainland firms still active

Leasing demand from PRC firms has been even more active than in previous years. During the first half of 2018, PRC businesses committed to around 300,000 sq ft in total, which is more than half of the total floor area committed by PRC firms in 2017. Around 80% of the 300,000 sq ft of floor space is situated in core districts which include Central, Admiralty, Sheung Wan, Wanchai, Causeway Bay and Tsim Sha Tsui while the remaining 20% is located in 'non-core' districts such as Mong Kok, Kowloon Bay and Kwun Tung. Apart from financial and banking sectors, we observed that there has been more PRC leasing demand from a broader range of industries such as real estate development, co-working, health care and online platforms.

GRAPH 3

PRC new lettings in core districts* vs non-core districts, 2008 – 1H/2018



Source: Savills Research & Consultancy
*Core districts include Central, Admiralty, Sheung Wan, Wanchai, Causeway Bay and Tsim Sha Tsui

Please contact us for further information

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