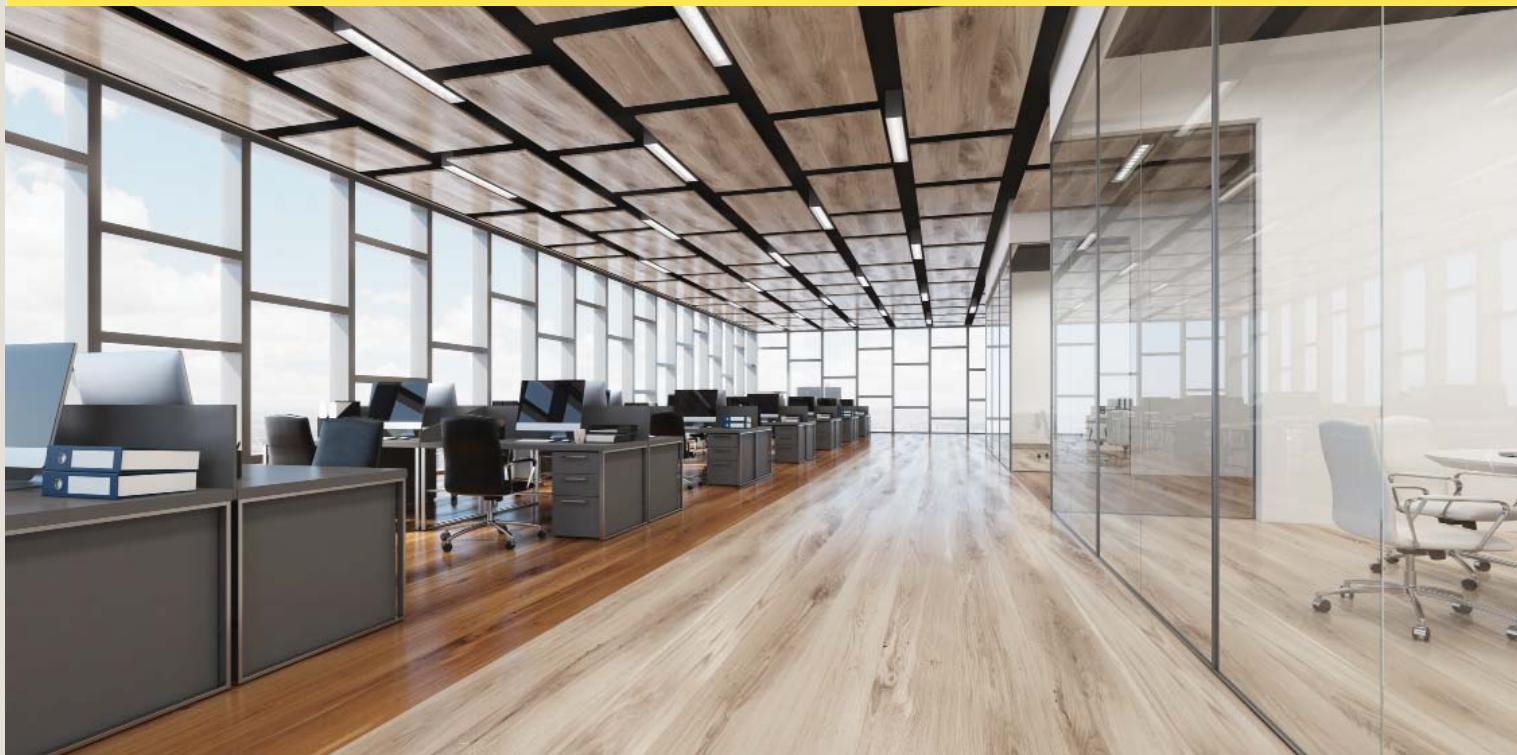


Briefing Office leasing

October 2018



SUMMARY

The eastward march of the law firms continues, lured by rental reductions of as much as 30% in some cases.

■ Wanchai/Causeway Bay rents increased by 2.3% over the third quarter, proving to be the main driver of rental growth again as Central costs continued to drive tenants elsewhere in search of savings.

■ BitMEX, a Cryptocurrency trading platform, leased a whole floor in Cheung Kong Center for HK\$225 per sq ft per month, a record-high for the territory in per square foot terms, as fintech joined PRC and co-working operators as an important new player in the leasing market.

■ WeWork took 100,500 sq ft in The Quayside in Kwun Tong, their fifth co-working location in Hong Kong as the sector shows no obvious signs of cooling.

■ One Taikoo Place is emerging as a hub for major law firms in Island East, with three international firms taking up 150,000 sq ft. Legal firms have traditionally clung to Central locations and this marks a major change in thinking.

■ Kowloon East saw mild rental growth over the quarter despite a slight increase in the vacancy rate.

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“With muted demand from PRC firms, fintech and a decentralizing legal sector seem to be taking up the slack.” Simon Smith, Savills Research
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→ Market commentary

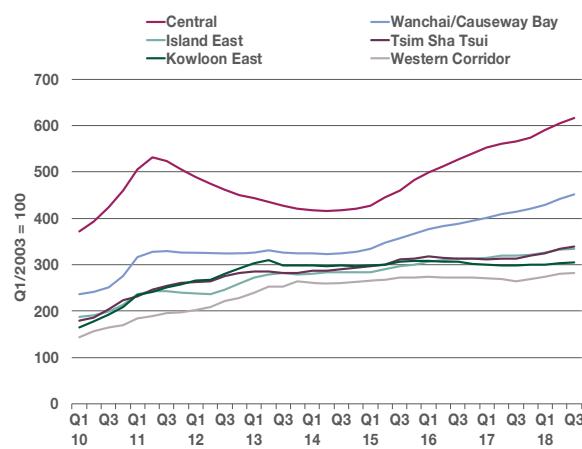
Overall rents increased by 1.5% during the third quarter of 2018 as Grade A office rents in all districts recorded positive growth for a fourth consecutive quarter. Island rents were the main driver, up by 1.7%, while Kowloon rents increased by 1.2%. Rental growth was supported by a drop in vacancy rates on both sides of the harbour - vacancy rates on Hong Kong Island dropped to 1.6% from 1.9% while Kowloon's vacancy fell slightly by 0.1 percentage points to 3.8%.

Wanchai/Causeway Bay remained the district with the highest positive growth (+2.3%), followed by Central (+1.8%) and Tsim Sha Tsui (+1.5%). Rental growth in Island East and Kowloon West stood at a more muted 0.8% in both districts during the quarter, down from 1.6% and 2.1% in the previous quarter. Although the vacancy rate increased by 0.2 percentage points, Kowloon East still saw rental growth of 0.7% over the period.

Major leasing deals were signed over the quarter with KPMG taking 10 floors (150,000 sq ft) in Swire's South Island Place, a 380,000 sq ft office building in Wong Chuk Hang scheduled for completion in 2018, for around HK\$30 per sq ft per month. This is the first pre-leasing deal recorded in this building. Established corporates are gradually branding the emerging Island South area and other major tenants include Valentino, Mizuho Bank, Mayer Brown and Noble Group.

GRAPH 1

Savills Grade A office rental indices by district, Q1/2010 – Q3/2018



Source: Savills Research & Consultancy

TABLE 1

Savills Grade A office rental growth, Q2/2018 vs Q3/2018

	Q2/2018 (%)	Q3/2018 (%)
Central	+2.5	+1.8
Wanchai/Causeway Bay	+2.8	+2.3
Island East	+1.6	+0.8
Tsim Sha Tsui	+2.6	+1.5
Kowloon East	+0.9	+0.7
Kowloon West	+2.1	+0.8

Source: Savills Research & Consultancy

TABLE 2

Major pre-leasing deals, Q3/2018

Tenant	Building	Area (sq ft)
KPMG	South Island Place	150,000 G
WeWork	The Quayside	100,500 G
Eversheds Sutherland	One Taikoo Place	21,800 L
Veolia Water	One Taikoo Place	21,800 L

Source: Savills Research & Consultancy

Meanwhile, The Quayside, a 900,000 sq ft commercial development by Link REIT and Nan Fung in Kwun Tong, recorded its second pre-leasing agreement with WeWork taking up 100,500 sq ft for HK\$20-25 per sq ft per month, their fifth co-working location in Hong Kong. The first tenant in The Quayside was JP Morgan who agreed to pre-lease 275,000 sq ft. The two big names will occupy around 40% of the development, which is expected to be completed in 2019. NEO, which was previously known as 8 Bay East, has yet to ink its first pre-leasing agreement before expected completion in 2019 but is actively marketing. With the completion of high quality office buildings in Kowloon East, we expect more big names to establish a major footprint in the district in the coming 12 months.

A record-breaking leasing deal hit the headlines during the quarter as BitMEX, a Cryptocurrency trading platform, agreed to rent 45/F of Cheung Kong Center for HK\$225 per sq ft per month, representing over

HK\$4.5 million for the 21,000 sq ft floor. Diginex, a Blockchain solutions provider, took 7,500 sq ft in Two IFC for around HK\$1.44 million per month (HK\$190 per sq ft). FinTech companies are clearly emerging as one of the key demand drivers for CBD office space.

International law firms have traditionally stuck close to Central even during previous cyclical rental peaks but this time things are different. Maples and Calder will move to Central Plaza in Wanchai from The Center while Eversheds Sutherland will set up their new office in One Taikoo Place, relocating from Gloucester Tower in Central. Such movements will enable these firms to reduce their rental overheads from over HK\$90 per sq ft per month to nearer HK\$60-70 per sq ft. In another move, Minter Ellison has decided to move eastward, from One Pacific Place in Admiralty to Wu Chung House in Wanchai where the firm is estimated to save 60% to 70% on rent.

TABLE 3

Major new lettings, Q3/2018

Tenant	Building	Area (sq ft)
KR Space	Times Square, Towers One and Two	50,000 G
Construction Industry Council	Enterprise Square 5 - Tower 2	34,800 G
Ernst & Young	Oxford House	21,800 L
BitMEX	Cheung Kong Center	21,300 L
Maple and Calder	Central Plaza	19,700 L

Source: Savills Research & Consultancy

→ Island East is also proving to be a favorable relocation option for international law firms as three major practices will take space in One Taikoo Place, namely, Baker & McKenzie, Simmons & Simmons and Eversheds Sutherland, occupying around 150,000 sq ft in total. Quantao Law, a PRC firm, will also take half a floor (10,300 sq ft) in this triple Grade-A rated office tower by Swire Properties completing in late 2018. One Island East, another iconic office building by Swire, is already home to two global law firms, Freshfields Bruckhaus Deringer and Ince & Co, who together occupy around 50,000 sq ft. The completion of the Central-Wan Chai Bypass in either late-2018 or early-2019 will further encourage multinational corporations to set up their offices in Island East given the much shorter travel time by car.

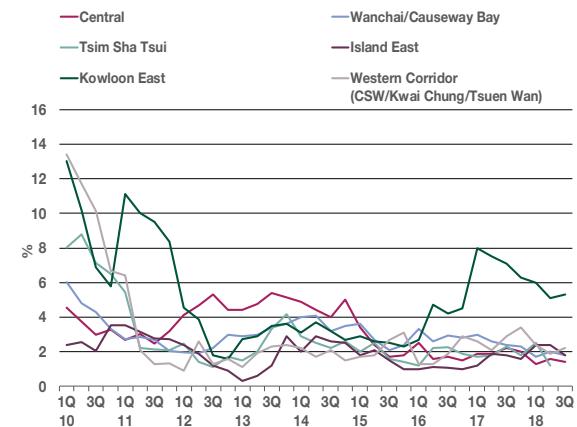
It is reported that HNA Group will surrender eight office floors (90,900 sq ft) in Three Exchange Square which were pre-leased in May 2017. One of the eight office floors surrendered will be taken by Standard Life, an insurance company headquartered in Edinburgh, Scotland. During the quarter, we observed a general slowdown in the very core-focused PRC leasing activity - one reason is simply that availability in the district is very limited with a vacancy rate of 1.4%, but the market is also concerned that, more generally, the US-China trade war could hurt business prospects across a range of sectors. While a significant negative effect on the Hong Kong office leasing market has yet to materialise, in six to nine

months' time the story may be rather different. It should be noted that Hong Kong's trading performance has yet to record any adverse consequences from the trade spat as both imports and total exports recorded double-digit yoy growth in August 2018.

Despite mild rental growth, Kowloon East's vacancy rate increased by 0.4 percentage points to 5.3% in Q3/2018, from 5.2% in Q2/2018. The main driver for this change is several floors in Landmark East which were previously occupied by a design and consultancy firm, and became available for lease after expiry in September 2018. The design and consultancy firm pre-leased around 70,000 sq ft in Two Harbour Square in early 2018 for their new offices.

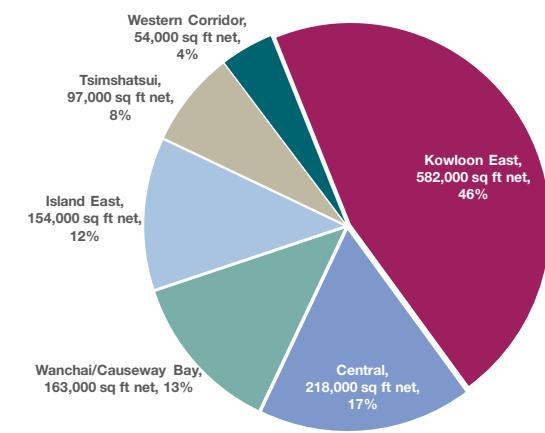
The vacancy rate on Hong Kong Island dropped to 1.6% in Q3/2018, from 1.9% in Q2/2018. Central's vacancy rate in September 2018 was 1.4%, just 0.2 percentage points above the historical low of 1.2% recorded in January and February 2008. Of the total vacancy across the six major business districts, around half is accounted for by Kowloon East (46%), followed by Central (17%) and Wanchai/Causeway Bay. ■

GRAPH 2

Savills Grade A office vacancy rates by district, Q1/2010 – Q3/2018

Source: Savills Research & Consultancy

GRAPH 3

Distribution of Savills Grade A office vacancy by district, Q3/2018

Source: Savills Research & Consultancy

Co-working space in Hong Kong

In September 2018, there were 146 co-working offices in Hong Kong, occupying a total area of 2.07 million sq ft. A quarter of the total floor area is in Wanchai/Causeway Bay with examples including WeWork in Tower 535 (105,000 sq ft) and Asia Orient Tower (60,000 sq ft) and Spaces in Lee Garden Three (35,000 sq ft). Kowloon East has 19 co-working offices occupying

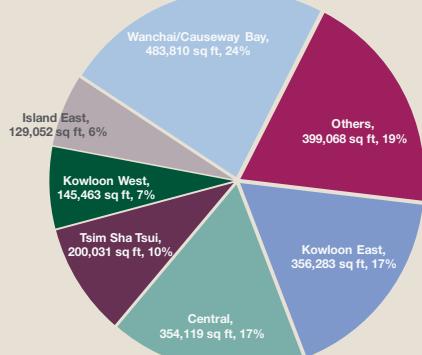
357,000 sq ft in total while Central has the largest number of co-working locations (33) but is third in terms of total floor area given the district's much higher rents.

Around 40% of the floor area occupied by co-working space is in non-grade A offices since rental cost is a main cost component for co-working operators. A lot of local operators, which are mostly smaller

scale and more cost-conscious, base their operations in industrial buildings as the features of industrial buildings such as high ceiling heights and lower rents are conducive to the co-working environment. We also find co-working space in revitalized industrial buildings in Kwun Tong, such as The Wave and Spaces in 133 Wai Yip Street.

GRAPH 4

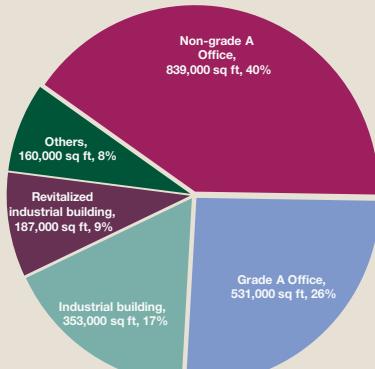
Floor area occupied by co-working operators by district, Q3/2018



Source: Savills Research & Consultancy

GRAPH 5

Floor area occupied by co-working operators by building type, Q3/2018



Source: Savills Research & Consultancy

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