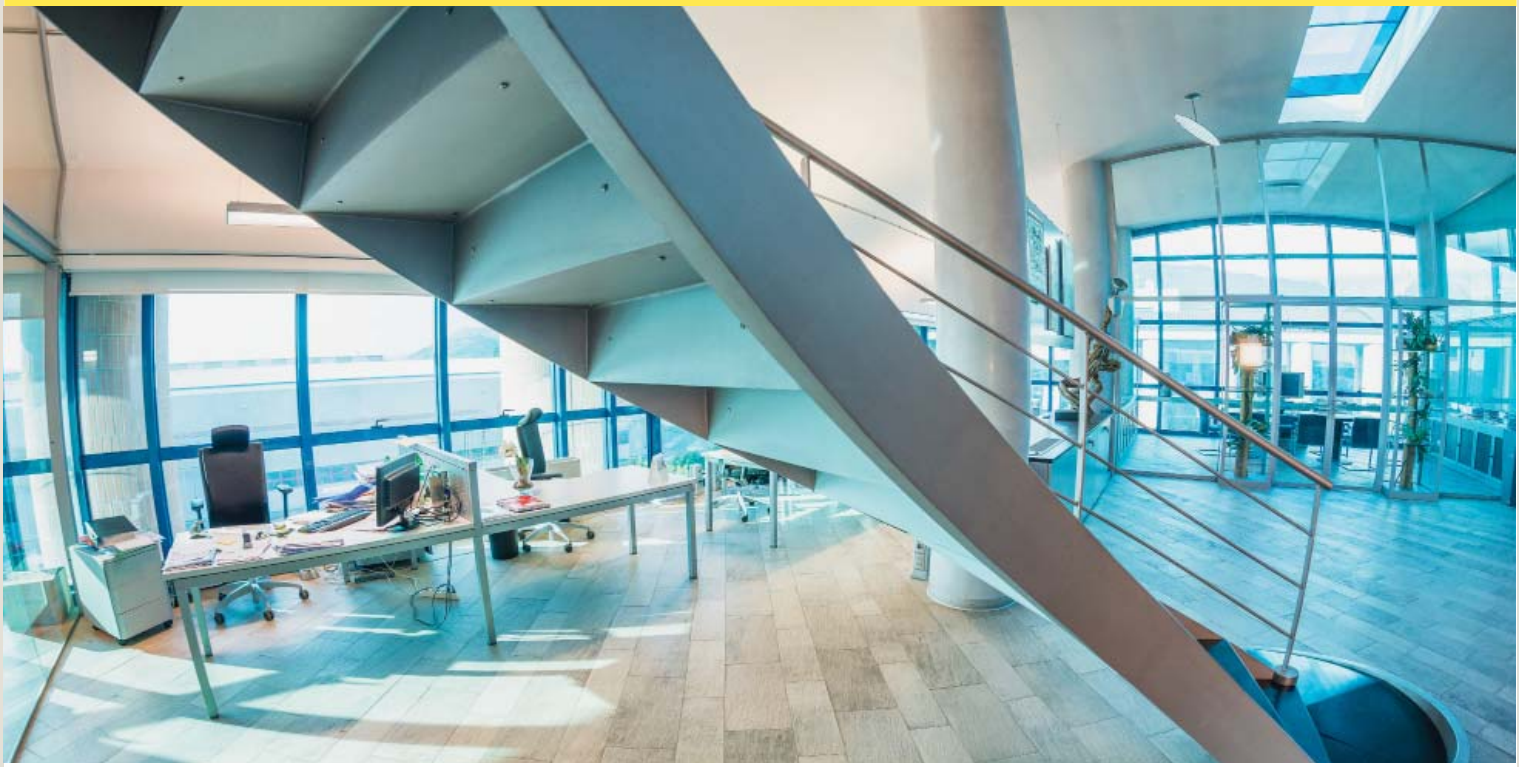
savills

**Savills World Research**
Hong Kong

# Briefing
# **Office leasing**

November 2017



## SUMMARY


Rental growth across most business districts slowed in Q3 as tenants from the PRC as well as the banking sector chose caution over action.

- Central and Wanchai/Causeway Bay rents were again the main drivers of rent increases, up by 0.9% and 1.1% over the quarter.

- Tech firms (alongside co-working) are now major players in the local leasing market and Wanchai/Causeway Bay is proving popular among the more well-established companies.

- A surge in grade A office sales prices is driving up costs in strata-title buildings as new owners push up rents to support the next sale.

- With government departments overloaded with applications, a growing queue of developers is waiting to receive Occupation Permits for their buildings in Kowloon East.

- Co-working operators with a capacity of 100 desks or more are meeting expansion demand, especially from companies looking for flexible terms in a fast moving business environment with an uncertain economic outlook.


"Tech and co-working are both exciting new demand drivers but both come with their challenges." Simon Smith, Savills Research

## Market commentary

Central rents have again recorded their highest premium over the rest of the market for a third consecutive quarter and island rents are still faring better than Kowloon. Grade A office rents in Central, Wanchai/Causeway Bay, Island East and Tsim Sha Tsui grew by 0.9%, 1.1%, 0.5% and 0.4% respectively over the quarter. Rents in Kowloon East experienced a minor rebound of 0.2% after dropping for 5 consecutive quarters. Kowloon West fell by 1.9% over the quarter. Overall Grade A office rents in Hong Kong grew by 0.6%, slightly down from the 0.8% growth we recorded in Q2/2017.

Rental growth across most business districts has slowed and tenants (both PRC and banking) are not particularly active currently. Maybe the conclusion of the 19th CPC National Congress will provide some PRC firms with new energy while others may fall behind. Smaller tech firms and co-working operators appear to be less fazed by recent rent rises, preferring better value offices in fringe locations.

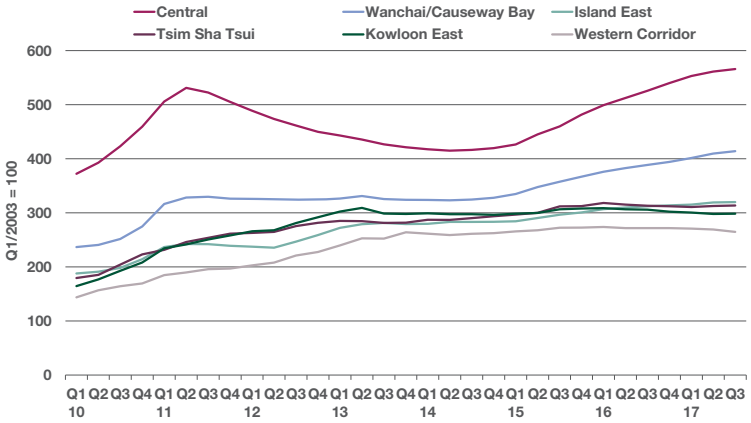
Broadly, the large tech firms continue to drive the market and Wanchai/Causeway Bay has been the grateful recipient of many of the biggest. Alibaba (104,000 sq ft), Google (44,300 sq ft), JD.com (4,000 sq ft), Amazon (35,100 sq ft), Linkedin (16,500 sq ft), Apple (33,600 sq ft) and Tencent (16,300 sq ft) are all resident in the district. It is notable that firms with a sizeable presence in Shenzhen are less likely to need a large office in Hong Kong. The balance of tech-related demand between the two cities will be interesting to watch over the next few years.

Looking at rental movements in individual districts, we have observed that rents in strata-title buildings are moving up swiftly. We think that this is probably a result of new owners pushing up rents to support the next sale as the sales market has been highly active over recent months (Grade A office sales prices are up by 15.9% YTD).

Strangely, in Kowloon East we have not yet seen any significant

GRAPH 1

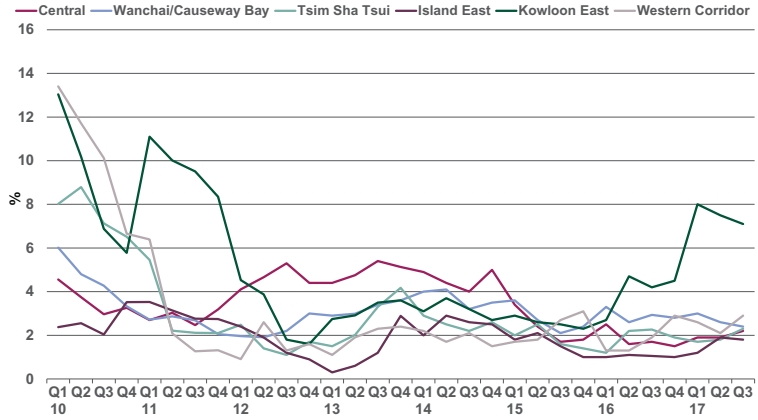
### Savills Grade A office rental index by district, Q1/2010–Q3/2017




Source: Savills Research & Consultancy

GRAPH 2

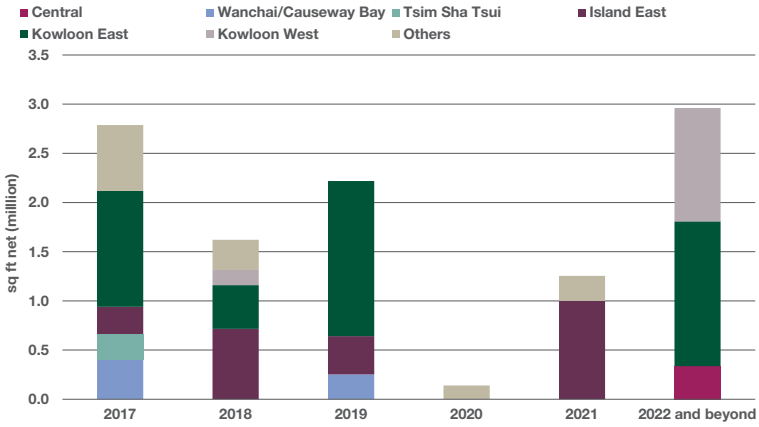
### Savills Grade A office vacancy rates by district, Q1/2010–Q3/2017




Source: Savills Research & Consultancy

GRAPH 3

### Future supply, 2017–2022 and beyond




Source: Savills Research & Consultancy

TABLE 1

## Savills Grade A office rental growth, Q2/2017 vs Q3/2017

| | Q2/2017 (%) | Q3/2017 (%) |
|---|---|---|
| Central | +1.5 | +0.9 |
| Wanchai/Causeway Bay | +2.0 | +1.1 |
| Island East | +1.2 | +0.5 |
| Tsim Sha Tsui | +0.6 | +0.4 |
| Kowloon East | -0.9 | +0.2 |
| Kowloon West | -0.5 | -1.9 |

Source: Savills Research & Consultancy

TABLE 2

## Major new lettings, Q3/2017

| Tenant | Building | Size (sq ft) |
|---|---|---|
| Otis Elevator Co Ltd | Goldin Financial Global Centre | 69,300 |
| Canon | One HarbourGate China Life Centre – Tower A | 51,100 |
| Pure Yoga | Millennium City 5 – BEA Tower | 14,800 |
| China Investment Securities | International Commerce Centre | 14,600 |

Source: Savills Research & Consultancy

TABLE 3

## Major pre-leasing deals, Q3/2017

| Tenant | Building | Size (sq ft) |
|---|---|---|
| Ocean Network Express | Two Harbour Square | 59,500 |
| Regus | Lee Garden Three | 40,000 |
| Maybank | | 35,800 |

Source: Savills Research & Consultancy

downshift in rents despite the volumes of new supply expected to come on stream this year and next (2017 – Mapletree Bay Point (660,000 sq ft), Hong Kong Pacific Tower (332,000 sq ft) and Two Harbour Square (479,000 sq ft), 2018 – Kingston Financial Centre (555,000 sq ft). Vacancy has remained low at 7.1%, down from 7.5% in Q2. The reason behind the delayed adjustment may lie in the growing queue of developers waiting to receive Occupation Permits for their buildings. With so many applications to process currently, we hear that relevant government departments are struggling to cope.

The co-working phenomenon continues to attract a great deal of attention. As this format becomes ever more popular as a source of expansion space it is clear that take-up by co-working operators is not 'take-up' in the traditional sense because the space actually remains on the market. Should market commentators regard such space as taken or still vacant?

Many digital firms, SMEs mostly, are reluctant to commit to capex (for both cost and accounting reasons), don't want to look ahead more than one or two years in a

fast moving business environment, and are concerned at the uncertain economic outlook. Companies like WeWork are an answer to their prayers with capacity for 100 desks or more on flexible terms. Taking a 3.5 to 4 year view, however, it can be more cost effective to commit to a longer lease in a traditional office building. The cost of relocating has risen dramatically over recent years and tenants now need a HK$20 to HK$30 difference in rents to realise savings from a move.

## The cost of relocating

**Office fit-out costs, 2017**

| Offices | HK$ per sq ft net |
|---|---|
| General office | 550-900 |
| Executive office | 900-1,200 |
| Prestige office | 1,200 plus |

Source: Arcadis, Savills Research & Consultancy

**Office reinstatement cost, 2017**

A typical range of HK$100 to HK$150 per sq ft net can be applied although this varies from building to building. Generally, the better the building, the higher the reinstatement cost.

Source: Savills Research & Consultancy

## Please contact us for further information


### Savills Office Leasing

**Ricky Lau**
Deputy Managing Director
Head of Office Leasing
+852 2842 4501
rklau@savills.com.hk

**William Yiu**
Deputy Senior Director
Kowloon Office Leasing
+852 2378 8664
wyiu@savills.com.hk

### Savills Research

**Simon Smith**
Senior Director
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk