MARKET IN MINUTES

Savills Research

Office Leasing

Grade A rents fall by 5.1% in last quarter

Grade A office rents are expected to continue to consolidate during the first half of 2021 while rental movement in the second half will be vaccine and travel dependent.

- Overall rents fell by 5.1% in Q4/2020 and by 16.6% over 2020 as a whole marking the largest yearly decline since 2009.
- Kowloon East recorded the largest fall in rents (-8.7%) among all office sub-markets.
- Overall Grade A office vacancy rose from 4.7% at the end of 2019 to 8.4% in the last month of 2020.
- We observe MNCs have begun to downsize their operations while working from home arrangements have been adopted mostly by overseas corporates.
- Opportunistic coworking brands are taking on surrendered space given lower rents and savings on capex and fixtures and fittings, allowing new operators to take a chance that things will improve this year.
- We expect overall Grade A rents to fall by 5.0% to 10.0% in 2021 with rents to decline over the first half before stabilising in the second, depending on the availability of vaccines and the status of cross-border restrictions.

"Vacancy rates remain stubbornly high and are expected to rise into this year as corporate woes persist."

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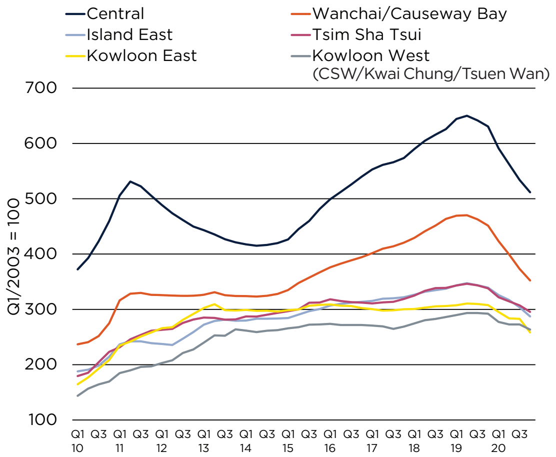
GRAPH 1: Savills Grade A Office Rental Indices By District, Q1/2010 to Q4/2020



Source Savills Research & Consultancy

TABLE 1: Grade A Office Rental Indices, Q3/2020 VS Q4/2020

DISTRICT	Q3/2020 (%)	Q4/2020 (%)
Central	-5.0	-4.2
Wanchai/ Causeway Bay	-6.6	-5.6
Island East	-4.2	-5.5
Tsim Sha Tsui	-2.3	-3.8
Kowloon East	-0.3	-8.7
Kowloon West (CSW/ Kwai Chung/Tsuen Wan)	0.0	-3.4
Overall	-3.4	-5.1

Source Savills Research & Consultancy

MARKET COMMENTARY

To say that 2020 was a grim year for the office market will surprise no one. Local unemployment rose by over 130,000 people as petitions presented for bankruptcy and winding-up increased by more than 550 during the year (even with plenty of government support). Most MNCs meanwhile have begun the grim task of rationalisation, cutting back headcount and reducing floorspace requirements.

Not surprisingly, Grade A rents have responded to the dearth of demand, falling steadily by around 5% per quarter to end the year 17% below where they started it. In some good news for landlords, new supply in 2020 hit a recent historical low of 255,000 sq ft providing modest market support.

In the fourth quarter of 2020, the rate of decline in overall rents increased to 5.1%, compared with 3.4% in Q3/2020. Hong Kong Island rents fell by 5.1%, with rents in Central, Wanchai/Causeway Bay and Island down by 4.2%, 5.6% and 5.5% respectively. Wanchai/Causeway Bay (-22.0%) was the sub-market on Hong Kong Island which posted the largest decrease over the year, followed by Central (-18.9%) and Island East (-15.3%). Kowloon rents recorded a fall of 5.2% in Q4/2020, mainly driven by Kowloon East rents which fell by 8.7% over the quarter. The main reason was landlords of new buildings in Kowloon East forced to cut rents more heavily to attract potential tenants who are reluctant to spend on fit-out. Tsim Sha Tsui and Kowloon West recorded rental declines of 3.8% and 3.4% respectively.

Demand from financial services has held up better than many expected but Central rents continued to consolidate in the fourth quarter falling by 4.2%. Firms with access to the IPO pipeline including PRC entities and the major overseas banks have remained committed to their floorspace while others have had to give up substantial amounts of area.

MNCs facing more cases at home, and with advanced IT platforms (they may have already been hot desking) are switching to more working from home while PRC firms, with fewer cases in their domestic market, have been more reluctant to make the change. We have also noted that with unemployment as high as it is, many local employees would rather be in the office.

Coworking operators, so prominent in the 2017/18 market have seen plenty of consolidation but where larger businesses have retreated, smaller operators have taken up some of the slack. With rents 20% down from peak, independent operators have been prepared to take a gamble and lease vacated space if it is fully fitted out. Savings on capex and fixtures and fittings can be substantial and many see 2021 as worth the risk.

The local retail market has been particularly badly hit as mainland shoppers have been prevented from visiting by travel restrictions and their absence has been felt most at the top end of the market. Overseas luxury brands have traditionally stationed themselves in Hong Kong where flourishing networks of shops could be effectively managed and sourcing from southern China could be best handled. As sales dwindle

TABLE 2: Major PRC New Lettings, Q4/2020

TENANT	BUILDING	AREA (SQ FT)
China Fortune Financial Group Ltd	Cosco Tower	7,748
China Minmetal	One Pacific Centre	4,924
China Huaxia Bank	Two International Finance Centre	4,543
CITIC Dameng Holdings Ltd	United Centre	4,194

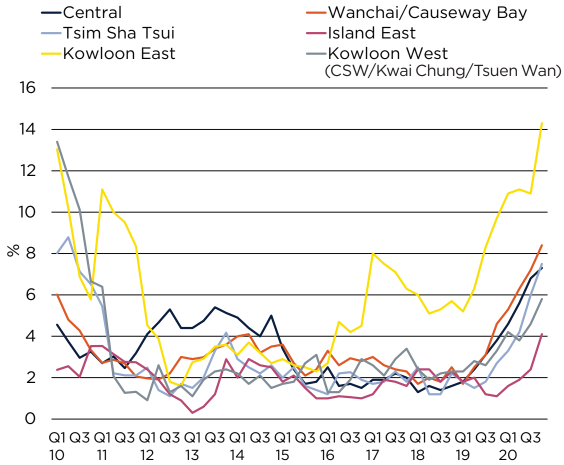
Source Savills Research & Consultancy

TABLE 3: Major New Lettings (Ex-PRC), Q4/2020

TENANT	BUILDING	AREA (SQ FT)
FWD Insurance	14 Taikoo Wan Road	19,331
Perfect Medical	Times Square	17,155
Convoy Ltd.	Hopewell Centre	15,450
Dr Reborn	World Trade Centre	12,770
Printing International Ltd	NEO	11,517

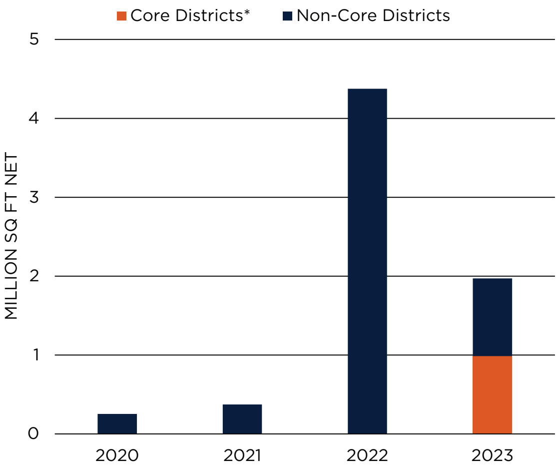
Source Savills Research & Consultancy

GRAPH 2: Grade A Office Vacancy Rates By District, Q1/2010 to Q4/2020



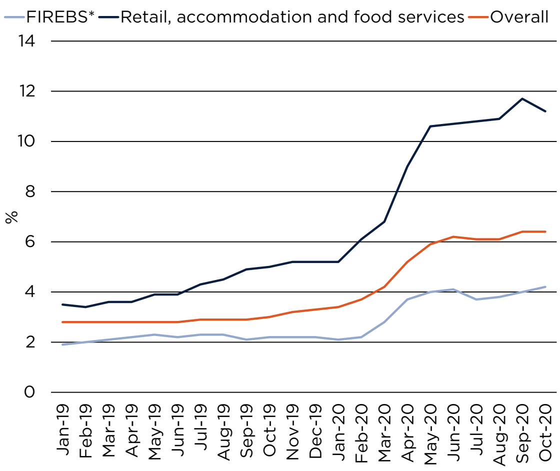
Source Savills Research & Consultancy

GRAPH 3: Savills Grade A Office Supply by District, 2020 to 2023



Source Savills Research & Consultancy
*Core Districts include Central, Wanchai/Causeway Bay and Tsim Sha Tsui

GRAPH 4: Unemployment Rate, January 2019 to October 2020



Source Census and Statistic Department, Savills Research & Consultancy
*FIREBS stands for Finance, Insurance, Real Estate and Business Services.

TABLE 4: Forecasts for 2021

	FORECASTS
Grade A office supply	0.37 million sq ft net @ 2021
Grade A office rents	Overall: -5% to -10% @ 2021

Source Savills Research & Consultancy

locally, however, and China's domestic tourists come into their own, we may see more greater China headquarters moving up to Beijing or Shanghai over the next few years to the detriment of the local office market.

Demand from IT firms is another office market driver we are often asked about as tech seems to have had a relatively good pandemic. While Hong Kong maintains its fund-raising role, however, Shenzhen is stretching its lead when it comes to the New Economy, with plenty of talent and ample available office space as well as strong government support. The GBA generally presents a very different economic structure to Hong Kong and office demand profiles are still too different to encroach directly on the territory.

The vacancy rate on Kowloon side reached 10.5%, with Kowloon East (14.3%) registering the highest rate among all districts while vacancy rates in Tsim Sha Tsui and Kowloon West stood at 7.5% and 5.8% respectively at the end of 2020. On Hong Kong Island, Central's vacancy increased to 7.3% from 6.8% in September, approaching a15-year post-December 2009 high (7.5%). Wanchai/Causeway Bay and Island East recorded vacancy rates of 8.4% and 4.1% in Q4/2020, the highest rates for both districts since February 2010.

If the macro-environment remains unchanged in 2021, we expect to see vacancy continue to rise as office take-up should remain weak, although new supply levels will only total 373,000 sq ft net in 2021, similar to the 253,000 sq ft net we saw in 2020.

Little is expected to change over the first half of 2021, with rents expected to continue their march downwards, falling by 5% to 10%. Vaccine and travel dependent, we could see a period of rental stability over the second half before supply challenges in 2022 again put landlords on the back foot.

On the supply side, one project in a decentralized area will be completed in 2021, namely, YLTL 532 (373,200 sq ft net) in Yuen Long. Since the project is in a non-core area, it is expected to have little impact on core markets.

In 2022, supply will reach 4.38 million sq ft net with some iconic new projects scheduled to be completed within the year, including Airside (905,000 sq ft net) at Kai Tak, Two Taikoo Place (786,000 sq ft net) in Quarry Bay, 98 How Ming Street (518,300 sq ft net) in Kwun Tong and 91 King Lam Street (798,500 sq ft net) in Cheung Sha Wan. Even though some of these projects could be considered non-core, with all above 500,000 sq ft, their scale could mean that they have a greater market impact.