MARKET IN MINUTES
Savills Research

Office Leasing

savills

Rents expected to fall into next year

Even in today's tough market conditions there are still tenants taking space and lot will depend on the return of PRC demand next year, particularly in core areas.

- Varied demand drivers in the final quarter of 2021 included crypto, art dealers and coworking operators with some (muted) mainland activity still in evidence.
- Overall Grade A rents fell by 1.3% during the fourth quarter with slightly higher rates of decline noted in Island East, Island South and Wanchai/Causeway Bay.
- Grade A rents fell by 5.4% over 2021 with the largest declines recorded in Island East (-8.1%), Wanchai/Causeway Bay (-7.7%) and Central (-6.5%).
- Looking ahead, over 2022 as a whole we are expecting a wave of new supply, 4.0 million sq ft net in total, only 120,000 sq ft of which has so far been pre-committed.
- Vacant space in today's market totals 6.0 million sq ft, much of which is concentrated in Kowloon East at 1.9 million sq ft, followed by Central and Wanchai/Causeway Bay.
- We currently anticipate a rental fall of 10% to 15% over the year as a whole, bringing the peak-to-trough rental decline to 40% by year-end 2022.

"In the absence of any major demand drivers and with the supply overhang persisting into next year, rents are likely to soften further in 2022."

SIMON SMITH, SAVILLS RESEARCH

Savills team

Please contact us for further information

OFFICE LEASING

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

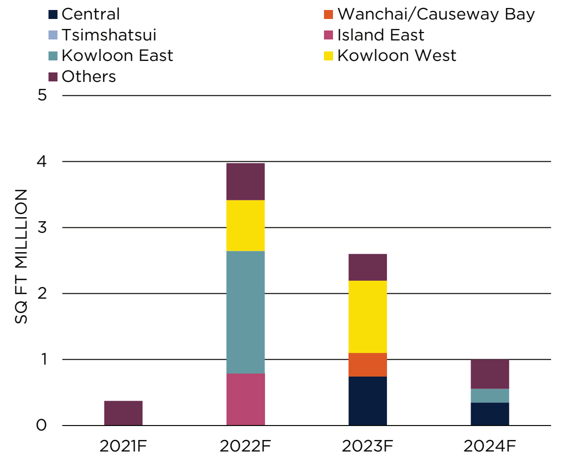
William Yiu
Deputy Senior Director
Kowloon Office Leasing
+852 2378 8664
wyiu@savills.com.hk

RESEARCH

Simon Smith
Regional Head of Research & Consultancy Asia Pacific
+852 2842 4573
ssmith@savills.com.hk

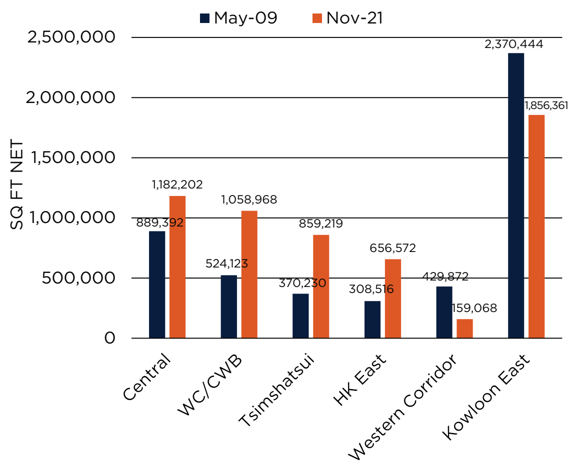
Jack Tong
Director
+852 2842 4213
jtong@savills.com.hk

GRAPH 1: Grade A Office Supply Forecasts, 2021 to 2024



Source Savills Research & Consultancy

GRAPH 2: Grade A Office Vacancy by District, November 2021 vs May 2009



Source Savills Research & Consultancy

MARKET COMMENTARY

Over 2022 we are expecting a wave of new supply, 4.0 million sq ft net in total, only 120,000 sq ft net of which has been pre-committed. Add to this the existing 6.0 million sq ft net of vacancy (four years of average take-up) and it is clear that rents will remain under pressure. We currently anticipate a fall of 10% to 15% over the year as a whole, bringing the peak-to-trough rental decline to 40% by year-end 2022. Kowloon East will see particularly elevated levels of vacancy, currently at 1.9 million sq ft, followed by Central and Wanchai/Causeway Bay.

Most of 2022's supply will come on stream in decentralised and fringe markets and of the nine projects anticipated, only two have so far secured anchor tenants (The Henderson in Central and Two Taikoo Place in Island East). Securing a good covenant as a first commitment is important in order to benchmark rents, but also to define the tenant mix and establish a building's branding and market profile. A multi-floor commitment is ideal.

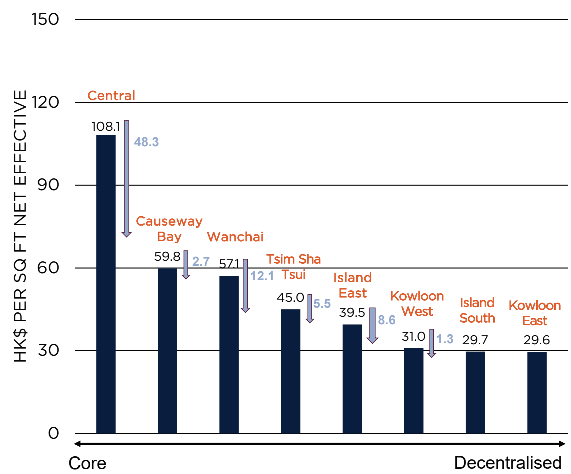
We have initiated coverage of a new business node, Island South, which covers both Wong Chuk Hang and Cyberport. This emerging decentralized area has become a popular choice for relocations recently, with its competitive rents (lower than Kowloon West and comparable to Kowloon East), Hong Kong Island address and convenient commute since the opening of the South Island Line in December 2016. Nevertheless, the pool of only 2.4 million sq ft net of Grade A stock in the district means relocating tenants face a limited choice. The completion of the 200,000-sq ft Landmark South next year may provide more high-quality options in this niche market.

Demand drivers in the final quarter of 2021 include crypto, art dealers and coworking operators with some (muted) mainland activity still in evidence, mostly driven by SOEs. Relocations are generally being hampered by rising fit-out costs (even as rents fall) and logistical challenges – furniture from Europe can take five to six months to arrive while in China, power shortages mean that factories are not operating at full capacity.

Dealing in crypto currencies was banned in China from September this year while the Hong Kong market remains lightly regulated and many crypto operators in this rapidly expanding sector are choosing the flexibility of co-working space. Coworking businesses themselves are benefiting from renewed interest and new sources of capital – TEC (US private equity group KKR and Singapore private equity group TIGA Investments), IWG (JV with Hysan Development to operate its 32 flexible workspaces in the GBA including Hong Kong), WeWorks (its Hong Kong and China operations are now owned by Trustbridge Partners, a Chinese equity firm). As WFH is still a grey area for many firms who do not yet know where the ideal office/home balance lies, taking temporary space while everyone decides seems sensible.

The art world seems to have come alive with major deals inked by Philips who have taken around 45,000 sq ft in M+ and Christie's who took around 50,000 sq ft in The Henderson in Q3 this year. Such businesses intend to host their own auctions (rather than relying on the Convention and Exhibition Centre) and ground floor/low floor space with removable windows is therefore

GRAPH 3: Grade A Office Rents by District, Q4/2021



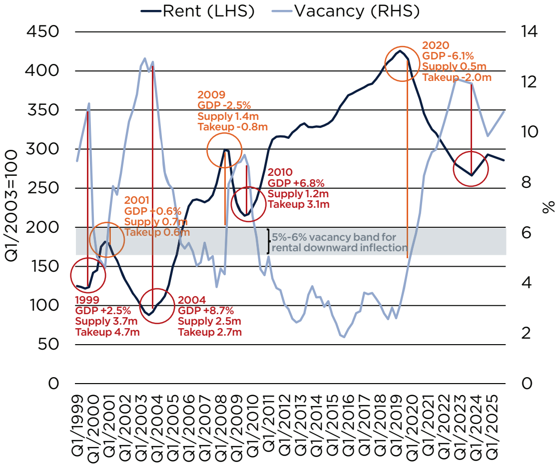
Source Savills Research & Consultancy

TABLE 1: Grade A Office Rental Indices, Q3/2021 vs Q4/2021

DISTRICT	Q3/2021 (QOQ%)	Q4/2021 (QOQ%)
Central	-2.2	-1.5
Wanchai/Causeway Bay	-2.7	-2.2
Island East	-2.8	-2.9
Tsim Sha Tsui	-0.5	-0.4
Island South	-2.6	-2.2
Kowloon East	-0.3	-1.0
Kowloon West (CSW/Kwai Chung/Tsuen Wan)	-0.2	-0.3
Overall	-1.5	-1.3

Source Savills Research & Consultancy

GRAPH 4: Grade A Office Rental Index and Vacancy Rate Forecasts, Q1/1999 to Q4/2025E



Source Savills Research & Consultancy

desirable. As art buying takes off in Hong Kong, it will be interesting to see how actively Non-Fungible Tokens are traded, maybe alongside crypto.

An important demand variable in 2022 will be the porousness of the mainland border. At the time of writing, governments may relax numbers to 1,000 business travellers per day. Still not enough to make a significant difference - at their peak in 2018, 12,000 Mainland business travellers crossed every day. Another market uncertainty lies with Mainland developers in distress and their need to return space. Many are based in southern China and have offices here in Hong Kong. We believe that they currently occupy around 200,000 sq ft across several business districts.

We have analysed major rental inflection points over the past two decades and discovered that whenever vacancy rates have risen above 5% to 6%, office rents tend to start heading down, which is what occurred with the latest rental decline when vacancy surpassed the 5%-mark in early 2020. With demand remaining uncertain and substantial availability (both current and upcoming) over the next two years, office rents therefore look set to continue to head south.

We also find that office rents tend to rebound whenever vacancy rates decline for two consecutive quarters, and in our forecast model, this is most likely in 2024 at the earliest as demand resumes and available space is gradually taken up, indicating that any meaningful rental rebound will only occur two years from now.