MARKET IN MINUTES
Savills Research

Office Leasing

An uncertain year ahead

Rents are 30% from their 2019-peak, while vacant space surged to 6.6 million sq ft net in Q4.

- The fourth quarter saw further rental declines across all districts ranging from -1.5% to -3.5%, bringing the full year decline to 7.6% for 2022. Vacancy rates also increased to 10.4% from 9.9% a year ago, with vacant space standing at 6.6 million sq ft net at the end of 2022.

- Of the 3.8 million sq ft net of Grade A office completions in 2022, only 19% has been pre-committed so far, adding 3.1 million sq ft of vacancy space to the market in 2023, on top of the 1.9 million sq ft net of scheduled completions.

- Most significant deals completed over the quarter were multi-floor pre-lettings of newly completed / to be completed Grade A offices in both the CBD and decentralized areas. Meanwhile, some wealth management firms and insurance companies are planning for expansion ahead of the proposed Mainland border reopening in early 2023.

- The rebounding stock market, a loosening of most COVID-related measures as well as the scheduled border reopening with the Mainland are all positive signs for office demand, but hangover vacancy from 2022, and doubts over the strength of both the local and Mainland economies are weighing on recovery.

- We expect office rents to continue to decline by 10% in 2023 as a result, with areas experiencing more upcoming supply (and overhang vacancy) likely to see the deepest discounts, while experiencing a pick-up in leasing activity.

"The rebounding stock market, a loosening of most COVID-related measures as well as the scheduled border reopening with the Mainland are all positive spins for office demand, but uncertainties linger given hangover vacancy from 2022 completions, and concerns over the speed of recovery."

SIMON SMITH, SAVILLS RESEARCH & CONSULTANCY

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

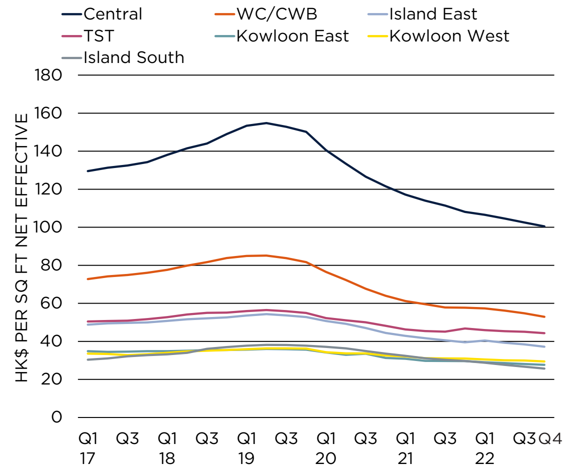
William Yiu
Deputy Senior Director
Kowloon Office Leasing
+852 2378 8664
wyiu@savills.com.hk

RESEARCH

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

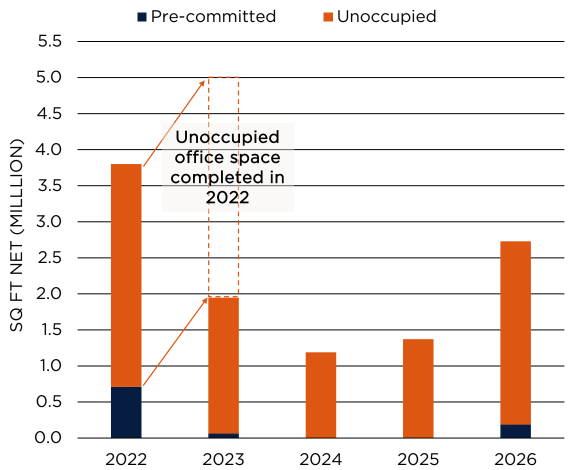
Jack Tong
Director
+852 2842 4213
jtong@savills.com.hk

GRAPH 1: Grade A Office Rents by District, Q1/2017 to Q4/2022



Source Savills Research & Consultancy

GRAPH 2: Grade A Office Supply Forecasts, 2022 to 2026



Source Savills Research & Consultancy

MARKET COMMENTARY

Grade A office rents slipped by another 2.3% in Q4/2022, with more moderate declines recorded in Kowloon East and Kowloon West (-1.5% and -1.6% respectively) while areas on Hong Kong Island such as Wanchai / Causeway Bay (-3.5%) and Island East (-3.3%) registered greater falls. Rents tumbled by 7.6% over the full year of 2022, with Grade A office rents now 31.4% below their previous 2019-peak. Vacancy rates also increased to 10.4% from 9.9% a year ago, with vacant space standing at 6.6 million sq ft net at the end of 2022.

Of the 3.8 million sq ft net of Grade A office completions in 2022, only 19% has so far been pre-committed, adding 3.1 million sq ft net of vacant space to the market in 2023, on top of the 1.9 million sq ft of scheduled completions. The total volume of vacant space may amount to 9.78 million sq ft at the end of 2023, representing a vacancy rate of 14.2%, if we assume take-up to rebound to 1.3 million sq ft for the year, the annual average from 2011 to 2019.

Some new office supply, originally scheduled for 2023, will see completion pushed back by six to nine months as COVID has hit both the supply chains for materials and construction schedules, partially alleviating the space overhang from 2022. Meanwhile, many of the upcoming office buildings are equipped with innovative and green features catering to the future needs of corporates. While most of them will be pre-qualified with BEAM, LEED and WELL certifications, many will arrive with green, wellness and energy-saving features such as landscaped gardens, wellness plazas, air quality control systems, smart building management systems and even rooftop solar panels.

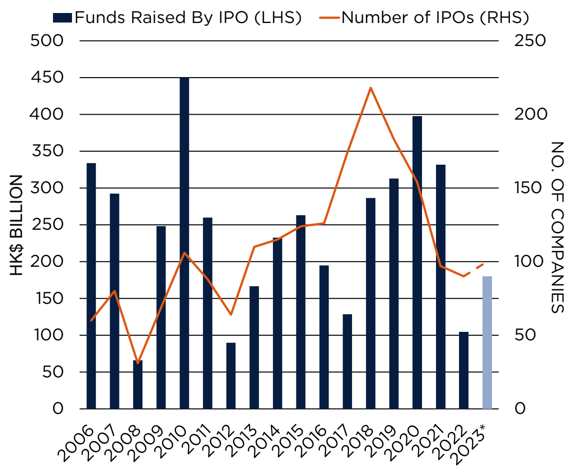
Most significant deals done over the quarter were multi-floor pre-lettings of newly completed / to be completed Grade A offices in both the CBD and decentralized areas. The highest profile was the UBS pre-commitment to 250,000 sq ft (nine floors) of SHKP's XRL Topside development, to which the Swiss bank will be relocating their IFC offices from 2026 onwards. Other new offices in decentralized areas continued to be favoured by MNCs as cost saving relocation options.

The recent stock market resilience has helped sustained financial-related office demand: while the Hang Seng Index crashed to its lowest at 14,700 in October, the market rebounded over the last two months of the year to reach 19,800 by the end of December. Couped with the proposed Mainland border reopening in early 2023, some wealth management firms and insurance companies are already framing expansion plans to cater for the anticipated influx of Mainland capital.

The rebounding stock market, a loosening of most COVID-related measures as well as the scheduled border reopening with the Mainland are all positive spins for office demand, but uncertainties remain for 2023 with hangover vacancies from 2022 completions, as well as lingering doubts over the speed of recovery of both the local and Mainland economies. We expect office rents to continue to decline by 10% in 2023 as a result, with areas expecting more upcoming supply (and overhang vacancy) likely to see deeper rental discounts even as take-up improves.

With stock market volatility for most of 2022, the IPO market was adversely

GRAPH 3: IPO Funds Raised and Number, 2006 to 2023E



Source Hong Kong Stock Exchange, Savills Research & Consultancy
* Forecast by PwC

TABLE 1: Examples of Significant Pre-leasing Deals in Q4/2022

TENANTS	PREMISES	FLOOR AREA (SQ FT)
UBS	XRL Topside development, West Kowloon	~250,000
Sumitomo Mitsui Banking Corporation	Two Taikoo Place, Taikoo	~45,000
SEB Asia	Airside, Kai Tak	~37,000
Konica Minolta	Airside, Kai Tak	~35,000

Source Savills Research & Consultancy

TABLE 2: GDP Forecasts for Hong Kong and China, 2022 to 2026

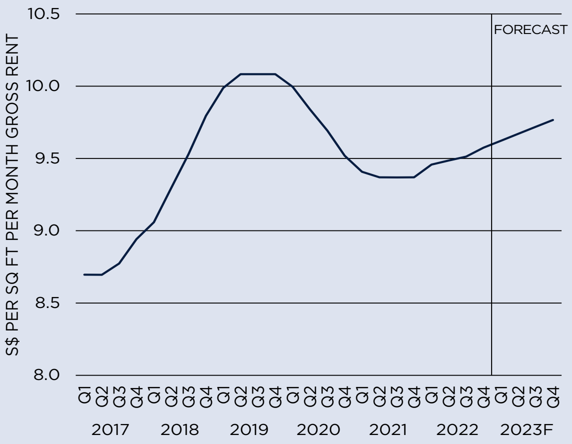
REAL GDP GROWTH	2022	2023	2024	2025	2026
Hong Kong	-3.0%	1.4%	3.5%	5.0%	3.1%
China	3.1%	4.2%	4.7%	5.3%	5.0%

Source Oxford Economics

impacted with only 90 new listings raising around HK$105 billion, a marked 68% decline from 2021 in terms of funds raised. Nevertheless, with China moving away from its zero-COVID policy, and both Hong Kong and China's economies expected to recover from 2023, the stock market is likely to revive favouring a return of IPO listings, with funds raised forecast to rebound by 72% to reach HK$180 billion on the back of new listing rules enabling pre-profit specialist technology companies to list in Hong Kong. Such movements should benefit investment banks and asset management firms (mainly PRC), pushing them into expansion mode after several years of stalemate.

A WORD FROM SINGAPORE

GRAPH 4: CBD Grade A Office Rents, Q1/2017 to Q4/2023F



Source Savills Research & Consultancy

At the onset of Q4/2022, the impact of what had transpired in the cryptocurrency, technology and real economy sectors was leaching through to the office market. Market chatter of companies relocating from HK to Singapore began to fade and was replaced by questions of what would happen to the space taken up by technology, crypto and social media (collectively 'tech') companies. Surprisingly, for Grade A CBD office rents, the impact is still not evident and in fact, rents in Q4/2022 increased at a faster rate.

In the first three months of 2022, the office market was driven by social media companies and crypto related unicorns (private companies with a valuation of over US$1 billion) either aggressively expanding their footprint here or breaking out from co-working locations to find private office space. While news of tech demand concentrated on just one name, which accounted for a large slice of new or replacement demand, there was a long list of companies in the crypto space which, after obtaining Series B funding, decided to take on private office leases rather than occupying co-working space. Linked to the demand from the smaller tech companies was the explosion of family offices which took up Grade A CBD office space.

What made Grade A CBD office rents rise in 2022 was not any major demand expansion but rather a lack of new completions. On the demand side, a panoply of tech-social media companies and family offices in Q1/2022, tended to take up 3,000 sq ft to 5,000 sq ft units. Although total demand for Grade A CBD office space in 2022 is estimated at about 600,000 sq ft, below the 2010 to 2019 average of 1.2 million sq ft, the low supply numbers gave a key boost to rents. Supply in 2022 was just 635,000 sq ft, well below the 2010 to 2019 average of 1.17 million sq ft.

At the start of Q4/2022 the market began to see the emergence of shadow space. However, this had not yet influenced CDB Grade A office rents. The space signed on earlier by tech companies and family offices had soaked up vacancies to very low levels, giving landlords an opportunity to raise rents because of the limited supply and to cover rising expenses due to inflation. Looking ahead to 2023, more landlords are expected to raise their conservancy charges, and this may lend support to gross rents.

Aside from the inflation drive, there is also an environmental aspect. Although tenants are operating in a tougher business environment, multinationals, who have to abide by the dictates of their head office green standards, may have no choice but to either renew leases in Grade A offices, most of which have at least a minimum Green rating, or relocate from non-Green to Grade A offices. The increasing density of smaller space users needing to move into Green buildings may mitigate the challenging business conditions tenants face.

We are forecasting a 2% YoY rental increase for Grade A CBD office space in 2023, slightly down from the 2.2% in 2022.

Alan Cheong
Head of Research & Consultancy
Savills Singapore