Briefing
Office leasing

February 2016

Image: Offices in Sheung Wan

SUMMARY

Local office rents are high compared with the rest of the region but a lack of supply will result in increases on Hong Kong Island this year.

- Prime Central is still the most costly office market in the region, 77% more expensive than second-placed Tokyo.
- Despite more subdued demand, the failure of supply to keep pace with even modest take-up is resulting in rising rents.
- Rents of trophy buildings this year could reach historical highs as supply across the market will remain tight into 2017.
- Central rents rose by 4.7% in Q4/2015, the highest rate since Q2/2011 taking them to 9.3% below their previous peak in 2011.
- In Kowloon, landlords face some large scale relocations to new developments leaving sizeable pockets of space behind.
- While rents on Hong Kong Island may rise modestly this year, Kowloon rents may drift down 5% to 10%.

"Even though we have recorded weaker demand from mainland firms, tight availability in core/prime buildings should see further rental increases in 2016."
Simon Smith, Savills Research

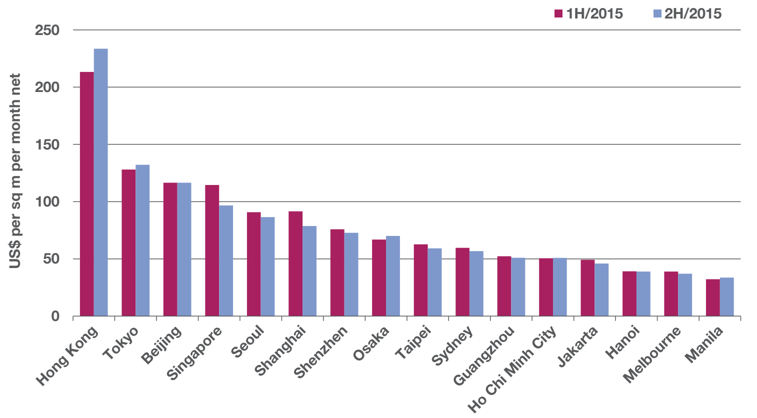
Market commentary

Hong Kong's property markets are generally in a lot more precarious position than they were at this time last year. Despite this, office rents offer a faint glimmer of hope. It is true that a stronger US Dollar has made our market even more expensive (prime Central is still the most costly office market in the region, 77% above second-placed Tokyo) and international financial services firms have continued to shed staff and hand back floors. But despite these headwinds core rents have remained remarkably firm and are actually rising in prime/core buildings. Why?

We believe that despite more subdued demand, the failure of supply to keep pace with even modest take-up is resulting in rising rents. Even demand from mainland firms, so often identified as the future of our market, faltered in the second half of 2015. But even at reduced levels PRC take-up has had an impact on prime buildings in core locations. What we are finding is that mainland financial institutions in particular are outbidding each other for scarce space in landmark properties with a 'brand'. As an example New China Asset Management leased 8,600 sq ft in Two IFC and Zhongtai International Securities leased 5,600 sq ft in COSCO Tower. Such firms are not blind to the benefits of a well-known address in a trophy building. Properties which fit the profile include, but are not limited to, International Finance Centre, AIA Plaza, Cheung Kong Center,

GRAPH 1

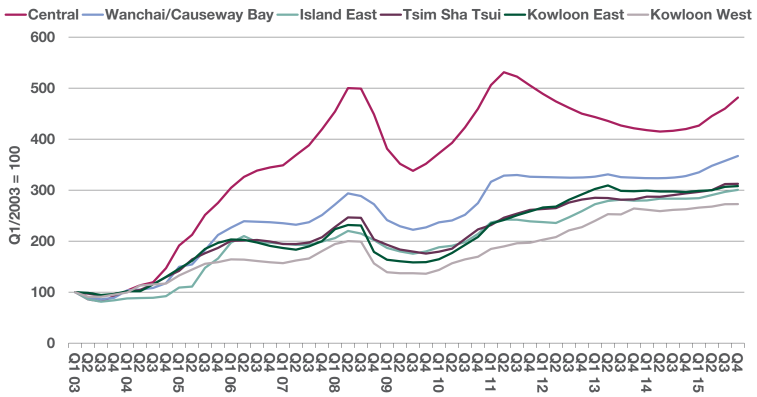
Savills top five buildings occupancy cost, 1H/2015 vs 2H/2015



Source: Savills Research & Consultancy

GRAPH 2

Savills Grade A office rental index by district, Q1/2003–Q4/2015



Source: Savills Research & Consultancy

TABLE 1

Savills Grade A office rental growth, Q3/2015 vs Q4/2015 and 2015

	Q3/2015 (%)	Q4/2015 (%)	2015 (%)
Central	+3.3	+4.7	+14.7
Wanchai/Causeway Bay	+2.8	+2.7	+11.9
Island East	+2.1	+1.4	+6.1
Tsim Sha Tsui	+4.0	+0.1	+6.4
Kowloon East	+2.3	+0.5	+4.0
Kowloon West	+1.7	+0.1	+3.9

Source: Savills Research & Consultancy

TABLE 2

Major new leasing deals, Q4/2015

Tenant	Building	Size (sq ft)
E-Kong	Two Pacific Place	14,000
Usana HK	Sino Plaza	11,500
LIDL	ICC	73,000
Aviva	One Kowloon	32,300
Prudential	Metro Plaza	69,200
Le TV	The Octagon	45,800

Source: Savills Research & Consultancy

Exchange Square and International Commerce Centre. In such stock, rents this year could reach historical highs as supply across the market will remain tight into 2017.

Central rents rose by 4.7% in Q4/2015, the highest rate since Q2/2011 taking them to 9.3% below their previous peak in 2011. Benefiting from spill-over demand from Central and extremely low vacancy rates on Hong Kong Island, rents in Wanchai/Causeway Bay and Island East rose by 2.7% and 1.4% respectively.

The story in Kowloon is a slightly different one where landlords face some large scale relocations to new developments leaving sizeable pockets of space behind. The result has been to weaken the hand of landlords for now, until excess space is absorbed. In Q4/2015, Kowloon office rents rose by sub 1% in Tsimshatsui (0.1%), Kowloon East (0.5%) and Kowloon West (0.1%). Arguably, the Kowloon tenant base may be harder hit this year as trade and tourism, IT, advertising and entertainment are all examples of industries which expect to face tough conditions if recent surveys are anything to go by. While rents on Hong Kong Island may rise modestly this year, Kowloon rents may drift down 5% to 10%.

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