MARKET
IN
MINUTES
Savills Research

Hong Kong – April 2019

Office Leasing

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Rental momentum continues in Q1

Central's growth rate outpaced all other districts in Q1 as average Grade A rents hit over HK$150 per sq ft per month net effective.

- Central replaced Wanchai/Causeway Bay as the main driver of growth, with rents increasing by 2.9% during the quarter.
- We have noticed that Island rents have outperformed Kowloon rents for four consecutive quarters.
- Despite worries over the trade war, stock market volatility and interest rate rises, the office leasing market has remained stable and tenants are no longer downsizing.
- Coworking operator KR space pulled out of all its leasing deals in Hong Kong while WeWork withdrew some commitments despite expanding actively elsewhere.
- North Point will see two new office buildings completed in 2019 totalling over 600,000 sq ft.
- Tenants now pay more attention to building quality and age as the accessibility of business districts has been greatly enhanced by new transport infrastructure over recent years.
- Record low vacancy rates have helped maintain the bargaining power of landlords, supporting the slight rise in office rents observed over the quarter.

> "A robust office market seems to have shrugged off earlier concerns over interest rates, the trade war and financial market turbulence."

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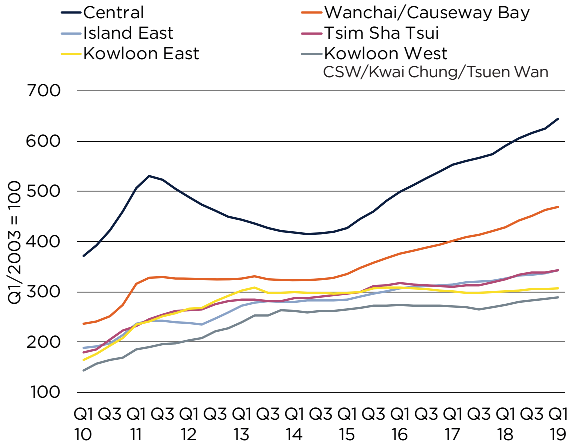
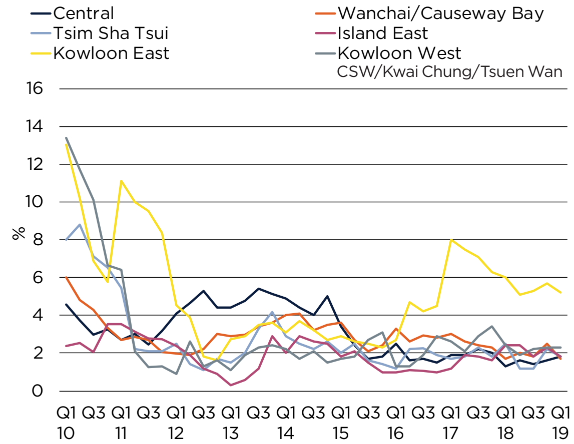
GRAPH 1: Savills Grade A Office Rental Indices By District, Q1/2010 to Q1/2019



Source Savills Research & Consultancy

GRAPH 2: Grade A Office Vacancy Rates By District, Q1/2010 to Q1/2019



Source Savills Research & Consultancy

MARKET COMMENTARY

Early 2019 saw a lot of caution in the tenant market as 2018 ended under the shadow of a trade war, a falling stock market and the threat of further interest rate rises. The fourth quarter had begun to see surrenders with more likely ahead, especially from the finance sector. By the end of Q1 however, things were not looking so bad as tenants were no longer downsizing, even if expansion remained firmly off the agenda.

Overall Grade A office rents were up by 1.6% over the first quarter and all districts have recorded positive rental growth for six consecutive quarters. Central (+2.9%) recorded the highest rental growth over the first three months, followed by Island East (+1.7%), Tsim Sha Tsui (+1.2%) and Wanchai/Causeway Bay (+1.2%%). Island rents (+2.0%) continued to outperform Kowloon rents (+1.0%) in Q1/2019 in a trend visible since Q1/2018.

A question continues to hang over the future of co-working demand as KR Space, a leading co-working operator from Mainland China, has pulled out of leasing deals with One Hennessy (80,000 sq ft) in Wanchai, K11 Atelier Victoria Dockside (30,000 sq ft) in Tsim Sha Tsui and The Center (50,000 sq ft) in Central. Although WeWork had been expanding aggressively, given the operator's deals in The Gateway – Sun Life Tower (144,000 sq ft) and International Commerce Centre (33,795 sq ft), we have heard that the co-working giant has pulled out of leasing transactions in several locations.

In 2019, North Point will see two new buildings completed, namely, K11 Atelier King's Road (487,486 sq ft) by New World and 218 Electric Road (143,996 sq ft) by Henderson Land. Both will be the leading green buildings as K11 Atelier King's Road is the world's first building to have achieved the WELL Building Standard's (core and shell) Platinum level pre-certification and 218 Electric Road has received a HK BEAM Plus v.1.2 Provisional Platinum rating. We will see more new buildings in North Point since Hang Lung Group confirmed its plan to redevelop 226-240 Electric Road (around 105,000 sq ft) as a new office building, with an expected year of completion in 2022.

The completion of new infrastructure over the years has significantly enhanced the accessibility of commercial nodes both on and off the island. New roads, rail lines, tunnels and bridges have all played their part and most recently the Central-Wanchai Bypass has successfully shortened travel times between Central and Island East. Such improved accessibility now allows tenants to consider building quality and age rather than simply location. So where is the most modern office stock found? Not in Central where the average age of a Grade A office building is almost 28 years and the most recent completion was York House in 2006 (except for owner-occupied CCB Tower in 2012). If we exclude owner-occupied and strata-titled stock, Grade A buildings of under 10 years old are relatively scarce: Central – 0, Wanchai/Causeway Bay – 3, Island East – 4, Tsim Sha Tsui – 1 and Kowloon West – 5 including ICC.

Over the first quarter of 2019, both Hong Kong Island and Kowloon experienced a drop in vacancy. The vacancy rate on Hong Kong Island fell to 1.8% at the end of March from 2.0% at the end of 2018 while the vacancy rate in Kowloon was down to 2.6% from 3.0% during the same period. Kowloon East's availability tightened, and the vacancy rate fell from 5.7% to 5.2% during the quarter. Vacancy has maintained record lows, giving landlords some bargaining power and the ability to raise rents marginally across most districts.

TABLE 1: Grade A Office Rental Growth, Q4/2018 VS Q1/2019

DISTRICT	Q4/2018 (%)	Q1/2019 (%)
Central	+1.6	+2.9
Wanchai/Causeway Bay	+2.6	+1.2
Island East	+0.9	+1.7
Tsim Sha Tsui	+0.2	+1.2
Kowloon East	+0.2	+0.5
Kowloon West (CSW/ Kwai Chung/Tsuen Wan)	+1.1	+1.2

Source Savills Research & Consultancy

TABLE 2: Major New Lettings, Q1/2019

TENANT	BUILDING	AREA (SQ FT)
WeWork	The Gateway - Sun Life Tower	144,000
Sun Life Hong Kong	Cheung Kei Center	133,096
Chanel	One Island East	129,478
China Merchants Bank	Three Exchange Square	56,820
ALDI Services Asia Ltd	Millennium City 6	51,351
City University of Hong Kong	Festival Walk	41,183
WeWork	International Commerce Centre	33,795

Source Savills Research & Consultancy