

Office Leasing



Grade A rents slump by 5.2% in Q1

Grade A office rents plunged by 5.2% over Q1/2020, the worst quarterly performance since the 2008/2009 financial crisis, with the average vacancy rate rising to over 5%.

- Overall office rents have registered declines for three consecutive quarters, for the first time since the financial crisis in 2008/2009.
- Wanchai/Causeway Bay and Central saw the largest falls (-6.2%) among all office sub-markets.
- Decentralization is still popular but capital expenditure is a prime concern for relocators.
- The co-working industry will be tested hard by the COVID-19 outbreak given the need for social distancing.
- COVID-19 has piled pressure on the retail and hotel industries as retail sales and tourist arrivals have both slumped. Businesses in these industries can be expected to cut headcount and give back space.
- As stock markets have seen increasing volatility, the IPO pipeline looks far less certain and lay offs and surrenders can be expected from financial and professional services firms.
- The overall vacancy rate has nearly doubled in a year, rising from 2.6% in March 2019 to 5.2% in March 2020.
- Overall Grade A office rents are projected to fall by 20% in 2020, factoring in the extensive economic disruption of the COVID-19 outbreak.

“The global spread of COVID-19, extensive travel restrictions and a stock market sell-off have undermined local office demand and taken rents down sharply.”

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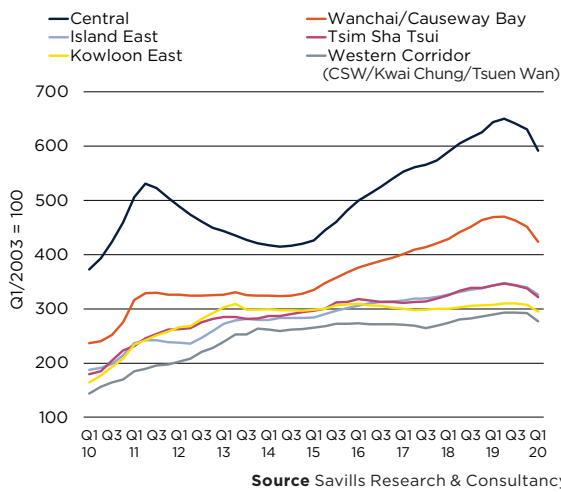
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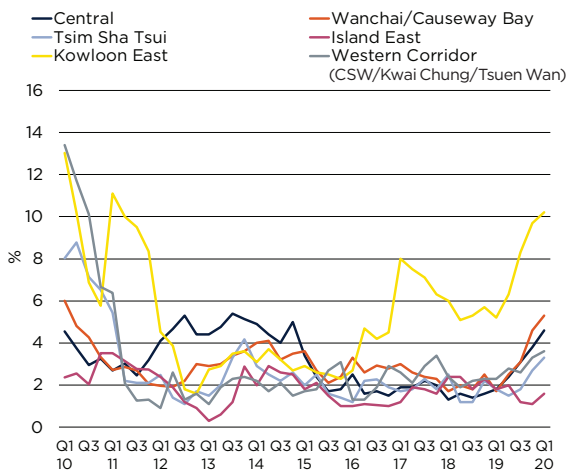
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GRAPH 1: Savills Grade A Office Rental Indices By District, Q1/2010 to Q1/2020

Source Savills Research & Consultancy

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

Source Savills Research & Consultancy

TABLE 1: Grade A Office Rental Indices, Q1/2020 VS Q4/2019 VS 2019

DISTRICT	Q1/2020 (%)	Q4/2019 (%)	2019 (%)
Central	-6.2	-1.7	0.8
Wanchai/Causeway Bay	-6.2	-2.5	-2.7
Island East	-4.0	-1.3	0.5
Tsim Sha Tsui	-4.7	-1.6	-0.3
Kowloon East	-4.1	-0.7	-0.6
Kowloon West (CSW/Kwai Chung/Tsuen Wan)	-5.1	-0.4	2.1
Overall	-5.2	-1.5	-0.1

Source Savills Research & Consultancy

MARKET COMMENTARY

Grade A office rents recorded their worst quarterly performance since Q2/2009, with overall rents falling by 5.2% QoQ in the first quarter of 2020, higher than the total of the previous two quarters. Both Wanchai/Causeway Bay and Central (-6.2%) recorded the largest rental falls among all sub-markets, followed by Kowloon West (-5.1%) and Tsim Sha Tsui (-4.7%). Rents Kowloon side performed better compared to those on Hong Kong Island, with rents in Kowloon and on Hong Kong Island declining by 4.7% and 6.8% respectively over Q1.

Despite a generally lifeless market, the decentralization remains popular continues because of the substantial 80% rental difference which persists between Central and all other business districts. As an example, two global law firms, currently based in Central, were reported to commit to space in United Centre in Admiralty and One Island East in Quarry Bay. We can also see companies based in core areas of Kowloon moving to non-core districts to cut costs given a company specialized in photographic products recently committed to a lease in Kwai Chung, relocating from their current office in Mong Kok. Despite the relocation cases, the capital expenditure incurred in a move can be substantial (HK\$600 to HK\$1,000 per sq ft net), and has become an overriding concern in the current uncertain economic environment.

Co-working operators are taking a severe hit from the COVID-19 outbreak as people avoid crowds and public areas. Servcorp founder and chief executive Alf Moufarrige

recently mentioned that the company's China and Hong Kong offices had taken a particularly hard hit. He also mentioned that Servcorp's co-working sales across the UK, Europe, US and Australia had fallen by around 30% to 40% from mid-February to early-March. The dilemma faced by co-working operators could result in another stage of consolidation for the industry.

Online businesses could be set for expansion, however, as the social unrest from the middle of last year and the COVID-19 outbreak have encouraged consumers to rely more on a wider variety of online services. Euromonitor reported Hong Kong's e-commerce sales value in 2019 rose by 13.3% compared to 2018. The institution forecasts e-commerce sales by value will grow at a CAGR of 12.5% from 2020 to 2024.

The vacancy rate increased sharply during the first quarter of 2020, from 4.65% in December 2019 (2.74 million sq ft net) to 5.22% in March 2020 (3.08 million sq ft net). Island East (1.6%) remained the district with the lowest vacancy while vacancy rates in Central and Wanchai/Causeway Bay rose from 3.8% and 4.6% to 4.6% and 5.3% respectively. One of the main reasons was the relocation of international luxury brands and an international professional firm out of these areas. On Kowloon side, Tsim Sha Tsui and Kowloon East recorded vacancy rates of 3.3% and 10.2%, up from 2.7% and 9.7% in last quarter of last year, caused partly by COVID-19's overwhelming impact on retailers, many of whom have their back offices in these two areas.

TABLE 2: Major New Lettings, Q1/2020

TENANT	BUILDING	AREA (SQ FT)
Adidas	The Quayside	72,000
Manulife (International) Limited	The Quayside	49,531
Olympus Hong Kong and China Ltd	Kowloon Commerce Centre	35,774
The Executive Centre	PCCW Tower	29,456
Bird & Bird	Central Plaza	23,362
China Huarong Overseas Investment Holdings	One Pacific Place	22,500

Source Savills Research & Consultancy

TABLE 3: Impact Of COVID-19

	LATEST FIGURES
Hang Seng Index	23,603.48* (-16.3% compared to 31 Dec 2019)
Retail Sales Value	HK\$22.735 billion @ Feb 2020 (-44.0% yoy)
Visitor Arrivals	199,000 @ Feb 2020 (-96.4% yoy)
Unemployment Rate	3.7% @ Feb 2020 (+0.4 ppt from Dec 2019)

Source Census and Statistics Department and Hong Kong Tourism Board
*As of 27 March 2020

LOOKING AHEAD

After a turbulent year in 2019, the COVID-19 outbreak from late-January again affected retailers and hotel operators who had already borne the brunt of the social unrest. This has been reflected in the rising unemployment rate in these sectors, from 5.2% in December 2019 to 6.1% in February.

In contrast, finance and professional services firms began the year looking forward to a healthy IPO pipeline and at first financial markets seemed to shrug off the outbreak but by March global bourses had begun to sell off. The falling stock market has now postponed many of Hong Kong's hoped for IPOs and Central office demand has weakened dramatically. Although we haven't seen this reflected in employment data, we expect FIREBS to be affected with a knock-on impact on Central rents.

Overall Grade A rents are projected to drop by around 20% in 2020, taking account the recent global spread of COVID-19. Retail and hospitality sectors have been hard hit and companies in these industries are having to cut costs by laying off staff, closing or downsizing, which will negatively affect rental levels and vacancy in non-core areas where the offices of such firms are concentrated. Some companies have postponed their Hong Kong IPOs due to the recent stock market sell off and this will in turn affect the rental affordability of the financial and professional services sectors housed predominantly in Central. COVID-19 has also caused extensive disruption to global production and trading activity and the solvency of some corporates is expected to be tested under these uncertain conditions with implications for the local office market.