Rental growth slows in Q2
Island rents saw a slowdown in growth while Kowloon rents rose at a slightly faster pace.

- Kowloon East rents posted the strongest performance among all sub-markets, rising by 1.3% during the quarter.
- Kowloon rents outperformed Island rents over Q2/2019.
- Availability in core areas will remain tight as new supply out to 2023 will be concentrated in non-core districts.
- Family offices and virtual banking are emerging as two new demand drivers in the office leasing market.
- Completion of new transport infrastructure will support further decentralization as the accessibility of non-core business districts will be greatly improved.
- A modest increase in vacancy rates has reduced the bargaining power of landlords, weakening rental growth on Hong Kong Island.

“New demand drivers are emerging as limited supply on Hong Kong island suggests continuing support for rents, even if room for strong growth is limited.”

SIMON SMITH, SAVILLS RESEARCH
MARKET COMMENTARY

Although all districts have recorded positive rental growth for seven consecutive quarters, the rate of growth decelerated in Q2/2019. For example, Central rents registered an increase of 0.9% in the second quarter, down from 2.9% in the first quarter. Rents in Wanchai/Causeway Bay, Island East and Tsim Sha Tsui also rose more slowly. The situation was different on the other side of the harbour as rents in Kowloon East and Kowloon West increased by 1.0% and 1.3% respectively, higher than the 0.5% and 1.2% growth recorded in Q1/2019. Overall Grade A office rents were up by 0.8% over the second quarter, lower than the 1.6% rise posted in the previous three months. Despite the slower growth rates, average rents in all districts hit record highs.

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Only four major office projects will be completed in Hong Kong island between 2019 and 2022. One Hennessy (315,000 sq ft, 2019), K11 Atelier King’s Road (487,000 sq ft, 2019), Two TaiKoo Place (1.0 million sq ft, 2021) and Landmark South (200,000 sq ft, 2022) are all located outside Central. New supply in Central will remain thin until 2023 when the Murray Road carpark redevelopment, URA Peel Street/Graham Street Site C and the Hutchison House Redevelopment will be completed. Of the buildings scheduled for completion in 2019, One Hennessy (Occupation Permit received in February) is now close to 50% let. K11 Atelier King’s Road is expected to be completed in Q3/2019.

Family offices are a rising demand driver in the office leasing market. Different from asset management firms, family offices are not required to be licensed for regulated Types 1, 4 and 9 activities from the Securities and Futures Commission. Although family offices are typically small in terms of area occupied, they are actively looking for space in prime locations and are willing to pay prime rents.

Among other demand sources, co-working operators seem to be active again as landlords are more willing to subsidize capital expenditure. Since March 2019, the Hong Kong Monetary Authority has granted eight virtual banking licenses, marking Hong Kong’s entry into the Virtual Banking Era. Rather than prime locations in core districts, these firms are looking for space in non-core areas.

Decentralization will be given a further boost with the completion of new infrastructure. The first major project was the Central-Wanchai Bypass which opened in January this year enhancing the accessibility of Island East as travel times between Central and the eastern office district have been dramatically shortened. The opening of the Hung Hom to Admiralty section of the Shatin-Central Link, which is expected to take place in 2021, will ease travel between the traditional CBD (Central) and CBD2 (Kowloon East) since the estimated journey time from the proposed Kai Tak Station to Central will be cut to only 15 minutes. In 2025, the Central-Kowloon Route is expected to relieve traffic congestion in the major east-west corridors in Kowloon and shorten the travel times between east and west Kowloon to the benefit of Kowloon East.

In the second quarter of 2019, the overall vacancy rate increased to 3.1% (1.8 million sq ft) from 2.6% (1.5 million sq ft) in the

Marketable Supply

With the exception of one office project expected to be completed in Q3/2019, the near-term office leasing market will be relatively thin. Vacancy rates in all districts continue to be impacted by the completion of major projects.Vacancy rates are expected to remain high until new space is available. Vacancy rates in all districts continued to rise for the fifth consecutive quarter. In Q2/2019 rent growth was stronger in the newer office buildings.

Despite the slower growth rates, average rents in all districts hit record highs in the second quarter. Only four major office projects will be completed in Hong Kong island between 2019 and 2022. One Hennessy (315,000 sq ft, 2019), K11 Atelier King’s Road (487,000 sq ft, 2019), Two TaiKoo Place (1.0 million sq ft, 2021) and Landmark South (200,000 sq ft, 2022) are all located outside Central. New supply in Central will remain thin until 2023 when the Murray Road carpark redevelopment, URA Peel Street/Graham Street Site C and the Hutchison House Redevelopment will be completed. Of the buildings scheduled for completion in 2019, One Hennessy (Occupation Permit received in February) is now close to 50% let. K11 Atelier King’s Road is expected to be completed in Q3/2019.

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In the second quarter of 2019, the overall vacancy rate increased to 3.1% (1.8 million sq ft) from 2.6% (1.5 million sq ft) in the
first quarter. The vacancy rate on Hong Kong Island reached 2.3% (0.77 million sq ft net) at the end of June, up from 1.8% (0.58 million sq ft) at the end of March. The vacancy rate in Kowloon stood at 4.1% (1.0 million sq ft net) from 3.7% (0.93 million sq ft net) in the first quarter. The mild rise in vacancy aligns with the decelerating rate of rental growth, and an uptick in unemployment in the FIREBS sector.

**REGIONAL COMPARISON - HONG KONG, SINGAPORE, TOKYO AND SHANGHAI**

Hong Kong, Singapore, Tokyo and Shanghai are all regarded as the most important financial hubs in Asia and all compete to some degree to attract international businesses and talent.

Hong Kong has been ranked top in terms of average Grade A office rental cost since Q4/2016 and the average Grade A office rent in Central is now at an 80% premium over Chiyoda Ward in Tokyo. Despite its high occupancy costs and generally high cost of living, Hong Kong is highly regarded for its infrastructure and ease of doing business. Notably, Hong Kong’s low and simple tax system and high level of economic freedom are also regularly cited as key attributes. Despite this accommodation costs are beginning to erode the city’s competitiveness compared with its nearest rivals.