MARKET
IN
MINUTES
Savills Research

Office Leasing

Overall rents dip in Q3

Grade A office rents fell marginally overall in Q3 with no signs yet of a more major adjustment as fundamentals remain generally sound.

- The positive rental growth recorded over the past seven quarters came to an abrupt end in Q3 with overall rents falling by 1.0%.
- On Hong Kong Island, Wanchai/Causeway Bay was hardest hit (-1.6%) with much milder falls recorded in Kowloon.
- Mainland firms and co-working operators have both been key drivers of office demand over recent years, but PRC businesses have come under pressure as a result of the US/China trade tensions and, more recently, the social unrest while co-working has been hit by the failed IPO of WeWork.
- On a positive note, Mainland firms remain committed to Hong Kong, even if some multinationals may be weighing up other regional alternatives.
- Uncertainties surrounding the unrest and the receding possibility of a swift resolution may play into the hands of serviced and co-working operators as more tenants are reluctant to commit to one- or two-year leases.
- Vacancy rates remain below the 5% threshold when rental growth tends to turn negative and as a result, landlords are not yet yielding to tenant requests for rental reductions.
- New supply over the next five years will be focused in Kowloon East and fringe island while 2023 will see major new projects completing in Central.

"Many businesses have been hard hit by the trade tensions and the recent social unrest but with vacancy below 5% rents remain relatively firm. If current conditions persist into next year, however, rents will see much heavier declines."

SIMON SMITH, SAVILLS RESEARCH

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

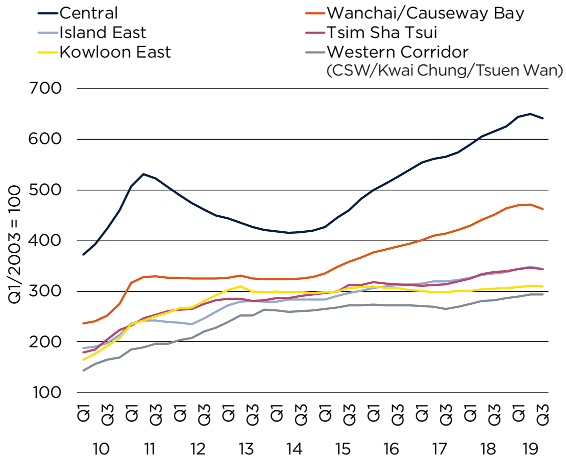
William Yiu
Deputy Senior Director
Kowloon Office Leasing
+852 2378 8664
wyiu@savills.com.hk

RESEARCH

Simon Smith
Senior Director
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk

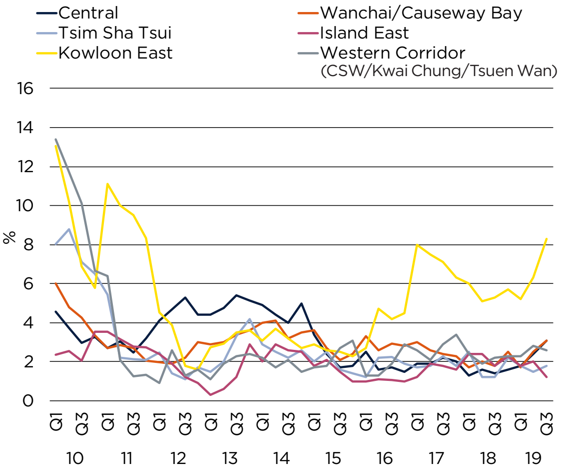
Jimmy Wong
Assistant Manager
+852 2842 4287
jtmwong@savills.com.hk

GRAPH 1: Savills Grade A Office Rental Indices By District, Q1/2010 to Q3/2019



Source Savills Research & Consultancy

GRAPH 2: Grade A Office Vacancy Rates By District, Q1/2010 to Q3/2019



Source Savills Research & Consultancy

MARKET COMMENTARY

Positive rental growth across all districts, which has lasted for seven consecutive quarters, ended in Q3/2019. Average Central rents experienced a fall for the first time since Q3/2014, registering a drop of 1.3% over the third quarter. The other sub-markets on Hong Kong Island, Wanchai/ Causeway Bay (-1.6%) and Island East (-1.1%), also experienced their first rental declines since 2014. The degree of rental change on the other side of the harbour was similar as rents in Kowloon East and Tsim Sha Tsui dropped by 0.2% and 0.8% respectively while Kowloon West rents remained unchanged. Overall Hong Kong Grade A rents fell by 1.0%, ending the rising trend seen since Q3/2014 when the Shanghai-Hong Kong Stock Connect was launched.

Over recent years we have consistently noted the rise of two demand drivers in the local office market – Mainland firms and co-working operators. Suddenly the prospects for both tenant groups have dimmed.

Most PRC firms remain committed to Hong Kong and are not considering alternative locations, but caution prevails. Airport disruption and growing concerns for physical safety have helped to mute corporate activity levels. As senior staff are now reluctant to visit Hong Kong this can paralyse the decision-making process and the ability of firms to make lease commitments. Facing expiry next year, most tenants are now prepared to wait before entering into negotiations.

Multinational tenants have similar business continuity concerns to their mainland counterparts. Some are looking at reweighting into other cities with Singapore a clear favourite but longer flight times to China and the fact that overall operational costs remain high have served to dampen interest. A lack of suitable available office stock in the city state may also be an issue.

In the co-working environment, the failure of WeWork to list may have lowered the fundraising aspirations of other operators. Burn rates in the industry are high and survivability may become a challenge. Any impact from a business contraction in the sector will probably be felt most in buildings with small and medium sized floorplates of 4,000 to 6,000 sq ft. where co-working has traditionally thrived. Looking more positively at the market for flexible space, current uncertainties and hazy prospects for a swift resolution may boost demand from tenants unwilling to commit to one- or two-year leases.

On a more positive note, at 3.8%, vacancy rates remain below the 5% threshold at which rental growth typically turns negative and as a result, landlords are currently standing firm and not yet entertaining requests to lower rents. Stock market trading has not been disrupted and there are still hopes that the IPO pipeline could revive in the last quarter.

FUTURE GRADE A OFFICE SUPPLY – FROM FRINGE TO CORE

During the 5 years from 2019 to 2023, we expect new Grade A office supply to total around 9.3 million sq ft net, an average of about 1.86 million sq ft net per annum.

TABLE 1: Grade A Office Rental Growth, Q2/2019 VS Q3/2019

DISTRICT	Q2/2019 (%)	Q3/2019 (%)
Central	+0.9	-1.3
Wanchai/ Causeway Bay	+0.2	-1.6
Island East	+1.2	-1.1
Tsim Sha Tsui	+0.9	-0.8
Kowloon East	+1.0	-0.2
Kowloon West (CSW/ Kwai Chung/Tsuen Wan)	+1.3	0.0

Source Savills Research & Consultancy

TABLE 2: Major New Lettings, Q3/2019

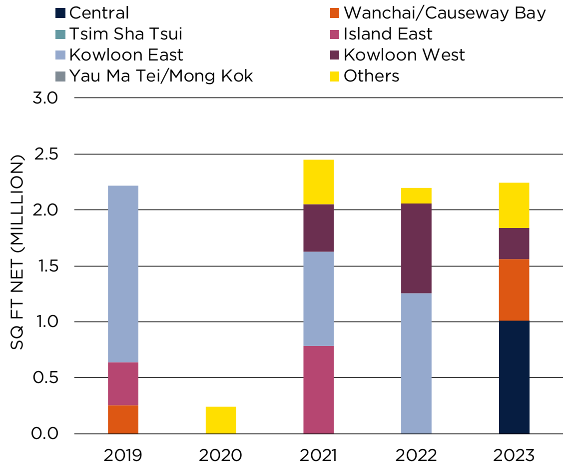
TENANT	BUILDING	AREA (SQ FT)
Dah Sing Bank	Sunlight Tower	76,600
WeWork	Hopewell Centre	72,300
Peak Reinsurance	The Center	31,500
Generalli	Cityplaza 1	26,000
WeLab	Infinitus Plaza	24,000

Source Savills Research & Consultancy

Kowloon East will see the most significant supply over the 5 years, with 3.7 million sq ft net or 39% of the total, followed by Kowloon West (1.5 million sq ft net, 16%) and Island East (1.2 million sq ft net, 13%). Five-year take-up in Hong typically averages around 1.1 million sq ft per annum.

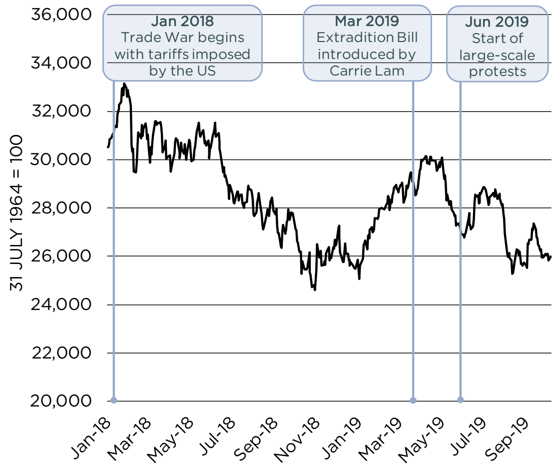
Only 1 million sq ft net (19.3%) will be situated in Central and all of it will be completed in 2023. New developments will include the Hutchison House and Murray Road Carpark developments and Site C of the Peel Street/Graham Street project. The late arrival of these buildings should provide support for rents in Central as availability tightens in the run up to 2023.

GRAPH 3: Distribution Of Grade A Office Supply, 2019 to 2023



Source Savills Research & Consultancy

GRAPH 4: Hang Seng Index, January 2018 to October 2019



Source Yahoo Finance, Savills Research & Consultancy

TABLE 3: Cities Comparison - Fragrant Harbour v Lion City

		Hong Kong	Singapore
Grade A stock (sq ft net)		83 million	32 million
Core rent @ Q3/2019		HK$97.66 / US$12.45 per sq ft net effective	S$10.08 / US$7.30 per sq ft
Fringe rent @ Q3/2019		HK$44.54 / US$5.68 per sq ft net effective	S$6.76 / US$4.90 per sq ft
Stock market capitalization[1]		HKD 30,521 billion / USD 3.821 billion (As at 30th September 2019)	S$917.44 billion / USD 664.7 billion (As at 31st August 2019)
Cost of living index[2]		79.21 (Ranked 35 out of 377)	80.23 (Ranked 31 out of 377)
Quality of life index[3]		99.58 (Ranked 68 out of 77)	146.09 (Ranked 35 out of 77)
Flight time	Beijing	3h 25min (flight number: KA 900)	6h 10min (flight number: SQ 800)
	Shanghai	2h 40min (flight number: KA 802)	5h 20min (flight number: MU 544)

Source Savills Research & Consultancy
1 Exchange rate: 1 USD = 7.8434 HKD / 1.3802 SGD
2 Reference: Cost of Living Index 2019 Mid-Year by Numbeo
3 Reference: Quality of Life Index 2019 Mid-Year by Numbeo