MARKET IN MINUTES

Savills Research

Office Leasing

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Rental declines continue across the board

Rental declines were milder in Kowloon with vacancy gradually absorbed after the aggressive rental adjustments of late last year.

- Grade A rents fell by 1.5% in Q3/2021 compared with a 2.6% decline in Q2/2021.
- The Central office market has been buffeted by the same headwinds as other markets, but despite this we have seen some selective expansion demand and new leases among Mainland financial institutions as well as new industry tenants.
- In the uncertain environment, serviced offices are popular, and we note more take-up from large operators in core business districts.
- Rental declines were milder in Kowloon with vacancy gradually absorbed, particularly in Tsim Sha Tsui and Kowloon East.
- Vacancy rates continued to climb to 9.3% in Q3 with office buildings in some areas, such as North Point and Kowloon West, suffering more than others.
- Upcoming supply in prime areas is seeing some early pre-commitment.
- As Central's rental premium over the rest of the market narrows, decentralised rents may in turn come under pressure. Looking ahead, during a period of uncertain prospects and elevated supply, a lot will depend on demand from PRC firms over the next 12 to 24 months.

"The recent stock market tumble and strong IPO pipeline have been two balancing forces behind the Central office market. Looking ahead, narrowing rental discounts between districts, uncertain economic prospects, together with elevated supply levels may put more pressure on decentralized office rents."

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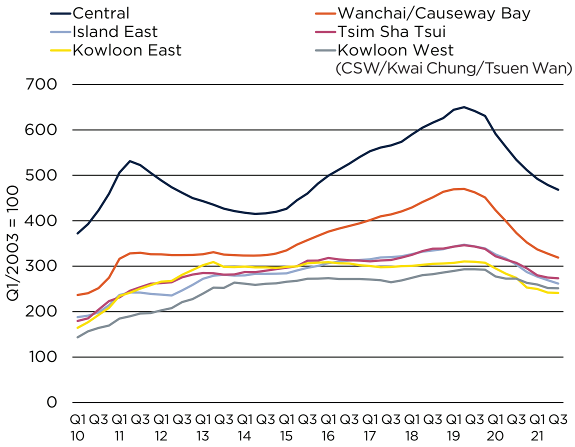
GRAPH 1: Savills Grade A Office Rental Indices By District, Q1/2010 to Q3/2021



Source Savills Research & Consultancy

TABLE 1: Grade A Office Rental Indices, Q2/2021 vs Q3/2021

DISTRICT	Q2/2021 (QOQ%)	Q3/2021 (QOQ%)
Central	-2.8	-2.2
Wanchai/Causeway Bay	-3.0	-2.7
Island East	-2.6	-2.8
Tsim Sha Tsui	-1.8	-0.5
Kowloon East	-4.2	-0.3
Kowloon West (CSW/ Kwai Chung/Tsuen Wan)	-2.9	-0.2
Overall	-2.6	-1.5

Source Savills Research & Consultancy

MARKET COMMENTARY

The Central office market has been buffeted by the same headwinds as other markets, from stock market wobbles in July/August to rising policy risk from the PRC and finally the on-going Evergrande drama. The local office market has seen a rising tide of Mainland demand over the last ten years, but recent events may cool activity levels in sectors from technology to real estate, from securities firms to i-banks and asset managers. Even e-games, casinos and education have not escaped the eye of the Mainland regulator.

Despite the challenges, we have seen some selective expansion among Mainland financial institutions as well as some new industry tenants. Amber Hill (a Mainland asset management house) expanded to take up a floor in Two IFC while CITIC Securities is also taking additional space. Haitong Securities also took up more space in One IFC. In other news, HashKey Group (a cryptocurrency service provider) has leased 14/F of Three Exchange Square as their new headquarters. In the HK$100 per sq ft plus bracket, One/Two IFC and Exchange Square remain go-to developments given their landmark status and strong transport links.

Grade A rents fell by 1.5% in Q3/2021 compared with a 2.6% decline in Q2/2021 as Kowloon rents proved more resilient than their Hong Kong Island counterparts due to the faster absorption of vacant space at discounted rates. In Q3/2021, rents in Central, Wanchai/Causeway Bay and Island East fell by 2.2%, 2.7% and 2.8% respectively while overall Hong Kong Island rents recorded their lowest rate of decline since Q1/2020, registering a fall of 1.5%. Rents in Tsim Sha Tsui, Kowloon East and Kowloon West fell by 0.5%, 0.3% and 0.2% respectively, significantly more moderate falls than in previous quarters.

In the uncertain environment, serviced offices are again popular, and we note further take-up by large operators in core business districts. The Executive Centre, with most of its existing serviced space fully occupied, expanded operations and took up the majority of 28 Stanley Street in Central. Regus, another well-known operator, was rumoured to have taken up two floors (around 23,000 sq ft) in Tower 535 in Causeway Bay, operating under its IWG brand.

Rental declines have been milder in Kowloon with vacancy gradually absorbed, in particular in Tsim Sha Tsui and Kowloon East: Centaline Property Agency relocated from Central to take up 60,000 sq ft in Wharf T&T Centre in Tsim Sha Tsui, while Prudential relocated from Causeway Bay to consolidate their back-office operations in two floors (around 50,000 sq ft) in The Gateway Tower 5. Another insurance company, Bupa, took up multiple floors of around 92,000 sq ft in The Quayside in Kwun Tong.

Vacancy rates stabilized at around 9.3% (5.8 million sq ft) but office buildings in some areas, such as Island East and Kowloon West, suffered more than others. Island East vacancy increased by 0.7 percentage points over Q3, which was almost entirely due to increased availability outside the Taikoo Place portfolio, in particular in North Point. Kowloon West vacancy increased by 1.0 percentage points with significant increases in availability in some older buildings in Cheung Sha Wan. Tsim Sha Tsui, on the other hand, saw vacancy rates decline by 0.7 percentage points with the Gateway portfolio seeing substantial take-up over the past three months.

TABLE 2: Major New Lettings In Central, Q3/2021

TENANT	BUILDING	AREA (SQ FT)
The Executive Centre	28 Stanley Street	Majority
Amber Hill	Two International Finance Centre	24,156
Schonfeld Strategic Advisors	Chater House	14,383
Lombard Odier Darier Hentsch	Three Exchange Square	11,208

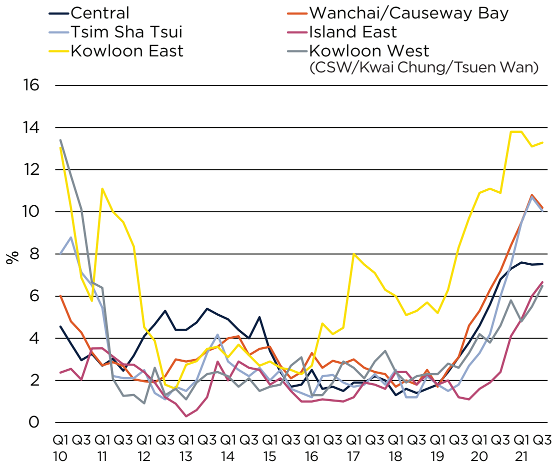
Source Savills Research & Consultancy

TABLE 3: Major New Lettings (Outside Central), Q3/2021

TENANT	BUILDING	AREA (SQ FT)
Bupa	The Quayside	92,490
Centaline Property Agency	Wharf T&T Centre	60,000
Food Panda	Times Square Tower Two	38,988
Nike	International Trade Tower	54,019
KAISA Group Overseas	NEO	19,983 (show suite)
BOCI-Prudential Trustee	1111 King's Road	18,323
HSBC	K11 Atelier	14,000

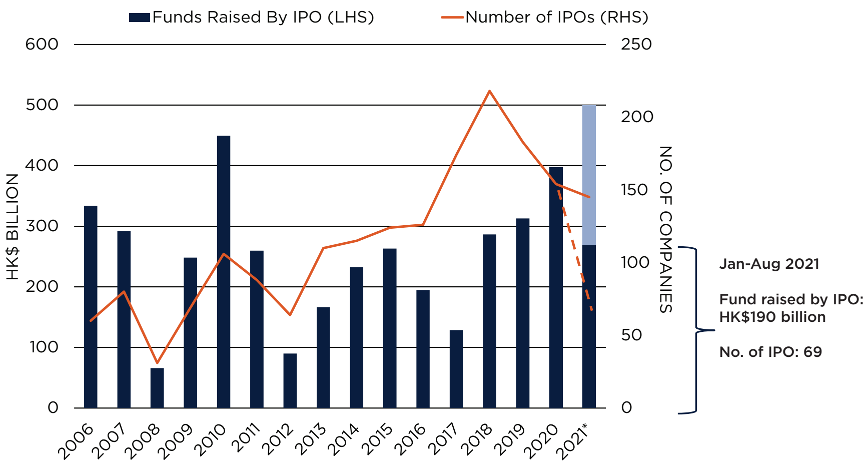
Source Savills Research & Consultancy

GRAPH 2: Grade A Office Vacancy Rates By District, Q1/2010 to Q3/2021



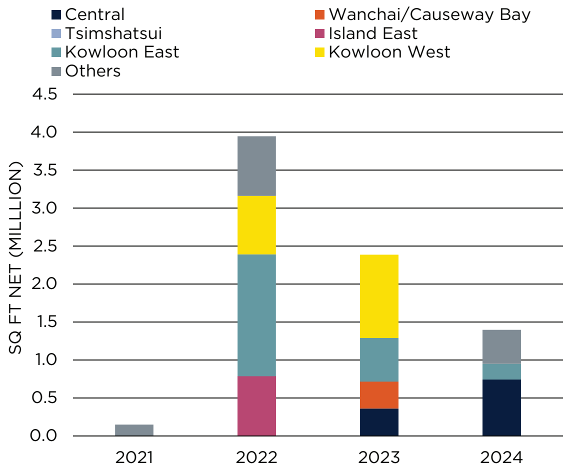
Source Savills Research & Consultancy

GRAPH 3: Funds Raised By IPO In Hong Kong, 2006 to 2021F



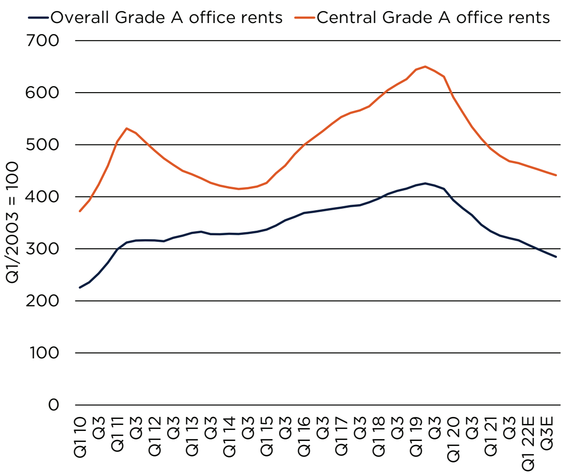
Source Hong Kong Stock Exchange, Savills Research & Consultancy
* Forecast by PwC

GRAPH 4: Grade A Office Supply Forecasts, 2021 to 2024



Source Savills Research & Consultancy

GRAPH 5: Grade A Office Rental Forecasts, 2022E



Source Savills Research & Consultancy

UNCERTAIN ECONOMIC PROSPECTS CLOUD OFFICE SECTOR OUTLOOK

As Central's rental premium over the rest of the market narrows, decentralised rents may in turn come under pressure. Looking ahead, during a period of uncertain economic prospects and elevated supply, a lot will depend on demand from PRC firms over the next 12 to 24 months.

On the back of worrying news for both Mainland and locally listed developers as well as other industries facing heavy regulation, the stock market tumbled by 15% in Q3/2021, clouding the already weak financial market sentiment. The only bright spot has been the strong IPO market so far this year, which has seen 69 new companies listed in HKEx, raising more than HK$190 billion over the first eight months. Nearly another dozen companies filed listing applications in September aiming to be listed over the rest of the year, including Ximalaya, the largest podcasting platform in China, and Xintiandi, Shui On Land's prime commercial assets in Shanghai. If all these applications are successful, Hong Kong could wrestle New York for the top spot of funds raised by IPO for 2021.

According to FocusEconomics, the Hong Kong economy is projected to recover lost ground this year to grow by 6.4% as it leaves behind its two-year-long recession, with stronger activity at home and abroad spurring private spending and external demand. Nevertheless, uncertainty over the course of the pandemic as well as uncertainty over the timing and extent of border reopening remain risks, with GDP growth projected to moderate to 3.1% in 2022.

The impact of the pandemic and general corporate downsizing on the office market this year has been partly counterbalanced by extremely low supply levels. Nevertheless, the rapid rise in office completions coming on stream from 2022 onwards will test the resilience of the market if demand does not turn around quickly. The good news is that we are seeing pre-commitment deals in some prime offices in both decentralized and core areas. Julius Baer, the private bank, has pre-leased four floors (around 90,000 sq ft) in Two Taikoo Place, which is due for completion in 2022. Meanwhile, international auctioneer Christie's has leased four floors (around 50,000 sq ft) in The Henderson in Central, the latest triple Grade A office development by Henderson Land to be completed in 2023.

With the uncertain economic outlook, elevated supply levels and clouded prospects for PRC demand, we expect overall and Central office market rents to decline by 10% and 5% respectively in 2022.