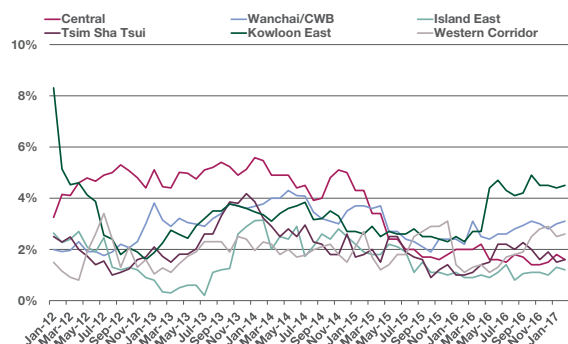


Asian Cities Report **Hong Kong Office**

1H 2017

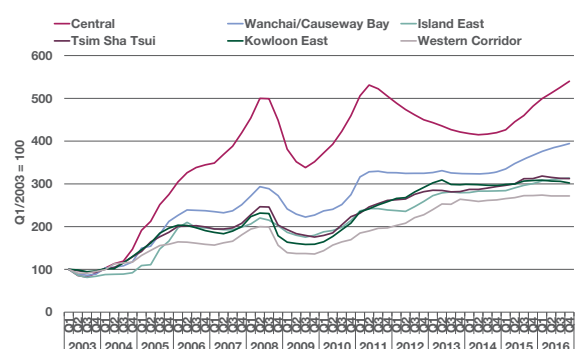


GRAPH 1
Grade A office vacancy rates, Jan 2012–Feb 2017



Source: Savills Research & Consultancy

GRAPH 2
Grade A office rental indices by district, Q1/2003–Q4/2016



Source: Savills Research & Consultancy

TABLE 1
Major PRC leasing deals (new lettings), Sep 2016–Jan 2017

Terms agreed date	District	Property	Unit/floor	Area (sq ft)	Tenant
Jan 2017	Causeway Bay	Times Square Tower 1	18/F, 19/F, 20/F, 21/F, 22/F, 23/F & 31/F	118,828	SCMP
Jan 2017	Central	AIA Central	27/F	13,166	Huarong Group
Dec 2016	Central	Two IFC	Units 3701-09 & 15-16, 37/F	15,776	HNA Group
Nov 2016	Tsim Sha Tsui	ICC	Units 7601A & 7607-8	12,164	Chinalin Securities
Nov 2016	Wanchai	Three Pacific Place	18/F	15,465	Agile Group
Oct 2016	Wanchai	Three Pacific Place	17/F	15,465	Hai Yin Int'l
Sep 2016	Admiralty	One Pacific Place	Units 2004-05 & 3207-12	15,000	Shanghai Pudong Dev. Bank

Source: Savills Research & Consultancy

Grade A offices

Hong Kong has firmly established itself as the most expensive office market in Asia and CBD rents are now at an all-time high, after registering 4.2% growth in 2016. On Hong Kong Island, rental growth generally remained in positive territory throughout 2016 driven predominantly by a lack of available stock. Grade A vacancy in the island's main business districts ended the year just shy of 2%, very low by historical standards.

Take-up

Take up last year came in just below the five-year average at one million sq ft across the Grade A office market as a whole but vacancy rose in Kowloon as new supply in Kowloon East put pressure on rents on that side of the harbour, which showed signs of faltering as early as Q2/2016. While vacancy in Tsimshatsui (1.6%) and the Western Corridor (2.6%) remained low, Kowloon East recorded 4.5% of empty space representing some 460,000 sq ft in total, a figure we expect to rise over 2017 and into 2018.

Looking ahead, the next five years should see the office market regain its equilibrium as supply levels rise just beyond historical five and ten-year take-up averages. The result should be a broadly stable market with some pressure on the downside. Demand, of course, is harder to forecast than supply but with increasingly active mainland firms establishing a presence here or expanding existing operations it looks likely that take-up will remain healthy. One wild card is the arrival of relatively new developers/landlords, especially in Kowloon East, who will prove less predictable than Hong Kong's traditional landlords when setting rents.

Demand drivers

Since 2014 new leases and renewals by PRC tenants have consistently totaled over half a million square feet. Over the same period we have also observed a marked tendency for such firms to look beyond Central to other business districts

to house their growing operations. This trend may partly reflect the high costs associated with the CBD but may also hint at a greater diversity among PRC firms in Hong Kong. Previously, demand was driven predominantly by financial services companies (mostly banks, securities firms and private fund and asset managers) whereas these days a growing share of take-up is accounted for by such industry sectors as pharmaceuticals, oil and gas or IT/telecoms. It is worth remembering that many PRC firms remain under-represented in the territory compared with their international peers.

There will be other sources of demand of course, besides mainland firms. Co-working space, a vital part of Hong Kong's 'startup ecosystem' has taken off over recent years and according to an InvestHK survey, August 2016 saw 1,926 startups (+24% YoY), involving 5,618 workstations (+24% YoY) and 5,229 staff (+41% YoY). Co-work spaces and incubation and acceleration programmes were found in 48 locations around the territory. Financial services can also look forward to 2017 if President Trump begins to deregulate the sector and the IPO pipeline forecast for this year materializes. Accounting firm PwC expects 130 firms to list in 2017 with a market value of HK\$220 billion, just above 2016 figures.

New supply

New Grade A office supply will total 4.3 million sq ft over 2017 and 2018, 500,000 sq ft of which will be for strata-title sale, while 132,000 sq ft has been pre-committed and 276,000 sq ft could potentially be made available for en-bloc sale leaving around 3.4 million sq ft of single-owned buildings for lease (annual take-up typically totals around 1.0 – 1.5 million sq ft). By far the majority of the remaining 3.4 million sq ft is expected to come on stream in Kowloon East (46%) followed by Island East (20%) so some further pressure can be expected on rents in the two districts. No new supply is expected

in Central with limited delivery in Wanchai/Causeway Bay (8%) and Tsimshatsui (7%) where vacancy levels are likely to remain low.

Rents and prices

Even though the rental outlook suggests a period of subdued-to-negative growth (we think there is still room for rent rises in Central during 2017 though), prices have continued to climb, rising by 5.5% in 2016. Indeed, towards the end of last year, records were still being broken in some buildings even if volumes were subdued. A negative real interest rate environment and ample local and international liquidity go some way to explaining the remarkable run in office prices which have been rising since 2009. Demand in early 2017 has also remained surprisingly resilient, supported by PRC investors and end users and we think that further price rises are likely this year with momentum slowing towards year-end and a period of downward adjustment likely from 2018. Central will outperform.

Variables

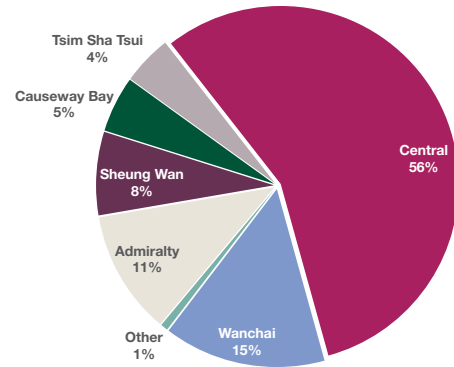
Several variables could change our outlook quite dramatically of course, including the timing and extent of US interest-rate changes, the possibility of a trade war between China and the US, upheaval in Europe where a series of referendums could result in considerable economic and political change as well as the success (or failure) of China's attempt to transform its economy from one lead by fixed asset investment, cheap labour and monetary expansion into one lead by private consumption expenditure.

Longer term

The supply pipeline from 2018 will be dominated by Kowloon East, Island East (the Taikoo Place redevelopment) and (much longer term) by the Central/Wanchai reclamation. Government sites will also feature largely over the next few years including the tender this year of the Murray Road Carpark site which could see a new lump sum land premium record and we expect

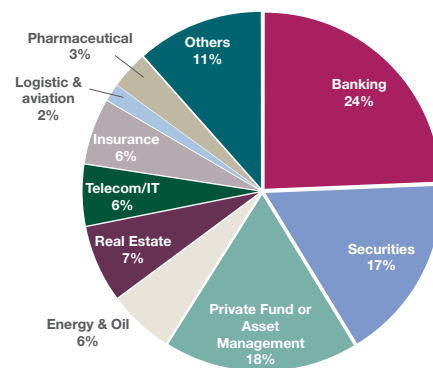
strong interest from PRC entities as well as local landlords with holdings in the vicinity. Other prominent sites will result from Government giving up land in Mongkok (Water Supplies Department office and the adjoining sites), Wanchai (Revenue Tower, Immigration Tower and Wanchai Tower) and Causeway Bay (former EMSD headquarters in Caroline Hill). The first office site in Kai Tak will also be tendered this year, planned to be the largest commercial (mixed use) development in the area, zoned CDA with the offices suitable for headquarter use. ■

GRAPH 3 PRC leasing transactions (sq ft net) by district, 2008–2016



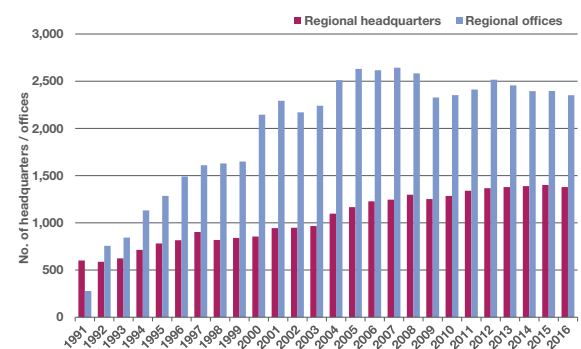
Source: Savills Research & Consultancy

GRAPH 4 PRC leasing transaction (sq ft net) by industry, 2008–2016



Source: Savills Research & Consultancy

GRAPH 5 No of regional headquarters and offices in Hong Kong, 1991–2016



Source: Census and Statistics Department, Savills Research & Consultancy

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