

Office Market Update Hong Kong

Latest updates on the Hong Kong office market, including our predictions on where the market is heading.

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The ongoing trade dispute between US and China, coupled with the tightening of financial controls in China, has caused demand from mainland (PRC) companies to drop off significantly and has almost come to a halt. Up until recently such companies dominated the leasing of the top Grade A office space in Central, but this has dissipated and now such space takes much longer to lease out.

Confidence has weakened amongst financial occupiers, which account for 55% of Grade A space in Central, with the Hang Seng Index having fallen 20% since it peaked in early 2018 but is beginning to recover now.

The market has been 'spooked' by some recent events involving PRC companies, such as HNA giving up 8 floors in Three Exchange Square amounting to 90,900 sq ft, which was pre-leased in May 2017 but never occupied. There have also been several accounts of PRC companies walking away from leases in ICC Kowloon. Hence security deposits for such firms have increased from the standard 3 months to up to 6 or 9 months rental.

Decentralization gathering momentum

It is not all doom and gloom though. For instance over half the space that was given up by HNA was taken up by China Merchants Bank. T. Rowe Price is expanding in Central, relocating from Jardine House to take up 37,250 sq ft in Chater House. Some demand has been created as a result of buildings being redeveloped such as AIA House and Hutchison House. AIA have taken up 5 floors in Hopewell Centre, whilst AIA Building in Wan Chai is being redeveloped. The anchor tenant of Hutchison House, Baker McKenzie has just moved to One Taikoo Place and Handelsbanken has moved to Sun Hung Kai Center.

Decentralization has been a prominent feature in this current market. Several law firms have relocated from Central to Quarry Bay, including Eversheds Sutherland which has relocated from Gloucester Tower to One Taikoo Place. Some banks have also decentralized to Quarry Bay, such as Royal Bank of Canada which is relocating from Cheung Kong Centre to One Taikoo Place. The largest decentralization coup this year

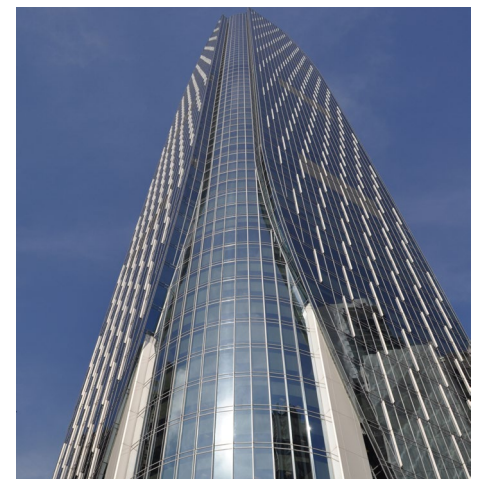
was the announcement in February that the Futures and Securities Commission will be giving up some 150,000 sq ft in Cheung Kong Center and has leased 9 floors (circa 200,000 sq ft) in One Island East, with effect from January 2020. In the process they will be slashing their rental overheads from around \$120 per sq ft to \$55.00 per sq ft.

In Kowloon the shift from Tsim Sha Tsui towards Kowloon East continues to gather momentum, with the largest transaction to take place recently being the leasing of some 130,000 sq ft of space to Sun Financial in Cheung Kei Centre in Hung Hom. They will be consolidating their operations and relocating from The Gateway. Many had anticipated a firming of demand in TST from mainland Chinese companies with the completion of the Express Rail Link Terminus in Kowloon West, but were disappointed when the boost in demand didn't materialize. Other movers in Kowloon include Lee and Wrangler, taking up some 44,000 sq ft in C-Bons International Centre, and Milway Development securing 28,500 sq ft of space in Kingston International Centre.

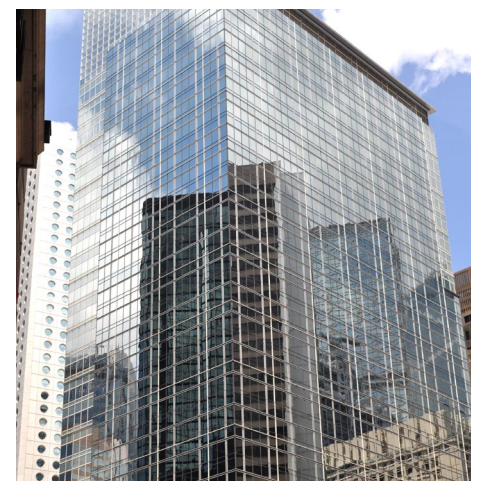
Some Notable Recent Leasing Transactions

Tenant	Building	District	Floor Area sq ft
Hong Kong Island			
Securities and Futures Comm.	One Island East	Quarry Bay	200,000
Baker McKenzie	One Taikoo Place	Quarry Bay	40,000
Royal Bank of Canada	One Taikoo Place	Quarry Bay	44,000
WeWork	Lee Garden One	Causeway Bay	60,700
WeWork	Hysan Place	Causeway Bay	33,000
United Overseas Bank	China Taiping Tower	Causeway Bay	26,800
China Merchants Bank	Three Exchange Square	Central	24,500
T. Rowe Price	Chater House	Central	37,250
HuaTai	The Centre	Central	23,500
Kowloon / NT			
Sun Life Financial	Cheung Kei Center	Hung Hom	130,000
Milway Development	Kingston International Centre	Kowloon Bay	28,500
Lee and Wrangler	C-Bons International Center	Kwun Tong	44,000
J.P. Morgan	The Quayside	Kwun Tong	50,000

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One Island East
18 Westlands Road, Quarry Bay



Chater House
8 Connaught Road Central, Central

Finding affordable office space is still an immense challenge in the CBD. Many more firms are now prepared to opt for decentralization, whilst still remaining on Hong Kong Island, to secure the quality of space they need at a budget that suits them. This is why many of the new office developments on Hong Kong Island, such as One Taikoo Place, South Island Place, 18 King Wah Road and One Hennessy are full or enjoy at least 90% occupancy.

Only 2 small/medium-sized office developments are scheduled for completion in the next 12 months on Hong Kong Island, namely K11 Atelier / 728 King's Road and 218 Electric Road in Quarry Bay and North Point respectively. The vast majority of new space will be found in Kowloon East, although even this location has limited supply in the next few years and buildings such as NEO at 123 Hoi Bun Road, and 38 Wai Yip Street have the bulk of available new supply for 2019.



218 Electric Road

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Over the next 10 years some 20 million sq ft of office space could be delivered from future government land sales, of which around 15 million sq ft will be in Kowloon.

In Central, there is space beginning to appear in some of the premium buildings, as a result of decentralization, but these are the top of the range buildings, which only a limited few can afford. Cheung Kong Center in particular will be hard hit when it's anchor tenant, the Securities and Futures Commission, moves out of 150,000 sq ft to relocate to Quarry Bay in 2020. They are also losing another significant tenant with The Royal Bank of Canada relocating to One Taikoo Place. There is likely to be more space coming available in The Landmark buildings, with several professional firms decentralizing. Plus, there is a new development (located at 152 Queen's Road Central) now under construction, offering an additional 44,421 sq ft, which is expected to be completed in the 4th quarter of 2019.

Admiralty is destined to become a more substantial prime office location. The redevelopment of Murray Street Car Park, by Henderson Land, is well under way and this 35-storey office tower, scheduled for completion in 2022, will provide some 465,000 sq ft of prime office space. The redevelopment of Hutchison House, on the site directly opposite, is set to start soon now all tenants have been decanted. This 41-storey office development, scheduled for completion in 2023, will provide a further 493,000 sq ft.

The redevelopment of Queensway Plaza has the potential to provide an additional 862,000 sq ft of office space. The scheme being planned includes a 38-storey office tower with 5-storey retail mall. This location will become an important transport hub as well, as Admiralty station will serve as the link terminus of the Shatin-Central Link, which will complement the existing bus and MRT stations.

New Developments 2019 – 2025+

Tenant	Building	Floor Area sq ft	Target Completion
Hong Kong Island			
K11 Atelier / 728 King's Road	Quarry Bay	382,000	2019
152 Queen's Road Central	Central	44,421	2019
218 Electric Road	North Point	144,000	2020
Two Taikoo Place	Quarry Bay	1,000,000	2021
Murray Street Car Park	Admiralty	465,000	2022
Hutchison House	Admiralty	493,000	2023
Queensway Plaza	Admiralty	862,000	2025+
Kowloon / NT			
NEO / 123 Hoi Bun Road	Kwun Tong	600,000	2019
38 Wai Yip Street	Kowloon Bay	395,000	2019
The Quayside	Kwun Tong	480,000	2019
The Gateway Extension	Tsim Sha Tsui	280,000	2021



K11 Atelier King's Road
728 King's Road, Quarry Bay



One Hennessy
1 Hennessy Road, Wan Chai

Hong Kong is still the most expensive office location in the world, with occupancy costs some 59% high than midtown New York.

However, with weaker sentiment in the financial sector prevailing and the drop off of leasing activity with PRC companies, prime rental rates have stopped advancing, peaking at the beginning of the year and were flat in Q1 this year. Notwithstanding this, growth in the secondary market / other submarkets still persists driven by rent refugees from Central.

Currently, landlords are holding out for their asking rates to secure quality tenants, but many tenants have become even more cost conscious and are prepared to consider other

locations/districts. The main beneficiaries of these conditions have been Causeway, Quarry Bay and Wong Chuk Hang.

The top prime Grade A rate averages around \$165.00 per sq ft, but in Central as a whole, the prime rates are static at around \$137.00 psf.

We expect demand from co-working space operators to soften compared to 2018. In fact, we may even see some consolidation in this sector and it is possible some outlets in less successful locations may be given up. With very few new developments for the next 2 years, rates overall will remain firm and movement may be stagnant due to a scarcity of supply. In the meantime, Central remains

the most exposed to any downturn and we anticipate prime rental rates to drop 3% to 6% in 2019. This is due to weaker demand and a more cautious cost conscious approach, at this time of uncertainty. Kowloon is expected to be stable, with insurance companies being particularly active and we anticipate a modest increase in rates of between 1% and 3% in 2019, due to ample supply.

Whilst demand from PRC firms has softened, The Greater Bay Area initiative and China's ambitions for its bigger companies to go global, is likely to ensure that this demand will eventually return and once again, provide important support for the office market's future growth in Hong Kong.

Average Net Effective Rents by District

Location	Average Net Effective Rent	Vacancy Rate
Central / Admiralty	\$137.00	2.3%
Wan Chai / Causeway Bay	\$77.00	1.8%
North Point / Island East	\$53.00	1.8%
Tsim Sha Tsui	\$80.00	2.3%
Kowloon East	\$40.00	13%

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NEO
123 Hoi Bun Road, Kwun Tong



The Quayside
77 Hoi Bun Road, Kwun Tong



Cheung Kong Center
2 Queen's Road Central

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