LEASING MOMENTUM STAYS SLOW AS UNCERTAINTIES REMAIN

Hong Kong’s business sentiment remained cautious in Q2 2019, despite the resumption of trade negotiations between the US and China. We believe that enterprises will maintain a wait-and-see view towards major business decisions over H2 2019.

Grade A office rents in the CBD started to soften due to the prolonged negative net take-up and the slower leasing momentum. Rents in Island East outgrew the other major submarkets, given the strong demand with a tight vacancy rate.

In Q2, rents edged up in Kowloon, due to the decentralization trend and the addition of new quality office buildings that helped to lift the average rents. Occupiers should consider Wan Chai / Causeway Bay given the recent rental adjustment and increased availability of office space.

Summary & Recommendations

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SUBDUED LEASING MOMENTUM IN MAJOR SUBMARKETS

The economic slowdown and the unresolved US-China trade war continued to weigh on office leasing demand. Although the overall market recorded a positive net take-up of 622,305 sq feet (57,814 sq metres), this was mainly due to the completion of partly pre-committed new office building.

The cautious business outlook was indicated by the soft demand in the CBD. Central recorded a negative net take-up for the fourth consecutive quarter, at -33,669 sq feet (-3,128 sq metres) in Q2 2019. Given the prolonged softening demand, Grade A office rents in the CBD edged down by 0.1% QOQ despite the low vacancy rate. Wan Chai/Causeway Bay recorded the lowest net take-up among all submarkets of -53,854 sq feet (-5,003 sq metres), and also recorded the largest rental decline among submarkets, dropping -2.4% QOQ, adjusting from its robust growth (14% YOY) in 2018. The declines were mainly due to some tenants relocating to Island East, which is still more affordable despite having the strongest rental growth among major submarkets.

Rents in Tsim Sha Tsui increased by 1.7% QOQ, driven by the rental growth in The Gateway office towers. Despite the contracting trading and manufacturing sectors, vacant office units were quickly backfilled by companies from the finance, technology and flexible workspace industries.

Kowloon East, which recorded a positive net take-up of 565,132 sq feet (52,503 sq metres) due to the completion of the new office building The Quayside which was over 60% pre-committed. New Grade A office buildings also contributed to the rental growth in Kowloon East, as they traded higher than the district average.

<table>
<thead>
<tr>
<th>Tenant</th>
<th>Building</th>
<th>District</th>
<th>Floor area (sq ft)</th>
<th>Transaction Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>SFC</td>
<td>One Island East</td>
<td>Quarry Bay</td>
<td>191,900 (L)</td>
<td>New Letting</td>
</tr>
<tr>
<td>AON Insurance</td>
<td>One Island East</td>
<td>Quarry Bay</td>
<td>42,650 (L)</td>
<td>New Letting</td>
</tr>
<tr>
<td>FWD Life Insurance</td>
<td>Devon House - Taikoo Place</td>
<td>Quarry Bay</td>
<td>17,700 (L)</td>
<td>New Letting</td>
</tr>
<tr>
<td>Ping An OneConnect</td>
<td>NEO</td>
<td>Kwun Tong</td>
<td>63,000 (G)</td>
<td>New Letting</td>
</tr>
<tr>
<td>CEO Suite</td>
<td>K11 Atelier</td>
<td>Tsim Sha Tsui</td>
<td>25,260 (G)</td>
<td>New Letting</td>
</tr>
</tbody>
</table>

Source: Colliers International. Note: (N), (G) and (L) stand for net floor area, gross floor area and lettable floor area respectively.
A STRONG REBOUND OF INVESTMENT VOLUME

The office investment volume increased 275.6% QOQ in Q2 2019 to HKD27.0 billion (USD3.5 billion). The surge was driven by a rebound of transactions in both the en bloc and strata title markets. A notable transaction in this quarter included PAG’s acquisition of the 690,000 sq feet (64,100 sq metres), Mapletree Bay Point, a new Grade A office building in Kwun Tong completed in 2017. The fund would pay HKD9 billion (USD1.2 billion) to Mapletree Investments for the purchase.

Another major deal included Gaw Capital entering into agreements to purchase the 26-storey Grade A office building at 625 King’s Road in Quarry Bay from Swire and China Motor Bus for HKD4.8 billion (USD609 million). The unit price was translated to about HKD15,780 (USD2,023) per sq foot based the total gross floor area of about 301,065 sq feet (27,970 sq metres).

Activities in the strata title office investment market rebounded significantly during the quarter, with volume up by 60.6% QOQ in Q2 2019 to HKD10.4 billion (USD1.3 billion). Despite a more active market, the average price for the strata title Grade A office market edged down by 0.4% QOQ. Meanwhile, the investors who participated in the record deal of The Center in Central during 2017 continued to put up their subdivided office units for sale. For instance, a mainland investor purchased the 38th floor in The Center for HKD1.1 billion (USD138.5 million). The transacted price translated into HKD42,000 (USD5,385) per sq foot, compared to the last price of HKD33,000 (USD4,231) per sq foot in 2017. Meanwhile, office units under the same roof but on the 39th floor were sold for between HKD42,000 (USD5,385) and HKD48,000 (USD6,154) per sq foot.

Looking ahead, we expect investment sentiment to stay cautiously optimistic for the rest of 2019, amid the recent protests while the US-China trade war remains unresolved. We believe Grade A office prices will stay relatively firm in H2 2019 while funds and investors stay financially strong. Investors could consider districts with a more bullish rental outlook, such as Island East, for a stronger growth potential for recurring income and capital appreciation of property value.

1 Mingtiandi, 8 February 2019
2 hkesnews, hkesnews, 21 May 2019

Hong Kong Office investment volume (deal size ≥HKD 30 million)

Hong Kong Grade A office price trend

Source: Colliers International

Source: Colliers International

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