

New office spaces enhance consolidation demand

Zac Tang Senior Analyst | Hong Kong

Decentralisation has gained stronger momentum in Q2 underpinned by large occupiers consolidating operations from multiple locations into new developments in Wong Chuk Hang and Causeway Bay. Relocation and consolidation have driven down vacancy rates in decentralised areas while Chinese companies have further expanded in Central. Given the stronger competition across Hong Kong Island, co-working operators have taken advantage of low rents and large floorplates in Kowloon East. We see Kowloon East in particular as an attractive location for occupiers with ample available space.

Forecast at a glance



Demand

New supply in decentralised areas to boost consolidation demand from large occupiers



Supply

A total of 3.8 million sq ft (0.35 million sq m) of office space to be completed in 2017, 52% more than 2016. Supply will stay strong with over 10 million sq ft (0.93 million sq m) to be completed over 2018-2021



Rent

Hong Kong Island to increase 2.1% and Kowloon to fall 4.3% in H2 2017. We expect overall rents to increase 9.4% in 2018



Investment

Office prices set to rise 10% on Hong Kong Island and 5% in Kowloon over 2017 due to strong demand

Strong demand in non-core areas

Overall net absorption improved in Q2 to 243,362 sq ft (22,609 sq m) compared to 10,582 sq ft in Q1. With performance concentrated in non-traditional districts, the total net absorption of Hong Kong Island, Kowloon East and West Kowloon only accounted for 77,605 sq ft (7,210 sq m). Central/Admiralty stayed positive at 8,882 sq ft (825 sq m). Wan Chai/Causeway Bay has returned to positive territory at 25,741 sq ft (2,391 sq m). Island East has decreased 43,175 sq ft (4,011 sq m).

Tsim Sha Tsui's quarterly net absorption declined over Q2 to -5,892 sq ft (-547 sq m) with demand diluted by the emerging Hung Hom. Kowloon East recorded a strong quarter with net absorption increasing to 92,100 sq ft (8,556 sq m).

Overall vacancy rate fell 0.1% to 4.0% by the quarter-end. Central/Admiralty maintained its popularity with the vacancy rate staying low at 1.7%. Wan Chai/Causeway's vacancy rate declined to 2.9%, benefiting from the consolidation of large corporates. The vacancy rate for Island East rose slightly but was still very low at 1.7%. In the absence of new completions, Wong Chuk Hang stayed attractive as an emerging market with vacancy dropping to 17.1%. This is the first time that vacancy here has fallen below 20% since December 2015.

The overall vacancy rate for Kowloon fell 0.3% to 6.6%. Tsim Sha Tsui's vacancy rate increased to 2.8% due to competition with Hung Hom. Having no new Grade A building completed in the quarter, Kowloon East's vacancy rate declined 0.4% to 10.0% with new space being filled gradually by new demand.

Submarkets	Grade A Vacancy	Grade A Net Effective Rents (HKD / sq ft / month)	QOQ Rental Change	2017 Rental Forecast
Central / Admiralty	1.7%	\$118.2	0.2%	\$123.2
Wan Chai / Causeway Bay	2.9%	\$68.6	1.0%	\$70.4
Island East	1.7%	\$51.1	0.3%	\$52.8
Tsim Sha Tsui	2.8%	\$53.8	0.0%	\$52.8
Kowloon East	10.0%	\$34.6	0.6%	\$33.2
Overall	4.0%	\$72.7	0.7%	\$75.2

Source: Colliers



A positive rental growth continued

Grade A office rent increased across all the major submarkets in Q2 except in West Kowloon and the New Territories. Central/Admiralty has increased 0.2% QOQ, the same growth in Q1. CBD fringe areas, Sheung Wan and Causeway Bay increased the fastest on Hong Kong Island, up 1.4% QOQ and 1.0% QOQ, respectively. Driven by large pre-commitments in new developments, Island East and Wong Chuk Hang, the decentralised areas on the Island, increased by 0.3% QOQ and 0.5% QOQ respectively.

Rental performance has improved on the Kowloon side. Tsim Sha Tsui rent remained unchanged compared to Q1. Kowloon East's increased by 0.6% QOQ but we expect a decline of 3.6% for 2017, pressured by strong supply despite the market being active.

Decentralisation trend continues

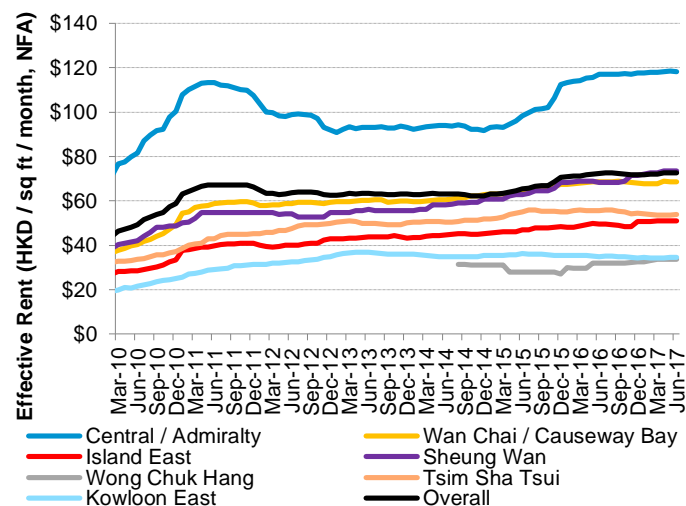
The decentralisation trend continued over Q2. Following the lease at Vertical Sq reported in Q1, AXA further relocated operations into Wong Chuk Hang, leasing 14 floors in 38 Southside and renaming the building AXA Southside. Furthermore, more than 70,000 sq ft (6,503 sq m) was separately leased to two government units - the Equal Opportunities Commission and the Provisional Insurance Authority.

Over Q2, Chinese companies were still expanding and concentrating in Central Grade A offices. Whole floor units or large unit space are more favourable for their expansion; HNA Group has further expanded its footprint in Central by leasing 96,000 sq ft (8,919 sq m) in Three Exchange Square. Industrial Bank Co Ltd leased 34,300 sq ft (3,187 sq m) in the same building for further expansion.

With rents increasing in Central, finance and insurance companies have been moving to the east for cost savings. Examples include Cathay United Bank leasing 17,000 sq ft (1,579 sq m) in Lee Garden Three in Causeway Bay, and Bank Sinopec leasing about 11,000 sq ft (1,022 sq m) under the same roof.

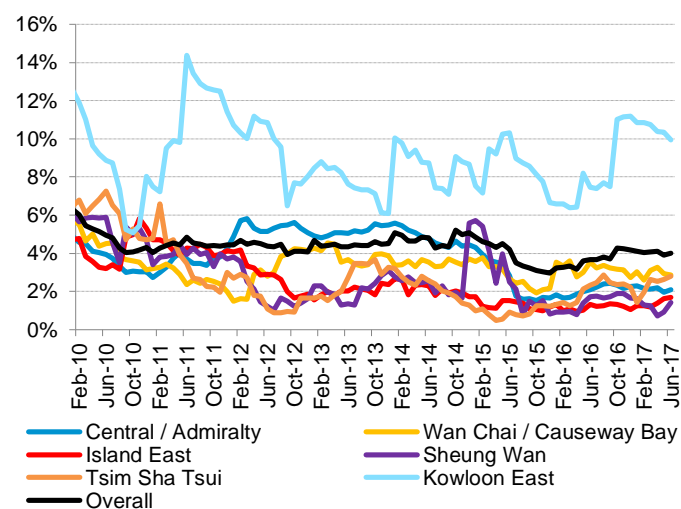
On the Kowloon side, there has been an emerging trend of co-working space moving into Kowloon East, driven by the strong competition with large business centres on Hong Kong Island. WeWork, one of the world's largest flexible workspace operators, pre-committed 36,397 sq ft in Mapletree Bay Point, a Grade A office building in Kwun Tong expected to be completed by Q4 2017.

Hong Kong Grade A Rental Trend



Source: Colliers

Hong Kong Grade A Vacancy Trend



Source: Colliers

Tenant	Building	District	Net Floor Area (sq ft)*	Transaction Type
HNA Group	Three Exchange Square	Central	96,000	New Lease
Equal Opportunities Commission	41 Heung Yip Road	Wong Chuk Hang	57,550	New Lease
AXA Insurance	AXA Southside	Wong Chuk Hang	53,900	Consolidation
Willis HK Ltd	Lee Garden Three	Causeway Bay	37,000	New Lease
JP Morgan	One Exchange Square	Central	41,000	New Lease
China Mobile	Kowloon Commerce Centre	Kwai Chung	32,990	New Lease
Regus Business Centre	Lee Garden Three	Causeway Bay	29,580	New Lease
Industrial Bank Co Ltd	Three Garden Road	Central	27,440	Expansion

Source: Colliers *approx. figure



En bloc transactions boosted investment volume

Investment volume was boosted by the record sale of the Murray Road Car Park site designated for super prime office development in Central, sold at HKD23.3 (USD3) billion to Henderson Land. With an accommodation value of HKD50,064 (USD6,418) per sq ft, the unit rate was a record high for office sites as well as for built properties.

Local investors and property funds were very active, while Chinese investors, who were being restrained by capital controls, were relatively quiet in the office investment market. The total transaction volume of office properties of HKD30 million or above reached HKD13.7 (USD1.8) billion, up 120% QOQ. Volume was boosted by 11 en bloc transactions for a total amount of HKD7.8 billion (USD1.0 billion), marking Q2 as the most active quarter over the past two years. The strata-title market stayed robust with a volume of HKD5.9 billion (USD0.8 billion), the same level as Q1.

The Wellington building in Sheung Wan was sold for HKD3.0 billion (USD 0.4 billion) or HKD30,000 (USD3,846) per sq ft to a local investor, marking the largest office transaction in Q2. The acquisition of Kwun Tong View (for HKD2.0 billion or USD0.3 billion, i.e. HKD13,600 or USD1,744 per sq ft) was the largest transaction on the Kowloon side in the quarter.

Major transactions were concentrated in Central and Sheung Wan with a number of properties being offered for sale. A local investor acquired the whole of 34/F in Cosco Tower for HKD638 million (USD82 million) or HKD31,100 (USD3,987) per sq ft, the highest unit rate for the building.

Wan Chai benefited from a spill-over effect from the active CBD with office units in Convention Plaza and Harbour Centre being sold for above HKD30,000 (USD3,855) per sq ft, pushing the district's price up 8.5% QOQ.

For more information:

Nigel Smith

Managing Director | Hong Kong
+852 2822 0508
nigel.smith@colliers.com
Individual Licence No: E-111570

Fiona Ngan

Head of Office Services
+852 2822 2571
fiona.ngan@colliers.com
Individual Licence: E-197789

Daniel Shih

Director | Research
+852 2822 2654
daniel.shih@colliers.com

Popularity growing in the East

The relocation trend is set to grow in H2. Apart from the upcoming completion of infrastructures, Island East is benefiting from attractive rents that grow its popularity. The rental premium of Central/Admiralty over Island East expanded from a 10-year average of HKD58 to HKD67 in June 2017 in terms of monthly rent per sq ft.

While we expect rents in Central to increase further driven by the demand from PRC firms, we expect Island East to be one of the biggest winners of relocation from Central. Furthermore, redevelopment for prime offices to be completed in the coming five years should further enhance the position of the district and develop Island East into the next key location for front offices. Office rents in Island East are set to rise in H2 2017, closing a widening rental gap between Central.

Relocation within the Kowloon side should be accelerating in H2. Despite the fact that rents in Hung Hom have increased 12% YTD in June, Tsim Sha Tsui was still over 20% more expensive. New office space in Hung Hom has been attractive to occupiers in Tsim Sha Tsui where the newest Grade A office building was completed 14 years ago.

The demand for flexible workspace has been strengthening thanks to a growing number of start-ups and the emergence of the millennial workforce. With the improvement in amenities in Kowloon East and a rental discount of up to 70% compared to Central, we expect the market penetration of co-working space operators in Kowloon East to increase further.

Despite strengthening demand, rents on Hong Kong Island should increase further by 2.1% in H2 amid strong demand. Rents in Kowloon should decline by 4.3% in H2, considering a large new supply in Kowloon (2.1 million sq ft or 195,170 sq metres for the whole of 2017).

Copyright © 2017 Colliers International.

The information contained herein has been obtained from sources deemed reliable. While every reasonable effort has been made to ensure its accuracy, we cannot guarantee it. No responsibility is assumed for any inaccuracies. Readers are encouraged to consult their professional advisors prior to acting on any of the material contained in this report.



Accelerating success.