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Accelerating success.

Low vacancy on Hong Kong Island supports overall rental growth

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Leasing momentum slowed with renewal dominating the overall market in Q3. Demand from banks and legal services firms supported growth in Central, while the footprint of mainland Chinese firms expanded further but at a slower rate. New developments in Kowloon East drove relocation of large companies. Local and foreign coworking operators continued to expand, helping to fill up space in new developments. Developers recognised the potential of Kowloon West, which benefits from high accessibility by the MTR and proximity to the container port. While Kowloon East and the New Territories are facing pressure from high new supply, we expect overall rent to increase 3-4% in 2018 amid positive business sentiment.

Forecast at a glance

Supply

The estimated amount of 2.4 million sq ft of new Grade A office space in 2018 will represent an increase of 13% YOY. New supply is concentrated in Kowloon East. Supply in Hong Kong Island is lower, and should be rapidly absorbed due to strong demand and low vacancy

Rent

Despite the increasing amount of new supply, we expect overall rent to increase 6.5% between 2017 and 2019 due to firm business sentiment, before turning down gradually in 2020 and 2021.

Investment

Despite high prices, office properties will still be the focus. Supply shortage helps ensure a positive price and rental outlook

Slower take-up amid low vacancy

The overall net absorption stayed positive in Q3 at 225,223 sq ft (20,923 sq m), a slight decline from Q2. The demand was concentrated in Kowloon East where net take-up increased 149,797 sq ft (13,917 sq m).

Various key submarkets on Hong Kong Island, including Central/ Admiralty (-75,192 sq ft or -6,986 sq m), Wan Chai/ Causeway Bay (-13,304 sq ft or -1,236 sq m) and Island East (-7,592 sq ft or -705 sq m), showed a negative net take-up, except Wong Chuk Hang, which posted positive net take-up of 19,598 sq ft (1,821 sq m).

The overall vacancy rate was down 10 basis points to 4.5% as net take-up remained positive. Vacancy rates increased across most submarkets on Hong Kong Island. While some MNCs are relocating to Quarry Bay, leading to a 0.1% decline in the vacancy rate there to 1.3%, the districts Central/Admiralty and Wan Chai/ Causeway Bay recorded 0.3% and 0.1% increases in vacancy, respectively. Wong Chuk Hang as an emerging market declined by a further 1.5% to 15.6% due to a lack of new Grade A supply in the quarter.

Kowloon's vacancy rate declined amid the strong absorption in Kowloon East. Being supported by renewals of existing tenants and the persistent relocation trend, Kowloon East's vacancy rate was down to single digit at 8.5%, the lowest vacancy figure in the past four quarters. Insurance companies, accounting for the majority of new demand for Grade A offices in Tsim Sha Tsui, have further pushed down the district's vacancy.

The New Territories have recorded the highest vacancy rate since Q1 2016, reaching 7.6%, as the new supply in the Kowloon area is creating strong competition.

Submarkets	Q3 Grade A Vacancy	Q3 Grade A Net Effective Rents (HKD / sq ft / month)	QOQ Rental Change	2018 Rental Forecast	2018 YOY Change
Central / Admiralty	2.4%	$118.7	0.4%	$126.4	5.7%
Wan Chai / Causeway Bay	3.0%	$68.5	-0.1%	$73.1	5.6%
Island East	1.8%	$51.2	0.2%	$54.0	4.6%
Tsim Sha Tsui	2.5%	$54.9	2.0%	$54.8	2.5%
Kowloon East	8.7%	$34.5	-0.4%	$33.4	-0.6%
Overall	4.5%	$73.0	0.4%	$76.6	3.8%

Rents increased marginally

Overall Grade A office rent was stable in Q3, edging up 0.4% QOQ amid a cost-savings tendency despite positive business sentiment. Rents in Central/ Admiralty increased 0.4% QOQ, supported by sustainable renewal and new demand irrespective of the rising relocation trend. Overall, rents on Hong Kong Island increased 0.3% QOQ, a marginal increase amid high occupancy.

Tsim Sha Tsui recorded a strong quarter with rents rising 2.0% QOQ, whereas in Q2 they remained unchanged compared to the previous quarter. Kowloon East started to feel the pressure from the large new supply with rent dipping 0.4% QOQ, compared to growth of 0.6% in Q2.

Rents in the New Territories have not recorded a positive QOQ growth this year to date as new supply in this region has caused a low take-up rate due to a strong supply market.

Renewals dominated the market

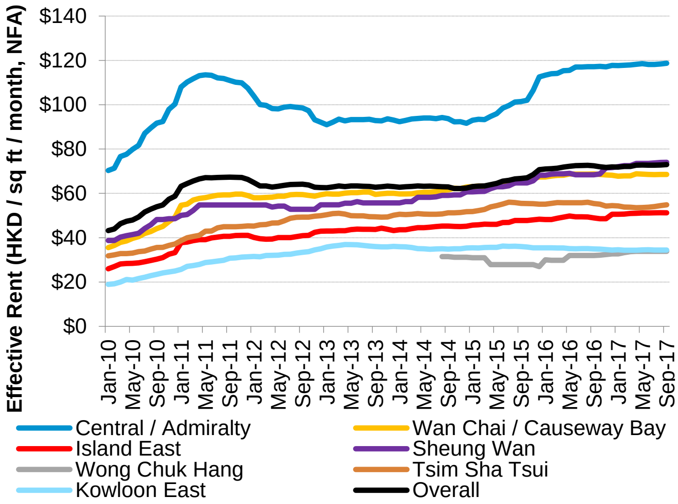
New leasing activity slowed, with renewals dominating the overall market in Q3. Central saw demand from banking and financial institutions and legal services firms, while mainland Chinese firms have further expanded but at a slower rate. China's Industrial Bank leased the three floors in One IFC, while China Galaxy International Financial Holdings Ltd leased the whole 20/F in Wing On Plaza. Decentralised areas such as Wong Chuk Hang and Island East were supported by demand from MNCs, even though they predominantly offer leased spaces of below 10,000 sq ft (930 sq m).

On the Kowloon side, renewals accounted for over 50% of transaction records. Regarding the strong demand from the Consumer Goods sector, Canon leased two floors in China Life Centre Tower A, while HMV leased the whole 8/F in D2 Place in Cheung Sha Wan.

New developments in Kowloon East attracted most of the major leases. Now TV leased three floors in Goldin Financial Global Centre, marking the largest transaction in Kowloon. New completions in CBD2 attracted more relocation, with Mott MacDonald pre-leasing a whole floor in Mapletree Bay Point in Kwun Tong.

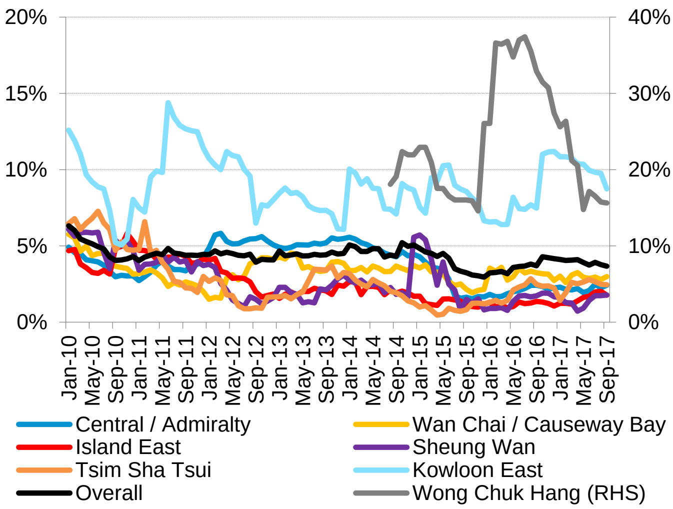
The leasing demand from coworking space operators further accelerated in Q3. Spaces, which is affiliated with the business centre leader Regus, leased the whole block of Sun House at 90 Connaught Road in Central for expansion. The new lease of 77,000 sq ft (7,153 sq m) in the building marks the largest leasing transaction so far this year in terms of area in the business district, with approximately 250,000 sq ft (23,235 sq m) of space leased to coworking operators in total so far in 2017.

Hong Kong Grade A Rental Trend



Source: Colliers

Hong Kong Grade A Vacancy Trend



Source: Colliers

Tenant	Building	District	Floor Area (sq ft)*	Transaction Type
Spaces	Sun House	Central	77,000 (G)	New Letting
Industrial Bank Co Ltd	One IFC	Central	59,500 (L)	New Letting
China Galaxy	Wing On Centre	Central	18,250 (G)	New Letting
Huawei Tech Investment Co Ltd	The Gateway Tower 6	Tsim Sha Tsui	25,699 (N)	Expansion
PCCW (Now TV)	Goldin Financial Global Centre	Kowloon Bay	104,770 (G)	New Letting
Otis Elevator (H.K.) Ltd	Goldin Financial Global Centre	Kowloon Bay	69,310 (G)	New Letting
Mott MacDonald	Mapletree Bay Point	Kwun Tong	36,433 (G)	New Letting

Source: Colliers *approx. figure

Record prices recorded

The investment market recorded another strong quarter in Q3 with transaction volume reaching HKD10.4 billion (USD1.3 billion), stronger than Q1 2017 and Q4 2016 despite falling 22% from the Q2 level. Overall office prices rose 3.2% QOQ, pushed up by the record sale of the Murray Road Car Park Site in Central, which will be converted into a premium Grade office development. The market has witnessed several record transactions. In Central, Tai United Holdings Ltd disposed of the 79th floor of The Center for HKD738 million (USD94 million) to a Chinese developer. Based on the gross floor area of 13,213 sq ft (1,228 sq m), the price translated to HKD55,854 (USD7,207) per sq ft. The transacted price per sq ft was the highest recorded price for an office transaction in Hong Kong so far. In Sheung Wan, a local investor purchased the 22/F on China Merchants Tower, Shun Tak Centre for HKD750 million or HKD30,992 per sq ft, representing a record high for the building.

On 16 October, Bloomberg just reported the sale of a 75% holding in The Center to a Chinese-led group for HKD40.2 billion (USD5.15 billion). If confirmed, this will be the largest en bloc transaction in Hong Kong ever.

Landlords made use of the favourable market conditions, by exploring disposal opportunities for large-scale properties. Examples are the properties Excelsior Hotel and Langham Place Office Tower, which were put on the market by the permanent owners as a high return was expected. The transaction of the Excelsior Hotel did not go through as the reported asking price of HKD30 billion was too ambitious for the bidders. We think the rental level of the post-conversion office building will have to be comparable to rents in Central, in order to achieve a yield similar to the current market level at about 2.8%.

We expect the office market to remain the core focus of investors among completed Hong Kong properties. While opportunities are also available in the other sectors, investors tend to purchase old industrial buildings and hotels for redevelopment which will increase the potentially new supply in the office market.

The emerging Kowloon West

New World Development has beaten eight other competitors to win its third business site in Cheung Sha Wan this year. Despite a comparatively small total office stock of 1.5 million sq ft (140,000 sq m), local investors and developers are recognising the district's potential. Despite its similarity to Kowloon East in terms of being transformed from an industrial area into a commercial district, Cheung Sha Wan benefits from higher accessibility by the MTR and its proximity to the container port. Cheung Sha Wan has seen its popularity grow among SMEs and companies from the logistics, manufacturing and sourcing sectors. New office supply with larger floor plates should allow Cheung Sha Wan to reposition itself into a strong commercial hub. Meanwhile in Kwai Chung and Tsuen Wan, we expect offices to benefit from the growth of demand and the proximity to infrastructure connecting to China and the airport, which will further strengthen business cooperation between Hong Kong and China.

Overall outlook positive

While we expect the office market to be stable in Q4, office rents, especially in Kowloon East, will face stronger pressure in 2018, given the majority of new supply scheduled to be completed in Q4 2017 and 2018. We expect the vacancy rate in Kowloon East to reach double digits for a period of time in 2018 until most of the new offices are absorbed, while the New Territories will face pressure with high vacancies in new developments.

However, prospects for Hong Kong Island are better. In addition to stable demand from MNCs, Chinese national initiatives such as the Belt and Road project and the Greater Bay Area plan will continue to support demand from mainland Chinese firms in 2018. We expect new demand to arise predominantly from smaller Chinese firms. This should benefit the growth of existing mid-tier professional services firms, most of which are located on Hong Kong Island. We also expect demand from coworking space operators to persist, with both local and foreign operators looking to expand in Hong Kong.

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