

# Amid high CBD rents, decentralised locations make their mark

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**Overall rental growth remained positive underpinned by mainland Chinese demand and the improving status of Island East. Vacancy rates in decentralised Wong Chuk Hang experienced a decrease while Kowloon East remained high with a large upcoming supply in 2017. Tenants should consider decentralised options or work place strategy solutions to maximise the efficiency of office space.**

## Forecast at a glance



### Demand

While demand in the CBD should remain stable, decentralised districts should raise their share in accommodating office leasing demand



### Vacancy

Kowloon East should experience rising double-digit vacancy while CBD vacancy should remain stable. Current vacancy at Kowloon East and CBD are 10.8% and 2.1% respectively



### Rent

We expect office rent on Hong Kong Island to increase by 4% while Kowloon rent to fall by 7%



### Investments

Investment activities will be focused on small ticket transactions due to mainland capital outflow controls

## Emerging markets begins to capture the new demand

The first quarter's overall net absorption for Hong Kong remained positive at 10,582 sq ft (985 sq m). However, this was a sizable decrease in take-up compared to Q4 last year which stood at 259,889 sq ft (24,145 sq m). The CBD, i.e. Central/Admiralty recorded QOQ net absorption of 26,822 sq ft (2,490 sq m). Wan Chai/Causeway Bay showed negative QOQ net absorption of 40,003 sq ft (3,715 sq m), while Island East recorded negative 12,224 sq ft. (1,135 sq m)

Kowloon's net absorption stood at 30,502 sq ft (2,835 sq m). Tsim Sha Tsui's QOQ net absorption was negative at -24,795 sq ft (2,305 sq m). Kowloon East's net absorption stood at 52,908 sq ft (4,915 sq m) for Q1.

Hong Kong Island's overall vacancy rate remained similar to Q4 2016 at 2.3%. Vacancy in Central/Admiralty was stable at 2.1%, while Wan Chai/Causeway Bay experienced a slight increase in vacancy from 2.7% in Q4 2016 to 3.1% in Q1 2017. The emerging market Wong Chuk Hang experienced a further reduction in vacancy from 27.4% in Q4 2016 to 21.2% in Q1 2017.

Overall Kowloon vacancy remained stable at 6.9%. Tsim Sha Tsui's vacancy rate showed a slight increase from 2.2% in Q4 2016 to 2.6%, while Kowloon East experienced a decrease in its vacancy rate from 11.2% to 10.8%.

Submarkets	Grade A Vacancy	Grade A Net Effective Rents (HKD/ sq ft/ month)	QOQ Rental Change	2017 Rental Forecast
Central / Admiralty	2.1%	\$117.9	0.2%	\$122.2
Wan Chai / Causeway Bay	3.1%	\$67.9	-0.4%	\$70.5
Island East	1.2%	\$49.1	0.7%	\$50.8
Tsim Sha Tsui	2.6%	\$53.8	-1.3%	\$53.8
Kowloon East	10.8%	\$34.4	-0.1%	\$33.4
Overall	4.1%	\$72.2	0.4%	\$72.9

Source: Colliers / Figures refer to grade A office buildings



## Office rent remains stable

Following negative overall rental growth in Q4 2016, overall rental growth was flat in Q1 this year at 0.4%. This was mainly supported by rising rents in the CBD (0.2%), Island East (0.7%) and Wong Chuk Hang (3.0%) that were sustained through the demand from mainland Chinese tenants and decentralisation of MNC occupiers.

Rents in Wan Chai/ Causeway Bay experienced marginally negative rental growth (-0.4%) as the district is beginning to be squeezed between emerging decentralised locations with high-specification buildings and the CBD. Tsim Sha Tsui also experienced negative rental growth of (-1.3%) owing to its old building stock and increasing challenge from high-quality, low-cost stock in Kowloon East. Kowloon East also experienced a negative rental growth (-0.1%), underpinned by the large supply of new office space coming into the submarket.

## Greater activity observed in non-core areas

The quarter saw several sizable transactions, mainly in non-core areas. AXA leased 44,000 sq ft (4,090 sq m) at Vertical Sq in Wong Chuk Hang, while the Law firm Freshfields moved into Island East leasing 38,800 sq ft (3,605 sq m) at One Island East. Furthermore, UBS and nakedHub, a co-working space operator, leased spaces at Infinitus Plaza and 40-44 Bonham Stand respectively in Sheung Wan.

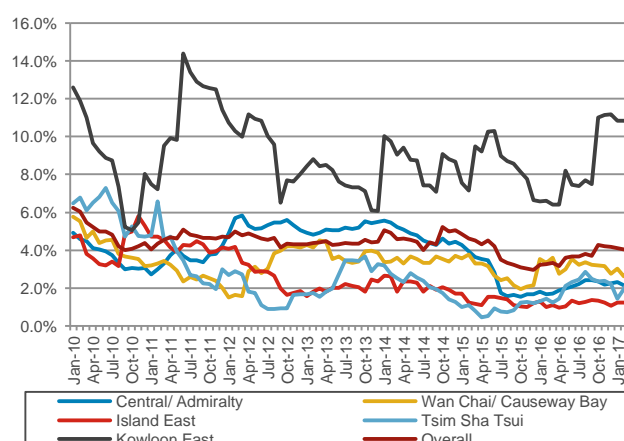
In Kowloon East, Principal Insurance's leased 19,200 sq ft (1,785 sq m) at Millennium City 6 and Guru Online leased 15,800 sq ft (1,470 sq m) at KOHO. Benetton leased 15,600 sq ft (1,450sq m) at Goldin Global Finance Centre, while Black & Veatch leased 14,900 sq ft (1,385 sq m) at AIA Kowloon Tower.

Within the CBD, CMB International leased 27,800 sq ft at Three Garden Road, Champion Tower, while Baring Asset Management leased 16,300 sq ft (1,515 sq m) at The Landmark, Gloucester Tower.

Tenant	Building	District	Net Floor Area (sq ft)	Transaction Type
AXA China Region Insurance Co Ltd	Vertical Sq	Wong Chuk Hang	44,400	New Lease
Hong Kong Exchanges and Clearing Ltd	Two Exchange Square	Central	42,100	New Lease
Freshfields	One Island East	Island East	38,800	New Lease
nakedHub Ltd	40-44 Bonham Stand	Sheung Wan	38,500	New Lease
UBS AG	Infinitus Plaza	Sheung Wan	26,800	New Lease
Principal Insurance	Millennium City 6	Kwun Tong	19,200	New Lease
Guru Online	KOHO	Kwun Tong	15,800	New Lease

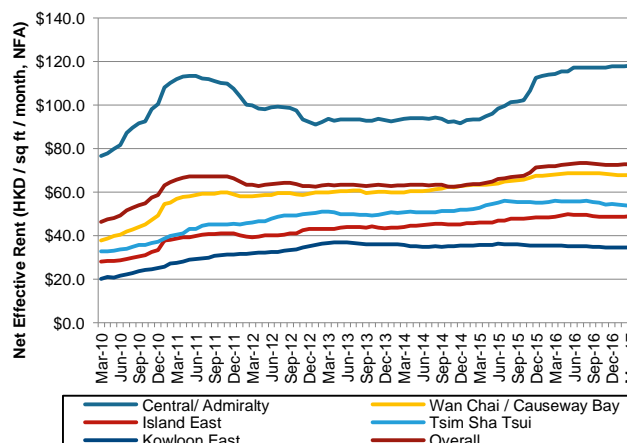
Source: Colliers

## Hong Kong Grade A Vacancy Trend



Source: Colliers

## Hong Kong Grade A Rental Trend



Source: Colliers

Mainland Chinese tenants were also active in Q1 2017. HNA Group leased 14,000 sq ft (1,300 sq m) at Two International Finance Centre. China Industrial Securities International Financial Group Ltd leased 10,707 sq ft (995 sq m) at Three Exchange Square, while Bank of Communications leased 8,300 sq ft (770sq m) at Wheelock House.

Leasing activity over Q1 2017 revealed an increasing trend for tenants to consider decentralised locations. For example, Wong Chuk Hang accounted for 9% of total Hong Kong Island transactions in Q1 2017, whereas in Q4 2016 Wong Chuk Hang accounted for 7% and in Q1 2016 for just 1%. Similar trends are observable in other decentralised districts such as Causeway Bay, Island East and Kowloon East, whose share of leasing transactions is increasing owing to the high rent together with low vacancy in the CBD compared to the affordable and quality spaces in these decentralised locations.

## Investment market remained buoyant

Based on Colliers' record, the total office transaction volume was HKD6.5 billion (USD835 million) in Q1 2017. This is a modest decrease from the HKD8.0 billion (USD1.03 billion) that was recorded in Q4 2016.

Kai Kwong Commercial Building in Wan Chai and Tak Cheung Building in Sheung Wan, which were sold for HKD410 million (HKD13,300/sq ft) and HKD320 million (HKD17,700/sq ft) respectively, were the two en-bloc transactions that were recorded in Q1 2017.

In the strata title market, several high value transactions were recorded in Hong Kong Island. Notably, Unit 1-2 on the 14th Floor of 9 Queen's Road Central was sold for HKD39,570/sq ft. Office 4701 was sold for a unit price of HKD36,360/sq ft.

Decentralised locations such as Kowloon East and Wong Chuk Hang also recorded numerous investment deals. The 11th Floor of Rykadan Capital Tower was sold for a unit price of HKD10,600/sq ft while the 8th Floor of Enterprise Square Three was for a unit price of HKD10,000/sq ft. In Wong Chuk Hang, 15th floor of One Island South was sold for a unit price of HKD12,520 per sq ft.

## 2017 brings diverse options for tenants

2017 should be a turning point for Hong Kong's office market following the relocation of several legal firms away from Central. The maturing of decentralised office districts, i.e. Island East, Kowloon East and Wong Chuk Hang, has made it easier for business to relocate when their leases are up for renewal.

In addition to the increasing popularity of decentralised locations, we see that tenants are focusing more on workplace strategies as a way of cutting costs and improving brand image. This new trend in the office market could increase the demand for flexible workspace operators as traditional tenants seek long-term and short-term office solutions while they reconfigure their office spaces and cut costs.

On the supply side, Two Harbour Square in Kwun Tong, a 570,000 sq ft (52,955 sq m) new commercial development by Sun Hung Kai and Wong's International, and 33 Tseuk Luk Street, another new development by Sun Hung Kai Properties with an office GFA of 217,600 sq ft (20,215 sq m) ought to be completed in Q2 2017. The completion of these two buildings will represent a large part of our estimate of 2017 new office supply in Kowloon East of 2.1 million sq ft (195,000 sq m; NFA). Of this total, 1.3 million sq ft (120,000 sq m) will be in Kwun Tong.

With current market conditions, Colliers Research forecasts that overall office rent will continue to grow in 2017. With limited new supply and healthy demand, Hong Kong Island rents should grow by 4%, while rents in Kowloon should fall by 7% owing to upcoming supply.

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