

LEASING MOMENTUM SLOWED WITH WEAKENED BUSINESS SENTIMENT

Rosanna Tang
Head of Research |
Hong Kong and Southern China
+852 2822 0514
rosanna.tang@colliers.com

Zac Tang
Assistant Manager | Research |
Hong Kong
+852 2822 0578
zac.tang@colliers.com

Summary & Recommendations

Hong Kong's business sentiment weakened in Q1 2019, as the US-China trade war provoked continued uncertainty. However, low vacancy rates have supported rents to edge up despite slow net take-up.

CBD rents increased despite negative net take-up, which implies a higher risk of a rental correction over the coming months. However, we expect modest rental growth in other submarkets on Hong Kong Island, especially in Island East thanks to improved accessibility. Kowloon is likely to feel the pressure from the continued slowdown in the trading sector.

With slower expansions of MNCs and flexible workspace operators, occupiers wishing to have a presence in the CBD should reconsider and explore options given the softer rental outlook in Central.

		Q1 2019	Full Year 2019	2018-23 Annual Average	
	Demand	> Leasing activity slowed with dampened business sentiment. Companies in general have no plan to expand significantly.	142,340 sq ft	2.9 mil sq ft	1.9 mil sq ft
	Supply	> The annual Grade A office supply from 2019 to 2023 should increase to 2.4 million sq ft (223,000 sq m) on average, up 29% from the average of the previous five year period.	625,500 sq ft	3.3 mil sq ft	2.4 mil sq ft
	Rent	> Despite the positive growth in Q1 2019, we remain cautious for whole year rental growth, given the weaker economic outlook and business environment.	1.1% HKD78.9	-1.4% HKD77.0	0.6% HKD80.7
	Vacancy	> Vacancy will likely increase in 2019, given the relatively strong pipeline of new supply to enter the office market.	0.6pp 4.7%	0.8pp 4.9%	0.5pp 4.6%
	Capital Values	> Strata-sale office prices declined further in Q1 2019 due to the slow transaction momentum. However, we expect volumes to rebound later in 2019 while interest rates remain low.	-1.8% HKD25,600	-5.0% HKD24,700	2.0% HKD28,700

Source: Colliers International. 1 USD = 7.84 HKD. 1 sq m = 10.76 sq ft.

Note: Rent = net effective rent in HKD per sq ft per month based on NFA. Capital Values = HKD per sq ft based on GFA.

BUSINESS SENTIMENT WEAKENED

The overall net-take-up returned positive 142,340 sq ft (13,224 sq m) in Q1 despite slow company expansions, mainly due to the completion of One Hennessy, a new Grade A office building in Wan Chai. The positive net take-up reflected a slight increase in overall office rent, by 1.1% QOQ.

With financial and mainland companies remaining cautious regarding expansion, Central/Admiralty recorded negative net take-up of -77,920 sq ft (9,990 sq m). Rents increased 1.4% QOQ amid tight vacancy. Rents in Island East, which is now directly connected to the CBD via the Central-Wanchai Bypass which opened this quarter, recorded stronger growth of 2.8% QOQ. Leasing requirements from the insurance sector were relatively active in Q1 2019, supporting the demand and rental growth in non-CBD areas.

Tsim Sha Tsui was relatively quiet in Q1 2019 with a low net take-up of 740 sq ft (68.7 sq m). Sun Life Financial will likely relocate from The Gateway Sun Life Tower to Cheung Kei Center in Hung Hom. Driven by this move, rents in Tsim Sha Tsui further declined by 1.1% QOQ in Q1 2019, following a drop of -1.5% in Q4 2018. Kowloon East continued facing pressure from high new supply and vacancy amid softened demand. Flexible workspace operators, which had been actively expanding in Kowloon East in 2018, have also lost steam. For example, WeWork, which was reportedly leasing multiple floors in Two Harbour Square, has given up its expansion plans in the building.

The US-China trade war and slower local economic growth should remain as headwinds for the office market. The decentralization trend should continue as occupiers remain cost-cautious. Kowloon's rents should face pressure with high supply of 1.9 million sq ft (243,600 sq m) to be completed this year. Island East should outperform thanks to new infrastructure and upgrades of landlords' portfolios.

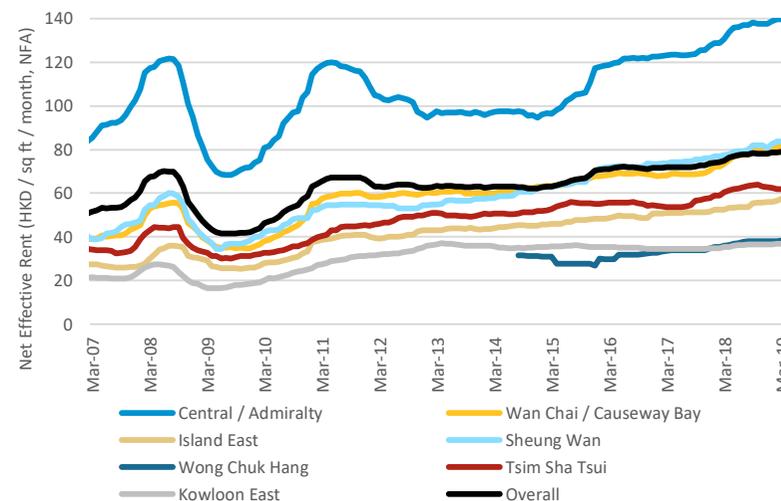
Selected Grade A office leasing transactions in Q1 2019

Tenant	Building	District	Floor area (sq ft)	Transaction Type
Reed Smith Richards Butler	One Island East	Quarry Bay	20,639 (L)	New Letting
AIG	One Island East	Quarry Bay	40,451 (L)	New Letting
Bank of China	Oxford House - Taikoo Place	Central	22,628 (L)	New Letting
Sun Life	Cheung Kei Center	Hung Hom	133,000 (G)	New Letting
WeWork	The Gateway Sun Life Tower	Tsim Sha Tsui	147,000 (G)	New Letting

Source: Colliers International

Note: (N), (G) and (L) stand for net floor area, gross floor area and lettable floor area respectively.

Hong Kong Grade A office rental trend



Source: Colliers International

Hong Kong Grade A office market performance in Q1 2019

Tenant	Vacancy Rate	Net Effective Rent	Quarter-on-quarter
Central/Admiralty	2.5%	\$139.6	1.4%
Wan Chai/Causeway Bay	2.6%	\$81.0	1.4%
Island East	1.7%	\$57.4	2.8%
Sheung Wan	1.4%	\$83.6	3.7%
Wong Chuk Hang	9.4%	\$38.4	0.6%
Tsim Sha Tsui	1.9%	\$62.0	-1.1%
Kowloon East	12.2%	\$37.0	1.4%
Overall	4.7%	\$78.9	1.1%

Source: Colliers International. Note: Net effective rents are monthly rents psf per month on net floor area basis.

ABSENCE OF BIG-TICKET DEALS

The economic slowdown and US-China trade war has prompted investors to rethink their strategy and to remain conservative. Local or individual investors continue their wait-and-see attitudes towards big-ticket investments. Hong Kong International Construction Investment Management Group, which had its 70% of shares sold from HNA Group to Blackstone in March 2019, was the only en-bloc office investor for the quarter, purchasing CentreHollywood at 151 Hollywood Road in Central for HKD700 million (USD90 million) or HKD21,400 (USD2,744) per sq ft¹.

However, funds with abundant liquidity were active in seeking core or core-plus assets. In the strata-titled sales market, office spaces in core locations remained popular. For instance, a local buyer purchased two units on the twentieth floor of Shun Tak Centre, with a unit price of HKD31,800 (USD4,077) per sq ft, on par with the average price of the building.

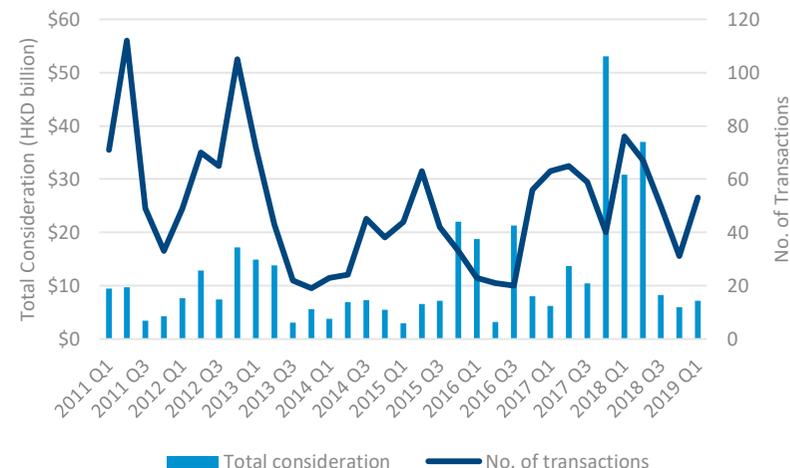
With only one en-bloc sale being concluded, the total office investment volume stayed low despite up by 14.2% QOQ to HKD7.2 billion (USD923 million) from the stagnant Q4 2018. The overall price of Grade A offices fell 1.8% QOQ amid the slow market.

The US Federal Reserve indicated on 20 March that there would be no rate increases in the US in 2019, in contrast to its previous indication of two increases². Hong Kong should be the Asian market to most benefit, where interest rates are effectively tied to US interest rates by the territory's currency peg to the US dollar. The pause of interest rate hikes should help investors regain buyers' confidence.

Looking ahead, with the US pausing interest rate hikes, the low yield environment will likely be extended for a longer period with Hong Kong's interest rates widely expected to remain low. This should provide support for the investment market as a whole, and perhaps act as a positive signal to counter balance the negative impact brought by the trade war tensions and slower economic growth.

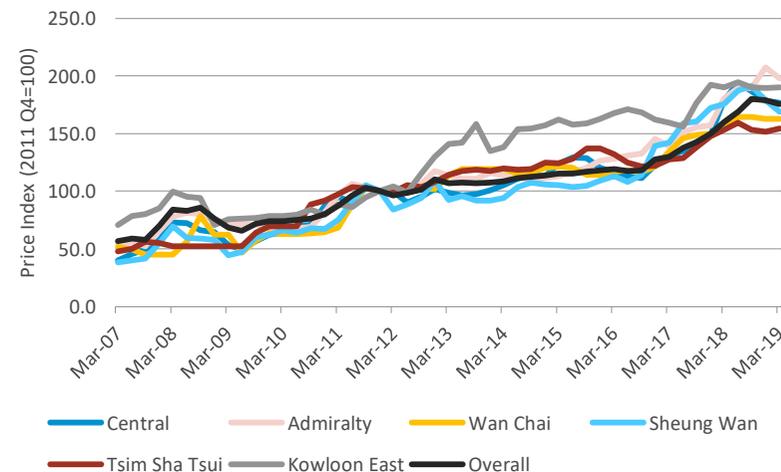
However, we see limited room for price growth in Grade A office buildings, given the already high price level and an expected slower global economic growth for 2019³. While we forecast Grade A office rents in Central and the overall Hong Kong to adjust downwards this year, we also expect the prices for strata-titled Grade A offices to decline by around 5% in 2019.

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



Source: Colliers International

Hong Kong Grade A office price trend



Source: Colliers International

¹ [hkexnews](http://hkexnews.com), 8 March 2019. ² Federal Reserve Press Release, 20 March 2019.

³ World Economic Prospects Monthly | Overview, Oxford Economics, as of 9 April 2019.

Primary Authors:

Zac Tang

Assistant Manager | Research | Hong Kong

+852 2822 0578

zac.tang@colliers.com

For further information, please contact:

Nigel Smith

Managing Director | Hong Kong

+852 2822 0508

nigel.smith@colliers.com

Fiona Ngan

Head of Office Services | Hong Kong

+852 2822 0751

fiona.ngan@colliers.com

Rosanna Tang

Head of Research | Hong Kong and Southern China

+852 2822 0514

rosanna.tang@colliers.com

About Colliers International Group Inc.

[Colliers International](#) (NASDAQ, TSX: CIGI) is a leading global real estate services and investment management company. With operations in 68 countries, our 14,000 enterprising people work collaboratively to provide expert advice and services to maximize the value of property for real estate occupiers, owners and investors. For more than 20 years, our experienced leadership team, owning more than 40% of our equity, have delivered industry-leading investment returns for shareholders. In 2018, corporate revenues were \$2.8 billion (\$3.3 billion including affiliates), with more than \$26 billion of assets under management.

For the latest news from Colliers, visit our [website](#) or follow us on   

Copyright © 2019 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.

