

Hong Kong Grade A Office, Q2 2015

Strong financial sector demand drives surge in net absorption

▲ Overall HK Rents
+3.1% q-o-q

▲ HK Island Rents
+4.1% q-o-q

▲ Kowloon Rents
+1.8% q-o-q

▲ New Territories Rents
+0.2% q-o-q

- Hong Kong Island enjoyed one of the strongest quarters in recent years in terms of leasing activity. Net absorption for the period was 426,200 sq. ft.^(*), the highest in a quarter since Q3 2010.
- Most activity took place in Greater Central (Central, Admiralty & Sheung Wan combined). Financial sector firms continued to drive leasing demand. Vacancy in Central dropped substantially.
- Demand for space in Kowloon was also strong, with the banking sector as well as retail and sourcing firms particularly active.
- CBRE expects office leasing market sentiment to remain positive in H2 2015 and into 2016. The Shenzhen-Hong Kong Stock Connect scheme and the Hong Kong-China mutual fund recognition scheme should support headcount and office demand in the financial sector. Firms from mainland China will remain a key demand driver in the CBD.
- The substantial improvement in leasing momentum and decline in vacancy observed since the beginning of Q2 2015 has prompted CBRE to hold a more positive view towards rental growth in 2015. The next 6 months shall see rents in the overall market growing by a similar magnitude as that recorded for the first half of the year (4.6% year-to-date [y-t-d]).

Office leasing momentum continued to pick up in Q2 2015, improving upon the strong first quarter. Overall net absorption this quarter totalled 1.3 million sq. ft.^(*), the highest for a single quarter since Q2 2008.

The majority of net absorption this quarter was due to the completion of One Bay East in Kowloon East for owner-occupation. However, even if this building was excluded from the overall figures, net absorption for the quarter would still total 598,400 sq. ft.^(*), a sizable increase on the 455,600 sq. ft.^(*) recorded in Q1 2015.

Most leasing transactions this quarter were concentrated in Greater Central (Central, Sheung Wan & Admiralty combined), with companies in the financial sector most active. Mainland Chinese firms continued to seek space in grade A1 buildings and also leased space in lower grade buildings when the space was unavailable. Space availability is increasingly becoming a major challenge for occupiers across most submarkets.

The only new office building completed this quarter was the aforementioned One Bay East. The development contains two towers totaling 694,400 sq. ft.^(*), with Manulife and Citi each purchasing one block for self-occupation in 2013 and 2014 respectively.

(*) NFA

HONG KONG ISLAND

In Q2 2015 Hong Kong Island's leasing market witnessed one of the most robust quarters in recent years. The period recorded net absorption of 426,200 sq. ft.^(*), which was the highest quarterly total since Q3 2010. Most activity took place in Greater Central (Central, Sheung Wan & Admiralty combined), with 363,000 sq. ft.^(*) of net absorption recorded during the quarter.

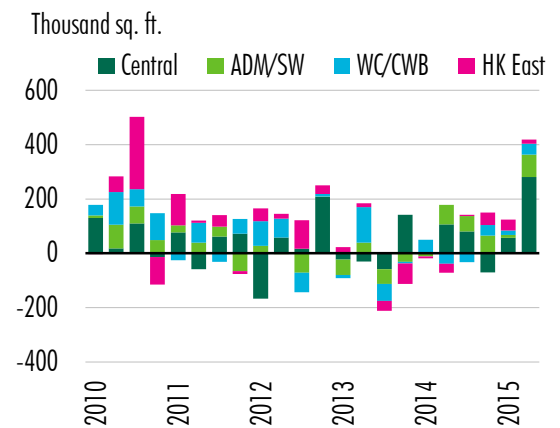
Financial sector firms, including those from mainland China, drove demand this quarter. Highlights included four finance and related sector tenants leasing a total of 128,700 sq. ft.^(*) in Citibank Plaza: BlackRock taking four whole floors to relocate and expand from Cheung Kong Center (CKC); Bloomberg leasing two floors as expansion space from CKC; Thomson Reuters also taking two floors to relocate from Quarry Bay; and Chinese firm Hani Securities (owned by Fosun) leasing a whole floor as part of a relocation and expansionary move from Wing On House.

Other examples of Chinese companies taking space in the CBD this quarter included Yunfeng Capital (co-founded by Alibaba Group chairman Jack Ma) leasing a whole floor of 12,800 sq. ft.^(*) in One Exchange Square to relocate and expand from 3,100 sq. ft.^(*) in Agricultural Bank of China Tower. Another whole floor in One Exchange Square was taken by VMS Investment Group, which will expand and relocate from its previous 4,500 sq. ft.^(*) space in Jardine House.

Also on Hong Kong Island, two whole floors of 13,900 sq. ft.^(*) each in Three Pacific Place in Wan Chai were leased this quarter. One floor was taken by China Merchants Capital while the other was leased to a financial sector firm.

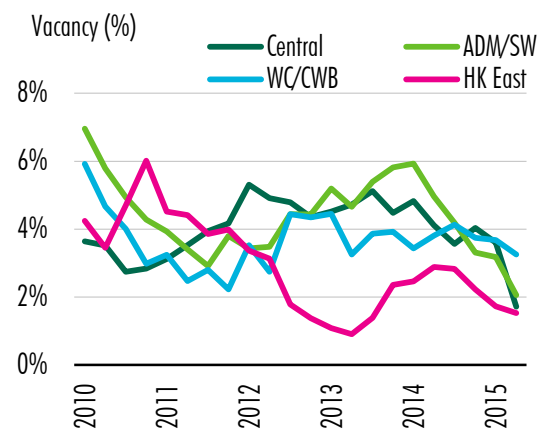
The strong take-up this quarter pushed down average Hong Kong Island vacancy by 1 percentage point quarter-over-quarter (q-o-q) to 2.6%. The most significant decline was in Central, where vacancy fell 1.9 percentage points to just 1.7%, the lowest level recorded since Q3 2008. Hong Kong Island rents increased by 4.1% q-o-q, with Central recording very strong gains of 6.2% q-o-q, bringing the y-t-d increase to 8.3%.

Figure 1: Hong Kong Island Net Absorption



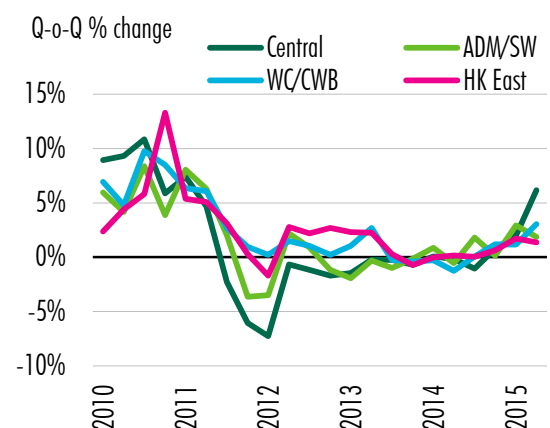
Source: CBRE Research, Q2 2015.

Figure 2: Hong Kong Island Vacancy Rate



Source: CBRE Research, Q2 2015.

Figure 3: Hong Kong Island Rental Growth



Source: CBRE Research, Q2 2015.

(*) NFA

KOWLOON & NEW TERRITORIES

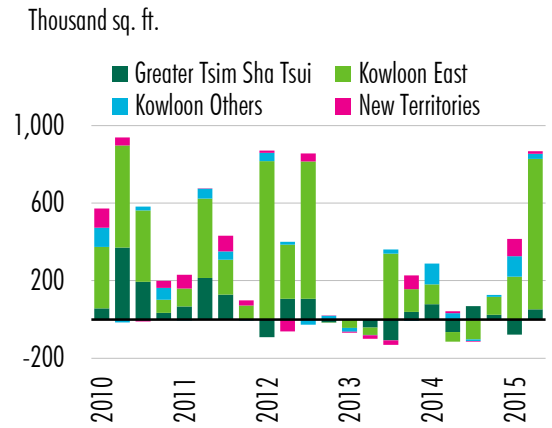
Leasing momentum in Kowloon lagged behind Hong Kong Island in Q2 but net absorption still amounted to 854,100 sq. ft.^(*), the highest in a quarter since Q2 2010. The completion of two office towers in One Bay East in Kowloon East, which were purchased by Manulife and Citi in 2013 and 2014 respectively for self-use, accounted for 694,000 sq. ft.^(*).

The banking sector was active in Kowloon this quarter. In Tsim Sha Tsui, UBS Wealth Management leased two whole floors totalling 17,400 sq. ft.^(*) in One Peking as well as the signage on the building. In The Gateway, Tower 6, Bank of Communications took 10,300 sq. ft.^(*) while another 7,600 sq. ft.^(*) was leased by the Industrial Bank of Taiwan. Insurance companies continued to expand in Kowloon, with Prudential taking 14,000 sq. ft.^(*) of expansionary space in Millennium City 1 in Kwun Tong.

Kowloon East saw more leasing transactions than other Kowloon sub-markets, given the district's relatively higher availability of space. Retail and sourcing firms were particularly active. Fila Marketing leased a whole floor of 15,600 sq. ft.^(*) in Manhattan Place to relocate and expand from its 5,000 sq. ft.^(*) space in Tsim Sha Tsui; MGA Entertainment leased an entire floor of 9,200 sq. ft.^(*) in YHC Tower; and Shiseido leased 8,800 sq. ft.^(*) in One Kowloon as expansion.

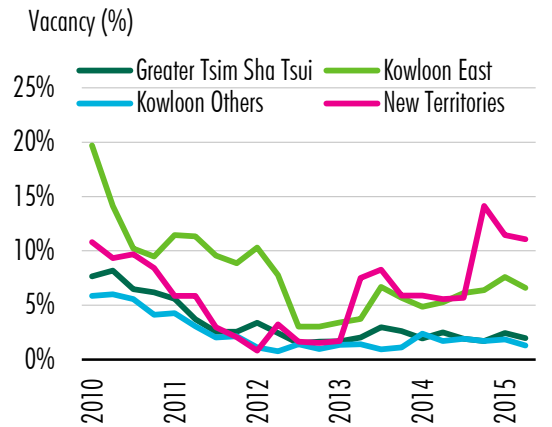
Vacancy rates across Kowloon continued to compress this quarter, falling 0.7 percentage point q-o-q to 3.9%. The overall vacancy rate in Kowloon East dropped 1 percentage point q-o-q to 6.6%. Among single-owned portfolio buildings, average vacancy stood at 1.5% at the end of Q2 2015. In contrast, average vacancy for stratified buildings was far higher, standing at 15.1%. Overall rental growth in Kowloon this quarter stood at 1.7% q-o-q. Rents in Tsim Sha Tsui rose by 4.2% q-o-q, mainly due to increases recorded in the International Commerce Centre. Kowloon East rents increased by 1.0% q-o-q, bringing the y-t-d gain to 1.7%

Figure 4: Kowloon & New Territories Net Absorption



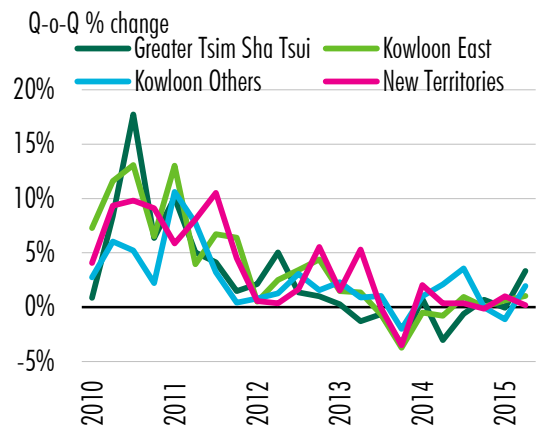
Source: CBRE Research, Q2 2015.

Figure 5: Kowloon & New Territories Vacancy Rate



Source: CBRE Research, Q2 2015.

Figure 6: Kowloon & New Territories Rental Growth



Source: CBRE Research, Q2 2015.

(*) NFA

Outlook

CBRE expects sentiment in the office leasing market to remain positive in H2 2015 and into 2016. In addition to the Shenzhen-Hong Kong Stock Connect scheme, which was announced earlier in the year and will be implemented in H2 2015, the Hong Kong-China mutual fund recognition scheme is expected to be put into practice in Q3 2015. These two initiatives will support headcount and office demand growth in the financial sector, among which firms from mainland China will likely remain a key demand driver in the CBD. As well as attracting new Chinese financial firms to Hong Kong, some funds which left the city following the onset of the Global Financial Crisis in 2008 may return to take advantage of the new arrangements for cross-border fund recognition.

Sustained demand will put further strain on the office leasing market, in which vacancy is already very low. Chinese firms' appetite for space in prestigious buildings will create stronger competition with traditional multinational occupiers for space in Central grade A1 buildings, which are mostly at near-full occupancy. Some firms will be forced to take space in other grade A buildings, but availability in those buildings is also shrinking. The introduction of abovementioned new financial market policies to support long-term business growth in Hong Kong will see Chinese firms occupy a larger share of the city's office space.

The lack of space in Central could see demand spill over to districts outside the CBD. However, space in most other submarkets is also very limited. Occupiers will therefore have to move quickly to secure space. CBRE expects to see more pre-leasing activity involving secondary space in the coming quarters.

In Kowloon and the New Territories, space availability continues to shrink, both for lease and for sale in single-owned buildings and stratified buildings. Cost conscious occupiers are expected to become more willing to lease space in revitalised buildings as more of these projects are completed and made available for lease.

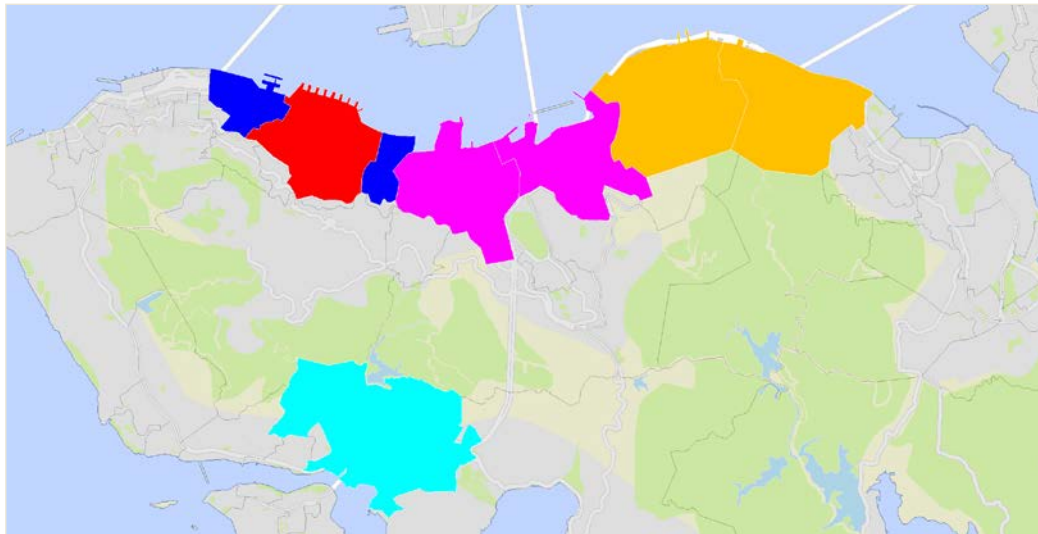
In a market where vacancy is low and demand is strengthening, landlords are expected to continue to enjoy a strong negotiating position over the remainder of 2015, and no major new supply will be completed until 2017. The substantial improvement in leasing momentum and reduction in vacancy observed since the beginning of Q2 2015 has prompted CBRE to raise our rental forecast for the overall market for 2015 from the previous 5% growth to 10%-15% growth. Strong demand from the financial sector should ensure that Central landlords enjoy the strongest rental growth (up 10%-15%) in 2015. Other submarkets are expected to benefit from the spillover effect from the CBD, supporting milder but still positive rental growth in H2 2015.

Figure 7: Selected upcoming new supply

Property	District	Size (sq ft NFA)	Expected completion date
Shanghai Commercial Bank Tower	Central	81,400	Q4 2015
Tower 535	Causeway Bay	128,330	Q3 2015
Vertical Sq	Wong Chuk Hang	137,480	Q4 2015
W50	Wong Chuk Hang	82,390	Q4 2015
8 Observatory Road	Tsim Sha Tsui	65,520	Q3 2015
1 On Kwan Street	Shek Mun	215,460	Q4 2015
3 On Kwan Street	Shek Mun	170,280	Q4 2015
Chinachem Central I & II	Central	36,210 & 67,600	Q3 & Q4 2016

Source: CBRE Research, Q2 2015.

Hong Kong Island



CENTRAL ; ADMIRALTY & SHEUNG WAN ; WAN CHAI & CAUSEWAY BAY ; HONG KONG EAST – NORTH POINT, QUARRY BAY ; WONG CHUK HANG

Figure 8: Selected leasing transactions in Q2 2015

Property	District	Size (sq ft NFA)	Tenant
Citibank Plaza	Central	57,070	BlackRock
Citibank Plaza	Central	28,480	Bloomberg
Citibank Plaza	Central	27,940	Thompson Reuters
Citibank Plaza	Central	14,890	Hani Securities
Cosco Tower	Sheung Wan	14,810	Bank of China Life Assurance
The Center	Sheung Wan	14,390	Expedia
Three Pacific Place	Wan Chai	13,920	China Merchant Capital
One Exchange Square	Central	12,970	Yunfeng Capital

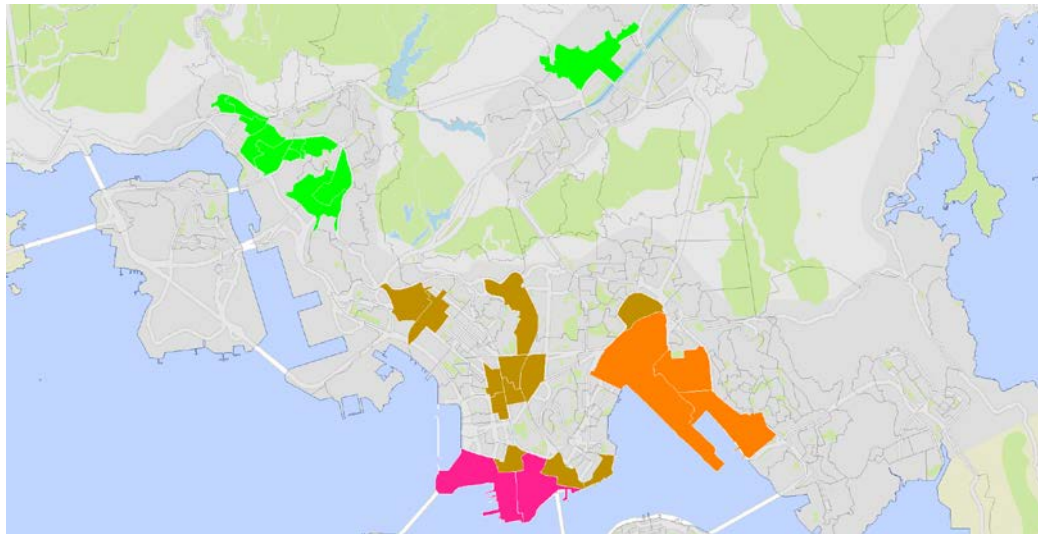
Source: CBRE Research, Q2 2015.

Figure 9: Key sub-market statistics

District	Q2 2015 net absorption (sq ft NFA)	Vacancy rates	Q-o-Q change (% pt)	Rents (HK\$/sq ft/mth)	Q-o-Q change	Y-o-Y change
Hong Kong Island	426,230	2.6%	-1.0	76.5	+4.1%	+6.9%
Central	281,240	1.7	-1.9	106.8	+6.2%	+8.0%
Admiralty & Sheung Wan	81,800	2.1%	-1.1	72.2	+1.9%	+6.9%
Wan Chai & Causeway Bay	40,750	3.3%	-0.4	62.7	+3.0%	+5.5%
Hong Kong East	14,830	1.5%	-0.2	47.0	+1.4%	+3.8%
Wong Chuk Hang	7,600	20.0%	-0.6	27.1	-4.3%	N/A

Source: CBRE Research, Q2 2015.

Kowloon & New Territories



GREATER TSIM SHA TSUI - TSIM SHA TSUI, TSIM SHA TSUI EAST; **KOWLOON EAST** - KOWLOON BAY, KWUN TONG; **KOWLOON OTHERS** - JORDAN, MONG KOK, HUNG HOM, CHEUNG SHA WAN, SAN PO KONG, KOWLOON TONG; **NEW TERRITORIES** - KWAI CHUNG, TSUEN WAN, SHA TIN, SHEUNG SHUI, TUNG CHUNG

Figure 10: Selected leasing transactions in Q1 2015

Property	District	Size (sq ft NFA)	Tenant
One Peking Road	Kowloon East	17,400	UBS Wealth Management
Manhattan Place	Kowloon East	15,640	Fila Marketing
Millennium City 1	Kowloon East	13,960	Prudential
The Gateway, Tower 6	Tsim Sha Tsui	10,280	Bank of Communications
Metroplaza, Tower 1	Kwai Chung & Tsuen Wan	9,600	Carl Zeiss Far East
YHC Tower	Kowloon East	9,200	MGA Entertainment
Skyline Tower	Kowloon East	8,980	K Wah Building Materials
One Kowloon	Kowloon East	8,800	Shiseido

Source: CBRE Research, Q2 2015.

Figure 11: Key sub-market statistics

District	Q1 net absorption (sq ft NFA)	Vacancy rates	Q-o-Q Change (% pt)	Rents (HK\$/sq ft/mth)	Q-o-Q change	Y-o-Y change
Kowloon	854,130	3.9%	-0.7	40.9	+1.8%	+2.2%
New Territories	12,470	11.1%	-0.4	33.3	+0.2%	+1.4%
Greater Tsim Sha Tsui	51,890	2.0%	-0.5	50.5	+3.3%	+3.3%
Kowloon East	775,300	6.6%	-1.0	33.4	+1.0%	+2.7%
Kowloon Others	26,950	1.3%	-0.6	38.9	+1.9%	+4.4%

Source: CBRE Research, Q2 2015.

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