

CBRE RESEARCH  
HONG KONG OFFICE

# Reshaping the Hong Kong Office Market

Chapter 1: The Flight-to-Quality Dynamic

OCTOBER 2020

CBRE



# INTRODUCTION

The Hong Kong office market has experienced several distinct eras over the past half-century. The 1970s saw rapid growth in demand from British and local firms, followed by the arrival and subsequent dominance of multinationals in the 1980s and 1990s. Mainland Chinese companies came to the fore since the 2000s and now account for a large portion of office leasing demand.

More recently, the adoption of agile working, emphasis on workplace wellness and growth in decentralised office supply have prompted a re-think in corporate real estate strategy among occupiers in Hong Kong – trends that together with the COVID-19 pandemic will result in very different demand patterns in future.

This three-part report by CBRE Research explores these and other key occupier trends in Hong Kong and explains how the city's office market will evolve in the years to come.



# CHAPTER 1: OCCUPIER FLIGHT TO QUALITY

Chapter 1 tracks the evolution of Hong Kong's office market over the past four decades, with a special focus on how and why flight-to-quality decentralisation has emerged as a key trend since the early 2000s.

Chapter 2 profiles existing and future office clusters and explains how leading portfolio landlords have transformed traditional office buildings into integrated communities, creating myriad benefits for both occupiers and the general public.

Chapter 3 lays out COVID-19 era office strategies in Hong Kong and includes a robust assessment of potential challenges and constraints.

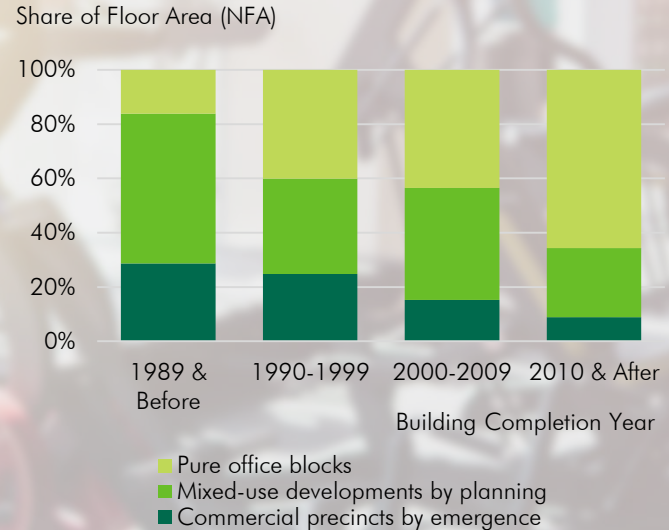
# OFFICE DEVELOPMENTS IN HONG KONG

Office buildings in Hong Kong can be classified into three general categories:

- Commercial precincts by emergence;
- Mixed-use developments by planning; and
- Pure office blocks.

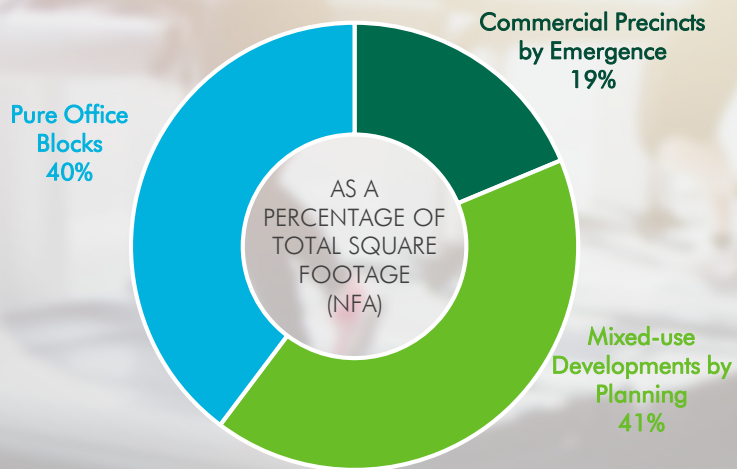
*(see definitions in the Appendix on page 25-26)*

**Figure 1: Composition of Grade A office developments over time**



Source: CBRE Research, October 2020

**Figure 2: Grade A office stock by development nature**



Source: CBRE Research, October 2020

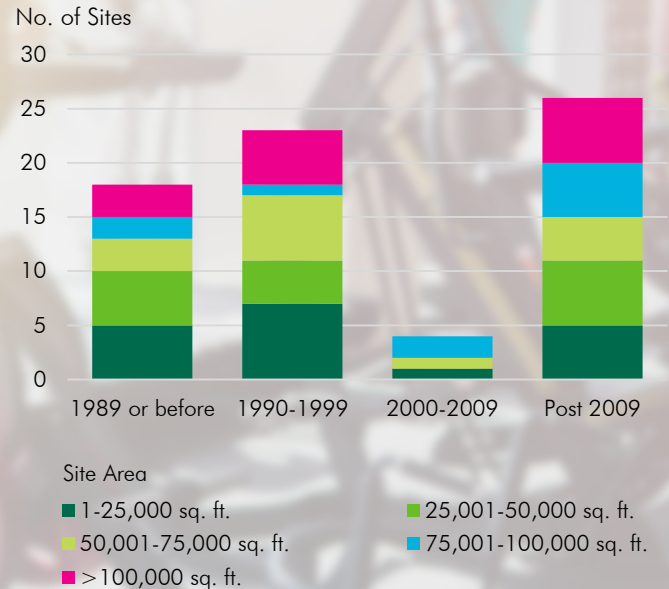
The 1970s saw the emergence of developer-landlords associated with local conglomerates. These firms created many of today's comprehensive commercial precincts by redeveloping ageing properties belonging to affiliated group companies. Examples include Wharf's Harbour City, Hongkong Land's Central portfolio and Hysan's Lee Gardens. While these commercial clusters were first formed three to four decades ago, owners have continued to maintain, modernise and redevelop individual properties in these developments, ensuring they remain competitive.

Planned mixed-use developments such as Times Square, Grand Central Plaza and IFC came to the fore in the 1980s and 1990s. These projects are typically built on scalable government land plots, rather than via site amalgamation.

Recent years have seen a sharp decline in new mixed-use developments as many of the larger sites available for tender are in emerging commercial districts with relatively light after-hours footfall. With little potential to generate strong retail sales, and e-commerce continuing to increase market share, developers now prefer to allocate most floorspace in new developments to office use to cater to strong demand.

Recent years have also seen an increase in the development of pure office blocks on smaller private sector redevelopment sites, particularly at a time when there has been a drop in government land supply.

**Figure 3: Government commercial land supply**



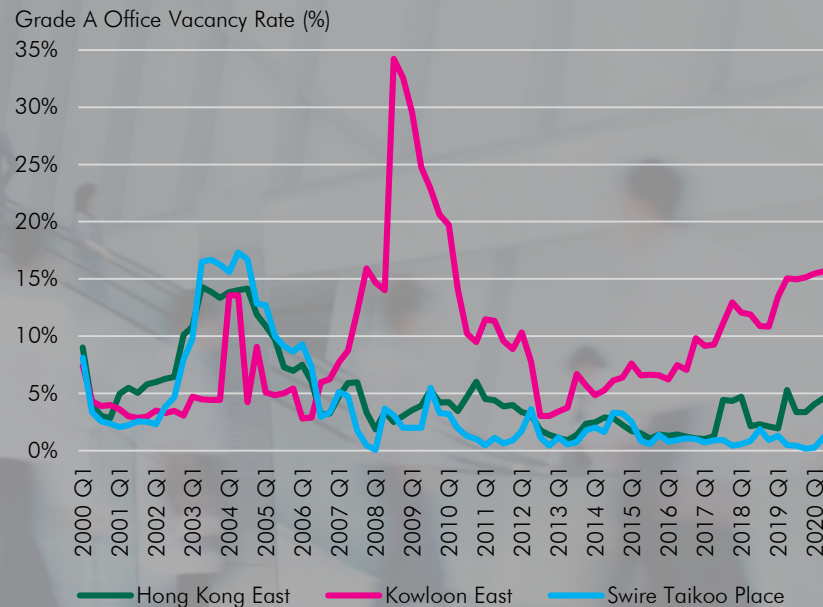
Source: CBRE Research, October 2020

# COMMUNITY-BUILDING

While many occupiers find offices located atop shopping malls to be appealing locations, buildings lacking such facilities but providing high specification, cost-effective space within a community environment nevertheless hold strong appeal. For many years, buildings in Swire's Taikoo Place portfolio, which lacks a large retail component, have recorded some of the highest occupancy rates on Hong Kong Island.

Another decentralised office market, Kowloon East, has seen relatively higher vacancy than Hong Kong East owing to its volume of new supply, longer distance to the CBD and lack of a strong community feel.

**Figure 4: Hong Kong East and Kowloon East vacancy**

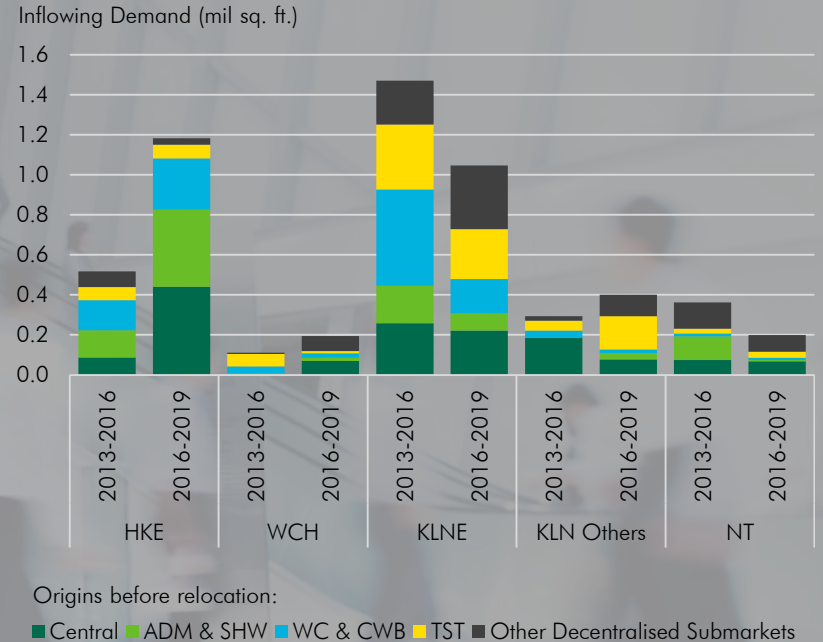


Source: CBRE Research, October 2020

Office development in Kowloon East commenced in the mid-1990s. Unlike Central and Quarry Bay, where Hongkong Land and Swire Properties have commercial precincts emerged by connecting portfolio buildings, office blocks in Kowloon East are mostly isolated and scattered across different locations.

Quarry Bay, being the core part of the Hong Kong East submarket, has been the most popular new office destination, attracting the bulk of tenant inflows from other office submarkets between 2016 and 2019. Much of the inflowing tenants were from Greater Central.

**Figure 5: Tenant inflow into decentralised submarkets**



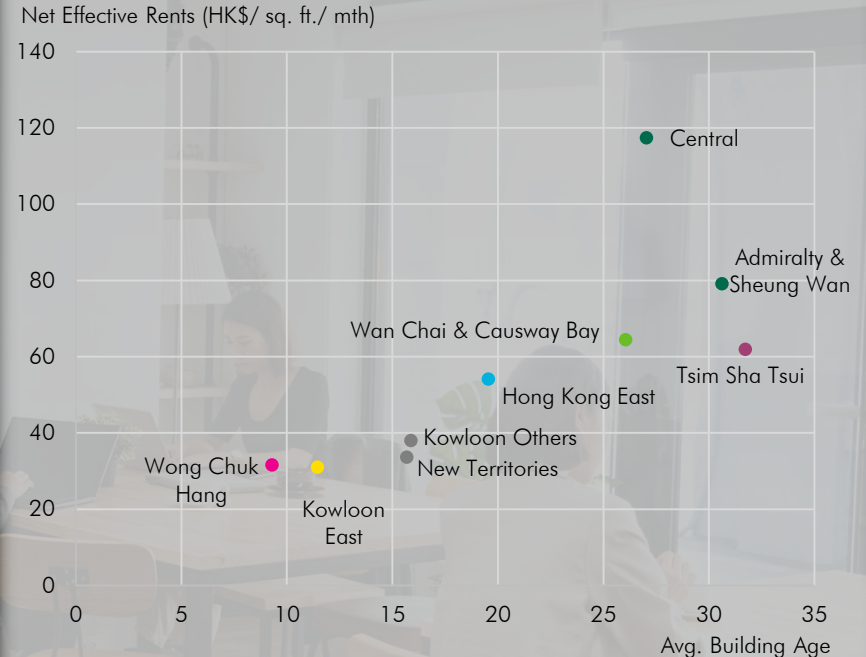
Source: CBRE Research, October 2020

\*Data as of March 2019

# FLIGHT-TO-QUALITY DECENTRALISATION

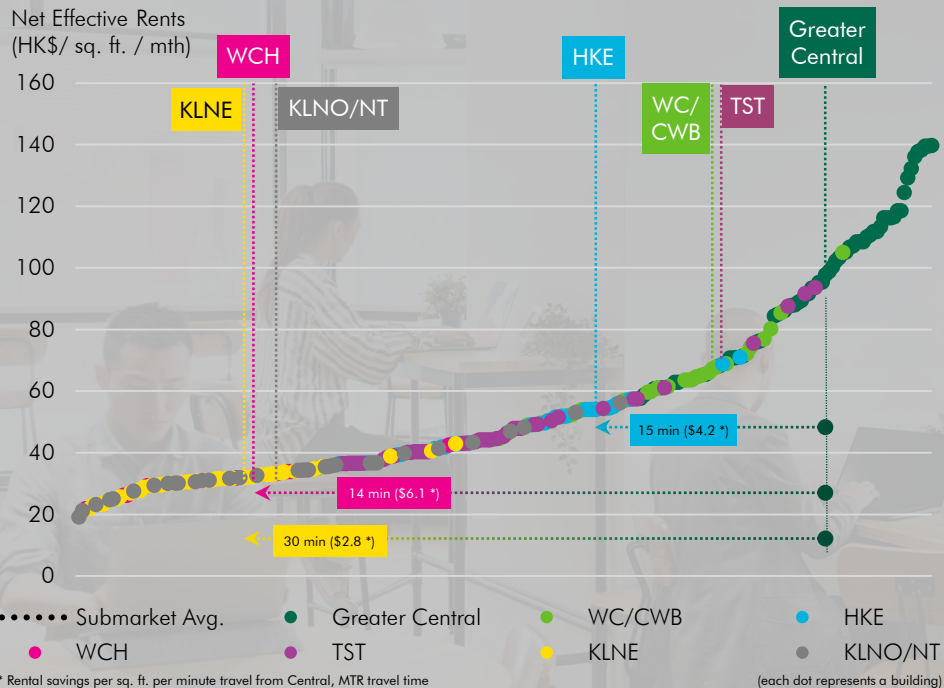
While cost is a major driver of office decentralisation, flight-to-quality is another key consideration. The average age of office buildings in Hong Kong's three core submarkets is 29 years. While older buildings owned by portfolio landlords are typically well-maintained, new and high-specification properties in decentralised locations offering major discounts on CBD rents are highly attractive to occupiers seeking to upgrade their office premises while keeping CAPEX under control.

**Figure 6: Grade A office building age and rental levels**



Source: CBRE Research, August 2020

**Figure 7: Grade A office rental spectrum**



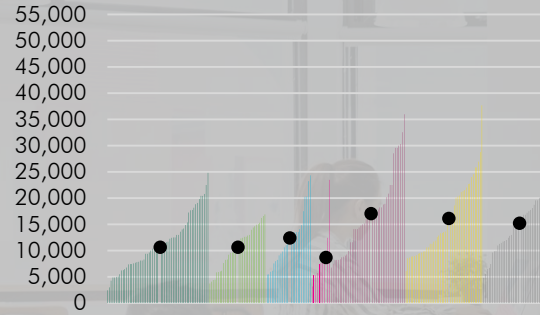
\* Rental savings per sq. ft. per minute travel from Central, MTR travel time

Source: CBRE Research. October 2020

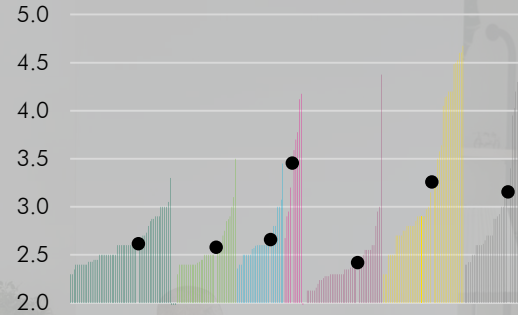
The high concentration of core submarket buildings towards the steep end of the rental distribution curve reflects the fact that office rents in Hong Kong are predominately determined by location, rather than other building attributes. Despite the high building age, rents in Central are three to four times higher than those for new and high-specification buildings in decentralised markets of Kowloon, which are just a 30-minute car journey or subway trip away. The high concentration of buildings in Central at the steep end of the curve indicates that the CBD retains its status as the city's premier office district, despite an uptick in flight-to-quality activity in recent years.

**Figure 8: Grade A office specifications spectrum**

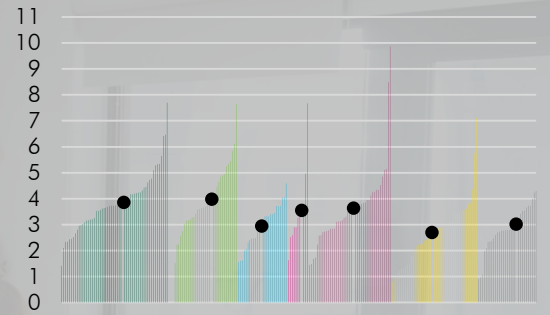
Floorplate Size (sq. ft., NFA)



Ceiling Height (m.)



Lift Ratio (# per 100,000 sq. ft. NFA)



Greater Central  
TST

WC/CWB  
KLNE

HKE  
KLNO/NT

WCH  
● Submarket Avg.

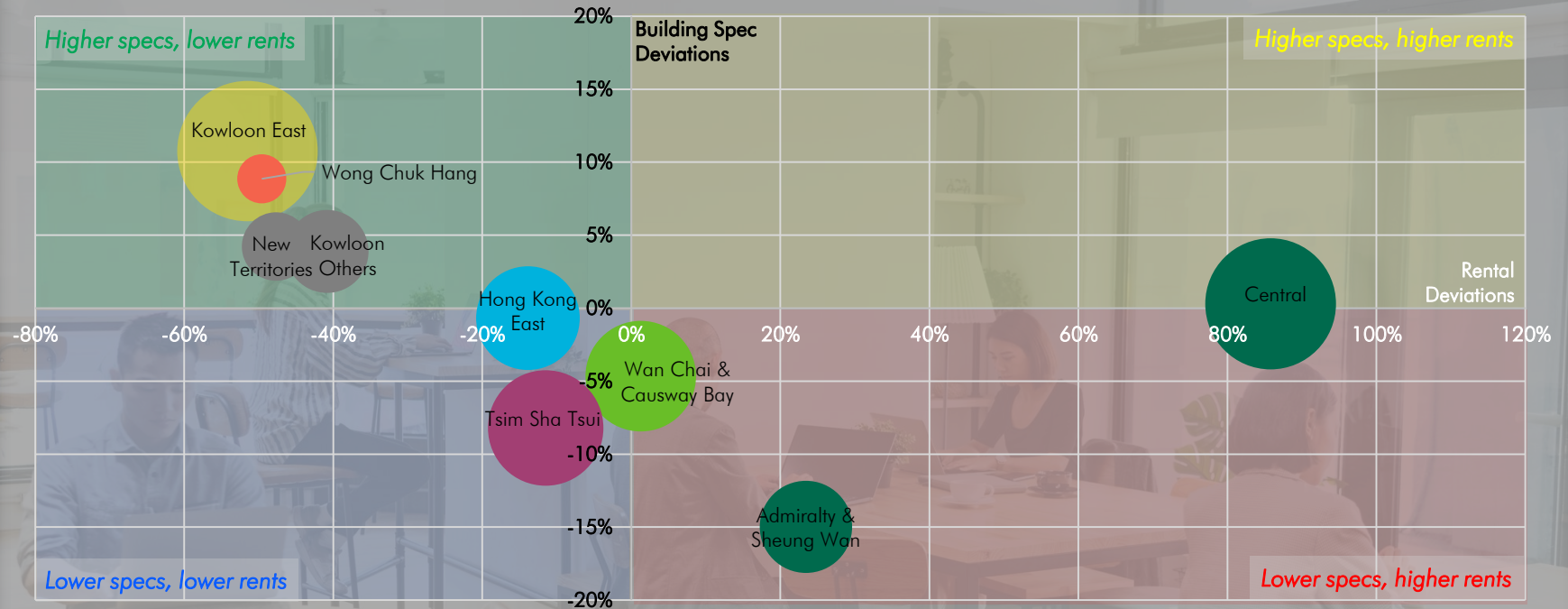
\*each line represents a building

Source: CBRE Research, October 2020

Buildings in decentralised submarkets typically have larger floorplates, higher ceilings and are newer than those in traditional core submarkets. For instance, 16 of the 41 office buildings in Hong Kong with a floorplate over 20,000 sq. ft. (net) are in Kowloon East.

There are, however, no significant differences in lift ratios between the two locations. Despite buildings in Central having smaller floorplates and lower ceilings, properties in the district generally have higher lift ratios, thereby providing more efficient vertical transportation.

**Figure 9: Grade A office rental levels v.s. building specifications**

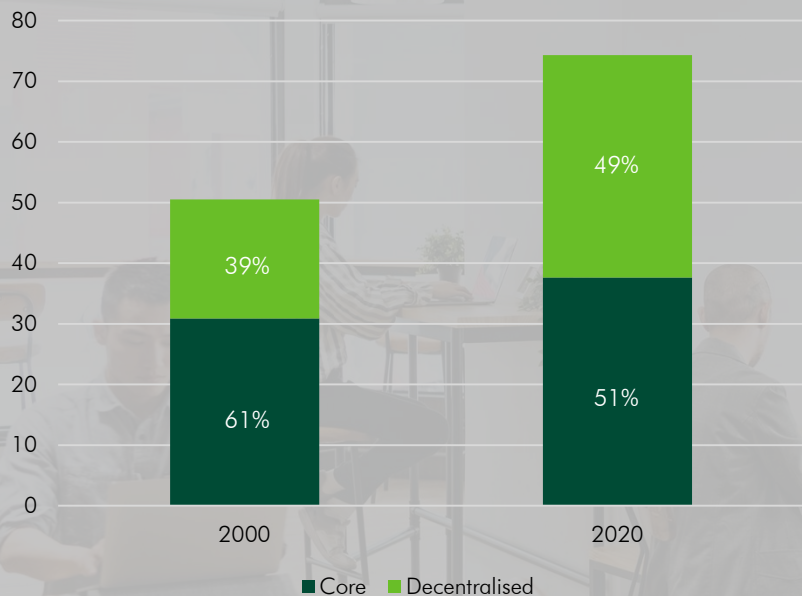


Source :CBRE Research, October 2020

- Specifications: floorplate, ceiling height, lift ratio, building age, green certificate
- 0 denotes market average
- Bubble size represents submarket stock size

**Figure 10: Distribution of total occupied space**

Total Occupied Space (mil sq. ft., NFA)



Source: CBRE Research, October 2020

High rents and tight space availability have inhibited occupier movement and expansion in core office submarkets for several years. However, by relocating entirely or partially to decentralised locations, occupiers can expand their office footprint without increasing overheads. Citywide occupied space has increased by 23.8 million sq. ft. over the past 20 years, 72% or 17.2 million sq. ft. of which has been realised in decentralised locations.

Corporates relocated 2.1 million sq. ft. of office footprint away from core submarkets between 2013 and 2019. Occupiers that completed such moves during the period now maintain a 70:30 ratio of space across decentralised and core markets, respectively.

**Figure 11: Distribution of larger corporate offices (2019 v.s. 2016)**



Several major occupiers have set up large offices in decentralised office buildings in recent years. This has been achieved either by moving some functions from core submarkets and/or by consolidating various smaller offices from across the city to improve operational efficiency. Buildings in Hong Kong East and Kowloon East have attracted a fair number of large-sized offices (30,000 sq. ft. to 50,000 sq. ft.), while Wong Chuk Hang has seen the establishment of numerous medium-sized (10,000 sq. ft. to 30,000 sq. ft.) offices owing to the smaller floorplates available in the district.

Source: CBRE Research, October 2020

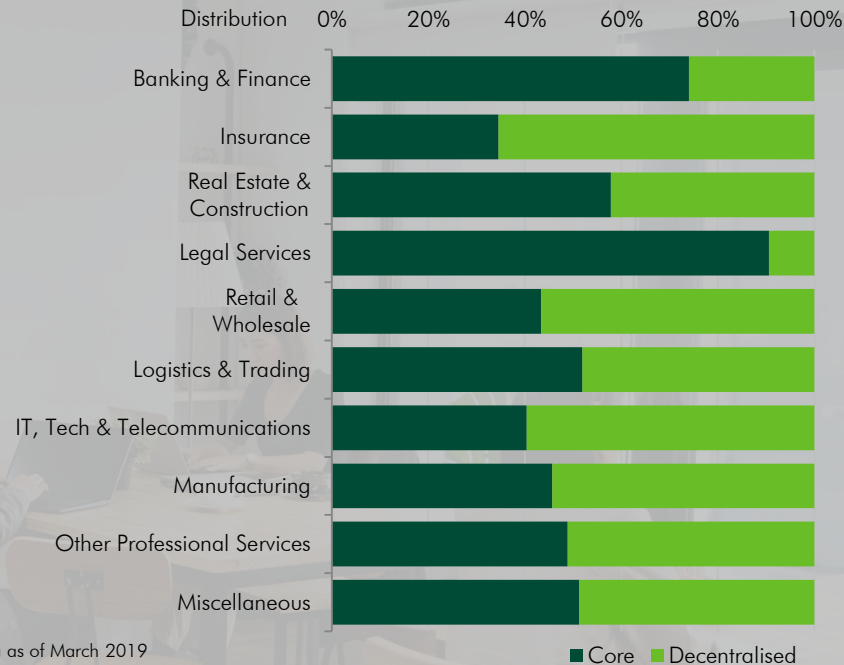
\*Data as of March 2019



The recent wave of decentralisation has transformed Hong Kong East and Kowloon East from back office districts to headquarters destinations. Multinational banks and insurance companies such as JP Morgan, Citi, Manulife and a few others now all operate offices of over 100,000 sq. ft. in these districts. Some companies now possess larger offices in decentralised areas than those in core locations.

While 90% of the legal sector's office footprint remains in core districts – making it the industry with the largest volume of space in the Central CBD - recent years have seen several international law firms establish offices in Hong Kong East.

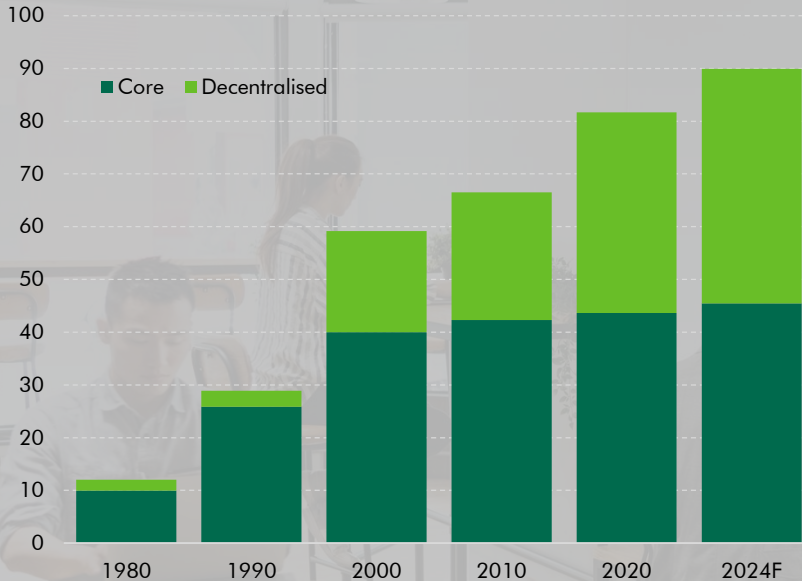
**Figure 12: Distribution of companies by sector**



\*Data as of March 2019  
Source: CBRE Research, October 2020

**Figure 13: Distribution of Grade A office stock**

Grade A Office Stock (mil sq. ft., NFA)



Source: CBRE Research, October 2020

While cost and flight-to-quality have been the major drivers of decentralisation, the completion of a large volume of new supply in non-core areas has also facilitated the movement of large occupiers out of the CBD. Over the past 20 years, Hong Kong's decentralised office stock has doubled to 37.8 million sq. ft. and now accounts for 46% of the city's total Grade A office stock. Around 44% (16.8 million sq. ft.) of decentralised space is in Kowloon East.

Although several new buildings are due to be completed in core submarkets over the next few years, the stock gap between core and decentralised submarkets will continue to shrink – a trend that could lead to more front offices in Kowloon East and Hong Kong East. The former will continue to account for most new decentralised supply (34%, 3 million sq. ft. in 2020-2024).

While the precise specifications of new projects under development have yet to be released, the estimated floorplate size of office buildings in the pipeline suggests that decentralised locations will continue to provide attractive options for large occupiers and facilitate office decentralisation in the coming years.

Cost-driven occupiers will likely focus on new schemes in East and West Kowloon due to the relatively high availability of a wide range of options at very competitive rents. Hong Kong East is set to attract Hong Kong Island-based occupiers wishing to pursue flight-to-quality moves.

**Figure 14: Floorplate size in Grade A office pipeline 2020-2024**



Source: CBRE Research, October 2020

# REDEFINING OFFICE SUBMARKETS

A range of factors including cost, business continuity planning, infrastructure and technological advancement have driven a shift in office leasing strategy in recent years. Depending on their industry and nature of business, many corporates now find it feasible to base their operations in locations outside core office districts. As new, attractively-priced and high-quality office buildings come on stream in decentralised areas, the role and function of Hong Kong's office submarkets will evolve in the post-COVID-19 era.



# HONG KONG EAST

Since 2000, Quarry Bay, which forms the core of the Hong Kong East submarket, has attracted a large number of multinational companies – a trend CBRE expects to continue and which may eventually dilute the concentration of headquarters offices in Central.

New and high-quality premium Grade A buildings with large floor plates will strengthen the appeal to Quarry Bay to sizable occupiers seeking a move away from the CBD. In the coming years, the district is expected to welcome a growing number of financial and professional services firms, some of which will consolidate front and back office functions.



Growing demand for space in Hong Kong East will gradually narrow the district's rental gap with other Hong Kong Island core office submarkets in the long run, although cost is not the sole reason for occupiers wanting to decentralise to the district.



# KOWLOON EAST

Kowloon East will continue to see a steady increase in the number of high-specification Grade A office buildings in the coming years – underlining its potential to become the city's largest office submarket.

Of the four sub-districts of Kowloon East, CBRE believes Kai Tak will attract the most top-tier companies in the long-term, with plans already underway to create a self-sustained and vibrant commercial community.

Future supply in Kowloon East will continue to have larger than average floorplates owing to the availability of bigger development sites. This will allow the district to accommodate large office requirements.



As Kowloon East is located the furthest from the city core among all urban submarkets, decentralisation to the district will likely remain cost driven. However, the completion by 2022 of all phases of the MTR's Shatin-to-Central Link will improve accessibility to Kai Tak from downtown.

# TSIM SHA TSUI & WEST KOWLOON

Tsim Sha Tsui's geographical footprint will extend westward in the coming years to include existing and future office developments in and around Kowloon Station, the Guangzhou–Shenzhen–Hong Kong Express Rail Link (XRL), and the West Kowloon Cultural District (WKCD). With a total of 14 million sq. ft. of Grade A office space, TST will be firmly established as Kowloon's core office submarket.

Offices near the XRL will attract companies with staff needing to make frequent cross-border travel. New retail, art and cultural facilities to be built on the XRL and within the WKCD will enhance the vibrancy of TST, particularly the western end, and create an attractive commercial community for office occupiers.



Cheung Sha Wan is a relatively small and somewhat detached district in the vicinity of West Kowloon and lacks an established community of large office occupiers. However, the submarket will continue to offer affordable options for cost-driven occupiers seeking access to West Kowloon.

# GREATER CENTRAL

Despite the Central CBD's high rental costs, the district provides an attractive, vibrant and convenient commercial environment. This will ensure the submarket remains the city's leading and most desirable business district for the foreseeable future.

Some occupiers hold concerns about the relatively high age of many office buildings in Greater Central, some of which are unsuitable for companies with sophisticated technical requirements. However, CBRE believes several new schemes in the supply pipeline in and around Central and Admiralty will redress the balance and facilitate upgrading within the CBD in the coming years.



Central is expected to remain a diversified submarket playing host to a growing number of Mainland Chinese firms alongside a broad spectrum of local and multinational corporations. The district will continue to be the location of choice for financial sector occupiers willing and able to pay relatively high rents.

# WAN CHAI / CAUSEWAY BAY

With an average age of 26 years, many buildings in Wan Chai / Causeway Bay are struggling to compete with recently completed new and high-specification buildings elsewhere. Future supply in Wan Chai / Causeway Bay will remain limited, thereby further reducing the appeal of this submarket.

With major occupiers either opting to stay in Greater Central or pursuing flight-to-quality moves to Hong Kong East, Wan Chai / Causeway Bay is set to fall further down the list of attractive locations from both a cost and building quality perspective.



While the regeneration of Wan Chai North following the redevelopment of the Wan Chai government office complex will provide a much-needed boost to the submarket, the project will not come on stream until towards the end of this decade.



# CONCLUSION

The economic downturn has prompted many occupiers in Hong Kong to put real estate plans on hold. Once the recovery begins and businesses return to expansion mode, companies will need to reconsider their occupier strategy for the COVID-19 era.

Cost remains the primary driver of office decentralisation but building quality and office environment are rising up occupiers' list of priorities. New and high specification office buildings providing a strong community feel will remain keenly sought after by companies looking to decentralise.

With several attractively-priced and high-quality office buildings due to be completed in decentralised areas in the coming years, the role and function of Hong Kong's office submarkets will continue to evolve.



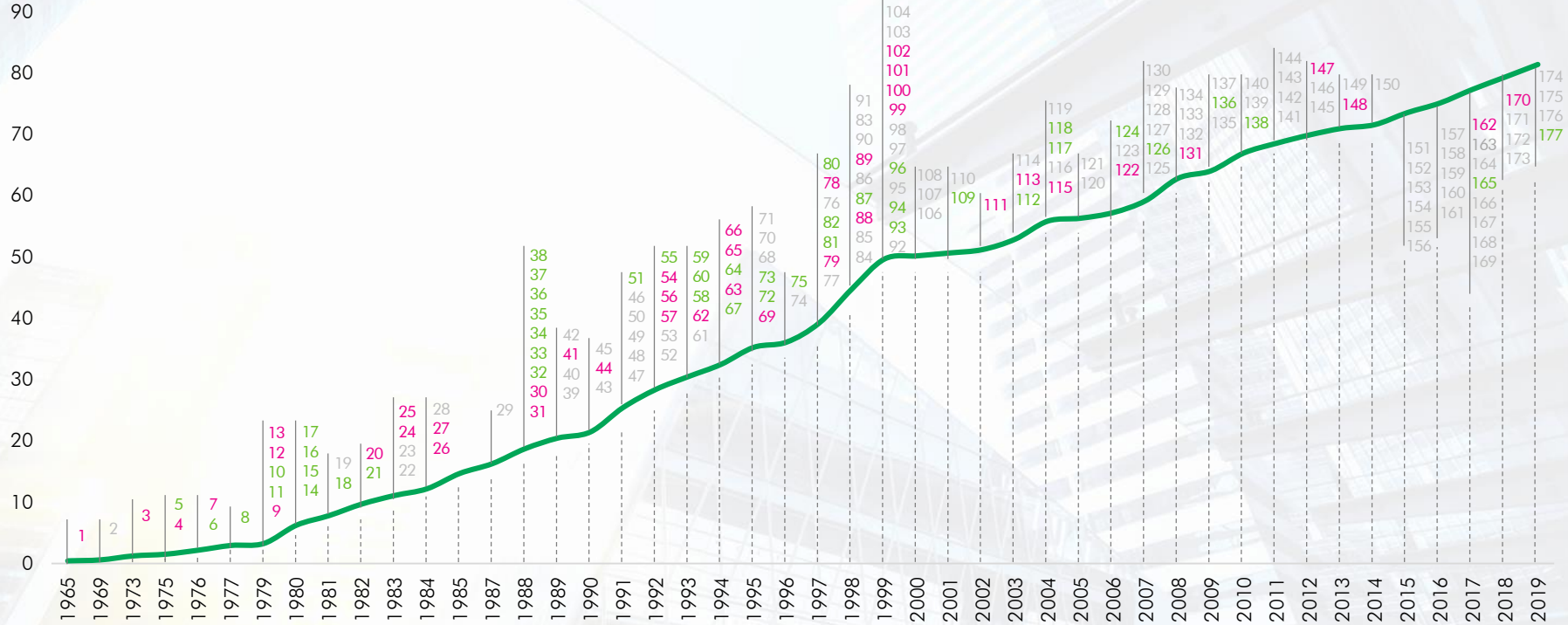
# COMING SOON: CHAPTER 2 & CHAPTER 3

Chapter 2 of this three-part report is scheduled to be published in late Q4 2020. This chapter will profile existing office clusters in Hong Kong and explain how leading portfolio landlords have transformed traditional office developments into integrated communities, creating myriad benefits for both occupiers and the public. Chapter 3, to be available in 2021, will discuss COVID-19 era office strategies in Hong Kong and assess potential challenges and constraints.

Stay tuned!

# APPENDIX - HONG KONG OFFICE DEVELOPMENT 1965-2019

Grade A Office Stock (mil. sq. ft. NFA)



Pure office blocks (offices with no or light in-house amenities)

Commercial precincts by emergence (offices as a component of a comprehensive business community)

Mixed-use developments (offices with at least a shopping arcade or mall component)

Source: CBRE Research, August 2020

# APPENDIX - HONG KONG OFFICE DEVELOPMENT 1965-2019

Grade A Office Stock (mil. sq. ft. NFA)

90

1	Prince's Bldg.	16	Tsim Sha Tsui Ctr., East Wing	31	One Pacific Place	46	Hang Seng Bank HQ Bldg.	61	COFCO Twr.	76	Henley Bldg.	91	Sunlight Twr.	106	8 Queen's Rd. Central	121	100QRC	136	Crocodile Center	151	Tower 535	166	Kingston Financial Twr.
2	St. George's Bldg.	17	Tsim Sha Tsui Ctr., West Wing	32	Infinitus Plaza	47	Allied Kajima Bldg.	62	Devon House	77	CITIC Twr.	92	Cheung Kong Center	107	148 Electric Rd.	122	York House	137	AIA Financial Ctr.	152	Vertical Sq	167	Two Harbour Square
3	Jardine House	18	Energy Plaza	33	China HK City, Twr. 1	48	Central Plaza	63	PCCW Twr.	78	Lee Garden One	93	One ifc	108	Bank of China Ctr.	123	One Kowloon	138	International Commerce Ctr.	153	41 Heung Yip Rd.	168	The Apex
4	Alexandra House	19	Hang Seng 113	34	China HK City, Twr. 2	49	Everbright Ctr.	64	Peninsula Hotel Office Twr.	79	Cityplaza One	94	Man Yee Bldg.	109	The Metropolis Twr.	124	Nina Twr.	139	Kerry Ctr.	154	8 Observatory Rd.	169	Port 33
5	World Trade Ctr.	20	Edinburgh Twr.	35	China HK City, Twr. 3	50	China Evergrande Ctr.	65	The Gateway, Twr. 1	80	Mira Place Twr. A	95	China Online Ctr.	110	Harbourfront Landmark	125	633 King's Rd.	140	Harbourside HQ	155	One Bay East	170	One Taikoo Place
6	China Bldg.	21	China Resources Bldg.	36	China HK City, Twr. 5	51	Metroplaza, Twr. 1	66	The Gateway, Twr. 2	81	Grand Century Place, Twr. 1	96	Olympia Plaza	111	Chater House	126	Enterprise Square Five	141	Agricultural Bank of China Twr.	156	Maxim's Ctr.	171	South Island Place
7	Ocean Ctr.	22	The HK Club Bldg.	37	China HK City, Twr. 6	52	3 Garden Rd. - Champion Twr.	67	Landmark North	82	Grand Century Place, Twr. 2	97	1063 King's Rd.	112	Two ifc	127	Millennium City 6	142	LHT Twr.	157	Shanghai Commercial Bank Twr.	172	FT Life Twr.
8	Chubb Twr.	23	Wheelock House	38	Chinachem Golden Plaza	53	3 Garden Rd. - ICBC Twr.	68	Li Po Chun Chambers	83	Stelux House	98	Prosperity Millennium Plaza	113	Cambridge House	128	Manulife Financial Ctr. - Twr. A	143	Prosperity Twr.	158	MassMutual Twr.	173	International Trade Twr.
9	Gloucester Twr.	24	World Fin. Ctr., North Twr.	39	Bank of China Twr.	54	Lee Garden Two	69	Dorset House	84	625 King's Rd.	99	Oxford House	114	One Peking	129	Manulife Financial Ctr. - Twr. B	144	CCB Ctr.	159	Goldin Financial Global Ctr.	174	One Hennessy
10	Sun Hung Kai Ctr.	25	World Fin. Ctr., South Twr.	40	Luk Kwok Ctr.	55	Sino Plaza	70	One Harbourfront	85	AIA Twr.	100	The Gateway, Prudential Twr.	115	Three Pacific Place	130	909 Cheung Sha Wan Rd.	145	CCB Twr.	160	China Life Center - Twr. A	175	K11 ATELIER King's Rd.
11	Hopewell Ctr.	26	One Exchange Square	41	Lee Garden Five	56	Cityplaza Three	71	Two Harbourfront	86	HSBC Ctr., Twr.s 1-3	101	The Gateway, Sun Life Twr.	116	Skyline Twr.	131	One Island East	146	28 Hennessy Rd.	161	Cheung Kei Center - Twr. A	176	NEO
12	Wharf T & T Ctr.	27	Two Exchange Square	42	Trade Square	57	Cityplaza Four	72	Grand Central Plaza, Twr. 1	87	Festival Walk	102	The Gateway, Twr. 6	117	Millennium City 5	132	Manhattan Place	147	Hysan Place	162	Lee Garden Three	177	The Quayside
13	World Commerce Ctr.	28	HSBC Main Bldg.	43	Standard Chartered Bank Bldg.	58	Entertainment Bldg.	73	Grand Central Plaza, Twr. 2	88	Berkshire House	103	Millennium City 2	118	Langham Place	133	AXA Twr., (One LME)	148	Exchange Square - The Forum	163	18 King Wah Rd.		
14	Empire Ctr.	29	Shui On Ctr.	44	Two Pacific Place	59	Times Square, Twr. 2	74	Central Twr.	89	Lincoln House	104	Wing On Kowloon Ctr.	119	Saxon Twr.	134	AIA Kowloon Twr., (Two LME)	149	Casey Aberdeen House	164	AXA Southside		
15	Mirror Twr.	30	Three Exchange Square	45	Lee & Man Com. Ctr.	60	Times Square, Twr. 1	75	Telford Plaza	90	Millennium City 1	105	One Citygate	120	AIA Central	135	Nexus Bldg.	150	The Octagon	165	K11 Atelier		

Pure office blocks (offices with no or light in-house amenities)

Mixed-use developments (offices with at least a shopping arcade or mall component)

Commercial precincts by emergence (offices as a component of a comprehensive business community)

Source: CBRE Research, August 2020

# Reshaping the Hong Kong Office Market

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## CBRE RESEARCH

This report was prepared by the CBRE Hong Kong Research Team, which forms part of CBRE Research—a network of preeminent researchers who collaborate to provide real estate market research and econometric forecasting to real estate investors and occupiers around the globe.

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