

Savills Prime Office Cost Index Q3 2017



The Savills Prime Office Cost (SPOC) Index presents a quarterly snapshot of occupancy costs for prime office space throughout the world, as provided by our expert, local tenant representation professionals.

Global occupancy cost volatility increased during the third quarter of 2017 as compared to a stable second quarter. Face rent increases drove up recorded costs in Paris, Frankfurt, Amsterdam, and Brussels as “post-Brexit” requirements materialized and leases were executed by occupiers in these markets. A stronger Euro also helped increase occupancy costs as recorded by our index.

Asian markets were less volatile and showed no discernible uniformity across the region. Tokyo, Singapore, and Seoul all recorded increases in occupancy costs as Mumbai and Shanghai recorded decreases. Overall, the impact of exchange rate volatility on recorded occupancy costs for the region was relatively low as compared to prior quarters.

Across the Americas, a weaker dollar impacted recorded occupancy expenses in Toronto while the US markets continued to trend in favor of occupiers with the exception of San Francisco.

In the remainder of this issue, we focus on Hong Kong. The Hong Kong market has consistently been ranked as the most expensive prime office market in the world for occupiers. Given the potential impact this market has on our client’s global real estate expense structure, we asked our top Hong Kong tenant reps to discuss the market dynamics and explore what the future may hold for global occupiers in “Asia’s World City.”

TABLE 1.

Top 10 Prime Markets by Total Cost

Rank	City	Total Occupancy Cost USD / USF
1	Hong Kong	\$250.96
2	London (West End)	\$207.68
3	Tokyo	\$190.17
4	Singapore	\$136.55
5	Paris	\$133.98
6	Shanghai	\$124.15
7	New York (Midtown)	\$106.50
8	Seoul	\$103.07
9	San Francisco	\$102.19
10	Mumbai	\$93.86

TABLE 2.

Greatest Percentage Change (Y-O-Y)

Rank	City	Y-O-Y Change
1	Brussels	+17.36%
2	Mexico City	-15.30%
3	Amsterdam	+9.16%
4	Paris	+8.68%
5	Frankfurt	+8.65%

Hong Kong Market Overview

MARKET SIZE
124M^{SQ}FT

VACANCY RATE

<4%

MAJOR SUBMARKETS

2 Hong Kong Island
Kowloon

STANDARD
LEASE TERM

2-3^{YR}

LARGE OCCUPIERS
STANDARD LEASE TERM

6-9^{YR}

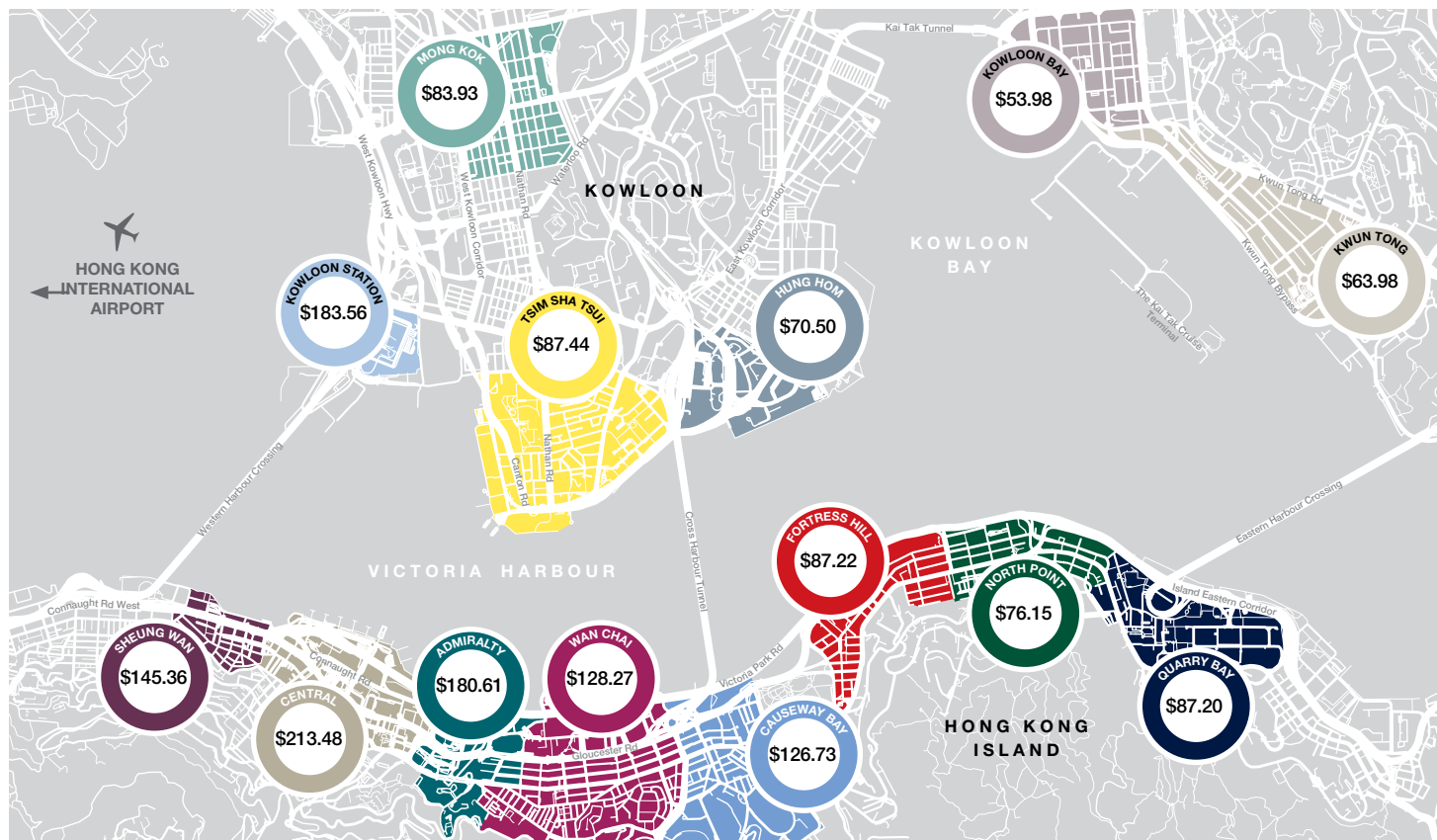
Hong Kong Rent Map Annual Face Rent (USD/USF)

Note:

Face Rent + Maintenance + Taxes = Headline Occupancy Cost as referenced on page 4

Example:

Hong Kong Central – \$213.48 (Face Rent) + \$17.08 (Maintenance) + \$8.54 (Tax) = \$239.10



Q&A

A Conversation with Savills Hong Kong Tenant Rep

Q: How do you see the market developing over the next 2-3 years?

HK: There is limited development forecast on Hong Kong Island, so we expect rents on the island to hold if current levels of demand remain constant. The main office development supply is occurring in Kowloon East, which will attract some Hong Kong Island tenants and relieve island markets.

Q: Where are the hotspots in the market and why?

HK: Quarry Bay continues to provide the most attractive decentralized options on Hong Kong Island for tenants seeking quality and financially competitive Grade A space. Swire's Taikoo Place portfolio has already demonstrated its 'pulling power' to attract tenants directly from Central, such as Freshfields and Alliance Bernstein. Wong Chuk Hang has also emerged as a new Hong Kong Island sub-market following the completion of the new MTR train station and completion of numerous new buildings and revitalization projects.

Q: What key infrastructure / redevelopment projects should tenants be aware of?

HK: The Central-Wanchai Bypass underground link with the Island Eastern Corridor scheduled to complete in 2018 will improve the travel time to Quarry Bay by road. Kowloon East is currently the main area of focus for multiple new Grade A office developments and is forecast to remain active with the large scale redevelopment of the old Kai Tak airport in to its own sub-market as a residential, commercial and entertainment district.

Q: Who are Hong Kong's major landlords?

HK: Cheung Kong, Henderson, Hong Kong Land, Hysan, New World, Sino, Sun Hung, Kai and Swire Properties. However, the influx of PRC investors has weakened the dominance of traditional owners, particularly in new, developing sub-markets.

Q: How are corporates in HK faring in the global war for talent?

HK: Hong Kong has very low levels of unemployment and attracts professional talent due to its position as a global financial centre and its lifestyle benefits. The test within Hong Kong is often to retain the talent within the company against competitors. In terms of new talent in emerging industries, Hong Kong has a burgeoning entrepreneurial and start-up scene that has been recognized by and will benefit from the recent influx of co-working providers in the city.

Q: Is there a particular submarket favoured by Millennials?

HK: Millennials have more recently favoured the fringe market of Central, in Sheung Wan. However, other areas have emerged in Wanchai's Queen's Road East area, as well as Cyberport. Accordingly, Sheung Wan has attracted co-working operators, however the spread and influx of co-working providers more generally is likely to also open up new hot spots for millennial talent.

Q: Which tenants have made the biggest impact in 2017? Why?

HK: WeWork, Naked Hub and Spaces have combined to make the biggest impact in 2017, due to large, multiple acquisitions in a variety of buildings and across most office submarkets.

How is the arrival of co-working / office suite providers impacting the market?

HK: Hong Kong was an early adopter of the co-working trend with many small operators in the market. Up until recently, their focus has been on small size operations in Grade B buildings. However the recent influx of major providers such as WeWork, Naked Hub and Spaces has seen some interesting developments in the market. Older style Grade B buildings suddenly have more relevance and value if they can be leased in their entirety and branded by a co-working operator, new developments are seeing multi-floor acquisitions by co-working providers, and traditional serviced office providers are starting to feel challenged in their value proposition and identity.



Julian Milne
Director, Tenant Rep



Simon Smith
Head of Research & Consultancy

What is strata title and how can it impact tenants?

HK: Strata title enables individual landlords to own either whole or part floors within a particular building. The system has drawbacks for multi-national corporate occupiers:

- Landlords are often unknown entities, inexperienced, or 'hands off' managers
- Individual floors are more likely to be sold to owner occupiers who will want to take back the space at lease expiry for their own occupation
- Expansion/Contraction involving neighboring units or other floors can become complicated if dealing with different landlords
- Upkeep of the building aesthetics and services will often suffer over the long-term due to the difficulty of achieving consensus amongst all owners.

What is "bond connect" and how has it impacted the market?

HK: Bond Connect is a new bond market trading scheme, using Hong Kong based infrastructure linked to the mainland, allowing overseas and Hong Kong investors to invest and buy debt in China's US\$9.57 trillion bond market. Previously this was a lengthy process, which limited foreign investors to holding only 1.3% of the market. Investment is expected to double over the next 5 years. China's likely future inclusion in global debt indexes would also ensure more foreign investment. Bond Connect is the most recent initiative in China's capital markets to develop more connectivity with foreign investors, complementing the recent cross-border share trading schemes of the Shanghai-Hong Kong Stock Connect in 2014 and Shenzhen-Hong Kong Stock Connect in 2016.

Have recent political headlines regarding Chinese rule made any impact?

HK: The influence of Chinese authority in Hong Kong's politics is a continued source of discussion and concern to many in Hong Kong, as was demonstrated by the 2013 protests. However, there have been no major repercussions despite the recent twentieth anniversary of the formal establishment of the Hong Kong Special Administrative Region.

The SPOC Global Rankings

Quarterly highlights

- Sentiment in London remains subdued, but the West End submarket just recorded its highest ever quarterly take up. Buoyed by large transactions for Aegis and Boston Consulting Group, as well as continued expansion by serviced office providers, there are signs that pent-up inertia following the Brexit referendum may begin to ease.

1 Hong Kong



Headline Occupancy Cost	\$239.10
Amortised Cap Ex	\$23.72
Credit Value of Abated Rent	(\$11.86)
Total Occupancy Cost/USF	\$250.96
Local Face Rent	HKD 125.00 SF/MTH
Typical Lease Term (Years)	6
Local Efficiency Factor	1.11
Who Pays Broker?	New: Landlord Renewal: Tenant

2 London (West End)



Headline Occupancy Cost	\$221.55
Amortised Cap Ex	\$12.80
Credit Value of Abated Rent	(\$26.67)
Total Occupancy Cost/USF	\$207.68
Local Face Rent	GBP 110.00 SF/YR
Typical Lease Term (Years)	10
Local Efficiency Factor	1.00
Who Pays Broker?	Tenant

3 Tokyo



Headline Occupancy Cost	\$146.54
Amortised Cap Ex	\$49.96
Credit Value of Abated Rent	(\$6.33)
Total Occupancy Cost/USF	\$190.17
Local Face Rent	JPY 38,000.00 Tsubo/MTH
Typical Lease Term (Years)	5
Local Efficiency Factor	1.11
Who Pays Broker?	Tenant

4 Singapore



Headline Occupancy Cost	\$99.05
Amortised Cap Ex	\$43.44
Credit Value of Abated Rent	(\$5.94)
Total Occupancy Cost/USF	\$136.55
Local Face Rent	SGD 8.20 SF/MTH
Typical Lease Term (Years)	3
Local Efficiency Factor	1.18
Who Pays Broker?	New: Landlord Renewal: Tenant

5 Paris



Headline Occupancy Cost	\$132.24
Amortised Cap Ex	\$14.69
Credit Value of Abated Rent	(\$12.95)
Total Occupancy Cost/USF	\$133.98
Local Face Rent	EUR 793.00 SM/YR
Typical Lease Term (Years)	6
Local Efficiency Factor	1.33
Who Pays Broker?	Tenant

6 Shanghai



Headline Occupancy Cost	\$101.59
Amortised Cap Ex	\$30.22
Credit Value of Abated Rent	(\$7.66)
Total Occupancy Cost/USF	\$124.15
Local Face Rent	CNY 12.50 SM/DAY
Typical Lease Term (Years)	3
Local Efficiency Factor	1.43
Who Pays Broker?	New: Landlord Renewal: Tenant

7 New York (Midtown)



Headline Occupancy Cost	\$106.16
Amortised Cap Ex	\$10.96
Credit Value of Abated Rent	(\$10.62)
Total Occupancy Cost/USF	\$106.50
Local Face Rent	USD 77.50 SF/YR Full Service Gross
Typical Lease Term (Years)	10
Local Efficiency Factor	1.37
Who Pays Broker?	Landlord

8 Seoul



Headline Occupancy Cost	\$93.68
Amortised Cap Ex	\$26.30
Credit Value of Abated Rent	(\$16.91)
Total Occupancy Cost/USF	\$103.07
Local Face Rent	KRW 113,564.00 Pyong/MTH
Typical Lease Term (Years)	5
Local Efficiency Factor	2.00
Who Pays Broker?	Tenant

9 San Francisco



Headline Occupancy Cost	\$97.50
Amortised Cap Ex	\$8.75
Credit Value of Abated Rent	(\$4.06)
Total Occupancy Cost/USF	\$102.19
Local Face Rent	USD 50.00 SF/YR Full Service Gross
Typical Lease Term (Years)	10
Local Efficiency Factor	1.25
Who Pays Broker?	Landlord

10 Mumbai



Headline Occupancy Cost	\$77.89
Amortised Cap Ex	\$17.31
Credit Value of Abated Rent	(\$1.34)
Total Occupancy Cost/USF	\$93.86
Local Face Rent	INR 255.00 SF/MTH
Typical Lease Term (Years)	9
Local Efficiency Factor	1.54
Who Pays Broker?	Tenant

11	Dublin
	3.7%
Headline Occupancy Cost	\$84.81
Amortised Cap Ex	\$9.49
Credit Value of Abated Rent	(\$3.56)
Total Occupancy Cost/USF	\$90.74
Local Face Rent	EUR 60.00 SF/YR
Typical Lease Term (Years)	10
Local Efficiency Factor	1.00
Who Pays Broker?	Tenant

12	Washington DC
	0.0%
Headline Occupancy Cost	\$89.89
Amortised Cap Ex	\$5.62
Credit Value of Abated Rent	(\$8.99)
Total Occupancy Cost/USF	\$86.52
Local Face Rent	USD 55.00 SF/YR Full Service Gross
Typical Lease Term (Years)	10
Local Efficiency Factor	1.12
Who Pays Broker?	Landlord

13	Amsterdam
	4.4%
Headline Occupancy Cost	\$59.95
Amortised Cap Ex	\$13.22
Credit Value of Abated Rent	(\$6.61)
Total Occupancy Cost/USF	\$66.56
Local Face Rent	EUR 400.00 SM/YR
Typical Lease Term (Years)	5
Local Efficiency Factor	1.00
Who Pays Broker?	Tenant

14	Frankfurt
	7.6%
Headline Occupancy Cost	\$70.79
Amortised Cap Ex	\$0.00
Credit Value of Abated Rent	(\$5.06)
Total Occupancy Cost/USF	\$65.73
Local Face Rent	EUR 39.00 SM/MTH
Typical Lease Term (Years)	5
Local Efficiency Factor	1.18
Who Pays Broker?	Landlord

15	Chicago
	-0.9%
Headline Occupancy Cost	\$66.27
Amortised Cap Ex	\$4.82
Credit Value of Abated Rent	(\$5.52)
Total Occupancy Cost/USF	\$65.57
Local Face Rent	USD 30.00 SF/YR Full Service Gross
Typical Lease Term (Years)	10
Local Efficiency Factor	1.20
Who Pays Broker?	Landlord

16	Brussels
	7.0%
Headline Occupancy Cost	\$50.56
Amortised Cap Ex	\$10.80
Credit Value of Abated Rent	(\$3.24)
Total Occupancy Cost/USF	\$58.12
Local Face Rent	EUR 300.00 SM/YR
Typical Lease Term (Years)	6
Local Efficiency Factor	1.18
Who Pays Broker?	Tenant

17	Toronto
	5.2%
Headline Occupancy Cost	\$53.37
Amortised Cap Ex	\$4.41
Credit Value of Abated Rent	(\$2.22)
Total Occupancy Cost/USF	\$55.56
Local Face Rent	CAD 29.50 SF/YR Full Service Gross
Typical Lease Term (Years)	10
Local Efficiency Factor	1.22
Who Pays Broker?	Landlord

18	Los Angeles (Downtown)
	0.0%
Headline Occupancy Cost	\$53.01
Amortised Cap Ex	\$3.01
Credit Value of Abated Rent	(\$4.42)
Total Occupancy Cost/USF	\$51.60
Local Face Rent	USD 26.00 SF/YR Full Service Gross
Typical Lease Term (Years)	10
Local Efficiency Factor	1.20
Who Pays Broker?	Landlord

19	Mexico City
	1.1%
Headline Occupancy Cost	\$35.21
Amortised Cap Ex	\$15.65
Credit Value of Abated Rent	(\$1.47)
Total Occupancy Cost/USF	\$49.39
Local Face Rent	USD 25.00 SM/MTH
Typical Lease Term (Years)	5
Local Efficiency Factor	1.05
Who Pays Broker?	Landlord

20	Houston
	0.0%
Headline Occupancy Cost	\$50.00
Amortised Cap Ex	\$3.98
Credit Value of Abated Rent	(\$5.00)
Total Occupancy Cost/USF	\$48.98
Local Face Rent	USD 27.00 SF/YR Full Service Gross
Typical Lease Term (Years)	10
Local Efficiency Factor	1.14
Who Pays Broker?	Landlord

Landlords Adopt Co-Working Solutions

- Co-working providers continue to dominate headlines across our SPOC survey. It remains to be seen whether there is sufficient demand to support current expansion, but it is clear the market is undergoing a structural transformation with more Landlords now offering full service solutions to help tenants improve flexibility, minimize hassle and capital expenditure, and, increasingly, offset the looming impact of IFRS 16.

SPOC Methodology

The adjusted annual gross occupancy cost represents real-time transaction terms for 20,000 sq ft (2,000 sq m) of usable space with prime views in a top quality asset with i) a stable capital stack, ii) institutional quality ownership, and iii) a quality location in the prime business district. All costs are reported in an annual, standardized format of USD per sq ft of usable space to “level set” variations in currency, reflect local payment protocols, and adjust for measurement practices across the globe. We have factored in the credit value to the tenant generated from abated rent and the cost associated with fitting out the premises in order to provide an “all in” total occupancy cost in USD per usable square foot.

The fit out costs were gathered from Savills project managers assuming the leasing scenario described above, plus the following: i) 30% private offices with the remainder of space open plan, ii) construction and cabling only (no furniture or professional fees).

Glossary

Headline Occupancy Cost

Gross rent including operating expenses and property taxes

Amortised Cap Ex

Net capital expenditure divided by lease term

Credit Value of Abated Rent

Value of rent free divided by lease term

Total Occupancy Cost

Headline Occupancy Cost plus Amortised Cap Ex minus Credit Value of Abated Rent

Local Face Rent

Taking rent quoted in local currency, measurement unit and payment frequency

Local Efficiency Factor

Conversion rate from rentable to usable space

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