

Hong Kong Monthly

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OFFICE

Landlords looking to keep premises occupied

Hong Kong Island

With the rampant spread of COVID-19 worldwide, business sentiment has been severely affected. The weaker global economy and the across-the-board impact of the virus has made businesses very cautious. Many office tenants, both local and multinational, have tended to delay or put on hold their real estate decisions, resulting in low levels of leasing activity.

That said, we note some green shoots in the office sector. Transactions are still occurring, with some occupiers proactively looking for opportunities for bargain deals, either for consolidation or expansion against the backdrop of an overall downward trend in rents.

Landlords in general have been more flexible in lease negotiation and more willing to offer favourable renewal terms to retain tenants. Since vacancy rates remained relatively low (Central: 3.7%, overall Hong Kong Island: 4.4%), we do not see any possibility of substantial rental reductions. Instead, we expect mild downward adjustments in rents in the coming months.

Kowloon

Similar to the situation on Hong Kong Island, activity in the office leasing market on Kowloon side remained low. Most of the deals were renewal leases of small-to-mid-size units of less than 5,000 sq ft. As cost-savings gain priority, leasing activities were largely dominated by renewals, unless the new space has significantly lower rents which would allow tenants to considerably reduce occupancy costs.

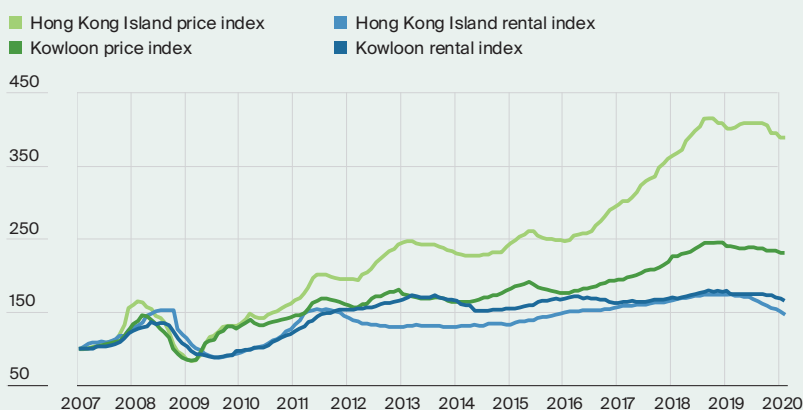
One example was the new lease of a 32,000-sq-ft space at Kowloon Commerce Centre Tower A, in Kwai

Chung by camera brand Olympus. By downsizing and economising at the same time, the new rent is about 30% lower than that of its current 35,000 sq ft-space in Langham Place in Mong Kok.

As the COVID-19 outbreak has been declared a pandemic, this will inevitably exacerbate market volatility and negative sentiment. The office market will be significantly dampened in the near-term. Coupled with mounting vacant office stocks, rents in Kowloon are expected to see visible shrinkage in the coming months.

Fig 1. Grade-A office rents and prices

2007 = 100



Source: Knight Frank Research

Grade-A office market indicators (February 2020)

| District | Net effective rent | Change | | Price (Gross) | Change | |
|-----------------------|--------------------|--------|-------|---------------|--------|-------|
| | HK\$ psf / mth | MoM % | YoY % | HK\$ psf | MoM % | YoY % |
| Premium Central | 156.1 | -1.4 | -21.1 | - | - | - |
| Traditional Central | 123.3 | -1.5 | -15.8 | - | - | - |
| Overall Central | 134.4 | -1.5 | -18.0 | 42,407 | 0.0 | -0.4 |
| Admiralty | 90.1 | -3.8 | -22.6 | 36,689 | 0.0 | -5.0 |
| Sheung Wan | 76.2 | -3.3 | -11.4 | 33,617 | 0.0 | -0.2 |
| Wan Chai | 69.1 | -4.8 | -14.1 | 28,764 | 0.0 | -4.2 |
| Causeway Bay | 74.8 | -2.0 | -11.9 | 25,549 | 0.0 | -1.8 |
| North Point | 47.2 | -3.6 | -12.5 | - | - | - |
| Quarry Bay | 53.5 | -1.7 | -1.6 | - | - | - |
| Tsim Sha Tsui | 67.6 | -1.3 | -5.6 | 17,840 | 0.0 | -2.6 |
| Cheung Sha Wan | 31.4 | -0.8 | -4.4 | - | - | - |
| Hung Hom | 44.5 | 0.7 | 0.8 | - | - | - |
| Kowloon East | 30.5 | -1.8 | -5.2 | 12,834 | 0.0 | -4.2 |
| Mong Kok / Yau Ma Tei | 57.9 | -1.7 | -2.0 | - | - | - |

Source: Knight Frank Research
Note: Rents and prices are subject to revision.

RESIDENTIAL

Market sentiment further eroded amid a wider outbreak

The rapid spread of COVID-19 around the world has further eroded market confidence and dampened the city's property market. As both buyers and sellers have become more vigilant amid the volatile economy, sales activity remained low during the month. Developers offer more flexible packages and payment terms to sell unsold units in the primary market. According to the Land Registry, sales volume continued to hover at a low level in February at 3,572 units.

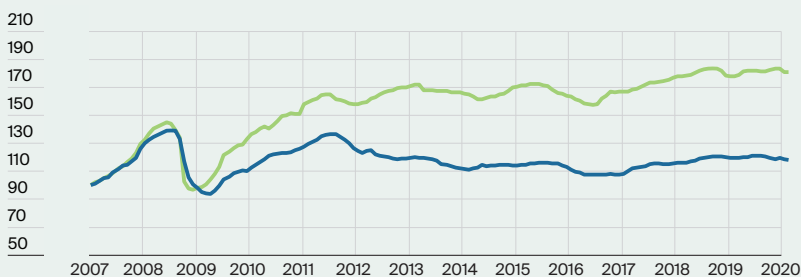
Meanwhile, potential homebuyers in the secondary market are grabbing the opportunity to negotiate a lower price in the downbeat market. Transactions at major estates were recorded at discounts ranging from 2% to 8%. Moreover, with rising market uncertainty, we note that more property owners have started selling long-held properties to generate cash flow. For instance, a 2,257 sq ft unit in Bellevue Court in Mid-Levels East with the same owner for 54 years was sold for HK\$58 million.

In the leasing market, given the growing impact of the coronavirus on the global economy, many international firms and other large corporates have

Fig 2. Luxury residential rents and prices

2007 = 100

Price index Rental index

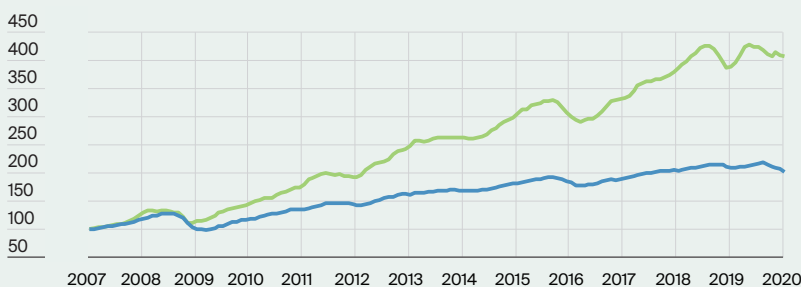


Source: Knight Frank Research / Rating and Valuation Department

Fig 3. Mass residential rents and prices

2007 = 100

Price index Rental index



Source: Knight Frank Research / Rating and Valuation Department

tightened business expenses and deferred expansion plans within the region, resulting in softer leasing demand from expatriates. Landlords in general were more willing to offer flexible terms and adjustments on the asking rent.

With the twice unexpected interest rate cuts in the U.S., HKMA followed suit by lowering its base rate. Hong Kong home market would benefit as HIBOR stays low for the foreseeable future. However, we

expect buyers to remain prudent in the short term as economic uncertainties and the various headwinds will continue to curb buyer confidence.

Selected residential sales transactions (February 2020)

| District | Building | Tower / floor / unit | Saleable area (sq ft) | Price (HK\$ million) | Price (HK\$ per sq ft) |
|-----------------|----------------------|-------------------------------|-----------------------|----------------------|------------------------|
| The Peak | 2 Island Road | House | 3,836 | 500 | 130,344 |
| Mid-Levels East | Dukes Place | Duplex unit A | 2,846 | 176.5 | 62,000 |
| Ho Man Tin | Ultima | Tower 5 / high floor / unit C | 2,130 | 128.6 | 60,376 |
| The Peak | 22 Mount Austin Road | Low floor / unit B | 2,221 | 130 | 58,532 |
| Kowloon Tong | 2 Lincoln Road | House | 6,659 | 380 | 57,066 |

Source: Knight Frank Research

Note: All transactions are subject to confirmation.

Selected residential lease transactions (February 2020)

| District | Building | Tower / floor / unit | Lettable area (sq ft) | Monthly rent (HK\$) | Monthly rent (HK\$ per sq ft) |
|--------------------|-----------------|-------------------------------|-----------------------|---------------------|-------------------------------|
| Mid-Levels West | Seymour | High floor / unit B | 1,398 | 95,000 | 68 |
| Island South | The Lily | Tower 4 / high floor | 5,644 | 380,000 | 67 |
| Island South | Marinella | Tower 1 / high floor / unit A | 1,949 | 110,000 | 56 |
| Island South | Pacific View | Block 3 / high floor / unit B | 1,674 | 80,700 | 48 |
| Mid-Levels Central | Tregunter Tower | Tower 1/ low floor / unit B | 2,330 | 85,000 | 36 |

Source: Knight Frank Research

Note: All transactions are subject to confirmation.

RETAIL

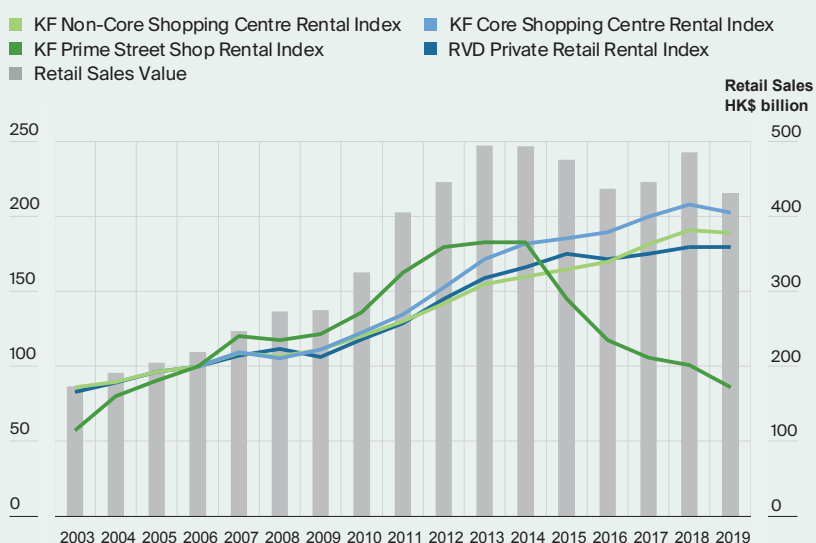
Retailers are in survival mode as headwinds multiply

Hong Kong's latest retail sales figure recorded a significant drop of 21.4% YoY in January as the outbreak of the coronavirus deterred mainland visitor arrivals, disrupted consumer activity and curbed market sentiment. The jewellery & watches industry continued to suffer the worst performance with sales value plummeted 43.5% YoY. Supermarkets, in contrast, enjoyed double-digit growth of 10.2% YoY, reflecting the surge in demand for daily necessities and household merchandise, and trades related to local spending such as fresh food and fuels thrived through the epidemic situation.

Many retailers and F&B operators suspended their operations temporarily to limit losses. The temporary closure of the Jumbo Kingdom restaurant is a case in point. Unfortunately, some of them closed down. For instance, Jamie's

Fig 4. Retail rents and sales

2006 = 100



Source: Knight Frank Research / Rating and Valuation Department / Census and Statistics Department

Italian shut down both of its restaurants which represented its complete withdrawal from the Hong Kong market. Michelin-starred Hong Kong restaurant Rech by Alain Ducasse also closed for good.

As the COVID-19 impact on markets continues to grow, it has shaken up the local retail landscape. The current retail

scene shows that retailers who target local clientele have regained their pivotal role, while the luxury segment and other retailers relying on Mainland visitors no longer dominate. From a long-term perspective, we expect many retailers to redistribute their retail footprint in Hong Kong and the market to recalibrate to cater for the local demand, resulting in greater diversity in retail offerings.

We expect retail sales value in the coming months to continue to fall off a cliff. Furthermore, with vacancy rates of street shops keep rising, shop rentals are expected to shrink further, which extent could be faster than the drop in retail sales. Looking ahead, we expect the COVID-19 pandemic to have a long-term impact on Hong Kong's retail scene and for it to be a long journey for the retail sector on the road to recovery.

Retail sales by outlet type (January 2020)

| Outlet | Value (HK\$ billion) | Share of total % | Change MoM % | Change QoQ % | Change YoY % |
|--|-------------------------|---------------------|-----------------|-----------------|-----------------|
| Jewellery, watches and clocks, and valuable gifts | 4.9 | 13.0 | -5.9 | 25.7 | -41.6 |
| Clothing, footwear and allied products | 4.6 | 12.1 | -6.5 | 54.0 | -27.5 |
| Department stores | 3.5 | 9.4 | -10.4 | 23.7 | -27.0 |
| Fuel | 0.9 | 2.3 | -0.9 | -6.4 | 12.4 |
| Food, alcoholic drinks and tobacco (excluding supermarkets) | 4.4 | 11.6 | 15.3 | 35.3 | -6.8 |
| Consumer durable goods | 5.2 | 13.8 | -6.7 | -8.9 | -20.6 |
| Supermarkets | 5.3 | 14.0 | 22.5 | 17.6 | 10.1 |
| Others | 9.0 | 23.8 | 19.6 | 51.9 | -22.9 |
| All retail outlets | 37.8 | 100.0 | 4.4 | 25.7 | -21.4 |

Source: Knight Frank Research / Census and Statistics Department

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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