This report analyses the performance of Hong Kong's office, residential and retail property markets

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Hong Kong Monthly

September 2020

OFFICE

Tenants grab opportunities to upgrade premises amid rental downtrend

Hong Kong Island

The weak economy and the lingering impact of the COVID-19 pandemic continued to weigh on the Grade-A office market. Rents in Central dropped 20.1% YoY in August, and rents in the overall Hong Kong Island market declined 18.7% YoY. On the bright side, the rent declines have provided a golden opportunity for tenants to upgrade their offices to more premium buildings with attractive packages. For instance, an international law firm, Sullivan & Cromwell relocated from No. 9 Queen's Road Central to Alexandra House with a similar floor area. After all, fundamentally strong companies in the professional services sector still value being located in Central despite the economic uncertainty, riding on falling rents.

While the co-working space industry has been hit hard by the COVID-19 pandemic, there were some new take-ups by local co-working space operators, reflecting their' confidence in the market prospects for flexible workspace. For example, a local co-working space provider, Sky Business Centre, took over an entire 15,000-sq-ft floor in Times Square, which had been surrendered by Kr Space in late 2019.

With market conditions remaining uncertain moving into Q4 2020, we expect the overall vacancy rate for office space to stay high and demand to remain weak. We also expect landlords to be more flexible in lease negotiations and offer lower rents to attract tenants.

Kowloon

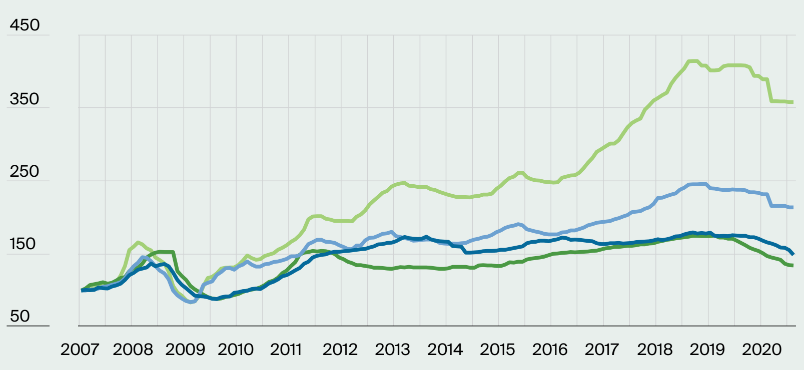
Due to the third wave of COVID-19, Kowloon witnessed a decline in leasing activity in the first three weeks of August, leading to a 14.9% YoY drop in office rents in August. Only at the end of August did business sentiment improve, underpinned by the gradual containment of the disease in Hong Kong and the easing of social-distancing rules, resulting in more tenants enquiring and searching for sizable offices in the market.

Some new leases of over 10,000 sq ft were recorded during the month. One significant lease was Hong Kong Mortgage Corporation's relocation from Sheung Wan to a 73,000-sq-ft space in Two Harbour Square in Kwun Tong. The effective rent of the new lease of HK$24.5 per sq ft per month is reported to be at least 50% lower than its previous unit rent.

At this point, the COVID situation appears to have stabilised in Hong Kong, so we expect the rental declines to narrow, at least for the next month or so. Since future supply is limited, coupled with stable demand from sourcing and electronics companies, office rents in core Kowloon districts are expected to bottom out in the near term.

Fig 1. Grade-A office rents and prices

2007 = 100



Source: Knight Frank Research

Grade-A office market indicators (August 2020)

District	Net effective rent	Change		Price (Gross)	Change	
	HK$ psf / mth	MoM %	YoY %	HK$ psf	MoM %	YoY %
Premium Central	145.5	0.0	-23.3	-	-	-
Traditional Central	110.6	0.0	-17.9	-	-	-
Overall Central	122.4	0.0	-20.1	38,235	0.0	-12.9
Admiralty	83.8	0.0	-20.5	33,815	0.0	-13.7
Sheung Wan	66.4	-3.7	-20.2	30,643	0.0	-10.8
Wan Chai	62.6	-0.5	-18.5	26,950	0.0	-11.6
Causeway Bay	64.9	-0.4	-17.2	23,639	0.0	-10.7
North Point	45.6	0.0	-11.9	-	-	-
Quarry Bay	50.1	0.0	-10.0	-	-	-
Tsim Sha Tsui	57.7	-6.6	-20.0	16,203	0.0	-11.3
Cheung Sha Wan	30.0	-1.1	-9.9	-	-	-
Hung Hom	42.4	-1.9	-5.3	-	-	-
Kowloon East	29.1	-0.8	-8.4	12,135	0.0	-8.1
Mong Kok / Yau Ma Tei	55.2	-0.7	-8.4	-	-	-

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

RESIDENTIAL

Purchase sentiment revives amid an improving COVID-19 situation

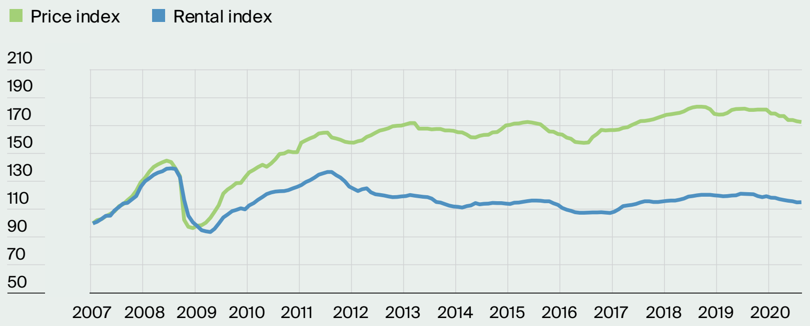
Despite the resurgence of COVID-19 in Hong Kong in August and the subsequent tightening of social distancing restrictions, the market recorded 4,358 sales transactions in August, a 29% decrease MoM, but a 7% increase YoY. With the number of infections dropping gradually in late August, potential buyers became active in flat viewing again, leading to improved sentiment in the residential market.

Against the backdrop of a slight decline of 0.5% in overall residential prices in July, according to the latest official statistics, buying sentiment has been well supported by low interest rates and incentives offered by developers, such as discounted mortgage plans. In the primary market, newly launched projects continued to draw interest, indicated by brisk sales in new projects such as Seacoast Royale and Regency Bay in Tuen Mun.

There were a few notable transactions in the luxury market. For instance, a 2,846-sq-ft duplex unit at Dukes Place in Jardine's Lookout was sold at a unit price of HK$70,274, for a total consideration of HK$200 million. An apartment at 8 Deep Water Bay Drive was sold for HK$180 million, for a unit price of HK$62,688.

Fig 2. Luxury residential rents and prices

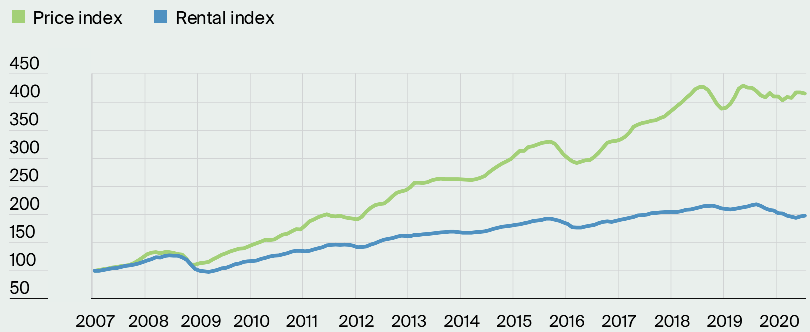
2007 = 100



Source: Knight Frank Research

Fig 3. Mass residential rents and prices

2007 = 100



Source: Knight Frank Research / Rating and Valuation Department

On the leasing front, activity regained momentum as well, with more property owners putting up properties for lease again. At the same time, there were more property viewings and enquiries from prospective tenants, especially in the luxury segment. Most of the leasing transactions were local moves, most at a monthly rent of HK$100,000 to HK$150,000. Although there were no explicit rent reductions, landlords in general were willing to provide some incentives, such as a rent-free period, to attract tenants.

Looking ahead, purchase sentiment in the residential market is expected to remain upbeat as the COVID-19 situation stabilizes. That said, prices will still be under pressure because of protracted unfavourable factors, including the weak economy and rising unemployment rate, which might erode affordability over time. Overall residential prices are expected to fall gradually for the rest of 2020.

Selected residential sales transactions (August 2020)

District	Building	Tower / floor / unit	Saleable area (sq ft)	Price (HK$ million)	Price (HK$ per sq ft)
Jardine's Lookout	Dukes Place	Mid floor / duplex unit	2,846	200	70,274
Island South	8 Deep Water Bay Drive	Tower 2 / mid floor	2,865	179.6	62,688
Ho Man Tin	St. George's Mansions	Tower 1 / high floor / unit A	2,140	115	53,738
Mid-Levels Central	Dynasty Court	Tower 1 / high floor / unit A	2,141	100.8	47,081
Shatin	La Vetta	House	5,129	180	35,095

Source: Knight Frank Research
Note: All transactions are subject to confirmation.

Selected residential lease transactions (August 2020)

District	Building	Tower / floor / unit	Lettable area (sq ft)	Monthly rent (HK$)	Monthly rent (HK$ per sq ft)
Island South	De Ricou	High floor / unit 02	1,310	125,000	95
Tsim Sha Tsui	Rosewood Hong Kong Residences	High floor / flat 12	1,109	100,000	90
Mid-Levels Central	Magazine Gap Towers	Mid floor / unit B	1,899	125,000	66
Mid-Levels Central	Queen's Garden	Block 2 / high floor	2,255	129,000	57
Island South	The Lily	Tower 2 / high floor	2,699	151,000	56

Source: Knight Frank Research
Note: All transactions are subject to confirmation.

RETAIL

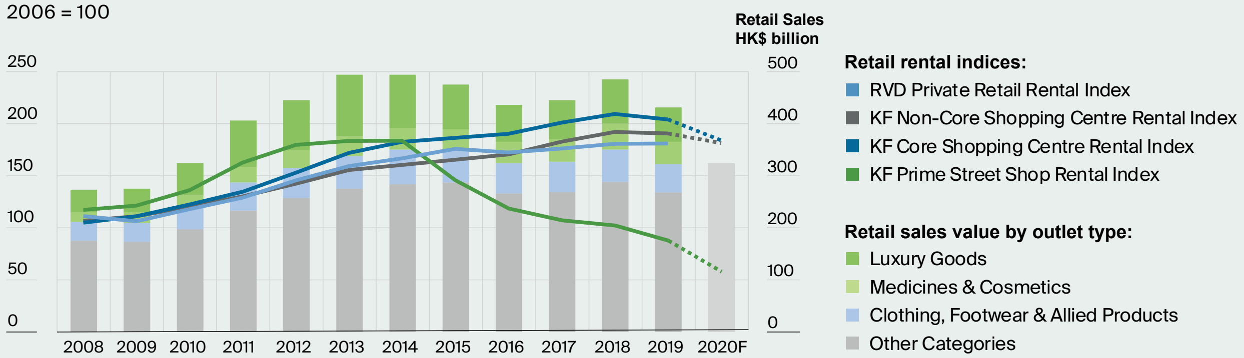
New benchmark set for retail sales as market seen bottoming

Hong Kong's retail sector continued to bear the brunt of the COVID-19 pandemic. With the absence of inbound tourism and a deteriorating labour market, Hong Kong's retail market has seen the worst period in decades, with retail sales value dropping by 23.1% YoY to HK$26.5 billion in July. Again, sales value of luxury goods recorded the largest drop among all categories, plunging 53.7% YoY in July.

As the retail market has faced a severe crash, retailers and landlords have strived to survive in the down-cycle. Setting up pop-up stores has become a lifeline strategy for some retailers. We have seen numerous brands set up thematic pop-up stores as a new sales channel, with wellness the prevalent theme. For some landlords, finding prospective tenants to fill the vacant shops surrendered by retailers is crucial but difficult in these tumultuous times. Rather than

Fig 4. Retail rents and sales

2006 = 100



Source: Knight Frank Research / Rating and Valuation Department / Census and Statistics Department leaving their shops empty, and to help subsequent tenants reduce fitting-out costs, some landlords have rented vacant shops to pop-up store retailers, who sell multi-brand products at discounted prices, with short-term leases.

Since tourist spending has evaporated and local consumers have significantly cut spending on luxury goods during the economic recession, most retail sales so far this year reflect spending on basic necessities. With tourist spending of around HK$140 billion per annum in the past couple of years removed this year, retail sales could bottom out at about HK$320 billion in 2020. This amount, on par with the level in 2010, represents a new benchmark for annual retail sales for Hong Kong as it transitions to a new decade. Since the retail sector can rely only on local consumption for now, sales of luxury goods will constitute only about 10% of total retail sales value compared to 19% a decade ago.

The lingering impact of the COVID-19 pandemic has taken a heavy toll on Hong Kong's luxury retail market, which supported the growth in prime street rents until the past year. The bleak outlook, coupled with competition from e-commerce, suggests that the vacancy rate in prime streets will continue to surge and that prime street shop rentals will continue to face downward pressure for the rest of 2020.

Retail sales by outlet type (July 2020)

Outlet	Value (HK$ billion)	Share of total %	Change MoM %	Change QoQ %	Change YoY %
Jewellery, watches and clocks, and valuable gifts	2.5	9.6	1.4	87.2	-53.7
Clothing, footwear and allied products	2.5	9.3	-8.1	27.3	-44.1
Department stores	2.5	9.6	-24.5	-18.8	-28.8
Fuel	0.9	3.4	-7.7	26.4	3.8
Food, alcoholic drinks and tobacco (excluding supermarkets)	2.7	10.1	-3.7	-10.6	-12.9
Consumer durable goods	4.3	16.4	3.4	3.3	-7.0
Supermarkets	5.7	21.6	22.6	19.7	26.5
Others	5.3	20.0	-1.5	5.5	-32.2
All retail outlets	26.5	100.0	-0.3	9.8	-23.1

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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