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

Knight Frank

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Hong Kong Monthly

March 2021

OFFICE

Growing pool of small to medium-sized companies moving their entire operations to co-working space

Hong Kong Island

In February, overall Grade A office rents on Hong Kong Island adjusted to HK$77.5 per sq ft, falling 14.8% on a YoY basis. Some landlords in Central reviewed their portfolios and adjusted their leasing strategy after Chinese New Year. Smaller landlords under greater vacancy pressure have cut rents more aggressively, offering generous incentives to attract good covenant tenants. However, some landlords of prime buildings that have successfully leased vacant space as a result of rental adjustments and concessions have begun tightening up their leasing strategy.

As flexible working arrangements have become prevalent in the wake of the COVID-19 pandemic, more tenants are taking the opportunity to explore viable alternatives to renting traditional office space. As a result, there is increasing demand for co-working space from small to medium-sized companies, especially those with 50 to 100 staff. Some companies are reportedly considering relocating their entire operations to co-working space.

Looking ahead, as cost-optimisation and high flexibility are set to become major concerns of businesses in the post-pandemic era, demand for co-working space will undoubtedly continue to grow.

Kowloon

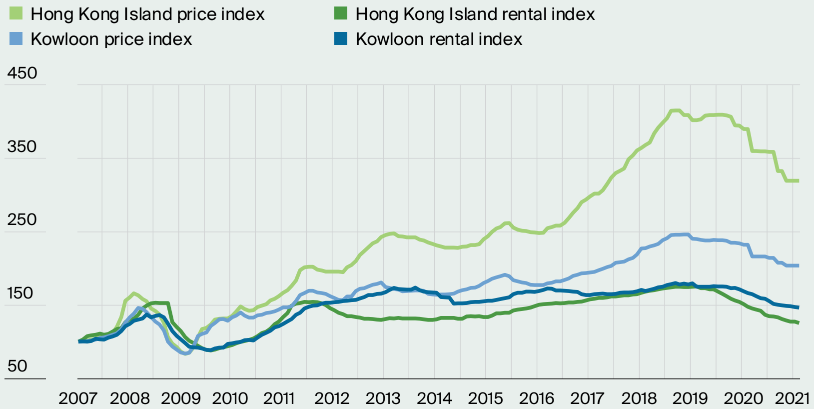
Tenants in Kowloon continued to be cautious and adopt the wait-and-see approach after Chinese New Year, leading to a low level of leasing activity in February. As cost savings are crucial for business amid the economic uncertainty, tenants have tended to renew their leases to avoid the fit-out costs in new premises. About 60% of leasing transactions during the month were renewals. Relocation cases were driven mainly by downsizing. For instance, Sony Corporation moved from a 27,000-sq ft office in Exchange Tower to a 16,800-sq ft space in C-Bons International Center.

In the 2021-22 Hong Kong Budget, the Financial Secretary proposed converting five parcels of commercial land in Kai Tak to residential use, which would incur a total loss of 4.5 million sq ft of future office space. As several sizeable new developments will be completed in late 2022, we expect the conversion to help relieve the burden of potential excessive office supply in Kowloon East and provide a better balance between the office and residential markets.

Given the introduction of the vaccination campaign in Hong Kong and across the globe, an upturn is expected in economic sentiment and business confidence. We expect leasing activity to be more robust in the coming quarters, as more multinational corporations that deferred corporate real estate plans owing to the COVID-19 pandemic will reactivate their plans in the near term.

Fig 1. Grade-A office rents and prices

2007 = 100



Source: Knight Frank Research

Grade-A office market indicators (February 2021)

District	Net effective rent	Change		Price (Gross)	Change	
	HK$ psf / mth	MoM %	YoY %	HK$ psf	MoM %	YoY %
Premium Central	135.2	-2.5	-13.4	-	-	-
Traditional Central	103.5	-0.4	-16.0	-	-	-
Overall Central	114.3	-1.3	-15.0	33,063	0.0	-22.0
Admiralty	76.0	-2.7	-15.7	29,501	0.0	-19.6
Sheung Wan	60.7	0.0	-20.4	27,647	0.0	-17.8
Wan Chai	58.3	-1.1	-15.5	24,748	0.0	-14.0
Causeway Bay	62.4	-2.4	-16.5	21,699	0.0	-15.1
North Point	43.7	0.0	-7.4	-	-	-
Quarry Bay	49.2	-1.4	-8.1	-	-	-
Tsim Sha Tsui	58.3	-0.2	-13.8	15,209	0.0	-14.7
Cheung Sha Wan	28.0	-0.6	-10.8	-	-	-
Hung Hom	42.1	1.4	-5.4	-	-	-
Kowloon East	27.6	-1.5	-9.7	11,817	0.0	-7.9
Mong Kok / Yau Ma Tei	51.3	-3.4	-11.4	-	-	-

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

RESIDENTIAL

Robust home sales defy economic doom and gloom

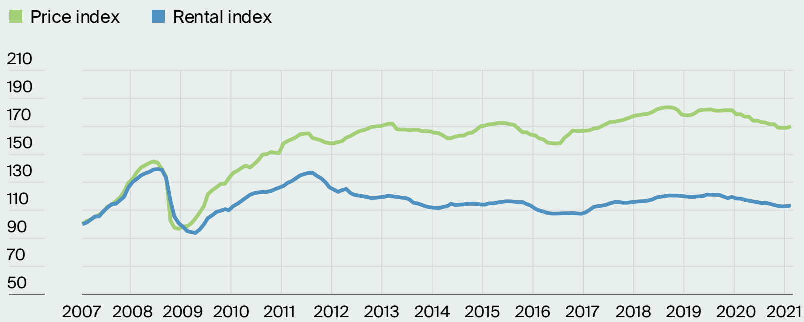
Purchasing sentiment in the residential market improved in February, as the fourth wave of COVID-19 cases slightly receded. Bolstered by the soaring stock market and the prospect of economic recovery, underpinned by the citywide vaccination programme, sales activity was robust during the month. According to the Land Registry, transaction volume increased 34.3% MoM to 6,125 units, of which primary sales accounted for 1,553 cases, a surge of 165% MoM.

Despite the lingering economic uncertainty, top-of-the-line residential assets continued to draw interest from high net-worth buyers. In February, a 3,378-sq ft high-floor unit at CK Asset Holdings' 21 Borrett Road in Mid-Levels Central was sold for a record-breaking HK$459.4 million or HK$136,000 per sq ft. The flat is touted as Asia's most expensive residence in terms of unit price.

The leasing market was also vibrant and has proven resilient despite the contracting economy. There were more enquiries from prospective tenants from overseas who plan to work in Hong Kong when the COVID-19 situation stabilises. During the month, a 10,804-sq ft house in Wharf Holdings' 11 Plantation Road on

Fig 2. Luxury residential rents and prices

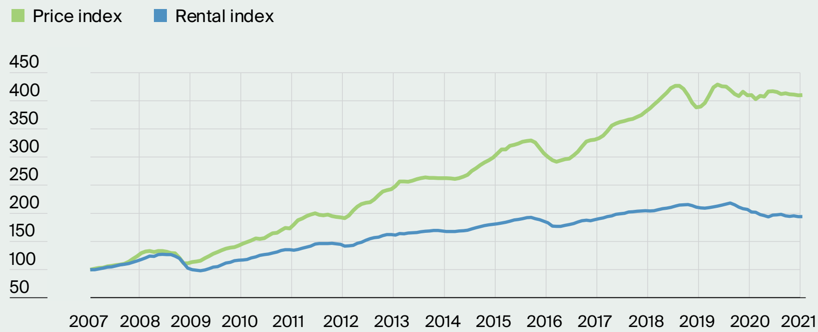
2007 = 100



Source: Knight Frank Research

Fig 3. Mass residential rents and prices

2007 = 100



Source: Knight Frank Research / Rating and Valuation Department

The Peak, was leased at a monthly rent of HK$1,350,000 or HK$125 per sq ft, which is among the highest recorded rents ever for a home in Hong Kong.

The recent significant transactions in the ultra-prime segment indicate that the luxury home market is turning the corner. Looking ahead, we expect developers to be active in launching new project sales, given strong interest from high-end buyers. But the downside risk has not dissipated amid the protracted pandemic. Fears of a fifth wave of COVID-19 infections may pose further uncertainty to the already hard-hit economy. If Hong Kong has to go back to tighter social-distancing rules, sales activity and purchase sentiment in the residential market will inevitably be affected.

Selected residential sales transactions (February 2021)

District	Building	Tower / floor / unit	Saleable area (sq ft)	Price (HK$ million)	Price (HK$ per sq ft)
Mid-Levels Central	21 Borrett Road	High floor	3,378	459.4	136,000
The Peak	77 Peak Road	House	7,388	598	80,942
Shek Kip Mei	Mont Rouge	House	2,846	159.5	56,044
Tai Tam	Le Palais	House	3,447	125.3	36,359
Clear Water Bay	Villa Cove	House	3,986	120	30,105

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

Selected residential lease transactions (February 2021)

District	Building	Tower / floor / unit	Lettable area (sq ft)	Monthly rent (HK$)	Monthly rent (HK$ per sq ft)
Island South	9 Headland Road	House	2,808	157,000	56
Island South	Harston, The Repulse Bay	High floor / unit A	1,970	102,000	52
Mid-Levels East	Bamboo Grove	Block 82 / high floor	2,191	108,000	49
Mid-Levels Central	The Harbourview	Low floor / unit A	2,036	98,000	48
Island South	The Lily	Tower 2 / low floor	2,625	115,000	44

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

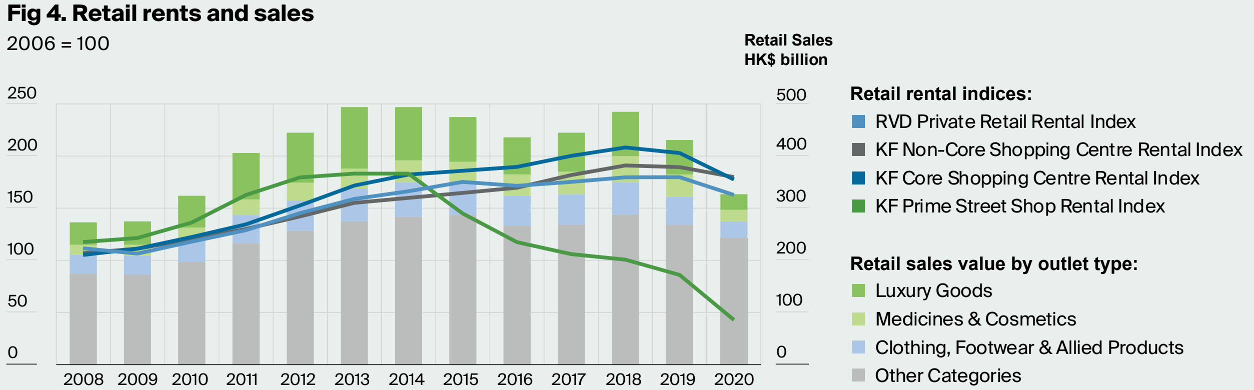
RETAIL

Weak luxury goods sales continue to exert pressure on prime shop rents

Hong Kong's retail market remained sluggish despite social-distancing restrictions being slightly relaxed after Chinese New Year. According to the latest official statistics, retail sales value dropped by 13.6% YoY to HK$32.6 billion in January. The value of online retail sales was HK$2.4 billion, accounting for 7.3% of total retail sales value in January. The proportion was 3.3% in January 2020 before Hong Kong was hit by the COVID-19 outbreak. This shows that the pandemic has driven up e-commerce volume sharply, as many consumers have shifted spending from brick-and-mortar stores to online shops.

Fig 4. Retail rents and sales

2006 = 100



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

The luxury sector has remained mired in a prolonged slump because of the absence of inbound tourism. The sales value of luxury goods was HK$3.4 billion in January, the highest since February 2020, albeit a 31.7% YoY drop. This implies that luxury sales might have reached a peak and that sales value is likely to hover at around HK$3 billion per month until the border reopens.

As business has been shaken badly in the absence of inbound tourists, some international luxury brands, which are the drivers of rents on prime streets and in premium shopping centres, continued to consolidate and reduce their presence in the city. Recently, luxury brands Louis Vuitton and FENDI closed their stores in Times Square in Causeway Bay, reflecting the difficult predicament facing the local luxury retail industry, which used to rely heavily on the large influx of mainland tourists, amid a bruising recession and in the massive drop in tourist arrivals.

The retail market outlook will continue to be gloomy in the coming months, as the effectiveness of the mass vaccination programme and the opening of the border remain uncertain. The government's announcement in the latest Budget that it would distribute HK$5,000 in electronic spending coupons to encourage domestic consumption is expected to provide limited support to the retail property market. The scheme may drive sales only during the five months when the coupons are effective, so they are unlikely to drive new leasing demand from retailers. Given the poor sales of luxury brands and the soaring street shop vacancy rate, we expect prime street rents to continue to be under considerable pressure in the near term.

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	3.4	10.3	9.3	17.6	-31.7
Clothing, footwear and allied products	3.5	10.7	1.1	31.6	-23.4
Department stores	2.9	9.0	-9.5	-9.0	-17.4
Fuel	0.8	2.4	-2.0	-14.6	-11.0
Food, alcoholic drinks and tobacco (excluding supermarkets)	3.7	11.3	12.4	21.3	-16.3
Consumer durable goods	6.4	19.5	-3.1	29.8	21.8
Supermarkets	4.8	14.7	-0.2	4.3	-9.0
Others	7.2	22.1	16.7	37.0	-19.5
All retail outlets	32.6	100.0	3.9	18.8	-13.6

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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