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

Knight Frank

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Hong Kong Monthly

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OFFICE

Rents in the CBD hit hardest amid cost-saving measures

Hong Kong Island

The COVID-19 pandemic continues to depress office rents during the month, with rents in Central and Admiralty dropping 18.6% and 22.2% YoY, respectively, extending the decline to 11 consecutive months. With current rents adjusted significantly downwards, cost-conscious occupiers started to seek bargain deals in the down market, triggering more leasing activity than in the previous month. In Island East, however, as office vacancies remained at a low level (Quarry Bay: 0.5%, North Point: 5.1%), rents in the area remained stable.

The pandemic has forced companies to adopt work-from-home and split-team operation arrangements, which has led to the growing use of technology and a reduction in onsite staff in the office. Whether these changes result in a long-term structural change to the Hong Kong workplace remains to be seen. But many occupiers are now considering their operations and exploring the feasibility of agile and flexible office space, office utilisation rates and remote working.

In the coming months, we expect landlords to be more flexible in negotiating new lease, renewal and lease restructure amid the weakening global economy.

Kowloon

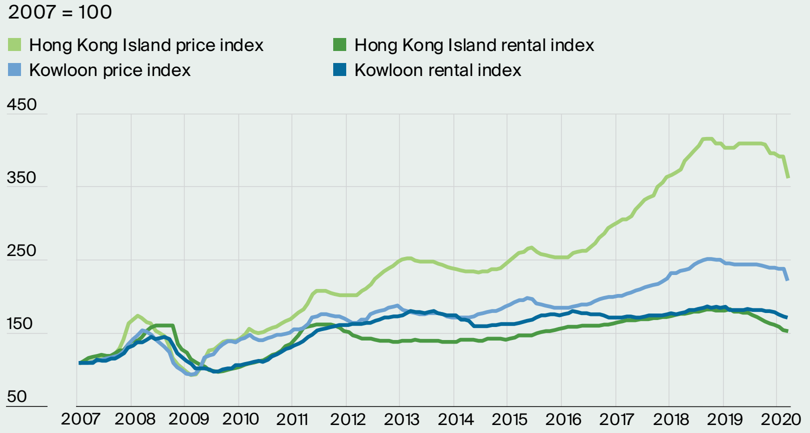
Office-leasing activity on Kowloon side remained sluggish, with an increasing number of tenants undertaking a wait-and-see approach in March. Leasing activity was dominated by renewal leases and a handful of cases of expansion and relocation in lower unit rents. For instance, an American fashion brand relocated and expanded from its 6,000 sq ft-office in Harbourfront APEX in Hung Hom to a 17,000 sq-ft space in C-BONS in Kwun Tong at an effective rent of HK$26.5 per sq ft per month, which is 35% lower than its previous unit rent.

Most of the new office lettings in March were small premises of less than 3,000 sq ft. As more tenants have implemented cost-saving measures, demand for higher-end buildings started to edge down, leading to a drop in their rents. For instance, rents in premium buildings in Tsim Sha Tsui and Mong Kok fell 4.7% and 3.5% QoQ, respectively.

During the month, more tenants adopted remote virtual inspections as an alternative to on-site inspections amid the public gathering ban by the government as one of the anti-epidemic measures. As economic uncertainty mounts, we expect the higher-end buildings in Kowloon to see stronger downward pressure in rents.

Fig 1. Grade-A office rents and prices

2007 = 100



Source: Knight Frank Research

Grade-A office market indicators (March 2020)

District	Net effective rent	Change		Price (Gross)	Change	
	HK$ psf / mth	MoM %	YoY %	HK$ psf	MoM %	YoY %
Premium Central	153.4	-1.7	-20.6	-	-	-
Traditional Central	119.6	-3.0	-17.3	-	-	-
Overall Central	131.0	-2.5	-18.6	38,563	-9.1	-10.6
Admiralty	90.1	0.0	-22.2	33,939	-7.5	-12.1
Sheung Wan	76.2	0.0	-11.4	30,793	-8.4	-9.1
Wan Chai	69.1	0.0	-11.7	26,950	-6.3	-10.3
Causeway Bay	74.8	0.0	-10.5	23,699	-7.2	-8.9
North Point	47.2	0.0	-9.5	-	-	-
Quarry Bay	52.4	-2.1	-3.2	-	-	-
Tsim Sha Tsui	66.8	-1.2	-6.8	16,355	-8.3	-9.9
Cheung Sha Wan	31.2	-0.4	-5.1	-	-	-
Hung Hom	44.5	0.0	0.6	-	-	-
Kowloon East	30.3	-0.6	-5.3	12,256	-4.5	-8.7
Mong Kok / Yau Ma Tei	57.1	-1.3	-3.3	-	-	-

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

RESIDENTIAL

Luxury market remained stable, given strong holding power of owners

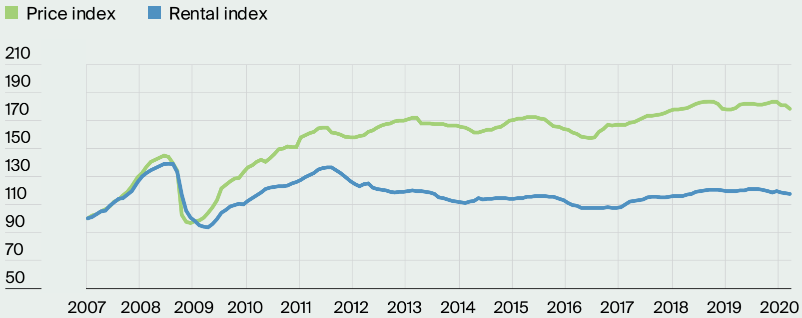
With the COVID-19 pandemic continuing to ravage the world, almost all levels of Hong Kong's economy have been affected. As the unemployment rate is picking up, purchasing sentiment in the mass residential market has been further eroded. According to the latest official figures, overall residential price has dropped by 6.6% from the peak in May last year. Given the current downtrend in the market, negative equity cases are gradually emerging.

With demand shrinkage, the luxury residential market was quiet, with low transaction volume. The asking prices for luxury properties stayed largely flat, however, as most landlords are in a stable financial position. This is in contrast to conditions in the mass residential market, where some property owners were desperate to cash in by selling their units, so prices continued to be under pressure.

In the leasing market, overall demand was weak, as immigration controls stopped expats from coming to Hong Kong and there was less demand from Mainland Chinese tenants with high budget. The mass leasing market in certain areas with large amount of supply was affected.

Fig 2. Luxury residential rents and prices

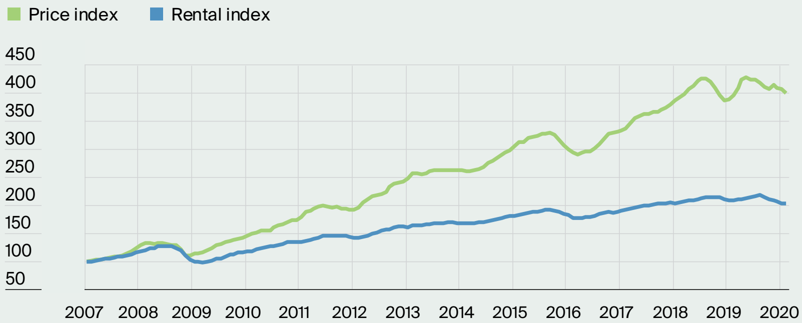
2007 = 100



Source: Knight Frank Research / Rating and Valuation Department

Fig 3. Mass residential rents and prices

2007 = 100



Source: Knight Frank Research / Rating and Valuation Department

Looking ahead, more economic pain is expected for the city, given the gloomy global economic outlook. However, luxury residential prices are unlikely to fall off the cliff, given the combination of strong holding power of owners and scarcity. In the short term, mass residential prices are expected to be more volatile. Although the number of negative equity cases is expected to rise, the adverse impact on the market will be limited as most of the mortgage borrowers with high LTV ratio should have passed stress test and so far it is unlikely to see foreclosure properties to increase substantially in the market.

Selected residential sales transactions (March 2020)

District	Building	Tower / floor / unit	Saleable area (sq ft)	Price (HK$ million)	Price (HK$ per sq ft)
Island South	90 Repulse Bay Road	House	5,862	469	80,000
North Point	Fleur Pavilia	Tower 3 / duplex unit	2,282	116.8	51,200
Happy Valley	Jardine Terrace	House	2,385	104	43,606
Island South	Bel-Air on the Peak	Tower 3 / high floor / unit A	1,975	82	41,519
The Peak	Mountain Lodge	High floor / unit A	2,415	85	35,197

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

Selected residential lease transactions (March 2020)

District	Building	Tower / floor / unit	Lettable area (sq ft)	Monthly rent (HK$)	Monthly rent (HK$ per sq ft)
Island South	The Lily	Tower 4 / high floor	2,584	155,000	60
Island South	South Bay Close	Block A / low floor	1,560	80,000	51
Mid-Levels Central	Garden Terrace	Block 3 / low floor / unit A	2,828	120,000	42
Mid-Levels Central	Tregunter	Tower 1 / low floor / unit B	2,330	85,000	36
Mid-Levels West	Scenic Villas	Block A3 / mid floor / unit J	2,311	82,000	35

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

RETAIL

Structural changes prompted retailers to adjust swiftly

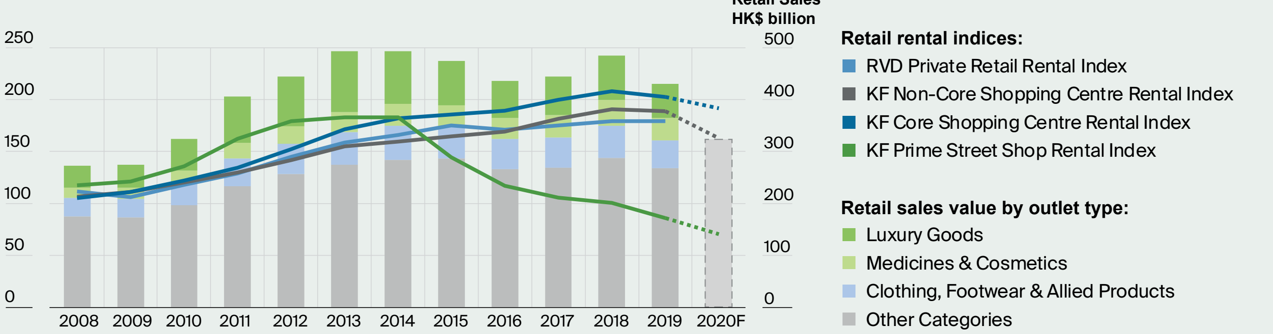
The Hong Kong retail market recorded the worst performance in a decade, as residents avoided going out, and travel restrictions kept tourists away. Retail sales plunged 44.0% YoY in February to HK$22.7 billion, the lowest since September 2009. Taking into account the impact of Chinese New Year, total sales for January and February still dropped by 33.9% YoY.

The luxury retail sector collapsed after months of social unrest, followed by the COVID-19 pandemic. Luxury brands closed their stores one after another, with some leaving the market temporarily. A recent notable case was Italian fashion brand Valentino's closure of its flagship store on Canton Road in Tsim Sha Tsui.

With luxury brands struggling to survive, tenants with lower rental affordability but stable sales performance, such as supermarkets, fitness centres and homes

Fig 4. Retail rents and sales

2006 = 100



Source: Knight Frank Research / Rating and Valuation Department / Census and Statistics Department for the elderly, seized the opportunity in the downbeat market to expand their presence. For example, Japanese grocery store chain Don Don Donki rented a 17,000-sq-ft shop on Queen's Road Central. This is the fifth opening for the grocery chain since it entered the Hong Kong market last year.

Since the social movement last year, some people have preferred to stay at home, resulting in lower consumption. The frequency of dining out has dropped, with annual restaurant receipts seeing the first drop in 10 years. The deepening economic recession has also made people tighten their spending. Retailers and F&B operators have had to adopt swift changes to cater for changing market demand, such as offering delivery services and stocking more mid- to low-priced products.

We forecast that retail sales value will hover at a low level in the first half of this year, with a slight improvement in the second half if the epidemic is mitigated. Total retail sales value in 2020 is expected to return to the level in 2010, at about HK$320 billion. As the retail market is undergoing a structural change, rental performance is expected to continue to fall this year.

Retail sales by outlet type (February 2020)

Outlet	Value (HK$ billion)	Share of total %	Change MoM %	Change QoQ %	Change YoY %
Jewellery, watches and clocks, and valuable gifts	1.6	6.8	-68.5	-53.0	-78.5
Clothing, footwear and allied products	1.7	7.4	-62.9	-48.1	-71.2
Department stores	1.8	7.8	-49.7	-52.1	-58.0
Fuel	0.7	3.1	-21.2	-22.9	-0.3
Food, alcoholic drinks and tobacco (excluding supermarkets)	3.4	15.1	-21.8	8.5	-12.4
Consumer durable goods	3.9	17.1	-25.6	-29.7	-28.7
Supermarkets	4.8	21.0	-9.5	11.0	12.2
Others	4.9	21.6	-45.0	-14.6	-44.9
All retail outlets	22.7	100.0	-39.8	-24.0	-44.0

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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