Cost savings by downsizing or decentralization dominate the market

HONG KONG ISLAND
Overall net effective rents were HK$67.5 per sq ft in July, dropping 0.3% MoM and 2.8% year to date (YTD). Among the major submarkets, overall Central and Causeway Bay recorded a larger rental decline at 0.6% and 0.7% MoM and 4.8% and 4.7% YTD, respectively.

Over the past month, there has been a more obvious cost savings trend involving downsizing or relocating to decentralized areas. Meanwhile, the flight-to-quality trend persists. Some less cost-sensitive occupiers took the opportunity of the rental downturn for office quality upgrades with a similar budget. Most of the leasing transactions involved small to medium-sized office space of about 3,000 to 4,000 sq ft. For instance, an investment management firm upgraded its office from Man Yee Building to Two IFC.

Supported by more affordable rents, office space in Wan Chai, Causeway Bay and Quarry Bay has been gradually filling up, driving down vacancy rates to 10.2%, 8.9% and 15.1%, respectively, in July. Compared to decentralized areas, we expect a potential upward trend in Central’s vacancy rate in the near term due to the continued cost-saving trends involving decentralization and downsizing.

KOWLOON
Market sentiment improved slightly in July as evidenced by an increase in transaction volume and size. Kowloon East and Tsim Sha Tsui were the primary focus among all sub-districts, as new buildings and competitive rents continued to attract attention from tenants. Companies in the manufacturing, shipping and logistics industries were the major demand drivers last month, with size optimisation and improved quality the reasons for moving. One large example was Avery Dennison’s relocation to Manulife Place in Kwun Tong to improve its proximity to the MTR.

Amid improved market sentiment, the average monthly rents in Kowloon moved upward to HK$22.5 per sq ft in July, and the average size of leasing transactions rose to 4,600 sq ft.

The market in July followed what was predicted in the first half of the year, when we expected a bottom-out and rebound in the Kowloon market by year end. As the trend of pursuing better cost-performance continues, this will continue to drive demand in the Kowloon market to neutralise the supply surplus. We expect marginal rental growth with a less pessimistic market in 2H 2023.

Fig 1. Grade-A office rents and prices
2007 = 100

Source: Knight Frank Research
Chinese mainland property crisis continues to affect investor confidence

The residential market appears to be reeling, with both volume and prices drifting down. Overall residential prices recorded a 0.5% MoM decline in June, down for the second consecutive month after a four-month rally in early 2023, further narrowing the YTD gain to 4.3%, according to the Rating and Valuation Department shows.

In addition to high mortgage rates and unsold inventories, the economy remained uncertain in both Hong Kong and the Chinese Mainland with the ongoing spread of contagion risk among Chinese developers. Recently, some of China’s leading private real estate developers have shown signs of a liquidity crisis, with missed interest payments on bonds and suspended payments on offshore debt. The Hang Seng Index has slumped accordingly, weighing heavily on sentiment.

The number of residential transactions struck a four-month low of 3,065 in July, down 15.2% MoM, among them, primary sales fell by 20.5% MoM, while secondary sales also fell by 13.1% MoM, indicating overall transaction volume remained under pressure.

The luxury residential market was more resilient than the mass market, given the scarce supply and strong holding power of existing owners. According to our data, overall luxury residential prices recorded a monthly drop of 0.3% or 1.8% YTD in July. Major transactions during the month included a 3,736-sq-ft house in Severn 8 at the Peak, which was sold for HK$300 million (or HK$80,300 per sq ft). Another 7,083 sq-ft house in La Villa de La Salle in Kowloon Tong was transacted for HK$254.8 million (or HK$35,973 per sq ft).

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**Fig 2. Luxury residential rents and prices**

2007 = 100

- Price index
- Rental index

Source: Knight Frank Research

**Fig 3. Mass residential rents and prices**

2007 = 100

- Price index
- Rental index

Source: Knight Frank Research / Rating and Valuation Department

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Residential

- Chinese mainland property crisis continues to affect investor confidence
The leasing market outperformed the sales market, as we note an increasing number of expat families trickling back to Hong Kong. Leasing demand for high-quality units in the Peak and Southern District saw an uptick. Notable transactions were recorded during the month, including a 3,527-sq-ft house on Plantation Road at the Peak, which was leased for about HK$340,000 per month (or HK$96 per sq ft), and a 4,190-sq-ft house in Residence Bel-Air Phase 5 in Pokfulam, which was leased for HK$245,000 per month (or HK$58 per sq ft). In addition, the mass market, typically areas around universities, was invigorated by the influx of overseas students prior to the beginning of the new academic year.

Under the current market headwinds, sell-offs are set to endure amid weakening purchasing power. Meanwhile, the market is sluggish as prospective buyers are observing whether the Fed will pause the rate hikes in September.

Retail

Market momentum improved softly amid the rebound in tourism but it is still far below pre-pandemic levels.

Hong Kong’s retail industry has been recovering gradually since the city’s borders were reopened at the beginning of the year. Total retail sales value in June recorded an uptick of 19.6% YoY to HK$33.1 billion. However, the increase in sales was due mainly to the low base effect in the same period last year. There are concerns that the upward trend may not be sustained owing to the ongoing increase in residents traveling outside Hong Kong.
In 1H 2023, the value of total retail sales registered an increase of 20.7% YoY but was still 15% lower than the pre-pandemic level in 2019. Visitor arrivals have been rising considerably since the reopening of the borders. The number of visitor arrivals in 1H 2023 increased to over 12.9 million from just 76,000 a year earlier. About 78% of the visitors were from the Chinese Mainland. But the arrivals figures have yet to return to the pre-pandemic level of 34.8 million in 1H 2019. Also, according to Hong Kong Tourism Board, the spending habits of Chinese mainland tourists have changed, with fewer coming to Hong Kong primarily for shopping. Young Chinese tourists are now more interested in arts and cultural activities.

In contrast, Hong Kong residents’ outbound travel, especially to the Chinese Mainland, has risen drastically since the reopening of the borders. According to the Immigration Department, 5,001,493 Hong Kong residents travelled to the Mainland in July. We believe the trend of Hong Kong residents traveling to the Mainland for short vacations and consumption will persist and become increasingly popular. With more local residents traveling outside Hong Kong than inbound tourists, it has sent a worrying signal to the retail market in Hong Kong.

On the leasing front, there were finally some signs of improvement in retail rents, thanks to the rebound in tourism. Notably, an 818-sq-ft ground floor retail unit at 45 Haiphong Road, Tsim Sha Tsui, was leased to a pharmacy for HK$300,000 per month (HK$367 per sq ft), representing an increase of nearly 70% in rent compared to the previous lease. Overall, we expect to see silver linings ahead with moderate growth of 0-5% in retail rents this year due to a falling shop vacancy rate in prime locations.

### Retail sales by outlet type (June 2023)

<table>
<thead>
<tr>
<th>Outlet</th>
<th>Value (HK$ billion)</th>
<th>Share of total (%)</th>
<th>Change MoM (%)</th>
<th>Change QoQ (%)</th>
<th>Change YoY (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jewellery, watches and clocks, and valuable gifts</td>
<td>5.6</td>
<td>16.8</td>
<td>9.3</td>
<td>9.6</td>
<td>64.4</td>
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<tr>
<td>Clothing, footwear and allied products</td>
<td>3.9</td>
<td>11.9</td>
<td>-14.9</td>
<td>-11.0</td>
<td>33.1</td>
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<tr>
<td>Department stores</td>
<td>2.7</td>
<td>8.2</td>
<td>-24.2</td>
<td>-2.6</td>
<td>4.2</td>
</tr>
<tr>
<td>Fuel</td>
<td>0.9</td>
<td>2.7</td>
<td>-0.2</td>
<td>0.6</td>
<td>-19.1</td>
</tr>
<tr>
<td>Food, alcoholic drinks and tobacco (excluding supermarkets)</td>
<td>3.0</td>
<td>9.1</td>
<td>-1.9</td>
<td>3.6</td>
<td>6.6</td>
</tr>
<tr>
<td>Consumer durable goods</td>
<td>4.9</td>
<td>14.7</td>
<td>7.4</td>
<td>-4.9</td>
<td>13.3</td>
</tr>
<tr>
<td>Supermarkets</td>
<td>4.2</td>
<td>12.6</td>
<td>-3.7</td>
<td>1.6</td>
<td>-3.4</td>
</tr>
<tr>
<td>Others</td>
<td>8.0</td>
<td>24.0</td>
<td>-4.8</td>
<td>-3.1</td>
<td>28.3</td>
</tr>
<tr>
<td>All retail outlets</td>
<td>33.1</td>
<td>100.0</td>
<td>-4.0</td>
<td>-1.2</td>
<td>19.6</td>
</tr>
</tbody>
</table>

Source: Knight Frank Research / Census and Statistics Department

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**We like questions. If you’ve got one about our research, or would like some property advice, we’d love to hear from you.**

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