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

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OFFICE

Hong Kong occupiers defer decisions, while US-listed Chinese enterprises provide a ray of hope

Hong Kong Island

Owing to a resurgence in the number of local COVID-19 cases and the return of social-distancing measures, the growth momentum witnessed in the office leasing market in Q4 2021 was inevitably pulled back. Tenants generally took a wait-and-see approach, leading to a high vacancy level of 8.5% for Hong Kong Island. Among the submarkets, Wan Chai recorded the highest vacancy rate of 11.8%.

Driven by the anticipated return of US-listed Chinese enterprises and the growing appetite from finance and cryptocurrency firms, the rental level in Central, especially in premium Grade-A buildings, continued to pick up. For example, a multinational bank recently added 17,515 sq ft in Champion Tower for an in-house expansion. This trend is expected to persist until mid-2023, when the next batch of new office supply, including The Henderson and Cheung Kong Center II, become available in the CBD.

Given the city's experience in dealing with the pandemic, business activity and sentiment during the recent outbreak may not have been affected as heavily as it was last year. Rental levels in the overall market will be supported by an uptick in the CBD. However, other submarkets may witness a further reduction in rents. This will be especially evident in Island East, given 0.9 million sq ft of new supply in Two Taikoo Place in 2022.

Kowloon

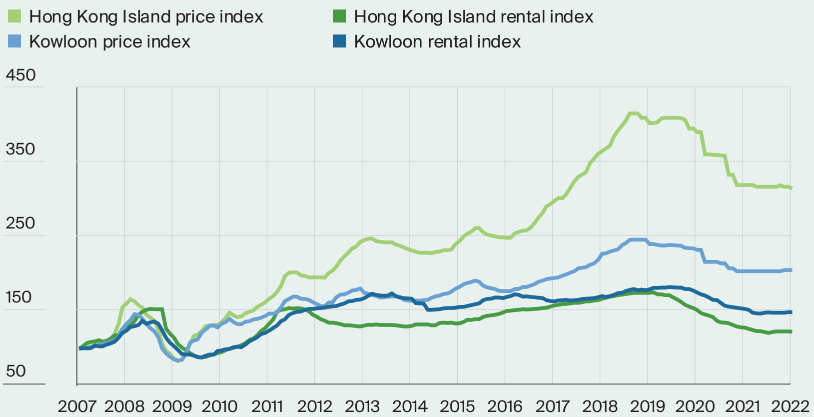
Market activity was strong, and rents in Kowloon continued to bottom out in the first three weeks of January. However, the outbreak of the fifth wave of the pandemic abruptly hampered market activity and business sentiment. Many on-site inspections were cancelled, and rents started to drop before Lunar New Year. During the month, most of the leasing activity was in Kowloon East and Cheung Sha Wan, mainly in the electronics and sourcing sectors, at an average rent of HK$22 per sq ft or less.

Tenants reconsidered their real estate plans at the beginning of the year, leading to more transactions of sizable new leases at market level. For instance, financial institution China Merchant Securities relocated from Exchange Square in Central to a 37,500 sq ft office in AIRSIDE at HK$26.5 per sq ft, while logistics company FedEx rented 33,400 sq ft in Landmark East at HK$24.5 per sq ft.

The fifth wave of COVID-19 disrupted the bottoming-out trend. Sizable relocation cases came to a halt starting in mid-January, and more short-term renewals and restructuring cases started to appear amid weak business sentiment. We expect tenants to slow down their business decision-making progress in the face of mounting uncertainties, resulting in subdued leasing momentum and a low level of activity in the first quarter.

Fig 1. Grade-A office rents and prices

2007 = 100



Source: Knight Frank Research

Grade-A office market indicators (January 2022)

District	Net effective rent	Change		Price (Gross)	Change	
	HK$ psf / mth	MoM %	YoY %	HK$ psf	MoM %	YoY %
Premium Central	134.2	0.1	-2.8	-	-	-
Traditional Central	104.0	0.0	0.0	-	-	-
Overall Central	114.2	0.0	-1.2	33,063	-0.9	0.0
Admiralty	73.1	-0.7	-6.3	29,049	-0.7	-1.5
Sheung Wan	60.2	-2.3	-0.7	27,147	-0.7	-1.8
Wan Chai	53.4	-0.2	-9.4	24,348	-0.8	-1.6
Causeway Bay	60.8	0.4	-5.3	21,299	-0.9	-1.8
North Point	41.6	-2.4	-4.8	-	-	-
Quarry Bay	52.3	-0.8	-8.3	-	-	-
Tsim Sha Tsui	57.5	0.2	-1.6	15,209	0.0	0.0
Cheung Sha Wan	28.7	-0.2	1.9	-	-	-
Hung Hom	39.6	-1.7	-4.6	-	-	-
Kowloon East	29.8	-0.7	-5.1	12,017	0.0	1.7
Mong Kok / Yau Ma Tei	50.3	0.0	-5.2	-	-	-

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

RESIDENTIAL

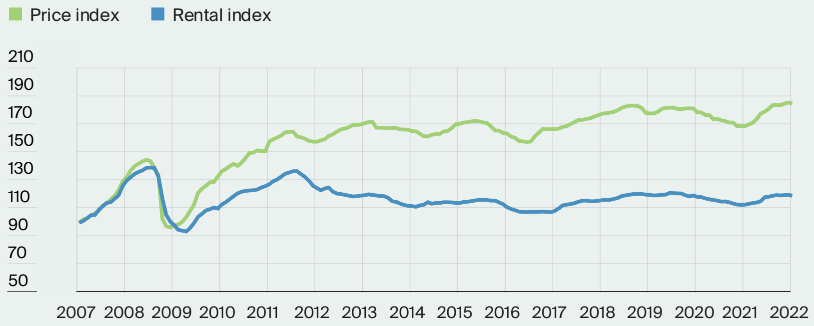
Fifth wave of COVID-19 dents market sentiment

Owing to the outbreak of the fifth wave of the pandemic, market activity slowed down abruptly in both the primary and secondary residential markets. A total of 4,275 transactions were recorded in January, for a consideration of HK$43.4 billion, dropping 16.9% MoM in the primary market and 10.5% MoM in the secondary market. Primary sales slipped 28.6% MoM to 1,081 because of a limited number of newly launched projects before Lunar New Year.

In the mass market, both property owners and potential buyers turned cautious, putting sales and purchase plans on hold, leading to a sharp fall in the number of enquiries and unit views. In the buyers' market, a small number of sellers were desperate and cut prices substantially to sell their properties, resulting in some isolated unexpectedly low-price transactions in blue-chip estates.

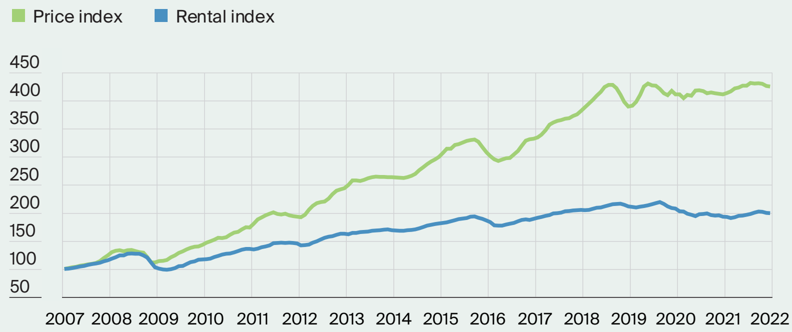
Despite this, unique and exclusive luxury properties were still sought-after by wealthy buyers. Notable transactions in January include a 3,548-sq-ft-unit at 8 Deep Water Bay Drive in Deep Water Bay, which sold for HK$393.2 million; and a unit at University Heights in Mid-Levels West, which sold for HK$258 million or HK$84,358 per sq ft.

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

Likewise, in the land sale market, a premium residential site received an enthusiastic response from developers. Local developer SEA Holdings won the luxury residential site in Repulse Bay for HK$1.19 billion, or an accommodation value of about HK$62,352 per sq ft. The unit price was the highest-ever for land sold through government tender, breaking the record of HK$50,010 set by a consortium led by Wharf Holdings for a site on The Peak in February last year. This demonstrates developers' confidence in the outlook for the luxury residential market in Hong Kong.

Because of the worsening fifth wave of the pandemic and tightened social distancing restrictions, developers will likely delay or reschedule their launch plans for new projects. Overall residential market sentiment and activity are expected to remain inactive in the near term.

Selected residential sales transactions (January 2022)

District	Building	Tower / floor / unit	Saleable area (sq ft)	Price (HK$ million)	Price (HK$ per sq ft)
Island South	8 Deep Water Bay Drive	Tower 1 / high floor / unit B	3,548	393.2	110,831
The Peak	Twelve Peak	House	4,391	387	88,135
Mid-Levels West	University Heights	Tower 1 / high floor / unit A	3,059	258.1	84,358
Mid-Levels Central	21 Borrett Road	High floor / unit 6	2,169	166.8	76,902
Wong Chuk Hang	La Marina	Tower 1A / high floor / unit A	1,848	139	75,216

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

Selected residential lease transactions (January 2022)

District	Building	Tower / floor / unit	Lettable area (sq ft)	Monthly rent (HK$)	Monthly rent (HK$ per sq ft)
Mid-Levels Central	Branksome Grande	Low floor / unit B	2,278	145,000	64
Mid-Levels Central	Tavistock	Low floor unit	3,838	222,000	58
Island South	Regalia Bay	House	3,379	180,000	53
Mid-Levels Central	Tregunter	Tower 3 / high floor / unit D	3,014	150,000	50
Pok Fu Lam	Residence Bel-Air	House	4,190	200,000	48

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

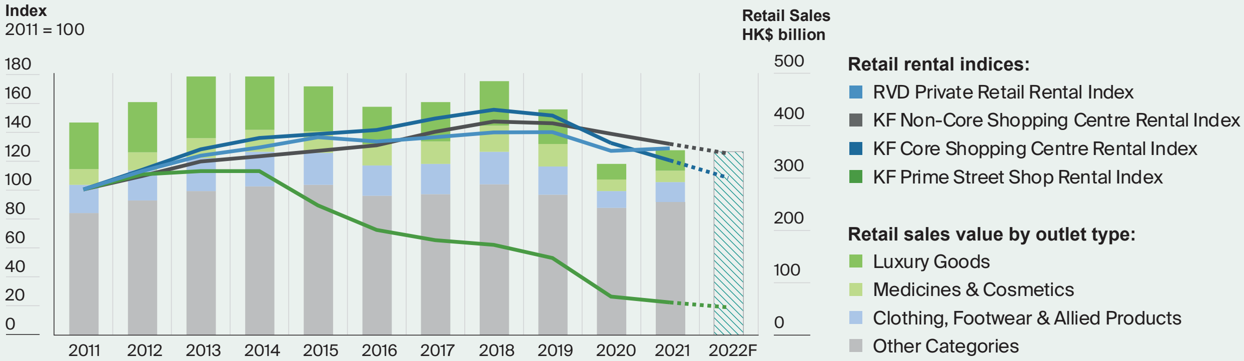
RETAIL

Exceptional uncertainty dimming hopes to short-term recovery

The resurgence of COVID-19 infections in the community prompted the government to re-impose stringent social distance restrictions in recent weeks. The epidemic has repeatedly delayed border reopening plans, and retailers missed the important consumption seasons of Chinese New Year and Valentine's Day. In addition, starting from 24 February, only vaccinated people will be permitted in shopping malls, supermarkets and other specified premises under a "vaccine pass" scheme. All these measures have severely dampened consumer sentiment and impacted footfall, and will take a heavy toll on the retail sector.

Under the current social distancing rules, F&B sector is among the most affected. While there was some light at the end of the tunnel by entering 2022, the

Fig 4. Retail rents and sales



Source: Knight Frank Research / Rating and Valuation Department / Census and Statistics Department current COVID outbreak has significantly dampened not only their short-term performance but could drive some operations out of business, especially for those large-scale restaurants at over 20,000 sq ft. Based on the experience in the previous few waves of pandemic, there is reason to believe that restaurant receipts could drop over 30% during the current outbreak, despite the partial adaptation to delivery operation.

Being different to the first waves of pandemic, sales performance in community malls are not suffering less as the current outbreak is spreading across the city. Community lockdowns and compulsory testing have significantly lowered the footfall in most shopping centres in both core and non-core areas. Necessity retailers are the only ones who manage to sustain their business, but not those who take up significant space, drive high-value sales and boost rents.

We believe that the latest round of measures under the Anti-epidemic Fund will provide some timely relief to retailers. Moreover, major landlords such as MTR, Link REIT and Swire Properties are going to offer rental subsidies to help tenants of premises affected by the pandemic. However, given the severe epidemic situation, retailers are still in dire straits and potential tenants are not confident in opening new stores. In battling the challenging environment amid exceptional uncertainty, landlords and tenants should work together and try to find a mutually beneficial solution. For instance, online-offline strategy could be further extended to landlords' participation, while tenants' involvement in placemaking could be raised further.

Retail sales by outlet type (December 2021)

Outlet	Value (HK$ billion)	Share of total %	Change MoM %	Change QoQ %	Change YoY %
Jewellery, watches and clocks, and valuable gifts	3.8	11.5	20.5	20.7	24.0
Clothing, footwear and allied products	3.9	11.6	18.6	53.3	12.5
Department stores	3.3	10.0	-6.9	25.7	2.5
Fuel	0.9	2.8	-0.3	-7.4	18.3
Food, alcoholic drinks and tobacco (excluding supermarkets)	3.2	9.5	14.6	-7.1	-3.0
Consumer durable goods	6.9	20.7	1.7	26.6	5.2
Supermarkets	4.5	13.5	6.1	0.6	-6.8
Others	6.8	20.4	12.8	27.3	10.1
All retail outlets	33.3	100.0	8.3	18.9	6.2

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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