MARKET IN MINUTES

Savills Research

Hong Kong – April 2020

Office and Retail Investment

savills

Investment sentiment shattered by COVID-19

Commercial volumes have declined dramatically with activity dominated by bargain-hunting investors looking for distressed assets which remain hard to come by.

- Coming as it has, during a period of trade tension and social unrest, COVID-19 has piled yet more pressure on the local economy and weakened prospects for the local property market. Commercial transactions plunged by 36% YoY in January 2020 as a result, following a weak Q4 performance.
- Only bargain-hunting investors were left in the office market looking for deeply discounted assets, with most end users refraining from making any purchase decisions due to worsening business prospects. Nevertheless, strata-title office landlords, who tend not to be very highly geared, were more prepared to cut rents to retain occupancy then sell assets at deep discounts.
- The retail investment market, one of the hardest hit sectors, only saw a handful of deals cross the line in Q1. Investors were looking for even larger price discounts (30% to 50% compared to previous peak) with even fewer landlords willing to entertain. Nevertheless, as the virus spreads globally, and with stricter controls on borders and social activities leading to a further deterioration in retail sales, retail landlords found it hard to retain tenants and sustain occupancy even with heavily discounted rents and generous rental concessions.
- As the coronavirus has become pandemic its containment looks likely to take much longer than SARS (which lasted for around six months, ending in July 2003). While we have discounted a V-shape rebound, prices may find some support from low interest rates, emergency fiscal measures, limited commercial supply and very early signs of an economic turnaround in China.
- Prospective office buyers are tending to hoard cash to weather any possible prolonged downturn in their own businesses, making them ultra-cautious when making investment decisions. Retail investors meanwhile are also paused, not just because of the current situation, but also because the retail market may be about to undergo another structural shift after enjoying years of success supported by Mainland spending. Looking ahead, e-commerce looks set to be a major beneficiary from the outbreak while vacancies will present the challenge of finding new tenants and an updated and relevant trade mix.

> "While commercial investment sentiment has hit a new low, China's cautious economic recovery, the benign interest rate environment, tight short-term commercial supply conditions and further rounds of fiscal stimulus may help to sustain price levels."
>
> SIMON SMITH, SAVILLS RESEARCH

Savills team

Please contact us for further information

INVESTMENT

Raymond Lee
CEO
Greater China
+852 2842 4518
rlee@savills.com.hk

Peter Yuen
Managing Director
Head of Investment & Sales
+852 2842 4436
pyuen@savills.com.hk

RESEARCH

Simon Smith
Senior Director
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk

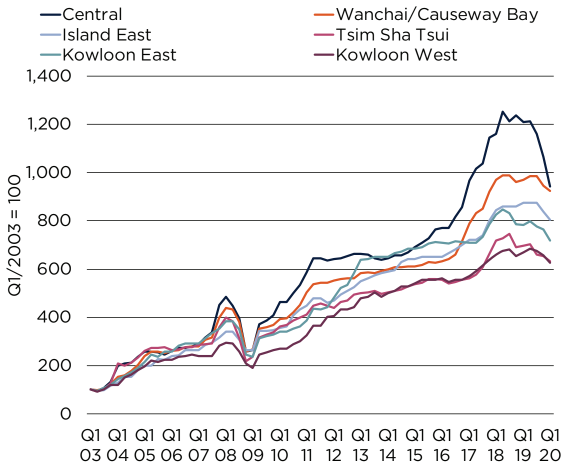
Jack Tong
Director
+852 2842 4213
jtong@savills.com.hk

TABLE 1: Non-residential Transaction Volumes

	JAN 2020	JAN 2019	2019	2018
Office	36 (-50%)	72	861 (-35%)	1,331
Retail	60 (-23%)	78	1,306 (-32%)	1,926
Total	**96 (-36%)**	**150**	**2,167 (-33%)**	**3,257**

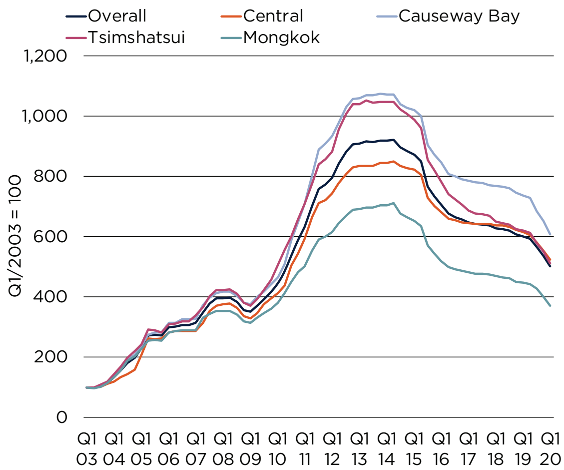
Source Rating and Valuation Department

GRAPH 1: Grade A Office Price Indices By District, Q1/2003 to Q1/2020



Source Savills Research & Consultancy

GRAPH 2: Prime Street Shop Price Indices By District, Q1/2003 to Q4/2019



Source Savills Research & Consultancy

THE PANDEMIC HAS HIT COMMERCIAL VOLUMES HARD IN AN ALREADY FRAGILE ENVIRONMENT

The twists and turns of the property market towards the end of last year were dictated first by the trade war, then by the social unrest and now by the COVID-19 outbreak which has quickly developed into a pandemic with over 1.1 million infected worldwide causing more than 62,000 deaths (6 Apr 2020). Together, these events have succeeded in putting economic growth into a tailspin, with Hong Kong falling into technical recession after registering negative GDP growth of 2.8% and 2.9% in Q3 and Q4 of 2019.

The worsening economic conditions have prompted cracks to appear in a hitherto robust property market. Hardest hit has been the retail sector, but office premises are also showing clear signs of weakness, with commercial transaction volumes recording another 36% decline in January 2020 YoY after a 33% YoY downward adjustment in 2019.

OFFICE SECTOR LEFT WITH BARGAIN HUNTERS

Only bargain-hunting investors were left in the office market looking for deeply discounted assets (30% or more), with most end users holding back from making any purchase decisions due to worsening business prospects. The gap between prospective buyer and seller has been widening with Grade A offices in fringe Central asking for HK$35,000 per sq ft receiving offers of HK$25,000 per sq ft. The few deals being done were closer to offer prices with vendors facing difficulties in their own businesses and in need of capital.

A high-floor unit in Bank of America Tower with a partial sea view which sold for just below HK$29,000 per sq ft was a good example of a particularly eye-catching deal as more than a year ago such units were trading at HK$40,000 to HK$45,000 per sq ft. Average Central Grade A office prices declined most by 11.5% in Q1/2020 while the general market registered a more modest rate of decline of 4.1%. Central's office prices have arguably overshot since 2018 when the Murray Road carpark site was tendered for an A.V. of HK$50,000 per sq ft thereby revaluing office prices across the district.

Other than such anomalies however, strata office landlords, who do not tend to be highly geared, were more prepared to cut rents to retain occupancy than sell assets at 20%+ discounts. Stratified Grade A offices in Admiralty and Sheung Wan, such as Lippo Centre and Shun Tak Centre, which used to lease for HK$60 per sq ft gross in 2018, saw units lease in the mid-HK$40s per sq ft gross in Q1/2020.

RETAIL INVESTMENT HARDEST HIT

The retail investment market only saw a handful of deals inked in Q1/2020, with the commercial building (2,800 sq ft) at No. 6 Sharp Street East selling for HK$280 million

TABLE 2: Grade A Office Price Growth, Q1/2020, 2019 And 2018

DISTRICT	Q1/2020 (%QOQ)	2019 (% QOQ)	2018 (% YOY)
Central	-11.5	-13.8	+7.9
Wanchai/Causeway Bay	-2.4	-1.6	+4.3
Island East	-4.0	-2.6	+7.2
Tsim Sha Tsui	-3.4	-5.6	+4.2
Kowloon East	-5.9	-2.7	-0.1
Kowloon West	-4.4	+0.5	+2.1
Overall	-5.4	-4.8	+3.7

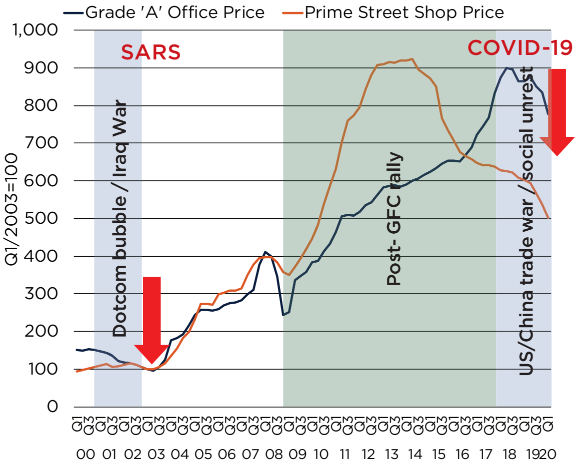
Source Savills Research & Consultancy

TABLE 3: Prime Street Shop Price Growth, Q1/2020, 2019 and 2018

	Q1/2020 (% QoQ)	2019 (% QoQ)	2018 (% YOY)
Central	-5.1	-11.4	-2.8
Causeway Bay	-6.7	-12.5	-3.3
Tsim Sha Tsui	-7.2	-11.9	-6.4
Mong Kok	-7.0	-11.4	-5.1
Overall	-6.5	-11.8	-4.5

Source Savills Research & Consultancy

GRAPH 3: Hong Kong Office and Prime Street Shop Price Indices, Q1/2000 to Q1/2020



Source Savills Research & Consultancy

(around HK$100,000 per sq ft) with a view to redevelopment. Another significant retail transaction was Shop 64 on G/F of Park Lane Shopper's Boulevard, reported to be sold for HK$40 million, a 40% discount to its original purchase price of HK$68 million in 2010.

Retail investors are looking for more sizeable price discounts (30% to 50% compared to previous peak) than their office counterparts, with even fewer retail landlords willing to entertain. Nevertheless, with the global spread of the virus, stricter controls on borders and limits on social activities leading to a dramatic reduction in retail sales and visitor arrivals (-96% in February 2020), retail landlords are finding it hard to retain tenants and sustain occupancy even with deeply discounted rents and generous rental concessions. Prime street shop prices fell by 6.5% in Q1/2020 as a result, with Tsimshatsui and Mongkok, the two shopping districts most popular among Mainlanders, registering greater declines.

MARKET OUTLOOK

As we are now faced with a pandemic with global economic implications, it looks increasingly likely that COVID-19 will last longer than SARS (which lasted for around six months, ending in June 2003). Even when the virus is brought under control, we may not see a V-shape rebound as 17 years ago as China's economic growth was accelerating at the time and Hong Kong was able to introduce supportive policies such as CEPA and the IVS. Today China is slowly fighting its way to economic recovery with GDP growth below 6%, but just as its supply chains are beginning to recover, final demand markets in Europe and North America are in disarray and this could potentially defer a swift recovery.

Nevertheless, the situation Hong Kong is now experiencing is also very different from the SARS period: then we were facing a tough economic environment after seven years of economic downturn (GDP growth of -2.4% in Q2/2003), record high unemployment of 8.8%, and high supply levels in most commercial property sectors suppressing price growth. Today the unemployment rate, though rising, is still at 3.7%, while the low interest rate environment (3-month HIBOR at below 2%), tight short-term commercial supply as well as another round of fiscal stimulus may help to sustain price levels.

Many prospective office buyers are currently holders of cash in order to weather any possible turbulence in their own businesses, making them ultra-cautious when making investment decisions. Retail investors meanwhile are also paused, not just because of the current situation, but also because the retail market may be about to undergo another structural shift after enjoying years of success supported by Mainland spending. Looking ahead, e-commerce looks set to be a major beneficiary from the outbreak while vacancies will present the challenge of finding new tenants and an updated and relevant trade mix.