Central office prices find some support

Commercial volumes continue to decline as economic recession, virus uncertainties and local political turmoil all weighed on buyers’ decisions.

- The impact of the virus in terms of social distancing and business disruption is taking its toll on the local property market with commercial volumes declining by 70% y-o-y in Q2/2020, with a majority of deals (82%) closed at HK$30 million or below. New World has continued to sell down non-core assets with over HK$6.6 billion of asset / income shares offloaded in 1H/2020.

- Potential purchasers in the office market were mainly local investors and old families sitting on cash looking for discounted stock, with end-users, Mainland corporates as well as investment funds all inactive. For the few deals closed in core areas at 20%+ discounts we note that some assets were held by Mainland companies now facing financial distress.

- While some veteran retail landlords are facing financial difficulties due to over-expansion during the past few years, there are newcomers who see this market downturn as a rare opportunity and have purchased street shops in less prime areas at big discounts.

- Persistently low interest rates as well as low levels of near-term commercial supply remain the two supporting pillars of the commercial market. While the rebounding stock market and robust IPO pipeline will likely boost office demand over the next few months, travel relaxations as well as incentives from both government and businesses may reinvigorate retail interest among both local shoppers and visitors.

- Nevertheless, a deepening economic recession, local political uncertainties, macroeconomic turbulence as well as the possible resurgence of the virus are all factors which may negatively impact property investment sentiment over the next six months.

“With most local businesses resuming normal operations, sentiment may gradually improve in the second half, with low interest rates and limited commercial supply continuing to support commercial prices.”

SIMON SMITH, SAVILLS RESEARCH
COMMERCIAL VOLUMES HAVE CONTINUED TO DECLINE

The impact of the virus in terms of the need for social distancing and business disruption continues to take its toll on the local property market with commercial volumes declining by 70% y-o-y in Q2/2020, more severe than the 45% y-o-y decline recorded in Q1, with a majority of deals (82%) concluded at HK$30 million or below. The total consideration, on the other hand, receded more moderately than volumes, registering a 48% y-o-y drop in Q2, due mainly to some significant deals in the retail market.

New World continued to sell down its non-core assets with over HK$6.6 billion of assets / income shares offloaded in H1/2020. New World sold off its income rights in Telford Plaza Phase 2 (30%) and PopCorn 2 (21%) to MTRC in February for a combined HK$3 billion. Meanwhile the company has just announced the sale of its 45% share in Shun Tak Centre Shopping Arcade (214,486 sq ft, together with 13,827 sq ft office space and 85 car parks) for HK$2.36 billion, as well as offloading Eight Kwai Fong, a 139-unit serviced apartment on Kwai Fong Street in Happy Valley, for HK$1.21 billion.

OFFICE PRICES FINDING A FLOOR 25% BELOW PEAK

Potential purchasers in the office market were mainly local investors and old families sitting on cash and looking for discounted stock, with end-users, Mainland corporates as well as investment funds all inactive. For the few deals in core areas at 20%+ discounts we note that some of them were for assets originally held by corporates as well as investment funds all inactive. For the few deals in core areas at 20%+ discounts we note that some of them were for assets originally held by Mainland companies facing financial distress. The most significant were sales of two repossessed units on 37/F in Lippo Centre Tower 1 (3,652 sq ft) for HK$102 million (HK$28,000 per sq ft), 6% lower than the original purchase price three years ago, and some 30% lower than the peak price registered at the end of 2018 of around HK$40,000 per sq ft. After a 25% discount from the peak in Q4/2018, Grade A office prices in Central seemed to find some support with a much more moderate decline of 1.9% recorded in Q2/2020.

Other districts saw steeper discounts with some individual landlords more eager to accept the 20%+ discount demanded by purchasers: units 3503, 05-07 in Wu Chung House were sold for HK$32.6 million or an average of HK$14,000 per sq ft to the Correctional Services Department Credit Union, again a 30% discount to 2018 peak levels; a whole floor of C-Bons International Building was sold for HK$76 million (HK$10,500 per sq ft), a 16% discount to the asking price and a full 28% below it's a peak price of around HK$14,500 per sq ft in 2018. Overall Grade A office prices fell by 2.8% over Q2/2020 as a result, less than the overall drop of 5.4% registered the first quarter.

SOME NEW RETAIL INVESTORS ENTER THE MARKET WITH BARGAIN BUYS

While some veteran retail landlords were facing financial difficulties due to over-expansion over the past few years, there are newcomers who see opportunity in this market downturn and who have purchased street shops in less prime areas at big discounts.

An investor new to the retail market bought two retail premises in peripheral

| TABLE 1: Grade A Office Price Growth, Q1-Q2/2020 And 2019 |
|---------------------|----------|----------|----------|
| DISTRICT            | Q2/2020 (%QoQ) | Q1/2020 (%QoQ) | 2019 (% QoQ) |
| Central             | -1.9      | -11.5     | -13.8     |
| Wanchai/Causeway Bay| -2.9      | -2.4      | -1.6      |
| Island East         | -1.9      | -4.0      | -2.6      |
| Tsim Sha Tsui       | -2.0      | -3.4      | -5.6      |
| Kowloon East        | -4.5      | -5.9      | -2.7      |
| Kowloon West        | -1.4      | -4.4      | +0.5      |
| Overall             | -2.8      | -5.4      | -4.8      |

Source: Savills Research & Consultancy
areas at discounted prices: One is the retail podium of Mei Sun Lau in Sai Wan (total net area of around 12,330 sq ft) for HK$108 million (average price of HK$8,759 per sq ft) at a 4.9% yield; and the other is G-1/F at 182 Fuk Wing Street in Sham Shui Po (total gross area of 5,438 sq ft), which was a distressed asset, for HK$48 million (average price of HK$8,826 per sq ft) with vacant possession.

Another newcomer purchased G-1/F of Bayview in Tokwawan (total gross area of 6,836 sq ft with nine car parking spaces) for HK$68.3 million, again in vacant possession. These non-core retail premises were sold at 30% to 50% discounts to their peak pricing back in 2014.

While prime street shops saw very few transactions due to the poor retail investment sentiment, there were some transactions on secondary streets in core retail areas: Shop A&B on G/F of Oriental Crystal Commercial Building on Lyndhurst Terrace in Central was sold for HK$141.8 million (HK$41,596 per sq ft) at a 3.2%-yield, while Shop 1-2 on G/F with attic at 33-35 Chatham Road South in Tsim Sha Tsui was sold for HK$85 million (HK$7,083 per sq ft) at a yield of 4.2%. Similar yield levels were last seen in 2009 right after the GFC. As such, prime street shop prices fell by 6.5% in Q2/2020, with prices almost half what they were when compared to the previous peak in Q2/2014.

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**MARKET OUTLOOK**

Persistently low interest rates (the Fed is expected to keep rates close to zero until 2022) as well as low levels of near-term commercial supply; we will only see two Grade A office projects (a total of 400,000 sq ft net, both in decentralized areas) and one shopping centre (LOHAS, 470,000 sq ft) completed this year, remain the two supporting pillars of the commercial market.

Office demand is likely to be given a boost in the near term by a rebounding stock market (a 3.5% increase in a turbulent Q2) and a robust IPO pipeline, where Chinese unicorns such as Baidu are considering following in the footsteps of Alibaba and JD.com with a secondary listing in Hong Kong. The booming stock market, strong IPO pipeline and strengthening Hong Kong dollar all indicate strong capital inflows into Hong Kong of late, keeping interest rates low. While investors are still looking for office assets offering 3% plus yields, landlords are likely to become less willing to offer substantial discounts.

Proposed travel relaxations with Mainland China, as well as incentives from the government, including the HK$10,000 handout to all Hong Kong citizens and several rounds of Employment Support Scheme payments amounting to HK$81 billion, as well as various discount programmes from businesses may reinvigorate interest among both local consumers and visitors in the coming months.

Nevertheless, a deepening economic recession, local political uncertainties as well as macroeconomic turbulence (US / China tensions the most significant), as well as the possible resurgence of the virus are all factors which may negatively impact local property investment sentiment in the second half of the year.