

# Office and Retail Investment



## En-bloc commercial volumes revive

Strata-title sales have staged a muted rebound but banks' prudent mortgage policies are hindering cash-strapped investors from re-entering the market.

- En-bloc commercial volumes staged a modest rebound in Q3 with seven transactions registered totalling around HK\$4 billion, as both local and Mainland investors returned for either high-yielding properties or older buildings with redevelopment potential.
- Strata-title sentiment was again subdued with the third wave of COVID cases delaying the anticipated recovery in the economy as well as the commercial investment market.
- While interest rates were at record lows, banks' prudent mortgage policies hindered potential investors, especially the cash-strapped, or those without a long-standing banking relationship, from re-entering the market.
- More end users were evident in the Grade A office market on Hong Kong Island but most were still looking for discounted stock, with only a few vendors facing financial difficulties willing to entertain offers. The Kowloon office market saw very few deals concluded with corporate solvency a major concern in the area.
- While high-end retail continued to suffer, retailers in the F&B, mid-priced cosmetics and health products segments have taken up prime street shops they could never have afforded a few years ago. Suburban retail performed well with its necessities focus, and several new investors were attracted to this segment as a result.
- More Mainland buyers re-entered the en-bloc market, while some of them exited the stratified segment due to financial concerns. It is still premature to predict a full-blown return of Mainland money, but the increasingly difficult investment environment elsewhere may push some of the SOEs back to Hong Kong for portfolio diversification.

“The rebound in COVID cases has delayed the anticipated recovery in the commercial investment market, with the retail sector again bearing the brunt, though suburban retail continued to perform well and attracted some investment interest.”

SIMON SMITH, SAVILLS RESEARCH

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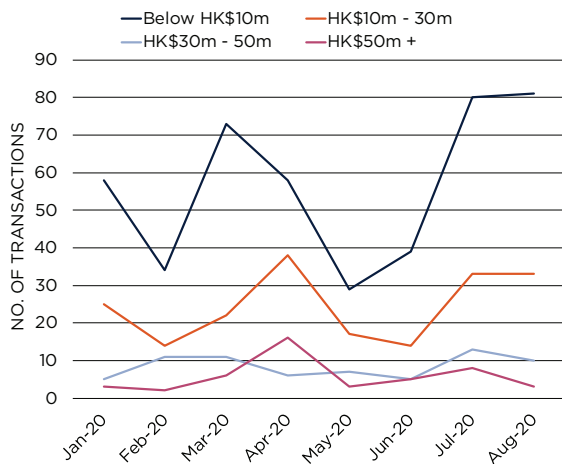
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**GRAPH 1: Commercial Transaction Volumes By Price Range (Office & Retail), January to August 2020**

BUDGET RANGE	2020								TOTAL
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	
HK\$50m+	3	2	6	16	3	5	8	3	46
HK\$30-50m	5	11	11	6	7	5	13	10	68
HK\$10-30m	25	14	22	38	17	14	33	33	196
Below HK\$10m	58	34	73	58	29	39	80	81	452
Total	91	61	112	118	56	63	134	127	762
Total Consideration (HK\$ mil)	1,102	1,101	1,851	3,028	949	3,301	2,410	1,478	15,220

Source Rating and Valuation Department, Savills Research & Consultancy

### EN-BLOC VOLUMES REBOUND WITH BOTH LOCAL AND MAINLAND INVESTORS RETURNING

En-bloc commercial volumes staged a modest rebound in Q3 with seven transactions registered totalling around HK\$4 billion, as both local and Mainland investors returned for either high-yielding properties or older buildings with redevelopment potential. The most eye-catching deal was the sale of Peak Castle, a refurbished office building in Cheung Sha Wan, by Hanison (a local company) and PAG (an investment fund) to a Mainland investor for HK\$1.8 billion yielding around 3%.

The shift to staycations and the rising numbers of local guests meant a rebound in hotel performance given the strict border controls: the latest hotel occupancy, though still hovering around 50% in July, was already sharply up from 30% in February / March, while the year-on-year decline in room rates also slowed from around 40% in March / April to around 22% in July. With hotel performance showing signs of stabilizing, and with more landlords willing to offload their holdings, investors rediscovered their appetite for this segment with two boutique hotels sold over the quarter, one to a Mainland company and the other to a local investor.

### STRATIFIED COMMERCIAL VOLUMES REBOUND DESPITE A WORSENING VIRUS SITUATION AND MORE PRUDENT BANK MORTGAGE POLICIES

Strata-title sentiment was again subdued with the third wave of COVID cases delaying

the anticipated recovery in the economy as well as the commercial investment market. Despite the setbacks, commercial (office and retail) transaction volumes actually rebounded slightly in July and August (261 transactions, compared with 237 transactions registered from April to June), with more vendors willing to accept price reductions.

While the US Fed announced its intention to keep interest rates at current levels in its latest FOMC meeting, the recent relaxation of the commercial mortgage LTV from 40% to 50% by the HKMA was thought to be a major catalyst behind the revival of the commercial market. Nevertheless, even with higher LTVs, most banks took a prudent attitude towards commercial mortgage lending, mainly reflecting their conservative valuations, which were usually 10% to 30% below proposed transaction prices, thereby eliminating any potential upside from the new policy. As such, cash-strapped investors, or those without a long-standing banking relationship, were hindered from re-entering the commercial market even in an era of ultra-low interest rates.

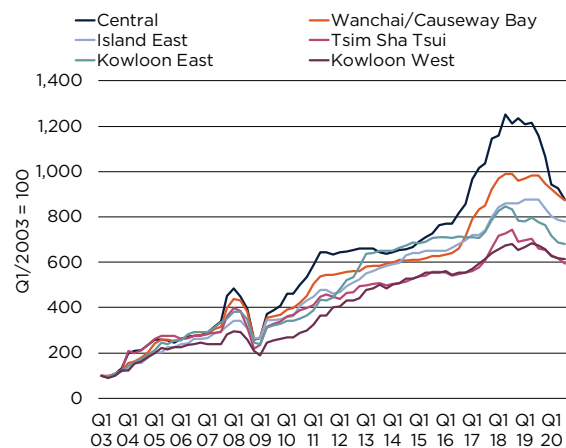
### NORTH POINT OFFICE PREMISES ATTRACT INTEREST

More end users were evident in the Grade A office market on Hong Kong island but most were still looking for discounted stock, with the few vendors facing financial difficulties prepared to entertain offers. Examples include a mid-floor unit in Shun Tak Centre

**TABLE 1: En-bloc Commercial Transactions, July to September 2020**

DATE	DISTRICT	PROPERTY	UNIT	CONSIDERATION (HK\$)	GROSS AREA (SQ FT)	GROSS UNIT PRICE (HK\$ PSF)	VENDOR	PURCHASER	TYPE	REMARKS
Jul	Cheung Sha Wan	Peak Castle, 476 Castle Peak Road	Whole Block	\$1,800,000,000	145,000	\$12,414	Hanison / PAG	Mainland buyer	Office	Avg rent \$30 psf, 3% yield
Jul	Tsim Sha Tsui	Tung Chiong Commercial Building, 221 & 221A Nathan Road	Whole Block	\$510,000,000	34,178	\$14,922	TBC	TBC	Office	-
Aug	Causeway Bay	Le Petit Rosedale Hotel, 7 Moreton Terrace	Whole Block	\$460,000,000	32,288	\$14,247	ITC Properties Group	Mainland buyer (CNEWCON FUND)	Hotel	94 rooms (HK\$4.89 mil per room)
Jul	Sheung Wan	99-101 Des Voeux Road West*	Whole Block	\$332,104,287	-	-	Individuals	Grand Connaught Co Ltd	Residential	Collective Sale*
Jul	Central	16-18 Gage Street*	Whole Block	\$332,000,000	-	-	Individuals	Favour Day Ltd	Residential	Collective Sale*
Aug	Sheung Wan	Queen's Hotel, 199 Queen's Road West	Whole Block	\$310,000,000	26,779	\$11,576	Top Power Holdings Ltd	Grand Fortune Overseas Holdings Ltd	Hotel	40 rooms (HK\$7.75 mil per room)
Sep	Sham Shui Po	Kim Sing Commercial Building, 124-126 Castle Peak Road	Whole Block	\$140,000,000	21,977	\$6,370	TBC	TBC	Office	-

Source Land Registry, newspaper, Savills Research & Consultancy  
\* Collective sales with potential to be redeveloped into commercial properties

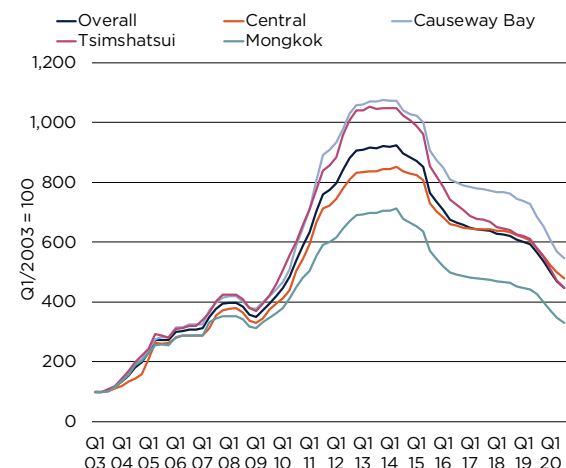
**GRAPH 2: Grade A Office Price Indices By District, Q1/2003 to Q3/2020**

Source Savills Research &amp; Consultancy

**TABLE 2: Grade A Office Price Movement, Q1-Q3/2020 And 2019**

DISTRICT	Q3/2020 (%QOQ)	Q2/2020 (%QOQ)	Q1/2020 (%QOQ)	2019 (%YOY)
Central	-5.1	-1.9	-11.5	-13.8
Wanchai/Causeway Bay	-2.5	-2.9	-2.4	-1.6
Island East	-0.9	-1.9	-4.0	-2.6
Tsim Sha Tsui	-4.0	-2.0	-3.4	-5.6
Kowloon East	-0.6	-4.5	-5.9	-2.7
Kowloon West	-0.6	-1.4	-4.4	+0.5
Overall	-2.5	-2.8	-5.4	-4.8

Source Savills Research &amp; Consultancy

**GRAPH 3: Prime Street Shop Price Indices By District, Q1/2003 to Q3/2020**

Source Savills Research &amp; Consultancy

which sold for HK\$20,500 per sq ft, and another low-floor unit in Bank of America Tower sold for HK\$27,000 per sq ft, both hitting their respective recent lows. Another deal involving a share transfer between JV partners saw a portion of a mid-floor in The Center selling for HK\$27,000 per sq ft.

Interest in Island East offices gathered pace with an improving business environment and discounted pricing compared to other business districts on Hong Kong Island. Two whole floors in SUP Tower in North Point were sold for HK\$12,000 and HK\$13,000 per sq ft to two end users, market levels in the area but some 30% lower than, for example, Grade B offices in Wanchai: a high floor in Sun's Group Building in Wanchai was sold for HK\$133 million to an investor (average price of around HK\$18,000 per sq ft).

The Kowloon office market saw very few deals concluded with corporate solvency becoming a major concern in the area. With many retail operators residing across the harbour, Kowloon East in particular, the abysmal retail performance saw many of them closing shops and shedding staff, thereby reducing their demand for office space. With vacancy in the area rising gradually from 5.1% in Q2/2018 to 10.9% in Q3/2020, and with over 2 million sq ft net of new office supply coming on stream over the next three years, many investors remained on the side lines with rental returns looking set to diminish further.

### SUBURBAN RETAIL GAINING IN POPULARITY

While high-end retail continued to suffer, retailers in the F&B, mid-priced cosmetics and health products segments have taken prime street shops on Kai Chiu Road in Causeway Bay, Wellington Street in Central and Haiphong Road in Tsim Sha Tsui. These were deals they could not have afforded a few years ago, but were made possible in recent months by core retail landlords slashing rents by 40% to 50% compared to the previous lease signed three years ago. With most prime street landlords still preferring rental rather than price reductions, transactions in core retail areas have been rare with prices adjusting slightly by 4.7% in Q3/2020.

Suburban retail performed well with its necessities focus, and new investors were attracted to this segment as a result. Both University of Hong Kong and UOW College have bought the retail podiums of new residential developments in suburban areas for HK\$459 and HK\$457 million respectively for owner occupation as education centres. Meanwhile, an industrialist, who has been inactive in the market over the past seven to eight years, bought Mount Sterling Mall in Mei Foo for HK\$300 million, while another investor, who used to buy residential properties, bought the retail podium of OASIS Place in Kai Tak for HK\$200 million, both eyeing long-term investment.

**TABLE 3: Prime Street Shop Price Movement, Q1-Q3/2020 And 2019**

	Q3/2020 (%QOQ)	Q2/2020 (%QOQ)	Q1/2020 (%QOQ)	2019 (%YOY)
Central	-3.7	-5.0	-5.1	-11.4
Causeway Bay	-4.1	-6.5	-6.7	-12.5
Tsim Sha Tsui	-5.3	-8.0	-7.2	-11.9
Mong Kok	-5.5	-6.3	-7.0	-11.4
Overall	-4.7	-6.5	-6.5	-11.8

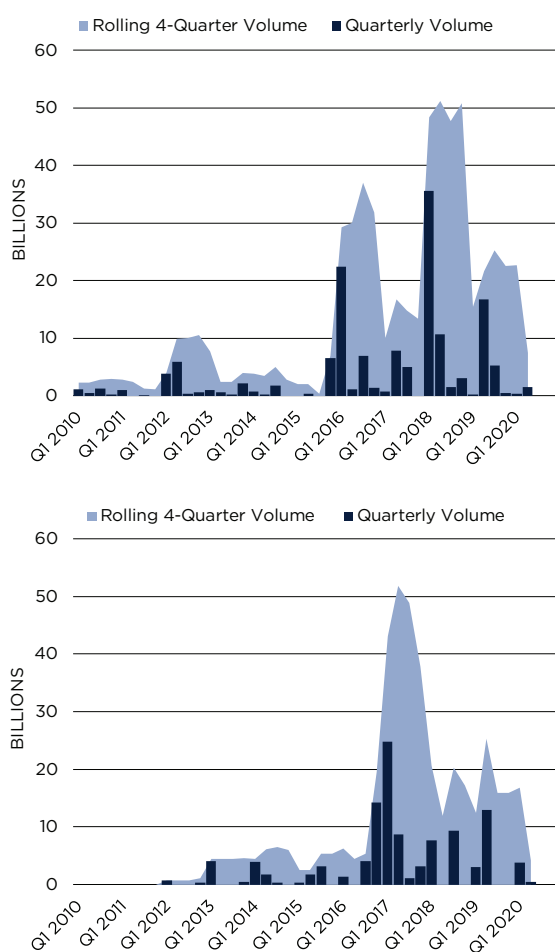
Source Savills Research &amp; Consultancy

TABLE 4: Major Suburban Retail Transactions, July to September 2020

DATE	DISTRICT	PROPERTY	UNIT	CONSIDERATION (HK\$)	GROSS AREA (SQ FT)	GROSS UNIT PRICE (HK\$ PSF)	VENDOR	PURCHASER	TYPE
Jul	Sai Ying Pun	Retail podium of Novum West	1/F	\$459,600,000	19,533	\$23,529	Henderson Properties	University of Hong Kong	Retail
Aug	Kowloon City	Billionaire Royale, 83 Sa Po Road	Shop 2 on G/F & 1/F-2/F	\$457,000,000	-	-	Sunnytact Co Ltd	UOW College Hong Kong	Retail
Jul	Mei Foo	Mount Sterling Mall, 10-16 Lai Wan Road	G/F shop N50A and 1/F	\$300,000,000	27,400	\$10,949	Max Era Properties Ltd	Apex Billion Ltd	Retail
Sep	Tokwawan	OASIS Place, Kai Tak	Shopping Mall	\$200,000,000	10,000	\$20,000	Wheelock Properties	TBC	Retail

Source Land Registry, newspaper, Savills Research & Consultancy

GRAPH 4: Sales Volume Of Income-producing Properties (upper chart) And Development Sites (lower chart) In HK By PRC Companies, Q1/2010 to Q2/2020



Source RCA

## MARKET OUTLOOK

More Mainland buyers re-entered the en-bloc market, while some left the stratified segment due to financial concerns. It is still premature to predict a full-blown return of Mainland money, with their investment in both income-producing assets and development sites in Hong Kong still registering notable declines (-90% and -73% y-o-y in 1H/2020 respectively). Nevertheless, the increasingly difficult investment environment elsewhere, in particular in the US and some parts of Europe where political tensions with China are mounting, may push some of SOEs back to the Hong Kong property market for portfolio diversification.

The COVID-19 outbreak has had many negative effects on the local economy, but it has also accelerated structural changes in many industries and sectors, the two most significant related to real estate being remote access and e-communication in the office segment, as well as online retail and e-commerce in the retail segment.

Commercial landlords and investors who are most responsive to these changes may emerge early winners after the containment of the virus.