

THE OFFICE MARKET IS LIKELY TO REMAIN UNDER PRESSURE

AVISTA PROPERTY CONSULTANCY

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RESEARCH**

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OUTLOOK

Earlier in a COVID-19 briefing, Dr. Mike Ryan, Emergencies Director of the World Health Organization (WHO), mentioned that 'The virus may never go away, no one can predict when it will disappear'. The spreading of pandemic remains unpredictable, which continues to dampen investment activities and lead to office size decreasing and office downgrading, etc.

We believe the leasing demands of office property will shrink by 5-10% in 2H 2020. We also expect a correction of rents in Sheung Wan, Central and Admiralty districts due to the foreseeable increase in vacancy rates.

With the COVID-19 pandemic and escalating geopolitical tensions continuing to weigh on business confidence, the prospects for Hong Kong's economy and property market remain highly uncertain. We suggest that investors sit on the fence during the current situations.

Although the geopolitical uncertainties between China and the US might cause instability, the backflow of listed Chinese enterprises from the US to Hong Kong is possible, which may reduce the economic loss resulted from COVID-19, acting as an opportunity for economic recovery.

TABLE 1: Q2 2020 GRADE A OFFICE PERFORMANCE OF SELECTED DISTRICTS

<i>District</i>	<i>Average Price (HKD/sq.ft.) (q-o-q change)</i>	<i>Average Rental (HKD/sq.ft.) (q-o-q change)</i>	<i>Vacancy Rate (q-o-q change)</i>
Sheung Wan	23,900 (↓13%)	71 (↓7%)	3.7% (↑)
Central	43,800 (↓2%)	125 (↓7%)	3.7% (↑)
Admiralty	31,700 (↑4%)	82 (↓9%)	8% (↑)
Wan Chai	30,500 (↑1%)	66 (↓4%)	8% (↑)
HK Island East	13,800 (↓3%)	48 (↓5%)	3.9% (↑)
Tsim Sha Tsui	14,900 (↑1%)	67 (↓1%)	5.3% (↑)
Kowloon East	11,200 (↓14%)	28 (↓5%)	13% (↑)

SOURCE: AVISTA Research

SELECTED TRANSACTIONS

TABLE 2: Q2 2020 SELECTED OFFICE SALE TRANSACTIONS

Location	Building	GFA (sq.ft.)	Floor	Consideration/Unit Price
Sheung Wan	Yue Thai Commercial Building	17,278	G/F-3/F, 8/F-11/F, Roof	\$350,000,000@\$20,257/sq.ft.
Sheung Wan	Wing On House	11,062	16/F (W/F)	\$286,000,000@\$25,854/sq.ft.
Admiralty	Lippo Centre Tower 2	3,652	37/F	\$101,800,000@\$27,875/sq.ft.
Kwun Tong	C-BONS International Centre	16,844	Low Zone (W/F)	\$176,860,000@\$10,500/sq.ft.

SOURCE: AVISTA Research

TABLE 3: Q2 2020 SELECTED OFFICE LEASING TRANSACTIONS

Location	Building	GFA (sq.ft.)	Floor	Rental (monthly)/Unit Rent
Central	Exchange Square Tower 1	23,281	46/F	\$3,957,800@\$170/sq.ft.
Wan Chai	Everbright Centre	21,097	28/F & 30/F (W/F)	\$1,434,600@\$68/sq.ft.
Causeway Bay	Time Square Tower 1	17,268	Mid Zone	\$1,036,100@\$60/sq.ft.
Kowloon Bay	Exchange Tower	27,457	27/F	\$928,046@\$34/sq.ft.

SOURCE: AVISTA Research

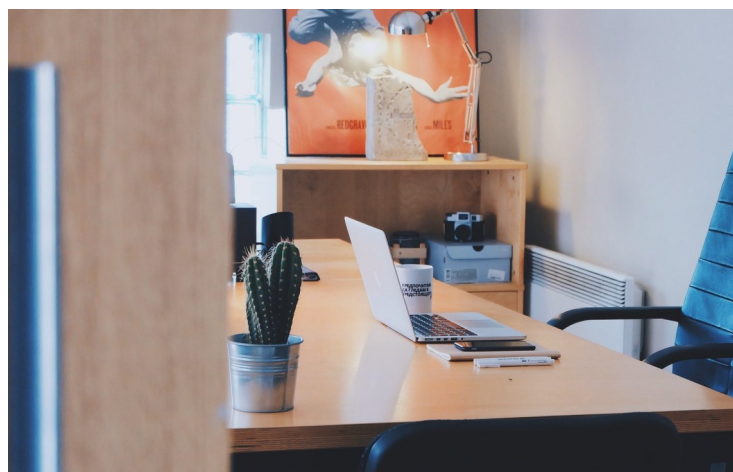
MARKET INSIGHTS

Despite the economic destruction, an innovation in rental settlement was devised. The Champion Real Estate Investment Trust (the 'Trust') and the Union Medical Healthcare ('UMH') agreed to settle UMH's rental payment for the property in the Langham Place Office Tower by UMH's listed shares. The Trust thus became a strategic partner of the UMH by receiving 8,078,927 shares based on the subscription price of HKD 4.2 per share. This unconventional practice eases the short-term liquidity of the tenants and might become a new market trend, especially in times of economic hardship.

Together with the pre-pandemic signed lease agreements, the above rental payment contributed to a positive rental reversion and an increase in total rental income in the Trust. Read more about the positive rental reversion in ['Case Study: New Rental Arrangement under COVID-19'](#) (available in Chinese version only).

Moreover, the pandemic changed companies' way of working — from a fixed rental office to a co-working

space. As working from home may not be a feasible practice for every staff member, those who are unable to work from home under a work-from-home policy may be arranged to co-working space nearby instead. The above contributed to the rising popularity of co-working space due to its cost effectiveness and lease flexibility. We expect an increase in demand for co-working space and a decline for traditional fixed rental office in the coming years.



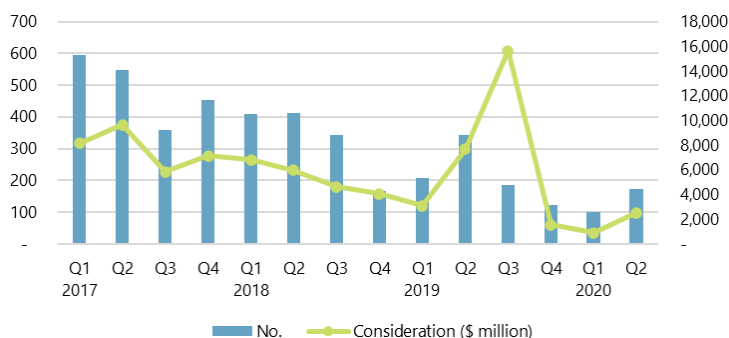
HIGHLIGHT—MARKET SITUATION

The COVID-19 pandemic has been posing unprecedented challenges to the property market, resulted in an economic slowdown and sluggish market sentiment. In the office market, tenants were cautious in cost-saving and lease renewal, contributed to downsizing and the implementation of work-from-home policies. Statistics from the Rating and Valuation Department have shown a significant decrease in both rental and price indices. Core business districts, such as Central and Admiralty suffer as many companies downsized and relocated to non-core business districts for more affordable rents.

Office transaction volume and value shrank by 50% and 67% respectively year-on-year in Q2 2020. The office property transaction volume was low and forfeiture cases were recorded due to pessimistic market sentiment.

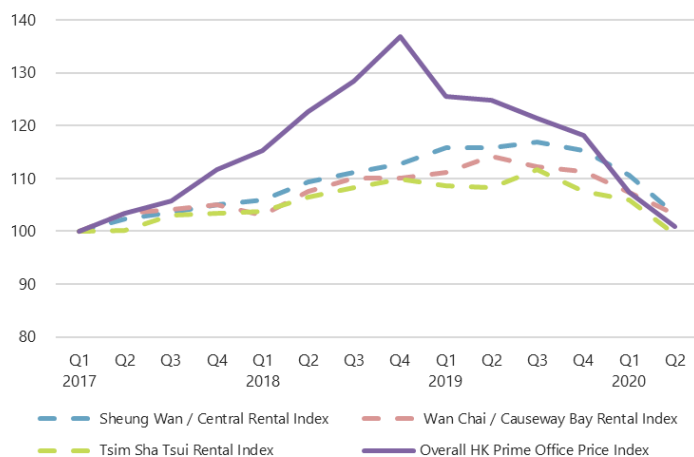
Meanwhile, rentals of grade-A offices of core district, such as Sheung Wan and Central experienced drops of 7% quarter-on-quarter and 11% year-on-year in Q2 2020. Occupiers downsized their rental units and relocated to a more cost-efficient office district, such as Kowloon East and Hong Kong Island East. Because of the economic downturn and outbreak of COVID-19, the office transaction price index has declined continuously for six quarters to a point that the price index in Q2 2020 almost equals to that in Q1 2017.

GRAPH 1: Q1 2017 – Q2 2020 NO. OF HK OFFICE TRANSACTIONS AND CONSIDERATION

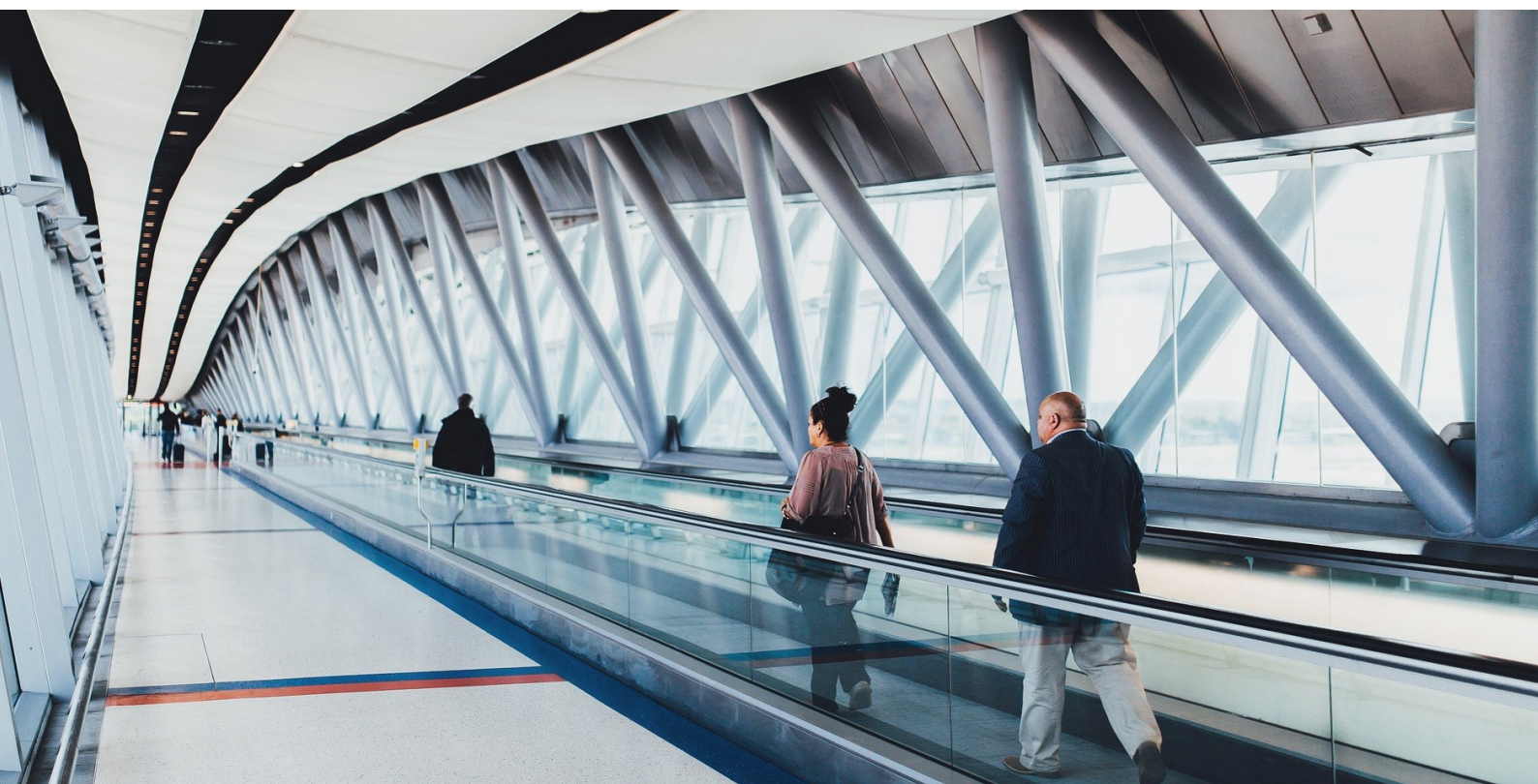


SOURCE: AVISTA Research, RVD

GRAPH 2: Q1 2017 – Q2 2020 HK PRIME OFFICE RENTAL AND PRICE INDEX (Q1 2017=100)



SOURCE: AVISTA Research, RVD



HIGHLIGHT—NEWS

RELAXATION OF MORTGAGE LOANS ON NON-RESIDENTIAL PROPERTIES

- The Hong Kong Monetary Authority (HKMA) relaxed the loan-to-value ratio caps for mortgage loans on non-residential properties (including office, retail, industrial properties and car parks) from 40% to 50% for general cases. The adjustment is effective from 20 August 2020.
- This measure will provide certain support, but it is not significant enough to create a long-term turnaround in the commercial property market. It is also unlikely to notably boost the office market in the short term.
- However, we foresee this relaxation will boost transaction numbers of non-residential properties as the threshold for investing these properties was lowered.

COMMERCIAL LAND SUPPLY IN 2020-2021

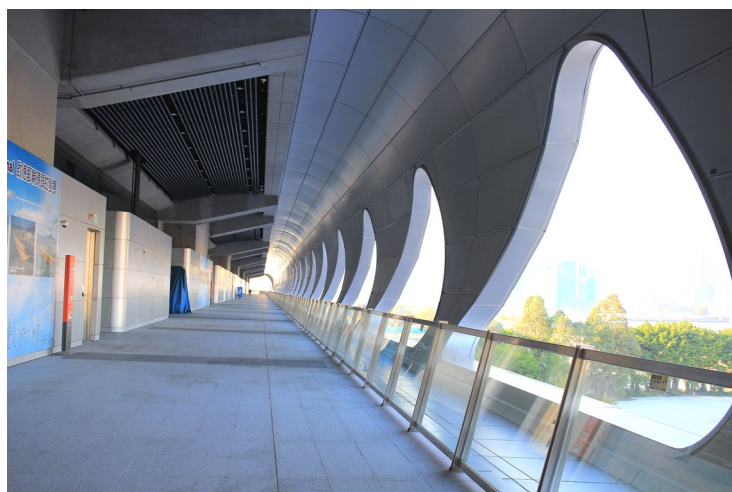
- 2020 new land sales programme of 6 urban commercial sites with a total permitted GFA of about 9 million sq.ft. was introduced, including a harbour front site in Central.
- Our preliminary estimated value of the harbour front site will be HKD 80 billion, i.e. about HKD 43,500/sq.ft.(GFA).
- The previously assigned commercial plot of land in Kai Tak (Area 2A Site 4, Site 5B and Site 10) was withdrawn from sale in May 2020 due to tepid response from bidders. We expect the accommodation values of the new commercial lands in Kai Tak (See **Table 4** Nos. iv - vi) to drop from the previous evaluated of HKD 7,000/sq.ft. to HKD 6,300/sq.ft.

TABLE 4: 2020-2021 COMMERCIAL LAND SALE PROGRAMME

No.	Lot No.	Location	Site Area (sq.ft.)	Approx. GFA (sq.ft.)
i	IL 9088	Man Yiu Street, New Central Harbour front, Hong Kong	516,312.49	1,840,000
ii	TCTL 45	Area 57, Tung Chung, Lantau Island	132,396.10	1,260,000
iii	IL 8945	Caroline Hill Road, Causeway Bay, Hong Kong	159,305.87	1,080,000
iv	NKIL 6578	Kai Tak Area 4D Site 2, Kowloon	639,376.28	4,800,000
v	NKIL 6590	Kai Tak Area 2A Site 2 and Area 2A Site 3, Kowloon	132,396.10	
vi	NKIL 6589	Kai Tak Area 2A Site 1, Kowloon	213,125.43	

SOURCE: AVISTA Research, Lands Department

PICTURE 1: HARBOUR FRONT SITE IN CENTRAL



SOURCE: Lands Department