

UNCERTAINTIES SURROUNDING OFFICE MARKET ALONGSIDE WORKPLACE TRANSFORMATION

AVISTA RESEARCH

The new wave of Coronavirus infections and the political instability have posed uncertainties on the recovery pathway of Hong Kong office market. In this unprecedented time, the companies demonstrate their resilience by transforming their working and business model.





MARKET OUTLOOK

The Office Market Remains Uncertain Despite Easing Monetary Environment

Change in Policies Supporting Office Investment:

In Q3 2020, further easing of monetary conditions in Hong Kong and the U.S. provides a favorable investment environment in Hong Kong office sector.

- 1) Hong Kong SAR government announced the Loan-to-Value Ratio cap for the mortgage of non-residential was relaxed from 40% to 50%.
- 2) The policy shift of U.S. Federal Reserve adopting average inflation targeting implies longer periods of lower rates and easier monetary policy in the market. This facilitates Hong Kong's banks to persistently offer a lower and competitive interest rate for mortgage loans to enhance investment.

Looming Uncertainties ahead Hindering Investment Sentiment:

In spite of favorable monetary environment, the office property market has not seen a significant increase in transactions as the uncertainties from health crisis and political tension are still looming ahead.

The global COVID-19 cases have just surged pass 50 million and Hong Kong is possible to face another wave of the epidemic, which may hinder the local economy recovery. Meanwhile, the political instability continues to dampen Hong Kong's investor confidence. It is reported that almost 30% members of the US Chamber of Commerce are considering moving their business out of Hong Kong. In addition, Naver, the parent company of LINE (a global instant communication application), has announced that they will transfer all of their users' data from Hong Kong to Singapore.

The abovementioned will drive uncertainty in the Hong Kong economy and property market. Hence, we advise the investors to adopt a "wait-and-see" attitude.

We believe that the office rental in core CBD (Central, Admiralty and Sheung Wan) will continue to shrink due to the increasing vacancy rate. We predict there would be an overall 10-15% drop and 15-20% drop for Grade A office price and rental respectively in 2020.

MARKET INSIGHTS

Reasons of the Tender Cancellation of Tung Chung Commercial Site and the Future Development of Tung Chung

Tung Chung Town Lot No. 45 ("TCTL 45"), a commercial site located in Tung Chung Extension Area, was opened for tenders in October 2020. The site area is approximately 132,000 sq ft. Since the permissible plot ratio is 9.5, the maximum Gross Floor Area ("GFA") would be approximately 1.26 million sq ft. Refer to the site's condition of sales, more than 90% of the GFA are restricted for "office" purpose, while the remaining 10% are restricted for "non-industrial (excluding residential, office, hotel, warehouse and petrol filling station)" use.

The tendering closed on 16 October 2020. Due to pessimistic market expectation, developers showed little interest to the site and only three bids were submitted. On 21 October 2020, the government announced the rejection of the bids because all of them could not reach the tender reserve price. This made the subject site the fourth scrapped commercial site tender within these two years.

PICTURE 1: EXTRACT OF TUNG CHUNG EXTENSION AREA OUTLINE ZONING PLAN



SOURCE: AVISTA Research, Town Planning Board

We believe that there are three main reasons contributed to the failure of this tender. First, the site is located at the new reclamation area of Tung Chung, which is remote from the Tung Chung Town Centre, and the infrastructures and supporting facilities are still under construction. These might have affected developers' confidence in the potential office demand.

Second, the lease stated that 90% of the GFA shall be used for office purpose, which limits the flexibility of the land's future development. Furthermore, Hong Kong economy has been weakened due to the pandemic and China-US conflict. With the uncertainty surrounding Hong Kong economy, a substantial initial investment and a long payback period for commercial development, it is understandable that the developers have little incentive to bid commercial sites.

In fact, the government has already made a comprehensive planning for "Tung Chung New Town Extension". It aims to develop Tung Chung New Town into a large-scale comprehensive development area. According to the government website, the future development will provide approximately 49,600 residential units, 5.4 million sq ft for office use, 3.5 million sq ft for retail use, and 540 thousands sq ft for hotel purposes. In recent years, the government has been actively improving the transportation network of Tung Chung, including constructing the Tuen Mun-Chek Lap Kok Link, and considering the construction of the new Tung Chung East and Tung Chung West MTR stations and the linkage road between Tung Chung East and North Lantau Island.

In the long run, with the completion of supporting infrastructures and the close proximity to Hong Kong International Airport and Hong Kong-Zhuhai-Macao Bridge, we believe that Tung Chung Extension area will be one of the most preferred locations for office.

PICTURE 2: CONCEPT PLAN FOR TUNG CHUNG NEW TOWN EXTENSION PROJECT



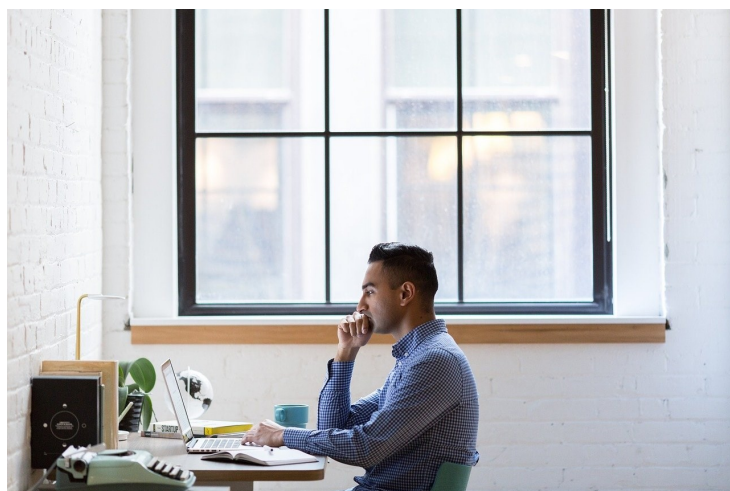
SOURCE: Planning Department

MARKET INSIGHTS

Hotels are Transforming into Co-working Space

The number of visitors to Hong Kong has dropped drastically due to the global outbreak of the pandemic. The local hotel industry has been severely affected. In order to survive, many hotels have undergone a transformation. For instance, the Kerry Hotel in Hung Hom partnered with theDesk (one of the local leading co-working space companies) to lease part of the hotel area as co-working space in the hope of introducing the new concept of "hotel cum business centre". The Kerry Group hopes that the hotel could become the intermediary between overseas business travelers and local businessmen in the future. For example, the hotel will first understand the needs of the overseas business travelers and then theDesk will arrange suitable business events and conferences accordingly. If the overseas business travelers wish to set up new branches in Hong Kong, theDesk will assist them in seeking suitable accounting firms and estate agents etc.

The set up of co-working space in hotels provides a platform to facilitate communication and collaboration between local businessmen and overseas business travelers. We believe this practice would be attractive to small and medium sized companies. With the rising popularity of this concept, we expect that office demand for small to medium sized office premises in non-core areas will be affected in the long run, but the impact on Grade A office buildings would not be significant.



The New Trend of "Remote Office"

As mentioned in our last report, the pandemic outbreak has induced many companies to adopt the work-from-home policies.

Recently, 9GAG, a Hong Kong social media startup, has ceased to rent their 7,000 sq ft headquarter in Tsuen Wan and has fully adopted remote work strategies. Meanwhile, Facebook has also announced that they will gradually adopt remote working in the coming years. The Company expected that 50% of the employees will be permanently adopting remote working in 5 to 10 years' time. Likewise, Twitter has announced that its employees will be allowed to work from home permanently. Sundar Pichai, the CEO of Google's parent company Alphabet, also stated in an interview in September 2020 that Alphabet would actively consider a "hybrid" working model and provide the option of working from home to cater for the demand of its employees. The new model allows the employees to enjoy greater flexibility to balance work and life and therefore improve working efficiency.

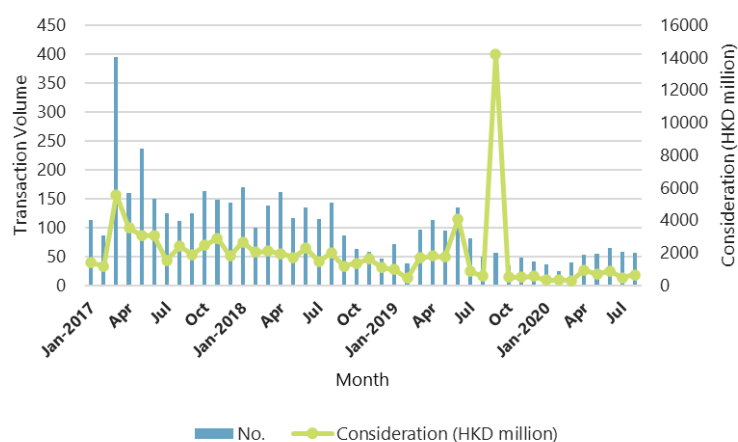
With different multinational corporation as pioneers, we expect that more companies will also adopt the "remote office" working model in the future. In that case, the design of office buildings must be adapted for the new working model.

MARKET DATA SNAPSHOT

Subdued Demand amid 3rd Wave of Epidemic

The COVID-19 hit Q3 2020 with even greater ferocity. With the third wave of the epidemic, the total number of cases has increased significantly, which posed unprecedented challenges to the property market. Due to the uncertain future of the office market, investors have become more cautious in making investment. According to the statistics from the Rating and Valuation Department, there were 58 and 57 office transactions in July and August 2020, and the transaction amounts were HKD 470 million and 640 million respectively. Compared with the performance in May and June 2020, although the transaction volume had maintained at a similar level, the transaction amounts had fallen by 29.4%. This figure was getting closer to that of Q1 2020, the time when COVID-19 emerged.

GRAPH 1: JAN 2017-AUG 2020 NO. OF OFFICE TRANSACTIONS AND CONSIDERATION

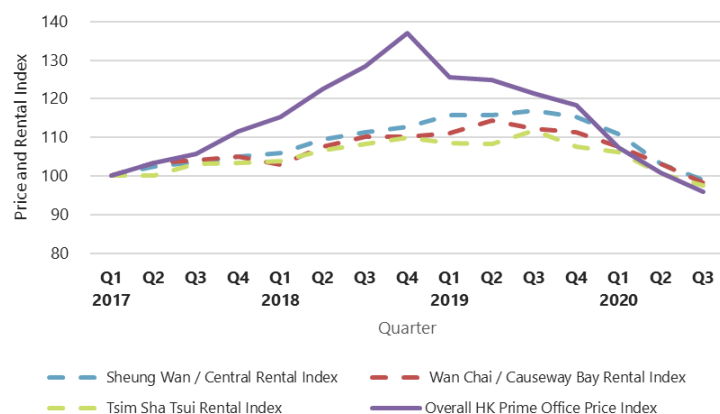


SOURCE: AVISTA Research, RVD

Meanwhile, Grade A office rents has remained on a downward trend. Tenants sought for opportunities to reduce rental expenses and thus downsized their rental units or withdrew from the core areas. As a result, the rental demand in the core area Sheung Wan/Central remained sluggish, with the rental index falling 4% quarter-to-quarter and 15% year-on-year. The rental indices in Wan Chai and Tsim Sha Tsui also decreased 5% and 4% quarter-to-quarter respectively. On the bright side, it was worth noticing that the decline of rental indices narrowed in the third quarter.

The economic recession and the outbreak of the COVID-19 have affected investor sentiment. Office sales had recorded a continuous decline for seven consecutive quarters. The price and rental indices in Q3 2020 were even lower than that of Q1 2017.

GRAPH 2: Q1 2017-Q3 2020 HK PRIME OFFICE RENTAL AND PRICE INDEX (Q1 2017=100)



SOURCE: AVISTA Research, RVD

MARKET DATA SNAPSHOT
TABLE 1: Q3 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	23,000 (↓4%)	67 (↓6%)	6.2% (↑)
Central	44,100 (↑1%)	121 (↓3%)	3.9% (↑)
Admiralty	31,200 (↓2%)	83 (↑1%)	8.0% (-)
Wan Chai	31,500 (↑3%)	63 (↓5%)	8.5% (↑)
HK Island East	14,000 (↑1%)	48 (-%)	4.5% (↑)
Tsim Sha Tsui	13,700 (↓8%)	64 (↓4%)	6.1% (↑)
Kowloon East	11,800 (↑5%)	30 (↑3%)	13.2% (↑)

SOURCE: AVISTA Research

TABLE 2: Q3 2020 SELECTED OFFICE SALE TRANSACTIONS

<i>Location</i>	<i>Building</i>	<i>GFA (sq ft)</i>	<i>Floor</i>	<i>Consideration/Unit Price</i>
Admiralty	Bank of America Tower	5,968	Mid Zone	\$144,323,000@\$24,183/sq ft
Kwun Tong	SML Tower	149,600	Whole Block	\$1,500,000,000@\$10,027/sq ft
Central	The Center	14,963	42/F	\$404,000,000@\$27,000/sq ft
Central	Euro Trade Centre	5,261	14/F (W/F)	\$150,000,000@\$28,512/sq ft
Kwai Chung	K83	15,276	20-22/F (W/F)	\$183,310,000@\$12,000/sq ft

SOURCE: AVISTA Research

TABLE 3: Q3 2020 SELECTED OFFICE LEASING TRANSACTIONS

<i>Location</i>	<i>Building</i>	<i>GFA (sq ft)</i>	<i>Floor</i>	<i>Rental (monthly)/Unit Rent</i>
Mong Kok	Langham Place	17,938	Top Zone	\$956,890@\$53/sq ft
Admiralty	Three Pacific Place	98,686	19 & 34-38/F (W/F)	\$8,980,400@\$91/sq ft
Kwun Tong	One Bay East-Citi Tower	27,000	8/F (W/F)	\$945,000@\$35/sq ft
Causeway Bay	Lee Garden Two	15,732	Mid Zone	\$991,116@\$63/sq ft

SOURCE: AVISTA Research