STABLE RECOVERY IN PROPERTY INVESTMENT MARKET WITH EXPECTATION OF RE-OPENING OF HONG KONG-SINO BORDER

AVISTA RESEARCH

Hong Kong's low interest rate continue to favor for investment in office properties. On the other hand, the effective pandemic containment gave rise to the expectation of re-opening of Hong Kong-Sino border, which hopefully will further support the recovery of property market and Hong Kong's economy.

MARKET OUTLOOK

Aware of Peripheral Undercurrent Amid Glorious Expectation on Economic Growth

Continuously low interest rate environment in favor of investment

Since the decision to remain the key interest rate at between 0% and 0.25% made by the United States (the "**U.S.**") Federal Reserve (the "**Fed**") in mid June, the interest rate of Hong Kong has been positioned at an extremely low range for approximately two quarters under the Linked Exchange Rate System between Hong Kong and the U.S. According to the Hong Kong Monetary Authority ("**HKMA**"), the 1-month Hong Kong Interbank Offered Rate ("**HIBOR**") in Q3 further dropped to 10-year low of 0.04% in mid July, ranging from 0.04% to 0.09% in Q3, and the HIBOR is below 0.1% for five consecutive months. It is believed that the interest rate of Hong Kong will remain below 0.1% in the last quarter of 2021 and the low interest rate environment will last until 2024 in spite of the possibility of rate increase by the U.S. In the near term, the low interest rate environment will favor the investors in the capital market with lower financing costs. It is expected that the property market will be supported and remain in high level.

Hong Kong's economic recovery underway with potential peripheral undercurrent

Hong Kong's economy has been on a steady recovery from the economic recession due to social unrest and the Coronavirus Disease 2019 ("**COVID-19**") pandemic. According to the Hong Kong's Census and Statistics Department ("**C&SD**"), Hong Kong's gross domestic product ("**GDP**") expanded by 7.6% year-on-year ("**y-o-y**") in Q2 2021, which is slightly lower than that of Q1 2021. The annual GDP is estimated to grow by 5.5% to 6.5% at the end of 2021. With an increasing vaccination rate and effective virus containment measure, the pandemic has been in controlled in Hong Kong gradually. As of the end of Q3, approximately 55.9% of Hong Kong citizens were vaccinated with 2nd vaccine dose. Moreover, as of the end of Q3, there was no local infection of COVID-19 for 43 consecutive days since 17 August 2021. The effective suppression of COVID-19 in recent months is expected to boost Hong Kong's pace of economic recovery. With stringent pandemic containment control, the Hong Kong government is striving to resume quarantine-free travel and economic activity with mainland China in due course. Once the Hong Kong-Sino border reopens, visitor arrivals will provide great support for Hong Kong's tourism and retail sectors while stimulating cross border trade, therefore reignites leasing demand for quality office space.

Nevertheless, Mr. Paul Chan, the Financial Secretary of Hong Kong warned about the potential slow down of economic recovery that might pose risk to Hong Kong's economic outlook, for instance, the Delta coronavirus variant, growing inflation rate due to the surging energy and commodity prices and uncertainty of geopolitical tension. It may lead to adverse impact on the sentiment of capital markets.

We expect that the decline of office rental in core Central Business District ("**CBD**") (Central, Admiralty, and Sheung Wan) will ease in the future alongside the low interest rate environment and continuous economic recovery, accompanied with the expectation of opening of Hong Kong-Sino border. We believe the office rent will edge up and vacancy rate to stabilize in Q4 2021.

MARKET INSIGHTS

Rising Commercial Competitiveness of Kowloon East Business District

Energizing Kowloon East has been introduced for nearly a decade, aiming at transforming Kowloon East into another CBD of Hong Kong. With government's initiatives for revitalization and redevelopment of industrial buildings, Kai Tak Development and more sale of commercial sites, Kowloon East is now shaping into "CBD2" that supplement the CBD in both Central and Tsim Sha Tsui.

Billion Development and Project Management Limited launched the sale of its latest commercial development in Kowloon East, 368 Kwun Tong Road, at the end of Q3 2021. The development is a 29-storey Grade A office building located at Kwun Tong Road and adjacent to Ngau Tau Kok MTR station, each unit with a gross floor area ranging from 654 sq.ft. to 9,566 sq.ft. Within a week from the kickoff of the sale, 13 office units have already been sold, with unit price ranging from HKD 11,400 to HKD 13,200 per sq.ft. A listed company acquired the 37th floor unit of 368 Kwun Tong Road and it will use the premises as the headquarter of the group. These transactions shows that property investors and cash-rich end-users are returning and actively exploring the commercial properties in Kowloon East as the market opportunities begun to emerge with the lowered prices since 2019 and the widened price gap from Hong Kong Island office premises.

It is worth noting that apart from the latest completion of 368 Kwun Tong Road, there will be more prime offices to be developed in Kowloon East, especially in Kwun Tong. Under the latest government policy of revitalization of industrial buildings, owners of industrial buildings in Kwun Tong are studying the possibility of redeveloping or revitalizing their industrial properties into commercial buildings with a more relaxed redevelopment and waiver application policies. It is estimated to have approximately 1.7 million sq.ft. of office area to be completed in Kowloon East in year 2020-2021, which account for 45% of new supply of office area in the whole of Hong Kong.

Apart from the enhanced railway connectivity, major government premises like Inland Revenue Tower will be relocated from Wan Chai to Kai Tak. Investors believed that the significant improvement of infrastructure and business atmosphere in Kowloon East will raise its commercial competitiveness and attract more businesses to setup their offices in Kowloon East. The most notable advantage of office buildings in Kowloon East is that they are relatively large in terms of floorplate size which make them more flexible for sizable occupiers to configure their workplace. Moreover, the building specifications and finishes are better than the offices in traditional CBD while the office rentals are much cheaper, which made it a comparative advantage for companies to consider relocating their offices to Kowloon East.

We believe that the Kowloon East business district has the greatest potential to emerge into a prominent core business center in Hong Kong in the coming future. The ample first-hand supply of prime offices in Kowloon East will take certain time to be absorbed by occupiers, however, office developers and investors remained positive about the long-term growth potential for Grade A offices in Kowloon East.

Table 1: New/ Potential Supply of Prime Offices at Kowloon East (Including Industrial Revitalization)

Location	Development	Developer
Kwun Tong	98 How Ming Street	Sun Hung Kai Properties
	Yip Fat Factory Building Block 1 & 2	Biel Crystal Holdings Limited
	Crystal Industrial Building	Crystal Group
	Chen Yip Industrial Building	Crystal Group's related parties
	368 Kwun Tong Road	Billion Development and Project Management Limited
Kai Tak	AIRSIDE	Nan Fung Group

SOURCE: AVISTA Research

MARKET INSIGHTS

Visionary Development – The Northern Metropolis

In October 2021, the Chief Executive introduced the development of the Northern Metropolis in the Policy Address of 2021–2022. The government planned to develop the northern New Territories into another metropolis of Hong Kong, in order to further connect Hong Kong and mainland businesses. The development involves approximately 300 sq.km., which accounts for one-third of the total land area in Hong Kong.

The Northern Metropolis will differ from the Harbour Metropolis with Central as its core. It will not be a core business district emphasis on financial and property sectors, but a unique metropolis gathering enterprises specializing in innovative technology development, similar to the initiative of Hong Kong Science Park and Shenzhen Innovation and Technology Zone. This also promote re-industrialisation and leverage the strengths of Hong Kong and Shenzhen to create synergies.

The idea of developing the Northern Metropolis is vital to the future development of Hong Kong, in particular after the COVID-19 pandemic, which brought substantially negative impact to the traditional pillar industries that mainly supports Hong Kong's economy. Hong Kong will need to develop a second engine of economic growth with Northern Metropolis to embrace new opportunities in Greater Bay Area and ensure a promising place for people to live in and work.

Slowed Trend of Decentralization

As of the end of Q3 2021, the vacancy rate of Grade A offices in Central further dropped to 7.2%, which is the second consecutive quarter to record a fall in vacancy rate and it is the lowest since November 2020. Furthermore, the rent of prime offices in Central and Admiralty slightly increased 0.3% in Q3. Since the outbreak of COVID-19, the prime office rental in traditional CBD has fell significantly due to sizable surrender and decentralization, which narrowed down the rental gap between Central and other districts, such as Quarry Bay and Kowloon East. It presented a rare opportunity for occupiers to lease prime offices in traditional CBD with a lower rent. Despite the new lease demand for Central prime offices were mainly from the banking and finance and professional sectors, it indicated the status and exclusiveness of Central area is still irreplaceable for investors and occupiers. We expected that the rental level of Central prime offices will gradually increase due to expectation of return of Chinese firms upon border reopen and discounted rental level.

It is worth noting that the tender of Site 3 of New Central Harbourfront will be awarded soon, with a maximum permitted gross floor area of 1.61 million sq.ft. for office, retail and public space. The site is expected to become an iconic landmark for Hong Kong, bringing in positive visual impact to the coastal landscape, prime Grade A office space as well as environmentally friendly amenities to Central.

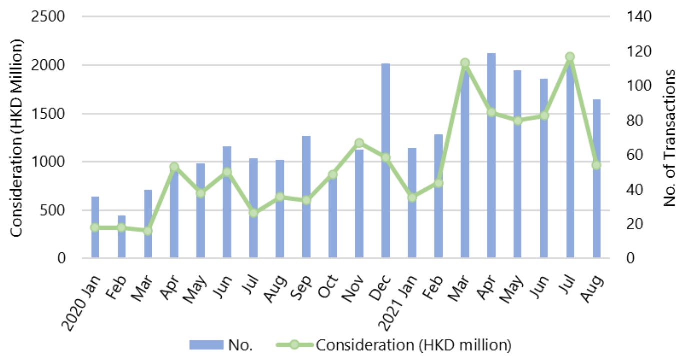
MARKET DATA SNAPSHOT

Stable recovery in office property investment

The investment sales activities for office properties remained stable with a growing considerations of office transactions completed in Q3 2021. Volume of office transactions remained comparable with Q2 2021 while consideration further accelerated to a higher record compared to Q2 2021, indicating the return of confidence of office investors. According to the statistics from the Rating and Valuation Department ("**RVD**"), there were 113 and 92 office transactions in July and August 2021, while the transaction amounts were HKD 2,085 and HKD 964 million respectively. On a y-o-y basis, the number of office transactions surged by 95% and 61% in July and August 2021, while the considerations of office transactions also advanced by 343% and 51% respectively in these two months.

It indicated that investors are now more optimistic about the office market and resumed the negotiation or closing of acquisition with property's owners. We expected to see capital gain in this asset class in 2022 given the hope of resumption of quarantine-free travel with mainland China and more Chinese investor to return.

Figure 1: 2020 Jan - 2021 Aug No. of Office Transactions and Consideration

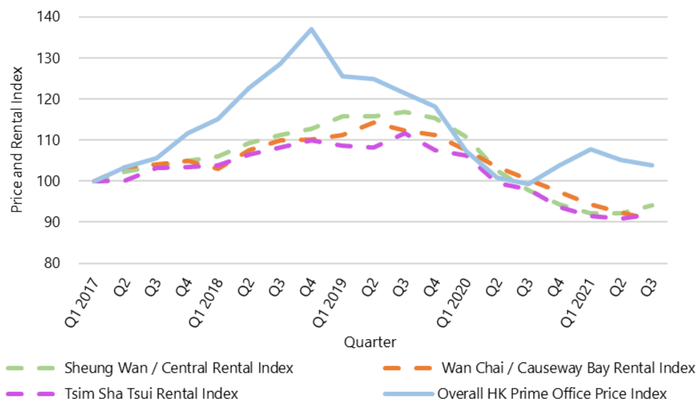


SOURCE: AVISTA Research, RVD

With an increasing rate of vaccination and effective virus containment measures by the government, Hong Kong's economy is expected to bottom out in the near future, which would boost the demand of commercial real estate investment with the help of consumption voucher scheme and improving business atmosphere. As a result, the office rentals bounced back in the Q3 2021, in particular the office rentals of Tsim Sha Tsui and Central / Sheung Wan rose by 1% and 2% quarter-on-quarter ("**q-o-q**"), respectively. However, the rental index of Wan Chai/ Causeway Bay recorded to a slight decrease by 2% q-o-q.

Alongside the low interest rate environment and economic recovery expected to continue, we expect the leasing momentum to rise continuously and catch up with the pace of economic recovery, following the substantial transaction and recovery trajectory reported in the investment market in recent months.

Figure 2: Q1 2017 - Q3 2021 Prime Office Rental and Price Index (Q1 2017=100)



SOURCE: AVISTA Research, RVD

MARKET DATA SNAPSHOT

Table 2: Q3 2021 HK Grade A Office Performance of Selected Districts

District	**Average Price** (HKD/sq.ft.) **(q-o-q change)**	**Average Rental** (HKD/sq.ft.) **(q-o-q change)**	**Vacancy Rate (q-o-q change)**
Sheung Wan	23,000 (↓4%)	64 (↑2%)	8.7% (↓)
Central	36,000 (↓14%)	112 (↓2%)	7.2% (↓)
Admiralty	29,200 (↑1%)	75 (↑2%)	8.6% (-)
Wan Chai	28,500 (↓1%)	57 (↓2%)	9.4% (↑)
HK Island East	13,850 (-)	49 (↑9%)	6.3% (↑)
Tsim Sha Tsui	12,100 (↓1%)	58 (↑1%)	9.9% (↓)
Kowloon East	11,000 (↑4%)	31 (↑11%)	12.6% (↓)

SOURCE: AVISTA Research

Table 3: Q3 2021 Selected Office Sale Transactions

Location	Building	**GFA** (sq.ft.)	Floor	**Consideration/Unit Price** (HKD)
Central	The Center	24,980	25/F Whole Floor	674,000,000 @ 27,000/sq.ft.
Sheung Wan	Shun Tak Centre, China Merchants Tower	1,632	Mid Zone	48,630,000 @ 29,800/sq.ft.
Kowloon Bay	Enterprise Square Three	8,970	25/F Unit 1, 2, 3, 5	92,000,000 @ 10,300/sq.ft.
Admiralty	United Centre	20,489	High Zone	515,000,000 @ 25,100/sq.ft.
Kwun Tong	368 Kwun Tong Road	37,624	High Zone	608,180,000 @ 16,200/sq.ft.

SOURCE: AVISTA Research

Table 4: Q3 2021 Selected Office Leasing Transactions

Location	Building	**GFA** (sq.ft.)	Floor	**Rental** (monthly)**/Unit Rent** (HKD)
Admiralty	One Pacific Place	70,790	Mid Zone	7,786,900 @ 110/sq.ft.
Central	Two International Finance Centre	23,638	Low Zone	3,782,080 @ 160/sq.ft.
Causeway Bay	Hysan Place	16,433	High Zone	1,561,135 @ 95/sq.ft.
Wan Chai	Three Pacific Place	16,290	23/F Whole Zone	1,384,700 @ 85/sq.ft.
Kwun Tong	International Trade Tower	54,000	Mid Zone	1,728,000 @ 32/sq.ft.

SOURCE: AVISTA Research