

COVID-19 CONTROL REMAINS THE KEY OF MARKET RECOVERY

AVISTA RESEARCH

The effectiveness of COVID-19 vaccines and the control measures are still the key for the future movement of the office market. The policy shift with the advancement of the investors and the office operators play a role in supporting the office market.





MARKET OUTLOOK

Stay vigilant on the control of COVID-19 despite policy relaxation

Relaxation of Stamp Duty to support the declining commercial properties

After the relaxation of the Loan-to-Value Ratio cap on the mortgage of non-residential property, the Hong Kong government announced the abolition of the Double Ad Valorem Stamp Duty (DSD) on the non-residential property in the 2020 Policy Address. From 26 November 2020 onwards, the transactions of non-residential property will be subject to ad valorem stamp duty at the original rates applicable before the introduction of the DSD in 2013. In particular, the highest tax rate will be reduced to 4.25% from the previously applicable 8.5%.

The abolition of DSD provides support to the capital market by lowering investment costs amid the raging coronavirus pandemic in Hong Kong. According to the Land Registry, the number and the considerations of agreements for sale and purchase of non-residential property surged 30.6% and 47.2% m-o-m in December 2020, respectively. The abolition of DSD, therefore, has increased the interests of the investors in the declining commercial property market.

Virus containment still the key to drive office market

However, the 4th wave of coronavirus infections in Hong Kong has weighed on the prospects of economic recovery. The new round of social distancing rules and work-from-home arrangements have been dampening the demand for office space again. In spite of the relaxation of mortgage or tax policy on non-residential property, the concern on coronavirus pandemic is still hindering the investment sentiment in the office market showing the worrisome vacancy and rental movement. Hence, we suggest the investors being cautious about the spread of COVID-19 and the effectiveness of the vaccines for assessing the impacts on the office market.

We believe that the decline of office rental in core CBD (Sheung Wan, Central and Admiralty) will be narrowed with vaccination and control of COVID-19. We predict that there would be an overall 5-10% decline for Grade A office price and rent respectively in 2021.

MARKET INSIGHTS

Divided intention from investors and landlords

The social unrest and the spread of coronavirus have taken a heavy toll on the Hong Kong office market, which has been showing rising vacancy as well as the falling price and rents. Some investors have been active in the capital market in a bid to hunt for the potential property with favourable discount. Some landlords, however, have been seeking divestment of their office property owing to the slashed cash flow from rental income. The divided attitudes between landlords and investors would reshape the investment landscape of the Hong Kong office market.

Under the coronavirus pandemic, some office landlords are divesting their office holdings with discounts to reduce their financial pressure. In late Oct 2020, Hong Kong tycoon David Chan Ping-chi sold the 48th floor of The Center office tower for HKD 980 million, representing HKD 38,140 per square foot. The final transacted price was 20% lower than the initial asking price of HKD 48,000 per square foot. The increasing vacancy and decreasing rental level have been threatening the cash flow and the investment return of the landlords. The landlords under pressure are seeking the exit to diminish their office holdings in order to reduce their risk exposure despite potentially with a shrunk profit margin.

On the other hand, some investors are hunting for investment opportunities in hopes of optimizing their office portfolios in Hong Kong.

One of the noticeable transactions in Q4 2020 was the Cityplaza One Office tower sold by Swire Properties to Gaw Capital Partners, a Hong Kong-based private equity firm. In early Nov 2020, Gaw Capital-led consortium completed the transaction to purchase the 21-storey Cityplaza One Office tower for HKD 9.85 billion (USD 1.27 billion), representing HKD 15,627 per square foot. The transaction price was 19% lower than the previous sale on neighbouring Cityplaza Three and Four towers 2 years ago with around HKD 19,350 per square foot, in which Gaw Capital Partners also acquired 49% stake from the mainland investor Chen Changwei's Henglilong investment. The Cityplaza towers are located in Hong Kong East, which demonstrated its resiliency in this unprecedented health crisis. Therefore, some investors regarded the current social unrest or pandemic as an opportunity to acquire the quality commercial property with favourable terms for long-run return.

Accordingly, the mixed sentiments between the landlords and the investors would balance each of the forces driving the office market amid the Covid-19 pandemic. Despite the increasing selling forces from the landlords which may cause the market to go down, the investors like Gaw Capital Partners would act as the buying forces to support the market downturn. In the medium to long term, the pace of decline in the office price may ease with the support of investors. The landlords, particularly those acquiring their office assets at the peak level, may record a dwindled margin of profit. The investors, on the other hand, could benefit from the discounted purchase price to optimize their portfolios with relatively favourable yield alongside the expectation of the economic rebound.



MARKET INSIGHTS

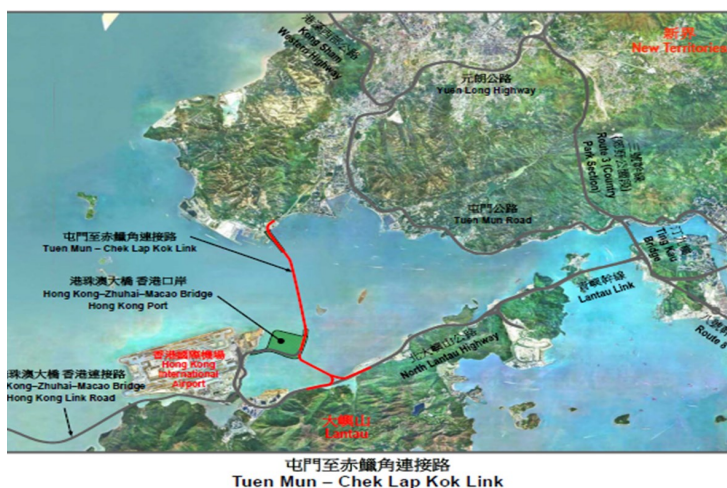
Asset enhancement alongside Greater Bay Area connectivity

The initiative of Greater Bay Area (GBA) integration has accelerated the demand for office space from the mainland companies to expand their business. Years earlier, the opening of the Express Rail Link led to an upswing in demand for offices in Tsim Sha Tsui. Recently, there was also activity of asset enhancement for office use alongside completion of infrastructure promoting greater connectivity with GBA.

The opening of Tuen Mun – Chek Lap Kok Link (TM-CLKL) in late Dec 2020 enhances the strategic connectivity of GBA via Hong Kong – Zhuhai – Macao Bridge (HZMB) Hong Kong Port. Specifically, it would only take 10 minutes to travel between TM – CLKL and HZMB, saving by 20 minutes from the original route. Furthermore, in Nov 2020, Transport International (0062.HK) and Sun Hung Kai Properties (0016.HK) announced the joint development project in Tuen Mun Town Lot No. 80, 1 Kin Fung Circuit with a cost of HKD 5.8 billion. The site will be jointly developed for offices, shop and services purposes from industrial or godown purposes currently restricted by the government.

The strategic connectivity strengthened by TM-CLKL will accommodate the increasing needs of business travel for those GBA-focused companies, which will potentially increase the value of decentralised office buildings like Tuen Mun in the long run. Meanwhile, it could also be expected that the improved infrastructure will also revitalise the asset enhancement for office use in the decentralised non-residential buildings to meet the emergence of GBA business development.

FIGURE 1: LAYOUT PLAN OF TUEN MUN – CHEK LAP KOK LINK



SOURCE: Highways Department



Greater workspace flexibility in Greater Bay Area

The co-working office operators have been evolving to provide the companies with a cost-efficient and business-specific office solution. Apart from the office layout and amenities, there have been operators enhancing the flexibility provided to their clients in terms of the working locations. In Dec 2020, WeWork launched a new “WeWork All Access” membership allowing their business users to access multiple WeWork co-working spaces across Greater Bay Area, including the spaces in Shenzhen and Guangzhou, with a monthly fee of HKD 2,320. Additionally, The Executive Centre (TEC) has also rolled out a new membership scheme in 2020 allowing its corporate members to access all TEC centres globally, which consist of 135+ centres across 32 cities.

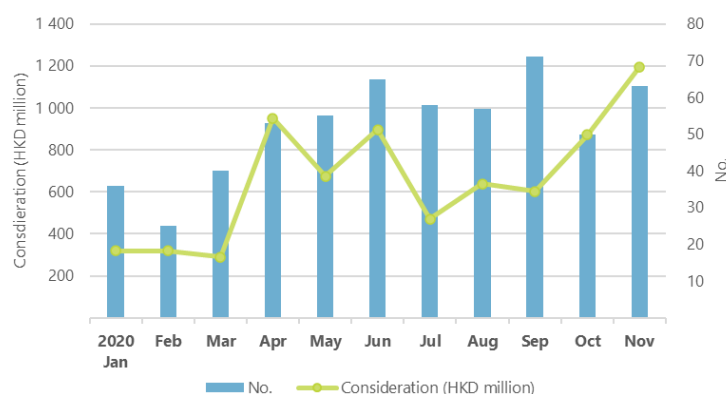
The unprecedented COVID-19 pandemic has caused significant downsizing in the labour force and the rise of distributed work, of which the employees may work from home or a dedicated office respectively. The initiative of GBA integration has also boosted the business travels across the cities in the GBA. This new scheme provides business users with a borderless and flexible workspace solution to meet their needs of distributed work model or frequent business travels within GBA. Hence, the flexibility of working locations under a single scheme will advance the attractiveness of the solution of co-working space and further impact the demand for the traditional office space, which has been hardest hit by the economic downturn amid COVID-19 pandemic.

MARKET DATA SNAPSHOT

Supported investment activity despite sluggish leasing demand

With the policy relaxation lowering the investment cost, the investment activity in the office market improved in Q4 2020. According to the statistics from the Rating and Valuation Department, there were 50 and 63 office transactions in October and November 2020, and the transaction amounts were HKD 873 million and HKD 1,197 million respectively. Despite the number of transactions remaining at a similar level with Aug and Sep 2020, the consideration of the transactions showed the recovery in office market with 45% m-o-m and 37% m-o-m in Oct and Nov 2020, respectively. The upswing in the transaction amounts reflected the supports from the investors further looking for quality office assets.

FIGURE 2: 2020 JAN - NOV NO. OF OFFICE TRANSACTIONS AND CONSIDERATION

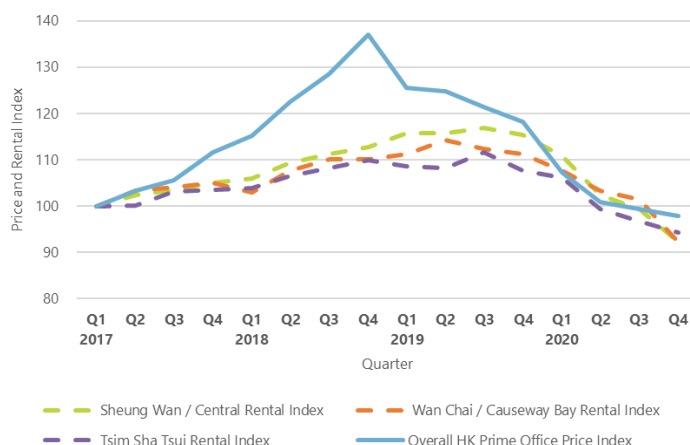


SOURCE: AVISTA Research, RVD

The ongoing threats of COVID-19, nevertheless, are still in place and therefore both prices of the Hong Kong prime office and the Grade A office rent have extended its descending trend in Q4 2020. In particular, the rental index of Sheung Wan/Central decreased by 3% q-o-q and 16% y-o-y respectively. The rental indices of Wanchai/Causeway Bay and Tsim Sha Tsui fell by 6% q-o-q and 3% q-o-q. The extended fall in office rents reflected the tenants continuously seeking office space with the reduced rental expense to tackle the challenges from the COVID-19 pandemic.

With the expectation of the vaccination, we would expect further support to the office market alongside the economic recovery narrowing the decline in investment and leasing demand triggered by the pandemic.

FIGURE 3: Q1 2017 - Q4 2020 PRIME OFFICE RENTAL AND PRICE INDEX (Q1 2017=100)



SOURCE: AVISTA Research, RVD



MARKET DATA SNAPSHOT

TABLE 1: Q4 2020 HK 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	22,500 (↓2%)	62 (↓7%)	8.3% (↑)
Central	38,500 (↓13%)	118 (↓2%)	6.5% (↑)
Admiralty	27,500 (↓12%)	79 (↓5%)	9% (↑)
Wan Chai	30,000 (↓5%)	60 (↓5%)	9.2% (↑)
HK Island East	13,850 (↓1%)	47 (↓2%)	4.7% (↑)
Tsim Sha Tsui	12,800 (↓7%)	61 (↓5%)	8.6% (↑)
Kowloon East	10,550 (↓11%)	29 (↓3%)	14.3% (↑)

SOURCE: AVISTA Research

TABLE 2: Q4 2020 SELECTED OFFICE SALE TRANSACTIONS

<i>Location</i>	<i>Building</i>	<i>GFA (sq ft)</i>	<i>Floor</i>	<i>Consideration/Unit Price (HKD)</i>
Taikoo	Cityplaza One	630,000	Whole Block	9,845,010,000 @ 15,627/sq.ft.
Central	The Center	25,695	48/F	980,000,000 @ 38,140/sq.ft.
Admiralty	Far East Finance Centre	10,800	4/F Whole Floor	237,600,000 @ 22,000/sq.ft.
Kowloon Bay	Enterprise Square Phase 3	16,100	Top Zone	201,250,000 @ 12,500/sq.ft.

SOURCE: AVISTA Research

TABLE 3: Q4 2020 SELECTED OFFICE LEASING TRANSACTIONS

<i>Location</i>	<i>Building</i>	<i>GFA (sq ft)</i>	<i>Floor</i>	<i>Rental (monthly)/Unit Rent (HKD)</i>
Central	One International Finance Centre	20,390	Top Zone	4,485,800 @ 220/sq.ft.
Central	Two International Finance Centre	20,802	Low Zone	3,120,300 @ 150/sq.ft.
Kwun Tong	Two Harbour Square	72,957	12/F	2,188,710 @ 30/sq.ft.
Jordan	Everest Building	44,956	02-11/F	2,023,020 @ 45/sq.ft.
Kwai Chung	Kowloon Commerce Centre Tower A	42,463	23/F	1,358,816 @ 32/sq.ft.

SOURCE: AVISTA Research