

Calling the bottom of the office market in 2021

Seizing the right timing for strata-title office acquisition opportunities

Insights & recommendations

We expect office rents and prices to remain under pressure in H1 2021 before bottoming out mid-year, followed by a more stable H2 before rebounding again from 2022 onwards, assuming that Covid is under control within the first half of 2021.

We believe that now is a good time for buyers to explore opportunities in the strata-title office sector:

- End-users with long term real estate needs should explore acquisition options, as office prices and rents could rebound quickly in core locations once the market recovers.
- Investors pursuing office sector exposure in Hong Kong, but had previously found it too expensive, should seize this window of opportunity to enter the market.
- Investors looking for offices with smaller lumpsum transaction values should consider areas in Kowloon, which offers more options and attractive pricing.



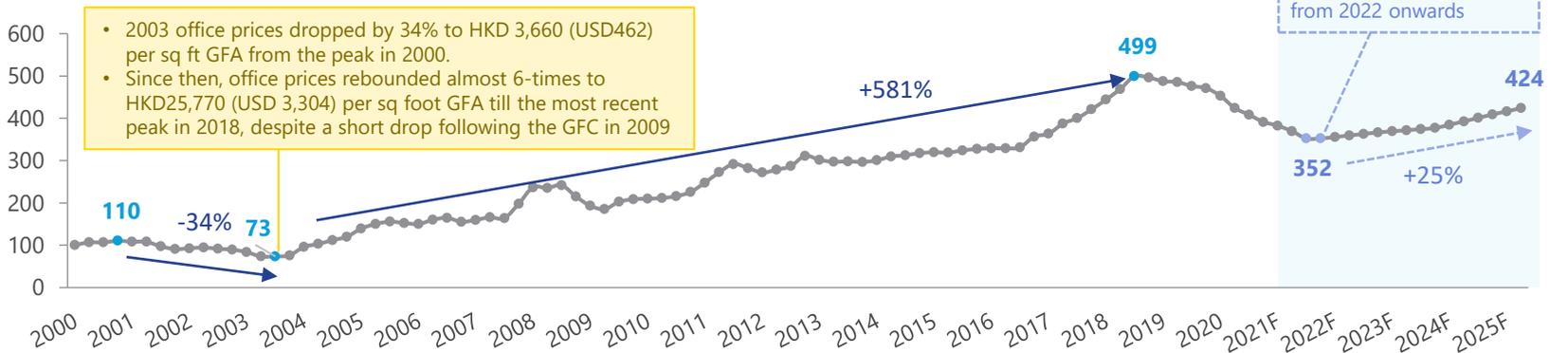
Hong Kong* is now over two years past the series of market disruptions including the US-China trade tension in 2018, local demonstrations in 2019, and Covid outbreak in 2020. Investment sentiment in the office sector has been dampened during the period, with overall prices falling by a total of 23% between the last peak in Q3 2018 and Q1 2021. The price correction cycle has encouraged buyers to expect more discounts, which further widened the bid-ask expectation and hindered transactions over the last two years.

We forecast the Grade A strata-title office prices to face another year of adjustment, with a 10% YOY correction in 2021. This also aligns with our office rental forecast trend for the year, wherein we expect rents to drop by another 7% YOY.

Despite the current challenging business environment, we believe rental and price corrections will likely be front-loaded and hit-the-bottom in H1 2021. Our assumption includes a rapid and successful vaccine roll-out, bringing Hong Kong a more controlled pandemic, which would support economic activities gradually picking up in H2 2021. We forecast both office rents and prices to rebound in 2022, by 3.0% YOY and 4.0% YOY, respectively, and we expect office prices to rebound by around 25% between 2022 to 2025. This suggests 2021 is the most optimal window for end-users and investors who are looking for acquisition opportunities in strata-title offices.

Hong Kong Grade A office price (Q1 2000 to Q4 2020; forecast 2021-2025)

Grade A office price index (2000 Q1 = 100)



Source: Colliers, [Real Capital Analytics](#), [EPRC](#)

Note: USD1 to HKD7.8; 1 sq m = 10.76 sq ft

*This report covers the Hong Kong Special Administrative Region of the People's Republic of China.

Where does the opportunity lie?

A steeper correction in the CBD and core-adjacent areas suggests a higher rebound potential

Among all key office submarkets, those located on Hong Kong Island and in the CBD area witnessed the largest price correction since the last peak in July 2018, but we expect submarkets on Hong Kong Island to see a greater extent of rebound from 2022 onwards, mainly for two reasons:

1. **On Hong Kong Island: limited new supply, especially for strata-sale.** Of the 11.2 million sq feet (1.0 mil sq meters) of new supply scheduled from 2021-2025, only around one-third will be located on Hong Kong Island, with most of this supply likely to be for lease instead of strata-sales. Subsequently, this hints at the limited future availability for strata-title office space on Hong Kong Island.
2. **In the CBD: the future supply face-lift suggests promising prospects in the long run.** Whilst all eyes are waiting for the result of the Site 3 land sale in Central, this future development,

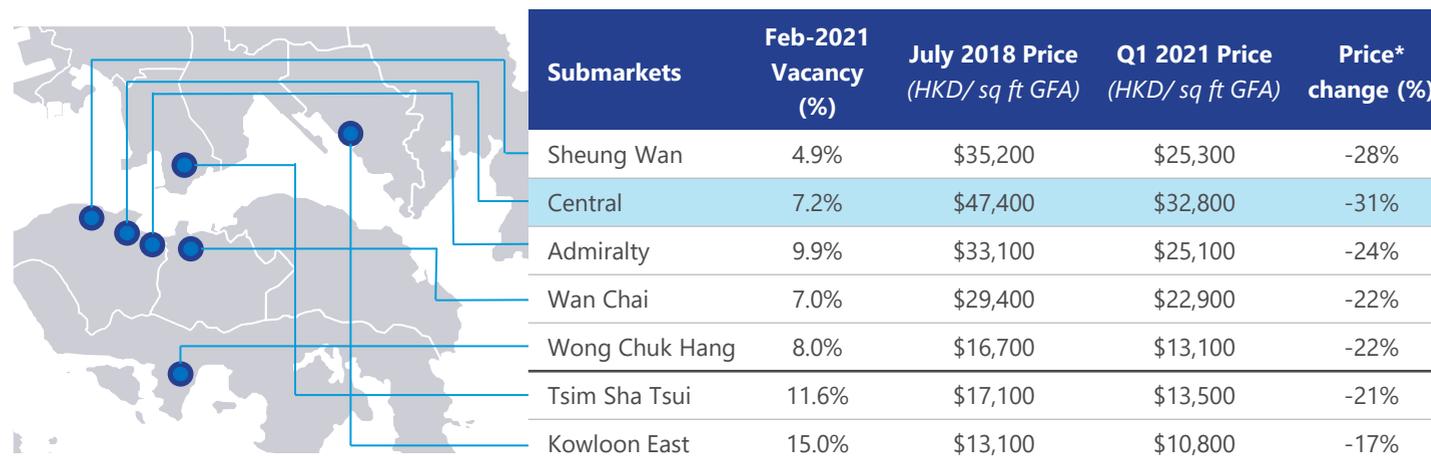
together with the other new key Grade A office supply, including the Hutchison House and Murray Road Car Park redevelopments, will likely bring in renewed design and vibrancy to the CBD area, supporting the long-term pricing level. As supply is limited, CBD office prices should rebound more quickly once the market picks up again.

Kowloon – new policy to restore supply-side balance

As of the end of February 2021, Kowloon is sitting on its record high vacancy rate of 13%, mainly due to two key submarkets, Tsim Sha Tsui (12%) and Kowloon East (15%). We believe this should provide more flexibility for negotiation on the asking prices from owners who are eager to sell their strata-title offices.

Whilst landlords have been concerned about rising office sector vacancy levels, in the Government’s latest Budget Speech, announced in February 2021, a feasibility study for the conversion of five commercial sites in Kowloon East into residential use was announced. We believe if implemented, the policy could help bring in some buffer to ease the vacancy pressure in the area over the next five years, which would also support strata-title office prices.

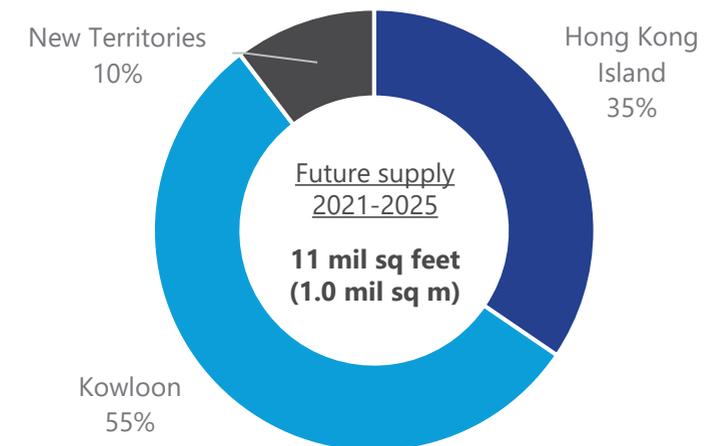
Hong Kong Grade A strata-title office price by key submarkets



Source: Colliers, [Real Capital Analytics](#), [EPRC](#)

* These percentage changes are based on the prices before rounding.

Grade A office future supply (2021-2025)



The way forward

Since the cancellation of the Doubled Stamp Duty* on non-residential property acquisitions in November 2020, there has been a healthy pick-up in strata-titled deals. We expect the overall investment volume and strata-title offices transactions to increase in 2021, as the market sees more liquidity by the higher level of investment capital, sustained expectation of low-interest rates, as well as the closer business ties and opportunities in the Greater Bay Area. The current adjustment of office prices should attract long-term investors and owner-occupiers to enter the market in 2021. They tend to buy for future capital gains but previously found Hong Kong too expensive.

*The Doubled Stamp Duty was a cooling measure introduced in 2013 to increase taxation levied on non-residential property transactions. Removing such stamp duty will lower the effective levy for commercial transactions from 8.5% to 4.25%.

Recommendations:

Investors:

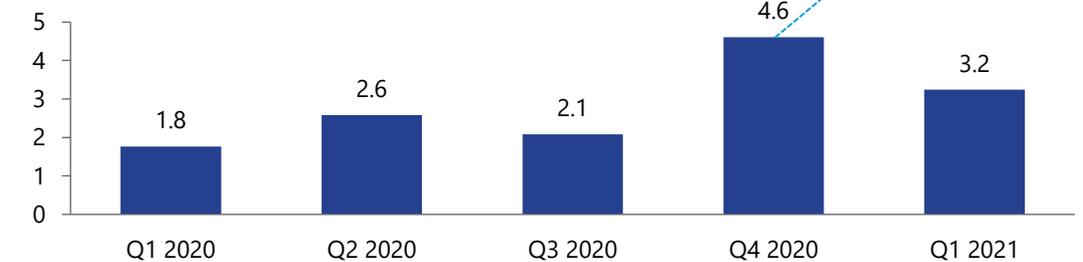
- Investors who are looking for **exposure in the Hong Kong office sector with smaller lumpsums available** should consider submarkets in Kowloon, wherein more options are available with attractive pricing.
- Investors with a stronger capital base should eye office spaces in **core CBD (Admiralty/ Central) and fringe CBD (Wan Chai, Western districts)** locations, with their higher transaction volumes and stronger rebound potential. In fact, **Central and Admiralty accounted for over 50%** of the total strata-title office transactions by total transaction value in 2020.

End-users:

- End-users with long-term real estate needs** should explore acquisition options whilst prices are still in the correction phase, especially those located in CBD or on Hong Kong Island, where new supply between 2021 and 2025 will be relatively limited, and office occupancy costs (both prices and rents) could rebound quickly in core areas once the market recovers.

Strata-title office transactions

HKD (Billion)



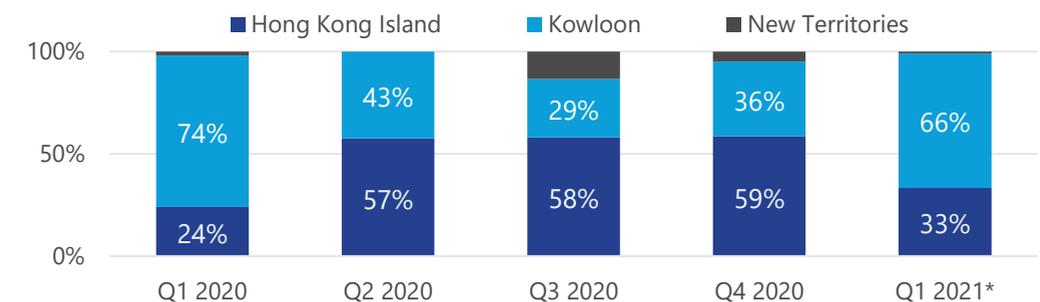
Source: Colliers, [Real Capital Analytics](#), [EPRC](#); *Data as of 6 April 2021

Selected recent transactions

Date	Submarket	Building	Unit	Price (HKD million)
Feb-21	Cheung Sha Wan	888 Lai Chi Kok Road	16th Floor	\$340
Mar-21	Kwun Tong	Montery Plaza	High Floor	\$207
Mar-21	Tsim Sha Tsui	Star House	Units on 12th Floor	\$144
Feb-21	Central	The Centre	Unit 3905	\$109
Feb-21	Sheung Wan	9 Des Voeux Road West	27th Floor	\$106

Source: Colliers, [Real Capital Analytics](#), [EPRC](#)

Strata-office transactions by location (by total transaction value)



Source: Colliers, [Real Capital Analytics](#); *Data as of 6 April 2021



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