REAL ESTATE

What is the future of retail real estate in Hong Kong?

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A recession is alarming Hong Kong's overseas investors and the local business community. But will the city's real estate market ever bounce back? Image credit: Shutterstock

By Adina-Laura Achim

The days when Hong Kong was the envy of the world seem long gone. In fact, after months of ongoing violent protests, rising unemployment, a pandemic, and ensuing government lockdowns, Hong Kong's appeal is starting to vanish.

Furthermore, the arrival of an unanticipated recession Hong Kong's economy shrank 8.9 percent in its worst contraction on record is alarming both overseas investors and the local business community.

Now, the city's economic and socio-political instability are cooling off its once-flourishing real estate market. And in a challenging market, even real estate assets that once brought high-yield returns could become liabilities.

In May, *Bloomberg* reported on a failed government auction in Hong Kong where a Kai Tak commercial plot that was up for sale had to be withdrawn.

According to the *South China Morning Post*, the four submitted bids were too far below the government's undisclosed reserve price. The move came after appraisers had decreased estimates for the land's value by 20 percent to between $820 million (6.38 billion HKD) and $1.35 billion (10.44 billion HKD).

But that is far from the only negative real estate news to come out of Hong Kong.

According to Cushman & Wakefield's estimations, Hong Kong's property prices could end up falling by up to 20 percent. And, according to data from Centaline Property Agency, average rent prices are also falling.

In March, the average rental fell by 2.3 percent month-on-month to $4.37 (33.9 HKD) per square foot.

Office space has also registered a significant drop.

The World Property Journal reports that Hong Kong's office market vacancy rate reached a 12-year high.

Furthermore, International property consultant JLL's latest Property Market Monitor highlights how Hong Kong's

Central's Grade A office rents fell 2.7 percent to $13.20 (102.4 HKD) per square foot this May while the vacancy rate reached 5 percent.

Nelson Wong, head of research at JLL in China, told the World Property Journal that "the overall Grade A office market recorded a negative net take-up of 196,500 per square foot in May due to the slowing leasing demand. In Central, the market recorded a negative absorption 115,600 square feet the highest monthly net withdrawal in more than a year."

Despite specific challenges to different sectors, retail properties remain one of the hardest hit, with tourism and business travel being brought to a standstill and retail collapsing against the backdrop of protests and COVID-19. It is a situation that has become increasingly challenging for commercial property developers.

The *South China Morning Post* reports that Sun Hung Kai Properties, the biggest Hong Kong developer by value, has seen its hotel operating profits drop by three-quarters to $25.4 million (197 million HKD).

Meanwhile, Sino Hotels saw a profit decrease of 93.4 percent to $825,800 (6.4 million HKD) for the six months beginning last December 31.

Commercial retail on Russell Street has also seen a drop.

The Real Deal reports that first-quarter rents on the acclaimed high-end street were 27 percent lower than in 2019.

Despite these price drops, luxury brands Prada, Louis Vuitton and Tiffany & Co., as well as high-street lingerie marketer Victoria's Secret have already announced their plans to vacate Causeway Bay.

It is safe to say that Hong Kong's status as the world's priciest market is being called into question.

The city will remain one of Asia's top luxury hubs. But given the animosity between mainlanders and Hongkongers, U.S. President Trump's probable tariffs, and the ongoing protests, investors are right to be reticent about the future of Hong Kong's real estate market.

We foresee that, in the short run, luxury brands will continue to downsize their footprint in the city and real estate prices will continue to fall.

Nevertheless, the long-time effects are not as grim.

Hong Kong's proximity to China and the positive attitude of the business community towards the new security law should not be underestimated.

While the security law could restore a certain level of stability, it will also encourage affluent mainland Chinese to return to their former favorite shopping destination.

Also, Hong Kong's proximity to mainland China has transformed the city into a global business hub, so it is doubtful that international companies will leave the territory, even if their own governments exercise pressure.

According to the 2019 Annual Survey of Companies in Hong Kong with Parent Companies Located outside Hong Kong (SCoP), the number of overseas and mainland Chinese companies in Hong Kong rose by 9.9 percent to 9,040 in 2019 (up from 8,225 in 2017).

Of the countries with the most businesses in Hong Kong, mainland China ranked first with 1,799 companies, followed by Japan (1,413), United States (1,344), United Kingdom (713) and Singapore (446), according to Hong Kong Business.

Ultimately, we view this sudden drop in real estate prices as a market correction of overheated asset prices.

Hong Kong's real estate market will not crash as long as there is a limited supply of inventory and strong demand, and the city's supply-demand imbalance favors higher prices.

Therefore, smart stakeholders are likely to continue chasing investment opportunities there.

Over the long haul, Hong Kong will remain a profitable real estate hub.

Despite the deteriorating economic outlook, the city continues to be a seller's market, which is why smart investors know that even when there is a temporary drop in profits, they still need to keep their property portfolios balanced and trust that the city's real estate market will eventually roar back.

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