Intelligent Investment

2023 Market Outlook

REPORT

HONG KONG S.A.R.
REAL ESTATE

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ASIA PACIFIC

Contents

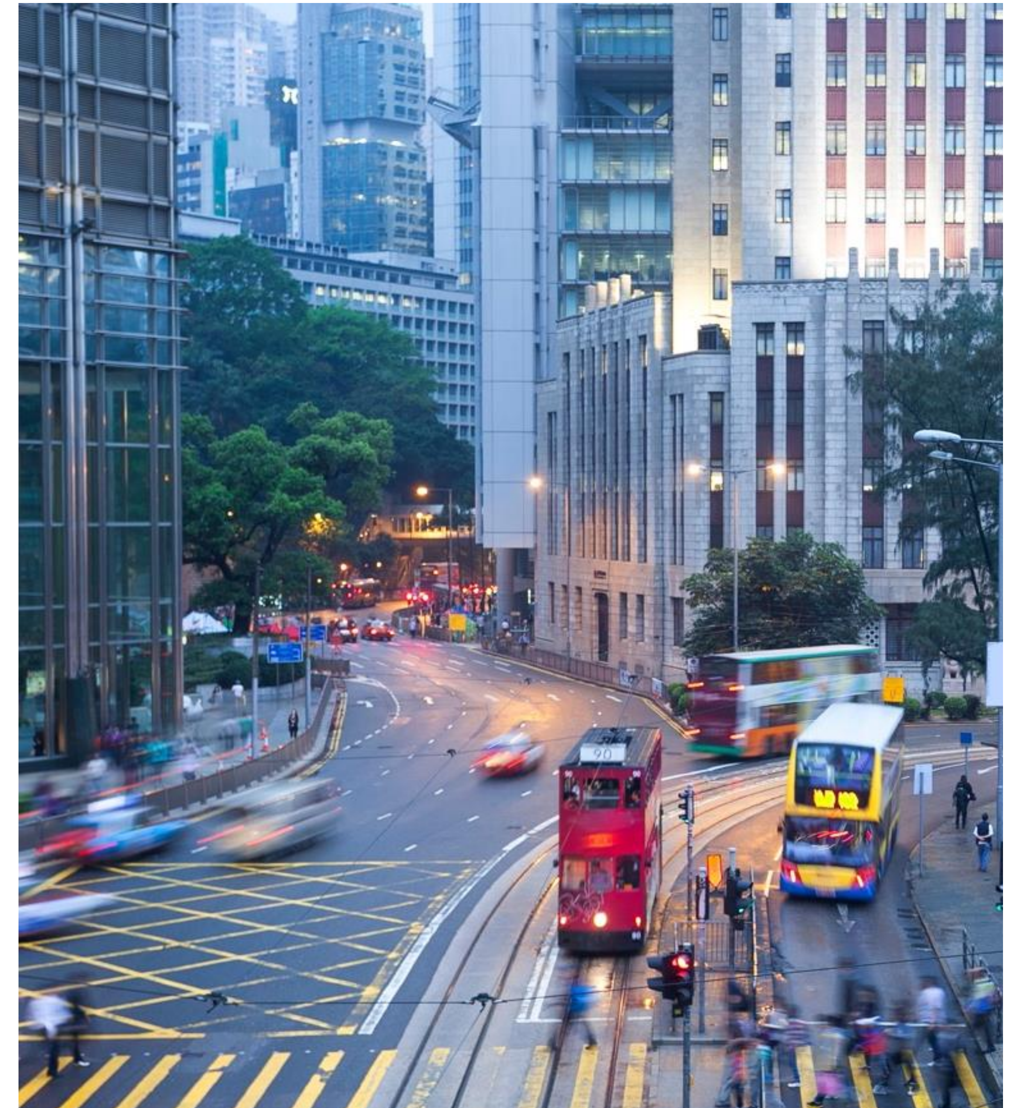
01 **Economy**
The economy will strengthen in 2023 as the border re-opens. Ongoing economic normalisation and peaking interest rates will offset some external uncertainty and support the recovery of commercial real estate demand.

02 **Investment**
The border re-opening will boost investment market sentiment. While investment volume will remain thin in H1 2023 due to high financing costs, activity should improve in H2 2023 as the economic recovery gains momentum.

03 **Office**
Improving business sentiment and travel normalisation will accelerate office leasing momentum in 2023. However, cost control and rising vacancy will weigh on rental growth.

04 **Retail**
Market sentiment will strengthen in 2023 along with the return of mainland Chinese tourists. Any expansionary demand will likely be led by tourist-oriented retailers.

05 **Industrial & Logistics**
The border re-opening will boost cross-border trade demand and benefit Hong Kong's trade and logistics sectors. However, recent strong rental growth will limit many occupiers' rental affordability.



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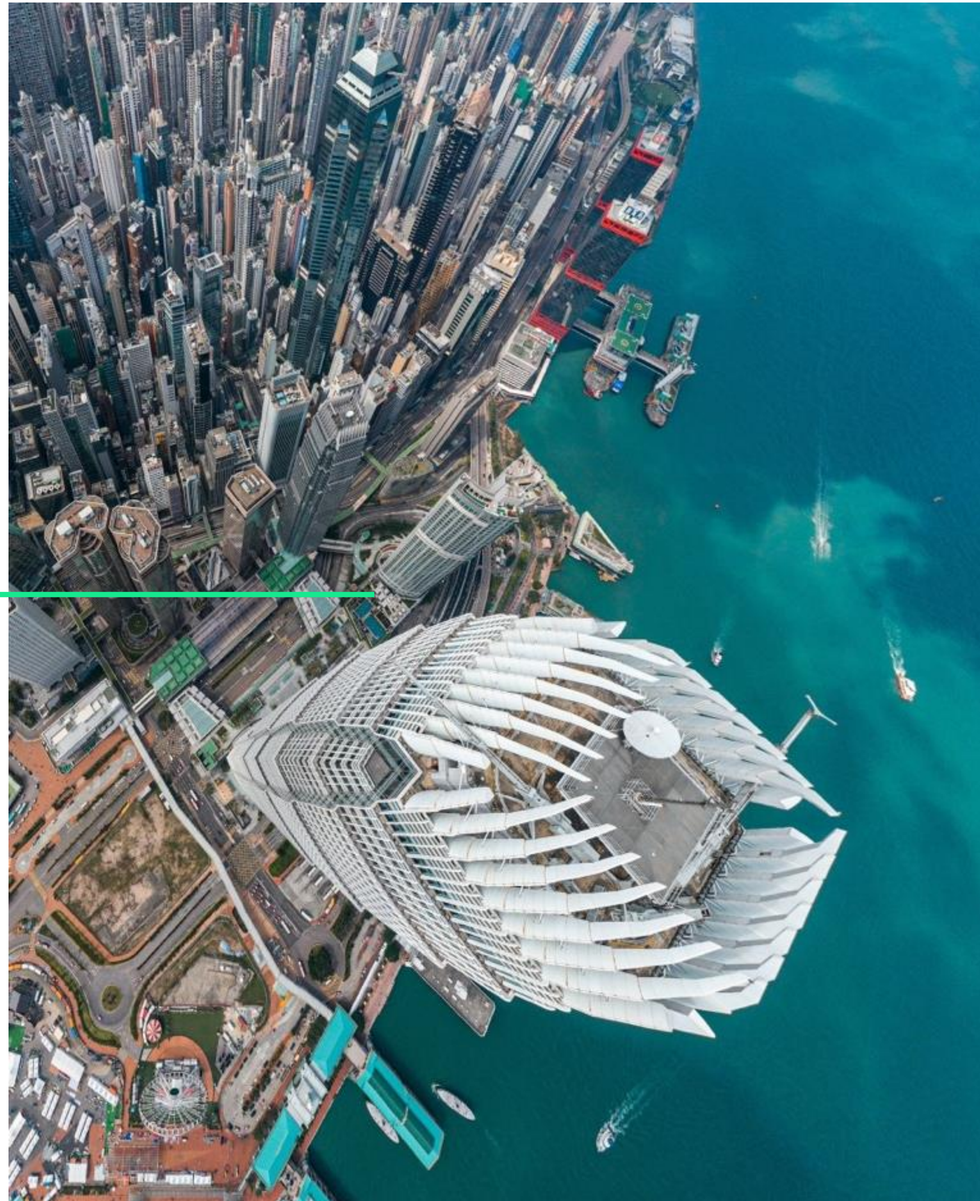
Executive Summary



2022 – A challenging year

A fifth wave of COVID-19 infections, the worsening global economic environment and higher financing costs weighed on Hong Kong's economic performance in 2022, dragging the city into its second recession in three years. Although a mild improvement in economic performance was observed in Q2 2022 and Q3 2022 along with the gradual relaxation of social distancing regulations, commercial real estate investment and leasing demand were subdued for most of the year. While both the office and retail sector reported higher vacancy and lower rents compared with 2021, the industrial sector continued to perform well, with rents edging higher. Investment volume declined by 35% y-o-y over the full-year amid a raft of market headwinds.

2023 – The recovery commences

The much-awaited resumption of quarantine-free cross-border travel between Hong Kong and mainland China in January 2023 will provide a welcome boost to the economy. With office and retail leasing momentum set to accelerate, the recovery of demand coupled with the expectation of peak interest rates in H2 2023 will offset some external risks. This year should therefore witness a significant improvement in market sentiment compared to 2022. CBRE expects that downward pressure on capital values will ease as vacancy and rents stabilise, with the office sector the only major exception due to supply side pressure.

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01

Economy

The economy will strengthen in 2023 as the border re-opens. Ongoing economic normalisation and peaking interest rates will offset some external uncertainty and support the recovery of commercial real estate demand.

2022: Hong Kong mired in recession

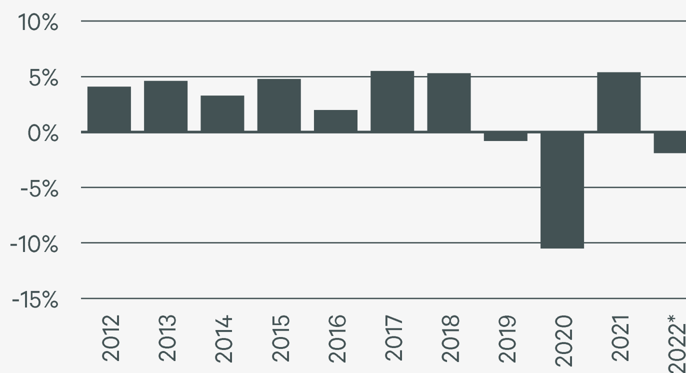
A fifth wave of COVID-19 infections, the worsening global economic environment and higher financing costs weighed on Hong Kong's economic performance in 2022, dragging the city into its second recession in three years.

Hong Kong's real GDP contracted by 3.3% y-o-y in the first three quarters of 2022. The government recently forecasted that full-year real GDP for 2022 would fall by 3.2% y-o-y, reversing the 6.3% y-o-y growth registered in 2021.

Economic and pandemic-related headwinds dampened local consumption demand over the year, although a mild improvement was seen in Q2 2022 and Q3 2022 following the gradual relaxation of social distancing regulations and support from the 2022 Consumption Voucher Scheme. Private consumption expenditure fell by 1.9% in the first three quarters of 2022, after logging 5.4% y-o-y growth in 2021. Despite the government's consumption subsidies, the economic recession and subdued equity market reduced the wealth effect. This led to a 1.1% y-o-y drop in total retail sales in the first 11 months of 2022, in contrast to growth of 8.1% y-o-y for the whole of 2021. Weaker external demand weighed on trading activity in 2022. Aggregate trade fell by 5.9% y-o-y in the first 11 months of the year, in contrast to full-year growth of 25.3% in 2021.

Figure 1: Private consumption expenditure

Private consumption expenditure (in real terms, annual, y-o-y)

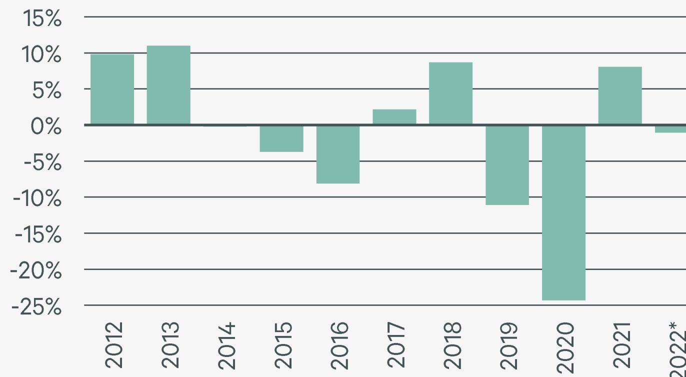


*First three quarters

Source: Census and Statistics Department, January 2023

Figure 2: Retail market momentum

Total retail sales growth (by value, annual, y-o-y)

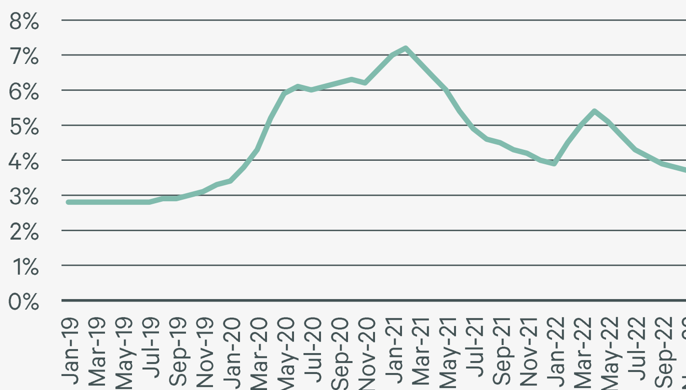


*First 11 months

Source: Census and Statistics Department, January 2023

Figure 3: Labour market conditions

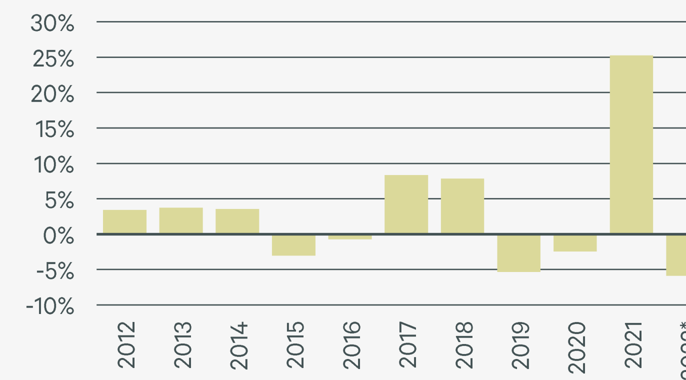
Unemployment rate (monthly, seasonally adjusted)



Source: Census and Statistics Department, January 2023

Figure 4: Trade flows

Aggregate trade growth (by value, annual, y-o-y)



*First 11 months

Source: Census and Statistics Department, January 2023

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The city's labour market nevertheless showed modest signs of improvement as the pandemic subsided. Overall unemployment rate fell 1.7-ppt from April's peak of 5.4% to 3.7% in November, down 0.3-ppt from end-2021. Retail sector unemployment rate declined from 10% in April to 5% in November, returning to levels last seen in October 2019.

The U.S. Federal Reserve's raising of the Fed's Fund Rate seven times and by a total of 425 bps this year resulted in three hikes in Hong Kong's Best Lending Rate from 5.0%-5.25% to 5.625%-5.872% from September 2022. Capital outflows as a result of the widening interest rate gap between Hong Kong and the U.S., coupled with a transfer of capital to the Exchange Fund Bills & Notes programme, led to a HK$281 billion y-o-y fall in the aggregate balance to HK$96.3 billion by end-2022, the lowest since May 2020. The three-month HIBOR climbed by 4.7-ppt y-o-y to 5.0% by end-2022, reaching its highest level since September 2007, while the one-month HIBOR rose by 4.2-ppt y-o-y to 4.3%.

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2023: Economy to recover as border re-opens

While global economic headwinds and high interest rates will pose a challenge to Hong Kong's economy in 2023, the gradual lifting of pandemic-related restrictions in mainland China and Hong Kong will support the recovery of local economic activity and spur business momentum.

The much-awaited resumption of quarantine-free cross-border travel between Hong Kong and mainland China in January 2023 will provide a welcome boost to local business sentiment. The re-opening of the border will fuel new investment and occupier demand and push up transaction volume in the city's commercial real estate market.

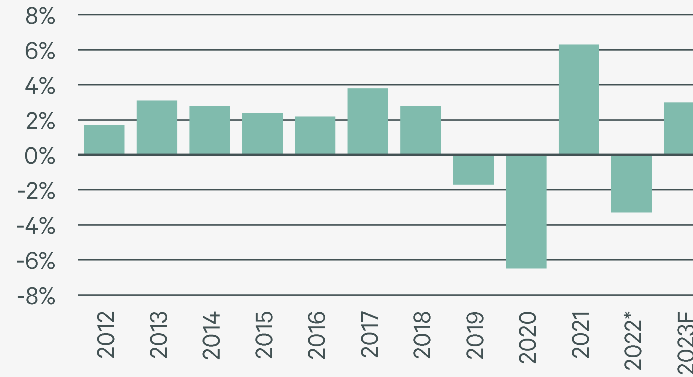
While higher financing costs will continue to weigh on real estate investment demand, interest rates are expected to peak in H2 2023 as the pace and magnitude of hikes slows in the U.S..

The impact of further interest rate hikes should be further mitigated by the recovery in business flow and revenue growth. While the performance of individual sectors will vary, some corporates may slowly return to expansion mode.

Although higher mortgage rates will affect households' disposable income, business growth and improving labour market conditions should help boost consumer confidence. The local stock market is expected to enter bull territory in H1 2023 as investors become more confident in the recovery of the mainland Chinese economy. Overall investment market sentiment and the wealth effect will improve compared to 2022.

Figure 5: Economic momentum

Real GDP growth (by value, annual, y-o-y)

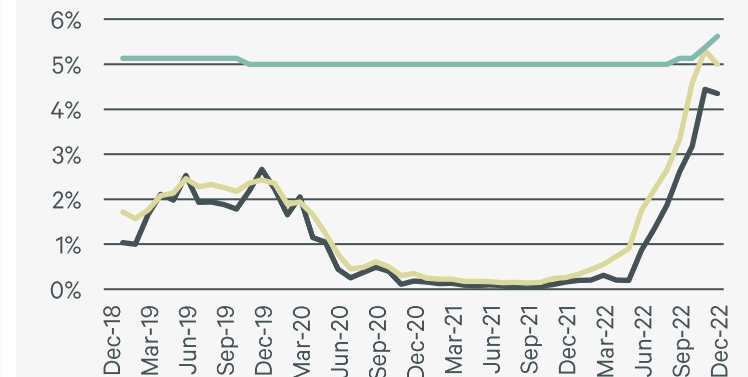


*First three quarters

Source: Census and Statistics Department, CBRE Estimates, January 2023

Figure 6: Interest rates

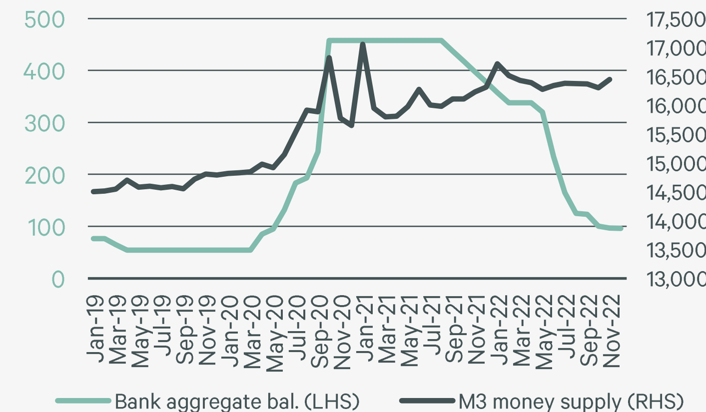
Best lending rate vs. three-month & one-month HIBOR



Source: The Hong Kong Association of Banks, HKMA, January 2023

Figure 7: Capital availability

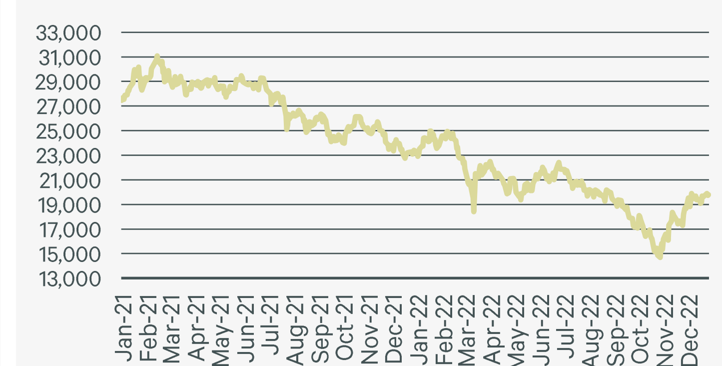
Bank balance vs. M3 money supply (HK$ bil., monthly)



Source: HKMA, January 2023

Figure 8: Stock market performance

Hang Seng Index (points, daily)



Source: HSI Limited, January 2023

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Local consumption is expected to register modest growth. The pandemic situation in mainland China and the performance of the RMB will influence the magnitude of the increase in tourist spending in 2023.

Logistics demand will hinge on mainland China's trade with the rest of the world. Global trade demand is expected to remain soft amid rising interest rates and high inflation in many western economies. A continued rise in COVID-19 infections in mainland China after the country's abandonment of its zero-covid policy in late-2022 might limit the pace of the demand recovery, although faster growth is possible later in the year.

As mainland China re-opens, an increase in IPO listings will energise Hong Kong's financial sector. Major global accounting firms expect homecoming listings to continue and Hong Kong to remain the preferred overseas listing destination for mainland Chinese companies, with IPO fund-raising set to turn more active in 2023.

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02

Investment

The border re-opening will boost investment market sentiment. While investment volume will remain thin in H1 2023 due to high financing costs, activity should improve in H2 2023 as the economic recovery gains momentum.

2022: Economic headwinds and rising interest rates drag on investment activity

Rapid increases in interest rates, falling equity prices and the local economic recession combined to inhibit investor appetite in 2022. Although the Hong Kong Monetary Authority reduced its interest rate stress-test requirement from 300 bps to 200 bps for all property mortgages in Q3 2022, investors remained cautious amid negative-carry and the absence of any signs of a demand recovery. Commercial real estate investment volume* fell by 35.3% y-o-y to HK$52.2 billion in 2022, with just 130 transactions registered during the year, about half of the total figure logged in 2021.

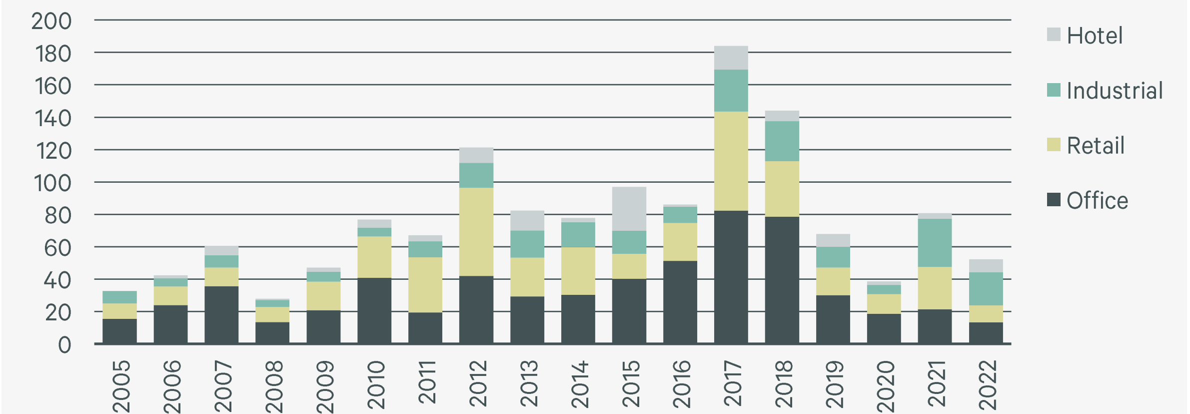
Low vacancy and rising rents ensured the industrial sector was the most traded asset class in 2022. Although industrial assets remained keenly sought after, investment volume fell by 31.1% to HK$20.6 billion. However, the sector still accounted for a 39% share of total investment volume. Despite the low volume of office transactions due to weak demand and mounting vacancy pressure, two big-ticket deals, including the sale of Goldin Financial Global Centre at 17 Kai Cheung Road and the purchase of 51% stake in 83 Wing Hong Street, accounted for 66% of the sector's investment volume in 2022.

The absence of a solid retail market recovery saw street shop investment fall to its lowest level since 2009, with just HK$10 billion-worth of deals changing hands over the full year. The top five retail deals all involved neighbourhood malls, which fetched a total of HK$4.3 billion, 41% of the sector's investment volume. In the hospitality segment, seven hotels were sold for a combined HK$8.0 billion, up from 2021's HK$3.4 billion. Four properties were sold for co-living use, with Weave Living spending HK$2.5 billion on three of these assets. Hotels accounted for 15.3% of total investment volume.

*deals worth over HK$77 million, excluding pure land and related transactions

Figure 9: Investment momentum

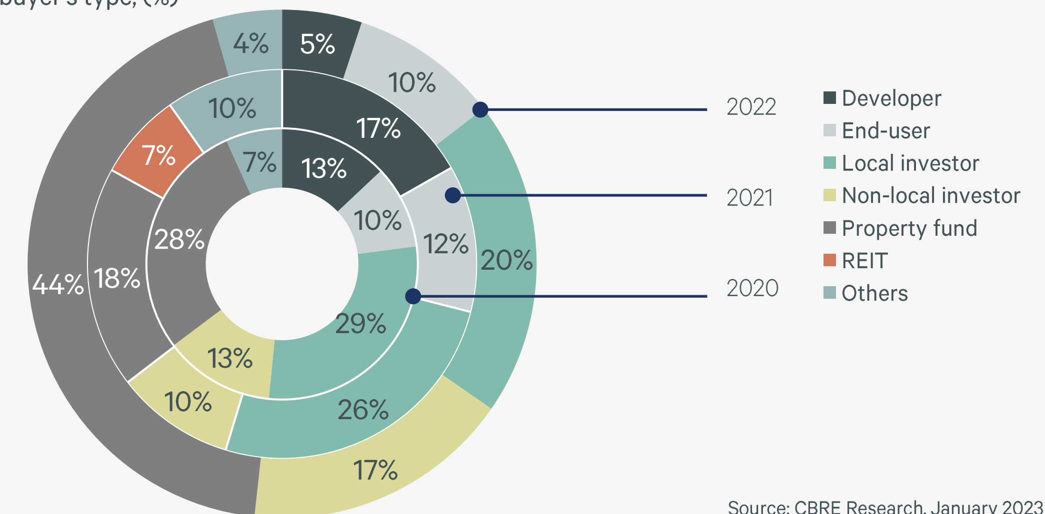
Commercial real estate investment volume* (HK$ bil.)



*deals worth over HK$77 mil., excl. pure land and related transactions
Source: CBRE Research, January 2023

Figure 10: Sources of commercial property investment demand

By buyer's type, (%)



Source: CBRE Research, January 2023

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Despite Hong Kong's challenges of late, global property funds spent HK$22.9 billion on acquiring commercial properties in the city in 2022, contributing 44% of annual investment volume, their highest share since 2005. At least six foreign property funds completed their first acquisitions in Hong Kong in 2022. The biggest deal involved a PAG and Mapletree joint venture's purchase of Goldin Financial Global Centre at 17 Kai Cheung Road in Kowloon Bay for HK$5.6 billion, marking the first en-bloc Grade A office deal since Q1 2021. Other highlights included Ares SSG Capital Management's purchase of a 51%-stake in 83 Wing Hong Street for HK$3.1 billion. While investment from Chinese capital stood at HK$9.2 billion, or 18% of the total, activity was mainly driven by China Resources, which shelled out HK$7.8 billion on four transactions, making it the year's single largest buyer.

Despite higher financing costs, 2022's weak investment volume meant yields did not move out noticeably in 2022. Strong fundamentals ensured prime warehouse capital values climbed by a further 8.6% y-o-y in 2022, after registering 10.2% y-o-y growth in the previous year. Yields compressed by 10 bps. Landlords' strong holding power saw high street shop capital values come down by just 1.1% y-o-y, with yields compressing by 5 bps. In contrast, strata-titled office yields expanded by 30 bps, after capital values declined by 15% y-o-y.

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2023: Investment sentiment expected to improve but high financing costs will remain major barrier

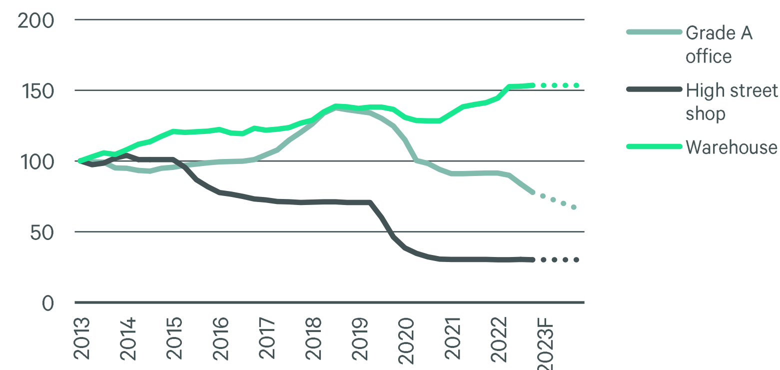
The January 2023 re-opening of Hong Kong's border with mainland China after three years will gradually accelerate business flows of all types and improve investment market sentiment.

While financing costs will remain high, further rate hikes are expected to be relatively modest. With nominal returns of investment properties staying in negative territory, Hong Kong's low inflation will also keep the real cost of borrowing at high levels. Overall investment volume is forecast to remain thin in H1 2023 but will likely improve in H2 2023 as the recovery gains momentum. Should interest rates peak later in the year, another layer of uncertainty for investors will be removed.

While demand from mainland Chinese capital will continue to fuel the Hong Kong investment market in the long run, the depreciation of the RMB in H2 2022 against the USD/HKD may deter short-term purchasing. However, this trend has begun to reverse since the beginning of 2023.

Figure 11: Capital value trends

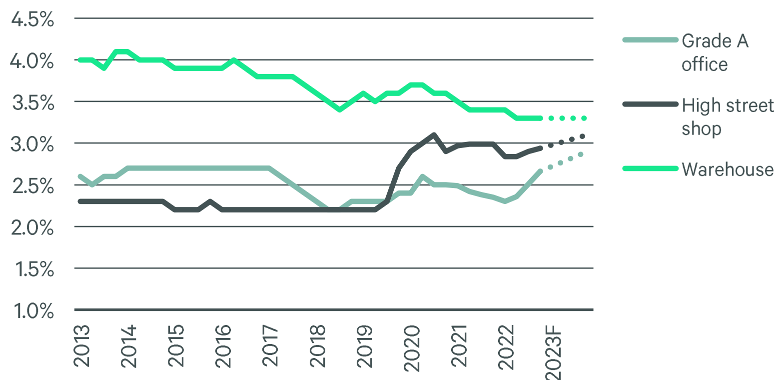
Index (2012 Q1 = 100)



Source: CBRE Research, January 2023

Figure 12: Investment yields

Yields (%)



Source: CBRE Research, January 2023

The recovery of inbound tourism once the travel situation normalises will entice investors to purchase retail properties. Improving shop occupancy and a potential rental rebound will cushion the impact of higher financing costs, with the focus expected to be on assets in tourist-heavy spots where sales volume will jump the most. While enquiries and inspections will climb, the expectation gap between buyers and sellers is expected to remain considerable, ensuring growth in investment volume is slow. Retail premises in and around emerging commercial hot spots such as Kai Tak and new promenades alongside Victoria Harbour will provide investors with opportunities, with leasing demand led by the F&B and other lifestyle trades.

The normalisation of business and travel activity will also strengthen the case for hotel investment. Buying mandates for traditional hospitality operations will increase as occupancy and room rates rise. Domestic schemes near universities are also expected to attract stronger demand as mainland Chinese students return.

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Backed by stable leasing demand, a shrinking pool of stock and low vacancy, industrial properties will remain a preferred asset class for investors in 2023. Despite sluggish home sales and weak office demand, government policies to relax the compulsory sale threshold for the redevelopment of older industrial buildings in selective zones and enhancing flexibility for land amalgamation will enhance redevelopment potential. This will lure interest from property developers and other long-term investors. However, reduced en-bloc opportunities and the widen expectation gap between vendors and prospective buyers will weigh on investment volume growth. Strata-titled industrial floors will continue to attract interest from strategic and opportunistic investors.

Investment demand for office properties is expected to remain weak amid a range of sector-specific headwinds. However, distressed sales will offer opportunities for cash-rich investors.

High vacancy will see office yields expand further in 2023, with capital values potentially falling by another 10%-15% over the year. The improved outlook matched with a gradual rental recovery will see retail yields expand marginally to justify the higher cost of financing, leading capital values to pick up by 0%-5%. Industrial yields will continue to be supported by low vacancy and sustained investment demand. Capital values for industrial assets are likely to stay flat in 2023, as will yields.

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03

Office

Improving business sentiment and travel normalisation will accelerate office leasing momentum in 2023. However, cost control and rising vacancy will weigh on rents.

2022: Vacancy reaches all-time high as new leasing volume slows

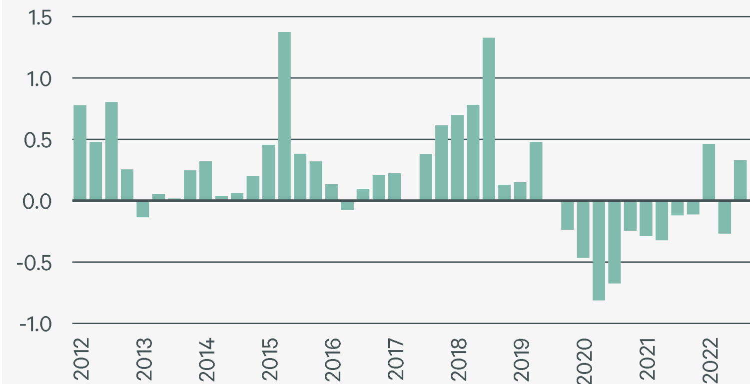
Grade A office leasing momentum was subdued in 2022 as businesses stayed cautious in response to Hong Kong's stringent COVID-19 policies. Global interest rate hikes and heightened geopolitical tension also prevented corporates from proceeding with expansion plans. While full-year new leasing volume dropped 11% y-o-y to 3.8 million sq. ft., this was still 64% above 2020 levels. Leasing demand continued to be primarily driven by relocation activity and smaller size requirements. Deals over 10,000 sq. ft. accounted for only 11% of the total number of transactions in 2022, 20% less than a year ago. New and future schemes were responsible for 76% of the space involved in the top 10 transactions and totalled 499,700 sq. ft..

Banking and finance was the most active sector, accounting for 27% of 2022's total leasing volume. The sector's top three largest transactions, totalling 395,100 sq. ft., all involved consolidations to new Grade A office space. Government departments were also active, leasing 336,900 sq. ft. of space, or 9% of full-year leasing volume, mostly in Kowloon.

High levels of pre-committed space in newly completed buildings ensured net absorption returned to positive territory in 2022. After contracting by 841,500 sq. ft. in 2021 and 2.2 million sq. ft. in 2020, total occupied space expanded by 601,100 sq. ft. in 2022. However, if earlier pre-commitments to new supply are excluded, net absorption for the year was -321,600 sq. ft.. Strict travel restrictions between Hong Kong and mainland China continued to limit cross-border demand, with mainland Chinese firms leasing just 537,300 sq. ft. of Grade A office space in 2022, down 14.8% y-o-y.

Figure 13: Grade A office net demand

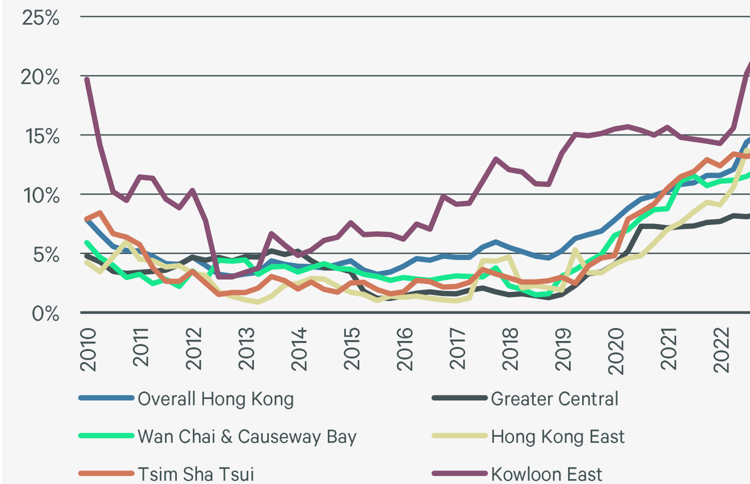
Net absorption (overall, mil. sq. ft., NFA)



Source: CBRE Research, January 2023

Figure 14: Grade A office vacancy trends

Vacancy rate



Source: CBRE Research, January 2023

The year saw the highest level of new supply since 2008, at 4.1 million sq. ft.. Commitments to new stock were few and bar between, with just 20% of space absorbed as of year's end. While some deals involved decentralisation, many others saw commitments by occupiers from within landlords' existing portfolios. As a result, city-wide vacant space reached a record-high of 13.0 million sq. ft., 53% higher than previous benchmark registered in 1999. Vacancy also reached an all-time high of 15.1%, surpassing the 14.4% recorded in 1999. This was more than triple the 10-year average level of 4.7% logged prior to the onset of the pandemic. Except for Greater Central, all submarkets reported double-digit vacancy, with Kowloon East recording the largest increase of 7.9-ppt from 14.5% at end-2021 to 22.4% at end-2022.

Sluggish leasing sentiment and record-high vacancy saw rents fall for a fourth consecutive year, albeit at a slower rate of decline. Overall net effective rents fell by 3.7% y-o-y following a 7.3% y-o-y drop in 2021. Rents in Greater Central declined by 3.4% y-o-y driven by prolonged vacancy in select buildings, while those in Wan Chai/Causeway Bay and Tsim Sha Tsui were down by 3.8% y-o-y and 3.6% y-o-y, respectively. Kowloon East posted the smallest decline, with rents falling by 2.5% y-o-y. In Hong Kong East, where the vacancy rate doubled, rents dipped by 6.5% y-o-y.

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2023: Potential recovery from mainland Chinese firms to support leasing activity

While business activity in Hong Kong has largely returned to normal, global economic headwinds and higher financing costs will ensure multinationals stay cost cautious in 2023.

As mainland China shifts away from its zero-covid policy and re-opens, office demand from Chinese enterprises is likely to gradually return. Overall office leasing momentum is therefore expected to accelerate from 2022, with Greater Central and Wan Chai the main beneficiaries of stronger demand from across the border. Depending on future trends, the previous weakening of the RMB against the USD/HKD could push up operating costs for mainland Chinese firms in Hong Kong. The fragile growth of the Chinese economy after bottoming out will also ensure Chinese firms adopt prudent expansion plans.

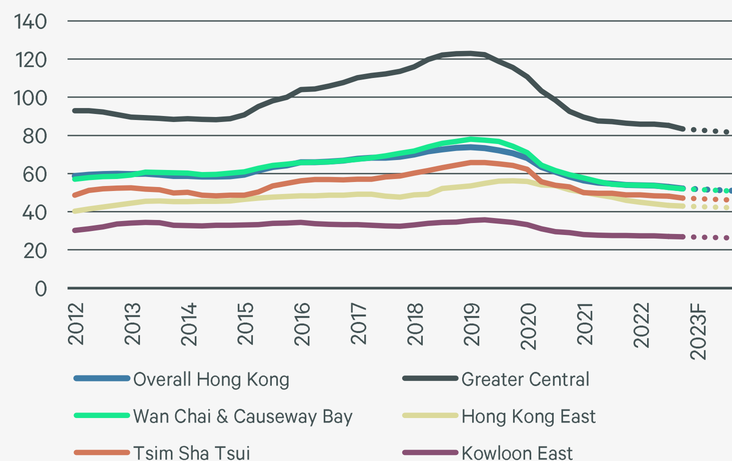
Travel normalisation and government policy support will fuel demand for wealth management services in Hong Kong. Banks and other financial firms are expected to increase their investment in this area of their business, facilitating demand for sky branches and client-facing offices in key business hubs. Demand will cover both whole-floor premises for prestige lounges for traditional banks and smaller units for boutique wealth management companies and family offices.

While established businesses will target custom-made offices, smaller partnerships and start-up financial and investment firms may choose to focus growth on co-working centres. Membership-based flexi offices in premium buildings will remain popular, with the leading operators expected to continue to expand to capture requirements from both infant businesses and major corporations.

Surplus space and improving business prospects will see non-traditional occupier groups such as healthcare centres and art galleries increasingly sought-after by office landlords. Tenants from these trades are typically whole-floor users and often have more stringent requirements for building specifications.

Figure 15: Grade A office rental trends

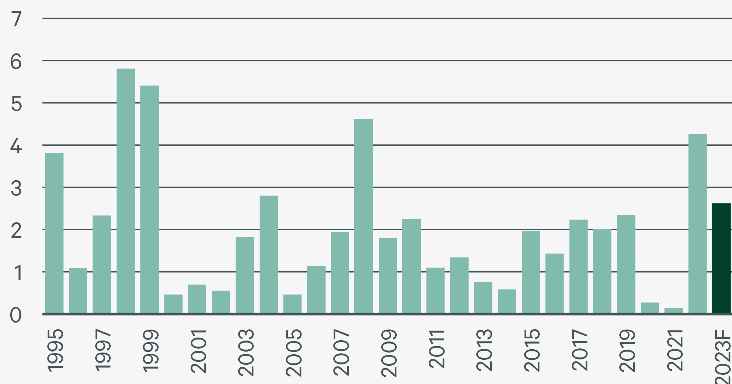
Net effective rent (HK$/sq. ft./month)



Source: CBRE Research, January 2023

Figure 16: Grade A office supply pipeline

Grade A office annual completions (mil. sq. ft., NFA)



Source: CBRE Research, January 2023

Other traditional occupiers looking to upgrade or pursue flight-to-quality moves may find new pipeline supply attractive. Adding to the 4.1 million sq. ft. of new stock in 2022 is another 2.7 million sq. ft. of pipeline supply due in 2023. 80% of this combined 6.8 million sq. ft. of new space is in decentralised locations, offering occupiers premium building quality at a fraction of the rents in traditional submarkets. Decentralisation demand is expected to recover in 2023.

Upgrading requirements can also be met within the CBD, with two new Grade A1 buildings applying for occupation permits this year. Due for completion in Q3 2023, the new schemes total around 800,000 sq. ft. net and are expected to house mainly financial and professional services firms. The arrival of new supply will drive relocation activity among some small-to-medium sized tenants from within core submarkets.

Improving business sentiment and travel normalisation will accelerate office leasing momentum in 2023. Net absorption is expected to remain positive, partly due to earlier pre-commitments in new schemes. However, with cost control set to remain a top priority for most companies and upward pressure on vacancy set to be noticeable, rents will decline until demand is strong enough to reverse the trend. Rents in major submarkets are forecasted to decline by a further 0%-5% in 2023.

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04

Retail

Market sentiment will strengthen in 2023 along with the return of mainland Chinese tourists. Any expansionary demand will likely be led by tourist-oriented retailers.

2022: Leasing demand fails to register strong improvement despite active F&B segment

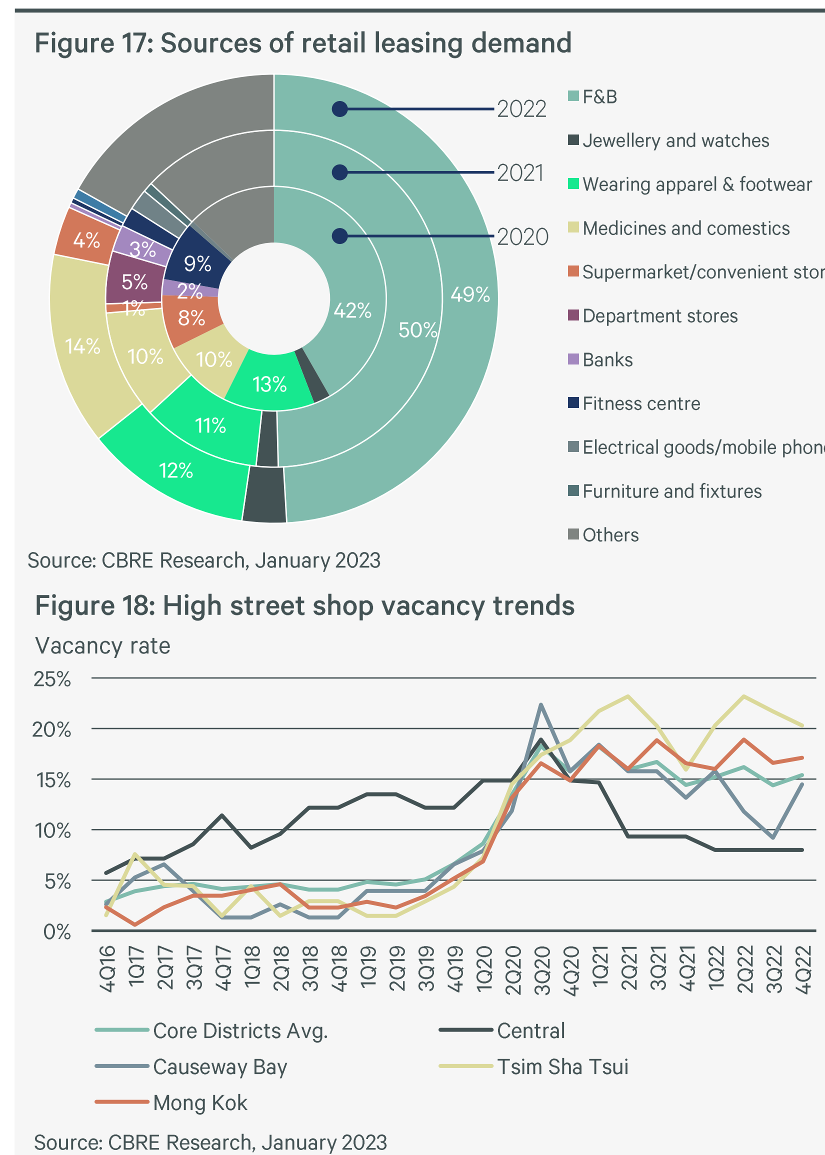
Amid strict social-distancing measures to contain Hong Kong's fifth wave of COVID-19 infections, retail market sentiment remained subdued for most of 2022. While the government-backed HK$36-billion Consumption Voucher Scheme helped support domestic consumption growth in Q3 2022, it was only after travel and other local restrictions were eased in Q4 2022 that retailer sentiment improved more noticeably.

The absence of tourist spending meant local consumption continued to be the main driver of goods and services. However, restrictive measures, escalating mortgage rates and a negative wealth effect stemming from the equity and home price correction ensured household spending did not improve over the year. Domestic consumption edged down 1.9% y-o-y in the first three quarters of 2022, while total retail sales dropped 1.1% y-o-y in the first 11 months of the year.

The return to the office and subsidised spending from the government consumption coupon scheme failed to boost dining volume in 2022. Total restaurant receipts fell 9.3% y-o-y in the first three quarters of 2022, reversing the low-base growth registered during the same period in 2021. This came despite the 1.8% rise in the total number of licensed restaurants during the period.

Despite weaker sales, F&B was the most active sector in the retail leasing market in 2022, accounting for 31% of transactions tracked by CBRE. Landlords turned increasingly accommodative in order to capture what little leasing demand that existed, ensuring F&B groups emerged as a popular choice of tenant. Major F&B deals included the signing of a lease for the world's first Transformers restaurant in the traditional tourist hotspot of Russell Street in Causeway Bay.

Figure 17: Sources of retail leasing demand



Source: CBRE Research, January 2023

Figure 18: High street shop vacancy trends

Source: CBRE Research, January 2023

In addition to their growing footprint in the office market, healthcare centres also displayed an interest in returning to street shops over the course of 2022 amid discounted rentals.

Amid growth of just 0.6% y-o-y in watch and jewellery sales in the first 11 months of 2022, luxury goods retailers were in no mood to expand. Most retailers in the sector retained a wait-and-see attitude, preferring to monitor the development of the pandemic and inbound tourism. Only 2% of the year's leasing volume involved luxury brands.

The period saw no improvement in occupancy despite a temporary drop in vacancy caused by short-term commitments. Overall high-street shop vacancy stood at 15.4% in December 2022, 1-ppt higher than a year earlier. Supported by a recovery in white-collar footfall, Central vacancy fell by 1.3-ppt to 8.0%, the only submarket to see single-digit and lower vacancy.

High-street shop rents in the four core districts reversed the 1.2% y-o-y growth logged in 2021, falling 3.0% in 2022.

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2023: Return of tourists to support street shop rental growth

Retail market sentiment will strengthen in 2023 along with the gradual return of mainland Chinese tourists, who contributed about 30% of Hong Kong's total retail sales before the pandemic.

While the current high level of COVID-19 infections in mainland China will ensure the inbound tourism and retail sales recovery will be less noticeable in Q1 2023, the rebound will accelerate as the situation improves.

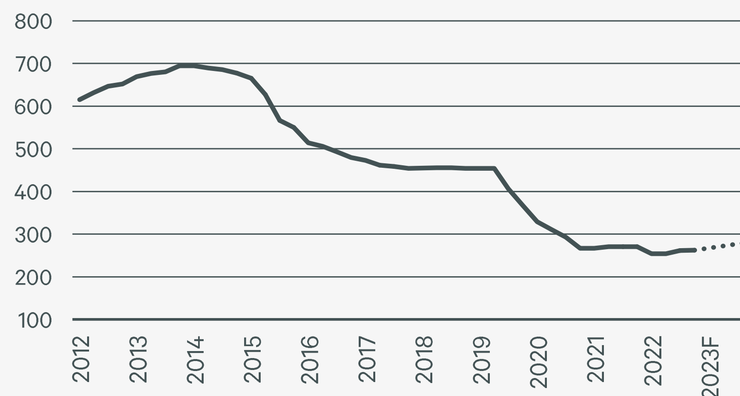
Although growth from last year's low base is expected to be significant, the weaker RMB against the USD/HKD, fast-growing onshore duty-free shopping and slower income growth on the mainland could dampen the pace of recovery.

Other risks include a rise in outbound travel, which will impact local consumption growth in Hong Kong. Spending patterns are expected to become more prudent as high interest rates weigh on household spending. Income growth will likely be mild amid the weakening global economic outlook.

Any expansionary demand in 2023 will likely be led by tourist-oriented retailers. Cosmetics and beauty product chains, pharmacies and also luxury brands, perhaps at later stage, will look to regain exposure after three years' inactivity. Depending on the pace of the inbound tourism recovery, expansion will likely be implemented with caution in H1 2023 and accelerate later in the year when retailers' business outlook becomes clearer.

Figure 19: High street shop rental trends

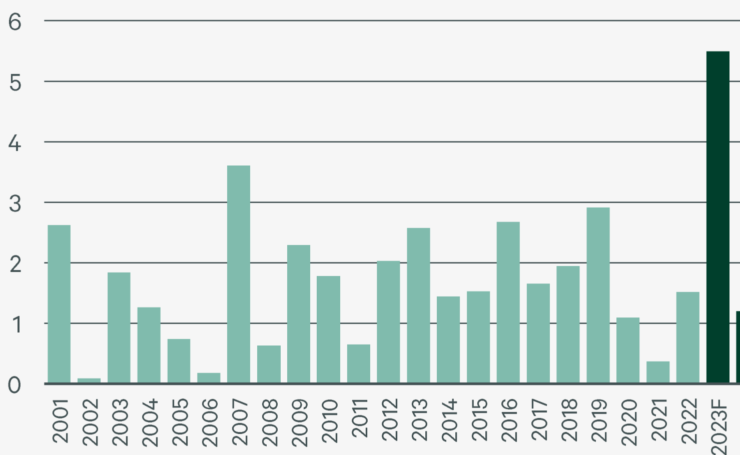
High street shop rent (core districts, HK$/sq. ft./month)



Source: CBRE Research, January 2023

Figure 20: Retail supply pipeline

Retail space annual completions (mil. sq. ft., GFA)



Source: CBRE Research, January 2023

F&B will remain an important trade for retail landlords as the removal of social distancing measures on dining-in helps restore restaurant operators' margins.

Although leasing in core shopping districts is expected to gain momentum, this will require landlords to set attractive rents at this early stage of market recovery. Affordability is set to remain a key consideration for most retailers, who continue to seek business stability.

While omni-channel sales will remain a broad trend, recovering footfall will see Hong Kong retailers channel more capital into boosting brick-and-mortar sales. Although online sales' share of total sales has risen to over 10%, growth in in-store sales could catch up in 2023. CBRE's recent "Voices from Hong Kong: How will people live, work and shop in the future?" report found that local consumers are inclined to shop in-store to a greater extent than their global and Asia Pacific counterparts. This will ensure in-store sales remain critically important in Hong Kong.

Renewed demand for retail premises will improve shop occupancy, with improvement in this metric depending on the narrowing of the expectation gap between landlords and retailers. As in the office market, retail supply is set to surge in 2023, with a total of 5.7 million sq. ft. of new shopping mall stock due to come on stream, 98% of which will be in decentralised districts. While leasing is ongoing, some major new malls are understood to be already over 50% pre-committed.

While several risks exist despite the anticipation of footfall and retail sales growth, CBRE expects high street shop rents to grow by 5%-10% in 2023. Should the pace of inbound arrivals accelerate in H1 2023, full-year growth could exceed the 5%-mark.

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05

Industrial & Logistics

The border re-opening will boost cross-border trade demand and benefit Hong Kong’s trade and logistics sectors. However, recent strong rental growth will limit many occupiers’ rental affordability.

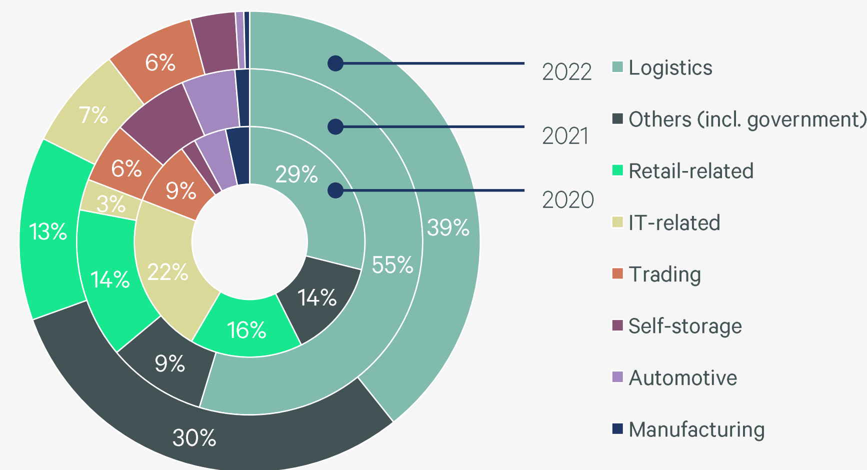
2022: Vacancy remains low despite persistent global trade headwinds

Trade activity slowed in 2022 as both external demand and mainland China trade volume softened. After logging record high 25.3% y-o-y growth in 2021, Hong Kong's aggregate trade fell by 5.9% y-o-y in the first eleven months of the year. The divergent pace of economic recovery across the region resulted in varied trade performance. Exports to China and Japan fell by 10.9% y-o-y and 11.2% y-o-y, respectively, while exports to EU-27 countries declined by just 0.5% y-o-y over the same period. In contrast, exports to ASEAN countries grew by 5.0% y-o-y.

Leasing volume nevertheless increased in 2022 and was primarily driven by demand from the public sector. The city's fifth wave of COVID-19 infections saw government departments take up 1.4 million sq. ft. of space for short-term storage of medical supplies in various locations, accounting for 25% of the year's total leasing volume. Other Third-Party Logistics (3PLs) companies also benefited from government procurement, which helped them commit to expansion.

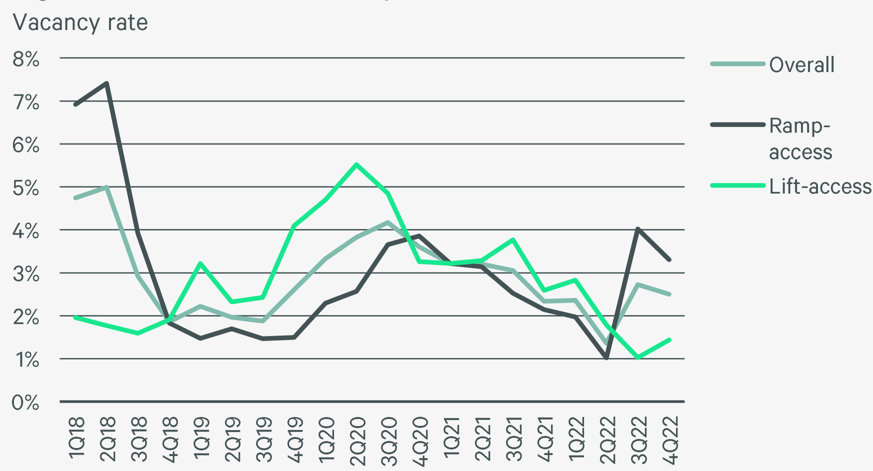
Space requirements were also seen from grocery retailers and electronics companies, which leased a combined 968,100 sq. ft. of industrial space in 2022. Noticeable expansions during the year included HKTV Mall, which took up 144,200 sq. ft. in Mapletree Logistics Hub Tsing Yi, and Don Don Donki, which relocated and expanded to a 87,800 sq. ft. space in Dynamic Cargo Centre in Tsuen Wan. Electronics distributor Omni Logistics expanded by a total of 261,200 sq. ft. across several sites.

Figure 21: Sources of industrial leasing demand



Source: CBRE Research, January 2023

Figure 22: Warehouse vacancy trends



Source: CBRE Research, January 2023

Data centre operators were also active, leasing a total of 387,800 sq. ft. of space in 2022, up from 235,000 sq. ft. in 2021. However, when land acquisition for conversion and redevelopment into data centres were taken into account, overall data centre leasing activity fell from 817,000 sq. ft. in 2021 to 687,700 sq. ft. in 2022.

Forced relocations remained a prominent phenomenon in 2022, albeit to a lesser extent than in 2021, with 177,000 sq. ft. of new leasing activity logged. Deals included SF Supply Chain leasing 97,700 sq. ft. in Kwong Sun Hong Godown in Fanling, moving from the soon-to-be-demolished Yuen Fat Godown in Cheung Sha Wan. Elsewhere, Eternal Asia leased 58,200 sq. ft. in Jumbo Plaza in Sheung Shui, ahead of its relocation from 11 On Chuen Street in Fanling, also slated for conversion to a data centre.

Sustained demand and forced relocations ensured warehouse vacancy remained low. Despite the completion of the 1.6 million sq. ft. Goodman Westlink in Tuen Mun, overall warehouse vacancy edged up by just 0.16-ppt to 2.5% in 2022. Of the 62 monitored buildings, 44 were fully occupied as of year-end. Low vacancy ensured warehouse rents grew at their fastest rate since 2015, rising 5.3% y-o-y in 2022. Growth was strongest for ramp-access buildings, which recorded gains of 5.9% y-o-y in 2022, while rents for lift-access premises also rose by 4.7% y-o-y over the same period.

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2023: Improved trade and logistics flows to support continued strong performance

The re-opening of the border with mainland China will drive cross-border trade demand and benefit Hong Kong's trade and logistics sectors in 2023.

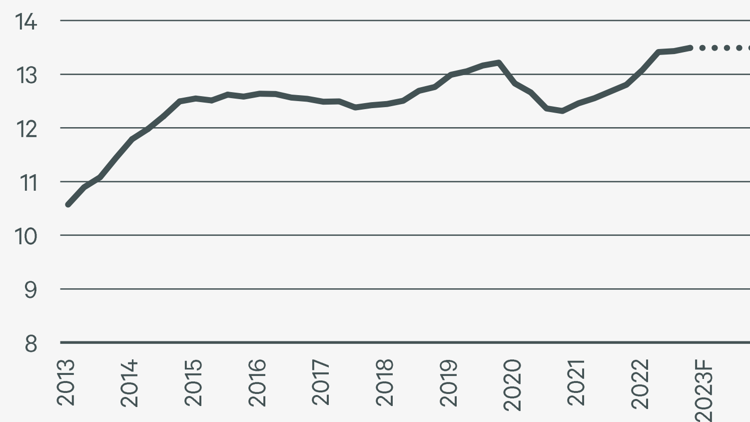
Combined with an increase in air traffic, this will alleviate supply chain disruption and improve global trade flow. While imports and exports are likely to rise, growth is expected to be gradual and modest as high interest rates and inflation dampen global consumption demand. China's high rate of COVID-19 infections will lead to slower leasing demand growth in H1 2023 but economic momentum and hence demand could accelerate in H2 2023.

Hong Kong's retail market recovery is expected to be led by tourist-oriented trades. Sales of pharmaceutical goods, cosmetics and personal care products as well as luxury items will likely see stronger growth and generate requirements for logistics and warehousing services in 2023. This will lend support to leasing demand from 3PLs.

As brick-and-mortar sales bottom out, retailers may consider investing more capital in physical stores. While e-commerce will remain a common mode of consumption, sales growth in physical stores will likely be more noticeable. After undergoing expansion over the past two years, warehouse leasing demand from e-commerce operators could slow relative to that from general retailers in 2023.

Figure 23: Industrial rental trends

Warehouse rents (overall, HK$/sq. ft./month)



Source: CBRE Research, January 2023

Figure 24: Warehouse supply pipeline

Warehouse annual completions (mil. sq. ft., GFA)

Source: CBRE Research, January 2023

Demand is also expected to come from the fast-growing innovation and technology sector, backed by strong government policy support. Re-industrialisation will spur demand for automation and other advanced manufacturing facilities.

Migration to 5G services will continue to boost demand for data centres. However, leading tech firms are under pressure to cut costs as revenues decline, while geopolitical tension continues to cloud the outlook for data centre demand in Hong Kong. Leasing demand from Chinese data centre operators is expected to be relatively resilient, while foreign operators will be more cautious.

Leasing demand from forced relocations will remain intact. Fifteen buildings are planned to be modified or demolished in 2023, resulting in the potential withdrawal of 5.3 million sq. ft. of industrial space. The commencement of the Phase 2 development of Hung Shui Kiu will require the clearance of 200-ha of land, spurring new relocation demand. The government's recent decision to lower the compulsory sale threshold for aged industrial buildings will also encourage the amalgamation of undivided shares for future redevelopment. The government also estimates that another 200-ha of brownfield sites will be cleared from now to 2026.

New warehouse supply will reach 5.4 million sq. ft. in 2023, the highest annual figure since 1992. Future supply will come solely from Cainiao's scheme at the Hong Kong International Airport, at which half of the space will be for self-use. Coupled with the volume of warehouse space estimated to be removed for alternative use or redevelopment, warehouse vacancy is expected to remain at single-digit levels in 2023.

Despite the promising outlook, recent strong rental growth has dented occupiers' rental affordability. This will ensure warehouse rents hold largely flat in 2023.

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