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PROPERTY INSIGHTS

Hong Kong | Quarter 2, 2014

Strong interests in en-bloc offices

Market Overview

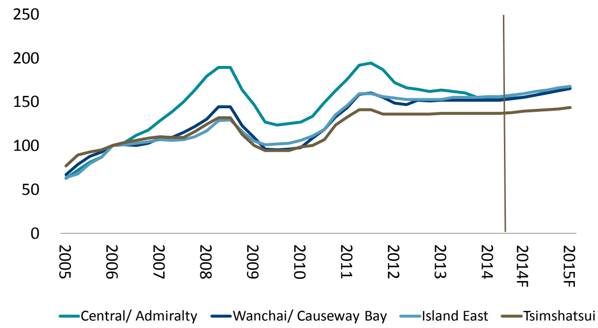
Office rents remained relatively flat this quarter with Kowloon East having dropped by 3.2% quarter-on-quarter (q-o-q) (Figure 1). Demand in Central/Admiralty is currently being fuelled by the expansion of Chinese financial institutions and this has caused vacancy to drop by 0.4 percentage point to 5.2%. Interest in Kowloon East persists but rents dropped in light of growing supply and increasing vacancy.

Within Q2, affected by negative sales growth, changing spending habit of the Mainland tourists and increasing vacancy in retail premises, retail rents in Hong Kong Island and Kowloon declined by 3.0% and 6.4% q-o-q, respectively. Shopowners have become more pragmatic but the rental expectation gap persists between landlords and tenants despite having narrowed.

The relaxation on Double Stamp Duty (DSD) has stimulated market activities with the number of S&Ps for building units and land spiking by 43.3% between Q1 and Q2 2014. Meanwhile, new residential projects launched across the city within the quarter saw very positive response.

Figure 1

DTZ office rental index (Q1 2006 =100)



Source : DTZ Research

Two major en-bloc office transactions were recorded this quarter in the non-core office submarkets of Kowloon East and Wong Chuk Hang. Hence, despite the number of major deals dropped from 60 to 29 between Q1 and Q2 2014, the total consideration increased from HK$12.4bn (US$1.6bn) in the first quarter to HK$17.8bn (US$2.3bn) in the second quarter.

Economic Overview

The preliminary figure on GDP shows that the economy grew moderately in the first quarter of 2014, with real GDP growth rate reaching 2.5%, slightly lower than the 2.9% in the preceding quarter (Table 1).

Total exports in May were up by 4.9% compared to a year earlier to reach HK$306bn (US$39.5bn) (Table 1). There are some improvements in advanced markets, with exports to Japan rising by 11.9% y-o-y and exports to Germany growing by 9.4% y-o-y.

Inflationary pressure remained low in May, with the overall consumer price rising by 3.7% on a yearly basis, but remaining the same as that in April (Table 1).

The labour market remained tight in March – May 2014, with seasonally adjusted unemployment rate stayed at the 16-year low of 3.1% (Table 1).

Domestic private consumption expenditure grew at an annual rate of 4.3% to reach HK$358.6bn (US$46.3bn) in Q1 2014, the slowest growth since Q3 2009. The sluggish growth is mainly due to the timing of the Easter holiday (Table 1). The expected low unemployment rate and further increase in wages will continue to support the growth of private consumer spending in the second half of the year.

Total visitor arrivals in May increased by 10.8% y-o-y to reach 4,590,579. As such, visitor arrivals in the first five months of 2014 reached 24,036,520, equivalent to a jump of 13.6%. The growth in tourism industry continued to be driven by Mainland Chinese visitors, as 75.2% or 3,452,734 were from Mainland China. On the other hand, total retail sales in May dropped by 4.1% y-o-y to be recorded at HK$39.0bn (US$5.0bn). Due to the change in consumption pattern of the mainland tourists, negative retail sales growth was recorded for the past four months (Table 1).

Table 1

Economic indicators

Indicator	Period	Unit	Value	Change y-o-y (%)
GDP at constant prices*	Q1 2014	HK$bn	517.8	+2.5
Total exports	May 2014	HK$bn	306.0	+4.9
Private consumption expenditure	Q1 2014	HK$bn	358.6	+4.3
Unemployment rate (seasonally adjusted)	Mar 2014 – May 2014	%	3.1	-0.3 pts
Visitor arrivals	May 2014	Million	4.6	+10.8
Composite CPI	May 2014	-	119.2	+3.7
Total retail sales value	May 2014	HK$bn	39.0	-4.1

* In chained (2012) dollars

Source : Census and Statistics Department, HKSAR, Hong Kong Tourism Board

Residential

With the proposed relaxation of Double Stamp Duty (DSD) in May, the residential market regained momentum and transaction volume rebounded in the second quarter of the year. As such, the number of S&Ps for building units and land reached 20,716 in Q2, equivalent to a jump of 43.3% from Q1. In particular, the transaction volume increased from 6,178 S&Ps in April to 6,978 in May, and further to 7,560 in June (Figure 2).

Recent land sales in Pak Shek Kok, Tai Po show that developers have become more conservative in making their bids in view of huge potential supply in the New Territories. By contrast, due to limited supply in the urban area, sites in both Kai Tak and Wan Chai sold at a very high price. Keen interest in bidding for a land plot in Shouson Hill also revealed that the high end niche has not been affected by government measures.

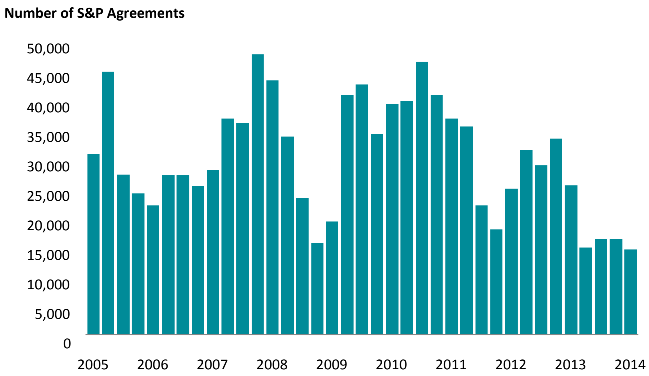
The government proposed a six-month exemption period from payment of the DSD which will take effect once the official contract is signed. This proposed delay in tax payment is expected to benefit up-graders and buyers of non-completed flats. As such, the first hand market is gaining momentum and several new projects across the city such as City Point received very good market response.

On the other hand, the relaxation of government measures, combined with the robust sales of new projects, activated the secondary market. The transaction volume of the secondary sales increased by 48.9% from March to April, and rose by another 21.5% to reach the level of 4,429 in May. As supported by strong fundamental demand and the reduced number of listings, room for negotiation has narrowed. As a result, vendors are more optimistic in raising their asking price and a number of high unit rate transactions were recorded.

With respect to price, the mass market and the luxury market performed differently. The mass market price index recorded a rise of 1.4% compared with the previous month and was up by 0.4% from the last quarter. Compared with the last price peak (February

Figure 2

Transaction volume of S&P Agreements (No. of S&P Agreements)



Source : Land Registry

Figure 3

Residential price index (Jan 2000 = 100)

Source : DTZ Research

Table 2

Primary residential market statistics TBU

	Total stock (no. of units)	price index (Jan 2000 = 100)	q-o-q change (%)	y-o-y change (%)
Mass Market	1,037,237	207.3	0.4	-0.2
Luxury Market	86,396	208.0	-1.6	-6.1
Overall	1,123,633	207.6	-0.4	-2.8

Source : DTZ Research, Rating and Valuation Departement HKSAR

2013), the drop narrowed down to 4.5%. However, prices in the luxury sector continued to soften, with its price index being recorded at 208.0 in May, down by 0.4% from April and 9.0% from the peak in February 2013 (Figure 3 and Table 2).

Looking into the second half of the year, prices in the luxury sector would continue to see downward pressure. By contrast, the demand for small lump sum units will remain strong, but with no major price increase anticipated.

Office

As there were no new completion in this quarter, the overall stock of Grade A office remains at 78,994,024 sq ft. Overall net absorption reached 96,482 sq ft and vacancy rate dropped from 5.6% in Q1 to 5.5% in Q2. However, the overall rent dropped further to be recorded at HK$59.3 (US$7.7) per sq ft per month, this being the fourth consecutive quarter in which overall rents have dropped (Table 3).

In the Central Financial District (CFD) of Sheung Wan/ Central/ Admiralty, demand of office space continues to be driven by companies of PRC origin. With the establishment of Shanghai-Hong Kong Stock Connect, the transaction volume of the stock market is expected to surge and Chinese brokerage companies are expected to benefit from this rapid business growth. As Chinese financial institutions have a strong preference for locating in the CFD, numerous leasing activities within this submarket have recently been recorded. To cite just one example, China Citic Security took up one floor of office space (13,107 sq ft) at Exchange Square Two. As such, the net absorption of the CFD reached 139,411 sq ft and vacancy rate dropped from 5.6% in Q1 to 5.2% in Q2. On the supply side, landlords are no longer willing to offer concessions, causing the overall rent to stabilize at HK$99.3 (US$12.8) per sq ft per month (Table 3 and Figure 4).

While rents in other sub-markets remained stable, the rents in Kowloon East softened by 3.2% q-o-q to be recorded at HK$32.0 (US$4.1) per sq ft per month (Table 3 and Figure 4). As the submarket is backed by the government policy "Energizing Kowloon East Office" and offers abundant choice of high quality office spaces, Kowloon East has increasingly attracted the attention of office market occupiers. In facts,

Table 3

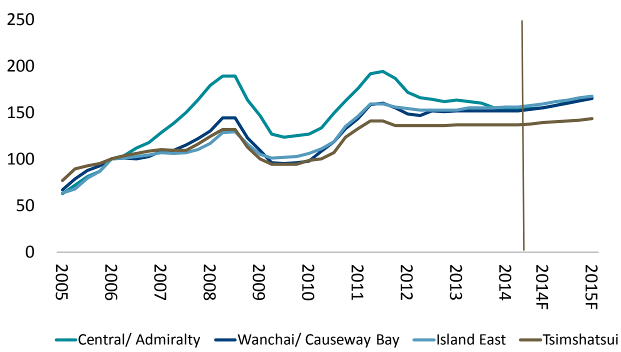
Grade A office market statistics

District	Total stock (million sq ft)	Availability ratio (%)	Monthly Rent (HKD per sq ft)	Change q-o-q (%)
Sheung Wan/ Central / Admiralty	29.5	5.2	99	0
Wanchai / Causeway Bay	16.0	4.3	47	0
Island East	11.0	2.8	38	0
Tsimshatsui	9.3	5.2	33	0
Kowloon East	13.3	10.1	32	-3.2
Overall	**79.0**	**5.5**	**59**	**-0.3**

Source : DTZ Research

Figure 4

DTZ office rental index (Q1 2006 = 100)



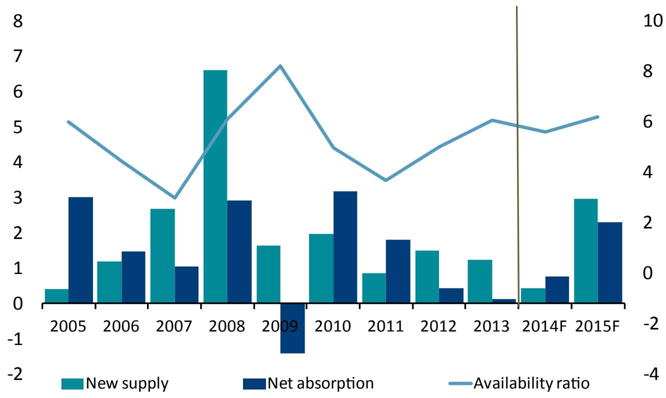
Source : DTZ Research

tenants from different sectors are looking for office space in this submarket. Though the demand for office space in this area is strong, rental growth is suppressed at the moment by huge supply and high vacancy rate.

Swire properties is moving forward with its intention to redevelop a portion of the Island East portfolio. Tenant relocation is expected to take place gradually. As there is a lack of office space in Island East, some tenants may be relocated to other submarkets, stimulating demand and market performance across various regions.

Figure 5

Grade A office supply (GFA sq ft million), net absorption (GFA sq ft million) and availability ratio (%)



Source : DTZ Research

Retail

According to the Immigration Department, 387,700 visitors from Mainland China visited Hong Kong between May 1st and 3rd, which is equivalent to a drop of 1.7% compared with the same period a year earlier. This is the first time to witness a drop of mainland visitors during the Labour Day Golden Week since the implementation of individual travel scheme in 2003.

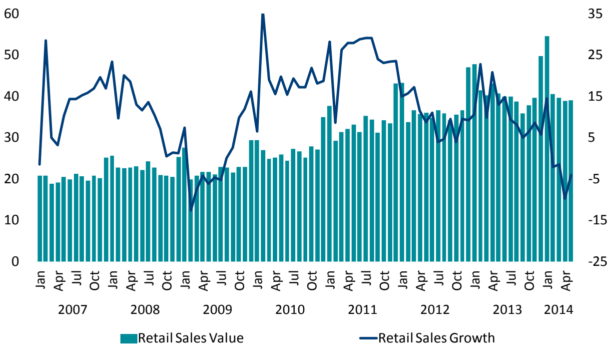
On the other hand, the introduction of anti-extravagance rules, the slowdown of the Chinese economy and the reduction of purchasing power of mainland visitors have adversely affected retails sales in Hong Kong, especially for luxury goods. As such, total retail sales in May dropped by 4.1% y-o-y to reach HK$39.0bn (US$5.0bn) (Figure 6). In particular, the sales of jewellery, watches and clocks, and valuable gifts recorded a y-o-y drop of 24.5%. However, the sales of mid-range products continue to thrive. In particular, the sales of medicines and cosmetics increased by 8.0% y-o-y, which explains why this group of tenants is more active recently. For instance, Nature Republic leased 2,242 sq ft in Taurus Building while Bonjour leased 1,941 sq ft in Hanley House.

Affected by the visitor arrival and retail sales figures, multinational brands have slowed down expansion plans in prime shopping districts and landlords are more willing to accept a lower rent and shorter-term tenancy agreements. Hence, both Hong Kong Island and Kowloon recorded rental decline in this quarter, with the former dropping by 3.0% compared with the previous quarter and the latter dropping by 6.4% over the same period (Table 4 and Figure 7).

However, the situation is completely different in non-core areas. As Mainland Chinese visitors prefer to shop in the New Territories due to ease of convenient access to the border, leasing activities were more active in areas like Sheung Shui, Yuen Long and Tuen Mun. As such, the New Territories rental index continued to outperform the other two submarkets, with rental growth of 3.4% q-o-q and 7.1% compared with the previous year (Table 4 and Figure 7).

Figure 6

Total retail sales (Value HK$bn, yearly growth %)



Source : Census and Statistics Department HKSAR

Table 4

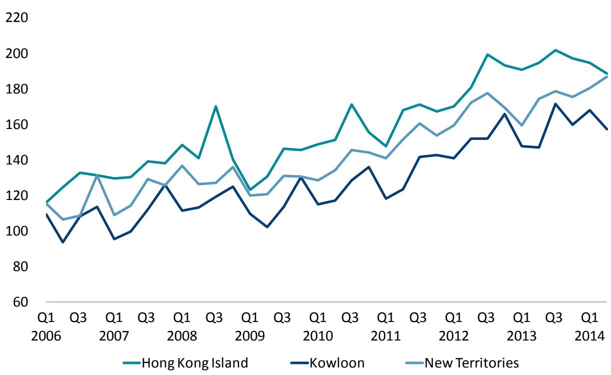
Retail market statistics

	Rental Index (Q1 2000 = 100)	q-o-q change (%)	y-o-y change (%)
Hong Kong Island	188.7	-3.0	-3.1
Kowloon	157.2	-6.4	7.0
New Territories	186.8	3.4	7.1

Source : Rating and Valuation Department HKSAR, DTZ Research

Figure 7

Retail rental index (Q1 2000=100)



Source : Rating and Valuation Department HKSAR, DTZ Research

The government has announced its intention to reduce the Individual Visit Scheme by 20%. If it is implemented, it will definitely place additional pressure on the retail market as both the tourist arrivals and retail sales figures will drop further. However, if the policy is modified to restrict multi-entrance travellers, the effect of the retail market in the North District will be affected more as parallel traders tend to purchase basic necessities near the border. Hence, the demand for shops in these areas will drop as a result.

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