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PROPERTY INSIGHTS

Hong Kong | Quarter 3, 2014

Strata-title office sales active in non-core areas

Market Overview

Office market activities were mostly driven by mid-sized professional services companies and finance companies that were actively looking for office space for in-house expansion or consolidation purpose in the core districts. At the same time, cost conscious foreign FIRE sector related companies remained conservative.

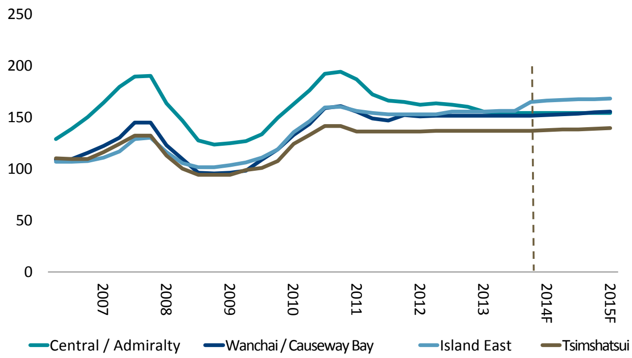
As jewellery & watches retailers are the major tenants for first tier street shops, their retail sales and moves on the retail market would greatly affect rents. Due to the recent sluggish growth on retail sales, their affordability on rents has reduced significantly.

According to the Land Registry, the number of residential S&Ps of less than HK$5mn continued to dominate the market. With 10,356 S&Ps recorded in Q3, this is equivalent to 51.9% of the total transactions. In view of the strong demand for proportion in this segment, developers have begun to adjust their product mix for new projects to include a larger proportion of smaller units.

The market sentiment of the investment market continued to improve and the market regained momentum. Developers, investment funds and private investors continued to show their interest in the property market. On the other hand, vendors, including both local private individuals and corporate, were active in seeking to offload their properties. As such, the total number of major deals (deals exceeding HK$100mn) jumped to 79 in Q3, and the total consideration increased to HK$22.0bn (US$2.8bn).

Figure 1

DTZ office rental index (Q1 2006 =100)



Source : DTZ Research

Trends & Updates

Economic Overview

The real GDP growth slowed down further to reach 1.8% in the second quarter, slower than the 2.6% growth in Q1 and is the slowest growth since Q3 2012 (Table 1). The sluggish growth is mainly due to the decline in tourist spending and the slower growth in domestic demand. As such, the 2014 FY GDP growth forecast has been revised downward to be less than 3%.

Total exports of goods amounted to HK$327.2bn (US$42.2bn) in August, representing growth of 6.4% on an annualized basis (Table 1). Over the same period, growth in total exports to certain major Asia destinations was particularly significant, with exports to India and Thailand grew at 38.1% and 32.7%, respectively.

Inflationary pressure continued to remain low in August, with Composite CPI rising by 3.9% on a yearly basis (Table 1). However, rental price of private housing and the cost of food continued to drive up the cost of living.

Table 1

Economic indicators

Indicator	Period	Unit	Value	Change y-o-y (%)
GDP at constant prices*	Q2 2014	HK$bn	507.5	+1.8
Total exports	Aug 2014	HK$bn	327.2	+6.4
Private consumption expenditure	Q2 2014	HK$bn	368.5	+4.2
Unemployment rate (seasonally adjusted)	Jun 2014 – Aug 2014	%	3.3	-0.1 pt
Visitor arrivals	Aug 2014	Million	6.0	+12.2
Composite CPI	Aug 2014	-	117.6	+3.9
Total retail sales value	Aug 2014	HK$bn	40.0	+3.4

* In chained (2012) dollars

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

After rising for two consecutive months, the seasonally adjusted unemployment rate for June – August 2014 stayed at 3.3% (Table 1). Unfavourable factors, including poor tourism performance and retail spending, may pose an upward pressure on the unemployment rate in the near term.

Private consumption expenditure in the second quarter of the year was up by 4.2% as compared to a year earlier and was recorded at HK$368.5bn (US$47.5bn), which appears positive (Table 1). However, if we consider the growth in real terms, the figure would be reduced to 1.2%. Domestic demand is weak in view of the sluggish economic growth for the first two quarters of the year.

According to the Hong Kong Tourism Board, visitor arrivals reached 6,009,577 in August, equivalent to a growth of 12.2% y-o-y (Table 1). The growth is mainly driven by Mainland China visitors, with 4,896,001 visitor arrivals recorded, a y-o-y increase of 15.9%. In addition, the value of total retail sales in August was up by 3.4% y-o-y to reach HK$40.0bn (US$5.2bn) after six consecutive months of negative growth (Table 1). Sectors that are heavily dependent on tourists continued to perform differently, while the values of sales of medicines and cosmetics were increased by 17.2% y-o-y, sales of jewellery, watches and clocks, and valuable gifts recorded a drop of 6.1% as compared with the previous year.

Residential

Ever since the proposed relaxation of Double Stamp Duty (DSD) in May, pent-up demand has been entering both the primary and secondary markets, where purchasing has turned active once again. As such, the number of S&Ps for building units and land reached 25,937 within the quarter, equivalent to a jump of 59.5% y-o-y. In particular, the number of S&Ps reached 9,569 in July, an increase of 69.2% y-o-y and is the highest since the implementation of DSD in March 2013 (Figure 2).

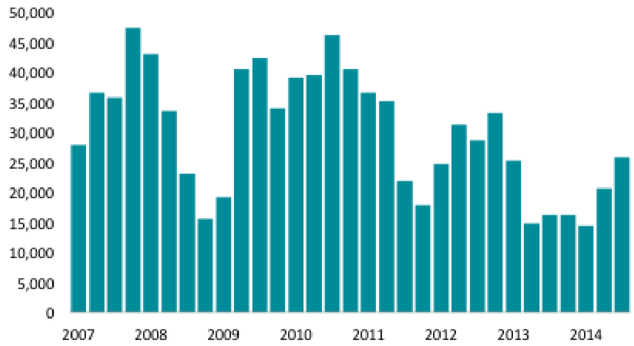
Small lump sum units continued to be the focus of the residential markets. According to the Land Registry, the number of residential S&Ps that amounted to less than HK$5mn continued to dominate the market. With 10,356 S&Ps recorded in Q3, this is equivalent to 51.9% of the total transactions. In view of the strong demand from the market, developers are now adjusting their product mix to include a relatively larger proportion of smaller flats to meet this demand.

Middle class residential units and the luxury sector received support from upgraders and investors and these market segments were more active as compared with the previous quarter. As such, property price picked up once again in the third quarter of the year, with the overall residential price index up by 5.9% q-o-q (Figure 3 and Table 2).

Occupy Central campaign broke out earlier than expected, but no serious effect on the residential market has been witnessed so far. As part of the buying interest has shifted to the primary market, this, coupled with the negative fallout from the protests and the fact that more units are expected to be placed on the secondary market, the room for negotiation in secondary flat sales has started to widen. If the campaign lasts for a long period, property prices could be seriously affected. At present, home buyers have resumed their wait-and-see attitude with respect to the impact of this event on economic growth and property prices.

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	231.0	8.0	9.5
Luxury Market	86,396	214.2	3.0	-2.9
Overall	1,123,633	224.0	5.9	4.3

Source : DTZ Research, Rating and Valuation Departement HKSAR

Looking ahead, it is expected that the last quarter of 2014 will witness a large number of new projects to be launched by developers, of which most are situated in the New Territories. As the Occupy Central campaign has created uncertainty with respect to the outlook for the residential market, it is expected that these new projects would be offered at market price to boost sales. On the other hand, nine residential sites will be offered by tender next quarter, and the site sales are expected to provide 6,700 units. Developers' strategy can be viewed as a key barometer with respect to their short-term market outlook.

Office

This quarter, market activities were concentrated amongst mid-sized professional services companies and finance companies that were actively looking for office space for in-house expansion or consolidation purpose in the core districts. In the mean time, cost conscious foreign FIRE sector related companies remained conservative. As such, overall net absorption in Hong Kong was recorded 86,924 sq ft, down from 96,482 sq ft in Q2 and the overall vacancy rate, which had dropped for two consecutive quarters, increased from 5.5% to 5.7% in Q3 2014 (Table 3, Figure 4).

In the core business areas of Sheung Wan/ Central/ Admiralty, rents remained stable at HK$99.3 (US$12.8) per sq ft per month. Small-scale take-up of premises in around 10,000 sq ft by professional services and finance companies were witnessed within the quarter. As a result, vacancy rate dropped slightly to 5.1% in Q3. As the Shanghai-Hong Kong Stock Connect will be executed very soon, this is expected to stimulate demand for office space in the CBD.

In Island East, the supply of office space remained tight with vacancy rate staying low at 2.9% and rental increment of 5.5% was witnessed within the quarter (Table 3, Figure 4). On the other hand, tenant relocation has been undertaking as a result of the on-going redevelopment of Swire Island East portfolio. For example, document management corporation Fuji Xerox reserved two floors of office space at Cityplaza 4 while advertising agency Leo Burnett Limited is relocating to Landmark East in Kwun Tong.

Table 3

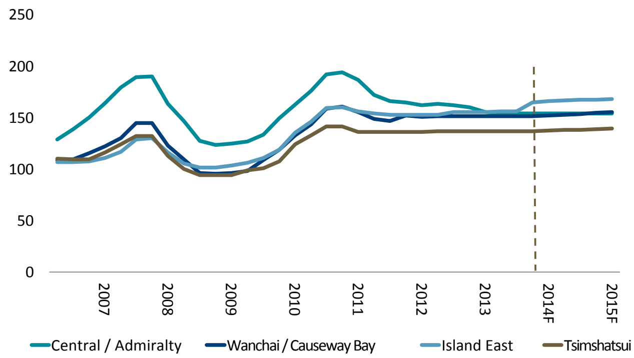
Grade A office market statistics

District	Total stock (million sq ft)	Availability ratio (%)	Monthly Rent (HKD per sq ft)	Change q-o-q (%)
Sheung Wan/ Central / Admiralty	29.5	5.1	99	0
Wanchai / Causeway Bay	16.0	4.5	47	0
Island East	11.0	2.9	40	+5.5
Tsimshatsui	9.3	5.3	33	0
Kowloon East	13.5	10.8	31	-4.3
Overall	**79.2**	**5.7**	**59**	**-0.1**

Source : DTZ Research

Figure 4

DTZ office rental index (Q1 2006 = 100)



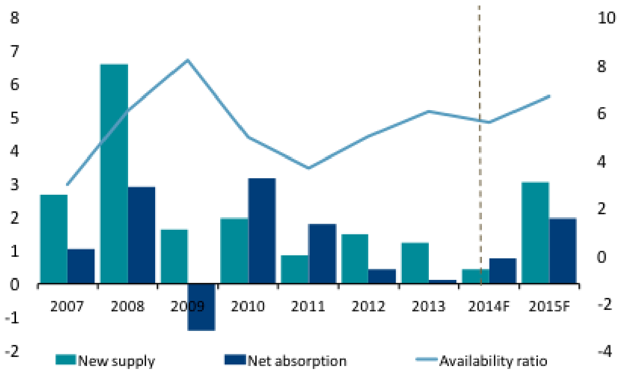
Source : DTZ Research

The first batch of industrial buildings being converted into office use, facilitated by the government policy which was introduced in 2009, is ready to come on stream and will definitely play an important role in augmenting office supply.

To pick up in the last quarter of the year in face of the potential major tenant surrenders on the part of several major office buildings in the district. With regards to new supply, there were not many completions between 2012 and 2014, but more are expected to be witnessed in 2015 and 2016.

Figure 5

DTZ office rental index (Q1 2006 = 100)



Source : DTZ Research

Retail

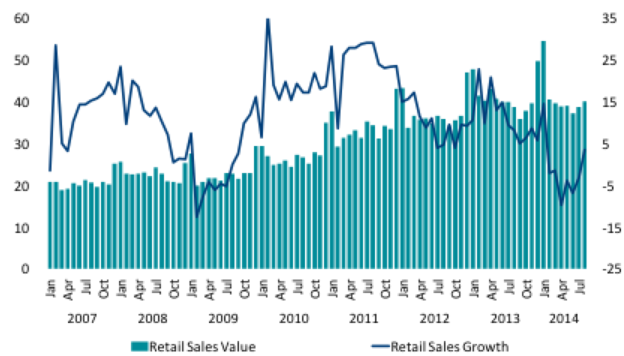
With 6,009,577 visitor arrivals recorded in August, of which 81.5% or 4,896,001 come from Mainland China, this is the first time that visitor arrivals exceeded 6 million in a single month and Mainland tourists account for more than 80% of travellers to Hong Kong since the implementation of individual travel scheme in 2003.

Although the amount of mainland visitors is still on a rising trajectory, their purchasing power and spending habits have changed quite a lot, and this is reflected in the retail sales figures. While the value of sales of medicines and cosmetics in August was up by 17.2% compared with a year earlier, jewellery, watches and clocks, and valuable gifts was dropped by 6.1% over the same period.

As jewellery & watches retailers are the major tenants for first tier street shops, their retail sales and moves in the retail market greatly affect rents. Due to the recent sluggish growth on retail sales, their notion of affordability with respect to rents has dropped significantly. For most of the recent noteworthy retail leasing transactions, rental level had either been maintained at their previous contract level or returned to the level of 2011. On the other hand, landlords have reduced their asking rents substantially in view of current market conditions. To cite just one example, shop nos. 3-5 of the ground floor of the Aon China Building was transacted at a monthly rent of HK$2.8mn (US$0.4mn). Comparing with the asking rent, the concession offered by the landlord is equal to 30%.

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	225.7	-0.5	11.9
Kowloon	174.7	7.2	1.8
New Territories	210.3	7.5	17.8

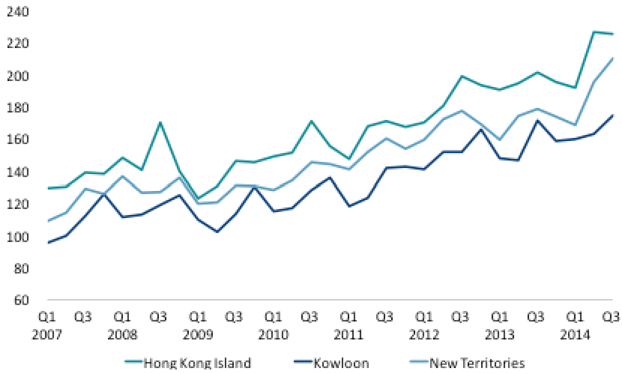
Source : Rating and Valuation Department HKSAR, DTZ Research

Another trend regarding Mainland tourists is that they have begun to demonstrate a preference to shop in non-traditional retail districts like Sheung Shui, Yuen Long and Tuen Mun. Rents in these areas are lower than the traditional prime areas. However, backed by growing number of visitors, these districts have continued to see increasing numbers of jewellery & watches retailers bidding up rents. As such, the rental index of the New Territories recorded an increase of 7.5% q-o-q, and 17.8% y-o-y (Table 4 and Figure 7).

The Occupy Central campaign has already started and the impact on the retail sector is hard to predict as it depends on how long the event will last. However, it is expected market sentiment will be severely affected and tenants will turn more conservative. This, in turn, will be reflected by the rental level and capital values of retail properties. Moreover, several shops in Russell Street are up for contract renewals early next year. Their rental performance will definitely provide some indicators regarding the rental trend in other districts in the near future.

Figure 7

Retail rental index (Q1 2000=100)



Source : Rating and Valuation Department HKSAR, DTZ Research

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