PROPERTY INSIGHTS

Hong Kong | Quarter 4, 2014

Rents diverge in core and non-core areas

Market Overview

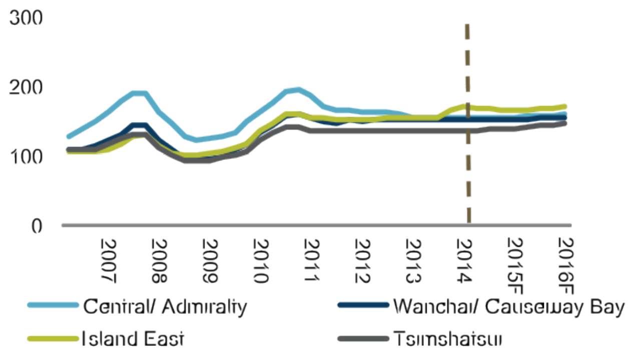
The overall net absorption rate 686,849 sq ft recorded in 2014 was the highest reported since 2011. As such, total net absorption outstripped total new supply, the overall vacancy rate dropped by 0.6 percentage point y-o-y to reach 5.5%. In the meantime, rental growth was the highest in Island East, where it reached 9.6% y-o-y, thanks to low availability and robust demand (Figure 1).

Retail rent performance diverged within the quarter upon lease renewal between tier one street high street shops in core and shops in non-core shopping districts. While rent corrections of 20-30% were common in the core area, rent increased by over 20% in many non-core areas.

The first hand residential market remained active since Q4 2013. With over 16,800 primary transactions in 2014, this is the largest number of transactions recorded since 2007. Driven by strong demand and positive market sentiment, prices increased by 10.2% y-o-y.

Figure 1

DTZ office rental index (Q1 2006=100)



Source : DTZ Research

Investors are seizing the last window of opportunity to acquire industrial buildings for revitalization purpose, due to application deadline for revitalization of industrial buildings in 2016 now approaching. Several industrial en bloc transactions were recorded this quarter. The total consideration of major deals across all property sectors jumps 212.7% q-o-q to reach HK$5.5bn (US$712.4mn) in Q4.

Economic Overview

Thanks to the strong growth from private consumption expenditure and exports of services, real GDP growth in the Q3 2014 reached 2.7% (Table 1). As the occupy movement began at the last few days of Q3, the impact on Hong Kong economy is yet to be reflected.

With HK$326.8bn (US$42.2bn) worth of goods exported in November 2014, the value of total exports reached HK$3,362.6bn (US$433.8bn) for the first 11 months of the year, equivalent to a growth of 3.4% compared with the same period a year earlier (Table 1). It should be noted that the sluggish global economic growth will negatively affect Hong Kong's exports in the short term.

The cost of living continued to rise in Hong Kong, with Composite CPI in November recorded as rising by 5.1% on a yearly basis and rising by 4.4% for the first eleven months, measured on an annualized basis (Table 1).

The seasonally adjusted unemployment rate was maintained at 3.3% in September – November 2014, remaining unchanged for the fifth consecutive period (Table 1). While the jobless rate has remained fairly stable after the outbreak of Occupy Central Movement, the potential impact on the labor market has yet to be fully registered. However, it is expected that demand for labor will remain strong during the Christmas and the New Year period.

After two quarters of sluggish growth, private consumption expenditure improved in Q3 2014, with annual growth of 6.4% (Table 1).

Table 1

Economic indicators

Indicator	Period	Unit	Value	Change y-o-y (%)
GDP at constant prices*	Q3 2014	HK$bn	546.6	+2.7
Total exports	Nov 2014	HK$bn	326.8	+0.4
Private consumption expenditure	Q3 2014	HK$bn	359.6	+6.4
Unemployment rate (seasonally adjusted)	Sep 2014 – Nov 2014	%	3.3	-0.1pt
Visitor arrivals	Nov 2014	Million	5.3	+15.7
Composite CPI	Nov 2014	-	123.1	+5.1
Total retail sales value	Nov 2014	HK$bn	41.3	+4.1

* In chained (2012) dollars

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

Total visitor arrivals reached 5,299,680 in November 2014, up 15.7% from a year earlier (Table 1). In particular, Mainland visitors rose 24.1% to 4,155,524 and accounted for over 78.4% of the city's total visitor arrivals. As supported by strong growth in the tourism arrival figures, the value of total retail sales in November was up by 4.1% y-o-y to reach HK$41.3bn (US$5.3bn) (Table 1). Sectors that are closely related to the tourism industry performed differently. While the value of sales of medicines and cosmetics recorded an annual growth of 10.3%, sales of jewellery, watches and clocks, and valuable gifts dropped by 2.0% over the same period.

Residential

The residential market for Q4 carried forward the momentum witnessed last quarter. The number of S&P agreements for Q4 reached 22,859. New launches received very positive market response and buying demand from a wide array of buyers, including a greater proportion of end users. With favourable market sentiment and strong pent-up demand, the number of S&Ps for building units and land reached 83,969 in 2014, equivalent to an increase of 15.6% y-o-y (Figure 2).

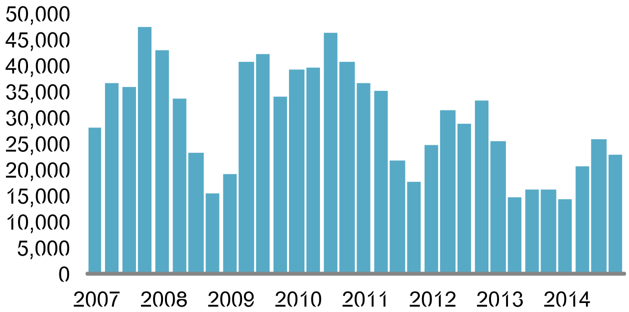
The primary home sales market, which began to pick up momentum in Q4 2013, continued to play an important role in driving residential sales in 2014. The number of S&Ps contributed by the first hand residential properties was over 16,800 for the whole year, which is equivalent to 26.4% of the S&Ps for all residential building units and is the largest number of first-hand transactions recorded since 2007. On the other hand, with the imposition of the enhanced special stamp duty, the supply of second hand units continued to drop and the secondary market remained relatively quiet.

Thanks to rising transaction volume and positive market sentiment, property prices continued to rise during the last quarter of the year. With overall prices go up by 3.3% in Q4, price has gone up by 10.2% y-o-y (Figure 3 and Table 2). The mass market continued to outperform the luxury sector, with the former rising by 4.5% q-o-q and 16.4% y-o-y, the latter up by 1.5% q-o-q and 1.8% y-o-y (Figure 3 and Table 2). With strong growth in house prices, it is unlikely for the government to withdraw the cooling measures implemented earlier and so it is anticipated that developers will continue to offer sweeteners to speed their clearance of inventory.

Looking forward, projects from the residential sites offered during government land sales over the past few years will enter the market over the short to medium term. Small to medium sized flats will continue to be the major focus of the first hand

Figure 2

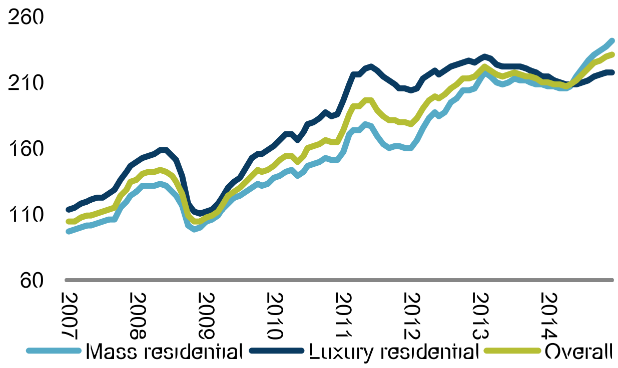
Transaction volume of S&P Agreements (No. of S&P Agreements)



Source : Land Registry

Figure 3

Residential price index (Jan 2000 = 100)



Source : DTZ Research

Table 2

Private residential market statistics

	Total stock (no. of units)	price index (Jan 2000 = 100)	q-o-q change (%)	y-o-y change (%)
Mass Market	1,037,237	241.3	4.5	16.4
Luxury Market	86,396	217.4	1.5	1.8
Overall	1,123,633	231.4	3.3	10.2

Source : DTZ Research, Rating and Valuation Departement HKSAR market, since their price is best aligned with market demand. In the meantime, availability from the second hand market is expected to rise as upgraders are expected to release their existing holdings in favour of units in new properties to be completed in the coming year in order to capitalize on the benefits provided in the recently fined-tuned DSD, as announced on 13 May 2014.

Office

With overall net absorption reaching 138,128 sq ft in Q4, the annual net absorption figure reached 686,849 sq ft in 2014, the highest level recorded since 2011. As annual net absorption outstripped new supply of 230,000 sq ft, the Hong Kong office leasing market witnessed a very positive year (Figure 5). Demand was mainly driven by medical and healthcare services groups and the finance sector. In the meantime, Island East, which lowest vacancy rate across all the submarkets, witnessed a rental rise of 3.4% q-o-q, causing the overall rent to rise by 0.3% in the last quarter of the year to reach HK$59.5 (US$7.7) per sq ft per month (Table 3).

In the core business areas of Sheung Wan/ Central/ Admiralty, leasing activity was mainly supported by small scale take up by the finance sector. On the other hand, major space release occurred in several buildings within the district. As such, the overall net absorption dropped from 23,526 sq ft in Q3 to -86,017 in Q4 and the vacancy rate rose from 5.1% to 5.4% (Table 3). With the launching of Shanghai-Hong Kong Stock Connect on 17 November 2014, demand for office space in CBD is expected to be boosted.

In Wanchai/Causeway Bay, where vacancy rate is low and available space is generally limited, market activity has been relatively stable over the past two quarters. One of the noteworthy leasing transactions which occurred involved the take up of one floor of office space (15,608 sq ft) at The Lee Gardens by Germany's second-largest bank Commerzbank. They downsized their leased footprint from 20,000 sq ft in 2IFC for cost saving purposes. As a result, the vacancy rate dropped by 0.1 percentage point to 4.4% (Table 3).

Table 3

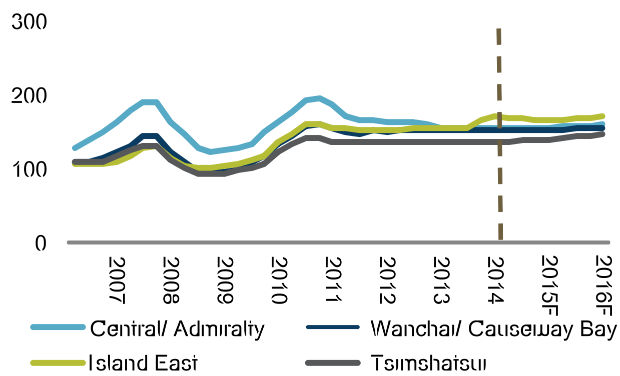
Grade A office market statistics

District	Total stock (million sq ft)	Availability ratio (%)	Monthly Rent (HKD per sq ft)	Change q-o-q (%)
Sheung Wan/ Central / Admiralty	29.5	5.4	99	0
Wanchai / Causeway Bay	16.0	4.4	47	0
Island East	11.0	2.9	41	+3.4
Tsimshatsui	9.3	4.4	33	0
Kowloon East	13.5	9.9	31	0
Overall	**79.2**	**5.5**	**60**	**+0.3**

Source : DTZ Research

Figure 4

DTZ office rental index (Q1 2006 = 100)



Source : DTZ Research

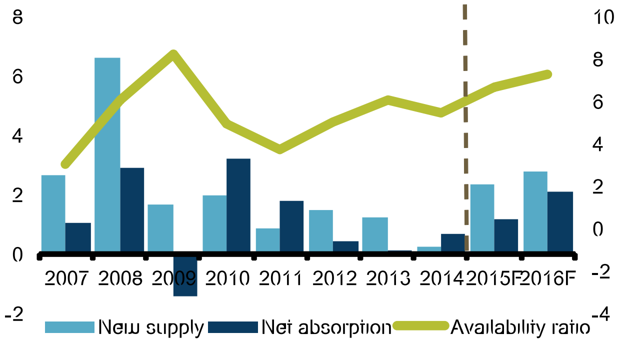
Turning to the Kowloon side, the leasing market turned more active and several large transactions were witnessed. With net absorption in Kowloon East reaching 130,352 sq ft, this was the biggest quantum of absorption recorded by any district Q4 2014. Insurance companies continued to be one of the largest single category of occupiers in the market. Following AIA, AXA and Manulife, Prudential Assurance Company Limited leased 48,743 sq ft in

Millennium City 1 – Tower 1. However, given the large amount of new supply, the vacancy rate has remained high at 9.9% and rents dropped by 6.6% y-o-y (Table 3 and Figure 4).

Looking forward, 2,574,000 sq ft of office space is expected to be completed in 2015, of which 77.8%, or 2,000,300 sq ft will be situated in Kwun Tong. Several of the properties which are being prepared to come on stream are conversion schemes, based on redeveloping industrial buildings as office buildings. This surge of supply will definitely place downward pressure on the rent within the submarket. On a positive note, some space is expected to be used for owner occupation purposes such as One Bay East with a GFA of 915,000 sq ft. As such, rent in Kowloon East is expected not to drop drastically, but only witness downward correction in the range of 0 to 5%. On the other hand, rent in Central is expected to remain flat as the vacancy rate of several buildings within the district remains high.

Figure 5

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



Source : DTZ Research

Retail

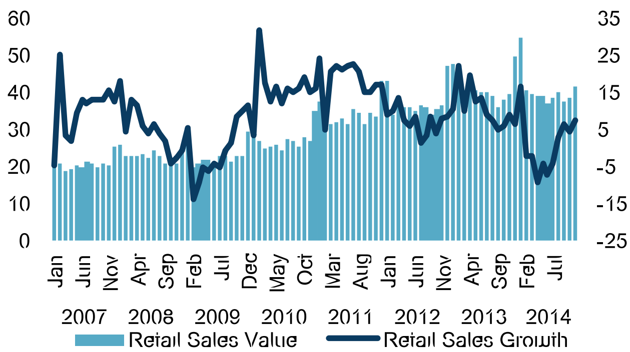
Although the Occupy movement occurred at the end of Q3 and continued well into Q4, visitor arrivals in October and November are still on the rise compared with the figures a year earlier. In particular, during the period of September 29 to October 16, over 3.0 million visitors arrivals was recorded, equivalent to an annual growth of 11.4% and mainland tourists accounted for 2.4 million, with an annual growth of 15.6%.

Total retail sales reached HK$38.3bn (US$4.9bn) and HK$41.3bn (US$5.3bn) in October and November, equivalent to an annual growth of 1.4% and 4.1%, respectively (Figure 6). Districts that were affected by the protests did take a direct hit, but as consumer spending shifted to other districts, total city-wide retail sales was not greatly impacted.

Turning to spending pattern, sales of jewellery, watches and clocks, and valuable gifts dropped by 13.4% for the first 11 months of the year compared with the same period a year earlier. This is consistent with the results announced by major jewellery retailers like Chow Tai Fok and TSL. On the other hand, sales of goods in other categories continued to record positive growth over the same period, with sales of medicines and cosmetics and clothing, footwear and allied products rising by 9.8% and 5.2%, respectively.

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	202.2	3.5	3.4
Kowloon	163.9	0.1	3.3
New Territories	172.7	-10.2	-0.8

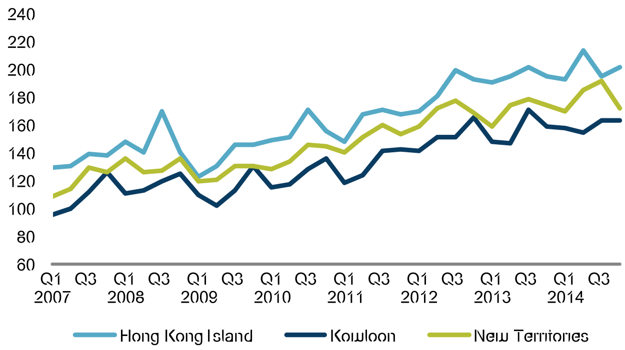
Source : Rating and Valuation Department HKSAR, DTZ Research

Given the change in visitor spending patterns, retailers of luxury brands and jewellery retails are now becoming more conservative in about engaging in business expansion and hence consolidation in this market segment is likely to occur. As a result, there were fewer outstanding leasing transactions in the second half of the year, with most of very notable transactions having been realized in the first half of the year.

Although the rental index in Hong Kong and Kowloon witnessed an annual growth of 3.4% and 3.3%, respectively (Table 4 and Figure 7), rental performance between prime and non-prime shopping districts continued to diverge significantly. As rental affordability by major tenants in tier one street shops in prime locations has declined, rental corrections of between 20-30% have been witnessed upon contract renewal. On the other hand, although the rental index of the New Territories (N.T.) dropped by 0.8% y-o-y, rents for tier one locations in N.T. recorded an increase of over 20% for new leases concluded (Table 4 and Figure 7).

Figure 7

Retail rental index (Q1 2000=100)



Source : Rating and Valuation Department HKSAR, DTZ Research

Looking forward, rental performance of prime and non-prime shopping districts will experience divergent rental performance, while tier one street shops in traditional shopping districts expected to experience rental correction of 5-10% due to diminished affordability by luxury retailers to pay top level rents, while rental performance for decentralized locations like Yuen Long and Tuen Mun will continue to witness rental increase of around 5% as they are targeted at the sale of necessary goods.

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