PROPERTY INSIGHTS

Hong Kong | Quarter 3, 2015

Retail rents in core markets plunged further

Market Overview

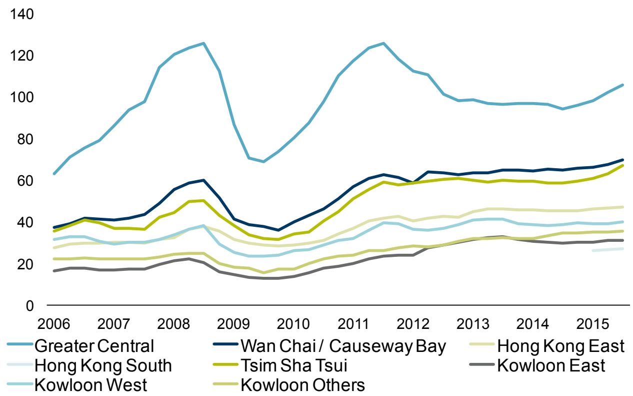
Weaker external demand amid visibly slower growth in tourist arrivals and the diminished level tourist spending continued to act as a drag on the local economy.

Market sentiment for residential market has worsened due to the downturn of both the China and Hong Kong stock markets. Concerns about the state of the global economy and possible future interest rate hikes continued to dent home buying sentiment, making developers less eager to launch new projects. Hence, the number of residential Sales and Purchase Agreements (S&Ps), declined to 13,552 in Q3 2015, making this the lowest residential sales volume recorded since Q1 2014.

Office leasing market remained positive in the third quarter as positive absorption was recorded in all districts. Overall Grade A office availability rate has decreased to 4.6% from 5.3% recorded in the previous quarter. Average rent for all districts continued to show a moderately growth, with Tsim Sha Tsui recorded the highest jump, at 6.7%, mainly prompted by the transactions in International Commerce Centre (Figure 1).

Figure 1

Grade A Net Effective Office Rent (HK$/SF/MTH)



Source : DTZ/Cushman & Wakefield Research

Retail market further weakened this quarter as retail sales continued to trend downwards due to the shift in spending patterns, slowdown in tourism growth and weaker tourist spending. Retail rents on high streets have down by 26-43% from the peak levels in Q4 2013.

Economic Overview

Weaker external demand amid visibly slower growth in tourist arrivals and weaker tourist spending continued to put a drag on the local economy. However with a strong growth in private consumption and investment expenditure, Hong Kong's economy still expanded slightly in the second quarter of 2015, with real GDP growing by 2.8% y-o-y, up by 0.4 percentage points from the preceding quarter (Table 1).

Inflationary pressure remained low, with overall consumer prices in August 2015 rising by 2.4% y-o-y (Table 1). The devaluation of RMB and the softening of rents in Hong Kong's residential market will cause inflation rate to stay low in the short term.

The wealth effect of the stock market rally has supported the private consumption expenditure to jump up by 6.0% in Q2 2015 (Table 1). However, as the stock market turned sour in late June, the growth in expenditure has slowed down.

As a growing number of Mainland tourists are traveling to destinations other than Hong Kong and due to the impact of the imposition of the one-trip-per-week policy, visitor arrivals saw a sharp decline in both July and August. With a drop of 8.4% and 6.6% respectively compared with a year earlier, visitor arrivals totalled 4.9 and 5.6 million (Table 1).

The sentiment of the retail sector stayed negative as retail sales contracted for the sixth consecutive months on a y-o-y basis (Table 1). While the sales of luxury items continued to decline, sales of basic necessities also turned soft as the number of tourists decreased, with the sales of wearing apparel and commodities in department stores dropping by 13.5% and 8.6%, respectively.

Table 1

Economic indicators

Indicator	Period	Unit	Value	Change y-o-y (%)
GDP at constant prices*	Q2 2015	HK$bn	533.1	+2.8
Private consumption expenditure	Q2 2015	HK$bn	384.5	+6.0
Total retail sales value	Aug 2015	HK$bn	37.9	-5.4
Total Exports	Aug 2015	HK$bn	307.3	-6.1
Visitor arrivals	Aug 2015	Million	5.6	-6.6
Unemployment rate (seasonally adjusted)	Jun - Aug 2015	%	3.3	0
Composite CPI	Aug 2015	-	120.5	+2.4

* In chained (2013) dollars

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

The labour market during the three months period between June and August 2015 was relatively stable, with seasonally adjusted unemployment rate reported at 3.3% (Table 1). However, poor performance from the tourism industry has driven up the unemployment rate in both the retail and hotel sectors.

Demand for Hong Kong exports remained low amidst a sluggish global economy, with total export in August 2015 dropping by 6.1% to $307.3bn (US$39.7bn) compared to a year earlier, representing the fifth consecutive month of y-o-y decline (Table 1).

Residential

The US Federal Reserve decided to postpone the interest rate hike in its September meeting. In the meantime, concerns about the global and local economy and interest rate hike uncertainty continued to put further pressure on the residential market. In addition, the impact of the major volatility of China and Hong Kong stock market this past summer also made itself felt on the property market. Hence, sentiment worsened and market activity was generally weak in Q3 2015. With 3,896 and 4,263 transactions in August and September, the total residential S&P dropped to 13,552 this quarter, equivalent to a drop of 12.5% compared with Q2 and was the lowest level since Q1 2014 (Figure 2).

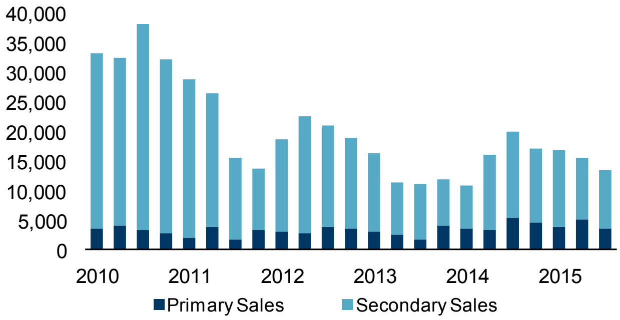
Sales of new home slowed down and as a consequence developers were less eager to launch luxury projects. Under these conditions, primary sales amounted to 3,488 in Q3, or the equivalent to 25.7% of all residential transactions, and total consideration dropped from HK$49.1bn (US$6.3bn) in Q2 to HK$38.8bn (US$5.0bn) in Q3.

At the same time, landlords in the secondary market had strong holding power given the continued low interest rate environment. As sentiment worsened, room for negotiation has widened and the bargaining power of potential buyers has increased. Landlords must offer substantial concession to potential buyers in order to sell their flats in the secondary market. Hence, the secondary market remained quiet and the number of transactions remained low.

Chief Executive CY Leung said the government would not withdraw the cooling measures in the near team in order to constrain investment demand, while supply will be increased by stepped up government land sales. In fact, the easing of government curbs may lead to a surge in flats offered for sale in the market, causing a major correction in the property price.

Figure 2

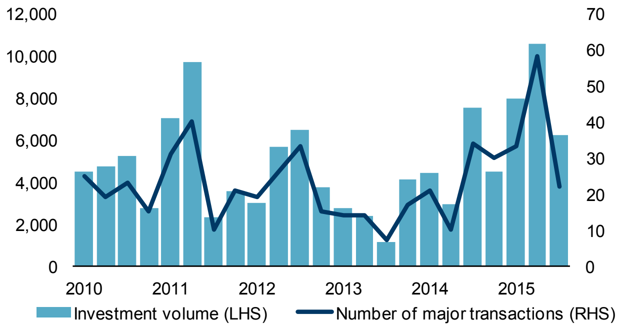
Number of Agreements for Sale and Purchase of Residential Building Units: Primary and Secondary Sale



Source : Land Registry

Figure 3

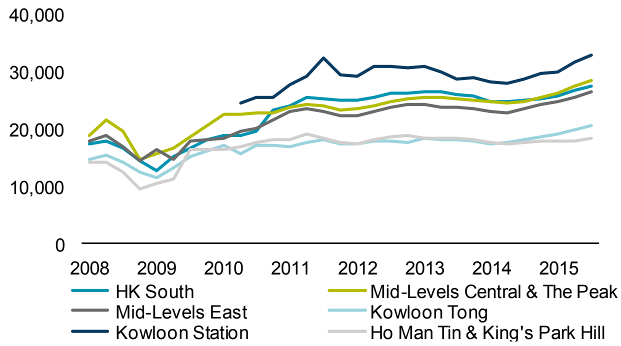
Residential Investment Volume (HK$ million) and Number of Transactions above HK$100 Million



Source : DTZ/Cushman & Wakefield Research

Figure 4

Luxury Residential Capital Values by District (HK$ psf)



Source: DTZ/Cushman & Wakefield Research

While sales activity in the mass market slowed down, the super luxury residential sentiment was comparatively stable, with several significant transactions recorded within the quarter. In particular, 22 Barker Road was transacted at a total consideration of HK$1.5bn (US$193.5mn). With a total GFA of 9,890 sq ft, the accommodation value reached HK$151,668.4 (US$19,570.1), making it the second highest unit rate paid for a residential property anywhere in the world. High-end residential properties located in traditional prime locations continued to receive support from both local and Mainland Chinese high net worth individuals. Responding to this stimulus, overall luxury residential prices was up by 3.2% compared with the previous quarter (Figure 4).

Purchasing requirements were largely satisfied by the over 12,000 first hand transactions recorded for the first nine months of the year, and the sales of subsequent new launches are expected to slow down. Meanwhile, although the Fed did not raise the interest rate in September, people still anticipate an interest rate increase in the coming months, and this is expected to impact directly on the residential market. Under these conditions, the number of residential transactions is expected to remain low for the last quarter of the year and home prices may witness some consolidation. However, major correction in the property market is not expected in the short term, as the market is buttressed by Hong Kong's overall sound economic condition.

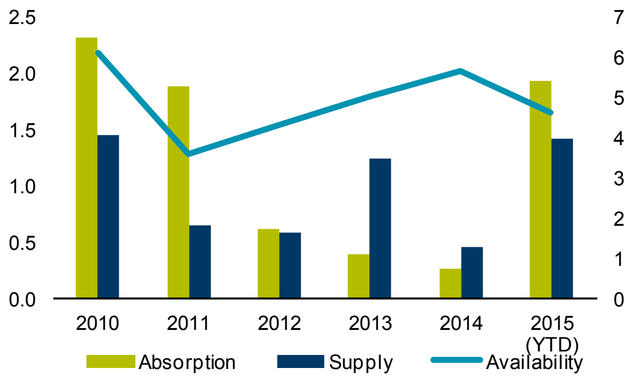
Office

Office leasing market remained positive in the third quarter of 2015, driven by renewed demand on finance, manufacturing and insurance sectors. Positive absorption was witnessed across all major business districts in Hong Kong, the total net absorption reached 470,521 sq ft. Under these conditions, overall availability ratio dipped to 4.6%, a drop of 0.7 percentage point compared with the previous quarter (Figure 5). Positive signs of the office market had created support for further rental increment, with overall rents increased by 2.9% q-o-q to HK$78.0 (US$10.1) per sq ft per month (Figure 6).

After a robust round of corporate expansion activity in H1 2015, leasing activities in Greater Central area slowed down rapidly this quarter with fewer major leasing transactions recorded. Although the pace of absorption was the slowest witnessed since Q3 2014, absorption nevertheless remained positive at 38,096 sq ft. Mainland Chinese financial institutions remained the primary driver for Greater Central office demand. For instance, China Everbright Bank leased 14,000 sq ft in AIA Central, while the Bank of Shanghai took 18,000 sq ft in Citibank Tower, Citibank Plaza in an expansionary move. As a result, the availability ratio dropped further to 3.8%, causing the Greater Central's average rent to rise by 3.6% q-o-q.

Figure 5

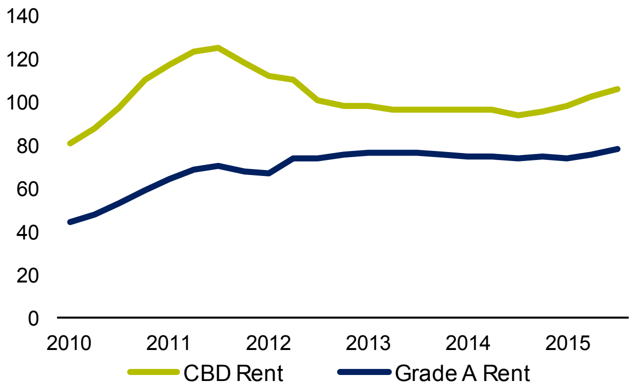
Grade A Office Net Absorption (NFA Million SF), Grade A Office Supply (NFA Million SF) and Availability Ratio (%)



Source: DTZ/Cushman & Wakefield Research

Figure 6

CBD Net Effective Rent VS Overall Grade A Net Effective Rent (HK$/SF/MTH)



Source: DTZ/Cushman & Wakefield Research

In Hong Kong East, the major redevelopment of Warwick House and Cornwall House stimulated some market activities across different submarkets, as affected tenants are now seeking space to relocate, acting to tighten further the district's available space. To cite just one example, ISS relocated within the district to Dorset House. In addition, a number of insurance companies were also very active in Hong Kong East this quarter. AXA leased one floor in @Convoy (169 Electric Road), while AIA insurance took up three floors of space in 633 King's Road for expansion purpose.

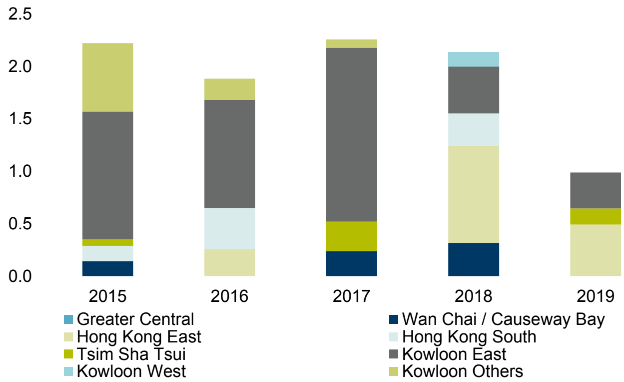
Market activity in Tsim Sha Tsui was very robust, with a total net absorption of over 100,000 sq ft. In particular, most of the significant deals were recorded in International Commerce Centre. Formerly vacant spaces were subdivided into smaller areas for individual lease, and these achieved a very positive response. The largest single transaction was by Equinix, an IT company, which leased 25,000 sq ft. Consequently, overall availability within Tsim Sha Tsui dropped 0.6 percentage point q-o-q to 3.4% and rent rose by 6.7%.

As the business environment in Kowloon East has continued to mature, occupiers from different sectors continued to show their interest in setting up operations in this sub-market. While the upturn in demand for office premises within the district was very much led by manufacturing sector occupiers, business services and media & publishing occupiers were also active in leasing space. However, high vacancy rate and fierce competition arising from the launch of a number of revitalization projects, has resulted in a situation in which the surge in leasing activity has not be mirrored by growth in rent, which remained sluggish in Q3.

Looking ahead, the lack of new office supply combined with the tightening availability in most buildings will combine to support a healthy rental growth in Greater Central (Figure 7). On the other hand, leasing activities in decentralized locations like Hong Kong East and Kowloon East will benefit by the demolition of Warwick House and Cornwall House.

Figure 7

New Grade A Office Supply (Million SF NET)



Source: DTZ/Cushman & Wakefield Research

Table 2

Hong Kong Office Market Statistics

SUBMARKET	Inventory (SF NET)	Availability Rate	Under Construction (SF NET)	Grade A YTD Construction Completion (SF NET)	Overall Direct Net Absorption (SF)	Grade A Net Effective Rent* (HK$/SF/MTH)		US$ SF/YR	EURO SF/YR
						2Q15	3Q15	3Q15	3Q15
Prime Central	7,576,489	4.7%	0	0	1,186	111.85	115.37	178.64	160.09
Greater Central (CBD)	15,534,437	3.8%	0	0	38,096	102.34	105.99	164.11	147.07
Wan Chai / Causeway Bay	8,633,598	4.0%	378,600	0	103,534	67.85	70.08	108.51	97.24
Hong Kong East	7,369,435	3.1%	1,184,400	0	85,377	47.64	47.31	73.25	65.65
Hong Kong South	1,600,453	4.9%	538,400	0	1,777	26.71	27.01	41.82	37.48
HONG KONG ISLAND TOTAL	33,137,923	3.7%	2,101,400	0	228,784	78.31	79.34	122.85	110.09
Tsim Sha Tsui	8,068,918	3.4%	282,600	0	100,966	63.13	67.38	104.33	93.50
Kowloon East	11,431,878	7.2%	3,137,200	0	77,769	30.97	31.30	48.46	43.43
Kowloon West	3,718,015	7.8%	135,500	0	60,697	39.19	39.91	61.80	55.38
Kowloon Others	1,381,253	3.5%	937,600	0	2,305	35.17	35.61	55.14	49.41
KOWLOON TOTAL	24,600,064	5.9%	4,492,900	0	241,737	42.46	43.41	67.22	60.24
OVERALL TOTAL	57,737,987	4.6%	6,594,300	0	470,521	75.75	77.95	120.70	108.16

*Grade A Net Effective Rent is exclusive of service charges and government rates and based on net area
1.00 USD = 7.750 HK$ / 1.00 EUR = 8.648 HK$

Source: DTZ/Cushman & Wakefield Research

Retail

Tourism arrivals were down by 8.4% and 6.6% in July and August respectively due to the drop in visitorship by Mainland Chinese tourists. Related sectors, such as hospitality, were also considerably impacted, with a downward trend in both change in occupancy and room rate both following a downward trajectory.

Besides the slowdown in visitor arrivals, the retail sector was also negatively affected by the Mainland stock market crash and the devaluation of RMB. As a result of this confluence of circumstances, total retail sales volume in the two months period declined to HK$75.4bn (US$9.7bn), equivalent to a drop of 4.2% compared with the same period a year earlier.

With respect to the changing in retail spending pattern, the high end retailing sector continued to suffer in the third quarter of 2015, with the sales of Jewellery, watches and clocks, and valuable gifts dropping by 8.8% in August. The change in purchasing patterns by mainland tourists has greatly impacted on the profitability of local jewelery and watch retailing chains, with jewellers such as Chow Tai Fook and Luk Fook having shifted their focus back onto the local market. In line with this drop in Mainland China tourist spending, sales of medicine and cosmetics were down by 5.1% in August and having dropped now for six consecutive months on a y-o-y basis (Figure 9). This downturn in sales has caused some pharmacies and cosmetics shops to surrender their retail outlets in the major shopping destinations.

All of the above mentioned phenomena have severely affected the affordability of leasing premises in traditional shopping districts by major tenants. However, despite the downturn in the retail market, vacancy did not spike up as concessions from landlords acted to hold some retail tenants in place. For example, Emperor Group had announced that it would lower the rent of six leased retail premises by over 30%. Hence, the rental levels have started to drop to a level that is affordable by new types of incoming tenants. For instance, a shop on the ground floor of 8 Russell Street was taken up by a cosmetics retailer at a monthly rent of HK$1.6 million. Compared with the rent paid by the previous watch and jewellery retailer in Q2 2012, this is equivalent to a rental drop of 42%. Surveying the correction in rent by individual sub-market, out of the four major shopping districts, the magnitude of rental correction in Causeway Bay was the highest. In Causeway Bay, retail rent was recorded at HK$2,257 per sq ft per month, equivalent to a drop of 12% as compared with the previous quarter and a drop of 43% as compared with the peak in Q4 2013. Rental performance for Tsim Sha Tsui,

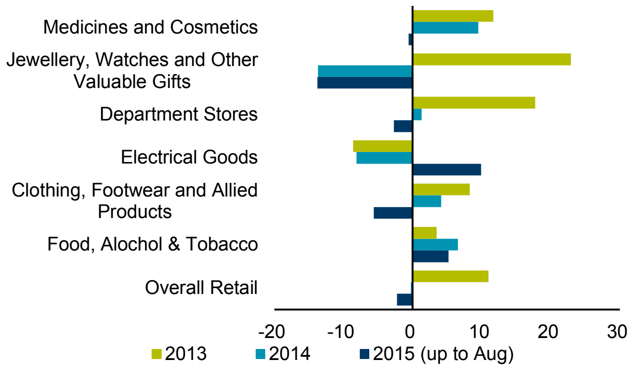
Figure 8

Hong Kong Tourist Arrivals (Million person)

Source : The Hong Kong Tourism Board

Figure 9

Retail Sales Value by Retail Outlets (y-o-y % chg)



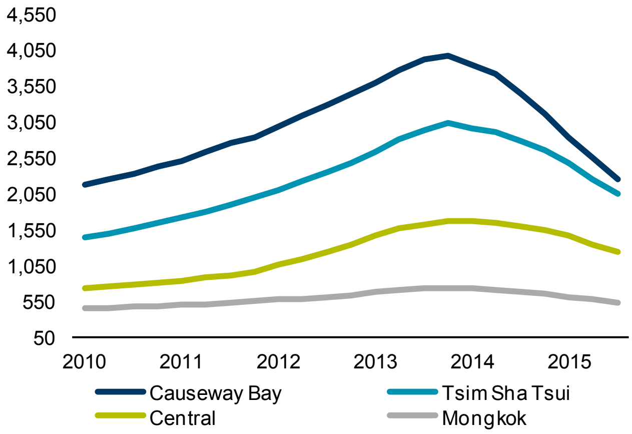
Source : Census and Statistics Department

Central and Mongkok mirrored the same trend. While the rents for all these districts were down by 9% q-o-q, they have all declined by 26-33% from their respective peak levels (Figure 10).

Looking forward to the last quarter of the year, although the provisional figures for tourism arrivals during the Golden week period witnessed some growth, but the tourism spending and consumption patterns did not change radically. Hence, mild rental correction within the four traditional shopping districts is expected to continue.

Figure 10

Retail Rent on High Streets (HK$/SF/MTH)



Source: DTZ/Cushman & Wakefield Research

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