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PROPERTY INSIGHTS

Hong Kong | Quarter 1, 2014

Finance sector active once again in Central

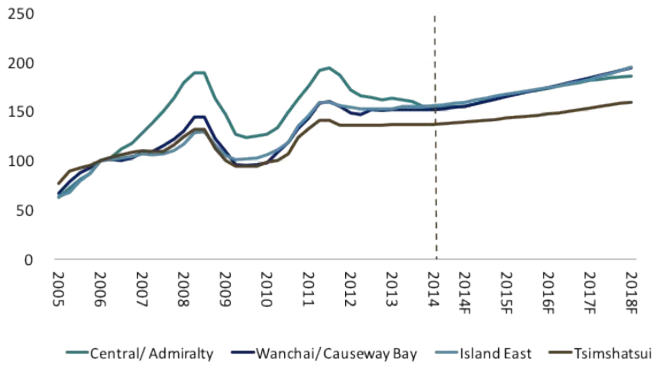
Market Overview

The finance sector was very active in Central and continued to be the most active demand driver in the Central Financial District (CFD). As a result, the net absorption for this submarket stayed positive for two consecutive quarters to reach 201,055 sq ft and its vacancy rate dropped from 6.3% in Q4 2013 to 5.6% in Q1 2014.

The Hong Kong retail market has continued to receive support from the growing number of visitor arrivals. While leasing demand for the top-tier locations stayed strong from brand name retailers, especially in the jewellery, pharmaceutical and cosmetics market segments, vacancy for tier 2 locations has grown due to growing discrepancy in rental expectations between landlords and prospective tenants.

Figure 1

DTZ office rental index (Q1 2006 =100)



Source : DTZ Research

The primary market remained the focus of the residential market this quarter as developers continue to offer incentives to boost sales. In contrast, besides the cooling measures imposed by the government and the seasonal factor, several adverse factors have emerged which have acted to suppress the secondary residential market sales activity in Hong Kong. As such, the total transaction volume of residential units remained low while prices were similarly under some downward pressure.

Investment transaction was dominated by the retail sector in Q1 as 8 Russell Street was offered in the market under strata title. In view of the robust tourism figures and the expected strong growth in tourist visitorship, hotel operators and investors are actively looking for hotel properties and development sites.

Economic Overview

Real GDP annual growth rate improved in the last quarter of 2013, growing at a rate of 3.0%, compared with the 2.8% annual growth rate recorded in Q3 2013 (Table 1). The finance and insurance sectors continued to support the growth of the economy, with net output increased by 4.1% in real terms in Q4 2013.

In February 2014, the value of total exports of goods dropped by 1.3% y-o-y to reach HK$212.9bn (US$27.5bn) (Table 1). The decrease in total exports to regions outside Asia was particularly significant, with exports to Germany dropped by 19.7% y-o-y and exports to USA dropped by 19.5% y-o-y.

Inflation pressure was seen to moderate slightly in Q1. The overall consumer prices increased by 3.9% y-o-y in February, less than the 4.3% growth rate in November and is the smallest increase since June 2013 (Table 1).

The seasonally adjusted unemployment rate in December 2013 – February 2014 recorded a 16-year low of 3.1% (Table 1). It is expected that local corporate demand will continue to play an important role in supporting the labour market and the unemployment rate will remain low, at least over the short term.

Domestic private consumption expenditure rose by 5.6% over a year earlier to reach HK$367.5bn (US$47.4bn) in Q4 2013 (Table 1).

Total visitor arrivals in February jumped 9.8% y-o-y to reach 4,417,376. The number of Mainland tourists rose 10.4% yearly to reach 3,458,215. Growth was also supported by visitors from other Asia countries, with travellers from South & Southeast Asia and North Asia added by 22.1% and 18.4%, respectively. On the other hand, total retail sales in February 2014 reached HK$40.5bn (US$5.2bn), equivalent to a drop of 2.3% y-o-y. The decline of the sales figures was mainly due to the timing of the Chinese New Year (Table 1).

Table 1

Economic indicators

Indicator	Period	Unit	Value	Change y-o-y (%)
GDP at constant prices*	Q4 2013	HK$bn	541.6	+3.0
Total exports	Feb 2014	HK$bn	212.9	-1.3
Private consumption expenditure	Q4 2013	HK$bn	367.5	+5.6
Unemployment rate (seasonally adjusted)	Dec 2013 – Feb 2014	%	3.1	-0.2 pts
Visitor arrivals	Feb 2014	Million	4.4	+9.8
Composite CPI	Feb 2014	-	118.8	+3.9
Total retail sales value	Feb 2014	HK$bn	40.5	-2.3

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

Residential

Under the influence of both the new government policies and the Chinese New Year holiday, residential transaction volume remained low in Q1. The situation has further worsened since an expectation gap has opened between owners and prospective buyers. While owners tend to hold onto their properties rather than reducing their prices, prospective buyers expect to see further price drops. As such, the number of S&Ps for building units and land reached 14,457 in Q1, equivalent to a drop of 42.9% y-o-y. In particular, the S&Ps figure in February was 4,124, only slightly better than the situation during the Global Financial Crisis, in which 3,884 S&Ps were recorded in November 2008 (Figure 2).

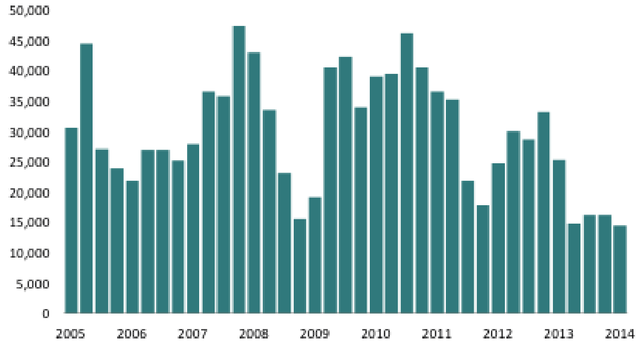
The primary home market remained active this quarter as developers continue to offer incentives to boost sales. As such, the number of primary market transactions stayed high, with 1,760 and 1,142 S&Ps recorded in January and February, respectively. The trend is likely to be sustained in the first half of the year and will continue to place downward pressure on secondary home market.

The secondary market was further subdued as the bids of the plot at Pak Shek Kok, Tai Po were rejected as being too low, the large surge of supply within the year and the earlier than expected announcement of the coming interest rates hike. In fact, as the Stamp Duty (Amendment) Bill 2012 was passed by the Legislators in late February, uncertainty has also been greatly reduced. Therefore, property owners who would like to off load their properties will be more realistic in setting their pricing.

The overall residential price index recorded a decline of 1.2% compared with the previous quarter and was down by 5.4% from a year ago. The price adjustment over the past twelve months can be used to measure the impact of cooling measures on the residential market. The adjustment of the mass residential is less than the luxury market as the impact of government curbs and lifting interest rate affect the luxury market more. While the price index of the former decreased by 3.9% y-o-y, the latter dropped by 7.3% y-o-y (Figure 3 and Table 2).

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	1,032,377	205.3	-1.0	-3.9
Luxury Market	85,555	210.3	-1.5	-7.3
Overall	1,117,932	207.4	-1.2	-5.4

Source : DTZ Research, Rating and Valuation Departement HKSAR

Looking ahead, the transaction volume of the secondary market is expected to remain low as there is a lack of incentive from both the supply side and the demand side. The price is expected to remain stable due to the stable economic environment and the fact that interest rate is likely to remain in the low zone in the near future. As such, the overall downward adjustment in price will be between 5 to 10%.

Office

Thanks to the improved demand for office space coming from the finance sector, which includes both Mainland companies and multi-national corporations, the seasonal drop in leasing activity around Chinese New Year was not very pronounced in the first quarter of 2014. Overall net absorption reached 365,315 sq ft, as compared with -206,702 sq ft in Q4 2013. The overall rents dropped further to reach HK$59.4 (US$7.7) per sq ft per month while the vacancy rate decreased from 6.1% to 5.6% q-o-q (Table 3). Although the overall rent has declined for three consecutive quarters, the vacancy figure improved after rising for two consecutive quarters.

The Central Financial District (CFD) which includes Sheung Wan/ Central/ Admiralty was very active this quarter since some landlords offered concessions. Rents decreased slightly by 0.7% q-o-q to reach HK$99.3 (US$12.8) per sq ft per month and the vacancy rate dropped by 0.8 percentage point q-o-q to reach 5.6% (Table 3 and Figure 4). Occupiers from the finance sector continued to be the major tenant in the CFD. US financial institution Wellington Management recently took up one floor of office space (23,000 sq ft) at 2IFC while Banco Santander leased 15,000 sq ft in the same building.

In Wanchai/ Causeway Bay and Island East, there was limited availability and market activity was quiet as a result. The net absorption of this quarter reached 29,453 sq ft and 36,566 sq ft, respectively, while vacancy rate stayed low at 3.8% and 2.7%, respectively (Table 3).

Table 3

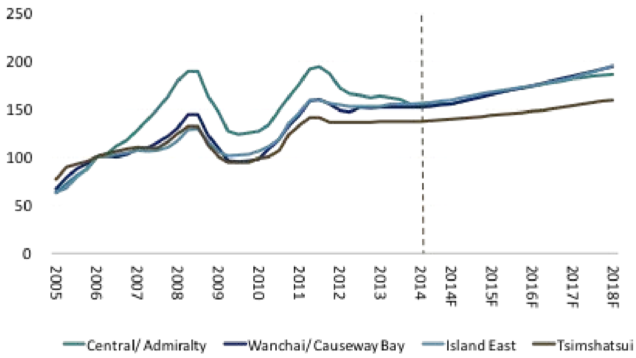
Grade A office market statistics

District	Total stock (million sq ft)	Availability ratio (%)	Monthly Rent (HKD per sq ft)	Change q-o-q (%)
Sheung Wan/ Central / Admiralty	29.5	5.6	99	-0.7
Wanchai / Causeway Bay	16.0	3.8	47	0
Island East	11.0	2.7	38	+0.5
Tsimshatsui	9.3	4.9	33	0
Kowloon East	13.3	10.7	33	0
Overall	**79.0**	**5.6**	**59**	**-0.5**

Source : DTZ Research

Figure 4

DTZ office rental index (Q1 2006 = 100)



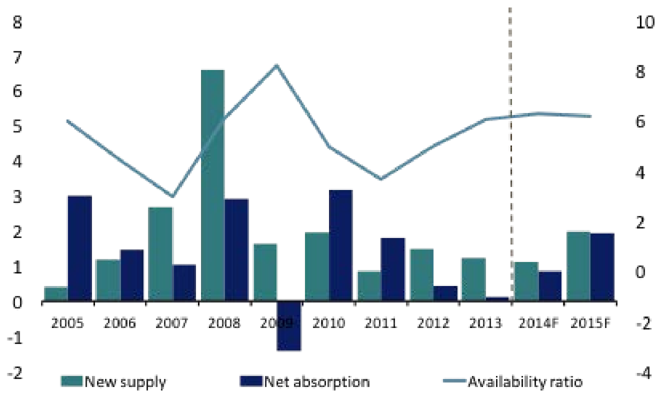
Source : DTZ Research

On the Kowloon side, Tsimshatsui witnessed negative net absorption of 7,663 sq ft and as a result vacancy rate increased by 0.1 percentage point q-o-q to reach 4.9%. In Kowloon East, some take up in the newly completed building in the last quarter pushed up net absorption to reach the level of 105,904 sq ft, causing the availability ratio to drop from 11.5% to 10.7% (Table 3).

Looking ahead, about 889,000 sq ft of office space is expected to come on stream this year but only 81,000 sq ft are located in the prime area. Several projects in Kowloon East are expected to be completed later this year and this will undoubtedly bring a downward pressure on the rental in Kowloon East.

Figure 5

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



Source : DTZ Research

Retail

Statistics from Tourism Board show that visitor arrivals in the first two months of the year increased by 14.1% over the same period a year earlier to reach 9,872,747. As such, total retail sales grew by 6.6% y-o-y to reach HK$95.0bn (US$12.3bn) (Figure 6).

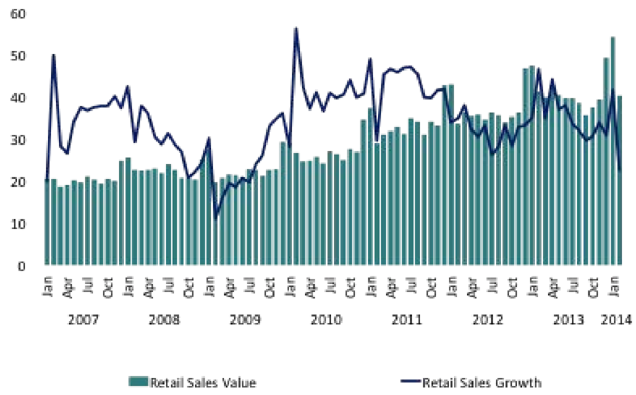
With regards to Hong Kong's retail spending pattern, the value of sales of wearing apparel in January and February jumped by 10.1% compared with the same period last year, followed by the 9.3% increase in medicines and cosmetics. On the other hand, the sales of jewellery, watches and clocks, and valuable gifts grew by only 5.3% over the same period. Such spending pattern reflects that increasing numbers of mainland tourist visitors are tending to shop more for non-luxury products on their trips.

The change in spending habit has undeniably played an important role on the revenue of the mid-range products retailers and this group of tenant is expected to be more active in the prime districts this year. For instance, sporting goods stores RSH (Hong Kong) Limited leased a portion of the G/F and the whole of 1-2/F of Thai Kong building. Restaurants are also benefited from the rising tourism figures, as restaurant chain Tsui Wah Restaurant planned to open its flagship store at 485 Lockhart Road.

Leasing demand for prime districts demonstrated differential performance in first tier and second tier streets. In top-tier shopping streets such as Russell Street and Canton Road, luxury brands and jewellery shops continued to be the major demand drivers. However, for the tier two locations, landlords who expected to enjoy the spill-over effect on rental growth may not be able to realize this due to the change in spending habits of mainland tourists. As the number of vacant shops has continued to increase, landlords may have to lower their rents in order to secure tenants. Therefore, both Hong Kong Island and Kowloon witnessed rental drop in this quarter, with the former dropping by 7.3% compared with the last quarter and the latter dropping by 6.3% over the same period. Thanks to the consumption of same-day visitors from mainland China, the performance of the

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	181.0	-7.3	-5.2
Kowloon	147.7	-6.3	-0.1
New Territories	175.6	0.8	10.1

Source : Rating and Valuation Department HKSAR, DTZ Research

Figure 7

Retail rental index (Q1 2000=100)

Source : Rating and Valuation Department HKSAR, DTZ Research

New Territories rental index outperformed the other two submarkets, with 0.8% q-o-q growth recorded in the first quarter of 2014 (Table 4 and Figure 7).

Looking further into the year, rental of tier 1 street shops is expected to reamain at a high level and a mild rental growth is expected to be witnessed. However, vacancy shops may pose some pressure on the rental growth of tier 2 locations.

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