PROPERTY INSIGHTS

Hong Kong | Quarter 2, 2015

Buoyant office take-up in CBD

Market Overview

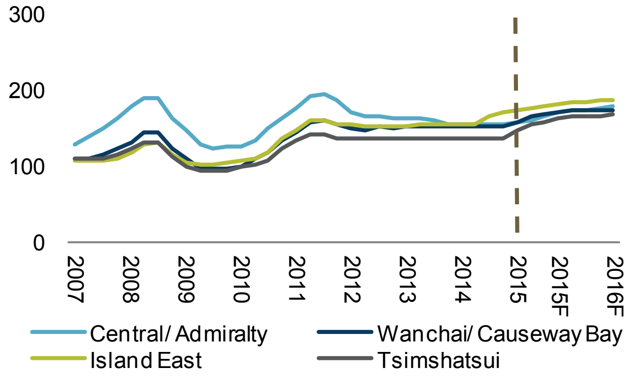
Demand for office space in CBD continued to be dominated by Mainland China financial institutions, however, expansion by global players like Bloomberg and Blackrock was also witnessed. A large number of major leasing deals were registered within the quarter and market sentiment continued to improve, further driving up the overall net absorption. Meanwhile, rental increase was recorded in all of the submarkets, and overall rent rose by 2.7% q-o-q to reach HK$63.0 (US$8.1) per sq ft per month (Figure 1).

The retail sector has been impacted by poor retail sales, sluggish growth in tourism arrivals and tightening of the Individual Visit Scheme for Shenzhen residents. The sector was further hit by the reduction in import tariffs for consumer goods in China which was implemented on June 1 2015. Rental index for all the three main regions of Hong Kong dropped between 3.9% to 7.7% y-o-y.

Number of S&P Agreements for all building units and land rebounded after the market digested the recent mortgage policy and the massive launch of new residential projects. Mid-priced units became the focus of the market as the percentage of residential S&P's ranging between 5 to 10 million Hong Kong dollar was recorded at 45.8% in Q2. At the same time,

Figure 1

DTZ office rental index (Q1 2006 =100)



Source : DTZ Research

residential property prices remained on the upswing, despite the recent surge in supply and indications of further regulatory tightening.

The investment market stayed active with the number of major deals continued to be recorded at a very high level. Luxury residential and strata-title office sectors were the focus as they accounted for almost two-thirds of the transactions and several record high price transactions were recorded.

Economic Overview

With strong domestic demand but poor external demand, real GDP grew mildly by 2.1% in the first quarter of the year, a drop of 0.3 percentage point compared with the previous quarter (Table 1).

The value of total exports of goods in May 2015 reached HK$291.8bn (US$37.6bn), equivalent to a drop of 4.6% y-o-y (Table 1). Strong US dollar plus slow global economic recovery have led to weak export performance and may continue to affect exports in the short term.

According to the Composite CPI, overall consumer prices in May 2015 rose by 3.0% y-o-y (Table 1). Meanwhile, underlying inflation remained moderate, being recorded at 2.6% in May. Looking ahead, China's low level of consumer inflation will likely continue to contribute to low inflation in Hong Kong.

The seasonally adjusted unemployment rate in March – May 2015 was 3.2%, up by 0.1 percentage point compared with the same period a year earlier (Table 1). Although the labour market remained strong, poor retail sales and sluggish arrival growth will continue to have a negative impact on the employment figures in the short term.

Domestic demand fared relatively better and remained the key source of economic growth within the first quarter. Private consumption expenditure grew by 3.5% in real terms in the first quarter over a year earlier, supported by stable labour market conditions in recent quarters (Table 1).

Buoyed by tourist arrivals from Mainland China, visitor arrivals totalled 4.8 million in May, up by 3.6% y-o-y (Table 1). However, high spending overnight visitor was down slightly by 1.3% y-o-y to reach 2.1 million. As such, total retail sales fell 0.1% y-o-y to HK$39.0bn (US$5.0bn) in May, this representing the third consecutive month of y-o-y decline (Table 1). While the value of sales of jewellery, watches and clocks, and valuable gifts continued to register double-digit y-o-y decline, sales of basic necessities like clothing, footwear and allied products, medicines and cosmetics, which earlier had proved more resistant to correction, also similarly went into the third consecutive month of y-o-y decline.

Table 1

Economic indicators

Indicator	Period	Unit	Value	Change y-o-y (%)
GDP at constant prices*	Q1 2015	HK$bn	541.3	+2.1
Total exports	May 2015	HK$bn	291.8	-4.6
Private consumption expenditure	Q1 2015	HK$bn	382.1	+5.3
Unemployment rate (seasonally adjusted)	Mar 2015 - May 2015	%	3.2	+0.1pt
Visitor arrivals	May 2015	Million	4.8	+3.6
Composite CPI	May 2015	-	122.9	+3.0
Total retail sales value	May 2015	HK$bn	39.0	-0.1

* In chained (2013) dollars

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

Residential

The market's full digestion of the recent round of government measures and the wave of launches in the primary residential market caused the number of S&P Agreements for all building units and land to pick up in recent months, increasing from 6,458 in April, to 7,085 in May, and further rising to 8,284 in June. As such, total transaction volume reached 21,827 in Q2, a drop of 7.0% q-o-q but up 5.4% y-o-y (Figure 2).

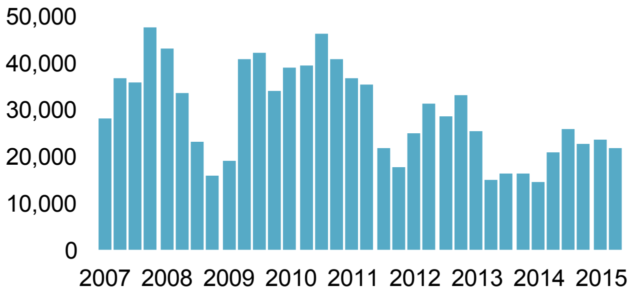
As supported by the wealth generating effect from the stock market boom in the first half year and continuous increase in property prices, the amount of small lump sum units available for sale continued to drop and the focus of the residential sales market turned to the mid-tier market segment. According to the Land Registry, the percentage of residential S&Ps valued at between 5 to 10 million Hong Kong dollar reached 45.8% in Q2, up from 38.1% in Q1, while the category between 3 to 5 million Hong Kong dollar dropped from 38.1% to 29.8% within the same time frame. On the other hand, the luxury sector also turned very active as developers which offered projects in traditional prime areas received very good market response from both domestic and mainland buyers. With 2,122 residential transactions of over HK$10mn registered in Q2, transaction volume in the luxury sector increased by 13.9% from Q1.

New projects which are priced at a reasonable market level were very well received by buyers. Large-scale new projects like Hemera, The Beaumount II and Corinthia by the Sea received very good market response. With 4,989 primary residential S&Ps recorded in Q2, the number reached 8,732 in H1, representing a total consideration of HK$84.1bn.

With respect to price, although the government continued to increase land supply and has implemented a series of curbs, property prices across all sectors continued to rise in Q2. The overall residential price index increased by 4.2% q-o-q and 22.3% y-o-y. The mass market continued to outperform the luxury sector. While the former was up by 28.9% in the last twelve months, the latter was up by 12.8% over the same period (Figure 3 and Table 2).

Figure 2

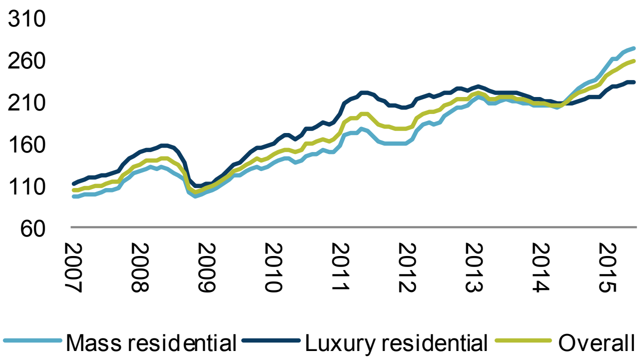
Transaction volume of S&P Agreements (No. of S&P Agreements)



Source : Land Registry

Figure 3

Residential price index (Jan 2000 = 100)



Source : DTZ Research

Table 2

Private residential market statistics

	Total stock (no. of units)	price index (Jan 2000 = 100)	q-o-q change (%)	y-o-y change (%)
Mass Market	1,049,196	275.7	5.3	28.9
Luxury Market	87,234	234.7	2.5	12.8
Overall	1,136,430	258.7	4.2	22.3

Source : DTZ Research, Rating and Valuation Departement HKSAR

Looking ahead, market sentiment is expected to become somewhat more cautious due to the recent volatility of the Mainland and Hong Kong stock markets. Transaction volume is likely to be constrained in the near-term. The primary market will remain the focus of buyers' attention as developers are actively preparing new launches in the coming quarter while the secondary market will slow down in face of rising competition and potential instability in market sentiment. In view that much of the future supply comprises small and medium-sized units and of persisting strong confidence in the luxury market, going forward, over the short term the performance of the luxury sector is expected to pick up and outperform the mass market.

Office

Market sentiment continued to improve as companies in the finance sector are seeking expansion space in Central. While Mainland China financial background occupiers continued to dominate the leasing transactions in CBD, global financial institutions like Bloomberg and Blackrock were also very active. Under these conditions, territory-wide net absorption reached 720,225 sq ft, as the rising trend entered its third consecutive quarter. Meanwhile, rental increase was recorded in all of the submarkets, driving the overall rents to rise by 2.7% q-o-q to reach HK$63.0 (US$8.1) per sq ft per month (Table 3).

In Sheung Wan/Central/Admiralty, net absorption reached 379,209 sq ft, the highest among the five submarkets tracked. Finance sector continued to be the key demand driver but unlike the previous quarters, this quarter recorded a greater number of major leasing deals. Citibank Plaza registered most of the significant deals. For example, Blackrock expanded by taking up three floors at about 67,137 sq ft, financial services company Thomson Reuters and Bloomberg each leased over 33,000 sq ft within the same building. As a consequence, the Sheung Wan/Central/Admiralty vacancy rate dropped to 3.6%, the lowest level recorded since Q3 2011 (2.9%). Meanwhile, rent rose by 2.7% to reach HK$103.4 (US$13.3) per sq ft per month, but was still far below the all time market high of HK$125.1 (US$16.1) per sq ft per month recorded in Q3 2011 (Table 3 and Figure 4).

Table 3

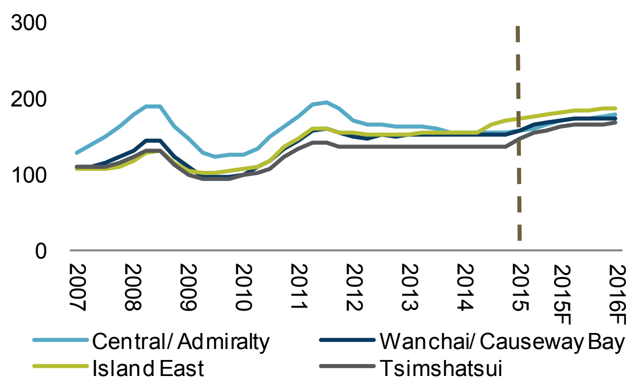
Grade A office market statistics

District	Total stock (million sq ft)	Availability ratio (%)	Monthly Rent (HKD per sq ft)	Change q-o-q (%)
Sheung Wan/ Central / Admiralty	29.5	3.6	103	+2.7
Wanchai / Causeway Bay	16.0	4.0	51	+5.8
Island East	11.0	2.9	43	+1.2
Tsimshatsui	9.5	3.9	38	+5.4
Kowloon East	14.5	12.3	35	+5.0
Overall	**80.5**	**5.2**	**63**	**+2.7**

Source : DTZ Research

Figure 4

DTZ office rental index (Q1 2006 =100)



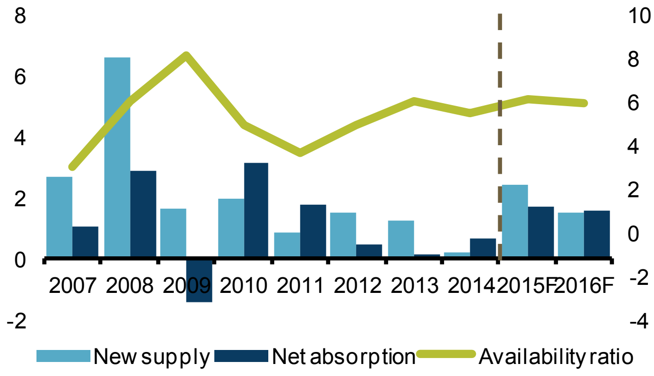
Source : DTZ Research

Turning to the Kowloon side, office demand for both the Tsimshatsui and Kowloon East submarkets was quite substantial. Since there were several leasing transactions driven by banks in Tsimshatsui, net absorption within the district reached 112,978 sq ft in Q2 and rents rose by 5.4% q-o-q to reach HK$37.5 (US$4.8) per sq ft per month (Table 3 and Figure 4). On the other hand, 5 office buildings with a total GFA of over 1.0mn sq ft entered the Kowloon East submarket, causing stock levels to reach 14.5mn sq ft. As this trend persists, Kowloon East will soon overtake the Wanchai/Causeway Bay submarket, in terms of scale, and emerge as the second largest business district in Hong Kong. Within the second quarter three newly completed buildings by Billion Development were offered for strata-title sale, and the sale of these units plus leasing transactions raised the level of net absorption to reach 282,218 sq ft. However, despite the increased net absorption, the market temporarily could not absorb the large quantum of space which became available within the quarter, and so vacancy rate spiked to reach 12.3%, an increase of 4.6 percentage points q-o-q (Table 3 and Figure 5).

Looking ahead, market activities are expected to remain buoyant due to the kick-off of the mainland-Hong Kong mutual recognition of funds program on July 1 and the upcoming inauguration of the Shenzhen-Hong Kong Stock Connect. Further, as One Bay East is expected to be completed in the fourth quarter of the present year, both Manulife and Citibank are scheduled to move into these new office facilities in Kowloon East and this will result in their surrendering some of their space. Hence, major tenant relocation and market movements are expected to continue to drive leasing market activities. Rents in the CBD will go further in the remainder of 2015, driven by strong demand.

Figure 5

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



Source : DTZ Research

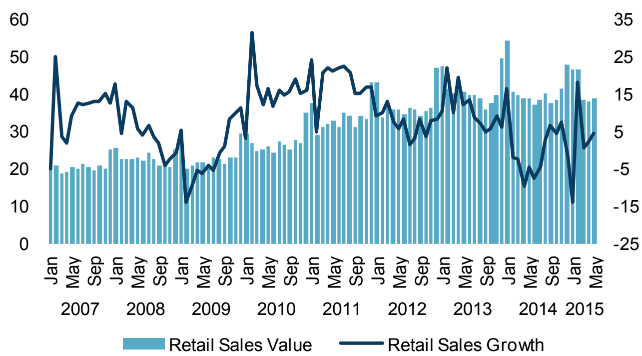
Retail

The Individual Visit Scheme for Shenzhen residents was reduced from multiple entry to one-trip-per-week on 13 April but the effects on retail sales and number of visitors are yet to be seen. During the Labour Day Golden Week, the number of visitors was up by 11.8% compared with a year earlier, and the number of mainland visitor was up by 13.8% over the same period. However, the retail sector did not benefit with the continued growth in tourist arrivals, with retail sales between April and May being recorded as dropping by 2.1% and 0.1% y-o-y respectively (Figure 6).

Jewellery, watches and clocks, and valuable gifts continued to be the worst-performing type of retail outlets. After recording an annual drop of 24.5% in May 2014, turnover for vendors in these categories further dropped by 15.0% this year. As such, the total

Figure 6

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



Source : Census and Statistics Department HKSAR sales for the first five months of the year reached HK$37.3bn (US$4.8bn), which was down by 28.8% from the peak in 2013. At the same time, sales of basic necessities like clothing, footwear and allied products, medicines and cosmetics also recorded the third consecutive month of y-o-y declining sales.

In Mainland China, the Ministry of Finance (MoF) announced the lowering of import tariffs for consumer goods by an average of 50% on products such as apparel, shoes and cosmetics beginning June 1. These tariff reductions are expected to reduce the number of visitor arrivals and causing retail sales to decline even further.

Apart from pharmacies, jewellers and watch shops, there are an increasing number of cosmetic shops giving up retail space in prime locations due to dropping sales. In particular, a leading cosmetics retailer Sa Sa International Holdings Limited released their latest earnings results, with profit after tax in Hong Kong and Macau being recorded as dropping by 10.7% y-o-y. As such, Sa Sa are cutting back on their presence in major tourism spots in order to reduce their occupancy costs.

All of the above mentioned phenomena have affected the rental trends with respect to shops in tier one locations in traditional shopping districts. Two shops in Russell Street signed leasing contract this quarter, with rental drop of 38% and 40%, respectively, as compared with the previous contract. As such, rental index for Hong Kong Island and Kowloon dropped by 7.7% and 3.9%, respectively (Table 4 and Figure 7). The tightening of the Individual Visit Scheme and lowering of import tariffs have severely affected the outlook for street shops in New Territories as same-day visitors from mainland China who used to make their purchases near the border are expected to decline in number. Uncertainty, as a result of dropping visitors, has caused vacancy in New Territories to rise again. Room for negotiation increased and rental drop of 5.1% y-o-y was witnessed within the quarter (Table 4 and Figure 7).

Table 4

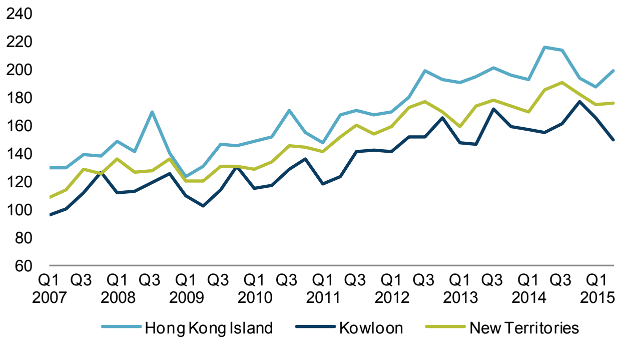
Retail market statistics

	Rental Index (Q1 2000 = 100)	q-o-q change (%)	y-o-y change (%)
Hong Kong Island	199.1	6.3	-7.7
Kowloon	149.4	-9.5	-3.9
New Territories	176.2	0.7	-5.1

Source : Rating and Valuation Department HKSAR, DTZ Research

Figure 7

Retail rental index (Q1 2000=100)



Source : Rating and Valuation Department HKSAR, DTZ Research

Looking ahead, as the full impact of the fine tuning of the Individual Visit Scheme and the slashing of import tariffs will progressively emerge, domestic demand is also anticipated to weaken as the impact of these negative factors is further exacerbated by the recent volatility in the China and Hong Kong stock markets. As a result, while the rents for major shopping district are expected to drop by 5-10% in the near-term, districts which cater less to the tourism trade are expected to be more resilient.

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