PROPERTY INSIGHTS

Hong Kong | Quarter 4, 2015

A good year for the office leasing market

Market Overview

As external demand remained weak, the exports of goods decreased by 3.2% in Q3 2015 compared with the same period a year earlier and the economy grew at a rate of 2.3%, representing a drop of 0.5 percentage point q-o-q.

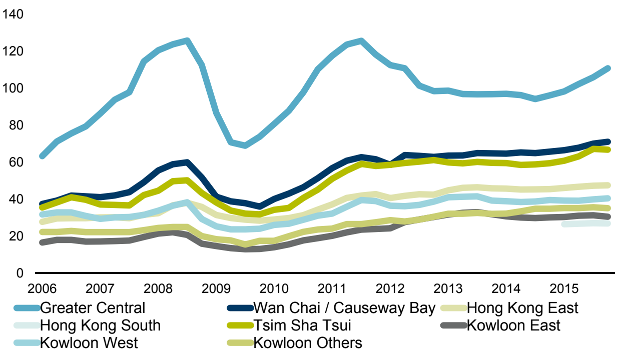
Uncertainty surrounding economic conditions and the future pace of interest rate hikes, plus the expectation of further consolidation in property prices caused market activity to slow down even further. Developers reacted quickly by providing aggressive financing plans to offload a substantial portion of their pipeline projects, thereby potentially overdrawing the market's purchasing power.

Although the overall office leasing market further slowed down in the last quarter of the year, the performance of the Greater Central area stayed strong on the back of demand from mainland Chinese financial occupiers. While the availability ratio of CBD dropped further to reach 3.0% in Q4 2015, rents have gone up by 15.2% y-o-y (Figure 1).

While both the visitor arrivals and retail sales kept falling, high street rental in traditional shopping districts dropped further from the level of Q3 2015, declining by a range of 4.0%-7.2%. The opening of the first phrase of Qianhai Chow Tai Fook Global Goods Shopping Centre in Shenzhen, further depreciation of RMB and the reduction of import tariffs in China are likely reduce the number of mainland visitors.

Figure 1

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



Source : DTZ/Cushman & Wakefield Research

Economic Overview

Economic growth in Hong Kong slowed down in the third quarter of the year as external demand remained weak. With real GDP recording at a rate of 2.3% in Q3 2015 compared with the same period a year earlier, this is equivalent to a drop of 0.5 percentage points from the previous quarter (Table 1).It is anticipated that the overall economy will achieve a growth rate of slightly over 2% in 2015.

The resilient labour market continued to support domestic demand, with private consumption growing at 4.3% in real terms in Q3 2015 (Table 1). Hence, it is anticipated that domestic demand will continue to be the major driver of the economy.

The labour market remained stable during September – November 2015, with seasonally adjusted unemployment rate stayed at 3.3%, and is flat for five consecutive periods (Table 1). As the prospects for the tourism and retail sectors are still dim, the unemployment rate may go up in the near term.

Table 1

Economic indicators

Indicator	Period	Unit	Value	Change y-o-y (%)
GDP at constant prices*	Q3 2015	HK$bn	571.7	+2.3
Private consumption expenditure*	Q3 2015	HK$bn	370.4	+4.3
Unemployment Rate (Seasonally Adjusted)	Sep to Nov 2015	%	3.3	0
Composite CPI	Nov 2015	-	126.1	+2.4
Visitor Arrivals	Nov 2015	Million	4.7	-10.4
Total Retail Sales Value	Nov 2015	HK$bn	38.1	-7.8
Total Exports	Nov 2015	HK$bn	315.3	-3.5

* In chained (2013) dollars

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

Inflationary pressure remained low as overall consumer prices rose by 2.4% y-o-y in November, having been below 3% for five consecutive months (Table 1). Given the mild imported inflation and the declining trend in housing costs, this low inflation environment is expected to persist over the near term.

The implementation of the one-day-per-week policy has caused the continue decline in mainland visitor arrivals. As the number of mainland visitors dropped by 15.5% y-o-y in November 2015, total visitor arrivals was drop by 10.4% y-o-y (Table 1).

The performance of the retail sector declined in November 2015, with retail sales dropped by 7.8% y-o-y to reach HK$38.1bn (US$4.9bn) (Table 1). In particular, the value of sales of jewellery, watches and clocks, and valuable gifts recorded a decline of 20.6% over the previous year.

The sluggish growth of the global economy, combined with the effect of strong US dollar, have continued to affect Hong Kong's exports. The value of total exports in November was down by 3.5% y-o-y to reach HK$315.3bn (US$40.7bn) (Table 1). However, due to the normalization of US monetary policy, the export performance is unlikely to improve in the near term.

Residential

Market sentiment for residential market has worsened as the concerns caused by weakening economic conditions and impact of the US interest rate hike caused potential buyers to expect further consolidation in property prices. Under these conditions, the number of residential S&P agreements plunged to a record low of 2,826 deals in November. With 10,169 units changed hand in the last quarter of the year, total transaction volume reached 55,982 in 2015, which was only 10.5% higher than the record low in 2013 (Figure 2).

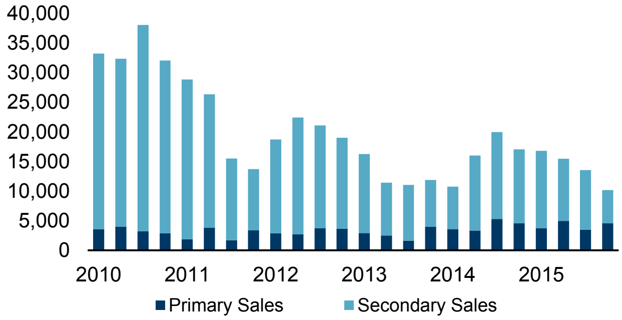
As the sales of the new projects showed signs of slowing down, developers reacted quickly by providing aggressive financing plans for both the mass and luxury markets to boost sales. Hence, 4,606 primary sales were recorded in Q4, representing a growth of 32.1% q-o-q and accounting for 45.3% of all residential transactions (Figure 2). However, this may mean that developers were worried about the prospect of the property market and their actions resulted in a further overdrawing of purchasing power.

The US Federal Reserve announced the hiking of the benchmark rate by 25bps on December 17. This was the first interest rate move in nearly a decade and several more hikes may potentially occur in 2016. Although the interest rate in Hong Kong has not yet been affected by this move, nevertheless home owners were willing to offer more concessions and this acted to further drive down property prices. However, as potential buyers anticipated a further downward movement in property price, second hand transactions shrank by 44.7% q-o-q to reach 5,563 in Q4 (Figure 2).

Meanwhile, the luxury residential sector also turned quieter this quarter, with both the number of major deals and total consideration dropping by over 60.0% from the previous quarter (Figure 3). However, as landlords in this segment have greater holding power and are offering less concessions, price performance has been more resilient in the luxury

Figure 2

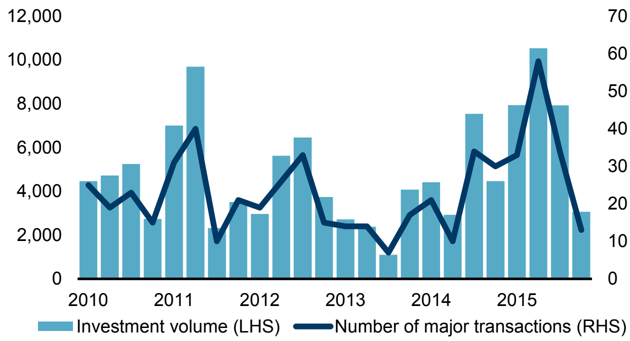
Number of Agreements for Sale and Purchase of Residential Building Units: Primary and Secondary Sale



Source : Land Registry

Figure 3

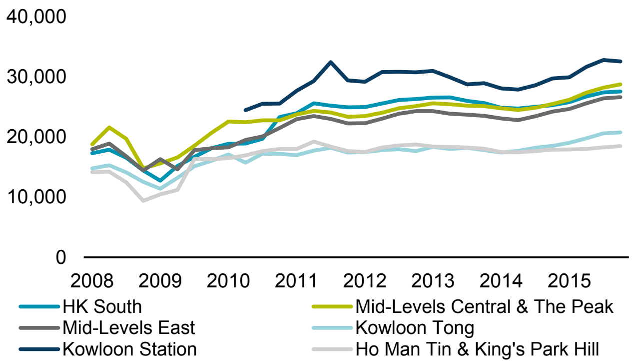
Residential Investment Volume (HK$ million) and Number of Transactions above HK$100 Million



Source : DTZ/Cushman & Wakefield Research

Figure 4

Luxury Residential Capital Values by District (HK$ psf)



Source: DTZ/Cushman & Wakefield Research

sector. For example, House 1 & 2 of Belleview Place were sold for HK$400.0mn (US$51.6mn). With a total saleable area of 5,041 sq ft, the unit rate reached HK$79,349.2 (US$10,238.6). Meanwhile, the No. 12 Oxford Road was sold to a mainland buyer at a total consideration of HK$195.0mn (US$25.2mn), equivalent to a unit rate of HK$39,093.8 (US$5,044.4).

Although the normalization of the US monetary policy is expected to reduce uncertainty about the interest rate hike, the wait-and-see attitude on the part of potential buyers and the growing concern regarding local economic conditions could cause the overall transaction volume to remain low. In the face of the large amount of future supply and the slowdown in the primary sales market, developers will continue to offer initiatives and financial plans to attract home buyers. Hence, first hand market will remain the focus of the Hong Kong residential market. Impacted by the aforementioned negative factors, prices for both the mass and luxury markets are expected to continue to follow a downward trend.

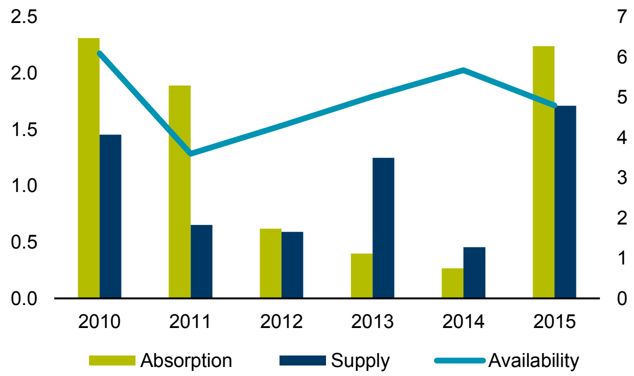
Office

After a long boom period, the overall market activity turned quieter in the last quarter of the year. Domestic Chinese financial institutions and insurance companies continued to be the major players on the Hong Kong leasing market. While the former were more interested in setting up their business in Greater Central area, the latter were more active leasing space in decentralized locations. Meanwhile, market activities were also driven by the demolition of the existing buildings. Under these conditions, overall rents were stable while territory-wide net absorption dropped from 470,521 sq ft in Q3 to 251,551 sq ft in Q4. At the same time, annualized net absorption reached to 2.2 million sq ft, the highest absorption level since 2010 and outstripped the 1.7 million sq ft of new supply. Hence, the overall availability rate dropped to 4.9% and rents went up by 3.2% y-o-y (Figure 5 and Figure 6).

Taking a closer look to the performance of different sub-markets, finance sector occupiers continued to show their interest in taking up office space in prime buildings within the Greater Central area. Ping An Asset Management relocated and leased an entire floor in Two International Finance Centre, while China Minsheng Investment established their first presence in in Hong Kong, taking 14,000 sq ft in Cheung Kong Center. As such, the availability ratio dropped further to 3.0% q-o-q and rents went up by 4.6% q-o-q, or 15.2% y-o-y (Figure 6).

Figure 5

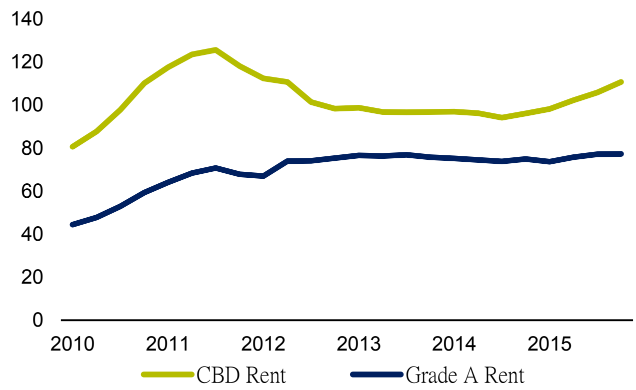
Grade A Office Net Absorption (NFA Million SF), Grade A Office Supply (NFA Million SF) and Availability Ratio (%)



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

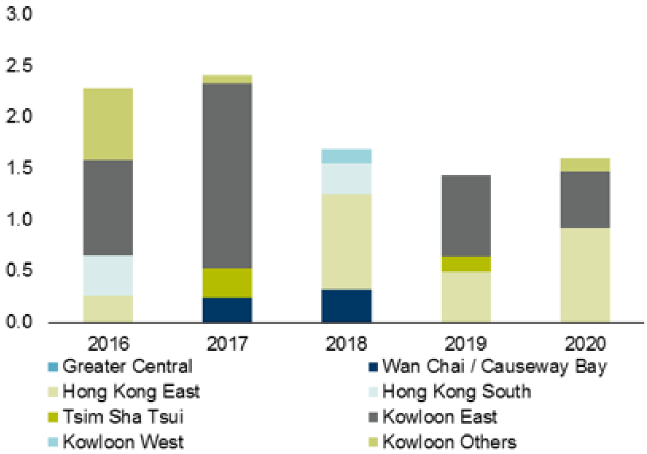
In Hong Kong East, as Warwick House and Cornwall House will soon be demolished, existing tenants continued to relocate to other office buildings, generating substantial amount of market activities. For instance, Pearson Education Asia moved from Cornwall House to 1063 King's Road and Nielsen relocated to Dorset House. Hence, the availability ratio dropped by 0.7 percentage point from the previous quarter and reached to 2.4%, the lowest level across all submarkets in Hong Kong.

In Tsim Sha Tsui, following the substantial level of absorption recorded last quarter, several major leasing transaction were recorded and net absorption stayed positive. A German based global supermarket chain Lidl leasing over 90,000 sq ft in International Commerce Centre for relocation and expansion. Meanwhile, global giant insurance company AIA leased 19,000 sq ft in The Gateway Tower 1 for expansion. Consequently, overall availability in Tsim Sha Tsui dropped 0.5 percentage point q-o-q to 2.9%.

Since several large occupiers will relocate to buildings which they had purchased, net absorption in Kowloon East recorded a negative 131,980 sq ft in Q4 2015 after four quarters of robust absorption. As affected by the large quantum of supply within the district, the district's availability ratio rose to 8.3% and rents dropped by 2.6% q-o-q.

Figure 7

New Grade A Office Supply (Million SF NET)



Source: DTZ/Cushman & Wakefield Research

Looking forward, 2.3 million sq ft of office space will enter the market in 2016, which is more than double of the average level of completion per annum witnessed during the 2010 to 2015 period (Figure 7). Although the Hong Kong leasing market will continue to benefit from the government policies, it is unlikely for the market to absorb this whole quantum of supply entirely due to the slowdown of both local and global economy. Hence, the availability ratio is expected to return to a healthier level and the tight available space environment will soon be relaxed.

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
						15 Q3	15 Q4	15 Q4	15 Q4
Prime Central	7,532,294	3.1%	0	0	122,700	115.37	122.42	189.55	174.33
Greater Central (CBD)	15,434,192	3.0%	0	0	126,814	105.99	110.83	171.61	157.82
Wan Chai / Causeway Bay	8,771,004	5.0%	378,600	128,332	29,324	70.85	71.08	110.06	101.22
Hong Kong East	7,367,940	2.4%	1,184,400	0	51,556	47.31	47.49	73.53	67.63
Hong Kong South	1,743,493	13.0%	538,400	142,974	-5,181	27.01	26.85	41.57	38.23
HONG KONG ISLAND TOTAL	**33,316,629**	**3.9%**	**2,101,400**	**271,306**	**202,513**	**79.34**	80.36	**124.43**	**114.43**
Tsim Sha Tsui	8,074,779	2.9%	282,600	60,890	40,812	67.24	66.80	103.43	95.12
Kowloon East	11,446,690	8.3%	3,137,200	1,216,389	-131,980	31.30	30.49	47.21	43.42
Kowloon West	3,701,237	8.1%	135,500	0	-9,155	39.91	40.47	62.66	57.63
Kowloon Others	1,545,909	4.1%	937,600	164,206	149,361	35.61	35.09	54.33	49.97
KOWLOON TOTAL	**24,768,615**	**6.3%**	**4,492,900**	**1,380,595**	**49,038**	**43.44**	42.78	**66.24**	**60.92**
OVERALL TOTAL	**58,085,244**	**4.9%**	**6,594,300**	**1,712,791**	**251,551**	**77.20**	77.31	**119.71**	**110.09**

*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 = 8.427HK$

Source: DTZ/Cushman & Wakefield Research

Retail

As the impact of one-trip-per-week policy continued to be felt, mainland visitors and total visitor arrivals in October and November 2015 plunged by 9.9% and 6.6%, respectively, compared with the same period a year earlier. Meanwhile, retail sales followed similar trend and declined by 5.5%, representing the ninth consecutive month of y-o-y decline. As a result, visitor arrivals and retail sales for the first eleven months of the year decreased by 1.7% and 3.1%, respectively (Figure 8 and Figure 9).

Taking a closer look at the retail sales by retail outlet, the sales of jewellery, watches and clocks, and valuable gifts was down by 20.6% y-o-y in November, while the sales of clothing, footwear and allied products and medicines and cosmetics were down by 8.5% and 7.0%, respectively. Hence, the sales of jeweller Chow Tai Fook in Hong Kong and Macau was down by 23% y-o-y in the last quarter of the year, and Burberry give up half their space of flagship store in Pacific Place, while Prada, Gucci and Miu Miu slashed their price by up to 50% to attract customers.

The poor performance of the retail sector was also illustrated by the amount of vacant shops and shops taking out short term leases in traditional shopping districts. Following Russell Street, Canton Road also witnessed the appearance of a vacant shop in Q4 2015. In fact, this was the first time for Canton Road to witness a shop position become vacant since the implementation of Individual Visit Scheme in 2003.

As such, prime street rentals in tier one locations dropped further from Q3 2015, declining by 4.0% in Mongkok to 7.2% in Causeway Bay (Figure 10). Although the high street rents followed similar downward trajectory across the four traditional shopping districts, rents in Mongkok were more resilient as it has fewer shops selling luxury goods. For example, a shop selling fashion & accessories on G/F – 3/F of 32 Argyle Street renewed their contract this quarter, and rental was down by 12.5% compared with the previous contract signed in Q4 2012. Meanwhile,

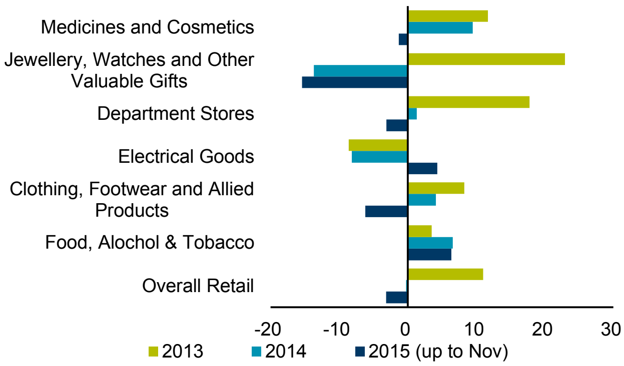
Figure 8

Hong Kong Tourist Arrivals (Million person)

Source : The Hong Kong Tourism Board

Figure 9

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



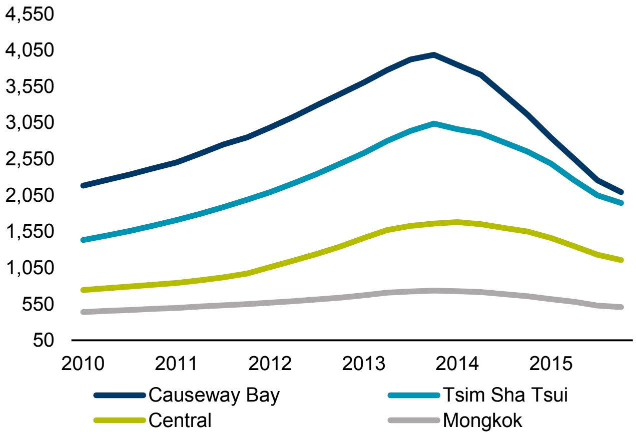
Source : Census and Statistics Department

Shop B1-B3 on G/F of 59-61 Russell Street & 78-82 Percival Street was transacted at a monthly rent of HK$1.5mn (US$0.2mn). Compared with the rent paid by the previous tenant in Q4 2012, this is equivalent to a drop of 40.0%.

The first phase of Qianhai Chow Tai Fook Global Goods Shopping Centre (CTF HOKO) was completed in December 2015 and is expected to attract numerous Shenzhen residents to purchase a wide variety of goods. Meanwhile, the further depreciation of RMB and the tax cuts on importation of both daily necessities and luxury goods in China beginning January 2016 will lower the incentive for mainland visitors to come to Hong Kong. Hence, the outlook of the overall retail sector in Hong Kong will remain gloomy in 2016 and non-core/suburban areas will continue to outperform.

Figure 10

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



Source: DTZ/Cushman & Wakefield Research

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