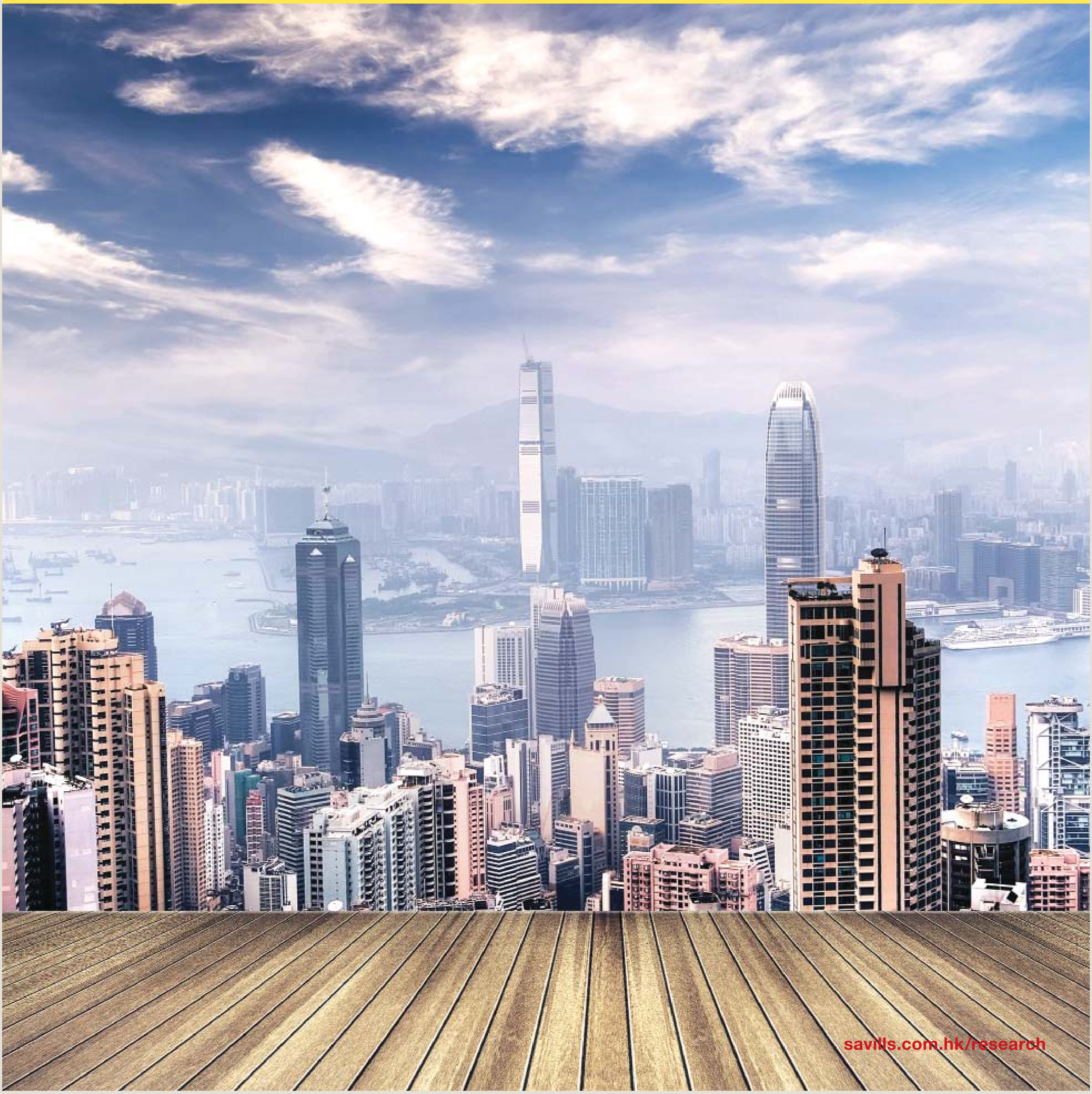
Savills World Research
Hong Kong

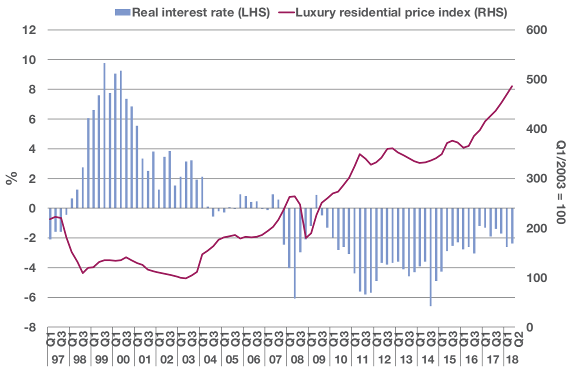
Asian Cities Report
Hong Kong Investment

2H 2018



GRAPH 1

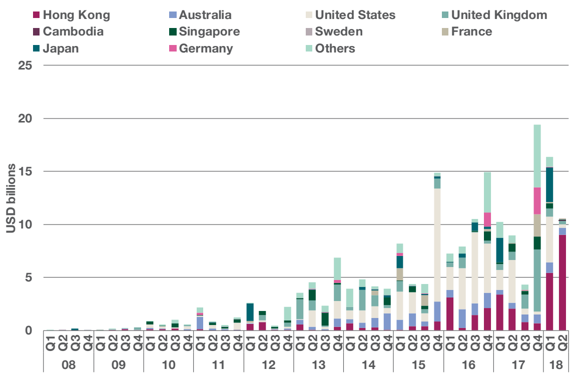
Real interest rates vs luxury residential prices, Q1/1997 – Q2/2018



Source: Census and Statistics Department, HKMA, Savills Research & Consultancy

GRAPH 2

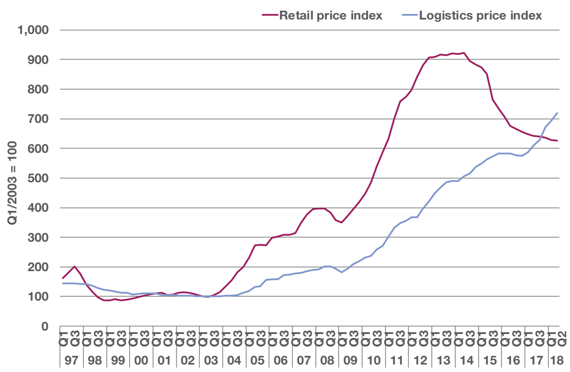
PRC overseas capital flows, Q1/2008 – Q2/2018



Source: Real Capital Analystics, Savills Research & Consultancy

GRAPH 3

Retail and logistics price indices, Q1/1997 – Q2/2018



Source: Savills Research & Consultancy

An unprecedented boom post-2009

Hong Kong's property markets have seen a remarkable period of growth since 2009 driven by an array of positive drivers, both domestic and foreign. Measures put in place to address the parlous state of the world's major economies post Global Financial Crisis (GFC) resulted in abundant liquidity and extremely low interest rates. Because of the US/HK Dollar peg, interest rates in the territory fell in tandem (and in inflation adjusted terms have been in negative territory for the past ten years), while excess liquidity found its way into local stock and property markets.

At the same time, Mainland Chinese capital began to look for opportunities overseas and became a significant player in an emerging pool of Asia-Pacific cross-border real estate funds. We also saw a boom in Asian (particularly PRC) tourism which proved hugely beneficial for the hotel and retail industries across the region while the impact of e-commerce transformed the supply chain and the outlook for the logistics sector. In Hong Kong, as PRC tourist numbers dwindled from 2014, the retail market fell in parallel and is only now beginning to recover. Logistics on the other hand has remained a popular asset class among developers, institutions and end users with values propelled ahead not just by the e-commerce revolution but also a chronic shortage of supply.

Overseas investment, however, was not just a prerogative of professionally managed funds, but also the individual. Looking to diversify risk, take advantage of capital growth, or driven to move overseas by better healthcare and education, mainland HNWs (alongside other Asian investors whose home markets had become unaffordable) bought residential units overseas in large numbers. Access to cheap finance was an additional lure and Hong Kong was a major beneficiary as luxury home prices soared by 156% over the period, fueled also by a severe lack of suitable housing stock. A growing raft of measures has so far done little to dissuade this wave of demand but pressure is growing.

Signs that the rally is long in the tooth

We believe that many, if not all of these factors which have driven historically unprecedented levels of asset price inflation, and an unusually long upcycle, are now unravelling and that risks are emerging both at home and abroad. At what point these factors force a correction in local real estate values is being hotly debated at the moment. Looking to the past, it has tended to be some unforeseen overseas crisis which has precipitated a downturn such as the Asian Financial Crisis and the Global Financial Crisis of 1998 and 2008 respectively. And here we are in 2018 as the world's emerging markets begin to come under pressure from a resurgent US Dollar.

Since late-2015 there have been seven rate hikes by the Federal Reserve signaling an end to 'easy money' and an inflection point in the interest rate cycle resulting in a higher cost of capital and a stronger US Dollar. At the same time, China has begun to tackle a domestic debt mountain which has been accumulating since 2013/14 while also restricting the outflow of capital and policing imprudent overseas investments and their backers. In addition, a weaker Renminbi and cooler economic growth at home are expected to have an impact on mainland overseas travel and spending in the near term, not least in Hong Kong.

In residential markets, governments worldwide are playing a much more active role in restricting overseas buyers whose activity has a tendency to push values beyond local affordability. Hong Kong is no exception and a series of policy interventions post-2012 have been aimed at both local speculators as well as overseas buyers. Typical measures include punitive stamp duties, restrictions on mortgage lending, and more recently a proposal for a vacancy tax on completed but unsold units (vacancy taxes are of course notoriously difficult to enforce). In Hong Kong luxury prices, especially on Hong Kong Island, are well supported by cash-rich owner occupiers and a dearth of good quality development sites.

At the same time the Lam Administration has established a Land Supply Taskforce and intends to significantly raise the supply of residential accommodation available to local families. A more recent concern is also the possibility of a full-blown US/China trade and currency war with significant negative implications for China's export-dependent economy and Hong Kong's role within it. Historically, adopting 1998 and 2008 as examples, a heavy correction in the stock market (-30% plus) is followed six to nine months later by a correction in property prices (-20% plus). It is worth remembering that while recovery post-2008 was swift thanks to QE, the post-1998 recovery was a much more protracted affair, lasting all the way until 2003/04.

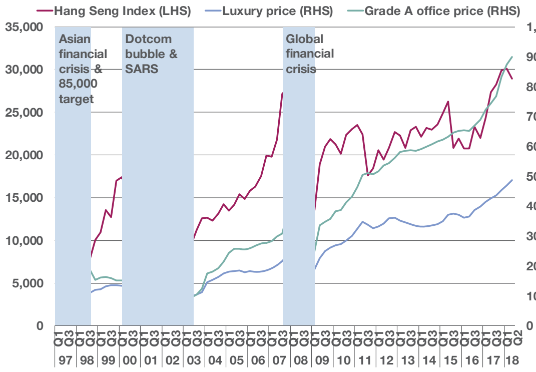
At the end of Q2/2018, with the exception of prime street shop prices, prices of all other property sectors, including residential, office and industrial, reached historical highs. We also observe that veteran investors have accelerated the pace of asset disposals as there have been more individual investment properties and portfolios launched for sale recently. We therefore expect a cyclical adjustment in the Hong Kong property market in the near future, possibly early next year. Timing is problematic given the buying momentum in this market at the moment and the number of buyers, commercial and residential, whose motives do not always include income return but often focus instead on capital security or the opportunity to grab trophy assets and development sites when they become available at substantial premiums to the general market. The Murray Road carpark site bought in May last year is a good example in this respect.

Closer economic integration with China the key

Despite the negative near term outlook we would reiterate that we believe that China will continue to engage with Hong Kong and the international community and that Hong Kong is uniquely positioned to provide vital skill sets to China in areas which include legal advice and financial intermediation services among many others. Hong Kong also looks set to benefit economically from greater integration with China as a whole and with the Greater Bay Area in particular. There is also a role for Hong Kong as part of the 'Maritime Silk Road', a component of the 'Belt and Road' initiative first announced by Central Government in 2013.

GRAPH 4

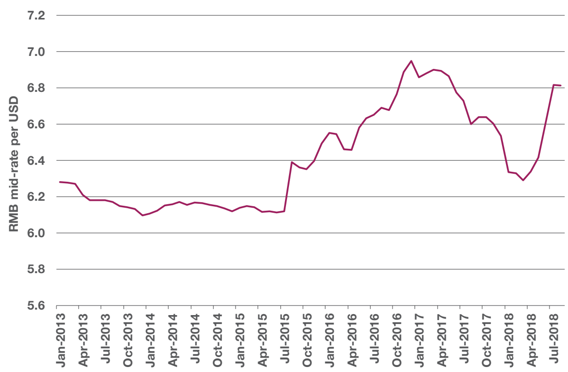
HSI vs real estate prices during AFC/GFC, Q1/1997 – Q2/2018



Source: HKMA, Savills Research & Consultancy

GRAPH 5

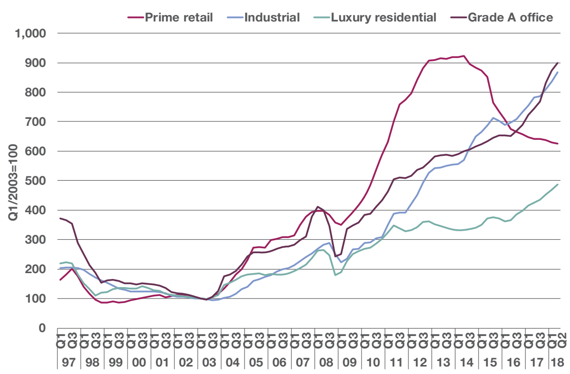
Renminbi vs USD, Jan 2013 – Aug 2018



Source: The People's Bank of China

GRAPH 6

All sector price indices, Q1/1997 – Q2/2018



Source: Savills Research & Consultancy

ASIA PACIFIC HEADQUARTERS

23/F Two Exchange Square, Central, Hong Kong
Tel: (852) 2842 4400   Fax: (852) 2868 4386

savills

ASIA PACIFIC EXECUTIVE COMMITTEE

CEO, Greater China
Contact: Raymond Lee   E-mail: rlee@savills.com.hk

Executive Chairman, Asia Pacific
Contact: Robert McKellar   E-mail: rmckellar@savills.asia

CEO, South East Asia
Contact: Christopher Marriott   E-mail: cjmarriott@savills.asia

CEO, Asia Pacific (Ex Greater China)
Contact: Christian Mancini   E-mail: cmancini@savills.co.jp

COO & CFO, Asia Pacific
Contact: Tim Robinson   E-mail: tbrobinson@savills.asia

CEO, Australia & New Zealand
Contact: Paul Craig   E-mail: pcraig@savills.com.au

HONG KONG SAR

Savills (Hong Kong) Limited
23/F Two Exchange Square, Central, Hong Kong
Tel: (852) 2842 4534   Fax: (852) 3007 2458
Contact: Raymond Lee   E-mail: rlee@savills.com.hk
EA Co. Licence: C-002450

Savills Valuation and Professional Services Limited
28/F Two Exchange Square, Central, Hong Kong
Tel: (852) 2840 4806   Fax: (852) 3007 4523
Contact: Charles Chan   E-mail: ccchan@savills.com.hk
EA Co. Licence: C-023750

Savills Property Management Holdings Limited
805-13 Cityplaza One, 1111 King's Road, Taikoo Shing, Hong Kong
Tel: (852) 2534 1688   Fax: (852) 2508 1883
Contact: Johnnie Chan   E-mail: jckchan@savills.com.hk
EA Co. Licence: C-002993

Savills Guardian (Holdings) Limited
7/F Cityplaza One, 1111 King's Road, Taikoo Shing, Hong Kong
Tel: (852) 2512 1838   Fax: (852) 2887 3698
Contact: Peter Ho   E-mail: peterho@savillsguardian.com.hk
EA Co. Licence: C-004089

MACAU SAR

Savills - Macau
Savills (Macau) Limited
Suite 1309-10, 13/F Macau Landmark,
555 Avenida da Amizade, Macau
Tel: (853) 8506 6288   Fax: (853) 2878 1805
Contact: Franco Liu   E-mail: fliu@savills.com.mo

CHINA

Savills - Shanghai
25/F Two ICC, 288 South Shaanxi Road,
Shanghai 200031, China
Tel: (86) 21 6391 6688   Fax: (86) 21 6391 6699
Contact: Siu Wing Chu
E-mail: siuwing.chu@savills.com.cn

Savills - Beijing
2101 East Tower, Twin Towers, B-12 Jianguomenwai Avenue, Chaoyang District, Beijing 100022, China
Tel: (86) 10 5925 2288   Fax: (86) 10 5925 2299
Contact: Anthony McQuade
E-mail: anthony.mcquade@savills.com.cn
Offices in Chengdu, Chongqing, Dalian, Guangzhou, Hangzhou, Nanjing, Shenyang, Shenzhen, Tianjin, Wuhan, Xiamen, Xi'an and Zhuhai

ASIA

Savills - Indonesia
PT Savills Consultants Indonesia
Panin Tower – Senayan City, 16th Floor, Unit C
Jl. Asia Afrika Lot. 19, Jakarta 10270, Indonesia
Tel: +62 (21) 293 293 80   Fax: +62 (21) 293 293 81
Contact: Craig Williams   Email: craig.williams@savills.co.id

Savills - Japan
Savills Japan Co., Ltd
15/F Yurakucho ITOCiA , 2-7-1 Yurakucho, Chiyoda-ku
Tokyo 100-0006, Japan
Tel: (81) 03 6777 5150   Fax: (81) 3 6777 5105
Contact: Christian Mancini   E-mail: cmancini@savills.co.jp

Savills - Korea
Savills Korea
13/F Seoul Finance Center, 136 Sejong-daero
Jung-gu, Seoul 04520, Korea
Tel: (82) 2 2124 4201   Fax: (82) 2 2124 4188
Contact: Crystal Lee   E-mail: csjlee@savills.co.kr

Savills - Malaysia
Savills (Malaysia) Sdn Bhd
Level 9, Menara Milenium, Jalan Damanlela, Bukit Damansara
50490 Kuala Lumpur, Malaysia
Tel: (603) 2092 5955
Contact: Christopher Boyd
Email: chris.boyd@savills.com.my

Savills - Singapore
Savills (Singapore) Pte Ltd.
30 Cecil Street, #20-03 Prudential Tower, Singapore 049712
Tel: (65) 6836 6888   Fax: (65) 6836 2668
Contact: Marcus Loo   E-mail: marcus.loo@savills.com.sg

Savills - Taiwan
Savills (Taiwan) Limited
21/F Cathay Landmark, No.68, Sec. 5, Zhongxiao E. Road
Xinyi District, Taipei City 110, Taiwan
Tel: (886) 2 8789 5828   Fax: (886) 2 8789 5929
Contact: Frank Marriott   E-mail: fmarriott@savills.asia
Office in Taichung

Savills - Thailand
Savills (Thailand) Limited
26/F Abdulrahim Place, 990 Rama IV Road
Silom, Bangrak, Bangkok 10500, Thailand
Tel: (66) 2 636 0300   Fax: (66) 2 636 0339
Contact: Robert Collins   E-mail: rcollins@savills.co.th

Savills - Vietnam
Savills Vietnam Ltd. Co.
18/F, Ruby Tower, 81-85 Ham Nghi Street
District 1, Ho Chi Minh City, Vietnam
Tel: (84) 28 3823 9205   Fax: (84) 28 3823 4571
Contact: Neil MacGregor
E-mail: nmacgregor@savills.com.vn
Offices in Danang, Hanoi and Ho Chi Minh City

INDIA

Savills - India
Savills India
Level 8, Vibgyor Towers, Bandra Kurla Complex
Mumbai 400 051 India
Tel: (91) 22 4090 7300
Contact: Bhavin Thakker Email : bthakker@savills.in
Offices in Bangalore and Gurgaon

AUSTRALIA

Savills - Sydney
Savills (Aust) Pty Ltd.
Level 25, 1 Farrer Place, Sydney, Australia NSW 2000
Tel: (61) 2 8215 8830   Fax: (61) 2 8215 8899
Contact: Simon Fenn   E-mail: sfenn@savills.com.au

Savills - Melbourne
Level 48, 80 Collins Street, Melbourne VIC 3000
Tel: (61) 3 8686 8000   Fax: (61) 3 8686 8088
Contact: Stuart Fox   E-mail: sfox@savills.com.au
Offices in Adelaide, Brisbane, Canberra, Gold Coast, Notting Hill, Parramatta, Perth and Sunshine Coast

NEW ZEALAND

Savills - New Zealand
Level 6, 41 Shortland Street, Auckland NZ 1010
Tel: (64) 9 951 5911
Contact: Thomas McAlister   E-mail: tmcalister@savills.co.nz
Offices in Auckland and Christchurch

THE AMERICAS

Savills – New York
Savills Studley, 399 Park Avenue, 11th Floor,
New York, NY 10022
Tel: (1) 212 326 8610   Fax: (1) 212 326 1034
Contact: Mitchell Steir
E-mail: msteir@savills-studley.com
Offices across Canada, the Caribbean, Colombia, Mexico and the United States

UNITED KINGDOM, EUROPE, THE MIDDLE EAST AND AFRICA

Savills - Europe
Savills, 33 Margaret Street, London W1G 0JD
Tel: (44) 207 499 8644   Fax: (44) 207 495 3773
Contact: Mark Ridley   E-mail: mridley@savills.com
Offices across Austria, Bahrain, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Guernsey, Hungary, Ireland, Italy, Jersey, Luxembourg, Monaco, Netherlands, Norway, Poland, Portugal, Qatar, Russia, South Africa, Spain, Sweden, Switzerland, UAE and the United Kingdom

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