

Briefing Sales & Investment

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SUMMARY

The last quarter of 2011 was a turning point for the Hong Kong property market.

- The investment market froze towards the end of Q4, with end users the only genuine buyers left in the market
- The luxury residential sector was hit not only by lower mainland interest and credit tightening, but also the first reverse in the leasing market since the global crisis
- Investment activity all but vanished in core office areas, while primary launches of brand-new offices in decentralised areas received

overwhelming responses from end users.

- Both prime street-shop prices and rents were well underpinned, but growth rates inevitably began to moderate.
- The industrial sector was unexpectedly active in the last quarter, with the CBD2 initiatives prompting investor activity in Kowloon East looking for revitalisation and redevelopment opportunities.

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 “The office and residential markets both look set for a shallow cyclical correction this year while we are more optimistic about the retail and logistics sectors which should stand up well in the current climate.”

Simon Smith, Savills Research

➔ **Overall**

The last quarter of 2011 was a turning point for the Hong Kong property market as rents and prices either slowed or went into decline. A poor macro-economic environment, tight credit and low affordability alongside policy risk conspired to dampen sentiment. The office and residential markets both look set for a shallow cyclical correction this year, while we are more optimistic about the retail and logistics sectors which should stand up well in the current climate, even if rates of growth slow. Most markets are well-supported by limited current availability and a narrow new supply pipeline.

With credit tightening remaining an issue and the leasing market outlook dampening, no billion-dollar deals were recorded over the last quarter, while there were only four deals over HK\$400 million, at least two of them for owner occupation. Affluent end users were the 'last man standing' in the property market, with investors and speculators being kept on the sidelines amid poor investment sentiment and prospects.

Residential market

In the luxury residential sector we saw a very slight retreat in values in Q4/2011, which we expect to continue into 2012. Rising mortgage rates and a weaker economy

TABLE 1 **Major property transactions, Oct–Dec 2011**

Property	Location	Price	Buyer	Usage
12 floors, 49 King Yip Street	49 King Yip Street, Kwun Tong	HK\$520 mil/ US\$67 mil	Kin Sang Chemical	Office
CWG Building	3 A Kung Ngam Village Road, Shau Kei Wan	HK\$475 mil/ US\$60.9 mil	Million Hope International Ltd	Industrial
Shops on G/F, 1/F and 2/F, Wingco Mansion	36–42 Soy Street, Mong Kok	HK\$471 mil/ US\$61 mil	World Hope International Ltd	Retail
19 Cooper Road	19 Cooper Road, Jardine's Lookout	HK\$468 mil/ US\$60 mil	Smart Approach Investment Ltd	Residential

Source: Savills Research & Consultancy

combined with falling rents (down 5% in Q4) all suggest a moderate correction. Nevertheless, in more speculative developments, such as Kowloon Station, a much heavier decline in prices to the degree of 15% have been noted, showing there may be some fire sales from less affluent investors with multiple holdings. Homeowners, however, are generally conservatively geared and little distressed selling looks likely, while new supply levels, in common with other sectors, are extremely low, helping to support values.

It is worth remembering that the government still has a number of policies in play to curb speculation and head off an asset price bubble, including a Special Stamp Duty and limits on bank lending, and therefore, has plenty of leeway should the market need support.

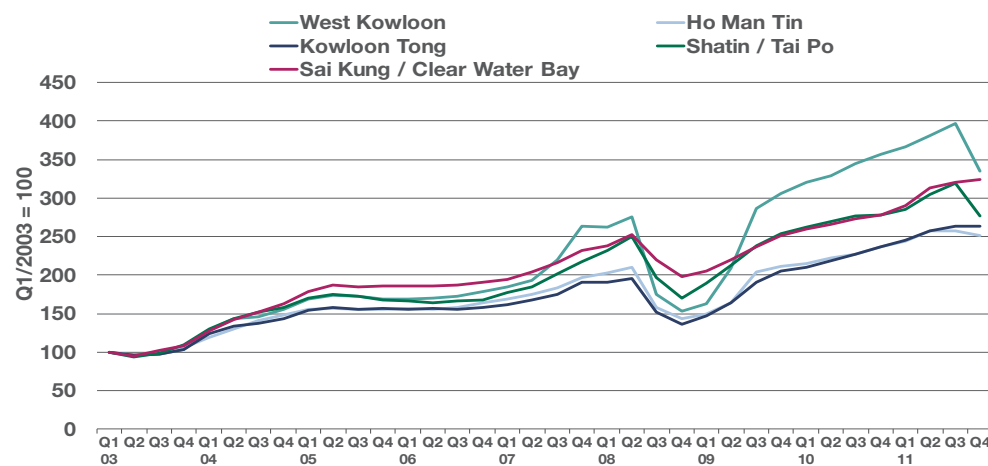
Mainland activity is a growing force and has been most apparent at the top end of the residential market, especially in the primary market for new builds. While there has recently been some discussion about how to safeguard local affordability, the government has so far stopped short of imposing any additional duties on overseas buyers, as has been the case in Singapore. We therefore think that prices will come off by only 10% to 15% over the year, with volume bearing the brunt of the correction.

Retail market

On a more positive note, the retail sector continues to enjoy a very good run with favourable knock-on effects on office demand and the logistics industry. Even in 2008, mainland visitors flocked to Hong Kong and 2012 looks set to be no exception, more than compensating for any pull-back in local demand. New-to-town brands are lined-up for prime space, while tourist spending is opening up fringe malls and secondary streets as potentially lucrative alternative locations.

Nevertheless, the promising leasing outlook and acute shortage of prime street stock meant volume remained extremely low, as vendors holding prime shops on Canton Road and Russell Street were reluctant to sell their prized assets at any price. Prime street-shop price growth moderated to 2% in Q4, but the 32% growth in 2011 was still the best across all property sectors. Save any unprecedented reversal of the mainland influx, prime street-shop prices should continue to grow by 5% to 10% in 2012. ➔

GRAPH 1 **Luxury residential price indices for Kowloon and New Territories, Q1/2003–Q4/2011**



Source: Savills Research & Consultancy

→ Office market

Banks are shedding staff at the moment as volatile financial markets and fewer IPOs cause a pullback after three years of robust growth. European banks are expected to fare the worst during this recent crisis, but the extent to which this will have an impact on their office requirements is unknown at present. Mainland firms have not been immune and many are taking a more cautious approach to expansion. The more sentiment-driven sales market has also begun to turn after hitting record highs earlier in the year.

The office market looks set to remain undersupplied over the next three years, with many new projects (around 60% by area) scheduled for strata-title sale. Pre-commitment levels have also been healthy, reducing tenant options further. We expect a modest correction in Grade A rents in the order of 10% to 15% in Central and 5% to 10% across the market. As cap rates move out marginally, values may fall by 10%, although the highly speculative nature of this market makes this a difficult call.

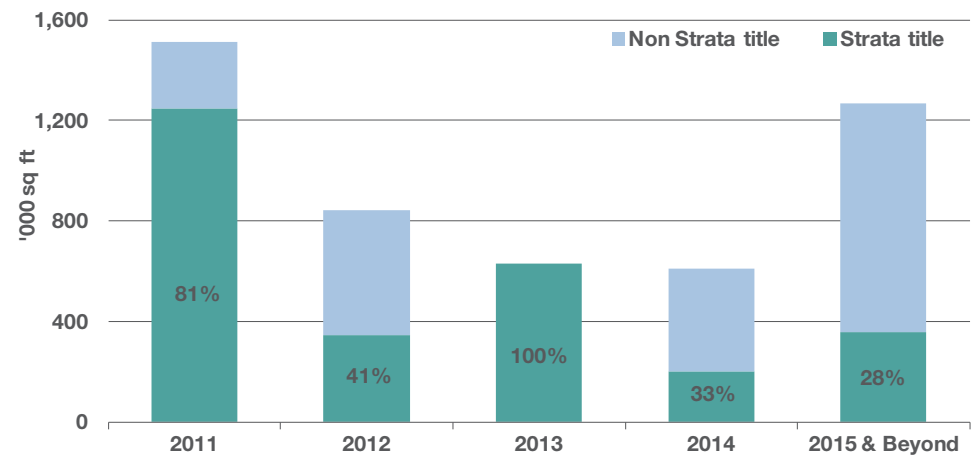
Industrial market

The industrial sector was unexpectedly active in the last quarter, with the CBD2 initiatives prompting investor activity in Kowloon East looking for revitalisation and redevelopment opportunities. Fourteen out of 20 major industrial transactions (over HK\$30 million) registered during the quarter were located in Kowloon East. An investor who already owned several floors at 167-169 Hoi Bun Road has recently purchased the G/F of the building for HK\$168 million (HK\$7,300 per sq ft) in an attempt to unify the ownership of the building. Another purchaser bought several units (total 50,000 sq ft) in Yip Fat Factory Building Phase 2 for HK\$150 million, and is thought to be targeting the redevelopment potential of this old flatted factory.

End users, in particular those located in transforming industrial areas, were also active to buy in, and relocate to, more genuine industrial zones, such as the Kwai Tsing and Tsuen Wan areas, to look for bargains and to facilitate their

GRAPH 2

Strata title as % of Grade A office supply, 2001-2015



Source: Buildings Department, Savills Research & Consultancy

TABLE 2

2012 property market forecast

	Rental growth	Price growth	Yield
Central Grade A offices	-10%	-5% to -10%	3.2%
Overall Grade A offices	-5 to -10%	-5%	3.5%
Prime street shops	+10%	+5% to +10%	3.8%
Luxury residential	-5% to -10%	-10% to -15%	3.5%
Townhouse	0% to -3%	-5%	N/A
Flatted factories	0%	-15%	5.4%
Godowns	+5%	0% to +5%	5.0%

Source: Savills Research & Consultancy

businesses with closer proximity to current and future logistics infrastructure. A logistics operator, who had its place of business in Quarry Bay, bought a floor in Wyler Centre II in Kwai Chung for HK\$45 million (HK\$1,800 per sq ft). Eugene Marketing, whose current address is in Wong Chuk Hang, purchased a floor in Kong Nam Industrial Building in Tsuen Wan for HK\$40 million (HK\$1,500 per sq ft).

While redevelopment will remain the key theme for industrial premises in 2012 – in particular those in Kowloon East – the aggressive pricing from vendors, who often ‘mark up’ the prices to include the exempted waiver fees for conversion, are pricing out most investors from this market. We expect prices have to come down by 10% to 15% to make industrial stock attractive again to investors

looking for redevelopment or long-term holdings, which may happen over the next 9 to 12 months. The godown sector, on the other hand, should be well supported by the derived demand from the robust retail sector and both rents and prices may register another 5% growth in 2012. ■

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