

Briefing Sales & investment

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Image: Tsim Sha Tsui

SUMMARY

The prime retail sector looks set for another difficult year, while most other sectors should be well supported.

- While Occupy was charged with deterring property investment, many purchasers were still in buoyant mood and several billion-dollar deals were closed in the last quarter of the year
- Luxury apartment prices rebounded another 1.3% in Q4/ 2014 and recorded a price rise of around 1.7% for the whole of 2014.
- Whole-floor office transactions were evident on both sides of the harbour, with the Kowloon office market seeing more end-user demand
- The prime retail market suffered further setbacks although the suburban retail market was still popular with long-term investors
- Industrial market sentiment was again robust, being supported by both investors and end-users
- While most sectors look set to stabilise in the coming year, prime retail may be the only sector to face more headwinds

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 "2014 has been a year of twists and turns for Hong Kong's property sector, with the robust mass residential price rally surprising the market most. While most commercial sectors held up well, the prime retail sector took a hit."

Simon Smith, Savills Research

➔ **Market commentary**

2014 has been a year of twists and turns for most property sectors, with most segments starting out well but facing challenges towards the second half of the year due to political tensions and social unrest. The last quarter of the year was headlined by Occupy and its adverse impact on the weakening prime retail sector, and yet many primary residential launches over the period received overwhelming responses. In fact, the 14,707 primary units transacted over the first eleven months of 2014 was a five-year high, while the near HK\$160 billion primary transaction value over the same period was a record high, reflecting the pent-up demand in the market despite the various restrictive measures in place.

The investment market was also in buoyant mood with major deals being recorded in almost all sectors.

In Q4 there were six transactions of over HK\$500 million, four of which were billion-dollar deals, as investors were still confident of the long-term leasing prospects in different property sectors. End-users were also keen to purchase properties sooner rather than later amid the recovering leasing market and a shrinking pool of available stock at market prices.

Luxury residential market

Hong Kong Island

In the last quarter of 2014, the luxury residential market rebounded another 1.3% and prices rose by 1.7% for the whole of 2014. Transactions were mainly by end-users entering the market in both Hong Kong Island and Kowloon.

Luxury transaction volumes remained very low. Savills recorded 383

transactions, a significant decline compared with 913 deals in 2012 and 1,493 deals back in 2009. The 2014 figure is even lower than during the SARS period in 2003.

The townhouse market remains weak due to a lack of demand from local end-users and investment buyers on the back of double stamp duty and buyers stamp duty, with prices falling by 4.5% and 0.3% in The Peak and Southside areas respectively. Notable transactions in this quarter included House 7 of Twelve Peaks on The Peak which sold for HK\$491.7 million. The property has a saleable area of 4,327 sq ft, with a 2,313 sq ft garden.

Kowloon and the New Territories

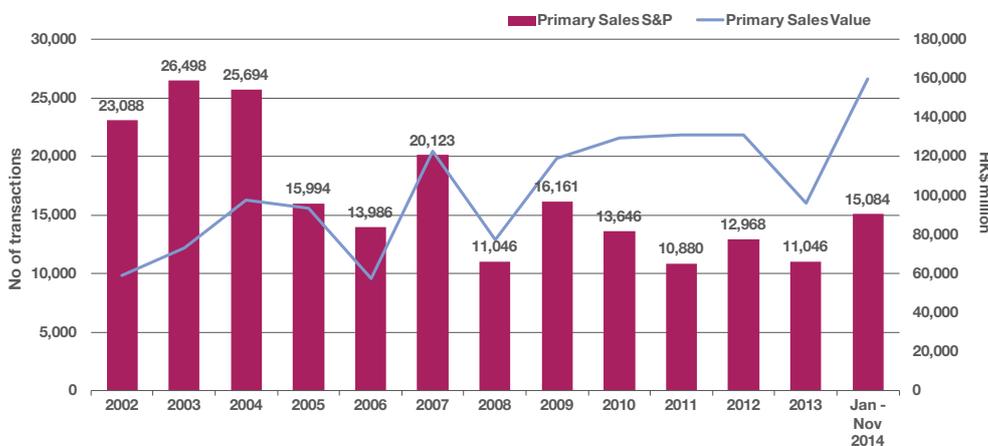
The secondary luxury residential market in Kowloon is weakening given little demand in the area, and is facing strong competition from the primary market. Demand in the Kowloon residential market is fairly strong, however, demand has been drawn to the primary market with developers offering discounts as a rebate to buyers stamp duty and double stamp duty. The primary sales value in 2014 is now at a record high, and primary volume in 2014 was the highest in five years.

Office market

Hong Kong Island

Investment demand heated up on Hong Kong Island with a few whole-floor deals being done, most of them purchased by foreign investors: 19/F (13,742 sq ft) of 9 Queen's Road Central sold to a Mainland investor for HK\$398 million (HK\$29,000 per sq ft) with an estimated yield of around 2.8%; and 22/F (19,746 sq ft) of COSCO Tower was sold to a southeast Asian investor for HK\$375 million (HK\$19,000 per sq ft) with a yield of around 3%. Local investment interest waned in the wake of Occupy and restrictive measures, especially the further tightening of mortgage conditions from HKMA, which further discounted rental incomes (from 80% to 60%) in the calculation of debt servicing ratio, and thus limited their ability to borrow.

GRAPH 1 **Primary sales value and volume, 2002–Nov 2014**



Source: Rating and Valuation Department, Savills Research & Consultancy

TABLE 1 **Major investment transactions, Oct–Dec 2014**

| Property | Location | Price | Buyer | Usage |
|---------------------------------------|--------------|-----------------------------|------------------|------------|
| Laguna City Commercial Complex | Kwun Tong | HK\$1,918.5 mil/US\$248 mil | Fortune REIT | Retail |
| KOHO | Kwun Tong | HK\$1,600 mil/US\$206 mil | New World | Office |
| Chevalier Engineering Service Centre | Kowloon Bay | HK\$1,413 mil/US\$182 mil | Tai Hung Fai | Industrial |
| Eastwood Centre | Shau Kei Wan | HK\$1,300 mil/US\$168 mil | A local hospital | Industrial |
| 18/F-22/F Grand Century Plaza Tower 1 | Sha Tin | HK\$642 mil/US\$83 mil | Hang Seng Bank | Office |
| Wilson Logistics Centre | Kwai Chung | HK\$633.8 mil/US\$82 mil | A local investor | Industrial |

Source: EPRC, Savills Research & Consultancy

→ End-user demand, in particular in the HK\$50 to HK\$100 million price bracket was also slow. With many of them tenants in Central, since Central rents have been on a declining trend over the past two years, they were faced with discounted or at least flat rents at renewal, and chose to stay put for two to three more years to avoid capital costs.

Kowloon

The Kowloon office market was buoyant with cost-saving end-users driving the market. Two floors (19,000 sq ft each) at One Harbour Square in Kwun Tong were sold to two different end-users for HK\$254 and HK\$289 million respectively, representing average prices of around HK\$15,000 per sq ft. Another two floors (12,000 sq ft each) at Elite Centre in Kwun Tong were also sold to two separate end-users for HK\$120 and HK\$125 million (HK\$10,500 per sq ft. An industrialist bought four units on two floors at Legend Tower for a combined HK\$380 million (HK\$11,000 per sq ft).

The sales market saw quite a few whole-floor transactions as more and more investors, who have bought stratified new offices over the past few years, in particular in Kwun Tong/Kowloon Bay, were facing stiff competition to lease their premises with some revitalised offices, such as KOHO and The Mark, being marketed. Many of them were willing to offload their premises at market prices, giving end-users the opportunity to purchase their place of business.

Retail market

Occupy had a profound impact on the prime street sector, with the immediate loss of patrons affecting street shops' businesses along Yee Wo Street, Gloucester Road by Admiralty Centre, Argyle Street and Nathan Road. Most of the tenants have requested a rental reduction or suspension from landlords, if not simply handed the shops back to the owners. Examples include the CSL (One2free) shops at 2-6 Yee Woo Street which were vacated by the tenant after the landlord asked

for a HK\$2 million renewal rent; CSL subsequently leased the shop next door for around HK\$500,000. The original CSL shop, despite the landlord slashing the asking rent to HK\$1.2 million, remains vacant.

With Occupy adding further pressure to the already weak prime street market, investors have been extremely cautious, with some veteran investors making no acquisitions at all in 2014. A vacant shop at 108-120 Percival Street saw its asking price reduced by more than 50% before eventually being sold for HK\$220 million in Q4/2014.

Nevertheless, suburban retail premises were still in demand: besides Laguna City Commercial Complex changing hands between funds for HK\$1.9 billion, other suburban areas in the New Territories such as Sha Tin, Tai Wai, Yuen Long and Sheung Shui were also highly sought after. A shop at 62 Castle Peak Road in Yuen Long was sold for HK\$140 million with an estimated yield of 1.7%, while shop L2 at Archie Garden Block 2 in Sha Tin was sold for HK\$120 million.

Industrial market

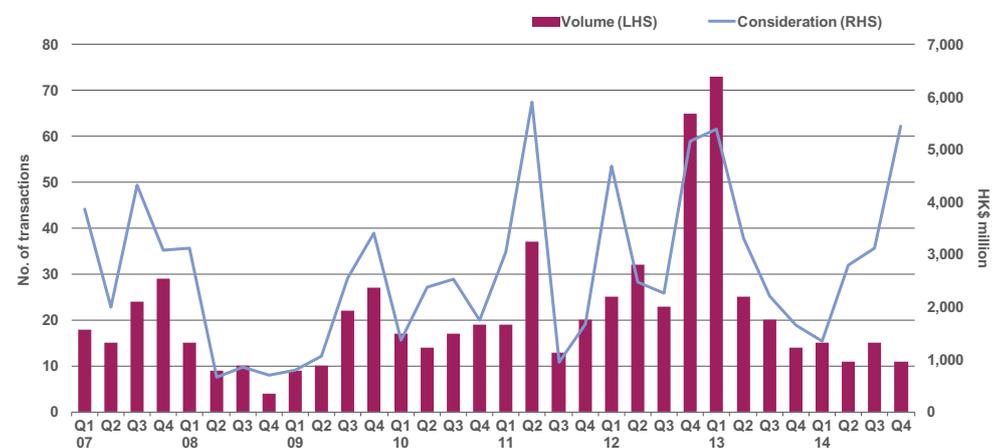
11 major transactions of over HK\$30 million were concluded in

Q4/2014. Although this was a 27% decline from last quarter, the total consideration of HK\$5.4 billion was up 74% quarter-on-quarter (QoQ). This was due to a few big ticket sales, including three, billion-dollar deals.

Investment sentiment in the industrial sector has not been hindered by the recent Occupy protests, with a number of significant deals being done. The two most eye-catching deals were New World purchasing the revitalised KOHO in Kwun Tong for HK\$1.6 billion (around HK\$8,000 per sq ft) for long-term investment purposes, and Tai Hung Fai purchasing the Chevalier Engineering Service Centre in Kowloon Bay for HK\$1.4 billion (around HK\$8,000 per sq ft), eyeing its revitalisation potential.

End users were also active in the market, with Hong Kong Sanatorium & Hospital reportedly buying (en-bloc) Eastwood Centre in Shau Kei Wan for HK\$1.3 billion for use as a medical centre, a listed company purchasing (en bloc) Luen Fat Industrial (No. 2) Building in Kwai Chung for HK\$222.8 million, and another end user acquiring a floor at Kerry TC Warehouse 1 in the same district for HK\$106.8 million, both for owner occupation. ■

GRAPH 2 Major industrial transaction (>HK\$30 million) volumes and values, Q1/2007–Q4/2014



Source: Savills Research & Consultancy

OUTLOOK

The prospects for the market

Luxury residential

The outlook for luxury home prices remains uncertain as Buyer's Stamp Duty, Double Stamp Duty and Special Stamp Duty cool transaction volumes. A possible rise in interest rates in the near-term has played another role in preventing prices from rising. We estimate luxury apartment prices in 2015 will remain largely stable.

Nevertheless, if we look at the super luxury segment (with a floor area of 5,000 sq ft or above and consideration of HK\$500 million or above), the picture is somewhat different as up-to-date there are already 28 units (8 apartments and 20 houses) of new super luxury development being completed an unsold, all located on the Peak and Mid-Levels. In the coming three years, a further 185 super luxury units (101 apartments and 84 houses) will be completed and potentially launched to the market, meaning this niche segment may face oversupply in the short-term, putting pressure on super luxury as well as townhouse prices in the near-term.

Grade A office

Throughout 2015, while we expect demand to revive in most submarkets, the future relationship between Hong Kong and China, as well as how major investors perceive Hong Kong, could become key factors dictating movement in the office market. Overseas investors may demand an increased risk premium for Hong Kong if the social unrest resurfaces, resulting in higher cap rates and lower prices, though stabilising rents, in particular in Central, should give support to prices. Therefore, we expect a fairly stable office market for 2015.

One area of concern is Kowloon East, the once hot prospect with the CBD2 concept and

comprehensive infrastructure programmes. After years of development, total Grade A office stock amounted to 12.5 million sq ft in 2014, with vacancy rates standing at 3.3%. Notably, the submarket has been dominated by strata-title sales of late, with new premises selling for HK\$12,000 to HK\$15,000 per sq ft but only leasing at the low HK\$20s. We believe office rents in Kowloon East may come under some pressure over the next two to three years, which in turn may affect the rising price trend in the area, for the following reasons:

- More stratified stock may come back to the leasing market at discounted rents; an escalating amount of new supply, which will amount to 3.6 million sq ft net over the next three years (a similar level to the three-year period of 2007-2009, which saw supply in Kowloon East amounting to 4 million sq ft net, and rents declining by 15% in the area, and in some buildings the discounts were as high as 30% to 40%)
- More office-revitalisation projects to come to the market in Kowloon East over the next few years (30 projects approved with a total GFA of 2.8 million sq ft net). Two of them have started leasing campaigns recently with asking rents ranging from HK\$25 to HK\$30 per sq ft, but leasing has been slow so far.
- The only support to office prices in the area would be strong end-user demand eyeing the future prospects of CBD2, which usually ignore leasing market trends. The imminent interest rate rise, albeit expected to be gradual in 2015, may yet affect investment sentiment.

Prime retail

2014 has been a difficult year for the prime retail market, both for retailers and landlords, with waning Mainland buying interest at the top end and the recent Occupy adversely

affecting some prime shopping areas in Causeway Bay and Mong Kok. We are yet to see significant vacant spaces in prime streets coming up, but the pace of expansion of most luxury brands has slowed, if not stalled, in the face of slowing luxury sales. As such, luxury retail sales declined by 13% in the first 11 months of 2014, with prime street shop rents and prices declining by 6% and 4%, respectively, in 2014.

The good news is local spending is holding up well. With a low unemployment rate (3.3%) and retail spending (mostly local) shifted to other unaffected shopping centres and areas during Occupy, retail sales (non-luxury items) in fact increased by 5% in the first 11 months of 2014.

In 2015, with a revision of IVS on the cards (most likely implying more restrictions on the current multiple-entry policy) and a possible decline in Mainland spending in response to anti-corruption measures and slower growth, we expect luxury retail sales to continue to slide, with both prime street shop rents and prices to decline by another 5% to 10%. We expect both rental and capital values of shopping centres, especially those non-core centres with a more local focus, to hold up well.

Industrial

We expect the investment market to remain cautiously optimistic with little stock available and end-users keen to secure whatever space is available to stabilise occupation costs. While industrial prices are already at a record high, with any interest rate rise not likely until the end of the year (and any increment is likely to be minimal) and limited new supply coming on stream, we expect industrial prices to rise by another 5% to 10% for the full year.

While warehouse vacancy remains at relatively low levels, we expect to see more space being made available to

OUTLOOK

The prospects for the market

the market in the first two quarters of 2015, mainly from modern warehouses in Kwai Chung / Tsing Yi, due partly to the imminent completion of SF Center in Tsing Yi. While we expect much of this 'released' space will eventually be renewed by the existing tenants, we do feel that landlords within the terminal area may face some pressure in rental terms and thus rents of modern warehouses may remain flat over the first half of 2015, before ticking up in the second half when this space is absorbed and SF Center becomes fully let. Warehouse prices should see modest growth in the order of 5% throughout the year.

TABLE 2 **2012-2014 property price review and 2015 forecast**

| Property | 2012 | 2013 | 2014 | 2015E |
|-----------------------------|--------|--------|--------------|-------------|
| Central Grade A office | +4.2% | -3.5% | +4.6 | 0% to +5% |
| Kowloon East Grade A office | +31.2% | +11.6% | +5.6 | -5% to 0% |
| Overall Grade A office | +10.1% | +5.5 | +5.4 | 0% |
| Prime street shop | +17.3% | +1.4 | -4.0 | -5% to -10% |
| Luxury apartment | +10.4% | -7.3 | +1.6 | 0% to +5% |
| Townhouse | +6.8% | -5.7 | -1.8 | -5% to 0% |
| Flatted factories | +34.3% | +5.0 | +17.4 | +5% to +10% |
| Warehouse | +18.5% | +16.3 | +9.4 | +5% |

Source: Newspaper, Savills Research & Consultancy

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