

Briefing Office and retail investment

November 2017



SUMMARY

The ongoing presence of Mainland buyers has reassured many that despite capital controls they will remain a feature of the market.

- The Central and Wanchai/Causeway Bay office markets are having an exceptional year with prices up 21% and 19% respectively YTD.
- Office supply outside Kowloon East remains tight while negative real interest rates and Mainland buying are supporting positive sentiment.
- Commercial land sales and tenders have generally attracted competitive bidding and winning bids have been at the high end of expectations or beyond.
- The retail sales market has been less buoyant recently as investors wait for clearer evidence that the sector has turned the corner.
- What activity there has been has tended to focus on the Northern New Territories where same day Mainland tourists are lifting spending.
- Street shop prices drifted down marginally over the quarter, but at a much slower rate than we saw at the beginning of the year.

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 "The office sales market is still active and plenty of positive factors remain in play while a subdued retail market waits for clearer signs of a turnaround."
 Simon Smith, Savills Research

→ **Office market snapshot**

The office market is thundering along this year with overall prices up by 15% YTD. While it is worth pointing out that market rallies seldom die of old age, often ending on a wave of euphoria, plenty of positive factors remain in play. Real interest rates are in negative territory, outside Kowloon East supply is tight, and (as two major recent deals highlight) mainland buyers have shown no inclination to desert the local market. Price growth did slow in the third quarter, however, as did rental growth, while average yields hit an historical low.

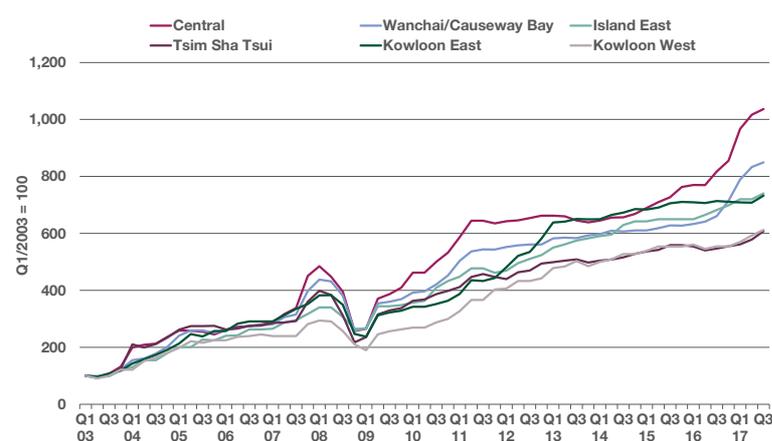
Some activity this year has been driven by opportunistic local buying – buildings of over 50 years old with redevelopment potential and a reasonably consolidated ownership structure for example. PRC buying meanwhile has targeted development sites as well as looking for high profile office buildings for owner-occupation - signage and naming rights a plus. One such significant deal concluded recently was the purchase of 8 Bay East, a 23-storey office building under construction by Wharf Holdings in Kwun Tong. The purchaser was by LVGEM, a Mainland developer who paid HK\$9 billion for the project, or an average price of HK\$15,095 per sq ft, the largest en-bloc commercial transaction in Kowloon to date.

TABLE 1 **Grade A office price growth, Q3/2017 and 2017 YTD**

	Q3/2017 (%)	2017 YTD (%)
Central	+2.0	+21.2
Wanchai/Causeway Bay	+2.0	+18.9
Island East	+2.8	+6.0
Tsim Sha Tsui	+5.2	+9.6
Kowloon East	+3.5	+3.1
Kowloon West	+3.3	+10.4

Source: Savills Research & Consultancy

GRAPH 1 **Grade A office price indices by district, Q1/2003–Q3/2017**



Source: Savills Research & Consultancy

TABLE 2 **Major strata-title office transactions (over HK\$400 million), Q3/2017**

Date	Property	District	GFA (sq ft)	Consideration (HK\$ million)	Average price (HK\$ per sq ft)	Purchaser
Sep 2017	22/F, Shun Tak Centre – China Merchant Tower	Sheung Wan	24,200	\$750	\$30,992	Blue Sapphire Global Ltd.
Sep 2017	79/F, The Center	Central	13,213	\$738	\$55,854	Profit Gate International Ltd.
Jul 2017	64-66 Wellington Street	Central	24,765	\$668	\$26,974 (AV)	Nan Fung
Sep 2017	Fung Shun Commercial Building	Mong Kok	32,845	\$658	\$20,033	Sunlight REIT
Sep 2017	19-22/F, China Shipbuilding Industry	Cheung Sha Wan	35,900	\$492	\$13,705	China Shipbuilding Industry

Source: Land Registry, Savills Research & Consultancy

→ In a major transaction, Li Ka-shing’s firm CK Asset Holdings Limited sold a 75% interest in The Center for HK\$40.2 billion to a Mainland led consortium. The Mainland entity is believed to be an energy firm but details are sketchy. The deal involved offices from 19/F-78/F and 402 car parking spaces and equates to HK\$33,000 per sq ft.

Commercial land sales reflect developer confidence

The URA announced that a Wing Tai-led consortium won the bid for a rare commercial site on Peel Street/ Graham Street (Site C), which will consist of offices, a hotel and retail developed in phases, with offices of around 300,000 sq ft. representing the major use. With a total GFA of around 433,000 sq ft, the rumoured winning bid of HK\$11.6 billion translates into an AV of around HK\$26,800 per sq ft, suggesting that developers remain broadly optimistic about the prospects for the Grade A office market in Central.

Another commercial site in Cheung Sha Wan was sold to New World for HK\$3.0 billion in Q3/2017, which was the third consecutive site bought by New World in the same area in 2017 alone. The three commercial sites, with a total GFA of 1.9 million sq ft, could be developed into a sizable commercial portfolio further transforming the Cheung Sha Wan area into a more rounded business district. Spurred on by the sales of the three commercial sites, Kowloon West office price growth

has outperformed the other two decentralized office areas of Island East and Kowloon East YTD.

Other tenders hit the headlines

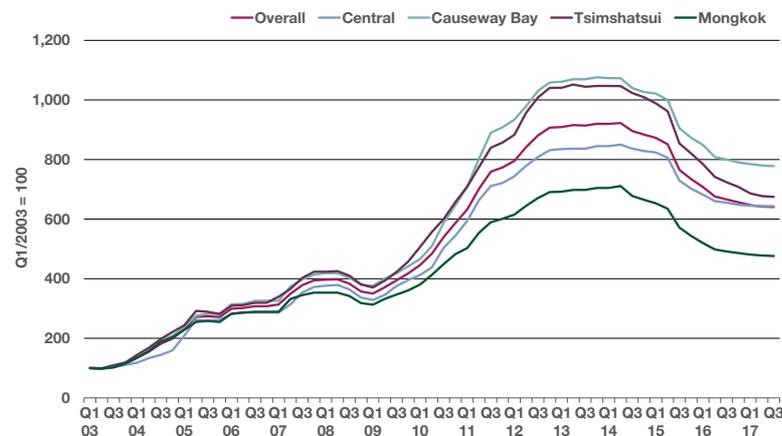
Perhaps the most sensational tender news during the quarter was the withdrawal by Mandarin Oriental Group of the sale of The Excelsior Hotel in Causeway Bay. “As the proposals have not provided the basis for the sale of the property at the current time, the company is continuing to review all options, including those that may result in redevelopment of the property into a commercial building,” the landlord said in a statement. The 848-room hotel has been approved for redevelopment into a 684,000-sq ft office building.

Other big tender news surrounded The Link sale of two portfolios, potentially offering investors respectable 4% yields and long term value. Each batch includes a good quality stabilised asset (Lion Rise in Wong Tai Sin, and H.A.N.D.S in Tuen Mun) alongside other properties with upgrade potential – ‘some meat, some bones’ said a colleague. The Link are known to prefer long term investors (with a 5 to 10-year view), often international funds with a strong track record of successful asset enhancement.

Retail market snapshot

The gentle downtrend in retail prices continued over the third quarter even as sales volumes rose marginally. Small and medium sized units valued at between HK\$10 million and HK\$20 million have been most active while

GRAPH 2 Prime street shop price indices by district, Q1/2003–Q3/2017



Source: Savills Research & Consultancy

TABLE 3 Major retail transactions (over HK\$300 million), Q3/2017

Date	Property	District	GFA (sq ft)	Consideration (HK\$ million)	Average price (HK\$ per sq ft)	Purchaser
Jul 2017	L’hart, 487-489 Lockhart Road	Causeway Bay	32,726	\$965	\$29,487	Mr. Lin
Sep 2017	G/F, Tai Lok House	Shau Kei Wan	TBC	\$360	TBC	Central Profit Inv Ltd.
Jul 2017	Shop on G/F and 1/F, Shaukeiwan Centre	Shau Kei Wan	24,600	\$318	\$12,927	Tang Shing Bor
Jul 2017	Shops B & C on G/F, 45-47 Tsuen Nam Road	Tai Wai	9,991	\$300	\$30,027	Local investor

Source: Land Registry, Savills Research & Consultancy

TABLE 4 Prime street shop price growth, Q3/2017 and 2017 YTD

	Q3/2017 (%)	2017 YTD (%)
Central	0.0	-0.7
Causeway Bay	-0.3	-1.6
Tsim Sha Tsui	-0.4	-4.7
Mong Kok	-0.3	-2.0

Source: Savills Research & Consultancy

trades above HK\$50 million remain extremely rare. What deals there are often result from local investors recycling capital from one premises to the next, generally chasing better returns.

The New Territories retail sales market is still hot with areas such as Sheung Shui, Yuen Long and Fanling firmly in investor's sights. The rise in same-day

visitors and the popularity of parallel trading are reasons behind the active market so proximity to the border is key.

Prime retail prices saw an end to a declining trend which began in 2014, on the back of recovering retail sales as well as stabilizing street shop rents. Yields remained flat at around 2.6% in Q3/2017. ■

OUTLOOK

The prospects for the market

The office market has enjoyed a robust first nine months of the year helped by several record commercial tenders, while the continued presence of Mainland buyers has reassured many that despite capital controls, they will remain a force in the market.

Near term market prospects will be driven by the results of potential commercial tenders, including the sale of the Link REIT's 17-property portfolio, what happens next with The Excelsior, as well as some ongoing rumoured sales such as the Langham Place office tower (93% stake). Any realization of these potential en-bloc sales, which may see new records set, would provide another catalyst for market sentiment.

Hong Kong in the region

Outbound real estate capital from Hong Kong & China

Over the first three quarters of 2017, real estate capital (mostly) originating in Hong Kong completed US\$12.36 billion of commercial (office/retail) deals

overseas, a staggering 72% growth YoY. The largest share (US\$6.59 billion) was invested in Europe which recorded a robust 226% rise. The UK alone accounted for 98.5% of Hong Kong's commercial deals on the continent, however, with a handful of particularly sizeable

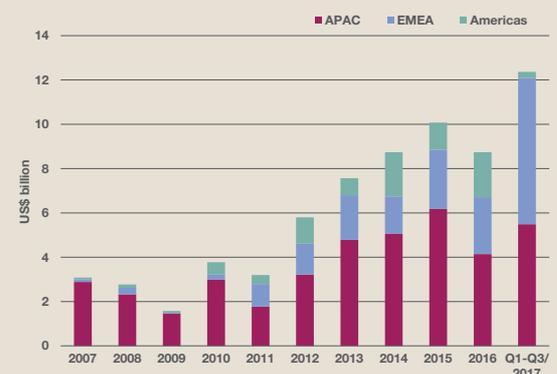
purchases grabbing the headlines (see table). Hong Kong investors have been more prepared to take advantage of a weak pound to pick up trophy assets in London, whereas mainland capital has been more focused on the security of first tier markets in the US.

TABLE 5 Major outbound transactions (office/retail) ordered by value, Q1-Q3/2017

Date	City	Property	Sector	Price (US\$ million)	Purchaser
Aug 2017	Central London	Walkie Talkie	Office	1,695	Lee Kum Kee
May 2017	Central London	Leadenhall Building	Office	1,485	C C Land Hldgs
Mar 2017	Singapore CBD	TripleOne Somerset	Office	892	Shun Tak
May 2017	Singapore CBD	One George Street	Office	847	FWD Group
May 2017	Guangzhou	Metropolitan Plaza	Retail	588	The Link REIT

Source: Savills Research & Consultancy, Real Capital Analytics

GRAPH 3 Hong Kong outbound investment (office/retail) by region, 2007-Q1-Q3/2017



Source: Savills Research & Consultancy, Real Capital Analytics

Hong Kong in the region

In China, capital outflows have gathered pace since 2014, escaping a slowing economy and a weakening Renminbi. This year, however, the government has moved to stem these outflows and at the same time encourage more 'rational' investment by placing overseas investments into

three broad categories: banned; restricted; and encouraged. Real estate falls under 'restricted' and many firms are currently digesting the new regulations and re-calibrating investment strategies accordingly. Outbound commercial real estate capital from the mainland fell significantly by 40% over Q1-

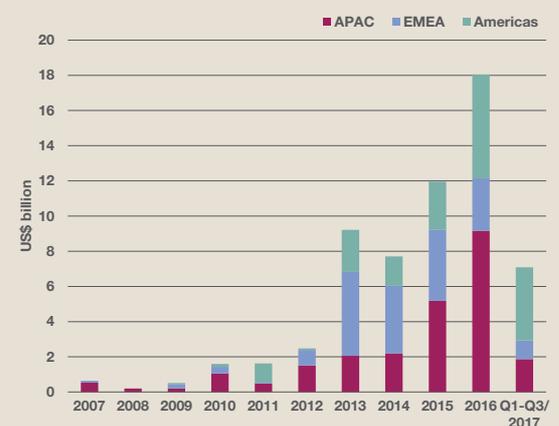
Q3/2017 and the year looks likely to end on a subdued note. Despite some short term cooling, however, we remain broadly bullish on China outbound and Hong Kong's role as China's global financial intermediary.

TABLE 6 **Major China outbound transactions in Hong Kong (office/retail) ordered by value, Q1-Q3/2017**

Date	District	Property	Sector	Price (US\$ million)	Purchaser
Oct 2017	Central	The Center	Office	5,153	Mainland led consortium
Oct 2017	Kwun Tong	8 Bay East	Office	1,152	LVGEM (China) RE
May 2017	Kwun Tong	133 Wai Yip Street	Office	257	Silk Road Fund
May 2017	Kwun Tong	Kwun Tong View	Office	256	HNA Group
Sep 2017	Quarry Bay	East Point Commercial Center	Retail	194	Bank of China
Sep 2017	Kwun Tong	The Wave	Retail	172	Bank of China
Aug 2017	Central	L Plaza	Retail	128	CITIC CLSA

Source: Savills Research & Consultancy, Real Capital Analytics

GRAPH 4 **China outbound investment (office/retail) by region, 2007-Q1-Q3/2017**



Source: Savills Research & Consultancy, Real Capital Analytics

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