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Briefing
Sales & investment

August 2014

Image: Offices in Central

SUMMARY

The market is reviving as end users are keen to secure office and industrial premises.

- Both end users and investors sought en-bloc buildings with different agendas.
- Luxury apartment prices were stable in Q2/2014, with transactions mainly focusing on good quality stock in traditional areas.
- The sale of East Tower, One Bay East is a prime example of an end user wanting to secure a place of business in the new and vibrant Kowloon East area.
- While the core retail area remained subdued, we saw increasing investment interest in fringe retail areas due to the emergence of suburban retailing.
- The industrial sector was active with both end users and investors looking for suitable targets.
- With immense en-bloc interest regenerating market sentiment in the commercial and industrial sectors, we expect volumes to gradually pick up in the second half of the year.

"As the impact of the DSD starts to wane and interest rates are likely to remain low in the near future, we note more end users purchasing office and industrial properties, while some investors have been lured by the suburban retail story." Simon Smith, Savills Research

Market commentary

The en-bloc segment was in the spotlight once again with Citibank spending HK$5.4 billion on East Tower, One Bay East in Kowloon East, with the West Tower of the same development being sold to Manulife a year ago, reflecting immense interest in the owner occupation of these brand-new en-bloc offices. Elsewhere, two billion-dollar investment deals were noted, the first being the sale of the shopping centre portion of Legend Tower in Kwun Tong to an investor for HK$1 billion, the other being Goodman's purchase of Central Textiles Factory in Tsuen Wan for HK$1 billion, eyeing a long-term redevelopment into a modern logistics facility for lease.

Luxury residential market

Hong Kong Island

Luxury residential prices stabilised in the second quarter of 2014, with some significant transactions reported in prime areas. Market sentiment in the luxury residential market was reactivated by transactions mainly focusing on good quality stock in traditional areas, with a few transactions reported on The Peak and Southside. The price expectation gap between buyers and sellers is now closing, resulting in more deals being completed.

The most notable transaction this quarter was the sale of the 11/F of Opus by Swire Properties. According to market news, this 5,409-sq ft net luxury apartment was sold for HK$430 million with two car parking spaces, equating to a price per sq ft of HK$79,497. Meanwhile, an eight-storey whole block at 74 Repulse Bay Road with eight residential units was sold for HK$350 million.

Kowloon and the New Territories

The luxury residential market in Kowloon and the New Territories was also stable in Q2/2014. The launch of the Grand Austin drew a strong response from the market, however, with demand seen from both end users and investors. Meanwhile, the Ho Man Tin market received support from the future Sha Tin–Central Link in the second quarter, and we expect the area to remain in the spotlight in the upcoming years. The most significant transaction in Q2 was the sale of a house at 35 Cambridge Road in Kowloon Tong for HK$218 million.

Office market

Kowloon

Boosted by the record-breaking sale of East Tower, One Bay East, the Kowloon office market continued to revive with a number of strata sales completed in newly launched buildings. Most of these units were transferred from the hands of investors to end users, usually with the investors making a 10% to 15% profit. Floors of Rykadan Capital Tower were first sold in 2012 with average prices ranging from HK$8,000 to HK$9,000 per sq ft, mainly to investors, and when these floors were resold to end users in 2013/2014, average prices increased to around HK$9,000 to HK$10,000 per sq ft. Many of these purchasers were occupants in either offices or industrial buildings and were buying to upgrade their places of business or to stabilise occupation costs in the long run. Grade A office prices in Kowloon East rose by 2.3% as a result, the highest across all districts.

Elsewhere, in Tsim Sha Tsui, volumes remained thin as vendors held out with high asking prices, but there were still end users looking for suitable space for long-term occupation. A tenant in East Ocean Centre bought a whole floor (11,475 sq ft) for HK$128.8 million (HK$11,224 per sq ft), looking to stabilise their occupation costs and yet remain at a place familiar to their employees and clients.

Hong Kong Island

Contrary to the active Kowloon market, the Hong Kong Island Grade A office market was more subdued with very few deals done above the HK$50 million mark. While vendors were as firm on asking prices as their Kowloon counterparts, very few end users were willing to match these prices, particularly in the Central/Admiralty area where stratified landlords were reducing rents by up to 10% (compared with the previous lease terms) given drifting Central market rents. Many occupants chose to renew their

TABLE 1

Property price movements by sector, Q2/2014

Property	Q2/2014 (%)	Q1/2014 (%)	2013 (%)
Luxury Residential	0.0	-0.9	-7.3
Townhouses	-0.5	-0.7	-5.7
Central Grade A offices	+1.6	+1.0	-3.5
Overall Grade A offices	+1.4	+0.8	+3.4
Prime street shops	+0.3	-0.1	+1.4
Flatted factories	+2.4	+0.7	+5.0
Godowns	+3.2	+0.9	+16.3

Source: Savills Research & Consultancy

TABLE 2

Major investment transactions, Apr–Jun 2014

Property	Location	Price	Buyer	Usage
East Tower, One Bay East	Kwun Tong	HK$5,425 mil/US$700 mil	Citibank	Office
Shopping mall, G/F–2/F, Legend Tower	Kwun Tong	HK$1,008 mil/US$130 mil	TBC	Retail
Central Textiles Factory	Tsuen Wan	HK$1,000 mil/US$129 mil	Goodman	Industrial
Fook Yee Building	Wanchai	HK$809 mil/US$104 mil	Family fund	Residential
Retail portion, Centrestage	Sheung Wan	HK$668 mil/US$86 mil	Kook Wah Mirrors	Retail

Source: Savills Research & Consultancy

leases for another two to three years before making any buying decisions.

The only active buying group in the Hong Kong Island market was, as expected, mainland companies, which were looking for good quality, whole-floor Grade A/B premises in Admiralty/Wanchai, preferably with sea views. A high floor (7,388 sq ft) with full sea views in the Sun's Group Centre in Wanchai was sold to a mainland company for HK$133 million (HK$18,000 per sq ft). While mainland companies remained in the spotlight of the otherwise quiet office market on Hong Kong Island, deals involving them normally take much longer to complete as they are required to report offers/counteroffers to headquarters on the mainland for internal approval, which usually takes a few months.

Retail market

The poor performance of luxury retail sales began to filter through to the prime street shop leasing market, capping any potential rental growth in the short run. Two shops on Nathan Road which were originally leased by the same jewellery brand were vacated recently. The one in an inferior location in Yau Ma Tei remained vacant even with a small monthly rental reversion from HK$800,000 to HK$1 million, while the other one, which is in a better section of Nathan Road in the heart of Tsim Sha Tsui, was subsequently leased to a cosmetics retailer for HK$1.95 million per month. The prime street shop sales market was adversely affected, with transactions hard to come by. One significant deal in a core retail area was the sale of a portion of the B/F of Star House in Tsim Sha Tsui for HK$1.18 billion by way of company transfer.

With the suburban retail story now well established and with many international retailers already expanding into suburban malls in fringe Kowloon and the New Territories, investors finally woke up and followed suit on a respectable scale. The Link successfully sold four of its shopping centres in Aberdeen, Shau Kei Wan, Lam Tin and Kwai Chung to two groups of investors for a combined HK$1.2 billion. East Plaza, the retail portion of Legend Tower in Kwun Tong, was also sold to an investor for HK$1.0 billion.

Industrial market

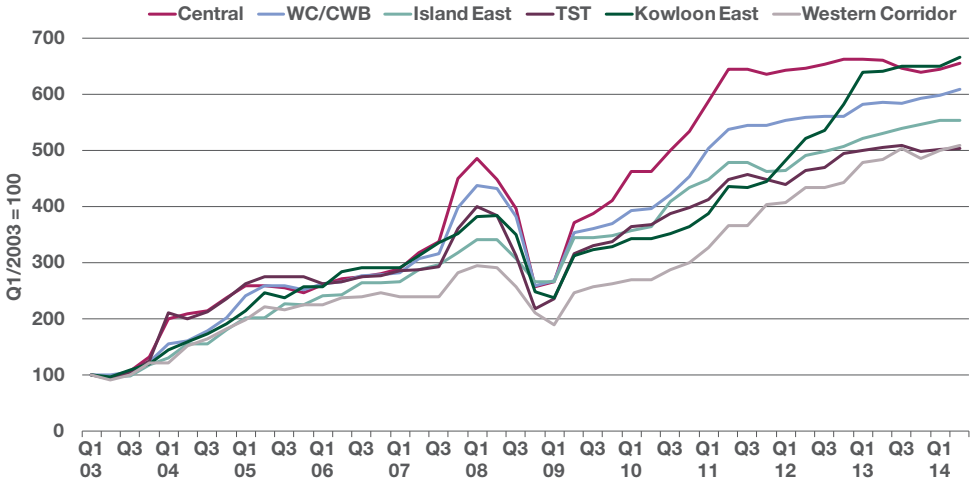
Industrial market sentiment remained subdued, with ten major transactions (over HK$30 million) recorded in Q2/2014, a 27% and 56% decline when compared with last quarter and a year ago respectively. Nevertheless, despite a decrease in volumes, values in fact doubled quarter-on-quarter, reflecting higher value properties (mainly en bloc) being pursued by both investors and end users.

Besides Goodman's purchase of the redevelopment site in Tsuen Wan, a number of significant deals were closed over the quarter. Both blocks of Harrington Building in Tsuen Wan (223,800 sq ft) were sold to Bonjour Cosmetics for HK$490 million (HK$2,189 per sq ft) for partial owner occupation and partial investment, while Law's Property bought Nan Sing Industrial Building (119,170 sq ft) in Kwai Chung for HK$382 million (HK$3,206 per sq ft) eyeing its redevelopment potential.

Revitalisation has long been the driving force of the industrial market but the relatively long payback

GRAPH 1

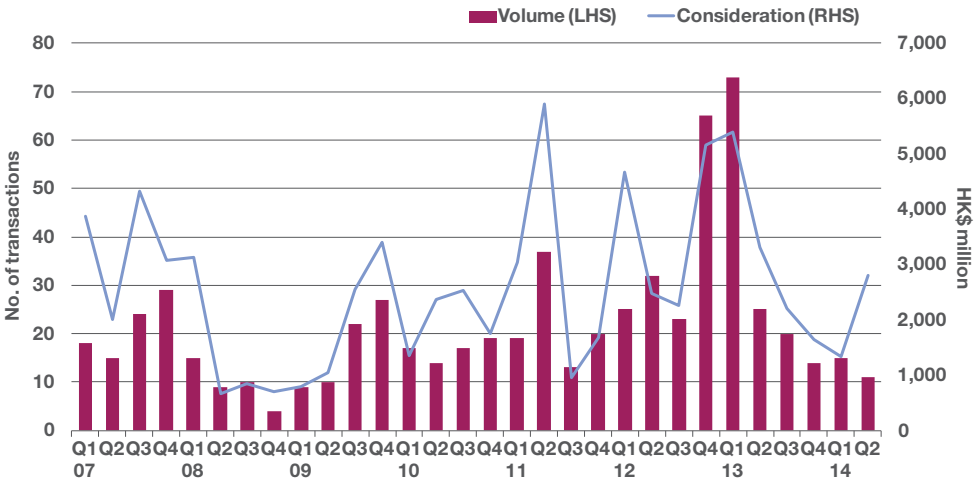
Grade A office price indices by district, Q1/2003–Q2/2014



Source: Savills Research & Consultancy

GRAPH 2

Major industrial transaction (>HK$30 million) volumes and values, Q1/2007–Q2/2014



Source: Savills Research & Consultancy

period (several years of incremental rents to pay back the initial outlay on refurbishment) has been the stumbling block for many. Recently, Tai Cheong had an innovative idea to solve this problem: In 2012, they received revitalisation approval to turn Metropole Square in Shek Mun into offices. Instead of launching the project for lease they will stratify the property with asking prices of around HK$6,000 per sq ft per floor. The only catch is that each strata-owner has to sign a consent letter for the revitalisation executed in 2012, meaning that while the ownership may be stratified, there will always be 100% owner consent for the revitalisation and thus no revitalisation requirements are violated. If the project is successfully sold, this will vastly shorten the payback period for a revitalised project and thus may increase its attractiveness to other landlords.

OUTLOOK

The prospects for the market

While we still see some minor declines in luxury residential prices, the rate of decline has slowed and some record deals have been completed, seemingly signalling the end of the current downcycle. Reviving en-bloc deals in both the commercial and industrial markets may induce further interest from both end users and investors, and with interest rates likely to remain low and the impact of the DSD diminishing, we may expect transaction volumes in the commercial and industrial sectors to gradually increase in the second half of 2014.

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