MARKET IN MINUTES
Savills Research

Residential Sales

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Home price rebound signals end of correction

Primary launches are again attracting market attention.

- Both luxury and mass residential prices rebounded in the first quarter of the year as sentiment revived.
- The strong correlation between the performance of the local stock market and residential price movements over the past two decades means that the recent HSI rally might indicate the end of the short-lived residential market correction.
- The end of the current rate hike cycle means that negative real interest rates and stable affordability will continue to support home prices.
- The latest RVD forecast reveals steadily increasing housing supply over this year and next (around 20,000 units in each year), but the increasing proportion of 'Nano flats' (Class A units) highlights the trade-off between increasing housing supply and average living space.
- Developers keen to deliver primary units should lead to a rebound in both home prices and volumes in the near term, but external uncertainties could cloud any meaningful recovery.

"Investment sentiment has been buoyed by the reviving stock market, negative real interest rates and stable affordability levels given the end of the current rate hike cycle. Developers' eagerness to deliver primary projects in both the luxury and mass markets should lead to a rebound in both volumes and prices in the near term."

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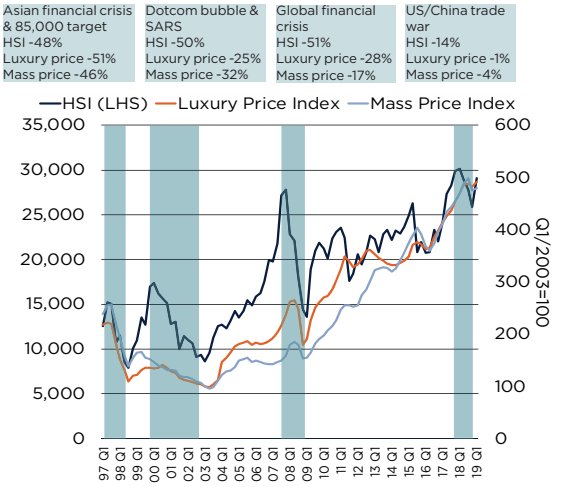
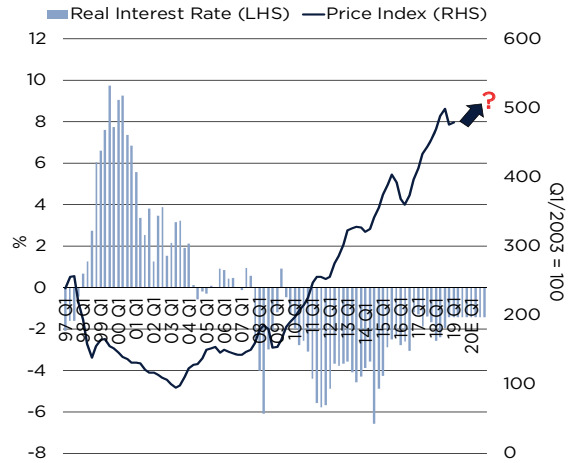
GRAPH 1: HSI vs Luxury and Mass Residential Price Indices, Q1/1997 to Q1/2019



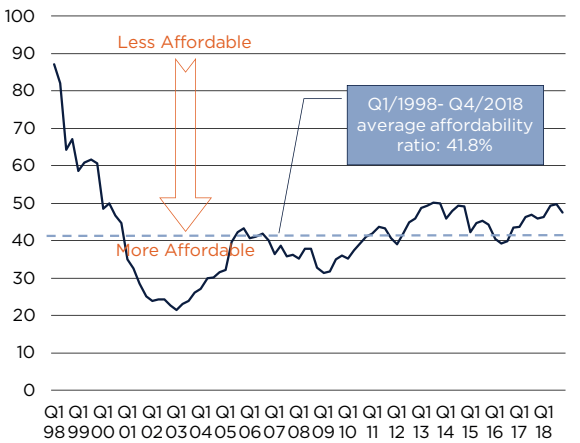
Source HKMA, Savills Research & Consultancy

GRAPH 2: Real Deposit Rates vs Mass Residential Prices, Q1/1997 to Q4/2020E



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

GRAPH 3: Residential Affordability Ratio, Q1/1998 to Q4/2018



Source Savills Research & Consultancy

MARKET COMMENTARY

Investment sentiment in the residential market has been buoyed by the reviving stock market, negative real interest rates and stable affordability levels given the end of the current rate hike cycle. Residential prices in both the luxury and mass segments all rebounded in Q1 as a result, with both townhouse and luxury apartment prices on Hong Kong Island recording strong growth amidst renewed interest from both Mainland and local wealthies.

Both luxury and mass residential price movements have shown a high correlation with stock market movements over the past two decades (correlation coefficients of 0.88 and 0.78 respectively). While the previous three crisis periods all saw the Hang Seng Index tumble by half, residential price adjustments had gradually narrowed to around 20% to 30% in the Global Financial Crisis ten years ago. The most recent 'mini-crisis', triggered by the US / China trade war, dragged the HSI down by 14% in 2018; nevertheless, the housing market was far less pessimistic with prices adjusting by only 1% to 4% during the year. With the subsequent rebound of the stock market by 19% over the first four months of 2019, save for any unexpected external turbulence, the short-lived home price correction seems to be nearing its end.

The US Fed has conveyed a clear message regarding interest rates by keeping the Fed funds rate constant at its two recent FOMC meetings in mid-March and late-April, meaning a possible continuation of the low interest rate era in Hong Kong. The extremely low interest rate environment since 2008 has given us a prolonged period of negative real interest rates, and capital has therefore been 'forced' out from the banking system to pursue higher yielding investment opportunities. The negative real interest rate situation has added momentum to the longest housing market price rally in Hong Kong's history. With inflation expected to remain fairly stable at around 2% over the next two years, negative real interest rates are expected to persist, providing further support to home prices.

Another factor supporting the residential market is stable affordability levels, which have been on a rising trend since 2016 but have hovered around 50% recently. Although Hong Kong is often touted as the most expensive city in the world by some reports looking only at price to income ratios (around 15 years, 50% higher than the 25-year average of 10.4 years), housing looks much more affordable when low interest rates are factored in.

MARKET OUTLOOK

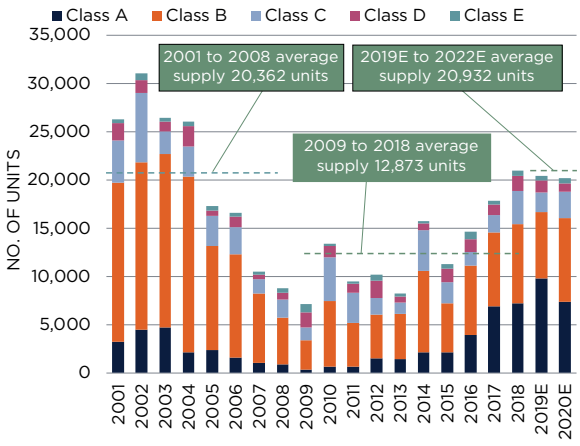
The latest figures from the RVD reveal residential completions of 20,968 units in 2018, a record high since 2004. The official report predicts similar levels of housing completions this year and next (20,415 and 20,181 units respectively), with the average forecast supply surpassing the 20,000-unit mark, reminiscent of the early 2000s when annual average supply was also above this level. Nevertheless, the increase in housing supply comes with a cost – the trade-off between the number of units and average living space. Notably the proportion of Class A units (units with a saleable area smaller than 40 sq m, more commonly known as 'Nano units') averaged around 12% of total completions from 2001 to 2008,

TABLE 1: Residential Price Growth by Segment, Q1/2019 and 2018

SECTOR	Q1/2019	2018
Townhouses	+1.5%	+4.3%
Hong Kong Island Luxury Apartments	+2.0%	+6.5%
Kowloon / New Territories Luxury Apartments	+0.3%	+14.8%
Mass Residential	+0.8%	+4.6%

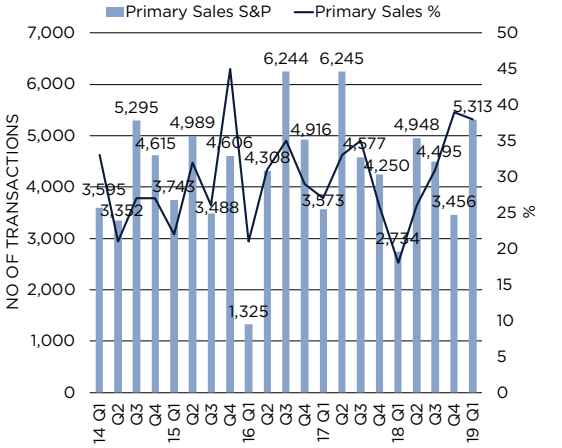
Source Savills Research & Consultancy

GRAPH 4: Residential Supply by Class, 2001 to 2020E



Source Rating and Valuation Department, Savills Research & Consultancy

GRAPH 5: Primary Sales Volume and Proportion, Q1/2014 to Q1/2019



Source Rating and Valuation Department, Savills Research & Consultancy

before dipping into single digits from 2009 to 2011. The ratio has picked up significantly from 15% in 2012 to a recent high of 39% in 2017, coinciding with the most recent rise in housing supply. While the proportion of Nano units declined temporarily to 34% in 2018, it is expected to rise again in 2019 to 2020 to average around 42%, a 20-year high. Multiple factors are behind this trend, but most notably the declining number of developable sites, together with tighter LTV ratios from banks, both incentivizing developers to build smaller units to maximize the number of units on their respective sites with the smallest possible lump sums, meaning higher gearing ratios for individual buyers, and possibly higher unit prices and better sales rates.

With sentiment rebounding and vacancy tax implementation looming, to which as many as 6,300 completed but unsold units could be subject, developers have been quick to pre-sell their primary projects, with primary sales rebounded to 5,313 transactions in Q1/2019, the highest first quarter sales since Q1/2004, representing 38% of total sales during the quarter, echoing the increasing primary sales proportion from Q4/2018, a ratio last seen back in Q4/2015.

We expect such trends to continue, which should lead to steadily rising home prices and volumes in the near term, but external uncertainties, in particular the recent twists and turns in the US / China trade negotiations, could cloud any meaningful recovery especially in the mass residential market.

The luxury sector, buoyed by strong sales of primary projects such as Mount Nicholson, 90 Repulse Bay Road and 8 Deep Water Bay Drive, as well as returning interest from both Mainland and local HNWIs, is likely to see more headline deals concluded over the next few months with potential launches of a few more prestigious projects, especially in Mid-Levels (Sun Hung Kai's Stubbs Road project and Cheung Kong's Borrett Road project spring to mind).