MARKET IN MINUTES

Savills Research

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INVESTMENT

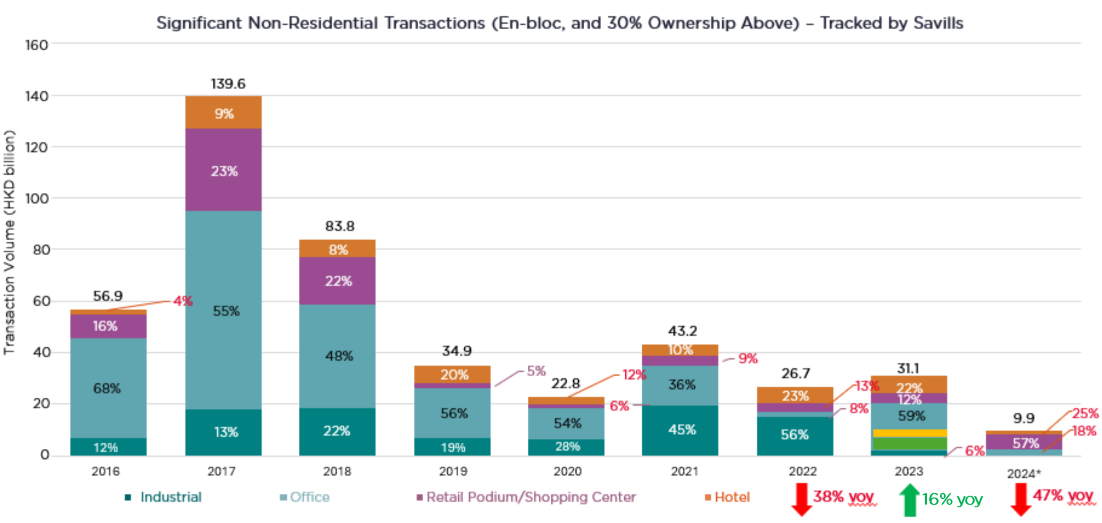
> **"Sustained high cost of fund has led to more property investors put their assets up for sales at discounted prices, but bank's reluctance to lend into the commercial real estate market restricts investment demand, with cash rich buyers and end users dominating the market."**

JACK TONG, SAVILLS RESEARCH & CONSULTANCY

Interest rates remained high in the first half of 2024 as the Federal Reserve did not lower rates as the market had anticipated. The HIBOR rate stayed elevated, prompting banks to adopt a more conservative lending approach. This shift was driven by a substantial increase in ratio of classified loans from 1.56% to 1.79%, making financial institutions more risk-averse, which led to a noticeable reduction in commercial lending and resulted in higher funding costs for borrowers, limiting the ability of many investors to enter the market.

Banks also tightened their risk appetites, reassessing previous loan portfolios and reclaiming property collaterals. Consequently, the investment landscape became increasingly favorable for cash-rich investors and end users. With a growing supply of foreclosed properties available in the market, these buyers were able to negotiate better prices from sellers in distressed financial situations.

GRAPH 1: Total considerations recorded in Non-Domestic Sales, Q1/2016 – Q2/2024*



Source Rating and Valuation Department; Savills Capital Markets Research

The en-bloc investment market was still facing some headwinds over the first few months of 2024. The total value of major property transactions stood at HK$9.9 billion in 1H/2024, representing a significant decline of 47% compared to the first half of 2023.

Despite that, some notable en-bloc transactions took place in Q2 2024, including the sale of a brand-new hotel in Hung Hom for HK$1 billion to the Hong Kong Metropolitan University. The transaction of a 255-room hotel was aimed at providing comfortable, conveniently located accommodation for its students. This transaction highlights the demand from cash-rich end users driving the market.

Savills Team

Please contact us for further information

Investment & Sales

Peter Yuen
Managing Director
+852 2842 4436
pyuen@savills.com.hk

Research

Jack Tong
Director
+852 2842 4213
jtong@savills.com.hk

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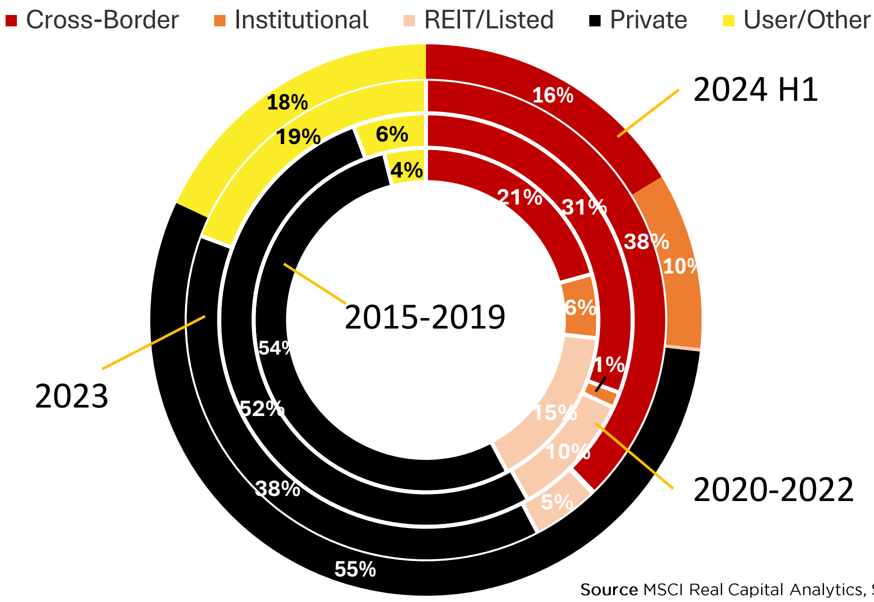
Whether we are working with a global corporate looking to expand, an investor seeking to sustainably optimise their portfolio, or a family trying to find a new home, we help our clients make better property decisions.

The office sector was dominated by distressed sales. For instance, 88WL, a newly developed commercial property in Sheung Wan, originally acquired and developed by Kai Long / Goldman Sachs for a reported amount of HK$1.6 billion, was subsequently sold to a local investor for only HK$700 million. Vendors incurred significant losses and banks involved just recouped their loans to facilitate the deal. The low unit price was a key incentive in the buyer's decision, in addition to the expected yield of approximately 5% when fully leased.

Other notable discounted sales included two entire floors of the Bank of America Tower, selling for HK$18,732 and HK$18,012 per sq ft respectively, marking almost 60% decline from the highest unit price achieved in the building. Additionally, the 29th floor of the No. 9 Queen's Road Central (QRC) commercial building was acquired for HK$22,514 per sq ft, again a more than 60% discount to the then peak prices.

GRAPH 2: Major Commercial Investment by Type of Investor



Source MSCI Real Capital Analytics, Savills Research & Consultancy

In the retail sector, a significant transaction involved the retail podium and public car park at Alto Residences, which is located seven minutes from Tseung Kwan O station. Following extensive negotiations, CR Longdation, a subsidiary of China Resources Group, acquired the property for HK$540 million. The retail podium offers an attractive 6% return which could lure long-term investors even under the high interest rate environment.

With banks' loan quality likely to further deteriorate over the next few months, meaning they would be equally if not more cautious in terms of lending attitude, coupled with high refinancing costs, pushing more large property portfolio owners to liquidate some of their fringe assets possibly at discounts, we may see more discounted / distressed sales in the commercial real estate market in the second half of 2024, with genuine cash-rich buyers the major beneficiaries to continue bargain hunting.

RETAIL MARKET FACING AN UPHILL BATTLE

The Hong Kong dollar's appreciation by 10% to 30% against major currencies since 2018 has significantly impacted the local economy. Hence, tourist spending downgraded by 48%, and high interest rates have led to over a 20% decline in disposable income for local homeowners with mortgages. New shopping malls in Shenzhen have diverted local spending to China with cheaper cost of spending, as evidenced by an average of 7.2 million monthly departures by land transport. These factors have collectively contributed to a 50% decrease in prime street shop rental rates since its peak in 2019. With reference to market transactions, it appears that active buyers in the 2024 investment market are predominantly cash-rich private investors and institutions, who have been targeting property deals that offer significant discounts and can generate a 5-6% rental yield. Many of these deals were eventually concluded in suburban areas mostly affected by the northbound travel trends, where we may see more of such high yielding assets being made available for sale in the second half of 2024.

Savills Price Forecast in Rest of 2024	
Grade A Office	-5% to -10%
Prime street shop	-5% to -10%