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Savills Research
China

# Asian Cities Report
# Hong Kong Investment

1H 2012

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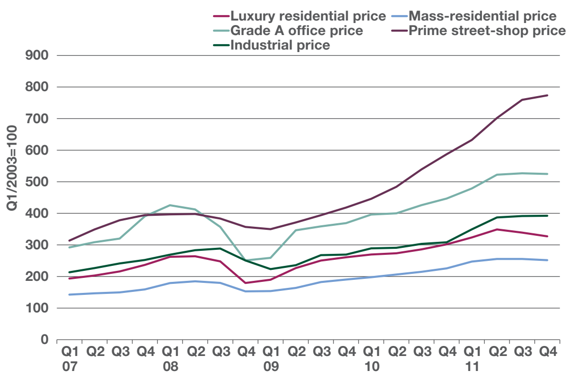
GRAPH 1

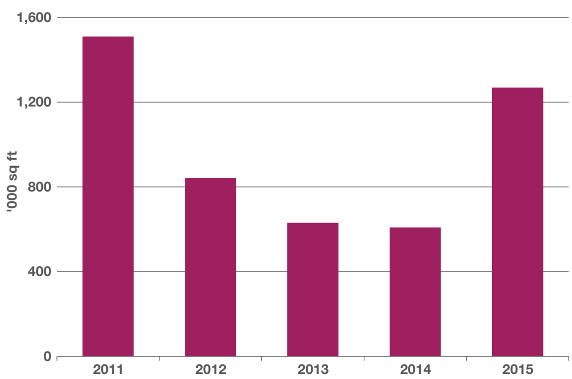
**Property price indices, Q1/2007–Q4/2011**




Source: Savills Research & Consultancy

GRAPH 2

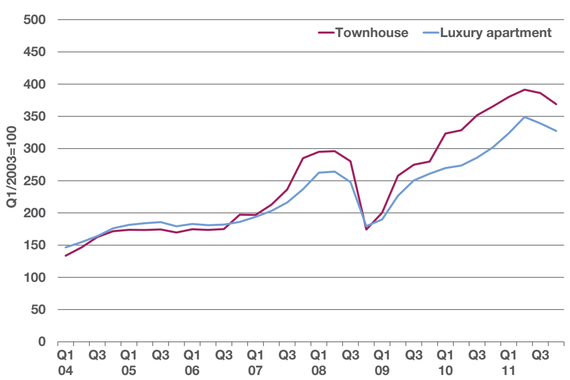
**Grade A office supply, 2011–2015**




Source: Buildings Department, Savills Research & Consultancy

GRAPH 3

**Luxury apartment and townhouse price indices, Q1/2004–Q4/2011**




Source: Savills Research & Consultancy

## Market commentary

The last quarter of 2011 was a turning point for the Hong Kong property market as rents and prices either slowed or went into decline. A poor macro-economic environment, tight credit and low affordability alongside policy risk, conspired to dampen sentiment. The office and residential markets both look set for a shallow cyclical correction this year, while we are more optimistic about the retail and logistics sectors which should stand up well in the current climate, even if rates of growth slow. Most markets are well-supported by limited current availability and a narrow new supply pipeline.

## Office market

The office market looks set to remain undersupplied over the next three years with many new projects (around 60% by area) scheduled for strata-title sale. Pre-commitment levels have also been healthy, reducing tenant options further. We expect a modest correction in Grade A rents in the order of 10% to 15% in Central and 5% to 10% across the market. As cap rates move out marginally, values may fall by 10%, although the highly speculative nature of this market makes this a difficult call.

The financial services sector has clearly entered a period of consolidation and we have already noted several instances of surrender space. PRC banks and financial institutions are proving to be an exception, however, with demand from these tenants still making modest headway. Mainland companies are becoming an increasingly important driver of local office take-up and this is undoubtedly the start of a multi-year trend. PRC firms often look to buy en bloc with naming rights, or to rent in high-profile buildings with harbour views and dedicated drop-offs. Another burgeoning source of new office demand is luxury retailers who continue to thrive on the back of mainland tourism.

## Luxury residential

In the luxury residential sector, we saw a very slight retreat in values in Q4/2011 which we expect to continue into 2012. Rising mortgage rates and a weaker economy, combined with falling rents (down 5% in Q4), all suggest a moderate correction. Homeowners are generally conservatively geared and little distressed selling looks likely, while new supply levels, in common with other sectors, are extremely low, helping to support values. We therefore think that prices will come off by only 10% to 15% during the year with volume bearing the brunt of the correction, particularly over the first half.

It is worth remembering that the government still has a number of policies in play to curb speculation and head-off an asset price bubble, including a Special Stamp Duty and limits on bank lending, and therefore has plenty of leeway should the market need support. Mainland activity is a growing force and has been most apparent at the top end of the residential market, especially in the primary market for new builds. While there has recently been some discussion about how to safeguard local affordability, the government has so far stopped short of imposing any additional duties on overseas buyers, as has been the case in Singapore.

## Retail market

On a more positive note, the retail sector continues to enjoy a very good run with favourable knock-on effects on office demand and the logistics and hospitality industries. Even in 2008, mainland visitors flocked to Hong Kong and 2012 looks set to be no exception, more than compensating for any pull-back in local demand. New-to-town brands are lined up for prime space while tourist spending is opening up fringe malls and secondary streets as potentially lucrative alternative locations. Rents are at record levels and while affordability is occasionally mentioned as an issue for retailers, alongside the potential saturation of some trades, we believe that this will not be enough to result in rental declines, and instead expect a slower rate of growth this year.

Mainland tourist spending is typically focused on fashion, cosmetics, jewellery, electronics and pharmaceuticals. In some instances, cosmetics for example, substantial savings of as much as 50% can be made by coming to Hong Kong. The reason for this is that luxury goods on the mainland often attract a number of taxes and duties which are simply not levied in Hong Kong, including import duties, VAT and a luxury goods tax. Savings are one issue; the other is reliability, which applies especially to jewellery and pharmaceuticals. Scandals involving tainted food and drugs on the mainland have become increasingly frequent over recent years.

## Industrial market

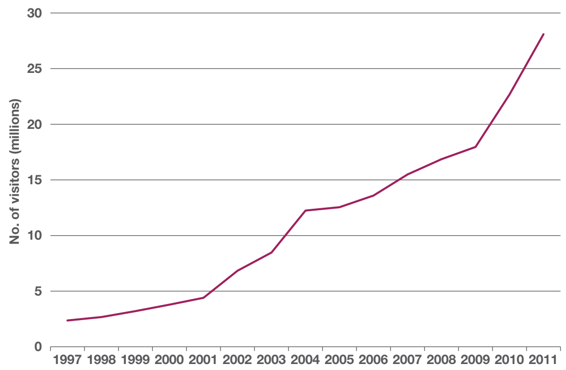
The industrial sector is one of Hong Kong's most diverse in terms of product and comprises modern logistics facilities, warehouses ('godowns'), and (flatted) factories. To this list we could add industrial/offices but this particular use has become all but redundant since its introduction in 1994 and no new supply is anticipated. The industrial sector has done well, with the retail boom spurring demand for modern logistics, while old factory sites offer investment potential in terms of change of use to residential, offices or even hotels.

The industrial sector was unexpectedly active in the last quarter, with the CBD2 initiatives prompting more investor activity in Kowloon East looking for revitalisation and redevelopment opportunities. Sixteen out of 23 major industrial transactions (over HK$30 million) registered during the quarter were located in Kowloon East, while 11 out of the 15 approved and executed wholesale conversion cases were also in this vibrant area. End users, in particular those located in transforming industrial areas, were also active in buying in, and relocating to, more genuine industrial zones, such as the Kwai Tsing and Tsuen Wan areas, to look for bargains and to help their businesses with closer proximity to current and future logistics infrastructure.

While redevelopment will remain the key theme for industrial premises in 2012, in particular those in Kowloon East, aggressive pricing from vendors, who often 'mark up' prices to include the exempted waiver fees for conversion, could price most investors out of this market. We expect prices have to fall by 10% to 15% to make industrial stock attractive again to investors, both those looking for redevelopment opportunities or a long-term hold, which may happen over the next 9 to 12 months.

GRAPH 4

### Mainland visitors to Hong Kong, 1997–2011




Source: HKTB, Savills Research & Consultancy

TABLE 1

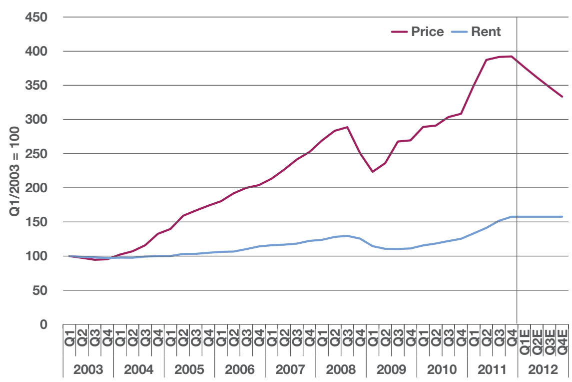
### Top five shopping items bought by tourists, 2010

| Shopping item | Estimated sales (HK$ billion) |
|---|---|
| Jewellery and watches | 18.07 |
| Clothing | 13.53 |
| Leather goods | 11.58 |
| Cosmetics | 9.45 |
| Electrical/cameras | 5.18 |

Source: HKTB, Savills Research & Consultancy

GRAPH 5

### Flatted factory price and rental forecast, Q1/2003–Q4/2012E




Source: Savills Research & Consultancy

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