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PROPERTY INSIGHTS

Hong Kong | Quarter 1, 2013

Decentralised office leasing gains pace

Market Overview

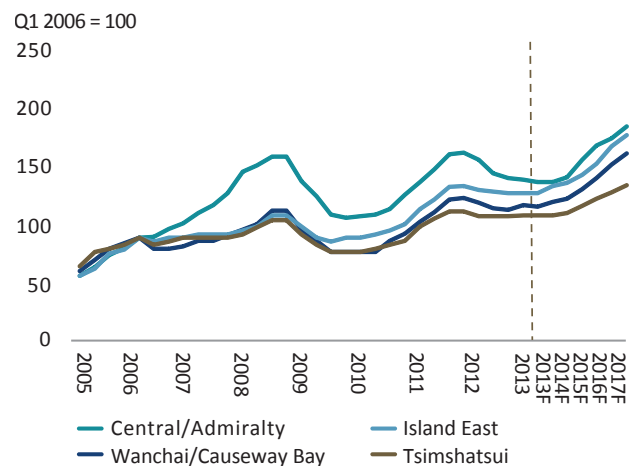
In Q1 2013, overall office net absorption increased quite substantially and reached 417,688 sq ft, thanks to two large transactions in Central. Meanwhile, overall office rent also stopped declining, and increased mildly by 1.26% quarter-on-quarter (q-o-q) to reach HK\$61.5 per sq ft per month (Figure 1).

The year-on-year (y-o-y) growth of total visitor arrivals remained strong at 19.3%, reaching 4,022,120 in February. Total retail sales have also shown stronger growth and reached HK\$41.4 billion (US\$5.3bn) in February, a 22.7% y-o-y increase. Although international retailers remain interest in setting up branches in Hong Kong, some second- and third-tier street shops remain vacant as a result of high expectation gap between landlords and retailers.

After the government's further cooling measures in February, along with the increase in mortgage rate by major banks in March, many prospective buyers adopt a wait-and-see attitude. As such, number of residential transactions in March fell to 4,534, the second-lowest monthly volume in the past 13 months. However, the overall residential price decreased only mildly in March, by 1.2% compared to February. And due to greater price surge in the first two months, the overall residential

Figure 1

DTZ office rental index (2005 - 2017F)



Source: DTZ Research

index increased 2.5% q-o-q.

Since the recent round of government measures were extended to cover non-residential properties, the total number of deals exceeding HK\$100 million dropped from 91 in Q4 2012 to 77 in Q1 2013, and investment volume dropped more significantly by 40.6% q-o-q to HK\$19.57 billion (US\$2.673bn). Transaction volume for office dropped more notably by 52.9% q-o-q to HK\$7.28 billion (US\$0.93bn) in Q1 2013, as the new policies have increased transaction costs significantly and scared off short-term investors.

Trends & Updates

Economic Overview

Real GDP annual growth rate reached 2.5% y-o-y in Q4 2012, a fairly significant improvement compared to the 1.3% y-o-y growth in Q3 2012 (Table 1).

Inflation rose slightly in Q1. The overall composite CPI in February increased 4.4% y-o-y, higher than the 3.7% growth rate in November 2012 (Table 1).

The seasonally adjusted unemployment rate this quarter remained at 3.4% (Table 1) reflecting a relatively positive employment sentiment.

Total exports dropped 16.9% y-o-y to HK\$215.7 billion in February thanks to the Lunar New Year holidays (Table 1). Without the distortion, the value of total exports of goods rose by 0.3% y-o-y.

Domestic private consumption expenditure growth improved compared to last quarter. In Q4 2012, it increased 4.1% y-o-y, greater than the 2.8% y-o-y growth in Q3 2012 (Table 1). Meanwhile, the total tourist arrival in February reached 4,022,120 visitors (Table 1).

Residential

The government has taken further market curbing measures recently, including increasing stamp duties and a tighter stress test for borrowers. Many prospective buyers have already adopted a wait-and-see attitude. As a result, total transaction volume of sale and purchase agreements for land and buildings further fell from 9,825 in February to 7,030 in March, a 28% drop (Figure 2). The number of residential transactions in March fell to 4,534, the second-lowest monthly volume in the past 12 months.

Developers were hurrying to launch residential projects prior to the implementation of the new

Table 1

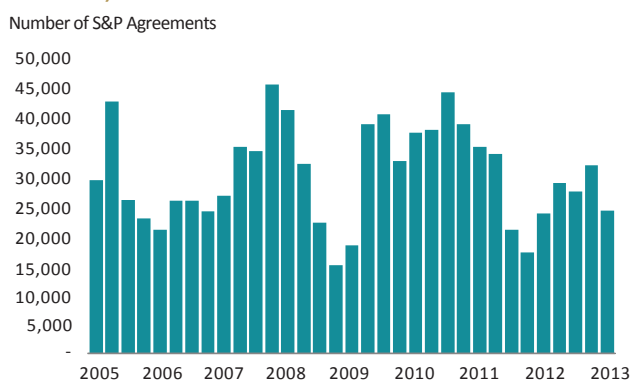
Economic indicator

Indicator	Period	Unit	Value	Indicator
GDP at constant prices*	Q4 2012	HK\$bn	504.6	+2.5
Total exports	Feb 2013	HK\$bn	215.7	-16.9
Private consumption expenditure	Q4 2012	HK\$bn	330.6	+4.1
Unemployment rate (seasonally adjusted)	Dec 2012 - Feb 2013	%	3.4	-
Visitor arrivals	Feb 2013	Million	4.0	19.3
Composite CPI	Feb 2013	-	114.3	+4.4
Total retail sales value	Feb 2013	HK\$bn	41.4	+22.7

Source: DTZ Research

Figure 2

Transaction volume of S&P Agreements (Q1 2005 - Q1 2013)



Source: Land Registry

regulation on the sales of first-hand residential properties in April. This has led to an increased first-hand residential supply. In general, developers are releasing their projects at less aggressive price levels with more added incentive to attract buyers. Property owners in the second-hand residential market have also been rationalising their asking prices.

As a result, the DTZ overall residential index decreased mildly in March, by 1.2% compared to February. However, since home price had already increased by approximately 4% in the first two months, the overall residential index still increased 2.5% q-o-q (Figure 3, Table 2). Supported by end-user demand, the mass market witnessed a greater price increase of 3.8% q-o-q, whereas luxury residential index only increased mildly by 0.8% (Figure 3, Table 2).

Looking ahead, transaction volume is expected to remain relatively low in the coming months as many prospective buyers have become cautious, especially in the second-hand residential market, but we expect the increased supply of first-hand residential projects to increase the transaction volume and partially offset some of the decreases. Therefore, we expect the total residential transaction to stabilise at the current level for the next few months.

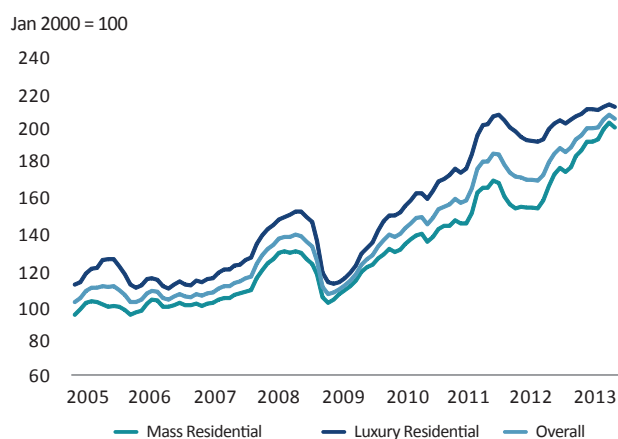
Office

Amidst signs of stabilisation this quarter city-wide overall rent also reversed its declining trend to increase slightly by 1.26% q-o-q to reach HK\$61.5 (US\$7.9) per sq ft per month (Table 3, Figure 4). Meanwhile, overall net absorption increased substantially to reach 417,688 sq ft.

In the Central Financial District (CFD) of Sheung Wan / Central / Admiralty, two major deals - Bank of America Merrill Lynch's relocation from Citibank Plaza and IFC to Cheung Kong Centre and China Construction Bank's take-up in its newly-completed CCB Tower - have raised the net absorption of the submarket to 307,093 sq ft. However, overall leasing

Figure 3

Residential price index (Jan 2005 - Mar 2013)



Source: DTZ Research

Table 2

Primary residential market statistics

	Total stock (no. of units)	price index (Jan 2000 = 100)	q-o-q change (%)	y-o-y change (%)
Mass Market	1,013,878	213.53	3.8	22.11
Luxury Market	81,697	226.99	0.8	6.7
Overall	1,095,575	219.11	2.5	15.0

Source: DTZ Research

Table 3

Grade A office market statistics

District	Total stock (million sq ft)	Availability ratio (%)	Monthly Rent (HKD per sq ft)	Change q-o-q (%)
Sheung Wan/ Central / Admiralty	29.31	5.97	104	-
Wanchai / Causeway Bay	16.24	4.74	48	+35
Island East	10.98	1.65	39	+48
Tsimshatsui	9.27	3.62	33	+0.3
Kowloon East	12.40	5.46	32	+1.4
Overall	78.20	4.75	62	+1.3

Source: DTZ Research

In Wanchai / Causeway Bay and Island East, solid demand from non-financial sectors such as IT and retail, as well as from finance sector's decentralisation, had driven net absorption of the two submarkets to reach 41,221 sq ft and 49,150 sq ft, respectively. Availability ratios in the two districts also dropped significantly (Table 3). In particular, the availability ratio in Island East has dropped to a historic low of 1.65% (Table 3).

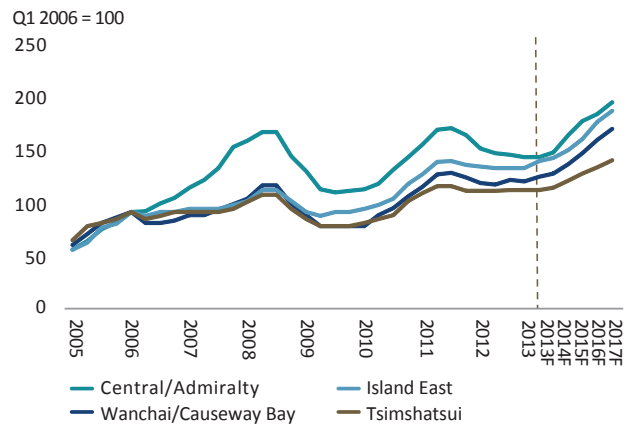
In Tsimshatsui and Kowloon East, net absorption this quarter remained stable at negative 1,971 sq ft and 22,195 sq ft, respectively, while rent increased marginally by 0.27% and 1.38% q-o-q to HK\$33.7 (US\$4.3) and HK\$31.5 (US\$4.0), respectively (Table 3, Figure 4).

The market of the CFD of Sheung Wan / Central / Admiralty is expected to be stable as multinational financial institutions remain cautious. Nevertheless, grade A office supply will remain tight throughout 2013 (1.45 million sq ft) and 2014 (0.889 million sq ft) which is expected to support the overall rental level (Figure 5).

In Causeway Bay, the redevelopment of Sunning Plaza will reduce leasing stock and create additional demand for leasing, especially for this submarket and even for Island East, as the building's existing tenants will need approximately 220,000 sq ft office space elsewhere.

Figure 4

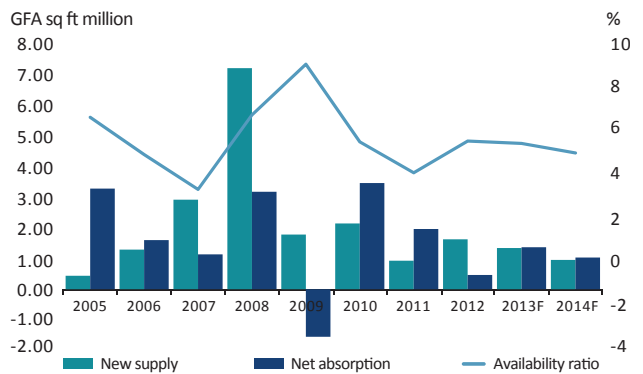
DTZ office rental index (2005 - 2017F)



Source: DTZ Research

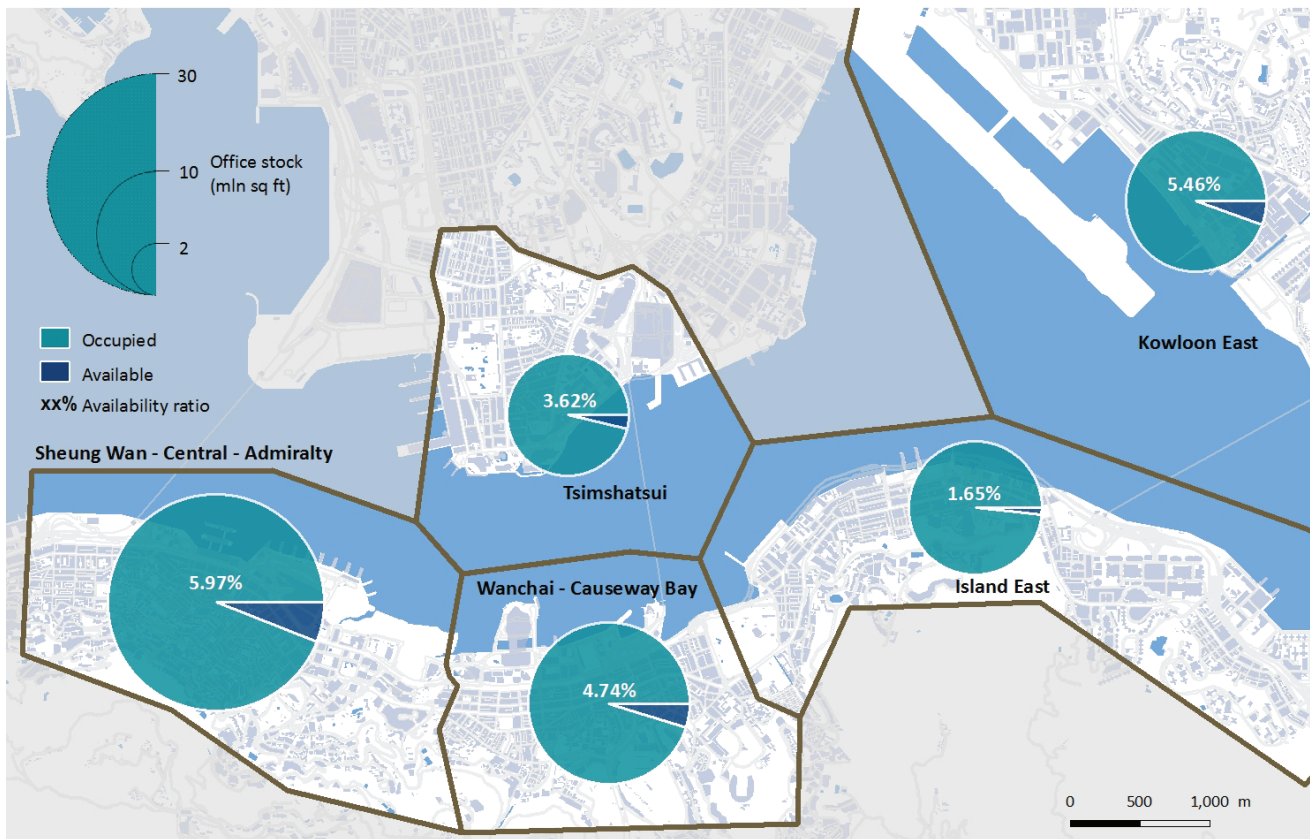
Figure 5

Grade A office supply, net absorption and availability ratio (2005 - 2014F)



Source: DTZ Research

Office availability by location



The Government of the Hong Kong SAR MAP Reproduced with permission of The Directors of Lands
Source: DTZ Research

Retail

Mainland Chinese visitors continued to contribute a significant part (78%) of the total tourist arrivals which in February had reached 4,022,120 visitors or grew 19.3% y-o-y. On the back of this, retail sales also grew significantly by 22.7% y-o-y in February to reach HK\$41.4 billion (US\$5.3bn) (Figure 6).

Although retailers that have not set up branches in Hong Kong remain interested in doing so, especially with the stronger retail sales growth after Christmas, they are cautious however facing limited available stock and high rents. Retailers who have already set up business in Hong Kong remain interested in expanding their brands, but they tend to be more interested in smaller space in secondary locations.

Due to limited supply, landlords have been asking high rents and there has been a significant expectation gap between landlords and retailers. This however has caused some street shops in second- and third-tier locations to remain vacant.

As a result, retail rental is growing at a slower pace this quarter. Hong Kong Island witnessed only mild rental growth of 1.1% q-o-q and 7.1% y-o-y. Although Kowloon witnessed negative q-o-q growth of 6.5%, it increased significantly y-o-y by 12.6%. New Territories witnessed the strongest q-o-q growth of 6.5%, an increase of 11.2% y-o-y (Table 4, Figure 7).

Looking further into the year, the tourist volume is expected to continue its present growth trend, which should sustain local retail sales. As a result, rental growth is expected to continue. We expect in the next 12 months that the rents for first-tier street shops to grow 10%-15% y-o-y, and that for the second and third tier street shops to grow 5-10% y-o-y.

Figure 6

DTZ office rental index (2005 - 2017F)

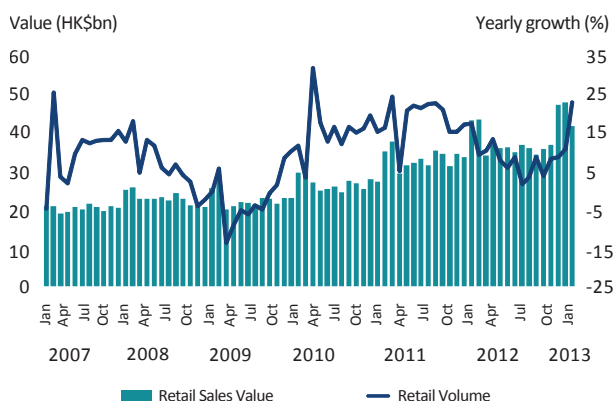


Table 4

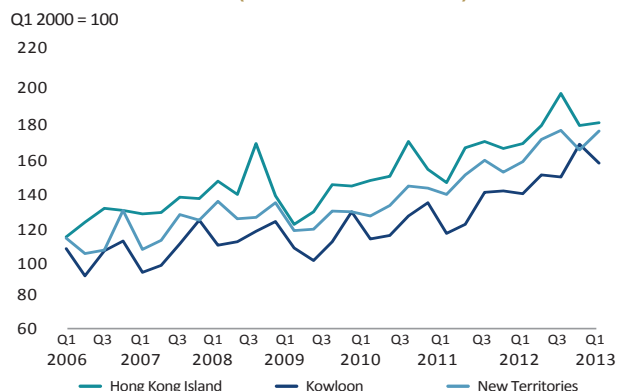
Retail market statistics

	Rental Index (Q1 2000 = 100)	q-o-q change (%)	y-o-y change (%)
Hong Kong Island	182.3	1.1	7.1
kowloon	158.9	-6.5	12.6
New Territories	177.4	6.5	11.2

Source: rating and Valuation Department HKSAR, DTZ Research

Figure 7

Retail rental index (Q1 2006 - Q1 2013)



Source: Rating and Valuation Department HKSAR, DTZ Research

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