PROPERTY INSIGHTS

Hong Kong | Quarter 1, 2016

Multi-sector Snapshot Q1 2016

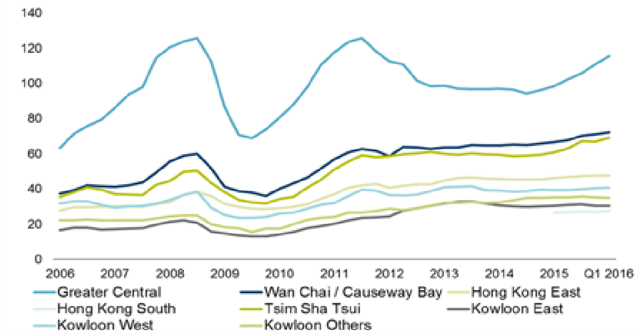
Market Overview

In the last quarter of 2015, Hong Kong economy expanded 1.9% in real terms, continuing its moderate growth trend and slowing down from the 2.3% over the past quarter. This was largely due to the subdued global economic recovery, moderate Mainland's economic momentum, weak trade-related and inbound tourism activities.

The overall residential market activity was generally weak in the first quarter of 2016, with sales of new and secondary home slowing as sentiment worsened. Several new projects were launched this quarter, all of which have received a reasonably market response, driven by the deep discounts and provision of aggressive financing plans by developers. Primary sales accounted for 21.3% of the total number of transaction and 37.5% of the total consideration in Q1.

Figure 1

Grade A Net Effective Office Rent (HK$/SF/MTH)



Source: Census and Statistics Department

Office leasing activity was relatively weaker in the first quarter of 2016 compared with the previous period, with the banking, financial services and insurance sectors continuing to support leasing demand in Hong Kong. Overall Grade A office rents increased by 1.4%, led by robust rental growth in Greater Central and Tsim Sha Tsui.

Since One-trip-per-week Individual Visit Endorsements has been launched, both mainland visitors and total visitor arrival growth rate keep diminishing. Furthermore, total retail sales value followed similar trend and plunged by 20.6%, representing a severe downward pressure in the retail sector.

Economic Overview

In the last quarter of 2015, Hong Kong economy expanded 1.9% in real terms, continuing its moderate growth trend and slowing down from the 2.3% over the past quarter. This was largely due to the subdued global economic recovery, moderate Mainland's economic momentum, weak trade-related and inbound tourism activities.

Weak external environment and strong US dollar exchange rate affected Hong Kong's external competitiveness. The advanced economies have not yet improved from the weak recovery since the global financial crisis. The emerging and developing economies also faced intense downward pressure. Not only did the Mainland economy undergo a period of rebalancing, those commodity exporting countries, like Russia and Brazil, have even entered into recession amid the weak commodity price environment. As a result, market concern over global and Mainland economic outlook intensified, together with the rising expectation of a US rate hike, leading to sharp capital outflows from the emerging economies and significantly affecting the trade activities in Hong Kong. Moreover, the Hong Kong dollar exchange rate also strengthened notably under the linked exchange rate system, and resulted in a 1.9% contraction in Hong Kong's total exports in the first quarter of 2016.

Tourism and retail industry slowed, negatively affecting export performance. For example, the weaker-than-expected global economic performance, strong Hong Kong dollar exchange rate, limited new tourism hotspots, no further expansion of the individual visitor scheme of Mainland tourists, and the preference of economically better-off Mainland tourists to visit other places around the world. Against this background, the number of visitor arrivals declined 20.5%, and the total retail sales value drop by 20.6% in the first quarter of 2016.

Table 1

Economic indicators

Indicator	Period	Unit	Value	Change y-o-y (%)
GDP at constant prices*	Q4 2015	HK$bn	596.7	+1.9
Private consumption expenditure*	Q4 2015	HK$bn	397.9	+3.2
Unemployment Rate (Seasonally Adjusted)	Dec to Feb 2016	%	3.3	0
Composite CPI	Feb 2016	-	128.1	+3.1
Visitor Arrivals	Feb 2016	Million	4.3	-20.5
Total Retail Sales Value	Feb 2016	HK$bn	37.0	-20.6
Total Exports	Feb 2016	HK$bn	237.6	-1.3

* In chained (2013) dollars

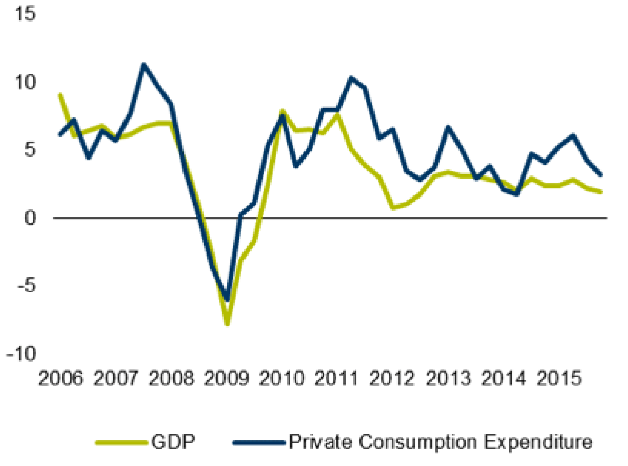
Source: Census and Statistics Department, HKSAR, Hong Kong Tourism Board

Domestic demand held up well on the back of full employment. The employment market remained largely steady and the unemployment rate stayed at 3.3% between December 2015 and February 2016, within the low level of 3.1%-3.5% since the second half of 2011 (Table 1). The resilient labour market continued to support domestic consumption, with a growth rate of 3.2% in real terms in Q1 2016 (Table 1). Hence, it is anticipated that domestic demand will continue to act as the main driving force behind economic growth. However, as prospects for the tourism and retail sectors remain dim, and the economy of China remains under downward pressure, the unemployment rate may go up in the near term.

The sluggish growth of the global economy, combined with increasing downward pressure of Chinese economy, have continued to affect Hong Kong's market. Following the Mainland and global financial markets correction, the equity markets in Hong Kong declined sharply since the third quarter of 2015, but started to move upwards from February 2016.

Figure 2

Hong Kong GDP and Private Consumption Expenditure (y-o-y % chg)



Source: Census and Statistics Department

Residential

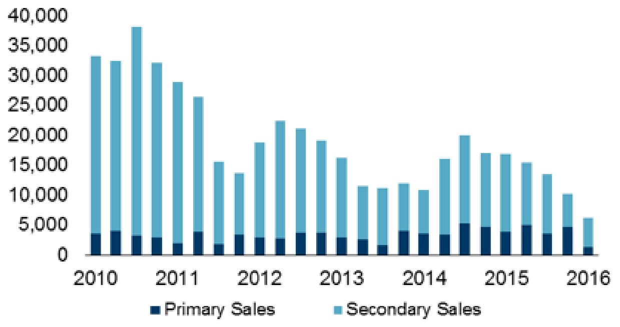
Residential market sentiment worsened within the quarter as falling prices and economic uncertainty deterred buyers and continued to place sales prices under further downward pressure. In February, the residential sales slumped to the lowest level witnessed since 1996, when only 1,807 sales were recorded. However the March figures recorded a rebound, rising to the level of 2,369 sales, this was still down by 45.3% as compared to the same period last year.

The overall residential market activity was generally weak in the first quarter of 2016, with sales of new and secondary home slowing as sentiment worsened. The total number of the sale and purchase agreements in Q1 2016 was recorded at 6,221 transactions, representing a decrease of 38.8% as compared to the previous quarter. The total combined consideration of residential sales agreements concluded in the first quarter amounted to $44.68 billion representing a decrease of 61.5% compare to same period of last year.

Several new projects were launched this quarter, all of which have received a reasonably market response, driven by the deep discounts and provision of aggressive financing plans by developers. Primary sales accounted for 21.3% of the total number of transaction and 37.5% of the total consideration in Q1.

Figure 3

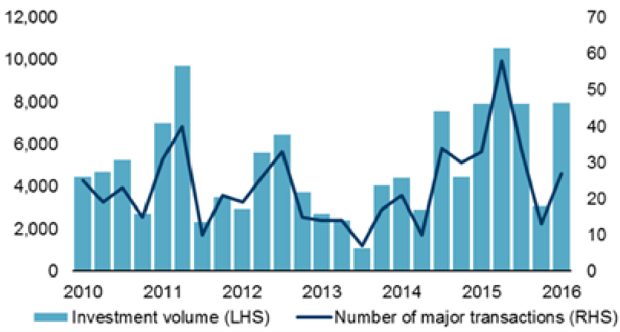
Number of Agreements for Sale and Purchase of Residential Building Units: Primary and Secondary Sale



Source: Land Registry

Figure 4

Residential Investment Volume (HK$ million) and Number of Transactions above HK$100 Million



Source: DTZ/Cushman & Wakefield Research

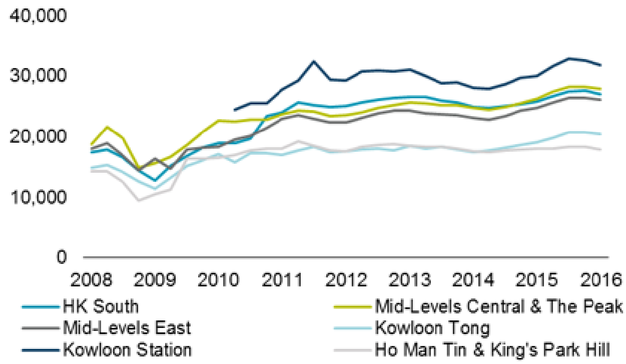
During the first quarter, the government tendered six residential sites, including one residential site that was subsequently withdrawn in Yuen Long. This was the third cancelled tender exercise since April 2012 and the second time in three months that the bids tendered did not meet the reserve price.

While sales activity in the mass market slowed down, sentiment in the super luxury residential segment was relatively stable, with several significant transactions recorded within the quarter. The number of transaction for residential properties above HK$100 million increased to 27 transactions compare to 13 transactions in the previous quarter and the total consideration increased 158.9% to 7.96 billion. Notable transactions included the sale of a residence at 28 Baker Road, which was transacted at HK$698 million with a total saleable area of 6,856 sq ft, its unit rate reaching HK$101,809 sq ft. Meanwhile, a 9,455 sq ft home in the new luxury residential project on The Peak – Mount Nicholson sold for HK$830 million, equivalent to unit rate of HK$87,784.

Looking ahead, it is unlikely that the US Federal Reserve will aggressively hike interest rates, over the short term, given the fact that inflation is expected to remain low in the near term. The primary market will remain the focus of activity in 2016 while activity in the secondary market will remain constrained. However the present wait and see attitude on part of the potential buyers and the growing concern about local economic conditions could cause the overall transaction volume to remain low for the remainder of this year. Hence, it is anticipated that present weakening price trend will continue for the remainder of year. With respect to the mass residential market, we expect to witness an accumulated drop of 15% in the first half of 2016, while prices for luxury properties are expected to display stronger resilience, dropping only by 5%

Figure 5

Luxury Residential Capital Values by District (HK$ psf)



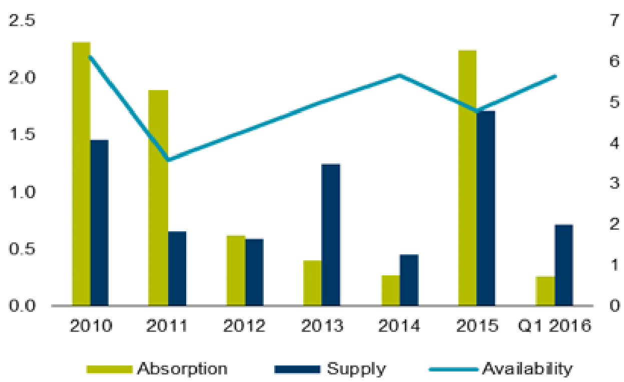
Source: DTZ/Cushman & Wakefield Research

Office

Office leasing activity was relatively weaker in the first quarter of 2016 compared with the previous period, with the banking, financial services and insurance sectors continuing to support demand. Three Grade A office buildings, including one pre-committed building, were launched this quarter, boosting overall Grade A office availability to 5.6% from the previous quarter's 4.9%. Negative absorption was witnessed across most major business districts with the exception of Hong Kong South, Kowloon West and Kowloon Others submarkets. However, overall net absorption remained positive at 262,244 sq ft, largely due to the completion of One HarbourGate West Tower, which was acquired by

Figure 6

Overall Grade A Office Net Absorption (NFA Million SF), Grade A Office Supply (NFA Million SF) and Availability Ratio (%)



Source: DTZ/Cushman & Wakefield Research

China Life for self-occupation (Figure 6). Overall Grade A office rents increased by 1.4%, led by rental growth in Greater Central and Tsim Sha Tsui.

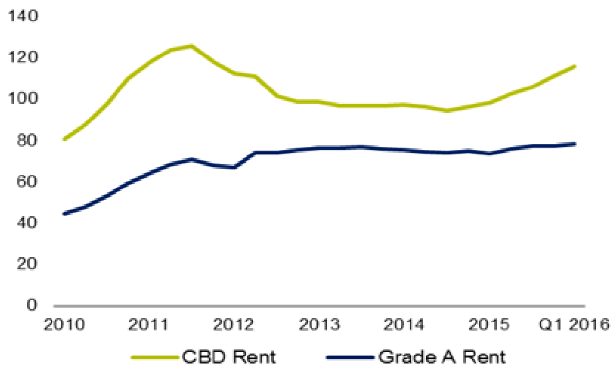
Returned stock caused Greater Central to record negative absorption for the first time since Q3 2014. However, the availability rate remained low at 3.4%. During the quarter, some Greater Central (CBD) tenants opted to relocate for cost reduction purposes. For example, a law firm, Ince & Co, has committed to relocate to Hong Kong East, while financial firm Mizuho prepared to move to Tsim Sha Tsui for consolidation. Mainland Chinese financial institutions remained the key source demand in Greater Central, accounting for almost half of the major new leases signed. For instance, Industrial Bank leased 16,200 sq ft in Citibank Plaza for expansion, while China Minsheng Investment and Bank of Jinzhou established their first presence in Hong Kong, Despite availability rate rising by by 40 basis points this quarter, average rent for Greater Central increased 4.3% quarter-on-quarter to $115.64 per sq ft per month following last quarter's 4.6% increase, (Figure 7).

In Hong Kong South, as the MTR South Island line will be put into operation later this year, serval leasing transactions were recorded and net absorption stayed positive. AXA leased over 63,000 sq ft in Vertical Sq for relocation & consolidation. Meanwhile 41 Heung Yip Road, a 226,800 sp ft Grade A office building was completed with no pre-commitment. Hence, the availability ratio increased by 5.6 percentage points from the previous quarter and reached to 18.6%, the highest level across all submarkets. Looking at the Kowloon side, the leasing activity in Tsim Sha Tsui was very positive in the first quarter, however it was not reflected in the quarterly absorption due to the high level pre-commitment of an upcoming building, Mizuho having preleased over 160,000 sq ft in Hong Kong K11 Office for consolidation. Meanwhile as several occupiers relocated to Kowloon West, the net absorption recorded as positive 72,325 sq ft in Q1 2016. One of the notable transactions was from LeTV, a Chinese technology company leasing over 46,000 sq ft in the Octagon in Tsuen Wan for expansion and relocation. Hence, the availability rate dropped by 1.9 percentage points from the previous quarter to 6.2%, being notable as the only submarket witnessing a decrease in availability.

Looking forward, we expect rents in Kowloon East will continue to ease in 2016, with new supply on the horizon along with limited movement among occupiers further increasing the pressure on most Grade A landlords within the district (Figure 8). Meanwhile, with no new supply in Greater Central, stable occupier demand from mainland financial institutions will continue to support positive rental growth in this submarket over the next two quarters, but more slowly than previously.

Figure 7

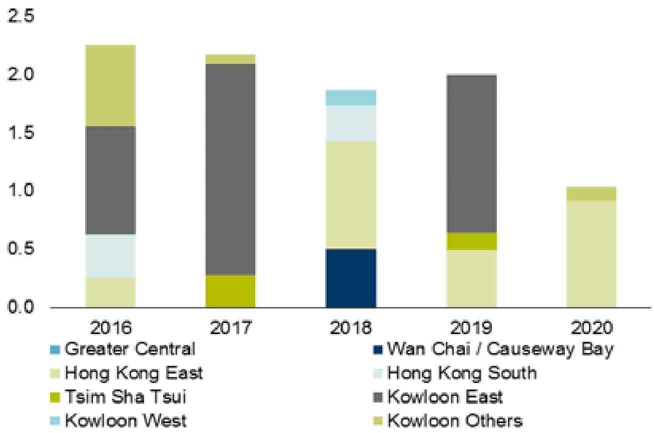
CBD Net Effective Rent VS Overall Grade A Net Effective Rent (HK$/SF/MTH)



Source: DTZ/Cushman & Wakefield Research

Figure 8

New Grade A Office Supply (Million SF NET)



Source: DTZ/Cushman & Wakefield Research

Table 2

Hong Kong Office Market Statistics

SUBMARKET	Inventory (SF NET)	Availability Rate	Under Construction (SF NET)	Grade A YTD Construction Completion (SF NET)	Overall Direct Net Absorption (SF)	Grade A Net Effective Rent* (HK$/SF/MTH)		US$ SF/YR	EURO SF/YR
						4Q 15	1Q 16	1Q 16	1Q 16
Prime Central	7,528,841	3.3%	0	0	-14,240	122.42	128.88	199.43	178.44
Greater Central (CBD)	15,415,764	3.4%	0	0	-56,474	110.83	115.64	178.94	160.11
Wan Chai / Causeway Bay	8,779,245	5.2%	498,400	0	-18,572	71.08	72.13	111.61	99.87
Hong Kong East	7,367,710	3.5%	1,184,400	0	-81,119	47.49	47.49	73.49	65.75
Hong Kong South	1,971,281	18.6%	455,100	226,800	87,031	26.85	27.49	42.54	38.06
HONG KONG ISLAND TOTAL	**33,533,999**	**4.8%**	**2,137,900**	**226,800**	**-69,134**	**80.36**	**81.39**	**125.94**	**112.69**
Tsim Sha Tsui	8,125,205	3.3%	282,600	0	-29,201	66.80	69.20	107.08	95.81
Kowloon East	11,439,202	8.4%	4,089,300	0	-9,944	30.49	30.32	46.92	41.98
Kowloon West	3,697,831	6.2%	135,500	0	72,325	40.47	40.55	62.75	56.14
Kowloon Others	1,955,604	13.0%	284,300	0	298,198	35.09	34.92	54.03	48.35
KOWLOON TOTAL	**25,217,841**	**6.8%**	**4,791,700**	**489,120**	**331,378**	**42.78**	**42.89**	**66.37**	**59.38**
OVERALL TOTAL	**58,751,841**	**5.6%**	**6,929,600**	**715,920**	**262,244**	**77.31**	**78.36**	**121.25**	**108.49**

*Grade A Net Effective Rent is exclusive of service charges and government rates and based on net area
1.00 USD = 7.755 HK$ / 1.00 EUR = 8.667HK$

Source: DTZ/Cushman & Wakefield Research

Retail

Since the launching of the One-trip-per-week Individual Visit Endorsements was launched in 2015, both mainland visitors and total visitor arrival growth rate has kept diminishing. Visitors from Mainland China sharply dropped by 18% and the total visitors declined by 13.6% in the first two months of 2016, respectively, compared with the same period a year earlier. Furthermore, total retail sales value followed similar trend and plunged by 20.6%, reflecting severe downward pressure on the retail sector. In addition to the policy change with respect to the Individual Visit Scheme for Mainland China visitors to Hong Kong, the quick shrinkage of retail sales value was, to some extent, are also due to the sluggishness of global market conditions and slowing conditions Chinese economy (Figure 9 and Figure 10).

Figure 8

Hong Kong Tourist Arrivals (Million person)

Source: The Hong Kong Tourism Board

Taking a closer look at the retail sales by retail outlet, jewellery & watches, fashion & accessories, medicines & cosmetics, electrical goods, and food, alcohol & tobacco, all showed the declining trend. Among the five components, some large value purchases plunged a lot. For example, the retail sales value of jewellery & watches, and electrical goods, was down by 24.2% and 26.7% y-o-y in 2016 so far, respectively. Moreover, the retail value of daily necessities, such as medicines & cosmetics, and food, alcohol & tobacco, also showed a downward trend, decreasing by 7.9% and 2.0%, respectively.

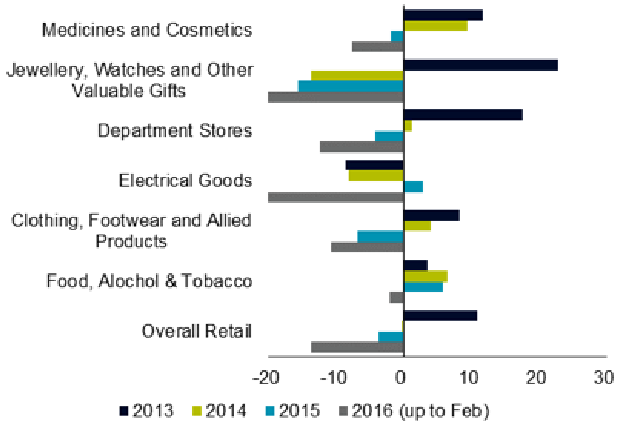
The poor performance of the retail sector was also illustrated by the amount of vacant shops in High Street of traditional shopping districts. All four districts, Causeway Bay, Tsim Sha Tsui, Central, and Mongkok, witnessed the appearance of some vacant shops. Among them, Sai Yeung Choi Street South and Argyle Street in Mongkok showed an increase in the number of vacant shops from 3.8% in Q4 2015 to 11.3% in Q1 2016. The rising number of vacant shops is attributable to the decreasing number of visitors since the launch of new Individual Visit Scheme and the recent riot in Mongkok.

As such, prime street rentals in tier one locations dropped further from Q4 2015, declining by 5.9% in Tsim Sha Tsui to 7.2% in Mongkok (Figure 11). Although the high street rents followed similar downward trajectory across the four traditional shopping districts, the value of restaurant receipts showed a subtle growth over the past several years, as street level dining falls under the category of a "daily necessity" which is largely driven by domestic demand rather than by the sales of luxury goods to tourists. The four traditional shopping districts all showed a stable rental growth for F&B spaces from 0.3% in Mongkok to 1.0% in Central. Despite the recent weak performance of the retail sector in Hong Kong, some retailers have been availing themselves of the opportunity represented by falling rental levels to re-enter the core retail area. For example, some fast fashion, accessories and cosmetic companies have moved quickly to tenant the shops which were previously occupied by the luxury goods companies.

Meanwhile, the further depreciation of RMB, the intensification of China's Anti-Corruption Campaign, and the cuts on import duties for both daily necessities and luxury goods in China lowered the incentive for mainland visitors to shopping in Hong Kong. Hence, the outlook of the overall retail sector in Hong Kong is expected to remain gloomy in 2016.

Figure 10

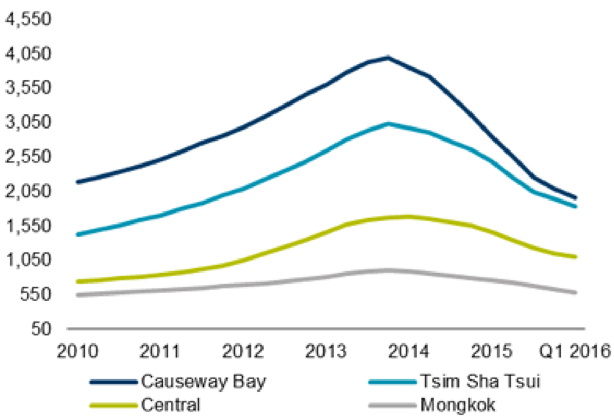
Retail Sales Value by Retail Outlets (y-o-y % chg)



Source: Census and Statistics Department

Figure 10

Retail Rent on High Streets (HK$/SF/MTH)



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