Colliers Radar

Hong Kong
Residential Leasing
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The changing dynamics of the residential leasing market

Opportunities behind the transforming market

Accelerating success.

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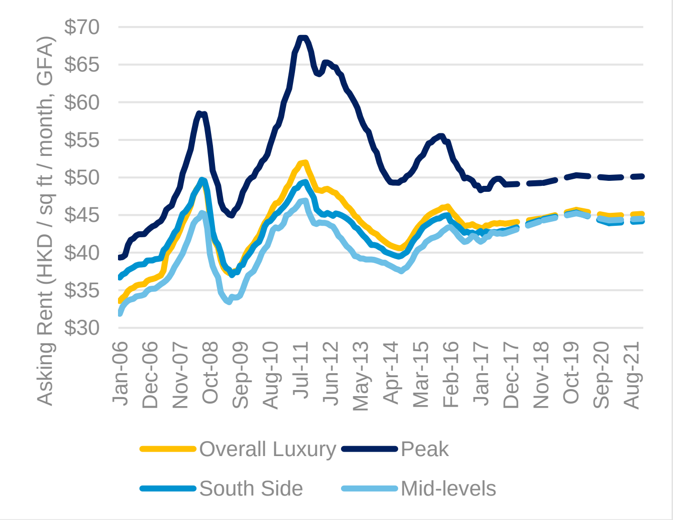
Overall, the luxury residential rent in Hong Kong declined 12% from September 2011 to October 2017 as MNCs cut packages for expatriate staff. While firms remain cost-conscious, robust market conditions have halted this decline. More expatriates are now considering leasing smaller units or moving away from traditional luxury districts such as the Peak, Mid-levels and Southside. Developers have the largest portion of their leasing portfolios located in traditional districts, so they need to refurbish older buildings to keep up standards, and explore opportunities outside traditional districts to capture the new leasing demand. Tenants, for their part, should be open to new options and start identifying the best-fit premises amid expectations of rising rents.

Luxury Residential Rental Forecast by District



Source: Colliers

More expatriates have found it hard to afford the ultra-luxury units in traditional luxury districts due to reduced salary packages. Nevertheless, we expect rents in traditional districts to increase further. The luxury residential rental growth will be supported by the stabilising expatriate packages and a positive business outlook. Against the backdrop of increasing rents and ageing buildings in traditional districts, dynamics in Hong Kong's residential leasing market have been changing.

The difference in rents between the traditional districts and other districts has narrowed due to the softening demand for ultra-luxury units and older units. Landlords should start refurbishing their properties to maintain standards, and should focus on family well-being, adoption of technology, and users' needs to maintain high occupancy in older buildings.

Tenants who are focusing on traditional districts should make their decisions after careful consideration of rent levels, building ages, and building management. Rents should be more negotiable for ultra-luxury units and townhouses, whereas there will be less room to negotiate in newer or refurbished buildings.

Tenants open to other options should take advantage of buildings adjoining upcoming new public transport routes such as the Shatin to Central Link and the Guangzhou-Shenzhen-Hong Kong Express Rail Link. However, such districts are usually popular with high occupancy rates.

We expect Shatin to be the market with the highest supply of large new units from 2017 to 2019, with developments in Kau To Shan and Whitehead set to provide over 500 large units. Mid-levels Central should have the second largest supply of large units over the same period, at about 240 units.

For tenants, community and school networks are very important factors in their location choice. Among decentralised districts, we recommend Island West, Kowloon Station/Olympic Station and Sai Kung as the top three leasing locations. Developers should therefore consider holding buildings in other areas to capture the increasing leasing demand.

We believe traditional luxury districts will remain the most popular overall. This is partly because we expect Central/Admiralty to remain Hong Kong's largest financial hub and the major CBD, supporting leasing values in the Central and Western District. However, we recommend prospective tenants to consider new areas with lower rents and increasing amenities. We also think the changing dynamics and decentralisation of the luxury residential leasing market will become obvious, as a result of urban regeneration with new residential and commercial clusters arising over the next few decades.

Contents

The change of leasing preferences

The context of Hong Kong's residential leasing market

Dynamics in Hong Kong's residential market have been changing in both the investment and the leasing segments. Residential prices have increased sharply due to prolonged loose monetary conditions in Hong Kong, featuring negative real interest rates. On the other hand, the residential leasing market has closely followed Hong Kong's overall economic performance and changes in household income.

We define flats with a size of 100 sq m (1,076 sq ft) or larger located on the Peak, in Mid-levels, and Southside to be the luxury residential market in Hong Kong. In the colonial era, these three areas were the location of most prime dwellings and so were home for the Britons and Europeans who effectively headed Hong Kong's social structure.

Development of traditional luxury districts

The Peak, Mid-levels, and Southside have developed into the most prestigious residential districts due to Hong Kong's colonial background. The dwellings on the Peak and in Mid-levels districts were originally reserved for Europeans; Chinese were not allowed to move into residential units on Queen's Road Central and in adjoining districts until the Governor John Pope Hennessy allowed Chinese immigrants in Hong Kong to become naturalised as British subjects during the 1880s. Development in the Peak District was restricted by statute to European-type dwelling houses as Chinese businessmen began replacing European-style buildings in Central with more profitable Chinese tenements, obliging Europeans to move their residences out of Central to Mid-levels and the Peak. The prestigious position of Mid-levels and the Peak, and the concentration of British and European residents in these areas lasted until the administration of the last Governor of Hong Kong, Chris Patten, who stayed in the Government House at Upper Albert Road in the Mid-levels. After World War II, most Europeans still resided on the Peak, but over the decades some started to move to places in Southside like Shouson Hill and Shek O. The development pace of the residential cluster in Southside accelerated from the 1960s as the beachfront location increased the value of the district.

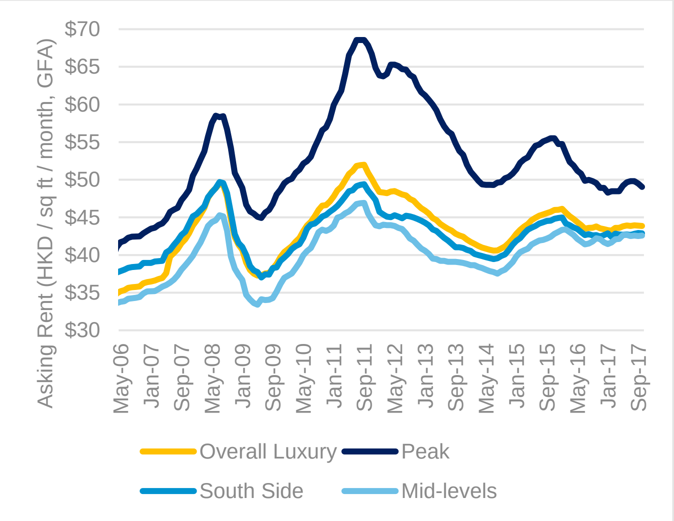
Mixture of townhouses and apartments differentiates the rental trends

Nowadays, the Peak remains the chief luxury residential district in Hong Kong with the largest proportion of townhouses and low-rise luxury apartments. We expect leasing demand for townhouses and ultra-luxury units to stay soft. However, overall occupancy levels in properties on the Peak should remain high given the strong owner-occupation demand from high net worth individuals.

Mid-levels, being the densest of the three districts, is home to high-rise luxury apartments. While the average unit size of an apartment is smaller than most house sizes, the shift in demand from ultra-luxury units to affordable luxury units should lead to opposite rental growth between the two segments, with demand for both still increasing. Against the backdrop of the positive business cycle and sustainable leasing demand, we expect Mid-levels to see the strongest rental increase in the coming three years.

The residential market in Southside is a mixture of townhouses and luxury apartments. Like the Peak, demand for townhouses has been softening. However, rental growth has been supported by a strong demand in apartments. Southside has been the leasing hotspot as the popularity of its apartments has been growing, while demand for ultra-luxury units on the Peak and Mid-levels has been softening.

Luxury Residential Rent by District



Source: Colliers

Luxury market losing momentum since the GFC

Leasing demand for luxury apartments in traditional luxury districts on Hong Kong Island such as the Peak, Southside, and Mid-levels has come mainly from multinational companies (MNCs) and large banks. The slowdown of headcount growth in the Central and Western District has weakened the demand for ultra-luxury units on Hong Kong Island, driving average rent down by 12% from its peak in September 2011 to October 2017.

Working Population in Central and Western by Industry (Top 5)

INDUSTRY	2007	2012	2017
Financing and insurance	85,430 (7,986)	93,470 (8,040)	93,300 (-170)
Professional and business services	69,224 (17,319)	68,618 (-606)	72,263 (3,645)
Social and personal services	28,867 (4,395)	33,539 (4,672)	39,170 (5,631)
Import/export trade and wholesale	48,765 (-2,572)	39,005 (-9,760)	35,493 (-3,512)
Accommodation and food services	24,811 (5,344)	22,085 (-2,726)	27,646 (5,561)
Total	321,430 (453)	333,204 (1,578)	335,201 (-770)

Source: Census and Statistics Department
Note: Figures in brackets represent a five-year change

The statistics from the Census and Statistics Department show that the increase of the working population in the Central and Western District has slowed down significantly over the past 15 years. Financing and Insurance, being the most well-paid sector recorded a negative employment growth of 170 between 2012 and 2017, a significant decline from the increase of more than 16,000 over the previous decade. The contraction of employment indicates the cost-cutting strategy of MNCs, implying a tighter housing budget for employees.

The Professional and Business Services, and Social and Personal Services segments have witnessed the strongest growth in working population in the Central and Western District between 2002 and 2017. However, the growth of these industries could not offset the decline of expatriate salary packages of large banks and investment banks, explaining the decline of luxury rents on Hong Kong Island over the past four years.

Shrinking housing allowance has affected expatriates' rental budget

The Global Financial Crisis caused MNCs and major banks to be more cost-conscious. Salary packages for expatriates have been scaled back and no longer include allowances for housing, school, car, club memberships or flight sponsorships for the employees and their families. According to a survey conducted by ECA International, salary packages for expatriates in Hong Kong hit a five year low in 2016. Still, the territory ranked fourth in the Asia-Pacific region in terms of generous packages after Japan, mainland China and India. Meanwhile, there are more companies offering their employees local salary packages, which feature lower housing allowances or personal leases instead of corporate leases.

While the amount of housing allowances for expatriates has declined over the past five years, the greater part of leasing demand from expatriates has shifted from ultra-luxury units (i.e. monthly rent of HKD120,000 [USD15,424] or above) to the mid-tier of the luxury market (i.e. monthly rent of HKD80,000 [USD10,283] or below).

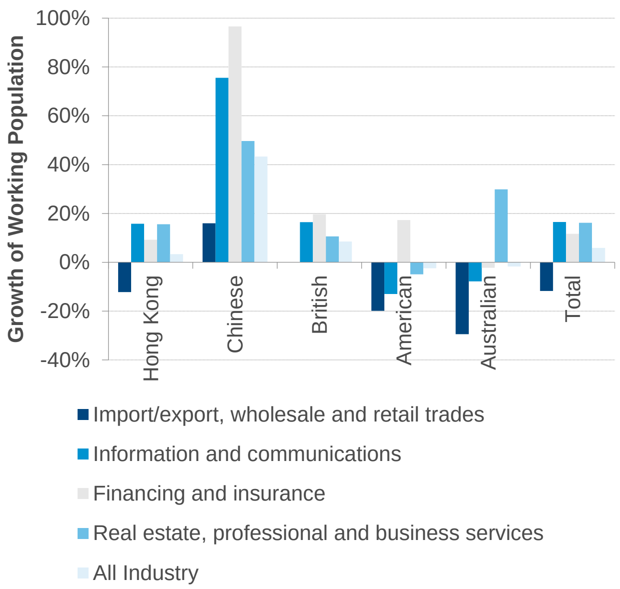
Demand from mainland Chinese is growing

Despite MNCs strictly controlling their staff expenses, the luxury residential market has witnessed high occupancy thanks to sustainable demand from local families and the increasingly strong demand from mainland Chinese.

Thanks in part to the Shanghai-Hong Kong Stock Connect, the financial sector in Hong Kong has returned to an expansion path, with PRC firms as the key drivers. Between 2011 and 2016, the working population of mainland Chinese in the financing and insurance sectors in Hong Kong surged by 97%, from 4,646 to 9,134, representing the strongest growth among the expatriate population.

The working population growth of mainland Chinese in Hong Kong has been driven by China's national initiatives such as the renminbi internationalisation, the Belt and Road Initiative, and the Greater Bay Area plan. Meanwhile, the HKSAR government implemented the Admission Scheme for Mainland Talents and Professionals in 2003, further increasing the influx of mainland Chinese population. Despite the apparent preference of most mainland Chinese for purchasing over leasing, their share of the luxury leasing market has increased, contributing to the high occupancy in the traditional luxury markets.

Growth of Hong Kong's Working Population by nationality (2011-2016)



Source: Census and Statistics Department

Supply will remain tight on Hong Kong Island

Although luxury rents have declined over the past four years due to cost control efforts by MNCs, limited supply is a factor that has been supporting rents to a certain extent. The supply on Hong Kong Island has been tight, with supply of large units in luxury districts being the most limited.

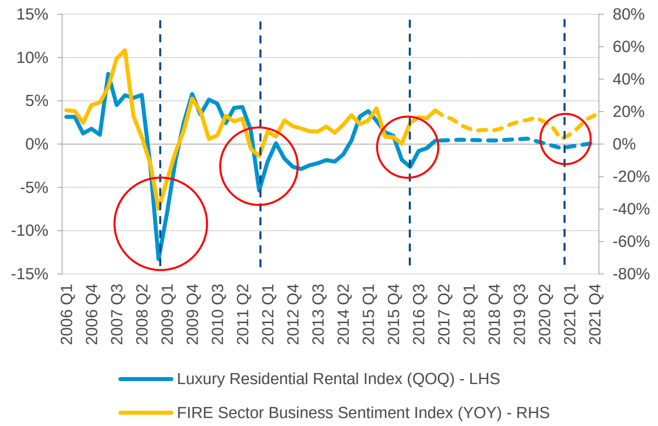
Consolidated data from the Lands Department show that the number of large units completed on the Peak, in Mid-levels, and Southside over the past ten years stayed low at a total of 715 units, representing merely 0.6% of total completions across Hong Kong within the same period. Developers are building smaller units amid the rising trend for purchasing "nano-flats". The outlook for prices and rents in the large unit category appears solid against a background of tight supply and stabilising expatriate salary packages.

Rental outlook: traditional districts set to increase amid positive cycle

A positive economic outlook supports household and business spending power

Being an open market and an international city, Hong Kong is highly sensitive to global economic changes. So far in 2017, the global economy has strengthened with many countries recording GDP growth above expectations, including Hong Kong's real GDP which rose 4.1% YOY in H1, and by 3.6% YOY in Q3. Oxford Economics expects a 3.6% YOY increase for the whole year, and Hong Kong's economic status to stay strong in the long term, estimating a 2.2-2.5% annual growth in the next five years. Given the positive economic outlook, business sentiment has improved over 2017, supporting employment expectations.

Colliers Luxury Residential Rental Index versus FIRE Sector Business Sentiment Index



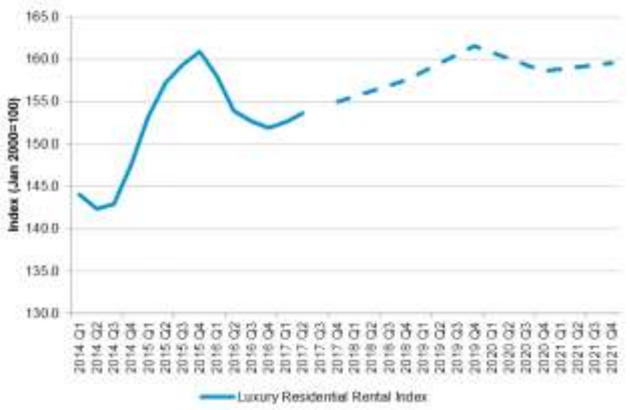
Source: Colliers; Census and Statistics Department

The Quarterly Business Tendency Survey Report published by the Census and Statistics Department provides an indicator of the performances of major industries in Hong Kong. We believe the business performance of high-value added service sectors Finance, Insurance, and Real Estate will directly affect companies' decisions on staff expenses planning and housing allowance budgets for expatriates. The report indicates a high correlation between business sentiment and Hong Kong's luxury residential rental changes. Past records have revealed that business sentiment tends to move in three to four year cycles, and that both indices rarely stay in negative territory for a longer period. From 2006 to 2012 the direction of luxury residential rents closely followed the business performances. The trends then moved in opposite directions from 2012 to 2014 mainly due to the changing cost strategies of MNCs.

Business sentiment in Hong Kong entered a positive cycle after the correction in 2015. Given the prediction of strong GDP growth and the modest growth of interest rates, we assume that the past trend will be repeated and that the positive cycle will last for three years until 2019. We believe that business sentiment will stay positive with MNCs willing to expand their headcounts and maintain housing allowances for staff. Based on this projection, the outlook for leasing demand and leasing budget for luxury flats should be promising. The rental growth is likely to stay positive due to firm leasing demand and limited supply.

Despite the positive outlook, the growing leasing demand in the affordable luxury market implies that the leasing demand for townhouses and ultra-luxury units should stay soft. While rental growth for the top-segment market should feel the pressure from softening demand, we expect rental growth for the overall luxury market to stay positive while being supported by the more affordable segment. In terms of location, the traditional luxury market should stay popular since it hosts the largest expatriate community and is close to Central.

Colliers Luxury Residential Rental Forecast



Source: Colliers

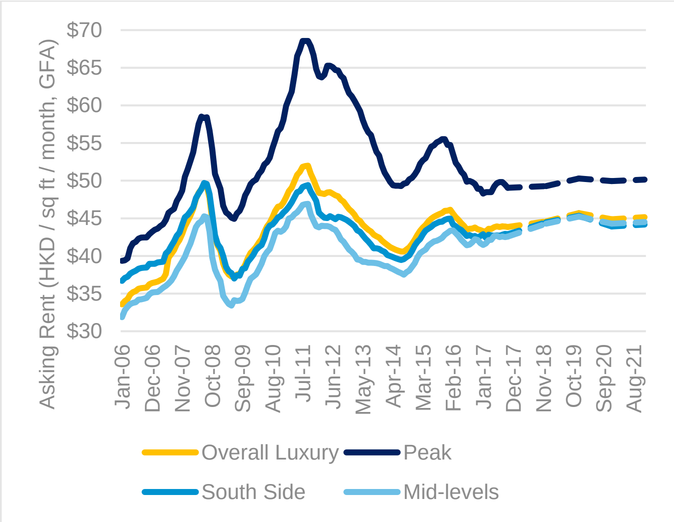
The robust mid-tier luxury market will drive luxury rental growth

According to the 2016's figures from the Census and Statistics Department, the median monthly household incomes of economically active households for the District Council Constituency Area Mid Levels East and Castle Road were HKD70,000 (USD9,000) and HKD104,210 (USD13,400) respectively, while the median monthly domestic household rents for the two districts are HKD23,000 (USD2,956) and HKD34,000 (USD4,370) respectively.

Expatriates targeting more affordable luxury flats, with monthly rents between HKD30,000 (USD3,856) and HKD60,000 (USD7,712), are facing strong competition with local families who are dominating the housing demand in the mid-tier market. The strong competition in the mid-tier market will maintain high occupancy in luxury districts and support rental growth.

We expect the overall luxury residential rent to increase 4.2% from 2017 to 2019 amid the positive business cycle. The rental performance by district has closely followed the overall trend due to the similarity of geographical features and tenant groups. We expect MNCs will remain cost-conscious despite the positive business outlook. It is unlikely that MNCs will increase expatriates' housing budgets in the coming few years. As leasing demand for ultra-luxury units and townhouses should remain relatively soft, we expect the rental outlook for Mid-levels to be the most resilient. Southside will be supported by the growth of apartments, while the Peak should see the most moderate growth.

Luxury Residential Rental Forecast by District



Source: Colliers

Mass market: deteriorating housing affordability strengthens leasing demand

The wealth effect and limited new supply have supported home price growth. Statistics from Demographia show that the price/household income ratio (the key measure of affordability in residential property markets) in Hong Kong stands at 19x, one of the highest levels in the world, indicating that private households can hardly afford to purchase their desired homes.

The owner-occupation ratio has been declining in Hong Kong while the number of residential transactions has been falling. The ratio for the private sector fell to 63% in Q3 2017, the lowest level since 1989, representing the shift of end-user demand from owner-occupation to leasing. While we expect home prices to increase for the next two years (though maybe at a more moderate rate), leasing demand is likely to remain strong, supporting rental growth.

Being supported by robust demand from local families, rental growth in the mass market should increase faster than in the luxury market in the coming years. Moreover, families not focusing on staying in traditional luxury districts should prove more willing to spend similar rental budgets for primary units of a larger size. This process ought to drive the rental growth for mass units, pushing some mass units to more expensive levels than luxury units in terms of monthly rent per sq ft.

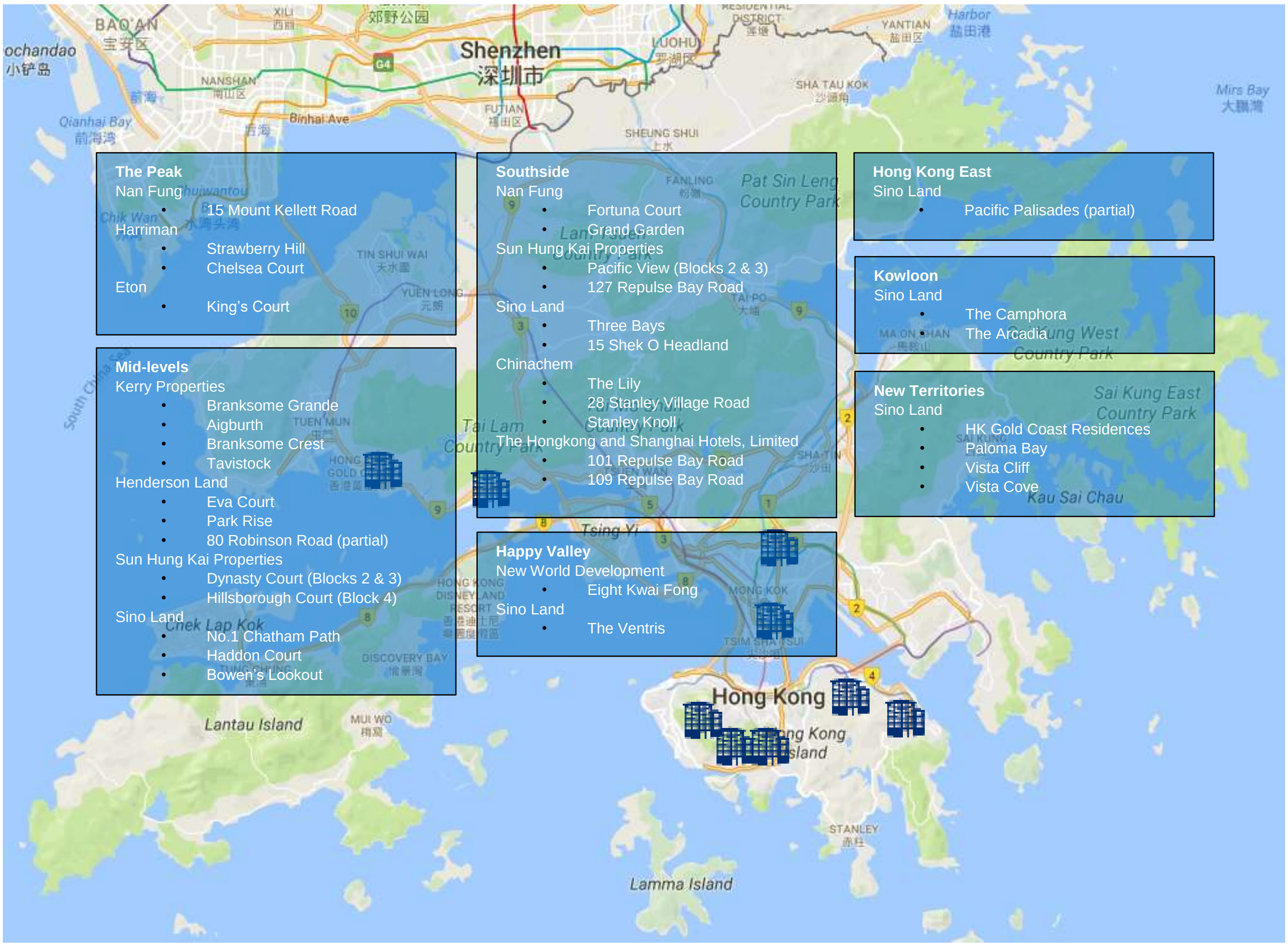
New approach to capture future demand

Developers have been holding more residential buildings for lease on Hong Kong Island to benefit from strong leasing demand. The traditional districts have the highest concentration of residential buildings owned by landlords for long lease. Mid-levels has the highest volume of leasing properties held by landlords, followed by Southside, The Peak, and Pokfulam. Even though residential rent for traditional districts declined significantly between 2012 and 2016, some developers have not been actively repositioning their residential portfolios. As the rental gap between traditional districts and non-core districts is narrowing, luxury buildings in traditional districts are losing their advantage. Moreover, buildings are ageing quickly and require a higher maintenance cost over time.

We expect rents in traditional districts to increase, yet, rents should increase slowly with an annual growth rate not exceeding 2%. Since buildings in traditional districts are getting old, developers may have to invest in refurbishments to enhance occupancy. Refurbishing older buildings can increase their value. However, developers will have to understand their customers to ensure that their investments match the market demand. It may not be necessary for developers to focus their investment on expensive materials, but they will need to pay attention to facilities, designs, and living standards.

It is, of course, not guaranteed that the investment in refurbishment will translate into rental increases because overall demand for ultra-luxury units has softened. In our opinion, developers should start to rethink their strategies for the residential leasing market more generally. They should consider investing in other locations or holding buildings with smaller units for lease.

Residential Buildings Owned by Major Landlords for Long Lease



Source: Annual Reports

Narrowing gap for price and rent across different areas

The price difference between traditional luxury districts and other districts has been narrowing. More quality primary units have been completed in non-core areas whereas the buildings in luxury districts are getting old. For example, there was a 37% rental difference between Island East and traditional luxury districts in 2012. With luxury rents declining since 2012, the rental difference has dropped to 15%.

Rental Gap between Traditional Luxury Districts and Island East

Source: Colliers

Since developers no longer position their developments according to location and development size, the definition of the luxury residential market has become obscure with more high-quality apartments being built in different locations. Smaller units are also becoming more popular as they offer high-quality design at a more affordable rent.

Given the new development context with very low new land supply in core CBD areas, the rental and valuation gap between core and emerging districts is shrinking, and the definition of luxury is changing. We therefore recommend developers to revise their strategy for holding "quality" or "high value" residential properties for leasing. Developers should consider the following factors when looking for suitable locations for their residential leasing properties.

> New business districts

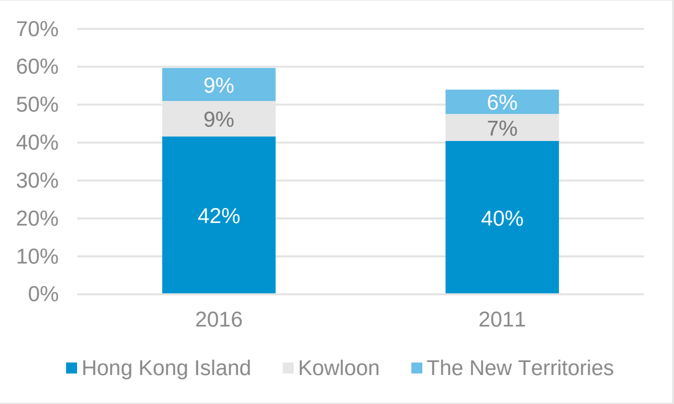
MNCs have started to relocate or split their office operations from Central to Island East and Kowloon East, with Kowloon East now already the second largest Grade A office market. Since the majority of MNCs currently provide their expatriate staff with luxury apartments on Hong Kong Island, the decentralisation of MNCs will lead to longer travelling times, especially for staff living in Southside who must travel to Kowloon East on a daily basis.

> Adjoining new international schools

Since the demand for luxury apartments used to be concentrated in traditional luxury districts, major landlords have not been holding many apartments for lease in other areas. However, given the reduced housing allowances for expatriate staff, we expect more leasing demand to shift to other districts in search of more comparable options. This suggests that landlords should consider developing and holding quality properties for lease in other districts.

In addition to rental costs and building quality, location has always been one of the most important factors for leasing a property in any property sector. For residential, the major drivers for location are spatial proximity to work place and schools. Although most international schools adjoin traditional districts, new schools are due to open in Kowloon and the New Territories in 2018 and 2019.

Proportion of Population Studying in Another District



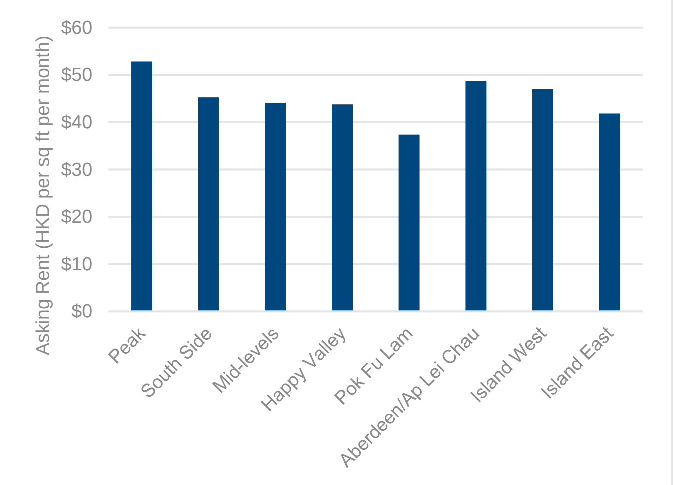
Source: Census and Statistics Department; Colliers
Note: Population in areas including Constituency Areas - Peak, Mid Levels East, Castle Road and Bays Area

> New infrastructure

As major new public transport routes such as the South Island Line, West Island Line, and the Shatin to Central Link have been completed, more districts are benefiting from improved accessibility, making unconnected districts less competitive. The chart shows that the average monthly rent per sq ft in Island West and Aberdeen/Ap Lei Chau is outperforming other districts. Although luxury apartments in Island West are much smaller in size, with the majority having a size of around 800-1,300 sq ft (74-121 sq m), the higher average rent indicates that the leasing demand for luxury apartments is changing to other locations and smaller units.

In addition to new schools and infrastructure supporting demand in other areas, the problem of ageing buildings is an important factor pressuring rental growth in the traditional luxury districts.

Luxury Residential Asking Rent by District



Source: Colliers

Refurbishment to increase rental income

While the Peak, Mid-levels, and Southside are the traditional luxury districts, the buildings in these locations are ageing quickly. Taking Central and Western as an example, about 74% of the buildings are older than 30 years, compared to 64% in Hong Kong overall. There is no doubt that the ageing factor is affecting the living quality of residents. The government has introduced the Mandatory Building Inspection Scheme which requires owners of buildings aged 30 years or above to carry out the prescribed inspection by a Registered Inspector.

Common defects in the old buildings:

> Water supply piping - corrosive chemicals, water dripping and peeling off of wall paint or paper

> Plumbing system - low pump efficiency

> Water heater - leak, uncontrolled water flow, resultant damage or catastrophic failure

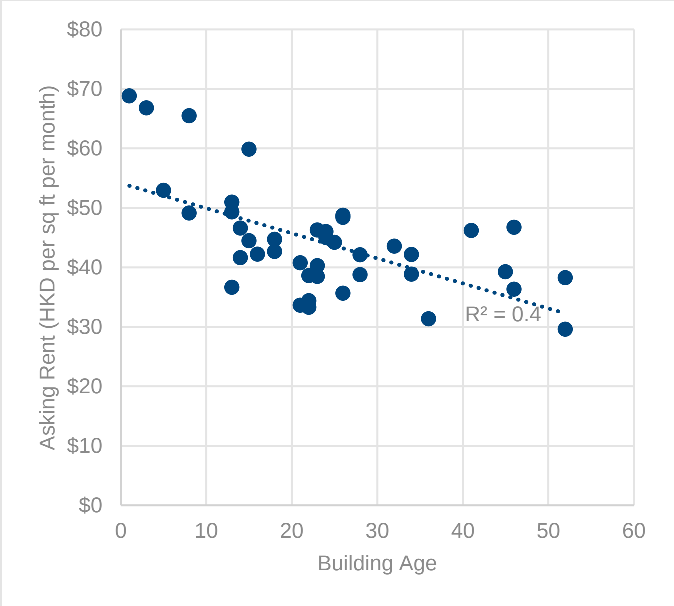
> Heating, ventilation, and air-conditioning (HVAC) - low fuel efficiency, inconsistent cooling and poor air quality

> Roofing - water leakage, growth of fungus

> Structural cracks - flaking concrete, loosing windows or doors

While ageing building structure affects the living quality, it will also have a negative impact on people's impression of the building, thus affecting demand and rental performance. Taking Mid-levels as an example, as about 65% of the luxury apartments are currently older than 30 years, a clear negative relationship can be shown between building age and rental performance. Despite being traditional luxury residential districts and accommodating a large expatriate community, regeneration of the ageing district is necessary to maintain the district's value and attractiveness. In this respect, residential property contrasts with office property. Although offices in Central are ageing quickly, most prime office buildings are managed by large commercial landlords. Residential buildings, on the other hand, are multiple-owned and generally less well managed.

Luxury Residential Rent versus Building Age (Mid-levels)

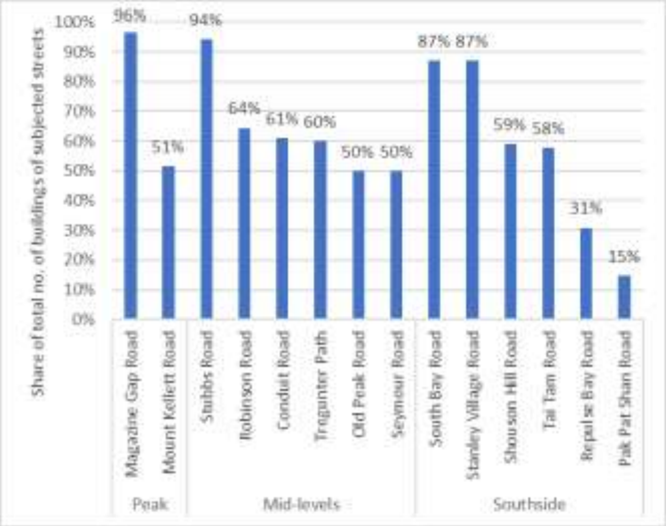


Source: Colliers

As ageing buildings have been an issue for years, some forward-looking developers have already taken the lead in refurbishing their developments to maintain the sustainability and long-term rental growth. According to Kerry Properties' annual reports, the group renovated Branksome Grande in Mid-levels in April 2014 to increase the income recurring from its investment portfolio. The group has improved the building quality by upgrading the facilities and building materials. Given the quality of living improvements through renovation, the building achieved 31% occupancy in the first two months after renovation and was fully occupied after a year.

In Mid-Levels, about 80% of properties on Stubbs Street, Robinson Road, and Conduit Road are more than 30 years old - the highest proportion in the district. On Magazine Gap Road on the Peak, 27 out of 28 buildings were built before 1987. Despite Southside being a younger district, with only 15% of the 315 buildings on Pak Pat Shan Road over 30 years old, nothing has been built since 1997.

Percentage of Buildings Older than 30 Years



Source: Home Affairs Department; Colliers

Since most buildings in traditional luxury districts are ageing, in particular on the Peak and in Mid-levels, we believe that individual owners should also start renovating their properties in order to attract tenants and increase rental income. Apart from the opportunity to generate a high rental income, renovation should make the premises stand out from the other units, increasing their capital value on sale.

Major developers have the advantage of providing better property management and services to their tenants. They can understand their tenants better by handling their daily issues. However, owners who do not have their own management teams will have to try to stand out by maximising building quality and living environment to make their refurbishment successful.

While expatriate tenants have lower rental budgets than in the past, they may not want to pay a premium to reside in an apartment with high specifications. Given some of them are living with their families, they may regard well-being and sustainability of the fit-out as greater priorities.

Developers may consider investing in technology and smart home devices such as lighting and appliance controls, home automation, and smart security systems.

According to IHS Markit, a UK-based global information company, the installed base of smart home devices grew more than 10 times by over 161 million units from 2010 to 2016. They project the market to broaden at a compound annual growth rate of about 31%, reaching 477 million devices in 2020. In fact, residential buildings in major countries such as China, Japan, and Korea have already been widely adopting smart home devices.

In Hong Kong, HKT, one of the largest telecom companies, is already working with local developers to install smart living devices in more than 10 new residential developments. Home automation will not just improve users' quality of living by increasing convenience for them, but will also provide better home security and energy savings.

As for developers, they should be able to understand their tenants' behaviour better. Similar to commercial properties, smart homes may allow developers to trace the energy usage of their buildings, the sustainability of devices and appliances, and the mobility of residents. This will allow developers to provide better services to their tenants, increasing the value of their buildings, and supporting rental growth.

Opportunities beyond the traditional districts

Due to the changing leasing pattern of expatriates and the narrowing rental gap between traditional districts, rents for some leasing properties in the traditional districts have become attractive. However, tenants who are focusing on traditional districts should make their decisions carefully between rental levels, building ages, and building management. Rents should be more negotiable for ultra-luxury units and townhouses, while newer or refurbished buildings should stay competitive.

For expatriates looking for affordable apartments in convenient locations and with good amenities, we suggest following these steps:

Pay attention to new infrastructure developments

While Hong Kong tops global infrastructure development rankings by the World Economic Forum, people living in Hong Kong are highly dependent on public transport. The completion of new public transportation routes such as the West Island Line and South Island Line in 2016 has increased the popularity of adjacent districts, with Aberdeen, Ap Lei Chau, Pok Fu Lam, and Island West benefiting the most. The Shatin to Central Link, the largest metro railway completion in the next five years, is expected to be fully completed by 2021 and will connect Tai Wan and Admiralty via Kai Tak, Ho Man Tin, and Wan Chai North. Meanwhile, the Guangzhou-Shenzhen-Hong Kong Express Rail Link connecting West Kowloon with various cities across China will cut travelling time dramatically for staff needing to commute between Hong Kong and China. Residents staying in luxury units atop Kowloon Station will only have to use the footbridge from Kowloon Station to the Express Railway Terminal, while the station is only one stop away from the Hong Kong CBD. The government expects the Express Rail Link to be completed in Q3 2018, and Chief Executive Carrie Lam signed a joint checkpoint agreement on 18 November 2017 that will allow mainland Chinese officials to carry out immigration and customs procedures in the future West Kowloon terminus of the Guangzhou-Shenzhen-Hong Kong express rail link.

Pick out districts with more new supplies

Although new infrastructure will increase the accessibility of the connected districts, new supply is the main driver to attract new occupation demand. According to the Buildings Department, 112,821 private residential units in total were completed over the past 10 years, while Hong Kong Island only accounted for 13% or 14,950 units of the total number of units completed. Three districts in the New Territories, Yuen Long, Tseung Kwan O, and Shatin, are the markets with the largest new supply, accounting for 45% of total completion of residential units over the past decade. The strong new supply in non-core urban areas has already triggered the relocation of some families, but we expect the trend to continue and probably accelerate.

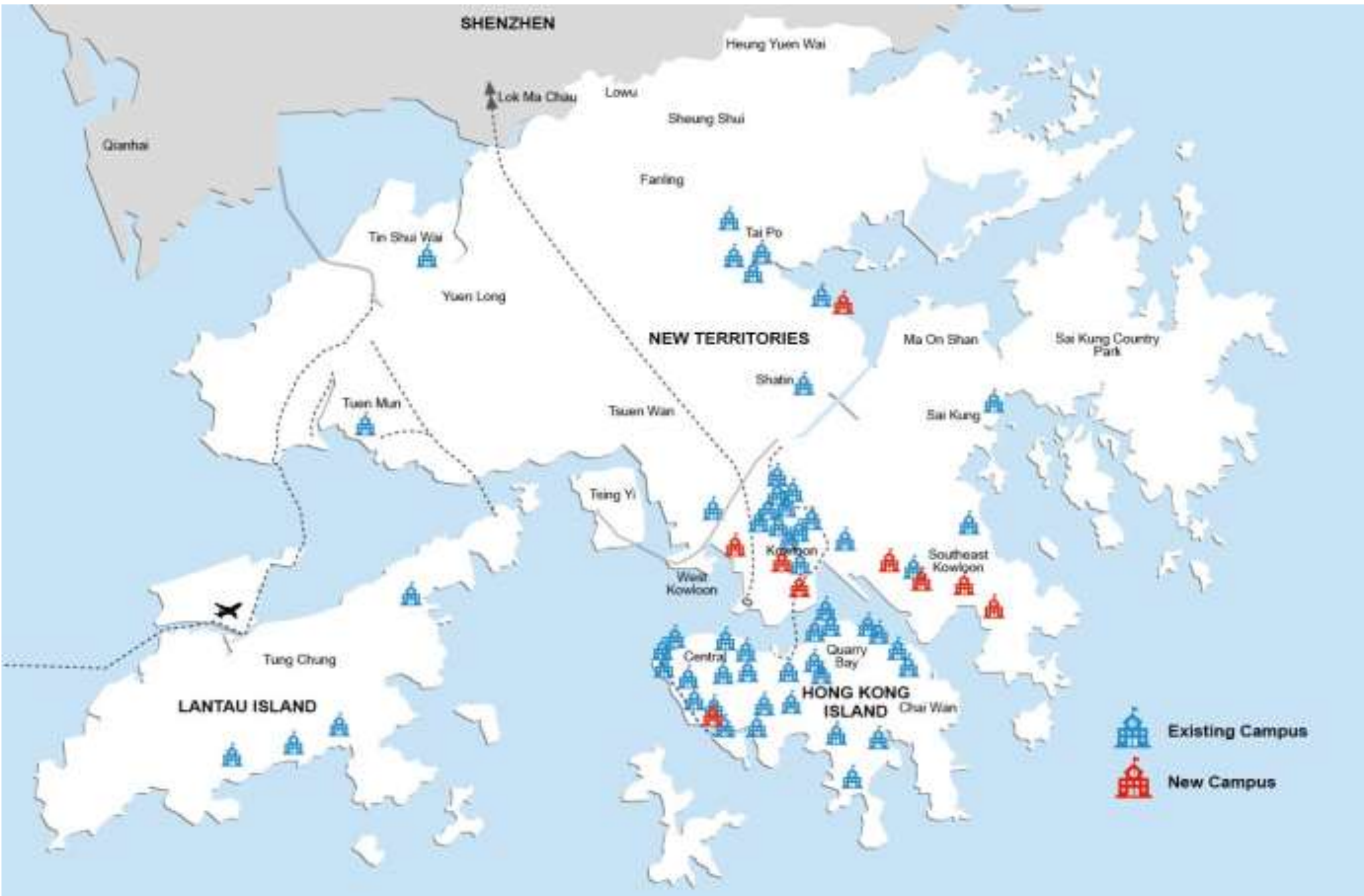
Looking ahead, we expect new completion to reach an annual average of 18,500 units in the private residential market from 2017 to 2019, of which 22% will be located in Tseung Kwan O, providing over 12,000 new units. Despite Tseung Kwan O being the market with the highest new supply for the coming three years, 97% of the new supply there will be units smaller than 100 sq m.

Wealthy families will still be given limited choices of large units in the primary market with only 2.4% of the overall new supplies being large units, according to our estimates. We expect Shatin to be the market with the highest supply of large new units from 2017 to 2019, with developments in Kau To Shan and Whitehead expected to provide more than 500 large units. However, the Peak, Mid-levels, and Southside will only have about 400 large units completed in the coming three years, representing only 0.7% of the total potential supply in those years. Meanwhile, Tuen Mun which is gaining popularity with local and Chinese families should see more than 110 large units completed.

Top Five Markets for New Supply in 2017-2019

Source: Colliers. Figures refer to the expected number of residential units to be completed

International Schools in Hong Kong



Source: HKEdCity; Colliers

Proximity to international schools

Despite connectivity and housing supply being important, the community and school networks are the most important factors for attracting expatriate families. According to HKEdCity, there are currently 48 international schools hosting 68 campuses across Hong Kong. There are 33 campuses on Hong Kong Island, of which about two-thirds are located around luxury residential districts. In Kowloon, while there are 20 campuses across the peninsula, nine of them are in Kowloon Tong, a luxury residential district in Kowloon. With over 50% of international school campuses located around the luxury residential district in the city, the opening of new schools in other areas can attract new leasing demand for luxury flats in those areas.

In 2018 and 2019, nine new school campuses are due to open in Hong Kong. However, most of them will be in decentralised locations, with three in Kowloon West and four in Kowloon East and Tseung Kwan O. Although the bus networks of international schools cover most urban areas in Hong Kong, travelling time will still be a concern for people who live in Southside studying in Sai Kung or further in the New Territories.

According to the Hong Kong Census, Britons represent the largest Western expatriate group in Hong Kong, ahead of the Americans, the Australians, the Canadians, and the French. The British account for 42% of the total for these five groups. The statistics from the Census show that there were 34,791 British in Hong Kong, while 6,542 persons or 19% were in Central and Western District in 2016. The proportion was the same as 2011. However, Southern District, covering areas from Pok Fu Lam to Shek O, witnessed the largest decline of the British population, declining from 14% to 10%, while Lantau increased the other way around from 10% to 14% in five years.

The French represent the fifth largest Western expatriate community, which has been expanding significantly over the past four years. According to data from the French Chamber, the majority (46%) of French expatriates live on the north side of Hong Kong Island. Southern Side areas including Repulse Bay, Stanley and Tai Tam are also popular districts for French families.

The population of Asian expatriates has increased the fastest in Hong Kong over the past five years. However, domestic helpers account for the largest proportion of this segment. In addition, Asian expatriates are less concerned about the international school network as mainland Chinese have a high proportion of children entering local schools.

Desirable non-core locations

Despite some expatriates considering relocating, the popularity of traditional districts should not fade as their properties and communities have been well-established. For people who started to explore non-core locations and examine the possibility of relocation, here are some emerging districts that we would recommend based on the growing demand we have seen.

Island West

The only district on Hong Kong Island we have taken into consideration is Island West. Island West gained attention after the West Island Line was completed in 2016. Previously only connected via the road network, accessibility has been increased and travelling time has reduced significantly, especially for residents who stay in the western part of Kennedy Town and need to travel across the harbour. Apart from the improved infrastructure, Island West has had a new supply of 3,233 units over the past decade leading to September 2017, mostly consisting of small but high-end apartments. Located on Hong Kong Island, Island West is close to most international schools in Hong Kong. The community has been diversifying, with an increasing number of bars and high-end restaurants replacing the traditional old shops. Districts such as Soho, Sheung Wan, and Sai Ying Pun are popular areas for Western expatriates.

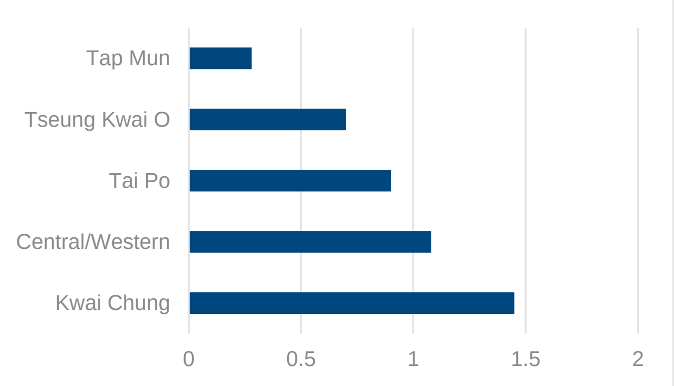
Kowloon Station/Olympic Station

The second district that should attract new demand is West Kowloon, including Kowloon Station and Olympic Station. Despite their location on the other side of the harbour, the two areas in Kowloon are close to the CBD in Central. They are connected to Hong Kong Station in Central through the MTR's Tung Chung Line. In addition to the existing infrastructure, the West Kowloon area will benefit the most from the completion of the Express Rail Link. The West Kowloon Cultural District provides arts and cultural venues, and museums that will increase the desirability of the area. Developments atop both stations benefit from the best quality design and renovation, while the building age for the developments are around 10-20 years, newer than traditional districts on Hong Kong Island. Despite the strategic location and good quality buildings, the monthly rent of the area is about HKD35-45 (USD4.5-5.8) per sq ft. The area offers smaller units suitable for families with housing budgets of HKD20,000-30,000 (USD2,571-3,856) per month.

Sai Kung

Sai Kung being the sixth largest expatriate community in Hong Kong is the most remote area that we have looked at. Despite its remoteness from the urban core and CBD, Sai Kung has the best country life and community balance that most expatriates look for. Located in a natural neighbourhood and near country parks, Sai Kung has the best air quality. According to the Environmental Protection Department, Tap Mun Monitoring Station recorded the lowest concentration of NO_2 in Hong Kong. While seven new schools are expected to open in Kowloon and Tseung Kwan O in the coming two years, Sai Kung will be convenient for families who have members studying in the new schools, given that some school bus networks may not extend to the southern part of Hong Kong Island.

Annual AQI Values of NO_2 (Jul 2016 - Jun 2017)



Source: Environmental Protection Department

District Comparison

	Island West	Kowloon Station / Olympic station	Sai Kung
Number of units <10 years	3,233	522	733
Largest expat community	British	British	Australian
Travelling time to Central	10 minutes	13 minutes	32 minutes
Travelling time to Kwun Tong	22 minutes	14 minutes	24 minutes
Infrastructure	West Island Line	Tung Chung Line/ Express Rail Link	Minibus
Approx. rent per sq ft (gross)	HKD35-60	HKD35-45	HKD30-40
Population density (person/ sq km)	19,391 (Central and Western)	13,484 (Tsim Sha Tsui West)	3,563

Source: Colliers. Note: Travelling time refers to the approx. time travelled by vehicles according to Google Map

Conclusion

Hong Kong is an expatriate-friendly city in terms of visa permission, local transportation, and lifestyle. Asian expatriates are increasing in numbers compared to Western expatriates as more companies are focusing on growth in the APAC region. However, Asian expatriates are more evenly distributed in the investment and leasing segments, and in different locations. Most leasing demands for luxury units in the traditional luxury districts still come from Western expatriates.

Despite having the second highest population density in the world, Hong Kong has only developed 7% of its total land area for residential use. While Hong Kong is already one of the world's most expensive cities, home rents should continue to increase due to the organic growth of population amid limited supply of residential units.

We expect new completions to reach an annual average of 18,500 units in the private residential market from 2017 to 2019, of which only 2.4% of will be large units. Shatin alone will have a potential supply of more than 500 large units. However, the Peak, Mid-levels, and Southside will only have about 400 large units completed in the next three years which will represent only 0.7% of the total potential future supply in the short term.

Tenants may start to ask themselves if they should buy a flat for owner-occupation or continue to lease amid the rising rents. There is no absolute answer but here are some factors that occupiers should consider. Firstly, Hong Kong residential property yield is the lowest globally, only 2% for large units according to the government figure. Although rental return is irrelevant to an owner-occupier, low yield indicates renting is more cost-effective than buying in Hong Kong compared to other countries. Secondly, non-Hong Kong permanent resident buyers in Hong Kong are obliged to pay a 15% Buyer's Stamp Duty and a 15% Ad Valorem Stamp Duty on any residential purchases in Hong Kong, totalling a 30% extra cost on top of the property value. Thirdly, we expect that price increases will start to feel pressure from the growing interest rates and new supply in the medium term. Besides, the declining owner-occupation ratio of the private housing market is indicating more occupiers are shifting to the leasing market as home prices have become too expensive.

As new land is scarce in the urban core, developers should start expanding their portfolios by offering their residential properties for lease. Leasing properties will provide a stable income when prices start to face pressure from increasing new supply and interest rates. Our analysis has shown that new developments should receive desirable rental income even if they are not large units located in traditional districts.

More expatriate families are willing to move to decentralised districts to save costs on their children’s education. Properties falling within the catchment area of a new international school are popular among families. International school placement has been a key concern with expatriates who need to start their search earlier to guarantee a spot for their children when they arrive. However, it is getting difficult for expatriate families to send their children to their preferred schools in Hong Kong. Other locations such as Island West, Kowloon Station/ Olympic Station, and Sai Kung can be desirable locations to live in given their proximity to the school network and CBDs, and the existing community and liveability.

We expect that the traditional districts will continue to be the hotspots of leasing. Central/Admiralty should remain Hong Kong's largest financial hub and the major CBD, supporting the value and the expatriate community of the Central and Western District. However, we recommend prospective tenants to consider new areas with more affordable rents and increasing amenities. We also think the changing dynamics and decentralisation of the luxury residential leasing market will become obvious, as a result of urban regeneration with new residential and commercial clusters arising over the next few decades.

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