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The secondary market is set to rebound

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Hong Kong residential prices have risen for 23 consecutive months, recording an increase of 34.1% over the whole period. Transaction volume declined in the primary market, while the secondary market regained momentum as the government extended the period for rebating stamp duty from six to 12 months for upgraders. We expect overall home price to increase 8-10% in 2018, and to stay firm in 2019 as low interest rates persist.

Forecast at a glance

Supply
We expect supply to increase further in 2018 to around 20,000 units, which will be 12% higher than 2017. Number of annual completion is likely to stay between 15,000 and 18,000 units for the next three years.

Demand
Pent-up demand has remained strong and has supported price growth in the mass market. PRC buyers have been active on acquiring ultra-luxury units.

Rent
We expect luxury residential rents to increase 4.2% over 2018 and 2019. A positive business outlook should continue to support leasing demand amid tight supply.

Price
In 2018, the overall residential price should increase by 8-10%. Residential prices should increase moderately in 2019, and should go flat in 2020 as a result of increasing supply and rising interest rates.

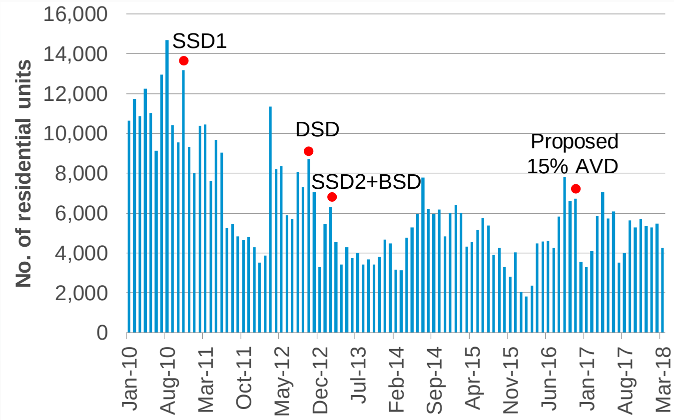
Stamp duty policies amended for stimulating the secondary market

A strong momentum has maintained during Q1 2018 with demand staying strong. Hong Kong's residential prices have increased over 23 consecutive months, recording an increase of 34.1% over the whole period. During his press conference after the Budget Speech, Financial Secretary Paul Chan reaffirmed that there is no plan to relax any cooling measures in the near future.

Total transaction volume has declined 8.0% QOQ to 15,015 units due to a soft primary market. Transaction volume for the primary market was down 35.7% QOQ, due to fewer units being launched for sale. Despite the decline, pent-up demand has remained strong in view of oversubscription situations and strong sale performances of particular new developments, buyers have become more selective due to high prices.

Thanks to the Stamp Duty Amendment Bill, which allows home owners to rebate the stamp duty if they offload their first property within 12 months instead of six months after purchasing their secondary property, the secondary market has recorded 12,281 transactions in the quarter, up 1.7% QOQ, the highest since Q1 2015.

Residential Sales and Purchase Agreements



Source: The Land Registry

Local developers regained market share

HNA Group has sold three of its sites acquired in the Kai Tak area in 2016 and 2017 to local developers due to capital controls. China's National Development and Reform Commission has been monitoring overseas property investments by PRC buyers in 2017 more closely, likewise, China Banking Regulatory Commission has required banks to check their credit exposure to selected companies including HNA. However, we think that the sale of the land parcels by HNA is not material for other PRC buyers' trying to purchase properties in Hong Kong. However, PRC buyers should be less aggressive than before as capital outflow restrictions for overseas real estate investments remain firmly in place, moderating upward pressure on land prices. They may also show stronger interest in smaller land parcels.

Further boost on the rising prices

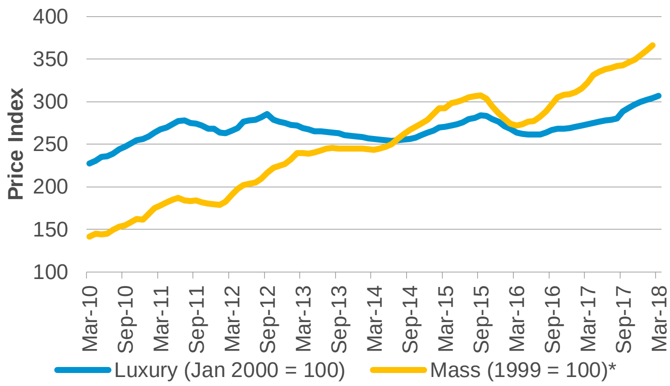
The overall residential price index has increased 4.9% QOQ. The price growth of the mass market has been the main driver, which has also increased 4.9% QOQ. The new development MALIBU in LOHAS Park, Tseung Kwai O has sold 1,070 units in two weeks. The developer has increased selling price by 9.7% for the latest batch from the first batch of units being launched in response to the strong demand from end-users.

The luxury price index which represents the price growth for luxury units on The Peak, Mid-levels, and Southside increased 2.4% QOQ. The market has regained momentum as more buyers plan to sell their properties during the market peak. However, the number of available stock is still fewer than that of buyers.

PRC buyers remain as the major demand for ultra-luxury units. Mount Nicholson, the new luxury redevelopment on The Peak continued its record selling spree. A PRC buyer purchased Unit C&D on the 11th floor in Phase 3 for a total of HKD1,137 million (USD146 million). The unit prices were HKD128,413 (USD16,505) per sq ft, which were the second highest records for strata residential units in Hong Kong. A duplex flat in Dynasty Court in Mid-levels was sold for a record unit price at HKD56,850 (USD7,307) per sq ft to a PRC buyer.

PRC groups were also active on purchasing in other districts. A Guangdong group was reported to have purchased 13 houses in Grand Riviera in Tsuen Wan for a total of HKD1 billion (USD128 million). Meanwhile, a PRC developer Fullsun International has spent HKD920 million (USD118 million) to acquire the 17-storey apartment at No.6 La Salle Road in Ho Man Tin.

Hong Kong Residential Price Index



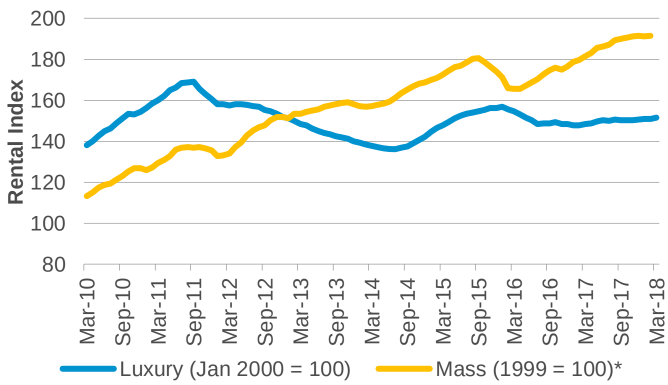
Source: Colliers; Rating and Valuation Department
Note: Luxury index represents luxury residential units in The Peak, Mid-levels and Southside. *refers to the units smaller than 1,076 sq ft

Leasing market picked up steadily

Leasing demand remained strong in Q1 amid low supply, landlords remained firm on asking rents as the number of enquiries increased. Owners who planned to have their flats leased quickly offered longer rent-free periods for their tenants instead of lowering rents. Apartments with monthly rents lower than HKD150,000 (USD19,280) per month have been popular and leased out quickly amid the strong demand.

Rents on the Peak has increased 1.3% QOQ. Particular owners have become aggressive in asking rents as they saw a trend in rising rents, but tenants who can afford a monthly rent higher than HKD200,000 (USD25,707) are not common in the market. Owners had to adjust their asking rents slightly to secure tenants. Rents in Mid-levels and Southside both increased 0.3% QOQ. Although the two areas remained tight, landlords consider high occupancy as their priority and have kept rents stable. Shouson Hill especially the apartments close to the MTR station have become more popular.

Hong Kong Residential Rental Index



Source: Colliers; Rating and Valuation Department
*refers to the units smaller than 1,076 sq ft

Low land supply in 2018

During the Budget Speech on 28 February 2018, the government announced that the future residential completion target for the next five years will increase to 20,800 units per year on average. The amount would be 50% higher than the average annual completion of the past five years. However, there was insufficient medium-to-long term initiatives to resolve the acute housing problems.

The government plans to sell 27 sites for residential development in FY2018/19, including 15 sites to be rolled over from FY2017/18. Together with railway property development projects, the Urban Renewal Authority's projects, and private development/ redevelopment projects, the total new supply is estimated to be 25,500 flats in FY2018/19, which is the lowest since 2011.

Weak Hong Kong dollar might hint interest rate to increase

The US Federal Reserve has raised interest rates by another 25 basis points on 21 March 2018. However, Hong Kong prime rates remained at 5%. Due to the dollar pegged system, Hong Kong Interbank offered rate (HIBOR) and the US London Interbank Offered Rate (LIBOR) should tend to converge due to the dollar pegged system. As of mid-March, the market recorded a 100 basis points spread between the two rates, the biggest spread since 2008.

While the HKD has depreciated against the USD, and is approaching the weak end of the band of the dollar pegged system at 7.85, the monetary base in Hong Kong could shrink and local rates could normalise when the Hong Kong Monetary Authority (HKMA) starts to lift the exchange rate. Although interest rates in Hong Kong are likely to follow the expected hikes in US Federal Fund Rates, the short-term interest rate in Hong Kong (as represented by three-month HIBOR) currently stands at only 1.3%. Oxford Economics forecasts that the Hong Kong short-term interest rate will rise to 1.6% by end-2018 and 2.4% by end-2019. At the same time, it forecasts CPI inflation of 2.3% by end-2018 and 1.9% by end-2019. Accordingly, Oxford Economics now assumes that the real short-term interest rate in Hong Kong will turn positive in Hong Kong in Q2 2019 - for the first time since the Global Financial Crisis. However, it expects the real short-term interest rate to stay below 1.0% until end-2020. While interest rates in Hong Kong are clearly now tuning upwards, in real terms they should therefore remain very loose for the next couple of years[1].

The market should stay resilient

There were concerns about PRC developers pushing land prices up and making Hong Kong's residential prices even more expensive. The sale of HNA's sites indicated that the Central government has been strengthening its supervision on overseas investments. We expect Hong Kong developers to regain market share and dominate the land sale market again in 2018.

We expect new completions to reach an annual average of 20,000 units in the private residential market from 2018 to 2020. In the medium term, we expect the MTR property projects will play a bigger role in the supply market, given a portion of the Shatin to Central Link expected to be completed by the end of this year. MTR Corp aimed to tender out four property packages totalling around 4,200 residential units in the next 12 months, and expected over 18,000 residential units to be completed over the next six years.

We reaffirm our forecast for 2018 that prices for the mass market will increase by 8-10%, and that the luxury market will grow by 3-5%. Residential prices should increase moderately in 2019, and should go flat in 2020 as a result of increasing supply and interest rates.

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[1] Oxford Economics, "Country Economic Forecast Hong Kong", 13 April 2018

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