Colliers Quarterly

HONG KONG | RESIDENTIAL

Q2 2017
26 July, 2017

Colliers INTERNATIONAL
Accelerating success.

No clear bubble despite fast-rising prices

Zac Tang Senior Analyst | Hong Kong

Despite the latest round of property cooling measures and US interest rate increases, the Hong Kong residential market has regained momentum with a total value of residential transactions rising 43% in Q2 over Q1. Overall home prices increased 3.7% QOQ. The market continued to be dominated by end-users rather than investors. The primary market has driven the price growth but there are signs of slowing down in recent sales. For H2 2017, we expect home prices to continue to rise but at a more modest pace. We expect negative real interest rates to persist till late 2018, supporting residential prices.

Forecast at a glance

Demand
Transaction volume rose 43% QOQ to 18,892 units as the market was mainly driven by end-users and the impact of cooling measures has been digested quickly

Supply
Given that construction work of around 15,000 and 19,000 uncompleted units started in 2015 and 2016 respectively, the completion target of 20,000 units per year is looking more achievable in 2017 and 2018 even though the target has been missed over the past five years

Rent
Overall luxury rent improved further with Mid-Levels and Southside being the most active areas. We expect rent to increase by another 0.9% in H2 amid limited leasing supply

Price
Home prices are set to grow by another 1.4% in H2 with more supply coming up. Increasing interest rates are unlikely stop price growth before late 2018, where we expect Hong Kong to move back to positive real interest rates

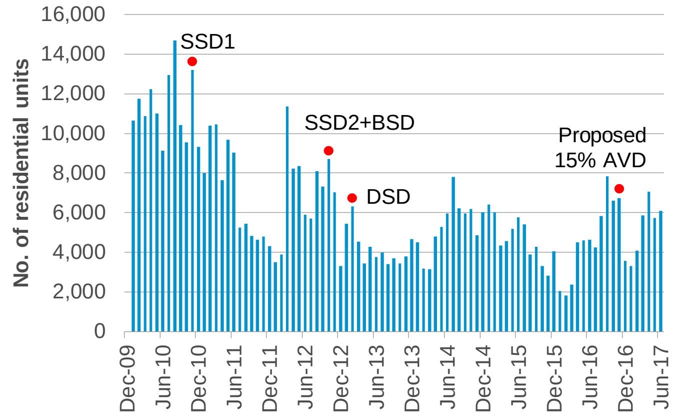
Limited exposure to risk

The 20th anniversary of the establishment of the Hong Kong Special Administrative Region reminded property players of the burst of the housing bubble in 1997. However, now that speculative activity has almost vanished from the market and tighter lending measures have been introduced by the Hong Kong Monetary Authority (HKMA), we believe the market's exposure to credit risk is limited. Solid market fundamentals have driven up prices, and in our view the upward price cycle has not yet reached a turning-point due to strong demand and a shortage of supply. Given that construction work of around 15,000 and 19,000 uncompleted units started in 2015 and 2016, respectively, the completion target of 20,000 units per year is becoming more promising despite missing the target over the past five years. However, supply is unlikely to overtake demand in the short term.

Local first-time buyers were unaffected by the HKMA's mortgage-tightening measures targeting borrowers of multiple home loans whose income sources come from outside Hong Kong. As buyers generally believe a sharp decline in prices triggered by the burst of a supposed housing bubble to be unlikely, the mass market has benefited from the demand from lower-net-worth buyers who only enter the market when the outlook is at the least uncertain stage.

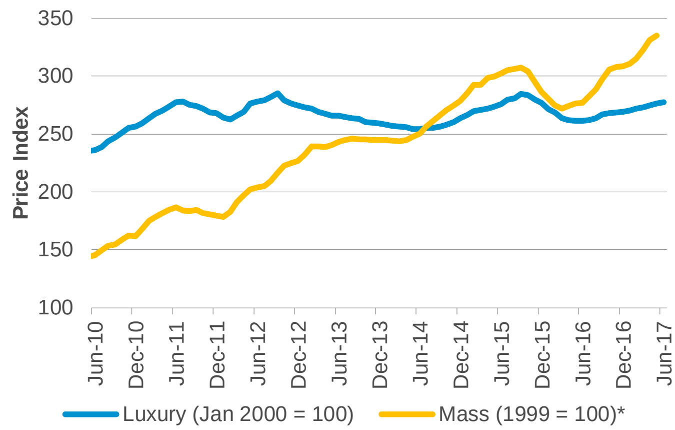
In addition, market sentiment continued to be supported by the strength of the Hong Kong stock market (up 22% over the last 12 months) and by robust economic conditions (Q1 real GDP growth of 4.3% YOY was the highest quarterly figure since 2011, and strength continued into Q2). Activity picked up further from Q1 as the market quickly digested the impact of the higher stamp duty policy introduced in November 2016. Total transaction volume rebounded to 18,892 units in Q2, 43% higher than the volume in Q1. Both the primary and secondary markets increased 75% QOQ and 31% QOQ.

Residential Sales and Purchase Agreements



Source: The Land Registry

Hong Kong Residential Price Index



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

The government sold two residential sites in Q2 and both were awarded to the Chinese developers. Site 1 in Kai Tak Area 1K was sold to the joint-venture of KWG Property and Longfor Properties for HKD7.23 billion (USD0.93 billion) or HKD12,563 (USD1,610) per sq ft, or about 5% above market expectations. A residential site in Kwun Chui Road, Tuen Mun Area 56 was awarded to another mainland group, Road King Infrastructure and Shenzhen Investment, for HKD3.17 billion (USD0.41 billion) or HKD6,700 (USD859) per sq ft, or about 22% above market expectations. So far in 2017, the government has sold five residential sites for a total value of HKD40.2 billion (USD5.2 billion), all of them were awarded to Chinese developers. Facing strong competition from the Chinese developers, local developers have to rely on the conversion of agricultural land banks or redevelopment for future project pipelines.

Low financing cost is the key driver

Negative real interest rates have been an important factor driving home prices in Hong Kong since the Global Financial Crisis in 2008-09. The home price index has increased by 211% since January 2009 when Hong Kong real interest rate entered the negative territory. Hong Kong interest rates are heavily influenced by US rates because the Hong Kong dollar is pegged to the US dollar. Although the US Federal Reserve raised its benchmark rate three times in the last eight months, banks in Hong Kong have yet to raise their prime rates due to strong monetary liquidity and fierce competition in the mortgage market. The low lending rates are critical to encouraging home purchases especially in the primary market. Developers are also offering generous financing packages to buyers.

Prices for mass units, or small-to-medium sized units, were further driven by the primary sales. Developers have been increasing selling prices after several rounds of launches of new development projects were oversubscribed. Cheung Kong's new development in Tsuen Wan, Ocean Pride, was one of the most popular new developments in Q2; it was reported to have increased unit prices by 7-10% within three weeks.

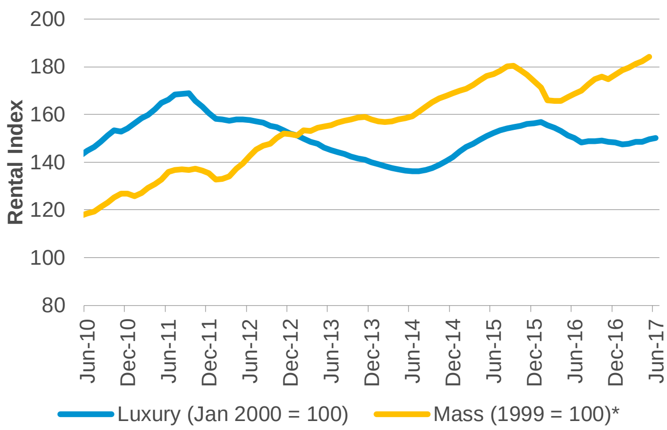
In the secondary and luxury market, prices stayed firm in Q2 as owners had strong bargaining power due to limited stock. While owners were generally less willing to negotiate, buyers were financially strong and were willing to secure their favourable purchases with high prices. This move drove overall private residential prices to increase in Q2, up 3.7% QOQ with luxury residential price increasing 1.6% QOQ.

Moderate growth in luxury rents

The leasing market has regained momentum in Q2. With leasing activity picking up, the overall luxury residential rent increased 0.7% QOQ. Southside remained the most active district given its proximity to international schools. However, rent here remained stable due to low transaction volume and limited stock. Considering that the value of their properties has increased due to rising prices, some owners have put their properties up for sale instead of leasing. This has put further pressure on the total available leasing stock. Less expensive units, i.e. those with a monthly rent of between HKD20,000 and HKD80,000 (USD2,564-10,256), have become the most targeted range by expatriates while the market for ultra-luxury units remained relatively quiet.

The opening of new schools and improved infrastructures, together with the decentralisation of operations from Central to other business districts across the harbour, have supported the demand for luxury apartments in Kowloon and New Territories. Expatriate leasing activity in Kowloon and New Territories is on the rise, with Sai Kung being the most sought-after district in Q2.

Hong Kong Residential Rental Index



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

Market to stay resilient in H2 2017

Recent economic news suggests that US economic growth should continue at a moderate pace with the Federal Reserve likely to raise interest rates only slowly. This is because there are few signs of economic overheating: wage growth is not yet rising meaningfully and recent readings suggest that inflation is slowing down.

The low probability of rapid US interest rate increases reduces the chance of a rapid return to positive real interest rates in Hong Kong. Therefore, we do not expect Hong Kong to return to positive real interest rates until late 2018. Right now, Hong Kong's three-month Hong Kong Inter-bank Offered Rate stands at 0.78%. Home buyers can easily finance new purchases since mortgage rates stand at about 2%.

We expect the completion of private residential units to increase gradually to the government's annual target of 20,000 units over the coming two years. However, as private residential supply has been insufficient since 2005, an oversupply situation is unlikely to be reached because the amount of new supply in the next two years will not compensate for the accumulated shortfall over the past decade.

It is possible to see price growth slow down or even experience a short turmoil if a wave of new launches of large-scale development projects cannot be sold out quickly. However, we expect any downward adjustment to be short and brief within a range of 3-5%, and to be followed by a rebound until the market supply overtakes the market demand. The market will then have to look for a new equilibrium at a lower price level. Increasing supply and interest rates will unlikely stop price growth until late 2018, where we expect Hong Kong to move back to positive real interest rates. We maintain our positive outlook for H2 2017 with the expectation of a 10% price growth for the whole year. We believe that the increasing supply could decelerate price growth in the next few years but a sharp decline in prices triggered by the bursting of a supposed housing bubble seems unlikely.

For more information:

Nigel Smith
Managing Director | Hong Kong
+852 2822 0508
nigel.smith@colliers.com
Individual Licence No: E-111570

Clara Chu
Senior Director | Residential Services
+852 2822 0667
clara.chu@colliers.com
Individual Licence No: E-046766

Daniel Shih
Director | Research
+852 2822 0654
daniel.shih@colliers.com