

Home prices rise despite tighter cooling measures

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Private residential prices increased over Q1 2017 despite the new 15% stamp duty on residential purchases for property owners. Market sentiment stayed strong, belying the government's belief that price increases were driven by speculative multiple-unit purchases under a single contract. Amid the tighter measures on multiple-unit purchases, we expect home price growth to stay firm due to strong domestic demand.

Market at a glance



Demand

Transaction volume dropped 22% QOQ due to the increased stamp duty for property owners and may further decline due to tightening housing measures



Supply

The government forecasts 17,120 private residential units to be completed in 2017, an increase of 17% from last year



Rent

Luxury residential rental trends point to stability. Relocation has driven leasing demand amid high occupancy



Price

We expect price growth to stay positive and forecast a 3-8% increase in 2017, reflecting strong domestic demand

Activity hit by tougher curbs

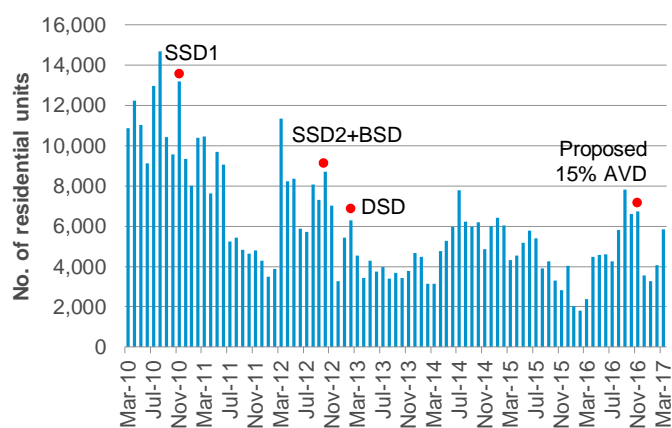
Against the backdrop of rising interest rates, capital outflow controls in China and the 15% ad valorem stamp duty (AVD), private home prices increased further over Q1 2017. Financial Secretary Paul Chan Mo-po has stated that there is no immediate urgency for Hong Kong to follow US rate hikes; HSBC's Best Lending Rate has been maintained at 5.0% while local banks have chosen not to raise their rates due to a competitive mortgage market and a large amount of international money parked in Hong Kong.

Market appetite remained strong due to low interest rates and an active land sale market helped to boost confidence. Chinese groups maintained their active participation in the market. Notably, HNA Group has not stopped its shopping spree and has acquired two more sites in Kai Tak for a total consideration of HKD13.0 billion (USD1.7 billion). The total residential gross floor area held by HNA Group in Kai Tak increased to 2.0 million sq ft (186,000 sq m), with the average accommodation value standing at HKD13,400 (USD1,726) per sq ft. Chinese developers also expanded their footprints in the Southern District. Logan Property and KWG jointly acquired the residential site of the former Hong Kong Motor School in Ap Lei Chau with a record bid of HKD16.8 billion (USD2.2 billion) or HKD22,118 (USD2,850) per sq ft. Meanwhile, Ping An Real Estate lined up with Road King Infrastructure and outbid 13 other bidders for the 576,950 sq ft (53,600 sq m) by GFA residential development atop the Wong Chuk Hang MTR station. The capital outflow controls in China have not kept these developers away from the Hong Kong property market.

Despite strong market appetite and demand, investment activities has been restrained by the 15% AVD, with the number of Double Stamp Duty cases (now the 15% AVD which applies to purchases of non-first time buyers) down to below 410 cases for three consecutive months from December to February, compared to a monthly average of 1,397 cases from 2015 to 2016. The tough stamp duty also affected the overall buying sentiment and increased pent up demand, with overall residential transaction volume down 22% QOQ.

An increasing number of first-time home buyers acquired multiple units in a single transaction as they were still considered as non-property owners who were only required to pay ad valorem stamp duty (AVD) according to the ratios of Scale 2 (HKD100 - 4.25%). Therefore, transaction volume rebounded in March, indicating investment demand still strong in the market. According to Anthony Cheung, Secretary for Transport and Housing, the number of multiple units purchased under one contract increased to 4.7% of total residential transactions in March. Assuming all multiple unit purchases happened in the primary market, the number of multiple-unit purchase equals 19% of total transaction volume in the primary market.

Residential Sales and Purchase Agreements



Source: The Land Registry

Home prices continue to hit record highs

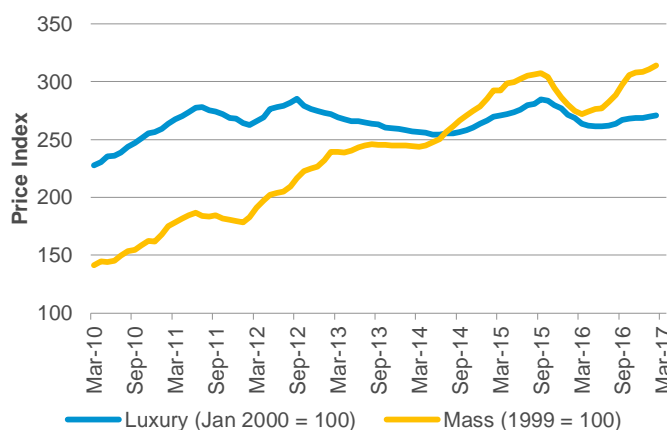
While the new stamp duty has curbed transaction growth in the market, it has not been effective in pressuring price growth. Overall home prices increased 1.6% QOQ in Q1 and have increased for 11 consecutive months amid strong user demand and low interest rates. Developers increased home prices after initial batches of units were snapped up quickly in new developments. Developers typically offer up to full subsidies on the 15% AVD and a comparable percentage of discounts to local first-time buyers to boost sales. They could still maintain the project margins by pushing up the face prices before buying incentives. This marketing strategy has helped boost market sentiment, resulting in further price growth.

Further tightening of the cooling measures has reduced the market liquidity in the secondary market. With lower

supply, owners are not willing to sell and reinvest, and vendors have a stronger bargaining power. This factor has helped home prices to increase, especially in the luxury market.

The ultra-luxury market has remained resistant to all the headwinds. There were various record-setting house acquisitions on the Peak. For example, in February, a mainland investor acquired a house at Mount Nicholson on the Peak for HKD720 million (USD93 million) or HKD89,032 (USD11,475) per sq ft.

Hong Kong Residential Price Index



Source: Colliers; Rating and Valuation Department

Luxury rents point to stability

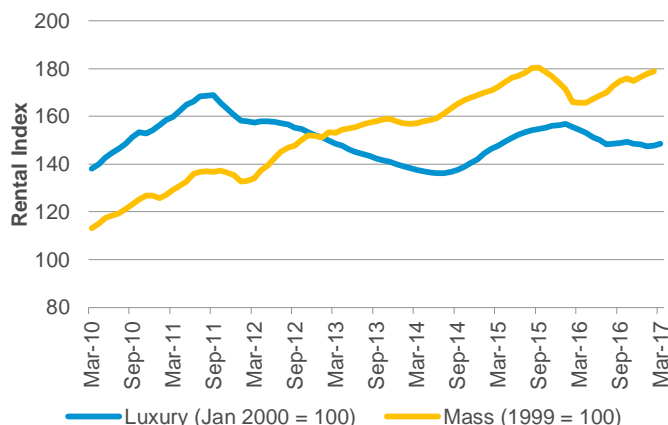
Leasing activity picked up in February and March after a subdued market in January. Despite improved global business sentiment, multinational companies have kept their housing allowances low, causing a shift in leasing demand away from the top-end segment. However, luxury rent stayed flat thanks to high occupancy rates.

Leasing demand for flats with monthly rent of over HKD100,000 (USD12,885) remained subdued. The leasing demand has shifted to more affordable options, flats with monthly rent of HKD40,000-80,000 (USD5,155-10,310). Overall leasing demand in the luxury market was driven by relocations and the increasing number of expatriates. Landlords did not see the need to offer discounts amid the low vacancy, while some landlords actually raised their asking rents. Flats with monthly rent of HKD20,000-50,000 (USD2,575-6,445) have been the most active as they are also popular among domestic users.



MNCs, banking and financial institutions have no intention of raising housing budgets in the short term. However, the weakening demand for the top-end segment should continue to slow the overall luxury rental growth. We assume, therefore, that rent in the luxury residential market will continue to trail behind the overall market in 2017.

Hong Kong Residential Rental Index



Source: Colliers; Rating and Valuation Department

End-users demand for property to stay strong

The government believes that the purchase of multiple units under a single contract has made the stamp duty policy less effective. The Hong Kong Monetary Authority has reminded banks to be prudent when lending to investors who buy multiple units with a single contract.

To close the policy loophole, Chief Executive CY Leung has announced that the 15% AVD will apply to all buyers who purchase multiple residential units with effect from 12 April 2017, with the exception of a home purchase with a rooftop, a car parking space, a garden, or two adjacent housing units with a joint partitioning wall that can be demolished. The Inland Revenue Department will recognise these purchases as one single residential unit.

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However, we believe that the impact of the tighter measures will be more significant on transaction volume than on price growth. The Rating and Valuation Department has released a preliminary figure of private residential completions in 2017 of 17,120 units, below the government target of 20,000 units per year. The shortage of supply is yet to be solved.

Meanwhile, we assume that demand in the Hong Kong residential property market will continue to be supported by negative real interest rates. Despite rising US interest rates, we do not expect Hong Kong to return to positive real interest rates until late 2018. There is a risk that faster than expected US economic growth will mean an earlier return to positive real interest rates for Hong Kong, but at this stage the chance does not seem great.

Incidentally, the impact on the Hong Kong residential market of potential weaker demand from Chinese buyers due to stricter controls on capital outflows and likely slower renminbi depreciation should be modest. The number of Buyer's Stamp Duty cases, which represents the demand from non-Hong Kong buyers, currently accounts for less than 10% of total residential property transaction volume. As the new measures are designed to help end-users and especially first-time buyers to make purchases, domestic demand should stay strong and continue to support increasing home prices in 2017.