While 2019 will be a different year in many aspects, we have confidence in Hong Kong’s resilience against adversities and the number of opportunities in the property market.

Regarding specific property markets:

- CBD fringe areas have a better combination of business amenities and affordable rents for occupiers considering moving away from core-CBD.

- Expanding retailers should look for first-tier high street locations, leveraging the adjusted rental level.

- Families should look into Kowloon for more affordable residential rental options, combined with new schools.

### Summary & Recommendations

While 2019 will be a different year in many aspects, we have confidence in Hong Kong’s resilience against adversities and the number of opportunities in the property market.

**Office**
- We expect industrial price and rent to continue to grow by 8.4% and 5.4%, respectively, amid the lack of new supply and revitalisation scheme, which is lowering the total industrial stock.
- The declining stock market and the US-China trade dispute have weighed on sentiment in Hong Kong’s residential market - affecting prices. However, rents should stay firm as we expect leasing demand to remain strong.
- The total transaction volume in 2019 will likely be lower than 2018, especially during H1 as many investors have been taking a wait-and-see approach. We expect the general office investment yield will increase by 0.3% to an average of 2.6% in 2019.

**Vacancy**
- CBD rents should adjust due to the slowdown in the expansion of mainland Chinese companies. Investors are waiting for the opportunity to return once the price adjustment period is over.
- Prime street retail rents should continue to grow slowly, between 1.7% in 2019 except for Central, which we believe will remain under pressure as shop spaces are larger than retailers currently prefer.

**Capital Value**
- Investment Sales

### Source
Colliers International

**Note:** USD1 to RMB6.61 as of end-Q2. 1 sq m = 10.76 sq ft
INVESTORS ARE STILL CONFIDENT IN HONG KONG’S PROPERTY MARKET

After two years of above average performance, Hong Kong’s economic outlook for 2019 should largely hinge on the outcome of the current round of US-China trade negotiations. The result may come as early as 1 March 2019, 90 days after the G20 summit between President Xi and President Trump. Nonetheless, Oxford Economics has cut its 2019 real GDP growth forecast for Hong Kong to 2.2%, the slowest since 2016\(^1\).

A further slowdown of China’s economy in 2019, with a government target of 6.0%-6.5% annual growth rate, will likely add pressure on Hong Kong’s growth prospects.

While Hong Kong’s external trade and inbound tourist arrival figures in 2018 have not been immediately impacted by the trade war, we shall observe these figures closely in 2019 as they would have direct implications for the industrial and retail property sector rents and prices.

While the market sentiment definitely turned negative by end of 2018, institutional investors are still confident in Hong Kong’s property market. The results of Colliers’ Annual Hong Kong Investor Survey Report 2018 show that investors have been taking a wait-and-see approach, starting in H2 2018. With abundant liquidity and the prospect of less interest rate increases in 2019, we expect that investors will return to the market once property prices have stabilised. A moderate recovery in residential market in H2 2019 will be possible if the market reaches bottom before mid-year.

We believe the industrial property sector has the largest upside potential with the expectation of a new round of industrial revitalisation.

\(^{1}\) Oxford Economics Country Economic Forecast – Hong Kong, 19 December 2018

Investors’ view of price movements for Hong Kong property sectors in 2019

<table>
<thead>
<tr>
<th>Sector</th>
<th>% of investors expecting price changes for each sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office</td>
<td>&gt; -15%</td>
</tr>
<tr>
<td>Industrial</td>
<td>48%</td>
</tr>
<tr>
<td>Retail</td>
<td>48%</td>
</tr>
<tr>
<td>Residential</td>
<td>55%</td>
</tr>
</tbody>
</table>

Source: Colliers International
OFFICE LEASING: DECOUPLING THE CBD AND NON-CBD AREAS

In the past few years, the influx of PRC companies has pushed up rents in Central and driven down vacancy. As a result, the rental gap between core-CBD and other areas has been widening. However, we are likely to observe a shift of momentum in 2019. Office supply in Central is growing due to a scaling back by some PRC companies and the addition of surrendered space during the current financial market decline. We expect Central/Admiralty rents to drop by 3.8% in 2019, a healthy correction following an over 40% growth since early 2015.

While Central is still the preferred location by the financial sector and MNCs, we consider the CBD fringe areas, i.e. Sheung Wan, Wan Chai and Causeway Bay, to have a better combination of business amenities and affordable rents for companies considering relocation from Central. Rents in CBD fringe areas are likely to see positive rent growth in 2019.

A slowdown in the office market should flesh out the viability of the co-working business model. Operators aggressively expanded their footprints throughout different districts across Hong Kong in 2018. Industry consolidation may be accelerated if the demand for co-working membership falls short of expectations.

OFFICE INVESTMENT: A BUYER’S MARKET FOR NOW

Hong Kong’s office market transactions amounted to HKD49.4 billion (US$6.3 billion) in 2018. Although activity slowed down considerably in H2 2018, Grade A office prices increased by 20% YOY. We expect office prices to drop by 5% in 2019 and investment yields to stabilise with rising capital costs. However, given a lack of supply for quality office stock, especially in the CBD, the current market downturn offers a good investment opportunity for potential buyers, especially end-users looking to occupy their own buildings, as good quality stocks are always in short supply.

2019 Grade A office rental forecast by district

<table>
<thead>
<tr>
<th>Tenant</th>
<th>End-2018</th>
<th>2019 Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central/Admiralty</td>
<td>+8.0%</td>
<td>-3.8%</td>
</tr>
<tr>
<td>Wan Chai/Causeway Bay</td>
<td>+13.6%</td>
<td>+2.3%</td>
</tr>
<tr>
<td>Island East</td>
<td>+8.0%</td>
<td>+3.5%</td>
</tr>
<tr>
<td>Sheung Wan</td>
<td>+5.9%</td>
<td>+0.8%</td>
</tr>
<tr>
<td>Wong Chuk Hang</td>
<td>+9.9%</td>
<td>+7.0%</td>
</tr>
<tr>
<td>Tsim Sha Tsui</td>
<td>+8.3%</td>
<td>+3.5%</td>
</tr>
<tr>
<td>Kowloon East</td>
<td>+4.2%</td>
<td>+2.0%</td>
</tr>
<tr>
<td>Overall</td>
<td>+6.0%</td>
<td>-0.6%</td>
</tr>
</tbody>
</table>

Source: Colliers International

Hong Kong Grade A office price trend (HKD)

Source: Colliers International
PRIME STREET RENTS: EXPECTING A SOFT PICK UP

Hong Kong experienced healthy growth in total retail sales and inbound tourist arrivals, which increased by 9.7% and 10.7% respectively between January and November 2018. Looking forward to 2019, we expect that the number of tourist arrivals will continue to grow, especially now that the Guangzhou-Shenzhen-Hong Kong Express Rail Link and the Hong Kong-Zhuhai-Macau Bridge have been completed. However, China’s weakening economy and possible further depreciation of the renminbi could discourage tourists from spending in Hong Kong.

Local consumption should continue to grow steadily, aided by a record low unemployment rate and rising household income. Key retailers continue to look for first-tier high street locations, leveraging the adjusted rental in the current shifted retail market landscape for a cautious expansion. Shops that come with a great street-front exposure are the most sought after, whilst retailers can compromise on the shop sizes given smaller size shops (below 3,000 sq ft) are the most popular and efficient to operate amid the influence of online shopping. We predict only a moderate pick up of prime street rents in 2019, of 1.7%, compared to less than 1% growth in 2018.

NEIGHBOURHOOD MALLS: AN ONGOING INVESTMENT FOCUS

Neighbourhood shopping centres have been an investment focus for local and institutional investors. Link REIT, Asia’s largest REIT, sold a batch of 12 local neighbourhood malls to a consortium led by Gaw Capital and Blackstone for HKD12 billion (USD1.53 billion) in 2018. In addition, investments in retail podiums in residential districts have been active. For example, Phoenix Property bought three retail podiums in the Tseung Kwan O area from Wheelock Properties for a total of HKD3.38 billion (USD432 million).

Neighbourhood shopping centres attached to new residential developments, where rents are marginally increasing YOY, can offer attractive value-added opportunities.

Source: Colliers International

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(1) SCMP, 12 December 2018; (2) Minitland, 9 October, 2018
RESIDENTIAL: NO GLOOM AND DOOM IN 2019

The residential prices index prepared by the Rating and Valuation Department rose 576% from July 2003 to July 2018. However, a further slowdown in the global economy in 2019 could threaten Hong Kong’s residential market. The current decline in the Hong Kong stock market, increasing loan ratios, rising interest rates and the US-China trade war suggest that residential market sentiment is hitting a turning point.

Declining investor confidence is likely to result in the continued fall of residential prices from August 2018 continuing into H1 2019. We do not expect a market collapse as the market has not been over-leveraged as in 1997-98. We believe that investors should look at the residential market again around mid-2019, when the impacts of rising interest rates and trade disputes become more apparent. In the most optimistic scenario, residential prices could stabilise by mid-2019 followed by a moderate recovery in H2 2019, with a whole year fall of 3.8% in 2019.

On the other hand, the leasing market should stay relatively firm as rental growth has been less volatile than price growth amidst a steady demand from tenants. The luxury residential leasing market should be mostly immune to downside risk, as landlords did not aggressively increase rents during the last upcycle, from Q3 2014 to Q2 2018.

While tenants are likely to be disappointed as residential rents in traditional luxury markets should stay relatively firm, they can search for more affordable options in other areas. The expansion of the MTR network and roads should improve connectivity and open up more districts, while new office supply in Kowloon East is scheduled to outstrip that of Hong Kong Island. As companies relocate across the harbour, families should begin to consider Kowloon and the New territories as places to live. They can benefit from the proximity to their workplace, as well as the new school campuses opening in the Kowloon East and Sai Kung Districts. We expect luxury residential rents to drop by 1% in 2019.
INDUSTRIAL PROPERTIES: SUPERCHARGED BY REVITALISATION SCHEME 2.0

We believe the US-China trade war will eventually take its toll on Hong Kong’s trade and logistics sector in 2019. Hong Kong’s total external trading figure was down by 0.8% YOY in November 2018, the first decline since 2017. However, the impact on industrial properties has been limited so far. Industrial rent and capital values increased by 8.9% and 15.1%, respectively, in 2018.

Looking forward, continuous conversion and redevelopment of industrial buildings for office, retail, hotel and residential use should sustain further rent and capital value increases in 2019. The previous revitalisation scheme between 2010 and 2016 has reduced the total industrial stock by 15.9 million sq ft (1.48 million sq m) or 6% of total existing stock. Forced relocation and a lack of new supply have pushed up rent and capital values by 121% and 230%, respectively, since 2010.

Hong Kong’s Chief Executive announced a new revitalisation scheme in her annual Policy Address in October 2018, and we expect the responsible bureau and departments to release more details in 2019. The key features of the new scheme include:

> Exempting the waiver fees incurred for wholesale conversion of industrial buildings aged 15 years or more
> Increasing the maximum permissible domestic plot ratio within certain “Residential” (R) zones up to 20% for redevelopment projects
> Allowing revitalisation schemes for industrial buildings to provide transitional housing
> Relaxing permissible uses for arts and cultural activities

The Colliers annual investor survey shows that many investors see industrial properties offering the best upside potential in 2019. Given the imbalance in demand and supply, we expect industrial rents and prices in 2019 to increase by 5.4% and 8.4% respectively.
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