PRICE STABILISING AMID THE SLOWER-THAN-EXPECTED INTEREST RATE HIKES

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Summary & Recommendations

Following a five-month correction from July 2018, Hong Kong's residential prices rebounded in the first two months of 2019.

With the US Federal Reserve indicating in March that interest rates will be stable in 2019, Hong Kong's interest rates should stay low, providing support to the residential market.

Home purchase demand should remain solid, driven by the recovering stock market and the widespread expectation of a slower pace of interest rate hikes, unless further market turmoil or global uncertainties arise.

Given the upcoming launch of the vacancy tax, landlords looking to lease should consider different strategies, such as integrating green living concepts, to improve the livability and competitiveness of their properties.

		Q1 2019	Full Year 2019	2018–23 Annual Average
Demand	> The total number of transactions increased 55% QOQ to 13,863 units. Buyer confidence is recovering with the widespread expectation of no interest rate increases in 2019.	▲ 13,863 transactions	▲ 60,000 transactions	▲ 60,000 transactions
Supply	> Over the next five years, annual completions could reach the government's target of 18,000 units at the highest.	▲ 540 units**	▲ 16,500 units	▲ 18,000 units

		QOQ / End Q1	YOY / End 2019	Annual Average Growth 2018–23 / End 2023
Rent	> Luxury residential rents should increase due to the limited supply and high demand. With more leasing activity, landlords are likely to consider increasing rents in 2019.	0.2% ▼ HKD47.1	2.0% ▲ HKD48.1	2.5% ▲ HKD53.4
Capital Values*	> Overall residential prices should continue to recover with an upside of 6.0% in 2019, unless further market turmoil strikes or the tension between US and China intensifies.	1.6% ▲ 365.2**	6.0% ▲ 381.1	3.1% ▲ 418.8

Source: Colliers International
*Provisional price index by Rating and Valuation Department, 1999 = 100. **as of February 2019. 1 USD = 7.8 HKD. 1 sq m = 10.76 sq ft

POSITIVE SIGNS AMID UNCERTAINIES

Buyer sentiment has been recovering with the stabilising stock market and the widespread expectation of slower interest rate hikes. In March, the US Federal Reserve decided to maintain the target range for the Federal Funds rate between 2.25% to 2.5%[1], indicating no further increase after trimming the number of hikes to two in December 2018[2]. Given Hong Kong's interest rates are effectively tied to US interest rates by the city's currency peg to the US dollar, Hong Kong's property market, in particular the residential sector, should benefit from the continuing low rate environment.

The strong local labour market and private consumption indicated firm market fundamentals, which supported the purchase confidence from end-users and home buyers looking for an upgrade. The government's low quantity of residential land planned for sale in FY2019/20, which should provide a total of 8,800 units and is the lowest annual amount since 2004/05, suggests a supply shortage is likely to remain. This will likely drive price increases.

The trade dispute between China and the US remains unresolved, and the negotiation has been delayed with no clear sign in either direction. However, China's Vice Premier had conducted talks in the US at the end of March indicating that the two countries have been working on a deal. We believe a more positive picture will result by mid-2019.

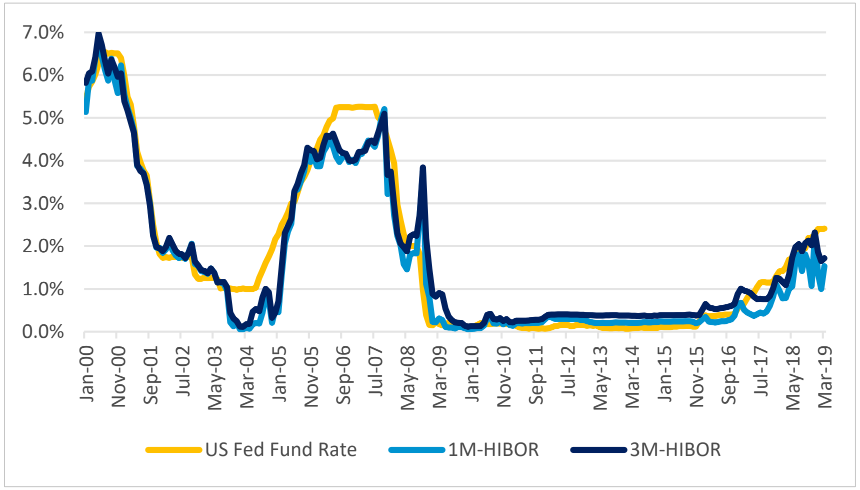
INVESTMENT MARKET IS REHEATING

Demand has been strengthening with the number of transactions increasing 55% QOQ to 13,863, according to the Land Registry. However, it is still lower than a five-year quarterly average of about 14,500.

The rebound mostly came from the active primary market, which saw the number of transactions increasing 60% QOQ to 5,500 units. However, the secondary market remained subdued with the number of transactions only accounting for 45% of total transactions in Q1 2019, compared to an average of about 70% for the past three years.

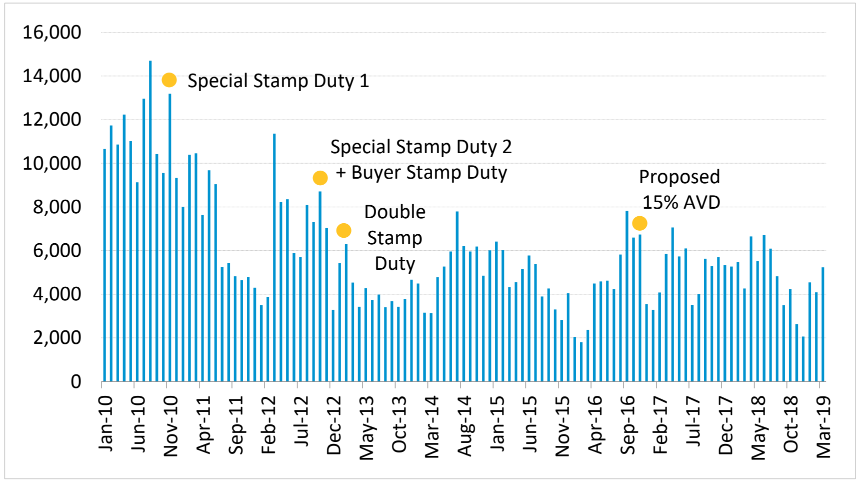
We expect the market to continue its recovering trend in Q2 2019, unless the market sees further market turmoil or global uncertainties.

US federal funds rate versus Hong Kong interest rates



Source: US Federal Reserve; Hong Kong Monetary Authority

Residential sales and purchase agreements (Number of transactions)



Source: Land Registry; Colliers International

[1] Federal Reserve Press Release, 20 March 2019; [2] Minutes of the Federal Open Market Committee, 18-19 December 2018; [3] The 2019-20 Budget, 27 February 2019

A REVERSAL FROM THE FALL

As of February 2019, the latest residential price index for the overall market released by the Rating and Valuation Department increased by 1.6% from December 2018, stabilising from the decline of 9% from August 2018 to December 2018.

Momentum was regained in the primary market. For example LP6, a new development in Tseung Kwan O, has reportedly increased the price for particular units by 6-7% during the next round of sale[4], while Maya by Nouvelle in Yau Tong has also increased prices by about 4% for the second batch of 33 units for sale compared to the first batch of units sold[5].

Prices in the luxury market, which were dominated by secondary sales, remained flat, given the low transaction volume in the first quarter.

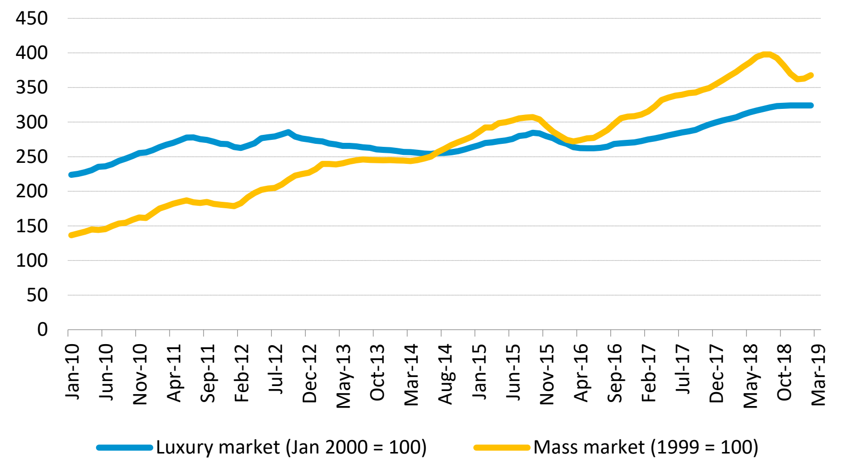
LEASING DEMAND REMAINS FIRM

The luxury residential leasing market remained active. With limited supply, tenants started early negotiations with landlords in order to secure leases of desirable homes. Despite rents in the overall and mass market declining, luxury residential rents stayed relatively firm, down marginally by 0.2%.

While the traditional luxury districts on Hong Kong Island remain the focus for corporate tenants, Tsueng Kwan O, Clear Water Bay and Sai Kung have gained stronger interest. An increasing number of school campuses and new residential buildings have been the driving factors for the leasing demand. Demand in West Kowloon remained strong with the new Express Rail Link infrastructure, making West Kowloon the gateway between Hong Kong and Shenzhen.

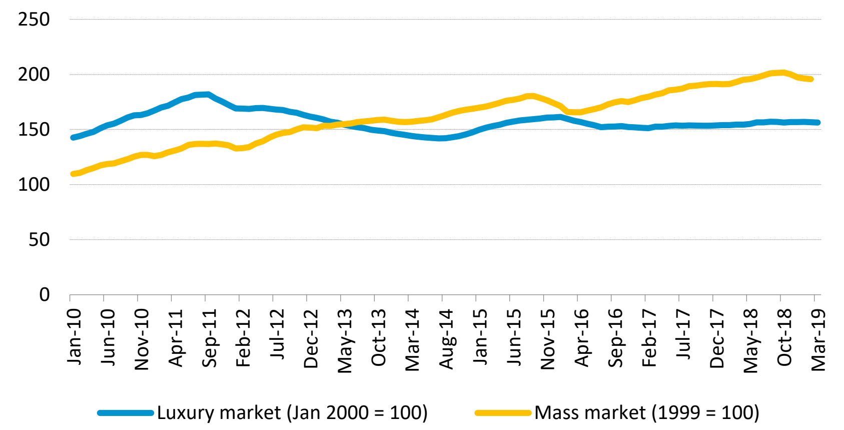
Despite a cautious business outlook, the tight labour market should continue to see strong leasing demand from expatriates for luxury residential properties. Given tenants are actively approaching landlords for new lease and lease renewal opportunities, amid limited supply, we believe rents will stay firm. Landlords looking to lease amid the unstable investment market and the upcoming vacancy tax should upgrade their properties by considering different strategies such as integrating green living concepts or wellness facilities to distinguish themselves from their competitors.

Hong Kong residential price index



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

Hong Kong residential rental index



Source: Colliers International; Rating and Valuation Department

[4,5] HKET, 20 March 2019

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