



# Hong Kong's two speed property market

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## Introduction

Back in June last year, we reported that over the prior few months, sales of Hong Kong residential properties had seen a significant increase.

Contrary to expectations at the beginning of the year that prices would drop by 5-10% in 2009, we had already seen increases of over 10% in the six months to June 2009. This trend continued and the year closed with residential prices posting more than a 20% hike – a rise far exceeded by HK property stocks which sky-rocketed by 69% (including dividends) in the full year 2009.

As concerns grow about the possibility of a bubble developing in the market in 2010, we assess how realistic these concerns are and examine the outlook ahead for property stocks in the territory.

## Super prime property at super prime prices

On February 11, the Hong Kong media reported that a group of Chinese mainlanders had purchased 3 Hong Kong apartments for a total of HK\$360 million (approx US\$46 million).

The apartments, housed in the same block as the world's most expensive apartment when it was bought for HK\$57 million (approx US\$7million) in October 2009, were paid for

with a deposit of HK\$35 million. While this is not extraordinary given the price of the properties, what has caused some eye-watering among commentators, is that the deposit was paid for entirely in cash. Indeed, the Hong Kong press reported that it took bank staff 2 hours to count the notes!

This is seen as further evidence that Hong Kong's property market is a bubble waiting to explode. Seemingly awash with cash from mainland investors buying up whatever they can get their hands on; the market is surely in danger of imploding?

Actually, we don't think so. We see a distinct two speed market developing. The super prime residences – those accounting for the top 3-5% of the property market - and the rest.

The super high end of the market is being supported by a growing number of super rich Chinese mainlanders who are searching for 'status symbol' properties – with properties in Hong Kong, Shanghai or on Hainan Island seen as the ultimate 'trophy asset'.

Supply is also a key issue here as these super wealthy mainlanders are all chasing a limited amount of super prime housing. In 2010, it is expected that between 11,000 -12,000 residential units will be launched in Hong Kong but that less than 1,000 of them will be above the H\$20 million market – now

considered by analysts to be the price-tag at which a property becomes “super high end”.

In our view, even if this super prime market were to dry up, the impact on the rest of the market would be minimal. Clearly, there would be a psychological effect while investors worry about whether this is the beginning of the end of the boom times but aside from that, we don't expect there to be much change in the rest of the Hong Kong property market.

There are three main reasons for this. Firstly, demand in the mainstream residential market continues to be fuelled by the positive carry between mortgage interest rates and residential rental yields. With mortgage interest rates at 2%-2.3% and residential rental yields at 3.5% or more, residential property continues to be an attractive investment for many Hong Kong people.

Ample liquidity in the market is compounded by the fact that consumer confidence is high – with retail sales continuing to increase – and companies are hiring again. Finally, with interest rates low, we are not seeing any issues with affordability at the moment.

### **Will overheating in China's economy lead to burnt fingers for Hong Kong property investors?**

The continued growth of China's economy is leading to concerns about overheating and the return of inflationary pressures. Many property commentators in Hong Kong are keeping an eye on the impact on liquidity if inflation starts to bite hard enough for China to introduce sharp monetary tightening policies.

We are not too worried about this. We believe that China's government will be able to contain inflation whilst not constraining growth. We expect that we are unlikely to see incremental liquidity in the property market in

the year ahead but that overall liquidity conditions will remain favorable.

### **Improved business sentiment bolstering commercial property**

Meanwhile, the commercial property market in Hong Kong is benefiting from improved business sentiment. It was reported in January that a dozen hedge funds are relocating to Hong Kong in order to participate in the Asia growth story. Meanwhile, Chinese and Asian investment banks are expanding in Hong Kong.

However, this expansion is not being matched by supply, which has remained largely unchanged and office rents in the financial district of Central are feeling the greatest effect of this. Many blocks in this prime part of town are putting up metaphorical 'no vacancies' signs as average rents continue to hover around the HK\$100 sq ft mark.

Here too, there is a clear discrepancy between this prime commercial market and the rest of the territory where rents across the water in Kowloon in districts like Kowloon Bay and Kwun Tong average less than a fifth of that at HK\$17 sq ft.

### **Property stocks expectations**

So, what does all this mean for property stocks in Hong Kong? Well, we believe the market is at a more healthy level than it was six months ago.

Property stocks corrected considerably over the last two months and are now at what we consider to be reasonable valuations. This pause was expected, given that the market had confounded expectations and risen dramatically in the full year 2009. We expect that 2010 will bring some consolidation in prices as the market continues to take a breather after last year's race up the indices. However, we do not expect any material decline in stock prices in the year ahead.

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