Staying in the OPod would only cost renters as little as HK$3,000 per month.

# Why property ownership is a pipe dream

Housing prices are not only at record high levels, putting the city consistently on top as the least affordable globally. Yet prices of mass residential housing climbed a further 8.6% in the first half of 2018.

Will you live inside an old drainage pipe? Hong Kong's expensive housing market has bred an unconventional low-cost housing alternative. Constructed from readily available 8-feet diameter concrete pipes, the OPod is tiny at 100 sqft but it can pack in most of living essentials, including a couch, a bed, a desk, some storage for clothes and other items, a kitchenette, and even a shower. A smart layout and use of space-saving furniture houses all of these amenities inside the OPod, making it comfortable for possibly even up to two dwellers.

When James Law came up with the concept for OPod Tube House, he had young Hong Kongers who are facing soaring rents firmly in mind. Staying in the OPod would only cost renters as little as HK$3,000 per month.

"Micro flats are the by-product of the immensely high costs of living in Hong Kong. The demand for them is really a result of people not able to afford more sizeable homes," said Law, although some analysts believe alternative options such as co-living spaces could be more feasible in the world's least affordable housing market.

A year after OPod was brought to life, Hong Kong property prices and rents remain at record high levels, and industry observers say a pullback on either front is unlikely even as recent cooling measures are set to weigh on residential demand.

**David Ji,** director, head of research & consultancy, Greater China, Hong Kong at Knight Frank said that despite uncertainties in the residential market, the supply shortage and price growth should persist although at a more cautious pace, forecasting home prices to rise 10% to 13% and office rents to climb at a relatively slower 5% at the end of 2018.

**Fusion Foundation, a startup building an "inclusive cryptofinancial platform," raised US$110m.**

"Today housing prices are not only at record high levels but the city is ranked as the least affordable city, globally. Yet prices of mass residential housing climbed a further 8.6% in the first half of 2018 and sell through rates have been strong," said **Denis Ma,** head of research at JLL in Hong Kong.

Ma reckoned policy measures, spanning from the introduction of higher taxes and lower loan-to-value to the rollout of the 15% Double Stamp Duty, have also inadvertently led developers to build ever smaller units and other properties they believe can be digested by the market.

About 3,300 new nano flats — units with a saleable floor area of 200 sq ft or less — will be finished between 2018 and 2020, up 35% from the previous three-year period, according to the JLL Residential Sales Market Monitor.

The new supply of nano flats accounts for over 4% of the total housing supply over the next three years. Notable upcoming developments with nano flats include 'Upper East' in Hunghom with about 450 flats and 'T Plus' in Tuen Mun with about 280 flats.

"The figures not only show developers building more nano flats, but also smaller flats," JLL noted, citing how 64 of the 68 flats at 'The Unit', a new serviced apartment project in Happy Valley developed by Emperor Group, are nano flats with a saleable floor area as small as 91sqft.

"Despite their small size and eye-popping rents, which can be as high as $124 per sqft per month, nearly all flats were leased within a few months of being made available, reflecting the general acceptance of nano flats by users in the market," JLL said.

"The popularity of nano flats has seen supply skyrocket in recent years with construction spreading from the city's urban areas to more decentralised regions," said Cathie Chung, National Director of Research at JLL. "And with the introduction of the new vacancy tax announced at the end of June, we expect this trend to continue as developers build more affordable housing units," she added.

JLL noted that a new upcoming development at Area 1a/1b in Discovery Bay will push the limits on how small nano flats can go. The smallest units at the project have a saleable floor area of less than 90 sq ft.

The strong buying appeal of nano flats stems from the relatively more attractive lump sums involved in the purchase, said **Henry Mok,** Regional Director of Capital Market at JLL. "With the growth in salaries lagging home prices, developers are now adjusting the sizes of flats built to maintain smaller lump sums that can be absorbed by buyers."

**Upswing in shared spaces**

Aside from smaller units, Ma noted that one of the more interesting new trends in the Hong Kong market that may make an immediate difference is the emergence of co-living schemes. Co-living spaces cost US$600/bed (HK$4700) to rent per month and the average facility size is at around 190 beds as average facility size, based on JLL's compilation of news articles and websites of co-living hub operators. One such example is Bibliotheque, a 166-bed project developed by Synergy Group.

"What we offer is an atmosphere for them to get to know each other," said **Joey Hui** of Synergy Group. "We notice that part of the application, the residents say they want to meet some people or learn new skills from other residents living in the building."

Denis Ma

Henry Mok

Simon Smith

Stephanie Lau

**Smaller units, bigger demand**


*Source: JLL*

VACANCY TAX

## Will the the new vacancy tax make a dent in prices?

In June, the Hong Kong government announced a plan to impose a new tax on newly built flats that remain unoccupied for six months in any year at a rate of 200% of the property's annual rental value. The measure is intended to help ease the tight housing supply and soaring prices in Hong Kong by freeing up units that have been completed but remain unsold.

The tax will likely have a mild cooling effect on residential property prices since developers will be incentivised to accelerate project launches and employe more competitive pricing strategies, said Lau."The initiative will have a moderate but manageable impact on our rated Hong Kong developers because most of them have either sufficient liquidity to absorb the proposed tax, or have a sufficient profit cushion to absorb discounts needed to clear inventory," she said.

Moody's cited government statistics which showed the number of unsold first-hand private residential units in completed projects has risen from around 4,000 units at the end of March 2013 to 9,000 units at the end of March 2018."With the tax estimated at around 5%, its effectiveness would depend on whether developers believe property prices would continue to grow at 5% or more a year," said Lau. Lau reckoned that if residential prices grow at more than 5%, the tax could be easily passed on to home buyers. However, Moody's expects residential market sales will be dampened by increasing capital and stock market uncertainty, which may lead developers to accelerate the pace of their project launches with less aggressive pricing. This will end up putting pressure on developers that have lower profit margins or weaker liquidity.

"Overall, we do not expect a material impact on Hong Kong's physical market because of a generally low overall private residential vacancy rate of 3.7% in Hong Kong at the end of 2017, and a relatively small level of inventory units held by most developers relative to their annual sales," said Lau. Ma reckoned the vacancy tax and the requirement to offer at least 20% of the total units in a project per batch launched will push developers to adopt a more conservative pricing strategy during sales, which has already been seen in recent launches. "The new tax is likely to have a bigger impact on the luxury segment of the market where properties usually take a longer period of time to sell," he said.

**Most notable transactions**

| | | | |
|---|---|---|---|
| Residential | Mount Nicholson Phase III (11/F, Tower D) | 590 | 128,414 |
| Residential | Mount Nicholson Phase I (House 2) | 1,399 | 151,785 |
| Residential | Mount Nicholson Phase I (House 17) | 780 | 97,695 |
| Residential | Twelve Peaks (House 8) | 730 | 152,592 |
| Residential | 28 Gough Hill Road | 900 | 161,319 |
| Office | W Square | 2,849 | 22,142 |
| Office | 18 King Wah Road | 9,950 | 30,170 |

*Source: JLL*

Synergy Group expects increased demand for co-living spaces in the coming years, and the developer is now looking for other properties, particularly old tenement buildings in the downtown area with low utilisation rates, that they can turn into their next projects.

"By providing a common space for residents to prepare meals and socialise, co-living operators are able to reduce rooms sizes and increase resident densities. With more residents, they are then able to offer lower rentals," he said. "Right now, most of these schemes revolve around affordable housing but it is the aim of operators to be able to transform this into a lifestyle, especially for the young."

Meanwhile, Ma had a less sanguine view of the OPod, arguing that whilst such unique ideas that have been proposed to solve the city's housing problems are conceptually attractive, "the reality is that they would be difficult to implement owing to issues around building, planning and land use regulations."

**Simon Smith,** head of research and consultancy, Savills Hong Kong said technology has helped a hand in transforming the functions in the Hong Kong property sector, resulting in key trends such as co-living and co-working, as well as mixed use logistics and experience-driven retail.

Co-working, in particular, has gained significant traction in the office market on the back of the high cost of renting office space. The number of co-working operators setting up in the city has exploded, according to Ma, led early on by the U.S.-based co-working giant WeWork. However, in the past 12 months, he noted a crush of mainland China operators, including Ucommune, Atlas and KR Space, launching in the island. Traditional service office operators have also been expanding into the sector.

**Key trends shaping the sector include Hong Kong venture capital firms also getting in on the ICO game.**

## Bye-bye Central

With office rents soaring to new highs, an increasing number of multinational corporations have also been pushed to decentralise their offices, observed Ma.

"For the leasing market, the biggest challenges for occupiers has been securing affordable office space," he said. "With mainland China corporates dominating the leasing market in Central, vacancy rates have been anchored below 2% whilst rents have soared to record high levels."

Ma noted that in the legal sector, which has traditionally been a stalwart industry in the Central office market, a growing number of firms have moved out over the past 24 months, mostly to Hong Kong East, which offers new supply and slightly higher vacancy.

"Whilst tight vacancies and limited new supply will support Grade-A office rents, we expect areas like Central's rental growth will moderate from a high base because of increasing cost consciousness of multinational corporation tenants," said **Stephanie Lau,** vice president-senior analyst at Moody's Investors Service.

"As such, we expect competition to increase for landlords in Central and other Hong Kong island locations amid a gradual migration trend of legal and financial institutions to decentralised locations, such as the eastern part of Hong Kong Island," Lau added, expecting overall office rental growth of Moody's-rated developers to moderate to 0%-5% in the next 12-18 months, lower than the overall office rental growth of 5.4% year over year at the end of December 2017.

Ma said there will be little incentive for landlords to soften on rents, given that vacancy rates on Hong Kong Island are currently below 2% and new supply have been largely pre-leased in the next 18 months.

However, Ji argued that there is not much room for decentralising on Hong Kong Island. "So even if they want to leave Central to other parts of Hong Kong Island, you're still facing a shortage of supply." Overall, Ji said the office market is still "doing very well", with rents going up in the single digits at 5% on average. "Considering this is the most expensive office market in the world, 5% rental growth year over year is actually quite fast," he noted, whilst flagging that investment yield on the office market will be "pretty low" even as prices and rentals continue to rise.

In terms of recent deals, Smith said one of the most notable ones in the office market was CK Asset Holdings sale of 75% of The Center for $40.2b at $32,951 psf in November 2017. "This was a record deal for an iconic Grade A office building in Central," he reckoned, adding that buyers are local veteran investors rather than mainland Chinese companies who are traditionally active in such en-bloc deals. "Some of the buyers sold their shares for over $50,000 psf, representing a gain of 50%

**Most notable transactions**

| | | | |
|---|---|---|---|
| Office | Octa Tower | 8,000 | 10,738 |
| Office | Cityplaza 3 & Cityplaza 4 | 15,000 | 19,491 |
| Office | 8 Observatory Road | 4,100 | 22,404 |
| Retail | Hsin Kuang Centre Arcade | 906 | 9,503 |
| Retail | Tai On Building (Retail Portion) | 255 | 51,000 |
| Retail | Lansing House (3-storey Shop) | 445 | 105,905 |
| Retail | 2-6 Bowring Street | 600 | 28,952 |

*Source: JLL*

**Twelve-month outlook**

| Sector | Rents | Capital Values |
|---|---|---|
| Office – Grade A | 5-10% | 5-10% |
| Retail – High Street Shops | 0-5% | 0-5% |
| Residential - Mass | N/A | 5-10% |

*Source: JLL*

within a year."

Over at the Hong Kong retail market, analysts reckoned a shift in customer buying habits amidst the recovery in tourist numbers. Whilst mainland Chinese tourists are returning to visit the island, their spending is now more focused on medicine and health products as well as F&B and mid-priced goods, according to Ji, which supports retail rents in many of the major districts. "The retail market is actually doing pretty well at the moment, although it cannot be compared to the heydays when everybody was buying lots of watches and jewellery. But this so-called 'new normal' is much healthier than the previous craze for luxury."

Analysts reckoned the completion of the Hong Kong-Zhuhai-Macao Bridge and the new Express Rail Link between Hong Kong-Shenzhen-Guangzhou will help further buoy inbound tourism and lend support to the retail sector. "After enduring a near 4-year long slump, the sector's property market appears to have turned the corner, with high street shop rents rising in the second quarter 2018 for the first time the middle of 2014," said Ma.

Ma noted that improvements in the retail property market have largely mirrored the recovery of key demand drivers for the sector, including inbound tourism, especially visitors from mainland China, and stronger retail sales. However, he said a V-shaped recovery will not likely be in the cards despite what recent data in inbound tourism and retail sales suggest. "Rather we expect an L-shaped recovery ahead, largely because much of the leasing demand that is driving the market continues to be from F&B and cost-conscious retailer groups who are unable to push rents up at the margins."

Lau expects overall shopping mall rental rates of Moody's-rated mall operators to rise 5% to 10% in the next 12 to 18 months, which will be reflected in their lease renewals. "This trend will track the overall Hong Kong retail sales recovery seen since the fourth quarter of 2017."

"Throughout the retail slump, what became apparent was that neighbourhood malls and retail assets that were more focused on the domestic shopper fared better," said Ma. "As a result, investors have been focusing primarily on shopping podiums and centres in more suburban locations rather than assets in traditional core retailing precincts such as Causeway Bay and Tsim Sha Tsui."

**Key trends shaping the sector include Hong Kong venture capital firms also getting in on the ICO game.**

DEALS

## Notable property deals in 2018

Overall, Ma reckoned investors remain optimistic on the long-term outlook for Hong Kong's property market despite increasing tail risks, especially those that believe that the recent influx of mainland Chinese demand is only the start of a secular trend spurred on by Beijing's going-out policies. "For investors, the influx of investment from mainland China has seen capital values soar to record high levels across the market and led to a convergence in yields. Capital values have also been boosted by strong results in the government land sales," said Ma, citing the sale of the former Murray Road Multi-storey Car Park on the fringes of the Central office market for $23.3b or $50,065 psf in May 2017, nearly 40% higher than the prevailing average for the Central Grade A office market at the time.

Ji, however, noted a slight shift in the investor landscape in 2018, with mainland Chinese investorsfailing to find adequate takeover targets apart from smaller investments, which will likely result in a decline in their total investment volume in 2018. "Everybody's still in the market. But the deals are more or less completed by Hong Kong local investors rather than mainland Chinese investors," he said.

Henderson Land Development, a property firm owned by one of wealthiest families in Hong Kong, bought the government's Murray Road commercial plot in Central for a record $23.28b, beating mainland Chinese developers.

Another notable deal in the past 12 months was Link REIT's sale of a portfolio of shopping malls totaling 2.2 million sqft. for $23b to a consortium of investors led by the private equity fund Gaw Capital Partners.

Ma further noted that the Hong Kong market has witnessed a string of record-breaking transactions over the past 12 months, with some strata-titled office units have sold well above $50,000 psf. "The challenge for investors will be whether they can continue to push rents to offset rising borrowing costs, especially with the outlook on demand less certain today compared to 6-months earlier," he said.

### Hottest locations for investment

Some of the hottest locations for Hong Kong property buying and investment lies in West Kowloon for residential, Wong Chuk Hang and Cheung Sha Wan / Lai Chi Kok for office and industrial, and Tseung Kwan O for retail, according to Ma. Looking forward in 2019, Ma reckoned investors should watch out for areas that will see a surge in new supply over the next few years such as Tseung Kwan O, Yueng Long, Tuen Mun, Tai Po and Ma On Shan. He said these will likely provide buyers more room for negotiation, especially if developers price new units to sell. He added that the new vacancy tax may also open up some opportunities to negotiate in the luxury segment, especially in the New Territories, where shifting rental markets are thin.

For Smith, top buying and investment locations include Kai Tak for residential, Tuen Mun for industrial and commercial, Grade B offices in fringe locations, and New Territories and Jordan for retail. Home buyers in 2019 can also look forward to Kai Tak as the Shatin to Central Link MTR is scheduled to open in 2019, although he said there is a fair chance it will be delayed. LOHAS Park should be of keen interest to home buyers as well, with one of the four sites launching in August and further launches in 2019.