IPTI Xtracts

Property Tax and Assessment News from Around the World

Hong Kong – November 2019

Hong Kong's protest-hit retail property market hasn't seen the worst yet. Will shopping mall landlords finally slash rents?

In addition to the global trend of stiff competition from online retailers, Hong Kong shops have faced a sharp drop in mainland visitors and protest vandalism

Stocks of retail property owners are not yet at historic lows, showing the sector has not hit rock bottom

Just a cursory glance at the latest data on global commercial property transactions shows that the retail sector remains deeply out of favour with investors.

In a report on investment activity in the world's leading commercial real estate markets in the third quarter of this year, property adviser JLL noted that the retail sector is still the least liquid, or actively traded, market. In the first nine months of this year, global retail transaction volumes fell 8 per cent year on year, compared with a 25 per cent increase in deals in the industrial sector.

The woes of the retail industry stem mainly from the huge disruption caused by the "Amazon effect" in the US and Britain – the world's largest and fifth-largest retail markets respectively – as spending migrates from bricks-and-mortar stores to online channels, fuelling concerns about a "retail apocalypse" at shopping malls and on high streets.

In Hong Kong, the disruption is of a different kind and has been much more severe since the mass anti-government protests erupted in early June.

Retail sales in the territory plummeted more than 18 per cent year on year in September, following a record-breaking 23 per cent decline in August. The tourism industry, a pillar of the economy, has been decimated, with visitor arrivals down 34 per cent in September as mainland tourists – who account for 78 per cent of arrivals – fear for their safety.

Never mind the Amazon effect, Hong Kong's retail industry is having to contend with violence and vandalism on a massive scale.

The unrest has dealt a crushing blow to a retail property market that was under strain long before the protests began.

Savills, another real estate adviser, noted in a report published last month that average prime high-street shop rents peaked as far back as the first quarter of 2013, and have since fallen 54 per cent.

This is in stark contrast to the dramatic increase in prime rents in core locations in Hong Kong's office market over the past several years, particularly in Central, the world's priciest office district.
While the decline in overall office rents has accelerated since the protests began, the retail sector entered the crisis in a much more vulnerable position. The "downturn has been a drawn-out affair," Savills rightly notes.

Causeway Bay's vacancy rate to soar as one in 10 shops stands empty

In contrast to the 2014 Occupy protests, which were relatively peaceful and mostly confined to Central and Admiralty, the current movement is much more defiant and widespread, hitting retailers and landlords much harder and dragging Hong Kong into its first recession since 2009.

According to a report published by property adviser CBRE last month, the unrest caused overall Hong Kong high street rents to plummet 10.5 per cent quarter on quarter last quarter, the sharpest drop since the Asian financial crisis. This has forced some landlords to offer tenants temporary rental reductions of up to 20 per cent for three months or longer.

However, such concessions have so far done little to stem the rise in vacancies. As the crisis intensifies, the shock-absorbing capacity and readiness of Hong Kong's retail property market is coming under intense scrutiny.

One of the biggest question marks is whether shopping centre landlords – most of whom, as reported by the Post last month, have so far resisted meaningful rent reductions – will start to adjust their rents and asking prices to better reflect the scale of the deterioration in the city's retail occupier and investment markets.

Short-term leases to become the norm if no let-up in Hong Kong protests

While shopping mall owners are better placed to withstand the unrest because many of their properties derive a large share of their revenues from non-discretionary retail (and are often located in residential areas less exposed to the protests), landlords can ill-afford to stand firm, given the strong likelihood of a further escalation of the crisis and the unpopularity of the retail sector among international investors.

CBRE notes that, overall, shopping centre rents remained flat last quarter. Just as worryingly, capital values have barely declined since the protests erupted.

As I argued previously, Hong Kong's excessively low rental yields – which currently stand at just over 2 per cent for prime retail assets, among the lowest globally – are putting the ravaged city at an even greater disadvantage to its main peers, particularly in Brexit Britain, where prime shopping centre yields have risen to almost 5.5 per cent.

Indeed, the only segment of Hong Kong's retail property market that has repriced significantly is the shares of the listed landlords. The stock of Link Reit, one of the largest retail-focused real estate investment trusts, is down almost 19 per cent since early June. Yet, even the valuation discount in the equity market is not as attractive as it was at the end of last year, or in early 2016 when fears about China's economy were rife.

The disruption in Hong Kong's retail real estate market, while brutal for tenants, looks like it may have only just begun.

Nicholas Spiro is a partner at Lauressa Advisory

Singapore rises as Hong Kong sinks in projected real estate price increases for 2020

Singapore has benefited from an uptick in interest among investors who are avoiding China and Hong Kong
Hong Kong's plunge to the least favoured real estate investment destination in Asia next year occurred as the city's tourism and retail sectors suffer

The fortunes of two of Asia's hottest property markets are diverging. Singapore is now ranked No. 1 for real estate investment prospects in terms of price increases in 2020. Hong Kong, buffeted by months of violent anti-government protests, has plunged to the bottom of the list from 14th place in 2019.

That's according to an Urban Land Institute and PwC report released on Tuesday into property trends in the region.

The city state has benefited from an uptick in interest among investors who are avoiding China and Hong Kong, which are seen as “geopolitical flashpoints”. Singapore ranked second-last in the list of 22 centres as recently as 2017, beaten out by cities including Tokyo, Bangalore and Sydney as vacancies surged and rents declined. In 2017, Hong Kong ranked 18th.

Over the past few quarters, apartment prices have rebounded in Singapore, signalling resilience in the residential market, while the office sector has largely absorbed the oversupply.

Hong Kong’s struggles bode well for Singapore, at least in the short term, Urban Land Institute CEO Ed Walter said.

“A lot of theory in investing is less about what was, versus what is or what is going to be,” he said.

Singapore was also one of the few markets regionally to see an increase in property transactions in the first half, with most activity driven by cross-border capital. Deals totalled US$4.9 billion in the period, up 73 per cent year-on-year, the report found.

Australia also registered a rise, with deals increasing 3 per cent to almost US$12 billion. More broadly, capital inflows into property from the US and Europe to Asia-Pacific dropped amid trade war concerns, reaching the lowest since 2012 in the second quarter.

Hong Kong’s plunge to the least favoured real estate investment destination next year occurred as the city’s tourism and retail sectors take a battering, impacting economic growth.

Investors scouting for deals, however, will be disappointed. Commercial and residential property owners alike will probably “opt to sit tight and wait out the storm” given they’re in general not highly leveraged, the report said.

Walter described Hong Kong as a “very resilient market” aided by its high property prices.

Once the protests end, sectors such as retail can rebound quickly, he said: “The bigger issue is what happens from a political perspective and what does that signal about Hong Kong’s place as a financial centre.”

From a purely residential investment outlook for 2020, Ho Chi Minh City is a bright spot, according to the report, which canvassed 463 real estate executives. Bangkok, Singapore, Shenzhen and Sydney round out the top five.
Foreign developers and private-equity firms have ploughed money into Vietnam, particularly the luxury end of the market. But concerns have been raised about the sustainability of such investments as land prices soar and supply threatens to outpace demand.

The many flaws of Hong Kong’s vacancy tax may lead to unintended consequences for the real estate market

The proposed vacancy tax requires units to be provided to employees as staff accommodation, which means they are liable for taxes if they are used as holiday homes even if they are fully occupied throughout the year

Many developers, to facilitate better management of their businesses, usually set up special corporate vehicles for property holdings. These corporate vehicles may not employ any staff

In the September 11 Legislative Council Brief on the Rating (Amendment) Bill 2019 (the “Bill”), the Transport and Housing Bureau stated that the number of unsold, completed first-hand residential units of Hong Kong have increased to 9,000 units at the end of March 2018.

The government considers the situation undesirable in the face of a housing shortage, and resolved that more effective measures must be taken to encourage developers to expedite the supply of such units. It is one of the Hong Kong Chief Executive’s six housing initiatives announced on 29 June 2018.

The government proposed to amend the Rating Ordinance to introduce special rates on vacant first-hand residential units. With a few excluded premises, the developers of residential units with the occupation permit issued for 12 months or more will be required to furnish annual returns to the government on their status.

The bill passed the first reading on 23 October 2019. The government expects the bill to deter developers' flat-hoarding practices. Whilst this initiative will accelerate the supply of first-hand units to the public which should be supported, the bill, when scrutinised closely, will result in unintended and unfair consequences to developers and owners alike.

Under the bill, first-hand units that remain unsold and have not been rented out for more than six months during the past 12 months will be subject to special rates. Special rates will be collected annually at two times the rateable value of the units concerned, which roughly equals to 5 per cent of the property value.

In reality, developers may retain certain residential units for legitimate purposes. Some developers have built, or reserved, units as housing for their staff. The bill provides an exemption for units provided by developer to employees as staff quarters for not less than 183 days during the reporting year.

The current drafting of this statutory exception is flawed on two major grounds. Firstly, the units must be provided to employees as staff accommodation, which means that they are liable for taxes if they are used as holiday homes, even if they are fully occupied throughout the year.

Secondly, many developers, to facilitate better management of their businesses, usually set up special corporate vehicles for property holdings. These corporate vehicles may not employ any staff. The restricted drafting, which only exempts residence provided directly by employers to employees, fails to provide relief to staff quarters provided by developers to employees of the same group, or to owners who purchase the staff quarters through acquisition of the developers' shares.

To provide relief to self-use among small-scale developers, the bill provides tax exemption to the only first-hand unit held by a developer. However, if an individual developer wishes to retain several units for family members without actually assigning the same to them, all these occupied units will be subject to vacancy tax even though they are not the target of the government's anti-hoarding initiative.

Apart from the above, the bill should also be criticised for its lack of flexibility as under the bill, the Rating and Valuation Commissioner is not granted any discretion to assess each unit on a case-by-case basis and adjust the proper amount of tax payable.

The Bill provides that vacancy tax will be levied on a unit leased to a tenant below market rent and the commissioner may determine the market rent. Once the commissioner is satisfied that the property is rented out below the market rent – however marginal it may be – the full tax of 200 per cent will be levied notwithstanding that the unit is rented out at arms-length and occupied by a genuine tenant throughout the year.

The bill also fails to accommodate a developer who does not rent out a unit that is undergoing renovation. The bill, if passed, will bring unjustifiably harsh results on developers who may genuinely need to renovate the property for subsequent rental.

The government should instead consider adopting a more flexible approach and allow the commissioner the discretion to levy special rates on the shortfall between the market rent and the actual rent payable; the Commissioner should also be granted power to exempt a property from the regime for the period during which it is undergoing genuine refurbishment work.

The bill is welcomed as part of the government's initiative to tackle Hong Kong's acute housing shortage. However, the current drafting of the bill is flawed in multiple ways and should be refined to properly reflect the government's true legislative intent without causing unnecessary disruption to the market.

Lilian Chiang is the senior partner at law firm Deacons

Hong Kong's homebuyers greet developers' attempt to sell leftover residential property with their collective cold shoulder

- The biggest sales weekend of residential property in almost five months was met with a collective shrug
- A total of 152 flats, or 35 per cent of the 435 units on offer by developers, found buyers

Hong Kong's biggest sales weekend for residential property in almost five months was met with a collective shrug, as homebuyers mostly ignored the 622 unsold homes left over from previous launches to wait for new projects that are due for release in the coming months.

A total of 152 flats, or 35 per cent of the 435 units offered by five developers, found buyers at 6pm, sales agents said. Another 187 homes were being offered on tender, whose results will only be revealed on Sunday.

"Market sentiment is different [from a year ago], where not selling is the new normal, and the ability to sell is a better-than-expected [outcome]," said CGS-CIMB Securities' head of Hong Kong and China research Raymond Cheng. The secret behind "previous sales that were successful came down to more reasonable or attractive pricing. If prices are set too aggressively or are higher compared to initial launches, buyers will hesitate," he said.

The weekend's dismal sales drew a stark contrast with the sell-out performance reported on Friday by the Grand Ming Group, which sold every one of its 375 flats on offer at The Grand Marine project in Tsing Yi during a fresh launch, a day after several of Hong Kong's biggest commercial banks cut their lending rates for the first time in 11 years in response to the city's third cut in interest rates in as many months.

Homebuyers had become more discerning, turning their shoulders on property that were not offered during earlier launches, particularly in areas that had been affected by anti-government protest rallies, agents said.

In Sham Shui Po, the flashpoint of clashes on August 6 between police and radical protesters, CK Asset managed to sell 15 flats, or a mere 13 per cent of the 112 units on offer. In protest-hit Tai Po, China Overseas and Investment sold 98 flats, or 38 per cent of the 259 units on offer. In Shau Kei Wan, the family of the late Lam Woo sold 39 units, or 74 per cent of their One Eighty project.