A notable rental growth amid limited supply

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The Hong Kong industrial market remained strong in Q1 2018. The trade sector has benefited from strong foreign merchandise demand and the robust global economy. Moreover, we have recorded remarkable growth in both rents and prices. Supported by the potential industrial revitalisation scheme, en bloc investment has remained active and the total value of investment has reached a historical high. However, new measures to deter inappropriate conversion to residential use has reduced the attractiveness of small workshops, and the strata title investment volume slightly decreased in Q1 2018. We expect that the potential revitalisation scheme will remain the key focus in 2018.

Forecast at a glance

**Demand**

The demand for warehouses should remain strong for relocation and expansion and the potential revitalisation scheme should be the key focus in 2018.

**Supply**

No new warehouse site was included in the land sale programme of the 2018 Budget. Vacancy should stay low due to the potential revitalisation scheme.

**Rent**

Warehouse and flatted factory rents should rise by 8% and 10% respectively in 2018, supported by strong demand and limited vacancy, and increase by 5% per annum over 2019-2022.

**Price**

Given firm investment sentiment and the potential industrial revitalisation scheme, prices of warehouses and flatted factories should rise by 10-15% in 2018 and by 8-10% per annum over 2019-2022.

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**Major Industrial Market Indicators | Q1 2018**

<table>
<thead>
<tr>
<th>Category</th>
<th>Q1 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Export (Jan - Feb)</td>
<td>10.7% YOY</td>
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<tr>
<td>Port Container Throughput</td>
<td>-0.6% YOY</td>
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<tr>
<td>Air Cargo Throughput</td>
<td>4.2% YOY</td>
</tr>
<tr>
<td>Warehouse Rent</td>
<td>5.6% QOO</td>
</tr>
<tr>
<td>Factory Rent</td>
<td>5.0% QOO</td>
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</tbody>
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Source: Colliers; Census and Statistics Department

**External trade stayed strong but business growth slowed**

Global economic acceleration and strong external trade activity drove the demand for industrial space in Q1 2018. According to Hong Kong’s Censuses and Statistics Department, the combined value in January and February of total exports and imports increased by 10.7% YOY and 10.5% YOY respectively. However, the latest Nikkei Purchasing Manager’s Index fell to 50.6 in March, from 51.5 in December 2017 due to negative business sentiment. Although easing input cost pressure can help firms cut selling prices to boost sales, the competition has remained high, hitting business confidence and the business sentiment.

Hong Kong’s external merchandise trade has continued to shift from sea-freight to air-freight. Air cargo throughput increased by 4.2% YOY; while port container throughput declined by 0.6% YOY. Besides, Hong Kong’s retail sales have remained strong, up by 15.7% over January and February 2018 combined, supporting the warehouse demand from retailers and wholesalers.

**Limited supply and low vacancy drove rental growth**

Strong expansion and relocation needs dominated the demand for warehouses in Hong Kong in Q1 2018. However, warehouse space has remained scarce. The vacancy rate stayed at below 3% and no new supply is expected in 2018. The rents of warehouses and factories increased by 5.6% QOO and 5.0% QOO respectively in Q1. We expect that the situation of excess demand for industrial properties will persist and push up industrial rents amid limited supply and low vacancy.
Notable leasing transactions in Q1 included the following. WPG Holdings, a global electronics distributor, relocated from Western Plaza to the whole floor of East Asia Industrial Building in Tuen Mun for relocation. Two logistics services companies, Dimerco Air Forwarders and Kerry Logistics, leased 76,135 sq ft (7,075 sq m) and 119,800 sq ft (11,130 sq m) for expansion at ATL Logistics Centre in Kwai Chung.

However, strata title investments recorded a decline of 4.7% QOQ. The government announced new measures to deter the inappropriate conversion of industrial buildings to residential use by prohibiting subdivision of industrial premises with usable floor area of less than 861 sq ft (80 sq m), and stipulating that non-provision of natural lighting and ventilation to the toilets will not be approved. Given the tighter restriction of industrial buildings, we expect that small industrial workplaces will not be as attractive as before, and hence the demand for such small workplaces will weaken modestly.

A cautiously optimistic outlook for 2018

Global real GDP growth in 2017 reached its highest level since 2011, and is likely to be slightly higher in 2018. China, Japan, South Korea, Hong Kong, and Singapore all saw growth accelerate in 2017, but will probably see mild slowdowns in 2018; in contrast, India should accelerate. We believe that Hong Kong’s merchandise trade will continue to grow in 2018, supported by overseas demand and firm domestic e-commerce growth. While a possible trade war between the US and China is a risk, at this stage we see insufficient reasons to change our forecasts for Hong Kong’s merchandise trade, and industrial and warehouse properties.

Regarding the Hong Kong 2018 Budget released by the Financial Secretary, Mr Paul Chan, although he highlighted the government’s objective to develop Hong Kong into a trading, storage, logistics, and distribution hub for high-value goods, there were no new warehouse sites included in the land sales programme. The warehouse supply is likely to be tight in 2018.

Overall, we remain optimistic about the industrial property market in 2018. Based on our forecasts, the warehouse prices and rents will increase by 8-10% YOY in 2018 and 5% per annum over 2019-2022, while flatted factory prices and rents will increase by 10-15% YOY in 2018 and 8-10% per annum over 2019-2022.