Colliers Quarterly

HONG KONG | INDUSTRIAL

Q1 2017

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Accelerating success.

Limited expansion despite improved trade flows

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The international and local trading environment has recovered in Q1 2017 with increases in total import and export. However, the current uncertain retail landscape has put some retailers' expansion plans for their warehouse space on hold. Assuming the external environment remains stable, we expect the warehouse demand from retailers to strengthen amid a better retail market outlook in late 2017. We stay optimistic on warehouse rental growth and demand.

Market at a glance

Demand

Mixed leasing demand for warehouse from retailers with luxury and clothing retailers being cost-conscious while mid-range retailers are looking for expansion

Supply

New supply still limited with the 1.7 million sq ft warehouse developed by China Merchants Group being the only new stock for this year, expected to be completed in Q2 2017

Rent

We expect warehouse rent to increase up to 3% in 2017 as demand for logistics space in general recovers

Price

Industrial property prices have increased by 1.2% QOQ, reflecting a strong investment demand amid calculations of the higher value of redeveloped projects

Major industrial market indicators	Q1 2017
Total Export	10.3% YOY
Container Throughput	14.3% YOY
Air Cargo Throughput	11.6% YOY
Warehouse Rent	0.2% QOQ
Factory Rent	1.9% QOQ
I/O Building Rent	-0.2% QOQ

Source: Colliers; Census and Statistics Department

Mixed leasing demand from tenants

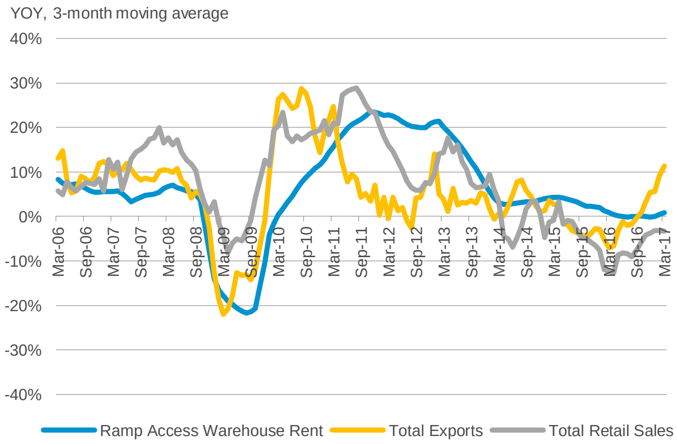
The trading sector in Hong Kong has shown strong signs of recovery in Q1 2017, reflecting strengthening global trade flows. The value of total exports increased 10.3% YOY, while air cargo throughput was up 11.6% YOY and container throughput surged by 14.3% YOY. Despite this positive background, total retail sales remained weak with the combined value of January and February sales down 3.2% YOY. Retailers of luxury and clothing items remained cost-conscious amid the continuous adjustment of the retail landscape. The leasing demand was driven by the consolidation of mid-range retailers and cosmetics suppliers, which have been taking up warehouse space in the Kwai Chung/Tsuen Wan area. Smaller tenants have to move to decentralised areas such as Yuen Long and Tuen Mun due to the strong competition in Kwai Chung/Tsuen Wan.

After the Chinese New Year in late January, leasing activity picked up in the warehouse market. Kwai Chung was the most active market for new leasing particularly in the ATL Logistics Centre, including Sa Sa Cosmetics taking up 200,000 sq ft (18,580 sq m) for consolidation. Hong Kong Suning Commerce, an electronic appliances giant, leased a unit on the 4/F for expansion.

Tsuen Wan attracted a few tenants thanks to low availability in Kwai Chung. Ricoh Asia Pacific Operations Ltd, an office equipment provider, leased two units in Dynamic Cargo Centre, supporting its business needs amid the growing trend of office relocation.

In Tsing Yi, Yusen Logistics (Hong Kong) Ltd, a local third-party logistics (3PL), leased space on 1-2/F in Goodman's Interlink building for expansion, being the largest leasing transaction of the quarter in term of monthly rent. The active leasing market in the core area has driven rent up, while other sub markets remained relatively quiet. We calculate that overall warehouse rent remained stable, up by 0.2% QOQ.

Hong Kong Warehouse Rental Trend



Source: Colliers; Census and Statistics Department

Record high investment volume

Industrial buildings have become very popular for investment since the imposition of a 15% stamp duty on residential purchases. Total transactions worth HKD30 million or above increased 18% QOQ to a record of HKD5.1 billion (USD651 million), thanks to the six en bloc acquisitions in the quarter. Even though the revitalisation scheme for industrial buildings ended a year ago, industrial properties located in the non-"Industrial" zones provide opportunities for investors to add value to their investments by redeveloping properties into apartments, commercial buildings or modern industrial buildings. Empire Group stole the spotlight by acquiring the Zung Fu Aberdeen Garage in Aberdeen for HKD1.56 billion (USD201 million). The unit price was at HKD9,541 (USD1,229) per sq ft based on the gross floor area of 163,500 sq ft (15,190 sq m). The buyers plan to redevelop the premises into a modern industrial building, and have applied to add commercial use to the zone at the same time to maximise its redevelopment potential.

A local investor bought Sze Chow Holdings Building and Pricerite Group Centre in Sai Kung in separate transactions for a total consideration of HKD733 million (USD95 million). The two sites can be redeveloped into residential buildings under the current zoning rules. Cheung Sha Wan, Yuen Long, Aberdeen and Yau Tong have been speeding up their transformation from industrial hubs into residential areas.

In addition to the redevelopment potential of industrial buildings, investors have been attracted by the strong leasing demand. Hanison Construction and Pagson Development jointly acquired Success Centre in Kwai Chung for HKD800 million (USD104 million) for hold and lease purposes, representing the second largest investment deal in the quarter. The overall factory yield currently stands at 3.8%, the highest level in the Hong Kong property market. High yield and strong leasing demand allow investors to achieve stable income during the process of redevelopment applications. At the same time, the outlook for industrial properties is reasonably predictable due to strong user demand, despite the prospect of interest rate hikes and uncertain retail landscape.

Investors can still search for industrial buildings which have the potential to be revitalised as only 149 of 226 applications for revitalisation have been processed so far. The planned transformation of Kowloon East into Hong Kong's CBD2 has accelerated with two special waiver cases being executed for redevelopment and conversion in Q1. Kowloon Godown on the Kowloon Bay harbour front was approved to be redeveloped into a 22-storey commercial building in January by the government being the highlight of the quarter.

The government restrictions on fire safety systems have put the expansion plans of self-storage operators on hold. Self-storage owners have been left with no choice but to invest in renovation and compensation for the affected facilities, while some of them have already downsized the number of operations. The strong user demand for industrial spaces has pushed up rents, putting extra pressure on self-storage operators who are already experiencing compression of profit margins.

Outlook is favourable overall

President Trump of the US recently stated that he does not consider China a currency manipulator. After the successful meeting between Mr Trump and China's General Secretary Xi Jinping, the president’s change of tone on the renminbi is good news for China. In the opinion of Colliers Asia, it is less likely now that the US will seek to impose large tariffs on Chinese exports, risking a trade war. Economic conditions in China remain robust, and Oxford Economics’ forecast of real GDP growth of 6.5% in 2017 (representing only a very modest slowdown from 6.7% in 2016) looks plausible.

With the chances of a trade war fading and economic conditions strong, the outlook for China's export sector has improved. This should provide a boost to Hong Kong, which is highly dependent on the re-export businesses from China. In addition, domestic demand for staple consumer items, F&B and mid-range products remains strong which supports the expansion and consolidation of logistics space in these sectors. On the other hand, the luxury and clothing sectors are still undergoing adjustment. Retailers' logistics arms and 3PLs should remain very cost-conscious for the rest of the year until the luxury retail sales recover.

We expect self-storage demand to slow in the short term. The government has clearly identified and issued warnings to self-storage facilities which do not meet the fire safety requirements, and has been following up closely. The decreased profit margin of self-storage business will make some operators exit the industry. However, user demand for industrial space should remain firm, given that non-industrial activities in industrial buildings keep increasing. The government should review the regulation against unauthorised use and expand the uses allowed in existing industrial buildings with no public safety hazards to meet the vigorous demand.

The manifesto of Carrie Lam, the elected Chief Executive, proposed the "Re-industrialisation" of Hong Kong by promoting the adoption of innovation and technology for the high-end and innovative production. Mrs. Lam also proposed further relaxations on the usage limits of certain industrial buildings to encourage creative industries and co-working space.

Existing Government policy has encouraged industrial buildings to be redeveloped or refurbished for non-industrial uses and has resulted in a reduction of total industrial building supply. However, the "re-industrialisation" policy, if successfully implemented, could further increase demand for industrial space. Given the tight supply and strong demand in the industrial market, growth in industrial rents seems highly probable.

Major En Bloc Transactions in Q1 2017

Date	District	Building	GFA	Price (HKD million)	Unit Price (HKD per sq ft)	Buyer
Mar-17	Aberdeen	Zung Fu Aberdeen Garage	163,500	$1,560	$9,541	Empire Group Holdings
Feb-17	Kwai Chung	Success Centre	24,000	$800	$3,333	Hanison Construction
Mar-17	San Po Kong	Jing Wah Building	96,500	$390	$4,000	PRC investor
Mar-17	Sai Kung	Sze Chow Holdings Building	100,600	$368	$3,658	a local investor
Mar-17	Sai Kung	Pricerite Group Centre	76,977	$365	$4,742	a local investor

Source: EPRC; Colliers

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