Self-storage in Hong Kong: A Growing Niche

- 80% Existing Self-storage Sites are 10,000 sq ft or less
- 24 Hour Access
- Convenient Locations
- Value-added Services
- Affordable Option
- Secure Storage
- Climate Controlled Storage
Contents

Introduction ....................................................................................................................... 3

Market Size of Self-storage in Hong Kong ........................................... 3

Increasing Demand ......................................................................................................... 5
  Improvement in accessibility and security ................................................................. 5
  Storing valuable items in self-storage ...................................................................... 5
  Value-added services are attracting more customers ............................................... 5
  Demand from domestic users .................................................................................... 5
  Demand from corporate users .................................................................................... 5
  An affordable and flexible storage option .................................................................. 5

Investment Risk and Return .......................................................................................... 6
  Lease or Buy? .................................................................................................................. 6
  Scale is needed .............................................................................................................. 6
  Investment risk ............................................................................................................. 7
  Market risk .................................................................................................................. 7
  Price volatility .............................................................................................................. 7
  Tenancy risk ................................................................................................................ 7

Impact of Government Policy ......................................................................................... 8
  Revitalisation of industrial building policy ................................................................ 8
cuts two ways ................................................................................................................... 8

Where? ............................................................................................................................. 8
  Industrial clusters on Hong Kong Island for high-income households ..................... 8
  Districts in New Territories provide economies of scale ......................................... 8

Tenure is Key .................................................................................................................... 9
  Joint venture with landlords ....................................................................................... 9

Conclusion ....................................................................................................................... 10
Introduction

The increasing volatility of prices in various asset markets and the growing difficulty of finding reasonable risk-adjusted returns have prompted real estate investors to look for non-traditional real estate investment opportunities. Self-storage has come onto the radar because this niche sector offers the benefits of stable rental income and premium yields.

For this report, we review the key market driver of the self-storage sector – insufficient on-site storage space among domestic and corporate users. This report also explains why this unique sector has been overlooked, and why investors should consider it now.

Market Size of Self-storage in Hong Kong

Hong Kong is well-known for its “shoebox” apartments. The Hong Kong Government provides public housing to meet grassroots families’ housing needs, with an average living space of 140 square feet (sq ft) per person in 2013. There are approximately 1.1 million private residential units in Hong Kong. About 8% of the private housing is classified as “large units” with a saleable area of over 1,076 sq ft, while the rest are classified as “small-medium size units”.

Some of the existing private residential properties are designed with dedicated storage rooms or utility rooms.

Among the existing popular private residential estates, 18% of the small-medium units and 88% of the large units are equipped with a dedicated storage room. Assuming the two ratios are representative for all private residential properties in the city, about 852,000 or 76% of private residential units lack a dedicated storage area.

There is a substantial gap between the existing stock of self-storage facilities and demand from households without a dedicated store room.

“Self-storage has come onto the radar because this niche sector offers the benefits of stable rental income and premium yields.”
The sizes of the dedicated store rooms or utility rooms are mostly within the range of 28-35 sq ft, regardless of the size of the private residential units. Given occupancy rates of 96.3% and 90.3% in small-medium size and large private residential units in 2013 respectively, about 820,000 households are living in homes without a store room. If half of these households lease 15 sq ft of self-storage space each to accommodate their storage needs, the market size of self-storage would be about 6.15 million sq ft. If these families demanded 30 sq ft of self-storage space each, the market size would be 12.3 million sq ft. According to Colliers’ estimate, there is about 2.8 million sq ft of self-storage space in the city.

Existing Distribution of Self-storage in Hong Kong

<table>
<thead>
<tr>
<th>District</th>
<th>Floor area (sq ft approx.)</th>
<th>Median Monthly Household Income (2013)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>HONG KONG ISLAND</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 Central and Western</td>
<td>102,700</td>
<td>$34,300</td>
</tr>
<tr>
<td>2 Wan Chai</td>
<td>0</td>
<td>$33,500</td>
</tr>
<tr>
<td>3 Eastern</td>
<td>432,200</td>
<td>$26,100</td>
</tr>
<tr>
<td>4 Southern</td>
<td>195,800</td>
<td>$26,700</td>
</tr>
<tr>
<td><strong>KOWLOON</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Yau Tsim Mong</td>
<td>42,300</td>
<td>$22,000</td>
</tr>
<tr>
<td>6 Sham Shui Po</td>
<td>101,700</td>
<td>$17,900</td>
</tr>
<tr>
<td>7 Kowloon City</td>
<td>81,900</td>
<td>$25,100</td>
</tr>
<tr>
<td>8 Wong Tai Sin</td>
<td>108,800</td>
<td>$19,200</td>
</tr>
<tr>
<td>9 Kwun Tong</td>
<td>465,700</td>
<td>$17,500</td>
</tr>
<tr>
<td><strong>NEW TERRITORIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10 Kwai Tsing</td>
<td>270,900</td>
<td>$19,300</td>
</tr>
<tr>
<td>11 Tsuen Wan</td>
<td>255,700</td>
<td>$26,000</td>
</tr>
<tr>
<td>12 Tuen Mun</td>
<td>149,200</td>
<td>$20,000</td>
</tr>
<tr>
<td>13 Yuen Long</td>
<td>43,800</td>
<td>$20,300</td>
</tr>
<tr>
<td>14 North</td>
<td>20,000</td>
<td>$21,400</td>
</tr>
<tr>
<td>15 Tai Po</td>
<td>62,400</td>
<td>$25,000</td>
</tr>
<tr>
<td>16 Sha Tin</td>
<td>450,000</td>
<td>$24,900</td>
</tr>
<tr>
<td>17 Sai Kung</td>
<td>0</td>
<td>$29,100</td>
</tr>
<tr>
<td>18 Islands</td>
<td>0</td>
<td>$24,500</td>
</tr>
</tbody>
</table>

Source: Colliers; HKSAR Government
Increasing Demand

More users accept self-storage as a solution to their storage needs amid improving operators’ service levels.

Improvement in Accessibility and Security

Accessibility and security are two major concerns for self-storage users. Traditional operators do not provide 24-hour access (which presents a hurdle for domestic users who desire unrestricted access to their possessions) nor surveillance systems.

A number of the self-storage operators have installed automatic identification systems - such as smart card readers - to provide their customers with 24-hour accessibility. Additionally, most self-storage sites are now equipped with CCTV and other security systems. Together, these systems have helped improve customers' confidence in the concept of self-storage.

Storing Valuable Items in Self-storage

Domestic users have traditionally stored bulky and/or infrequently accessed items in self-storage. Recently, however, users are becoming increasingly comfortable storing highly valuable and ‘special’ items in facilities with robust security systems. Sports gear, wine collections and seasonal clothing are increasingly being stored as these items usually require a climate-controlled environment which is costly in a private flat.

Value-added Services are Attracting More Customers

The provisions of value-added services that cater to the users’ needs are also bringing in more self-storage users. For example, some self-storage operators provide moving assistance, while others offer product receiving services for customers who make purchases online and want the items delivered to and stored in their self-storage space.

Demand from Domestic Users

The well-publicized efforts by the Hong Kong Government to increase residential supply will impact the self-storage sector positively. The sale by the Government of several mass residential sites for development of small-medium sized units will (almost without exception) have no dedicated store room.

Demand from Corporate Users

The scarcity of office space in the last several years has been a challenge for business operators. Since 2013, there has been a growing trend among large businesses to remodel their space in order to accommodate additional staff. Given the high cost of office space it is unlikely business operators will increase their storage space in situ, making self-storage an increasingly viable solution.

An Affordable and Flexible Storage Option

The average rent of self-storage is on par with private residential flats in nearby locations. Despite this seemingly high cost, because self-storage provides size options down to 15 sq ft monthly rentals below HK$1,000 per month are common, meaning it is still an affordable option for many domestic users.

Self-storage also offers private and corporate users flexibility with respect to their commitment over time. This is particularly pertinent to corporate users when compared with the typically minimum 3 year office lease term.
Investment Risk and Return

The self-storage investment opportunity has often been overlooked because the existing size of the sector is relatively small in Hong Kong. Virtually all of the 2.8 million sq ft of self-storage area is established in existing industrial buildings, which represents only a small portion of the more than 200 million sq ft of existing industrial property stock.

There is a shift of investment demand from traditional to non-traditional property sectors in view of higher returns. Self-storage gained real estate investors’ interest because the sector provides a better return when compared with the traditional option of buying industrial premises simply to lease out.

Lease or Buy?

**Lease:** We estimate it takes about 18 months for a new 20,000 sq ft self-storage site to reach a stabilized occupancy rate at 90%. This results in a payback period of about 4.5 years. Assuming a 9 year lease the Internal Rate of Return (IRR) is estimated at more than 30%.

**Buy:** If a property is purchased for conversion into self-storage the acquisition cost accounts for over 85% of the total investment amount (assuming a 20,000 sq ft site). We calculate the IRR over the same 9-year period at approximately 15% (assuming capital growth in line with the annual inflation forecast by the Economist Intelligence Unit of 3.4% over the next few years).

Although the internal rate of return of this buying case is lower than the leasing case, the returns of the buying case are more secure. In Hong Kong, the typical lease term of industrial premises is 2 to 3 years. The self-storage operations may make a loss if they cannot renew their lease after the first lease term as the payback period would be about 4.5 years. Securing a long term lease is critical to ensure viability. Whilst this analysis of buy versus lease appears to support leasing, it does not factor in the potential capital gains if the capital value of the building outperforms forecast inflation.

Scale is Needed

Existing self-storage sites in Hong Kong are relatively small. About 80% of the existing self-storage sites have a gross floor area of 10,000 sq ft or less. Assuming a floor area efficiency of 70%, a 10,000 sq ft site provides about 233 self-storage units with a net lettable area of 30 sq ft. According to self-storage operators, it is estimated that about 25 leases could be sold per month. Based on these assumptions, a 10,000-sq ft self-storage site would be fully occupied in less than 1 year.

Regardless of the sizes of the establishment, the staff requirements for operating self-storage sites are virtually identical. We conclude that there is adequate local demand in most locations to justify 20,000 sq ft and larger.

> “Assuming a 9-year lease, the Internal Rate of Return is estimated at more than 30%”

Size Distribution of Self-storage Sites

Source: Colliers
Investment Risk

The principal risks that self-storage companies encounter include market risk, industrial property price volatility in medium term, and tenancy risk. Most of these can be mitigated

Market Risk

Similar to other business sectors, local economic performance affects the demand for self-storage services. However, a structural need exists as a significant portion of private housing lacks dedicated storage space. Given the extreme undersupply even if a significant downturn in the economy occurred this sector is likely to outperform other property sectors.

Price Volatility

Comparing to the long-term industrial yield average of 8.7%, today’s average of 2.8% indicates there is a risk of softening yields in the medium term. The trigger for this is often speculated on, but an increase in US interest rates will almost certainly occur during the hold period of any investment in this sub-sector.

Despite potential price volatility, industrial property prices are expected to trend upwards in long term. During the period from 1Q 1995 to 1Q 2014, the average year-on-year change in industrial property prices was 8.1%. Given the government incentives to enable conversion of industrial assets into other uses and the low new supply levels the overall supply of industrial property is likely to reduce and thus support capital appreciation. We believe the industrial sector will outperform other mainstream investment sectors.

Tenancy Risk

Developing self-storage sites in locations with compromised accessibility will negatively impact occupancy rates. Good accessibility to public transport, such as MTR and buses, is a major factor considered by private customers. Corporate clients are less sensitive towards public transport links, but accessibility to a good road network that provides easy access to their off-site inventory is important.

“A structural need exists as a significant portion of private housing lacks dedicated storage space.”
Impact of Government Policy

The Revitalisation of Industrial Buildings Policy Cuts Two Ways

The revitalising industrial building policy is a double-edged sword for self-storage companies. Under this policy, the whole block of eligible industrial buildings can be converted to other uses at nil waiver fees. According to the Government, a total of 54 special waiver cases have been executed. Most of these building owners opt to convert their premises to office, retail and hotels. The impact to the investor is positive, but this creates a risk to self-storage operators operating under a head lease (which often have redevelopment clauses). A landlord will often have the right to terminate leases for the purpose of redevelopment. Thus it becomes imperative that this risk is considered when entering into any new lease – a minimum period of tenure is essential to ensuring the businesses viability.

Where?

Industrial Clusters on Hong Kong Island for High-Income Households

The latest Government statistics indicated that the median monthly household income in the four District Council districts on Hong Kong Island are HK$26,100 – HK$34,300 in 2013, above that of HK$22,400 for the whole city. Self-storage operators would be well advised to look for property options in industrial building clusters in Chai Wan, Quarry Bay and Wong Chuk Hang/Ap Lei Chau targeting high-income households in relatively small residential properties.

Districts in New Territories Provide Economies of Scale

Industrial buildings in New Territories provide more property options with larger floor areas. Moreover, the rents of industrial buildings in New Territories are cheaper than their counterparts on Hong Kong Island. For the operators seeking to consolidate multiple addresses under one roof, industrial buildings in New Territories provide more viable options.
Tenure is Key

Frequent relocation is not an option for self-storage operators. The cost of set up requires a long period of occupancy in which to amortise these costs, not to mention the disruption to customers.

Joint Venture with Landlords

Overseas operators are looking for leases of nine years or more to allow them to amortise their setup costs and minimise the risk of losing customers should they need to relocate. In view of the operators’ requirements for these longer lease terms, a viable property option is those premises owned by long-term investors for lease. Depending on the investment strategies, some owners accept a three-year lease with an option to renew for three years followed by another three-year renewal option. This still leaves a degree of exposure to the operator as at lease renewal they are exposed by the cost of relocation when negotiating rental rates. Some operators have entered into joint ventures with property owners to ensure location stability and aligned interests.

“Overseas operators are looking for leases of nine years or more to allow them to amortise their setup costs and minimise the risk of losing customers should they need to relocate.”
Conclusion

According to our estimations, about 852,000 or 76% of private residential units in Hong Kong lack dedicated store space. Based on this and using very conservative assumptions there is demand for over 6.15 million sq ft of self-storage facilities. Current supply is less than half this at 2.8 million sq ft in the city. This market gap represents a significant opportunity for investors and operators alike. As a non-traditional real estate investment category in Hong Kong, the self-storage sector provides a higher return when compared to traditional buy-and-lease-out investment options for industrial properties. Although the self-storage market outlook is positive, it is important to develop self-storage sites in locations with good accessibility to public transport and/or a road network to lower the tenancy risk.

Tenure security is a key challenge for self-storage operators. As many operators seek to develop sizeable sites of 20,000 sq ft and larger, long lease terms are required to amortise their setup costs. Self-storage operators need premises owned by long-term investors who accept leases with renewal options for nine years or longer.

The returns possible in this sector are compelling. Expansion in the self-storage sector is certain.

Major Infrastructure Links in Hong Kong

Source: Colliers
Industrial Specialists in Hong Kong

Fiona Ngan
General Manager
fiona.ngan@colliers.com
+852 2822 0751
Individual Licence  E-197789

Wayal Chiu
Senior Director, Industrial Services
wayal.chiu@colliers.com
+852 2822 0648
Individual Licence  E-094101

Kenny Lam
Director, Industrial Services
kenny.lam@colliers.com
+852 2822 0552
Individual Licence  E-094125

Raymond Kwong
Director, Industrial Services
raymond.kwong@colliers.com
+852 2822 0591
Individual Licence  E-113758

Paul Dwyer
Manager, Industrial Services
paul.dwyer@colliers.com
+852 2822 0596
Individual Licence  S-466184

Janet Chan
Senior Marketing Officer, Industrial Services
janet.f.chan@colliers.com
+852 2822 0660
Individual Licence  S-221538
About Colliers International

Colliers International is a global leader in commercial real estate services, with over 15,800 professionals operating out of more than 485 offices in 63 countries. A subsidiary of FirstService Corporation, Colliers International delivers a full range of services to real estate users, owners and investors worldwide, including global corporate solutions, brokerage, property and asset management, hotel investment sales and consulting, valuation, consulting and appraisal services, mortgage banking and insightful research. The latest annual survey by the Lipsey Company ranked Colliers International as the second-most recognized commercial real estate firm in the world.

collectors.com