The unresolved trade tensions between the US and China continued to weigh on Hong Kong’s external trade sector with the value of total trade down 3.7% YOY in April-May. The PMI remained below the 50-point watershed level for the fourteenth consecutive month, standing at 46.9 in May.

Despite Hong Kong’s slowing external trade performance, tight vacancy as well as in-house expansion driven by the new air cargo screening policy (see page 2) supported the growth of warehouse rents.

The Revitalisation 2.0 scheme should continue to attract investments in industrial properties. Investors should look for industrial properties in Tuen Mun with redevelopment potential as they are relatively undervalued.

**Summary & Recommendations**

The Revitalisation 2.0 scheme, including a new policy on the relaxation of the plot ratio up to 20%, should enhance the investment appetite for industrial buildings.

With only one building completed in Q2, the supply of industrial properties remains tight.

The relaunch of the revitalization should further reduce the existing stock designated for industrial use.

Warehouse rents continued to trend higher on the back of tight vacancy as well as in-house expansionary activities driven by the new air cargo screening policy.

Amid a quiet investment market, the relaunch of the revitalisation scheme should trigger more investment interest to support industrial capital values.

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Data as of April 2019

1. Census and Statistics Department, 25 June 2019
2. IHS Markit, 5 June 2019

Source: Colliers International.

Note: USD1 to HKD7.8 at the end of Q1 2019. 1 sq m = 10.76 sq ft
EXTERNAL TRADE REMAINS WEAK AMID TRADE TENSIONS

While the truce proposed during the G20 meeting between the US and China served as good news for Hong Kong, the latest trading figures show that the city’s external trade sector remained weak. In April–May, the value of total exports and imports dropped 2.4% YOY and 4.3% YOY, respectively, dragged down by the decline in trade with China and the US where drops of 2.8% YOY and 10.8% YOY, respectively, were recorded over the same two-month period. Meanwhile, port container throughput and air cargo throughput also declined 5.1% YOY and 7.6% YOY, respectively. The number of container and goods vehicles crossing the border dropped 4.5% YOY in April.

The trade tensions also affected business sentiment. According to IHS Markit, in April the Nikkei Hong Kong PMI further deteriorated to 46.9*, below the 50-point watershed level for the fourteenth consecutive month. The weak business confidence largely stems from the lack of new business from China.

IN-HOUSE EXPANSIONS DRIVE RENTS

Warehouse rents continued to trend higher amid limited availability, on the back of the ongoing revitalization policy that displacing certain industrial space for other usages. Against this backdrop, over warehouse rents grew 1.3% QOQ.

Leasing activities took place during the quarter mainly focused on renewals. For instance, Panalpina China Ltd renewed their facilities at ATL Logistics Centre in Kwai Chung, according to EPRC. Meanwhile, the quarter also saw in-house expansion enquiries for warehousing space coming from 3PLs’, driven by the new air cargo screening policy which is scheduled to be fully implemented in July 2021. 3PLs who are not validated by the Civil Aviation Department as Known Consignors are required to have their cargo subject to 100% security screening prior to being loaded on commercial aircraft. As such, some existing tenants require more warehouse space to accommodate the installation of X-ray equipment for screening purposes.

**Major industrial market indicators**

<table>
<thead>
<tr>
<th>Major Industrial Market Indicators</th>
<th>Q2 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Exports (Apr – May)</td>
<td>-2.5% YOY</td>
</tr>
<tr>
<td>Port Container Throughput (Apr – May)</td>
<td>-5.1% YOY</td>
</tr>
<tr>
<td>Air Cargo Throughput (Apr – May)</td>
<td>-7.6% YOY</td>
</tr>
<tr>
<td>Warehouse Rents</td>
<td>1.3% QOQ</td>
</tr>
<tr>
<td>Factory Rents</td>
<td>1.7% QOQ</td>
</tr>
</tbody>
</table>

**Hong Kong warehouse rents**

![Growth of 3-month moving average](image)

Source: Census and Statistics Department, Colliers International. Note: data is a three month moving average.

*IHS Markit*, 5 June 2019
INVESTMENT ACTIVITIES PICKED UP IN Q2 2019

This quarter saw investment volume rebounded by 36% QOQ, largely due to the sales of strata titled factories. Some investors targeting potential redevelopment tried to unify ownership within the target building. For instance, three factory units at Yip Fat Industrial Building Phase 1 in Kwun Tong were snapped up for HKD103 million (USD13.2 million) by a company owned by the owner of Biel Crystal, while the company already had previous purchases in the building3.

Only one en-bloc transaction was recorded over the quarter. Laws Group bought4 822 Lai Chi Kok Road in Lai Chi Kok for HKD1.4 billion (USD179 million), realising a unit price of HKD9,532 per sq ft (USD13,154 per sq m). While the building could be converted to retail use to create synergies with Laws Group’s D2 Place located nearby, the company can also choose to redevelop the building under the relaunch of the revitalisation scheme, which allows the non-residential plot ratio to be relaxed by up to 20%.

Similarly, Emperor Group took advantage of the relaunch of the revitalisation scheme, by applying to the Town Planning Board5 for relaxing the plot ratio of Toppy Tower in Kwai Chung from 9.5 to 11.4. According to the application, the owner planned to redevelop the building into a 22-storey industrial building with total floor area of 162,500 sq ft (17,097 sq m).

REVITALISATION 2.0 TO PROVIDE SUPPORT FOR CAPITAL VALUES

Looking ahead, unless the trade tensions are completely resolved, the truce should provide limited support to Hong Kong’s import and export trade. However, the new air cargo screening policy should continue to drive the leasing demand for warehouse space. Coupled with tight vacancy and the lack of new supply, warehouse rents will probably stay on the uptrend in 2019. Meanwhile, we believe the revitalisation scheme 2.0 should enhance the investment appetite. We expect the capital values of industrial properties to trend higher for rest of the year.
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