Re-vitalisation of Hong Kong's Industrial Buildings

It has been more than 18 months since the introduction of the industrial building's revitalisation scheme by the Hong Kong Government. With more than a thousand eligible industrial buildings for wholesale conversion, statistics suggest that the number of executed wholesale conversions is only 7.

Since the Policy Speech 2011/2012, the Government has provided further refinements to encourage more vendors to go ahead with their wholesale conversion schemes. This paper reviews the provisions and comments on the potential impact. In addition to the pace of conversion, analysis has been done on the executed conversions, to establish the preferred type of conversion and location.

Colliers INTERNATIONAL

Market Responses

In order to facilitate redevelopment, or wholesale conversion, of a significant number of under-utilised and vacant industrial buildings into other uses, the government has officially implemented a number of initiatives collectively known as the "New Policy of Revitalisation of Industrial Buildings" since 1 April 2010. The government has added sweeteners in their initiatives to encourage existing vendors to truly re-vitalise their premises. In general, the incentives include favourable financing arrangements for the payment of land premiums (in the case of redevelopment) and the implementation of a "nil waiver fee" for changes of use of industrial buildings during their lifetime.

Just before the Policy Speech 2011/2012 by the Chief Executive of the HKSAR Government in October 2011, there were 11 applications received for redevelopment. Nine schemes have been approved but only one has gone ahead with redevelopment. On the wholesale conversion front, market responses were relatively stronger as there have been a total of 50 applications received since the beginning of April 2010. A total of 26 applications have been approved so far, but only seven vendors have executed the "nil waiver fee" arrangement for their conversion schemes.

STATISTICS ON WHOLESALE CONVERSIONS (BY BOARD DISTRICT)

Location	Number of Applications Received	Number of Cases Executed
Hong Kong	2	0
Kowloon	34	7
New Territories	14	0
Total	**50**	**7**

Source: Lands Department, HKSAR Government

Colliers' View:

With reference to the total stock of more than 185 million sq ft of industrial buildings in Hong Kong, the market response to the government's initiative on redevelopment of aged buildings, is at best, lukewarm. According to our market surveys in 2010, there were a total of over 1,200 aged industrial buildings (i.e. 15 years or older) which were eligible for wholesale conversion. Seven conversions under this scheme over an 18-month period represents 0.5% of the total stock. The clear reason for this low conversion rate, in our view, is that the current provisions of industrial building revitalisation initiatives have not been viewed by the private sector as sufficient to create significant value enhancement on those buildings eligible for wholesale conversion.

Refinement to the Existing Package

Further to the announcement of the progress of revitalisation of industrial buildings by the Chief Executive in his 2011/2012 Policy Speech, the Development Bureau of the HKSAR Government provided additional details on the refinement to the existing re-vitalisation package based on the outcome of the mid-term review completed by the government. Besides encouraging vendors to obtain certification by "BEAM Plus Assessment", the following are the four major refinements.

- To allow gross floor area (GFA)-exempted utility installations (e.g. machine room for lifts) on the main roof; such installations would not be regarded as an increase in building height

- To allow installation of cladding or curtain walls on the external walls; such installations would not be regarded as increases in building bulk

- To allow minor changes to the existing building frame, including variations of the internal and external structures, on the condition that demolition of external structures should involve no more than 10% of the total GFA of the existing building and that there is no net increase in the GFA after conversion

- To extend the application period for the revitalisation measures for three years - extending the deadline for submission of applications from 31 March 2013 to 31 March 2016

Colliers' View:

Judging from the perspective of most vendors of industrial buildings, the first two refinements carry a minimal positive impact on the market since they provide no net increase in either building height or bulk. However, they do provide vendors with additional design flexibility for conversion schemes. The third refinement involving the changes to existing building structure is good to have for building design but it is not a major incentive to most vendors. The fourth, extending the application period, should be welcomed by most vendors including those looking to wholesale convert their premises but have yet to submit their applications. The extension implies that the pace of conversions has not been in line with the government's own expectations.

What Buildings Executed the "Nil Waiver Fee"?

According to the information provided by the Lands Department of the HKSAR Government, all seven cases of "Nil Waiver Fee" executed are industrial developments located in Kowloon East (i.e. Kwun Tong and Kowloon Bay). To generalise, the approved cases for wholesale conversion are principally making the change of use to "office" and "shop & services". The size per development in terms of gross floor area ranges from 21,000 to 150,000 sq ft. With a total of seven developments, the average is slightly below 100,000 sq ft.

CASES OF EXECUTION FOR "NIL WAIVER FEE"

Approved Date	Lot Number	Address	Number of Storeys	Converted Uses	Total GFA (sq ft)
Oct-10	KTIL 532	11 Lai Yip Street	10	Office	96,126
Dec-10	KTIL 235	94 & 96 How Ming Street	8	Shop & Services	107,000
Dec-10	KTIL 299	163 Hoi Bun Road	12	Office & Other uses	150,000
Dec-10	KTIL 419	137 Wai Yip Street	18	Office	66,512
Mar-11	KTIL 81	71 Hung To Road	15	Office	121,950
Mar-11	KTIL 57	4 Hing Yip Street	12	Eating Place, Shop and Services	100,000
Jun-11	KTIL 548	326 Kwun Tong Road	7	Office, Shop and Services	21,883
Total					**663,471**

Source: Lands Department, HKSAR Government

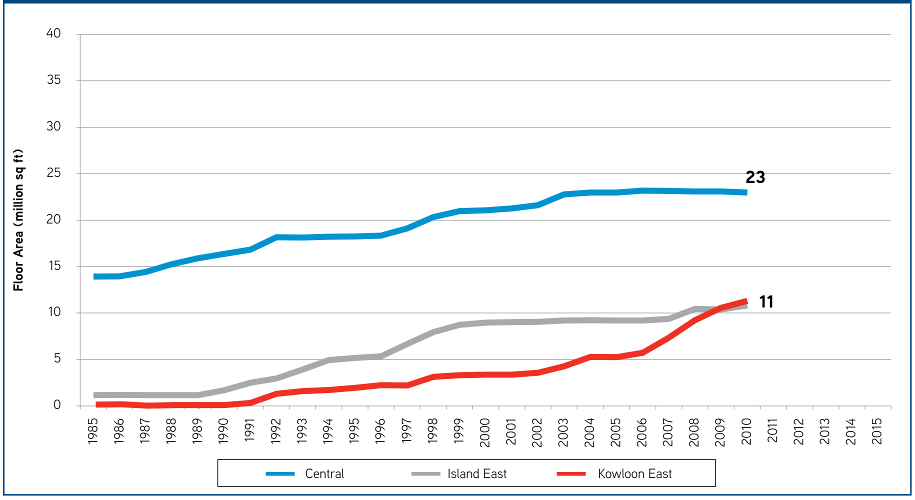
NUMBER OF INDUSTRIAL BUILDINGS ELIGIBLE FOR WHOLESALE CONVERSIONS

Source: Development Bureau, HKSAR Government; Colliers

Colliers' View:

Of the 7 executed conversions, it is obvious that Kowloon East has been the focus. The reasons are twofold. First, the district contains more than 300 industrial buildings eligible for wholesale conversion. Second, Kowloon East has come into the limelight due to the government's determination to convert the area into a business / commercial hub via infrastructure development and town planning initiatives. The government has actually planned to remodel the whole area into a so-called "CBD2" containing more than 58 million sq ft of gross office floor area which is much larger than the current size of Central (see chart below).

SIZE OF HONG KONG OFFICE STOCK
(BY KEY DISTRICT)



Source: Rating & Valuation Department of HKSAR Government

The vast majority of existing vendors favour office space as the key use in their conversion plans. In addition to the long-term planning concept put forward by the government, vendors in Kowloon East have also been encouraged by an increase of office leasing demand over the past years. One of the key changes to the leasing side of the office market is the profile of office tenants. Historically, the typical mix included a broad range of small-to-medium-sized trading, logistics and technology companies. With the continued trend towards decentralisation and a general lack of stock in traditional business districts on the Island, Kowloon East has witnessed an increasing proportion of office tenants from the insurance and financial services sectors.

The following are examples showing the recently completed office buildings in Kowloon East. It is noteworthy that a number of the major tenants are engaged in the insurance or banking sectors.

Office Buildings in Kowloon East

Octa Tower

8 Lam Chak Street, Kowloon Bay

MAJOR TENANTS

CSL, 永隆銀行 WING LUNG BANK, MUSTANG JEANS, Chubb

Landmark East

102 How Ming Street, Kwun Tong

MAJOR TENANTS

Cytech, CHARMING SHOPPES, INC., Hedgren

Manulife Financial Centre

223 – 231 Wai Yip Street, Kwun Tong

MAJOR TENANTS

利達 LEADER, 宏利 Manulife

The Next Stage

With reference to the 'go-ahead' and approved cases, some might ask why there are only seven 'go-ahead' cases out of the total 26 approved applications. Will the remaining 19 developments be going ahead with their "Nil Waiver Fee" executions?

Colliers' View:

Since many vendors remain very cautious about making substantial capital investments in their wholesale conversion schemes, it is unlikely that the remaining approved cases will go ahead with their plans in the near term. In addition, some of the existing vendors may delay their conversions in anticipation that the government will offer more incentives in the overall revitalisation package, notwithstanding the recent refinements of October 2011.

- ***Financial Subsidy***

  Based on the current provisions, vendors who modify their leases for redevelopment are allowed to opt for payment of 80% of the land premium by instalment over five years at a fixed rate of interest (2% above the average best lending rate), if the total premium exceeds HK$20 million. As such, individual vendors might expect the government to provide similar forms of financial subsidies for their wholesale conversion schemes. Essentially, this is a critical consideration for most vendors particularly for a number of small- to medium-size enterprises with limited financial resources

- ***Car-parking Space***

  The necessity of providing sufficient car-parking space at ground level is another key hurdle holding back the pace of revitalisation. Vendors in the private sector have been waiting on the sidelines to see if there is any refinement in the package such that car-parking provisions are provided without jeopardising the total value of a conversion scheme

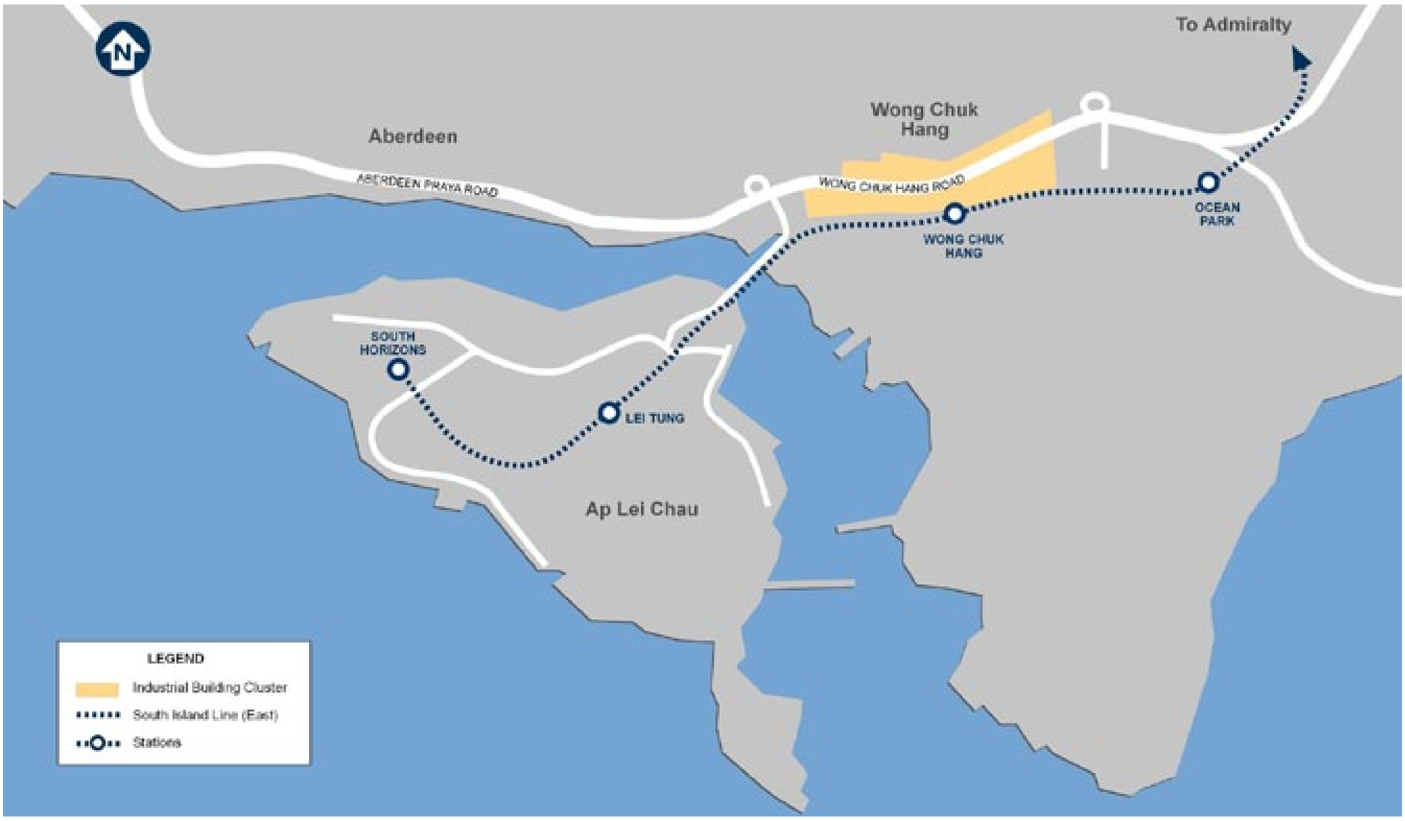
The Next Target: Aberdeen and Wong Chuk Hang

Driven by the new infrastructure link, Aberdeen and Wong Chuk Hang are two areas where a number of aged industrial buildings are eligible for wholesale conversion.

Colliers' View:

According to our information, there were a total of 54 industrial buildings eligible for wholesale conversion in Aberdeen / Wong Chuk Hang as of November 2011. The largest cluster is in Wong Chuk Hang where a total of 47 eligible buildings are located. The rest are located either in Ap Lei Chau or Tin Wan Praya Road.

In anticipation of the completion of the new MTR South Island Line (East) in 2015, vendors have been motivated to redevelop or convert their developments into other commercial uses such as hotels and offices. As with Kowloon East, the investment prospects of Aberdeen / Wong Chuk Hang look positive. The trend has been illustrated by strong buying interest in the strata-titled offices at One Island South. Developed by Wheelock, the building is a 31-storey office block at 2 Heung Yip Road, Wong Chuk Hang. With an average floor plate of 29,800 sq ft, the latest transacted prices in 4Q 2011 were in the order of HK$8,500 per sq ft compared to HK$6,500 per sq ft in early 2011.



Source: Colliers

Summary

It is our view that the overall pace of wholesale conversions for aged industrial buildings will pick up with more applications coming from a much wider group of small-to-medium-sized vendors who usually have relatively limited access to financial resources. This projection is based on the assumption that the government will provide more concrete incentives, including financial subsidies, after feedback from the private sector.

In terms of geographical preference, Kowloon East will continue to be the market focus given the size of the market and a series of infrastructure and town planning initiatives pushed forward by the government. In the case of the former, an Environmentally Friendly Linkage System (EFLS) connecting Kai Tak commercial / business developments and Kowloon East is scheduled for operation by 2023. This is essentially a 9-kilometre long elevated monorail system linking the existing MTR Kwun Tong station and Kowloon Bay station to the future Kai Tak station in the Shatin-to-Central link.

Source: Development Bureau, HKSAR Government

The overall size of the office cluster in Kowloon East will continue to expand by virtue of the government's town planning initiatives. The first block of the Kai Tak Government offices containing 540,000 sq ft of floor area is expected to be completed in 2014. A total of eleven government departments, including the Trade and Industry Department, will relocate to the building. The other two plots of land with a developable floor area of 1.07 million sq ft will be reserved for the other government offices which are currently located in Wan Chai. These are regarded as some key drivers, initiated by the government, to make Kowloon East an enlarged office hub for both the public and private sectors.

According to our surveys conducted in November 2011, office rentals in Kowloon East have grown at the fastest rate of all office locations in Hong Kong. It is our prediction that the average rental in Kowloon East, currently trading at a discount of about 30% to Tsim Sha Tsui, will narrow to less than 10% in the next 10 years.

AUTHORS:

Richard Kirke
Managing Director | Hong Kong

EMAIL richard.kirke@colliers.com
TEL +852 2822 0699

Wayal Chiu
Director
Industrial Services | Hong Kong

EMAIL wayal.chiu@colliers.com
TEL +852 2822 0648

Simon Lo
Executive Director
Research & Advisory | Asia

EMAIL simon.lo@colliers.com
TEL +852 2822 0511

COLLIERS INTERNATIONAL
Suite 5701 Central Plaza
18 Harbour Road
Wanchai, Hong Kong

TEL +852 2828 9888
FAX +852 2828 9899
Company Licence No: C-006052