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HONG KONG | INDUSTRIAL

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Rent to increase amid low vacancy

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The international and local trading environment continued to improve in Q2 2017. Retail sales are bottoming out, and this should support the demand for logistics warehouse space from retailers. Market activity is being driven by consolidation of large operators, demanding large warehouse spaces in core areas. The leasing market remains favourable and rents should increase moderately amid limited availability. Given the firm demand for warehouses, landlords appear to be in a strong position during rental renewal negotiations.

Forecast at a glance

Demand
We see continuous demand for warehouses amid the recovery of retail sales and consolidation of large logistics operators at prime warehouses

Supply
The China Merchants Group's new warehouse in Tsing Yi will be the only major addition to supply this year. New warehouse supply will be absent in 2018

Price
Industrial property prices increased by 2.9% in Q2 over Q1, reflecting strong investment interest

Rent
We expect warehouse rent to increase by 5% in 2017 as demand for logistics space stays positive. We also expect industrial rent to stay firm beyond 2017 amid limited availability

Major Industrial Market Indicators	Q2 2017	H1 2017
Total Export (up to May)	5.5%	8.2%
Container Throughput	11.1%	10.8%
Air Cargo Throughput	9.0%	11.3%
Warehouse Rent	0.7% QOQ	1.3% YTD
Factory Rent	1.4% QOQ	3.5% YTD
I/O Building Rent	0.9% QOQ	0.7% YTD

Source: Colliers; Census and Statistics Department
Note: YOY change of the total amount of the stated period for non-rental items

Rebounding external trade and domestic retail sales boost warehouse demand

The trading sector in Hong Kong continued to recover in Q2 2017. The latest Nikkei Purchasing Managers' Index (PMI) data indicated that the recent upturn was being driven by output growth, while a renewed increase in new orders, especially stronger export sales to China, contributed to the overall expansion. The PMI came in at 51.1 in June, up from 50.5 in May, signalling a further improvement in the health of the private sector.

Hong Kong government statistics also show continuous recovery in Q2. The combined value of total exports in April and May increased by 5.5% YOY, while container throughput was up 11.1% YOY and air cargo throughput climbed 9.0% YOY over the same period.

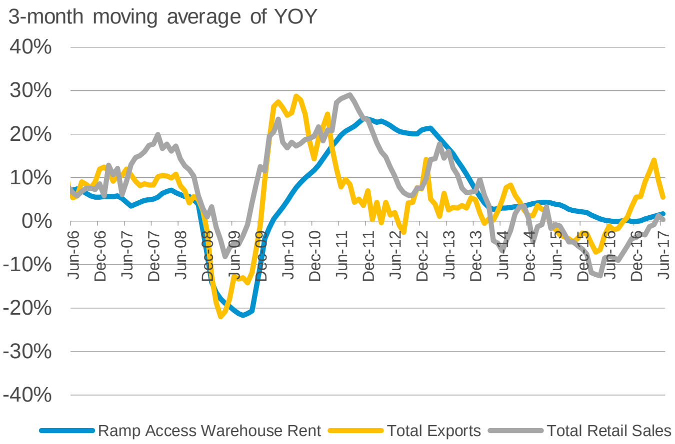
The value of total retail sales has rebounded and has increased for three consecutive months from March to May amid a sustained recovery in visitor arrivals. Warehouse demand should keep up assuming that the improved retail and trading market prevails for the rest of 2017.

Warehouse rent to stay positive amid fast take-up of new stock

Apart from the recovery in external trade and local retail sales, the warehouse leasing market was also driven by consolidation of large occupiers. Demand for quality warehouses stayed strong, as indicated by the fact that Mapletree Logistics Hub in Tsing Yi, which was completed in 2016, is now almost fully leased. The 1.7 million sq ft (158,000 sq metre) China Merchants

Group's new ramp-access warehouse in Tsing Yi, which is expected to be completed in July, has been a popular choice for consolidation and relocation by large occupiers. Despite a higher rent, ramp-access warehouses in the core areas, such as Kwai Chung and Tsing Yi, offer the higher operating efficiency required by e-commerce operators. The demand for warehouses has been firm whose rent increased 0.7% QOQ in the second quarter.

Hong Kong Warehouse Rent



Source: Colliers; Census and Statistics Department

Sentiment remains robust towards industrial buildings

The imposition of the 15% ad valorem stamp duty on residential purchases has continued to shift new investment into the industrial sector. Total transactions of industrial properties worth of HKD30 million or above maintained at a high level at HKD4.1 billion (USD0.52 billion), thanks to the four en bloc transactions in Q2. These included the 10-storey in Hsin Cheong Centre in Kwun Tong, which fetched HKD760 million (USD97.30 million) or HKD9,220 per sq ft (USD12,706 per sq metre) based on a gross floor area of 82,434 sq ft (7,658 sq metre). Another en bloc transaction was recorded in Chai Wan where a 14-storey industrial building (Asia One Tower) was sold for HKD610 million (USD78.1 million). Given that the average gross factory yield currently stands at 3.1%, investors are taking advantage of strong leasing demand and a higher yield that is available in the Hong Kong office market (2.3-2.8%).

Investors are searching for industrial buildings with revitalisation or redevelopment potentials. Sterling International Building in Kwun Tong received approval for redevelopment into a 16-storey workshop building in April from the Buildings Department, which indicates a growing confidence from industrial building owners in the future demand for workshop spaces.

Small strata-title units have received ample interest from investors due to their small ticket price. Khora in Tai Kok Tsu is a new industrial building subdivided into units for individual release; 70% of the new releases from the building (about 170 units) are 300 sq ft or less. Khora sold 77% of available stock (about 187 units) after it was released to the market in June. Apart from the new stocks, owners with large floorplates are also partitioning their premises into smaller units to meet the demand for smaller industrial units. The latest batch of sales from The ICON, a refurbished industrial building in Kwun Tong, saw 13 new releases (with floor area from 279 sq ft to 763 sq ft) sold at a price ranging from HKD3.4 million to HKD7.1 million (USD0.44 million to USD0.91 million).

A favourable outlook for the industrial market

Industrial buildings in general have low vacancy, and the Town Planning Board continues to amend town plans to allow art studios and other non-industrial uses within industrial buildings. Competition for space in industrial premises among different end-users is therefore set to intensify in the future. Hence we expect industrial rents to stay strong, with more room for growth in the near term if more industrial buildings are approved under the revitalised scheme.

The self-storage industry has been under consolidation with smaller operators leaving the market since the fire incident last year and the tougher enforcement of fire safety took place thereafter. Major market players are undertaking discussions with the Government regarding new fire safety measures. Given the ever-shrinking size of residential units in Hong Kong, the demand for self-storage space should stay firm.

Consolidation of large operators into prime warehouses is freeing up existing warehouse spaces. A flight to quality is currently taking place with large logistics operators consolidating their operations into newly completed warehouses to meet the new business requirements of their clients. The large space freed up by them should maintain a stable rent for older warehouses in the short term. However, a brighter outlook for external trade and domestic retail sales would support a more positive growth outlook for rent. We reaffirm our view that warehouse rent will increase by 5% for 2017.

We expect industrial rent to stay firm next year due to the limited new supply and the continuous conversion of industrial buildings into other uses will further reduce stocks.

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