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Revitalisation Scheme 2.0 and Favourable E-commerce Supporting Industrial Market

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Hong Kong's trade sector has benefited from a strong economy and from buoyant domestic and foreign merchandise trade demand. Growth in total exports remained strong while retail sales showed an appreciable YOY growth in November 2017. Investors have shown growing interest in investing in strata-title industrial properties, converting such properties into small workstations amid the strong demand from small and medium sized enterprises and start-up companies. We expect industrial properties to be a key focus in 2018 for investors who expect the government to launch a new round of revitalisation scheme for industrial buildings.

Forecast at a glance

Supply
We predict 1.5 million sq ft (139,000 sq m) of new supply for industrial properties but no new logistics warehouses in 2018. The new supply of industrial properties will raise total stock by 0.6%.

Demand
Rapid e-commerce, domestic retail sales, and foreign demand growth should drive the demand for logistics properties as well as warehouses.

Rent
We expect that warehouse and flatted factory rents will increase by 5% YOY on average between 2018 and 2022 respectively, being supported by strong demand and decreasing stocks

Price
Given firm sentiment in the investment market and the potential industrial revitalisation scheme, the prices of warehouses and flatted factories should rise by 8-10% YOY on average between 2018 and 2022.

Major Industrial Market Indicators	Q4 2017
Total Export (Oct - Nov)	7.3% YOY
Port Container Throughput	-3.2% YOY
Air Cargo Throughput	6.9% YOY
Warehouse Rent	0.6% QOQ
Factory Rent	0.9% QOQ

Source: Colliers; Census and Statistics Department

Strong External Trade and Retail Sales Growth Remains

Supported by global economy acceleration and growth of external trade in 2017, leasing demand for warehouses has remained strong in Hong Kong. The latest Nikkei Purchasing Managers' Index (PMI) rebounded up to 51.5 in December from 50.7 in November, a four-year high since February 2014. Driven by the stronger rise in output and renewed order book growth, Hong Kong's business activity has expanded at a fast pace.

The combined value in October and November of total exports increased by 7.3% YOY partly because of Hong Kong's retail market rebounded in 2017, which increased the warehouse demand from retailers and wholesalers. While air cargo throughput increased by 6.9% YOY, port container throughput declined 3.2% YOY.

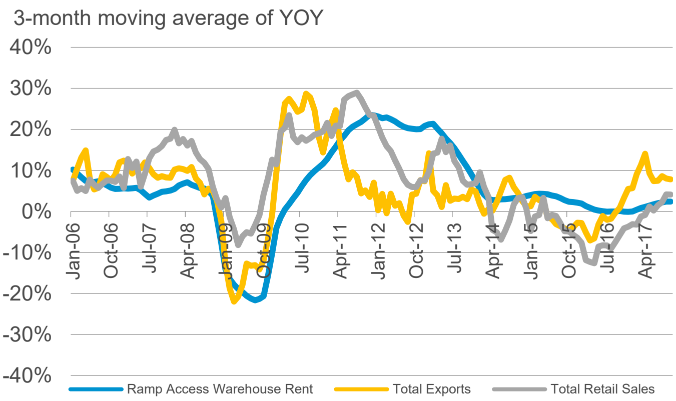
Rapid E-commerce Growth Drives Warehouse Demand and Rent

During Alibaba's "Double 11" in November 2017, the 24-hour sale recorded a new high compared to previous years, reaching a total gross merchandise volume of RMB168 billion (USD25.8 billion), up by 39% YOY.

Among the top cross-border buying countries and regions in mainland China, Hong Kong recorded the second highest transaction volume after Russia. According to Statista, the total revenue and average revenue per user in Hong Kong's e-commerce market grew by 12.5% YOY and 4.1% YOY respectively, in 2017. Indicating that Hong Kong's e-commerce market has started to pick up.

Strong e-commerce demand drove the demand for logistics services and warehouses in Hong Kong. Warehouse landlords started to refurbish their facilities to cater for the increasing warehousing demand. DHL Express, one of the biggest postal and logistics companies in the world, invested HKD2.9 billion (USD0.4 billion) to expand the capacity of its Central Asia Hub. The logistics centre in the Hong Kong International Airport, grew by 50% to cater for the needs of substantial growth in e-commerce and international trading in the region and around the world. In Q4 2017, overall warehouse rent increased by 0.6% QOQ.

Hong Kong Warehouse Rent



Source: Colliers; Census and Statistics Department

Record High Investment Volume

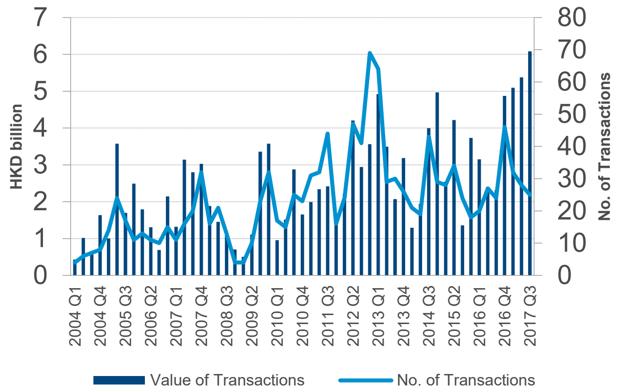
Investment sentiment has been the most positive in recent years after Ms Carrie Lam's policy address, announcing that the Hong Kong government will consider implementing the industrial revitalisation scheme again. With the expectation of a new revitalisation scheme round, namely Revitalisation Scheme 2.0, to be launched by Hong Kong Government in 2018, industrial properties have become more attractive for investors.

Apart from revitalising or redeveloping an entire building, an increasing number of investors would like to invest in strata-title industrial properties and undertake their conversion to small workstations for small and medium-sized enterprises (SMEs and start-up companies).

According to our research, total industrial property transactions of over HKD30 million recorded a quarterly high in Q4 2017, up by 32% QOQ to HKD8.02 billion (USD1.03 billion). This figure was supported by the record high volume of strata title investment, which surged by 86% QOQ. For example, Lead Harvest Group bought the entire 13th floor of Zung Fu Industrial Buildings in Quarry bay for HKD218.5 million (USD28 million). With the gross floor area (GFA) of 15,000 sq ft (1,393 sq m), the unit price was HKD14,600 (USD1,872) per sq ft. The group has purchased five floors for HKD935 million (USD120 million) starting from January 2016. The adjoining new office developments should energise the market with the necessary amenities to further support the growth of the property value, suggesting a high redevelopment potential.

The total consideration of en-bloc investment (over HKD30 million) was also a record high in Q4 2017 and posted a QOQ increase of 11%. Maxwell Electronic Group sold the whole block of Maxwell Industrial Buildings in Kwun Tong for a total of HKD1,039 million (USD178 million) to Laws Group. The unit price was HKD6,043 (USD775) per sq ft. Meanwhile, Winning Godown Building in Tsuen Wan was sold for HKD2,160 million (USD277), with GFA of 500,000 sq ft (46,430 sq m), translating to HKD4,320 (USD534) per sq ft, to Billion Development. With limited supply of industrial buildings, we expect the potential Revitalisation Scheme 2.0 to continue to encourage investors to acquire industrial buildings.

Value of Industrial Property (deal size over HKD30 million)



Source: Colliers; EPRC

Cautiously Optimistic For 2018 Outlook

Global real GDP growth in 2018 should be higher than 2017, and reach the highest level since 2010, although certain Asian countries may experience mild slowdowns from very strong levels in 2017. We believe that Hong Kong's merchandise trade will remain favourable in 2018, supported by rising commodity prices and stronger overseas demand. Moreover, the trade policy of the US president, Donald Trump, toward China has been more moderate than his election campaign suggested. As the most important entrepôt for mainland China, we expect Hong Kong will still benefit from the trade between the U.S. and China.

The details of the Revitalisation Scheme 2.0, announced in October's policy address, are likely to be released by mid-2018. The scheme will focus on the consolidation of ownership to facilitate comprehensive conversion and other non-industrial uses, such as transitional houses, recreational centres, and retail spaces. The scheme should further intensify the supply in the industrial market, which will support the investment demand and industrial property prices.

The growth of air cargo throughput outpaced the growth of port container throughput in 2017. While logistics demand has been shifting from sea-freight to air-freight, the rapid growth of the e-commerce market should further strengthen the logistics and warehouse demand at the international airport.

Furthermore, the overall vacancy rate of industrial properties during the end of 2017 remained low, at 6.4% on average, especially for logistics warehouse sat 4.9%. We project zero new supply of logistics warehouses in 2018. The existing stock ought to decline as a result of the potential Revitalisation Scheme 2.0, which would allow landlords to convert industrial buildings to other uses. Therefore, with the declining supply and growing demand for logistics warehouses, we expect the logistics warehouse vacancy rate to decrease in 2018.

Overall, we remain optimistic about the industrial property market in 2018. Based on our forecasts, the warehouse prices and rents will increase by 10% YOY and 5% YOY respectively, while flatted factory prices and rents will increase by 10% and 5% respectively.

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