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Conditions in logistics firm, but may cool if the trade war escalates

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After a strong Q2 2018, growth in the industrial market could decelerate with the Hong Kong PMI dropping in June to a two-year low of 47.7 coupled with rising interest rates. The leasing market remained active in Q2 supported by forced relocation and expansion pushing rents to increase by 2.3% QOQ. Investment sentiment has thus far been spared from the threat of a US/China trade war with prices rising 9.3% YTD. Looking forward, tenants should consider using more robotic driven warehouses in Hong Kong to reduce the demand for warehouse space and further improve operating efficiency and cost savings.

Forecast at a glance

Demand

The demand for warehouses should be dominated by forced relocation and expansion, and continue to drive the market in 2019-2022. However, a trade war may slow down the investment market in H2 2018.

Supply

There should be only one industrial land sale, included in FY2018 land sale programme, in Fanling, providing GFA of 202,630 sq ft, but there should be no new warehouse supply in H2 2018. We expect new supply of 889,099 sq ft (82,600 sq m) in 2019 with warehouse supply of 86,111 sq ft (8,000 sq m).

Rent

Warehouse and flatted factory rents should each rise by 8% in 2018, supported by strong demand and limited vacancy, and increase by 5% per annum on average over 2019-2022.

Price

Given positive investment sentiment, prices of warehouses and flatted factories should rise by 10-15% in 2018 and by 8% per annum over 2019-2022.

Major Industrial Market Indicators	Q2 2018
Total Exports	9.0% YOY
Port Container Throughput	-6.4% YOY
Air Cargo Throughput	3.3% YOY
Warehouse Rents	2.3% QOQ
Factory Rents	3.3% QOQ

Source: Census and Statistics Department, Colliers Research

Strong trade and retail figures but weaker market expected for Q3

Strong trade and retail figures in Q2 drove demand for warehouses space. According to the Census and Statistics Department, total exports surged by 9.0% YOY for Q2 2018, benefiting from continuing global economic strength. Besides, logistic services continued to shift from sea-freight to air-freight. During the second quarter, air cargo throughput increased by 3.3% YOY while port container throughput decreased by 6.4% YOY, driving the demand for warehouses near Hong Kong International Airport. Regarding the domestic market, robust retail sales, showing 12.4% YOY growth for Q2 2018, was supported by a buoyant local consumption and the return of mainland visitors.

Nonetheless, Nikkei Hong Kong's June PMI dropped to 47.7, the lowest level in two years. Dipping below 50 points indicates a contraction in activity. According to their survey, private sector activity in Hong Kong has been deteriorating since the end of Q1, as a result of lower outputs and slower new orders, a rise in purchasing costs, and softening business confidence. The figures implied that the GDP growth rate should decelerate in H2 2018.

Relocation and expansion dominate the leasing market

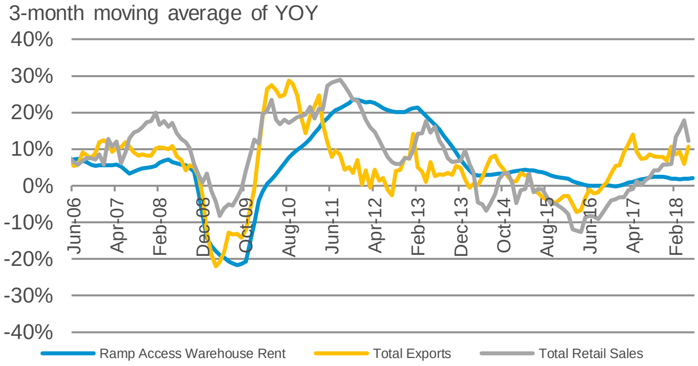
The leasing market remained active, being driven by expansion and forced relocation. Warehouse and factory rents increased by 2.3% QOQ and 3.3% QOQ respectively. Rents have risen continuously since 2010 and the growth rate has been accelerating in recent quarters.

As a result, more landlords prefer to shorten lease terms to no longer than five years, rather than seven to 10 years, to capture the latest rental growth. On the other hand, more firms would like to use third-party logistics services (3PLs) to reduce their logistics costs and warehouse rentals, and to enjoy more flexibility.

Although the deadline for the previous round of revitalisation schemes has already passed, about 40 industrial buildings have not yet started their works. Meanwhile, tenants are being served with notices to move out before construction can start. Therefore, we expect to see more forced relocations due to revitalisation this year.

Notable leasing transactions in Q2 included the following: WT Microelectronics Co. Ltd., a global semiconductor distributor, leased Hutchison Logistics Centre (HLC) in Kwai Chung for 76,000 sq ft (7,060 sq m) for expansion. Forewide Company (Logistics) Ltd. leased 90,600 sq ft (8,415 sq m) at ATL Logistics Centre in Kwai Chung for expansion.

Hong Kong Warehouse Rent



Source: Census and Statistics Department, Colliers Research

Investment sentiment remains positive

While the total investment transaction volume in Q2 was 20.3% lower than Q1, sentiment has remained strong. The delay in the announcement of a new round of revitalisation schemes by the government has not affected the market. According to our research, warehouse and factory prices increased by 4.7% QOQ and 4.3% QOQ respectively, and YTD increases were 9.3% and 8.9% respectively.

Looking forward, a lack of stock should further slowdown transactions. Our research shows that the number of transactions over HKD30 million in Q2 declined by 20.3% QOQ to HKD9.0 billion (USD1.15 billion). The volume of en bloc investment dropped to HKD5.9 billion (USD761 million), down by 28.1% QOQ.

Major Industrial Transactions in Q2 2018

Location	Property	Floor	GFA (sq ft)	Price (HKD million)	Unit Price (HKD per sq ft)	Buyer
Shatin	Shatin Industrial Centre Block A	5/F	28,261	158	5,604	Hanison Construction Holdings Ltd
Kwun Tong	No. 1 Hung To Road	Unit 1-3, 5-13, 15-22, 31/F	22,800	182	7,982	SIS International Holdings Ltd.
Kwai Chung	57-59 Kwok Shui Road	En bloc	117,000	950	8,120	China Aoyuan Property Group Co., Ltd.
Kwai Chung	Brillant Cold Storage Tower 2	En bloc	293,850	1,600	5,517	Mr Tang Sing Bor
Kwai Chung	Cargo Consolidation Complex	En bloc	266,200	2,000	7,513	China Aoyuan Property Group Co., Ltd.

Source: Colliers Research, Market News

Notable en bloc transactions during Q2 included Brilliant Cold Storage Tower 2 at 11-15 Wing Yip Street, Kwai Chung, which was sold to veteran investor Mr Tang Sing Bor for HKD1.6 billion (USD205 million). Based on the GFA of 293,850 sq ft (27,300 sq m), the average price was HKD5,517 (USD707) per sq ft. The value of the property had increased more than three times in nine years, as the previous owner bought it for HKD390 million (USD50 million). Meanwhile, PAG sold the Cargo Consolidation Complex for HKD2.0 billion (USD256.4 million), with a GFA of 266,200 sq ft (24,731 sq m). The new investor is eyeing the opportunity to redevelop this site into a data centre.

Logistics industry to embrace new robotic technology

Hong Kong is likely to see more technology driven logistics facilities. For example, Goodman, an Australian logistics property developer, and Cainiao Network, an Alibaba affiliated company, have both expressed their intention to develop high-tech robotic driven logistics centres in Hong Kong after winning the two new logistic sites at Tuen Mun and Hong Kong International Airport (HKIA) respectively.

Goodman had paid HKD2.75 billion (USD350 million), for a site area of 340,870 sq ft (31,670 sq m) at Tuen Mun. Based on the plot ratio of 2.5, the maximum GFA of the warehouse should yield a GFA of 852,175 sq ft (79,170 sq m). The new warehouse will likely apply robotic technology in receiving, sorting and storing cargo.[1]

Cainiao Logistics Network, taking a 51% stake of a joint venture with China National Aviation Corp. and YTO Express, plans to invest HKD11.7 billion (USD1.5 billion) to build a new logistics centre at HKIA. The logistics centre will probably cover a GFA of 4,090,286 sq ft (380,000 sq m) and is scheduled to become operational in 2023, handling 1.7 million tonnes of cargo per annum at full capacity. It should also feature automated warehousing and temperature-control solutions and is planned to include an air cargo processing centre, a sorting centre and a fulfilment centre. Cainiao has announced that Hong Kong will be one of the six logistics hubs planned for its global network. [2]

Goodman's and Cainiao's investments display Hong Kong's advantages and attractiveness to international logistics investors and operators, notably in air-freight and cross-border e-commerce. We expect more logistics operators to introduce new technology, such as blockchain, in their operations to streamline collaboration and documentation across the entire supply chain.

The escalation of trade disputes to create short term uncertainties

After recording a strong growth in H1 2018, Hong Kong's real GDP growth could soften amid a trade war between the US and China. The US has recently planning to impose the second round of 10% tariffs targeting US$200 billion worth of Chinese exports. China and the US are Hong Kong's top two trading partners, with Hong Kong acting as a major transhipment centre for imports and exports from China.

Although a China-US trade war has yet to have an immediate effect on the industrial market, it has already triggered a deterioration of business sentiment and may cause further delay in future investment plans. We expect the investment market to further slowdown in H2.

Industrial properties to benefit from integration with GBA

On a positive note, we expect Hong Kong's economy to continue growing in H2 2018. According to Oxford Economics, the real GDP annual growth rate and exports of goods is forecast to be 3.6% YOY and 6.2% YOY in 2018 respectively.

We expect one industrial land sale to take place in H2 2018. The 40,526 sq ft (3,765 sq m) site at On Chuen Street, On Lok Tsuen, Fanling should have a maximum GFA is 202,630 sq ft (18,825 sq m).

The Hong Kong-Zhuhai-Macau Bridge is scheduled to open in Q3 2018, which could greatly reduce the travel time between Hong Kong and the West Peral River Delta area, further expanding the catchment area for HKIA. The growth in air logistics in Hong Kong should remain strong in the next three to five years.

Overall, we remain optimistic about the industrial property market in H2 2018, supported by force relocation and expansion; however, the growth rate could decelerate when compared to H1 2018 due to deterioration of business sentiment and trade war. We forecast warehouse and flatted factory rents to increase by 8% YOY in 2018 and 5% per annum over 2019-2022, while prices should increase by 10-15% YOY in 2018 and 8% per annum over 2019-2022.

[1] Source: Goodman media releases on 7 May 2018

[2] Source: Alibaba News on 6 June 2018

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