Briefing
Industrial sales and leasing November 2017

SUMMARY

Modern warehouses are seeing more leasing activity while traditional warehouses are facing higher vacancies.

- The sales market saw the high profile sale of Maxwell Industrial Building in Kwun Tong for HK$1.39 billion.

- Investment sentiment elsewhere was more muted with a lack of available en-bloc sales stock, as well as flattening rental returns.

- The warehouse leasing market saw more movement in Q3/2017, mainly upgrade demand from medium-sized 3PLs.

- Elsewhere in the more traditional warehouses, vacancy crept up with smaller landlords unable or unwilling to cut rents to retain tenants facing lease expiries.

- We expect the bottoming out of the trading sector as well as the recovering retail segment to provide some support to logistics demand.

- We expect warehouse prices to remain more or less unchanged over the remainder of the year while industrial prices may increase further as a result of redevelopment interest.

"The sale of Maxwell Industrial Building for HK$1.39 billion was a high profile transaction, reflecting confidence from local investors in the long-term redevelopment prospects for industrial premises in Kowloon East." Simon Smith, Savills Research

Sales market

The sale of Maxwell Industrial Building for HK$1.39 billion was a high profile transaction, reflecting interest from local investors and a belief in the long-term redevelopment prospects of industrial premises in Kowloon East. The premises can be redeveloped into a commercial complex with a maximum GFA of 229,200 sq ft, representing an AV of HK$6,065 per sq ft before land premiums.

The investment market slowed in Q3/2017 with a lack of available en-bloc stock, and the largest transaction was the sale of 87% of Tin Fung Industrial Centre for HK$1.7 billion. The new buyer intends to unify the ownership for redevelopment. Other warehouse transactions were mainly stratified floors in traditional warehouses in Kowloon East and Kowloon West for long-term investment, and as such major industrial transactions declined both in terms of volume and value by 50% and 19% QoQ respectively. Industrial prices remained broadly stable in Q3/2017 as a result.

TABLE 1

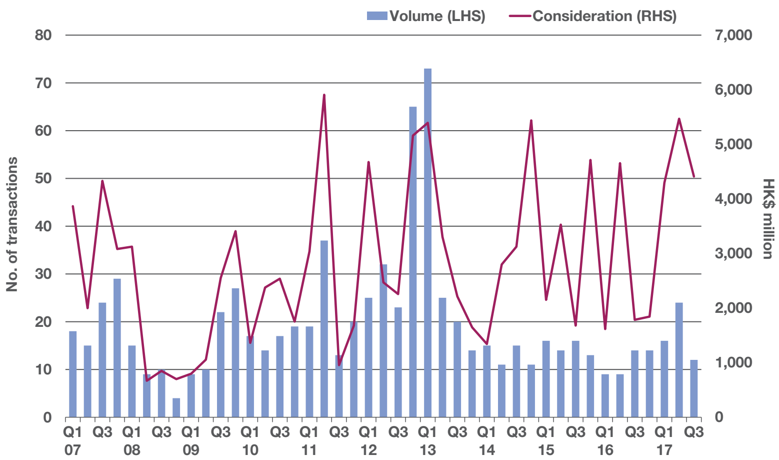
Industrial price growth by subsector, Q3/2017

	Q3/2017 (%)	Q2/2017 (%)	Q1/2017 (%)	2016 (%)	2015 (%)	2014 (%)
Flatted factories	+0.4	+3.7	+3.2	+4.1	+8.3	+17.4
I/O	+0.3	+3.5	+3.2	+3.4	+5.1	+13.2
Warehouse	+2.9	+3.9	+2.1	-1.2	+8.5	+9.4

Source: Savills Research & Consultancy

GRAPH 1

Major industrial transaction volumes and values (>HK$30 million), Q1/2007–Q3/2017



Source: Savills Research & Consultancy

Leasing market

The warehouse leasing market saw more movement in Q3/2017, mainly upgrade demand from medium-sized 3PLs (50,000 sq ft or below) from traditional to modern warehouses. A number of tenants facing expiries in traditional warehouses seized the opportunity presented by the increased availability of modern warehouses and relocated to better quality premises in the Kwai Chung / Tsing Yi area over the quarter, with ATL / Global Gateway the main beneficiaries. Modern warehouse vacancy declined further to 1.0% in Q3/2017 as a result.

Elsewhere in the more traditional warehouses, vacancy rose gradually with smaller landlords unable or unwilling to cut rents to retain tenants facing lease expiries, and the situation was worse in stratified warehouses where landlords with inconsistent leasing strategies within the same buildings did not help. As such, overall vacancy increased from 2.4% in Q2 to 2.6% in Q3.

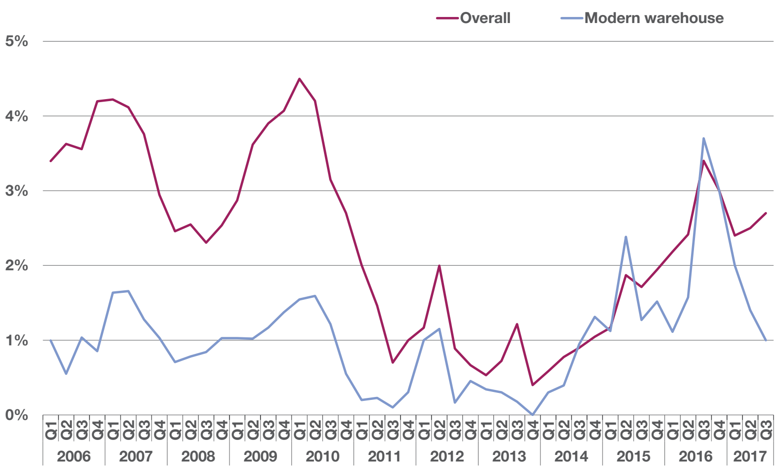
Policy Address update

In her latest Policy Address, the Chief Executive reiterated the need *"to increase the supply of various types of land, including logistics land, to maintain Hong Kong's competitiveness and to meet the needs arising from economic development. In addition to a site of about 3.2 hectares for logistics use in Tuen Mun Area 49, the Government will continue to identify suitable sites for such use at different locations (including Hung Shui Kiu New Development Area, Yuen Long South development, Tuen Mun Areas 40 and 46 and New Territories North)."* While there is no definite timing for the provision of the logistics sites mentioned, it shows an intention by government to tackle the current undersupply of modern logistics facilities.

The Policy Address continued: *"The Government is also exploring different approaches to facilitate the transformation of industrial buildings and releasing land resources. Possible options include reactivating the revitalisation scheme for industrial buildings by offering incentives to encourage owners of old industrial buildings to undertake redevelopment or wholesale conversion, and considering how operating space can be provided legally and safely under the scheme for certain industries with development potential, such as cultural, arts and creative industries, and for appropriate community facilities."* We think that this time round, the Government may be much more cautious in reintroducing revitalization policies, wanting to facilitate genuine redevelopment/conversion rather than providing scope for speculators to push up prices.

GRAPH 2

Warehouse vacancy rates, Q1/2006–Q3/2017



Source: Savills Research & Consultancy

The vacancy situation was further complicated by the imminent completion of China Merchant Logistics Centre, which has a total GFA of 1.7 million sq ft. According to market news, four of the ten warehouse floors of the building have been leased, with two floors available for lease in the open market. The remaining four floors, which have been earmarked for owner-occupation, were also available for short-term lease (3 years or less). Therefore total vacant space in the new premises amounted to 1.0 million sq ft and adding back this project into our vacancy basket increased both modern warehouse and overall warehouse vacancy rates to 4.2% in Q3/2017.

OUTLOOK

The prospects for the market

Looking ahead, the bottoming out of the trading sector as well as the recovering retail segment should provide some support to weakened logistics demand, though we see some structural shift in retail logistics demand from luxury / high-end products to more daily necessities / affordable luxury. The growing e-commerce and online shopping segments are expected to once again change the market landscape and to accommodate such modern e-commerce operations existing landlords have to adapt both physically and in terms of lease structure (maybe by providing longer lease terms and more rent free periods to help alleviate their high initial capex). More sophisticated modern warehouse landlords may gain further ground on their traditional counterparts. The key concern for landlords is again new supply with 60% of the newly completed China Merchant Logistics Centre available for lease, limiting the potential for rental increases even as logistics demand is showing signs of a rebound in the short term.

While real interest rates remain low the lack of available sales stock may drag transaction volumes down further over the remainder of the year, with warehouse prices likely to remain more or less unchanged, meaning that warehouse yields are now set to stabilize after years of compression.

Please contact us for further information

Savills Industrial

James Siu
Deputy Managing Director
Head of Kowloon
+852 2378 8628
jsiu@savills.com.hk

Savills Research

Simon Smith
Senior Director, Asia Pacific
+852 2842 4573
ssmith@savills.com.hk

Jack Tong
Director
+852 2842 4213
jtong@savills.com.hk