Asian Cities - 2H 2022

SPOTLIGHT
Savills Research

Hong Kong Industrial

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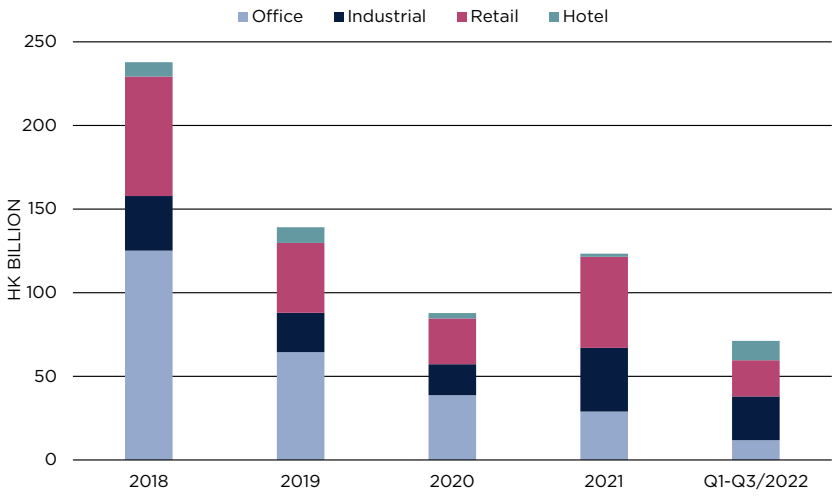
Industrial investment sentiment softens against uncertain outlook

INDUSTRIAL DEALS PREVAIL IN A WEAK ECONOMIC ENVIRONMENT

The city continued to struggle against a confluence of downside risks including a slowing domestic economy, stringent border policies, rising interest rates and an uncertain macro-outlook. Total imports and exports of goods and services are expected to drop by 9.9% YoY and 10.3% YoY respectively due to restrictions on cross-border activity with mainland China and the deterioration in demand from the rest of the world. All in all, Real GDP growth is poised to retreat by 3.2% YoY for the full year of 2022, making Hong Kong one of the very few major markets slipping into recession within the Asia Pacific this year.

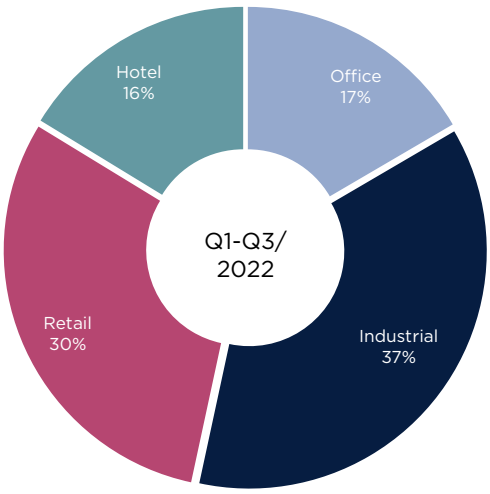
The property investment market has followed suit, with a total investment volume of commercial properties worth over HK$10 million or above falling by 38% YoY in the first three quarters of 2022, coming off from a high base, with the number of transactions down 48% YoY. Amid this gloomy backdrop, the industrial market has continued to show resilience, buoyed by several large en-bloc transactions. About 37% of the total investment volume was attributable to this asset class over the period, followed by retail and offices which accounted for 30% and 17% each.

GRAPH 1: Commercial Properties Investment Volume by Property Type, 2018 to Q1-Q3/2022



Source Savills Research & Consultancy

GRAPH 2: Commercial Properties Investment Volume by Property Type, Q1/2022 to Q3/2022



Source Savills Research & Consultancy

CASH-RICH LOGISTICS OPERATORS SNAP UP EN-BLOC DEALS

With a vacancy rate below 5% over the past 10 years, the industrial leasing market has weathered the storms which have beset other sectors with uninterrupted growth. E-commerce and 3PL operators have remained the dominant driving force, lifting modern warehouse rents by 3.1% YoY over the first three quarters of 2022, after 6.5% YoY growth in 2021.

The industrial sector has outperformed its other commercial counterparts, as office and retail rents have dropped by 13.5% and 7.9% respectively over the past two years. Amid the tight vacancy environment, many cash-rich operators have continued to acquire mature properties for their own operations. For example, China Resources Logistics has bought five warehouse properties in Hong Kong, totalling over HK$11 billion, over the past decade. Its latest purchase was in May, adding two warehouses, Kerry Godown Chai Wan and Kerry Godown Shatin, priced at HK$2.29 billion (HK$4,393 per sq ft) and HK$2.33 billion (HK$5,762 per sq ft) respectively. The vendor realised a gain of HK$1.02 billion over the course of three years. The firm also spent another HK$264 million (HK$3,649 per sq ft) two months later buying two floors in Riley House in Kwai Chung from Tsui Wah Group under a sale and lease back arrangement, reflecting confidence in the city's long-term prospects.

Private equity funds have been another major source of capital. GLP made their first logistics investment in Hong Kong by acquiring the warehouse at 8-12 Tsing Tim Street, Tsing Yi from Swire Properties for slightly over HK$1 billion (HK$5,405 per sq ft). Meanwhile, Goodman continued their recent venture into the strata-titled market by purchasing another floor in Sunshine Kowloon Bay Cargo Centre for HK$368 million (HK$5,280 per sq ft), as well as paying HK$380 million (HK$2,262 per sq ft) for a 72% share of Chuan Kei Factory Building in Kwai Chung. KaiLong, on the other hand, purchased a 90% stake in the Wing Shing Industrial Building in Kwai

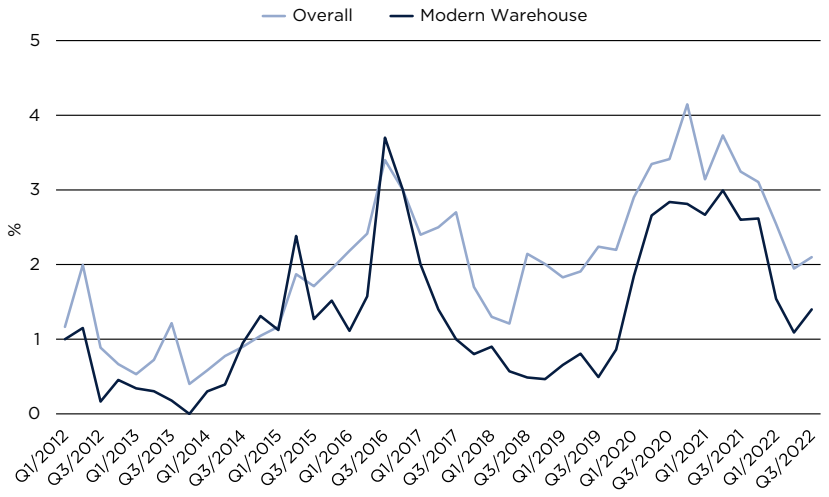
Chung for HK$433 million from a veteran local investor, the Tang family, possibly with an eye to its redevelopment potential.

ALTERNATIVE INDUSTRIAL ASSETS GATHER MOMENTUM

Apart from warehouses, we have also noticed a growing trend for institutional investors to look for self-storage properties. A joint venture between Blackstone and self-storage operator Storefriendly acquired the 12-storey Novel Industrial Building in Cheung Sha Wan in October for a consideration of HK$850 million, reflecting an average unit price of HK$5,667 per sq ft. Meanwhile, Warburg Pincus-backed StorHub continued to expand its portfolio in Hong Kong, snapping up its third acquisition within the year. The self-storage operator reportedly bought a whole floor in the nearby Precious Industrial Centre for HK$98 million (HK$5,102 per sq ft). The biggest institutional player in this field is Canadian asset manager Brookfield. After taking over RedBox Storage from InfraRed NF, a joint venture between local developer Nan Fung Group and British investment firm InfraRed Capital Partners, it has since made two major acquisitions, namely a HK$211 million (HK$7,522 per sq ft) purchase in Shatin Industrial Centre in May and a HK$55 million (HK$7,559 per sq ft) deal for a pair of units in the Chai Wan Industrial Centre in August.

Cash-rich logistics operators and fund investors are still taking an interest in industrial and logistics assets, however, with industrial pricing hitting new highs and interest rates on the rise, investor sentiment may cool in the near term.

GRAPH 3: Warehouse Vacancy Rate by Property Type, Q1/2012 to Q3/2022



Source Savills Research & Consultancy

GRAPH 4: Number of Regional Headquarters in Hong Kong by the Origin of the Parent Companies, 2011 to 2021

Source Savills Research & Consultancy

NEAR-TERM TURBULENCE AHEAD, WITH LONG-TERM PROSPECTS STILL POSITIVE

While this asset class has been regarded as a safe haven over the pandemic, we have started to see dwindling demand from investors. Looking ahead, Hong Kong will continue to face a highly challenging economic outlook in 2023. The elevated inflation and continued monetary policy tightening in major advanced economies are likely to further dampen global trade growth and hinder investment sentiment in the near term. With industrial pricing hitting new highs and interest rates on the rise, the positive yield carry for traditional warehouses is expected to diminish over the coming months. With applications for the 20% additional GFA for industrial redevelopment also slowing, we may see redevelopment-related industrial transactions quieten, leaving end users as

TABLE 1: Notable Industrial Transactions, Q2/2022 to Q3/2022

QTR/YR	LOCATION	FLOOR	TOTAL GFA (SQ FT GROSS)	AMOUNT (HK$ MIL)	AVERAGE PRICE (HK$ PER SQ FT)	SELLER	PURCHASER	TYPE	REMARKS
Q3/2022	8-12 Tsing Tim Street, Tsing Yi	Whole	186,495	$1,008	$5,405	Swire Properties	GLP	G	Investment
	Novel Industrial Building, 850-870 Lai Chi Kok Road, Cheung Sha Wan	Whole	149,995	$850	$5,667	Chao Kuang Piu's Family	JV of Blackstone and Storefriendly	I	Redevelopment
	Wing Shing Industrial Building, 26-30 Wing Kei Road, Kwai Chung	90% share	209,000 (max GFA)	$433	$2,286 (A.V.)	Tang's Family	KaiLong	I	Redevelopment
	Chuan Kei Factory Bldg, 15-23 Kin Hong Street, Kwai Chung	2/F B, 4/F-6/F, 8/F-14/F & RF (72.53%)	168,000	$380	$2,262	Cheerful Gain Development Ltd	Goodman	I	Investment
	Sunshine Kowloon Bay Cargo Ctr, 59 Tai Yip Street, Kowloon Bay	1/F	69,700	$368	$5,280	TBC	Goodman	G	Investment
Q2/2022	Kerry Godown (Shatin), 36-42 Shan Mei Street, Shatin	Whole	404,374	$2,330	$5,762	Kerry Properties	China Resources Logistics	G	Self-operation
	Kerry Godown (Chai Wan), 50 Ka Yip Street, Chai Wan	Whole	521,253	$2,290	$4,393	Kerry Properties	China Resources Logistics	G	Self-operation
	Riley House, 88 Lei Muk Road, Kwai Chung	16/F & 17/F Units 1-4	72,341	$264	$3,649	Tsui Wah Group	China Resources Logistics	G	Investment (Sales and lease back)
	Shatin Industrial Centre Block A, 5-7 Yuen Shun Circuit, Shatin	Units 1-23 on 4/F & 2 parking	28,050	$211	$7,522	Hanison	Brookfield Asset Management Inc	I	Investment

Source Market Sources, Real Capital Analytics, Savills Research & Consultancy

the only active players in the market.

On the supply side, Goodman Westlink in Tuen Mun was completed in Q3/2022, adding about one million sq ft of quality modern warehouse space into the market. Another major upcoming project, Cingleot Premium Logistics Centre (5.3 million sq ft) at the airport is expected to come online in 2023. Though about half of its space is pre-committed by CiaNiao and its related operators, this spike in new supply will likely put a stop to the rental uptick, as landlords prioritise maintaining occupancy over the next six to 12 months. Meanwhile, the yields of more niche properties, such as self-storage, cold storage and data centre are likely to compress at a brisker pace in comparison.

Nonetheless, the leasing fundamentals remain strong in Hong Kong, as demand should continue to outstrip supply over the forecast horizon. As such, we expect overall warehouse rents to slip by 5% to 10% in 2023 given macro demand conditions before resuming their growth trajectory from 2024.

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