Asian Cities - 2H 2023

SPOTLIGHT
Savills Research

Hong Kong Logistics

savills
第一太平戴維斯

The local logistics sector faces some short-term challenges

WAREHOUSE STOCK[1] BY CATEGORY AND DISTRIBUTION

Hong Kong's warehouse stock has grown at a relatively low CAGR of 0.5% over the past 20 years. This is largely due to severe land constraints, resulting in a limited supply of sites for warehouse use.

Modern warehouse stock[2] accounted for 51% of total warehouse stock (43.3 million sq ft IFA) at the end of Q3/2023, 2% of which (1.0 million sq ft IFA) is situated at Hong Kong's International Airport (HKIA) at Chek Lap Kok. Modern warehouses have been developed over recent years and are managed by a few experienced developers and investors, including Goodman, Hutchison, Mapletree, China Merchants and Kerry.

There are 16 modern warehouses in Hong Kong with a total gross floor area of around 33.1 million sq ft gross, with the largest cluster in the Kwai Tsing / Tsuen Wan area close to both the cargo terminals and HKIA. The stock distribution of warehouses overall shows a clear shift of warehouse facilities towards the northwest New Territories over the past two decades.

1 All floor areas in this section are measured in Internal Floor Area (IFA) as defined by the Rating and Valuation Department, which is different from gross floor area (GFA) used in other sections of the report and is defined as the area of all enclosed space of a unit measured to the internal face of enclosing external and/or party walls, unless otherwise stated.
2 A modern warehouse is defined as space with a floor to ceiling height of at least 15 feet, a floor loading of at least 250 lbs per sq ft, a floor plate of at least 50,000 sq ft and direct vehicular access to a majority of its floors.

WAREHOUSE SUPPLY, TAKE-UP AND VACANCY

Looking at the overall warehouse market, new supply of warehouse space has rebounded over the past decade. While average annual supply over the period from 2006 to 2010 was 69,000 sq ft IFA, from 2011 to 2020, average annual supply increased to 469,000 sq ft IFA. 2019 saw no new supply completed. From 2011 to 2019, eight warehouse projects were completed in Kwai Tsing, Yuen Long and Fanling, five of which (China Merchants Logistics Centre, China Resources International Logistics Centre, Goodman Interlink, SF Centre and Mapletree Logistics Hub Tsing Yi in Kwai Tsing) are built to modern warehouse standards. There was no new warehouse supply in either 2020 or 2021.

Goodman Westlink was completed in August 2022 with an estimated IFA of 802,987 sq ft, which was quite well received in the market with over 60% of space being taken up so far. Coupled with reviving leasing demand in general warehouses with more affordable options, take-up rebound to slightly over 1 million sq ft net in 2022, with overall vacancy rates declining to 6.2% as a result.

The logistics sector has faced challenges in recent months, marked by a decline in imports and exports, with decreases of 2.8% and 6.0% YoY respectively in Q3. This has directly impacted container throughputs, which experienced a 13.4% YoY decline during the same period. However, there has been a positive development in air cargo throughputs, which rebounded with a 7.6% YoY increase in Q3 of this year.

Not only freight forwarders and cross-border 3PLs, but also local 3PLs catering to the local retail and F&B sectors have encountered stagnant business conditions. The retail sales and restaurant receipts remained stable in Q2/2023 compared to Q1, indicating that both local and visitor spending in retail and dining were not as robust as initially expected.

The completion of CaiNiao Smart Gateway at the airport, which offers 4.1 million sq ft of lettable area, poses a significant supply overhang for the sector. With this newly completed warehouse still actively pursuing its anchor tenants, 2023 warehouse vacancy rate is expected to rebound to around 10% as a result.

WAREHOUSE RENTAL TRENDS

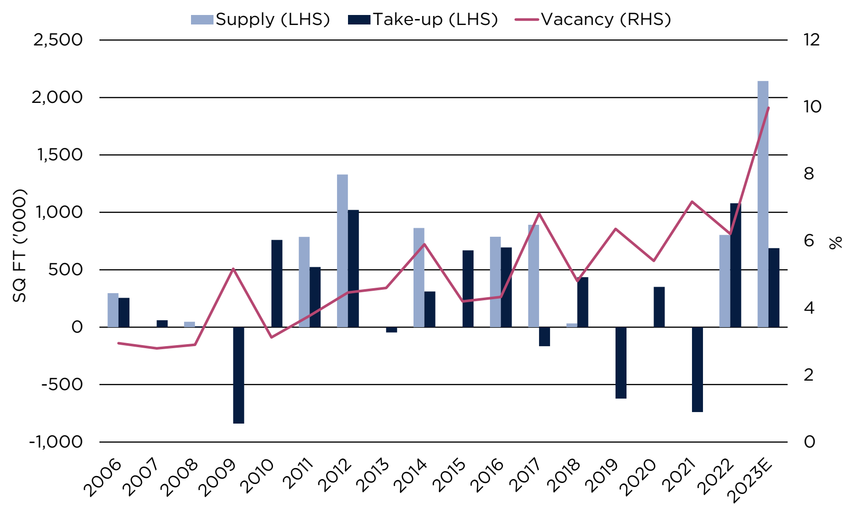
In the first half of 2022, external uncertainties, such as Russia's invasion

TABLE 1: Hong Kong Warehouse Market Key Metrics by District, Q3/2023

DISTRICT	TOTAL STOCK AT THE END OF Q3/2023 (MILLION SQ FT IFA)	Q3/2023 AVERAGE RENT (HK$ PER SQ FT EFFECTIVE)
Hong Kong Island	1.8	10.3
Kwun Tong	2.6	11.4
Sham Shui Po	1.5	9.4
Kwai Tsing / Tsuen Wan	23.3	13.0
Tuen Mun / Yuen Long	3.7	10.1
North	1.4	10.7
Shatin	4.8	11.8
Others	4.2	NA
Total	43.3	12.0

Source Rating and Valuation Department, Savills Research & Consultancy

GRAPH 1: Warehouse Storage Supply, Take-up and Vacancy Rates, 2006 to 2023E

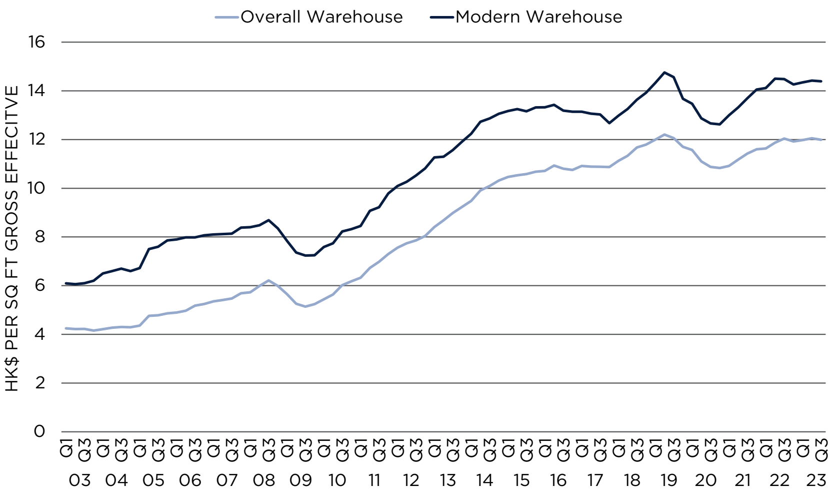


Source Rating and Valuation Department, Savills Research & Consultancy of Ukraine, as well as the re-emergence of COVID cases in China, disrupted both global and regional supply chains. Nevertheless, the immediate impact of the former on the local logistics sector has so far been minimal. The Mainland outbreak, however, had a much more profound impact on the supply of daily necessities, and the affected areas were mostly land transport to supermarkets and wet markets. Against this backdrop, however, logistics demand remained strong with the COVID outbreak gradually contained and the retail sector regaining some momentum alongside strong performance from e-commerce. We therefore saw overall and modern warehouse rents rising by 2.2% and 3.2% respectively in the first half of 2022.

Logistics sentiment weakened from Q3/2022 onwards, with the warehouse leasing market beginning to feel the heat, and many operators opting for renewal rather than relocation, and very few logistics players, except e-commerce operators, in expansion mode. International 3PLs, whose businesses were gradually recovering alongside global supply chains, had the ability to re-route their throughputs to other regional airports / ports, and were thus least affected by the situation in Hong Kong. Local 3PLs who are much more dependent on local supply chains and logistics operations, bore the brunt of the local market downturn, and many saw their 2021 profits wiped out and were thus forced into contraction mode.

Logistics demand held up well during the COVID period due to operators refocusing on regional supply chain. Nevertheless, the sector faces many uncertainties in 2023 despite border reopening, with declining merchandise trades, slower-than-expected retail recovery as well as the prolonged closure of borders diverting supply chains away from Hong Kong among the key issues facing the local logistics sector.

GRAPH 2: Savills Overall Warehouse and Modern Warehouse Average Rents, Q1/2003 to Q3/2023



Source Savills Research & Consultancy

TABLE 2: Warehouse Supply, 2023 to 2027

PROJECT	DISTRICT	DEVELOPER	TOTAL GFA (SQ FT)	EXPECTED COMPLETION
Cingleot Premium Logistics Centre	Airport Island	Cainiao Network	5,395,286*	2023
KCTL 531	Kwai Chung	ESR	1,485,418	2027
K.C.L. 2	Kwai Chung	MTL	4,959,242	2027

Source Savills Research & Consultancy, Buildings Department
* According to Consent to Commence Work in the Monthly Digest April 2022 published by the Buildings Department. According to CaiNiao marketing materials, the lettable floor area of the building is around 4.1 million sq ft, the discrepancy is mainly due to its extraordinary floor-to-floor height (8.8m – 11.3m), of which according to Buildings Regulations, some of the GFA has to be double counted.

As logistics demand continues to diminish, warehouse tenants are not actively seeking expansion opportunities. Additionally, the high interest rates and associated cost of funds have made it increasingly challenging for expiring tenants to justify relocations for cost-saving purposes, as any potential rental savings would likely be negated by capital expenditure. Consequently, leasing activities in Q3 were primarily focused on renewals. As a result, overall and modern warehouse rents experienced a slight adjustment of 0.5% and 0.2% respectively in Q3.

WAREHOUSE MARKET FORECAST

Upcoming warehouse supply between 2023 and 2027 will amount to 11.84 million sq ft gross, an addition of 21.1% to existing warehouse stock. This supply comprises CaiNiao Smart Gateway on the Airport Island, one logistics site tendered by the Government in Kwai Chung to ESR, and another potential warehouse development by MTL at Terminal 2.

The weaker rebound in retail sales and disappointing external trade performance are expected to further weaken logistics demand. However, sustained growth in e-commerce will

TABLE 3: Modern Warehouse Rental Forecast, 2023 to 2025

	OVERALL WAREHOUSE	MODERN WAREHOUSE
Q4/2023	0% to -3%	-3% to -5%
2024	0% to -5%	0% to -5%
2025	0% to +5%	+3% to +5%

Source Savills Research & Consultancy

likely provide some support to the sector in the coming months. Warehouse landlords facing tenant expiries in the next two years are likely to be flexible with rental terms to maintain occupancy, considering the scarcity of new logistics demand. The market is expected to resume growth from 2025 onwards as new warehouse completions are gradually occupied, and the full recovery of China's economy brings more supply chain solutions back to the country, with Hong Kong benefiting significantly.

Most warehouse landlords facing tenant expiries in these two years will likely be flexible on rental terms to maintain occupancy, given that new logistics demand is hard to come by. Market likely to resume growth from 2025 onwards when new warehouse completions are gradually taken up, and full recovery of China's economy to bring more supply chain solutions back to the country, with Hong Kong being the key beneficiary.

savills

For more information about this report, please contact us

Savills Hong Kong

Raymond Lee
CEO
Greater China
+852 2842 4518
rlee@savills.com.hk

Savills Research

Jack Tong
Director, Research & Consultancy, Hong Kong
+852 2842 4213
jtong@savills.com.hk

Simon Smith
Regional Head of Research & Consultancy, Asia Pacific
+852 2842 4573
ssmith@savills.asia