Modern warehouse rents stabilize

Modern warehouse vacancies remained unchanged with a number of large-scale renewals, while general warehouse landlords continued to suffer.

- With the Mainland economy and trading performance rebounding strongly, coupled with a lower base of comparison, we saw a much milder decline in the trading and logistics sector in Q4.
- Modern warehouse landlords proved to be more pragmatic than their general warehouse counterparts with a number of large-scale renewals helping to stabilise both rents and vacancies in Q4, while the general market continued to face tenants downsizing or ceasing operations altogether.
- Both investors and developers were again keen to acquire industrial premises / sites for their respective needs, with industrial sales volumes resembling the previous quarter, while prices remained generally flat as sentiment gradually returned.
- Looking into 2021, while the virus situation is difficult to foresee, a forecast global logistics revival, a potential local retail market rebound, as well as newly completed infrastructure should all contribute to brighter local logistics prospects.

“Investment sentiment rebounded in the last quarter of 2020 with more deals at both ends of the price spectrum, buoyed by the cancellation of DSD at the lower end and redevelopment potential at the higher end. Looking into 2021, a forecast global logistics revival, a potential local retail market rebound, as well as newly completed infrastructure should all contribute to brighter local logistics prospects.”

SIMON SMITH, SAVILLS RESEARCH
Industrial Sales and Leasing

THE MACRO ECONOMY FARED BETTER THAN EXPECTED WITH MODERN WAREHOUSES BENEFITTING

Thanks to a lower base of comparison late last year as well as a more controlled virus situation in September and October, both the trading performance and retail sales fared better than expected, with total exports (+9.1% and -1.1%) and imports (+3.4% and +0.6%) registering their first positive growth in a while, while retail sales fell by a more modest 12.8% and 8.8% respectively in the two months.

Although the macro environment has become more complicated since November with first the US Presidential Election (which was slow to resolve) and the ‘fourth wave’ virus outbreak locally, the business outlook for both 3PLs and freight forwarders improved in Q4, with many no longer faced with the prospect of handing back space or ceasing operations altogether. This was particularly the case among multinational operators, with some significant renewals concluded over the quarter. Examples include DHL, renewing some of their leases in Goodman Interlink, Goodman, for five years, as well as a European logistics operator, which was one of the anchor tenants in Western Plaza in Tuen Mun, who extended their current leases for a further five to seven years.

Renewals were more common in modern warehouses, as these corporate landlords, who are experienced at managing large portfolios, have been more proactive in reducing rents since the second half of last year due to the increasingly difficult operating environment, with modern warehouse rents declining by 14% over the past year. General warehouse landlords’ reluctance to reduce rents leading to rising vacancies, however, with many landlords who are mainly owned by local individual landlords / industrialists, were slower in terms of marking their asking rents to market (with rents only declining by 10% over the past 18 months), and with many of their tenants being SMEs, they have been more vulnerable to adverse market conditions.

As such, modern warehouse vacancies remained stable at 2.8% in Q4/2020, while vacancy rates in the general warehouse market continued to surge to 4.3% over the quarter, the highest since 2009 after the GFC.

The inactivity in the general warehouse segment outweighed the active renewals in modern warehouses, with the number of leasing transactions declining further from 72 in Q3 to 51 in Q4 (up to Dec 21). Given general warehouse landlords’ reluctance to reduce rents leading to rising vacancies, and modern warehouse landlords’ firming negotiation stance due to stabilising modern warehouse vacancies, both overall and modern warehouse rents remained relatively stable in Q4/2020.

Basic warehouses in the North-western New Territories, which are regarded as low-cost alternatives to general warehouses, saw declining demand over the quarter with a gradually narrowing rental gap, as well as an increasing scarcity of even brownfield sites to accommodate such alternative warehouses, which usually take a few months to get their temporary approvals and another few months to construct. Hence, they became more attractive for investors for their speculative nature.

Both investors and developers active in the sales market

While investors were lured back to the industrial sector with moderating rates of rental decline and consistently higher yields than other sectors (typically 3% to 3.5% vs 2% to 2.5% in the office and retail markets),...
we also saw revived redevelopment interest with the sale of Ideal Plaza in Tsuen Wan for HK$310 million, where an under-utilized plot ratio (9.8 vs 11.4) was an additional incentive to redevelop the premises. Industrial sales volumes in October and November (372) were on a par with the 336 transactions registered in July and August with renewed investment and redevelopment interest. Nearly 85% of the transactions in the first eleven months of 2020 (1,294 out of 1,517) were priced at HK$10 million or below, indicating that stratified sales are still dominant. All industrial prices declined more moderately by 0.1%, 0.3% and 2.0% respectively in Q4/2020 alongside reviving investment sentiment.

OUTLOOK
Looking into 2021, while the virus situation is difficult to foresee with any clarity, a forecast global logistics revival, a potential local retail market rebound, as well as newly completed infrastructure should all contribute to brighter local logistics prospects. According to Transport Intelligence's estimates, the global contract logistics (resembling 3PLs operations) market is going to rebound by a CAGR of 5.4% per annum from 2020 to 2024 after a 4.1% contraction in 2020, due mainly to economic recovery, gradual factory re-openings as well as improving retail sector prospects from 2021 onwards. The Asia Pacific market is going to stand out with an 8.0% CAGR over the next four years given the already strong recovery in the region lead by China.

We expect modern warehouses to see most of the benefit with their specifications more suitable to multinational 3PLs, and we expect modern warehouse rents to rebound by 5% to 10% in 2021. Areas benefiting from newly completed infrastructure, such as Liantang / Heung Yuen Wai Border Control Point in the North-eastern New Territories, as well as Tuen Mun–Chek Lap Kok Link linking up Tuen Mun South and Hong Kong International Airport, should also see improving demand prospects.

Meanwhile, redevelopment interest and strong investment prospects for industrial premises are supporting values for the moment. Given no material adverse events and low interest rates, we expect industrial prices to rebound by up to 5% in 2021.

TABLE 3: Industrial Price Growth By Subsector, Q4/2020

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<th>2020 (%)</th>
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<td></td>
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<td>Q2</td>
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Source Savills Research & Consultancy

Graph 2: Industrial Transactions By Price Range, January to November 2020

Source Rating and Valuation Department, Savills Research & Consultancy