

Industrial Sales and Leasing

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COVID-19 disrupts local supply chain

Despite the widespread damage wrought by the pandemic, local supermarket operations as well as e-commerce logistics have been less affected.

- The COVID-19 outbreak which began at the turn of the year has disrupted first Mainland China and now global supply chains, resulting in a dismal local trading performance. While local retail sentiment was also knocked back, supermarkets as well as online retailing have remained relatively unaffected as people have continued to shop for necessities and shifted to online over the past three months.
- The challenging short-term business prospects of many traders and industrialists are expected to limit their buying activity in the strata-title industrial market, while industrial sites and buildings with redevelopment potential will continue to attract interest over the next few months as many developers are eager to replenish commercial landbanks.
- Most 3PLs and freight forwarders are facing a dramatic decline in business with the chaos in supply chains and the reduction in local retail sales. As a result, some have chosen to downside propelling warehouse vacancy from 2.2% in Q4/2019 to 2.9% in Q1/2020.
- While many landlords remained flexible in lease negotiations, most of them were not prepared to entertain the rental concessions demanded by tenants from the start of the year, which helped rents post a milder-than-expected decline of 1.2% and 1.8% respectively for overall and modern warehouses in Q1.
- Developers are seeing the current crisis as an opportunity to kick start redevelopment projects with a number of industrial sites transacted during the quarter. Nevertheless, such optimism has not filtered through to the strata-titled market as smaller occupiers / potential purchasers are fighting for survival.

“Warehouse vacancies are on the rise given the underwhelming trading and retail performance with the outbreak affecting both global supply chains and local retail sentiment. Nevertheless, many developers are seeing this as a golden opportunity to kick start redevelopment projects with a number of industrial sites changing hands as a result.”

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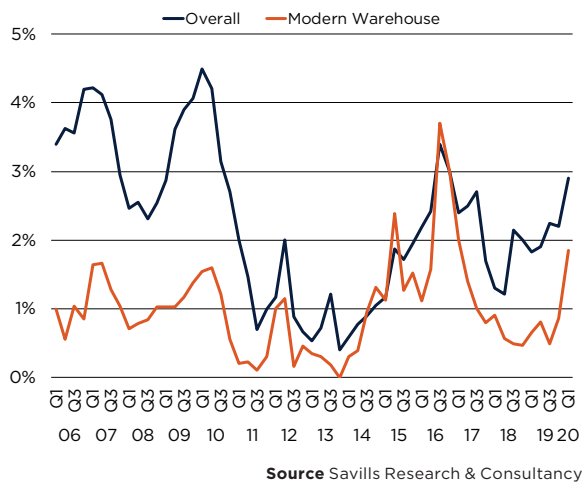
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GRAPH 1: Warehouse Vacancy Rates, Q1/2006 to Q1/2020**TABLE 1: Industrial Rental Growth By Subsector, Q4/2019**

	Q1/2020 (%)	2019 (%)	2018 (%)	2017 (%)
Flatted factories	-2.9	-2.5	+7.9	+7.0
I/O	-2.4	+2.2	+3.9	+2.9
Warehouse	-1.2	-0.5	+8.3	+0.1
Modern warehouse	-1.8	-1.5	+10.2	-4.2

Source: Savills Research & Consultancy

THE COVID-19 OUTBREAK HAS DISRUPTED SUPPLY CHAINS BOTH GLOBALLY AND LOCALLY

The COVID-19 outbreak has disrupted first Mainland China and global supply chains, resulting in a dismal local trading performance which saw both imports and exports decline by 9% and 12% in the first two months of 2020. With local retail sentiment also affected by border closure and a general lack of consumer confidence, retail sales declined sharply by 32% over the same period. Supermarkets (11.1% growth in Jan-Feb 2020) as well as online retail remained unaffected as people have continued to shop for necessities and shifted to online over the past three months.

Most 3PLs and freight forwarders saw a dramatic decline in their business with the chaos in supply chains and the reduction in local retail sales. As a result, some chose to downsize propelling warehouse vacancy to increase significantly from 2.2% in Q4/2019 to 2.9% in Q1/2020. A Japanese logistics operator decided to pull out its entire operation (over 100,000 sq ft) from a cargo-lift warehouse in Kwai Tsing, while an owner-occupier in the same area has released more than 100,000 sq ft previously reserved for lease due to slower-than-expected business expansion. The vacancy rate in the Kwai Tsing area alone increased by more than 400,000 sq ft over Q1/2020, representing most of the vacancy increment over the quarter.

In some good news for warehouse

landlords given uncertain prospects, many operators who did survive chose to renew their leases in Q1 as any long-term rental cost savings from moving are currently outweighed by relocation costs. This was especially the case for modern warehouses as tenants do not benefit from any potential rental cost savings from moving back into general warehouses as the latter simply cannot accommodate their more sophisticated operations.

While many landlords remain flexible during lease negotiations, most were not prepared to entertain the rental concessions demanded by tenants since the start of the year, and as a result, rents posted a milder-than-expected decline of 1.2% and 1.8% respectively for overall and modern warehouses in Q1/2020.

DEVELOPERS KEEN FOR INDUSTRIAL SITES EYEING REDEVELOPMENT OPPORTUNITIES

Developers saw the current crisis as an opportunity to kick start redevelopment projects with a number of industrial sites being transacted during the quarter. Among them, First Group was the most active with three sites purchased for a combined HK\$2.4 billion, together with another site bought towards the end of last year for HK\$1.1 billion, they will possess a landbank of over 600,000 sq ft for commercial redevelopment over the next three to four years.

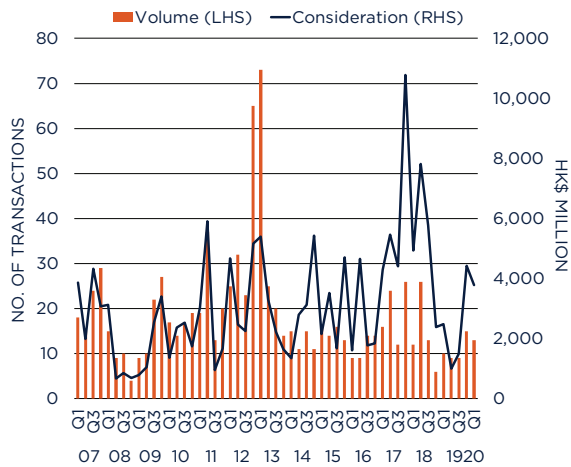
Nevertheless, such optimism has not filtered through to the strata-title market

TABLE 2: Major Industrial Transactions Over HK\$100 Million, Q1/2020

DISTRICT	LOCATION	FLOOR	TOTAL GFA (SQ FT GROSS)	CONSIDERATION (HK\$)	AVERAGE PRICE (HK\$ PER SQ FT)	DATE	SELLER	PURCHASER	TYPE	REMARKS
Tsuen Wan	11-15 Chai Wan Kok Street	Whole	154,962 (max GFA)	\$980,000,000	\$6,324 (A.V.)	Jan-20	TBC	First Group	I	Redevelopment into commercial, land premium paid
Cheung Sha Wan	924-926 Cheung Sha Wan Road	Whole	144,000 (max GFA)	\$790,000,000	\$5,486 (A.V.)	Feb-20	Fung Properties (CB) Ltd	First Group	I	Combined with adjacent site for redevelopment
Cheung Sha Wan	916-922 Cheung Sha Wan Road	Whole	115,000 (max GFA)	\$640,000,000	\$5,565 (A.V.)	Mar-20	TBC	First Group	I	Combined with adjacent site for redevelopment
Cheung Sha Wan	Wing Cheung Factory Bldg., 121 King Lam Street	Whole	66,000	\$395,000,000	\$5,985	Feb-20	TBC	Wealth Plan Development Limited	I	Compulsory sales for redevelopment
Tsuen Wan	Sandoz Centre, 178-182 Texaco Road	6/F-10/F	77,110	\$300,729,000	\$3,900	Jan-20	MF Jebsen Properties Ltd	Cheer Yield Investment Development Ltd	I	Investment
Tai Kok Tsui	71-75 Bedford Road	Whole	47,837	\$192,000,000	\$4,014	Mar-20	TBC	Lofter Group	I	Redevelopment
Aberdeen	Victory Factory Bldg, 16 Wong Chuk Hang Road	2/F	8,790	\$118,000,000	\$13,424	Mar-20	Belleville Co Ltd	Main Century Investment Ltd	I	Investment
Kwun Tong	King Wan Ind Bldg., 54 Hung To Road	1AB, 2AB, 3A-D, 4B, 8C	28,100	\$102,569,600	\$3,650	Jan-20	Profit King Int'l Dev Ltd	Perfect Joint Investments Ltd	I	Investment

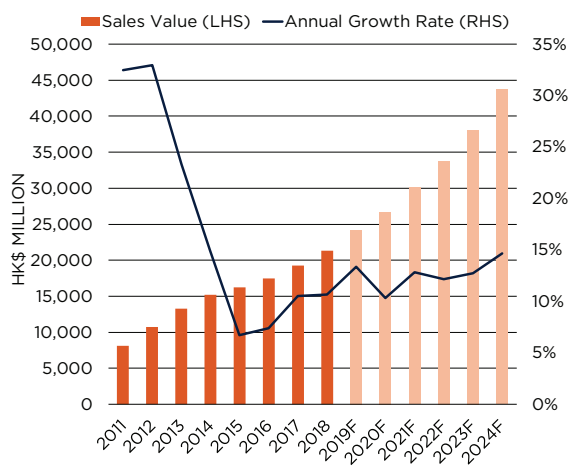
Source: EPRC, Savills Research & Consultancy

GRAPH 2: Major Industrial Transactions Over HK\$30 Million, Q1/2007 to Q1/2020



Source Savills Research & Consultancy

GRAPH 3: Sales Value And Growth Rate Of Internet Retailing In Hong Kong, 2011 to 2024F



Source Euromonitor

TABLE 3: Industrial Price Growth By Subsector, Q1/2020

	Q1/2020 (%)	2019 (%)	2018 (%)	2017 (%)
Flatted factories	-2.7	+1.6	+7.0	+10.8
I/O	-4.0	-0.3	+7.4	+10.5
Warehouse	-3.8	-2.3	+9.2	+16.9

Source Savills Research & Consultancy

as smaller occupiers / potential purchasers are fighting for survival right now with their businesses (mostly trading-related) shattered by the virus outbreak. Major transaction volumes and values both declined slightly by 13% and 15% over Q1/2020, with industrial prices declining by 2.7% over the period.

OUTLOOK

Because the pandemic has just begun in Europe and North America, the logistics sector is expected to face tough times ahead with higher vacancy over the next few months. While business prospects for some traditional freight forwarders and 3PLs will be negatively impacted resulting in a further reduction in warehouse rents, the changing shopping behaviour of the general public may finally induce the long-anticipated growth in online retail, with Euromonitor

forecasting an average of 13% growth per annum 2020-2024 for local e-commerce retail sales, a benefit to e-commerce related logistics.

The challenging short-term business prospects of many traders and industrialists are expected to limit their buying activity in the strata-title industrial market. However, the prospect of cheaper prices and easier premium negotiations means that industrial sites and buildings with redevelopment potential will continue to attract interest over the next few months with developers eager to replenish their commercial landbanks.