Logistics demand shrinks in Q2

Modern warehouses saw rising vacancies with freight forwarders and 3PLs continuing to lose business due to global supply chain disruptions as well as weaker local consumption.

- The second quarter saw a continued drift in Hong Kong’s trading and retail performance negatively affecting logistics demand, particularly from end users, 3PLs and freight forwarders. Market activity virtually ground to a halt over April and the first half of May as the virus outbreak hit a peak, but gradually resumed towards the end of May and June with many operators looking for cheaper accommodation options given the challenging conditions.

- While some were looking to relocate to cut costs, other larger operators decided to downsize to reduce overheads, and distressed operators surrendered their space midway through their leases leaving heavily invested renovations behind. As a result, warehouse vacancy continued to increase to 3.3% in Q2/2020, with warehouse rents falling by 4.1%, the highest q-o-q downward adjustment since the GFC in 2009.

- Even though downsizing and business closures have been commonplace among logistics operators, demand was sustained from e-commerce logistics operators, food factories and mask manufacturers who took up warehouse and industrial spaces, though only in small parcels.

- While regional and global supply chains are gradually re-establishing themselves and retail activity levels are improving locally, any large-scale virus outbreak could kill off any green shoots of recovery in the logistics segment. While redevelopment remains the main theme in the en-bloc industrial sales market and is likely to continue into the second half, the worsening business environment for most industrialists means that the buoyant investment sentiment in the stratified market may be more short-lived.

“Developers continued to be keen to acquire industrial sites for redevelopment, with volumes revived amidst rebounding investment sentiment. Looking ahead, more vacancies are likely to be seen in the warehouse sector with landlords becoming more flexible in lease negotiations.”

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DRIFTING TRADING AND RETAIL PERFORMANCE CONTINUES TO HAUNT THE LOGISTICS SECTOR

The second quarter saw a continued drift in the city’s trading and retail performance, with both imports and total exports declining by 9.6% and 5.6% y-o-y respectively in April and May, while retail sales dropped by a whopping 34.4% y-o-y over the same period. It should come as no surprise then that logistics demand, particularly from end users, 3PLs and freight forwarders, was severely affected.

Market activity virtually ground to a halt over April and the first half of May as the virus outbreak peaked, gradually resuming towards the end of May and June with many operators looking for cheaper accommodation options given the challenging business conditions. The number of leasing transactions (including both new leases and renewals) in the five key logistics districts (Kwai Tsing/Tuen Wan, Kowloon East, Cheung Sha Wan, Shatin, Tsuen Mun / Yuen Long) totalled 76 deals in Q2/2020, a marked increase of 35.7% from the 56 deals concluded in Q1/2020.

While some firms were looking to relocate to cut costs, other larger operators decided to downsize to reduce overheads, including some owner-occupied space held by both logistics operators and retailers in modern warehouses in the Kwai Tsing area, amounting to almost 300,000 sq ft. Two distressed cold store operators were rumoured to have surrendered their space midway through their leases, again in modern warehouses in the Kwai Tsing area, leaving heavily invested renovations behind. As a result, warehouse vacancy continued to increase to 3.3% in Q2/2020, with modern warehouse vacancy further rising from 1.8% in Q1/2020 to 2.7% Q2/2020, the highest since 2016.

While downsizing and business closures have been commonplace among logistics operators, demand was in evidence from e-commerce logistics operators, food factories and mask manufacturers taking up warehouse and industrial space, though only in small parcels. Part of G/F (67,000 sq ft) of Sunshine Kowloon Bay Cargo Centre was taken up by Royale International, a local full logistics service provider. Another e-commerce logistics operator was reported to have expanded internally in a modern warehouse in Kwai Tsing taking advantage of more space becoming available. With landlords proving to be increasingly flexible, warehouse rents fell by 4.1% in Q2/2020, the highest q-o-q downward adjustment since the GFC in 2009.

MORE NICHE DEVELOPERS LOOKING FOR INDUSTRIAL REDEVELOPMENT SITES

Developers are still keen on acquiring industrial sites for redevelopment, and Grand Ming Group, a data centre developer and operator, acquired two industrial sites in Fanling (with site areas of 19,000 and 17,900 sq ft respectively) for HK$88 million and HK$68 million respectively. Assuming a maximum plot ratio of five, the two sites can be redeveloped into high-tier data centres with GFA of 95,000 and 89,500 sq ft, representing AV prices of around HK$1,900 to HK$2,000 per sq ft.

Industrial sales volumes rebounded slightly from their first quarter low alongside reviving investment sentiment, with 293 transactions registered in Q2, a 4.3% rebound from Q1. Notably, nearly 85% of the transactions in the first half of 2020 (486 out of 574) were priced at HK$10 million or below, indicating that stratified sales are still dominant in the market. Both industrial and I/O prices declined more moderately by 0.8% and 1.1% respectively in Q2/2020, with warehouse prices dropping more steeply by 3.8% over the same period reflecting receding leasing demand.

OUTLOOK

The short-term logistics market prospects are far from certain with confirmed COVID-19 cases rebounding both domestically and worldwide, particularly in the US which is a
significant trading partner of Hong Kong. While regional and global supply chains are gradually re-established and there is evidence of increasing retail activity locally, any large-scale virus outbreak could kill of any green shots of recovery in the logistics segment. Therefore, warehouse vacancy is expected to continue to increase until meaningful recovery in both the trading and retail sectors can be found, and until then warehouse landlords may need to remain flexible in lease negotiations.

While redevelopment remains the main theme in the en-bloc industrial sales market and is likely to continue into the second half, the worsening business environment for most industrialists casts some doubt over whether the buoyant investment sentiment in the stratified market can continue in the short-term. If the worsening economy begins to drive more and more SMEs out of business sentiment in the stratified industrial market will inevitably be negatively affected.