Hong Kong – October 2020

Industrial Sales and Leasing

savills

Necessities logistics prevails in Q3

Warehouse vacancy has stabilized with more renewals and consolidation of leases taking place thanks to greater flexibility in rental negotiations.

- While the macro economy continued to drift in Q3 due to an uptick in virus cases and increasing US / China tensions, local logistics demand was buoyed by escalating demand for necessities and online retailing, with warehouse vacancies stabilizing.
- We saw more renewals and consolidation of leases in modern warehouses as landlords became more flexible in rental negotiations. There were also some cost-saving relocations to basic warehouses in Tin Shui Wai / Yuen Long, where larger and more efficient floor plates at lower rents were on offer.
- After months of redevelopment sites dominating the sales headlines, there were significantly more income-producing assets changing hands in Q3, as the relatively high and stable yields of industrial properties attracting long-term investors.
- Looking ahead, while the virus situation is expected to remain volatile, steady logistics demand from necessities should help stabilize the warehouse market, with the gradual resumption of sea and road freight providing some upside in the near term.

"Deal volumes increased in Q3 with more long-term investors entering the market. Looking ahead, while the virus situation may remain volatile, steady logistics demand from necessities should help stabilize the warehouse market, with a gradual resumption of sea and road freight providing some upside in the near term."

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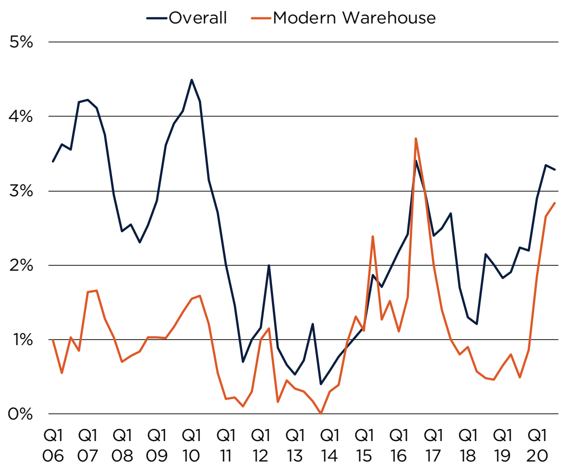
GRAPH 1: Warehouse Vacancy Rates, Q1/2006 to Q3/2020



Source Savills Research & Consultancy

TABLE 1: Industrial Rental Movement By Subsector, Q3/2020

	Q3/2020 (%)	Q2/2020 (%)	Q1/2020 (%)	2019 (%)
Flatted factories	-2.8	-1.9	-2.9	-2.5
I/O	-1.5	-1.9	-2.4	+2.2
Warehouse	-2.0	-4.1	-1.2	-0.5
Modern warehouse	-1.5	-4.7	-1.8	-1.5

Source Savills Research & Consultancy

NECESSITIES DEMAND SUPPORTING THE SUBDUED LOGISTICS SECTOR

The third quarter saw a continued drift in the city's trading and retail performance due to a rebound virus cases and increasing US / China tensions, with both imports and total exports declining by 4.5% and 2.7% y-o-y respectively in July and August, while retail sales dropped by a more moderate 23.1% y-o-y in July compared with previous months.

Nevertheless, local logistics demand was given a boost by escalating demand for necessities and online retailing. The most significant new lettings, though not the largest, included the lease of two units (26,000 sq ft) of Goodman Kwai Chung Logistics Centre by Pan Pacific Retail Management (HK) Co. Ltd. As the logistics arm of DON DON DONKI, the famous Japanese supermarket and retail chain, these spaces are intended to serve the logistics needs of the six outlets in Hong Kong (three have already opened and three more are in the pipeline). With such deal flow, overall and modern warehouse vacancies stabilized at 3.3% and 2.8% respectively in Q3/2020.

While the number of industrial leases declined significantly from 94 in Q2 to 57 in Q3, we saw an increasing number of renewals and consolidations in modern warehouses as landlords became more flexible in rental negotiations. ALPS Logistics renewed their lease in ATL (occupying around 100,000 sq ft) for three years at around HK$14 per sq ft, while Fuji Xerox also signed a one year extension (with two annual renewal options) to its lease in Dynamic Cargo Centre (again around 100,000 sq ft) for an initial HK$11.5 per sq ft, rising to HK$12.7 per sq ft if the lease is renewed in the third year. Omni Logistics (previously JSI), a long-term anchor tenant in Tsuen Wan International Centre, also renewed their leases at HK$12.05 per sq ft (upper floors amounting to 80,000 sq ft) and HK$15 per sq ft (17,604 sq ft ground floor space) for three years.

Circle K, which previously occupied some 30,000 sq ft in Sunshine Kowloon Bay Cargo Centre, relocated and took up one floor in Mapletree Logistics Hub Tsing Yi (144,000 sq ft), and with the expansion it is anticipated that the convenience store operator may also relocate some of their space from ATL. Another logistics operator, which occupied space in both Y.K.K. Building in Tuen Mun and Jumbo Plaza in Sheung Shui, decided to move out from the former and took up one more floor (120,000 sq ft) in the latter for consolidation. Given such activity, both overall and modern warehouse rents declined more moderately by 2.0% and 1.5% respectively in Q3/2020.

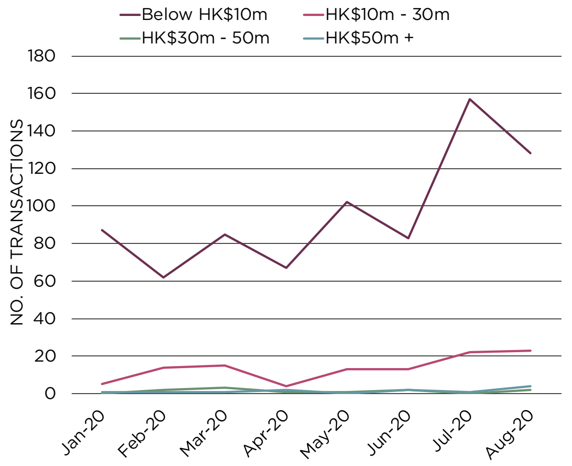
There were also some cost-saving relocations to basic warehouses in Tin Shui Wai / Yuen Long, where larger and more efficient floor plates with lower rents were on offer. A large local 3PL, which currently leases around 250,000 sq ft in an en-bloc building in Tsuen Wan, was offered HK$2.5 million per month to renew their lease. Instead, they chose to relocate to a one-storey basic warehouse in Tin Shui Wai with a 100,000-sq ft floorplate, 25 feet clear ceiling height and adequate numbers of loading / unloading bays capable of housing their entire operation more efficiently, at around HK$1 million per month.

TABLE 2: Major Industrial Transactions Over HK$100 Million, Q3/2020

DISTRICT	LOCATION	FLOOR	TOTAL GFA (SQ FT GROSS)	CONSIDERATION (HK$)	AVERAGE PRICE (HK$ PER SQ FT)	DATE	SELLER	PURCHASER	TYPE	REMARKS
Fanling	Kader Industrial Building, 17-19 Lok Yip Road	Whole Block	202,000	$820,000,000	$4,059	Aug 2020	TBC	TBC	G	Investment
Tsuen Wan	PBE Building, 14-18 Ma Kok Street	49% Share	-	$360,000,000	-	Aug 2020	TBC	Chinese Estates	G	Investment
Kwai Chung	Angliss Hong Kong Food Service Ltd, 47-51 Kwai Fung Crescent	Whole Block	65,062	$325,000,000	$4,995	Aug 2020	Angliss Hong Kong	HSBC Life (Property)	G	Investment
Western	Cheung Hing Ind Bldg., 12P Smithfield Rd	G/F	7,752	$180,000,000	$23,220	Jul 2020	Triumph Knight Industrial Ltd	First Yield Investment Ltd	I	Potential collective sales
Quarry Bay	Cheung Wah Ind Bldg., 10-12 Shipyard Lane	2B, 3/F, 8A, 12/F, Portion MR	-	$173,630,000	-	Jul 2020	Xin Lei Int'l Ltd	Parksea Investments Ltd	I	Potential collective sales
Quarry Bay	Cheung Wah Ind Bldg., 10-12 Shipyard Lane	G/F B	6,312	$125,040,000	$19,810	Jul 2020	Mega Joy Enterprises Ltd	Parksea Investments Ltd	I	Potential collective sales

Source EPRC, Savills Research & Consultancy

GRAPH 2: Industrial Transactions By Price Range, January to August 2020



Source Rating and Valuation Department, Savills Research & Consultancy

TABLE 3: Industrial Price Growth By Subsector, Q3/2020

	Q3/2020 (%)	Q2/2020 (%)	Q1/2020 (%)	2019 (%)
Flatted factories	-0.2	-0.8	-2.7	+1.6
I/O	-0.1	-1.1	-4.0	-0.3
Warehouse	-3.1	-3.8	-3.8	-2.3

Source Savills Research & Consultancy

LONG-TERM INVESTORS ATTRACTED BACK TO THE INDUSTRIAL SECTOR

After months of redevelopment sites dominating the sales headlines, significantly more income-producing assets changed hands in Q3, as the relatively high and stable yields from industrial properties attracted long-term investors. The most significant deal concluded over the quarter was the sale of Kader Industrial Building in Fanling (202,000 sq ft) for HK$820 million (HK$4,059 per sq ft) to a Mainland company, which may hold the building for long-term investment. Another deal saw Angliss Hong Kong involved in a sale and lease back of its cold store in Kwai Chung (65,000 sq ft) to HSBC Life (Property) for HK$325 million (HK$4,995 per sq ft), again possibly for long-term investment. The 3.5% to 4% yields on offer for this kind of asset are high enough (compared to sub-3% in other commercial sectors) to lure long-term investors back to this segment.

Industrial sales volumes continued to rebound with 336 transactions registered in July and August, already 15% higher than those registered in Q2. Again, nearly 85% of the transactions in the first eight months of 2020 (771 out of 908) were priced at HK$10 million or below, indicating that stratified sales are still dominant in the market. All industrial prices declined more moderately 0.2%, 0.1% and 3.1% respectively in Q3/2020 alongside reviving investment sentiment.

OUTLOOK

Looking ahead, while the virus situation is likely to remain volatile, the steady logistics demand from necessities should help stabilize the warehouse market, with the gradual resumption of sea and road freight providing some upside in the near term. Air freight volumes may take longer than expected to recover not due to sluggish demand but more to capacity constraints: according to the International Air Transport Association, global cargo capacity available aboard passenger flights in July 2020 was 71% below July 2019 levels, leading to an overall air cargo capacity decline of 31% over the same period. Until a meaningful recovery in passenger flights and thus air cargo capacity, we may not see an imminent recovery in air freight in the near future.

With investment interest shifting to income-producing assets, we expect more focus on yields and cost of capital (which is expected to remain low until 2023). We believe that the ability of industrial landlords to finally raise rents will dictate whether long-term investors will continue to take an interest in this segment over the next few months.