MARKET IN MINUTES
Savills Research

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INDUSTRIAL SALES AND LEASING

Local buyers dominate investment market

> "The leasing market continued to see weak demand with relocations hard to come by. Rate of take-up of newly completed warehouse would dictate the rate of recovery of the sector over the next 12 months."

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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.

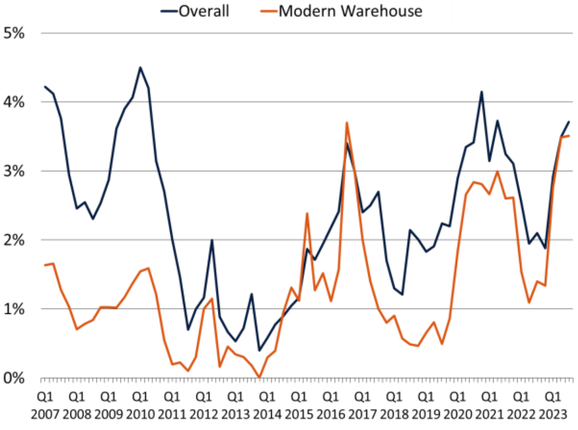
Not only freight forwarders and cross-border 3PLs, but also local 3PLs catering to the local retail and F&B sectors have encountered stagnant business conditions. The retail sales and restaurant receipts remained stable in Q2/2023 compared to Q1, indicating that both local and visitor spending in retail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

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. The overall vacancy rate saw a slight increase to 3.7%, while the modern warehouse vacancy remained at 3.5% throughout the quarter.

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. Notably, the rumored leasing agreement with a duty-free operator fell through, resulting in their leasing efforts being reset.

Interest rates have continued to rise, with the 3-month HIBOR standing at 5.2% in Q3. This translates to commercial mortgage rates ranging from 6.7% to 7.7%, making property investment less attractive. With such high cost of funding, only end users remained as keen buyers in the market. For instance, the Salvation Army purchased various units in Tung Chun Industrial Building in Kwai Chung for HK$122 million for self-use.

GRAPH 1: Warehouse vacancy rates, Q1/2007 – Q3/2023



Source Savills Research & Consultancy

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TABLE 1: Major industrial transactions (over HK$100 million), Q3/2023

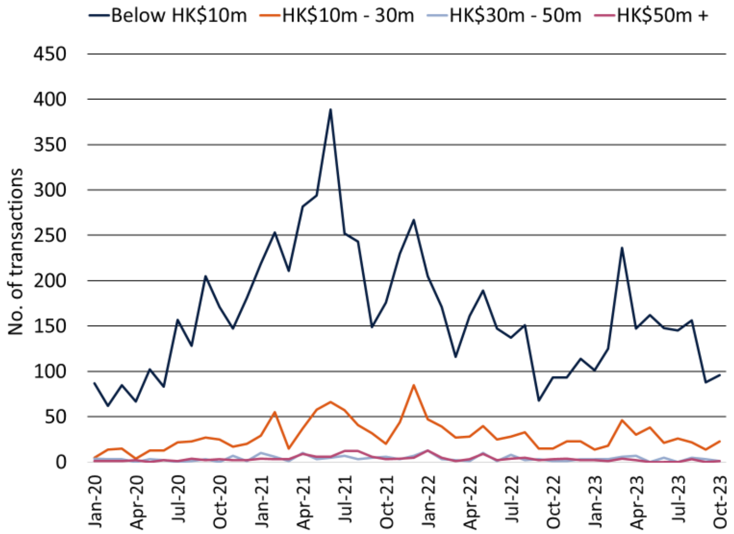
District	Location	Unit	Total GFA (sq ft gross)	Consideration (HK$)	Average Price (HK$ per sq ft)	Seller	Purchaser	Type	Remarks
Kwai Chung	Tung Chun Industrial Building Block A	Various units on G-3/F	33,000	$122,000,000	$3,697	Soundwill Holdings	Salvation Army	I	Owner occupation

Source EPRC, Savills Research & Consultancy

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 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.

The sales market will continue to be affected by the high cost of funds, leading to further constraints on transaction volume. Positive signs in the investment market may only be observed when interest rates begin to decline, which is anticipated to occur around the end of 2024 or early 2025.

GRAPH 2: Industrial transactions by price range, Jan 2020 - Aug 2023



Source Rating and Valuation Department, Savills Research & Consultancy

TABLE 2: Industrial price and rental growth by subsector, Q3/2023

Price change	2023 (%)			2022 (%)			
	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Flatted factories	-2.2	0.0	0.0	-0.9	0.0	+0.5	-0.3
I/O	-1.7	0.0	0.0	-0.8	0.0	+0.1	-0.1
Warehouse	-1.0	-1.6	-1.6	-2.4	+0.3	0.0	-0.1

Rental Change	2023 (%)			2022 (%)			
	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Flatted factories	+0.2	-0.6	-1.0	-1.3	-0.7	+0.7	+0.8
Warehouse	-0.5	+0.6	+0.5	-1.0	+0.8	+1.9	+0.3
Modern Warehouse	-0.2	+0.5	+0.6	-1.5	-0.1	+2.7	+0.5

Source Savills Research & Consultancy

Logistics Land Supply in Kwai Tsing

Among the various measures proposed in the latest Action Plan on Modern Logistics Development published by Transport and Logistics Bureau, the most eye-catching one would be the provision of four parcels of logistics land covering around 19 hectares regularly from 2024 to 2027 in the Kwai Tsing District, in order to provide a ‘stable supply of affordable logistics land for the industry to develop multi-storey logistics facilities for modern logistics operations.’

While the initial reaction of the public was focused on a potential oversupply of modern logistics facilities in the short-term, we doubt if these potential supply will be built to modern warehouse standard hosting the most sophisticated and high-end logistics demand. As these land plots are catered for ‘affordable logistics’, the actual structure to be built on these sites will depend on government’s intention and specific clauses likely to be inserted to their respective tenders.

Also, given the muted responses of government tender of late (6 government / quasi-government sites being withdrawn in 2023), it would be doubtful if all 4 logistics sites could be successfully tendered within the prescribed timeframe.