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Rising Investment Demand for Hong Kong* Industrial Properties

Institutional investors are becoming more active looking for acquisition opportunities

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Insights & recommendations

Since the start of 2021, investment market sentiment for industrial assets improved. Industrial transaction volumes reached HKD1.9 billion (USD245 mil) in Jan-Feb 2021, surpassing the previous three quarterly figures.

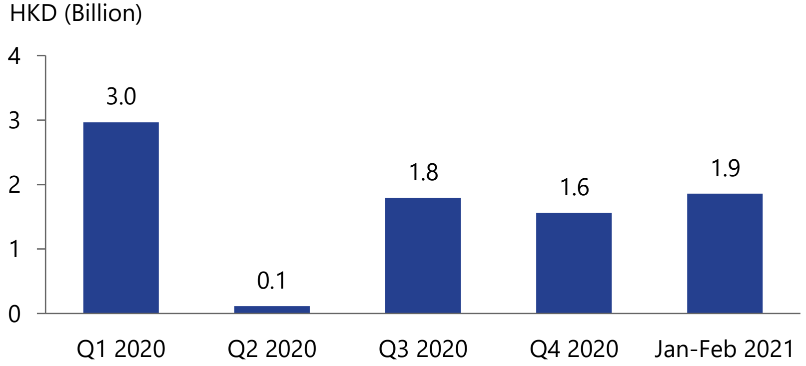
It is also worthy to note that most of these transactions are coming from institutional investors, which have recently become more active after a quiet 2020.

We recommend investors pay attention to the rising cold storage demand from the robust supermarket retail sales performance, whilst logistics facilities are also capturing increasing requirements from e-commerce operators. Meanwhile, the increasing penetration of tech and roll-out of 5G networks should focus investor attention on the growth prospects of data centres.

Hong Kong's industrial sector had a relatively resilient year in 2020. We expect it will continue to attract investment in 2021, largely supported by the trade recovery, removal of the Double Stamp Duty[1], and the positive long-term outlook for the sector:

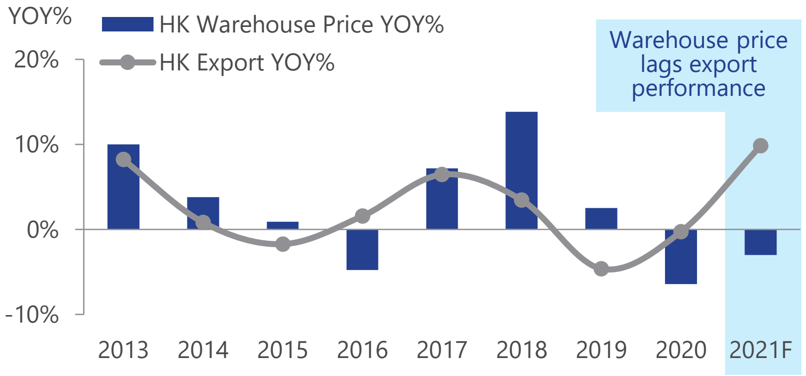
- Trade recovery – Hong Kong suffered two years of negative annual export growth, but Oxford Economics is now forecasting that there will be a strong rebound of +9.8% in 2021. In January 2021, the value of Hong Kong's total goods exports and imports both recorded strong increases, by 44.0%YOY and 37.7% YOY, respectively. The improving trading figures points to stronger demand for industrial space, providing support to the rent and price level of industrial properties.
- Removal of Double Stamp Duty – Announced in the 2020 policy address, removing the Double Stamp Duty lowered the effective levy for commercial transactions from 8.5% to 4.25%. The lower transaction costs should provide some positive spin to the investment market, while sellers are becoming more willing to negotiate and lower their asking prices to seal transactions.
- Positive long-term outlook – COVID-19 triggered a boost in demand for e-commerce, cold storage and logistics facilities. Meanwhile, the rise of the 5G networks and big data has also strengthened the need for data centres.

Hong Kong industrial transaction volumes (Deals above HKD100 million, Q1 2020 to Feb. 2021)



Source: Real Capital Analytics, Colliers International

Warehouse Price vs. Total Export Volume (HKD)



Source: Colliers International, Oxford Economics.

Note: USD1 to HKD7.8; 1 sq m = 10.76 sq ft
*This report covers the Hong Kong Special Administrative Region of the People's Republic of China.
[1]The Double Stamp Duty was a cooling measure introduced in 2013 to increase taxation levied on non-residential property transactions in Hong Kong

"Protests, coronavirus pandemic and trade war: all these risk factors have been priced in. We expect a more stable future in the years ahead," said KaiLong Hong Kong CEO Ivan Ho, adding that it is the right time to look for sustainable long term investments.[2]

"The purchase was motivated by the recent cancellation of the double stamp duty on commercial properties and the long-term outlook for the market", added Mr. Ho.

Return of institutional capital and increasing industrial investment deals

The transaction volume of Hong Kong's industrial sector slowed during 2020, due to COVID-19 and mounting economic uncertainty. Quarterly transaction volumes for industrial properties reached the recent bottom in Q2 2020 at HKD115 million (USD14.7 million). However, transactions started catching up since the start of 2021 after the removal of Double Stamp Duty in November 2020. The first two months' sales volume of HKD1.9 billion (USD245 million) of industrial assets over HKD100 million already surpassed the previous three quarters.

Institutional investors and real estate funds sped up their hunt for industrial assets. In fact, among the aforesaid HKD1.9 billion transactions, all were acquired by funds or institutional investors. In January 2021, Kailong, a fund manager active in Greater China, acquired Hang Fat Industrial Building near Lai Chi Kok station. This property is expected to be redeveloped into a new industrial office building[3]. Another pan-Asian fund manager, SilkRoad, also purchased Smile Centre near Fanling station, which is currently leased for logistics use. Meanwhile, Goodman purchased ground floor to fourth floor of Seapower Industrial Centre in Kwun Tong, with cold storage facilities, for HKD570 million (USD 73.5 million).

Key Transactions in Q1 2021 (as of end-February)

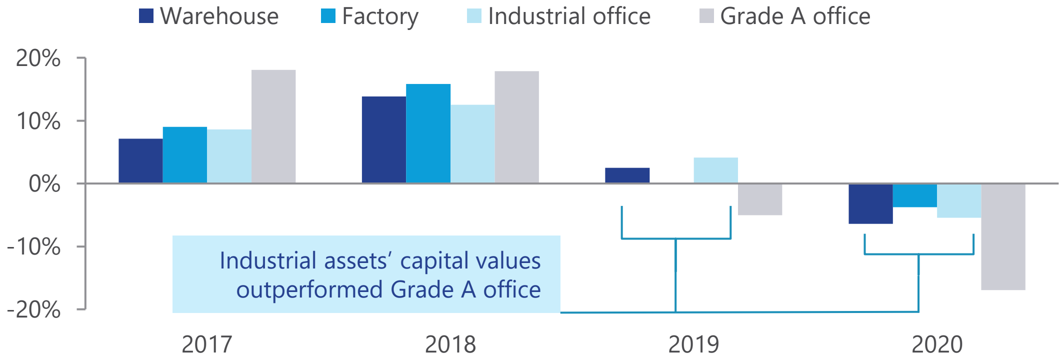
Date	Building	Area (sq ft, GFA)	Buyer	Price in (HKD Mil)
Jan-2021	Hang Fat Industrial Building	156,100	KaiLong	965
Jan-2021	Smile Centre	97,750	SilkRoad	323
Feb-2021	Seapower Industrial Centre (G/F to 4/F)	117,381	Goodman	570

Source: Real Capital Analytics, Colliers International

[2] KaiLong Press Release [3] Town Planning Board, planning application A/K5/829

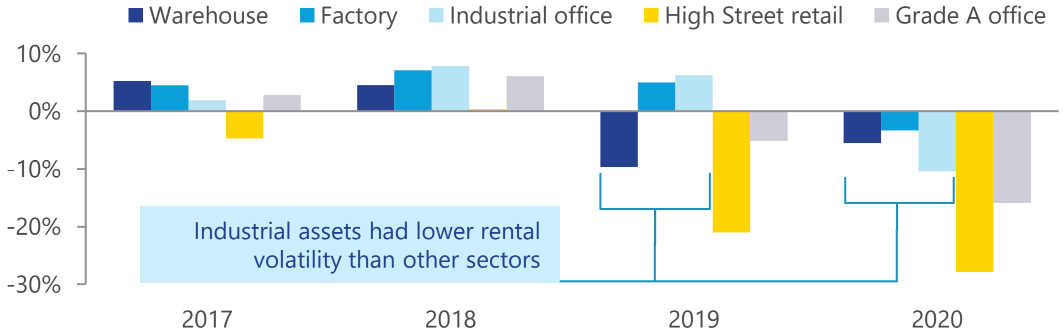
Looking into 2021, we believe institutional capital and funds will become more active again, given the pent-up acquisition requirements that have piled up over the last 18 months due to the market uncertainties, which now seem to be easing. Compared to the retail and office sector, industrial properties demonstrated a high level of resilience and stability in terms of rents and capital values. Meanwhile, the industrial Revitalisation Scheme 2.0 also presented investors with redevelopment opportunities, and some investors are eyeing the relaxed plot ratio restrictions to improve the return on their investments with higher floor area ratios.

Capital value YOY change by property sub-sectors, 2017 to 2020



Source: Colliers International

Rental value YOY change by property sub-sectors, 2017 to 2020



Source: Colliers International, Rating and Valuation Department

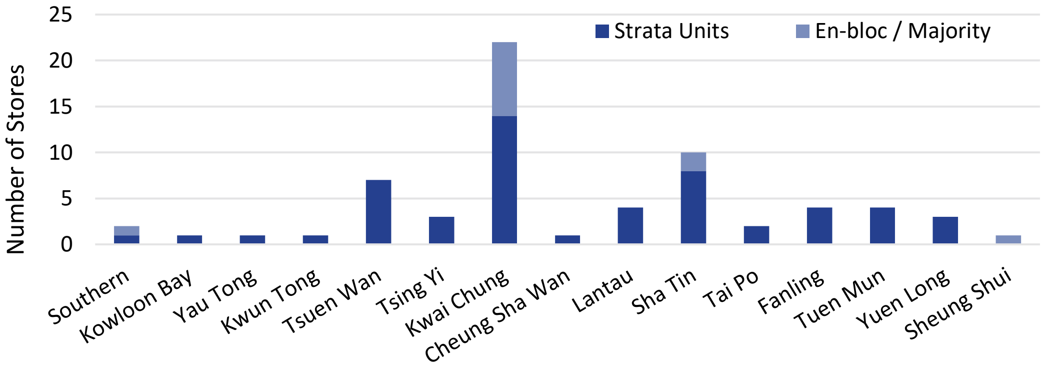
Emerging industrial subsectors

COVID-19 had increased the investment appetite for logistics facilities, cold storage and data centres in Hong Kong, supported by other long-term macro drivers including the growing 5G network, cloud computing, e-commerce and F&B demand. Investors are increasingly interested to explore these industrial subsectors for long term income streams and their redevelopment potential.

Cold storage boosted by strong supermarket performance

- Cold storage demand had shifted from fine dining to retail and supermarkets, as people had to dine-at-home amid the COVID-19 restrictions. According to the government, retail sales in supermarket increased by +9.7% YOY[4] for the twelve months in 2020, while the overall retail sales dropped -24% YOY[4].
- As of February 2021, there are 66 licensed cold storage facilities in Hong Kong[5]. While cold storage is showing positive prospects with higher rents and stable yields compared to traditional industrial assets, investors interested in this subsector should pay attention to opportunities in proximity to Kwai Chung and Shatin stations, where most en-bloc licensed cold stores are located and hence presenting more sale-and-leaseback opportunities.

Distribution of licensed cold stores by district (2020)



Source: Centre for Food Safety, Colliers International

Note: [4] Census and Stats data, [5] Centre for Food Safety [6] Lands Department, [7] Rating and Valuation Department

Industrial, Cold Storage and Data Centre Comparison

Subsectors	Specifications	Cap Rate (%)	Gross Rents (HKD /sq ft/ month)
Industrial*	- Loading: varies - Ceiling height: varies	2.9-3.1	10-16
Cold Storage	- Loading: 315+ lbs/sq ft - Ceiling height: varies	3.3-3.5	13-19
Data Centre	- Loading: 200-350lbs/sq ft - Ceiling height: about 5m	3.1-3.75	24-34

Source: Colliers Valuation & Advisory Services, RCA, EPRC *Industrial refers to flatted factories and logistics warehouse

Data centres hold optimism with a vast accumulation of data

- The acceleration of 5G network rollouts, the IoT and cloud computing induced technology demands are reinforcing data centres as a prominent industrial subsector. The long-term step-up lease structure* also points to a stable and growing income stream.
- Most recently, two data centre plots were sold under the government land sale[6], including the STTL 613 in Shatin (Jul 2020) and FSSTL 268 in Fanling (Jan 2021) successfully bought by China Mobile and Mapletree respectively, demonstrating solid investment interests from both end-users and property funds.
- We recommend well capitalised investors partner with experienced operators to bid for data centre development sites, while more boutique investors focus on strata-titled units for conversions opportunities.

Limited industrial supply creates opportunities for capital growth

- Colliers forecasts the 2021 to 2023 average industrial supply remains tight at 1.2 mil sq ft NFA (111,500 sq m) per annum, compared to the 10-year annual average to 2020[7] of 1.5 mil sq ft NFA (139,400 sq m). E-commerce growth will likely strengthen the ongoing demand for industrial space, which suggests capital growth for logistics facilities from 2022 onwards once the market starts recovering from the current correction phase.

*Note: A step-up lease establishes future rental increases for the lessee at set times throughout the life of the contract to protect the landlord from the risks that inflation or a rising market present for a long-term lease.

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