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AVISTA RESEARCH

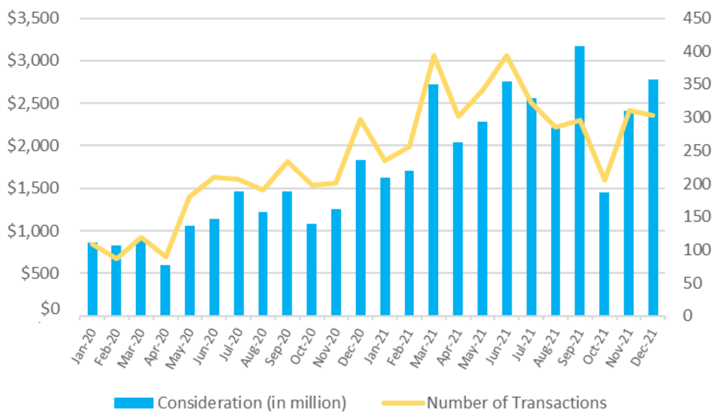
TO REAP THE MARKET POTENTIAL OF INDUSTRIAL BUILDINGS IN HONG KONG

Over past decades, the manufacturing industry has notably scaled down to a tiny fraction of Hong Kong's economy, which has been developing with high value-added economic activity. Accordingly, the space of industrial buildings may not meet the ever-changing economic needs of society. In order to achieve the highest and best use value of industrial buildings, the Hong Kong government has implemented diverse policies including Industrial Building Revitalization Scheme and the abolition of Double Ad Valorem Stamp Duty ("**DSD**") on non-residential property.

In the 2020 Policy Address, the government announced the transactions of non-residential property would be subject to ad valorem stamp duty at the original rates applicable before the introduction of the DSD in 2013 from 26 November 2020 onwards. The highest tax rate would be reduced to 4.25% from the previously applicable 8.5%. Furthermore, the Development Bureau announced that it would launch a pilot scheme ("**Pilot Scheme**"), which would run for two years from 15 March 2021 onwards, to charge land premiums at standard rates for lease modifications for redevelopment of industrial buildings constructed before 1987. The scheme provides owners greater flexibility to calculate land premiums apart from the existing conventional approach.

Driven by policies' implementation, an accelerating pace in the redevelopment of industrial buildings led by investors or owners could be expected, which could unleash the market potential of the industrial buildings. According to Rating and Valuation Department ("**RVD**"), the transactions and consideration of flatted factories have sharply increased in March and June 2021. In particular, the number of transactions has surged by 231% and 88% year-on-year ("**y-o-y**") in March and June 2021 respectively. Meanwhile, the considerations have also notably accelerated by 205% and 142% y-o-y respectively.

Figure 1: Number of Flatted Factories' Transactions and Consideration (Jan 2020 – Dec 2021)



SOURCE: AVISTA Research, Rating and Valuation Department

Therefore, it is worth examining how various revitalization policies boost redevelopment or renovation of industrial buildings, which would result in an increase in property value and the emerging development opportunity in traditional industrial areas.

Redevelopment

According to the latest revitalization policies for industrial buildings, the developers are allowed to gain a maximum of 20% non-domestic plot ratio for redeveloping industrial buildings that were constructed before 1987 and located in "Residential" zones. Moreover, the Pilot Scheme establishes a set of standard rates applicable to calculate the land premiums to be charged for lease modifications between Industrial/Godown use and Commercial/ Modern Industrial use or Residential use, which allows the industrial building owners to consider the feasibility of redevelopment projects in advance. With policy supports, the redevelopment decision-making process could be simplified, thereby motivating the redevelopment projects and lifting the use value of industrial buildings.

In particular, the Pilot Scheme provides owners of industrial buildings greater flexibility as regards the land premiums charged for redevelopment so that the owners could select an appropriate calculation method from which the land premium calculated would be beneficial to the redevelopment project. For example, Able Engineering Holdings Limited ("**Able Engineering**") announced a plan to redevelop the site of 7 Lai Yip Street, Kwun Tong from industrial use to non-residential use, which would not exceed 14,775 sqm (around 159,000 sq.ft.). Following the existing conventional approach, Able Engineering was required to pay HKD 550 billion for the land premium on 5 February 2021. If Able Engineering followed the standard rates in the Pilot Scheme, the land premium would be expected to be 369 HKD billion ([$65,000 - $40,000] x 14,775 sqm), which was lower than that of the existing conventional approach by HKD 186 billion.

The Pilot Scheme that remains unchanged within 2 years provides transparency and certainty in the standard rates applicable for the land premium, by which the owners with less experience can easily manage the cost of lease modification and relevant financial arrangements. Under the existing conventional approach, the owners typically need to spend 1.5 years on average or even 4 years to reach a consensus about the land premiums with the Lands Department. Taking into consideration of burdensome time and economic cost of a redevelopment project, an owner who lacks financial resources and relevant experience intends not to redevelop the industrial buildings. Hence, the Pilot Scheme can simplify the calculation procedure for land premium and save negotiation time for the owners with the government officials , thereby reigniting the interest for industrial building redevelopment and accelerating the redevelopment pace.

The implementation of various policies is expected to lower the cost of redevelopment, particularly for those in the core districts, thereby enhancing the land value after the redevelopment and increasing the attractiveness of the redevelopment scheme.

Table 1: Standard Rates Applicable to the Lease Modification

Region	Use Before Lease Modification	Use After Lease Modification	
	Industrial/ Godown	**Commercial/ Modern Industrial**	**Residential**
Hong Kong Island	$40,000/sqm (~$3,700/sq.ft.)	$75,000/sqm (~$7,000/sq.ft.)	$130,000/sqm (~$12,100/sq.ft.)
Kowloon East	$40,000/sqm (~$3,700/sq,ft.)	$65,000/sqm (~$6,000/sq.ft.)	$100,000/sqm (~$9,300/sq.ft.)
Kowloon West	$35,000/sqm (~$3,300/sq.ft.)	$60,000/sqm (~$5,600/sq.ft.)	$110,000/sqm (~$10,200/sq.ft.)
New Territories South	$35,000/sqm (~$3,300/sq.ft.)	$50,000/sqm (~$4,600/sq.ft.)	$75,000/sqm (~$7,000/sq.ft.)
New Territories North	$20,000/sqm (~$1,900/sq.ft.)	$30,000/sqm (~$2,800/sq.ft.)	$55,000/sqm (~$5,100/sq.ft.)

SOURCE: Lands Department

Renovation

Apart from redevelopment, the owners of industrial buildings who plan to convert the industrial buildings aged 15 or above in "Commercial", "Other Specified Uses" annotated "Business" and "Industrial" zones could submit valid applications for a special waiver to Lands Department from 2 April 2019 to 31 March 2022. To enjoy the special waiver, the owners must meet the condition that 10% of the converted floor space must be designated for specific uses prescribed by the government, including but not limited to arts and cultural sectors, creative industries, innovation and technology industries, social service facilities or sports and recreational uses. As mentioned, the space and facilities of industrial buildings may not be able to meet the needs of Hong Kong's economy with focuses on retail sales and high value-added economic activities. The investors or owners could convert the industrial buildings through renovation to accommodate the requirements of up-to-date business models in Hong Kong, thereby effectively realizing the use value of the industrial buildings.

Among various revitalization projects, D2 Place project at Cheung Sha Wan is one of the successful cases that converted the industrial space into a retail mall. Years earlier, LAWSGROUP, one of the leading apparel manufacturers, revitalized 2 of its industrial buildings into – D2 Place One and D2 Place Two – with over 500,000 sq.ft. of restaurants, cinemas, retail stores and revitalized office space, etc. The Weekend Markets regularly organized by D2 Place has also attracted over 30,000 visitors. The D2 Place project has become a landmark shopping mall in Cheung Sha Wan. With conversion, the owners could improve the occupancy rate of industrial buildings, investment return as well as brand image.

The owners of industrial buildings can also benefit from the relaxation of plot ratio. In 2016, Hanison Construction acquired an industrial building – West Castle – located at 22 Yip Shing Street, Kwai Chung with consideration of HKD 150 million. The building was revitalized in 2018 with 27,138 sq.ft. appropriate for the use of education, healthcare, retail and restaurants. Subsequently, the Town Planning Board ("**TPB**") approved the relaxation of plot ratio by 20% in June 2020 which allowed the building to be redeveloped into a new 23-storey modern industrial building with a maximum floor space of 65,294 sq.ft. Therefore, revitalisation for an industrial building could improve the building's quality and use value, thereby increasing the valuation for greater financial return.

In general, the owners and investors of industrial buildings could leverage various policy policies to identify industrial properties with great potential for long-term investment. With the property conversion to meet social or tenants' needs, the highest potential value of industrial buildings could be realized to benefit the owners or the investors.

Development Potential of Tuen Mun Industrial Area

Under the initiative of Greater Bay Area ("**GBA**") integration, the market potential for the industrial buildings in Tuen Mun Industrial Area has aroused investors' interest. The completion of infrastructure in Tuen Mun that enhances the connectivity with other cities in the GBA has further strengthened the advantages of the properties in Tuen Mun. Particularly, the connection between Tuen Mun – Chek Lap Kok Link ("**TM – CLKL**") and Hong Kong – Zhuhai – Macao Bridge ("**HZMB**") would only take 10 minutes, saving by 20 minutes from the original route.

Alongside an increasing cross-border trade and business activity in the GBA, a well-rounded infrastructure would benefit Tuen Mun from rising demand for office or retail space in the region, from which a vast amount of industrial buildings in the Tuen Mun Industrial Area could take advantage of the redevelopment or revitalisation. In recent years, there have been various redevelopment or revitalization projects in Tuen Mun, accounting for over 2 million sq.ft. floor space to be converted for commercial use. For instance, One Vista Summit, redeveloped by an industrial building, provides 320 office units with floor space from 478 sq.ft. to 3,098 sq.ft. According to the latest release in 2019 that involved the sale of the units between 480 sq.ft. and 950 sq.ft., the sale prices ranged from HKD 4.5 million to HKD 10.3 million, representing around HKD 8,000 per sq.ft. and HKD 13,500 per sq.ft. The prices were higher than that of the industrial buildings nearby which ranged from around HKD 3,000 per sq.ft. to HKD 5,000 per sq.ft.

Supported by favourable policies, the owners of industrial buildings could implement redevelopment or renovation to convert the industrial buildings into commercial projects so as to accommodate the increasing demand for workplace and cross-border consumption. It is worth noticing that the industrial buildings in Tuen Mun could enjoy a lower land premium if the owners choose to adopt standard rates for calculation, which amount to HKD 900 per sq.ft (commercial/modern industrial use after lease modification) and HKD 3,200 per sq.ft. (residential use after lease modification). Therefore, the industrial buildings in Tuen Mun could be redeveloped or renovated into office or retail projects with a lower cost to meet the growing demand from the GBA.

Table 2: Industrial Building Redevelopment and Revitalization Projects in Tuen Mun

Property/Address	Floor Area (Thousand sq.ft.)	Use
Yick Fung Group Building	107	Office & Retail
4 Kin Fat Lane	179	Office, Restaurants & Retail
Parklane Centre	87	Restaurants & Retail
East Asia Industrial Building	466	Hotels, Office & Retail
Yeu Shing Industrial Building	23	Hotels
Platmates Factory Building	334	Office, Restaurants & Retail
Oi Sun Centre	204	Office, Restaurants & Retail
Gold Sun Industry Building	85	Office, Restaurants & Retail
5 San Yick Lane	19	Office, Restaurants & Retail
13 & 15 San On Street	228	Modern Industrial Building
Kui Kwoon Industrial Centre	82	Office, Restaurants & Retail
Tin's Centre Block 9	303	Office, Restaurants & Retail

SOURCE: AVISTA Research

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