Singapore – August 2019

Industrial

Demand for industrial space remains weak

Newer business parks and high-tech industrial clusters prove resilient.

- The industrial leasing market was more active in Q2/2019 with a record 2,883 deals, an increase of 6.7% year-on-year (YoY).
- The rental market was stable with the average monthly rent for factory and warehouse space remaining unchanged at S$1.13 per sq ft in Q2/2019.
- Industrial transacted value fell in Q2/2019 despite a more active sales market, reflecting a possible drop in transacted prices.
- On a YoY basis, prices of 30- and 60-year leasehold industrial properties both slipped, to S$333 per sq ft and S$441 per sq ft respectively.
- Freehold industrial properties continued their upward trend, albeit at the slowest pace since the positive growth began in Q4/2017, with prices rising to S$701 per sq ft in Q2/2019.
- The robust performance of newer business parks and high-tech industrial spaces continue to drive growth in their respective sectors, though older business park clusters are experiencing rising vacancies.

"The challenging external environment is having a significant negative impact on our manufacturing sector."

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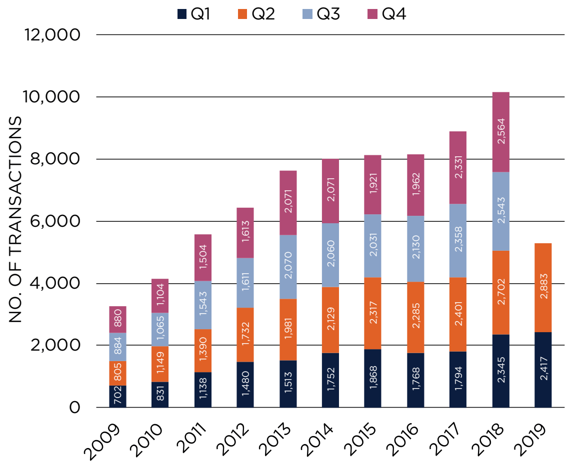
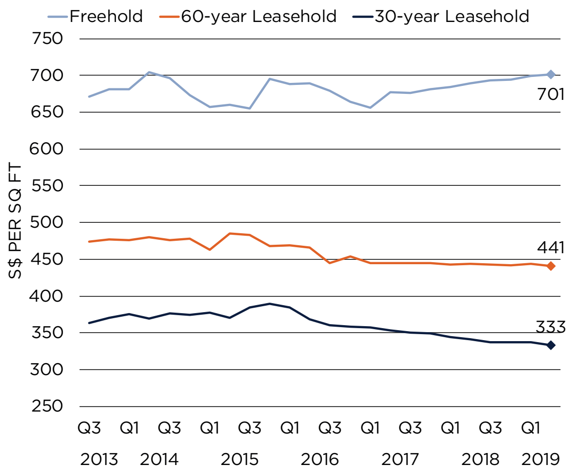
GRAPH 1: Leasing Volumes Of Factories And Warehouses, 2009 to Q2/2019



Source JTC, Savills Research & Consultancy

GRAPH 2: Prices Of Upper-storey Factory And Warehouse Units, Q3/2013 to Q2/2019



Source JTC, Savills Research & Consultancy

GRAPH 3: Vacancy Rate Of Business Park Space, 2003 to Q2/2019

Source JTC, Savills Research & Consultancy

MACROECONOMIC OVERVIEW

According to the Ministry of Trade and Industry (MTI), in Q2/2019 the Singapore economy recorded its most subdued expansion in ten years. Gross Domestic Product (GDP) growth slowed to 0.1% YoY in Q2/2019, a sharp fall from 1.1% in the previous quarter. The manufacturing sector shrunk 3.1% YoY, which MTI attributed to falling output in the electronics, transport engineering and precision engineering clusters, worsening the 0.3% contraction recorded in Q1/2019.

The overall manufacturing sector remained weak, with the Purchasing Manager's Index (PMI) slipping to 49.6 in June, marking the second month of contraction after 32 consecutive months of expansion. The electronics PMI continued on an eight-month contraction, hitting a low of 49.2 in June. In the same month, non-oil domestic exports (NODX) continued a double-digit fall for five consecutive months, posting the steepest YoY decline of 17.3% since February 2013.

RENTAL MARKET

Leasing volume[1] attained a record high with 2,883 deals sealed for factory and warehouse space in Q2/2019, a rise of 6.7% YoY, driven mainly by increased leasing demand for single- and multiple-user factories. Notably, there was a spike in leasing activity observed in Geylang and Bedok Planning Areas in Q2/2019 as compared to the previous quarter.

The increase in leasing activity for single-user factories corresponded with positive demand for single- and multiple-user factory space in Q2/2019. Nonetheless, on the back of major completions such as Qualcomm Building at Kallang, supply outpaced demand for single-user factory space, hence increasing the vacancy rate by 0.3 of a percentage point (ppt) quarter-on-quarter (QoQ) to 9.1% in Q2/2019. On the other hand, the vacancy rate of multiple-user factory space eased 0.9 of a ppt QoQ to 12.8% in Q2/2019, due to a slightly higher take-up than the preceding quarter and the removal of some stock. Meanwhile, the warehouse market saw a slowing pace of absorption. In conjunction with the addition of new supply, mostly in West Region, this led to a slight jump in the island-wide warehouse vacancy rate of 0.5 ppt QoQ, to 11.3% this quarter.

The factory and warehouse rental market generally remained soft, with single-user factories seeing an increase in the rental index of 0.5 QoQ. Multiple-user factories and warehouses experienced negligible changes in rents, with a rise of 0.1 QoQ and a dip of 0.2 QoQ in their respective rental indices, attributable to the reaction of businesses to the slowdown in manufacturing and the US-China trade war. Some firms have deferred business expansion plans in light of the current economic climate, leading to a slowdown in demand for industrial rental property. However, given already low industrial rents, any further reduction in rents likely will not lead to any significant improvement in take-up because a firm's financial performance is generally affected much more by external events than by further rent reductions. As such, rents have stayed at current levels, with the average monthly rent[2] for factory and warehouse space based on the Savills basket remaining constant at S$1.13 per sq ft.

SALES MARKET

Although industrial sales activity in Q2/2019 rose by 14.6% YoY to 338 transactions[3], the total transaction value fell by 17.4% across the same period to S$435 million, possibly due to a decline in the average price of each transacted unit. As some industrial firms disposed of assets to improve cash flow in the face of soft business conditions, they may have sold for less than market price. This quarter also saw an absence of large transactions, as buyers' appetites for big-ticket purchases was sapped.

As such, overall prices for factory and warehouse space, except for those on freehold leases, continued their downward trend. Following more than three years of decline, prices of 30-year leasehold industrial units in the Savills basket of industrial properties[4] fell by 1.1% QoQ to S$333 per sq ft in Q2/2019. Compared to other tenures, the decline was more significant because of depleting leases. Prices of 60-year leasehold industrial units were also down by 0.6% QoQ to S$441 per sq ft in Q2/2019, reversing the short-lived uptick observed in the previous quarter. In contrast, the average price of freehold industrial properties continued its seven-quarter increase to S$701 per sq ft in Q2/2019. However, the pace of increase (0.3% QoQ) was the slowest since the first positive growth in Q4/2017.

BUSINESS PARKS AND HIGH-TECH SPACES

The island-wide vacancy rate for business parks fell 0.4 ppt from the previous quarter to 14.0%, due to stable demand and the lack of new supply. Occupancy at the newer business parks, such as Mapletree Business City and one-north, remained healthy due to their favourable city-fringe locations and higher-end specifications. New entrants included American agri-tech firm Corteva Agriscience, which opened its Asia-Pacific head office at Biopolis in May. On the other hand, ageing clusters continued to exhibit poor occupancy due to weakening demand. The vacancy rate of Changi Business Park jumped 1.2 ppt QoQ to 14.1% and International Business Park's vacancy rate reached a record high of 30.2% in Q2/2019.

1 Excluding business park spaces; comprises only single- and multiple-user factory as well as warehouse spaces.

2 Based on Savills' basket of factory and warehouse properties that are more than 10,000 sq ft and on the ground floor.

3 According to JTC, caveats that are lodged on industrial properties with the Singapore Land Authority as of 19 August 2019.

4 Only includes strata sales of upper-storey factory (single- and multiple-user factory) and warehouse units, excluding all ground floor units.

In terms of rent, there is a similar disparity between newer and ageing clusters. While rents in the former remained buoyant, declining rents in older clusters are supressing overall rental growth. Savills average monthly rent for business parks in general is unchanged from the previous quarter, at S$4.05 per sq ft.

The ongoing digital transformation and growth of advanced manufacturing, supported by government initiatives, has fuelled the buoyancy of the high-tech industrial market. Moreover, the continual rise in office rents has also been encouraging qualifying firms to relocate to high-tech premises. As demand for high-tech industrial space appears poised for stability, the average monthly rent for high-tech industrial space in the Savills basket inched up 0.3% QoQ to S$3.36 per sq ft in Q2/2019.

As the rental market for high-tech industrial space looks positive, industrial landlord Mapletree Industrial Trust has outlined plans to redevelop its flatted factory space at Kolam Ayer into a high-tech industrial cluster, spanning about 865,600 sq ft (Gross Floor Area). Slated to be completed in 2H/2022, the project has secured a pre-commitment rate of around 24.4%, with an anchor tenant—a global medical device firm from Germany—taking up a built-to-suit facility in the new precinct.

OUTLOOK

MTI has lowered its full-year GDP growth forecast to between 0.0% and 1.0% on the back of falling manufacturing output and weakness in the electronics and precision engineering clusters. Moreover, the export-oriented local economy is also expected to enter a challenging period as Enterprise Singapore reduced its latest full-year NODX forecast to -9.0% to -8.0%, amid concerns over weak global demand and the US-China trade war. As an economy heavily reliant on global trade, Singapore is likely to be heavily affected. Therefore, as industrial firms react to poorer business sentiments by deferring expansion plans, demand for factory space is projected to be further subdued in the near future.

The rapid Q2/2019 slowdown in Singapore's economic growth has been attributed to the sharp 3.8% YoY contraction in the manufacturing sector. This drastic decline may have overtaken the ability of rents to react in step as landlords do not directly face conditions that affect their tenants . Landlords will adjust rents based solely on their ability to let out vacant units or renew leases of existing tenants.

Here, we take a brief look at how the headwinds facing the industrial market are affecting the manufacturing and transport and storage sectors. Using a simple conceptual block design, we begin by looking at the manufacturing sectors in Singapore, Malaysia and Thailand, three neighbouring countries with large manufacturing bases and with the highest GDPs per capita in ASEAN. Table 1 shows the top five Foreign Direct Investment (FDI) inflows by sectors. Other than the chemical industry, Singapore shares few major FDI sectoral drivers with Malaysia and Thailand. Therefore, we should expect different performances in manufacturing growth rates for these three countries when subjected to common treatments. These three treatments are:

1. The ongoing US-China trade war;
2. Slowing growth rates in China; and
3. Slower global economic growth rates.

These three treatments are likely to be correlated with the trade war that's further slowing economic growth in both China and the rest of the world. In addition, any slowdown in China will have an impact on global growth rates.

Now we look at the YoY GDP manufacturing growth rates for the three countries to see how each responded to the three treatments.

Graph 4 shows that Malaysia's manufacturing sector appears to be only slightly affected by the three treatments while Singapore and Thailand respond similarly, with Singapore being the most sensitive to the three treatments. As the trade war intensified in the beginning of 2018, global economies began to be affected. Malaysia and Thailand felt that impact less while Singapore's manufacturing performance fell faster, leading us to ask if, moving forward, will the trade war remain at its current intensity, escalate or de-escalate? We believe the trade war will probably continue until 2020 with stronger consequences for Singapore's manufacturing sector than that for Malaysia (see Graph 4). Unless Singapore's major FDI inflows into manufacturing can be rejigged to industries less likely to be affected by the three treatments, it will be a challenge for factories to raise rents.

There appears to be a silver lining, though, as we find that despite the three treatments, growth in Singapore's Transport and Storage sector has been accelerating since Q4/2018 (see Graph 5). We believe that Singapore's new-economy drive could have immunised this sector from the three treatments, and modern warehouse and storage space rents could find increasing support from e-commerce and other 4.0 industrial users

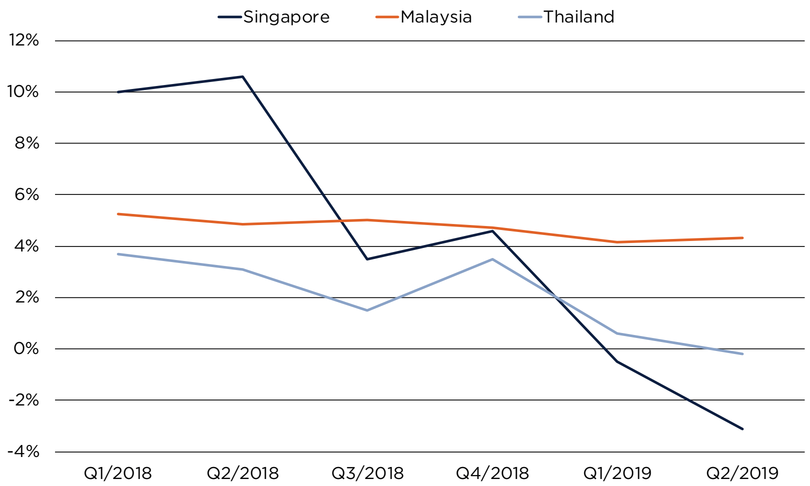
However, despite the downbeat outlook,

TABLE 1: Manufacturing Sector Characteristics

COUNTRY	GDP PER CAPITA USD	TOP FIVE MANUFACTURING-RELATED FDI BY SECTOR (% OF TOTAL FDI) (2009 TO 2013)*
Singapore	65,627	1. Food, Beverage and Tobacco (38%) 2. Semiconductor and Electronics (15%) **3. Chemicals (13%)** 4. Medical, Precision and Medical (6%) 5. Mineral-based Products (5%)
Malaysia	11,385	1. Electrical Machinery (20%) 2. Other Transport Equipment (20%) 3. Basic Metals (14%) **4. Machinery, Equipment and Appliances (6%)** **5. Fabricated Metal Products (6%)**
Thailand	7,607	1. Motor Vehicles and Components (42%) 2. Rubber and Plastic Products (14%) **3. Fabricated Metal Products (9%)** **4. Chemicals (6%)** **5. Machinery, Equipment and Appliances (6%)**

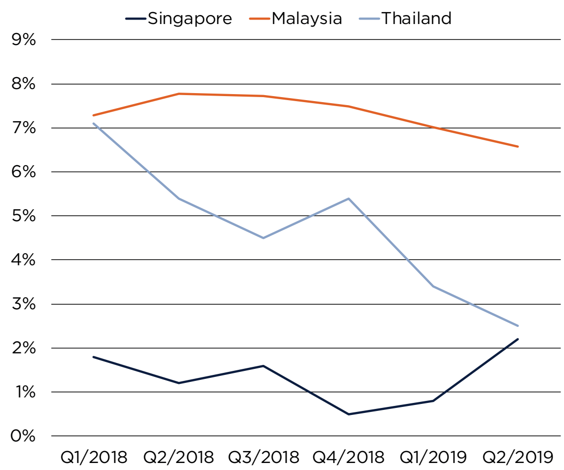
Source McKinsey, Savills Research & Consultancy
*: The bracketed numbers show the sector's percentage contribution to total manufacturing FDI.

GRAPH 4: GDP Manufacturing YoY Growth



Source MTI, Bank Negara, NESDC, Savills Research & Consultancy

GRAPH 5: GDP Transport And Storage YoY Growth



Source MTI, Bank Negara, NESDC, Savills Research & Consultancy

global companies continue to be attracted to the Singapore industrial property sector as a preferred base to access Asian markets. This is due, in part, to Singapore's business-friendly policies and higher quality of industrial infrastructure vis-à-vis its competitors within the Asia-Pacific region. Two instances of resilient sectors include the pharmaceutical and agri-technology sectors in which GSK has recently launched a manufacturing facility in Jurong, while a massive agri-food innovation park spanning 18 hectares is set to open in Sungei Kadut. Additionally, with the announcement of Dyson's intention to expand their Singapore Technology Centre located at Science Park, the business park segment continues to flourish. This steady influx of renowned global firms into the local industrial market could partially forestall the adverse effects brought about by weakening market sentiment, and thus help to keep the industrial sector afloat.

We are keeping our forecast range of overall factory and warehouse rents unchanged for 2019 and 2020. As mentioned, although manufacturers are negatively impacted by the effects of the trade war and the global economic slowdown, even if rents were to fall further, impact on finances would be limited. Whilst vacancies hold steady, that may belie the fact that single-user factories are operating at less than optimal capacity, thereby harbouring "shadow" space.

TABLE 2: Rental Forecast For General Industrial Factory And Warehouse Space

PERIOD	YOY % CHANGE IN INDUSTRIAL FACTORY AND WAREHOUSE RENTS
2019F	-0.5% to +0.5%
2020F	0.0% to +1.0%

Source Savills Research & Consultancy