MARKET IN MINUTES
Savills Research

Industrial

savills

At this juncture, rents have found support

Newer business parks and high-tech industrial space continue to fare well.

- The industrial leasing market remained healthy in Q3/2019 with 2,679 deals, an increase of 5.3% year-on-year (YoY).
- The rental market was stagnant, with the average monthly rent for factory and warehouse space remaining unchanged at S$1.13 per sq ft in Q3/2019.
- Total industrial transaction value fell 42.4% YoY in Q3/2019, in conjunction with a 6.6% YoY decline in the number of transactions.
- On a YoY basis, prices of 60-year leasehold and freehold industrial properties declined markedly to S$436 and S$680 per sq ft respectively, while prices of 30-year leasehold industrial units edged up to S$334 per sq ft.
- The robust performance of newer business parks and high-tech industrial spaces continues to drive growth in their respective sectors, though older business park clusters are experiencing rising vacancies.
- As the manufacturing and trading industries are facing issues relating to a lack of demand rather than rents being the major drag on their operating surpluses (if any), we maintain our rental forecast for rents to remain stable over 2019 and 2020.

"The general manufacturing sector is facing a lack of demand rather than a profit drag due to rents."

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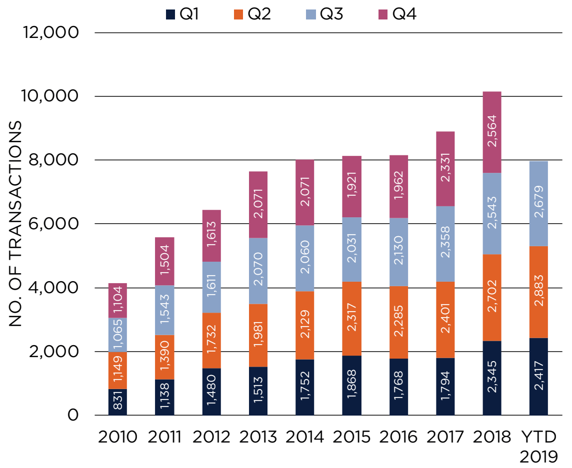
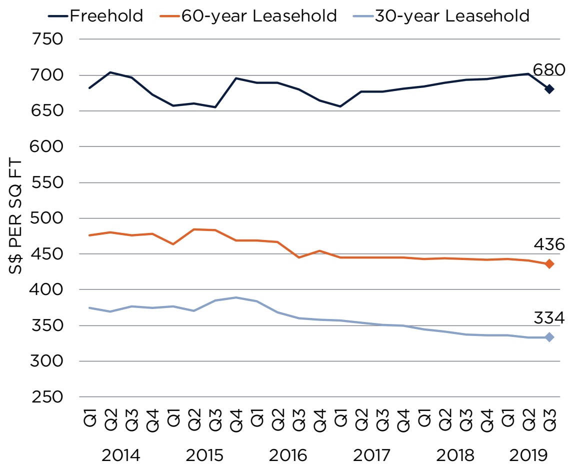
GRAPH 1: Leasing Volumes Of Factories And Warehouses, 2010 to Q3/2019



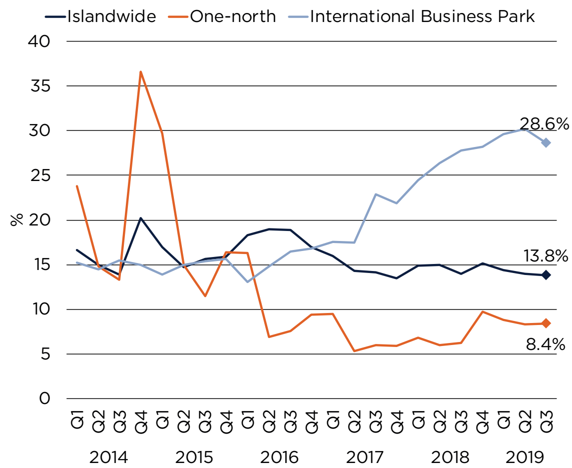
Source JTC, Savills Research & Consultancy

GRAPH 2: Prices Of Upper-storey Factory And Warehouse Units, 2014 to Q3/2019



Source JTC, Savills Research & Consultancy

GRAPH 3: Vacancy Rate Of Business Park Spaces, 2014 to Q3/2019



Source JTC, Savills Research & Consultancy

MACROECONOMIC OVERVIEW

According to flash estimates from the Ministry of Trade and Industry (MTI), the Singapore economy in Q3/2019 continued its lacklustre performance with a negligible Gross Domestic Product (GDP) growth of 0.1% YoY, a similar pace of growth as the previous quarter. The manufacturing sector in Q3/2019 contracted 3.5% YoY, extending the negative trend from the 3.3% contraction recorded in Q2/2019. MTI attributed the contraction to declining output from electronics, precision engineering and transport engineering clusters.

The manufacturing sector remained weak in Q3/2019, as the Purchasing Manager's Index (PMI) declined to a three-year low of 49.5 in September. Following a 9.0% YoY contraction in August, non-oil domestic exports (NODX) saw a smaller decline of 8.1% in September. The fall was due to decreases in both electronic and non-electronic exports.

RENTAL MARKET

Although leasing volumes[1] fell 7.1% QoQ, it is still considered healthy with 2,679 deals for both factory and warehouse space in Q3/2019. On a YoY comparison, there was a 5.3% increase in number of leases. This was driven by a surge in leasing transactions for single- and multiple-user factories, with a marginal increase in warehouse leases on a YoY basis. Compared to Q3/2018, there was a rise in the number of sign-on for factory space, particularly in the Bukit Merah, Sembawang, and Geylang Planning Areas observed in Q3/2019. The increase is likely to be due to coincidental clustering of rental renewals as there had been no new building completions in those areas in recent quarters.

Net new demand for single-user factory space in Q3/2019 reached almost 3.0 million sq ft, the highest quarterly rise since Q4/2016. This meant that net new demand for this quarter exceeded the approximately 2.6 million sq ft of net new supply, the bulk of which was due to the completion of Micron's expanded facility at 1 North Coast Drive. This resulted in a slight drop of the vacancy rate for single-user factories to 8.9% as at Q3/2019. On the other hand, net demand for multiple-user factory space in Q3/2019 receded by about 190,000 sq ft, in line with the net reduction of multiple-user factory stock of about 21,000 sq ft for the quarter in review. As net take-up shrunk more than net supply, the vacancy rate for multiple-user factories edged up to 12.9% as at Q3/2019. In the quarter, although the total warehouse space occupied increased by 313,000 sq ft, it was nevertheless outpaced by the rise in supply of over 1.2 million sq ft. The spike in supply is due to numerous completions, such as Schenker Singapore's warehouse development at 20 Alps Avenue which has a gross floor area (GFA) of over 553,000 sq ft. As a result, the warehouse vacancy rate surged to 11.9% as at Q3/2019.

Rents for single-user factories continued recovering on the back of improving occupancy, with the rental index for single-user factories recording a second consecutive rise of 0.5% QoQ. The rental index for multiple-user factories remained flat, while warehouse rents slipped by 0.2% QoQ in correspondence to falling occupancy rates. Rents multi-user factories have been falling since Q2/2014 while those for single-user have been coming off since Q3/2014. Warehouses have seen their rents decline from their peak in Q3/2014 as well. Notwithstanding the declining GDP for the manufacturing sector and the US-China trade war dampening sentiments, a level of rental support for all three industrial space users appear to have formed. We believe that this could be because rents have fallen to a level that any further declines would still not help the cause of the users whose principal plight is that of the lack of demand. Unless there is a crisis, we expect rents to form a base at around current levels. For Q3/2019, the average monthly rent[2] for factory and warehouse space based on the Savills basket remained unchanged at S$1.13 per sq ft.

SALES MARKET

Industrial sales activity fell 6.6% YoY with a total of 282 transactions[3] recorded in Q3/2019, while the total transaction value declined by 42.4% YoY to S$671.5 million; thus indicating that the average transacted prices fell during the quarter. As the average deal size fell, it may imply that selling activity is skewed towards units in older industrial buildings and/or in by industries that could not adapt to the changing industrial climate – for instance, the inability of some firms to automate, declining demand for their services, or ageing operators deciding to sell their facilities and calling it a day, etc.

Aside from the sale of MBC II, other major industrial transactions this quarter include the purchase of a warehouse development at 48 Pandan Road for S$225 million, by a joint venture which included ESR-REIT; and the acquisition of a 60-year leasehold factory at 6 Tampines Industrial Avenue for S$77.4 million by a joint venture led by Boustead Projects.

From the basket of properties[4] compiled by Savills, the overall price for 60-year leasehold and freehold factory and warehouse spaces saw an accelerated downturn this quarter. Following seven quarters of increase, prices of freehold industrial properties fell by 3.1%

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

2 Based on Savills basket of factory and warehouse properties which are more than 10,000 sq ft on ground floor.
3 According to JTC caveats which are lodged on industrial properties with the Singapore Land Authority as of 4 November 2019.
The tally for Q3/2019 does not include the sale of Mapletree Business City II (MBC II) to Mapletree Commercial Trust (MCT), as the transaction was still pending the approval of MCT's unitholders as at the end of Q3/2019.
4 Only include strata sales of upper-storey factory (single- and multiple-user factory) and warehouse units, excluding all ground floor units.

QoQ to S$680 per sq ft in Q3/2019. The large fall is due to two transactions at Innovation Place at Sungei Kadut. Owing to the small basket of comparables, if these transactions are omitted, prices would have declined by a more moderate 1.2% QoQ. Meanwhile, prices of 60-year leasehold industrial units fell by 1.0% QoQ to S$436 per sq ft in Q3/2019, a bigger decline from the previous quarter. For 30-year leasehold industrial units, prices inched up by 0.1% QoQ to S$334 per sq ft in Q3/2019 reversing the drop observed in the preceding quarter.

BUSINESS PARKS AND HIGH-TECH SPACES

The island-wide vacancy rate for business parks in Q3/2019 eased another 0.2 ppt QoQ from the previous quarter to 13.8%. This was achieved on the back of an estimated net new demand of 47,750 sf during Q3/2019 and a tiny reduction of 4,350 sf in net island-wide stock which can be attributed to ongoing addition & alteration (A&A) works, notably at one-north. The one-north cluster saw a slight 0.1 ppt QoQ increase in vacancy to 9.1%. However, the occupancy levels at the older business park clusters seemed to have improved. At International Business Park (IBP), the rising vacancy rate observed in past quarters reversed with a 1.6 ppt QoQ drop, to 28.6% as at this quarter. This was due to a surge in net take-up in IBP. The vacancy rate at Changi Business Park has likewise dipped slightly, by 0.1 ppt QoQ to 14.0% as at Q3/2019 as a result of increased occupancy. New entrants this quarter included local e-commerce firm Shopee, which opened its six-floor regional headquarters at Science Park in September.

In terms of rent, the disparity between newer and ageing clusters has widened, as rents in the former continued growing at the expense of older clusters. As a whole, Savills' average monthly rent for business parks remained flat this quarter at S$4.05 per sq ft.

The high-tech industrial market continues to shine, spurred by the growth of e-commerce and value-added manufacturing. This has been aided by timely asset enhancement initiatives (AEI) at high-tech industrial properties, notably the ongoing revamp at Sabana REIT's New Tech Park and the recently-concluded enhancements at Frasers Commercial Trust's Alexandra Technopark. The average monthly rent for high-tech industrial space in Savills basket increased by 2.5% QoQ, to S$3.46 per sq ft in Q3/2019.

OUTLOOK

In August, MTI had lowered its full-year GDP growth forecast to between 0.0% and 1.0%, on the back of declining manufacturing output and the weak electronics and precision engineering clusters. Moreover, in line with Enterprise Singapore adjusting down its latest full-year NODX forecast to -9.0% to -8.0%, as global trade tensions continue to persist, the health of the export-reliant industrial sector continues to be subdued. Therefore, as industrial firms react to poorer business sentiments by deferring expansion plans, the demand for factory and warehouse space on the whole is projected to be weak in the near future.

The story is however not bleak across the board as we have had investment enquiries for data centres, last-mile logistic centres, high-tech and business park assets coming in at a rather constant rate each month. Industrial and warehouse properties which cater to the non-oil and gas industries and with namely better built quality, high-tech enabled and a central location, are still in demand by tenants because they cater to users who have a need to be close to the Central Business District (CBD).

The ongoing rise in office rents have spurred the migration of growth companies in the technology and multi-media sector to business parks and high-tech premises. As asking rents per sq ft for Grade A office space hover around double-digits levels, cost-sensitive tenants who qualify might instead opt for newer business park clusters and high-tech properties located in city fringe areas, especially those developments that offer comparable high-quality specifications and amenities. This might in turn raise expectations among newer business park landlords for an increase in asking rents. Ageing business park and high-tech properties would have to undergo renewals and AEI prior to leasing their spaces out at higher rents, in order to be on a competitive field with their newer, higher-quality counterparts.

Meanwhile, the general manufacturing industry here is facing an issue of a lack of demand rather than high rents being a drag on operating profits. We believe that this is the case because despite the sharp fall in NODX and more products being affected by tariffs arising from the US-China trade war, rents for both multi and single-user factories and warehouse space have been relatively stable for the past few quarters. Therefore, unless there is a new crisis that shake landlords' confidence, we believe that rents should continue to stay flat this year. Although total factory and warehouse supply until end-2020 is expected to reach almost 18.0 million sq ft, rents are likely to remain flattish for the reason explained earlier (that manufacturers are facing a lack of orders rather than being squeezed by rents). Our rental forecast remains.

TABLE 1: 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