Singapore – February 2020

MARKET IN MINUTES

Savills Research

Industrial

2019 investment beats expectations

The market has been beaten down but those left standing are the seeds of a new age.

- The industrial leasing market continued expanding with leasing volume rising for a tenth consecutive year with 10,465 deals done. However, this is a significantly slower pace of growth of 3.1% year-on-year (YoY).
- The average monthly rent for factory and warehouse space stayed flat at S$1.13 per sq ft in Q4/2019, as JTC rental indices showed signs of stabilisation.
- Industrial sales volumes picked up 8.9% YoY, with 1,196 factory and warehouse properties worth over S$3.1 billion changing hands in 2019.
- On a quarter-on-quarter (QoQ) basis, prices of 30-year leasehold industrial properties fell by 1.7% to S$328 per sq ft, while 60-year leasehold and freehold industrial units saw a marginal uptick of 0.4% to S$438 per sq ft and 0.1% to S$680 per sq ft respectively.
- To tap into the resilient growth of business park and high-tech industrial segments, major landlords continued with their asset enhancement plans to rejuvenate their portfolios and cater to the changing demands of new emerging industries.
- For industries which are still standing, we still believe that they are facing a lack of demand rather than cost pressures. We therefore believe that the rental downside is limited, but because of the COVID-19 outbreak we have marginally revised our rental forecast for 2020 to -1%.

> "The COVID-19 outbreak has merely speeded up the early stage global realignment of supply chains away from China."
>
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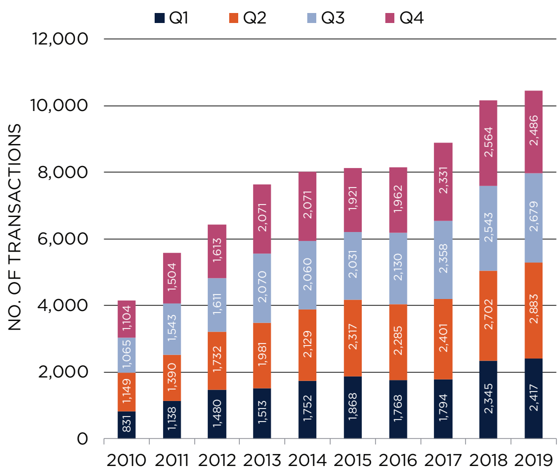
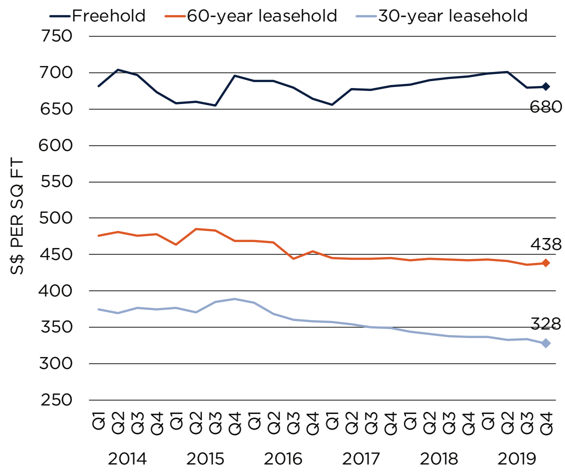
GRAPH 1: Leasing Volumes Of Factories And Warehouses, 2010 to 2019



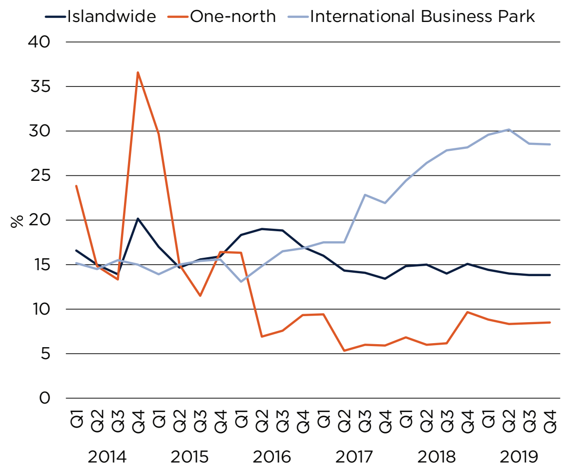
Source JTC, Savills Research & Consultancy

GRAPH 2: Prices Of Upper-Storey Factory And Warehouse Units, Q1/2014 to Q4/2019



Source JTC, Savills Research & Consultancy

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



Source JTC, Savills Research & Consultancy

MACROECONOMIC OVERVIEW

According to the Ministry of Trade and Industry (MTI), the Singapore economy expanded 1.0% YoY in Q4/2019, showing an improvement from the 0.7% registered in the previous quarter. The full-year economic growth in 2019 moderated to 0.7% YoY, compared with 3.4% in 2018. The main drag came from the manufacturing sector which contracted by 1.4% in 2019 on the back of output declines in the electronics, chemicals, precision engineering and transport engineering clusters.

After falling for seven straight months, sentiments in the manufacturing sector improved towards the end of 2019, with the Purchasing Manager's Index (PMI) posting an expansion of 50.1 in December. Although it contracted marginally with a reading of 49.9, the electronics PMI showed its best reading in December. In the same month, non-oil domestic exports (NODX) reversed nine months of decline with a recovery of 2.4% YoY, which were mainly lifted by non-monetary gold and pharmaceutical exports.

RENTAL MARKET

In 2019, the industrial leasing market continued expanding with leasing volume[1] rising for the tenth consecutive year to 10,465 deals. However, the pace was albeit significantly slower at 3.1% YoY[2] and was due to the softer leasing market for multiple-user factory space[3] and warehouse space[4] (Graph 1). The rise in new tenancies for industrial space could be an indication of tighter budget control, instead of a pick-up in demand, which led to downsizing, relocation or consolidation of operations to a more cost-efficient facility. Apart from removal of stock for redevelopment, the decentralisation of certain business activities to lower cost locations could be a reason for the 4.7% YoY decrease in leasing transactions in the Central Region, which saw the largest decline across the region in 2019.

Despite the slowdown in leasing interest from the preceding year, the vacancy rate for multiple-user factory space eased 0.4 of a percentage point (ppt) QoQ to 12.5% in Q4/2019 as supply tightened, reaching its lowest level since Q1/2015. On the other hand, for the warehouse segment, the vacancy rate continued inching upwards by 0.1 of a ppt QoQ to 12.0% in Q4/2019, its highest since Q3/2017. The vacancy rate was under pressure due to weak occupier demand, especially in Central and East Planning Region which recorded negative net demand in 2019.

As tenants consolidated their businesses, they adjusted their leasing strategies and for the single-user factory segment, this boosted the overall leasing activity with net demand hitting a five-year high in 2019. However, it was offset by the large injection of new supply throughout the year which resulted in an increase of 0.3 of a ppt QoQ in vacancy rate to 9.2% in Q4/2019. In Q4/2018, the vacancy rate was marginally lower at 9.1%.

Even though there is no significant recovery in industrial rents, there were some early signs of stabilisation. According to JTC's rental indices, rentals of single-user factory ended a four-year decline with a 0.5% YoY recovery while the other two segments showed signs of bottoming out with moderated pace of decline[5] in Q4/2019. Savills average prime monthly rent[6] for factory and warehouse space stayed flat at S$1.13 per sq ft in Q4/2019.

SALES MARKET

The industrial sales market was active in 1H/2019 and this was due to a surge in transactions for multiple-user factories. Although the sales market quietened down in 2H/2019 with a decline of 2.7% in sales volume from the same period a year ago, the 1,194 sales transactions[7] in 2019 was an 8.9% YoY increase and this was greatest rise since 2011.

The total investment sales value of factory and warehouse properties totalled S$3.1 billion in 2019, 6.6% higher than in 2018. The numbers was boosted by the sale-and-leaseback transaction for a site at Tuas which comprises an integrated industrial and warehouse facility. The site was sold to LOGOS for S$585 million and fully leased back to REC for 20 years. This signals that there is still investment interest for quality tenanted assets that provide a stable rental yield. However, the sales value for warehouse assets decreased by over 50% from the previous year due to the base effect caused by a major sale-and-leaseback transaction in 2018 involving Mapletree Logistics Trust's acquisition of five ramp-up logistics properties from CWT International for S$778.3 million.

Based on Savills' basket of industrial properties, the average prices for islandwide 30-year leasehold industrial units decreased 1.7% QoQ to S$328 per sq ft in Q4/2019. This is not conflicted with the 0.3% QoQ decline in JTC price index for multiple-user factory properties of less than 30-year lease. On the other hand, prices of longer tenures displayed higher resilience as they are limited in supply, hence sellers are generally maintaining their price expectations. On a quarterly basis, prices of 60-year leasehold and freehold industrial units saw a marginal uptick of 0.4% to S$438 per sq ft and 0.1% to S$680 per sq ft respectively (Graph 2).

1 Excluding business park spaces, only comprises single- and multiple-user factory as well as warehouse spaces.
2 Industrial leasing volume increased by 14.3% YoY in 2018 and 9.1% YoY in 2017.
3 Compared to 10.3% in 2018, leasing volume for multiple-user factory increased by 2.4% in 2019.
4 Compared to 33.5% in 2018, leasing volume for warehouse space dropped by 0.9% in 2019.
5 JTC rental index for multiple-user factory space and warehouse space declined 0.1% and 0.2% YoY respectively in Q4/2019.
6 Based on Savills basket of factory and warehouse properties, which are more than 10,000 sq ft on ground floor.
7 Only include strata sales of upper-storey factory (single- and multiple-user factory) and warehouse units, excluding all ground floor units.

BUSINESS PARKS AND HIGH-TECH SPACES

As a result of healthier occupier demand with vacancy rate for business parks eased from 15.1% in Q4/2018 to 13.8% in Q4/2019, reaching its lowest in the last two years (Graph 3). The better showing was mainly due to strong take-up in the newer business park clusters including Mapletree Business City and one-north. Nonetheless, the rental growth was dragged on by the lower committed rents of the older business park developments. Despite some new major tenants such as Xylem and Bio-Rad Laboratories in ICON@IBP Tower, as well as Dyson who expanded its head office at Science Park, the committed rents were supressed due to the age of the buildings. While JTC's business park rental index inched up by 0.1% QoQ in Q4/2019, Savills average monthly rent for business park space remained stable at S$4.05 per sq ft.

Along with the on-going restructuring of the manufacturing sector and industrial activities, leasing demand for high-tech industrial space has also grown. This is especially so for those well-maintained and upgraded developments with facilities which are aligned with Industry 4.0. Following the completion of enhancement works in January 2019, Alexandra Technopark saw improved occupancy[8] and achieved higher rents for the leases signed. The premise vacated by Microsoft Operations in January 2020 is also fully committed with the average rent for the new leases coming in higher than the existing rent. Based on Savills basket of properties, the average monthly rent for high-tech space increased 1.0% QoQ to S$3.48 per sq ft in Q4/2019.

To tap into the resilient growth of business park and high-tech industrial segments, major landlords continued with their asset enhancement plans to rejuvenate their portfolio and cater to changing demands of the new emerging industries. For example, The Capricon and The Galen at Science Park 2 have commenced its AEI works to enhance the common area and facilities for tenants while iQuest@IBP will unlock its value and redevelop to its maximum plot ratio with new facilities. Kolam Ayer 2 Flatted Factory Cluster will also get a facelift, upgrading into a new high-tech industrial area which is 24.4% pre-committed by a German medical device firm for its new central hub in Asia Pacific[9].

OUTLOOK

For the outlook, we have broken it to two sections. The first would be how the market may react if the COVID-19 outbreak is either short-lived and/or not causing any radical disruption to the way the supply chain is presently structured. The second section talks about the potential disruptive impact this pandemic may cause to the Business-to-Business and Business-to-Consumer landscape.

A business as usual market

Coupled with the uncertainty surrounding US-China trade relations and COVID-19 outbreak, the Singapore economy is expected to be negatively impacted in 2020. Therefore, economic growth is likely to come in lower than earlier projected due to the negative spillovers on the region and Singapore. The fall in global consumption alongside prolonged disruptions to global supply chain and production will have a significant impact on the export-oriented economy like Singapore, especially the outward-oriented sectors such as manufacturing and wholesale trade. The declining visitor numbers and domestic consumption also contributed to the weaker economic outlook. Against this backdrop, MTI has lowered its full-year GDP growth forecast to between -0.5% and 1.5%, with growth expected to come in at around 0.5%, the mid-point of the forecast range. Furthermore, Enterprise Singapore also cut its latest full-year NODX forecast to -0.5% to 1.5% amid concerns over potentially softer demand in several key markets, such as China. In face of the protracted weaker trading environment and global headwinds, firms are likely to take cautious stance to their leasing plans.

Notwithstanding the downbeat assessment, there is still a silver lining for the Singapore economy. In 2019, Singapore outperformed expectations for fixed asset investments for the year, driven by commitments from semiconductor as well as energy and chemical firms. Even though the global economic environment remained uncertain, the investment flows in 2019 are expected to create new jobs upon full implementation of the projects. This will help to drive growth in the local economy and enhance Singapore's competitiveness as a hub for manufacturing and digital activities. In turn, this may create some demand for certain types of industrial space, particularly the better-maintained business park and high-tech industrial developments with smart features which can help to improve productivity and reduce operating costs.

In view of resilient strong growth in biomedical manufacturing cluster which expanded by 10.7% YoY in 2019, research and development hub Biopolis will undergo expansion works. Slated to complete by mid-2022, phase 6 of Biopolis is expected to add another 377,000 sq ft of business park space for biomedical sciences research and supporting activities and 66,000 sq ft of commercial space. Also scheduled to complete around 2022, the first phase of Jurong Innovation District, a new hub for advanced manufacturing, will house firms such as German conglomerate Siemens and engineering firm Bosch Rexroth[10].

Although the displacement of tenants from maturing assets may continue to drive up the vacancy rate in older factory and warehouse properties and exert downward pressure on overall industrial rents, rental levels could find some support from the modern and well-kept facilities which may see some demand from logistics and food delivery operations, the better performing sectors during the virus outbreak. GrabFood has recently launched a new shared kitchen space at Lam Soon Industrial Building, with plans to further expand in 1H/2020. In addition to its Prime Now facility at Mapletree Logistics Hub, Amazon has also ramped up the logistics warehouse infrastructure here to support its retail operations.

In the near term, the virus outbreak in China will inevitably dampen the performance of the trading and manufacturing sectors, which is expected to have adverse effects on Singapore's industrial market, given the supply chain connectivity. By today, after facing years of cost and labour pressures, those industries left standing are those who have been refined through the fire. We still hold the belief that they are being affected by a lack of demand rather than the passé issue of cost pressures. Arising from this, our forecast for rents for 2020 is revised from 0% to +1% to -1% YoY.

COVID-19 and its potentially disruptive impact

The lack of demand facing our industrialists has been made worse by the viral outbreak. For many industrialists, shipping and logistics players, their supply chain has been severely broken. However, we believe that this alone would not derail the undercurrents that are sweeping through the industrial and warehousing markets. What may happen when this event blows over is the main issue.

The weaker Small and Medium Enterprises (SME) here would most likely feel this COVID-19 outbreak more than the Multinational Corporations (MNC). The twin effects of falling end-user demand has put further strain on many firms' financial resources. Whilst some multinationals may suffer greater declines in revenues than local SMEs, they still have stronger financial muscle and their objective-driven presence in Singapore may see them ride through this storm in better shape than smaller local companies.

In our view, what this outbreak has probably done is to quicken the sieving out process in the industrial landscape and accelerated the movement to rely less on China, something that manufacturers have already been planning before this. While their supply chains may be immediately impacted by events going on in

TABLE 1: Rental Forecast For General Industrial Factory And Warehouse Space

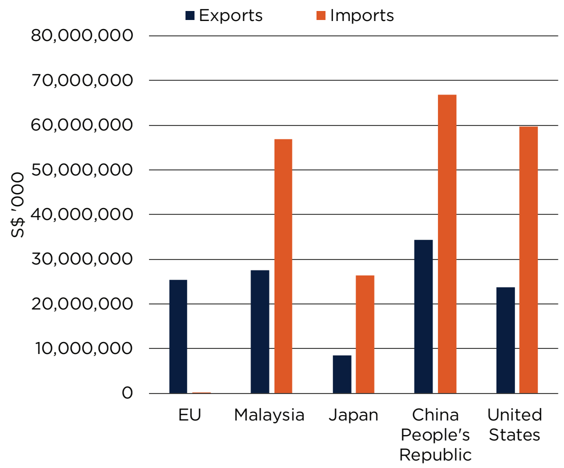
PERIOD	YOY % CHANGE IN INDUSTRIAL FACTORY AND WAREHOUSE RENTS
2020F	-1.0%

Source Savills Research & Consultancy

8 According to Frasers Commercial Trust 1QFY20 Financial Results, occupancy rate improved from 68.6% on 31 December 2018 to 97.2% on 31 December 2019.
9 A seven-storey built-to-suit facility which accounts for about 24.4 per cent of the enlarged gross floor area.

10 Simens will set up an Advanced Manufacturing Transformation Centre while Bosch Rexroth plans to open its regional training centre in the upcoming Jurong Innovation District.

GRAPH 4: Singapore Merchandise Trade With Selected Countries



Source Singapore Department of Statistics, Savills Research & Consultancy

China, they nonetheless are likely to weather through this well once they diversify and intensify their hub and spoke networks around the world (for example to Mexico for the automobile industry and Ethiopia for textile, just to name two hubs).

For Singapore, at the end of this supply chain reorganisation, excluding firms that serve the local market, those remaining will be those that have both financial muscle and less affected by the high fixed and variable costs here. These companies are likely those that consider themselves as part of Industry 4.0 and serving as a spoke to one of the regional or global hubs. However, because timeliness of delivery rather than cost of production is key, location rises up the ranking of importance. For example, closeness or easy access to the airport may be one major factor. There may be a realignment of trade flows and the general pattern of imports and exports with various countries see in Graph 4 may change drastically. At this juncture though, it is still a little early to sense how this may pan out because of too many permutations (permutation amongst trade partners multiplied by possibilities of whether the export-import ratio remains ≥1 or <1.)

For those that serve the domestic market, be it SMEs or MNCs, they may still have to upgrade. For example, the structural change going on in the retail market here will spawn further demand for last mile logistics and central kitchens. However, with cost sensitivities involved in serving the local market, Industry 4.0 will likely remain the buzzword for these players.