Briefing
Industrial sector

May 2018

Image: Mapletree Hi-Tech Space @ Kallang

SUMMARY

The industrial market is expected to remain muted in the near term with slow take-up.

- Industrial sales volume surged by 19.8% year-on-year (YoY) to 242 transactions in Q1/2018, but was still lower than the average 335 deals for the last three years.

- Prices of freehold upper-storey factory and warehouse units in the Savills basket increased by 1.4% quarter-on-quarter (QoQ) to S$684 per sq ft.

- Prices of 30- and 60-year leasehold industrial properties hit record lows with a decline of 1.5% QoQ to S$344 per sq ft and 0.6% QoQ to S$442 per sq ft respectively.

- The industrial rental market recorded 2,345 deals in Q1/2018, 11.8% higher than the three-year quarterly average.

- However, the average prime monthly rent for factory and warehouse properties continued to decrease, by 1.0% QoQ to S$1.14 per sq ft.

- We may need to see a broad-based turnaround in the manufacturing industry that also benefits local companies before industrial rents start to rebound.

"Until we see a broad-based turnaround in manufacturing activity, rents may just limp along." Alan Cheong, Savills Research

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Macro economy

According to the advanced estimates released by the Ministry of Trade and Industry (MTI), Singapore's gross domestic product grew by 4.3% YoY in Q1/2018, surpassing the 3.6% YoY expansion in the preceding quarter. For the full year 2017, boosted by expansion across all clusters, manufacturing output increased by 10.1% YoY.

In January 2018, the Singapore Manufacturing Purchasing Manager's Index (PMI) expanded for the 17th month to a high of 53.1, a mere 0.2 of a point below the highest reading in December 2009. After a dip to 52.7 in February, the PMI reading in March rose to 53.0.

Supported by the rise in non-electronics exports, non-oil domestic exports (NODX) rose 2.9% YoY in January 2018. However, in February, NODX declined by 6.0% from the same period last year. This could be due to the Chinese New Year festive season when there is a slowdown in production levels, especially for countries like China. Even though the decline in NODX eased in March, the decrease of 2.7% YoY could be a result of several factors: the high base rate from last year; a drop in electronics demand; and the country's strengthening currency.

Sales market

Despite a surge of 19.8% YoY, or 242[1] transactions registered in Q1/2018, the sales volume was still lower than the average of 335 deals for the last three years. According to the Urban Redevelopment Authority (URA), the total value of industrial sales transactions in Q1/2018 was S$559.7 million, which was also below the average industrial sales value of S$590.4 million[2] for the past three years.

The dip in total industrial sales value over the past three years could be attributed to the price decline for 30- and 60-year leasehold industrial properties over those years. For the last three years, prices of 30- and 60-year leasehold industrial properties decreased at a compounded annual growth rate (CAGR) of 3.0% and 1.5%, respectively, while freehold properties stayed resilient with a 1.3% price appreciation.

Prices of freehold upper-storey factory and warehouse units in the Savills basket saw an increase of 1.4% QoQ to S$684 per sq ft in Q1/2018. Based on the Savills basket of properties, prices of 30- and 60-year leasehold industrial properties saw a decline of 1.5% QoQ to S$344 per sq ft and 0.6% QoQ to S$442 per sq ft, respectively, the lowest recorded rate since the basket was constituted in 2013.

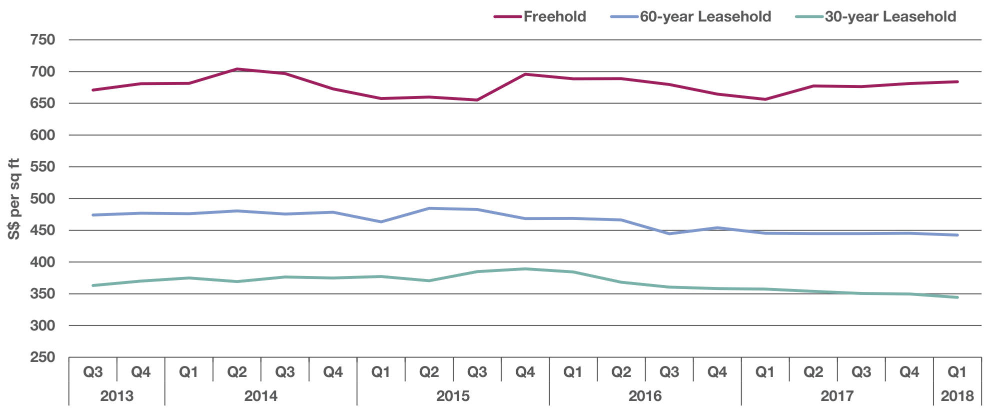
Leasing market

The industrial rental market recorded 2,345 deals [3]in Q1/2018, 11.8% higher than the three-year quarterly average of 2,097 transactions since 2015. Despite the rise in the number of leases, there was no significant improvement in the take-up for industrial space in the reviewed quarter.

Even though the factory vacancy rate eased 0.2 of a percentage point (ppt) QoQ to 10.8% in Q1/2018, the take-up was just 205,000 sq ft. The vacancy dip was partly affected by the removal of 51,000 sq ft of factory stock. The warehouse rental market deteriorated with a 0.2 of a ppt QoQ rise in the vacancy rate to 11.1% as occupied space decreased by 22,000 sq ft in the quarter. Furthermore, the vacancy level was also worsened by 151,000 sq ft of

GRAPH 1

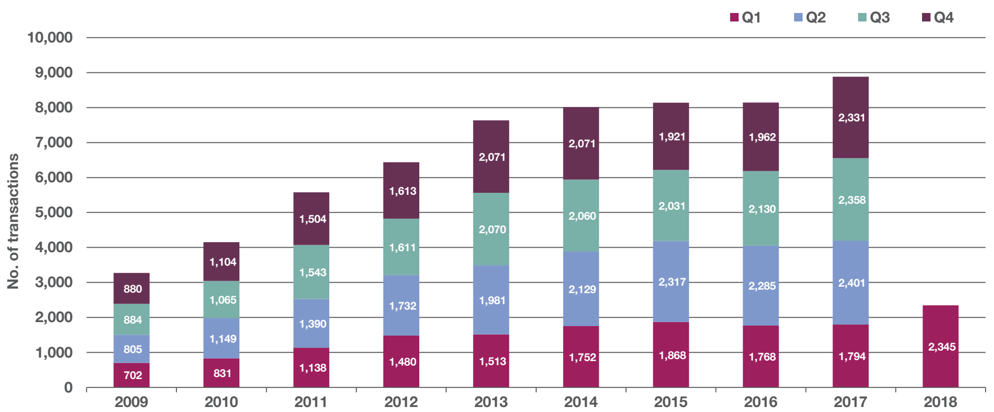
Prices of upper-storey factory and warehouse units, Q3/2013 – Q1/2018



Source: Urban Redevelopment Authority (URA), Savills Research & Consultancy

GRAPH 2

Leasing volumes of factories and warehouses, 2009 – Q1/2018



Source: URA, Savills Research & Consultancy

1 Singapore Institute of Surveyors and Valuers REALink caveats as of 20 April 2018.

2 Excluding the industrial sales in Q3/2017 where there was a surge in total transaction value due to some big-ticket factory land resale transactions.

3 Excluding business park spaces; this number only comprises factory and warehouse spaces.

new warehouse stock being added to the market.

This flowed through to rents and was reflected in the third consecutive year of quarterly decline in the rental index of industrial properties. According to URA, the industrial rental index dipped by 0.1% QoQ in Q1/2018. Similarly, for the Savills basket, the average prime monthly rent for factory and warehouse properties continued to decrease by 1.0% QoQ to S$1.14 per sq ft in Q1/2018.

While digital disruption in the retail sector may have shifted demand from conventional industrial to warehouse space, advances in technology have also had an impact on other industrial space segments including business parks and high-tech spaces.

The net absorption of business park spaces has been positive over the past four years. However, demand fell 344,000 sq ft in Q1/2018, raising the vacancy rate by 1.4 ppt QoQ to 14.9%. The latter was mainly due to the record high vacancies at Changi Business Park (CBP) and International Business Park (IBP). As vacancy levels at CBP and IBP increased in Q1/2018, their respective median rents also slipped by 6.1% and 7.5% from last quarter.

TABLE 1

Business parks and high-tech spaces

	No. of deals	Total value (S$)	Average value per transaction (S$)	Median rent (S$ per sq ft)
Technopark @ Chai Chee	9	68,043	7,560	3.40
Changi Business Park	2	44,158	22,079	4.57
International Business Park	32	324,960	10,155	4.37
Science Park I	5	67,945	13,589	3.80
Science Park II	12	221,848	18,487	4.04
One-North	10	316,964	31,696	5.10
Mapletree Business City	3	321,949	107,316	6.00

Source: URA, Savills Research & Consultancy

On the other hand, newer business parks such as Mapletree Business City and one-north achieved a comparatively healthy occupancy level. This was likely driven by the relocation of businesses as office rents escalated. Nonetheless, the business park rental market was still restrained by the slow demand for older business parks. As such, the monthly average rent for business park space in Q1/2018 remained unchanged at S$4.05 per sq ft for the fifth consecutive quarter.

There were also positive spill-over effects for the high-tech industrial sector. Reversing the downward trend of the last 11 quarters, rentals increased 1.8% YoY, and monthly average prime rents for high-tech industrial space went up 0.5% from last quarter to S$3.31 per sq ft in Q1/2018.

OUTLOOK

The prospects for the market

Based on the latest Economy Survey of Singapore, Singapore economy growth is expected to remain firm in 2018, albeit with some moderation from last year. The global demand for semiconductors and semiconductor equipment is likely to remain healthy, driving further expansion in the manufacturing sector and supporting the overall economy. As such, MTI forecast that the economy will expand slightly above the middle of the range of 1.5% to 3.5% in 2018.

Even though the manufacturing sector has been performing well over the past few quarters, the overall vacancy rate of industrial spaces is still on the rise. Furthermore, the market must prepare for an upcoming new supply of 15.4 million sq ft of industrial space in 2018. The vacancy level might worsen if net demand for industrial space remains in negative territory as in Q1/2018, hence putting downward pressure on rents.

Thus, despite the improvement in manufacturing performance in recent quarters, the sector is unlikely to drive up rents for factory and warehouse space because the government is placing more emphasis on diversifying into new value-added and productive-growth markets. With the implementation of the Precision Engineering, Electronics and Energy & Chemicals ITM, the shift in focus within manufacturing could fuel the demand for high-tech and business park spaces instead. Unfortunately, as a large swath of industrial space in Singapore is operated by local Small and Medium Sized Enterprises (SMEs) that cannot yet benefit from the new productivity drive, their business fortunes have not turned around.

Viewed in this light, industrial activity is a tale of two markets: with those in the electronics, pharmaceutical and high-tech sectors benefitting both now and moving forward, while SMEs continue to face strong headwinds. These growth industries, often housed on JTC allocated lands, or in buildings hived off to Real Estate Investment Trusts on long-term leases, have very

OUTLOOK

The prospects for the market

little touch points with industrial leasing specialists, private sector landlords or local SMEs. Thus, their sterling performance is not felt outside their restricted circle of influence. This view is congruent with the view of our industrial leasing specialists who feel that the industrial market is still not out of the woods.

Therefore, unless we see broad-based improvements within the manufacturing (particularly the oil, gas and marine industries) and construction sectors, rising PMIs or NODX may not translate to a convincing turnaround in industrial and warehouse space rents. Nevertheless, for the manufacturing sector, because the worst has probably passed, the downside pressure on rents and prices is likely to ease. Ultimately, while we will still be forecasting a moderate quarterly rental decline in 1H/2018, rents may only start to stabilise in 2H/2018.

Period	QoQ % change industrial factory and warehouse rents
Q2/2018F	-1.0% to -2.0%
Q3/2018F	0.0%
Q4/2018F	1.0%

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