MARKET IN MINUTES

Savills Research

Industrial

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Industrial rental market remains soft

With the rise of value-add manufacturing and digital transformation, business park and high-tech industrial segments are bright spots.

- The industrial leasing market started well in 2019, with leasing volume rising for the eleventh consecutive quarter to 2,417 deals in Q1/2019.
- The average monthly rent for factory and warehouse space remained unchanged at S$1.13 per sq ft, after over a year of consecutive quarterly declines.
- Industrial sales activity picked up by 27.6% year-on-year (YoY), with 286 factory and warehouse properties worth over S$1.3 billion exchanging hands in Q1/2019.
- On a YoY basis, prices of 30-year leasehold industrial properties fell at a slower pace, to S$337 per sq ft, while 60-year leasehold industrial properties saw the first signs of recovery after decreasing for over a year, inching up to S$443 per sq ft.
- Freehold industrial properties went against market headwinds, with prices rising YoY for six consecutive quarters to S$699 per sq ft in Q1/2019.
- There is still some optimism in the business park and high-tech industrial segments in contrast to more downbeat market sentiments for general industrial space.
- In today's trade environment, industrial and warehouse space users are facing greater challenges than just rents and any further rental decline would still not save the day for them.

"Although rents have fallen significantly, further declines still won't save the day for beleaguered tenants."

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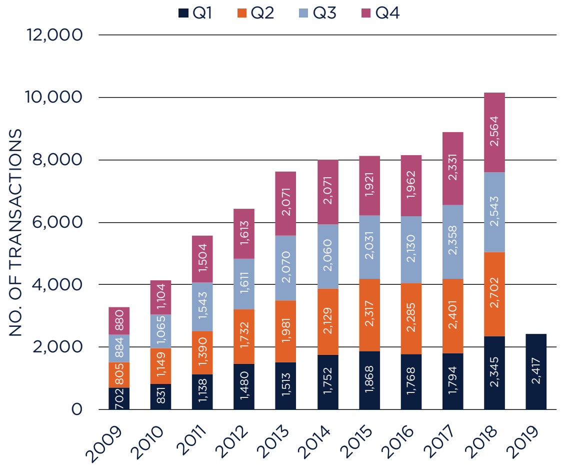
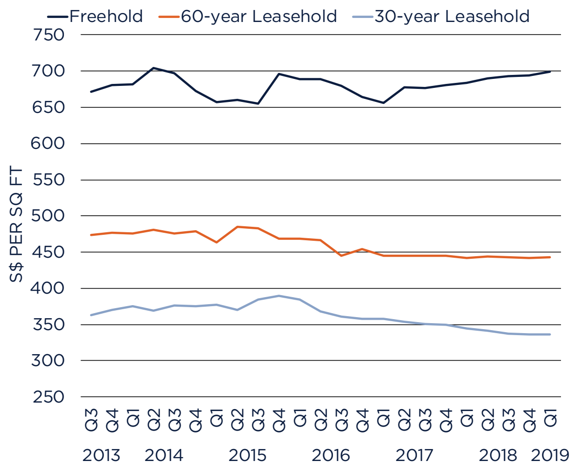
GRAPH 1: Leasing Volumes Of Factories And Warehouses, 2009 to Q1/2019



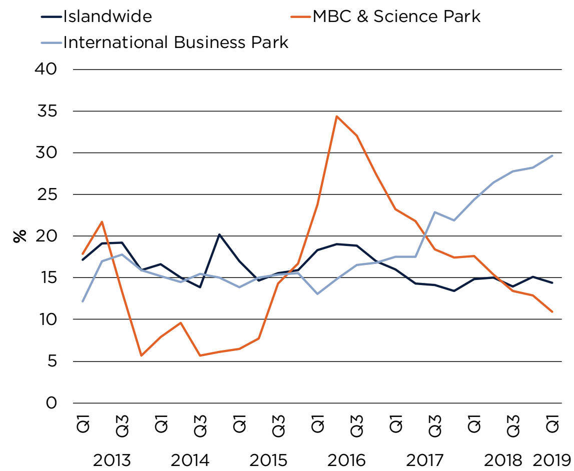
Source JTC, Savills Research & Consultancy

GRAPH 2: Prices Of Upper-storey Factory And Warehouse Units, Q3/2013 to Q1/2019



Source JTC, Savills Research & Consultancy

GRAPH 3: Vacancy Rate Of Business Park Space, 2003 to Q1/2019



Source JTC, Savills Research & Consultancy

MACROECONOMIC OVERVIEW

According to the Ministry of Trade and Industry (MTI), the Singapore economy in Q1/2019 recorded its weakest expansion since the global financial crisis in Q2/2009. Gross domestic product (GDP) growth came in at 1.2% YoY in Q1/2019, easing from 1.3% in the preceding quarter. The manufacturing sector contracted 0.5% YoY on the back of output declines in the precision engineering and electronics clusters, reflecting a significant slowdown from the 4.6% growth recorded in Q4/2018.

The overall manufacturing sector remained soft in the first three months of 2019, with the Purchasing Manager's Index (PMI) trending down to 50.8 in March. Even though the PMI reading marked its 31st consecutive month of expansion, the electronics PMI remained in contraction over five straight months through March. In the same month, non-oil domestic exports (NODX) posted the sharpest decline since October 2016, plunging 11.7% YoY due to the drag from electronic exports.

RENTAL MARKET

The industrial leasing market started well in 2019, with leasing volume[1] rising for the eleventh consecutive quarter in Q1/2019 (refer to Graph 1). JTC Corporation recorded a total of 2,417 deals sealed for factory and warehouse space in Q1/2019, which is 3.1% higher than a year ago and 6.7% more than the three-year quarterly average leasing volume. The increase was led mainly by higher leasing demand for single-user factory space due to the segment's declining rents. The buoyant leasing market was also attributed to the prolonged weakness of the economy as well as the manufacturing sector, which drove industrialists to capitalise on low rents rather than spending capital on purchasing space.

Leasing demand for single-user factory space combined with the removal of warehouse space resulted in an improved occupancy rate for both segments while multiple-user factory space saw a marginal dip due to poor take-up in Central Planning Region. Even though there was some level of leasing interest in general, rental rates remained soft as industrial tenants were very cost-conscious in light of global trade tensions and the slowdown in the manufacturing sector. With an abundant supply of factory and warehouse space in the market, rental indices extended the YoY decline in Q1/2019, albeit at a slower pace than the period of early-2018. In Q1/2019, the average monthly rent[2] for factory and warehouse space held on at S$1.13 per sq ft.

SALES MARKET

Despite weakening business conditions and market sentiments, industrial sales activity picked up by 27.6% YoY, with 286 factory and warehouse properties[3] worth over S$1.3 billion exchanging hands in the first quarter of 2019. The high investment value was boosted by some major resales of land parcels for single-user factories in Tuas South Avenue 14 and Banyan Drive, which were sold for S$585 million and S$227.5 million, respectively. This could imply that the industrial sales market was dominated by owner-occupiers instead of investors. In the midst of escalating trade tensions, the upbeat sales momentum for multiple-user factory and warehouse space in Q4/2018 did not extend to 2019, dropping to almost the same sales volume as a year ago.

Prices of 30-year leasehold industrial units in Savills basket of industrial properties[4] fell again, though the pace of decline slowed from an annual average of 3.6% YoY in 2018 to 2.2% YoY in Q1/2019. After three years of consecutive quarterly declines, prices remained unchanged from the previous quarter at S$337 per sq ft. On a YoY basis, prices of 60-year leasehold industrial units saw the first recovery after decreasing for over a year, inching up by 0.2% to S$443 per sq ft in Q1/2019. Prices of freehold industrial properties went against market headwinds and after a six-quarter increase approached the record high set in 2014, hitting S$699 per sq ft in Q1/2019 (refer to Graph 2).

BUSINESS PARKS AND HIGH-TECH SPACES

In Q1/2019, newer business park spaces saw a slight uptick in occupier demand (refer to Graph 3). Other than the young age of the developments, industrialists are also attracted by the synergy formed by the existing tenant mix in the newer clusters. Major tech players such as Razer and Grab are setting up their new headquarter (HQ) in one-north, which is scheduled to be completed next year. In Mapletree Business City, China artificial intelligence firm Yitu opened its first research and development (R&D) centre outside China.

Even though demand remained subdued in older business parks, especially in International Business Park where the vacancy rate climbed to a new record level of 29.6% in Q1/2019, the overall occupancy level was nevertheless supported by strong take-up in newer business parks. While the vacancy rate dipped 0.7 of a percentage point (ppt) from last quarter to 14.4%, the business park rental index increased by 1.3% YoY and 0.9% QoQ in Q1/2019. In the reviewed quarter, Savills average monthly rent for business park space stayed firm from a year ago at S$4.05 per sq ft.

As requirements for industrial space evolve due to the rise of value-add manufacturing and digital transformation, data centre and high-tech industrial segments continue to thrive. In March, Global Switch launched its new data

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 27 May 2019.
4 Only include strata sales of upper-storey factory (single- and multiple-user factory) and warehouse units, excluding all ground floor units.

centre at Woodlands, expanding their footprint to 4.0 million sq ft in Singapore. Neo Group is also consolidating its central kitchen, office, warehouse, R&D, logistics and storage facilities at a new high-tech HQ in Jurong, which is slated to be ready by 2020. With the growing appeal of this segment, Savills basket of properties showed that the average monthly rent for high-tech space rose 1.3% YoY to S$3.35 per sq ft in Q1/2019.

OUTLOOK

The Monetary Authority of Singapore (MAS) said in its latest macroeconomic review that the pace of global economic growth is expected to moderate from 4.3% to 3.9% in 2019 and 2020. In addition to the global economic slowdown, the MTI downgraded its full-year GDP growth forecast to between 1.5% and 2.5%. This coincides with concerns raised by businesses about the on-going trade war and downswing in the global electronics sector, which have been taking a toll on the export-dependent industry. With the recent imposition of further tariffs hike and United States' ban on the sale of US technology to Huawei, the manufacturing sector is likely to see more moderation in growth. This is in line with the latest forecast by Enterprise Singapore which projected NODX to either stay flat or contract by 2.0% YoY this year.

There could be some signs of a silver lining amid the trade tensions, but it would mainly benefit low-cost manufacturing hubs like Vietnam, Malaysia and Thailand, which are gaining ground in the information technology equipment and electronics manufacturing sectors as the cost of production in China increases.

For trade-dependent economies like Singapore, business sentiments are being affected by declining orders and revenue. Unless there is a shift in high-skills industries from China to Singapore, activity in the industrial property market is likely to stay sluggish as firms remain cautious about expansion plans while adapting to trade disruptions.

Nonetheless, there is a recent trend for established firms to set up their individual facilities in business park clusters and high-tech industrial spaces. In addition to the completion of Grab and Razer's HQ next year, Shopee and Google are also planning massive expansions in Science Park and Alexandra Technopark, respectively. These moves provide some bright spots as general market sentiments dim, lending support to the business park and high-tech industrial rental market.

With economic concerns lingering in the current climate, the rental market for general industrial factory and warehouse space may remain lacklustre this year, particularly in light of a constant stream of traditional industrial supply coming on to the market (refer to Table 1). As business sentiments and conditions are generally not too sanguine, we believe that rents for general factory and warehouse space have fallen to such a level that any further decline would not generate much cost savings to help turn things around for tenants. For tenants already in Singapore, the immediate challenges will be manpower-related and/or whether their goods and services remain in demand. Rents are now at a level that any further declines would not save the day for tenants who cannot meet those two major challenges. Therefore, we believe that rents this year for general factory and warehouse space should remain flattish.

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	+1.0%

Source Savills Research & Consultancy