Briefing
Industrial sector

August 2015

Image: Tai Seng Avenue

SUMMARY

Optimism in the Purchasing Managers Index (PMI) could be a positive blip, but looming oversupply is likely to outweigh any positives, placing further pressure on rents.

- In Q2/2015, industrial sales of strata-titled factories and warehouses rose 21.0% quarter-on-quarter (QoQ) with 408 caveats lodged. However, this is still a 26.4% decline year-on-year (YoY).
- Prices in the Savills basket inched up 4.6% QoQ to S$485 per sq ft for 60-year leasehold, and 0.3% QoQ to S$660 per sq ft for freehold units, while 30-year leasehold units slipped 1.8% QoQ to S$370 per sq ft.
- The leasing market picked up with 2,317 rental transactions in Q2, a 24.0% rise QoQ, mainly due to seasonal factors. The 8.8% YoY increase could be attributable to rental renewals rather than new take-ups.
- Q2/2015 factory/warehouse and high-tech rents managed to hold at S$1.85 per sq ft per month and S$3.00 per sq ft per month respectively.
- Despite an impending supply of industrial space completing in the near term, rents may only react mildly on the downside. Low interest rates and the high purchase prices landlords paid for their properties will result in landlords maintaining their asking rents, which may then hold in the short term.

"Although the underlying fundamentals for both end-users and industrial investors remain challenging, rents and prices are unlikely to react likewise because the ultra-low interest rate environment which has persisted for years has increased the holding power of landlords and developers." Alan Cheong, Savills Research

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Macro economic overview

In the reviewed quarter, the continued concerns over the slowdown in China's growth and 'Grexit' in the Eurozone crisis were partially offset by better-than-expected economic performances in Japan and the US. The US GDP was estimated to have grown 2.4% in the second quarter, slightly stronger than the forecast of 2.3%. However, Singapore's stronger exports to the US were insufficient to outweigh its weaker exports to China, Japan, Europe and the rest of ASEAN. The US Federal Reserve is also expected to raise interest rates in the coming months due to improving employment data.

Singapore's non-oil domestic exports (NODX) dipped 0.3% YoY in May but rebounded 4.7% YoY in June. Singapore's GDP in Q2/2015 showed a disappointing 1.8% growth YoY, lower than the 2.8% growth achieved in Q1/2015. This was largely attributable to a 4.0% YoY contraction in the manufacturing sector. On a QoQ seasonally-adjusted annualised basis, the economy contracted by 4.6% in Q2, a reversal from the 4.2% expansion in the preceding quarter.

However, after five consecutive months of contraction, the Purchasing Manager's Index (PMI) registered a reading of 50.2 in May and June (a reading below 50 signifies a contraction), hinting a sliver of optimism in the sentiments of the manufacturing sector in the last two months of the quarter.

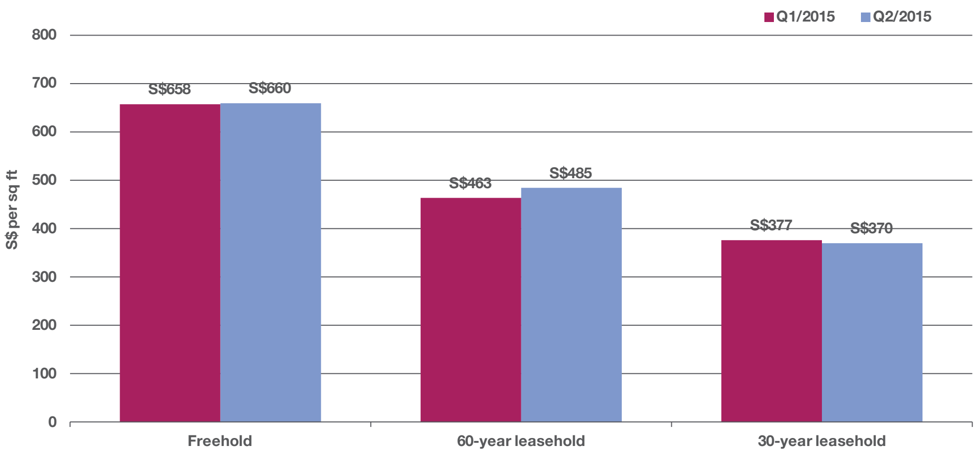
Sales market

In Q2/2015, industrial sales of strata-titled factories and warehouses rose 21.0% QoQ, with 408 caveats lodged[1]. However, this is still a 26.4% decline YoY. The diminished interest in industrial properties comes on the back of the sluggish performance of the manufacturing sector. Industrialists are saddled with several issues, including rising labour costs, fears of the Fed's interest rate hike and weak commodity prices. That said, 60-year leasehold properties remain the most popular among buyers, with the highest number of transactions when compared to their 30-year leasehold and freehold counterparts.

Despite the inertia in the industrial sales market, prices of upper-storey factory and warehouse units in the Savills basket inched up 4.6% QoQ to S$485 per sq ft for 60-year leasehold, and 0.3% QoQ to S$660 per sq ft for freehold units. 30-year leasehold units, on the other hand, slipped 1.8% QoQ to S$370 per sq ft. Thin sales volume could have had a part to play in this price volatility.

GRAPH 1

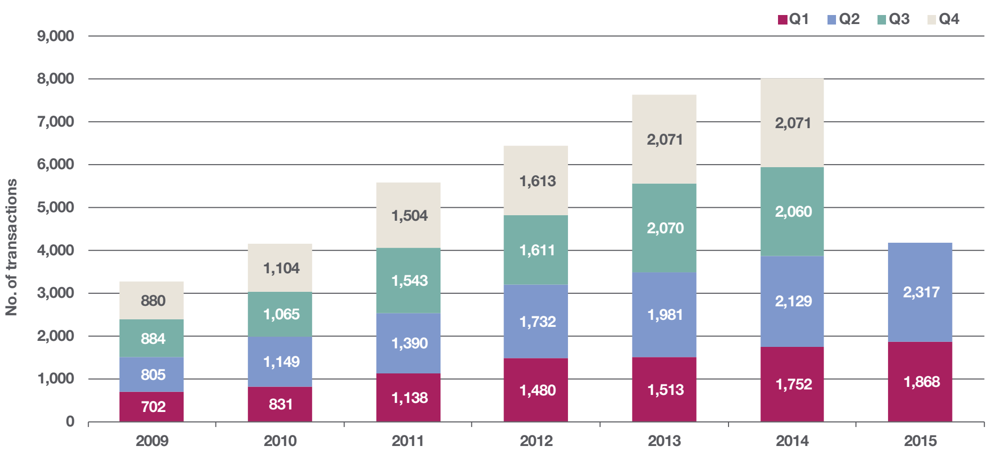
Prices of upper-storey factory and warehouse units, Q1/2015 and Q2/2015



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

GRAPH 2

Leasing volumes of factories and warehouses, 2009 – Q2/2015



Source: URA, Savills Research & Consultancy

Leasing market

Regardless of the lacklustre manufacturing growth numbers, the leasing market picked up, with 2,317 rental transactions in Q2, a 24.0% rise QoQ, mainly due to seasonal factors. Compared to last year, the 8.8% increase in leasing volume could be attributable to rental renewals rather than new take-ups. The reviewed quarter saw some manufacturers riddled with high production costs pulling out of Singapore. Japanese petrochemicals giant Teijin announced that it would shut down its Singapore operations at the end of this year. KTL Global, a rigging equipment company, will be relocating its manufacturing operations to Johor Bahru while keeping its headquarters here. The situation bears out the industry's challenges that could quite easily oust smaller manufacturers who are less resilient to the onslaught of issues buffeting the industry. Nonetheless, Q2 factory/ warehouse and high-tech rents managed to hold at S$1.85 per sq ft per month and S$3.00 per sq ft per month respectively.

1 Singapore Institute of Surveyors and Valuers REALink caveats as of 24 July 2015.

Business Parks

Rental demand for business park space surged to 75 leasing deals in Q2 from 59 in the preceding quarter. Healthy absorption of the recently-completed developments in Changi Business Park, Science Park and One-North has led to a fall in vacancy rate of business parks. Island-wide vacancy dipped further by 2.3 percentage points (ppts) QoQ to 14.7% in Q2/2015. A total of 3.7 million sq ft of business park space is expected to come on stream from now to next year, beyond which no planned supply is known.

TABLE 1

Business park leasing volumes and values, Q2/2015

	No. of deals	Total value (S$)	Average value per transaction (S$)	Median rent (S$ per sq ft)
Changi Business Park	9	140,709	15,634	4.00
International Business Park	17	320,261	18,839	4.20
Science Park 1	13	95,658	7,358	3.90
Science Park 2	17	124,031	7,296	3.98
One-North	19	309,981	16,315	5.40

Source: URA, Savills Research & Consultancy

Outlook

External factors, such as threats of a slowdown in global demand and economic uncertainties, place the manufacturing sector in a precarious position, despite recent positive blips of recovery. Regardless of whether the recovery in manufacturing can be sustained, the upcoming oversupply of factory and warehouse space for the rest of the year and into the next will place further downward pressure on industrial rents, while sales are expected to remain thin.

Unlike rents, which are expected to remain under pressure, prices may still be biased towards the upside. The ultra-low interest rate environment that persisted for years has started to distort the ability of prices to react to underlying fundamentals. Therefore, even if rents decline and vacancies increase, prices may not react in accordance with economic intuition. Instead, low interest rates could have exponentially increased the holding power of landlords and, given the high purchase prices they paid for their properties, they would be keen to maintain their asking rents, which may then hold in the short term. Similarly, should there be no meaningful decline in rents, more end-users may take the option of buying. This cyclical turn of affairs may keep lifting prices, especially of those properties that have longer leases of 60 years or more. Even if interest rates rise, they may not rise significantly enough to counter this inflationary bias in the market. Therefore, for the rest of the year we expect rents to only slightly soften (flat to -1%), but general prices to continue to be biased upwards (+3% for freehold, +1% for 60-year leasehold properties but -0.5% for 30-year leaseholds).

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