

Briefing Industrial sector

November 2015



Image: Natural Cool Lifestyle Hub, Tai Seng Avenue

SUMMARY

The current woes confronting the manufacturing sector are distracting us from the dawn of a new age where technological innovation is creating companies providing efficient supply chain and manufacturing processes.

- In Q3/2015, sales of strata factory units reached a new low of 326. This represents a 28.4% quarter-on-quarter (QoQ) fall and 41.5% year-on-year (YoY) decline.

- 30-year leasehold properties are leading the way in price appreciation, with a QoQ increase of 3.9% to S\$385 per sq ft. Freehold and 60-year leasehold properties trailed with marginal declines of 0.7% to S\$655 per sq ft and 0.4% to S\$483 per sq ft respectively.

- Economic headwinds and labour constraints continue to be a drag on rental prospects. Rental transactions of factories and warehouses declined 12.3% to 2,031 in Q3/2015 from 2,317 deals in the preceding quarter.

- Q3 factory/warehouse and high-tech rents are still gridlocked at S\$1.85 per sq ft per month and S\$3.00 per sq ft per month respectively.

- Over the next five years, the industrial space market is set to enter a period of oversupply with an

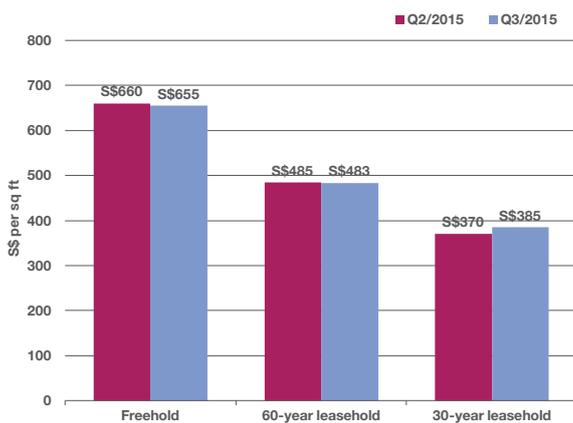
influx of 40.4 million sq ft of factory and warehouse space. Invariably, this should dampen prices of general industrial space.

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 “Although Singapore is creating more innovative industries, the oversupply situation will remain a fact of life in the near to medium term.” Alan Cheong, Savills Research

➔ **Macro economy**

Global economic headwinds continued to buffet Singapore in Q3/2015. After its stock market correction in June, China's slowing economy continues to impede her other trade-dependent economies. Japan's industrial output data, albeit showing a marginal improvement in September, is also doing little to allay concerns over its longstanding economic stagnation. In the Eurozone, its central bank has signalled further monetary policy easing as a response to the region's lacklustre recovery. Notwithstanding challenges to the global economy the US Federal Reserve has signalled an intention to raise interest rates,

GRAPH 1 **Prices of upper-storey factory and warehouse units, Q2/2015 and Q3/2015**



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

GRAPH 2 **Leasing volumes of factories and warehouses, 2009–Q3/2015**



Source: URA, Savills Research & Consultancy

TABLE 1 **Business park leasing volumes and values, Q3/2015**

| | No. of deals | Total value (S\$) | Average value per transaction (S\$) | Median rent (S\$ per sq ft) |
|-----------------------------|--------------|-------------------|-------------------------------------|-----------------------------|
| Changi Business Park | 10 | 183,482 | 18,348 | 3.90 |
| International Business Park | 17 | 187,471 | 11,028 | 4.27 |
| Mapletree Business City | 1 | 58,200 | 58,200 | 4.65 |
| Science Park 2 | 15 | 273,625 | 18,242 | 4.06 |
| One-North | 7 | 279,365 | 39,909 | 4.60 |

Source: URA, Savills Research & Consultancy

possibly as early as December this year. However, as there have been so many false alarms before, markets may turn sceptical about that happening as we move closer to the final month of this year. Ultimately, the Fed's action on the interest rate front may end up as a non-event because the markets have cried wolf so often.

Singapore's economic figures point towards similarly weak sentiment. Although non-oil domestic exports (NODX) inched up 0.3% YoY in September, it was not enough to turn around Singapore's Purchasing Managers' Index (PMI) which fell for a third consecutive month to 48.6 – down from 49.3 in August (a reading below 50 indicates a contraction).

Going by the flash estimates, Singapore's gross domestic product grew by 1.4% YoY in 3Q/2015 – a significant digression from the growth rates of above 2.0% experienced since Q2/2013. The manufacturing sector was the biggest drag on growth with three straight quarters of YoY contraction. This comes from tepid external demand and domestic cost pressures (tight labour supply, mounting wage and operation costs) which continue to put a lid on manufacturing growth.

Sales market

On the sales front, transactional activity remained muted in Q3/2015 as buyers and sellers remained cautious. The number of caveats lodged for strata factories and warehouses reached a new low of

326¹ in Q3/2015. This represents a 28.4% QoQ fall and 41.5% YoY decline. The decrease was concentrated in the sale of freehold units, which contracted by more than half over the reviewed quarter.

Nonetheless, prices of upper-story factory and warehouse units in the Savills basket show that sellers are not compelled to lower their price expectations despite waning buyer interest. 30-year leasehold properties are leading the way in price appreciation, with a QoQ increase of 3.9% to S\$385 per sq ft. Freehold and 60-year leasehold properties trailed with marginal declines of 0.7% to S\$655 per sq ft and 0.4% to S\$483 per sq ft respectively.

Leasing market

Economic headwinds continue to act as a drag on the rental front. Rental transactions of factories and warehouses declined 12.3% to 2,031 in Q3/2015 from 2,317 deals in the preceding quarter. However, cumulative transactions for the first nine months of 2015 still managed to surpass levels achieved over the same period last year. This can be attributed to the progressive leasing of interim spaces which have accrued from the conversion of single-user buildings into multitenant assets. The push for conversion comes as master-leasees are consolidating operations, with landlords reacting to the industrialists' need for smaller floor areas.

¹ Singapore Institute of Surveyors and Valuers REALink caveats as of 5 Nov 2015

Nevertheless, with occupancy rates remaining steady and positive rental reversions still coming through, there is still a positive side to the market. In a challenging business environment, either because there is a lack of similar space to move into or to save on relocation costs, tenants are opting to stay-put. Landlords are also doing their part to keep their units occupied by offering competitive rents in order to retain tenants. With both tenants trying to save on relocation costs and landlords being more understanding, rents across the factory types have remained flat in Q3. Factory/warehouse and high-tech rents are gridlocked at S\$1.85 per sq ft per month and S\$3.00 per sq ft per month respectively.

Business Parks

After a surge of 75 leasing deals in Q2, rental demand for business park space normalised to 50 in the reviewed quarter while island-wide vacancy edged up 0.9 percentage points (ppts) QoQ to 15.6% in Q3/2015. Recently-completed developments in Changi Business Park and Science Park saw an additional 629,000 sq ft of space added in Q3. Another 3.1 million sq ft is expected to come into the market by 2016. ■

OUTLOOK

The prospects for the market

With manufacturing constituting up to one-fifth of Singapore's GDP, any slowdown in this sector will inevitably weigh on Singapore's economy. Factory activity continues to be depressed by falling domestic and external demand as a result of the slowing economies of Singapore's major trading partners. With the outlook for most economies remaining weak, below trend growth is expected until end-2016.

Although factory output has been contracting, the structure of Singapore's industrial sector is about to change. This change is being driven by a convergence of physical and technological forces which are impacting manufacturing processes and new industries taking root here. This includes the reconfiguration of regional supply chains and the growth of the digital economy which are pushing industrialists to seek new development opportunities.

Most notably, Singapore Post's centre in Paya Lebar is set to be transformed into an e-commerce hub while Kingsland Data Centre opened its doors to almost full-occupancy in October. The government is also trying to attract more companies in the Surface Mount Technology² (SMT) and 3D printing industries here. Incubation hubs are also being planned to facilitate new age entrepreneurial businesses which will provide an additional boost to economic growth and employment here.

These plans will take time to gestate and in the near term, the industrial space market is still set to enter a period of oversupply over the next five quarters with an influx of 40.4 million sq ft of factory and warehouse space. This will inevitably have a negative impact on prices in the industrial market.

² In SMT, the components are mounted on the surface of the board using surface mount devices (SMDs), rather than having connections that go through holes in the board. The idea for SMT was adopted very quickly because it enables greater levels of mechanisation to be used and it considerably saves on manufacturing costs.

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