Industrial

savills

Rents rise across the board

Despite escalating headwinds and subdued growth in the manufacturing sector, most industrial property types are expected to see further growth.

- Leasing activity in the industrial market has remained active, with leasing volumes rising 6.1% year-on-year (YoY) to 3,298 tenancies in Q2/2023.
- The average monthly rents of Savills' basket of prime multiple-user factories rose 5.3% quarter-on-quarter (QoQ) to S$2.13 per sq ft in Q2. Alongside rising inflation and strong demand for logistics and food spaces, Savills' average monthly rent for prime warehouse and logistics properties increased by 4.5% QoQ to S$1.61 per sq ft in Q2.
- Strata industrial sales activity increased 8.4% QoQ to 424 transactions in Q2.
- The Savills' basket of industrial properties showed prices for 30- and 60-year leasehold industrial properties increasing 1.4% and 2.4% QoQ to S$320 per sq ft and S$495 per sq ft respectively in Q2/2023.
- Compared with 1.6% QoQ in Q1, prices for freehold properties rose 1.1% QoQ to S$797 per sq ft.
- Savills prime business park monthly rents fell 1.0% QoQ to S$5.89 per sq ft in Q2, while standard business park monthly rents rose 3.2% QoQ to S$4.11 per sq ft.
- From the Savills high-spec industrial basket, the average monthly rent increased 2.3% QoQ in Q2 to S$3.83 per sq ft.
- The market may experience elevated vacancy rates, but as most landlords are financially strong, it puts them in a better position to pass both inflation and higher interest expenses to tenants.

> "Industrial properties on shorter-term land leases may see prices come under upward pressure when companies downgrade from expensive longer-term commitments to free up capital."
>
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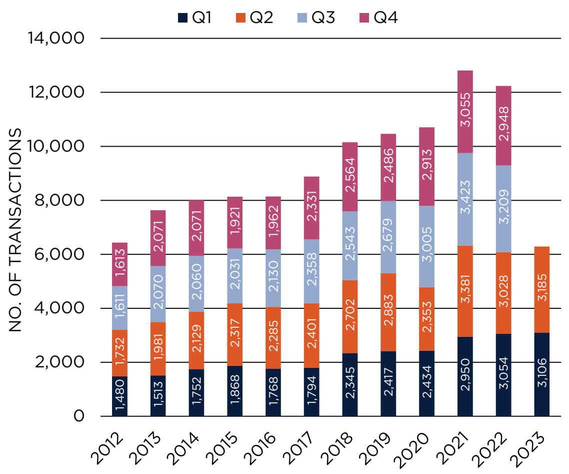
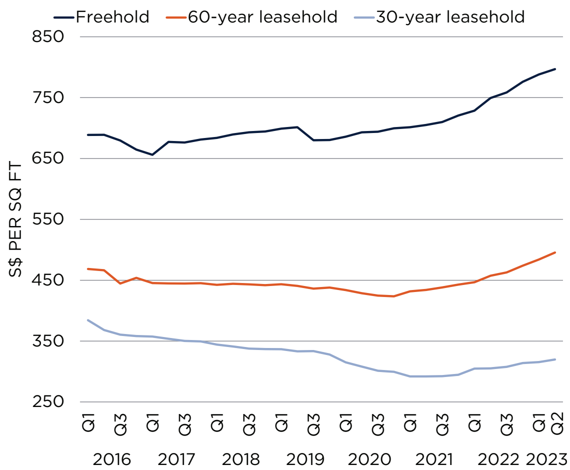
GRAPH 1: Leasing Volumes of Factories and Warehouses, 2012 to Q2/2023



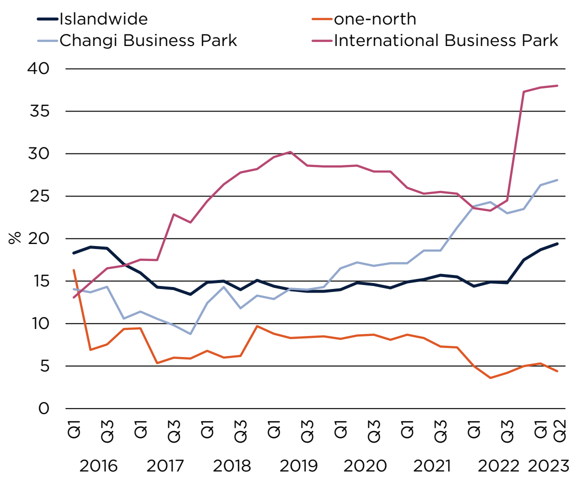
Source JTC, Savills Research & Consultancy

GRAPH 2: Prices of Upper-Storey Strata Factory and Warehouse Units, Q1/2016 to Q2/2023



Source JTC, Savills Research & Consultancy

GRAPH 3: Business Park Space Vacancy Rates, Q1/2016 to Q2/2023



Source JTC, Savills Research & Consultancy

MACROECONOMIC OVERVIEW

According to the Ministry of Trade and Industry, the Singapore economy expanded 0.5% YoY in Q2/2023, extending the 0.4% growth of the previous quarter. Although Singapore narrowly avoided a technical recession, the overall economic growth was dragged down by a downturn in the manufacturing sector. While the other sectors posted an expansion in Q2, manufacturing shrank 7.3% YoY, extending the 5.4% contraction registered in Q1. This was attributed to output contractions across all manufacturing sectors, except for transport engineering.

In the face of higher interest rates and strong inflationary pressures, Singapore's manufacturing sector faces weaker demand from major trading partners like China. The city-state's exports have shown no signs of picking up yet, with Singapore's non-oil domestic exports (NODX) contracting for the ninth consecutive month in June. Manufacturing PMI has also weakened for three straight months in July, and electronics PMI remains subdued.

RENTAL MARKET

The leasing activity in the industrial market remained active, with leasing volume[1] rising 6.1% YoY to 3,298 tenancies in Q2/2023. The increase was due to more tenancies signed for multiple-user factory spaces, which rose 10.6% YoY to its highest in the last two years. Meanwhile, leasing transactions for single-user factory and warehouse segments fell by 5.7% and 13.6% YoY respectively. Although leasing activity for the two segments had been down, the rents recorded in Q2 were higher than a year ago. Apart from rental increases, the higher total rental value could be due to a rebound in demand for larger facilities.

The vacancy rate for multiple-user factory fell 1.0 percentage point (ppt) QoQ to 10.1% in Q2, reversing three consecutive quarters of increase. This rate is the lowest since Q4/2021. While vacancy rate for single-user factory remained relatively flat at 11.4% in Q2 (11.3% in Q1), that for warehouse eased 0.7 of a ppt QoQ to 9.0% in Q2. The improvement was largely attributed to healthy take-up in the West and North Planning Region.

JTC's overall industrial rents continued to increase further for eleven consecutive quarters in Q2/2023, reaching its highest record in the last eight years. Rents rose across the board in Q2, albeit at a slower pace for single-user factory and warehouse spaces. Nonetheless, prime rents remained strong, with Savills' average monthly rents for prime multiple-user factories[2] rising by 5.3% QoQ to S$2.13 per sq ft in Q2. Alongside rising inflation and strong demand for logistics and food spaces, the average monthly rents for prime warehouse and logistics properties[3] in the Savills' basket increased by 4.5% QoQ to S$1.61 per sq ft in Q2.

SALES MARKET

Following three consecutive quarters of decline, strata industrial sales activity[4] increased 8.4% QoQ to 424 transactions in Q2. Although there are factors such as high interest rates and a slowdown in the manufacturing sector, sales activity started to show recovery across all segments of the industrial property type. While multiple-user factory saw the slowest recovery (4.6% QoQ), single-user factory and warehouse recorded an uptick of 44.0% and 28.6% QoQ in their respective sales volume. Despite the increase in sales volume, the total transaction value for single- and multiple-user factory segments fell in Q2. This could imply that buyers are more attracted to more palatable size and quantum, given uncertain future business conditions, and higher borrowing costs.

Industrial prices also continued growing, with the JTC price index rising consecutively since Q2/2021. The Savills' basket of industrial properties showed that in Q2/2023, prices for 30- and 60-year leasehold industrial properties increased by 1.4% and 2.4% QoQ to S$320 per sq ft and S$495 per sq ft respectively. Owing to higher financing costs, some demand could have shifted to properties with shorter leases and more affordable quantum. The quantum play could lead to faster price escalation for the leasehold properties in future. On the other hand, the rate of price growth for freehold properties continued to moderate in Q2. Compared with 1.6% QoQ in Q1, prices for freehold properties rose 1.1% QoQ to S$797 per sq ft.

BUSINESS PARKS AND HIGH-SPEC INDUSTRIAL

Islandwide vacancy level for business parks worsened again for the third quarter, rising by 0.7 of a ppt QoQ to 19.4%, the highest since 2014. Although areas such as one-north recorded healthy take-up, the vacancy rate in the Central Region eased by 0.4 of a ppt QoQ to 7.3% in Q2. However, CleanTech Park and ESR Bizpark @ Chai Chee saw lower occupier demand with more premises being vacated,

1 Based on JTC's rental data (excluding business park spaces, only comprises single- and multiple-user factory as well as warehouse spaces).

2 Based on Savills basket of private multiple-user factory properties which ranges from 1,000 sq ft to 3,000 sq ft in size, with an average monthly asking rent of at least S$1.50 per sq ft.

3 Based on Savills basket of private multiple-user warehouse properties which ranges from 2,000 sq ft to 80,000 sq ft in size, with an average monthly asking rent of at least S$1.30 per sq ft.

4 Based on JTC's sales caveat data, downloaded on 8 August 2023.

driving the vacancy rate in West and East Planning Region to a record high at 41.9% (+2.4 ppts QoQ) and 26.3% (+0.7 of a ppt QoQ) respectively. Nonetheless, some landlords could have lowered their rental expectations to keep their premises occupied. This might have led to a 1.0% QoQ decline in Savills' prime business park[5] monthly rents to S$5.89 per sq ft in Q2. On the other hand, some landlords of the standard business park properties with better accessibility and amenities might have better negotiating power to raise their rents after experiencing quarters of rental decline. As a result, the monthly rents of Savills' standard business park properties[6] recorded an uptick of 3.2% QoQ to S$4.11 per sq ft in Q2, a reversal of a two-quarter decline.

Owing to the prime-quality specifications of high-spec buildings, the occupier demand for such spaces remained strong, hence resulting in further rental growth in Q2. According to Savills' high-spec industrial basket[7], the average monthly rent increased 2.3% QoQ in Q2 to S$3.83 per sq ft.

OUTLOOK

As outlook for the global economic growth remains lacklustre, local manufacturers are bracing for continuing challenges in 2H/2023. Although inflation is showing signs of easing, they are still elevated and could restart rising. Also, margins are being squeezed as competition heats up when business conditions become tougher. Singapore manufacturers grapple with weak demand from the major economies, especially when large markets like China are experiencing a slower-than-expected reopening. We believe that this will continue to be the case for the foreseeable future as global supply chains rewire towards a China plus one network. The latter is a move by manufacturers to build other plants outside China to hedge against future supply chain disruption. Thus, not only do we have a global-ex-US economic slowdown, but South-East Asia (with the exception of Vietnam) also faces a dilution of demand/supply of goods and services coming from China due to the re-routing of supply chains.

Despite escalating headwinds and subdued growth in the manufacturing sector, most industrial property types are expected to see further growth, with prices and rents remaining on an upward trend for the rest of the year. While demand for multiple-user factories is likely to be driven by new growth areas such as high-value manufacturing, rents are forecast to increase by 4% to 6% in 2023. Owing to limited supply for quality warehouse space, rents for warehouses are also expected to grow by 3% to 5% in view of the strong demand for modern and high-specification logistics spaces.

The challenges facing manufacturers, especially Small and Medium Enterprises (SME), will motivate those who have excess industrial space or are holding onto assets with longer term leases to either sub-let or arbitrage the lease by downgrading to those with a shorter lease term. If business conditions continue to remain tough for SMEs, the prices of 30 or shorter-term industrial leases may see prices being forced up by a cascade of downgraders. Ultimately, when push comes to shove, an entrepreneur will need to raise cash or reduce his burn and the shorter term industrial properties will provide that avenue for him/her to raise liquidity.

For business parks, looking beyond the current tech winter, there should be sustainable interest in the medium term. This comes from the tight supply in business park space where we have new supply collapsing from 3.3 million sq ft GFA in 2024 to 818,000 sq ft GFA in 2025. Thereafter, the JTC statistics show no supply. For high-spec industrial space, demand has been strong, underpinned by the rise of high-value manufacturing industries such as advanced manufacturing, technology and biomedical science firms. High-spec industrial spaces with modern facilities and excellent accessibility are expected to see healthy demand amid tight supply. With that, overall rents for prime business park and high-spec industrial space are forecast to continue to trend up this year.

We believe that both rents and prices for industrial and warehouses should continue to rise in 2023. One factor keeping these two afloat is inflation. The other is higher interest rates. Also, as most landlords are financially strong, it puts them in a better position to pass their higher interest expenses on to tenants.

TABLE 1: Rental Forecast for Multiple-user Factory and Warehouse & Logistics Segments

PERIOD	YoY % CHANGE IN MULTIPLE-USER FACTORY RENTS	YoY % CHANGE IN WAREHOUSE & LOGISTICS RENTS
2023F	4% to 6%	3% to 5%

Source Savills Research & Consultancy

5 Based on business park-zoned spaces in the newer clusters which range from 1,000 sq ft to 5,000 sq ft in size, with an average monthly asking rent of at least S$5.50 per sq ft.
6 Based on business park-zoned spaces in the older clusters which range from 1,000 sq ft to 5,000 sq ft in size, with an average monthly asking rent of at least S$3.50 per sq ft.
7 Based on office-like industrial space which ranges from 2,000 sq ft to 4,000 sq ft in size, with an average monthly asking rent of at least S$3 per sq ft.