Industrial

savills

Continual improvement brings positivity

Increasing demand from an improving manufacturing sector alongside delayed completions has brought about a decline in vacancy rates.

- As a result of the pandemic, there have been more tenant relocations as well as downsizing as businesses implemented cost-cutting measures and this resulted a higher leasing transaction volume, which rose by 21.2% year-on-year (YoY) to 2,950 deals in Q1/2021.

- In conjunction with JTC's rental indices which rose across all property types in the quarter, the average monthly rent for Savills' basket of multiple-user factories also recorded a quarter-on-quarter (QoQ) increase of 1.1% to S$1.72 per sq ft due to limited new supply and the improving performance of the manufacturing sector. This turnaround occurred after five consecutive quarters of decline.

- Given the scarcity of such assets, prices of freehold properties remained resilient, inching up slightly by 0.2% to S$701 per sq ft.

- Similarly, average prices across Savills basket of 60-year leasehold properties rose by 1.9% QoQ to S$432 sq ft. However, 30-year leasehold property values declined for a sixth straight quarter, falling by 2.5% QoQ to S$292 per sq ft.

- With business parks facing challenges, evident from increases in vacancy, the average monthly rent in Savills basket of prime and standard business park properties contracted on a QoQ basis, by 0.9% and 1.2% to S$5.76 and S$3.96 per sq ft respectively.

- While some of business park occupiers moved to less costly high-spec industrial space, the average monthly rent for Savills high-spec industrial basket also fell by 0.5% QoQ to S$3.48 per sq ft, after a 0.9% QoQ increase in Q4/2020.

- With some industries are performing better than others, our rental forecast for multiple-user factory and warehouse space is maintained at -3.0% to 0% (multiple-user factory) and +1.0% to 3.0% (warehouse).

"The pandemic has separated the goats from the sheep with sunset industries winding down faster while new economy firms expand rapidly."

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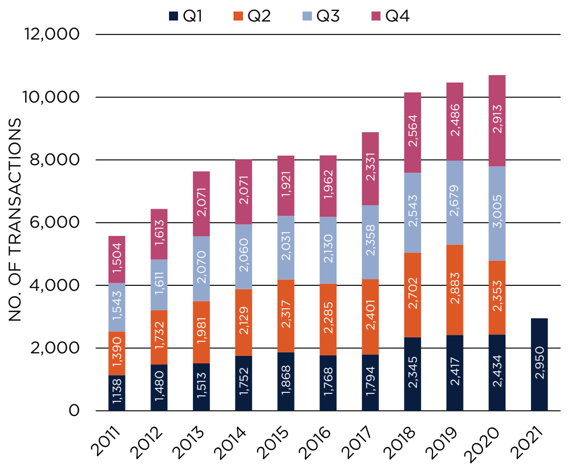
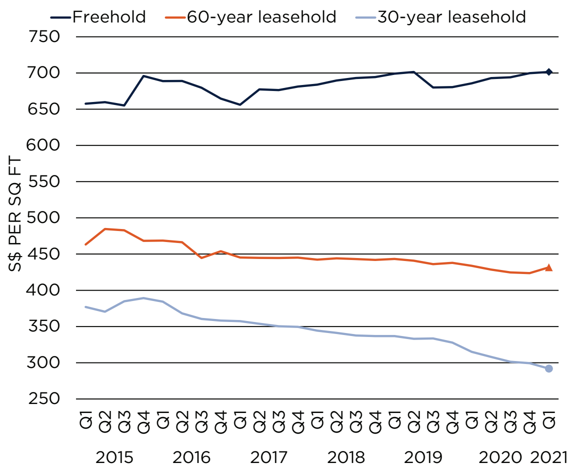
GRAPH 1: Factory And Warehouse Leasing Volumes, 2011 to Q1/2021



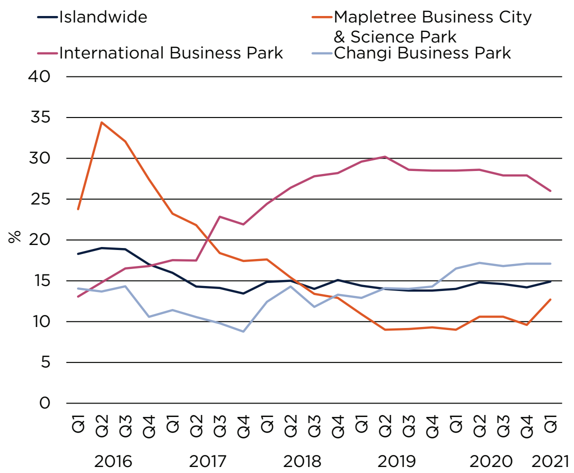
Source JTC, Savills Research & Consultancy

GRAPH 2: Prices Of Upper-Storey Strata Factory And Warehouse Units, Q1/2015 to Q1/2021



Source JTC, Savills Research & Consultancy

GRAPH 3: Business Park Space Vacancy Rates, 2016 to Q1/2021



Source JTC, Savills Research & Consultancy

MACROECONOMIC OVERVIEW

After three quarters of YoY declines amid the COVID-19 pandemic, Singapore's gross domestic product (GDP) registered its first year-on-year (YoY) growth of 0.2% in Q1/2021 due to increased business activities that came with Phase 3 of the opening up of the economy. This came as a surprise as economists had previously forecast a contraction in GDP. The growth in GDP was largely attributed to continual expansion in the manufacturing sector of 7.5% YoY in the first quarter, after growing 10.3% in Q4/2020, along with moderated contractions in the construction and services sectors. Output expansions in the electronics, precision engineering, chemicals and biomedical manufacturing clusters outweighed output contractions in the transport, engineering and general manufacturing clusters.

Manufacturing sentiment continued to improve with the overall Purchasing Manager's Index (PMI) in expansionary mode for nine consecutive months. In March 2021, the PMI recorded a faster rate of growth by 0.3 points from February to 50.8, the highest since March 2019 when the PMI was also 50.8. Similarly, the electronics sector PMI also registered its eighth straight month of expansion, albeit a dip of 0.2 points from February to 50.6 in March. Despite a global chip shortage which may affect consumer electronics, the electronics sector is still expected to grow on the back of higher demand for semiconductors. Moreover, external trade was also largely healthy, with non-oil domestic exports (NODX) recording a YoY growth for Q1/2021. In March 2021, NODX expanded by 12.1% YoY, stronger than February's 4.2%. Electronics NODX rose 24.4% in March 2021 from a low base a year ago, which was led by an increase in exports of integrated circuits amid strong global semiconductor demand and chip shortages. Non-electronic NODX growth accelerated to 9.4% in March 2021 after registering 3.2% in the previous month. This was largely attributable to petrochemicals, specialised machinery and pharmaceuticals.

RENTAL MARKET

The leasing market remained active in Q1/2021, with leasing volume[1] increasing for a third consecutive quarter by 1.3% QoQ and 21.2% YoY to 2,950 transactions. Among the property types, leases of multiple-user factories increased the most, rising by 23.9% YoY to 2,320 transactions. This may be due to tenant relocations and renewal of leases with some downsizing due to cost-cutting measures.

Apart from multiple-user factories, rental transactions of other property types also rose on a YoY basis. The leasing volume of single-user factory units increased by 14.3% YoY to 184 transactions while for warehouses volumes grew by 11.5% from 400 in Q1/2020 to 414 in Q1/2021. Rental demand for warehouse space continued to be supported by logistics and e-commerce players as they looked to expand their operations, sourcing larger units to house their operations in a single location.

The overall industrial vacancy rate eased for a fourth consecutive quarter in Q1/2021, albeit a slower pace of 0.1 of a percentage point (ppt) QoQ to 10.0%, the lowest since Q1/2016, when vacancy rates were below 10.0%, at 9.9%. This was due to increasing demand as conditions in the manufacturing sector start to improve, as well as delayed completions. The QoQ decline of 0.5 of a ppt for multiple-user factory space outweighed the QoQ increases of 0.1 of a ppt in vacancy rate for single-user factory and warehouse space respectively.

As the economic recovery broadens across various fronts, JTC's rental indices reflected this with increases across all property types. The rental index of all industrial property grew by 0.6% QoQ in Q1/2021. Similarly, for Savills basket of industrial properties, the average monthly rent for prime multiple-user factories[2] rebounded, increasing by 1.1% QoQ to S$1.72 per sq ft. This turnaround came after five consecutive quarters of decline and was led by the strong growth in the manufacturing sector. In the same light, the average monthly rent for prime warehouse and logistics[3] properties continued to inch up further, albeit at a slower pace, rising by 0.5% QoQ to S$1.44 per sq ft. This was supported by strong demand for warehouse space from e-commerce, logistics, stockpiling and shifts in supply chains.

SALES MARKET

In the strata sales market, after two consecutive quarters of increase, sales volumes declined 21.6% QoQ to 366 in Q1/2021. However, on a YoY basis, the transaction volume in Q1/2021 almost doubled from the 196 recorded in the same period last year. Demand came from local firms such as those in the disposable Tupperware and frozen food processing business. Local companies which had in the past leased space are now willing to purchase as they see attractive pricing in the market. Many of the local companies buying have benefited from the fallout from the pandemic.

The improvement in the industrial market was observed with the JTC price index of all industrial property registering a 0.9% QoQ growth for a second consecutive quarter. However, on a YoY basis, the price index recorded a decline of 1.3%. The 0.9% increase was largely led by a 1.1% QoQ growth in the price index of single-user factories, while multiple-user factories rose by 0.9% QoQ. From

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

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$1.40 per sq ft.

Savills basket of leasehold industrial properties[4], price movements were mixed during the quarter under review. After four consecutive quarters of decline, prices for 60-year leasehold properties rebounded by 1.9% QoQ to S$432 per sq ft in Q1/2021. On the other hand, prices of 30-year leasehold properties fell for a sixth straight quarter, declining 2.5% QoQ from S$299 per sq ft in Q4/2020 to S$292 per sq ft in Q1/2021. More properties with shorter leases have been for sale in the market. Sellers of such properties do not see the need to hold on to their assets, particularly due to uncertainties arising from the pandemic. Separately, prices of freehold properties remained resilient, with a marginal QoQ increase of 0.2% to S$701 per sq ft.

BUSINESS PARK AND HIGH-SPECS INDUSTRIAL

After registering positive net demand for the past two quarters, net demand fell back into negative territory of -75,300 sq ft in Q1/2021. This was largely led by a decline in take-up of 161,500 sq ft in the Central Region. As a result, the islandwide vacancy rate rose by 0.7 of a ppt from 14.2% in Q4/2020 to 14.9% in Q1/2021, the highest since vacancy rates reached the 15.1% registered in Q4/2018. The increase was mainly due to firms moving out of business parks. While occupancy rates of new business parks increased in the quarter, older parks continued to face greater challenges in attracting or retaining tenants. Nevertheless, demand for business park space continued to emanate from technology and fintech firms which have thrived during the pandemic. However, for some fintech companies, they may still prefer to take up conventional office space which imparts a more professional image compared with business parks or high spec industrial space. Although the JTC rental index for business parks recorded a marginal QoQ increase of 0.1% for a second consecutive quarter, the average monthly rent in Savills basket of prime business park properties[5] registered its first decline since Q2/2020 of -0.9% QoQ to S$5.76 per sq ft. Similarly, the average monthly rent of Savills basket of standard business park properties[6] declined for a fourth consecutive quarter by a larger 1.2% QoQ to S$3.96 per sq ft as this type of space needs to provide greater flexibility in rental negotiations to maintain occupancy rates.

As companies adopt cost-cutting measures amid uncertainties from how the pandemic will pan out, some of the demand for high-spec industrial space came from firms moving out of business parks to high-spec industrial units, which are less costly (for older buildings) but still able to provide a respectable corporate look. Nevertheless, as with business parks, the average monthly rent for Savills high-spec industrial basket[7] declined by 0.5% QoQ to S$3.48 per sq ft in Q1/2021 after a QoQ increase of 0.9% in Q4/2020. With firms remaining budget conscious, older high-spec buildings may be better received by tenants. Demand for such space is expected to be stable in the long term, emanating from the technology, media and telecommunications and electronics sectors, which continue to perform well.

OUTLOOK

One year into the pandemic, driven by the need to buffer against supply chain disruptions, demand for biomedical devices and a global shortage of semiconductors, the industrial market continues to perform better than most other real estate sectors. The heavy demand for the products from the latter two industries have spurred on the chemical industry as well. Broadly speaking, the manufacturing and logistics sectors have two driving forces. One is knowledge intensive while the other is basically supply chain in nature. Between these two lie pockets of demand from the food industry and those who try to save rental overheads by moving to lower cost premises. How these two tracks will fare in the coming year will determine the outlook for the factory, warehouse and business park markets.

Notwithstanding the broad vaccination program underway here, the pandemic has reared its head again with community cases spiking in late-March to the time of this writing. Overseas, the pandemic in some countries has been counted in multiple waves. So long as the threat of a resurgence in infections lingers, the demand for industrial space should remain firm. Remote working and the drive to achieve ESG (Environment Social and Governance) targets will spur demand for new technologies and materials. All these are likely to result in greater manufacturing activity in the semiconductor and chemical sectors here as most of the global companies have set up operations.

The knowledge intensive industries are likely to continue to operate and even expand at the various locations earmarked for specific clusters. Local Small and Medium Enterprises (SME) are often not in such industries and their performance will be patchy. However, at a micro-locational level, they are likely to continue to look to set up in more central locations.

The pandemic has decimated the industrial market in various ways. While the traditional users from industries such as oil & gas and ship building are still weighed down by problems which afflicted them prior to the viral outbreak, others who were doing well prior to 2020 are now starting to settle down to a lower level of activity. However, there are those who have not been faring well over the past few years, who have started to see their fortunes brighten. The following points highlight some of the observations that we have noticed of late.

- Local Small and Medium Enterprises (SME) have been active in the quarter in review and are expected to remain interested in acquiring industrial properties for their own use. Examples of such companies are those in the manufacturing of Tupperware (mainly for export), processing of frozen food (the latter often needing 5,000 built in to 40,000-50,000 sq ft of land). These local enterprises are taking this opportunity where prices softened to acquire properties where the lease is often less than 30 years. The shorter-term lease means they can rein in non-production related capital expenditure. Food zoned industrial buildings and central kitchens located in the Central and Eastern parts of the island are still highly sought after.

- Warehouse – rental demand from e-commerce (200,000 sq ft leasing demand). Companies in the e-commerce and last mile transportation industries have been actively looking for logistics space. A year ago, the pandemic was viewed with uncertainty and short-term leases for stock piling were popular. However, with the realization that COVID is not likely to go away anytime soon, these short leases have extended from half a year to a year or more. E-commerce firms have been sourcing in the Central and Eastern regions for space, often <100,000 sq ft. These are often around Kallang, Bendemeer and Tampines where easy access to expressways makes them more conducive for last mile delivery. They would have liked to lease larger areas but for the fact that most of the warehouse space in the abovementioned regions is smaller than in the West. For the Western region, as these areas have more warehouse space which offers larger floor plates and higher ceiling heights, they are popular amongst tenants who require general storage facilities e.g. fashion companies, where there is less of a delivery time requirement.

- Self-storage – Investor demand and rental demand have remained elevated. As they are the equivalent to co-working operators providing short term flexi leases, they have become popular amongst tenants who have downsized from larger premises where lease terms are more rigid.

- Light and high-spec industrial space – Tenants signing up for <20,000 sq ft in the quarter have been those from the IT, procurement and technology companies. For the rents charged, the look and feel of the buildings present it as value for money.

- Business Parks – First generation parks are generally facing challenges. Counterintuitively, for some of the newer and well-located ones, there has been some resistance by tenants to

4 Only include upper-storey strata-titled factory (single- and multiple-user factory) and warehouse units, excluding all ground floor units.
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.

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
2021F	-3.0% to 0.0%	+1.0% to 3.0%

Source Savills Research & Consultancy

expand or locate there. Some technology firms with smaller spatial needs are finding Grade B office space in the CBD to be an attractive proposition because rents for such buildings have fallen significantly since the start of the pandemic and now overlap some of those charged in better located business parks.

Although the performance of the industrial market is still mixed, we see that the worst is behind us. It is not that it is about to expand sharply across locations and types of buildings, but there will be some that are growing whilst some still languish due to COVID-related reasons. If we leave out the left tail of performance, those industries performing well clearly stand out from the others. In fact, COVID has distinctly separated the goats from the sheep with sunset industries winding down faster while new economy firms expand rapidly. We maintain our rental forecast for multiple-user factory and warehouse space (refer to Table 1). For Business Parks, average rents are expected to be flat.