Industry Outlook

Singapore Industrial REITs

DBS Group Research. Asian Insights Office 23 May 2023

Overall Outlook

Key observations

Three consecutive quarters of negative net absorption. Following another quarter of elevated new completions, 1Q23 recorded the third consecutive quarter of negative net absorptions for industrial space. Total available stock rose by 357,000sqm while take-up during the quarter only increased by a marginal 5,000sqm. All four segments reported negative net absorption, and there was a decline in occupied stock for three out of the four segments. The warehouse, business park, and single-user factory segments reported a reduction in occupied space, while only the multi-user factory segment saw an increase in occupied space. Interestingly, despite the optimism surrounding the logistics sector, there was a decline of c.30,000sqm in occupied space for the warehouse segment. This was only the second quarter in over the past three years where the warehouse segment saw a decline in occupied stock. Similarly, for the business park segment, the c.18,000sqm decline in occupied space in 1Q23 marked only its second quarter of decline in over the past three years.

Looking ahead, an estimated 1.0m sqm of new supply is expected to be delivered in the next three quarters of FY23. The bulk of the new supply for the year will come from the single-user factory segment (c.62%), c.21% will come from the warehouse segment, and the remaining c.17% will be attributed to the multiple-user factory and business park segments. This brings the total estimated new supply in FY23 to c.1.3m sqm, similar to the amount of new stock that came online last year.

Singapore PMI remained in contractionary territory for the second consecutive month. Amid the global economic slowdown, Singapore's April PMI came in at 49.7, a 0.2 point decline from March. The contraction in PMI was led by the ninth consecutive quarter of contraction in the electronics sector (which represents 42% of manufacturing output), as demand of electronic goods from Singapore's major trading partners such as the US, Europe, and Japan, remains weak. Despite the earlier optimism of a rebound of the electronics sector as China reopens, it has largely driven domestic consumption and services so far, providing limited demand for exports. New orders and inventories for the electronics sector continue to contract, and the order backlog also recorded a decline after muted growth in the two months prior.

On a y-o-y basis, Singapore's manufacturing output retreated by 4.2% in March 2023. Although transport engineering and biomedical manufacturing recorded an increase in output, general manufacturing, precision engineering, electronics, and chemical output declined y-o-y. Looking ahead, the Economic Development Board is expecting the output of electronics and chemicals to continue contracting in 2Q23. Consequently, employment in these two sectors is also expected to remain weak and potentially contract as well.

What are we watching?

Take-up rates of industrial properties. With the pick-up in new supply over the past few quarters, we continue to see negative net absorption in industrial properties. Most notable in 1Q23 was the decrease in occupied stock for warehouses despite the continued strength of the logistics sector. We believe that this may be a function of a timing difference between when the tenants return space at existing properties and when they physically occupy the new space. Judging by a similar trend seen last year (1Q22), the second quarter posted a strong rebound in occupied space for warehouses following a slight decline in the first quarter.

With the EDB reporting a contraction in several sectors, such as electronics and precision engineering, coupled with expectations of a further slowdown in these sectors, we will be keeping a close eye on how this will impact the multiple-user and business park segments for the rest of FY23. Despite this, we believe that the biomedical sector, marine and offshore, and aerospace sectors will continue to support take-up and rents for the business park segment. The protracted rebound of the precision engineering and general manufacturing sectors in 2Q23 will also likely support continued rental growth for newer and high-specification multiple-user factory space.

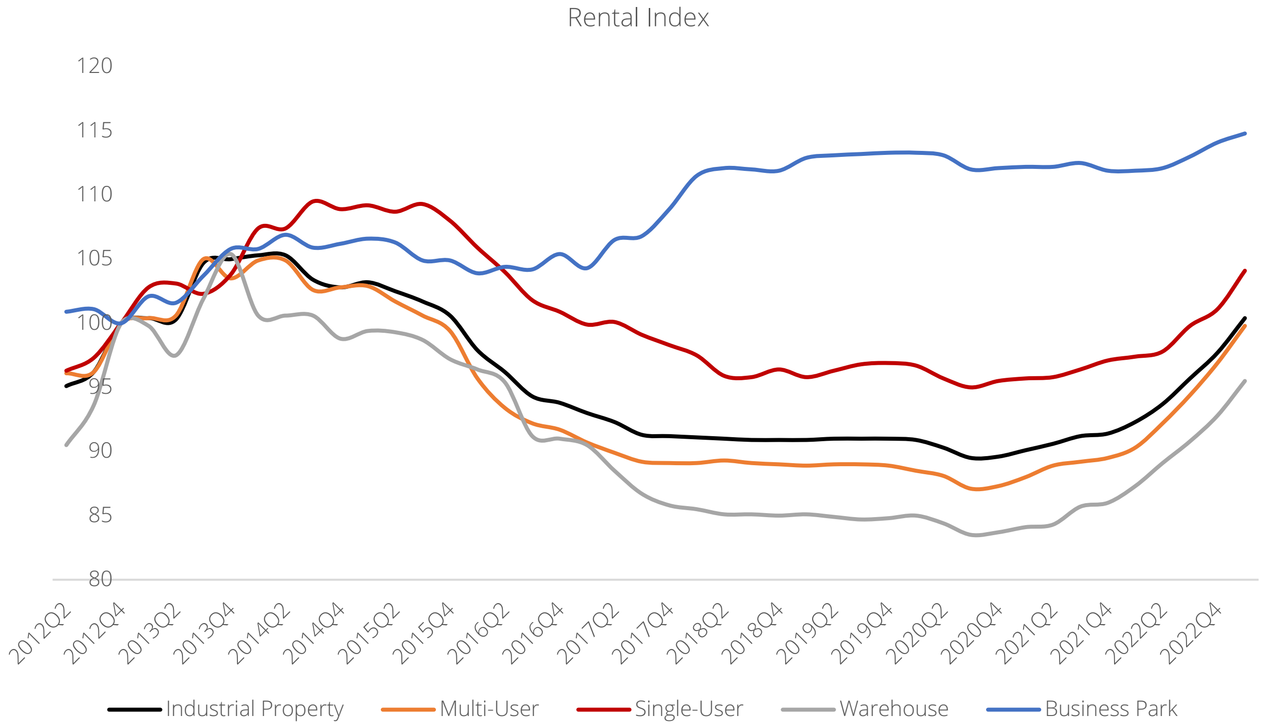
Key statistics for industrial sector

Key indicators of industrial sector

Key Indicators	4Q22	3Q22	% Change (q-o-q)	4Q21	% Change (y-o-y)
Price index					
Industrial Property	99.4	97.9	1.5%	93.0	6.9%
Multi-User Factory	104.2	102.1	2.1%	96.1	8.4%
Single-User Factory	87.6	86.8	0.9%	83.6	4.8%
Rental index					
Industrial Property	100.4	97.7	2.8%	92.3	8.8%
Multi-User Factory	99.8	96.9	3.0%	90.3	10.5%
Single-User Factory	104.1	101.1	3.0%	97.4	6.9%
Warehouse	95.5	92.8	2.9%	87.3	9.4%
Business Park	114.8	114.1	0.6%	111.9	2.6%
Vacancy rate					
Industrial Property	11.2%	10.6%	5.7%	10.2%	9.8%
Single-User Factory	11.3%	10.9%	3.7%	9.6%	17.7%
Multi-User Factory	11.1%	10.9%	1.8%	11.2%	-0.9%
Warehouse	9.7%	8.3%	16.9%	9.7%	0.0%
Business Park	18.7%	17.5%	6.9%	14.4%	29.9%
Pipeline under construction					
Industrial Property	38.0	43.4	-12.5%	48.1	-21.0%
Single-User Factory	20.3	22.1	-8.1%	22.1	-8.3%
Multi-User Factory	6.2	8.5	-26.7%	12.3	-49.3%
Warehouse	6.7	7.8	-15.1%	8.3	-19.6%
Business Park	4.8	5.0	-3.9%	5.4	-11.1%

Source: JTC Corporation, DBS Bank

Rental Index: Rentals for industrial properties are at a 5-year high

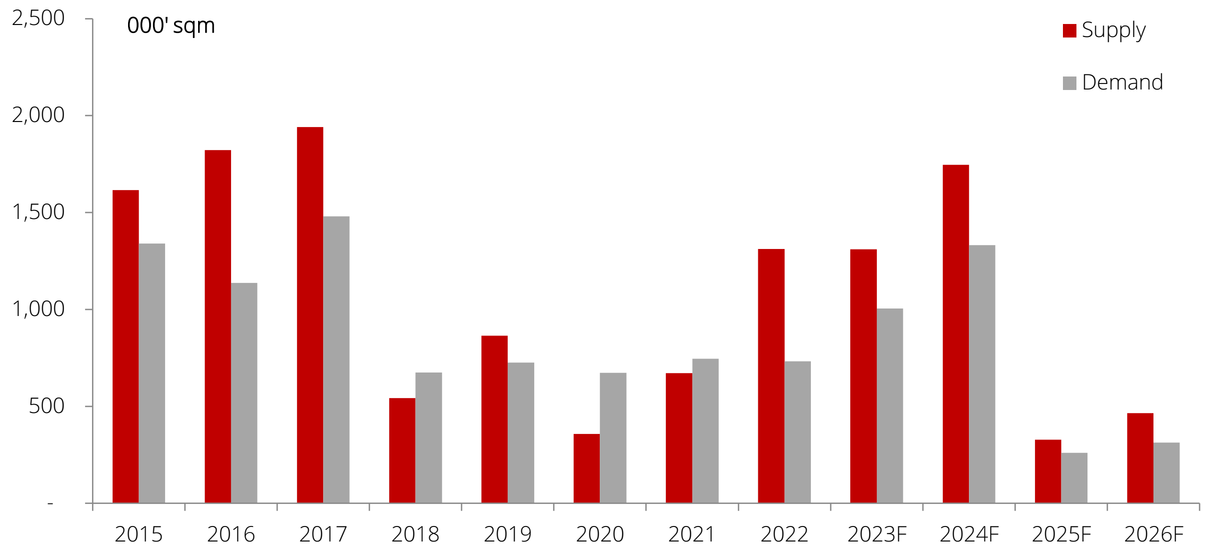


Source: JTC Corporation, DBS Bank

- The overall Industrial Properties Rental Index has been on an uptrend since late FY20, likely due to a lack of new supply as construction delays hit.
- The Industrial Properties Rental Index is currently at 100.4, a level not seen since the end of FY15. The rise in the rental index has mostly been driven by the multiple-user factory and warehouse segments.
- The multiple-user and warehouse rental indices are currently at 99.8 and 95.5, respectively. The last time both rental indices were this high was between FY15 and FY16.
- The Single-User Rental Index is currently at 104.1, the highest level since early FY16.
- The Business Parks Rental Index is currently at 114.8, the highest level since FY10.

Key Charts – Industrial Sector

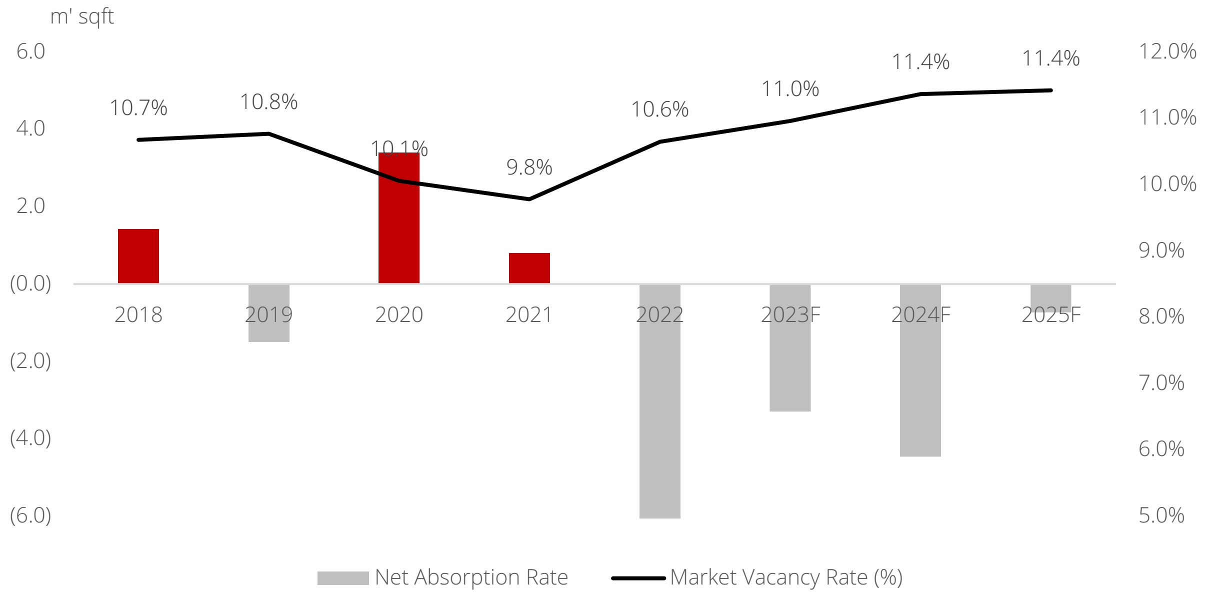
Bumper crop of new supply expected to continue into FY24F



Source: JTC Corporation, DBS Bank

- A total of c.1.3m sqm of new industrial space is expected to be added to the market in FY23, almost the same amount of space that was added to the market last year. Similarly, the amount of new supply last year and this year is at the highest level since FY18. This is a result of a rollover in project completions from prior years, as the COVID-19 pandemic led to construction delays and disruptions to supply chains.
- As compared to the start of FY23, it seems like the completion of c.0.5m sqm of new supply has been rolled over to the next two years, even as construction delays and supply chain disruptions ease.
- Of the c.1.3m sqm of new supply that is expected to be delivered in FY23, single-user factory space contributes 62%, which is likely to have been developed by industrialists for their own use.
- Delivery of new warehouse space in FY23 will constitute 21% of the supply, potentially easing the strong demand seen in FY21 and FY22.
- Multiple-user factory space and business parks make up the remaining 17% of the upcoming supply.
- Take-up of multiple-user and warehouse spaces has been healthy so far in FY21 and FY22, with positive net absorption, despite the delivery of new stock. However, the spike in supply expected in FY23 and FY24F may put some pressure on occupancy and rental rates going forward.

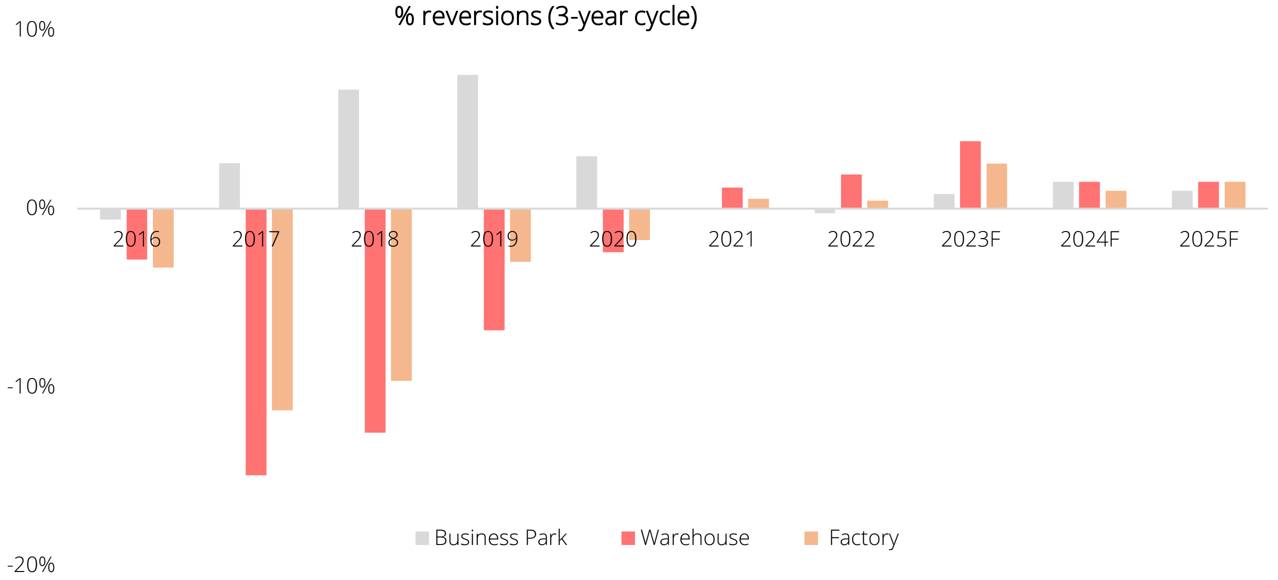
High levels of new supply in 2023F likely to lead to continued negative net absorption



Source: JTC Corporation, DBS Bank

- Net absorption in FY20 and FY21 were positive due to the delays in construction and supply chain disruptions caused by the COVID-19 pandemic.
- Although the amount of new industrial supply in FY21 was more than twice the amount seen in FY20, pent-up demand and expansion needs led to a slightly positive net absorption in FY21.
- The positive net absorption in FY21 came from the multi-user factory and warehouse segments, partially offset by the negative net absorption from the single-user factory and business park segments.
- With the spike in new industrial supply (c.1.3m sqm) that hit the market in FY22, we saw negative net absorption. The negative net absorption was mainly contributed by the single-user factory segment, while the other segments like warehouse and business parks reported a slowdown in take-up.
- In the medium term, we expect net absorption to continue to stay in negative territory, leading to the softening of occupancy and rental rates, unless demand in FY23 surprises on the upside.

Rental reversion trend expected to remain healthy in the coming years

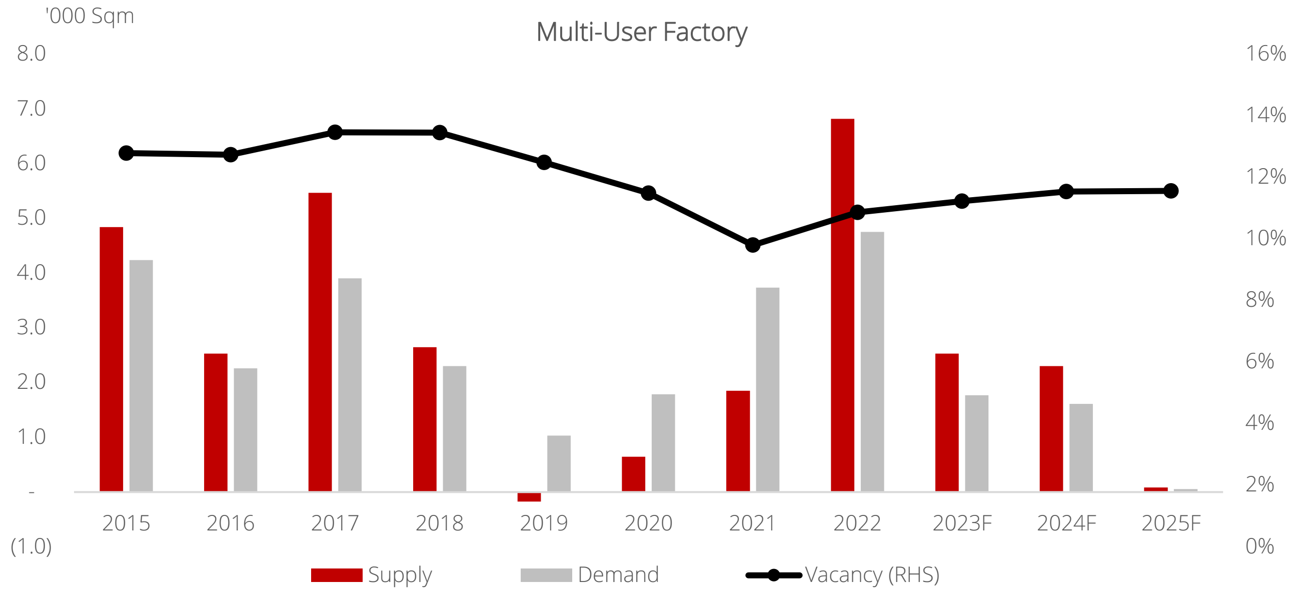


Source: JTC Corporation, Urban Redevelopment Authority, DBS Bank

- After several years of negative rental reversions (three-year cycle) for the factory and warehouse segments, the trend reversed in FY21.
- Positive rental reversions for business parks have been tapering off in the past two years and were slightly negative in FY22. However, we expect the trend to reverse in FY23 due to limited new supply.
- The positive rental reversion cycle continued into FY22 for the warehouse and factory segments, owing to strong demand, despite the pick-up in new supply.
- Overall rentals in the near term are expected to continue to remain healthy, even as more new supply is expected to come online.
- Over the last two years, the logistics sector has been driven by the advancement of e-commerce and stockpiling activities. This has led to the outperformance of rentals for the warehouse segment, and we believe its outperformance will continue through to the coming years.

Industrial Sub-sector – Multi-User Factory

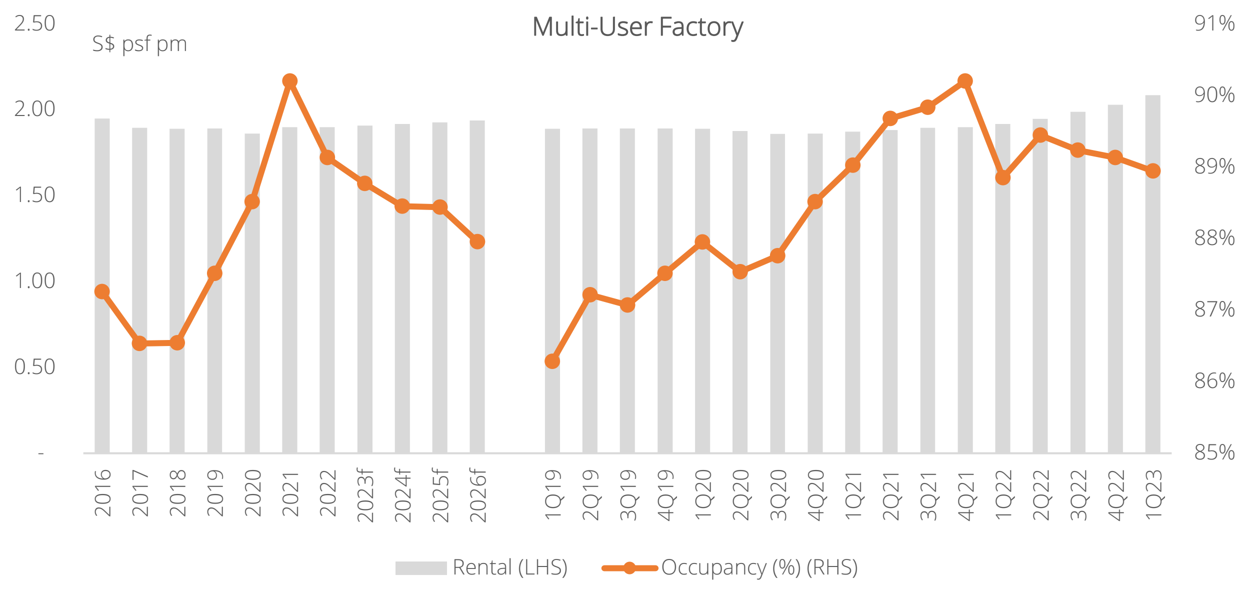
Multi-user factory supply: Supply spike in 2022 due to construction delays in previous two years



Source: JTC Corporation, Urban Redevelopment Authority, DBS Bank

- New completions picked up in FY22 after more than three years of construction delays. A total of 634,000sqm of new supply of multi-user factory space was delivered in FY22, the largest increase in annual supply in over a decade.
- Despite the spike in supply, take-up of multi-user factory space was very strong. A total of 442,000sqm of space was taken up in FY22, thereby cushioning the increase in the vacancy rate. The vacancy rate in FY22 was 10.9%, only a 100bps increase.
- The sudden spike in both supply and demand in FY22 was likely a result of construction delays over the past three years and pent-up demand from businesses waiting to occupy the newly completed projects. Although we saw a slight increase in vacancy rates in FY22, overall occupancy is still at a very healthy level, the strongest seen in over a decade.
- We are expecting another year of healthy supply for the multi-user factory space, with an estimated 235,000sqm of new supply projected to come online in FY23. Demand is also expected to taper off, as we believe most of the pent-up demand has already been satisfied.
- We could see a slight increase in vacancy rates unless demand picks up and available stock is backfilled at a faster pace.

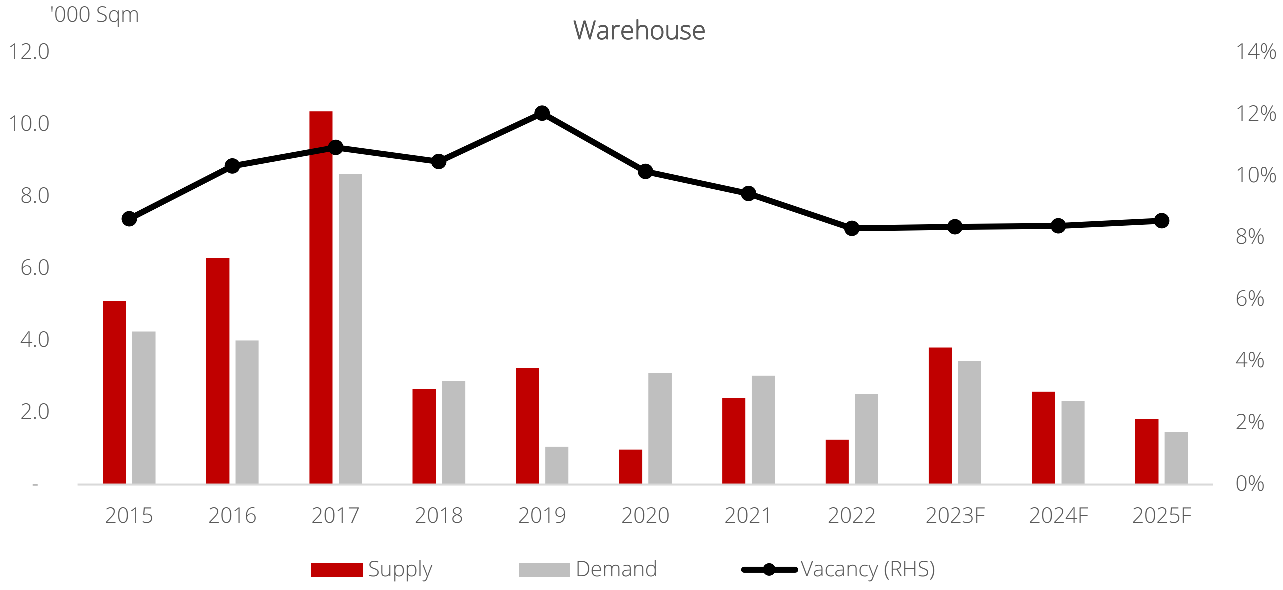
Multi-user factories: Surprise rebound in occupancy rate despite delivery of more stock



Source: JTC Corporation, Urban Redevelopment Authority, DBS Bank

- Rentals surprised on the upside with a c.8.2% increase in FY22 despite the spike in new supply delivered. This was likely due to cost inflation as well as higher rents that the newer multi-user factory commands.
- As anticipated, occupancy rates dipped slightly due to the spike in delivery of new supply. Occupancy rates dipped 110bps in FY22 to c.89.1%, but this is still at a multi-year high. Aside from the past three years (where new supply was constrained by construction delays), occupancy rates are currently at the level last seen in FY13.
- We expect some downward pressure in occupancy rates going ahead, as the market has to gradually backfill the bumper crop of new supply in FY22.
- Rents could also see some downward pressure, but we believe it will remain relatively sticky in the near term. In fact, rentals in 1Q23 remain on an upward trajectory, rising 3.0% q-o-q.
- However, occupancy and rents could surprise on the upside if there is any further slowdown in construction and new supply continues to be rolled over to the following years.

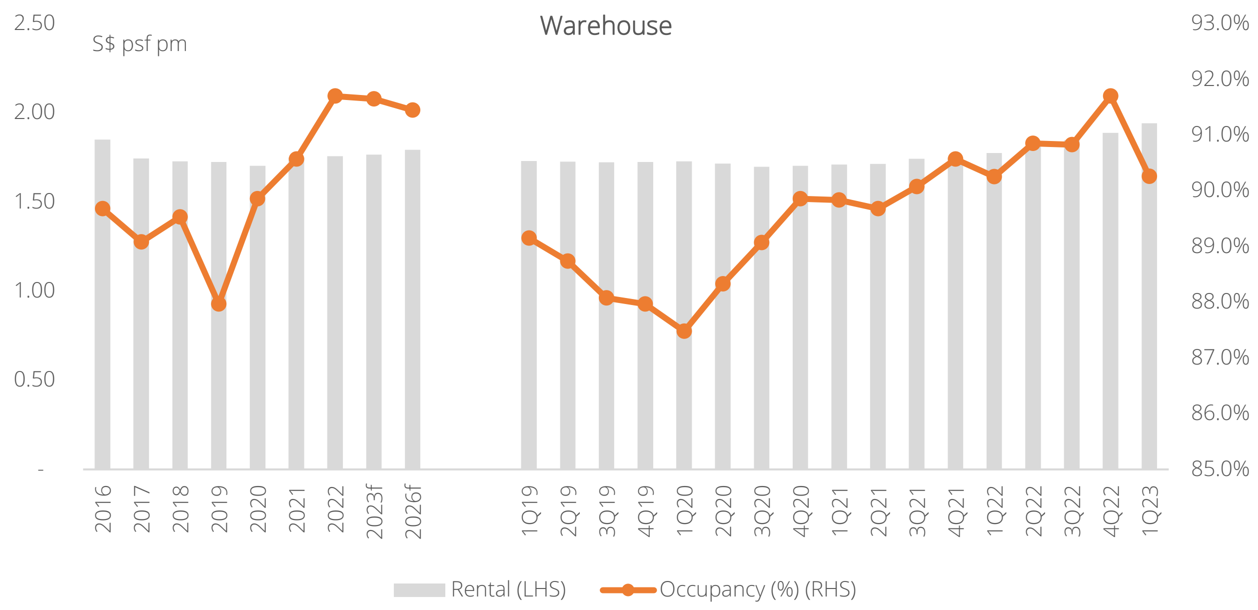
Warehouses: Logistics sector driving demand for warehouses



Source: JTC Corporation, Urban Redevelopment Authority, DBS Bank

- Delivery of new warehouse supply slowed down in FY22 to only c.116,000sqm. Aside from FY20, this has been the slowest pace of new supply delivered in the past decade.
- With the logistics sector's continued expansion in FY22, demand remained relatively healthy, and we saw a strong backfilling of available space in the market. Vacancies declined sharply in FY22 to c.8.3%, levels not seen since FY14.
- Third-party logistics businesses and those supporting the e-commerce sector are expected to continue driving demand for modern warehouse space in the medium term.
- Even with more new supply expected to be added to the market in FY23, we believe occupancy rates will remain relatively stable with the continued strong demand for modern warehouses.

Warehouses: Despite some new supply coming online, occupancy and rental rates are expected to remain robust

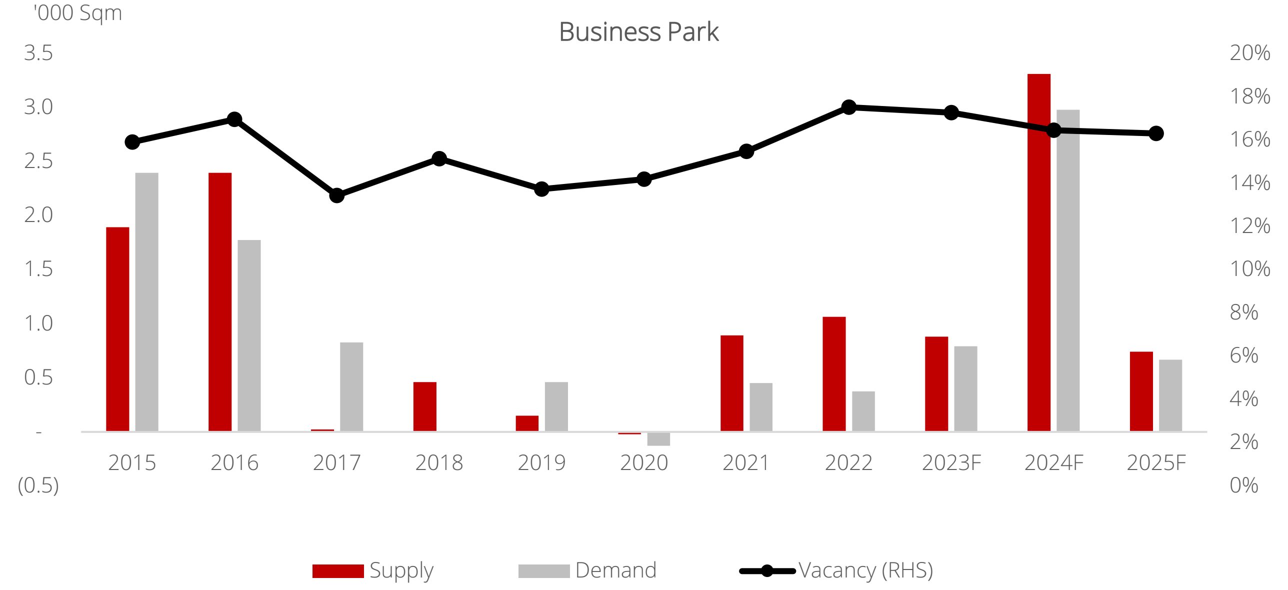


Source: JTC Corporation, Urban Redevelopment Authority, DBS Bank

- After six years of consecutive declines in rents, rental rates for warehouses started to pick up from early FY21, as supply was absorbed, boosted by demand for stockpiling and the growth of the logistics sector.
- Riding on the surge in demand for storage and delays in completion of new supply, occupancy rates continued to inch up by 1.1% to c.92% in FY22.
- Rents also continued to pick up together with the improving occupancy rates, and rents are currently at levels not seen since FY16.
- Although some new supply is expected to come online in FY23, we expect overall warehouse occupancy and rental rates to continue inching up, driven by the continued expansion in the logistics sector.
- Despite some softening in occupancy rates in 1Q23, rentals continue to increase by 2.9% q-o-q.
- However, we could start to see a divergence in occupancy and rental performance between the modern logistics warehouses and the older general warehouses, which could face stiff competition.

Industrial Sub-sector – Business Parks

Majority of business park space has been pre-committed



Source: JTC Corporation, Urban Redevelopment Authority, DBS Bank

- There has been some addition to the supply of business parks in FY22, and demand was relatively muted. However, we believe that there has been a divergence in performance among business parks in the city fringe and those in the rest of the island.
- Even though vacancy rates have inched up to c.18.7% currently, we believe the available space will be gradually taken up over the course of the year.
- Looking ahead, the limited new supply of business park space in FY23 should lead to an improvement in occupancy rates as technology, biomedical, and consumer goods tenants continue to drive demand.
- As business parks in the city fringe precincts of Buona Vista and Alexandra are favoured over the rest of the island, we believe these will outperform business parks in other areas such as Jurong, Changi, and Tuas.

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