Quarterly Review

SINGAPORE | INDUSTRIAL

Q2 2016

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Colliers INTERNATIONAL

Accelerating success.

More leasing and sales activity

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Amid the economic uncertainties, we expect industrial rents and capital values, which continued to decline in Q2 2016, to soften further over the next six months. We think this is an opportune time for owners and landlords to upgrade their buildings and align their building specifications with current technologies and industry trends.

Forecast at a glance*

Demand
We think industrialists will remain prudent and cautious in evaluating their real estate requirements.

Supply
We predict that more than 20 million sq ft of new industrial space will be completed in 2016, higher than 2015's 17.4 million sq ft.

Vacancy Rate
We expect the island-wide vacancy rate to rise in 2016, since supply should surpass absorption.

Rent
Prime conventional industrial rents could fall by up to 13% in 2016. Island-wide business park rents could increase by 1%, while independent high-specs industrial premises could see rents fall by up to 10% in 2016.

Price (strata-titled capital values)
Prime freehold conventional industrial prices could fall by up to 3.5% in 2016.

*Refers to full year 2016 forecasts

Outlook mixed in H2 2016

It remains to be seen if the pick-up in leasing and sales activities in Q2 2016 can be sustained in the coming quarters. We think the industrial property segment will continue to reflect the headwinds arising from the mixed signals on the manufacturing and economic fronts, as well as the heightened economic uncertainties following Brexit.

We believe industrialists will continue to focus on cost containment, while landlords will take proactive steps to retain existing tenants and attract new tenants.

As such, we foresee further downward pressure on industrial rents in the coming six months. However, the pace of decline is likely to moderate.

Across the various categories of industrial space tracked by Colliers International, we project that rents for prime multi-user conventional industrial space will witness the steepest declines of up to 13% in 2016 due to the heightened competition for qualifying tenants.

For high-specification (high-specs) industrial space, rents for premises located in the science and business parks could see very modest upside potential – perhaps up to 1% – in 2016, mainly due to the higher rents attainable by the newer developments. In contrast, we predict that rents of independent high-specs industrial premises will decline by up to 10% in 2016 as landlords focus on filling vacancies.

In the strata-titled industrial sales segment, we maintain our view that buyers will stay cautious and selective in the wake of falling rents, economic uncertainties and expectations of further price corrections.

However, there may be more sales activity in view of the narrowing price expectation gap between buyers and sellers, provided buyers are able to clear financial hurdles like the Total Debt Servicing Ratio (TDSR) requirement.

We think prices of prime freehold conventional industrial prices should remain fairly resilient in H2 2016 due to limited supply.

Leasing market and rental values

More leasing activity

Singapore's manufacturing output expanded by 3.0% year on year (YOY) and 0.9% YOY in April and May 2016, respectively. However, the Singapore Purchasing Manager's Index (PMI)[1] – a barometer of the health of the manufacturing sector – indicated the 12th straight month of decline in factory activity with a 49.6 reading in June 2016.

Over the same quarter, Singapore's non-oil domestic exports (NODX) surged unexpectedly by 11.6% YOY in May. And while non-electronics exports jumped by 19.0% YOY, electronics exports shrank by 6.0% YOY. In June, however, NODX contracted by 2.3% YOY with declines in both electronics and non-electronics exports.

Amid these mixed signals, industrialists generally stayed cautious and selective on their business space requirements. However, with landlords being more flexible in their rental packages, we see improved leasing activity in Q2 2016.

Notably, there were more multinational corporations (MNCs) taking the opportunity of the weak industrial property market to negotiate their renewal rents or commit to a cheaper alternative.

We also see more occupier movements because both landlords and single-owners are working towards the December 2017 timeline to comply with JTC's revised subletting policy.

Recent merger and acquisition (M&A) activity also led to some reshuffling of business units and business space consolidation. This generated new business space requirements in Q2 2016.

All this contributed to the more active leasing market in Q2 2016, and ended three consecutive quarters of contraction.

Reflecting the increase in leasing activity, rental records sourced from the Urban Redevelopment Authority's Real Estate Information System (URA REALIS) showed 2,330 leasing transactions in Q2 2016, up 29.0% quarter on quarter (QOQ).

However, this was insufficient to lift the leasing volume in H1 2016. Overall, the 4,136 leasing deals in H1 2016 were 2.5% above the 4,034 leasing transactions in H2 2015 but 4.2% lower than the 4,319 deals closed in H1 2015.

Rents for conventional industrial space fell at a slower pace

Despite the uptick in leasing activity, rents stayed under pressure in Q2 2016 as industrialists, wary of the prolonged economic uncertainties, remained sensitive to rent levels.

Competition for qualifying tenants also remained intense, especially with developers placing their unsold inventory in the leasing market for rent.

Against this backdrop, landlords stayed focused on retaining existing tenants and attracting new and reputable occupiers by offering very attractive leasing packages.

Some individual property owners, especially those with outstanding mortgages, also reduced their rental expectations to fill vacant space, while larger corporate landlords appeared to be giving longer rent-free periods and other incentives to attract and retain tenants.

However, the pace of rental decline slowed down for prime conventional industrial premises in Q2 2016. By and large, landlords who had already lowered their rental expectations substantially in Q1 2016 were not willing to drop rents by the same extent, especially in view of the pick-up in leasing activity.

Based on a representative basket of buildings tracked by Colliers International, the average monthly gross rents for both ground and upper-level prime conventional factory premises saw more modest declines of 0.9% QOQ and 1.6% QOQ to SGD2.33 per sq ft and SGD1.80 per sq ft, respectively, as of Q2 2016. In comparison, rents fell by a steeper 6.0% QOQ for ground level space and 9.0% QOQ for upper-level space in Q1 2016.

We observed a similar rental movement in the prime conventional warehouse space segment.

During the quarter, the average monthly gross rent for ground level space remained constant at SGD2.33 per sq ft, after falling by 6.4% QOQ in Q1 2016. Over the same quarter, the decline in the average monthly gross rent of upper-level space moderated to 1.8% QOQ in Q2 2016, from 9.5% QOQ in the preceding quarter.

As a consequence, rents for ground and upper-level prime conventional factory premises fell by 6.8% and 10.4%, respectively, over H1 2016 as a whole.

Likewise, rents for ground and upper-level prime conventional warehouse space were down by 6.4% and 11.1%, respectively, compared to Q4 2015.

[1] A PMI reading of above 50 indicates that the manufacturing sector is expanding while a PMI reading of less than 50 indicates that the manufacturing sector is declining.

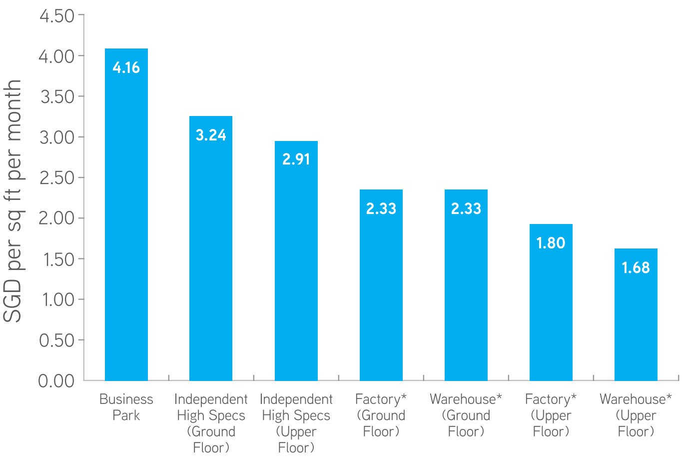
High-specs industrial rents saw uneven rental movements

Meanwhile, underpinned by lease renewals and landlords' continued focus on tenant retention, the average monthly gross rent for business park premises island-wide stood at SGD4.16 per sq ft as of Q2 2016. This was relatively unchanged from the SGD4.17 per sq ft and SGD4.15 per sq ft in Q1 2016 and Q4 2015, respectively.

However, rents for independent or standalone high-specs industrial buildings located outside the science and business parks were weighed down by landlords who were willing to consider lower rents in the face of increased vacancies from tenants relocating or consolidating their operations.

Consequently, the average monthly gross rent for ground level independent high-specs space fell by 3.6% from the Q1 level to SGD3.24 per sq ft in Q2. This was a reversal of Q1 2016's 1.5% QOQ rise which arose mainly from the higher rents sought for upgraded ground level space.

Average Monthly Gross Rents of Prime Industrial Space (as of Q2 2016)



** This refers to prime conventional factory or warehouse space.*

Source: Colliers International Singapore Research

For upper-level independent high-specs industrial premises, the average gross monthly rent also remained under pressure and corrected by another 3.3% to SGD2.91 per sq ft in Q2 versus Q1, albeit at a slower pace than Q1 2016's 3.8% QOQ slide.

This brought the overall rental decline in H1 2016 for ground and upper-level independent high-specs industrial premises to 2.1% and 7.0%, respectively.

Strata sales and capital values

Selective purchase of strata-titled industrial units

Mirroring the leasing segment, there were more strata-titled industrial sales in Q2 2016, reversing three straight quarters of decline.

According to preliminary records from URA REALIS as of 15 July 2016, 228 caveats were lodged in Q2 2016, up 38.2% from the 165 caveats in Q1 2016. And the final caveat tally for Q2 2016 will likely be higher.

Notwithstanding Q2 2016's increase, the total caveat count in H1 2016 at 393 was still lower than the 438 and 555 caveats recorded in H2 2015 and H1 2015, respectively.

To some extent, the increase in transactional activity in Q2 2016 was due to the narrowing price expectation gap between buyers and sellers. Similar to the past few quarters, some sellers with weaker holding power had lowered their pricing expectations to move sales.

But buyers generally remained cautious and price sensitive during the quarter. Even though there were end-users or industrialists making selective or opportunistic purchases for their business operations, investors were generally staying away.

Reaffirming this, some developers released their unsold inventory for sale at prices that were lower than was stated in the previous price lists two to three years ago, in the hope to move sales.

Additionally, take-up of units at two brand new 30-year leasehold Business 2 (B2)[2] strata-titled industrial projects which debuted in Q2 2016 appeared to be slow. These were also the first two new strata-titled industrial project releases in 2016.

Specifically, all 249 industrial units at T-Space at Tampines North were released for sale in late April 2016 at prices starting from SGD180 per sq ft, while Shine at Tuas South released all 174 industrial units at prices starting from SGD220 per sq ft in June 2016.

[2] Business 2 (B2): These are areas used or intended to be used for clean industry, light industry, general industry, warehouse, public utilities and telecommunication uses and other public installations. Special industries such as the manufacture of industrial machinery, shipbuilding and repairing, may be allowed in selected areas subject to evaluation by the competent authority.

Prime freehold conventional industrial prices fell for second consecutive quarter

Although we believe that property owners were generally more realistic in their price expectations and showed greater willingness to negotiate and give discounts in Q2 2016, this was not widespread in the prime freehold conventional industrial space segment.

Many owners of such prime freehold industrial units, especially those with no outstanding bank loans or strong financial holding power, maintained their pricing expectations. They were unwilling to drop prices due to the rarity of such freehold assets, and would rather lease out their units than sell at a price discount.

In light of the above, the average capital values of ground and upper-level prime multi-user freehold conventional industrial space recorded their second consecutive quarterly decline, but at a slower pace in Q2 2016.

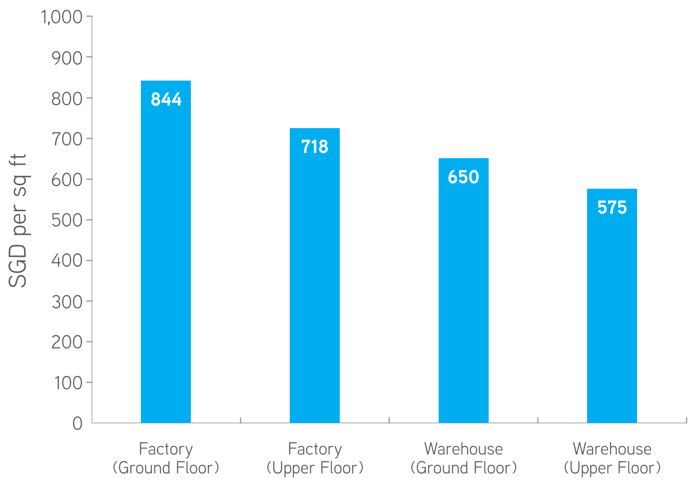
Specifically, the average capital values of ground and upper floor prime freehold conventional factory space fell by 0.2% QOQ and 0.4% QOQ to SGD844 per sq ft and SGD718 per sq ft, respectively, as of Q2 2016. In Q1 2016, the rate of decline was 2.0% QOQ and 1.9% QOQ for ground and upper floor space, respectively.

Likewise, the average capital values of prime freehold conventional warehouse space registered marginal quarterly declines of 0.5% and 0.7% for ground and upper floor space in Q2 2016, compared to the corresponding 1.2% QOQ and 1.4% QOQ declines registered in Q1 2016. This brought the average capital values of ground- and upper-level prime freehold conventional warehouse space to SGD650 per sq ft and SGD575 per sq ft, respectively, as of Q2 2016.

Overall, the average capital values for ground and upper-level prime freehold conventional factory premises retreated by 2.2% and 2.3%, respectively, in H1 2016.

Over the same six months, the average capital values of ground and upper-level prime freehold conventional warehouse space recorded a total contraction of 1.7% and 2.0%, respectively.

Average Capital Values of Prime Freehold Industrial Space (as of Q2 2016)



Source: Colliers International Singapore Research

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