Colliers Quarterly

SINGAPORE | INDUSTRIAL

Q3 2016

24 October 2016

Colliers INTERNATIONAL

Accelerating success.

Opportune time for real estate review

Doreen Goh Associate Director | Research

We believe this is an opportune time for industrialists to evaluate their future space requirements. Given the tentative economic outlook, we expect industrial rents to remain soft over the next three to six months. Coupled with the ample space options available, there will be opportunities for industrialists to secure choice business premises at competitive rents.

Forecast at a glance

Demand
We foresee most industrialists will stay cautious on their real estate requirements in Q4 2016.

Supply
We expect more than 20 million sq ft of new industrial space completions in 2016, above the five-year annual average net new supply of 14.7 million sq ft from 2011 to 2015.

Vacancy Rate
The rise in supply against subdued demand will result in a higher islandwide vacancy rate in 2016.

Rent
We expect further easing in rents of prime conventional and independent high-specs premises over Q4 2016.

Price (strata-titled capital values)
We expect prime freehold conventional industrial prices to ease in Q4 2016, and by up to 3.0% in FY 2016.

Cautious undertone likely to stay for at least another six months

While there were some initial signs of a possible stabilisation on the manufacturing front, the question remains whether this can be sustained, given the challenging business and economic environment.

Hence, we expect most industrialists to stay cost conscious, which will prompt landlords to remain flexible and proactive in meeting the real estate requirements of tenants.

Against this backdrop, we predict that prime conventional industrial rents will ease further, albeit at a slower pace in Q4 2016. This will bring the full year rental decline for prime multi-user conventional industrial space to 7.0%-14.0% in 2016.

With landlords facing stiff competition for qualified tenants, we expect rents at independent high-specification (high-specs) industrial buildings located outside the science and business parks could soften further in Q4 2016, bringing the full year decline to up to 9.0%.

The exception is the business park segment, where we project a modest 1.0%-2.0% rental increase for full year 2016, on the back of limited new multi-user supply and the higher rents attainable at newer developments.

Prices of prime freehold conventional industrial spaces eased up to 0.5% in Q3 2016. We expect a full year decline of up to 3.0%, lagging the rental decline due to rarity of such assets and financial holding power of these owners.

As for the strata-titled industrial sales segment, we expect the total number of caveats lodged to stay below the 2,000-level in 2016. This takes into consideration the cautious and selective buying activity, as well as the traditionally slower moving year-end holiday and festive period. The last time the number of sales caveats lodged breached the 2,000-mark was in 2013.

Leasing market and rental values

Overall leasing transactions fell

Reflecting the slowdown in leasing transactions, the Urban Redevelopment Authority's Real Estate Information System (URA REALIS) captured 2,172 leasing records in Q3 2016, as at 18 October 2016. This was down 6.8% QOQ and a reversal of the previous quarter's 29.0% QOQ rebound.

The more subdued leasing activity was despite some signs of stabilisation on the manufacturing and exports fronts.

Specifically, the Singapore Purchasing Manager's Index (PMI)[1] – a barometer of the health of the manufacturing sector – crossed the 50-point threshold in September 2016 with a reading of 50.1, ending 14 consecutive months of contraction.

Similarly, Singapore's manufacturing output expanded by 0.1% year on year (YOY) in August, after contracting by 3.5% YOY in July 2016. Singapore's non-oil domestic exports (NODX) also stayed flat in August 2016, after recording two consecutive months of YOY decline.

However, Q3 2016's leasing activity was affected, to some extent, by the Lunar Seventh Month or Hungry Ghost Festival from 3 to 31 August 2016, a period typically deemed inauspicious by businesses for committing to, renovating and moving into new business premises.

Notwithstanding the overall decline in leasing volume, we note leasing interest continued to stem from firms in growth industries, particularly from the infocommunications and technology (ICT) sector.

Interest in ready-fitted industrial units picked up

We observed a pickup in interest for ready-fitted industrial units. This is a win-win arrangement for the outgoing tenant, landlord and new tenant.

Typically, landlords require tenants to reinstate their premises after their leases end. The new incoming tenant will then need to fit out/renovate the premises again. However, with industrialists/end-users according high priority to cost containment these days, landlords found it easier to market such ready-fitted spaces. With minimal fit-out works required, the incoming tenant can save on the upfront renovation cost and is able to move into the new premises earlier. This also helps to reduce the total relocation cost for industrialists seeking justification to move to new premises.

The outgoing tenant also benefitted from this arrangement as they do not need to incur the reinstatement cost. For landlords, this means a shorter vacancy period where they were unable to collect rents.

Some larger occupiers initiate forward lease arrangements

During the quarter, we also noticed a number of multinational corporations (MNCs) and larger small-and-medium sized enterprises (SMEs) initiating forward lease arrangements with landlords to lock in the current low rental rates. Some of these companies were riding on the opportunity to secure a business space with better building specification, corporate image and transport accessibility.

As such, other than future renewals of the existing premises, we saw some companies securing new spaces for their future relocations, even though their current leases will expire only a few years later, in as far as 2018 to 2020.

Landlords enticed tenants with more incentives

Meanwhile, landlords remained realistic on their rental expectations and stayed flexible during lease negotiations in Q3 2016, in tandem with the slower leasing market and continued stiff rivalry for qualifying tenants. However, most landlords were not willing to drop rents by a large margin in Q3 2016, after having already adjusted rents downwards in H1 2016.

Instead, we observed some of the larger corporate landlords enticing tenants with more incentives. These ranged from longer rent-free and fitting out periods, to covering alteration works, providing office fit-out services, subsidising repairs and waiving the reinstatement clause.

[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.

Business park rents buck general downward rental trend

Consequently, there were no drastic rental reductions across all the various industrial property segments tracked by Colliers International in Q3 2016.

Based on Colliers International's research, the average monthly gross rent for business park premises on an islandwide basis bucked the general downward rental trend to register a 1.0% QOQ increase to SGD4.20 per sq ft in Q3 2016. This was due mainly to the higher achievable rents at a recently completed development with better specifications that was added into the rental basket during the quarter. Excluding this new addition, the average rent was relatively stable.

In contrast, rents for independent or standalone high-specs industrial buildings located outside the science and business parks continued to face downward pressure in Q3 2016, amid slow take-up. To some extent, these independent high-specs industrial premises also faced competition from newer conventional industrial properties where rents were lower.

However, the rate of rental decline has moderated. During the quarter, the average monthly gross rent for ground-level independent high-specs space eased by 0.3% QOQ to SGD3.23 per sq ft in Q3 2016, compared to Q2 2016's steeper 3.6% QOQ slide.

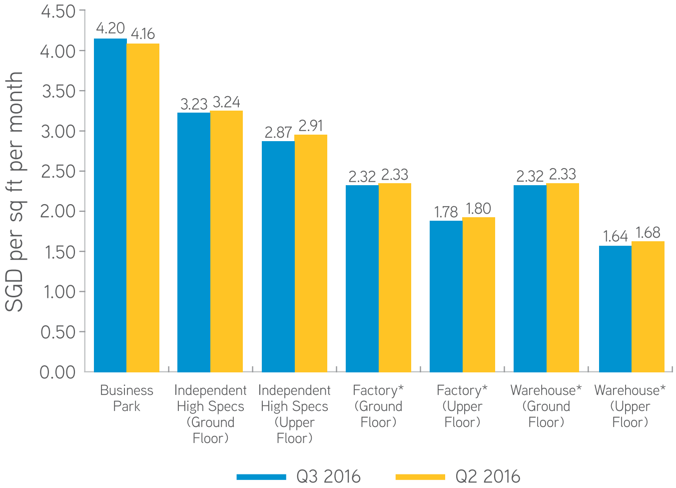
Similarly, the average monthly gross rent for upper-level premises fell by 1.4% QOQ to SGD2.87 per sq ft in Q3 2016, a slower pace of decline than the 3.3% QOQ drop in the second quarter.

Meanwhile, rents of prime conventional industrial space continued to post modest declines in Q3 2016.

According to Colliers International's research, the average monthly gross rents for ground- and upper-level prime conventional factory premises eased by another 0.4% QOQ and 1.1% QOQ to SGD2.32 per sq ft and SGD1.78 per sq ft, respectively, in Q3 2016, following the previous quarter's 0.9% QOQ and 1.6% QOQ decline.

For prime conventional warehouse space, the average monthly gross rent for ground-level space dipped 0.4% QOQ to SGD2.32 per sq ft in Q3 2016. For upper-floor premises, the average monthly gross rent fell by 2.4% QOQ to SGD1.64 per sq ft over the same quarter. In comparison, ground-level prime conventional warehouse space saw stable rents in Q2 2016, while rents for upper-floor premises eased by 1.8% QOQ over the same period.

Average Monthly Gross Rents of Prime Industrial Space (Q3 2016 vs Q2 2016)



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

Source: Colliers International Singapore Research

Strata sales and capital values

Fewer strata-titled industrial properties changed hands

Affected by the effects of the Lunar Seventh Month, and industrialists' continued reluctance to part with a huge capital outlay and be locked into a long-term real estate arrangement given the challenging business operating climate, sales of strata-titled industrial units fell in Q3 2016.

Preliminary records from URA REALIS as at 18 October 2016 showed the number of caveats lodged fell by 32.0% QOQ to 185 caveats in Q3 2016. This was a reversal of Q2 2016's 52.0% QOQ increase. Even though it is likely that the final caveat tally for Q3 2016 will be higher, it is not expected to surpass Q2 2016's level.

Indeed, most investors continued to shun the industrial property market due to the weak leasing market and expectation of a further softening in prices. Some industrialists also held back their purchase decisions during the Hungry Ghost Month as it was deemed inauspicious to do so. Developers also did not push out any new strata-titled industrial developments for sale in Q3 2016.

Other sales hurdles included the continued wide price expectation gap between buyers and sellers, and difficulty in obtaining financing due to the Total Debt Servicing Ratio requirement.

In light of the above, we observed that some individual strata-titled property owners – especially those with weaker holding power – widened their options and were concurrently looking for a buyer or tenant. There were also those considering "lease to buy" arrangements.

Prime freehold conventional industrial prices softened further

However, similar to past quarters, the subdued strata-titled industrial sales segment did not trigger any widespread panic selling or drastic reduction in prices in Q3 2016.

In particular, Colliers International's research showed prices of prime freehold conventional industrial properties recording only slight quarterly declines of less than 1.0% during the quarter.

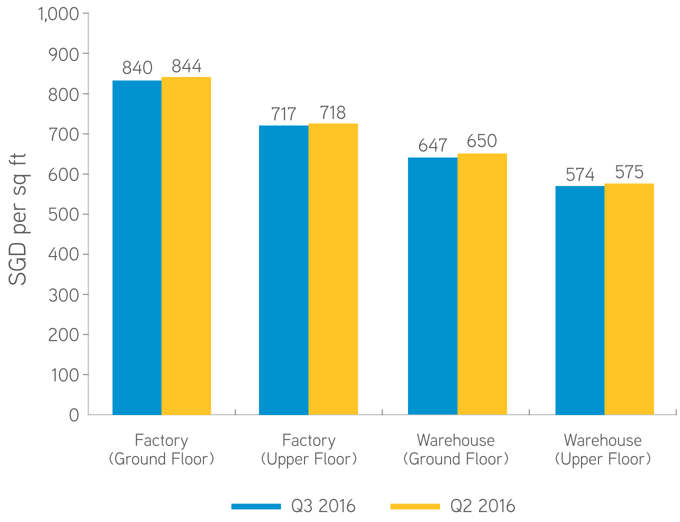
This is attributable to the limited supply of such freehold assets, the financial holding power of the property owners and their preference to lease rather than sell at a substantial price discount.

Entering its third consecutive quarter of decline, the average capital values of ground- and upper-floor prime freehold conventional factory space eased by only 0.5% QOQ and 0.1% QOQ to SGD840 per sq ft and SGD717 per sq ft, respectively, in Q3 2016. In Q2 2016, the rate of decline was 0.2% QOQ and 0.4% QOQ for ground- and upper-floor space, respectively.

Similarly, the average capital values of ground- and upper-floor prime freehold conventional warehouse space saw marginal quarterly declines of 0.5% and 0.2% in Q3 2016, comparable to the corresponding 0.5% QOQ and 0.7% QOQ declines seen in the second quarter.

This brought the average capital values of ground- and upper-level prime freehold conventional warehouse space to SGD647 per sq ft and SGD574 per sq ft, respectively, in Q3 2016.

Average Capital Values of Prime Freehold Industrial Space (Q3 2016 vs Q2 2016)



Source: Colliers International Singapore Research

For more information:

Lim Kien Kim
Executive Director
Industrial Services
kienkim.lim@colliers.com

Tricia Song
Head of Research
Research
tricia.song@colliers.com

Anthea To
Head of Consulting
Advisory and Consulting
anthea.to@colliers.com

Colliers International | Singapore
1 Raffles Place, #45-00,
One Raffles Place,
Singapore 048616
Tel: +65 6223 2323
Fax: +65 6222 4901
RCB No. : 198901352R
CEA Licence No: L3004691J