Research & Forecast Report

SINGAPORE | INDUSTRIAL
Q4 2015

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A quiet end to 2015; challenges ahead

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Singapore's industrial property market wrapped up 2015 on a muted note. Besides the traditional year-end holiday lull period and the effect of the loan curbs in place (i.e. the Total Debt Servicing Ratio or TDSR requirement), market sentiment was also dented by the lingering global macroeconomic uncertainties and rising interest rate.

At the same time, the performance of the key manufacturing sector continued to disappoint, with advance data released by the Ministry of Trade and Industry (MTI) on 4 January 2016 indicating a 6.0% year on year (YOY) contraction in Q4 2015. This marked the fifth consecutive quarter of decline in manufacturing output.

Likewise, the Singapore Purchasing Managers' Index (PMI)[1], a barometer of the health of the manufacturing sector, slipped back into contractionary territory in July and stayed within the contractionary zone in October, November and December 2015, recording readings of 48.9, 49.2 and 49.5, respectively.

Fewer Q4 leasing deals but 2015 leasing volume at historic high

In light of the challenging business operating environment, industrialists kept a tight rein on total business costs (of which real estate cost is a component) and took longer to review their space requirements.

This affected the number of leasing deals, with rental records obtained from the Urban Redevelopment Authority's Real Estate Information System (URA's REALIS) as of 19 January 2016, reflecting a fall in the number of transactions (inclusive of warehouse, factory and business park premises) from 2,081 in Q3 2015 to 1,953 in Q4 2015.

The lower leasing volume in Q4 2015 occurred despite tweaks by the JTC Corporation to its policies for Third-Party Facility Providers, where land has been leased through its Third-Party Build & Lease or Sale & Lease-Back schemes.

Specifically, effective 1 October 2015, JTC reduced the minimum Gross Floor Area (GFA) requirement for anchor subtenants from 1,500 sq m (16,146 sq ft) to 1,000 sq m (10,764 sq ft). Existing anchor subtenants renewing their premises with no changes to the quantum of occupied space and/or space usage also do not need to be reassessed.

Additionally, the minimum occupation period (MOP) of three years per term that was imposed on subsequent anchor subtenants, i.e. replacement of the original anchor subtenants, was relaxed to allow for greater flexibility. Notably, JTC will consider the overall duration that the anchor subtenants have been on the site. Subject to JTC's approval, these anchor tenants can now renew for any duration (depending on their business needs) after fulfilling the initial MOP. This flexibility was also extended to original anchor subtenants for their renewals after they have fulfilled their MOP.

However, although the quantum of leasing deals fell for the second straight quarter in Q4 2015, the total number of leasing transactions reached a historic high of 8,353 in 2015 based on rental records from URA's REALIS. This represents a slight 0.6% YOY increase from 2014's 8,307 leasing transactions.

No significant movement in rents

Meanwhile, landlords maintained realistic rental expectations and a flexible stance during lease negotiations in Q4 2015, with tenant retention and attraction being key priorities. This took into consideration tenants' continued cost sensitivity, the stiff competition for qualifying tenants, as well as the traditionally slower moving year-end period.

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As a result, rents mirrored the previous quarter's trend and continued to move laterally or registered a slight decline in Q4 2015.

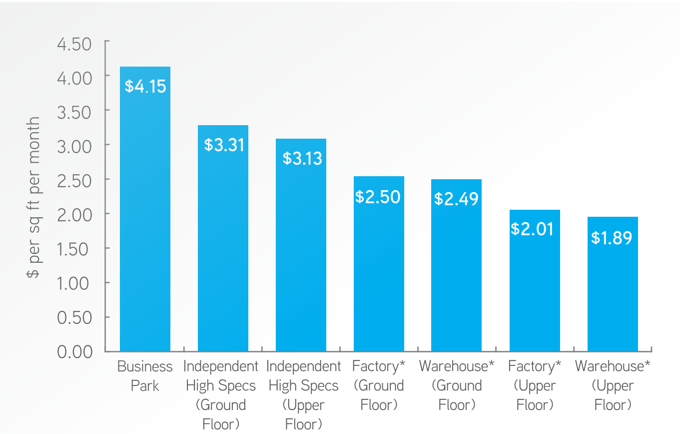
In the prime conventional factory space segment, the average monthly gross rents of both ground- and upper-level space shed another 0.4% quarter on quarter (QOQ) and 0.5% QOQ, respectively, to end the year at $2.50 per sq ft and $2.01 per sq ft. This brought the overall rental declines in 2015 to 1.2% and 2.9% for ground- and upper-level premises, respectively.

Over the same quarter, the average monthly gross rent for upper-level prime conventional warehouse space retreated by another 0.5% QOQ to reach $1.89 per sq ft as of Q4 2015, bringing the total decline in 2015 to 3.6%. However, the average monthly gross rent for ground-level space was stable for the fourth consecutive quarter at $2.49 per sq ft as of Q4 2015.

Within the high specification (high specs) industrial space category, business park rents dipped for the second successive quarter by 0.2% QOQ to $4.15 per sq ft as of Q4 2015. Similar to Q3 2015, this can be attributed to tenants' pressure for lower rents, as well as landlords' greater flexibility during lease negotiations, particularly for older developments or buildings with higher vacancies. Notwithstanding the easing in rents in H2 2015, the average business park rent as of Q4 2015 was still up by 1.0% YOY.

In contrast, the average monthly gross rents for independent high specs premises continued to defy gravity on the back of the limited supply of new multi-user (non-data centre) independent high specs premises.

Average Monthly Gross Rents for Prime Industrial Space as of Q4 2015



** This refers to prime conventional factory or warehouse space.*
Source: Colliers International Singapore Research

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As of Q4 2015, the average monthly gross rents for independent high specs space held steady for the second consecutive quarter at $3.31 per sq ft for ground-level space and $3.13 per sq ft for upper-level premises. Nevertheless, when compared to Q4 2014, these ground- and upper-level rents were still 3.4% and 5.4% higher, respectively. This was primarily due to the addition of a recently completed independent high specs industrial development that was able to attain higher rents into the representative rental basket of properties tracked by Colliers International in Q1 2015.

Q4 strata sales remained low; 2015 sales may be lowest since 2006

On the strata-titled industrial sales front, the volume of transactions stayed thin in Q4 2015, attributable in part to the usual market dampeners such as the TDSR requirement, rising interest rate and generally weak sentiment, as well as the typically slower moving year-end period.

In addition, some industrialists preferred to lease their business premises to stay nimble rather than fork out a large capital outlay to buy and commit into a longer-term real estate arrangement, given the current challenging business operating climate.

The sluggish sales were also despite the release of units in another new 30-year leasehold factory development for sale in Q4 2015. Mega @ Woodlands was the third strata-titled industrial project to debut in 2015 after Proxima @ Gambas and Wave 9, which released units for sale in the second and third quarters, respectively. The eight-storey multiple-user clean, light and general industrial factory development at Woodlands Close offers a mix of units for Business 1 (B1)[2] and Business 2 (B2)[3] use.

While Mega @ Woodlands has reportedly sold over 50 units, of which some 80% are B2 units, in Q4 2015, this has not been captured in the preliminary caveat records obtained from URA's REALIS as of 19 January 2016, which showed the number of caveats lodged falling from 209 in Q3 2015 to 132 in Q4 2015.

Although the final caveat count for Q4 2015, which would have accounted for the sales at Mega @ Woodlands, is expected to be higher, it is not expected to lift the total sales tally for strata-titled industrial properties for the whole of 2015 beyond the 1,200 mark. This means that 2015's total caveat tally could be the lowest since the 763 caveats in 2006.

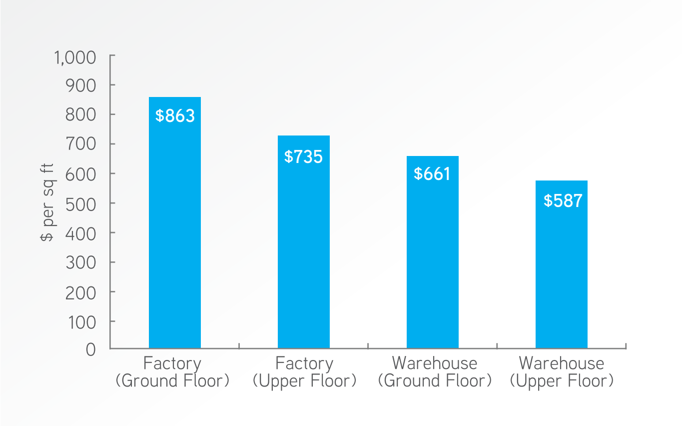
However, the stalemate in the strata-titled industrial sales segment has not led to any significant downward adjustment in prices.

Notably, prices of freehold conventional factory/warehouse developments in prime locations held firm in Q4 2015, as owners of such properties continued to show their holding power with no motivation to let go of their properties at a lower price, especially since overall interest rates, though rising, remained low.

Affirming this trend, the average capital values of prime freehold conventional ground- and upper-floor factory space tracked by Colliers International was unchanged at $863 per sq ft and $735 per sq ft, respectively, as of Q4 2015. Compared to Q4 2014, the average rent for ground-level space was flat but marginally 0.1% YOY lower for upper-floor premises.

Likewise, the average capital values of prime freehold conventional warehouse space were stable for the eighth consecutive quarter at $661 per sq ft for ground-level premises and $587 per sq ft for upper-level space as of Q4 2015.

Average Capital Values for Prime Freehold Industrial Space as of Q4 2015



Source: Colliers International Singapore Research

Headwinds ahead, outlook mixed in 2016

Going forward, the business operating climate is expected to remain challenging in 2016 amid a jittery global macroeconomic environment, the lacklustre manufacturing sector and rising interest rates.

Reflecting the downbeat sentiment, the results of the Q4 2015 business expectations survey for the manufacturing sector conducted by the Economic Development Board between September and October 2015 showed a net weighted balance of 16% of manufacturers anticipating a less favourable business situation from October 2015 to March 2016 compared to Q3 2015. This was a contrast to the previous survey conducted from June to July 2015 in which a net weighted balance of 2% of manufacturers expected an improved business situation over the July to December 2015 period.

Similarly, the results of a poll of 1,002 companies conducted by DP Information Group in Q4 2015 and released by the Singapore Business Federation (SBF) on 12 January 2016 showed that more than half or 54% of respondents indicated that they were adversely affected by the current economic climate. This was significantly higher than the 35% in the previous year's survey.

In light of the above, industrialists are expected to remain cost sensitive and cautious in assessing their real estate requirements in 2016. Coupled with the availability of ample space options in the market, rents for prime multi-user conventional industrial space are projected to dip by up to 2.0% in 2016.

However, rents for multi-user high specs premises could register some upside in 2016, as the new developments completing during the year are expected to be able to command higher rents. As such, for the whole of 2016, the average islandwide business park rent could appreciate by up to 3.5%, while rents for independent high specs premises could rise by up to 1.0%.

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Meanwhile, prices of prime conventional industrial properties could correct by up to 3.0% in 2016, given the ample choices in the market and prospective buyers expected selective and cautious stance. Some investors may also be more willing to seal the deal at a lower price.

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For instance, those who bought their industrial properties on or after 12 January 2013 and were subjected to a Sellers' Stamp Duty (SSD) should they resell within three years of purchase may now be more willing to transact after crossing the three-year mark.

Additionally, investors who could not secure a tenant after a prolonged period of time to help service their bank loans may also be more compelled to reduce their price expectations, especially in the current rising interest rate environment.

[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.*

[2] *Business 1 (B1): These are areas used or intended to be used mainly for clean industry, light industry, warehouse, public utilities and telecommunication uses and other public installations for which the relevant authority does not impose a nuisance buffer greater than 50 metres. Certain general industrial uses that are able to meet the nuisance buffer requirements of not more than 50 metres imposed by the relevant authority may be allowed in the B1 zones, subject to evaluation by the relevant authority and the competent authority.*

[3] *Business 2 (B2): These are areas used or intended to be used for clean industry, light industry, general industry, warehousing, 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.*

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