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Not as bad as it looks

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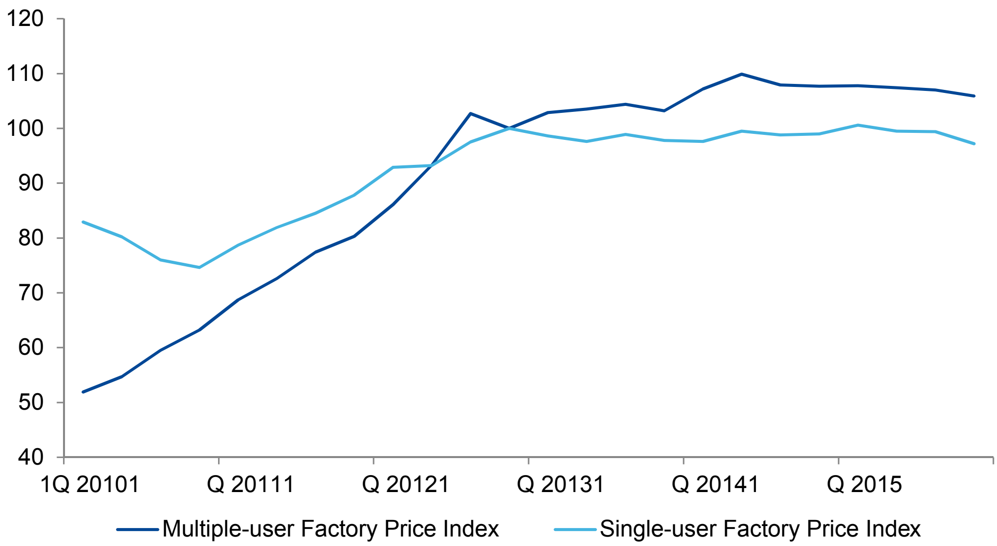
The headwinds experienced by the Singapore industrial property market gradually increased in 2015. However, they are still fairly mild compared to the market conditions in the market downturn of 2003 and 2009.

In 2015, the major causes of the marginal decline in prices and rents of industrial properties are the various government policies, including the tight labour restrictions and the lingering global macroeconomic uncertainties.

Industrial property prices weakened

Industrial property prices declined further in 4Q 2015. The decline in the industrial price index gathered pace in the last quarter of 2015 as it dropped 1.5% quarter-on-quarter (qoq), compared to the 0.3% decline in 3Q 2015. For the whole of 2015, the price index fell 1.7% year-on-year (yoy).

Chart 1: Multiple user vs Single user Factory Price Index



Source: SLP Research, URA

Capital values of multiple-user factory space contracted by 1.0% qoq while that of single-user factory space decreased by 2.2% qoq. This translated into a 1.7% and 1.8% year-on-year (yoy) fall in prices of multiple-user factory and single-user factory space respectively.

The rate at which the capital values of industrial space are declining is starting to increase gradually. This is in tandem with the current market sentiments shared between both industrialists and investors in view of the slower economic growth among Asian economies and the sluggish local manufacturing sector. However, the rate of price decline is still very gentle, typically measuring less than 3% per quarter.

The transaction volume of industrial properties in 2015 was 30% lower than the level seen last year, based on the number of sales caveats lodged for industrial properties. However, most of the contraction was concentrated between new sale and sub-sale transactions. Particularly, the number of reported new sale transactions decreased from 283 in 2014 to 63 in 2015, while that of reported sub-sale transactions slipped from 118 to 31 in 2015.

However, the decline in capital values of industrial space in 2015 is still very gentle as compared to the level observed during the previous financial crisis in 2008-2009. In particular, during the Global Financial Crisis, the price index fell for four consecutive quarters by a cumulative amount of 23.3%. Most notably, in 1Q 2009, the contraction slipped the most at 10.2% qoq, which was the highest rate of price decline recorded since the Asian Financial Crisis in 1997-1998.

As such, in retrospect, it is fair to conclude that the current downward trend in prices of industrial space is very mild and it is partly caused by government policies.

Table 1: Transaction Volume of Industrial Properties in 2014 and 2015

Type of transaction	2014	2015	%yoy
New sale	283	63	↓77.7%
Sub sale	118	31	↓73.7%
Resale	963	882	↓8.4%

Source: SLP Research, URA Realis
As of 23 February 2016

How different regions fared

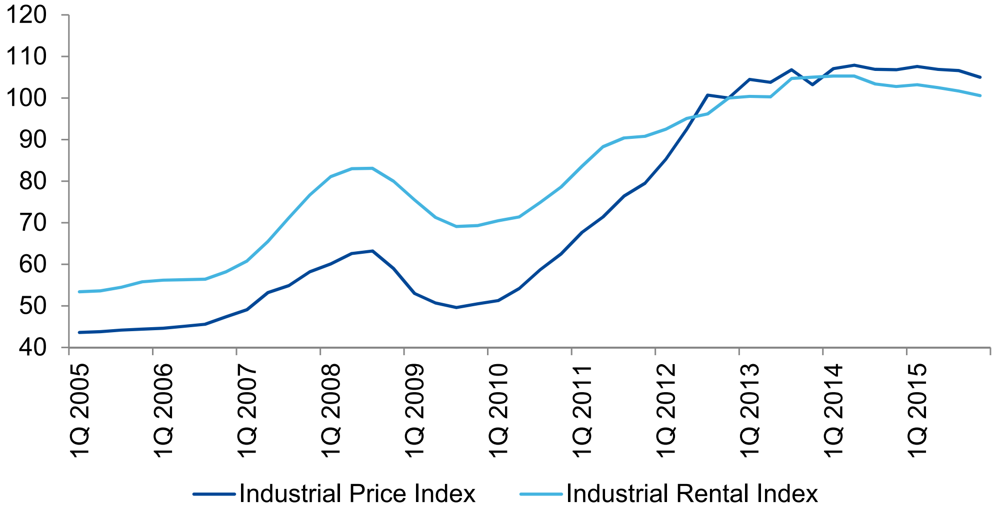
Among the industrial properties in the different planning regions, the capital values of industrial space in the West Region declined the most. The fourth quarter of last year marked the eighth consecutive quarter of decline of the multiple-user factory price index at 3.1% qoq, which translates to the cumulative contraction of 13.8% over the past two years.

The only exception of this broad-based downturn is the capital value of multiple-user factory space in the Central Region. The price index increased by 0.2% qoq. However, on an annual basis, it still slipped by 0.1% yoy.

Industrial property rentals slipped

Mirroring the decline in industrial capital values, the rental indices of all types of industrial space also decreased in 4Q 2015. Specifically, the rental index of warehouse space contracted the most at about 1.5% qoq, followed by a 1.2% qoq drop in the rental index of both multiple-user and single-user factory space.

Chart 2: Singapore Industrial property - Price and Rental Indices



Source: SLP Research, URA

Among different market localities, the rental index of Northeast Region continued to slip the most on the quarterly basis at 2.9%. This is partly due to the influx of completed stocks entering the market. The soft demand coupled with the large supply continuing to be added led to further downward pressure on rental rates.

Nevertheless, the current industrial property market is not as bad as it appears. Specifically, the rental index slipped for the three consecutive quarters in 2015 by a cumulative amount of 2.5%. During the previous crisis in 2008-2009, the rental index also dropped for four consecutive quarters. However, the total contraction was much more significant at 18.0%.

How low can prices of industrial space fall?

In view of the challenging business environment, many industrialists and investors have adopted the "wait-and-see" approach, betting that both the asking price and rent would decline further.

On the surface, taking a "wait-and-see" approach seems to make sense. After all, the investors are dealing with an array of uncertainties, namely the sluggish manufacturing sector in Singapore, economic headwinds in China and constant news reports that predict a long and dreadful period of economic slowdown in

Asia. As such, these investors are hoping on a further drop in capital values of industrial properties.

However, it is very unlikely that the prices of such real estate can fall to the previous low in 2009, when the Global Financial Crisis badly affected the Singapore economy and led to the sharp fall in prices of industrial space. This is primarily because the amount of construction costs and land costs incurred by developers of industrial space in 2015 has escalated substantially as compared to the previous level in 2009.

As construction costs account for a fairly large proportion of the project development costs, the developers will have to pass some of this increase onto buyers in the form of higher prices. This in turn also limits the extent to which the developers can lower the asking price to attract more market demand. Therefore, it is highly plausible that the current offer prices of industrial space are already close to the developers' break-even level and hence, investors shouldn't bet on further price drop.

Market Outlook

Structural headwinds are expected to weigh on the Singapore industrial property market this year. An estimated 19 million sqft of industrial space will be completed in 2016, which could potentially push the island-wide vacancy rate to above 10.5%. As a result, both the price and rental indices would face downwards pressure. However, the extent of the contraction in rental and capital values are likely to be much less than what happened in 2015 due to the rising costs incurred by developers and the absence of an economic recession. Hence, the price and rental indices are projected to fall by a minimal amount of 1-2% yoy.

The supply of new factory premises will moderate after 2016 with a more manageable 6.8 million sqft of space expected to be completed in 2017. As a result, the buyers' and tenants' market that would appear in 2016 may gradually disappear as the rental and capital values stabilize at a new equilibrium in the following year.