Real Estate Outlook

Singapore – Edition 2020

Patience is a virtue

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Cooperation key to transformation.

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As the city state enters middle age, there is a keen awareness that the coming years will not prove as easy to navigate. Transforming the economy will take a concerted effort from both government and businesses, with the next few years key in gauging progress. Patient investors can still access pockets of real estate opportunities.

Singapore

Signposts

- Industry Transformation Programme progress
- General Elections by April 2021
- Completion of infrastructure projects

Threats

- Goods & Services Tax hike by 2025
- Retail subsectors in City Hall / Marina Center
- Short land tenure across Industrial sector

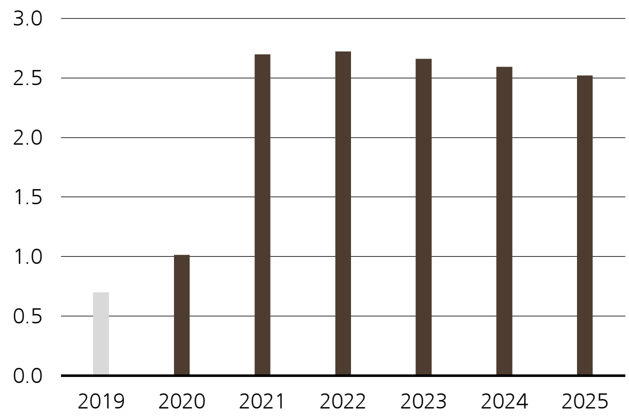
Opportunities

- Business parks and selected industrial segments
- Hotel sector to break out (after COVID-19 blip)
- Decentralization will create new options

Transformation calls for patience

It was not too long ago that the city-state marked its 50th year of independence, with much to celebrate amid the economic progress made within half a century. But as Singapore enters middle age, there is also a keen awareness that the coming years will not be as easy to navigate, with the low-hanging fruits already plucked and the country in advanced stages of growth.

Figure 1: GDP forecast
(Real, annual, %)



Source: Oxford Economics (as at 24 February 2020), UBS Asset Management, Real Estate & Private Markets (REPM), February 2020
Note: Data for the period 2020-2025 are forecasts.

2019 ended with GDP growth of 0.7% YoY[1], the weakest rate of growth since the GFC – except this time, there wasn't a major one-off trigger such as the meltdown of the financial sector; instead, it was a protracted trade war, the broader trend of rising trade barriers, and a period of synchronized stagnation in the global economy underpinned by a lack of demand drivers that are proving to be worrisome, given that these issues take longer to overcome. The services sector was fairly resilient, supported by the finance, insurance, and business services sectors, while the construction sector pulled ahead, buoyed by public sector infrastructure works.

Signposts we are watching out for

We are focused on the government's multi-sectoral, multi-year plan to restructure the economy, in a bid to ensure it remains ready and able to tackle the challenges of increased volatility. The next few years will be key in gauging the progress of Singapore's economic restructuring plans, encapsulated in the SGD 4.5 bn Industry Transformation Programme. This is a high-level initiative first introduced by the government in early 2016 to facilitate efforts to raise productivity and innovation levels across 23 industries that make up over 80% of the country's GDP.

Over the past few years, the Industry Transformation Maps (ITMs) started to take more shape and form, and while all 23 ITMs have been launched, the results are mixed. Sectors such as the financial industry have adapted better, but industries that comprise of more small and medium-sized enterprises have yet to make that leap from strategy to execution, especially when they remain bogged down by the perennial bugbears of high labor costs, skills shortages and foreign worker restrictions. Over the next five years, industry will continue to look to government for more clarity on policies and more understanding of and support for business needs, all of which are critical in enabling companies to automate, digitalize, upskill and regionalize.

The next five years will also see several major infrastructure projects, some of which were conceptualized decades ago, inch closer towards completion. Of these, the longest in the making is the Circle Line, the fourth of Singapore's mass rapid transit train lines and one which connects the three other rail lines to the city. Proposals for this rail line first began in the 1990s, with construction and the first operations taking place in the 2000s. With 30 stations now up and running and travel times between some parts of the island reduced by as much as half, the rail line will finally come full circle by 2025 when the loop will be closed with the completion of three new stations.

[1] Based on preliminary estimates

In addition, the sixth rail line in Singapore, the Thomson-East Coast Line, will also be progressively completed between 2020 to 2024, and work on the North-South Corridor, a 21.5km long route for vehicles and pedestrians, will also take place. All these are part of the Land Transport Authority's (LTA) long-term plan to improve connectivity across the island and reduce traveling times, with the ambitious aim of compressing 90% of peak period journeys to within 45 minutes by 2040.

In the medium term, greater connectivity would eventually unlock the economic potential of certain decentralized parts of the island. A case in point is Paya Lebar which has been rejuvenated in recent years thanks, largely, to the opening of the Circle Line. Equally importantly, this would also ease the strain on the country's infrastructure, particularly as the population has grown from 2 to 5.7 million in 50 years. What would be the hot-button issues that will require a policy response in the next five years? There would be no shortage of opinions about this as the country heads towards its next General Election (GE), which must take place before April 2021.

As it is, in November 2019, Prime Minister Lee Hsien Loong already called the upcoming GE a "high stakes" one, particularly as it comes at a time of leadership transition within the ruling People's Action Party and a growing trend of the erosion of trust in political leaders seen around the world. To complicate things, the COVID-19 virus started to spread in the region in early 2020, becoming the black swan event that is likely to weigh on a barely-recovering economy.

But an unintended effect is that this has now become a test for Singapore's fourth-generation (4G) leadership, according to political observers, and while it is still relatively early days, the Republic has so far received plaudits for its handling of the crisis, from implementing contact tracing to its upfront communication with the public. In this time of uncertainty, certain topics might be skirted for now, but bread-and-butter issues such as costs of living, job security and inequality will likely come to the fore again the closer the country draws to the GE.

Imminent threats

One of the clouds looming on the horizon had been the planned Goods & Services Tax (GST) hike, which was announced in early 2018. Given the COVID-19 outbreak, the government has decided to delay the implementation of the tax hike, but affirmed that it would still take place by 2025 in light of rising healthcare and other spending needs. The recent experiences in Japan with its consumption tax hikes in 2014 and 2019 have shown that such a move tends to be followed by a temporary contraction in GDP.

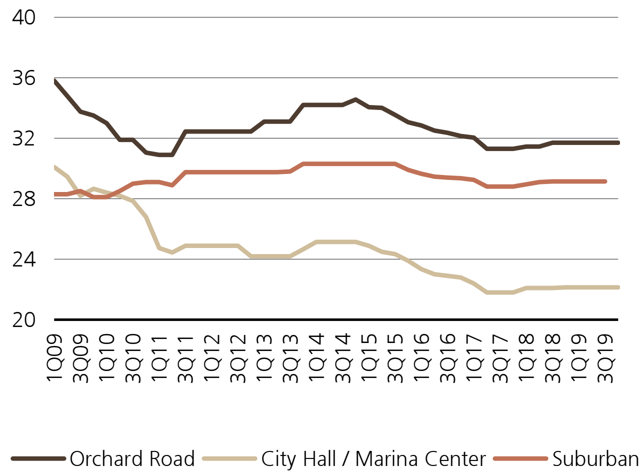
While Singapore's experience has not always been the same (GDP continued to expand after its last GST hike in July 2007) nor is its economy directly comparable with that of Japan, there are legitimate concerns that a GST increase would have a negative impact on household spending and the economy, particularly as growth is now slower and the global environment uncertain. In the real estate space, the sector most likely to be affected would be retail. Some upside could come from the broadening of the tax base to include online purchases and digital services, although this is unlikely to have a major slowing effect on the structural trend of rising e-commerce.

By and large, the Singapore retail sector appears to have weathered the worst of the global retail downturn. And while pipeline supply is tapering off, it might be too early to deem that the whole sector is out of the woods – landlords may have been implementing experiential elements to increase footfall and dwell-time but there is limited evidence to show that this has translated into sales.

The road to recovery could thus be a long one, with most caution reserved for shopping centers in the Downtown Core or City Hall/Marina Center area. Of the three broad areas that the retail market is categorized into – the prime Orchard area, City Hall/Marina Center and the Suburban shopping malls – it is the City Hall/Marina Center area which seems to lack the draw of the prime shopping belt and the residential catchment that supports the suburban malls.

This is evident in retail rent performance – average rents in City Hall/Marina Center used to be higher than that of the suburban area but that relationship has been overturned since early 2010, and while Suburban rents have largely remained range-bound, that for City Hall/Marina Center have continued falling and is now roughly 12% below its previous peak in 4Q14, the largest correction among the three sub-markets (Figure 2).

Figure 2: Singapore average shopping center rents
(SGD per sq ft per month)



Source: CBRE ERIX, UBS Asset Management, Real Estate & Private Markets (REPM), March 2020

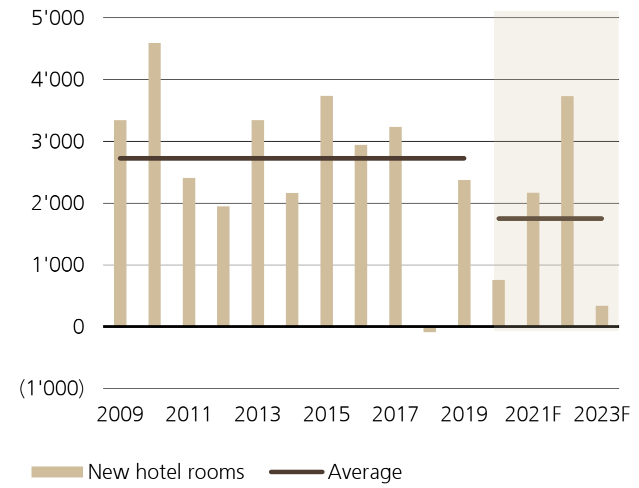
The final risk to highlight is that of the short land tenures in the industrial property market. This has been an issue for the investment market ever since authorities halved the maximum tenure for industrial sites under its land sales programme from 60 to 30 years in mid-2012. For eight years now, land sale sites have had either 20 or 30-year leases, and prime industrial properties with freehold or land tenures of 60 years and above are scarce. This effectively deters investors from getting into the market, particularly amid the other challenges facing industrial property. Among these is tepid demand from industrialists in recent quarters given the weak global trade picture, with many firms using the current period to consolidate operations.

From a structural perspective, Singapore's manufacturing sector is changing – though it remains a core pillar in the country's economic strategy, it faces a cost disadvantage and thus has to move up the value chain, but this is a massive challenge with no easy executional pathways. The resurgence in new completions in 2020 and again in 2022 after only recently coming out of a multi-year supply glut further compounds the risks in the sector.

Opportunities in the next five years

Despite the challenges, we think that pockets of strength exist amidst a vastly disparate industrial landscape – in particular, business parks and high-tech industrial buildings. Business park space designed with flexible layouts, ancillary amenities, and good connectivity are still well-occupied and demand remains resilient. Singapore has also primed itself well to be in a strong position to serve high-value added manufacturing including the bio-medical, pharmaceuticals, aerospace and transport engineering sectors, and growth in these industries is expected to support demand for good quality factory space. Investors might find themselves keen to play these themes, but the challenge is finding good quality assets which also have a long-enough land tenure at a reasonable enough price.

Figure 3: Singapore hotel supply
(Number of rooms)



Source: Singapore Tourism Board, URA, UBS Asset Management, Real Estate & Private Markets (REPM), March 2020

Despite the near-term threat posed by COVID-19, we think that the long-term structural picture is still supportive of the hotel sector in Singapore. Investors with a higher risk appetite might benefit from the upside of a favorable demand-supply situation. Tourist arrivals in Singapore have put on a strong showing over the past 10 years, and while there are ebbs and flows as is expected in the hospitality sector, the trend is undeniably upward.

Part of this is no doubt attributed to the rise of China as an economic superpower and the resultant growth of the middle class, but that highlights the opportunities that come about when a destination country manages to capture a period of rapid growth in a source market – which is exactly the strategy that Singapore is seeking to replicate and adapt for the growing middle class in Southeast Asia. In addition, the Singapore Tourism Board (STB) is also actively working on efforts to cultivate the appeal of the city-state as an attractive tourist destination.

Between 2009 and 2019, tourist arrivals grew at a CAGR of 7.0% while supply of hotel rooms have barely kept up with a CAGR of 5.0% over the same period. Occupancy rates are thus well-supported, with the standard average occupancy rate climbing to 87.1% in 2019, higher than the 10-year average of 83.8% according to STB data, and revenue per available room (RevPAR) was similarly above the historical average.

Going forward, pipeline supply of hotels remains limited with the stock of hotel rooms expected to grow at a CAGR of 2.4% between 2019 and 2023, half the levels of the past 10 years (Figure 3). Barring the expected short-term blip from COVID-19, this should further support the hotel market when visitor arrivals start to recover in the medium term.

On the back of the growth of the transport infrastructure network, we think this will benefit decentralization in the medium-term. Areas like the Jurong Lake District, which has already been positioned as Singapore's second CBD, will see these development plans inch closer to fruition with improved connectivity supporting 'work, live and play' formats. As part of the government's long-term land planning strategies, otherwise unfamiliar areas such as the Punggol Digital District and Paya Lebar are undergoing transformation that will see previously-underdeveloped areas become more vibrant and current.

Will they eventually become established enough to draw commercial occupiers away from well-established areas like the CBD? Decentralized rent levels are generally competitive and asset quality is on par or even better than many aging Grade A and B builing in the CBD. For many, that is still too far-reaching an idea, but we think the possibility is that these decentralized areas could eventually become decent core plus options for investors, bearing in mind that the compact size of Singapore renders most locations very near by time proximity.

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