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Strata-titled units rising in popularity

TAN BOON LEONG explains how high yields, improved designs and other factors have drawn investors to such industrial properties

PROPERTY investors are channelling more of their funds into alternative asset classes, one of which is the industrial sector. Especially for non-traditional industrial property investors, thinning profit margins from residential developments as a result of high prices and government intervention have led to the switch. New industrial projects offering higher gross rental yields at lower capital outlay have thus become a welcome investment option.

Because of strong demand for strata industrial properties, developers have shown keen interest in building industrial properties. They have been competing for industrial sites, putting in strong bids for some of the recent Government Land Sales (GLS) tenders.

For instance, land bids received for three 30-year industrial sites located next to one other along Pioneer Road North leapt by more than 250 per cent over a 19-month period. The first site sold in December 2009 attracted a top bid of $48 per square foot per plot ratio (psf ppr) and the second plot transacted 12 months later fetched $87 psf ppr. A third site was sold in July this year for $176 psf ppr. The aggressive bids demonstrated developers' confidence in the industrial market in Singapore.

Competition for GLS sites has also gotten tougher with more contenders in the fray. Non-traditional industrial developers have jumped onto the bandwagon to take part in industrial land bidding exercises.

The stellar performance of industrial strata-titled property seen after the Lehman crisis in late 2008 therefore begs two questions: What has been the driving force for the strong performance? Do strata-titled industrial properties make good investments?

Understanding industrial properties

Industrial properties in Singapore are under Business 1 (B1) or Business 2 (B2) zoning. Developments classified under B1 use are meant for light and clean trades which are non-polluting. Such developments are usually found within housing estates. Polluting and general trades are kept in industrial developments zoned for B2 uses and they are located in suburban areas.

The tenure for industrial strata-titled developments can be either freehold or leasehold. A majority of strata-titled developments are built on GLS sites, with tenure ranging from 30 to 60 years.

Similar to residential developments, an industrial development can be divided into many units with individual title. These strata-titled industrial properties are either flatted or terrace developments, with the typical unit size ranging from 1,000 sq ft to 2,000 sq ft for the former, and 5,000 sq ft to 30,000 sq ft for the latter.

Drivers behind the strong performance

- **Shift in demand from residential properties to industrial properties**

The allure of strata-titled industrial properties was greatly enhanced when stricter government measures were implemented to cool the residential property market. For instance, regardless of the number of industrial properties owned, buyers need to pay only a 20 per cent down payment for each property they purchase, provided they are for their own use. This is much lower than the 40 per cent down payment required for residential property purchasers if they have one or more outstanding housing loans at the time of the new home purchase.

Also, unlike residential property purchasers, industrial property purchasers are not subjected to a high stamp duty if they decide to dispose of their property within one year from the date of purchase.

- **Limited strata stock in other asset classes**

Unlike other property types such as office and retail which have limited stock for strata sale, there has been a good line-up of strata-titled industrial properties launched in the market. Some of the recent launches include North Spring Bizhub, CT Hub, **9@Tagore**, Oxley Bizhub and **T5@Tampines**, among others.

- **Improved design and specifications**

Property purchasers have become more sophisticated and they look for better products and specifications. To cater to purchasers' expectations and to differentiate products from competitors', industrial developers are embarking on the creative route to offer better quality industrial buildings in terms of aesthetics, functionality and specifications.

Industrial strata-titled developments have undergone a great transformation over the last three years. New projects now boast of cutting-edge architectural designs and have amenities such as ramps which allow vehicular access to all levels - some are even designed for 40-foot containers to park right next to the unit. Features not commonly found in older industrial developments such as swimming pools, gymnasiums, landscaped gardens and hotel-like lobbies can be found in newer developments.

- **Spill-over demand from office**

The industrial property market has continued to benefit from spill-over demand from office users. Qualifying office users in sectors such as software design and information technology, and financial institutions with backend operations, are taking up cheaper industrial premises to seek refuge from high office rents. This has been a strong driving force in raising end-user demand in the market.

- **Low interest rates**

The current all-time-low SOR (swap offer rate) is highly favourable for genuine buyers. For investors, this translates to either an opportunity to afford larger premises or a lower mortgage payment. For instance, a buyer taking an 80 per cent loan on $500,000 for a 1,500 sq ft unit in North Spring Bizhub would need to make a monthly mortgage payment of $1,400 - based on a 30-year loan with a 1.68 per cent interest per annum. This sum, compared to the latest bid monthly rent of $4,200 for a 1,819 sq ft unit in YS-One (an industrial development next to North Spring Bizhub), has made it more attractive for one to buy a unit than to rent one in the long term.

- **Divestment of JTC flatted factories**

In July, JTC said that it will be divesting its high-rise ready built factories to the private sector to promote competitiveness and vibrancy in the industrial property market. As a result, existing tenants in these premises will no longer enjoy rental rates which are up to 20 per cent below market rate, especially if the property they are occupying is spun off into a real estate investment trust. Instead of paying a higher rent, some tenants are now finding it more worthwhile to purchase their own premises.

Good investments

Many investors are attracted to the lower equity needed for industrial properties. The availability of smaller strata-titled industrial units of about 1,000 sq ft to 1,500 sq ft has appealed to a wider range of investors as they are much more affordable compared to residential properties.

For instance, units in a 60-year leasehold industrial property located within a matured industrial location such as Paya Lebar, Ubi and Kallang are currently transacting at about $650 psf to $820 psf. The absolute price for a typical unit is in the range of $650,000 to $1.23 million. Meanwhile, similar units in suburban locations such as Yishun and Woodlands are transacting in the region of about $280 psf to $380 psf. The total price for a typical unit would range from $280,000 to $570,000.

As for buyers who wish to purchase more than one industrial property for their businesses, they are not subject to a higher down payment policy.

The yield generated by industrial leasehold properties is also more attractive than that for other asset classes. Currently, the average yield for 30-year or 60-year leasehold industrial properties ranges from 5 per cent for those located in matured industrial estates to 9 per cent for those in suburban areas.

Downsides

Just as for any type of investment, one should have a good understanding of the product and the market, and should be aware of the downsides before diving in. Some pointers to note when buying an industrial property:

- Unlike buying a residential property, an industrial property buyer has to factor in a 7 per cent Goods and Services Tax on the purchase price. This is because sellers are usually developers which are GST-registered companies.

- Similar to buying commercial properties, the use of CPF money is not allowed for the purchase of industrial properties.

- For owner-occupiers, the Loan-to-Value (LTV) limit is up to 80 per cent of the purchase price. For investors, the LTV is much lower at 60 to 70 per cent.

- When calculating the projected yield, one should consider the possibility of an increase in interest rates in the near future. Initial interest rates are subject to a first-two-year lock-in period.

- Strata-titled industrial properties with a 30-year tenure might be more difficult to dispose of in the resale market, as compared to those with a 60-year tenure.

Conclusion

Current uncertainties in the local stock market and expected higher inflation would have minimum impact on buying sentiment as property investment is generally viewed as a safer investment alternative and also as a hedge against inflation.

The industrial market is expected to see continued interest from investors, given that the fundamentals are generally healthy and improving. This asset class would also continue to benefit from funds diverted from the residential sector, which is facing increasing risks of a supply glut and government intervention.

Moreover, given that interest rates are expected to stay low for another two years coupled with rising inflation, industrial properties would greatly appeal to genuine investors, as it offers the highest yield compared to other property types.

However, the intense competition among developers for GLS industrial sites would translate to a higher break-even cost and units in new developments are likely to be priced higher. Moreover, new amenities would also contribute to higher costs of developing these new developments.

Sellers of existing or older industrial properties, especially those situated in the same vicinity as some of the new developments, would then raise their asking prices. The industrial market would likely undergo another round of price increment, but it would be limited by economic issues such as the US debt crisis, eurozone sovereign debt crisis and the tightening of China's monetary policy.

The outlook for the industrial property market is expected to remain stable with prices and rental growth trending at 5 to 10 per cent for the rest of the year.

Given the strong demand drivers in the market and the attractive returns that industrial properties can offer, strata-titled industrial properties are expected to remain a top choice for investors in the next few years.

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