

Briefing Office sector

May 2015



Image: Paya Lebar Square, Paya Lebar Road

SUMMARY

Rental growth has started to taper off in Q1/2015.

■ Amid economic and business uncertainties, companies are focusing on cost reduction and the office user market is now dominated by flight-to-quality or a consolidation to smaller premises rather than business expansion.

■ In the face of competition from newly-completed and better-quality space in both the CBD and decentralised locations, landlords of older CBD buildings are trying to retain existing tenants to avoid falling occupancy.

■ The overall vacancy rate for the Savills basket of CBD Grade A office buildings decreased slightly in

Q1/2015, falling 0.1 of a percentage point (ppt) to 3.6%, while the vacant stock stood at 0.96 million sq ft at the end of March.

■ In Q1/2015, the average monthly rent of CBD Grade A offices edged up 0.4% quarter-on-quarter (QoQ) to S\$9.92 per sq ft, while capital values of CBD Grade A offices stabilised at S\$2,850 per sq ft.

■ Office tenants in the financial sector are acting sooner than expected to return surplus space left over from business lines which they have either exited from or reduced in scope. This will increase the shadow space which, if no new market entrant or industry

comes to the fore, may add to greater rental pressures soon, beginning as early as the end of this year.

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“The return of shadow space by financial institutions has come sooner than expected, upsetting the ability of the market to digest the space in such a short time and therefore compelling us to revise our rental forecast down year-on-year.”

Alan Cheong, Savills Research

→ Market commentary

The Ministry of Trade and Industry's advance estimates showed that Singapore's economy grew at a steady pace of 2.1% year-on-year (YoY) in the first quarter of 2015, unchanged from the previous quarter. The growth was mainly due to an expansion in the construction sector and the services producing industries, which offset a contraction in manufacturing.

From the Urban Redevelopment Authority's Realis records, the office leasing market remained relatively stable with a total of 1,160 leases signed in the three-month period from January to March. This represented a dip of 2.1% YoY from the 1,185 recorded in Q1/2014, but a rise of 5.0% from the 1,105 a quarter ago. In terms of size, most of the deals (1,001 or 86.3%) were for premises of 5,000 sq ft or less.

Owing to the slow pace of global economic recovery and transitional friction brought on by the domestic economic restructuring, business prospects remained modest as in the previous quarters, with more companies focusing on cost reduction. Consequently, the office leasing market continued to be dominated by flight-to-quality or a consolidation to smaller premises rather than business expansion. In the face of competition from newly-completed and better-quality space in both the CBD and decentralised locations, such as Jurong East and one-north, landlords of older CBD buildings are trying their

best to retain existing tenants to avoid a fall in the occupancy rates of their respective buildings.

After CapitaGreen at Market Street which received its temporary occupancy permit (TOP) in Q4 last year, another premier office development, South Beach Tower at Beach Road was completed at the start of 2015. The limited new supply in the CBD pre-2017 has benefitted both CapitaGreen and South Beach Tower which saw good take-up from tenants seeking quality office space with more efficient floor plates. Besides tenants from the financial, insurance, professional services and energy sectors, companies from the technology and social media sectors also showed their strong appetite for such premium space. For example, Facebook became the anchor tenant at South Beach, taking up 70,000 sq ft of space in the 34-storey office tower. At CapitaGreen, Twitter has signed up 22,000 sq ft and Apple has leased 35,000 sq ft with options to take up more space.

Sales activity, however, was lacklustre in Q1/2015. Besides the Chinese New Year period, high capital values with compressed yields, a recent spike in interest rates and the lack of new launches of strata office projects for sale are the reasons behind the slow market. There were only three big-ticket office transactions in the reviewed quarter – AXA Tower (S\$1.17 billion), the 41st level at Suntec City Tower One (S\$14.5 million) and the 8th level at Samsung Hub (S\$42.6 million).

Vacancy

The overall vacancy rate of Savills basket of CBD Grade A office buildings decreased slightly in Q1/2015, falling 0.1 of a ppt to 3.6%, while the vacant stock stood at 0.96 million sq ft as at end of March.

The increase in vacancy was only seen in two sub-markets – Tanjong Pagar and Orchard Road – where it increased by 2.9 ppts and 1.1 ppts respectively, as the secondary stock vacated in some buildings boosted vacancy rates. In the Tanjong Pagar area for example, Aon moved from Mapletree Anson to SGX Centre 1 while Shimizu relocated from 78 Shenton Way Tower 1 to Aperia at Kallang.

Vacancy rates in the other micro-markets, including Marina Bay, Raffles Place, Shenton Way and Beach Road, recorded marginal declines between 0.3 of a ppt and 1.1 ppts from the previous quarter, while City Hall's vacancy rate has remained unchanged at 1.9% for two consecutive quarters.

By grade, the vacancy rate of the A Grade segment inched up 0.4 of a ppt to 3.5% by the end of Q1/2015. In contrast, the vacancy levels of the AAA and AA Grade segments dipped by 0.4% and 0.3% respectively.

Rental and capital values

The average monthly rents of CBD Grade A offices in Savills basket continued its upward trend, edging up 0.4% from S\$9.88 per sq ft in Q4/2014 to S\$9.92 per sq ft in Q1/2015.

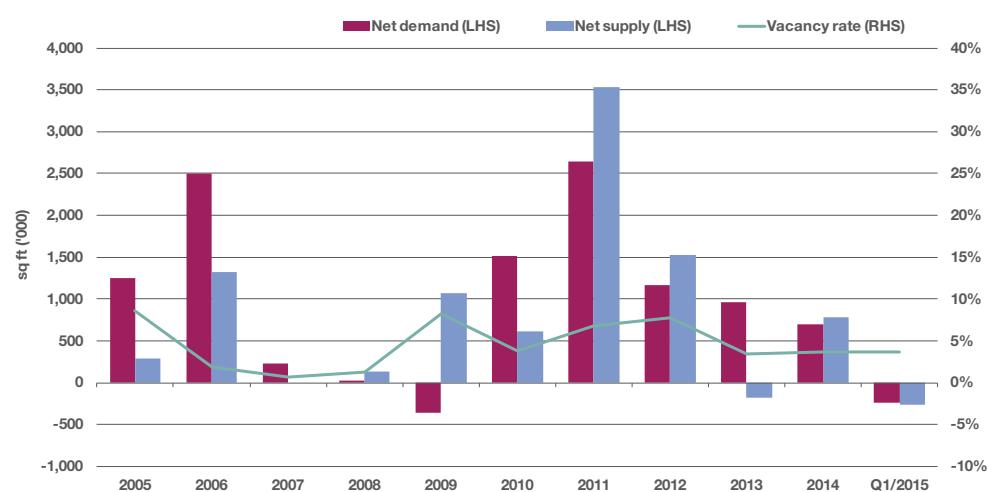
Nonetheless, after a strong 14.3% growth for the whole of last year, rental growth has started to taper off due to tenants' resistance to the continued upswing in asking rents, uncertainties about the global economy and influx of substantial amount of secondary and shadow space.

On a quarterly basis, rents in Marina Bay gained 0.7% to S\$13.75 per sq ft, followed by Raffles Place which registered a slight growth of 0.5% to S\$10.34 per sq ft, while rents in other sub-markets remained unchanged from last quarter.

Capital values of CBD Grade A offices in the reviewed quarter stabilised at S\$2,850 per sq ft. The most notable office investment deal was BlackRock's sale of AXA Tower, a 50-storey office tower with a balance lease term of about 66.5 years. A consortium led by Perennial Real

GRAPH 1

Net demand, net supply and vacancy rate of CBD Grade A offices, 2005–Q1/2015



Source: Savills Research & Consultancy

→ Estate Holdings Limited paid S\$1.17 billion – S\$1,735 per sq ft of net lettable area. On the strata office front, the 41st level at Suntec City Tower One was transacted at S\$14.5 million (S\$3,009 per sq ft), while the 8th level at Samsung Hub was sold for S\$42.6 million (S\$3,250 per sq ft).

Outlook

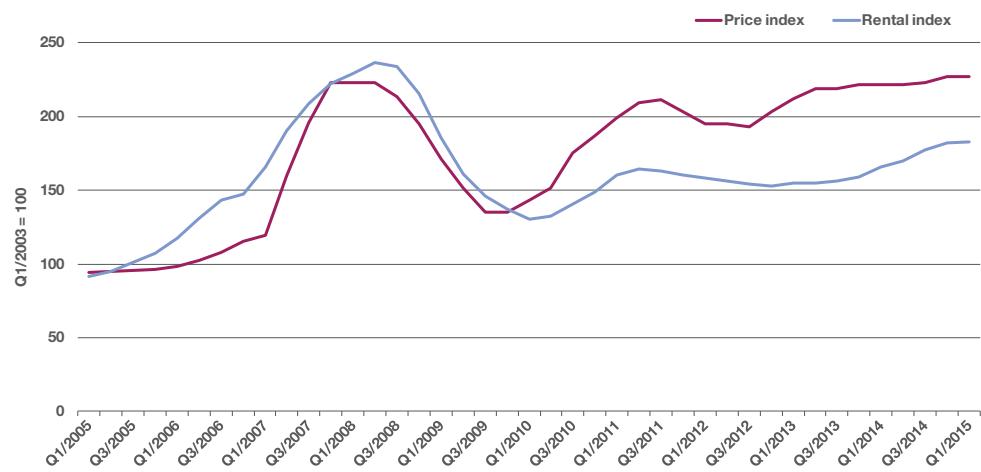
Events that have transpired at the start of this year have a strong bearing on our outlook for the CBD Grade A office market. The decisions of quite a number of financial institutions to scale back or exit risk-taking business lines came much earlier than expected. More unexpected was the extent of the reduction in their spatial requirements. Some have begun the process of returning the space to the market and these will, over the course of the next 24 months, add to the increasing amount of shadow space coming onto the market from existing Grade AAA offices. Taking the new supply entering the market, together with other residual stock from existing Grade A offices as well as secondary space vacated by tenant relocations, the CBD Grade A office market may be looking at around 5.37 million sq ft in total from Q2/2015 until the end of 2017. The confluence of decisions by these financial institutions has made it much more challenging for the office market to continue its upward momentum. Consequently, we are compelled to revisit our earlier forecast of office rents and make a call that despite rents having risen marginally in Q1/2015, effective office rents are now likely to soften by 3% YoY in the second half of 2015. ■

TABLE 1
Micro-market Grade A office rents and vacancy rates, Q1/2015

| Location | Rent (S\$ per sq ft per month) | Vacancy rate (%) |
|------------------------|-----------------------------------|------------------|
| Marina Bay | 13.75 | 5.4 |
| Raffles Place | 10.34 | 2.5 |
| Shenton Way | 8.26 | 2.0 |
| Tanjong Pagar | 8.30 | 9.8 |
| City Hall | 9.75 | 1.9 |
| Orchard Road | 10.08 | 3.0 |
| Beach Road/Middle Road | 7.73 | 3.2 |

Source: Savills Research & Consultancy

GRAPH 2
Price and rental indices of CBD Grade A offices, Q1/2005–Q1/2015



Source: Savills Research & Consultancy

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