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Savills World Research
Singapore

Briefing
Office sector

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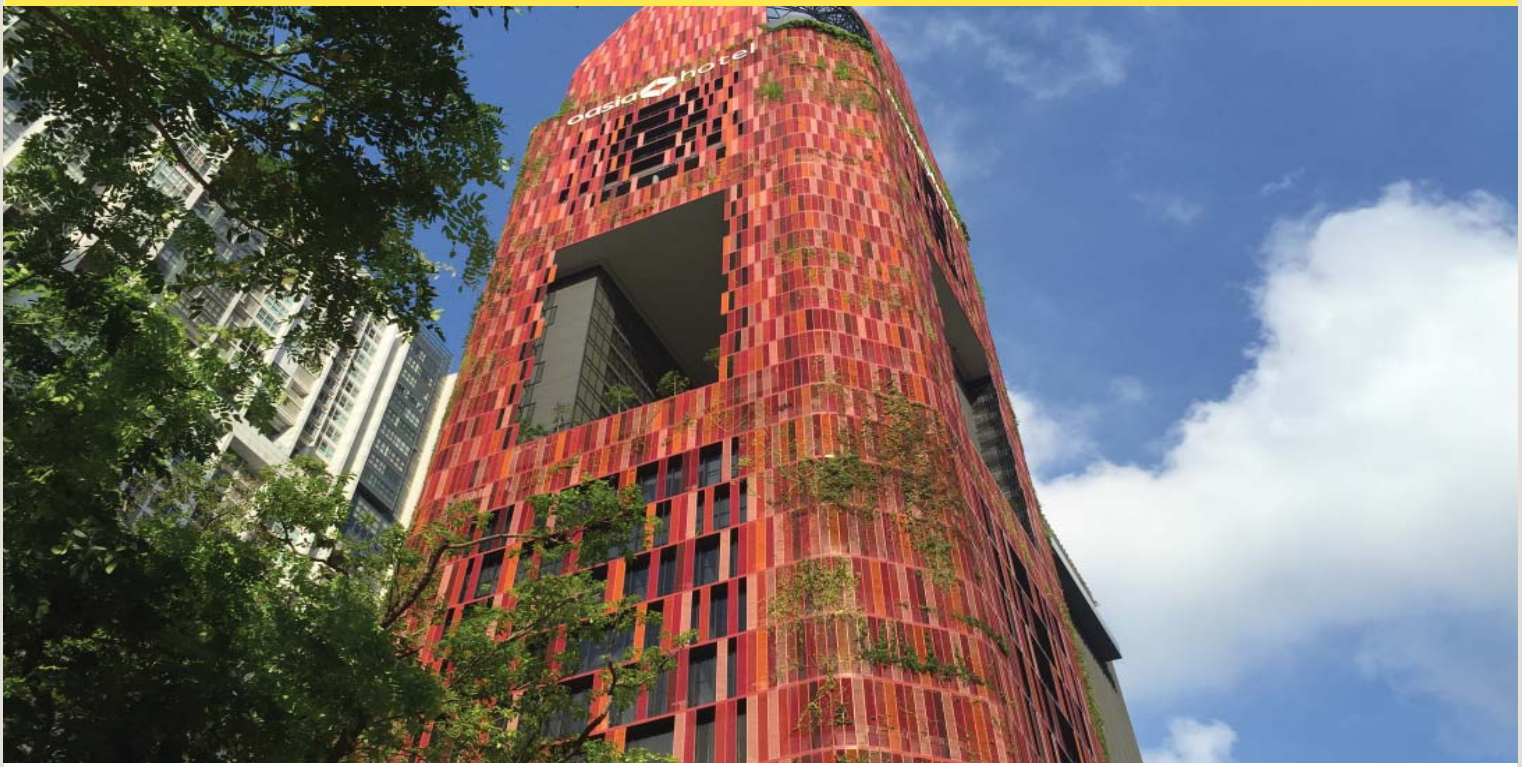

Image: PS100/Oasia Hotel Downtown, Peck Seah Street

SUMMARY

CBD Grade A rents have slowed for a fourth consecutive quarter.

- The twin effects of slow economic growth and continuing corporate restructuring affected the performance of the office leasing market, with island-wide transaction volumes further declining in Q1/2016.

- The pre-commitment level in the upcoming Guoco Tower at Tanjong Pagar has increased to 18%. Newly-signed tenants include AccorHotels, K Line, Bunge and ManpowerGroup.

- The average vacancy rate of CBD Grade A offices continued to fall, dipping 0.4 of a percentage point (ppt) to 4.4% as at the end of Q1/2016.

- Q1's average monthly rent of CBD Grade A offices corrected 7.1% to S$9.21 per sq ft from its recent peak of S$9.92 per sq ft in Q1/2015.

- Although the level of sales activity for office properties continued to be weighed down by a combination of factors, prices have remained firm. If prices remain supported, it may create the baseline for higher benchmarks to be set across the spectrum of deal sizes in the subsequent quarters of the year.

- In the short to medium term, demand for new offices is expected to remain weak. Existing landlords will face stiff competition, not only from those soon-to-be completed office and business park/high-tech buildings, but also from the growing amount of shadow space given up by existing tenants.

"The fear of falling rents may be lifted if a large amount of capital, looking to invest for the long haul, takes a risk and returns momentum to the investment market."
Alan Cheong, Savills Research

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Market commentary

According to the preliminary figures released in mid-April, Singapore's gross domestic product in the first quarter of 2016 registered a growth of just 1.8% on an annualised basis. Amid softer global economic conditions, business sentiment in Singapore has fallen in the last few quarters. Coupled with on-going business restructuring, after 5,370 were retrenched in Q4/2015, companies laid off another 4,600 employees in Q1/2016. Although unemployment remained low at 1.9% for these two consecutive quarters, the numbers of redundancies are the two highest since Q3/2009, after the global financial crisis.

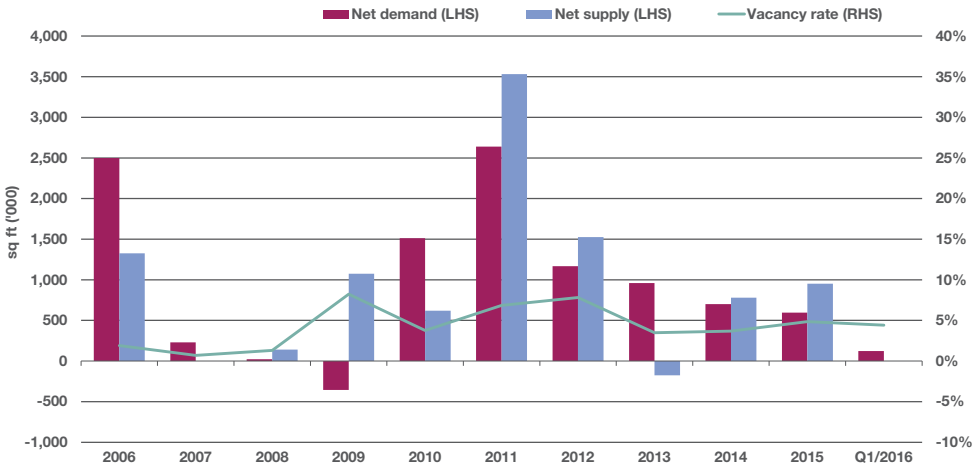
Owing to the slow economic growth and continuing corporate restructuring, the office leasing market remained lacklustre, with island-wide transaction volumes declining further to 1,019[1] from January to March 2016. This makes Q1/2016 the quarter with lowest amount of leasing volume since Q1/2012. The most notable deals in the quarter were in the upcoming Guoco Tower at Tanjong Pagar, in which the pre-commitment level has increased to 18%. The newly-signed tenants were AccorHotels (21,000 sq ft), Japanese transportation group K Line (20,000 sq ft), global agribusiness and food company Bunge and human resource consulting firm ManpowerGroup. These companies will relocate from their existing premises in Raffles City Tower, AXA Tower, 77 Robinson Road and International Plaza, respectively.

1 Source: Real Estate Information System (REALIS)

Sales activity for office properties continued to be weighed down by a combination of uncertainty in the global economy, volatility of financial markets, a wide bid-ask spread and concerns about the supply of office space in the pipeline. The biggest sale in the quarter was Alpha Investment Partners' acquisition of a 50% stake in 78 Shenton Way for S$301.5 million. In addition, there were some notable strata-office transactions inked in the quarter, including 27,351 sq ft of office space on the high floors of SBF Center (S$85.5 million), the 30th floor of Suntec Tower 2 (S$29.0 million) and the 20th floor of Prudential Tower (S$33.1 million).

GRAPH 1

Net demand, net supply and vacancy rate of CBD Grade A offices, 2006–Q1/2016



Source: Savills Research & Consultancy

GRAPH 2

Price and rental indices of CBD Grade A offices, Q1/2006–Q1/2016

Source: Savills Research & Consultancy

Demand, supply and vacancy

The average vacancy rate of CBD Grade A offices improved 0.4 of a ppt to 4.4% as at the end of Q1/2016. Arising from a net take-up of about 122,500 sq ft, and in the absence of new supply during the three-month period from January to March, vacancy levels fell.

To some degree, office tenants' flight-to-quality has helped to ease the vacancy rate in the Marina Bay and Raffles Place areas which generally have better quality office space with softening rents. Their vacancy rates slipped to 5.4% in Marina Bay and 3.4% in Raffles Place by the end of Q1.

On the other hand, due to existing tenants' relocation and demand contraction, sub-markets outside the core CBD, including Shenton Way, Tanjong Pagar, City Hall and Orchard Road, suffered from higher vacated stock, with vacancy rates inching up from 0.4 to 0.9 of a ppt quarter-on-quarter (QoQ). However, occupancy rates in most of these areas still remained above 95.0%.

TABLE 1

Micro-market Grade A office rents and vacancy rates, Q1/2016

Location	Monthly rent (S$ per sq ft per month)	Vacancy rate (%)
Marina Bay	11.77	5.4
Raffles Place	9.51	3.2
Shenton Way	8.08	4.4
Tanjong Pagar	8.04	8.1
City Hall	9.35	4.5
Orchard Road	9.29	3.1
Beach Road/Middle Road	7.56	4.6

Source: Savills Research & Consultancy

Rental and capital values

According to Savills basket, by the first quarter of 2016, CBD Grade A office rent had posted its fourth straight quarterly decline. From its recent peak of S$9.92 per sq ft in Q1/2015, the average monthly rent has corrected 7.1% to S$9.21 per sq ft. Rents in the Marina Bay sub-market continued to lead the quarterly drop by 2.6%, followed by the Raffles Place, Orchard Road and City Hall market segments, which has eased by 1.8%, 1.2% and 0.5% QoQ respectively. The average rents of Grade A offices in Shenton Way, Tanjong Pagar and Beach Road remained unchanged.

Price wise, for Q1/2016, the Savills basket of CBD Grade A office buildings stayed flat at S$2,723 per sq ft. Although the quarter in review saw muted transactions of office properties, with a mere S$491.4 million of investment sales going through, there were no clear signs of softness insofar as prices go. For example, the 27,351-sq ft office space at SBF Center was sold at S$3,125 per sq ft, while the transaction of Prudential Tower's 20th floor was recorded at S$2,800 per sq ft. Both are in the high end of the two buildings' transaction history.

OUTLOOK

The prospects for the market

2016 will remain a challenging year for the local economy. In its latest Macroeconomic Review released in April, the Monetary Authority of Singapore (MAS) confirmed that negative business sentiment has become more pervasive and unemployment is expected to rise this year. Therefore, in the short to medium term, demand for new offices is expected to remain weak. Existing landlords will face stiff competition, not only from those soon-to-be completed office and business park/high-tech buildings, but also from the growing amount of shadow space given up by existing tenants, particularly in the financial, energy and chemical industries. In view of that, Grade A office rental decline is likely to accelerate towards the end of 2016. Although investment sales volumes were low, the fact that prices remained firm hints of the strong holding power of sellers. With high net worth individuals and institutions continuing to build up their largesse of capital in order to invest for the long term, the market should improve. These investors are in for the long haul and are more forgiving towards the short term where rents and therefore yields are expected to fall. On top of that, with many developed economies sporting negative interest rates, inbound funds from these countries may perk up investment sales of office properties in Singapore.

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