MARKET IN MINUTES
Savills Research

Office

savills

Covid-19 has started to take its toll

The office leasing market remained quiet in the first three months from January to March.

- Not only has the Covid-19 outbreak dashed all hopes of a recovery in the global economy, it has also caused significant disruption to companies' operations and slowed their decision-making process to a crawl.
- A contraction in investment activity for transactions above S$10 million (including) was another feature of the office sector in Q1.
- For the Savills basket of CBD Grade A offices, at the end of March 2020, the overall vacancy rate edged down a surprisingly modest 0.1 of a percentage point (ppt) quarter-on-quarter (QoQ) to 4.3%.
- Net take-up of about 28,000 sq ft of CBD Grade A office space was recorded in the quarter, a significant drop compared with the previous few quarters.
- Over Q1/2020, average monthly rents of CBD Grade A offices tracked by Savills recorded a drop after having remained flat for two consecutive quarters, slipping a marginal 0.9% QoQ to S$10.00 per sq ft.
- Grade A CBD office rents are expected to fall by 10% year-on-year (YoY) in 2020. Looking to 2021, if the global economy makes a rapid recovery in late-2020, a 5% upside is possible. But if the global response to the pandemic is poor, another 10% decline cannot be discounted.

"Post pandemic, while the world is trying to find a new equilibrium, the office market is faced with great uncertainties."

ALAN CHEONG, SAVILLS RESEARCH

Savills team

Please contact us for further information

SINGAPORE

Marcus Loo
CEO, Singapore
+65 6415 3893
marcus.loo@savills.com.sg

Ashley Swan
Executive Director
Commercial
+65 6415 3872
ashley.swan@savills.com.sg

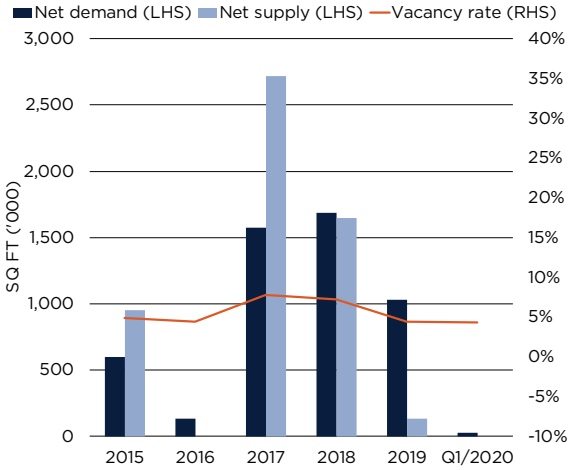
RESEARCH

Alan Cheong
Executive Director
Singapore
+65 6415 3641
alan.cheong@savills.com.sg

Simon Smith
Senior Director
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk

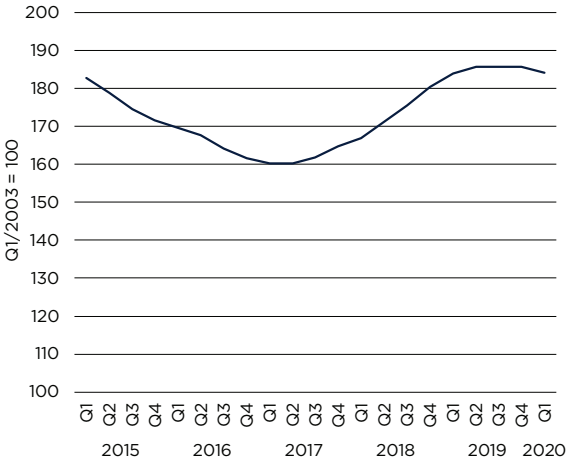
MCI (P) No. 018/10/2019
Company Reg No. 198703410D

GRAPH 1: Net Demand, Net Supply and Vacancy Rate of CBD Grade A Offices, 2015 to Q1/2020



Source Savills Research & Consultancy

GRAPH 2: Rental Indices of CBD Grade A Offices, Q1/2015 to Q1/2020



Source Savills Research & Consultancy

TABLE 1: Micro-Market Grade A Office Rents and Vacancy Rates, Q1/2020

LOCATION	MONTHLY RENT (S$ PER SQ FT)	VACANCY RATE (%)
Marina Bay	12.98	5.7
Raffles Place	10.17	3.9
Shenton Way	9.26	4.4
Tanjong Pagar	8.91	5.1
City Hall	10.28	3.2
Orchard Road	9.58	3.4
Beach Road/Middle Road	8.00	2.9

Source Savills Research & Consultancy

MARKET COMMENTARY

The Singapore economy, like the rest of the world, is being crippled by the Covid-19 pandemic. Based on advance estimates by the Ministry of Trade and Industry (MTI), the Singapore economy contracted by 2.2% on a YoY basis in Q1/2020, the worst performance since the global financial crisis in 2009. The construction and services industries have been especially hard hit by supply chain disruptions and falling external demand due to global measures to prevent the Covid-19 spread. Meanwhile, according to the Accounting and Corporate Regulatory Authority (Acra) data, in the first three months of 2020, the number of companies going into liquidation stood at 239, doubling from the 119 recorded during the same period last year. Also, another 18,923 businesses and companies ceased operations, a rise of 78% YoY.

In view of the increasing levels of uncertainty in the global economy, higher asking rents by landlords and limited supply, office leasing activity began losing momentum from the second half of last year. Coming into 2020, the outbreak has not only dashed all hopes of a recovery in global economic growth, it has also caused major disruptions to companies' daily operations and slowed their decision-making process to a crawl. For example, many companies have implemented split operations or work from home measures, while corporate expansion and relocation plans have been put on hold. As a result, the office leasing market remained quiet in the first three months from January to March.

Likewise, a contraction in investment activity for transactions of no less than S$10 million was also clearly seen in the office sector and only a handful of strata-titled office transactions were inked in the first two months of 2020. These deals included Level 11 of Samsung Hub on Church Street, Level 33 of Suntec City Tower Two and Level 10 and a unit on Level 17 of Suntec City Tower One. Despite a lack of big-ticket deals, the former two transactions achieved high per sq ft prices of S$3,800 and S$3,209, respectively. The high per sq ft prices achieved surprised the market to some extent and suggested still-healthy investment demand for Singapore's office properties, under the current volatile market conditions.

DEMAND, SUPPLY AND VACANCY

For the Savills basket of CBD Grade A offices, at the end of March 2020, the overall vacancy rate edged down 0.1 of a ppt QoQ to 4.3%. With no new supply entering the market, this minor improvement was attributable to net take-up of about 28,000 sq ft in the quarter, a significant drop compared with the previous few quarters.

By location, the vacancy rate in Raffles Place inched down 0.1 of a ppt to 3.9%, while Marina Bay dropped 0.7 of a ppt to 5.7%. Conversely, the other micro-markets, including Shenton Way, Tanjong Pagar, City Hall, Orchard Road and Beach Road, witnessed increases in vacancy in the range of 0.1% to 0.5% from the preceding quarter.

RENTS

On the ground, we have begun to see some landlords reduce rents to retain existing or attract new tenants. However, the impact of the outbreak has in a large part not been factored into rents yet. This is because tenants are prioritising their affairs and deferring their leasing decisions which they deem to be a lower priority. Also, landlords in Q1/2020 were not pressured to slash rents as most Grade A buildings are still enjoying low vacancies and landlords know that there is limited new supply until 2022 (even before the lock down which halted construction work, which will lead to completion delays).

Consequently, for Q1/2020, the average monthly rent of CBD Grade A offices tracked by Savills recorded a drop after remaining flat for two consecutive quarters, slipping a marginal 0.9% QoQ to S$10.00 per sq ft. The rental decline in the reviewed quarter was sharpest in the Beach Road micro-market, registering a 2.0% fall from a quarter ago. This was followed by the Tanjong Pagar micro-market which slipped by 1.4%, and the Marina Bay and Raffles Place areas which both dipped by 1.1%, on a quarterly basis.

OUTLOOK

To look at the possible outcomes arising from this pandemic, we need to separate the possible actions of landlords and their tenants and then recombine them to provide scenarios. For this quarter's briefing, we will take a brief look at time independent scenarios. Including the time dimension into the outlook sharply raises the number of outcomes or scenarios (we will use these two words interchangeably), making it impossible at this stage where, the changes to the new norm has not even begun, to pick the likely outcomes.

We have identified some of the factors which are occupying the minds of landlords and tenants. By no means exhaustive, the major considerations are highlighted below.

Landlords

Building owners are looking at these potential developments.

1. Construction delays of new buildings. There could be a potential delay of new supply for a year or more.

2. Tenants will be coming in increasing numbers to ask for rental reductions as their businesses have been badly affected.

3. Many companies with operations in Singapore may be forced to close because of the effects of prolonged lock downs elsewhere in the world.

4. Demand from tenants is likely to decline.

5. Likely extension of or additional assistance schemes from the government.

Tenants

Tenants are likely to be facing these general issues on the corporate real estate front.

1. Negotiate for a significant reduction in rent.

2. No or reduced fit out budgets for moving into new office premise(s).

3. Engaged in survival mode discussions which include significantly reducing occupancy costs.

4. New corporate structures for their regional operations.

5. Implementing additional Business Contingency Planning measures which could affect their real estate footprint.

6. Further changes to the regulatory environment in which tenants operate e.g. changes in accounting standards.

TABLE 2: YoY Change to Singapore Grade A CBD Office Rents - Scenarios

SCENARIO	YEAR 2020	YEAR 2021
Worse Case	-15%	-10%
Normal Case	-10%	-5%
Best Case	-10%	+5%

Source Savills Research & Consultancy

7. Deciding on the split between flexible office space and working from home.

8. New to market or existing tenants who offer services and/or products which could benefit from the pandemic e.g. work from home, ICT or e-commerce setting up or expanding operations here.

9. New to market or existing tenants using Singapore as a Business Continuity Hub.

For landlords, the situation is compounded by the fact that they have to deal with a multitude of tenants from different industries on a case-by-case basis. This should complicate the tenant's position when he tries to optimise his position in the post-pandemic game of rental negotiations.

Nevertheless, despite the many uncertainties surrounding the virus, we can still arrive at an interim opinion that Grade A CBD rents are likely to soften in Singapore.

The best case for 2021 is if the pandemic eases off rapidly and a swift resumption of economic activity is seen in late-2020. The normal case for 2021 arises when there is a significant positive gradient of improvement in the global fight against COVID-19. The worse case for both 2020 and 2021 is when the global response to the pandemic is poor and further waves of infection are possible. We have omitted the worst case scenario because the outcome lies beyond our explainable range.