# Briefing
# Office sector

August 2015

Image: South Beach, Beach Road

## SUMMARY

Grade A office rents recorded their first drop after a good run of nine consecutive quarterly increases.

- With the thinning number of leasing enquires, substantial supply in the pipeline, and the return of excess space by financial institutions, landlords have become more pro-active in their marketing efforts to fill up their space.

- Business park and high-tech industrial spaces are increasingly competing with offices located in the CBD. These non-office developments offer Grade-A office specifications at more attractive rents, luring qualified tenants to relocate.

- The overall vacancy rate for CBD Grade A offices increased by 0.7 of a percentage point (ppt) to 4.3% at the end of Q2/2015.

- In Q2/2015, average rents of CBD Grade A offices tracked by Savills fell 2.1% quarter-on-quarter (QoQ) to S$9.70 per sq ft (psf) per month.

- The average capital value of Savills' basket of CBD Grade A office buildings remained resilient in Q2, dipping slightly by 2.0% QoQ to S$2,793 psf.

"Although rents are moderating, capital values may yet surprise on the upside as heady levels of global liquidity seek to find a home." Alan Cheong, Savills Research

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Company Reg No. 198703410D

## Market commentary

Singapore's Q2/2015 GDP recorded an anaemic 1.8% growth year-on-year, the slowest pace in three years. Continued contraction of the manufacturing sector and sluggish growth of the service-producing industries were the key reasons behind the weakness, although the construction sector recorded a healthier expansion during the same period. The employment situation has also stayed cautious. According to the latest report by recruitment firm Hudson, more employers are choosing a 'wait and see' approach in the hiring market, as the net hiring sentiment dropped from 47.3% in 2H/2014 and 37.0% in 1H/2015 to 32.1% in 2H/2015.

In the reviewed quarter, a significant portion of the leasing activity still stemmed from relocation activities. Although the existing supply remains relatively tight, the thinning number of leasing enquiries, coupled with substantial supply in the pipeline, continued to vex the landlords of office buildings in the CBD. The returning of excess space by financial institutions, which arose either because of mergers and acquisitions or through the scaling back of certain risky business lines, has put further pressure on the leasing market. Landlords have thus become more pro-active in their marketing efforts, such as making further rental adjustments or offering incentives to both tenants and agents.

Business park and high-tech industrial spaces are increasingly competing with offices located in the CBD. These non-office developments offer Grade A office specifications at more attractive rents, luring qualified tenants to relocate. Shimizu, Dimension Data and BBC Asia Bureau have headed for Aperia, a high-tech industrial development at Kallang, from their address at 78 Shenton Way, Suntec Tower 4 and Shaw Tower, respectively. Google could also move to the second phase of Mapletree Business City, a business park development located at Pasir Panjang, when the lease of its CBD premises expires in 2016.

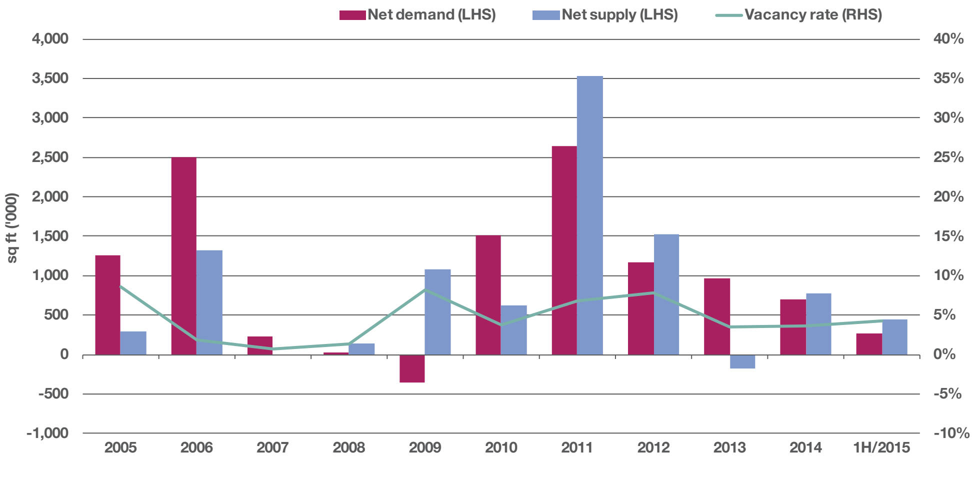
On the supply side, the second land parcel in Paya Lebar Central under the GLS programme was awarded in April to a joint venture between developer Lend Lease and sovereign wealth fund Abu Dhabi Investment Authority. This 3.9-ha mega site is earmarked for a mixed-use development comprising office, retail and residential space, with at least 968,751 sq ft (or 55% of the total gross floor area) being allocated for office use.

In the sales market, the pick-up in new sales has lifted the total transaction volumes of strata-titled office units island-wide to 70[1] in Q2/2015, up 75.0% from the 40 recorded in the previous quarter. Notably, Vision Exchange, located near Jurong East MRT station, has sold another 21 units in the quarter. The choice of Jurong East for the Singapore terminal of the high speed rail link with Malaysia may have re-ignited buying interests in this area. In contrast, take-up of new units in the CBD was relatively slow, as seen in GSH Plaza and Crown at Robinson, with each having only eight transactions in Q2.

1 Downloaded from REALIS on 27 July 2015.

GRAPH 1

### Net demand, net supply and vacancy rate of CBD Grade A offices, 2005–1H/2015




Source: Savills Research & Consultancy

## Vacancy

The net absorption of Grade A office space in the CBD was nearly 500,000 sq ft in Q2/2015, reversing the negative take-up of 238,300 sq ft in Q1. However, it was still less than the 702,000 sq ft of net supply in the same period, edging the overall vacancy rate by 0.7 of a ppt to 4.3% as at end of Q2/2015.

Vacancy in the Marina Bay area inched up by 0.6 of a ppt to 6.0% in the quarter, mainly because of the release of secondary stock in Marina Bay Financial Centre and One Raffles Quay. In the Raffles Place sub-market, the remaining vacant space in CapitaGreen pushed up the vacancy rate to 3.6% from the 2.5% recorded three months ago. Shenton Way's vacancy rate also increased by 2.1 ppts as a result of RaboBank's relocation from Robinson 77 to South Beach Tower.

Compared with the preceding quarter, vacancy rates in the Orchard Road and Beach Road micro-markets recorded a marginal decline of 0.2 and 0.9 of a ppt respectively, while that in City Hall and Tanjong Pagar remained unchanged.

## Rental and capital values

As of Q2/2015, average rents of CBD Grade A offices tracked by Savills fell 2.1% QoQ to S$9.70 psf per month. This is the first drop after nine consecutive quarterly increases. The rental fall in Q2 was sharpest in the AAA Grade segment that saw a 7.4% drop from a quarter ago. This was followed by the AA Grade segment which slipped 2.4%, and the A Grade segment which dipped 0.7% on a quarterly basis.

By location, the average monthly rents of Grade A offices in the Marina Bay micro-market declined 7.9% QoQ to S$12.67 psf in the reviewed quarter, while rents in the Beach Road, Raffles Place and City Hall areas recorded a more sedate quarterly drop of 3.8%, 2.8% and 0.6% respectively. Conversely, rents for Grade A office space in the other sub-markets, including Shenton Way, Tanjong Pagar and Orchard Road, remained flat from a quarter ago.

The average capital value of Savills basket of CBD Grade A office buildings remained resilient in Q2, dipping slightly by 2.0% QoQ to S$2,793 psf.

On the investment front, a few large-ticket deals of CBD commercial buildings were inked in Q2/2015. These included the transaction of a minimum 61.16% stake in One Raffles Place in Raffles Place (S$1.29 billion or S$2,382 psf NLA); the 30.0% stake in PWC building at Cross Street (S$201.9 million or S$1,892 psf NLA); and 158 Cecil Street (S$240.0 million or S$2,100 psf NLA). In the strata-titled sales market, the most notable deals were the 26th level at GSH Plaza (S$31.6 million or S$3,055 psf of strata area), and a 5,016-sq ft unit on the 19th level of Prudential Tower (S$14.1 million or S$2,802 psf of strata area).

## Outlook

Looking ahead, the leasing market will continue to soldier on under a cloud of issues, including weak economic performance, a cautious hiring market, an evolution of spatial needs by different office tenants and the onset of a quantum leap in supply. Under such circumstances, rents will be under more downward pressure and are likely to shed another 5% to 10% in the second half of the year.

Sales activity is expected to remain tepid in the short to medium term. However, the market could spring a surprise should Asia Square Tower 1, CPF Building, and Keppel Land's 50.0% stake in Capital Square that are on the market, find buyers this year. Barring such surprises, Savills expects that there will be a further, but moderate, price correction ahead.

TABLE 1

### Micro-market Grade A office rents and vacancy rates, Q2/2015

| Location | Rent (S$ per sq ft per month) | Vacancy rate (%) |
|---|---|---|
| Marina Bay | 12.67 | 6.0 |
| Raffles Place | 10.09 | 3.6 |
| Shenton Way | 8.26 | 4.1 |
| Tanjong Pagar | 8.30 | 9.8 |
| City Hall | 9.69 | 2.0 |
| Orchard Road | 10.08 | 2.8 |
| Beach Road/Middle Road | 7.56 | 2.3 |

Source: Savills Research & Consultancy

GRAPH 2

### Price and rental indices of CBD Grade A offices, Q1/2005–Q2/2015


Source: Savills Research & Consultancy

# Please contact us for further information

## Savills Singapore


**Christopher J Marriott**
CEO, Southeast Asia
+65 6415 3888
cjmarriott@savills.asia

**Marcus Loo**
Executive Director, Commercial
+65 6415 3893
marcus.loo@savills.com.sg


## Savills Research


**Alan Cheong**
Senior Director, Singapore
+65 6415 3641
alan.cheong@savills.com.sg

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