savills

Briefing
Office sector

August 2016

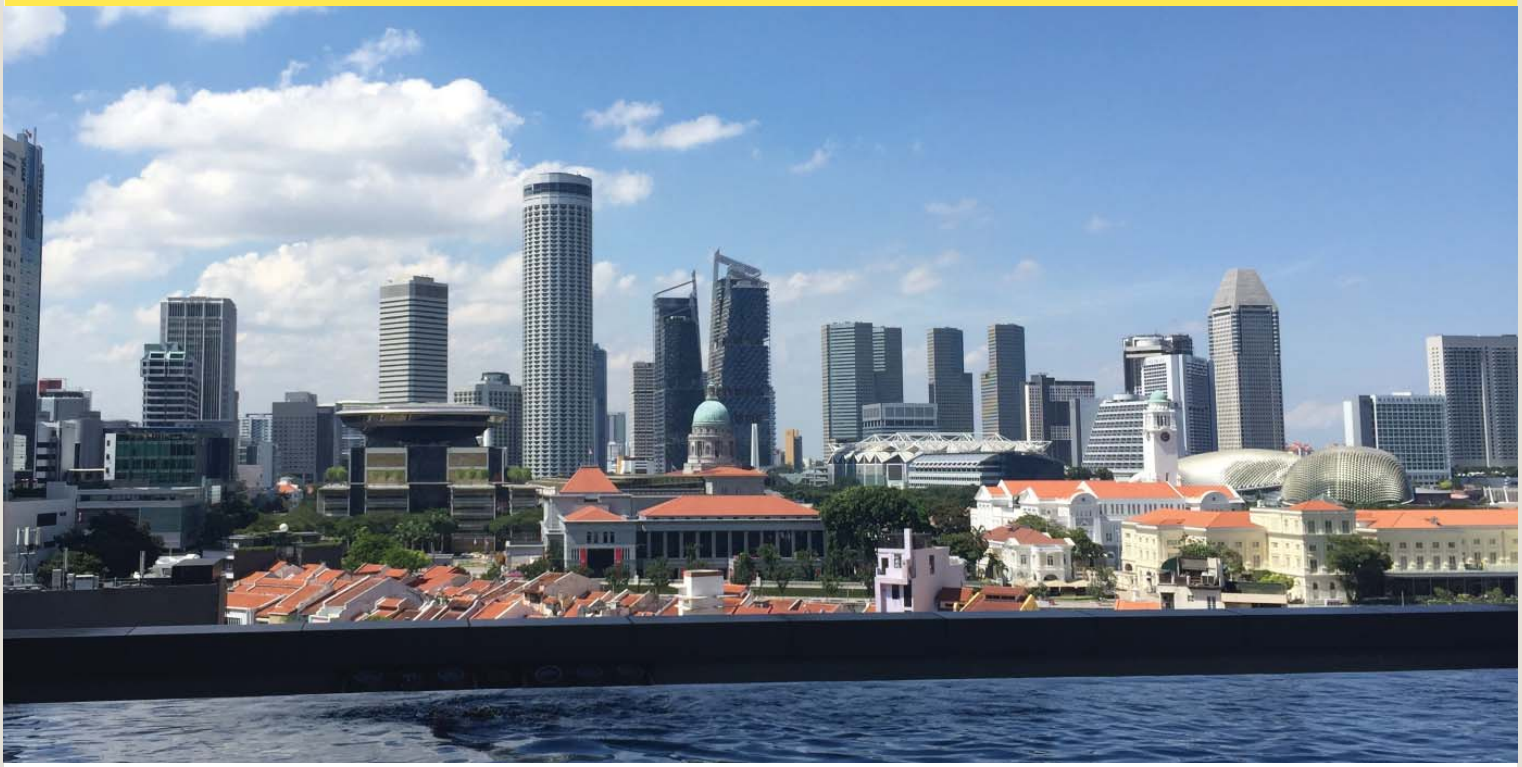

Image: City Hall, Beach Road

SUMMARY

CBD Grade A rents continued to fall as weak demand and elevated supply levels kept the market under pressure.

- According to the statistics from URA's Real Estate Information System (REALIS), by Q2/2016, island-wide office leasing volumes had decreased for the fourth consecutive quarter, with 1,022 deals recorded. 782 contracts, or 76.5% of the total transactions, were for premises of 2,000 sq ft or less.

- The Bank of Tokyo-Mitsubishi UFJ and PricewaterhouseCoopers LLP are under negotiations to lease office space at Marina One, a 1.88 million-sq ft premium office development in Marina Bay that is scheduled for completion in early 2017.

- Shared co-working space, which provides flexible office spaces with individual desks designed for freelance workers or start-ups, has become a new demand driver in the CBD area.

- The average vacancy rate of CBD Grade A offices remained low at 4.4% as at the end of Q2/2016. However, because the total available stock stayed the same as Q1, the market experienced a negative absorption of just 4,000 sq ft.

- For CBD Grade A office buildings, Savills statistics showed that the average gross monthly rent fell 1.3% from S$9.21 per sq ft in Q1/2016 to S$9.10 per sq ft in Q2/2016, while the capital value held firm and averaged at S$2,723 per sq ft in Q2/2016.

- The looming supply, together with the weakening office demand caused by greater economic uncertainties, will continue to weigh on the market. The situation could be exacerbated when tenants move out of existing buildings to new builds, starting from the second half of 2016.

"While the outlook for vacancy rates looks dour, rents may well prove relatively inelastic on the downside." Alan Cheong, Savills Research

MCI (P) 022/10/2015
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Market commentary

The Ministry of Trade and Industrial (MTI) announced that in the April-June period, the Singapore economy expanded, on a quarter-on-quarter (QoQ), seasonally-adjusted basis, by 0.3%, slower than the advance estimate of 0.8% given in mid-July. Amid subdued global and local economic conditions, the job market is also facing challenges, with slower employment growth and increasing layoffs. Preliminary estimates showed that unemployment had risen for both residents and citizens in June 2016, with the seasonally-adjusted overall unemployment rate rising to 2.1% in June 2016 from 1.9% three months ago.

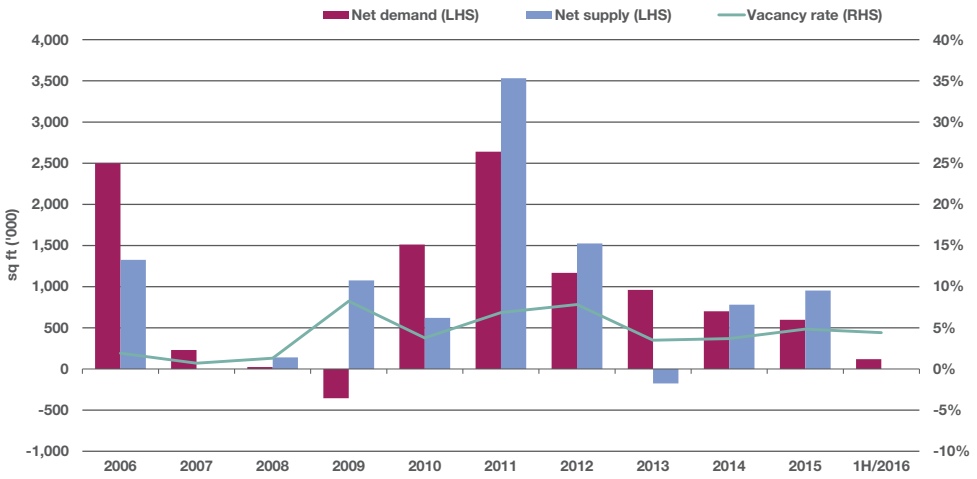
The deterioration in the business environment inevitably affected office occupiers' sentiments, which in turn led to a sluggish office leasing market. According to the statistics from URA's REALIS, by Q2/2016, island-wide office leasing volumes had decreased for the fourth consecutive quarter, with 1,022 deals recorded. 782 contracts, or 76.5% of the total transactions, were for premises of 2,000 sq ft or less. The increasing number of completed, small, strata-titled office units could be one major reason behind this, but at the same time, it most likely illustrates that most companies have adopted a conservative strategy when accessing their real estate requirements amid a dimmer business and economic outlook.

On a brighter note, some big deals are brewing in the office towers of the upcoming Marina One, a 1.88 million-sq ft premium office development in Marina Bay that is expected to be completed in early 2017. The Bank of Tokyo-Mitsubishi UFJ (BTMU) is negotiating to lease about 140,000 sq ft and will move in mid-2017 from Republic Plaza I where the bank is currently occupying about 150,000 sq ft. Another potential tenant is one that is presently residing in the PWC Building as its anchor tenant, PricewaterhouseCoopers LLP. The company is also said to be in advanced discussions to lease about 180,000 sq ft. Together with other small tenants, such as Daiwa Securities, Marina One reported that it had already leased over 550,000 sq ft of office space ahead of its completion in 2017.

Separately, under the pressure of high rents for traditional office space, shared co-working space, which provides flexible office spaces with individual desks designed for freelance workers or start-ups, has become a new demand driver in the CBD area. Besides low occupancy costs, such premises also provide the community culture of an office space with access to professional necessities such as meeting rooms, as well as flexibility and freedom essential to the users. Recent examples include the 20,000-sq ft co-working space on the 12th floor of Capital Tower by a joint venture between CapitaLand and co-working space operator Collective Works, and the 10,000-sq ft Hub@ Cuppage, which will occupy a row of 10 heritage shophouses at Cuppage Terrace, providing both hot desks and private offices.

GRAPH 1

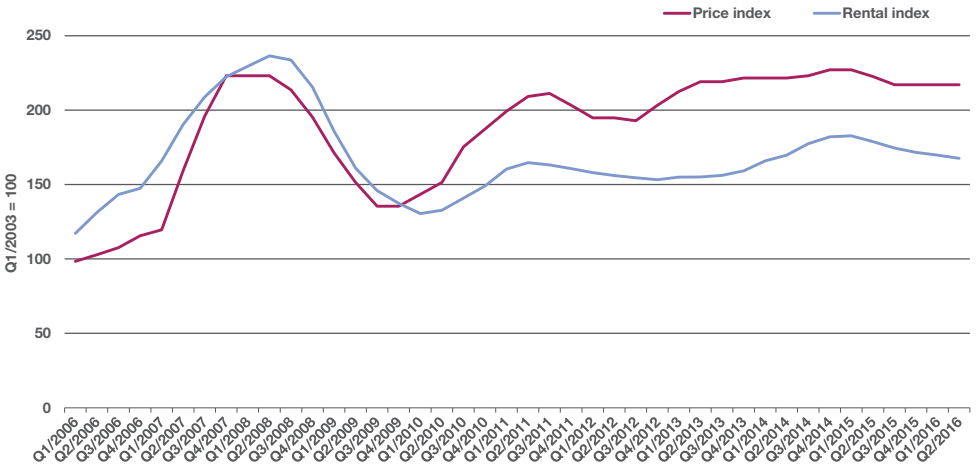
Net demand, net supply and vacancy rate of CBD Grade A offices, 2006–1H/2016



Source: Savills Research & Consultancy

GRAPH 2

Price and rental indices of CBD Grade A offices, Q1/2006–Q2/2016



Source: Savills Research & Consultancy

TABLE 1

Micro-market Grade A office rents and vacancy rates, Q2/2016

Location	Monthly rent (S$ per sq ft per month)	Vacancy rate (%)
Marina Bay	11.30	5.3
Raffles Place	9.41	2.9
Shenton Way	8.08	5.1
Tanjong Pagar	8.00	9.5
City Hall	9.22	4.3
Orchard Road	9.20	3.7
Beach Road/Middle Road	7.51	4.0

Source: Savills Research & Consultancy

In spite of tepid buying activity for office properties, two investment sales set records in their categories. The first was Indonesian tycoon Mr. Tahir's acquisition of the 999-year leasehold Straits Trading Building for S$560.0 million. This works out at S$3,524 per sq ft of net lettable area (NLA), which is the highest price per sq ft for an office building in Singapore. The other is the S$3.38 billion (or S$2,674 per sq ft NLA) sale of Asia Square Tower 1 by BlackRock. This is the highest ever transaction price for a single building in Singapore. These two deals to some extent confirmed institutional investors and ultra-high net worth individuals' confidence in the local market over the medium to long term.

Demand, supply and vacancy

As at the end of Q2/2016, the average vacancy rate of CBD Grade A offices remained low at 4.4%. On a quarterly basis, the vacancy rate dipped by just one basis point from that of a quarter ago. This is because the total available stock stayed the same as Q1, while the market saw a slight negative absorption of about 4,000 sq ft. Generally, tenants have moved from building to building, taking up the same or smaller-sized offices, or taken over the shadow space of other tenants who were looking to pre-terminate ahead of their lease expiry.

By location, vacancy rates in the Shenton Way, Tanjong Pagar and Orchard Road sub-markets continued to inch up, mainly because of tenants' relocation. Among these, the vacancy rate in Tanjong Pagar recorded the biggest quarterly increase of 1.4% in Q2, followed by 0.7% in Shenton Way and 0.5% in Orchard Road. In contrast, occupancy in the Marina Bay, Raffles Place, City Hall and Beach Road submarkets improved in Q2, with vacancy rate sliding marginally from 0.1 to 0.6 of a percentage point (ppt) QoQ.

Rental and capital values

For CBD Grade A office buildings, Savills statistics showed that the average gross monthly rent continued to soften, falling 1.3% QoQ from S$9.21 per sq ft in Q1/2016 to S$9.10 per sq ft in Q2/2016. However, capital values held firm, averaging S$2,723 per sq ft in Q2/2016. Consequently, yields became more compressed.

Compared with the previous quarter, except for the Shenton Way area where the rents remained unchanged, rental decline was witnessed in all the other micro-markets that Savills tracked, and for the Marina Bay and City Hall areas, the rental decline accelerated by 4.0% and 1.4% respectively. ■

OUTLOOK

The prospects for the market

With additional downside risks arising from slower global economic growth and China's rising corporate credit levels, Singapore's trade-dependent economy is expected to slow in the second half of 2016. Therefore, on 11 August, the MTI revised their full-year economy growth down to 1% to 2%. Their previous forecast was for a 1% to 3% growth. Economic growth this year could turn out to be the slowest since the global financial crisis.

Sizable projects completing in the next 12 months include Guoco Tower, Duo Tower, Marina One and 5 Shenton Way, all of which will add some 3.6 million sq ft to the current market. The looming supply, together with the weakening office demand caused by greater economic uncertainties, will continue to weigh on the market. The situation could be exacerbated when tenants move out of existing buildings to new builds, starting from the second half of 2016. On the investment front, transactions are likely to be sporadic. While institutional funds will continue to remain on the sidelines, opportunistic private investors are likely to drive market activity.

However, while there are sizeable negatives impacting the office market, it can be dangerous to adopt an overly-bearish view of the market. As the shift to newly-built Grade AAA buildings continues and gains momentum, there are scenarios that could mitigate the conventional view that rents will come off sharply.

The supply side is dynamic, and one possibility that could dampen rental declines is developers taking buildings or major floors off-line for major additions and alteration works. Another could be developers resisting lowering rents by the amounts that the market expects them to. (Meaning rents are not so elastic to rising vacancies but elastic to falling vacancies.) On the demand side, surprises could be sprung if new-to-market companies in growth sectors like technology and telecommunications take up sizeable space, and in the process, uplift optimism.

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