Briefing
Office sector

July 2017

Image: Vision Exchange in Jurong East

SUMMARY

Office leasing market has hit bottom.

- By the second quarter of 2017, island-wide office leasing activity had risen for two straight quarters, making this the most active quarter since Q4/2015.

- Propelled by a slew of healthy economic data, increasing leasing enquiries from tenants and easing concerns over the oversupply situation due to a healthy level commitments in newly completed large developments, the market has reversed sharply from being a tenant to a landlord's market in just a few months.

- For the first half of 2017, net new demand for Grade A office space in the CBD went up to 781,000 sq ft, exceeding the five-year average of 712,000 sq ft per annum from 2012 to 2016.

- As demand lagged behind supply during the same period, the overall vacancy rate for Grade A offices in the CBD rose 1.3 percentage points QoQ to 6.5% at the end of June 2017.

- Office rents have begun to turn the corner well ahead of expectations. Based on Savills' basket, average monthly gross rents have found a base in Q1/2017 at S$8.70 psf, and this was sustained in Q2/2017.

"The recent counter-market moves by landlords have broken down the tradition relationship between rents and vacancy rates. Rents for 2017 are now forecast to increase by 1%-3% while vacancies could rise to 11.5%."
Alan Cheong, Savills Research

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Market commentary

Driven by healthy growth in manufacturing and services, Singapore's GDP expanded at 2.5% year-on-year (YoY) in Q2/2017, the same pace of growth as the previous quarter. In tandem with the economy stabilising and improving global economic conditions, business confidence in Singapore improved. According to several surveys undertaken recently, pessimism over business prospects in the next six months has diminished substantially.

According to Urban Redevelopment Authority (URA) statistics, island-wide office leasing activity has risen for two straight quarters and registered a total of 1,111[1] transactions in Q2/2017, the highest volume since Q4/2015. The Central Area, where the CBD is located, witnessed the strongest growth in leasing volume, up from 698 in Q1/2017 to 805 in Q2/2017.

Propelled by a slew of healthy economic data, increasing leasing enquiries from tenants and easing concerns over the oversupply situation due to healthy commitments in newly completed large developments, such as Guoco Tower and Marina One, the market has turned sharply from a tenant to a landlord's market in just a few months. Landlords, particularly those who are financially strong, are either holding their rents firm or raising them substantially for both new leases and renewals. On the other hand, it appears that for the moment, tenants have lost some bargaining power, and have accepted rents that are higher than expected.

Marina One continued to secure tenants for its 1.88 million of office space. One of the new sign-ons is the ride-hailing firm Grab, which will take about 100,000 sq ft in Marina One after moving from its current premises in Sin Ming estate. The other tenant is Ocean Network Express, a joint venture of Japan's three big shipping lines, Kawasaki Kisen Kaisha (K Line), Mitsui OSK Lines (MOL) and Nippon Yusen Kabushiki Kaisha (NYK Line). It will occupy some 50,000 sq ft of office space. So far, Marina One has reached a pre-commitment level of about 70%.

Except for traditional office occupiers, co-working spaces have become one of the major demand drivers for office space, and this type of user has seen increasing activity levels over the last two years. In the reviewed quarter, The Work Project's 24,000-sq ft co-working space at OUE Downtown Gallery opened. Beside freelancers, start-ups and small and medium-sized enterprises (SMEs), the space also accommodates 100 staff from Australian property group Lendlease. Meanwhile, co-working space operator Spacemob has officially launched its second co-working space spanning some 14,000 sq ft in Ascent at Science Park 1, while UrWork, a Chinese co-working space provider, also set up a 6,889-sq ft co-working space at JTC LaunchPad @ one-north. In the next few quarters, there will be some new co-working spaces entering the market, including JustCo in Marina One and the new UIC Building, WeWork in Beach Centre and Distrii in Republic Plaza I.

In Q2/2017, investment sales of office properties remained relatively active. There were two notable transactions sealed in the CBD. In May, Hong Kong-based insurer FWD Group acquired a 50% stake in One George Street, a Grade A office building on George Street, from CapitaLand Commercial Trust (CCT). Based on the agreed property value, the 50% stake amounted to S$591.6 million or S$2,650 per sq ft (psf) of net lettable area (NLA). Later in June, Afro-Asia Shipping Co (Pte) Ltd (AAS) sold Afro-Asia Building on Robinson Road at S$170.0 million to Robinson Development (Pte) Ltd, a joint venture of AAS and Shimizu Corporation, for redevelopment. Outside the CBD, Tuan Sing Holdings, purchased Sime Darby Centre at Bukit Timah for S$365.0 million (S$1,800 psf of NLA) from Sime Darby Property (Dunearn) Private Limited, a 70:30 consortium of Blackstone and Sime Darby Berhad in April.

1 Based on data downloaded on 25 July 2017

Demand, supply and vacancy

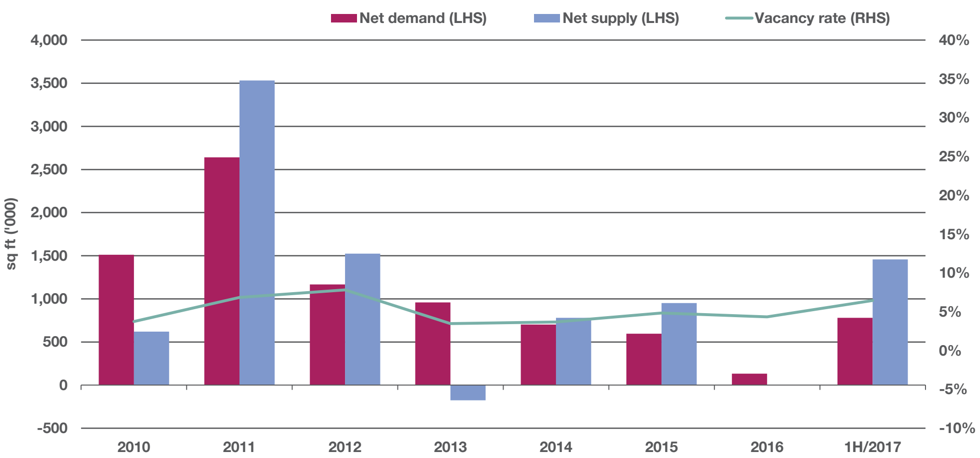
In Q2/2017, some 570,000 sq ft of office space was added to the Savills CBD Grade A office basket, from DUO Tower at Fraser Street. Although the building was completed at the end of last year, we only added this building to our basket after giving it the customary six months for a new building to stabilise. On a net take-up basis, about 173,000 sq ft of Grade A CBD office space was absorbed in the second quarter.

Net new demand for Grade A office space in the CBD went up to 781,000 sq ft for the first half of 2017, exceeding the five-year average of 712,000 sq ft per annum from 2012 to 2016. After registering a paltry 134,000 sq ft of net new demand for the whole of 2016, we expect that the full-year number for 2017 will be on target to hit or slightly exceed our 1.24 million sq ft forecast.

Despite the raised activity levels, demand still lagged behind supply over the period, and the overall vacancy rate for Grade A offices in the CBD continued to rise to 6.5% at the end of June 2017, an increase of 1.3 percentage points from three months ago.

GRAPH 1

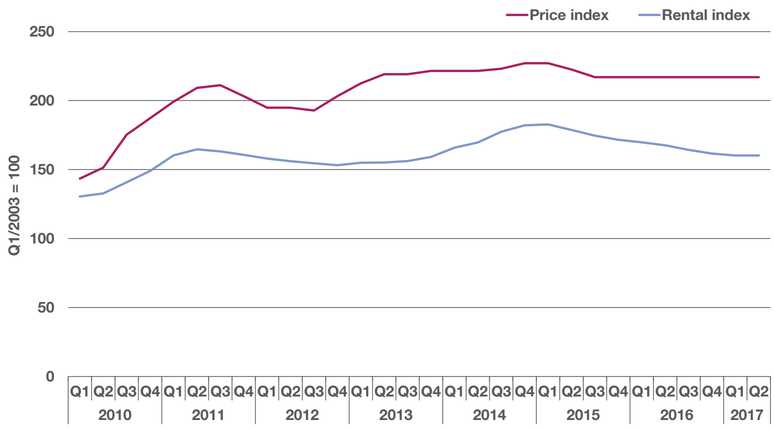
Net demand, net supply and vacancy rate of CBD Grade A offices, 2010–1H/2017



Source: Savills Research & Consultancy

GRAPH 2

Price and rental indices of CBD Grade A offices, Q1/2010–Q2/2017



Source: Savills Research & Consultancy

TABLE 1

Micro-market Grade A office rents and vacancy rates, Q2/2017

Location	Monthly rent (S$ per sq ft)	Vacancy rate (%)
Marina Bay	10.07	5.0
Raffles Place	8.85	3.4
Shenton Way	7.87	3.6
Tanjong Pagar	7.65	14.2
City Hall	9.08	6.0
Orchard Road	9.15	2.6
Beach Road/Middle Road	7.13	22.8

Source: Savills Research & Consultancy

Rental and capital values

Office rents have begun to turn the corner well ahead of expectations with a breakdown in the traditional relationship between vacancies and rents. Based on Savills' basket, the vacancy rate for CBD Grade A offices has risen for three consecutive quarters since Q4/2016, while, counter-intuitively, the average monthly gross rents however found a floor in Q1/2017 at S$8.70 psf, sustained in Q2/2017.

Some micro-markets, including Marina Bay, Raffles Place and Shenton Way, continued to witness rental declines in the reviewed quarter but the falls were substantially lower compared with the previous quarter, ranging from 0.2% to 0.7% QoQ. Average rents in the Tanjong Pagar, Orchard Road and Beach Road/Middle Road areas remained unchanged from a quarter ago, while City Hall is the only sub-market which experienced a marginal rental increase of 0.7% QoQ.

While passing yields have been compressing due to rising vacancies and interest rates have risen, prices for office space are holding. In Q2/2017, average capital values of CBD Grade A offices remained at S$2,723 psf.

OUTLOOK

The prospects for the market

With the new space offerings in the market already substantially committed, we believe that their owners, possessing the financial muscle, will be able to fight against rising vacancies and will be able to sign on tenants at increasing rents. While our model forecast for demand and vacancies has been relatively accurate, the behaviour of the few large landlords in the market is causing the historical vacancy-rents relationship to break down. Instead of a 10% decline for rents for 2017, we have drastically revised our rental forecast to a rise of 1% to 3% to account for the new reality.

Please contact us for further information

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