

# Briefing Office sector

November 2015

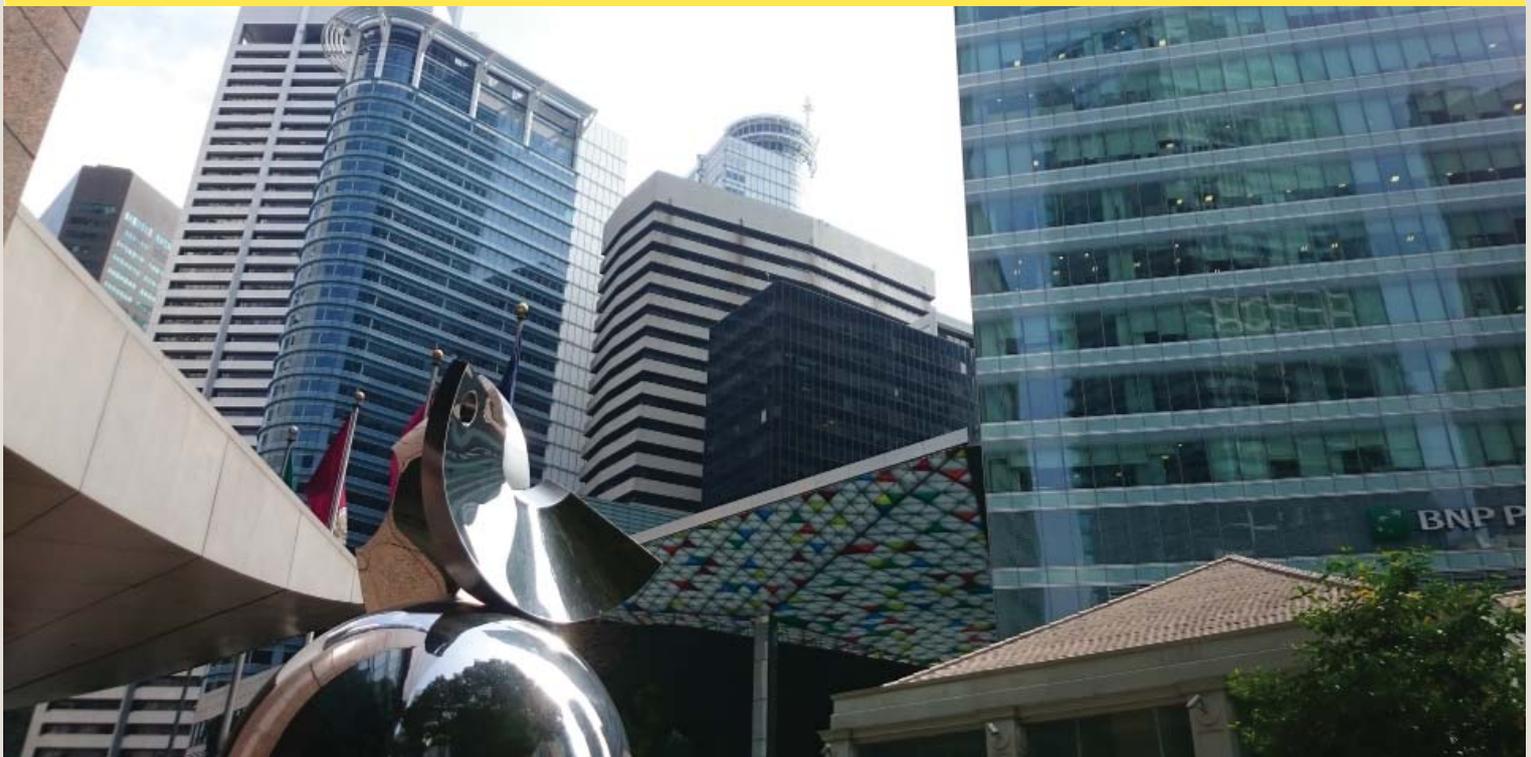


Image: Raffles Place

## SUMMARY

Rents have witnessed two successive quarters of decline.

- Global economic uncertainties have continued to weaken sentiment in the local business community. This has made companies hesitant to relocate or expand as cost saving and revenue generation have become priorities.
- In the CBD, the overall vacancy rate of Grade A offices rose for a second consecutive quarter, edging up to 5.1% at the end of September 2015.
- According to Savills' estimates, the net absorption of CBD Grade A offices was only about 240,400 sq ft in Q3, less than half of the 499,800 sq ft achieved a quarter ago.
- The average monthly rents of Grade A CBD offices slipped another 2.4% quarter-on-quarter (QoQ) to S\$9.47 per sq ft in Q3/2015. Similarly, the average capital values of CBD Grade A office buildings in Q3/2015 slid by 2.5% QoQ to S\$2,723 per sq ft.
- We are forecasting a 4.4% year-on-year (YoY) decline in CBD Grade A office rents for 2016 with an 11.7% decline in 2017 before the market stabilises in 2018.

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 "CBD Grade A office dynamics are undergoing an epochal change with major space users such as global banks reducing their real estate footprint and tech companies moving to business parks. This comes at a time when supply is expected to balloon in the coming years."  
 Alan Cheong, Savills Research  
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➔ **Market commentary**

Preliminary government data has revealed that on a seasonally-adjusted annualised basis, Singapore's Q3/2015 GDP growth came in at 0.1% QoQ, reversing the 2.5% decline in Q2. Although the economy narrowly avoided a technical recession, the slow down was broad-based across all segments. The tepid economy is reflected in various recent surveys which show that business sentiment is poor and companies are wary of hiring new staff.

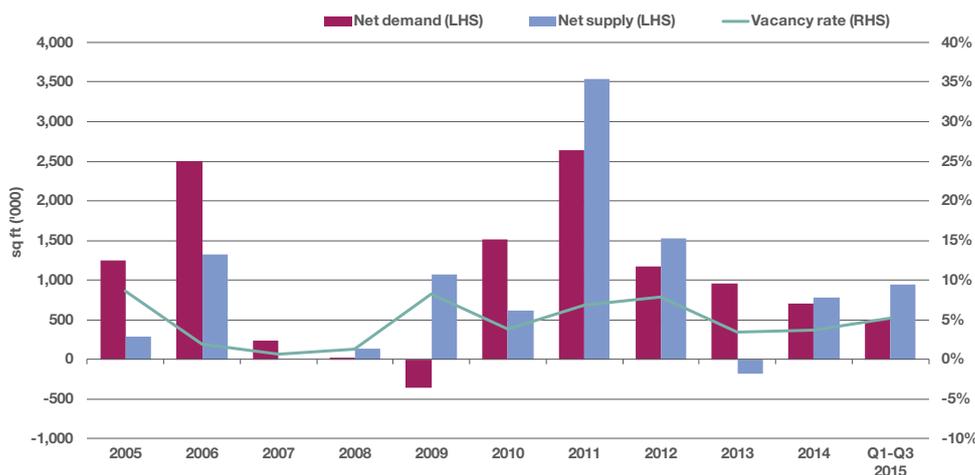
Based on the Urban Redevelopment Authority's Real Estate Information

System (Realis), a total of 1,115 office leases were signed island-wide in Q3/2015, representing a decline of 11.9% from the 1,265 recorded in the previous quarter. The decline is likely due to global economic uncertainties spilling over to dampen expectations amongst the local business community. This has resulted in a reluctance by companies to relocate or expand as cost saving and revenue generation have become priorities. In view of the gloomy outlook and the imminent supply looming over the market, tenants are seeking bargain rents when renewing or securing new leases. Landlords on the other hand, especially those

who own prime office buildings, are trying to hold up rents, taking advantage of the lull in supply before substantial completions come on stream from the second half of 2016. Consequently, leases are taking longer to conclude.

Sentiment in the investment market has remained lukewarm over the past few quarters. The only block transaction in the reviewed quarter was the July sale of a newly-furnished freehold office building at 137 Cecil Street. The price tag was between S\$210 and S\$215 million, which translates to a unit price of more than S\$3,100 per sq ft of net lettable area. Meanwhile, there were two notable strata-title sales in Q3 - three floors (25th to 27th levels) in Prudential Tower (S\$100.6 million) and the 11th level of Crown at Robinson (S\$12.6 million).

GRAPH 1 **Net demand, net supply and vacancy of Grade A CBD offices, 2005–Q3/2015**



Source: Savills Research & Consultancy

GRAPH 2 **Price and rental indices of CBD Grade A offices, Q1/2005–Q3/2015**



Source: Savills Research & Consultancy

**Vacancy**

The overall vacancy rate of CBD Grade A offices rose for a second consecutive quarter, edging up 0.9 percentage point (ppt) to 5.1% at the end of September 2015. Savills estimates that the net absorption of CBD Grade A offices was only about 240,400 sq ft in Q3, less than half of the 499,800 sq ft achieved a quarter ago. The healthy take-up seen in newly-completed developments, such as CapitaGreen and South Beach Tower, was offset by the growing amount of space released from relocation and businesses scaling down.

By location, the vacancy rate in Tanjong Pagar dropped by 0.8 ppt to 9.0%, while Orchard Road remained unchanged. Conversely, the other five sub-markets, including Marina Bay, Raffles Place, Shenton Way, City Hall and Beach Road, witnessed increases in vacancy in the range of 0.1% to 3.9% from the preceding quarter. At the end of Q3, in spite of the slower take-up, the occupancy rate of CBD Grade A offices was still considered healthy as vacancies remained well under 10% in all micro-markets which we track.

**Rental and capital values**

The average monthly rents in Savills' basket of CBD Grade A offices slipped another 2.4% QoQ to S\$9.47 per sq ft in Q3/2015. A clear sign

→ that the rental market is soft across the board comes in the form of witnessing two successive quarters of decline. Although the AAA Grade segment's rental fall moderated at 2.6% (versus 7.4% in Q2), the rental fall in the AA and A Grade segments accelerated to 2.7% (versus 2.4% in Q2) and 2.1% (versus 0.7% in Q2) respectively.

The softening of Grade A office rents was also seen in most of the micro-markets, except for the Beach Road area where rents remained flat in the reviewed quarter. Having remained stable for the last three quarters from Q4/2014 to Q2/2015, average rents in the Shenton Way, Tanjong Pagar and Orchard Road sub-markets recorded their first quarterly drops of 2.2%, 2.7% and 4.1% respectively. Meanwhile, rents in the Marina Bay, Raffles Place and City Hall areas continued to trend downward for the second successive quarter with declines ranging from 1.7% to 3.2% QoQ.

Similarly, the average capital value of CBD Grade A office buildings which are tracked by Savills slid by 2.5% QoQ and 2.7% YoY to S\$2,723 per sq ft.

### Outlook

Amid concerns of increasing global economic headwinds and regionally weaker demand hitting exports, office occupiers have become more cautious with many adopting a "wait-and-see" attitude. On the one

hand, landlords are now faced with dwindling demand and on the other, substantial new completions over the next three years. The sudden about turn in rental performance this year, from positive to negative, showed the stark reality of the situation; there was not even time for any standoff to materialise. The bulge in supply next year together with the rapid change in tenant business dynamics is obvious to both landlords and tenants.

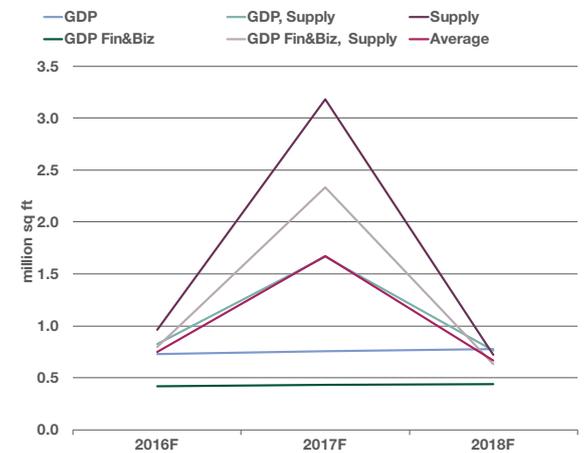
With the new supply coming online beginning next year, many are wondering what impact it will have on rents, particularly when the economy is expected to grow more slowly in the years ahead. To gauge the performance of this market from 2016 to 2018, we use quantitative forecasting methods. Having predicted demand and given what we know about CBD Grade A office supply in the pipeline, we compute the vacancy and that becomes the predictor variable in our rental model. The five models<sup>1</sup> for demand are specified with various combinations of predictive variables such as:

1. GDP
2. GDP and Supply
3. Supply
4. GDP Financial & Business Services Sector
5. GDP Financial & Business Services Sector and Supply

A key difference between our approach and most others is that

<sup>1</sup> For the period 2016-2017, GDP is assumed to grow 3% pa and GDP Financial & Business Services Sector is taken to expand at 3% pa.

GRAPH 3 Upper and lower bounds of annual demand for CBD Grade A offices, 2016 – 2018F



Source: Savills Research & Consultancy

while forecasters often pick the best model to predict the outcome, we will not. Instead of having just one model, we will provide the upper and lower bounds where demand as predicted by the various models is likely to fall within. The reason for using bounds is that it will allow us to re-think and re-strategize over the course of the next few years when we take stock of how the various outcomes match with reality.

Providing a range of forecasts therefore widens our spectrum of understanding of the market structure for each of the forecast years. However, for the purpose of

TABLE 1 Micro-market Grade A office rents and vacancy rates, Q3/2015

Location	Rent (S\$ per sq ft per month)	Vacancy rate (%)
Marina Bay	12.33	7.4
Raffles Place	9.92	3.7
Shenton Way	8.08	6.1
Tanjong Pagar	8.08	9.0
City Hall	9.38	3.3
Orchard Road	9.67	2.8
Beach Road/Middle Road	7.56	6.1

Source: Savills Research & Consultancy

our forecast below, we have taken the average of the five models as the likelihood of where demand may be for the coming three years. Using the average of the five models, CBD Grade A rents are forecast to fall by 4.4% YoY in 2016 and 11.7% in 2017, before stabilising in 2018. ■

TABLE 2 **Forecast for CBD Grade A Offices, 2016–2018F**

Period	Net take-up (sq ft)	Vacancy rate (%)	Average monthly rent (S\$ per sq ft)	YoY % change
2016	746,864	4.8	9.05	-4.4
2017	1,672,171	8.4	7.99	-11.7
2018	664,891	8.2	8.04	0.7

Source: Savills Research & Consultancy

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