Savills World Research
Singapore

Briefing
Office sector

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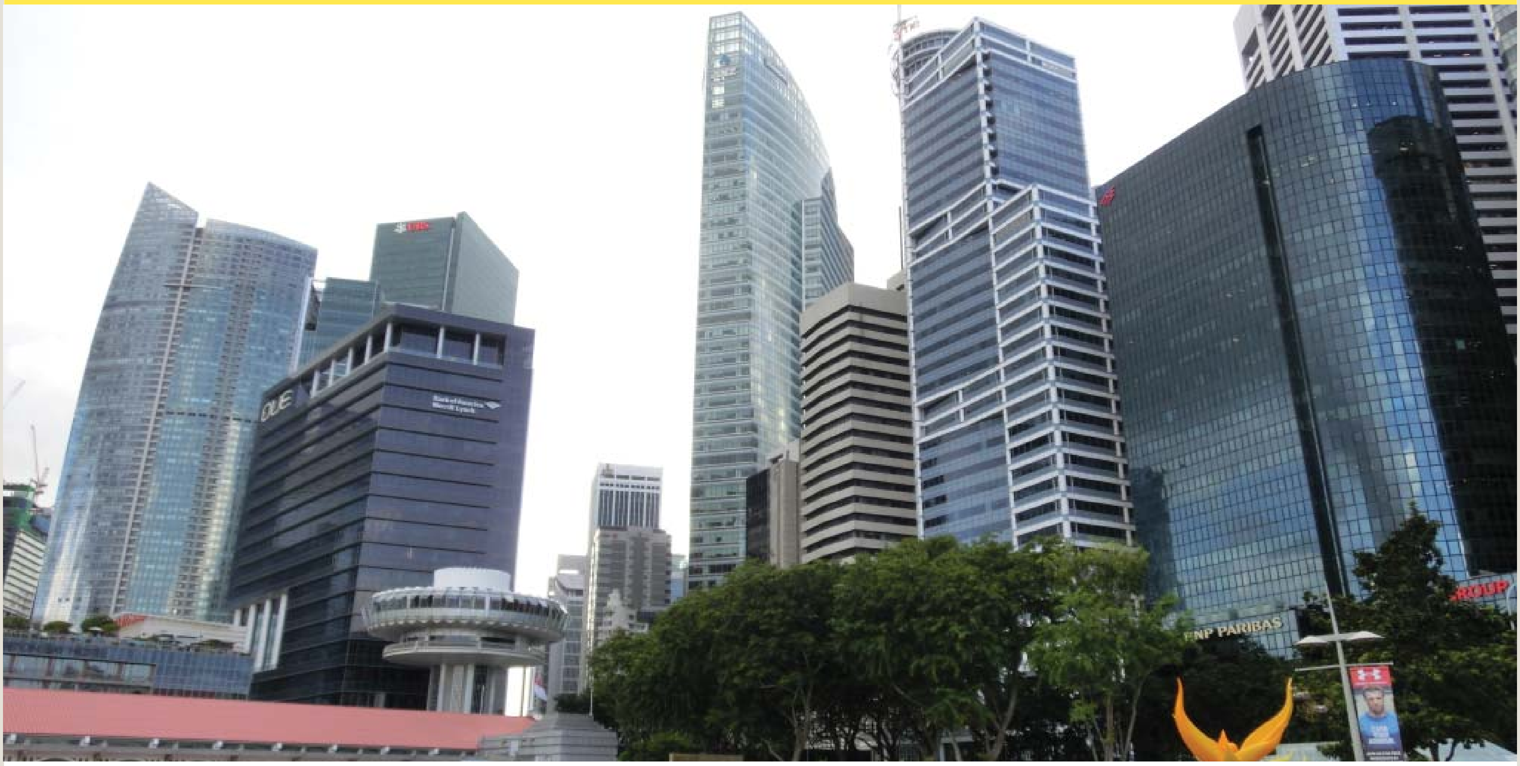

Image: Collyer Quay

SUMMARY

The last quarter of 2015 ended with the office leasing market mixed, with vacancies improving but rents falling.

■ The slowdown and rebalancing of the Chinese economy, lower commodity and oil prices, and falling global demand, precipitated a significant dampening of business confidence in the last few months of 2015.

■ The office leasing market concluded 2015 with a relatively mild performance. Based on the Urban Redevelopment Authority's (URA) statistics, island-wide leasing volume fell 2.6% quarter-on-quarter (QoQ) to 1,101 transactions in Q4/2015.

■ From data compiled by Savills, the net demand of CBD Grade A offices was estimated at some 94,900 sq ft in Q4/2015. Due to the dearth of new completions in Q4/2015, the average vacancy rate still inched down 0.3 percentage points (ppts) QoQ to 4.8% as at Q4/2015.

■ In Q4/2015, average monthly rents of CBD Grade A offices tracked by Savills stood at S$9.31 per sq ft, representing a decline of 1.7% QoQ and 5.7% year-on-year (YoY).

■ Although sales activity subdued in the reviewed quarter, the prices of office properties held relatively firm. In Savills basket of CBD Grade A office buildings, the Q4's average capital value remained at S$2,723 per sq ft from a quarter ago.

"The immediate challenge is the as yet ungraspable amount of shadow space that banks and beleaguered companies in the marine, oil & gas and chemical industries are saddled with." Alan Cheong, Savills Research

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Market commentary

As a passenger in the slowing global economy, Singapore saw a relatively muted GDP growth of 2.0% YoY in 2015. The slowdown and rebalancing of the Chinese economy, lower commodity and oil prices, and falling global demand, precipitated a significant dampening of business confidence in the last few months of 2015, resulting in the economy expanding by just 1.8% YoY in the last quarter of the year. According to the latest survey done by the Singapore Commercial Credit Bureau, the results revealed that the quarterly Business Optimism Index fell into negative territory of -2.93 ppts for the first time in three years, whilst hiring levels also fell into the contractionary zone at net -4.93 ppts.

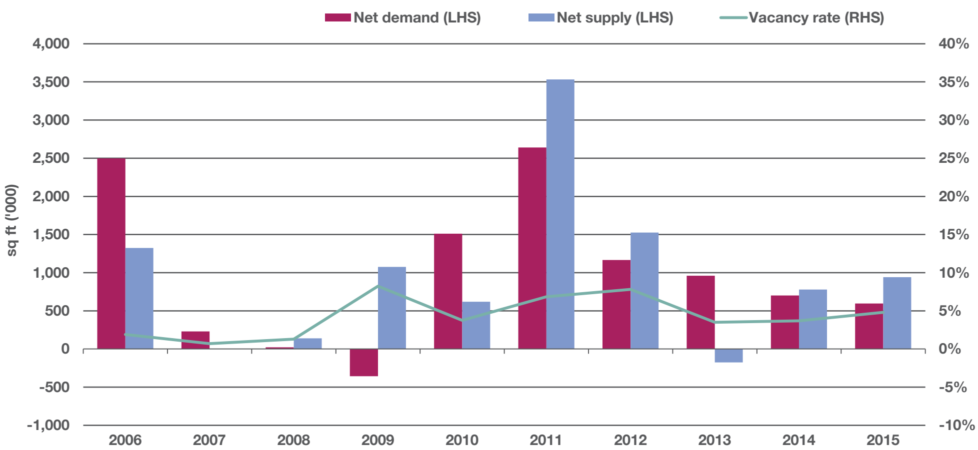
For the final quarter of 2015, the Grade A CBD office leasing market ended mixed, with some statistics improving while others softened. From URA's latest statistics, island-wide leasing volume fell 2.6% QoQ to 1,101 transactions in Q4/2015. This is the second consecutive quarter of decline. Landlords began to adopt a more defensive position by prioritising tenant retention. On the other hand, cost-cutting measures by occupiers and the sub-letting of excess space taken up during the expansion fervour in the past few years continued.

On a positive note, the market still witnessed sizable new leases and expansions, albeit at a slower pace. For example, IBM took over 75,000 sq ft of shadow office space spanning three floors in Marina Bay Financial Centre (MBFC) Tower 2 to house their Asian headquarters (which was a surprising relocation from Shanghai), while LinkedIn expanded their premises in the same building with the lease of another whole floor. The above-mentioned four floors were formerly occupied by BHP Billiton, the world's biggest mining company. Set to be the first major completion in mid-2016, Guoco Tower, which is located above the Tanjong Pagar MRT station, has secured DNB Asia, Hong Leong Bank, Open Link and Regus for 10% of its 890,000-sq ft office space. It was reported that the landlord is having advanced discussions with tenants who could potentially lease another 40% of the space.

Sluggish sales of office properties continued into the last three months of 2015. A total of 52 caveats have been recorded in URA's REALIS system, down 24.6% and 37.3% from Q2 and Q3 respectively. However, from the point of investment sales, six office block transactions, including the CPF Building, Central Mall Office Tower, Tampines Grande, Manulife Centre, a 30% stake of Keppel Bay Tower and a 39% interest of Harbourfront Tower One and Two, coupled with the sales of three floors in Suntec Tower Two, contributed a total of S$2.13 billion.

GRAPH 1

Net demand, net supply and vacancy rate of CBD Grade A offices, 2006–2015



Source: Savills Research & Consultancy

GRAPH 2

Price and rental indices of CBD Grade A offices, Q1/2006–Q4/2015

Source: Savills Research & Consultancy

Demand, supply and vacancy

From data compiled by Savills, although the net demand of CBD Grade A offices continued to shrink for the third successive quarter since Q2/2015, it is still in positive territory. For the last quarter of the year, the net take up was 94,900 sq ft. Owing to the dearth of new completions in the same period, as at Q4/2015, the average vacancy rate of CBD Grade A offices inched down 0.3 ppts QoQ to 4.8%.

The full-year absorption ended at around 596,800 sq ft, a decrease of 14.9% from the annual demand

TABLE 1

Micro-market Grade A office rents and vacancy rates, Q4/2015

Location	Monthly rent (S$ per sq ft per month)	Vacancy rate (%)
Marina Bay	12.04	7.1
Raffles Place	9.68	3.6
Shenton Way	8.08	4.0
Tanjong Pagar	8.04	7.6
City Hall	9.39	3.7
Orchard Road	9.41	2.3
Beach Road/Middle Road	7.56	6.6

Source: Savills Research & Consultancy

achieved in 2014. This is also the lowest recorded since 2009. Together with the 942,000 sq ft of net new supply in 2015, the vacancy rate for CBD Grade A offices increased 1.1 ppts YoY from 3.7% as at the end of 2014. Geographically, the increase was evidenced in most micro-markets, except for Tanjong Pagar and Orchard Road.

Rental and capital values

In Q4/2015, average monthly rents of CBD Grade A offices tracked by Savills was S$9.31 per sq ft, representing a decline of 1.7% QoQ and 5.7% YoY. The softening of Grade A office rents was seen in all the micro-markets. Among these, the Marina Bay precinct, where the most modern grade A office projects are located, recorded the sharpest rental fall of 11.8% YoY. As most major global banks are located in this precinct, their recent financial woes have had an impact on their space requirements.

Although sales activity subdued in the reviewed quarter, the prices of office properties held relatively firm. For example, Suntec Real Estate Investment Trust (REIT) bought the 12th, 13th and 29th floors at Suntec Tower Two for S$101.6 million, or S$2,648 per sq ft of strata area.

Therefore, in Savills basket of CBD Grade A office buildings, the Q4's average capital value remained at S$2,723 per sq ft from a quarter ago.

OUTLOOK

The prospects for the market

For 2016, global economic growth was originally expected to improve on the back of a better performance in the US. However, the collapse of oil and commodity prices on top of a drastic slowdown of the Chinese economy has upset any forecast of recovery. Against this backdrop, the growth outlook for the Singapore economy in 2016 is modest and expected to be within the range of 1.0 to 3.0%.

In the near term, the office leasing market will continue to face challenges, including prolonged weak demand, protracted “wait-and-see” attitudes adopted by occupiers, imminent substantial future supply with low pre-commitment levels, and continued give-up of excess space by existing tenants, particularly from the financial and energy industries.

For tenants in the financial, energy and chemical industries, although their businesses have taken a severe hit for a myriad of reasons, they have yet to fully reflect that in their real estate footprint. In the immediate term, beleaguered companies may find it easier to shed staff, as this brings about an almost immediate improvement in managing costs. Owing to the long lease terms signed by many of these companies, it is much more difficult for many to reduce their real estate footprint. This may give landlords some assurance that, unless the tenants fold, vacancies will remain low. However, for buildings which are expected to complete in a turbulent market, the spectre of an enlarging shadow space market can be upsetting. At this stage, it is still difficult to get a grasp on the amount of shadow space in the market because things are moving so rapidly for tenants

OUTLOOK

The prospects for the market

faced with very challenging business conditions; they do not yet have an idea of where the new norm for their industry is.

Although it is expected that global and local economic growth will be slow this year, given the time it takes to fit out a newly-completed office unit, the amount of Grade A CBD office space that can effectively house a tenant is still limited in 2016. This lack of effective supply is a silver lining that may buffer rents. Also, if the case of IBM moving into MBFC Tower 2 is any sort of precursor to more multinationals shifting part of their North Asian operations here, this flow reversal may signal a new source of demand for Grade A office space. Nevertheless, the challenge for 2016 is the as yet ungraspable amount of shadow space that banks and afflicted companies in the marine, chemical and oil & gas sectors are saddled with.

On balance, we therefore expect prime office rents to decline by 7.0% to 10% this year. Although these are significant falls, this is not considered a hard landing. Capital values are expected to remain at end-2015 levels, as softer rents may be offset by lower capitalisation rates due to interest rates possibly declining.

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