Briefing
Office sector

February 2017

Image: DUO at Fraser Street

SUMMARY

CBD Grade A rents softened by 5.8% in 2016.

■ Office occupiers have become more cautious with many adopting a "wait-and-see" attitude. Landlords are however reluctant to lower their quoted rents, but have tried to offer sweeteners to attract potential tenants.

■ Going by the statistics from the Urban Redevelopment Authority (URA), there was a total of 939 office leasing transactions in Q4/2016, declining 6.7% quarter-on-quarter (QoQ).

■ Two future projects, namely the redevelopment of the Golden Shoe Car Park and an office development on the Central Boulevard white site, could yield a total of approximately 1.9 million sq ft of Grade A office space in 2021/2022.

■ Average Grade A vacancy rate rose 0.2 percentage point (ppt) to 4.5% as at end of Q4/2016 from three months ago.

■ In Q4/2016, based on Savills basket of CBD Grade A offices, average monthly rents recorded a decline of 1.6% QoQ, while capital values remained unchanged.

■ In the short-term at least, firms are expected to be more conservative in their expansion plans and net take-up of office spaces is expected to be moderated.

"2017 will be a pivotal year to see whether landlords can maintain their composure in holding rents or start a race to the bottom."
Alan Cheong, Savills Research

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Market commentary

Owing to eleventh hour strengths in the manufacturing and services sectors, for the last quarter of 2016, Singapore's economy expanded at a higher-than-expected 2.9% year-on-year (YoY), bringing the full-year growth to 2.0% YoY. In view of the slow economic growth and continuing economic restructuring, the job market in Singapore continued to soften. Advance estimates showed that the overall unemployment rate averaged at 2.1% in 2016, the highest since 2010. For the full year, total employment increased by 16,400, the lowest since 2003, while redundancies hit a seven-year high of 19,000 during the year.

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. In addition, the year-end festival season could also have lengthened their decision making process. On the other hand, in spite of lower demand and new completions, landlords are still trying to hold up the rents. While reluctant in lowering their quoted rents, they are instead offering sweeteners, such as longer-than-normal rent-free periods or up–front incentives to attract potential tenants.

Consequently, leasing activity in the last quarter stayed anaemic as some negotiations have either ended in a stalemate with tenants preferring to stay put or carried over till 2017 for further discussions. Going by the statistics from the Urban Redevelopment Authority (URA), the state registered a total of 939 office leasing transactions in Q4/2016, a decline of 6.7% QoQ. For the whole year, 4,025[1] deals were recorded, the lowest volume since 2011.

In the reviewed quarter, there are two future projects that have substantial office space. Firstly, in October, CapitaLand Commercial Trust (CCT) submitted plans to the authorities to redevelop the 10-storey Golden Shoe Car Park into a commercial development with a gross floor area (GFA) of about one million sq ft. Later In November, Wealthy Link Pte Ltd, a subsidiary of IOI Properties Group Bhd clinched the white site at Central Boulevard in the core CBD for almost S$2.57 billion (S$1,689 per sq ft per plot ratio), beating six rivals in a public tender by the URA. The Malaysian developer has plans for an office development with a childcare facility and some retail space. These two projects are estimated to yield a total of approximately 1.9 million sq ft of Grade A office net lettable area (NLA) straddling the years 2021 and 2022.

In the sales market, the transactions of office properties worth S$10 million each totalled S$1.2 billion in Q4/2016, up 55.7% from the previous quarter. The increase was partly driven by deals done by institutional funds and regional wealthy individuals, who, despite yields compressing, have continued to invest in Singapore. Notable deals in the quarter include ARA Asset Management's acquisition of a 50% stake in Capital Square at Church Street for $475.5 million (S$2,450 per sq ft of NLA) and five floors in Suntec City Tower One for S$129.3 million (S$2,400 per sq ft on strata area), and the purchase of Robinson 77 by CLSA Capital Partners at S$530.8 million (S$1,810 per sq ft of NLA).

1 Based on data downloaded on 17 February 2017

Demand, supply and vacancy

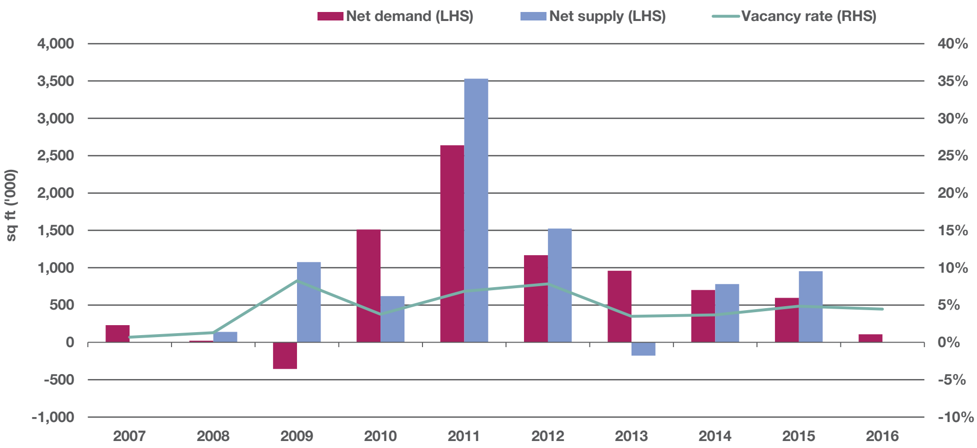
From data compiled by Savills, the net take-up of CBD Grade A offices contracted by some 61,000 sq ft in Q4/2016. The net absorption had been shrinking for five consecutive years since 2012. For 2016, the net absorption was about 109,000 sq ft, the lowest recorded since 2009. For 2016, we also noticed that the expansion plans or new enquiry of office space had been muted. Instead, the main feature of the market was one characterized by a flight-to-new builds with most tenants moving but taking up the same or smaller-sized premises.

Although there was a completion of 1.46 million sq ft of net new supply in 2016, coming from Guoco Tower in September and DUO Tower in December, our method of defining supply is not based on the physical completion date but when the tenant has fitted out the premises and ready to move in. This means that the date where Guocco Tower and DUO Tower is ready to take in physical occupation is in the first half of 2017. Therefore, based on this definition, there had been no net effective new supply for Q4/2016 and for the whole of 2016.

As of end-Q4/2016, the average Grade A vacancy rate rose 0.2 ppt QoQ to 4.5%. Compared to a year ago, however, the vacancy rate was still better, 0.4 ppt lower than Q4/2015's 4.8%. The improvement was due to a mixture of positive net absorption and an absence of net new supply.

GRAPH 1

Net demand, net supply and vacancy rate of CBD Grade A offices, 200–2016



Source: Savills Research & Consultancy

Rental and capital values

In Q4/2016, average rents of CBD Grade A offices stood at S$8.77 per sq ft per month, representing a decline of 1.6% QoQ and 5.8% YoY.

The softening of Grade A office rents was seen across the micro-markets that Savills tracked. In Q4/2016, rents decreased the most in the Marina Bay area, down 5.3% QoQ and 14.9% YoY. This is followed by the 2.1% QoQ and 7.5% YoY fall in the Raffles Place sub-market.

On the other hand, average capital values of CBD Grade A offices remained resilient and stayed at S$2,723 per sq ft for the sixth consecutive quarters since Q3/2015.

TABLE 1

Micro-market Grade A office rents and vacancy rates, Q4/2016

Location	Monthly rent (S$ per sq ft per month)	Vacancy rate (%)
Marina Bay	10.29	5.9
Raffles Place	8.95	3.4
Shenton Way	7.95	3.6
Tanjong Pagar	7.70	6.2
City Hall	9.11	3.5
Orchard Road	9.15	4.6
Beach Road/Middle Road	7.26	6.8

Source: Savills Research & Consultancy

GRAPH 2

Price and rental indices of CBD Grade A offices, Q1/200–Q4/2016

Source: Savills Research & Consultancy

OUTLOOK

The prospects for the market

With uncertainties rising as a result of slower global economic growth and China's rising corporate credit risks, Singapore's trade-dependent economy is expected to face continued headwinds in 2017. The government expected the state's economy in 2017 to remain modest with a yearly growth of 1.0-3.0%. Coupled with the ensuing uncertainty on policy issues following the changes in US's political administration, in the short-term at least, firms are expected to be more conservative in their expansion plans and net take-up of office space in the near term is expected to be soft. Given substantial unleased space in both newly-completed and upcoming developments as well as secondary stock returned to the market after tenants' relocation, we believe that gross rents are therefore likely to come under more downward pressure and decline by 10.0% in 2017.

However, gross face rents may still have the potentiality to surprise by either falling only marginally or stabilising in 2017 if the commitment rates of new buildings that are physically completing this year is healthy. This will generate a wave of positive vibes to landlords who may feel more confident to adopt the strategy of maintaining rents rather than engage in any pernicious acts of undercutting each other. Given that the effective rents for large tenants in some upcoming Grade A CBD buildings are already higher than last year's, the rental gradient from now till then is actually positive.

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