Briefing
Office sector

February 2018

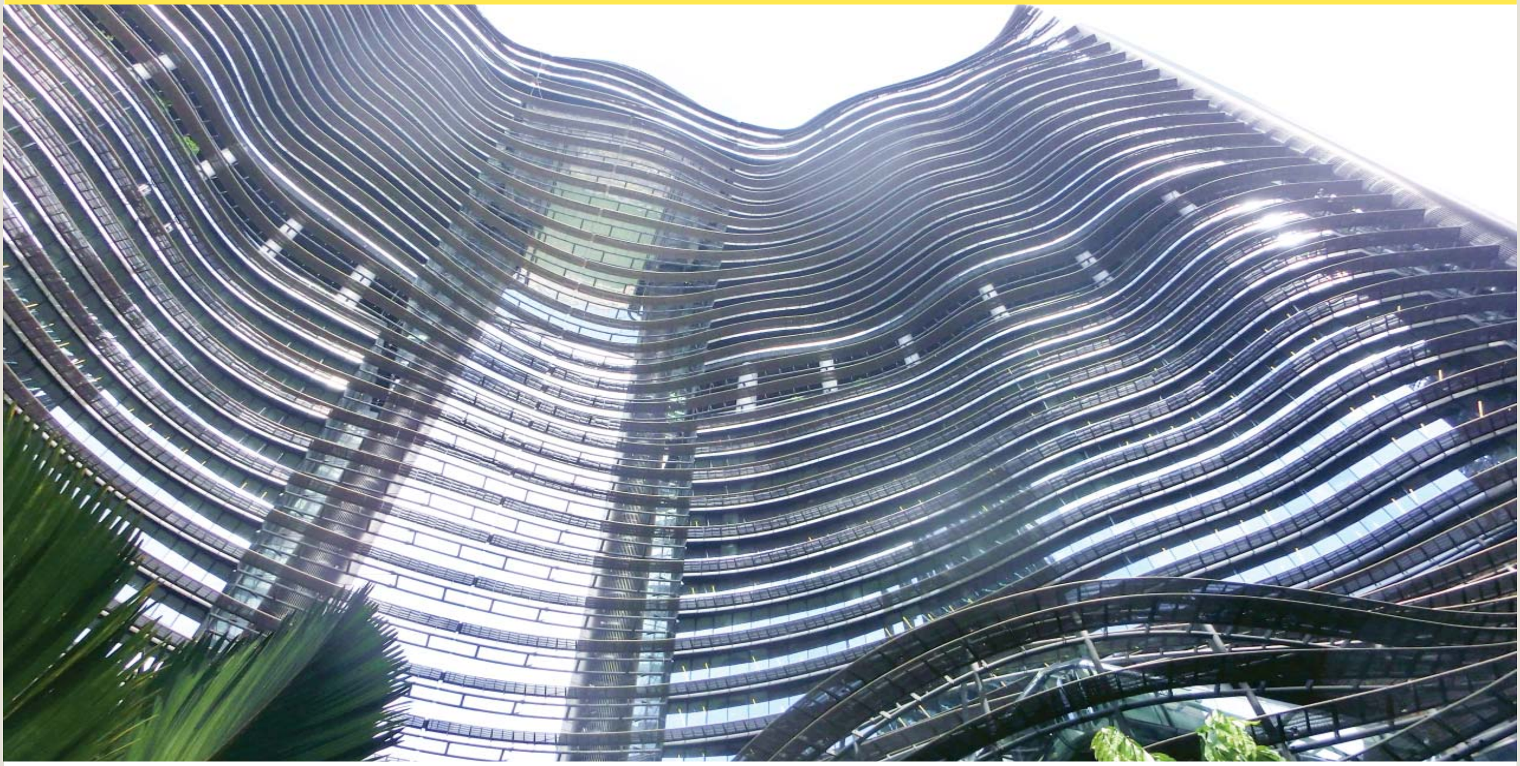

Image: Marine One at Straits View

SUMMARY

Net take-up of Grade A offices in the CBD hit a high in 2017.

- Demand for prime office space remained resilient in spite of increasing rents. In the meantime, co-working space providers continued to be active and have rapidly ramped up their presence in Singapore.

- The net take-up of CBD Grade A offices amounted to 607,000 sq ft in Q4/2017, bringing the full-year number to 1.59 million sq ft. This is the highest yearly demand since 2011.

- The vacancy rate of Grade A office space rose 1.9 percentage points (ppts) quarter-on-quarter (QoQ) to 7.7% as at end of Q4/2017.

- According to Savills basket, average rents of Grade A office space in the CBD rose 1.9% QoQ to S$8.94 per sq ft (psf) in Q4/2017. The rental rebound was led by Grade AAA office, which rose 3.9% during the Oct-Dec period.

- The lack of investible grade office stock from the private sector has been the restraining factor to having more transactions. Capital values of CBD Grade A offices remained flat at S$2,723 psf in Q4/2017.

- Our base case scenario is for average CBD Grade A office rents to rise 10% each year from 2018 to 2019.

"The strong take up in 2017 has given office landlords cause for further optimism in 2018. However, unbridled optimism can also be dangerous and potential threats should be taken into account." Alan Cheong, Savills Research

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Market commentary

Data from the Ministry of Trade and Industry (MTI) showed that Singapore's economy finished 2017 on a solid footing with a better-than-expected growth rate of 3.5% year-on-year (YoY). This full-year GDP advanced estimate hit the upper limit of the revised growth forecast range of 3.0-3.5%, and this was the best performance since 2014. The labour market in Singapore also showed signs of recovery in 2017 with fewer retrenchments and an increase in the number of employed local residents. Although the annual average unemployment rate for 2017 was 0.1 of a ppt higher than 2016, on a QoQ basis, it had fallen to 2.1% in December 2017 from the 2.2% recorded three months ago.

In light of stronger economic growth and a stabilising job market, momentum in office leasing carried on towards the end of the year. Also, the leasing volume did not fall because of seasonality factors. According to the statistics from the Urban Redevelopment Authority (URA), the number of leasing contracts that commenced in Q4/2017 rose 6.1% QoQ to 1,269[1]. The growth may also have been due to the substantial supply from newly-completed office space which has entered the market from the second half of 2017.

1 Based on data downloaded on 31 January 2018

Notwithstanding rising rents, the demand for prime office space remained resilient. In the CBD, Frasers Tower at Cecil Street received pre-commitments for more than 70% of its 663,000 sq ft office space, ahead of its completion in the first half of 2018. Following Microsoft's signing of some 125,000 sq ft in the development, French oil and gas company Total became another anchor tenant at Frasers Tower, leasing more than 100,000 sq ft in the mid-zone of the 38-storey building. Other tenants taking substantial floor space at Frasers Tower include Shiseido, Sumitomo Corporation, Arup, ABN Amro, Fonterra, Pacific Life and The Executive Centre.

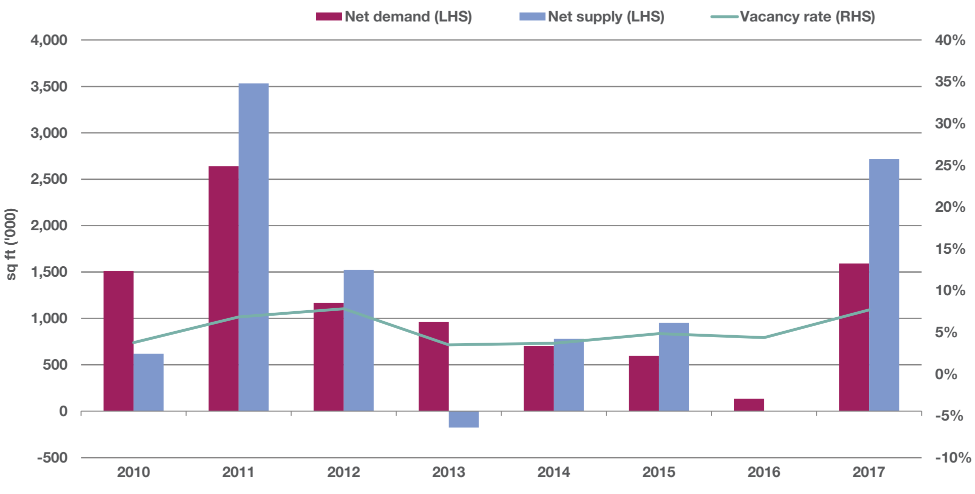
Co-working space providers continued to be active in looking for space in the market, as they ramped up their presence in Singapore. They have taken up large amounts of office space in new Grade A buildings as well as the secondary stock left behind in older buildings by tenants moving to newer office towers. WeWork, the largest co-working space operator in the world, finally opened its first location in Singapore – WeWork Beach Centre - in December 2017. WeWork will have other co-working spaces, such as those at 71 Robinson Road, China Square Central's heritage shophouse blocks and Funan (the redeveloped Funan DigitaLife Mall), which are scheduled to open from 2018 to 2019. In Q4/2017, local operator The Great Room opened its 36,000 sq ft second branch at Centennial Tower. UrWork, a co-working space operator from China, also secured about 15,000 sq ft of space at Suntec City as its second location, which is expected to open in Q1/2018.

In the sales market, the lack of investible grade office stock from the private sector has been the restraining factor to securing more transactions. Therefore, there were only two significant block transactions sealed in Q4/2017; the S$342.0 million sale of PoMo, a nine-storey office and retail block in Selegie Road, bought by Hong Kong's Gaw Capital Partners, and Oxley Holdings' S$660.0 million acquisition of Chevron House, a 32-storey commercial development at Raffles Place. Based on Chevron House's existing net lettable area, the price calculates to be approximately S$2,526 psf.

In the public sector, under the 2H/2017 Government Land Sales (GLS) Programme, a commercial site at Beach Road was awarded to a joint-venture between GuocoLand and Guoco Group for S$1.622 billion or S$1,706 psf per plot ratio, based on the plot's maximum GFA of 950,592 sq ft. To some extent, the bullish winning bid reflects the optimism of developers underpinned by the recent recovery in the office leasing market and better economy outlook. According to the authorities, at least 60% of the maximum GFA for the site must be for office use. This will be the only known major supply of prime office that comes to market beyond 2022.

GRAPH 1

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



Source: Savills Research & Consultancy

Demand, supply and vacancy

Demand for Grade A office space in the CBD powered ahead in the last quarter of 2017. Based on Savills estimates, the net take-up of CBD Grade A offices amounted to 607,000 sq ft in Q4, substantially higher than the 197,000 sq ft recorded the quarter previous. By location, the Marina Bay area

TABLE 1

Micro-market Grade A office rents and vacancy rates, Q4/2017

Location	Monthly rent (S$ per sq ft)	Vacancy rate (%)
Marina Bay	10.72	10.5
Raffles Place	9.05	4.5
Shenton Way	8.17	8.6
Tanjong Pagar	7.84	8.1
City Hall	9.31	4.1
Orchard Road	9.17	3.6
Beach Road/Middle Road	7.52	22.5

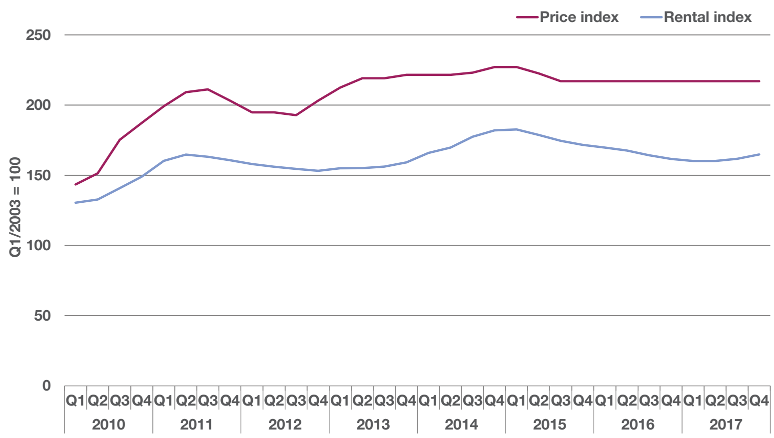
Source: Savills Research & Consultancy

recorded the highest net demand of about 468,000 sq ft in Q4/2017, followed by the Shenton Way micro-market that saw a net absorption of 151,000 sq ft. This was mostly bolstered by tenants' take-up in the newly completed Marina One East Tower in Marina View and UIC Building in Shenton Way.

As at the end of Q4/2017, the vacancy rate of Grade A office space rose 1.9 ppts QoQ to 7.7%, the highest since Q4/2012. This was due to demand not meeting net new supply of 1.26 million sq ft, coming from Marina One East Tower and UIC Building. Although these two developments have achieved high commitments, there remains vacant space as tenants have not moved in.

GRAPH 2

Price and rental indices of CBD Grade A offices, Q1/2010–Q4/2017



Source: Savills Research & Consultancy

Rental and capital values

According to Savills basket, average rents of Grade A office space in the CBD rose 1.9% QoQ to S$8.94 psf in Q4/2017. For the whole of 2017, the rental growth was also 1.9%. The year therefore saw a turnaround in rents which had been falling for nearly two years since Q2/2015. The rental rebound was led by the Grade AAA office sector, which rose 3.9% during the Oct-Dec period and 4.4% for the full year.

On a location basis, recovery in rents was broad-based. The Marina Bay micro-market enjoyed the strongest rental uptick of 3.9% QoQ in the fourth quarter and 4.2% YoY for the full year.

Compared with the improvement in rents, capital values of CBD Grade A offices continued to stay flat at S$2,723 psf in Q4/2017.

OUTLOOK

The prospects for the market

The overall outlook for 2018 is promising in terms of economic growth and business confidence. For the office market, there is reduced pipeline supply in the next few years. Based on the URA's latest statistics, the future supply of office space was nearly 8.5 million sq ft at the end of Q4/2017, with 2.2 million sq ft in 2018 and 1.1 million in 2019 respectively.

The psyche of Grade A office landlords was boosted and we are expecting them to continue to hold firm in the belief that this trend will carry over to 2018. However caution remains, given that such confidence cannot be taken for granted and is predicated on the ability of the tech and disruptive business model segments continuing their ease in obtaining ready funding. Any disruption in the ability of the two sectors to raise funds will have negative multiplier effects on both the economy and office space demand.

For instance, if co-working space operators decide to consolidate or their funding dries up towards the second half of 2018, the ability of new buildings and secondary stock to soak up their soon-to-be available space can suddenly become a concern. The office sector here is particularly subjected to global business trends. As mainstream market watchers are still expecting the telecommunication, media and technology (TMT) sector to expand rapidly, significant new supply of Grade A office space in the CBD should not be of concern.

Today, an air of optimism surrounds the office sector with landlords believing that demand is robust enough to accept higher asking rents. However, we do feel it necessary at this early stage to highlight some risks because unbridled optimism can be dangerous when complacency sets in. If we conduct a post mortem on the industrial space market, we saw occupancy and rents tumble when oil and gas prices collapsed. In the process, the cross linkages between this sector and others like the marine industry decimated a large chunk of demand for industrial and warehousing space. The probability of that being replayed in the Grade A CBD office sector is not insignificant. All it takes is a major sector which is a key occupier to be subjected to a sizeable downfall, similar to that of the oil, gas and marine sectors, for the office sector to take a beating. As of Q4/2017, the stock of Grade A CBD office space recorded by Savills stood at 30.4 million sq ft. Given that approximately 20% of leases in a stabilised Grade A office building expire or are due for renewal in a year, this equates to about 6.08 million sq ft, which is not insignificant. If there is a downturn in a major global growth sector which uses both office and business parks space, the fallout could be earth shaking.

For now, if the existing trend is set to continue then we can expect CBD Grade A office rents in 2018 and 2019 to rise 10% YoY each year.

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