Briefing
Office sector

May 2018

Image: UIC Building at Shenton Way

SUMMARY

Tenants are beginning to balk at high rents, especially in the CBD.

- On the back of strong economic growth, the office leasing market remained healthy in Q1. However, leasing activity in the CBD slowed slightly due to the hike in asking rents.

- Some 984,000 sq ft of prime office space was added to Savills basket of CBD Grade A offices in Q1/2018, bringing the total stock of such space to around 31.4 million sq ft.

- Approximately 754,000 sq ft of Grade A office space in the CBD was absorbed in Q1/2018, with the Marina Bay precinct leading the market at a net take-up of about 400,000 sq ft.

- As at end Q1/2018, the vacancy rate of CBD Grade A office space inched up 0.5% quarter-on-quarter (QoQ) to 8.2%.

- The average gross rent for Grade A office space in the CBD in Q1/2018 strengthened for a third consecutive quarter, albeit at a slower rate of 1.3% QoQ.

- Thus far, the market views that the downside risks in the office leasing market are declining, underpinned by healthy pre-commitment levels in two upcoming projects – Frasers Tower and Paya Lebar Quarter - as well as faster than expected absorption of secondary stock.

"Although a large part of demand is from disruptive businesses yet to make money, landlords are ignoring this and capitalizing on healthy take-up to raise asking rents."
Alan Cheong, Savills Research

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Market commentary

According to the Ministry of Trade and Industry (MTI), Singapore's GDP growth for the first quarter of 2018 hit 4.3% year-on-year (YoY), higher than the 3.6% growth in Q4 of last year. This was bolstered by the manufacturing sector, which grew 10.1% YoY, and the services industry, led by finance & insurance and wholesale & retail trade, which registered 3.8% YoY growth.

On the back of stronger than expected economic growth, the office leasing market remained healthy in Q1. Based on data from the Urban Redevelopment Authority (URA), a total of 1,264[1] office leases commenced in the first quarter of 2018, inching down 0.6% from a quarter ago.

However, leasing activity in the CBD has slowed slightly due to the hike in asking rents. While the strengthening economy has lifted business sentiment and encouraged business expansion, manpower and operating costs remain key concerns for most companies here. In light of increasing rents, cost-conscious tenants are deciding either to pull down their expansion plans or relocate their middle/back offices to city fringe or regional centres so as to release space for core business. On the other side, landlords, particularly those owning premium buildings with tight vacancy, continue to be in a strong position during rental negotiations. This has caused a stalemate in the market, which is expected to continue in the coming quarters.

As one of the major completions expected in 2018, Paya Lebar Quarter (PLQ), located next to Paya Lebar MRT Station, has secured tenants for more than half of its nearly one million sq ft of office space, ahead of its scheduled opening in Q3. The SMRT Corporation has taken up three levels for about 100,000 sq ft of space in one of PLQ's three office towers, and will move its headquarters from North Bridge Road to this new location next year. At the same time, up to 15% of available office space in PLQ will be used to house co-working facilities, which will allow smaller start-ups to network and partner with established companies on special projects.

Demand, supply and vacancy

Some 984,000 sq ft of office space from the West Tower of Marina One in the Marina Bay micro-market was added to Savills basket of CBD Grade A offices in Q1/2018, bringing the total stock of such space to around 31.4 million sq ft.

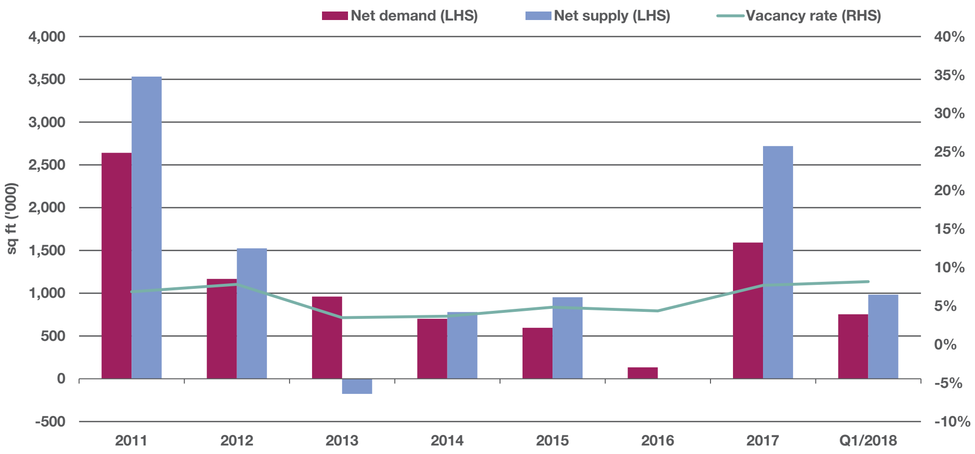
On the demand side, owing to tenants' moves in to newer developments over the last two years - including DUO Tower, Marina One and UIC Building – and the steady take-up of secondary space left by those relocations, approximately 754,000 sq ft of Grade A office space in the CBD was absorbed in Q1/2018. The Marina Bay precinct continued to lead the market with a net take-up of about 400,000 sq ft, while the remaining sub-markets of Raffles Place, Shenton Way, Tanjong Pagar, City Hall, Orchard Road and Beach Road/Middle Road witnessed net absorption rates ranging between 12,000 sq ft and 97,000 sq ft.

The vacancy rate of CBD Grade A office space in Savills basket inched up 0.5% QoQ to 8.2% for Q1/2018. Marina Bay was the only sub-market where the vacancy rate edged up higher, by 5.8% QoQ, because net supply outpaced net demand during the same period. In contrast, positive take-up coupled with no new supply meant that occupancy levels in other

1 Based on data downloaded on 2 May 2018.

GRAPH 1

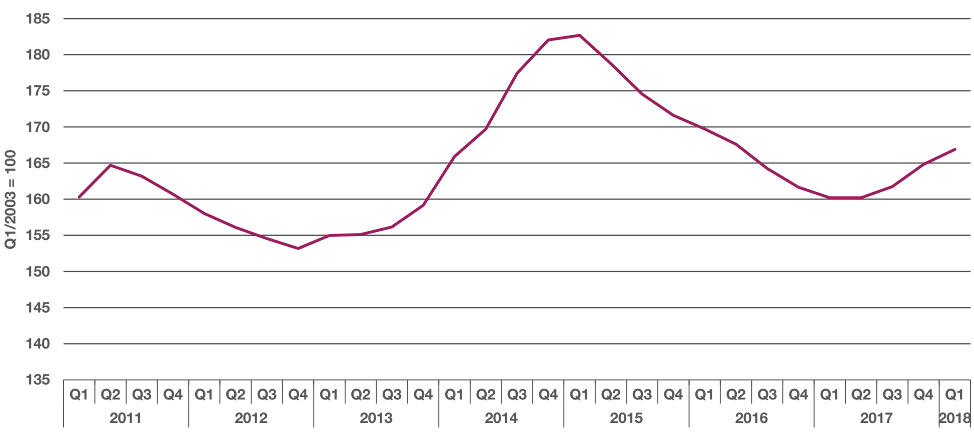
Net demand, net supply and vacancy rate of CBD Grade A offices, 2011 – Q1/2018



Source: Savills Research & Consultancy

GRAPH 2

Rental index of CBD Grade A offices, Q1/2011 – Q1/2018



Source: Savills Research & Consultancy

micro-markets tracked by Savills showed improvement, with vacancy rates falling by 0.7% to 4.9% from a quarter ago.

Rents

In the first quarter of 2018, the average gross rent for Grade A office space in the CBD strengthened for a third consecutive quarter, albeit at a slower rate of 1.3% QoQ. This growth has brought rents to S$9.06 per sq ft (psf) per month. The moderate rental growth was seen in the AAA and AA grade office sectors, especially the former where rates had risen quickly - by 6.1% over two quarters - from the last trough in Q2/2017 to Q4/2017.

By location, the Tanjong Pagar and City Hall sub-markets both enjoyed the highest rental growth of 2.5% QoQ, while Marina Bay, Raffles Place and Shenton Way recorded quarterly gains of 1.1% to 1.8%. The rents in two remaining micro-markets – Orchard Road and Beach Road/ Middle Road – stayed flat from a quarter ago.

TABLE 1

Micro-market Grade A office rents and vacancy rates, Q1/2018

Location	Monthly rent (S$ per sq ft)	Vacancy rate (%)
Marina Bay	10.91	16.3
Raffles Place	9.15	3.8
Shenton Way	8.27	7.0
Tanjong Pagar	8.05	5.2
City Hall	9.54	2.8
Orchard Road	9.17	2.9
Beach Road/Middle Road	7.52	17.6

Source: Savills Research & Consultancy

OUTLOOK

The prospects for the market

Thus far, the market views that the downside risks in the office leasing market are declining, underpinned by healthy pre-commitment levels in two upcoming projects – Frasers Tower at Cecil Street and PLQ - as well as faster than expected absorption of secondary stock. However, due to tenants increasing resistance to rent hikes and the widening rental gap between the CBD and outside the CBD, demand for CBD office space may divert to sites on the city fringe and in regional centres, and even in business parks if tenants can meet the qualifications for use.

The rise in both prices and rents in Q1/2018 comes as no surprise given improved sentiment amongst buyers, landlords and tenants. For rents, the healthy pre-commitment by tenants last year helped absorb a substantial amount of space in the new builds. On top of that, the secondary space found replacement tenants in the form of co-working spaces. In fact, over the past two years, co-working space operators have been the major lifeline for CBD office buildings. Through the end of 2017, the amount of floor space in the CBD taken up by co-working space operators was about 390,000 sq ft. Although quite a few of the operators did not take up prime Grade A office space, they nevertheless soaked up the backfill or secondary space vacated by tenants moving to new builds.

The demand for CBD office space from co-working space operators from 2018 onwards is forecast at about 600,000 sq ft, about half of which will be housed in secondary space. Consequently, landlords expect the momentum from 2017's strong take-up to spill over in to 2018 and thus have been bold in asking for higher rents. Given that all parties engaged in the office leasing nexus are vectored positively in their views of their respective businesses, we

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expect rents to continue to rise for prime Grade A space. Already, there is evidence of such optimism as S$15 psf has been achieved for partial floor lettings in the Marina Bay area. This may rise to S$16 psf by the latter part of 2018.

The one thing that the market appears to ignore is that a large portion of rental demand in the past few years and for the rest of 2018 will come from alternative or disruptive-model businesses, which are a long way from registering positive cash flow. This is a major risk factor, but for now, barring any blowout in the disruptive business economy, we maintain our view that CBD Grade A office rents are expected to rise 10% YoY by Q4/2018.

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