Office

Office market en route to recovery

With limited supply in the pipeline, the office leasing market has seen a pickup in demand with rents of CBD Grade A offices recording their first quarterly increase in 11 quarters.

- Our office leasing professionals believe that office demand is starting to pick up in the quarters ahead with additional companies, aside those from the technology industries, embarking on modest expansion plans. This is a reversal of the downsizing plans expected by the market in previous quarters.

- A two-tier office market has emerged with premium buildings continuing to perform well with tight vacancy rates where landlords remain bullish on the rental trajectory while older buildings face declining demand pressures.

- The improvement in the office leasing market, alongside a gradual recovery in economic activity, led to more buying activity in the office investment market. In particular, investors continue to favour quality offices in prime CBD locations.

- With the addition of the recently completed CapitaSpring into our office stock basket, the vacancy rate rose 1.6 percentage points (ppts) on a quarter-on-quarter (QoQ) basis to 7.2% in Q1/2022. This was attributed to the significant increase of 4.2 ppts in the vacancy rate of Grade AAA offices. Nevertheless, although vacancy rates rose in the quarter, net demand for CBD Grade A offices tracked by Savills remained positive for a third consecutive quarter, albeit for a more moderate 59,000 sq ft, compared with 206,000 sq ft in Q4/2021.

- The gradual pickup in office demand brought about the first QoQ increase in average monthly office rents in Savills basket of CBD Grade A offices since Q2/2019 when office rents rose by 1.0%. In Q1/2022, office rents inched up by 0.7% QoQ to S$9.44 psf per month.

- As there is still plenty of macro uncertainty impacting the business outlook as well as supply constraints, we will keep our Grade A CBD office rental forecast for 2022 to 3%, up 1% from our previous 2% upper band.

"Office rents are likely to have entered a new cycle but the steepness of the trendline is still unclear."

ALAN CHEONG, SAVILLS RESEARCH

Savills team

Please contact us for further information

SINGAPORE

Marcus Loo
CEO, Singapore
+65 6415 3893
marcus.loo@savills.com.sg

Ashley Swan
Executive Director
Commercial
+65 6415 3872
ashley.swan@savills.com.sg

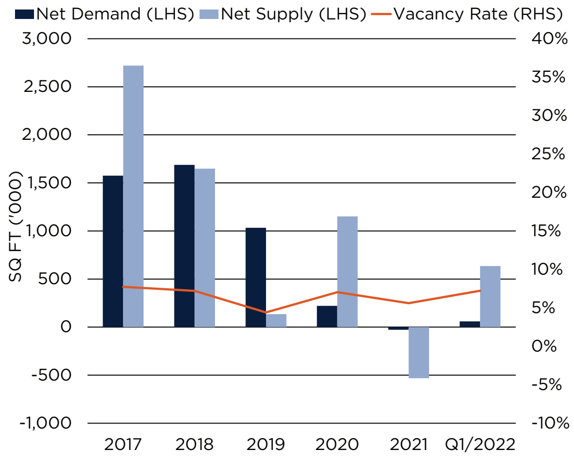
RESEARCH

Alan Cheong
Executive Director
Singapore
+65 6415 3641
alan.cheong@savills.com.sg

Simon Smith
Regional Head of
Research & Consultancy
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk

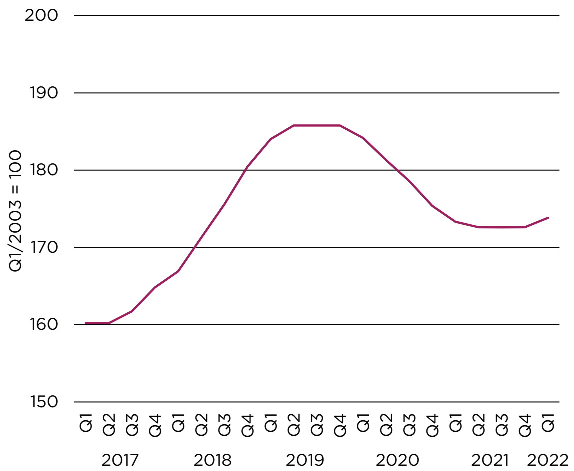
MCI (P) No. 022/10/2020
Company Reg No. 198703410D

GRAPH 1: Net Demand, Net Supply and Vacancy Rate of CBD Grade A Offices, 2017 to Q1/2022



Source Savills Research & Consultancy

GRAPH 2: Rental Indices of CBD Grade A Offices, Q1/2017 to Q1/2022



Source Savills Research & Consultancy

TABLE 1: Micro-Market Grade A Office Rents and Vacancy Rates, Q1/2022

LOCATION	MONTHLY RENT (S$ PER SQ FT)	VACANCY RATE (%)
Marina Bay	12.13	3.8%
Raffles Place	9.64	10.7%
Shenton Way	8.73	11.8%
Tanjong Pagar	8.50	9.2%
City Hall	9.70	3.7%
Orchard Road	8.91	2.1%
Beach Road/ Middle Road	7.64	6.5%

Source Savills Research & Consultancy

MARKET COMMENTARY

Advance estimates showed that Singapore's Q1/2022 gross domestic product (GDP) grew 3.4% year-on-year (YoY) moderating from the 6.1% growth seen in the previous quarter. On a QoQ seasonally adjusted basis, the Singapore economy expanded 0.4%, slower than the 2.3% recorded in Q4/2021. In the quarter in review, the manufacturing, construction and services producing industries registered YoY growth of 6.0%, 1.8% and 3.9% respectively. The 6.0% YoY growth in the manufacturing sector, a slowdown compared to the 15.5% increase in Q4/2021, was supported by all clusters except for chemicals. Output of the electronics and precision engineering clusters continued to grow strongly and this was attributed to sustained global demand for semiconductors and semiconductor equipment. Out of the sectors in the services producing industries, the strongest growth was from the Information & Communications, Finance & Insurance and Professional Services sectors. This came in with a YoY expansion of 5.3%. The expansion of the information & communications sector continued to be supported by robust demand for IT and digital solutions, while the growth in the finance & insurance sector was led by activities auxiliary to financial services (such as security dealing and payments processing activities) as well as the insurance segment.

Compared to the past few quarters, the belief amongst our office leasing professionals is that office demand is starting to pick up again. The main demand driver remains technology firms, such as ByteDance, with ongoing expansion plans as the firm is reportedly taking up space at Capital Tower after occupying significant pockets of space at One Raffles Quay and Guoco Tower. Interestingly for other firms, instead of downsizing, the prevalent expectation last year, some have embarked on modest expansions. For others, many are still contemplating adopting hybrid work arrangements. At this juncture, these companies have not yet decided on what form they will adopt and will need more time to craft plans.

With more staff able to return to their workplaces, co-working spaces are also picking up and there are more enquiries for such spaces. Among these, much are enterprise solutions, which provide companies with customised office space to fit their business needs with flexibility, while deciding on any future long-term spatial needs. For co-working operators, many of them continue to hold management contracts with landlords of buildings instead of taking up leases themselves.

A two-tier market appears to be forming. On one hand, the premium, high-specification buildings continue to perform well where vacancy rates remain tight, and landlords hold a bullish view about the rental trajectory. These are also the buildings largely favoured by technology firms and with the limited potential supply of such buildings (until the completion of Guoco Midtown in late Q4/2022 and IOI Central Boulevard Towers in late-2023), any vacant space in the CBD Grade A buildings which enters the market has been absorbed relatively quickly. On the other hand, older buildings continue to face vacancy pressures and if this persists, it may lead the owners of such buildings to either upgrade or redevelop them. It is this potential withdrawal of stock from the market which should keep rents high in the foreseeable future.

With the improving leasing market and a gradual renormalisation of economic activity, buying interest in office assets remains high with investors favouring quality assets in prime CBD locations. In the first quarter, there were five block transactions four of which are in the CBD. Of the four the two office buildings are 79 Robinson Road (sold for S$1.26 billion) and Cross Street Exchange (sold for S$810.8 million). The largest office investment deal in Q1/2022 was the acquisition of the remaining 68.2% stake in Jem by Lendlease Global Commercial Reit for around S$1.42 billion.

DEMAND AND VACANCY

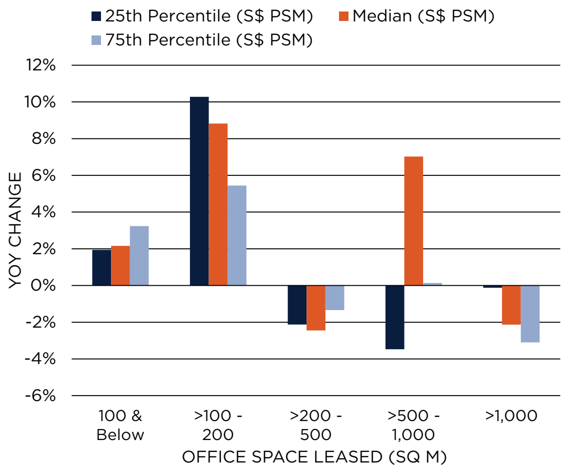
Based on the CBD Grade A offices tracked by Savills, the vacancy rate rose by 1.6 ppts QoQ to 7.2% in Q1/2022. This was attributed to the addition of CapitaSpring, a Grade AAA building, into office stock. In the previous quarter, the addition was Afro-Asia-i-Mark. As a result, there was a significant increase of 4.2 ppts in vacancy in CBD Grade AAA buildings from 3.3% in Q4/2021 to 7.5% in Q1/2022. Similarly, vacancy rates of Grade AA buildings rose 2.2 ppts QoQ to 7.1%. On the other hand, vacancy rates of Grade A buildings declined from 8.5% in Q4/2021 to 7.1% in the quarter. Despite the increase in vacancy rates in Q1/2022, net take-up of CBD Grade A offices remained positive for the third consecutive quarter, albeit moderating to 59,000 sq ft, from 206,000 sq ft in the previous quarter.

Across the various micro-markets, QoQ increases in vacancy rates were observed for Raffles Place, Shenton Way, City Hall and Beach Road/Middle Road. Out these areas, the largest rise in the vacancy rate was in Shenton Way and this was largely due to JP Morgan relocating to the newly completed CapitaSpring. While vacancy rate of offices in Orchard Road remained unchanged in the quarter, declines in vacancy rates were registered for Marina Bay (-0.4 of a ppt) and Tanjong Pagar (-0.2 of a ppt).

RENTS

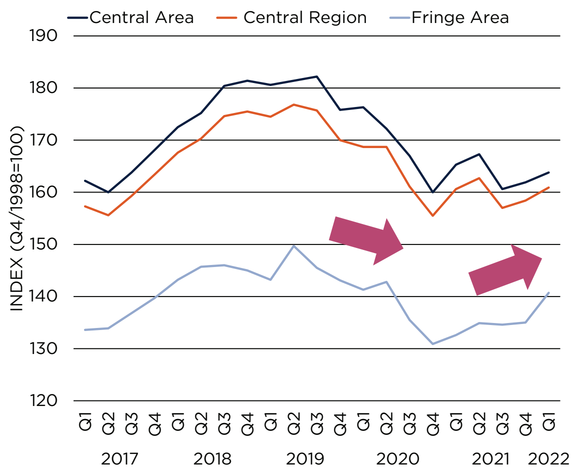
Coinciding with our office leasing professionals' view that more tenants are deciding not to right size but maintain their office footprint or even accommodate staff increases in future through hybrid work arrangements, the average monthly rents of Savills basket of CBD Grade A offices

GRAPH 3: Q1/2022 Category 1 Office Building QoQ Rental Changes by Leased Areas



Source Savills Research & Consultancy, URA Realis

GRAPH 4: URA Private Sector Office Rental Index, Q1/2017 to Q1/2022



Source Savills Research & Consultancy, URA Realis

recorded its first QoQ increase since Q2/2019 when office rents rose 1.0% QoQ. In the quarter, monthly CBD Grade A office rents inched up by 0.7% QoQ to S$9.44 psf. On a YoY basis, this represented a 0.3% growth, the first increase since Q1/2020 when office rents rose by 0.1% YoY. Rents of Grade A offices registered the largest QoQ expansion of 0.8%, followed by Grade AAA offices and Grade AA offices which grew by 0.7% and 0.6% respectively in the quarter. While rents of Grade AA and A offices continued their upward trajectory, rents of Grade AAA offices saw their first quarterly increase since Q2/2019 when office rents rose 1.0%.

Rents of CBD Grade A offices across all micro-markets increased in the quarter. The only micro-market which did not experience any increase was Orchard Road and Tanjong Pagar. Amongst the micro-markets which showed QoQ rental growth, the largest was observed in Beach Road/Middle Road where office rents rose 2.9% on a QoQ basis. This was followed by Raffles Place, which registered a QoQ increase of 1.1%, after showing a marginal growth of 0.1% QoQ in Q4/2021. With the office leasing market continuing to improve, rental growth is expected to accelerate in the coming quarters.

OUTLOOK

Market observers have been jumping the gun with their predictions of when office rents would start to rise significantly in 2021. However, when the year ended, going by URA's definition of prime CBD offices which they term Category 1 Office Buildings[1], it was a mixed picture. For 2021, the URA computed office rental index for the Central Area rose a mere 1.2% YoY. Savills basket of Grade A CBD office rents fell by 1.6% over a similar time frame. Graph 3 shows the QoQ changes for Category 1 Office Building rents in Q1/2022. While the performance in general can be seen to be positive, the variances amongst the various quartiles and leased areas are great.

In 2021, tenants were unsure whether to expand or right size with many leaning towards the latter option when the time came for a decision with regards to their tenancy renewal. With rents in 2021 improving marginally, recovery was not so much in doubt but was more a timing issue. We believe that 2022 may be the year when the rental growth rate of Grade A CBD offices is likely to see an acceleration on a QoQ basis. However, we do not believe that the increases will be sharp.

Graph 4 shows that the Q1/2022 URA index for office rents in the Central Area rose 1.2% QoQ. We see that the downward trend of rents which began in Q3/2019 appears to have inflected around the middle of 2021 and is presently in the initial stages of forming a new trajectory in the current cycle. From what one sees from the graph, the increase, though noticeable, has been rather subdued.

The Grade A CBD office market appears to have entered a new post pandemic cycle. However, it may take a few more quarters to get an idea of the gradient of office rents in this new cycle. As there are still plenty of macro uncertainties impacting the business outlook as well as supply constraints, we will keep our Grade A CBD office rental forecast for 2022 to 3%, up 1% from our previous 2% upper band.

1 Category 1 office buildings are defined as those located in core business areas in Downtown Core and Orchard Planning Area which are relatively modern or recently refurbished, command relatively high rentals and have large floor plate size and gross floor area.