Singapore – April 2024

MARKET IN MINUTES
Savills Research

Office

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Stable rents after 8 quarters of increase

The office leasing market appears to be in limbo with no sector standing out as a significant demand driver. With no new supply, office rents to remain unchanged in Q1/2024, coming after eight consecutive quarters of increase.

- While there may be rental reduction for some older buildings that have higher vacancies, the cost savings are not significant enough for companies to get approval from their head offices to relocate due to the high capex and reinstatement costs. Hence most of the leasing activities were for lease renewals.

- The office investment market turned lacklustre in the quarter after a large rebound in Q4/2023, declining 95.0% to S$69.7 million. This was due to a lack of block transactions and lesser strata office sales.

- Based on data compiled by Savills, the vacancy rate of CBD Grade A offices fell for the second consecutive quarter by 0.4 of a percentage point (ppt) quarter-on-quarter (QoQ) to 6.1% in Q1/2024, the lowest since Q4/2022 when office vacancy rate was 5.6%.

- After eight consecutive quarters of increase, the average monthly rents of CBD Grade A offices in Savills basket flattened out in Q1/2024 at S$9.65 psf. While offices with high occupancies can continue to demand high rents, this was offset by some office buildings that recorded declining occupancies and rents were adjusted to attract tenants. Hence, this resulted in a two-tier market in the office leasing scene, which is also evident for Grade AAA offices.

- Higher interest and operating expenses are expected to add resistance towards any significant rental corrections. With the average annual new supply of Grade A CBD space expected at about 808,000 sq ft for the period 2024 to 2026, versus the annual average ten-year net take up at 696,000 sq ft, landlords may still have that negotiation power and any downward rental adjustments may be mild. For 2024, we maintain our Grade A rental forecast at -2% to -3%.

"Leasing activity will only begin to increase towards the end of the year when more major leases are due for renewal."

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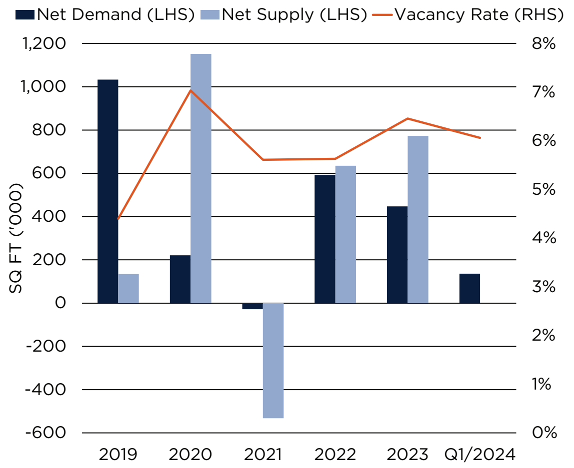
GRAPH 1: Net Demand, Net Supply and Vacancy Rate of CBD Grade A Offices, 2019 to Q1/2024



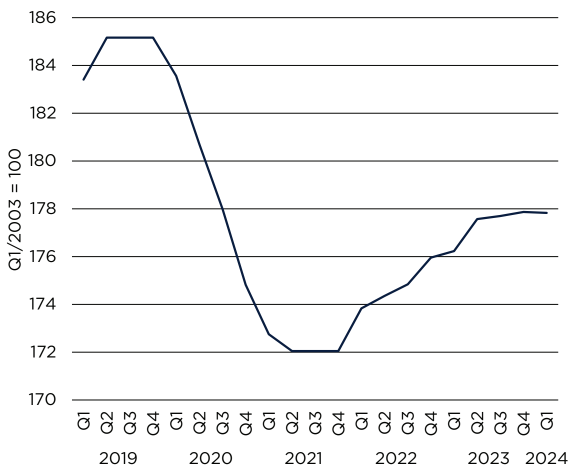
Source Savills Research & Consultancy

TABLE 1: Micro-market Grade A Office Rents and Vacancy Rates, Q1/2024

LOCATION	MONTHLY RENT (S$ PER SQ FT)	VACANCY RATE (%)
Marina Bay	12.62	4.7%
Raffles Place	9.99	7.3%
Shenton Way	8.94	6.0%
Tanjong Pagar	8.50	10.5%
City Hall	10.08	5.1%
Orchard Road	8.98	2.7%
Beach Road/ Middle Road	8.02	7.0%

Source Savills Research & Consultancy

GRAPH 2: Rental Indices of CBD Grade A Offices, Q1/2019 to Q1/2024



Source Savills Research & Consultancy

MARKET COMMENTARY

According to the advance estimates provided by the Ministry of Trade and Industry (MTI), Singapore's economy grew 2.7% year-on-year (YoY) in Q1/2024, faster than the 2.2% in Q4/2023. On a QoQ seasonally adjusted basis, the Singapore economy expanded by a mere 0.1%, extending the 1.2% growth in the previous quarter. The accelerated YoY growth in Singapore's economy was attributed to larger growth in the services producing industries of 3.2% in Q1/2024, as compared to the 2.0% in Q4/2023. While the manufacturing and construction sectors continued to expand, the pace of growth slowed in the quarter, from 1.4% and 5.2% respectively in Q4/2023 to 0.8% and 4.3% respectively in Q1/2024. Growth in the manufacturing sector was led by output expansions in the chemicals, precision engineering and transport engineering clusters. Among the services sectors, the group of sectors consisting of the information & communications, finance & insurance and professional services sectors grew by a larger 4.2% YoY, compared to the 3.6% growth in the previous quarter. Growth in the information & communications sector was supported by continual firm demand for IT and digital solutions, while that in the professional services sector was largely led by the head offices & business representative offices segment. The finance & insurance sector also grew on the back of strong performance of the banking and activities auxiliary to financial services segment.

As tech firms take a backseat in taking up large chunks of space, there are no replacement sectorial drivers in the office leasing market to boosting leasing activities. The end result is a lackadaisical leasing market. While some older buildings with higher vacancies have adjusted their rents to fill those voids, the reductions are not significant enough for companies to get approval from their head offices to move in from other locations due to the high capex and reinstatement costs. In addition, because of high borrowing costs, landlords are presently less willing to finance the capex to attract new tenants. On the supply side, apart from IOI Central Boulevard Towers that will be completing soon, the supply of new Grade A office space is limited and this has the effect of reducing the number of tenant relocations. As such, much of the leasing activity continue to be centered on lease renewals, and most of the leases are renewed for short term, ie. three years instead of the usual five to seven years, until further clarity on business decisions by the head offices and improvements in the economy. There was also a reduction in shadow space as companies stay put in their existing locations. The office leasing market may take a turn for the better if more buildings get redeveloped. Tenants who have been displaced by this will then have to relocate.

On the investment sales front, after the large rebound in Q4/2023, transaction values fell 95.0% to S$69.7 million in Q1/2024. This was attributed to a lack of block transactions and strata office investment sales in the quarter. In the reviewed quarter, there were three strata office units sold, lower than the five in the previous quarter. Two of the larger transactions in Q1/2024 were from Vision Exchange, which were for all the units on the 21st floor.

DEMAND AND VACANCY

From data compiled by Savills, the vacancy rate of CBD Grade A offices fell for the second consecutive quarter by 0.4 of a ppt to 6.1% in Q1/2024, the lowest since Q4/2022 when it was at 5.6%. On a YoY basis, vacancy rate of overall CBD Grade A offices declined by a marginal 0.1 of a ppt. Quarterly declines in vacancy rates were observed across Grades AAA and A buildings, falling 0.8 of a ppt for Grade AAA buildings to 6.2% and 0.4 of a ppt for Grade A buildings to 7.3%. Vacancy rates of Grade AA buildings remained unchanged in the quarter at 4.8% after three consecutive quarters of decline. With the lower vacancy rates, net demand for CBD Grade A offices remained positive for the third consecutive quarter in Q1/2024, amounting to 136,000 sq ft, relatively similar to the 128,000 sq ft in the previous quarter.

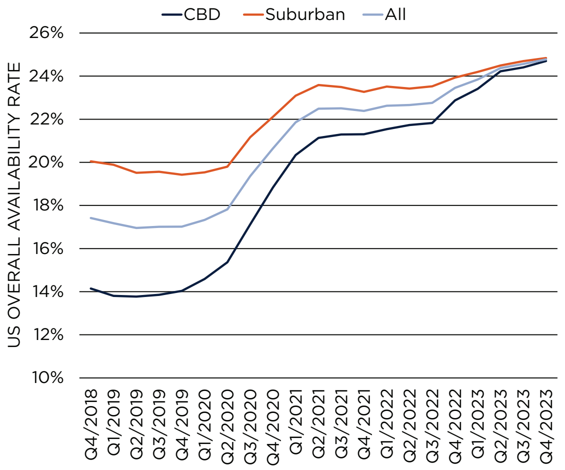
By location, almost all submarkets registered quarterly declines in vacancy rates except for Raffles Place, which rose by a marginal 0.2 of a ppt to 7.3% after having remained unchanged in the previous quarter. After two consecutive quarters of decline, the vacancy rate at Shenton Way stayed flat at 6.0%. The other submarkets recorded decreases in vacancy rates ranging from 0.1 of a ppt to 2.1 ppts. The largest contraction in vacancy rate was at City Hall, due mainly from more tenants moving into the recently completed Guoco Midtown. Centennial Tower and Suntec Tower 5, which are also in the same submarket, also recorded quarterly declines in vacancy rates.

Compared to the same period last year, there was also a fall in overall Grade A office vacancy rates, albeit a marginal 0.1 of a ppt. While YoY growth in vacancy rates were observed for City Hall (0.2 of a ppt), Marina Bay (0.8 of a ppt) and Orchard Road (1.7 ppts), yearly decreases in vacancy rates between 0.4 of a ppt and 1.1 ppts were observed for the other submarkets.

RENTS

With new office supply manageable, and lease expiries largely due in 2025 and 2026, for now, landlords are generally not in much pressure to reduce rents. Consequently, the average monthly rents of CBD Grade A offices in Savills basket remained unchanged at S$9.65 psf in Q1/2024, levelling off after eight consecutive quarters of increase. On a YoY basis, the increase was 1.0%.

GRAPH 3: US Cities Vacancy Rates, Q4/2018 to Q4/2024



Source Savills US

TABLE 2: Tech Companies Layoffs

PERIOD	2022	2023	JAN - 12 APR 2024
Layoffs	165,269	263,180	60,000
Tech cos.	1,064	1,191	254
Layoff per tech no.	155	221	236

Source Layoffs.fyi

By grades, rents also did not change in the quarter. Rents of Grades AAA and AA offices remained unchanged for the second consecutive quarter at S$12.70 psf and S$10.53 psf respectively. Grade A office rents stayed firm at S$8.56 psf after nine consecutive quarters of increase. While there was no change in CBD Grade A office rents on a QoQ basis, the rents still manage to register growth on a YoY basis. Rents of Grade AAA offices rose the most by 1.3%, followed by Grade A by 1.0% and Grade AA by 0.8% respectively. Office buildings that continued to enjoy high occupancies are still able to command high rents and even recorded rental increments, which are offset by some office buildings that have increasing vacancies and hence face pressure to reduce rents to attract tenants. This resulted in a two-tier market.

By micro-markets, rents of Grade A offices in City Hall and Marina Bay dipped by 0.1% and 0.2% in the quarter. This was the first quarter of decline for rents in City Hall and second consecutive quarter of contraction for those at Marina Bay. Rental declines in these two submarkets were offset by rental increase in Beach Road/Middle Road, which grew 0.2% QoQ. This increase was from the higher rents at Bugis Junction Towers. Grade A offices in the four other submarkets (ie. Orchard Road, Shenton Way, Tanjong Pagar and Raffles Place) registered no rental change in Q1/2024. For Raffles Place, this levelling off came after nine consecutive quarters of increase.

OUTLOOK

The office leasing market is expected to remain in a stupor for the first half of 2024 as many of the larger leases are only expiring towards end-2024 to 2026. Even if they are due, based on the feedback from tenants, they are likely to renew as the option to relocate is not a luxury they can afford. Expectations of a continuation in challenging business conditions in Europe and Asia are reigning in corporate expenditures. This led to two developments. One is the usual headcount reductions, and the other is a closer examination of office planning. Together, the net effect on office footprint is a scale back on office space or, maintaining the same area but a reconfiguration of the office by reducing the number of work desks and assigning more to collaborative spaces.

In the decades prior, the large office space users were often those in the financial industry. This moved onto tech companies for the period 2015 to early-2022. However, with Covid spawning the Work-from-Home practice and hybrid working, subsequently, enduring high interest rates and tax law changes in the US, forced through the urgent need to cut overheads (Please refer to Table 2). Consequently, office vacancies there rose sharply (Please refer to Graph 3). So far, because the supply of new offices was constrained in the later part of the last decade, and the fact that tech companies had signed long leases, current vacancy levels here are still healthy.

Moving forward, companies must contend with how they can harness Artificial Generative Intelligence (AGI) to bring about productivity gains. We are now at the early stages of what could be a new industrial revolution. Ultimately, whether a tenant is in the traditional or tech industries, they are saddled with common constraints. One, fitout budgets are hard to come by, two, headcount reductions and three, workplace reorganization is still on going. The first and second points are leading to the current stasis we are witnessing in the leasing market. The first and third are still in the works and we will see them executed once leases come due for renewal.

Although the general trend is towards some form of downsizing by tenants, there is additional resistance to downward rental adjustments. This comes in the form of much higher interest rates and elevated inflation causing operating expenses to rise. If the Grade A CBD market sess greater supply, the resistance would be much lower. However, with the three-year average annual new supply of Grade A CBD space expected at about 808,000 sq ft, versus the annual average ten-year net take up at 696,000 sq ft, landlords may still have that negotiation power and any downward rental adjustments may be mild. For 2024, we maintain our Grade A rental forecast at -2% to -3%.