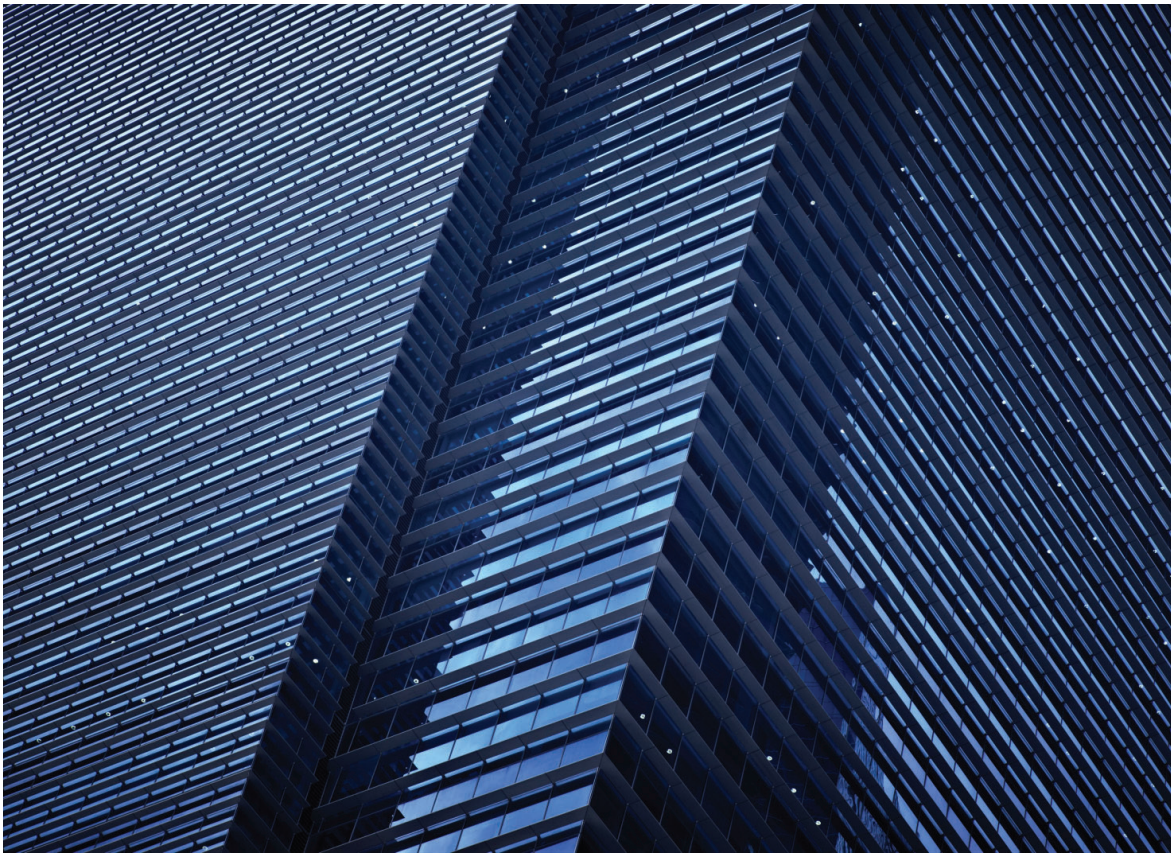
MARKET IN MINUTES
Savills Research

Office

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Office market improves, albeit at a slower pace

Although falling off from Q1/2022 levels, office leasing activity remains high with demand continuing to increase in the quarter.

- Technology firms continue to be the main demand driver for office space, with Amazon intending to take up significant space at IOI Central Boulevard Towers when it is completed in late-2023. Nevertheless, with news on headcount freezes in large global technology firms coming through, we may need time to see how this may pan out here because the freeze could affect certain regional offices but not all.

- For non-technology and social media companies, many are still considering their options when their leases are due. Most of these firms are retaining or taking up a similar amount of space and accommodating future headcount expansions within that.

- Despite geopolitical uncertainties and higher interest rates, there is still demand for office assets. The largest deal over the quarter was the sale of Income at Raffles for slightly over S$1 billion to Bright Ruby Resources.

- The vacancy rate of CBD Grade A offices tracked by Savills declined slightly by 0.4 of a percentage point (ppt) on a quarter-on-quarter (QoQ) basis to 6.8% in Q2/2022, after an increase of 1.6 ppts in the previous quarter. Decreases in vacancy rates of Grade AAA and Grade AA offices outweighed the increase in vacancy rates of Grade A buildings. With the contraction in vacancy rates, net demand for CBD Grade A offices remained positive for the fourth consecutive quarter, amounting to 136,000 sq ft in Q2/2022, higher than the 59,000 sq ft in Q1/2022.

- The robust demand for office space led to a quarterly increase in average monthly rents of Savills basket of CBD Grade A offices for the second consecutive quarter, growing 0.4% QoQ to S$$9.47 psf. In Q1/2022, the QoQ increase was 0.7%.

- Rising recurrent costs and the need for future spend on environmental capital expenditures is making landlords pass these to tenants and they can do that because new Grade A CBD office supply in 2022 and 2023 is low. Our rental projection for 2022 maintains at 3% year-on-year (YoY).

> "Although there are economic challenges, with low levels of new supply, rents have been able to rise to offset inflation and future environmental related expenditures."
>
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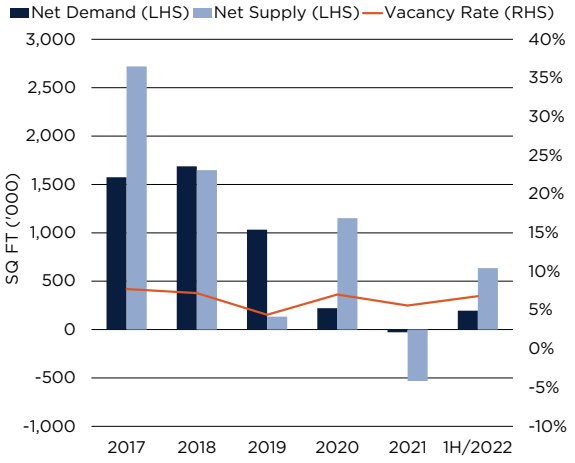
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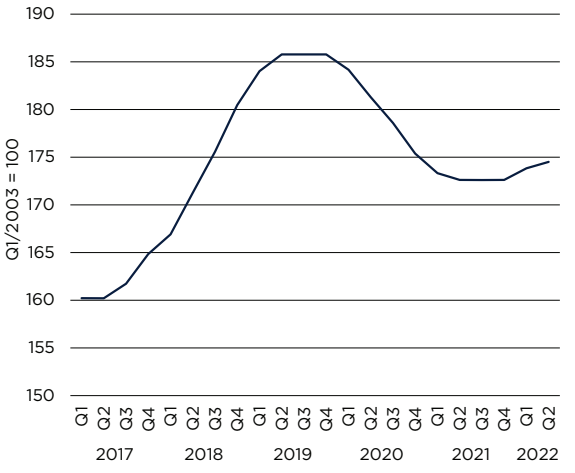
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GRAPH 1: Net Demand, Net Supply and Vacancy Rate of CBD Grade A Offices, 2017 to 1H/2022



Source Savills Research & Consultancy

GRAPH 2: Rental Indices of CBD Grade A Offices, Q1/2017 to Q2/2022



Source Savills Research & Consultancy

TABLE 1: Micro-Market Grade A Office Rents and Vacancy Rates, Q2/2022

LOCATION	MONTHLY RENT (S$ PER SQ FT)	VACANCY RATE (%)
Marina Bay	12.18	3.7%
Raffles Place	9.66	9.6%
Shenton Way	8.73	10.3%
Tanjong Pagar	8.50	8.9%
City Hall	9.82	4.4%
Orchard Road	8.91	2.3%
Beach Road/ Middle Road	7.74	7.4%

Source Savills Research & Consultancy

MARKET COMMENTARY

According to advance estimates from the Ministry of Trade and Industry, Singapore's Q2/2022 gross domestic product (GDP) expanded 4.8% YoY, building on the 4.0% growth recorded in the previous quarter. On a QoQ seasonally adjusted basis, the Singapore economy remained unchanged, after recording a 0.9% growth in Q1/2022. In Q2/2022, the manufacturing, construction and services producing industries registered YoY growth of 8.0%, 3.8% and 4.7% respectively. The 8.0% YoY growth in the manufacturing sector was almost similar to the 7.9% expansion in Q1/2022 and was supported by output expansions in all clusters except for the biomedical manufacturing and chemicals clusters. In particular, the electronics and precision engineering clusters continued to register strong output growth, driven by sustained global demand for semiconductors and semiconductor equipment respectively. Among the services sectors, the information & communications, finance & insurance and professional services sectors grew 4.1% YoY in the quarter, slowing down from the 5.7% expansion in the previous quarter. Growth in the information & communications sector continued to be supported by strong demand for IT and digital solutions, while expansion in the finance & insurance sector was attributed to activities auxiliary to financial services (such as security dealing and payments processing activities) as well as fund management activities.

Tenant demand for office leasing mirrored the sectorial growth paths of the economy with the technology sector being the main driver. For example, Amazon was reported to be signing up around 369,000 sq ft of office space at the IOI Central Boulevard Towers, a Grade AAA building currently under construction. This came after Amazon took up significant space at Asia Square last year. Apart from having a presence at Asia Square, the technology firm currently also has offices at One George Street and Capital Square. With the significant space at IOI Central Boulevard Towers, it is possible that in the future, they could consolidate their offices to one or two locations. As the global economic conditions turn south in the coming quarters, it is likely to affect their corporate real estate strategies. However, because some are banking on getting a digital banking license in Singapore, their global call to freeze expansion may not apply to Singapore. However, this remains to be seen.

Apart from technology firms that are taking up larger pockets of space, there is still much activity in the office leasing market with occupiers considering their relocation options. However, activity is still relatively muted as new office supply in the pipeline apart from IOI Central Boulevard Towers (close to 1.3 million sq ft of office space) is not significant. Most occupiers are still largely retaining or taking up the same amount of space to accommodate their current and future spatial needs. Even for companies are adopting the hybrid working arrangements as the norm, most intend to maintain, or at worst marginally trim their office footprint and absorb their future headcount expansions and office attendance schedules around this constraint.

Despite headwinds from geopolitical uncertainties and higher interest rates, there is still robust demand for office assets. In Q2/2022, there were four block transactions, with two of which exceeding S$500 million each. The largest of the two was the sale of Income at Raffles for slightly over S$1 billion by NTUC Income Co-operative. Much interest was obtained during the expression of interest exercise for the office development and the 999-year leasehold office was eventually sold to Bright Ruby Resources. Another significant deal was AEW's acquisition of Westgate Tower from Sun Venture Group for around S$675 million. This came after AEW's sale of two office buildings in the CBD which included 55 Market Street for S$286.9 million and Twenty Anson for S$598 million.

DEMAND AND VACANCY

Based on the basket of CBD Grade A offices tracked by Savills, the vacancy rate declined marginally by 0.4 ppt QoQ to 6.8% in Q2/2022. The decrease in vacancy rate was largely attributed by fall in vacancy rates of Grade AAA and AA buildings. Vacancy rate of Grade AAA buildings declined by a larger 1.1 ppts QoQ to 6.4%, as more tenants moved into CapitaSpring, while that of Grade AA buildings fell by 0.5 ppts QoQ to 6.6%. However, vacancy rate of Grade A buildings rose slightly by 0.3 ppts QoQ to 7.4%. With the quarterly fall in vacancy rates, net take-up of CBD Grade A offices continued to remain positive for the fourth consecutive quarter, with a higher 136,000 sq ft in Q2/2022 as compared to the 59,000 sq ft in Q1/2022. As such, net take-up totalled 195,000 sq ft in 1H/2022, significantly higher than the -707,000 sq ft for the same period a year ago.

Across micro-markets, QoQ declines in vacancy rates were observed for Raffles Place, Marina Bay, Shenton Way and Tanjong Pagar, with the largest observed in Shenton Way (-1.5 ppts) and Raffles Place (-1.1 ppts), contributing much to the overall decrease in vacancy rates of CBD Grade A offices. On the other hand, increases in vacancy rates were recorded for Beach Road/Middle Road (+0.9 of a ppt), City Hall (+0.7 of a ppt) and Orchard Road (+0.2 of a ppt).

RENTS

In conjunction with an active office leasing market, rents continued to climb although the rate of increase slowed. The average monthly rents of Savills basket of CBD Grade A offices rose for the second consecutive quarter by 0.4% QoQ to S$9.47 psf, a slower increase compared

TABLE 2: Pipeline Supply of Office Space in the CBD, 2022 to 2023

QUARTER	PROJECT NAME	DEVELOPER/OWNER	ADDRESS	ESTIMATED NLA (SQ FT)
Q4/2022	Redevelopment of Hub Synergy Point	Hub Synergy (S) Pte Ltd	Anson Road	123,000
Q4/2022	Guoco Midtown	GuocoLand and Guoco Group	Beach Road	650,000
Total Within CBD for 2022				773,000
Q4/2023	IOI Central Boulevard Towers	IOI Properties	Central Boulevard	1,258,000
Total Within CBD for 2023				1,258,000

Source Savills Research & Consultancy

to the 0.7% in Q1/2022. On a YoY basis, office rents grew 1.1% in Q2/2022, higher than the 0.3% growth in Q1/2022. Rents of Grade A offices registered the largest QoQ expansion of 0.6%, followed by Grade AAA offices and Grade AA offices which grew by 0.3% and 0.1% respectively in the quarter.

By micro-markets, rents of CBD Grade A offices in the Shenton Way, Tanjong Pagar and Orchard Road areas remained unchanged in the quarter, while the other micro-markets recorded QoQ increases. Out of these micro-markets that registered QoQ rental growth, the largest was observed in City Hall (+1.3%) and Beach Road/Middle Road (+1.2%). Apart from City Hall and Beach Road/Middle Road, monthly rents of CBD Grade A offices in Marina Bay and Raffles Place rose 0.4% and 0.1% QoQ respectively.

OUTLOOK

The office market was expected to come out of the 2020 and 2021 period storming and 2022 was the year where market observers believed it so. However, the spectacular collapse of cryptocurrencies in early 2022, followed by the Fed being late in the game of raising interest rates and now playing aggressive catch up is turning the outlook of the economy murky. In the latest World Economic Outlook released in July 2022, the International Monetary Fund (IMF) has revised its baseline growth forecast to slow from 6.1% in 2021 to 3.2%, 0.4% lower than their forecast provided in April this year. Growth is expected to further moderate to 2.9% in 2023 with Advanced Economies contributing to the slowdown. Emerging Market and Developing Economies are however expected to expand in 2023, up 3.9% from 3.6% in 2022. The IMF opines that the further downward revisions in growth hinges on the gas supply from Russia to Europe, sticky inflation, credit stresses and renewed pandemic outbreaks.

While the macro landscape is strewn with dangerous bends and potholes ahead, the Singapore office market thus far appears to be quite insulated from these global developments. What are the reasons for this? Just one. The slow dribble of new Grade A CBD office supply in 2022 and 2023. For 2022, we have Guoco Midtown, a 650,000 sq ft Net Lettable Area (NLA) development which is slated for completion in Q4/2022. In our basket of Grade A CBD offices, this development is a classified as a AAA development (the highest of the sub-grades) and this is the only completion for 2022 in that classification. The next new release of AAA space is expected to come in late-2023 where we have Central Boulevard, a 1.26 million sq ft (NLA) AAA office development. (Please refer to Table 2.)

The average (2012 to 2019) net take-up of CBD Grade A offices (comprising AAA, AA and A classifications), was 982,000 sq ft. Although the combined NLA of Guoco Midtown and Central Boulevard would exceed the two-year historical average take up (2020 to 2021) of 97,000 sq ft (NLA), we have been sensing that pandemic induced working arrangements e.g., work-from-home and some migration of corporate departments from North Asia to Singapore, coupled with the pervasion of technology and social media companies here is channelling demand towards AAA and AA buildings. The new economy companies, where the remuneration for human capital is above white-collar averages and the need to retain finicky staff is encouraging them to relocate to the top two tiers of Grade A offices. Within a year or so from now, we believe that this migration would create a dynamic feedback loop to landlords of older buildings, those in the A classifications or Grade B and C types to redevelop or undertake serious renovation works. That in turn would take supply off the market, leading to a further coalescing of demand towards either the AAA and AA office classifications or to business parks. There is also an increasing likelihood that some of the redeveloped buildings may have reduced commercial content in them, its use being converted to residential or hospitality.

The abovementioned market dynamics and this period of high inflation would allow rents to form a new baseline in 2022 and 2023. On the inflation front, increasing manpower and service provider costs and the need to comply with environmental standards is pushing landlords to raise gross rents to cover recurrent costs while concurrently trying to grow their sinking fund for future spend on the environmental front. Unfortunately, without any precedence of this being played out, it would be difficult for spreadsheet warriors to underwrite the cash flow projections in an office investment evaluation exercise. This leaves the investment field open to those (corporations, family offices and speculative funds) who are willing to take the investment plunge based on their current virtual belief that rents will rise becoming real in the coming years.

In the meantime, the Grade A CBD office market is expected to show moderate growth in 2022 and 2023 as both old and new economy companies are concurrently facing their winter solstice. The probability of rents declining is therefore not negligible, but at this juncture, it is lower than its complement, namely, holding firm or rising. The reason behind our outlook is summed up as follows: a dearth of new supply of Grade A CBD office space this year and next is permitting landlords to raise rents to cover inflation and building the sinking fund for future environmental spend. We expect rents to rise 3% YoY in 2022.