Singapore – July 2023

MARKET IN MINUTES

Savills Research

Office

Slowdown in the office market

The slowdown in economic activity made for a lacklustre office leasing market. This has been noticeable since the start of June when leasing enquiries diminished. The leasing deals being inked are mostly for renewals.

- Tenants are staying put in their current locations for the time being as they are not keen to face capital expenditure for fitting out costs. Apart from Morgan Stanley taking up substantial space at the upcoming IOI Central Boulevard Towers, there have been hardly any major office leasing deals.
- While overall office investment sales declined on a quarter-on-quarter (QoQ) basis led by a plunge in block transactions, sales of strata-titled offices have remained relatively resilient as foreign investors have steered away from the residential market due to the higher Additional Buyer's Stamp Duty (ABSD) rates.
- According to data compiled by Savills, the net take-up of CBD Grade A offices remained negative for a third consecutive quarter, with demand contracting by a further 15,000 sq ft in Q2/2023. As such, for the first half of the year, office demand fell by 459,000 sq ft. This brought about a third consecutive quarter of increase in the vacancy rate, albeit at a much moderated 0.1 of a percentage point (ppt) to 7.4% in the quarter.
- Despite the global economic uncertainties and slowdown in office demand, office landlords are standing firm on their rental expectations. The Savills basket of properties saw rents rising by 0.5% QoQ to average S$9.64 per sq ft.
- In its current phase, the office market dynamics are quite different from previous decades. With limited supply and the prevalence of tenants committed to longer term leases, their ability to reduce their office footprint is limited, and this will give confidence to landlords to raise rents. We maintain our CBD Grade A office rental forecast for 2023 at +2% YoY.

"The many tenants who signed long leases are supporting the fundamentals and keeping rents on an upward trajectory."

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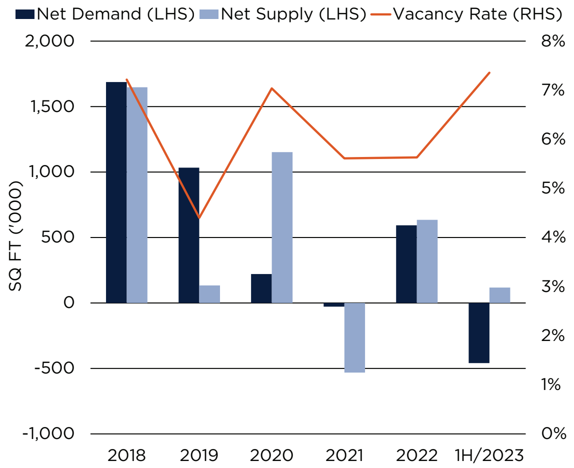
GRAPH 1: Net Demand, Net Supply and Vacancy Rate of CBD Grade A Offices, 2018 to 1H/2023



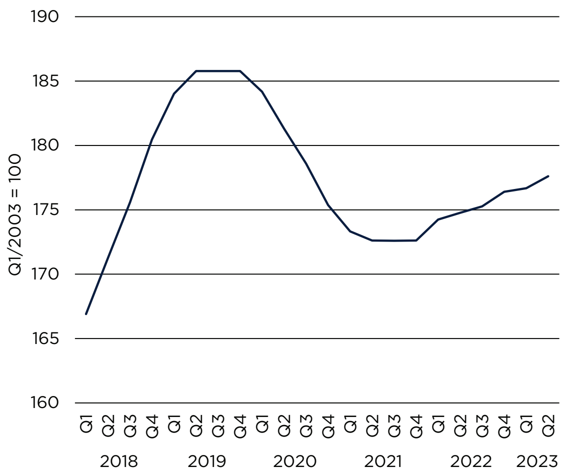
Source Savills Research & Consultancy

TABLE 1: Micro-Market Grade A Office Rents and Vacancy Rates, Q2/2023

LOCATION	MONTHLY RENT (S$ PER SQ FT)	VACANCY RATE (%)
Marina Bay	12.67	5.8%
Raffles Place	9.96	8.3%
Shenton Way	8.91	10.8%
Tanjong Pagar	8.50	14.0%
City Hall	10.10	4.1%
Orchard Road	8.91	1.2%
Beach Road/ Middle Road	7.91	8.8%

Source Savills Research & Consultancy

GRAPH 2: Rental Indices of CBD Grade A Offices, Q1/2018 to Q2/2023



Source Savills Research & Consultancy

MARKET COMMENTARY

From advance estimates provided by the Ministry of Trade and Industry (MTI), Singapore's economy expanded 0.7% YoY in Q2/2023, a faster pace than the 0.4% growth recorded in the previous quarter. On a QoQ seasonally adjusted basis, the Singapore economy grew by 0.3%, a reversal from the 0.4% contraction in Q1/2023. The slowing economic growth was largely due to a 7.5% YoY contraction in the manufacturing sector, which came about due to faltering external demand on the back of rising interest rates and inflationary pressures. On the other hand, both the construction and services sectors continued to expand in the quarter. Among the services industries, the group of sectors consisting of the accommodation & food services, real estate, administrative & support services, and other services sectors recorded the largest growth, growing 6.1% YoY in the second quarter of the year, extending the 7.1% growth of the previous quarter. The group of sectors comprising the information & communications, finance & insurance and professional services sectors grew 1.5% YoY, a larger expansion compared to the 1.3% in the previous quarter. Growth in the information & communications sector was supported by continual strong demand for IT and digital solutions, while that in the professional services sector was mainly attributed to the other professional, scientific & technical services and architectural & engineering, technical testing & analysis segments.

In this quarter in review, the office leasing market appeared to be performing relatively well for the months of April and May before quietening down in June, with more tenants opting for lease renewals instead relocating or expanding. At present, many tenants have no appetite to incur capital expenditure for fit outs and are choosing to stay in their current premises. There is still a significant amount of shadow space in the market although some has been filled up. Apart from news on Morgan Stanley planning to relocate to the upcoming IOI Central Boulevard Towers and taking up over 100,000 sq ft across five floors, there are hardly any other major office leasing deals. As the lease expiry dates for some of the larger spaces at premium offices are still quite a way off, landlords of such office buildings are using this opportunity to stand pat on their rental expectations and even increasing them. Given that more tenants face the rising cost of a new fit out when relocating, some landlords are taking advantage of this stickiness to raise rents.

On the investment sales front, in Q2/2023, office transactions fell sharply due to a lack of block transactions. The only transaction of a sizeable office building was that of Liberty House at 51 Club Street. This was sold by Singapore-incorporated Liberty Insurance for S$92.2 million. This contrasted with Q1/2023 when there were two block transactions. On the other hand, for the second quarter, the sales of strata offices remained resilient with eight transactions worth a total of S$298.5 million. The most expensive deal in terms of price quantum was for Levels 10 and 14 in Solitaire on Cecil, which was sold for a combined S$103.2 million to three entities affiliated to the Thye Hua Kwan (THK) Group of Charities. This works out to S$4,140 per sq ft based on strata area. Separately, as a traditional hot-selling project, Suntec City registered four transactions in the quarter. Among these, three deals were inked at per square foot prices of S$3,600, S$3,700 and S$3,725 respectively.

DEMAND AND VACANCY

From data compiled by Savills, the net take-up of CBD Grade A offices remained in negative territory for a third consecutive quarter, with demand contracting further by 15,000 sq ft in Q2/2023. Nevertheless, the contraction was much more moderated compared to that in the previous quarter. As such, for the first half of 2023, net office space demand amounted to -459,000 sq ft, in contrast to the +397,000 sq ft in 2H/2022 and +195,000 sq ft in 1H/2022. Due to the further contraction in office demand, the overall vacancy rate for CBD Grade A offices inched up marginally by 0.1 of a ppt to 7.4% in the quarter. This was the third consecutive quarter of increase. While vacancy rates of Grade AAA offices continued to increase by 0.7 of a ppt QoQ to 6.2%, vacancy rates of both Grades AA and A offices declined by 0.3 of a ppt QoQ to 8.1% and 7.7% respectively in Q2/2023, after two consecutive quarters of increase. Despite the increase in vacancy rates in premium buildings (ie. Grade AAA buildings), the vacancy rate is still lower than that of Grade AA and A buildings.

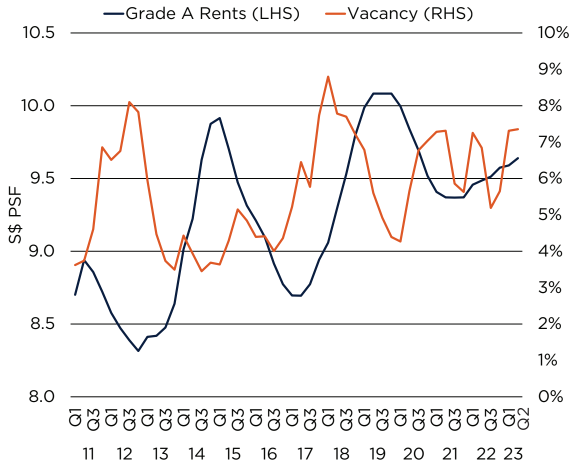
By location, only Raffles Place and City Hall recorded quarterly declines in vacancy rates of 0.8 of a ppt and 1.4 ppts respectively. On the other hand, in QoQ increase in vacancy rates for the other micro-markets were observed, particularly from Tanjong Pagar (1.8 ppts) and Marina Bay (1.0 ppts). Office vacancy rates in Orchard Road remained unchanged in the quarter.

RENTS

Despite global economic challenges and layoffs in the tech sector, office landlords are firm on their rental expectations, especially those of CBD Grade A offices. In Q2/2023, average monthly rents of CBD Grade A offices in Savills basket inched up for a sixth consecutive quarter by a larger 0.5% QoQ, in comparison to the 0.2% growth in the previous quarter, to S$9.64 per sq ft.

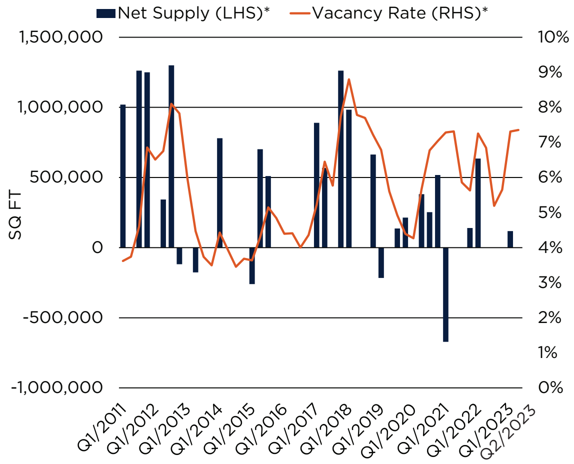
Across the gradings, rents of premium offices

GRAPH 3: CBD Grade A Office Rents and Vacancies, Q1/2011 to Q2/2023



Source Savills Research & Consultancy

GRAPH 4: CBD Grade A Office Vacancies and Net Changes in Supply, Q1/2011 to Q2/2023



Source Savills Research & Consultancy
* New supply is deferred by 6 months to allow for fit out time before it enters our stock.

(Grade AAA) were the most resilient, recording the largest increase of 1.2% QoQ, while Grade A buildings rose by a smaller 0.7% QoQ. The rental changes for Grade AA offices remained unchanged after a 0.1% growth in Q1/2023. By location, rental increases were registered in City Hall (1.2%), Raffles Place (1.0%), Marina Bay (1.0%), Shenton Way (0.8%) and Beach Road/Middle Road (0.7%). On the other hand, monthly rents of Grade A offices in City Hall and Orchard Road remained unchanged on a quarterly basis in the quarter.

OUTLOOK

It used to be that the office rental market here had a common storyline. The explanations given in the past were mainly fundamental correlations with economic performance. However, in this current phase of the market, the narrative has changed somewhat.

Graph 3 shows that in the previous decade, when vacancies began rising, rents moved in the opposite direction. The explanations given in the past can be grouped together as being a mix of the general economic performance and the ushering in of new supply to the market. However, it is new or the lack of supply that dictated vacancies and rents generally performed in line with vacancies.

So, what's so different this time? Well, because new supply in the pipeline has been slow in materialising, it could negate the effects of the rapidly slowing economy. Also, in the quarters running up to the pandemic and slightly beyond, the tech sector bloomed and with copious new funding, was willing to hire more staff to roll-out new initiatives. Core technology and social media companies took up much of the space vacated by tenants who were affected by the slowdown in their respective industries e.g oil & gas, commodities, wholesale banking, general services. The former, together with private banks, who saw bright prospects ahead took up large amounts of office space on long leases which would only be due for renewal in late-2024 to 2026. Consequently, when fortunes for the tech sector took a sudden turn in 1H/2022, followed by the floundering of the global economy in 2023, these tenants were saddled with excess floor space which they couldn't easily dispose of.

In brief, the market structure today is different for the following reasons.

1. The rightward shift in the clusters of lease terms from the 3-year tenure to the 5-to-7-year term has reduced the freedom of tenants to give up their office space. While the shadow space has increased, landlords are under no pressure at the moment to reduce rents as the underlying tenant is still committed to the lease.

2. The relocation of some office functions from Hong Kong to Singapore has helped boost landlords' confidence that there is demand for offices despite a slowing economy. This flow from Hong Kong is a new phenomenon, absent from past cycles.

3. The relative lack of new supply and the possible removal of CBD Grade A stock from the market. Together, they have the effect of reducing the freedom of tenants to adjust their spatial needs to match their business requirements.

4. A further reduction in tenants' freedom to move is the high cost of fit out. With the latter now having risen about 20% compared to 2019, and tenants now facing business headwinds, they are likely to renew their leases.

5. An environmental checklist will increasingly be a feature in tenants' approach when they assess an office building. This will leave the field open mainly to those buildings which are Grade A offices and hold a Green Mark stamp. The flight of tenants to the limited pool of Grade A buildings in the CBD is expected to buttress rents.

For these reasons, we maintain our 2% YoY increase for CBD Grade A offices for 2023.