Office

savills

Office market remains tight

For the first half of the year, the market was characterized by few companies relocating, low vacancies of premium office buildings and companies opting to renew their leases. This led to Grade A CBD office rents staying firm.

- Within an environment of persistently high interest rates and political uncertainties, global economic activity appears to be slowing down. Together with the layoffs from tech companies, the office leasing market has been quite quiet in the recent quarters and most activities are for lease renewals.

- On the other hand, the office investment scene saw an improvement in Q2/2024, with a surge from S$69.7 million in Q1/2024 to S$1.26 billion in Q2/2024. The significant jump was led by six block transactions with three of which exceeding S$100 million each.

- According to data compiled by Savills, after two consecutive quarters of decline, the vacancy rate of CBD Grade A offices in Q2/2024 rose by a marginal 0.1 of a percentage point (ppt) on a quarter-on-quarter (QoQ) basis to 6.0%.

- While office rents stayed flat in Q1/2024, the average monthly rents of CBD Grade A offices in Savills basket inched up marginally by 0.2% QoQ to S$9.67 psf in Q2/2024. As the vacancies of office buildings, particularly those of premium grades, remaining tight and with most companies opting to renew leases, landlords have an advantage in rental negotiations.

- We had a rental projection of -1% to -3% for 2024 in our previous reports. With half a year gone, Grade A CBD office rents had risen 0.2% increase year-to-date, and given the low level of new leasing activity expected for the second half, we have revised our rental forecast to -1% to +1% for 2024.

"As most tenants opt to renew to save on high relocation costs, landlords have an upper hand during rent review negotiations."

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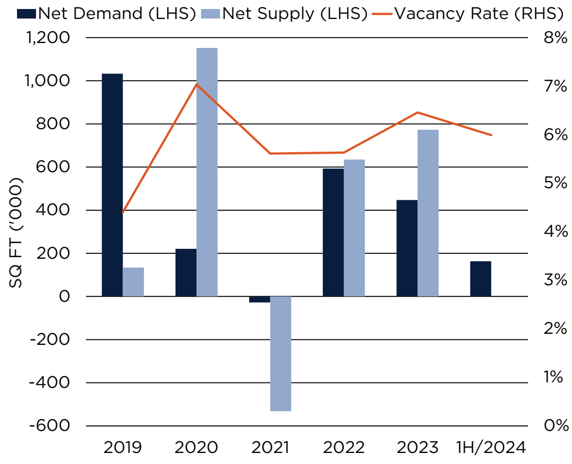
GRAPH 1: Net Demand, Net Supply and Vacancy Rate of CBD Grade A Offices, 2019 to 1H/2024



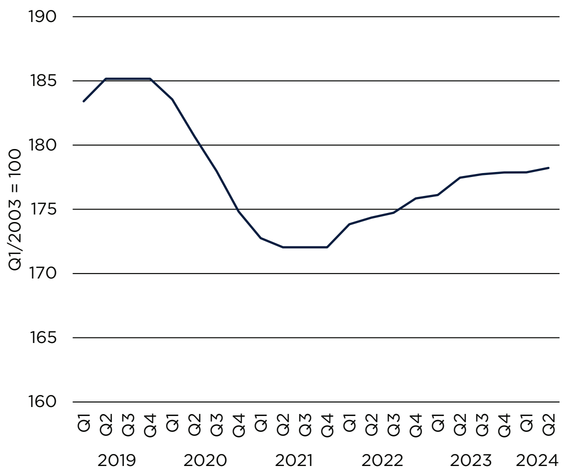
Source Savills Research & Consultancy

TABLE 1: Micro-market Grade A Office Rents and Vacancy Rates, Q2/2024

LOCATION	MONTHLY RENT (S$ PER SQ FT)	VACANCY RATE (%)
Marina Bay	12.66	4.6%
Raffles Place	10.02	7.1%
Shenton Way	8.94	6.3%
Tanjong Pagar	8.52	10.1%
City Hall	10.12	5.5%
Orchard Road	8.98	2.7%
Beach Road/ Middle Road	8.03	5.8%

Source Savills Research & Consultancy

GRAPH 2: Rental Indices of CBD Grade A Offices, Q1/2019 to Q2/2024



Source Savills Research & Consultancy

MARKET COMMENTARY

According to the advance estimates provided by the Ministry of Trade and Industry (MTI), Singapore's economy expanded 2.9% year-on-year (YoY) in Q2/2024, extending the 3.0% growth in the first quarter of the year. On a QoQ seasonally adjusted basis, the Singapore economy expanded by 0.4% in the quarter, slightly faster than the 0.3% growth in the previous quarter. The expansion in Q2/2024 was brought about by growth in both the goods producing and services producing industries. While there were faster expansions in both the manufacturing and construction sectors in the quarter, growth in the services producing industries slowed down. In contrast to the 1.7% YoY contraction in Q1/2024, the manufacturing sector grew 0.5% in Q2/2024. Growth in the sector was supported by output expansions across all manufacturing clusters, except for the biomedical manufacturing and precision engineering clusters. Among the services sectors, the group of sectors consisting of the information & communications, finance & insurance and professional services sectors expanded by a 5.6% YoY, relatively similar to the 5.7% growth in the previous quarter. Growth in the information & communications sector was led by robust demand for IT and digital solutions, while that in the professional services sector was supported by the head offices & business representative offices segment. Similarly, growth in the finance & insurance sector was largely supported by the activities auxiliary to financial services, banking and fund management segments.

Within the backdrop of layoffs from tech companies, tepid economic growth, a high interest rate environment and geopolitical uncertainties, the office leasing market had been at a standstill for a few quarters. Due to the high fit out and reinstatement costs, and the lack of cheaper alternatives, companies chose to renew their leases instead. Hence, the action on the office leasing front has been largely made up of renewals, and this caused no significant changes to the vacancy rates. In the next few quarters, some activities may be seen in the office market, as the only office completion in the CBD for 2024 – IOI Central Boulevard Towers – obtains Temporary Occupation Permit (TOP) and companies that have previously pre-committed to space there relocate from their existing locations and to the new building. This is deemed to be the most significant new office development in the CBD, with its net lettable area of 1.26 million, since Marina One's TOP in 2017. Pre-committed firms include Amazon and Morgan Stanley, which have reportedly taken up around 40% of the space in the development.

On the investment sales front, because of a lack of block transactions and fewer strata office deals since the start of the year, the office investment scene saw an improvement in the second quarter, surging from S$69.7 million in Q1/2024 to S$1.26 billion. For the quarter in review, there were six block transactions amounting to S$1.12 billion, while the remaining S$137.7 million came from six strata office transactions. For the block transactions, three exceeded S$100 million each. The largest deal in the quarter was the sale of Mapletree Anson for S$775.0 million to PAG, on behalf of its PAG Real Estate Partners Fund III, from Mapletree Pan Asia Commercial Trust. This translated to S$2,352 psf based on the net lettable area of nearly 330,000 sq ft.

DEMAND AND VACANCY

From data compiled by Savills, the vacancy rate of CBD Grade A offices rose by a marginal 0.1 of a ppt to 6.0% in Q2/2024, after two consecutive quarters of quarterly declines. On a YoY basis, vacancy rate of overall CBD Grade A offices fell by a marginal 0.3 of a ppt. The vacancy rates of Grade AAA and A offices remained unchanged at 5.9% and 7.3% in the quarter, while Grade AA offices rose slightly by 0.2 of a ppt QoQ to 4.9%. The slightly higher vacancy rates in Q2/2024 also corresponded to net absorption heading south to the negative territory for the first time after three consecutive quarters, to -20,000 sq ft. Nevertheless, the net demand for the first half of the year remained positive at 163,000 sq ft, which was higher than the -96,000 sq ft in the same period last year.

By location, the increases in vacancy rates in three of the submarkets marginally outweighed the decreases in vacancy rates in three of the remaining submarkets, leading to that slight hike in vacancy rates. Quarterly declines between 0.1 of a ppt and 1.2 ppts were observed in Raffles Place, Tanjong Pagar and Beach Road/ Middle Road. On the other hand, three of the remaining submarkets registered QoQ increases in vacancy rates. Out of which, the largest increase came from Marina Bay, which recorded a growth of 0.4 of a ppt to 4.6. Vacancy rates of offices in Shenton Way and City Hall rose 0.3 of a ppt to 6.3% and 5.5% respectively. For City Hall, the increase in vacancy rates came after two consecutive quarters of decline. Vacancy rates of offices in Orchard Road remained unchanged at 2.7% in Q2/2024 after increasing by 0.2 of a ppt in the previous quarter.

Compared to the same period last year, most of the submarkets recorded quarterly declines in vacancy rates. Five of the seven submarkets saw lower vacancies of between 0.3 of a ppt and 2.9 ppts on a YoY basis. The largest contraction came from Tanjong Pagar, with vacancy rates falling 2.9 ppts YoY.

RENTS

Owing to cost containment pressures, most companies are opting to renew their leases. On top of this, the larger leases are only due for renewal in 2H/2025 and 2026, and landlords are maintaining their asking rents, resulting in office rents to remain resilient. Hence, the average monthly rents of CBD Grade A offices in Savills basket inched up marginally by 0.2% QoQ to S$9.67 psf in Q2/2024 after remaining flat in the previous quarter. Compared against the same period a year ago, office rents increased for the 10th consecutive quarter by a smaller 0.4%, in comparison to the 1.0% in Q1/2024.

By grades, quarterly increases were observed across offices of all grades. The largest rental growth was from Grade AAA offices, growing 0.3% QoQ to S$12.74 psf in the quarter. This came after two consecutive quarters of no rental movements. Landlords of premium offices that enjoy high occupancies and whose tenants are opting to renew their leases have an advantage to raise rents. Similarly, rents of Grade AA offices inched up slightly by 0.1% QoQ to S$10.54 psf after two consecutive quarters of staying constant. Grade A office rents crept up 0.2% on a QoQ basis to S$8.58 psf.

For Q2/2024, almost all the micro-markets registered QoQ increase in rents except for Orchard Road and Shenton Way. Rents of Grade A offices in both these submarkets stayed firm in Q2/2024. For Shenton Way, this is the third consecutive quarter that rents have remained unchanged. Among the other submarkets, rental growth ranged from 0.2% to 0.4%. The largest increase came from City Hall, with a rise of 0.4%, a reversal from the 0.1% dip in the previous quarter. Rents of Grade A offices in Marina Bay also rebounded in Q2/2024, rising 0.3% QoQ after two consecutive quarters of decline.

OUTLOOK

For the first half of 2024, there were few large relocation deals signed and the remaining transactions were for lease renewals. Consequently, the rental market cannot truly be described by what one normally understands it to be, namely comprising rents that tenants signed to move into a building. The result of this is a market that leasing professionals are opining is drifting sideways. As more tenants are now faced with the need to contain costs, they would have preferred to relocate to lower cost accomodation. However, given the high cost of reinstatement works and fit outs, they do not have the budget for that and so choose to renew their leases. If the need to reduce costs is an objective, they would right size. Landlords, realising their predicament, would hold some form of ransome value over tenants and thus are able to extract some rental increases in the renewed lease. This could summarise why, despite challenging business conditions, rents managed to eke out a 0.2% increase for the period Q4/2023 over Q2/2024.

For the rest of this year, the same leasing market dynamics is expected to be repeated. This means that there would be few large tenants relocating. The rental market would thus continue to be dominated by renewals and given the conditions mentioned above, this has an upside bias on rents. Although there is new supply in the Grade A CBD space, coming from IOI Central Boulevard Towers, because this new building is still asking market rents, the remaining landlords are expected to keep their rents firm as well. We had a rental projection of -1% to -3% for 2024 in our previous reports. With half a year gone, Grade A CBD office rents had risen 0.2% increase year-to-date, and given the low level of new leasing activity expected for the second half, we have revised our rental forecast to -1% to +1% for 2024.