MARKET IN MINUTES
Savills Research

Office

A lacklustre office leasing market

Geopolitical tensions and business uncertainties are dissuading tenants from relocating and they are choosing instead to right size while waiting to see how the situation pans out.

- Apart from tenants feeling the strain from capital expenditure costs, of late, landlords are becoming reluctant to fund the fit-out costs to tenants. For tenants waiting for their new buildings to complete, they are requesting short 12 to 18 months extensions, which are also being accepted by landlords at lower premiums than before.

- Office investment sales continued to decline in the quarter due to fewer strata title deals and a lack of block transactions. The 11 strata transactions in Q2/2023 fell to only six strata title deals in Q3/2023.

- Based on data compiled by Savills, the vacancy rate of CBD Grade A offices grew 0.6 of a percentage point (ppt) quarter-on-quarter (QoQ) to 7.1% in Q3/2023, the highest since Q1/2022. This was mainly attributable to the addition of the newly completed Guoco Midtown.

- Although economic headwinds are stronger, due to low new supply levels, office rents eked out marginal gains. The average monthly rent of CBD Grade A offices in the Savills basket inched up for a seventh consecutive quarter by 0.1% QoQ to S$9.64 psf. This was a smaller increase compared to 0.8% in the previous quarter.

- As economic and global political risk levels rise, tenants' desire to expand or embark on new fitouts may be crimped. Our forecast for CBD Grade A rents in 2023 is still a 2% YoY rise. For 2024, because of the spike in CBD and non-CBD supply, we are forecasting a – 2% to -3% YoY change, followed by 0% change for 2025. Given the dynamic nature of the market, some landlords may perhaps use this period as an opportunity to undertake extensive asset enhancement works.

"With a volatile geopolitical environment, and with new supply coming to the market, it would be a tall order for CBD Grade A rents to continue rising in 2024."

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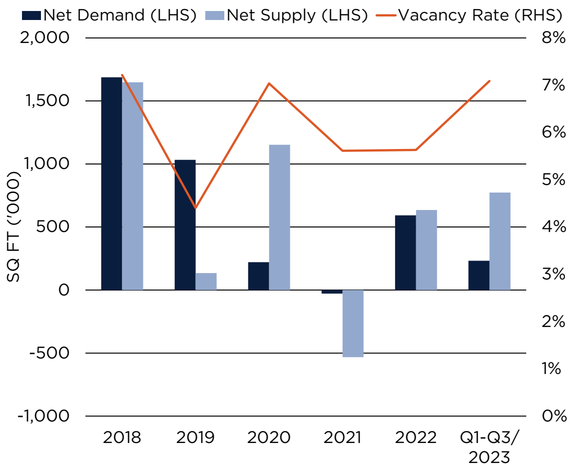
GRAPH 1: Net Demand, Net Supply and Vacancy Rate of CBD Grade A Offices, 2018 to Q3/2023



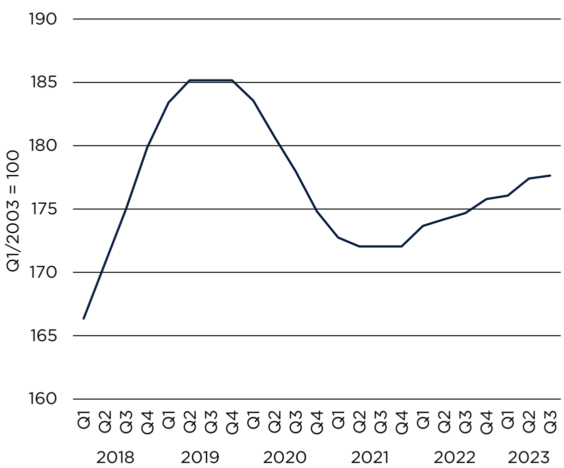
Source Savills Research & Consultancy

TABLE 1: Micro-Market Grade A Office Rents and Vacancy Rates, Q3/2023

LOCATION	MONTHLY RENT (S$ PER SQ FT)	VACANCY RATE (%)
Marina Bay	12.67	4.2%
Raffles Place	9.98	7.1%
Shenton Way	8.94	9.4%
Tanjong Pagar	8.50	12.0%
City Hall	10.10	10.6%
Orchard Road	8.91	1.1%
Beach Road/ Middle Road	8.00	6.6%

Source Savills Research & Consultancy

GRAPH 2: Rental Indices of CBD Grade A Offices, Q1/2018 to Q3/2023



Source Savills Research & Consultancy

MARKET COMMENTARY

According to the advance estimates provided by the Ministry of Trade and Industry (MTI), Singapore's economy grew 0.7% YoY in Q3/2023, extending the 0.5% growth recorded in Q2/2023. On a QoQ seasonally adjusted basis, the Singapore economy expanded by 1.0%, a faster pace than the 0.1% growth in the previous quarter. While the manufacturing sector continued to contract by 5.0% YoY, the construction sector and services producing industries grew, albeit at a moderated pace of 6.0% and 1.9% respectively (compared to the 7.7% and 2.8% in Q2/2023). The weaker performance of the manufacturing sector was led by output declines across all manufacturing clusters, except for the transport engineering cluster. Among the services sectors, the group of sectors consisting of the accommodation & food services, real estate, administrative & support services and other services sectors registered the largest growth of 4.7% YoY, with the accommodation sector recording strong growth from the continual recovery in international visitor arrivals. The group of sectors comprising the information & communications, finance & insurance and professional services sectors grew 1.5% YoY. The expansion in the information & communications sectors was largely supported by the IT & information services segment, while that in the professional services sector was mainly led by the architectural & engineering, technical testing & analysis and other professional, scientific & technical services segment. However, the finance & insurance sector contracted on the back of weaker performance of the banking & insurance segments.

With geopolitical tensions and economic uncertainties, there seems to be an unprecedented lack of a willingness for tenants to move. For the quarter in review, leasing transactions were low. For some firms, despite them wanting expansions, there are no approvals for capital expenditure from the senior management. Similarly, due to much higher borrowing costs, landlords have little appetite to stomach tenants fit-out costs. Consequently, with both landlords and tenants both facing constraints, the latter is less inclined to relocate, resulting in the lower number of office leases in the market. Also, as new supply this year has been relatively low, the tenants that had the budget to relocate can only do so in the years 2025 and 2026. For them, if their leases are running out, they seek for short term renewals. When the market was hot, these short-term renewals often come at significantly higher rents. However, this time, landlords granting shorter-term lease extensions of 12 to 18 months are charging a more reasonable markup than before. In addition, landlords do not feel the pressure yet (despite a substantial amount of shadow space) as leases of the major tenants are mostly expiring in 2025. This is particularly so for the premium offices, whereby the rents of these buildings are still holding up due to the lack of supply.

On the investment sales front, in Q3/2023, office transactions declined further with fewer strata title deals and no block transactions. While there were 11 transactions in Q2/2023, there were only six transactions of strata units totalling S$166.9 million. Out of which, three of the deals were from Suntec City, with transaction prices of S$11.5 million (S$2,850 psf), S$11.6 million (S$3,100 psf) and S$16.5 million (S$2,350 psf) respectively. Apart from that, the third storey of the freehold Nomu at Handy Road was also sold to a Singapore-incorporated entity that is an indirect wholly-owned subsidiary of IMC Group Holdings which was founded by the late Frank Tsao of Hong Kong. This was bought over from a company owned by Wong Mun Summ and Richard Hassell, the founders of Woha Architects for nearly S$24.0 million (S$3,790 psf).

DEMAND AND VACANCY

From data compiled by Savills, the vacancy rate of CBD Grade A offices rose in Q3/2023, unchanged in the previous quarter, increasing 0.6 of a ppt QoQ to 7.1%, the highest since Q1/2022. This was largely led by the inclusion of Guoco Midtown into the office stock, which brought about an increase in vacancy rates of Grade AAA buildings from 5.5% in Q2/2023 to 7.2% in Q3/2023. This was the fourth consecutive quarter of increase. Similarly, vacancy rates of Grade A offices also inched up 0.5 of a ppt to 8.2% in the quarter. On the other hand, the vacancy rate of Grade AA offices saw a second consecutive quarter of decline, decreasing 0.9 of a ppt to 6.1%. Although there was an increase in vacancy rate of overall CBD Grade A offices, the net demand turned positive to 415,000 sq ft in Q3/2023, after three consecutive quarters of negative take-up. This was supported by tenants moving into the newly completed Guoco Midtown.

By location, almost all the micro-markets recorded QoQ decreases in vacancy rates, particularly for Tanjong Pagar and Beach Road/Middle Road which observed declines in vacancy rates of 1.0 ppts and above. On the other hand, vacancy rates in Orchard Road inched up marginally by 0.2 of a ppt QoQ to 1.1%, while that in City Hall recorded a jump as the tenants at Guoco Midtown that have committed space have not all moved in.

RENTS

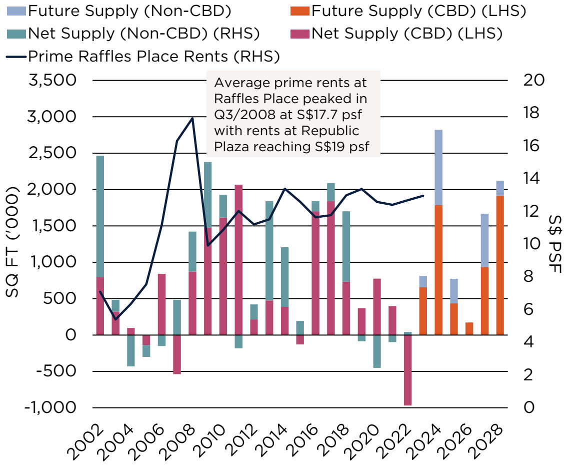
Owing to lower activity in the office leasing market, rental growth slowed. The average monthly rents of CBD Grade A offices in Savills basket inched up marginally for a seventh consecutive quarter, albeit at a moderated pace of 0.1% QoQ in Q3/2023, compared to the 0.7%

TABLE 2: CBD Grade A YoY Change for Rents, 2023F to 2025F

YEAR	2023F	2024F	2025F
YoY Rental Change	2%	-2% to -3%	0%

Source Savills Research & Consultancy

GRAPH 3: CBD and Non-CBD Net Supply vs Rents in Raffles Place, 2002 to 2028



Source Savills Research & Consultancy, URA

in Q2/2023, to S$9.64 psf. For the first three quarters of this year, rents have risen by 1.1%.

Rents of prime offices in the CBD across grades recorded QoQ increases, with Grade A buildings increasing 0.2% QoQ and the higher grades (Grades AA and AAA) rose 0.1% QoQ. However, the QoQ rental growth across the gradings were lower in the third quarter. By location, only Raffles Place, Shenton Way and Beach Road/Middle Road recorded quarterly increases in rents of 0.1%, 0.1% and 1.1% respectively. For Beach Road/Middle Road, the larger QoQ increase in Q3/2023 was largely led by higher rents at Bugis Junction Towers. Rents of Grade A offices in Marina Bay, Tanjong Pagar, City Hall and Orchard Road remained unchanged in the quarter. For Marina Bay, this stagnation in rents came after six consecutive quarters of increase.

OUTLOOK

The office market is presently insulated from inclement economic conditions. That Grade A rents could still eke out a small increase of 0.1% QoQ is due to few major lease expiries and a market that only saw a modest new supply of prime space. Also, the total net office supply in the CBD (all Grades) was a negative 969,000 sq ft in 2022, and this reduction created a tight market situation that despite the famine technology companies experienced on the funding front last year, and net supply turning positive in 2023, landlords still felt confident asking for higher rents.

However, confidence may wane when new supply in 2024 draws near. Graph 3 shows that in the quarters running up to a spike in new supply, rents in prime locations (using Raffles Place here as an example) tended to move down in anticipation of the building completions in both CBD and non-CBD locations. For rents, we saw this happening in the 2009 and 2010 period and for the years 2014 to 2016. We also saw that rents began rising before net supply turned negative. The graph is not meant to be a robust statistical analysis, rather it points to what leasing professionals, with decades of experience, have opined, that landlords are anticipatory creatures.

If this behaviour continues, we may expect to see rents soften in 2024 because the CBD and non-CBD completions are at record levels. The rental adjustment is expected next year rather than this because the significant reduction in net supply in 2022 created a tight market situation whose effects could be felt for 2023 and partially into 2024.

As business and global political risk levels rise, the sharp drop in new supply in 2025 and 2026 may not be strong enough to convincingly turn rents around. The recent attacks on Israel and consequent retaliatory actions may disrupt the Middle East, with economic consequences. Our forecast for CBD Grade A rents is still a 2% YoY change for 2023. However, for 2024, arising from the economic and political flareups, and because of the spike in CBD (Central Boulevard and Keppel South Central) and non-CBD supply (Labrador Tower and Paya Lebar Green), we are forecasting a – 2% to -3% YoY change, followed by 0% change for 2025. (Please refer to Table 2.) Given the fact that the market is dynamic, some landlords may use this time to undertake extensive asset enhancement work.