Briefing
Office sector

January 2015

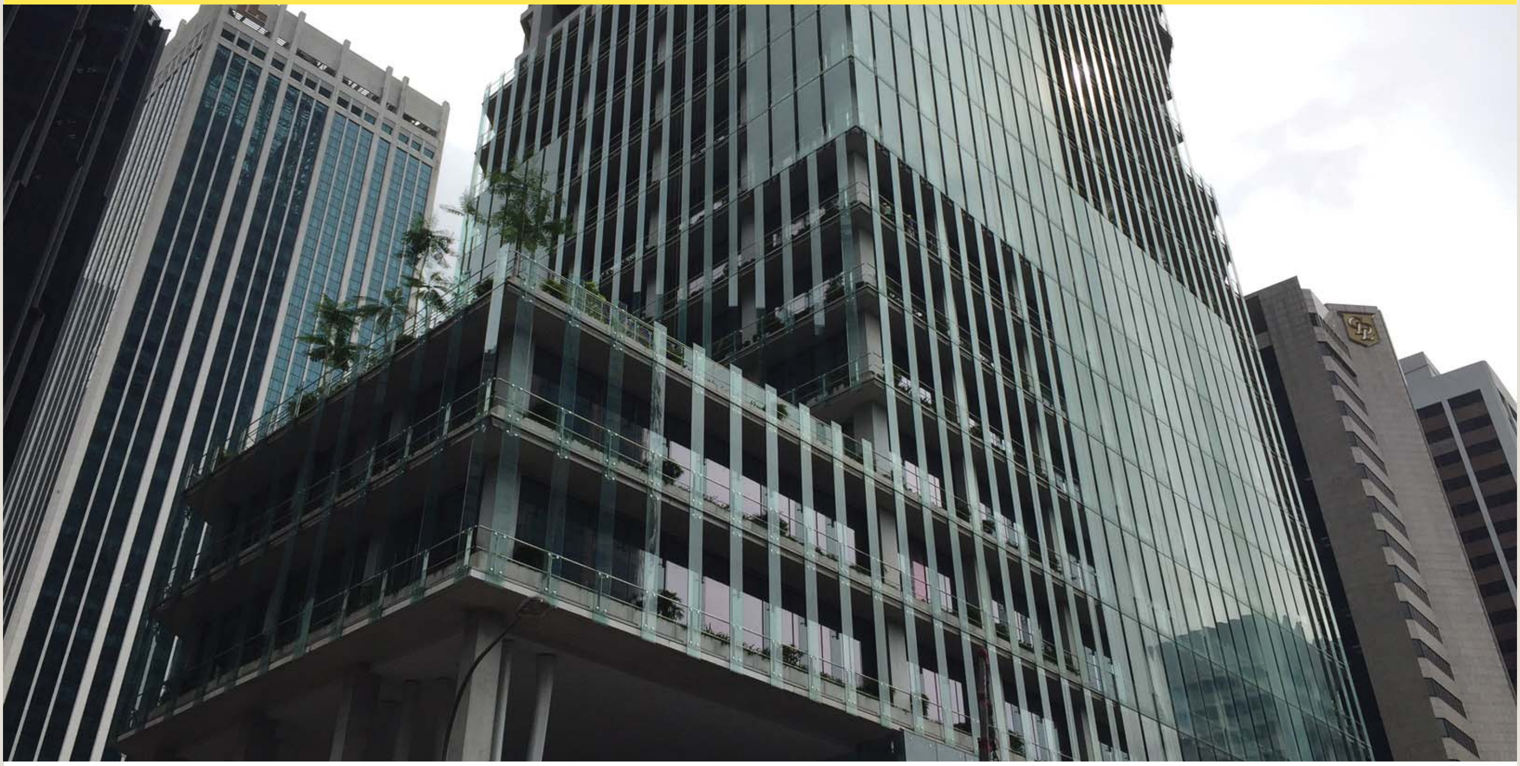

Image: CapitaGreen, Market Street

SUMMARY

2014 saw strong leasing and investment activity in the office market, with robust rental growth and high occupancy levels. Office rental growth is expected to continue in the coming year in view of the limited supply forecast for 2015.

- 2014 saw an unabated rise in office leasing and sales activities, with sustained broad-based demand from new set-ups and expanding existing businesses, mainly from the IT and telecommunications industry and legal service providers.
- Net absorption of office space in 2014 was an estimated 713,300 sq ft. Despite the shortage of supply, the overall vacancy rate of CBD Grade A offices tracked by Savills increased marginally from 3.4% in Q3/2014 to 3.6% by Q4/2014.
- In Q4/2014, the average monthly rent of the Savills basket of CBD Grade A office buildings stood at S$9.88 per sq ft, representing an increase of 2.6% quarter-on-quarter (QoQ) and 14.3% year-on-year (YoY).
- After registering a stellar S$1.94 billion in office investment sales in Q3, the volume of investment activity dropped drastically to S$156.6 million in Q4. Nevertheless, this still brings the total to S$4.2 billion for the whole of 2014, up 17.5% from 2013's S$3.6 billion.
- Capital values of Grade A offices edged up 1.8% from S$2,800 per sq ft in Q3/2014 to S$2,850 per sq ft in Q4/2014.
- Savills expects CBD Grade A rents for spaces less than 10,000 sq ft to rise by an estimated 12.9% in 2015 due mainly to the shortage of new office supply.

"Contrary to expectations, the office market should continue to shine in 2015 as the dearth of supply enables landlords to manage rents upwards. However, changing organisational dynamics may mean a move towards smaller requirements."
Alan Cheong, Savills Research

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Market commentary

According to flash estimates by the Ministry of Trade and Industry (MTI), Singapore's economic growth in Q4/2014 slowed to 1.5% on an annualised basis due to economic restructuring, bringing the full-year GDP growth for 2014 to 2.8%, slightly less than the 3.0% forecasted by the MTI.

Despite the slowdown in GDP growth, the office property market was unaffected. 2014 saw an unabated rise in office leasing and sales activities, with sustained broad-based demand from new set-ups and expanding existing businesses, mainly from the IT and telecommunications industry and legal service providers. This was amid rising rents that resulted from limited new office supply and high occupancy in the existing CBD stock. Demand for smaller spaces (less than 10,000 sq ft) from real economy companies continued to dominate the market.

Although landlords are now in a better bargaining position, it seems that they are starting to face some resistance in smaller-sized lettings. This stems from tenants in the business services and consultancy sectors which are affected by domestic economic restructuring.

TABLE 1

Micro-market Grade A office rents and vacancy rates, Q4/2014

Location	Rent (S$ per sq ft per month)	Vacancy rate (%)
Raffles Place/Marina Bay	10.66	2.5
City Hall	9.75	1.5
Shenton Way	9.59	7.7
Tanjong Pagar	8.30	7.3
Orchard Road	10.08	2.0
Beach Road/Middle Road	7.73	3.5

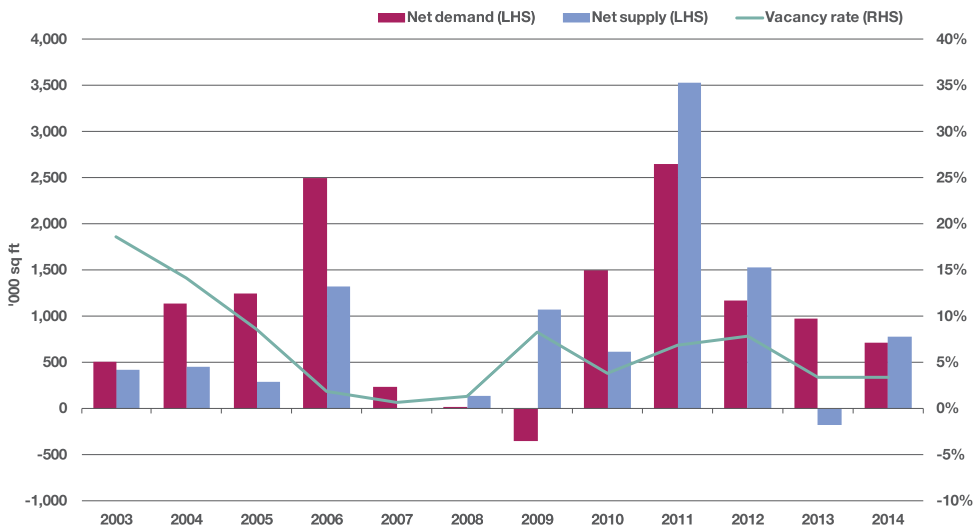
Source: Savills Research & Consultancy

A saving grace is that demand for such spaces is beginning to come from new overseas start-ups using Singapore as their base to tap into the region.

After registering a stellar S$1.94 billion in office investment sales in Q3, the volume of investment activity dropped drastically to S$156.6 million in Q4. Nevertheless, this still brings the total to S$4.2 billion for the whole of 2014, up 17.5% from 2013's S$3.6 billion. Compared with a year ago, the number of strata office sales has decreased, while investment interest in existing buildings in the CBD is on the rise.

GRAPH 1

Net demand, net supply and vacancy rate of CBD Grade A offices, 2003–2014



Source: Savills Research & Consultancy

Vacancy

Net absorption of office space for the whole of 2014 is estimated at 713,300 sq ft, of which 81.7% was in the Shenton Way area. This is mainly due to the take-up of Asia Square Tower 2 which was completed in late-2013. The Raffles Place area contributed about 16.5% of the total absorption. The only new CBD Grade A office supply for the year came from orchardgateway, which contributed 37,000 sq ft. The recently-completed CapitaGreen (TOP in December) will effectively contribute about 681,650 sq ft in 1H/2015. South Beach Tower, which was originally planned to be ready in Q4/2014, has been delayed until Q1/2015.

Despite the shortage of supply, the overall vacancy rate of CBD Grade A offices tracked by Savills increased marginally from 3.4% in Q3/2014 to 3.6% by Q4/2014. The rise in vacancy rate was led mainly by the Beach Road and Tanjong Pagar micro-markets, with increases of 1.3 and 0.9 percentage points (ppts) QoQ respectively. Vacancy rates in the other micro-markets inched up 0.1 ppt, while only the Shenton Way area remained unchanged. Most of the vacant units recorded were less than 10,000 sq ft in size, implying that landlords are encountering resistance from small-space occupiers. This group of tenants have been affected by a combination of factors from rising rents to bearing up with tougher business conditions such as the labour force restructuring measures. By grade, the AA segment saw the greatest rise in vacancy level, up by 1.1 ppts to 3.0% by the end of 2014. Conversely, the vacancy rate for the AAA Grade segment dipped 0.2 ppts to 4.8%, while that of the A Grade segment stayed at 3.2%.

Rental and capital values

In Q4/2014, the average monthly rent of the Savills basket of CBD Grade A office buildings stood at S$9.88 per sq ft, representing a 2.6% increase QoQ. Overall rental growth has slowed by 1.8 ppts from a 4.4% growth in the past quarter. The slowdown could be due to tenants' resistance after having faced eight consecutive quarters of rental increases.

Record high rents (since Q3/2010) were observed across all submarkets, with Raffles Place/ Marina Bay continuing to lead at S$10.66 per sq ft, followed by Orchard Road at S$10.08 per sq ft and City Hall at S$9.75 per sq ft. Rental growth in all micro-markets, except for Tanjong Pagar which went up by 0.6 ppts, slowed in Q4 compared with the previous quarter.

CBD Grade A office rents grew by 14.3% in 2014, compared with 3.9% in 2013. Monthly rents at AAA Grade office buildings reached a high of S$13.54 per sq ft in Q4, a 24.9% YoY increase. This is followed by AA Grade and lastly A Grade rents, with annual increases of 14.3% (S$10.45 in 2014) and 9.6% (S$8.82 in 2014) respectively.

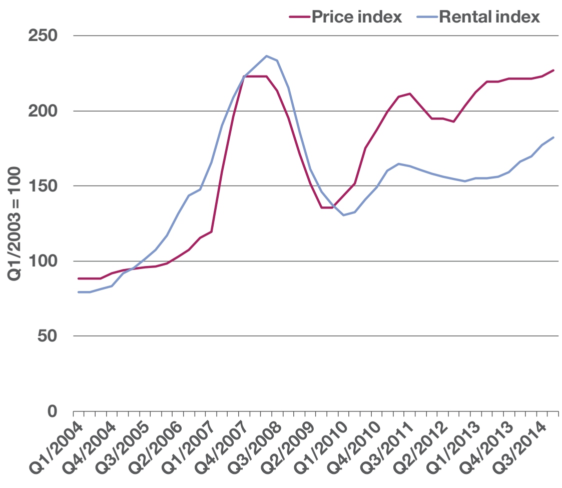
The biggest office investment deal in 2014 was the sale of a one-third stake in Marina Bay Financial Tower 3 in September, at S$1,248 million for approximately 1.34 million sq ft (S$2,794 per sq ft of NLA). Located at Marina Boulevard, the 46-storey office building with a balance lease term of about 92 years was acquired by Keppel REIT from Keppel Land.

The strata sales market saw higher record prices set once again. In August, the 18th level of Samsung Hub was transacted for S$3,225 per sq ft of NLA. In October, the 19th and 21st levels of the same building were also sold separately for S$3,175 and S$3,280 per sq ft of NLA respectively.

Capital values of Grade A offices edged up 1.8% from S$2,800 per sq ft in Q3/2014 to S$2,850 per sq ft in Q4/2014. On a yearly basis, capital values were up by 2.4% from S$2,780 per sq ft in Q4/2013. Steep rental growth has outpaced the moderately improving capital values, leading to rising yields in the last few quarters.

GRAPH 2

Price and rental indices of CBD Grade A offices, Q1/2004–Q4/2014



Source: Savills Research & Consultancy

OUTLOOK

The prospects for the market

2015 is expected to experience more tepid economic growth. The squeeze brought on by a tight labour market working in conjunction with global economic uncertainties is the main cause. The finance and oil and gas industries would likely be the most affected.

On the supply front, however, there is limited new CBD Grade A office supply in 2015, where only 1.25 million sq ft would come from CapitaGreen, South Beach and PS 100. Including the withdrawal of Equity Plaza in March 2015 (due to its major refurbishment works), the net supply would be about 1.0 million sq ft. Setting 2014's sluggish take-up rate of 713,300 sq ft as the baseline, the supply of office space in 2015 could possibly match its demand. This leads us to conclude that the office market will be fundamentally sound in the year ahead.

With the recent positive news from the Fed that interest rates would remain benign for a considerable period of time, landlords with an increased percentage of debt to be refinanced in 2015 will be able to hold out for higher rents rather than rush to fill up their buildings at subdued rates. In addition, the tight supply situation in 2015 gives landlords the opportunity to squeeze the most out of the market before 2016 or 2017, when new office supply enters the market and when the rise in interest rates is expected to kick in and adversely affect their debt refinancing.

On the demand side, Singapore's open economy has attracted many overseas commercial firms to set up their regional headquarters here. Although the banking and financial sector is still licking its wounds post Global Financial Crisis (GFC), new-to-market companies and those already with a presence here and in growth sectors will make up the demand for office space. We see 2015 as a year when more new-to-market office tenants with smaller space requirements than banks and financial institutions, resulting in small lettings, will dominate the office leasing market. Hence, Savills expects CBD Grade A rents for small spaces (less than 10,000 sq ft) to trend upward by an estimated 12.9% in 2015.

For existing large tenants, many are embedded in long term leases that

OUTLOOK

The prospects for the market (cont'd)

were renewed in 2012 to mid-2014, thus benefitting from the difference between the higher future rents and their current signed-on rents, thereby reaping a virtual arbitrage.

The investment strata office market activity for 2015 is expected to fall somewhere between 2013 and 2014 full-year figures. Owing to the lumpy nature of the offerings in the market, with some over a billion dollars in value, a single transaction may lift the sales figures significantly. In view of the tight supply situation, end-users and more seasoned investors may turn to strata offices. However, it is also precisely the limited supply that will result in the lack of investment opportunities and widen the pricing gap between buyers and sellers, thereby limiting transactions. Unless a record price-breaking deal is done, the growth of capital values is thus expected to be modest.

TABLE 2

CBD Grade A office rents and capital value, 2015F

	% change YoY
Rent	12.9
Capital value	2-5

Source: Savills Research & Consultancy

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