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Rise of the bull market

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Sharply higher rent growth herald a sea change from the soft market conditions of 2015-2017. We view the Singapore office market as the strongest income-growth opportunity within Asia for investors, with the potential to achieve up to 20% rental growth over 2018-19. Firm economic momentum, bolstered by synchronized growth across office-using sectors, should elevate prime office rents by 10% to 12% over 2018, and by 5-7% over 2019. As the market turns up and vacancy tightens, we recommend occupiers to bring forward impending lease reviews.

Forecast at a glance

Demand
We believe net absorption will be driven by financial, professional services, technology and flexible workspace firms.

Supply
We expect diminished supply over 2018-2020, with annual expansion averaging 2% of stock. The next major jump in supply (7% of stock) should be in 2021.

Vacancy
CBD prime vacancy has fallen sharply and should continue declining until the next anticipated supply hike in 2021.

Rent
RENT
CBD prime rents recorded a rise of 2.3% YOY for 2017. Rent growth should accelerate in 2018 (+10-12%), and taper down in 2019 (+5-7%). We expect a slight dip in 2020 before rebounding over 2021-22.

Price
Capital values should rise in tandem with rents, but at a slower clip. Yields should remain largely flat or rise marginally, due partly to rising rents.

Double-digit growth over 2018F

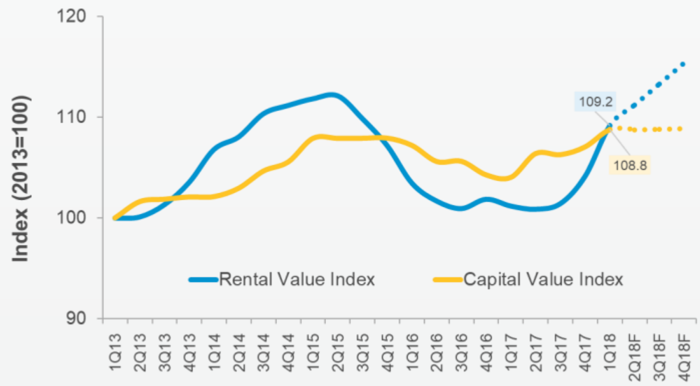
Prime office rents gained further momentum in Q1 2018, supported by strengthening economic fundamentals. CBD Premium and Grade A rents rose 4.8% QOQ to SGD8.60 (USD6.56) psf pm, a marked acceleration from the 2.7% QOQ increase in Q4 2017. Encouragingly, the recovery in rents is supported by growth across a wide range of sectors, boding well for a robust market outlook over 2018-19. The average vacancy rate in CBD Premium and Grade A buildings also fell by 2.3 percentage points (ppt) QOQ to 5.8%.

Given the fast pace of recovery, we expect prime office rents to surpass the previous peak seen in 2015 by end-2018, and realise additional upside over 2019. CBD Premium and Grade A rents should see an accelerated increase of 10-12% over 2018, before moderating to a growth rate of 5-7% in 2019. This positions the Singapore office market as the strongest income growth opportunity in Asia for investors over 2018-2019.

For occupiers, the cyclical shift to a landlord's market is a prime impetus to conduct early rent reviews or relocation decisions, given that market rents may be up to 20% higher than 2017 rates by end-2019, and CBD prime vacancy expected to dip to sub-4% in 2019.

The office investment market continued to pick up in Q1 2018, driven by future income growth expectations, with average imputed capital values for the CBD Premium and Grade A market rising 1.6% QOQ to SGD2,281 (USD1,739) psf.

CBD Prime Rental and Capital Value Indices



Source: Colliers International Singapore Research

Leasing market and rental values

Rental growth steepens sharply on bullish sentiment

In Q1 2018, the Singapore office market recorded robust growth. The bullish sentiment was especially strong in the CBD, with Premium and Grade A rents climbing to SGD8.60 (USD6.56) psf pm, an increase of 4.8% QOQ. This is a sharper acceleration than the preceding upticks of 2.7% QOQ and 0.6% QOQ in Q4 and Q3 2017 respectively. Renewed strength amongst businesses, particularly the service sectors, coupled with a conspicuous moderation of upcoming new CBD supply (averaging 2% of stock per year) over 2018-2020, likely drove the brisk rental recovery.

On an island-wide basis, the Premium and Grade A markets recorded rental growth ranging from 2.9% to 6.7% QOQ, while Grade B buildings saw slightly more moderate, but otherwise encouraging upticks of between 2.1% and 4.8% QOQ.

Average Gross Effective Rents* (by Micro-Market)

Micro-Market	Q1 2018 Average Gross Effective Rents (SGD psf pm)	QOQ Change (%)	YOY Change (%)
Premium			
Raffles Place / New Downtown	10.49	6.7%	13.9%
Grade A			
Raffles Place / New Downtown	8.90	4.1%	7.7%
Shenton Way / Tanjong Pagar	8.43	4.7%	8.9%
City Hall	8.89	4.1%	6.0%
Beach Road	7.60	5.8%	7.8%
Orchard Road	8.43	4.1%	5.2%
CBD Premium and Grade A	**8.60**	**4.8%**	**7.9%**
City Fringe	7.01	2.9%	5.1%
Suburban	4.69	4.7%	5.4%
Grade B			
Raffles Place / New Downtown	7.77	3.5%	4.6%
Shenton Way / Tanjong Pagar	7.24	4.2%	6.9%
Beach Road	6.10	4.1%	5.7%
Orchard Road	7.69	4.8%	6.4%
City Fringe	6.46	2.1%	3.2%
Suburban	3.83	3.2%	4.9%

*Assuming a full-floor lease on a mid-zone level. Effective rent refers to average rate payable over the lease term after including incentives (e.g. rent-free period).

Source: Colliers International Singapore Research

The highest tier developments in the CBD, characterised by the Premium micro-market in Raffles Place / New Downtown, saw the sharpest rental increase of 6.7% QOQ.

Since the rental trough in H1 2017, CBD Premium buildings' average rents have recorded a cumulative increase of 14.3%, nearly double the 8.2% growth in the overall CBD prime office market over the same period.

The shift towards a climate favouring landlords was evident from drastic cuts in lease incentives (aside from standard fit-out periods). During Q1 2018, the average incentive level for CBD Premium and Grade A transactions was 4.6% of face rents, equivalent to about 1.7 months of rent-free assuming a 36-month lease term. This implies a sharp reduction of about three weeks of rent-free from the levels of 2016 and H1 2017, in which incentives typically amounted to some 6.8% of face rents, or 2.4 months of rent-free assuming a 36-month lease term.

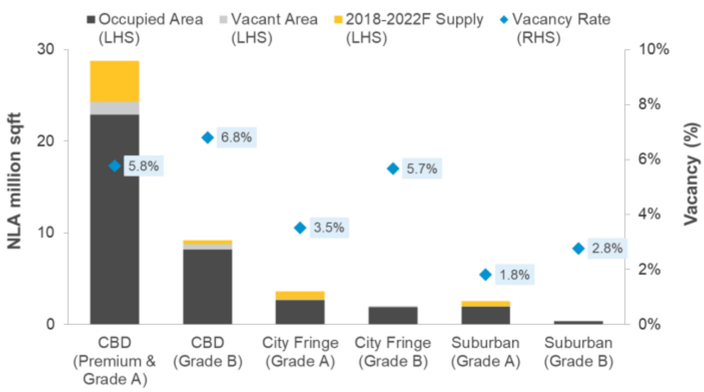
Swift decline in prime vacancy rate

CBD Premium and Grade A vacancy fell a sharp 2.3ppt QOQ to 5.8%. The reduction in vacancy rates was observable across all CBD prime office districts ranging from the traditional core CBD area to Beach Road and Orchard Road.

CBD Grade B vacancy recorded a marginal increase of 0.2ppt QOQ to 6.8%. This suggests that the flight-to-efficiency trend - characterised by relocations to newer buildings for efficiency gains - is slowing down, and becoming more evenly matched against the rate of back-fill space re-absorption in older buildings.

The swift decline in vacancy in the higher-tier Premium and Grade A baskets, coupled with the resilient take-up in Grade B buildings, suggests that strong occupier demand fundamentals are supporting the current office market upturn.

Stock, Supply and Vacancy Rates (as at Q1 2018)



Source: Colliers International Singapore Research

SELECTED LEASING TRANSACTIONS - Q1 2018			
Tenant	Building	Net Lettable Area (sq ft)	Relocation / Expansion / New Site
Total Oil	Frasers Tower	125,000	Relocation
Reed Smith	Ocean Financial Centre	15,000 (add-on)	Expansion
Cloudera	One Raffles Place Tower 2	18,000	Relocation
Amazon	Capital Square	15,000 (add-on)	Expansion
Ultimate Software	One George Street	8,000	Relocation & Expansion
Baker McKenzie Wong Leow	Marina Bay Financial Centre Tower 1	7,000 (add-on)	Expansion
Asia Citi	Robinson Centre	4,000	Relocation & Expansion
Appier	Asia Square Tower 1	2,000 (add-on)	Expansion

Source: Colliers International Singapore Research

Expansionary demand led by tech players, law firms

In Q1 2018, the bulk of expansionary demand came from the technology and legal services sectors. Most of these expansionary deals were clustered within the core CBD precinct.

The technology sector continued its growth trajectory, mainly driven by software and cloud computing firms navigating their explosive growth stage. Artificial intelligence start-up, Appier, doubled its space take-up within Asia Square Tower 1 to 4,000 sq ft. Software company, Cloudera, relocated to One Raffles Place Tower 2 (18,000 sq ft) from a serviced office. Similarly, Ultimate Software, a cloud-based technology firm, took up 8,000 sq ft at One George Street in a growth-driven relocation from a serviced office. E-commerce giant Amazon was in expansion mode, taking up an additional 15,000 sq ft at Capital Square.

Transactions by law firms also featured prominently during Q1 2018, with Reed Smith taking up an additional 15,000 sq ft of space at Ocean Financial Centre, and a 7,000 sq ft expansion by Baker McKenzie Wong Leow within Marina Bay Financial Centre Tower 1.

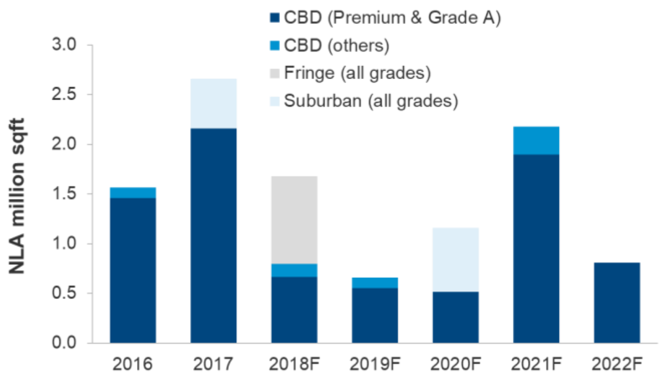
US-based investment bank JP Morgan became the first anchor tenant at the upcoming Golden Shoe redevelopment project, CapitaSpring, taking up some 155,000 sq ft or approximately 25% of lettable office space. Another highlight was Paya Lebar Quarter, which saw SMRT Corporation (100,000 sq ft) and CBRE (31,000 sq ft) pre-committing as anchor tenants.

Muted short-term supply, rapid pre-leasing in upcoming Grade A builds

Over 2018-2020, we expect a moderate CBD Premium and Grade A supply pipeline averaging 0.58 million sq ft (53,670 sq m) per year, equivalent to an annual growth of 2% of stock. This is significantly muted against the large supply injection witnessed in 2017 (approximately 10% of stock).

The supply drought should be especially pronounced in 2019, as new office space is slated to be heavily concentrated outside the core CBD. The next major jump (approximately 7% of stock) will actualize in 2021 from CapitaSpring and the Central Boulevard greenfield site, totalling 1.9 million sq ft (180,000 sq m) within Raffles Place / New Downtown.

Island-wide Office Space Supply (2016-2022F)



Source: Colliers International Singapore Research

In Q2 2018, Frasers Tower is slated to come on-stream in the Shenton Way / Tanjong Pagar precinct, offering some 663,000 sq ft (61,595 sq m) of office space. As of 31 March 2018, Frasers Tower achieved a healthy pre-commitment rate of 83%, alluding to the micro-market's rising attractiveness.

In Q3 2018, the City Fringe market should see Paya Lebar Quarter's completion. As of 30 March 2018, more than 50% of its 880,000 sq ft (81,755 sq m) office component has been pre-leased, or is under advanced stages of negotiation. 18 Robinson, a smaller development in Raffles Place totalling some 194,000 sq ft (18,023 sq m), should also come on-board in Q3. It was approximately 30% pre-leased as of 31 March 2018.

Broader range of growth drivers

Singapore's real GDP grew 4.3% YOY in Q1 2018 according to advance estimates by the Ministry of Trade and Industry, higher than the full-year growth rates of 3.6% and 2.4% seen in 2017 and 2016 respectively.

Based on Oxford Economics' analysis[1], Singapore's growth momentum should moderate but remain firm, with GDP growing 3.1% over 2018, and edging down to 2.5% over 2019-2022. The main growth engine is expected to shift back to the service sectors, after 2017's cyclical manufacturing outperformance.

Looking ahead, Colliers International expects expansionary absorption to be driven by financial and business services firms over 2018, in tandem with the sustained growth velocity of technology companies and flexible workspace operators.

Growing office usage demand by the service sectors, coupled with muted supply pipelines in the next three years, should pave the way for double-digit rental growth over 2018-19. We forecast CBD Premium and Grade A rents to record a cumulative increase of 17% over 2018-19, with accelerated rental growth ranging from 10% to 12% in 2018, and a more moderate 5% to 7% over 2019. In anticipation of the large supply in 2021, rents should see some consolidation (-4%) in 2020, before rebounding again over 2021-22.

Strata sales and capital values

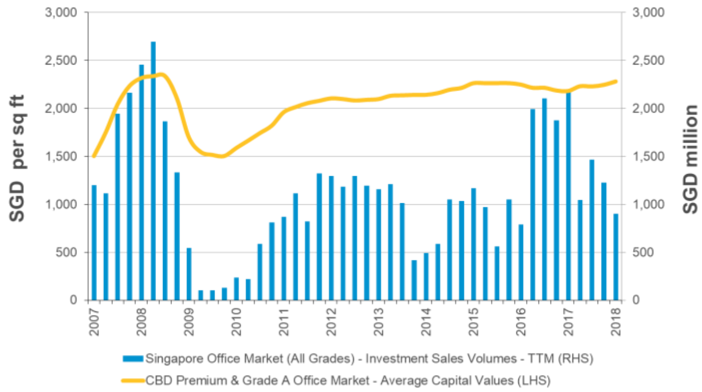
Strata sales held flat, capital values on gradual upward trend

Based on Urban Redevelopment Authority (URA) REALIS data as of 23 April 2018, strata office sales transactions in Q1 2018 fell 47.6% QOQ to 65 deals, from the three-year high of 124 sales in Q4 2017. Nonetheless, this is 18.2% higher YOY from 55 deals in Q1 2017. The CBD continued to see a healthy volume of strata transactions. This was complemented by robust interest in decentralised locations, as evidenced by Paya Lebar Square and Vision Exchange being amongst the biggest movers of resale units during Q1, and at substantially higher prices PSF on a YOY basis.

Based on Colliers International's research, average capital values of CBD Premium and Grade A office properties inched up slightly (+1.6% QOQ) to SGD2,281 (USD1,739) psf, on the back of a strong recovery in the occupier market, with the bulk of valuation growth in the Shenton Way / Tanjong Pagar and Beach Road districts. Raffles Place / New Downtown Premium and Grade A capital values remained flat at SGD2,743 (USD2,091) psf and SGD2,644 (USD2,016) psf, respectively.

CBD Premium and Grade A office yields remained largely stable in Q1 2018. We anticipate capital values to grow in tandem with rents, albeit at a slower clip. Yields should remain largely flat or rise marginally over the medium-term from 2018 through 2022.

CBD Prime Capital Values & Total Investment Sales



*Valuation-based methodology is used to derive capital values. Investment sales only include transactions over SGD5million. TTM refers to trailing 12 months.

Source: Colliers International Singapore Research

[1] Source: Oxford Economics, Country Economic Forecast, Singapore (28 March 2018)

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