Quarterly Review

SINGAPORE | OFFICE

Q2 2016

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Colliers INTERNATIONAL

Accelerating success.

Continual consolidation in office market

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Flight to quality will remain the driver for leasing activities in good quality buildings. However, we expect this will create some "trickle down" effect on demand and rental values in the secondary market. This presents both a challenge and an opportunity to the owners of lower grade buildings to look at improving and upgrading their properties to remain competitive.

Forecast at a glance*

Demand
Set to moderate, with demand lagging behind supply

Supply
Upcoming island-wide supply remains high with 2.7 million sq ft expected in 2016 and 2.4 million sq ft expected in 2017

Vacancy Rate
To increase due to the surge of impending office supply

Rent
We expect average Premium and Grade A rents to decline up to 10% from Q2 2016 till end 2016

Price
We expect modest declines in prices of up to about 2% between now and the end of 2016

*Refers to full year 2016 forecasts

Upcoming office supply spells greater relocation opportunities for tenants

Based on a quarterly survey released by the Monetary Authority of Singapore, the forecast for GDP growth in 2016 has been revised to 1.8% in June 2016. General business sentiment remains largely cautious with some ongoing consolidation and rationalisation plans.

The current market presents tenants an opportunity to capitalise on the softening office market by reviewing their existing space requirements. As pockets of good quality secondary and new office space becomes available, tenants should be able to devise viable plans for their future space requirement at more palatable rental levels. This is especially so for tenants who were on a three-year lease with rents secured in 2014 when the rental levels were relatively higher.

We believe the growing office supply is outstripping the growth in demand which will therefore lead to continual downward pressure on average monthly gross office rents . We predict that average rents will fall by up to 10% between Q2 2016 and the end of 2016.

We expect overall occupancy levels of office buildings in the Central Business District (CBD) will continue to be affected by the impending supply from DUO Tower, Guoco Tower and Marina One. More relocation activities are likely as more secondary office space is released to the market.

Despite solid investment interests in selected prime grade office buildings, we expect that average capital values of Premium and Grade A office buildings in Raffles Place/New Downtown will continue to see a decline of up to 2.0% between Q2 2016 and the end of 2016.

Leasing market and rental values

Office rents declined up to 2.1% in Q2 2016

With the exception of the suburban micro-market, average monthly gross office rents in Singapore trended downwards between 0.1% and 2.1% on a quarter on quarter (QOQ) basis which was less severe than the QOQ drop between 2.0% and 6.0% seen last quarter.

Average monthly gross rents of Grade B office buildings seemed to be most affected in Q2 2016 as landlords offered more attractive rental levels and incentive packages to retain existing tenants and attract new tenants.

Average Monthly Gross Office Rents by Micro-market

Micro Market	Q2 2016 Average Monthly Gross Office Rents (SGD per sq ft)	QOQ Change (%)
Premium		
Raffles Place/New Downtown	10.48	-1.0%
Grade A		
Raffles Place/New Downtown	9.47	-0.3%
Shenton Way/Tanjong Pagar	8.18	-0.7%
Marina/City Hall	9.23	-0.2%
Beach Road	7.50	-0.8%
Orchard Road	8.40	-0.6%
City Fringe	7.21	-1.5%
Suburban	4.89	0.0%
Grade B		
Raffles Place/New Downtown	7.92	-1.9%
Shenton Way/Tanjong Pagar	7.42	-0.1%
Beach Road	6.66	-2.1%
Orchard Road	8.06	-0.6%
City Fringe	6.81	-0.6%
Suburban	4.24	0.0%

Source: Colliers International Singapore Research

Among the older office buildings, monthly gross rents of Grade B buildings in the Beach Road micro-market saw the largest fall of 2.1% QOQ.

We observe that the landlords of buildings in this micro-market are adopting more favourable terms for potential tenants in a bid to compete for tenants.

The average monthly gross rents of Grade B office buildings in the Raffles Place/New Downtown micro-market also saw a decline of 1.9% QOQ as a result of relocation and flight to quality activities.

Tenants focusing on "right-sizing"

Cost concerns remain as one of the key agendas for most industries. Office space occupiers are examining their existing space requirements and reviewing relocation opportunities to a more efficient space, whilst weighing up capital cost of doing so.

While we expect market demand for office space to lag behind upcoming office supply in 2016/2017, there is still a relatively healthy level of demand for smaller sized offices and compact offices in view of their requirements for streamlined business units and changing office space patterns.

There is a continued emphasis on the importance of space efficiency and office workplace flexibility as a result of a growing demand from mid-sized firms and start-up companies not needing large spaces but preferring to operate in prime office buildings.

Older buildings experience greater fluctuations in occupancy

With no major new office developments completed in Q2 2016, the market continues to absorb the space which has been released by large occupiers such as those in the financial industry.

While the Q2 2016 average occupancy level for Grade A office buildings in CBD hovered around the 95% levels, several Premium and Grade A office buildings have started to see declines in their occupancy rates to hit below 85%. With the upcoming supply of about 4.0 million sq ft from the completion of Premium and Grade A office buildings such as DUO Tower, Guoco Tower and Marina One in the next three quarters, we expect that the average occupancy levels in this micro-market will see a further drop, especially for the older developments.

Meanwhile in Q2 2016, occupancy levels in older Grade B office buildings across Singapore saw greater fluctuations as tenants started to implement plans to move to upcoming new buildings or relocate to nearby buildings. Average islandwide and CBD occupancy rates for Grade B office buildings in Q2 2016 fell between 0.7% and 0.9% QOQ respectively.

The market also saw more tenant movements from buildings intended for strata subdivision and sale such as TripleOne Somerset and AXA Tower.

A change in property management of the office buildings from a wholly-own building centralised management to a MCST (Management Corporation Strata Title) management may have led to some tenants such as K Line and DNB Bank to move from AXA Tower to Guoco Tower. Similarly in TripleOne Somerset, some tenants in oil and gas industry have moved to other offices in Regency House and Shaw House.

Average Occupancy Rates for Premium Grade and Grade A Office Space by Micro-market

Micro Market	Q2 2016 Average Occupancy Rate (%)
Premium	
Raffles Place/New Downtown	93.7%
Grade A	
Raffles Place/New Downtown	95.5%
Shenton Way/Tanjong Pagar	98.2%
Marina / City Hall	95.1%
Beach Road	93.2%
Orchard Road	97.4%
City Fringe	93.8%
Suburban	95.0%

Source: Colliers International Singapore Research

Developers taking interest in co-working space

Major landlords have begun to adopt a more pro-active approach to adjust to the changing demand for office space in Singapore. Since Hackerspace opened its first office in Bussorah Street in 2009, the co-working space arena has risen to greater heights in the last two years alongside the increased demand from a larger demand pool of Technology, Media and Telecommunication (TMT) tenants.

Recently, major landlords such as Keppel Land Limited and CapitaLand Limited have entered the serviced office/co-working office space market as the office market looks to accommodate an increasing number of start-ups and smaller companies which prefer the flexibility and privilege of such co-working spaces.

Keppel Land for example launched a 6,400 sq ft workspace at Keppel Tower to enable a 1-person to 20-person outfits with a flexible lease structure. The landlord combined the characteristics of both a co-working space and a service office to offer furnished office suites and hot-desking work stations.

Similarly, CapitaLand Limited also made its first foray in Capital Tower when the group formed a 50:50 Joint Venture (JV) with co-working space operator, Collective Works to launch a premium 22,000 sq ft of co-working space in the building. The JV will lease the space from CapitaLand Commercial Trust and Collective Works will manage the space on behalf of the JV. The space is expected to accommodate about 250 companies and will be completed by the end of Q2 2016.

Besides JTC LaunchPad@one-north which currently houses about 500 start-ups, interest is also coming from other major industrial landlords to include co-working space in their portfolio. Additionally, OUE will be leasing 20,000 sq ft of space to a co-working provider in the upcoming OUE Downtown.

Even though co-working space constitutes a small portion of the overall real estate portfolio for these major landlords, participation from the landlords demonstrate the potential and positive outlook for this segment, as well as the appreciation of the concepts benefits.

Major Occupier Activities

MAJOR OCCUPIER ACTIVITIES IN Q2 2016		
BUILDING	**TENANT**	**NET FLOOR AREA (SQ FT)**
Marina One East Tower	PwC	180,000
Marina One	Tokyo-Mitsubishi UFJ (BTMU)	140,000
Asia Square Tower 2	Mitsui & Co.	80,000
Marina One East Tower	Daiwa Capital Markets	35,000
Guoco Tower	SAS Institute Pte Ltd	20,000

Source: Colliers International Singapore Research

Strata sales and capital values

Capital value sees deeper fall in Q2 2016

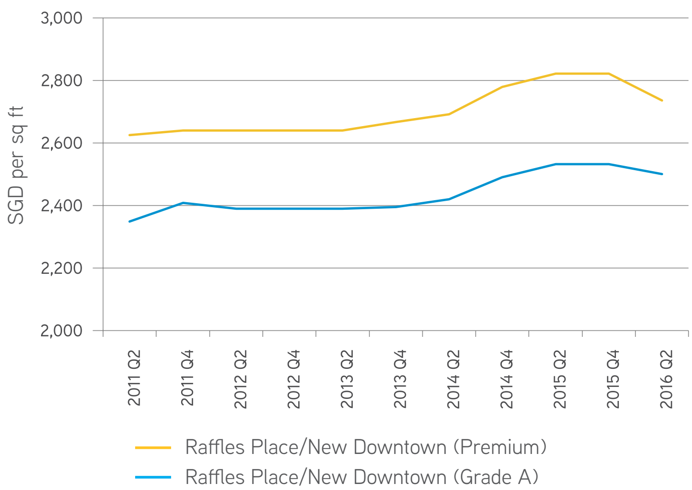
Capital values of office buildings took a deeper fall this quarter as they succumbed to the continual downward pressure of easing office rents. As sellers adjust to the price expectation for office buildings against a background of rising occupancies and increasing supply, the average imputed capital value in Premium office buildings in Raffles Place/New Downtown fell by 2.0% QOQ to SGD2,736 per sq ft in Q2 2016. On the other hand, average imputed capital value of Grade A office buildings in the same micro market fell by a smaller margin of 0.4% QOQ to SGD2,500 per sq ft.

The largest drop was seen in Shenton Way/Tanjong Pagar whereby average imputed capital values of Grade A office buildings registered a 2.3% QOQ fall in Q2 2016.

In terms of transaction volume in the office strata-title market, based on the URA caveats downloaded on 27 Jun 2016, there are 67 transactions in Q2 2016 which represents a 69.3% increase from the 39 transactions recorded in Q1 2016. The increase in transactions volume is due to the launch of Centrium Square in Serangoon Road, which saw the total sale of 19 office units at an average price of SGD2,502 per sq ft.

The number of transactions in Downtown Core Planning Area remained the same at 21 this quarter.

Average Capital Values* for Premium and Grade A Office Space in Raffles Place/New Downtown



*A valuation-based methodology is adopted for the derivation of average capital values for Premium and Grade A office spaces in Raffles Place/New Downtown.

Source: Colliers International Singapore Research

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