Colliers Quarterly

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Accelerating success.

Still a tenants' market

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Amid benign economic conditions and large new supply, we expect Premium and Grade A office rents and capital values, which continued to decline in Q3 2016, to soften further into H2 2017. Pre-committment rates for the new schemes rose as tenants plan to relocate from older buildings. We expect competition among landlords to fill the backfill spaces to intensify in the next few quarters. Besides pro-active lease management, there could be opportunities for landlords of older properties to enhance their assets to improve their marketability.

Forecast at a glance

Demand
Demand continues to lag behind supply comprising more office relocations than expansions

Supply
Premium and Grade A supply in CBD to grow 5.6%* in 2016 and another 12.1%* in 2017 due to bumper completions

Vacancy Rate
Vacancy rates likely to surge as the new office buildings are completed

Rent
Premium and Grade A office rents in CBD to decline by up to 3.0% in Q4 2016, bringing full year decline between 7.0% and 12%, and a cumulative average of 9.4% since the recent peak in Q2 2015

Capital Value
Prime office capital values to remain subdued on weak rents

*Based on Colliers Premium and Grade A office supply

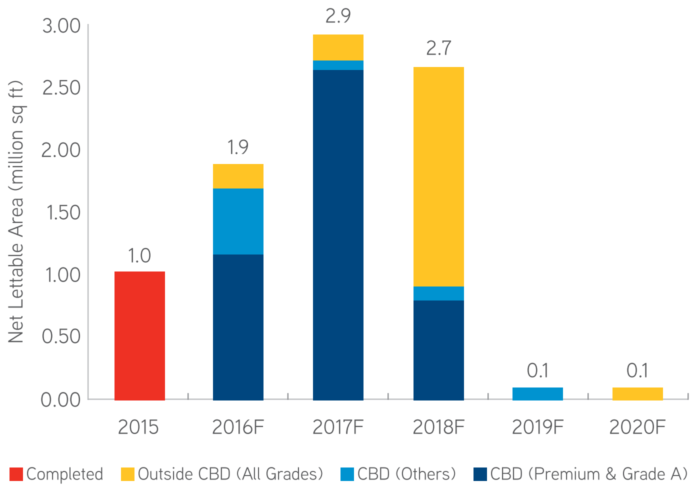
Expect rent declines to persist

In view of the above average levels of new prime office supply, mainly Guoco Tower, DUO Tower and Marina One, completing in the next three quarters, we note three key trends:

- Higher pre-commitment rates for some upcoming projects albeit at the expense of older prime buildings. Hence, we expect competition among landlords to fill the backfill spaces, especially in older office buildings, to intensify over the next few quarters;
- Demand is mainly characterised by relocations and flight to quality rather than expansions;
- Landlords could favour shorter leases at more attractive rates, allowing them to ride any rent recovery after the next two years.

As such, we believe overall Central Business District (CBD) office rentals in Q4 2016 will continue to decline by up to about 3.0% quarter-on-quarter (QOQ), bringing full year 2016 decline to 7.0%-12.0%, and a cumulative average of 9.4% since the recent peak in Q2 2015. Overall capital values of Premium and Grade A office buildings in CBD have fallen 2.1% since Q1 2016 and we expect them to remain muted against a background of declining rents and higher vacancies.

Islandwide Office Space Supply (2015 – 2020F)



Source: Colliers International Singapore Research

Leasing market and rental values

Fifth quarter of rental decline since recent peak in Q2 2015

Overall office rentals across Singapore continue to slide under pressure of oversupply and lacklustre demand as the market saw the fifth consecutive QOQ rental decline in Q3 2016.

Rentals in Grade B office buildings are the most affected this quarter as landlords continue to be squeezed by the flight to quality phenomenon in the rise of wider office space options offered to tenants.

Average Monthly Gross Office Rents by Micro-market

Micro Market	Q3 2016 Average Monthly Gross Office Rents (SGD per sq ft)	QOQ Change (%)	YOY Change (%)
Premium			
Raffles Place/New Downtown	10.30	-1.7%	-11.8%
Grade A			
Raffles Place/New Downtown	9.33	-1.5%	-8.3%
Shenton Way/Tanjong Pagar	8.13	-0.6%	-8.1%
Marina/City Hall	9.07	-1.7%	-7.4%
Beach Road	7.50	0.0%	-5.9%
Orchard Road	8.31	-1.1%	-6.5%
City Fringe	7.15	-0.8%	-8.3%
Suburban	4.86	-0.6%	-4.3%
Grade B			
Raffles Place/New Downtown	7.88	-0.5%	-8.5%
Shenton Way/Tanjong Pagar	7.31	-1.5%	-6.6%
Beach Road	6.50	-2.4%	-8.1%
Orchard Road	8.02	-0.5%	-5.6%
City Fringe	6.63	-2.6%	-7.4%
Suburban	4.24	0.0%	-4.1%

Source: Colliers International Singapore Research

Across the various micro-markets, Grade B office buildings in City Fringe and Beach Road fell the most QOQ by 2.6% and 2.4% respectively. Declines in rents are in part due to the correction of vacating spaces from some key tenants such as MasterCard and Amadeus GDS Singapore moving from the Beach Road micro-market to DUO Tower and Guoco Tower respectively.

We also see sharper drops in rents in Raffles Place/New Downtown this quarter compared to Q2 2016. Monthly gross rents in the Premium and Grade A office buildings fell 1.7% and 1.5% QOQ respectively in Q3 2016 as compared to the 1.0% and 0.3% QOQ drop in in Q2 2016.

Moderate office space expansions in upcoming new buildings

Underpinned by gloomier economic outlook from potential US rate hikes, an uncertain Chinese economy and concerns on the repercussions of Brexit, business sentiments and overall office space expansion remain restrained.

The Singapore GDP advance estimate for Q3 released on 14 October showed Singapore GDP contracted by 4.1% on a seasonally adjusted annualised basis from a meagre 0.2% in Q2. Manufacturing and construction sectors were weak but notably, the services sector - which accounts for two-thirds of the economy - continued to contract for the third straight quarter, registering a QOQ decline of 1.9% in Q3 2016. Oxford Economics does not rule out a technical recession (two consecutive quarters of sequential GDP growth) in Q4, and expects the full-year GDP growth to come in at the lower end of the 1.0% to 2.0% government's forecast range.

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

Micro Market	Q3 2016 Average Occupancy Rate (%)	Q2 2016 Average Occupancy Rate (%)
Premium		
Raffles Place/New Downtown	95.3%	93.7%
Grade A		
Raffles Place/New Downtown	97.4%	95.5%
Shenton Way/Tanjong Pagar	98.5%	98.2%
Marina/City Hall	96.2%	95.1%
Beach Road	90.1%	93.2%
Orchard Road	96.7%	97.4%
City Fringe	94.5%	93.8%
Suburban	95.3%	95.0%

Source: Colliers International Singapore Research

While relatively high pre-commitment levels in some upcoming office buildings such as Guoco Tower are being achieved, overall business expansion in to the new office buildings remains moderate as potential new tenants seek to minimise overall occupancy cost and optimise space efficiency.

MAJOR OCCUPIER MOVEMENTS FOR PREMIUM AND GRADE A OFFICE BUILDINGS IN Q3 2016			
BUILDING	TENANT	NET FLOOR AREA (SQ FT)	Relocation[1] / Expansion[2] / New to Market[3]
Marina One	Bank Julius Baer	100,000	Expansion
Guoco Tower	Dentsu Aegis Network	100,000	Expansion
V on Shenton	Just Office	40,000	Expansion
Guoco Tower	Palo Alto Network	36,000	Expansion
Guoco Tower	Amadeus GDS Singapore	36,000	Expansion
Guoco Tower	Itochu Singapore	28,000	Reduction

Source: Colliers International Singapore Research, The Business Times, The Straits Times
(1) Relocation refers to tenants moving to a similar Premium or Grade A office building with no expansion in size
(2) Expansion refers to tenants expanding to a similar Premium or Grade A office building
(3) New to Market refers to tenants that are previously not located in a Premium or Grade A office building

Despite this, there are pockets of strength. Swiss private bank Julius Baer will increase 28,000 sq ft from its current office space at Asia Square Tower 1 to a total 100,000 sq ft in Marina One. Cybersecurity company, Palto Alto Networks and IT solutions provider for the travel industry, Amadeus GDS Singapore will almost double their existing space of 20,000 sq ft in Millenia Tower and Parkview Square respectively to 36,000 sq ft in Guoco Tower. Daiwa Capital Markets will increase by about 10,700 sq ft from its current space in OUE Downtown 2 to 35,000 sq ft in Marina One.

Other additional space expansions in Guoco Tower from potential tenants include SAS Institute Pte Ltd, K Line, Agoda, Manpower Group and Accor Hotel. Accountancy firm, PricewaterhouseCoopers, have also increased marginally by 5,000 sq ft from about 175,000 sq ft at 8 Cross Street to occupy 180,000 sq ft in Marina One.

According to market information, Dentsu Aegis Network, is expected to occupy about 100,000 sq ft at Guoco Tower, relocated from 77 Robinson Road and also other locations occupied by its member firms.

ING, which now occupies 70,000 sq ft at Republic Plaza, is close to securing a similar amount of space at Guoco Tower in Tanjong Pagar Centre

Meanwhile, presumably due to higher efficiency of space within the new office buildings, some potential tenants such as Itochu Singapore and The Bank of Tokyo-Mitsubishi UFJ have indicated a reduction in current space when relocating to Guoco Tower and Marina One respectively.

As at Q3 2016, the pre-commitment level for Guoco Tower, which recently obtained the Temporary Occupation Permit (TOP) in September 2016, is reported to be at 80% while DUO Tower which extended its completion date to early 2017 has about 30% pre-commitment level.

Meanwhile, more than30% of its 1.88 million Net Lettable Area (NLA) sq ft in Marina One have either obtained signed leases or are under documentation. The office tower is expected to be completed by Q1 2017.

More attractive rents for shorter leases

In a bid to ensure a higher level of overall returns in their asset portfolio, we see landlords engaging a more active lease management in the current office property market. While landlords have been offering greater incentives and more palatable rental levels to achieve higher occupancy levels, an increasing proportion of these leases offered in the market are trending towards shorter tenures.

A longer lease secured at current softened rents may effectively cap the potential rental upside when the office market picks up. As such, we see a stronger preference from some landlords to adopt a shorter lease for selective tenants.

Average monthly gross office rents for a five-year lease offered at first cut in some of the upcoming office buildings are noted to be about 8.0% to 10% higher than the average monthly gross rents on a three-year lease.

Greater changes await Shenton Way /Tanjong Pagar

The old CBD Shenton Way/Tanjong Pagar looks set to welcome a second wave of rejuvenation as the micro-market sees the completion of new office and retail buildings, and asset enhancements of older ones.

In Q2 2016, SBF Centre which has about 227,000 sq ft NLA obtained TOP. Guoco Tower, of about 890,000 sq ft, which will be the tallest office tower in Singapore, obtained TOP in September 2016. Redevelopments of UIC Building and OUE Downtown that had commenced since 2012 will offer additional upgraded space of 332,000 sq ft by end of 2016.

Some nearby old buildings are also expected to be redeveloped in the next three years. CPF Building, which was bought by Ascendas Land in 2015, will be redeveloped and will remain an office building with supporting retail amenities. The major tenant, CPF Board is likely to vacate around Q1 2017. Just a block away, Afro-Asia building is also planning to undergo redevelopment, adding more quality office space in the micro-market.

Upgrading works are also expected for AXA Tower (8 Shenton Way) as it includes more retail and F&B options, two storey annex block of medical offices and enhancement of facilities such as a double-volume grand entrance lobby and lifts and security features. Meanwhile, the office component of the building will be strata-sold.

Come 2018, Frasers Tower at Cecil Street, will also add 664,000 sq ft NLA of premium Grade A office space.

We will also see sizeable retail space offerings emerge with the 100,000 sq ft of retail podium from the upcoming Tanjong Pagar Centre, and 150,000 sq ft of retail space from Downtown Gallery, the retail platform from OUE Downtown which is also slated to open in Q1 2017.

On the longer term horizon, the future development on the Government Land Sale site, Central Boulevard, which flanks New Downtown and Shenton Way could add to the vibrancy of old downtown. The site can be built to a maximum gross floor area of about 1.52 million sq ft with at least 70.8% being allocated to office use.

Strata sales and capital values

Overall capital values remained soft, slight increase in selected good quality office buildings

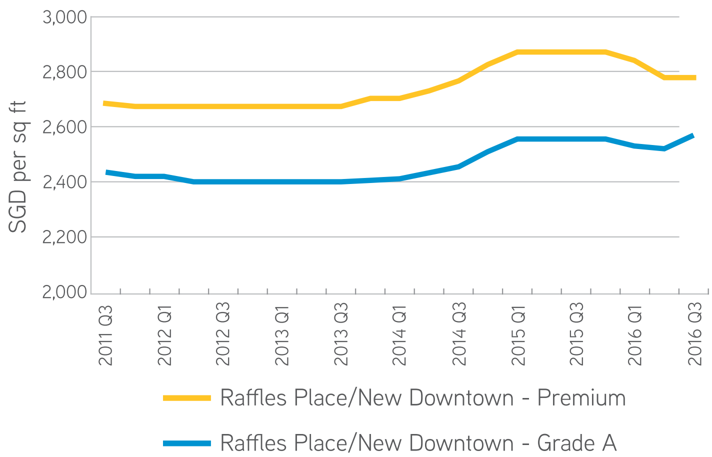
Largely due to the decline in sales transactions of Centrium Square in Kallang in Q3 2016, overall strata sales volume in the quarter dropped by more than half from a total transaction volume of 85 in Q2 2016 to 46. The proportion of new sales in Q3 2016 also took a dive from 40.0% registered last quarter to 28.3% in Q3 2016.

Despite weak rents and occupancies, investment sentiments for selected freehold or long leasehold office buildings remained buoyant with record sales transacted in June 2016. Singapore-listed investment firm MYP has set a new record for per sq ft price of SGD3,520 (on a NLA basis) for 999-year leasehold Straits Trading Building, and bought a freehold office block at 110 Robinson at SGD3,169 per sq ft in Q3 2016.

As a result, average capital values for Grade A office space in Raffles Place/New Downtown saw an increase of 1.8% QOQ to SGD2,545 per sq ft in Q3 2016 as investors take a long term view of the Singapore office market amid a lack of investable bulk buildings.

Average capital values for the other micro-markets across Singapore, on the other hand, stayed soft amidst a more subdued underlying office space demand.

Average Capital Values[1] for Premium and Grade A Office Space in Raffles Place/New Downtown



Source: Colliers International Singapore Research

[1]A valuation based methodology is used to derive the average capital values

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