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A turnaround

JieMei Tan (JM) Senior Analyst | Research

In Q3 2017, CBD Premium and Grade A office rents rose for the first time in nine quarters, up 0.4% QOQ, signaling a turnaround. Occupancy declined only slightly under the weight of the final batch of supply coming to market this year, reflecting healthy net demand and a turnaround in the works. While vacancy may rise with the gradual return of backfill space to the market, landlords' confidence in raising rents is bolstered by the tapering supply pipelines in 2018-2020. We expect rent growth to accelerate over 2018, driven by rising occupier demand alongside a broad-based economic recovery.

Forecast at a glance

Demand
Continued flight to quality, broad-based expansionary demand and incremental absorption from the coworking sector.

Supply
We expect a more moderate supply pipeline over 2018-2020F, after the 2017 supply peak which expanded CBD Premium and Grade A stock by nearly 10%.

Vacancy rate
The CBD Premium and Grade A vacancy rate as of Q3 2017 was 8.5%. We expect that to rise to approx. 10% by end-2017, and taper off in 2018-2019.

Rent
CBD Premium and Grade A office rents are stabilizing, having clocked a marginal rise of 0.1% YTD. We expect faster rental growth of 5-7% in 2018 and 3-5% in 2019.

Price
Prime office capital values should rise with ample market liquidity and investor interest.

Rental uptick supported by resilient demand

CBD Premium and Grade A office rents rose 0.4% QOQ and 0.3% YOY to SGD8.57 (USD6.30) psf pm, after sliding for eight quarters amounting to a cumulative decline of 9.6%.

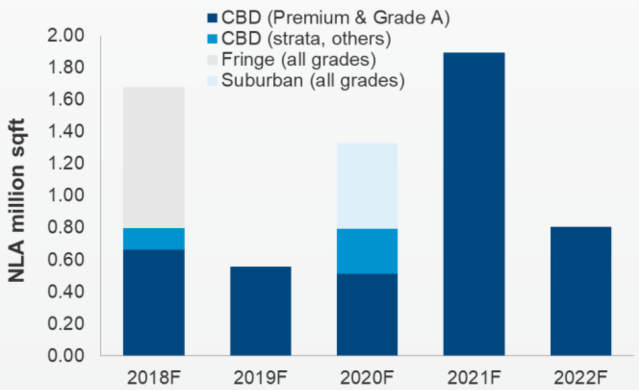
Occupancy rates remained relatively buoyant, declining by only 1.6ppt QOQ to 91.5% despite the large new supply from the completion of the 940,000 sq ft Marina One West Tower.

Commitment levels in new builds continued to strengthen over 2017. New developments in the Downtown Core CBD, such as Marina One and Guoco Tower, reflected the strongest leasing momentum on the back of occupiers' "flight to quality".

We expect accelerated rental growth ranging 5% to 7% over 2018 and a more moderate 3% to 5% in 2019, propelled by strong economic growth momentum in the medium term. The pace of rental growth should abate in the period thereafter in anticipation of increased supply.

The investment market for prime office assets remained robust in Q3 2017, with capital values largely stable compared on a QOQ basis. In a landmark deal, Asia Square Tower 2 was sold for SGD2,689 (USD1,977) psf, similar to the psf pricing transacted for Tower 1 in Q2 2016.

Island-wide Office Space Supply (2018 – 2022F)



Source: Colliers International Singapore Research

Leasing market and rental values

First notable rise in nine quarters

In Q3 2017, CBD Premium and Grade A office rents rose 0.4% QOQ and 0.3% YOY, after sliding for eight quarters amounting to a cumulative decline of 9.6%. This is the first concurrent QOQ and YOY uptick since Q2 2015. Rents have been going sideways for a while and we believe this distributed uptick signals a rental upturn in the works.

Average Monthly Gross Office Rents (by Micro-market)

Micro Market	Q3 2017 Average Monthly Gross Office Rents (SGD psf)	QOQ Change (%)	YOY Change (%)
Premium			
Raffles Place / New Downtown	10.00	0.3%	-2.9%
Grade A			
Raffles Place / New Downtown	9.09	0.1%	-2.6%
Shenton Way / Tanjong Pagar	8.45	0.8%	3.9%
Marina / City Hall	8.94	0.0%	-1.4%
Beach Road	7.72	0.5%	2.9%
Orchard Road	8.22	0.0%	-1.1%
City Fringe	7.09	1.1%	-0.8%
Suburban	4.86	0.2%	0.0%
CBD Premium and Grade A	**8.57**	**0.4%**	**0.3%**
Grade B			
Raffles Place / New Downtown	7.67	-0.4%	-2.7%
Shenton Way / Tanjong Pagar	7.16	0.4%	-2.1%
Beach Road	6.19	0.0%	-4.8%
Orchard Road	7.75	0.4%	-3.4%
City Fringe	6.54	0.0%	-1.4%
Suburban	4.26	0.5%	0.5%

Source: Colliers International Singapore Research

The sharpest sequential improvement was seen in the City Fringe (1.1%), followed by the Shenton Way/ Tanjong Pagar micro-market (0.8%). The Premium Raffles Place/New Downtown micro-market rose 0.3% QOQ after a 0.6% QOQ decline in the preceding quarter.

Grade B rents gave a mixed picture, with Raffles Place/ New Downtown declining 0.4% QOQ while the rest of the micro-markets either held stable or rose marginally.

Buoyant occupancy rates

CBD Premium and Grade A occupancy dipped 1.6ppt QOQ to 91.5%. The marginal decline mainly stems from the recent completion of the 940,000 sq ft (87,500 sq m) Marina One West Tower in the Raffles Place/New Downtown micro-market. Occupancy in the rest of the CBD improved across the board - ranging between 0.2ppt to 3.0ppt QOQ - signalling healthy demand.

On a year-to-date basis, Premium and Grade A CBD occupancy dipped only 1.5ppt despite the first three quarters witnessing 2.16 million sq ft (0.2 million sq m) of new office space.

In comparison, the previous bumper supply in 2011 effected a relatively more severe compression of occupancy rates (-7.3ppt), on the back of a 2.5 million sq ft (0.2 million sq m) injection of new prime office space.

The buoyant occupancy rates should be partly due to the more gradual return of secondary space to the market this time round. While we expect the staggered return of space to push up vacancy rates in the next quarter, landlords may now have more confidence in raising rents given resilient demand and tapering future supply.

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

Micro Market	Q3 2017 Average Occupancy Rate (%)	Q2 2017 Average Occupancy Rate (%)	QOQ Change (ppt)
Premium			
Raffles Place / New Downtown	88.2%* (93.8%)	95.0%	-6.8* (-1.1)
Grade A			
Raffles Place / New Downtown	97.0%	96.7%	0.3
Shenton Way / Tanjong Pagar	91.8%	88.8%	3.0
Marina / City Hall	95.4%	94.2%	1.1
Beach Road	70.7%	68.4%	2.3
Orchard Road	92.5%	92.3%	0.2
City Fringe	95.1%	95.6%	-0.5
Suburban	98.0%	98.2%	-0.2
CBD Premium and Grade A	**91.5%**	**93.1%**	**-1.6**

*Included Marina One West Tower in Q3 2017. Brackets show calculated values excluding the new addition.

Source: Colliers International Singapore Research

SELECTED OCCUPIER MOVEMENTS FOR CBD OFFICE BUILDINGS IN Q3 2017			
Building	Tenant	Net Floor Area (sq ft)	Relocation /Expansion /New site
Frasers Tower	Arup	38,000	Relocation and Expansion
DUO Tower	Temasek Holdings (Subsidiary Unit)	40,000	Relocation and Expansion
Beach Centre	WeWork	38,000	New site
Centennial Tower	The Great Room	36,000	New site
CapitaGreen	Lloyds Merchant Bank	15,000	Expansion
Ocean Financial Centre	Loomis Sayles Investment Asia	6,000	Expansion

Sources: Colliers International Singapore Research, The Business Times, The Straits Times

Continued "flight to quality" in Downtown Core

Q3 2017 saw a continuation of healthy commitments in most of the new builds. The "flight to quality" is prevalent amongst banking and financial services, and professional services companies.

In terms of leasing velocity, new developments in the Downtown Core area significantly outperformed, led by the Shenton Way/Tanjong Pagar and Raffles Place/ New Downtown micro-markets.

The 890,000 sq ft (82,500 sq m) Guoco Tower in Shenton Way/Tanjong Pagar reached a 99% take-up rate in Q3 2017, marking a robust stabilisation within twelve months of its completion in Sep 2016. The same micro-market also featured another strong performer, UIC Building, which is more than 85% leased as at October 2017.

Within the Raffles Place/New Downtown precinct, we estimate the 1.88 million sq ft (175,000 sq m) Marina One has surpassed 70% in commitments as of October.

In comparison, DUO Tower in the Beach Road micro-market is reportedly 60% leased as of Oct 2017. Given that it debuted around the same time as Guoco Tower in 2016, this reflects a more gradual filling up of space.

New demand from micro-occupiers via coworking spaces

During Q3 and H1 2017, we saw movements in tenants across various trade sectors including banking and financial services, business services, commodities, media, marine and shipping etc.

In Q3, there were some small expansions by financial services companies within their existing locations such as Lloyds Merchant bank and Loomis Sayles Investment Asia. Meanwhile, Arup, a global design, engineering and business consultancy, has signed on 38,000 sq ft at Frasers Tower, and will relocate from its existing location in Keppel Towers in Tanjong Pagar.

Incremental new demand has also continued to come from coworking operators. In our view, the surge of new demand from coworking and other flexible workspace operators coincided with the large new supply, forming an absorption 'sponge' that quickly soaked up the backfill space vacated by occupiers taking up space in the new builds. In Q3 2017, The Great Room took up 36,000 sq ft (3,300 sq m) at Centennial Tower, while WeWork made its first foray into the Singapore market with a 38,000 sq ft (3,500 sq m) lease at Beach Centre.

We hold the view that a bevy of coworking spaces joining the fray should channel the previously untapped "micro-occupier" category into the CBD office micro-market.

These micro-occupiers, which includes small-medium-sized enterprises, start-ups, freelancers and entrepreneurs, typically have inadequate headcount to consider a traditional office lease. While insignificant as individual tenants, in aggregate, this micro-occupier category may represent a fresh new demand driver in the CBD, channelled in proxy via coworking space providers.

Broad-based, gradual growth augurs well for sustained demand

Based on advance estimates, Q3 2017 GDP rose 4.6% YOY, and 6.3% QOQ on a seasonally-adjusted annualised rate (SAAR), led by manufacturing which grew 15.5% YOY. The growth was above expectations, and led many economists to upgrade their full year GDP forecasts for 2017. As of 20 October 2017, Oxford Economics expects Singapore GDP to grow 3.0% in 2017, before moderating to 2.8% in 2018.

The services sector grew an estimated 2.6% YOY in Q3, maintaining the accelerated velocity from Q2 2017 (+2.5% YOY). This is an encouraging uplift from the preceding few quarters' weak 0.4-1.5% YOY growth, and may reflect a gradual broadening of growth momentum to the financial services, business services, and wholesale and retail trade sectors, which should translate into further demand for office space.

Prime new supply tapering until 2021

With this bumper wave of completions, the CBD supply pipeline will taper off in the next 3 years. The next major jump in new supply is expected to actualize in 2021, from the 1.9 million sq ft (180,000 sq m) of new office space from the Golden Shoe redevelopment and the Central Boulevard greenfield site.

The tender for the commercial government land sale (GLS) site at Beach Road was awarded in early October to a 70:30 joint venture between GuocoLand and its parent Guoco Group. Assuming a four-year development cycle, the project should be completed by 2022.

Based on URA guidelines, at least 70% of the Beach Road development's maximum buildable Gross Floor Area (GFA) - or 665,424 sq ft (61,820 sq m) - must be used for offices, with a maximum of 32,292 sq ft (3,000 sq m) for retail space. Assuming 85% efficiency and 100% maximisation of allowable office floor area, the upcoming mixed development could contribute up to 808,000 sq ft (75,000 sq m) of net lettable office space in the Beach Road locality in 2022.

Strata sales and capital values

Capital values held stable, mega-deal transacted

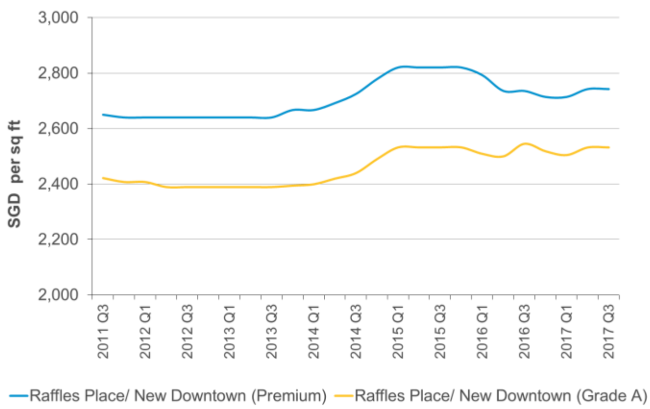
Based on Urban Redevelopment Authority (URA) REALIS data as of 30 October 2017, strata office sales transactions in Q3 2017 increased 35.9% to 87 deals, from 64 in the previous quarter.

During Q3 2017, there were 11 new strata unit sales, all of which were for suburban office development Woods Square in Woodlands. The median price for the project was SGD1,842 (USD1,354) psf. The proportion of new sales to overall transactions during the quarter was 13% vs 21% in Q2 2017.

In Q3 2017, Asia Square Tower 2 was sold to CapitaLand Commercial Trust for SGD2.094 billion or USD1.5 billion. This translates to SGD2,689 (USD1,977) psf, similar to the price transacted for Asia Square Tower 1 in Q2 2016 on a psf basis. The deal is reported to have an initial yield of 3.6%, which suggests stable cap rates. This deal also marks the largest en-bloc transaction in Singapore YTD, reflecting ample liquidity and investor interest.

Based on Colliers International's research, the average capital value of prime office buildings located in Raffles Place/New Downtown held stable at SGD2,743 (USD 2,017) psf and SGD2,532 (USD1,862) psf respectively for the Premium and Grade A segments.

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



Note: (1) A valuation based methodology is used to derive the average capital values. Source: Colliers International Singapore Research

For more information:

Duncan White
Executive Director and Head
Office Services
duncan.white@colliers.com

Tricia Song
Director and Head
Research
tricia.song@colliers.com

Stephanie Sun
Director and Head
Consulting
stephanie.sun@colliers.com

Colliers International | Singapore
1 Raffles Place, #45-00
One Raffles Place
Singapore 048616
Tel: +65 6223 2323
Fax: +65 6222 4901
RCB No. : 198901352R
CEA Licence No: L3004691J