Colliers Quarterly

SURABAYA | OFFICE

H1 2018

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Colliers INTERNATIONAL

Accelerating success.

Ferry Salanto Senior Associate Director | Surabaya

As the second largest city in Indonesia, Surabaya is a business gateway for companies wishing to invest in the eastern part of the country. Despite the large opportunities, average office absorption was only around 14,000 sq m per annum from 2010 to 2017. This modest absorption was offset by a relatively small increase in office space supply during that period, which brought the average occupancy rate to remain steady at 81%.

The competition from shop-houses for lease, known as *ruko* and *rukan,* is still a challenge. *Ruko* and *rukan* offer cheaper rents than office buildings.

In anticipation of a large upcoming supply in 2018, we expect landlords to maintain the current level of rents, especially for new office buildings with less than 50% occupancy. Large vacant spaces have already pushed the Surabaya office market into a tenant's market. Landlords of existing office buildings should also need to be wary of relocating tenants to newer buildings that offer competitive rents.

Forecast at a glance

Demand

Total office space absorption in Surabaya is scheduled to reach 13,000 sq m per annum in 2018-2020. We expect forthcoming leasing or sales transactions to come from the insurance, finance and shipping industries.

Supply

Total office supply in Surabaya should exceed 400,000 sq m by the end of 2018, which is an increase of 19.3% YOY. Between 2019 and 2020, total office space is planned to increase to 550,000 sq m.

Occupancy rate

We expect 2018's supply projection to effect the occupancy at the end of 2018, pushing it to drop below 70%. We expect occupancy to decline continuously until 2020.

Rents

Large vacant spaces and additional new supply in the remainder of 2018 should push rents down by 2.6% to IDR128,138/sq m/month. In 2019, with limited new supply, rent is predicted to move upward by 4%, but could again see pressure from a substantial amount of new space in 2020, which could bring the average rent to IDR127,678/sq m/month.

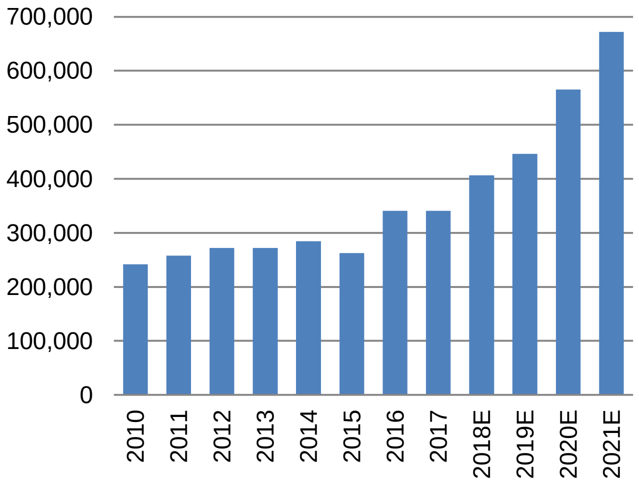
Prices

In Surabaya, the current slowdown in the economy has made investments in office property less attractive. Landlords are keeping their average prices at IDR30 million/sq m for the rest of 2018. We anticipate prices to climb in 2019-2020, albeit gradually at between 2.0% and 2.5%.

Lease

Supply

Cumulative Office Supply



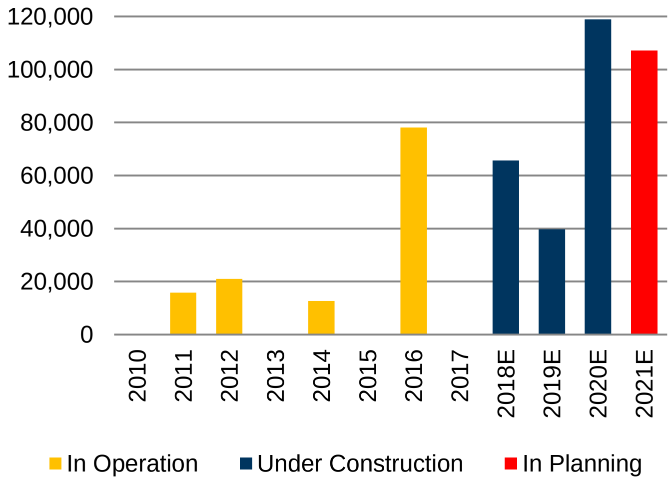
Source: Colliers International Indonesia - Research

New office supply in Surabaya is scheduled to be substantial between 2018 and 2021, with at least 11 new buildings bringing approximately 330,000 sq m of office spaces. During the first half of 2018, eight office buildings continue to be under construction, with four of these scheduled for completion in 2018. This will likely bring about 65,000 sq m of new office supply online.

Future developments that are already under construction this year include Satoria, Pelindo Place and an office building within the Capital Square Complex. We expect these three establishments to be completed in 2020. Pelindo Place, located near Tanjung Perak Harbour, is planned to become the first commercial office building in North Surabaya.

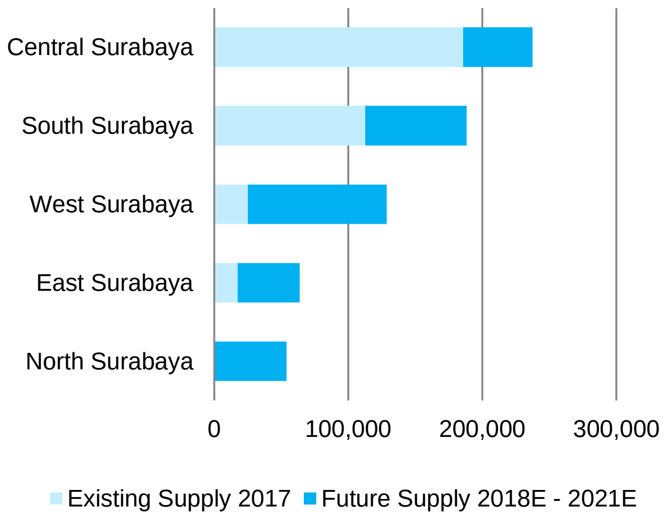
We expect the growth of office supply to continue at least through 2021, however, three buildings that are scheduled to be completed in 2021 are still in the planning stages.

Annual Supply



Source: Colliers International Indonesia - Research

Cumulative Office Supply by Region



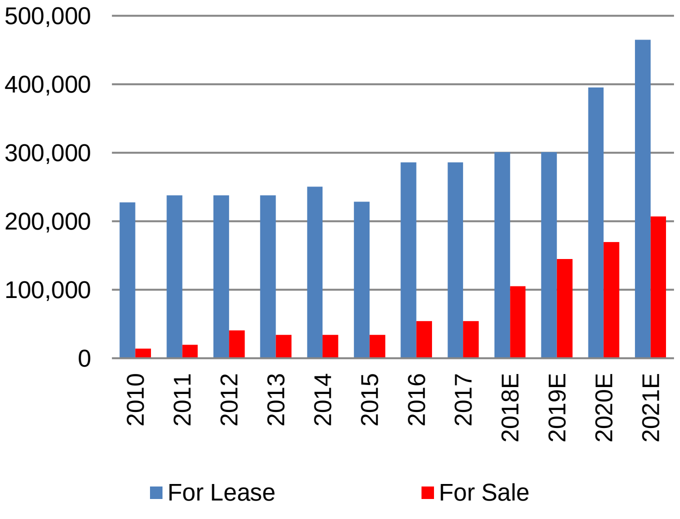
Source: Colliers International Indonesia - Research

Future office supply in Surabaya is planned mainly in West Surabaya, particularly in the HR Muhammad-Darmo area, which is in line with the Surabaya government's spatial planning policy (RTRW) 2014-2034 that designates the area for trade and residential use.

NEW SUPPLY PIPELINE				
OFFICE BUILDING	LOCATION	DEVELOPER	SGA (SQ M)	MARKETING SCHEME
2018				
Praxis Office	Panglima Sudirman	Intiland Development	12,000	For Lease & Sale
Voza Office Tower	HR Muhammad	Avia Avian	18,607	For Sale
Spazio Tower	Bukit Darmo Boulevard	Intiland Development	20,000	For Sale
Tirta Kencana	Kertomenanggal	Tirta Kencana	15,000	For Lease
2019				
Pakuwon Tower	Basuki Rahmat	Pakuwon Jati	39,740	For Lease & Sale
2020				
Satoria Tower	HR Muhammad	Satoria Group	34,000	For Sale
Capital Square	HR Muhammad	Greenwood	39,950	For Lease
2021				
One Galaxy	Dharmahusada	Puri Galaxy (Sinar Galaxy Group)	31,450	For Lease
Grand Sungkono Lagoon	Abdul Wahab Siamin	PP Property	38,250	For Lease
Ciputra World Surabaya Office Tower	Mayjend Sungkono	Ciputra Group	37,400	For Sale

Source: Colliers International Indonesia - Research

Cumulative Office Supply by Marketing Scheme



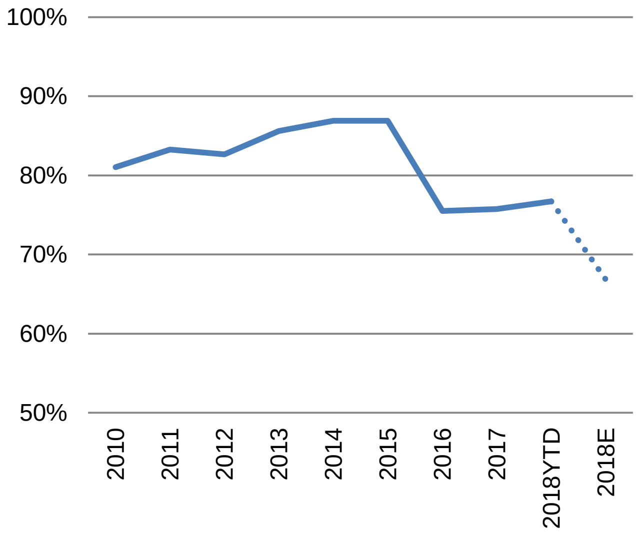
Source: Colliers International Indonesia – Research

Since 2016, strata-title offices regained popularity in Surabaya, and three new strata-title office buildings composing about 100,000 sq m are scheduled to come online this year alone. This is a significant jump, almost double, from 2017. We expect the strata-title office stock to double from 2018 to 2021. Both individual and institutional investors continue to be the main targets of strata office buildings in Surabaya.

Performance

Occupancy

Occupancy Rates



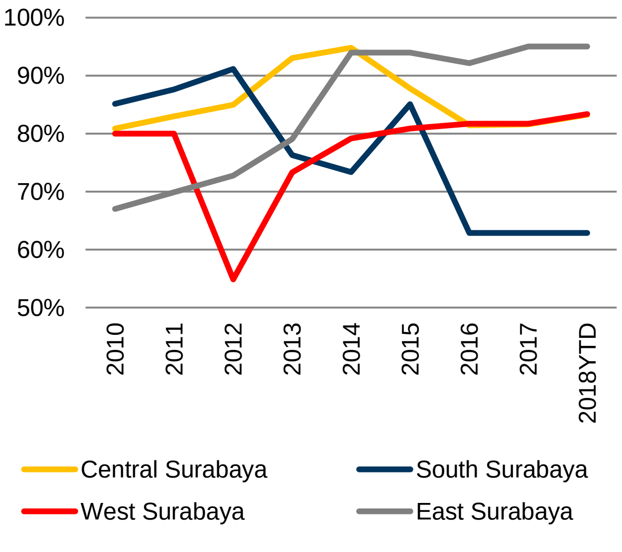
Source: Colliers International Indonesia - Research

The pattern of declining occupancy in 2016 will likely recur at the end of 2018, given the substantial supply coming online. The absence of new office supply for the last 18 months has helped occupancy rates stabilise at around 76.7%. Leasing activity was still dominated by trading, shipping and freight forwarding business lines, particularly in the central business district.

The occupancy performance of office buildings in Central Surabaya still helps underpin the overall occupancy performance in Surabaya. To date, the occupancy rate in Central Surabaya was 83.2%, revealing a 1.7% increase from the previous period.

We still see several local and overseas investment companies targeting Surabaya for business expansion. Nevertheless, such companies only require relatively small office spaces (some needing below 100 sq m). Typically, these companies are commonly new or start-up businesses that require some time before firming up their operations with a wider and permanent operation in Surabaya. Having said that, we think that there is a great opportunity for flexible workspace operators that provide a more flexible scale of office spaces in Surabaya. Similar to what we are seeing in Jakarta, these flexible workspace operators provide more options in the market. In line with this situation, we have identified that in the past year some flexible workspace operators have started to emerge in Surabaya, such as Sub CO, Koridor and Revio.

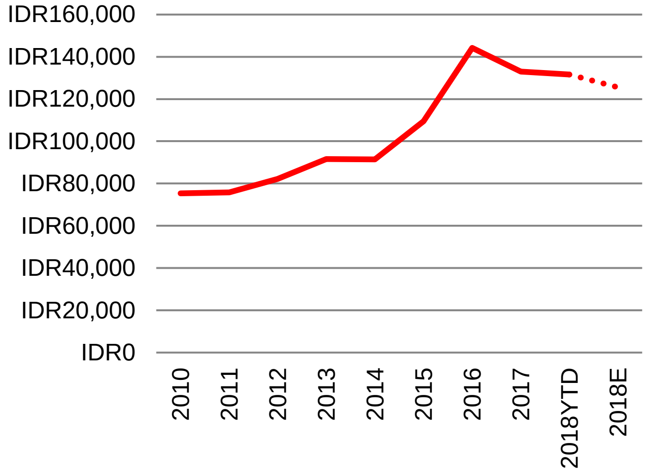
Occupancy Rates Based on Regions



Source: Colliers International Indonesia - Research

The Rents

Average Asking Base Rents, per sq m

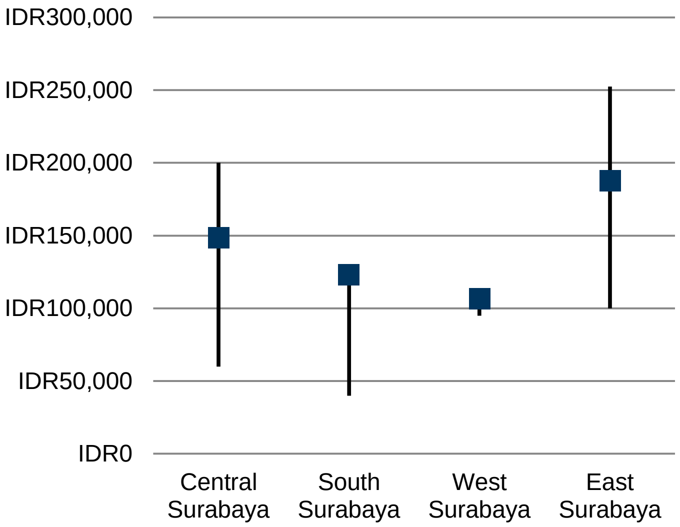


Source: Colliers International Indonesia - Research

Starting in early 2017, we witnessed average rental rates declining, which continued in H1 2018. A further downward trend will likely to occur in the remainder of 2018. Two office buildings located in Central Surabaya announced they were lowering their rents by about 15% HOH, despite the fact that there were not many vacant spaces in these buildings. With this adjustment, the overall average rental rate in Surabaya declined 2.1% YOY to register at IDR131,561/sq m/month. The average asking rental rates in Surabaya were 55% lower than in Jakarta.

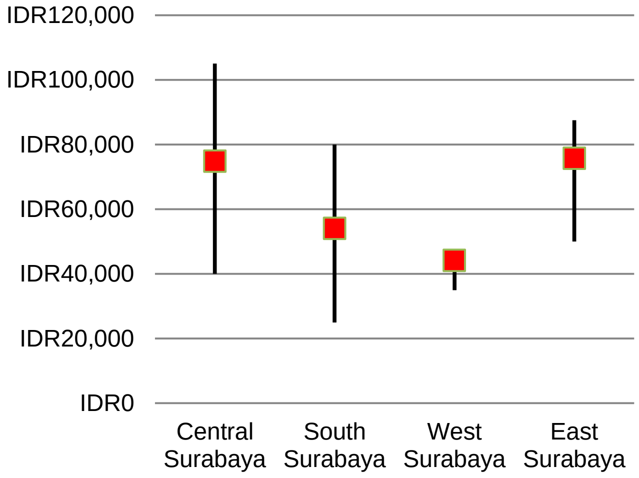
The currently sluggish market coupled with a large number of additional office buildings pushed landlords of newer office buildings to refer to the market price as basis, in order to maintain their competitiveness. Average asking rental tariffs for new office buildings is currently ranging from IDR135,000 to IDR150,000/sq m/month.

Asking Base Rents Based on Region, per sq m



Source: Colliers International Indonesia - Research

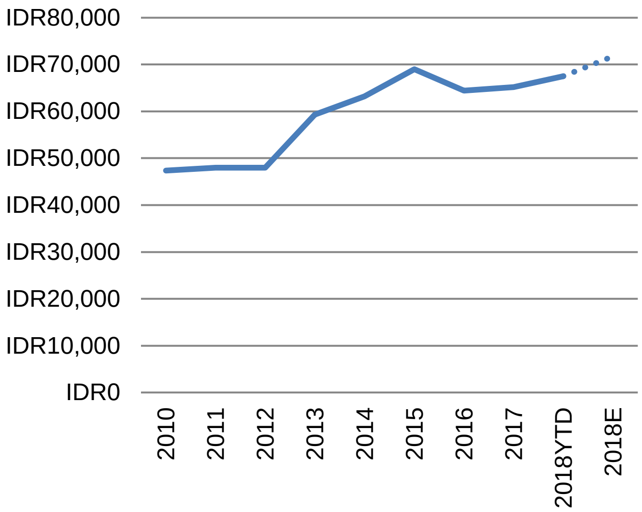
Service Charges Based on Region, per sq m



Source: Colliers International Indonesia - Research

Service Charges

Average Service Charges, per sq m

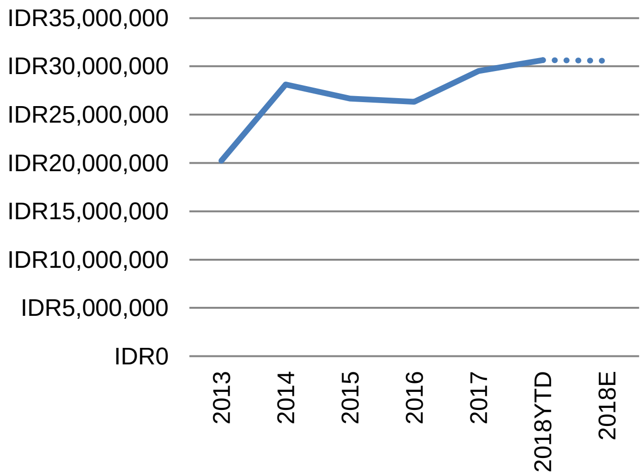


Source: Colliers International Indonesia – Research

Over the last year, service charges have increased a slight 4.4%, with the majority of office buildings in Surabaya increasing the tariff by IDR5,000. In the review period, average service charges were registered at IDR67,497/sq m/month. With more strata-title buildings in the pipeline, the average service charge is likely to increase moderately, mainly because strata-title office buildings generally quote lower tariff than buildings offered for lease.

Strata-title

Average Asking Prices



Source: Colliers International Indonesia – Research

In Surabaya, asking prices have been relatively stable at IDR28 - IDR29 million/sq m since 2017. Nevertheless, some landlords with limited availability of spaces confidently set the selling prices higher than the market prices.

Some strata-title office buildings in Surabaya saw good absorbtion in H1 2018, although it took about three to four years to achieve this level of absorption. Sales transactions for strata-title office buildings were still dominated by investors

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