Colliers Quarterly

SURABAYA | OFFICE

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Colliers INTERNATIONAL

Accelerating success.

Office

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Without additional office spaces, occupancy only improved very moderately YOY and registered at 75% in 2017. Most office buildings maintained their base rents and service charges relatively stable. Nevertheless, we observed that an office building's rent adjustment caused the average asking rents down almost 10% YOY.

Surabaya's office market is still facing the classic problem against office spaces that were provided by the shop-houses and rukan. Potential tenants still assume that occupying office spaces in shop-houses/rukan is simpler than in office buildings. Meanwhile, those with growing businesses (and have more money) prefer to construct their own office building. This trend has stagnated the level of demand for office spaces in Surabaya and has pushed most landlords to maintain their base rental, particularly within the last two years.

Forecast at a glance

Demand

Demand for office buildings is still expected to be centralised in the CBD area of Surabaya. Insurances and banking remain to be potential business lines, where recently they conducted a lot of investigations for office spaces in Surabaya. In addition, the market for service offices and co-working spaces are also expected to grow in Surabaya.

Supply

Five office buildings are scheduled to finish in 2018-2020 and will bring around 125,000 sq m of new additional office spaces in Surabaya. Out of these, two buildings will begin to officially operate in 2018. There will be more strata-title office buildings in Surabaya over the next three years.

Vacancy rate

With office supply projected to inflate in 2018 and enquiries for office space to grow only moderately, occupancy rate is forecasted to decline from around 2% to 3%.

Rent

RENT

Amidst the downturn in new office space enquiries, landlords will retain their current rental tariff. However, the overall rent will only climb in 2018 due to the future operation of two office buildings that offer higher rents compared to operating office buildings.

Price

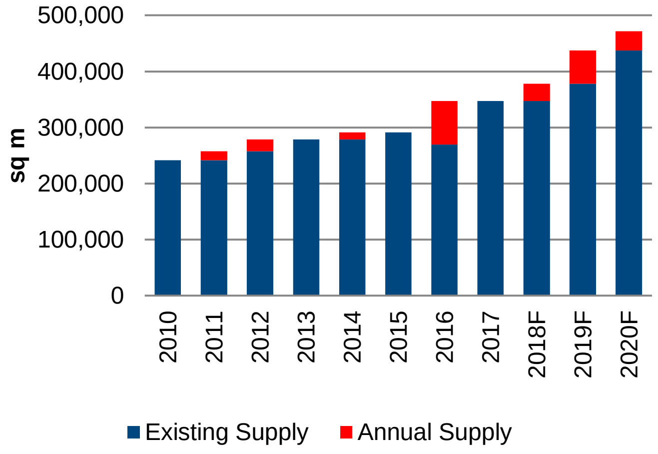
Investment in property, especially in strata-title office buildings in Surabaya, was still not strong as that in Jakarta. Investors prefer to refrain from purchasing strata-title office buildings whilst observing the progress of an office building's construction. In addition, they also want to see the track record of developers. Coupled with a low level in the take-up rate of newly operating strata-title office buildings, we predict landlords to offer the prices for the vacant spaces starting at IDR25 million to IDR40 million/sq m in 2018.

Lease

Supply

The office market in Surabaya closed 2017 without any supplies after having around 78,000 sq m additional office space last year. Cumulative office supply remained at 347,333 sq m. In 2018-2020, we anticipate 124,347 sq m of additional office space to enter the market, of which two office buildings, namely Praxis and Voza will begin operation in 2018.

Cumulative Office Supply

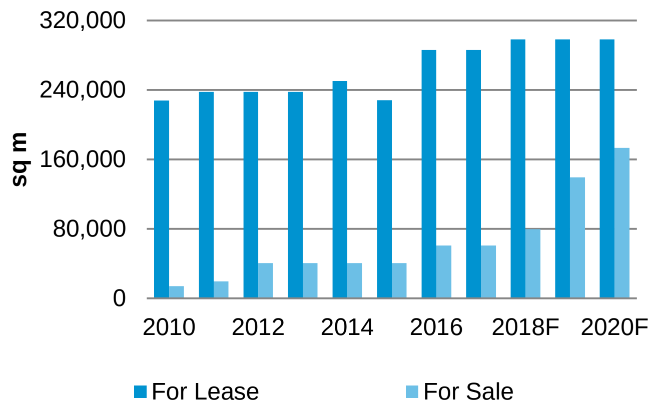


Source: Colliers International Indonesia - Research

Going forward, there will be more strata-title office buildings for sale.

Based on marketing scheme, the performance of strata-title office buildings in Surabaya improved in 2014-2016. Coupled with expectations of getting faster profit return than rental system, the pioneer developers began to look at the possibility of building strata-title office buildings in Surabaya. As a result, the supply of strata-title office buildings is expected to grow in Surabaya from 2018 to 2020. Based on their current progress, almost all of these strata-title office buildings are under construction.

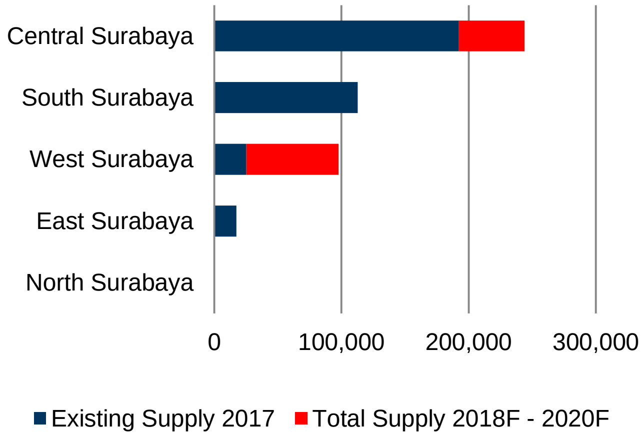
Cumulative Office Supply Based on Marketing Scheme



Source: Colliers International Indonesia - Research

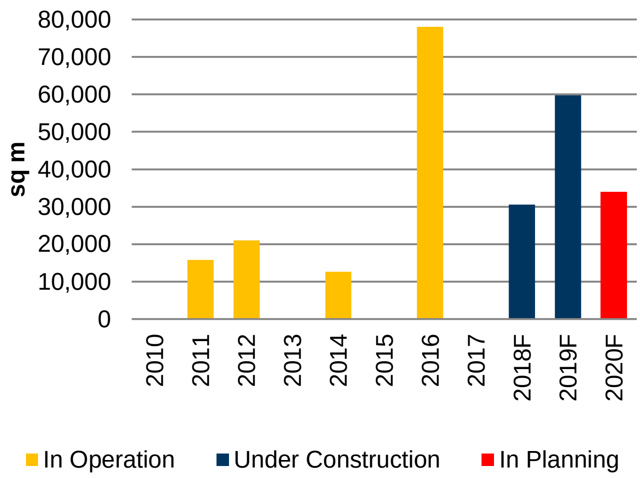
The CBD in Surabaya (mainly concentrated in Central Surabaya) will still captivate business activities. By the end of 2017, the total office supply in Central Surabaya was already beyond the total office supply in other areas in Surabaya. Given the supply pipeline, West Surabaya is expected to become the other next commercial area in the area. The city government of Surabaya continuously pushes infrastructure development in West Surabaya in order to transform the area into a vast growing residential and commercial area in the region. Up to 2020, total office space in West Surabaya will triple.

Existing and Future Supply in Several Regions



Source: Colliers International Indonesia - Research

Annual Supply



Source: Colliers International Indonesia - Research

NEW SUPPLY PIPELINE						
OFFICE BUILDING	LOCATION	REGION	DEVELOPER	SGA (SQ M)	MARKETING SCHEME	DEVELOPMENT STATUS
2018						
Praxis Office	Panglima Sudirman	Central Surabaya	Intiland Development	12,000	For Lease & Sale	Under Construction
Voza Office Tower	HR Muhammad	West Surabaya	Avia Avian	18,607	For Sale	Under Construction
2019						
Pakuwon Tower	Basuki Rahmat	Central Surabaya	Pakuwon Jati	39,740	For Lease & Sale	Under Construction
Spazio Tower	Bukit Darmo	West Surabaya	Intiland Development	20,000	For Sale	Under Construction
2020						
Satoria Tower	HR Muhammad	West Surabaya	Satoria Group	34,000	For Sale	Under Construction

Source: Colliers International Indonesia - Research

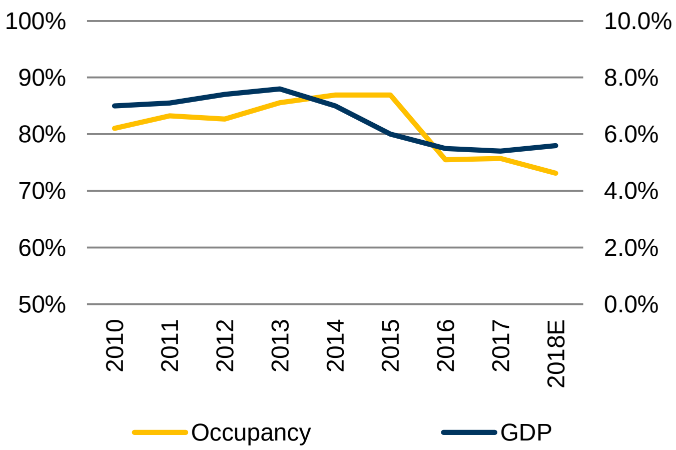
Performance

Occupancy Rates

The absence of new office supply in 2017 only helped lift occupancy rates marginally and was recorded at 75.7% at the end of 2017. In general, office market in Surabaya has yet to perform better; even the lack of supply this year did not impact the overall occupancy performance. The 5.3% GDP growth projection for 2018 seems insufficient to propel the office space business in Surabaya, considering that the average annual office space absorption for the last three years was only around 3,200 sq m, far below the average annual supply of around 26,000 sq m in the same period. Furthermore, the operation of several future office buildings in 2018 would bring down occupancy by around 2-3%.

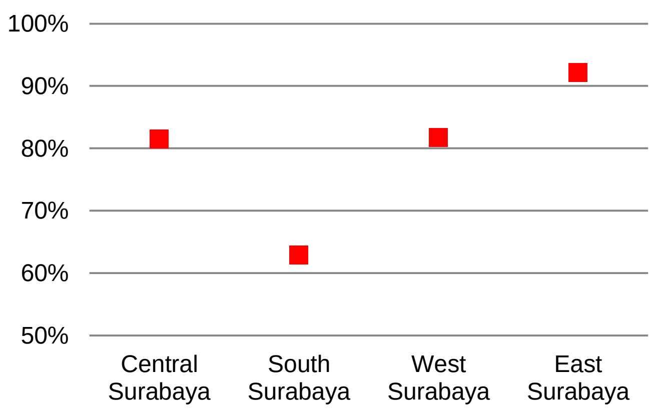
Businesses related to finance industries, such as banking and insurance, remained major office occupiers particularly in the central business district of Surabaya. Overseas occupiers recorded were from East Asia, including China, Korea and Japan. They have actively penetrated Surabaya, either for their representative office operation or for initial observation over the business climate before officially opening and/or expanding their offices. This situation is capitalised by service offices and operators of co-working spaces to provide private office spaces for business with a shorter lease period than conventional office spaces. Today, service offices and co-working spaces are continuously growing in Surabaya. Operators, such as Nin3 Space, Revio, SUB, Regus Surabaya, Forward Factory and Digital Hub, have opened co-working space facilities in Surabaya.

Average Occupancy Rates and GDP Growth Trend



Source: Colliers International Indonesia - Research

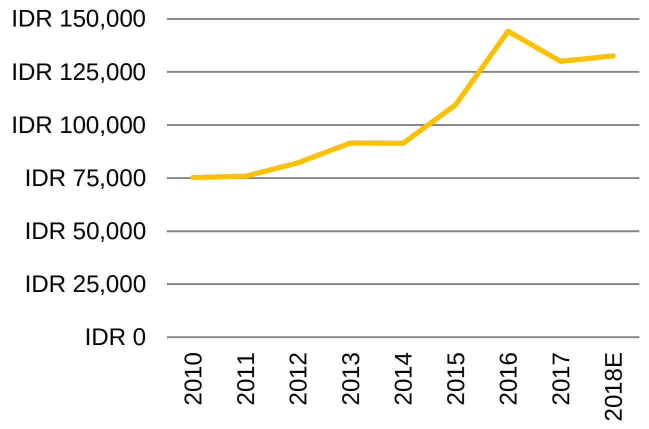
Occupancy Rates in Different Regions in Surabaya



Source: Colliers International Indonesia - Research

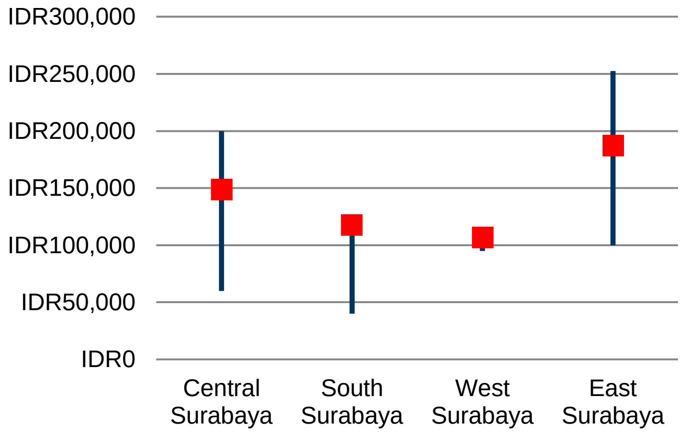
Average Asking Base Rent

Average Asking Base Rents



Source: Colliers International Indonesia - Research

Average Asking Base Rents in Different Regions in Surabaya



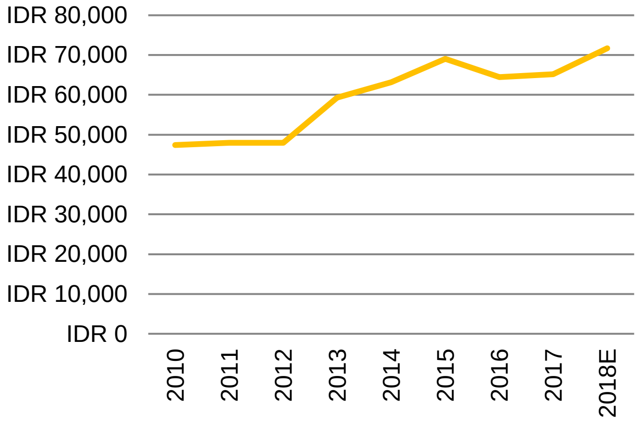
Source: Colliers International Indonesia - Research

Service Charges

The majority of office buildings in Surabaya still maintain service charges between IDR50,000 and IDR100,000/sq m/month, whilst two newly operating office buildings only quote tariffs below market prices, i.e. IDR45,000 and IDR55,000/sq m/month. The average service charge was registered at IDR65,172/sq m/month in 2017, increased very modestly YOY.

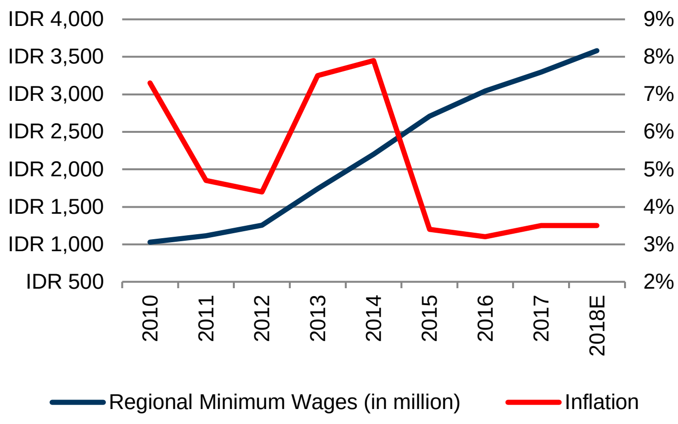
Two strata-title office buildings that are expected to meet completion in 2018 would likely peg their service charges below market prices. However, regional minimum wages (UMR) are expected to increase around 9.5% in 2018. Contributed by this UMR projection, we predict the average service charge to increase around 10% in 2018.

Average Service Charges



Source: Colliers International Indonesia - Research

Regional Minimum Wages and Inflation Rate



Source: Colliers International Indonesia - Research

Strata-title

Based on available spaces, the average asking prices were recorded at IDR29.2 million/sq m by the end of 2017. Some future strata-title office buildings are currently offering asking prices starting at IDR23 million up to IDR38 million/sq m. Meanwhile, due to location and those that have not been sold yet caused prices of two operating office buildings to be lower than market prices.

In our view, Surabaya's strata-title office market will continue to struggle against headwind from the oversupply and lacklustre market performance. Thus, we anticipate office space prices to continue to hover in 2018. In 2017 alone, the absorption of strata-title office spaces in Surabaya experienced a slowdown, and this has pushed landlords to be more negotiable in setting the prices lower. In our record, from around 150,000 sq m of future office spaces for sale available between 2018 and 2020, currently only 15% has been absorbed and this has not taken into consideration the unsold units from the supply available before 2016.

Concluding Thought

Amidst the continuing building construction over the next three years and limited market capacity to absorb it, we expect increasing vacancy rates to lead Surabaya's office market to a period of recession. Nevertheless, there is always hope particularly when Indonesia improves its rank in the World Bank Survey of Easy of Doing Business (OEDB) report, which put Indonesia as a less costly business place.

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