Briefing
Office sector

January 2012

SUMMARY

Leasing activity remained subdued as a result of softening demand and cautious market sentiment

- There has been a sharp decline in hiring expectations from the banking and financial services sector amid ongoing economic volatility.
- Vacancy rates in CBD Grade A office buildings climbed to 6.9%.
- Grade A rents continued to slip by 1.5% for the second consecutive quarter.
- Investment activity of en-bloc office space resumed, but Grade A capital values fell by 3.8% quarter-on-quarter.
- Only two sites were offered for office development under the Reserve List of the 1H/2012 Government Land Sales (GLS) Programme.
- The weaker economic outlook for 2012 will adversely affect the leasing market, with Grade A rents expected to fall by 15% and capital values by 10% during the year.

"Negative fallout arising from the prolonged financial turbulence and global economic slowdown has intensified, resulting in slower absorption of Grade A office space. This has continued to push up vacancy rates and put downward pressure on rents in the CBD."
Alan Cheong, Savills Research

Market commentary

Advance estimates show that Singapore's economy expanded by 3.6% year-on-year in the last quarter of 2011, bringing the whole-year GDP growth to 4.8% in 2011. The pace of growth has dropped significantly on a quarter-on-quarter basis. The economy shrank by 4.9% from the previous quarter as a result of the slowdown in the manufacturing sector.

Slowing economic activity has dampened sentiment in the job market. According to the Hudson Report (October to December 2011), hiring expectations were declining across the board in Q4/2011, with the banking and financial services sector recording the steepest fall from 56% in Q4/2010 to 30% in Q4/2011. This is one of the most rapid declines since the global financial crisis in 2008. It was reported that, notwithstanding the relatively better performance of Asian economies, some banks here have started to layoff staff as a result of the financial turmoil.

In tandem with the deteriorating macro-economic conditions, the office leasing market remained subdued in the last couple of months. Slower absorption of Grade A office space was shown by the easy availability of pocket space in new completions, and deceleration in pre-commitment levels in projects which will be completed within the next two years. According to Savills estimates, net demand for Grade A office space shrank by about 36% from 1.0 million sq ft in Q3/2011 to 643,000 sq ft in Q4/2011.

While landlords are now more receptive to negotiating with tenants and are offering more incentives and benefits, tenants are adopting a wait-and-see approach amid current uncertainties. Supply may also be boosted by the return of shadow space given up by existing tenants, particularly financial institutions, in the wake of retrenchments and other cost-saving measures.

Vacancy rates

After enjoying vacancies below the 5.0% mark for five consecutive quarters, CBD Grade A offices saw vacancy rates rise to 6.9% in Q4/2011. Except for the Beach Road/Middle Road and Tanjong Pagar areas, increases in vacancy rates were witnessed in most micro-markets. The Shenton Way area recorded the largest vacancy increase of 8.8 percentage points to 14.7% by the end of Q4. This arose mainly from unlet space in newly completed buildings. The City Hall micro-market saw vacancy levels going up 222 basis points, due largely to the secondary stock returned by Citi Group.

Rental and capital values

Grade A office rents averaged S$8.71 per sq ft per month in Q4/2011, slipping for the second successive quarter by 1.5% from S$8.86 per sq ft per month in Q3. Rents in most micro-markets declined faster in Q4/2011 compared with the previous quarter. This confirms that Grade A office rents have now softened and are now in the early stages of a downswing. However, average rents are still higher than 2010 by 7.8% year-on-year.

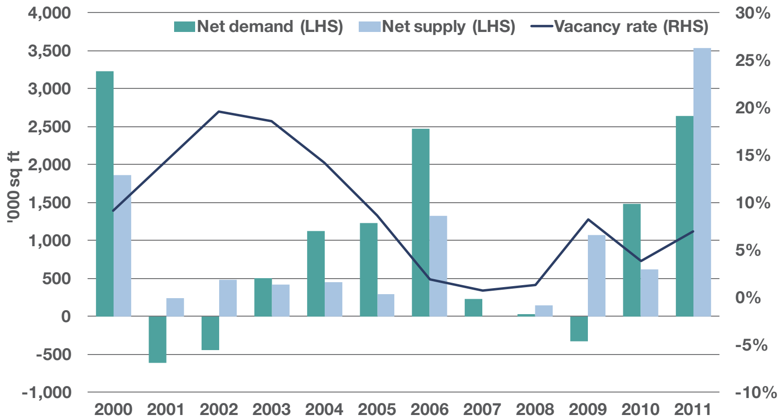
Compared with the remaining Grade A stock, rents in the international-grade office buildings recorded a greater decline of 4.6% quarter-on-quarter in Q4/2011. The strong rental growth seen in the first half of 2011 has been reined-in, as landlords adopted a defensive approach in attracting new tenants.

In Q4/2011, investment activity resumed with six office buildings sold for a total of S$2.7 billion. The most notable deal was K-REIT's S$2.01-billion acquisition of an 87.5% stake in Ocean Financial Centre. This translates to a unit price of S$2,600 per sq ft of net lettable area. However, sales of investment-grade strata office remained tepid. Only one transaction above S$10 million was recorded – the 41st storey of Suntec City Tower 2 was sold for S$2,570 per sq ft in December, significantly lower than those transacted in the preceding quarter at the same development.

The capital value of Grade A offices fell by 3.8% from S$2,650 per sq ft in Q3/2011 to S$2,550 per sq ft in Q4/2011. This is the first drop since capital values recovered from the trough in Q4/2009. Nevertheless, on a yearly basis, capital values were up by 8.5% from S$2,350 per sq ft in Q4/2010.

GRAPH 1

Net supply, net demand and vacancy rate for CBD Grade A office space, 2000–2011



Source: Savills Research & Consultancy

TABLE 1

Micro-market Grade A rent and vacancy rate, Q4/2011

Location	Rent (S$ per sq ft)	Vacancy rate (%)
Raffles Place/Marina Bay	9.35	6.5
City Hall	8.77	3.4
Shenton Way	8.25	14.7
Tanjong Pagar	7.25	9.0
Orchard	9.29	3.5
Beach Road/Middle Road	6.81	2.6

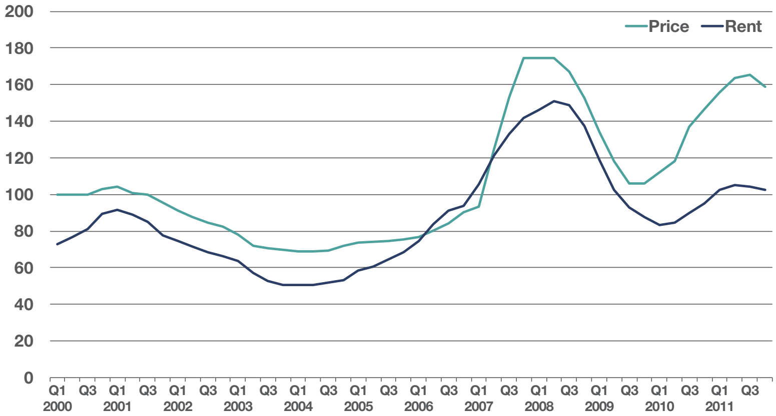
Source: Savills Research & Consultancy

GLS Programme

In view of the large pipeline supply, the government released only two sites for office development under the Reserve List of the 1H/2012 GLS Programme. The first is the white site at Marina View, which was carried over from the 2H/2011 Reserve List and can generate at least 765,744 sq ft GFA of office space. The other is the commercial site at Sims Avenue/ Tanjong Katong Road. At least 374,231 sq ft or 40% of its maximum permissible GFA must be set aside for offices. The site was put up for tender under the 2H/2011 Confirmed List but was not awarded as the price offered was deemed too low.

GRAPH 2

Savills Grade A price and rental index, Q1/2000–Q4/2011



Source: Savills Research & Consultancy

OUTLOOK

The prospects for the market

Along with the significant risks looming over the global economic environment, Singapore's economy is expected to remain weak with a 1% to 3% yearly growth in 2012. The worsening economic outlook is likely to place more companies on a cautious mode, holding-off expansion plans or reconfiguring their offices to sub-let excess space. This may slow down leasing activity and put downward pressure on rents as tenants factor-in expectations of a softening market. Savills expects overall Grade A rents to trend downward by 15% in 2012, with capital values softening by 10%.

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