

FRAGILE OUTLOOK

Rents are bottoming, supply pipeline is easing but the retail market is still vulnerable

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Summary & Recommendations

Retail rents improved in H2 2019, as the URA retail rental index in the Central Region rose 4.7% HOH (2019: +2.9% YOY). Going forward, we expect rents to be relatively flat despite limited new supply. The COVID-19 outbreak could pose near term risks to a still-fragile market.

Island-wide vacancy declined 1ppt in 2019 to 7.5% with higher net absorption. Vacancy should decline further in 2020-2024 given tight new supply.

Meanwhile, 2019 was a record year for retail transactions, as volumes trebled YOY on keen investor interest.

We recommend landlords to actively optimise tenant mix and digitalise. Retailers should adjust to changing consumer trends, and refresh product offerings continuously.

	H2 2019	Full Year 2020	2020-24 Annual Average
 Demand <ul style="list-style-type: none"> Net demand in 2019 was supply led with the completion of a few major malls. In 2020, with limited new supply, we expect new demand to be more muted compared to 2019. 	 592,000 sq ft	 255,000 sq ft	 392,000 sq ft
 Supply <ul style="list-style-type: none"> New annual supply is tight through 2020-2024 at 0.5% of stock versus past 10-year average of 1.4%. Planned supply is mainly in suburban and fringe areas, where there are well-defined population catchments. 	 484,000 sq ft	 183,000 sq ft	 346,000 sq ft
	HOH/ End H2	YOY / End 2020	Annual Average Growth 2020-24 / End 2024
 Rent* <ul style="list-style-type: none"> Ground-floor rents at Orchard Road were up 0.1% HOH in H2 2019, while that of Regional Centres stayed flat. The rental market remains fragile and we expect rents to stay relatively flat in 2020. 	 +0.1% SGD40.65	 +0.3% SGD40.77	 +0.8% SGD42.21
 Vacancy <ul style="list-style-type: none"> We expect Island-wide vacancy to continue declining over 2020-2024 as the front-loaded supply in 2018 and 2019 gets absorbed. Vacancy should trend towards 7.0% as supply tapers off. 	 -0.2pp 7.5%	 -0.1pp 7.4%	 -0.1pp 7.0%
 Capital Values/ Yields <ul style="list-style-type: none"> 2019 was a record year for transaction volumes which jumped 204% YOY, driven by keen investor interest. In 2020, we expect capital flows to continue chasing assets, thereby compressing yields marginally. 	 -0.15pp 4.5%	 -0.1pp 4.4%	 0pp 4.4%

Source: Colliers International. *Refers to ground-floor rents in prime shopping malls within the Orchard Road district. Note: USD1 to SGD1.35 as at 31 December 2019. 1 sq m = 10.764 sq ft. "pp" refers to percentage point.

LEASING MARKET AND RENTS

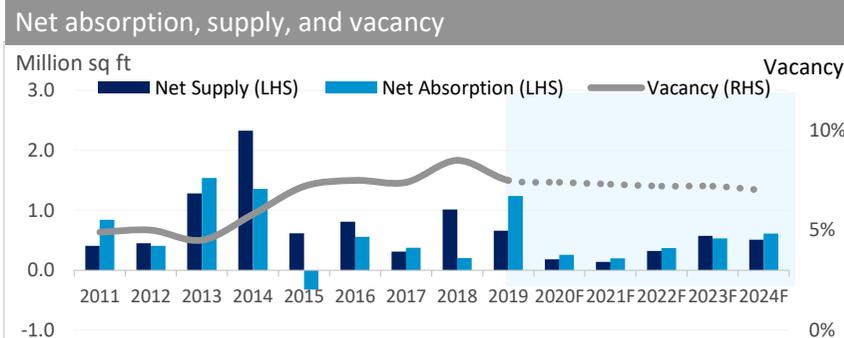
Rents bottoming out, but recovery likely subdued

Based on Colliers' research, ground-floor rents on Orchard Road rose marginally by 0.1% HOH in H2 2019 to SGD40.65 (USD30.17) per sq foot per month, while that of Regional Centres remained flat at SGD33.60 (USD24.62) per sq foot per month. For the full year, rents fell 1.3% YOY for Orchard and stayed flat for Regional Centres.

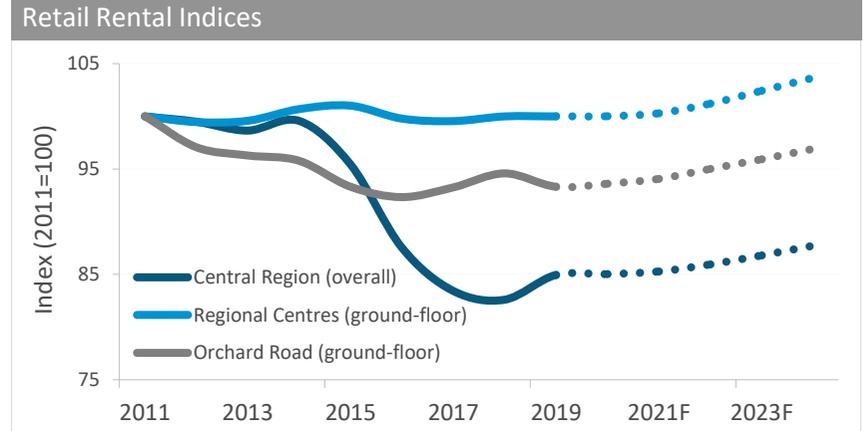
We expect rents to be relatively stable in 2020, as the easing of new supply pipeline over 2020-2024 should offset the fragile sentiment. In addition, tenants typically sign two-year leases where rents are locked in during the period, hence rents do not mirror retail sales volatility. Retail sales (excl motor vehicles) declined 1.2% YOY for the whole of 2019, and would likely remain weak in 2020 in view of COVID-19 outbreak. However, in the longer term, barring a protracted downturn, we believe Orchard Road prime rents could lead a gradual recovery, with potential boost from Orchard Road rejuvenation plans, and a recovery in visitor arrivals and tourism receipts.

Increasing adoption of technology

After years of consolidating, testing new concepts, rejigging tenant mixes, and rental adjustments, we think the market has reached an equilibrium. Notably, new brand openings, F&B expansions and the advent of flexible workspace into retail malls provided some relief to vacancy and, in some cases, helped to draw traffic and improve tenant sales.



Source: Colliers International, URA. *A business model by which an online retailer (clicks) integrates an offline presence (bricks) by expanding into physical marketplaces to enhance their offerings.



Source: Colliers International, URA

We also see an increasing adoption of technology by retailers to enhance the customer experience. For example, Haidilao Hot Pot restaurant at Marina Square is equipped with self-developed smart machines and a 5G experience corner; and Geox opened an X Store concept outlet in Paragon which uses technology to provide a multi-sensorial shopping experience. Further, several retailers are also expanding their product/services to provide more options for consumers. Daiso launched its Threeppy store at Funan Mall selling premium products; while Marks & Spencer announced the launch of halal-certified ready-meals in Asia.

Vacancy to decline with limited supply

Despite large completions in 2019, island-wide retail vacancy improved to 7.5% as of end-2019, (-1ppt YOY, -0.2ppt HOH), driven by higher net absorption which is likely boosted by the good takeup at Jewel at Changi Airport and Funan in H1 2019, and Paya Lebar Quarter Mall in H2 2019.

As the market continues to digest the major supply completions in 2019, we expect new supply to ease significantly and stay tight in 2020 (0.3% of total stock versus 10-year historical average of 1.4%) and throughout 2020-2024 (0.5% of total stock). In addition, the new supply is mostly concentrated in suburban and fringe areas, where there are well-defined population catchments. This should help support occupancies in the retail market going forward.

INVESTMENT MARKET AND CAPITAL VALUES

Record year for retail transactions

Retail transactions jumped 204% YOY in 2019

In H2 2019, transaction volumes contracted 6.7% HOH on a high base. Nonetheless, 2019 was a record year with retail transaction volumes at a decade high. Total retail investment sales jumped 204% YOY to reach SGD4.1 billion (USD3.0 billion), driven by keen investor interest and M&As. Major transactions in 2019 included The Star Vista, Duo Galleria and Liang Court in H2 2019, and Chinatown Point and Rivervale Mall in H1 2019.

REITs have also been active. 313 Somerset was injected into newly-listed Lendlease Global Commercial REIT as part of the initial portfolio for SGD1.0 billion (USD745 million), while the merger of OUE Hospitality Trust and OUE Commercial Trust priced Mandarin Gallery at SGD3,908 (USD2,901) per square foot, as reported by the media.

Over the next few years, the market remains conducive for deals given a favorable interest rate outlook, limited new supply and bottoming rents.

Capital values rose 2.0% YOY, expect improvement going forward

H2 2019 capital values in the Orchard area rose 2.0% HOH. With flat growth in H1 2019, this brings 2019 growth in capital values to 2.0% YOY. According to Colliers International Valuation and Advisory Services (CIVAS) team, cap rates for prime shopping malls island-wide compressed 15bps in Q4 2019 (unchanged in Q1-Q3 2019) to range between 4.25%-4.75%.

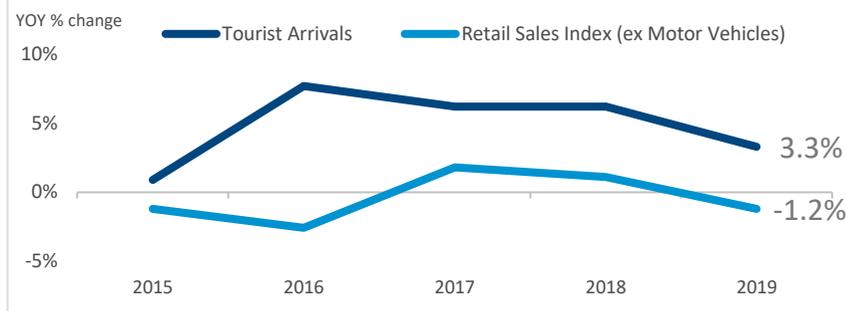
Barring a protracted downturn, we expect capital values to improve further. Retail or mixed-use development transaction volumes are likely to grow in line with global capital's increasing allocations to real estate amidst rising global volatility. However, we note prime retail assets in Singapore are often tightly-held with relatively limited stock. Despite an unexciting rental outlook, cap rates could compress further on the weight of capital allocation.

Notable retail transactions | H2 2019

Property	Transacted Price (SGD million)	Price PSF NLA (SGD)	Planning Region
313 Somerset	1,003	3,479	Central Region
Mandarin Gallery	493.5	3,908	Central Region
The Star Vista	296	1,822	Outside Central Region
DUO Galleria	137.6	2,457	Central Region

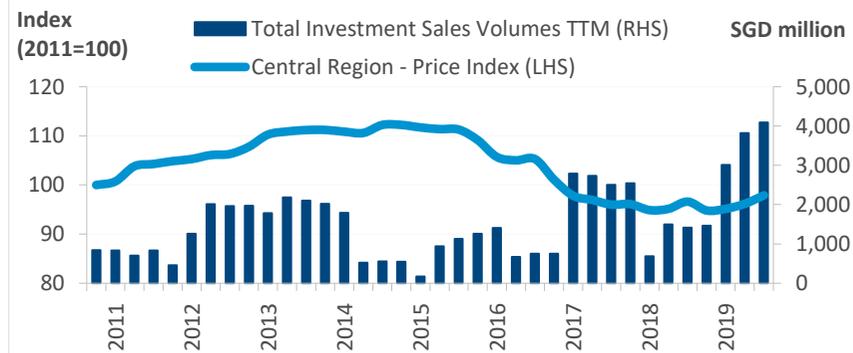
Source: Colliers International

Retail sales index and tourist arrivals (YOY growth)



Source: Colliers International, Singapore Tourism Board, Department of Statistics.

Retail price index and total investment sales volumes



Source: Colliers International, URA. *Investment sales only include transactions over SGD10 million. "TTM" refers to trailing 12 months.

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