MARKET IN MINUTES
Savills Research

Office

Rents have flattened for two straight quarters

The last quarter of 2019 was a relatively quiet quarter for leasing activity given cautious economic sentiment and the year-end holiday season.

- Pre-commitment levels in upcoming projects have seen some improvement in the last few months.
- Flexible workplace remained the anchor or sub-anchor tenants in upcoming projects and expansion of these kind of facilities was one of the key themes for 2019's office leasing market in Singapore.
- Net demand for CBD Grade A offices ended the final quarter of 2019 at about 385,000 sq ft, bringing the year's total to 1.04 million sq ft. On the back of a limited net new supply of 134,200 sq ft in 2019, the overall vacancy rate fell to 4.4% at year-end.
- The average monthly rent for CBD Grade A offices in Savills basket remained stable at S$10.08 per sq ft for two consecutive quarters.
- We have not changed our 2020 forecast for CBD Grade A office rents. Rental growth is expected to range from -2% to 0%.

"All we can say is that the outbreak is likely to lead to future structural changes in spatial demand but exactly how evolution ends is unclear at this juncture."

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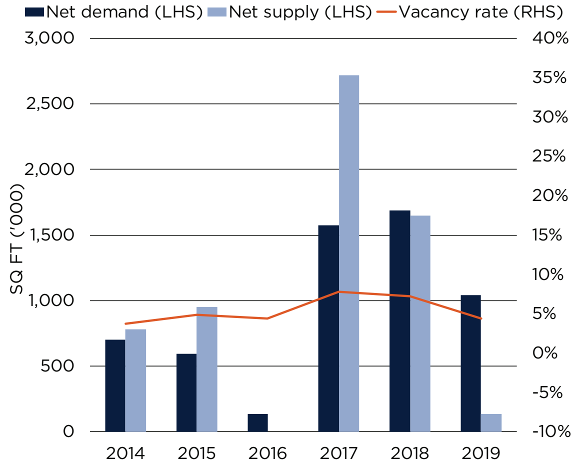
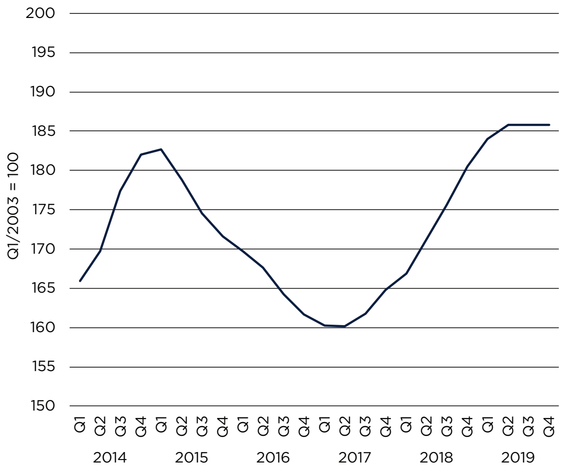
GRAPH 1: Net Demand, Net Supply and Vacancy Rate of CBD Grade A Offices, 2014 to 2019



Source Savills Research & Consultancy

GRAPH 2: Rental Indices of CBD Grade A Offices, Q1/2014 to Q4/2019



Source Savills Research & Consultancy

TABLE 1: Micro-Market Grade A Office Rents and Vacancy Rates, Q4/2019

LOCATION	MONTHLY RENT (S$ PER SQ FT)	VACANCY RATE (%)
Marina Bay	13.12	6.4
Raffles Place	10.28	3.8
Shenton Way	9.32	4.3
Tanjong Pagar	9.04	5.2
City Hall	10.31	2.8
Orchard Road	9.58	3.2
Beach Road/Middle Road	8.16	2.2

Source Savills Research & Consultancy

MARKET COMMENTARY

Amidst an easing of US-China trade tensions, Singapore's gross domestic product expanded by 1.0% year-on-year (YoY) in the final quarter of 2019, a minor improvement from the 0.7% growth recorded in the previous quarter. The overall growth rate of 0.7% for last year was the slowest Singapore had registered in a decade. Notwithstanding the services and construction sectors posting decent YoY growth of 1.1% and 2.8% respectively, manufacturing remained in the doldrums with a 1.4% contraction from a year ago.

In view of the weakening economy, the overall unemployment rate in December 2019 stayed at 2.3% from three months ago and brought the whole-year average to 2.3%, edging up by 0.2 of a percentage point (ppt) YoY. New employment numbers (excluding foreign domestic workers) also dropped from Q3's 21,700 to Q4's 16,600, and the slowdown was witnessed across the manufacturing, construction and services sectors.

Given the economic headwinds, limited space available for rent (including new completions and existing stock) and seasonal factors such as the year-end holiday season, the office leasing market ended relatively quietly in the last quarter of 2019. A total of 1,176[1] leasing transactions commenced in three months from October to December. This was down 8.0% quarter-on-quarter (QoQ) and 15.4% YoY.

However, good news was that the pre-commitment levels in upcoming projects have seen some improvement in the last few months. For example, co-working provider The Great Room will occupy 37,000 sq ft of office space in Afro-Asia i-Mark at 63 Robinson Road through a revenue-sharing deal with the landlord. This deal has brought the pre-commitment rate to 26.0% of the total net lettable area (NLA) of 140,000 sq ft. A short distance down the road 79 Robinson Road, owned by CapitaLand, also secured some more tenants. Among these, CapitaLand's Bridge+ will take up 56,000 sq ft to set up a fintech hub with flexi desks, dedicated fixed desks and private suites. In the Raffles Place area, the committed occupancy in CapitaSpring reached about 31% for its 635,000 sq ft NLA. One of the two new tenants who leased 22,000 sq ft space is The Work Project (Commercial), a joint venture between CapitaLand and flexible space provider The Work Project.

It was reconfirmed that flexible workplace remained the anchor or sub-anchor tenant in upcoming projects and expansion of these kind of facilities was one of the key themes for 2019's office leasing market in Singapore. In spite of financial woes faced by some operators, such as WeWork and Wosto, the co-work providers have continued to grow in Singapore, supported by direct or indirect involvement from landlords. According to Savills statistics, at least 20 new co-working facilities opened for the whole year, taking up a total of about 765,000 sq ft of space island wide. Coming to 2020, the expansion will continue, albeit at a much slower pace. Meanwhile, consolidation among some operators can be expected.

Buying activity for office properties also slowed in the final quarter. The most notable deal was the S$340.0 million acquisition of Robinson Centre, a 99-year leasehold office building along Robinson Road, by a private fund managed by ARA Asset Management. Outside the CBD, there were two small office blocks transacted - Fragrance Group's S$28.8 million divestment of its five-storey freehold namesake building at Changi Road to Pergas Investment Holdings and the S$79.3 million acquisition of KH Kea Building on North Bridge Road by UOL Group.

DEMAND, SUPPLY AND VACANCY

Based on Savills statistics, for Q4/2019, net demand for CBD Grade A offices stood at about 385,000 sq ft. This strong showing was mainly the result of tenants' move into Frasers Tower on Cecil Street and the newly completed Funan office towers on North Bridge Road. The latter injected about 214,000 sq ft of new supply into the Grade A office market in the same quarter.

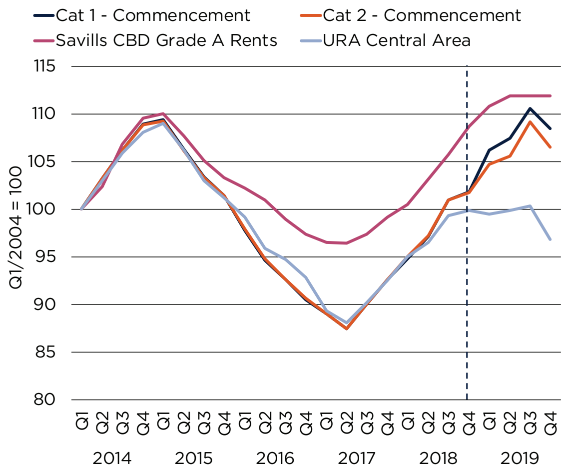
For the whole of 2019, the net take-up of CBD Grade A offices tracked by Savills amounted to 1.04 million sq ft. On the back of a limited net new supply of 134,200 sq ft during the same period, the overall vacancy rate fell by 2.9 ppts YoY to 4.4% at year-end. Compared with the 4.4% recorded in Q4/2016, this indicates that the bulky new supply which has entered the market since Q1/2017 (see Graph 1) has finally been absorbed.

RENTS

Rental growth had by Q3/2019 levelled off and remained at the same levels in Q4/2019. The average monthly rent of CBD Grade A offices in Savills basket has stood at S$10.08 per sq ft since Q3/2019. A softening in demand and upcoming secondary stock vacated by tenant relocations capped further rental growth; on the other hand, limited new supply and low vacancy in existing buildings limited tenant options and provided a cushion for a significant drop in rents. We conclude that office rents are expected to remain stable and will avoid a sharp decline at least in the near term.

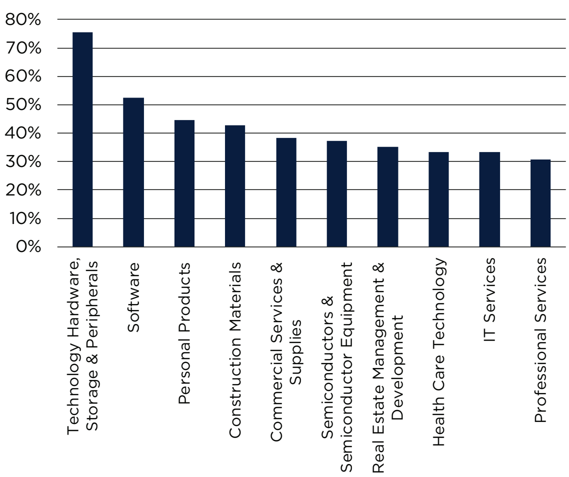
1 Based on the statistics downloaded on 10 February 2020.

GRAPH 3: Rental Indices for Various Categories and Locations of Offices, 2014 to 2019



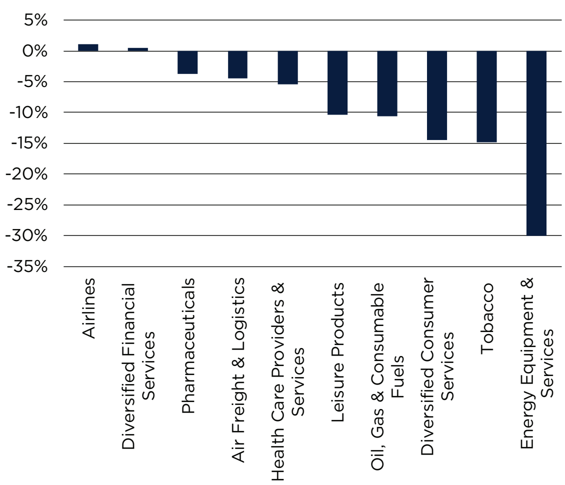
Source URA, Savills Research & Consultancy

GRAPH 4: Top 10 One Year US Equity Performance by Industry as of 3 February 2020



Source Fidelity, Savills Research & Consultancy

GRAPH 5: Bottom 10 One Year US Equity Performance by Industry as of 13 November 2019



Source Fidelity, Savills Research & Consultancy

OUTLOOK

In this quarter's brief, we shall be discussing the CBD Grade A office rental performance in 2019, the improving fundamental drivers of office demand in the medium term and the effects of the coronavirus outbreak on the market.

Resolving the performance disparity between the URA office rental indices

General market watchers may have noticed that the URA office rental index recorded a 3.1% YoY decline. However, does this really paint a true picture of rents for CBD Grade A offices? A breakdown of the rental performance by building category shows conflicting results. For instance, median rents for URA's Category 1 and 2[2] buildings rose YoY by 6.5% and 4.7% respectively. Savills CBD Grade A rents also increased, albeit at a slower pace of 2.9%. (Please see Table 2.)

Graph 3 shows the diverging performance of rents for URA's Category 1 & 2 buildings and Savills CBD Grade A offices compared to the URA office rental indices. As mentioned in our Q1/2019 Office Briefing, the Savills rental time series closely tracks that of the URA's Category 1 and 2 buildings. Since Q3/2018, the URA's Central Area (encompassing the Downtown Core and Orchard Planning Area) rental index began to part ways with both the URA's Category 1 & 2 building rents and Savills in-house data.

Looking at the Graph, there is a 3 to 1 vote in favour of office rents having risen in 2019. We are of the view that CBD Grade A office rents in 2019 actually rose rather than fell. It is also noteworthy that rents for URA Category 1 buildings went up sharply and this is corroborated by our Savills data which is populated by inputs from our leasing team.

Improving fundamentals driving medium term demand for CBD Grade A offices in Singapore

From a trendline perspective, rents for CBD Grade A offices are still vectored up. Although 2020 may be a year where we may see rents moderate to a range of 0% to -2%, it is at this juncture expected to be a hiccup resulting from the lagged effect of the late-2018 poor share price performance of US listed corporates followed by the dearth of unicorn IPOs in the period from end-2018 to mid-2019. But as we entered H2/2019, the S&P500 and NASDAQ began to rally and ended the year near record highs. For 2019, both of these two indices recorded annual gains of 28.9% and 35.2% respectively, the best one-year performance since 2013. Imputing a 6-month lag, multinational tenants in our CBD Grade A offices should regain business confidence, followed by a more aggressive stance towards their spatial requirements.

Graph 4 shows the equity performance of US stocks by industry. Technology and associated tech-enabled media companies are right up there in the rankings. We believe that, as it was in 2019, these will be the main tenants who will drive CBD Grade A office demand in 2020.

What is interesting is that the bottom ten performers are no longer banks and financial related companies and there is a vast difference between the performance of this bottom end group in November 2019 and 3rd February 2020 (see Graph 5 and 6).

For the period ending 3rd February 2020, of the ten industries, four still managed to eke out positive yearly returns versus three months ago. If history is a guide, then this should translate into firmer office demand in the later part of 2020.

Ultimately, for the first half of 2020, because of the lagged effect of the poor stock price performance of listed companies from late-2018 to mid-2019, we expect leasing transactions to be dominated by renewals rather than signing on for new and/or larger premises elsewhere. It is perhaps towards the second half of the year when record equity prices recorded in late-2019 will translate into more aggressive corporate action and a need for more space.

Should activity on the Venture Capital (VC) front start to pick up, we should see added demand from the new economy sectors. Indicators so far still point to a rather lukewarm front forming here as the number of US-backed VC deals and investments in

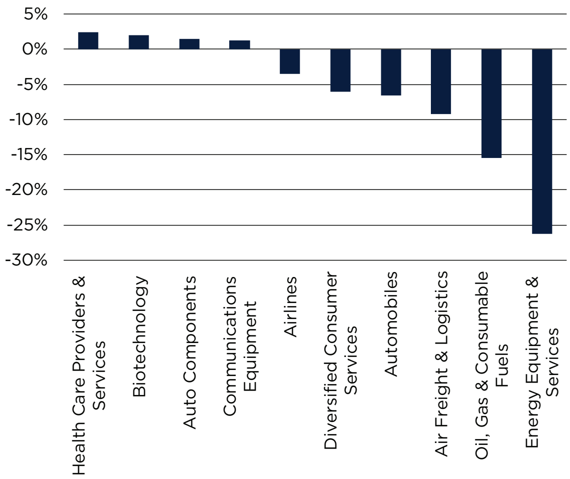
2 Category 1 buildings are located in the Downtown Core and Orchard Planning area and refer to buildings which are relatively modern or recently refurbished and are commanding higher rents than Category 2 buildings in the same area.

TABLE 2: YoY Rental Change for Various Categories and Locations of Offices

URA CAT 1 BUILDINGS	URA CAT 2 BUILDINGS	SAVILLS CBD GRADE A RENTS	URA CENTRAL AREA INDEX	URA CENTRAL REGION	URA FRINGE AREA
6.5%	4.7%	2.9%	-3.1%	-3.1%	-1.3%

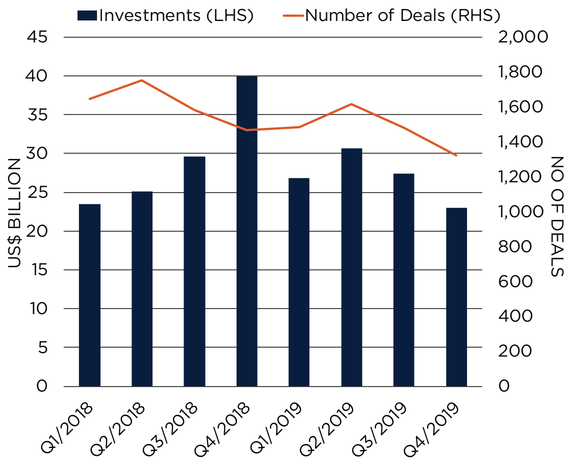
Source URA, Savills Research & Consultancy

GRAPH 6: Bottom 10 One Year US Equity Performance by Industry as of 3 February 2020



Source Fidelity, Savills Research & Consultancy

GRAPH 7: Number Of Deals And Investments Made By US VCs



Source PWC Moneytree, Savills Research & Consultancy

the US for Q4/2019 fell on both a QoQ and YoY basis.

Coronavirus and impact on Singapore CBD Grade A offices

Unlike its impact on the hospitality and retail sectors, the coronavirus outbreak is unlikely to affect the office market in the medium term (say 12 months). CBD Grade A office tenants are often multinationals who hold a long-term view of the market, not only in Singapore, but the region as well. As such, the viral outbreak will not disrupt our views of the sector in 2020.

For the Singapore office market, we believe that it would not be helpful to conduct a scenario analysis or attempt to revisit the SARs period to see how the market will react. The outcome of this viral outbreak is still an unknown, coming at a time when news feeds from social media and smart phones pervade our lives, something which was lacking during the SARs period. Also, the importance of China in the global supply chain and Chinese corporations expanding overseas was then not as great as it is today. Therefore, a what-if analysis is just what-if guesses. This pandemic is either in the process of breaking or has broken the connectedness of the market structure. Only when this event passes or is close to passing that one can give better analysis.

The long-term impact of the coronavirus outbreak may however change the landscape of how corporates are structured in the region and this may or may not have an impact on the office market here (and in the region). But very likely, it will have. In some ways, this pandemic is an accelerator of disruption. It has also created new branch points for all sectors of real estate. For example, the recent evacuation of 300 employees from a Grade A office building in the CBD because of two infected cases may lead companies to rethink the trade-off between office and home office. If so, this will likely affect office demand whether as direct tenants or from co-working operators. Technology will be the catalyst that quickens this new evolution. With that comes greater business opportunities for tech companies and more new-to-market companies setting up here and/or existing ones taking on more headcount. But as of the time of this writing, it is still too hazy to see what form this new evolution will morph office space demand into.

We have not changed our 2020 forecast for CBD Grade A office rents. Rental growth is expected to range from -2% to 0%.