Business Times - 15 Sep 2011

Singapore office market in reasonable health

Rents are reflecting fair value and the market should be able to absorb upcoming supply, says MORAY ARMSTRONG

IT is a tough office market to read at present. On the face of it, current fundamentals look buoyant. Singapore's economy has been charging ahead, driving strong occupier demand. Vacancy is relatively low and rents have enjoyed significant growth through the past 18 months.

Against this backdrop, however, there are a multitude of external economic shocks which do not seem likely to be resolved easily or swiftly. Singapore's economy, and by extension its office market, has shown itself vulnerable in the recent past. So where has the office market come from and where might it be heading?

The most extraordinary aspect of the current cycle is the altitude attained in a fairly short period since the global financial crisis (GFC) of 2008 and 2009. Singapore's Grade A rent is 32.5 per cent above the market trough in Q1 2010 and currently stands at $11 per square foot (psf) per month. Vacancy levels have fallen dramatically across all locations and are now in the 5 per cent range.

This is all the more remarkable given the sheer volume of new office developments that has come on-stream over the past 18 months. There are only a few office markets in the world that could have absorbed a total of 4.5 million sq ft of office development - representing approximately a 10 per cent increase in the total stock - and actually see occupancy rates rise.

Having one of the fastest GDP growth rates globally (14.5 per cent in 2010) clearly underpins the strength of occupier demand. Beyond this, however, there are also some structural changes in the occupier make-up driving Singapore's burgeoning office sector.

A number of exciting positive factors beyond the perennial growth in the financial sector include the rapid expansion of professional service companies, most notably foreign legal firms, and a similarly major ramp up by commodity and energy companies.

Singapore has also attracted centres of excellence and has become a popular destination for global process offshoring. Occupier demand has been more broad-based than in previous market upturns, which is encouraging.

Looking forward, however, it is undeniable that a far greater sense of caution pervades the market. There is a sizeable confirmed office pipeline and more available space on the way via second hand office space released back to the market from recent relocations by major tenants.

With all of this in focus, we have undertaken our own office market 'stress tests' to determine future market direction. Our conclusions are maybe a little surprising.

- **Test 1: Will the volume of new office developments create over-supply?**

From our tracking, the total confirmed new office supply from now until 2016 (including H2 2011) is 9.7 million sq ft, translating to just below 1.8 million sq ft per annum on average. This quantum has grown significantly over the past year as a result of a number of major government land sales both within the Central Business District (CBD) and in the decentralised markets, and certainty around development plans on a few CBD sites including Market Street Car Park and UIC Building.

While this appears to be a daunting supply pipeline, it is instructive to compare this against historic market performance. The past five-year new supply (including H1 2010) was 10 million sq ft - as it happens, 1.8 million sq ft per annum - and the market absorption rate over the same period was 9.2 million sq ft or 1.7 million sq ft per annum. The latter absorption performance was underpinned by a 6.5 per cent per annum historic average GDP growth rate.

If we assume that similar absorption levels are deliverable over the next five years, then vacancy levels are expected to rise to a small degree, but importantly, will remain in single-digit territory. These are hardly over-supply conditions.

Furthermore, given that 25 per cent of the total five-year new supply is already pre-let and we are coming off a relatively low existing vacancy rate, our sense is that the market will be able to absorb this supply without major distress.

- **Test 2: The sustainability of current rents**

The pace of rental growth had been moderating since Q4 2010 in line with forecasts CBRE made a year ago. This leaves today's rental level well shy of the 2008 pre-GFC market peak. In fact, Grade A office rents are still some 40 per cent below the peak levels.

Rents do not look excessive by comparison to previous cycles in Singapore, nor indeed with reference to the other key Asian city benchmark - Hong Kong - where 'like for like' rents are 60 per cent higher than in Singapore (even after factoring in the Singapore dollar's appreciation against the US/Hong Kong dollar).

We believe that current Singapore rents reflect fair value, taking into account the emergence of the city as a key global financial centre, the underlying growth in the economy and the vastly improved quality of the office stock. Rents at present look set to stabilise at a level that we consider sustainable.

Looking ahead, a period of less extreme volatility in rents could in fact be a blessing.

- **Test 3: How will occupier demand hold up in Singapore?**

Singapore is not immune to external shocks. It is patently not delinked from the US and European economies. It does, however, have every opportunity to outperform other global office markets. From our multinational client base, we have noticed a few encouraging trends, that Singapore could in fact be a net beneficiary of sovereign debt uncertainty.

The low to no-growth expectations that plague many Western countries is in stark contrast to Singapore's growth story. The prospect of greater government regulatory intervention and rising tax rates in the home base may act as a push factor, providing MNCs with compelling reasons to divert investment and expansion eastwards.

Add in a high volume of available office space at reasonable rates (a situation that contrasts with Hong Kong's) and office demand could be bolstered. This may look excessively optimistic given the procession of grim news at present, but in the medium to long term, it looks like a winning formula.

Reasonable health

In conclusion, we believe that Singapore's office market is in reasonable health. The supply and demand imbalances of the past look just that - historic. Corporates have ample top quality space within which to grow, and can enjoy a more stable occupation cost base to aid budgeting and planning. Landlords and developers have every reason to be positive.

Singapore's overall offering is looking more attractive than ever to many global businesses - the city has moved up to another level.

The writer is executive director of office services at CB Richard Ellis