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VACANCY RATES FOR CORE CBD AND FRINGE CBD CONTINUE TO DROP

The office market continued to strengthen throughout 2006 with demand driven primarily by the banking and financial institutions. Logistics firms, oil companies and I.T. firms also featured prominently among the major leasing deals. Underpinned by a strong economy, companies increased their headcount and expanded their space needs. Of some concern is that the strong demand has come at a time of increasingly tight office availability situation.

Vacancy rate for Core CBD, which comprises the Raffles Place, Marina Centre and Raffles Quay/ Shenton Way micro-markets, has fallen from 4.5 per cent in Q3 06 to 3.6 per cent to date. It was 8.6 per cent in Q4 05. The Fringe CBD, which comprises the Orchard Road and Tanjong Pagar micro-markets, has shown a drop in vacancy rate from 7.7 per cent in the past quarter to 6.9 per cent so far in the current quarter. The drop in vacancy is due to the filter-down effect of tight supply within the Core CBD area as well as the redevelopment of some offices within the Fringe CBD area. Vacancy rate for the Fringe CBD area was 10.6 per cent in Q4 05. Similarly the decentralised markets also reflect a low vacancy of 3.3 per cent for the fourth quarter to date, down from 4.2 per cent in the past quarter and 5.5 per cent a year ago.

Although Grade A stock increased to 7.76 million square feet with the completion of the 760,000-square feet One Raffles Quay (ORQ) North Tower in the fourth quarter, Grade A vacancy remains below 1.0 per cent at 0.8 per cent so far for the current quarter. It was 7.5 per cent in Q4 05 and 0.7 per cent last quarter. Take-up for Grade A offices stands at 751,214 square feet for this quarter so far, totaling 1.744 million square feet to date. This is nearly five times the annual demand for Grade A space in 2005 (362,635 square feet) and is attributable to the high pre-commitment level achieved at the ORQ as well as the rapid expansion of the financial sector.

In view of the robust leasing market, we have reviewed our projections and have reverted to our earlier estimate of 2.2 million square feet for islandwide office demand for full-year 2006.

Other office developments likely to be completed by end-2006 include 55 Market Street and SIF Building. These will add another 146,000 square feet to the stock. Major office buildings completed in the first three quarters of 2006 included Parakou Building (64,000 square feet) and ORQ South Tower (565,000 square feet). As such, full-year supply is likely to total 1.54 million square feet.

No Government Land Sales Sites for office development were triggered in 2006. A Beach Rd site (3.5 ha), designated for office and hotel use, was, however, released for tender in December 2006.

There was also limited impact from the secondary office supply that was slated to be released to the market due to relocations by some major financial institutions. Such spaces were either retained by the occupiers or have attracted new leasing commitments. As such there was no relief to hard-pressed occupiers from this.

The tight office supply pipeline encouraged larger occupiers to pursue early pre-commitment to future schemes. There is a high level of pre-letting. Most notably Merrill Lynch has pre-let the entire development at Harbourfront Tower 5 (208,000 square feet), which is scheduled for completion in late-2008.

"It has clearly been a landlord's market in 2006 and competition from tenants for space was typical. Rents were being reviewed on an increasingly regular basis. Back-to-back transactions were prevalent in the second half of the year, whereby space vacated by relocating occupiers was immediately committed by new tenants" said Moray Armstrong, Executive Director, Office Services.

To date, prime office rent has risen 50.2 per cent in the year to average $7.81 per square foot per month. This reflects a 13.2 per cent increase from the $6.90 per square foot per month rate in Q3 06. The current Grade A office average is $ 8.73 per square foot per month. At this rate, it is a 14.9 per cent increase quarter-on-quarter and 53.1 per cent year-on-year.

According to CBRE's Global Market Rents, Singapore moved up six notches from 43rd place in the previous survey in May 2006. This rise in ranking is consistent with the rental growth acceleration experienced over the past six months. Notwithstanding the rising costs, Singapore continued to be cost competitive relative to other key Asia cities such as Tokyo, Hong Kong and even Mumbai.

More major office transactions were seen in 2006, as some $4.34 billion worth of office assets have been transacted so far this year, up from $1.923 billion in 2005.

Purchases were made by Funds, developers, end-users and REITs. For example, CapitaCommercial Trust bought Raffles City jointly with CapitaMall Trust while a new office REIT, the K-REIT was listed and traded. There is a growing number of Funds seeking property deals in 2006, but there has not been a Grade A office building transacted yet.

Higher prices were achieved for strata-titled offices at Suntec City (from $1,100 per square feet in Q1 06 to $1,340 per square feet to date) and International Plaza (from $500 per square foot in Q1 06 to $800 per square foot to date). Boosted by recent transactions, valuation-based prime capital value has grown 11.1 per cent quarter-on-quarter so far and 50 per cent year-on-year to average $1,500 per square foot in the current quarter. Based on latest figures, prime office yield has risen from 4.54 per cent in end-2005 to 4.90 per cent so far.

"The outlook is very positive for the landlords and investors community, but it is increasingly worrying for corporate occupiers as the tight availability situation is expected to persist for another three years due to the construction time-lag. The steepest rental increase is expected in the next 12-18 months as demand drivers remain extremely strong" added Mr Armstrong. Strong upward pressure on rents will only be alleviated by a sharp slowdown in demand and possibly from greater supply hitting the market in 2009/2010. Tenants have to be creative in coming up with solutions to cope with the shortage in office supply. They may look into maximizing existing space use as well as accelerating decision-making on future expansion sites. Office occupiers may also consider the opportunities in business parks.

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