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Continued MNC Expansionary Demand Drives Rentals Upward in Asia's Major Office Markets

The third quarter of 2006 saw continued strong demand for premium office space in Asia's leading office markets. The sustained demand resulted in increases in top grade office rentals in most markets, with Singapore, New Delhi and Mumbai seeing the steepest rises.

Strong demand from banking and financial institutions drove rentals substantially higher in Singapore. Average prime rents in Singapore soared to S$6.90 (US$4.35) per square foot per month, soaring 15 per cent quarter-on-quarter. These levels were last seen in 2000-2001. At the end of September, the vacancy rate in the core CBD had dropped to 4.5 per cent, while rates in the decentralised office markets averaged 1.5 per cent. Strong tenant expansion and limited space have placed landlords in a strong position and their expectations have risen accordingly. "The rate at which MNCs are expanding in Singapore is phenomenal. We have not witnessed occupier growth of this scale since the mid nineties", said Moray Armstrong, Executive Director, Office Services, Singapore.

Buoyant demand in Tokyo's prime office market continued to give upward momentum to rents which rose 2.9 per cent quarter-on-quarter. In Hong Kong, rents for the best quality space in Central continued to rise on the back of the strong demand for top grade space by banking and finance tenants keen on internal expansion. Turning to the Mainland, both Beijing and Shanghai witnessed persistent demand from multi-national corporations, which continued to propel prime office rentals upward. Prime office rentals in Guangzhou's Grade A office market edged slightly upwards as the market saw strong demand and the opening of two prime office projects during the quarter. Vacancy rates remained at the 2 per cent level in Seoul's CBD and Gangnam office sub-markets, and leasing activity was strong across all markets. India's prime office markets continued to see eye-catching increases in rentals, including quarter-on-quarter increases of 34.3 per cent and 15.9 per cent, respectively, in Mumbai's Bandra Kurla Complex and Nariman Point CBD, while Delhi saw rentals rise 21.2 per cent in the CBD and 31 per cent in Gurgaon.

Due to the strong demand and near record lows in vacancy, Tokyo's prime office market has seen rent-free incentives fall from an average of four months a year ago to one month. This quarter saw the first major wave of fixed-term lease renewals since their introduction in 2000, and landlords leveraged the opportunity to increase rents to new highs. DaVinci Advisors set a new benchmark for prime office rents by asking for rents approximately 30 per cent above the market average in the Pacific Century Place Marunouchi Building. Landlords' rising rental expectations and their belief in the value of holding some vacant stock gave rise to the rebound in vacancy to 1.5 per cent, from the all-time low of 0.6 per cent recorded in the previous quarter.

In the Hong Kong market, top grade space in Central continued to exert a strong gravitational pull on existing banking and finance tenants. A CBRE Research occupancy analysis of the top ten Grade A buildings in Central determined that vacancy in the buildings fell to 1.3 per cent in the third quarter, half the second quarter rate. Take-up was fairly low, largely because of compression in Central and other districts. The hardening of rentals and absence of availability in prime districts fuelled rental growth and take-up in Hong Kong Island's decentralised office districts. The tight market conditions for prime offices on Hong Kong Island are expected to continue in the near and medium term, as the limited up-coming supply is unlikely to ease the demand pent up in the market.

A wave of expansionary plans by overseas enterprises has fuelled strong demand for prime office space in a number of office centres in Beijing. There were a number of significant leasing deals during the quarter. Landlords of top Grade A offices have begun to adjust their tenant mix, becoming increasingly selective in picking office tenants in order to attain higher rental levels. Meanwhile in Shanghai, keen demand outstripped available space, and the market warmly welcomed the launch or pre-commitment of high-quality projects. In Pudong, the Zhuyuan area is expected to develop into the second major office micro market after Lujiazui. In the next five years, at least five office projects, including Hutchison's Century Avenue, will be completed in Zhuyuan. Guangzhou Grade A office rents were supported by companies entering Guangzhou or expanding their presence in the city, who absorbed most available space. Optimistic about Guangzhou's office market, many developers are working to build up their land banks in Pearl River New City, the city's planned new CBD. Some, including the domestic developer Agile Properties, have shifted part of their investment from residential projects into the commercial sector.

Seoul's office leasing market maintained its upbeat performance, with vacancy tightening and prime rental values edging upwards. The limited supply of new prime office space in Gangnam is exerting upward pressure on both rentals and capital values in the area. In September, the Morgan Stanley Real Estate Fund announced that it would invest US$350 million in the development of Songdo International City, beginning with US$150 million this year to construct a 65-storey mixed-use building.

Rentals for prime offices in India's business centres continued to rise at an accelerated rate in the third quarter of 2006. In Delhi, the prime office market remained brisk, as insufficient availability and the pre-commitment of most supply drove both rental and capital values in the CBD and Gurgaon to all time highs. Prime office rentals posted steep quarter-on-quarter rises of 21.2 per cent and 31 per cent, respectively, in the CBD and Gurgaon. Major infrastructure improvements in Gurgaon helped spur the district's ongoing emergence as a preferred business destination.

The increasing demand for commercial properties, coupled with the lack of new supply, resulted in continued step increases in rental and capital values across Mumbai's markets. Rentals in the CBD recorded a 15.9 per cent increase quarter-on-quarter, while Bandra Kurla Complex saw rentals appreciate 34.3 per cent quarter-on-quarter.

Bangalore's CBD remains the location of choice for most corporates, and demand continued to exceed supply, with the majority of the space that became vacant within the quarter committed or leased by the end of the period. The vacancy rate in the CBD continued to shrink, tightening to 3.7 per cent but prime office rentals in the CBD remained stable. Trianz Consulting, Swiss Re, AXA and ABB were involved in significant leasing transactions in Bangalore during the third quarter.

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