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LEASING ACTIVITIES HINDERED BY LIMITED OFFICE SUPPLY BUT RENTS ARE STILL BELOW MID-1990 LEVELS

Continued high demand and tightening availability of office space underpinned further escalation of rents through the third quarter. Rents have returned to the last peak level recorded in 2000-2001. While this brought rent some 72.5 per cent above the last trough in 2004, it is important to note that mid-1990 peak levels are still some 43 per cent higher than today's average prime rent.

At end-September the vacancy rate within the Core CBD, which comprises the Raffles Place, Marina Centre and Raffles Quay/Shenton Way sub-markets, dropped to 4.5 per cent from 7.1 per cent in the previous quarter. Interestingly, the decentralised office markets outperformed the Core CBD with an average vacancy rate of only 1.5 per cent in the third quarter, down from six per cent in the previous quarter.

The Grade A segment of the market increasingly faces a crunch of availability. Grade A office occupancy increased from 97.3 per cent in Q2 06 to 99.3 per cent in Q3 06. In large part this was due to strong take-up at One George Street where vacancy rates fell from 22 per cent a quarter ago to a mere 1.7 per cent in Q3 06. Take-up for grade A offices rose from 141,935 square feet in the previous quarter to 688,103 square feet in the third quarter principally due to the inclusion of fully pre-committed office space at ORQ South Tower.

A backdrop of strong tenant expansion and limited availability has created conditions for strong rental growth. Landlords were in a strong position and their expectations have risen accordingly. At end-September, average prime rents soared to $6.90 per sq. ft. per month. This reflected an increase of 15 per cent quarter on quarter. Grade A rents also rose 11.8 per cent quarter on quarter to average $7.60 per sq. ft. per month.

We are projecting prime rents and grade A rents to reach $7.30 per sq. ft. per month and $8.30 per sq. ft. per month respectively by end-2006. "Rents are also likely to increase further in the next 12 months, boosted by the growth of the financial institutions, logistics and oil & gas sector companies" said Moray Armstrong, Executive Director, Office Services.

We had earlier projected office demand for 2006 to be 2.2 million square feet. However it was observed that tenants' expansion were challenged by tight availability of space. As such, our demand projection for the year will be revised down to 2.0 million square feet.

Known new office supply from 2007 to 2010 will average 0.59 million square feet per annum. Meantime, the proposed redevelopment of several office blocks could potentially remove about 1.0 million square feet from the existing CBD office stock. "There is some concern that the absence of suitable premises could constrain new entrants and businesses seeking expansion. Relief is likely to come by in 2009 with the completion of BFC Phase 1 and, thereafter, with BFC Phase 2, together with any potential additional supply from the sites that may be successfully sold from the Government Land Sale list." added Mr Armstrong.

The office investment market remained active as investment funds continued to source for limited products. Investment transactions during the quarter include the sale of Asia Insurance Building to The Ascott Group for $109.5 million ($1,093 per sq. ft.). Keppel Land would be acquiring a 35.37 per cent stake in Equity Plaza from CapitaLand Limited as well as a 29.26 per cent stake in the same development from Sumitomo Corporation for a total sum of $45.3 million. Upon completion, Keppel Land will attain a 100 per cent stake in the development.

For strata-titled sales, Samudera Shipping Line Limited sold a floor at 6 Raffles Quay for $14.69 million ($1,450 per sq. ft.). They had bought the property at $13.27 million ($1,310 per sq. ft.) in the first quarter this year.

Boosted by recent transactions, valuation-based prime capital value grew 17.4 per cent to average $1,350 per sq. ft. in the third quarter. As a result of increases in both rents and capital values, the prime office yield worked out to be 4.72 per cent in the third quarter.

END