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Office rentals in Singapore go up

Tight supply of space and surging demand will sustain upward trend, say experts

Weekend • May 6, 2006

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IN A sure sign of surging demand in a strengthening economy, office rents in Singapore have gone up from US$31.68 ($49.94) per sq ft (psf) in the last quarter of 2005 to US$35.76 in the first quarter of this year.

Singapore is now the 21st most expensive in office rentals in the world, up from 29th place last year, according to a just-released report by international real estate consultancy Knight Frank.

The latest spike in office rents is a continuation of an upward trajectory since average prime office rent rose 10 per cent last year. The upsurge came after three years of decline brought on by excess supply and weak demand due to economic slowdown.

Now the situation has reversed.

"The rise in rental ranking is caused by tight supply of prime office space coupled with buoyant demand," said Mr Nicholas Mak, director of consultancy and research at Knight Frank.

According to Mr Mak, the Singapore office market can absorb about 1 million sq ft of office space with moderate economic growth. Most of the demand for new office space comes from financial and business services occupiers.

Singapore's overall vacancy rate is 12 per cent and it has been falling since the end of 2003, said Mr Mak. It is expected to keep falling until the end of the year.

In the prime office sector, the vacancy rate is even lower. For the top 25 office buildings, the rate is as low as 3.8 per cent and for prime office buildings it is 5.1 per cent, said Mr Donald Han, managing director of international property consultancy Cushman & Wakefield.

And there is no relief in sight for the immediate future. "Rents are expected to come under more pressure over the next 12 months due to a lack of supply and availability of quality space," said Mr Han.

So what impact will this have on the economy considering that higher office rents usually translate into higher cost of business? Fortunately for Singapore's economy, the impact will be minimal. The problem will arise only if the rise in rentals outpaces economic growth, say experts.

"As long as the economy expands at a moderate rate — between 4 per cent and 6 per cent — businesses can generally cope with a 10-per-cent per annum rise in rent," said Mr Han.

"This is what's happening in Hong Kong, where office rents are about to test new record levels, rising by as much as 50 per cent per annum — clearly outstripping economic growth."

Also, while rents may increase "one part" of business cost, they are not the biggest part, said Knight Frank's Mr Mak.

"Labour costs may be a bigger part of business cost."

Office rental income growth is driven more by volume and less by rates.

Knight Frank's rental ranking of the world's major cities shows that there is still a good bit of upside for Singapore office rentals, which still lag behind Asian cities. Ahead of it are cities such as Hong Kong (2), Tokyo (3), Mumbai (14) and Shanghai (20).

Current average net yields for prime office rentals are 4.5 to 5 per cent but some developers and analysts that Today spoke to predict 5- to 6-per-cent yields for the Singapore office market.

In comparison, yields in Shanghai are a notch higher than in Singapore — between 6 and 7 per cent per annum, said Mr Han. Yields in Hong Kong are similar to that in Singapore while yields in Tokyo are between 3 and 4 per cent per annum.

The growing demand and tight supply situation of commercial space makes office space "a good sector of real estate in which to invest — if one can find any", said Mr Mak. "Unfortunately, available stock is very limited."

In the event that they are available, the best investment quality office properties are the older ones — those with retrofitting possibilities. "Capital enhancement (of such stock) may attract higher quality tenants who may be able to pay higher rents," said Mr Han.