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REAL ESTATE SECTOR RESEARCH

Singapore Office Real Estate Market View

Summary

The Singapore economy grew by 2.1% on a yoy basis in the fourth quarter of 2022, moderating from the 4.0% yoy growth in the previous quarter. For the whole of 2022, the economy grew by 3.6% yoy, slower than the 8.9% yoy growth in 2021. GDP growth in 2022 was largely supported by the services sector following the reopening of Singapore's borders, with market indicators in 2022 exceeding pre-pandemic levels. MTI forecasts an economic expansion of 0.5%-2.5% in 2023, barring the materialization of downside risk from larger than expected rate hikes, a sharp repricing in financial assets and further escalation in geopolitical tensions.

Prices and rental of office space increased by 3.7% qoq and 5.1% qoq respectively in 4th Quarter 2022. The office sector continued to improve on the back of firm return-to-office demand and healthy building occupancies. Vacancy rates, however, could potentially rise as a result of weaker economic conditions and a slowdown in expansionary activity from the tech sector. For 2023, office rental growth is expected to grow at a more modest pace due to expected weaker GDP growth.

We have summarized the latest performance indicators of the Office real estate market as shown in **Exhibit 1**.

Exhibit 1: Latest Performance Indicators

Key Indicators	Change	3Q2022	4Q2022
Price Index	3.70%	111.9	116
Rental Index	5.10%	168.3	176.9
Pipeline Supply	1.60%	858,000 sq m (GFA)	872,000 sq m (GFA)
Vacancy Rate	-0.4 percentage point	11.70%	11.30%

Source: URA

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Contents

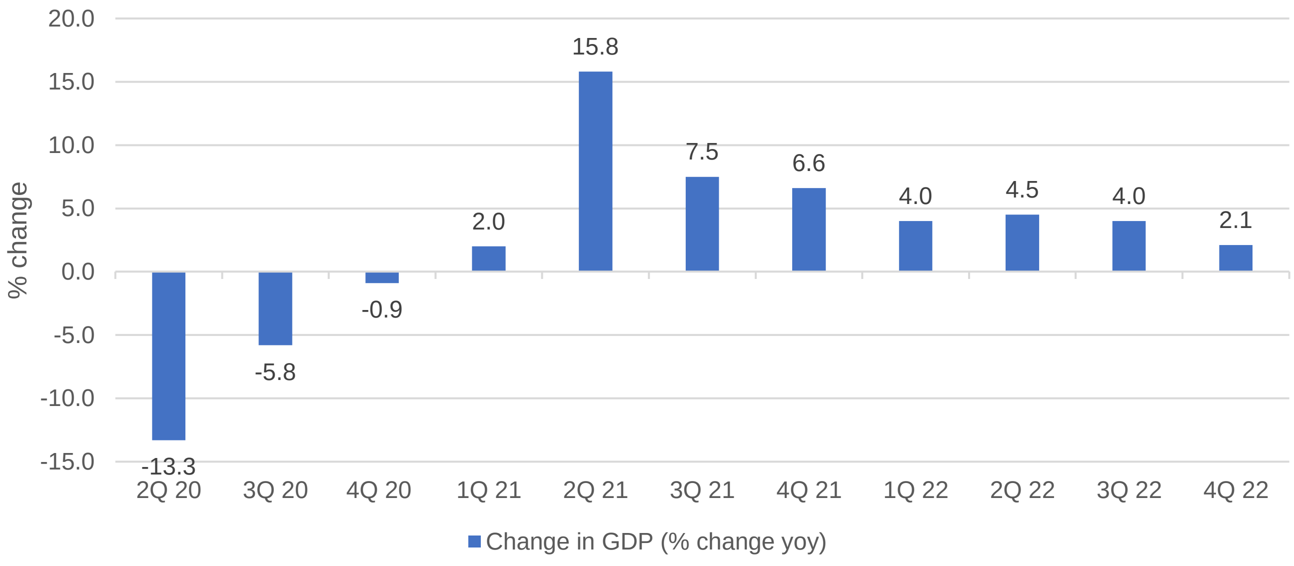
Singapore Office Real Estate Market View

In this Singapore office real estate market overview, we will first review Singapore's economic situation and then discuss the market outlook.

Singapore's Economic Outlook

The Ministry of Trade and Industry (MTI) reported that based on advance estimates, the Singapore economy grew by 2.1% on a yoy basis in the fourth quarter of 2022, moderating from the 4.0% yoy growth in the previous quarter as shown in **Exhibit 2**. For the whole of 2022, the economy grew by 3.6% yoy, slower than the 8.9% yoy growth in 2021.

Exhibit 2: Change in Singapore quarterly GDP (%, yoy)



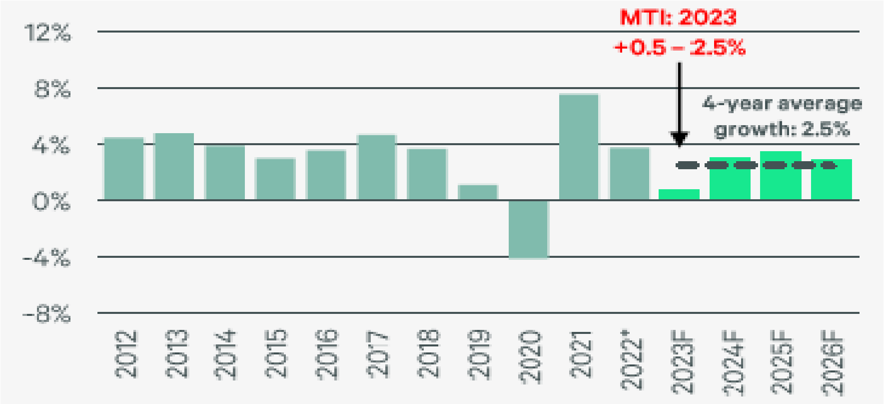
Source: Data compiled from MTI

For 2023, MTI expects GDP growth rates in most major economies to moderate further from 2022 levels, with sharp slowdowns projected in the US and Eurozone. Meanwhile, global supply disruptions are likely to continue into 2023 as the war in Ukraine drags on, even though the extent and frequency of disruptions is expected to ease. MTI also highlighted significant uncertainties and downside risks in the global economy. First, with many advanced economies raising interest rates simultaneously to combat high inflation, the impact of tightening financial conditions on global growth could be larger than expected. Second, financial stability risks could intensify if there are disorderly market adjustments to monetary policy tightening in the advanced economies. A sharp re-pricing of assets could trigger capital outflows from the region and increase debt servicing burdens, thereby dampening regional economies' growth outlook. Third, further escalations in the war in Ukraine and geopolitical tensions among major global powers could worsen supply disruptions, dampen consumer and business confidence, as well as weigh on global trade.

Considering the above, MTI expects the growth of outward-oriented sectors in Singapore to weaken in tandem with the deterioration in external demand conditions. However, the growth prospects of several sectors remain positive. In particular, the continued recovery in air travel and international visitor arrivals will support the expansion of aviation- and tourism-related sectors. Taking these factors into account, and barring the materialisation of downside risks, MTI expects the Singapore economy to grow by "0.5 to 2.5 per cent" in 2023.

CBRE noted that GDP growth in 2022 was largely supported by the services sector following the reopening of Singapore's borders, with retail and labour market indicators in 2022 exceeding pre-pandemic levels. This has helped to offset sluggish performance in the manufacturing sector. Significant headwinds lie ahead for Singapore's economy in 2023. A global economic slowdown is expected amid tighter financial conditions from repeated rate hikes in the US and Europe as central banks attempt to reel in inflation. This slump is likely to weigh further on Singapore outward-oriented manufacturing sector. However, growth prospect remain positive in several sectors with the reopening of China's borders and the continued recovery in international travel and tourism which could lend support to aviation and tourism-related sectors and cushion the overall slowdown. Beyond the MTI's 2023 GDP forecast of between 0.5% -2.5%, CBRE believes the Singapore's 4-year average growth would be 2.5% as shown in **Exhibit 3**.

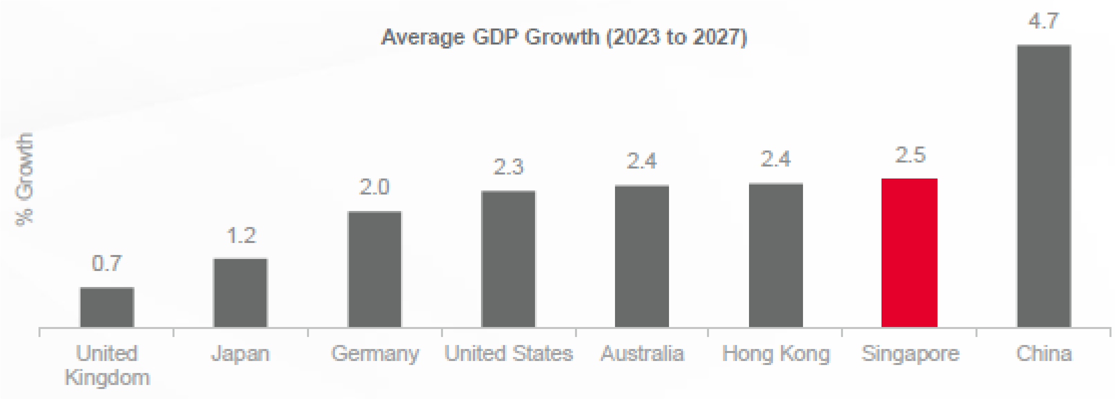
Exhibit 3: Singapore Projected Growth (CBRE) (% change yoy)



Source: CBRE

Similarly, Cushman & Wakefield (C&W) believes that Singapore remains supported from a flight to safety as capital gravitates towards "safe havens" for wealth preservation and diversification amidst global uncertainties. Singapore's strategic geographical location, pro business policies and stable political situation are key advantages that continue to attract inbound investments. Companies with a long-term South-east Asia or Asia Pacific strategy would be less inclined to drastically cut budgets in Singapore, supporting Singapore's resilience. Over the mid term, Singapore's GDP growth is expected to average about 2.5% per annum from 2023 to 2027, outperforming the US, Australia, Hong Kong, Japan, Germany and the UK as shown in **Exhibit 4**. This bodes well for property demand.

Exhibit 4: Singapore Projected Growth (C&W) (% change yoy)



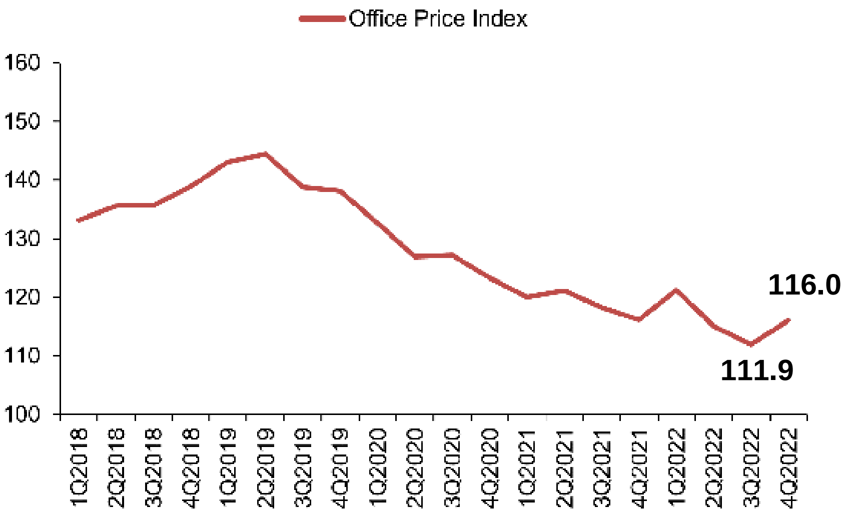
Source: C&W

Singapore Office Real Estate Sector

(I) Overview

According to data from the Urban Redevelopment Authority (URA), prices of office space increased by 3.7% quarter-on-quarter (q-o-q), as reflected by an increase in the Office Price Index to 116.0 from 111.9, as shown in **Exhibit 5**. For the whole of 2022, prices of office space decreased by 0.1%, compared with the decrease of 5.8% in 2021

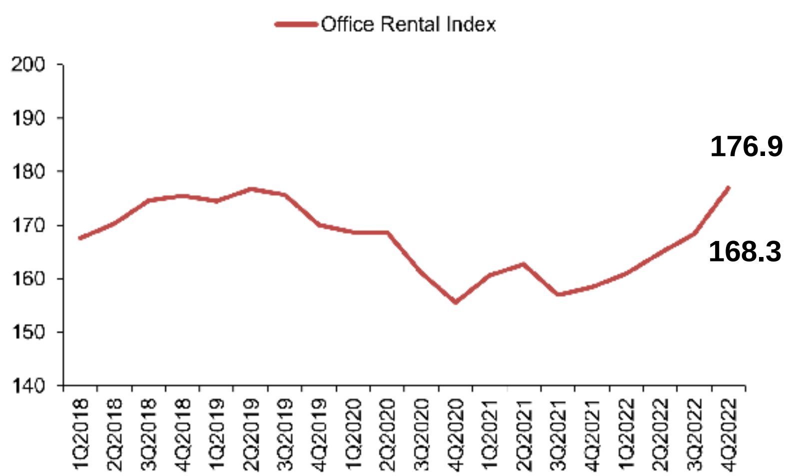
Exhibit 5: Property Price Index Of Office Space



Source: URA

According to URA, rentals of office space increased by 5.1% qoq in 4th Quarter 2022, compared with the 2.1% qoq increase in the previous quarter, as reflected by an increase in the Office Rental Index to 116.0 from 111.9, as shown in **Exhibit 6**. For the whole of 2022, rentals of office space increased by 11.7%, compared with the increase of 1.9% in 2021.

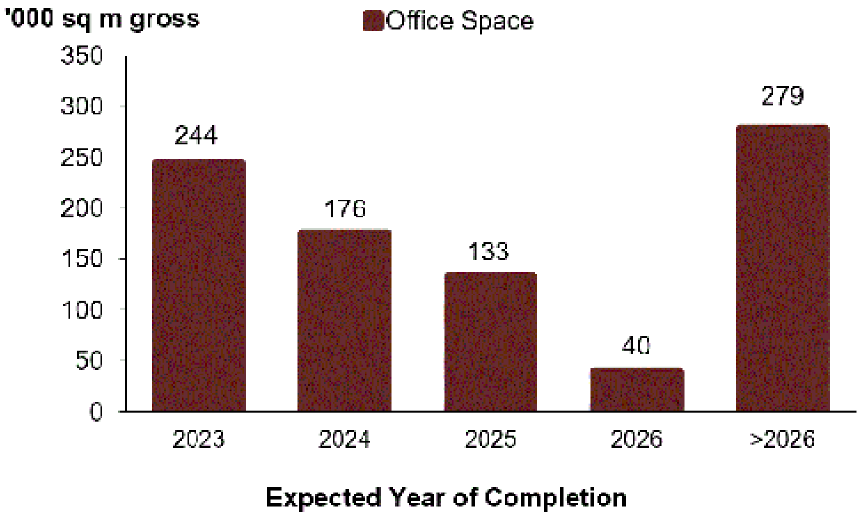
Exhibit 6: Rental Index Of Office Space



Source: URA

URA noted that as at the end of 4th Quarter 2022, there was a total new supply of about 872,000 sq m GFA of office space in the pipeline, compared with that of 858,000 sq m in the previous quarter. Of which, 244,000 sq m are expected to be completed in 2023 as shown in **Exhibit 7**.

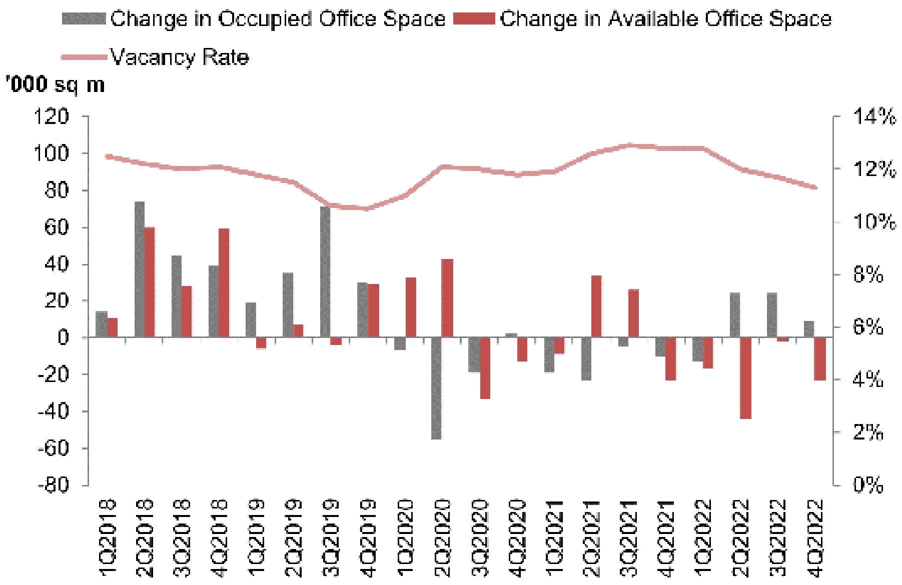
Exhibit 7: Pipeline Supply Of Office Space



Source: URA

The amount of occupied office space increased by 9,000 sq m in 4th Quarter 2022, compared with the increase of 24,000 sq m in the previous quarter. The stock of office space decreased by 23,000 sq m in 4th Quarter 2022, compared with the decrease of 2,000 sq m in the previous quarter. As a result, the island-wide vacancy rate of office space decreased to 11.3% as at the end of 4th Quarter 2022, from 11.7% as at the end of the previous quarter as shown in **Exhibit 8**.

Exhibit 8: Stock And Vacancy Of Office Space

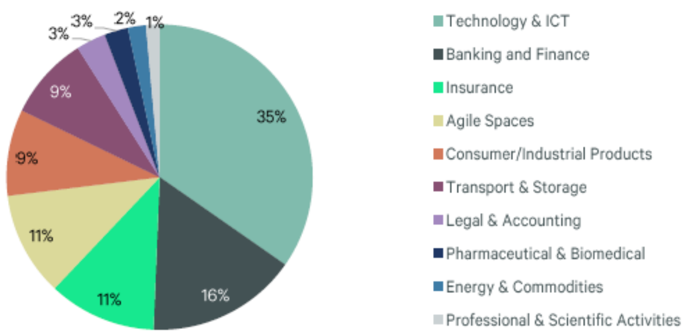


Source: URA

(II) Broad-based Demand Drivers in 2023

CBRE noted that 2022 ended on a high note for the office sector, as it continued to outperform expectations with the full relaxation of pandemic-related measures and gradual return to office. Island wide net absorption for the year totaled 1.15 mil sq ft, which was 3.6 times 2021's net demand of 0.32 mil sq ft, and 17.9% higher than the 10-year average of 0.97 mil sq ft. In terms of leasing demand, the tech sector accounted for 35% of leasing demand among the top 10 sectors in 2022 as shown in **Exhibit 9**. Although it has traditionally been a dominant force, having taken up some of the best quality space in CBD, expansion activity from this sector is likely to take a breather due to cost cutting measures. Some tech companies have also begun rightsizing or offering their office space on an early surrender basis.

Exhibit 9: CBRE 2022's Leasing Demand Among Top 10 Sectors



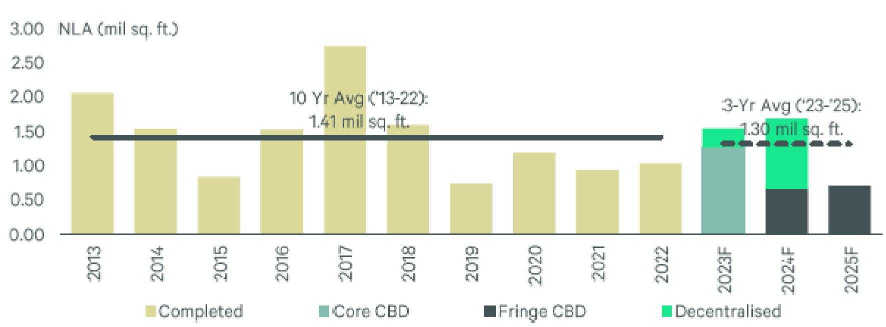
Source: CBRE

CBRE believes leasing demand in 2023 is likely to be more broad-based. Given Singapore's status as a key financial and wealth management hub, non-banking financial sectors, such as private wealth and asset managers have been expanding. This has also created higher demand for supporting industries, such as legal & tax advisory, real estate and insurance sectors.

(III) New Supply To Be Below Historical Average

According to CBRE, over the next three years (2023-2025), total new supply is estimated at 1.30 mil sq ft per annum, which is 7.6% lower than the historical 10-year annual average new supply as shown in **Exhibit 10**. Core CBD future supply remains extremely limited in the horizon with IOI Central Boulevard Towers, the only new CBD Grade A development in 2023. The tight supply situation will also be compounded by the removal of existing stock in the CBD as well as potential redevelopments.

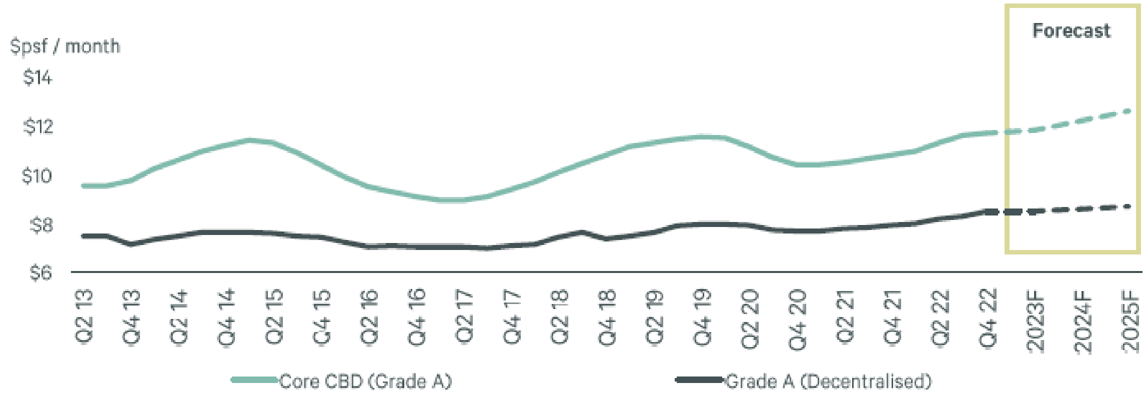
Exhibit 10: Historical Completions and Gross Future Supply



(IV) Outlook

CBRE noted that on the back of firm return-to-office demand and healthy building occupancies, Core CBD rents grew by 8.3% to $11.70 psf/month in 2022, surpassing rental growth of 3.8% in 2021. That said, the pace of rental increase in the last quarter of 2022 has slowed as sentiment soured and turned more cautious. On the back of weaker economic conditions and a pullback in expansionary activity from the tech sector, vacancy rates could potentially increase. CBRE expects mild rental growth in the short-term and Core CBD rents could rise by about 1.0% yoy in 2023, while Decentralized rents are likely to remain stable before making a more meaningful recovery in the next couple of years as the economy picks up. CBRE's rental forecast is shown in **Exhibit 11**.

<u>Exhibit 11: CBRE's Office Rental Forecast for Core CBD and Decentralized</u>



Source: CBRE

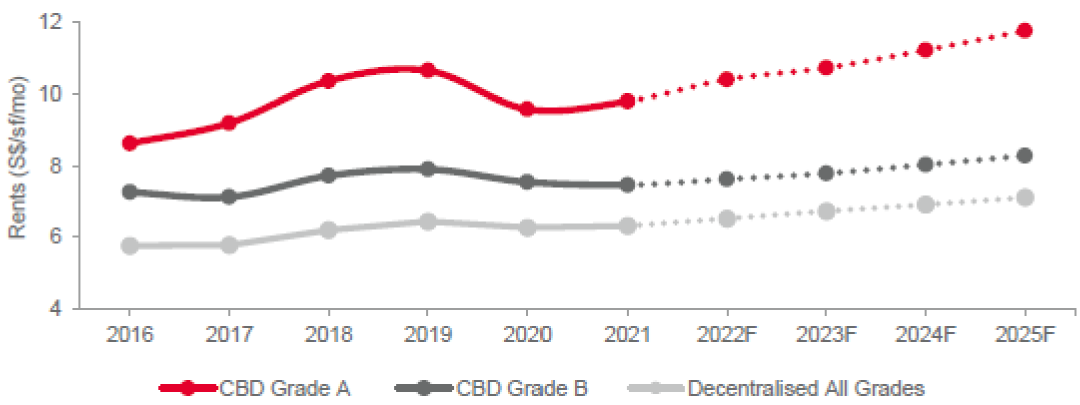
Colliers noted that leasing demand continued to be broad-based, with net absorption coming in stronger in the fourth quarter. However, the changing economic outlook and drought in funding has led to a slowdown in demand from technology firms. These firms have switched their focus from growth to profitability; hence, many are putting their expansion plans on hold, reducing their footprints or withdrawing from prior commitments. This trend is likely to extend to the other sectors, particularly the financial sector, and lead to more shadow space emerging, thereby capping rental growth. However, there should be other industries or new entrants backfilling this space, unless there is a prolonged economic downturn.

For 2023, rental growth would come in at a more modest pace due to weaker GDP growth, but this will be mitigated by the lower supply situation, as well as the fact that Singapore remains an attractive destination for businesses regionally and globally. Colliers expects full year 2023 rental growth forecast for the core CBD Premium & Grade A segment to ease to between 2 to 3% yoy. The availability of higher quality offices in the Core CBD remains tight due to a lack of new supply and withdrawal of existing office stock for redevelopment. In addition, Colliers expects more global firms to set up their regional headquarters in Singapore to hedge against geopolitical risks. There are also more family offices and asset managers setting up here, attracted to Singapore's reputation as an international financial hub. In turn, this will lead to the growth of ancillary business services such as law firms, management consultancies, insurance companies and accounting firms expanding their operations and looking for office space. It is likely to remain a landlord's market for the next few quarters due to the tight supply situation, with most maintaining their rents. However, with leasing activity slowing, and should there be a sharp downturn in economic conditions, landlords might have to start prioritizing occupancy and offer more competitive incentives and/or rents.

C&W noted that as firms reassess expansion plans against the backdrop of economic headwinds, leasing demand for office spaces could cool in 2023 and lead to slower office rental growth. CBD Grade A office rental growths are projected to grow by 2% to 4% yoy in 2023, With higher supply in 2023, vacancy rates are expected to increase, though remain at relatively tight levels. Potential redevelopments in the CBD could tighten office supply and drive displacement demand.

Also, the progressive expiry of transitional office sites over the next few years would accentuate this trend and bolster pre commitment rates at upcoming developments. Limited available space in the CBD Grade A market has driven some demand to the Grade B office market, where rents are lower and there are more available options. CBD Grade B office rents are poised to rise by 2.1% yoy in 2023. Given a combination of higher CBD office rents and uncertain economic conditions, some occupiers could look towards the more cost-efficient decentralized office space. Given the rental gap between CBD and decentralized office markets, and an expected increase in property service charge, C&W could see a faster rent growth in decentralized markets, growing by 3 to 5% y o y in 2023. The office could emerge stronger post 2023 as an economic slowdown may encourage higher office attendance, which would stimulate future office demand. C&W's rental forecast is shown in **Exhibit 12**.

Exhibit 12: C&W's Office Rental Forecast



Source: C&W

Meanwhile, Jones Lang LaSalle (JLL) noted that demand slowed in 4Q22 as global economic headwinds intensified and weighed on business sentiment. The ongoing consolidation in the tech sector also moderated its appetite for office space. CBD investment grade office rent growth decelerated for the first time since recovering from the COVID-19 pandemic in 2Q21. With interest rates climbing further and investors staying on the sidelines in 4Q22, CBD investment grade office capital values fell for the first time since turning around in 2Q21. Singapore's office market is expected to cool further over 2023 with limited impetus for rental growth. This could put office investment assets under greater re-pricing pressure as interest rates are expected to stay elevated.

Knight Frank believes that slower growth is expected in 2023, due to inflation and volatility in the technology sector. Nevertheless, demand is likely to be sustained by corporates shifting business functions from other parts of Asia with Singapore as a flight-to-safety destination as uncertainty grows. International firms poised to gain from the receding pandemic in growth regions such as South-East Asia are also looking to set up or expand in the city-state from which to reach the steadily growing middle class in these countries. With these sources of demand and with IOI Central Boulevard Towers the only substantial new office development completing in the CBD, rents are likely to increase by around 3% for the whole of 2023, barring any further substantial pre-termination or reduction of space from technology companies.

Savills believes that coming into 2023, a new movement is gaining greater momentum, namely the need for multinational tenants to comply with the ESG standards of their respective country of origin. As shareholders and clients expect greener practices, tenants from countries with strict ESG standards may have little choice but to locate in offices, even for their branches offshore, which are graded Green. This mandate would result in skewed demand towards green rated Grade A offices. While the challenges encountered on the economic front may take away demand, for Grade A offices, it may be partially offset by the flight of MNCs to these buildings. In conjunction with inflation working its way through the service charge component, and the constant flow of family offices setting up here, the overall gross rents for its basket of offices may still eke out a 2% yoy increase in 2023. However, there may be quarters which we may see either no or slight negative qoq rental changes amongst the sub-grades in our basket of CBD Grade A offices.

(V) Summary

Against the above backdrop, the outlook for the Singapore office market appears to have improved, and leasing demand has remained broad-based. Vacancy rates, however, could potentially rise as a result of weaker economic conditions and a slowdown in expansionary activity from the tech sector. The tech industry's ongoing consolidation has also reduced its appetite for office space. For 2023, office rental growth would come in at a more modest pace due to weaker GDP growth, but this would likely be offset by the lower supply situation and the fact that Singapore is still a desirable location for businesses on a regional and international scale. The summary of the rental growth projections from various real estate firms is shown in **Exhibit 13**.

<u>Exhibit 13: Summary Of Real Estate Firms’ 2023 Office Rental Growth Forecast</u>

	2023 Rental Growth Forecast	
	CBD	Decentralized
CBRE	1.00%	0.00%
Colliers	2.00%-3.00%	-
C&W	2.00%-4.00%	2.10%
Knight Frank	3.00%	-
Savills	2.00%	-

Source: Respective real estate firms

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