

## DIVERGING PERFORMANCE EXPECTED IN PRIME OFFICE MARKET, AS TENANTS' FLIGHT TO QUALITY PUTS PRESSURE ON GRADE A SPACES

Greater divergence in both rental and occupancy performance is expected in the prime office market (Grade A+ and Grade A offices), as Grade A offices are expected to see larger rental and occupancy declines than Grade A+ offices in coming quarters.

### Heightened uncertainty in global economy

- Expectation over a US Federal Reserve rate hike before the end of this year remains, although the US central bank once again left rates unchanged at the 21 September meeting.
- The sudden fall in oil prices during the week ended 9 September 2016, caused by a significantly lower-than-expected decline in crude inventory, caused a shock to stock markets around the world.
- Apprehension over the impact of Brexit, particularly on the UK and EU economies, continues to loom in the mid- to long-term horizon, although safe haven assets and locations around the world could be potential beneficiaries of capital leaving London for safety.
- Rising corporate credit levels in China are another cause for concern. A spike in debt defaults could lead to a tightening of financial conditions, further restraining the growth of the Chinese economy.

### Muted economic performance of Singapore economy as labour market weakens

- The labour market showed emerging signs of weaknesses, as overall unemployment rate rose to 2.1% in June 2016, compared to 1.9% in March 2016. Long-term unemployment rate, which is the percentage of residents unemployed for at least 25 weeks to the labour force, came in at 0.8%, its highest since 2010. Job vacancies fell short of job seekers for the first time since June 2012, at 93 openings per 100 job seekers.
- Professional services and financial services formed 15% and 11% of redundancies in Q2 2016, even as total layoffs rose to the highest second quarter level since 2009. Further sustained weakness in these sectors, which are major occupiers of office space in the Central Business District, will likely lead to the return of more space to the market.
- The 2016 GDP growth forecast was narrowed to between 1.0% and 2.0%, from between 1.0% and 3.0%, the Ministry of Trade and Industry (MTI) announced in August.
- GDP growth is one of the key factors influencing office occupancy. Historically, when GDP growth last fell to around 2% in 2008, office occupancy fell over the next two years to reach an average of 87.5% in 2010.

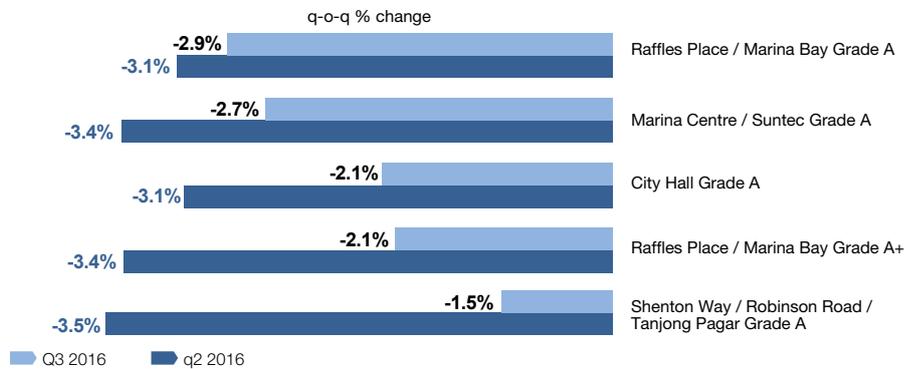


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“While we are seeing tenants able to relocate taking the opportunity to take flight to quality, the test over the coming quarters will be for buildings which will lose their tenants to backfill the vacancies amid the on-going economic uncertainty.”

EXHIBIT 1

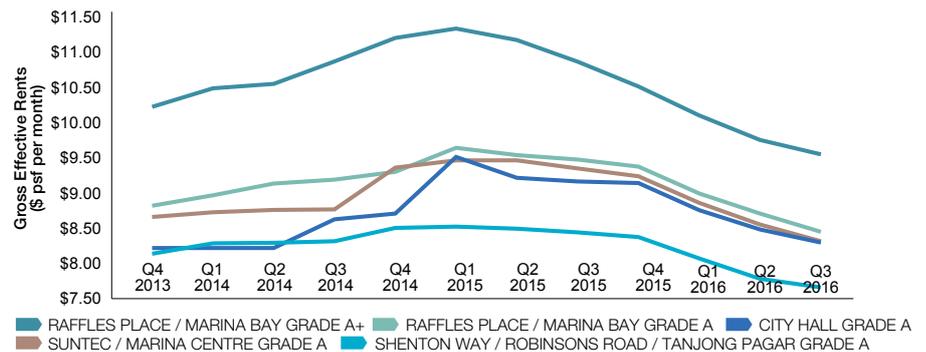
**Quarterly % Change in Average Office Rentals, by Key Precincts within CBD in Q2 2016**



Source: Knight Frank Research

EXHIBIT 2

**Average Office Rentals, by Key Precincts within CBD**



Source: Knight Frank Research

**Upcoming vacancies in buildings whose tenants took flight to quality**

- Grade A office space in the Raffles Place / Marina Bay district saw the largest quarter-on-quarter (q-o-q) rental decline of 2.9% of the various locations in Q3 2016, while Grade A+ office space in the same area saw rental decline moderate slightly, falling 2.1% q-o-q (Exhibit 1).
- Grade A offices in the Shenton Way / Robinson Road / Tanjong Pagar cluster fell at the lowest rate of -1.5% of the various locations, after having fallen most quickly the preceding quarter. However at \$7.70 psf in Q3 2016, rents are at its lowest since Q3 2010. Whether this slowdown dissipates or becomes more acute remains to be seen, contingent on the rate of these vacancies being backfilled.
- The pursuit by upcoming and newer buildings to secure tenants gained momentum in the past two quarters. Several established tenants from Grade A buildings will take flight to Grade A+ quality in the coming quarters.
- Upcoming vacancies in Grade A buildings will increase in the next two years as these tenants relocate, and put pressure on rents as a result.

**Competition for tenants will continue to grow in the coming quarters**

- Competition for tenants will be rife, particularly among buildings vying to backfill vacancies from tenants relocating to quality over the upcoming quarters.
- Buildings with significant Net Lettable Area (NLA) due for lease renewal from now till 2018 will continue to be under threat of losing tenants to quality buildings.

Market Outlook

- A two-tiered performance is expected in the prime office market. Greater divergence in rental and occupancy performance is expected in the prime office market, as Grade A offices are expected to see larger rental and occupancy declines than Grade A+ offices in the upcoming quarters.
- Singapore's prime office rents for upper floors in skyscrapers, ranked eighth regionally, will stand more favourably with businesses looking to locate or increase their footprint in Singapore, as compared to major global cities in the region, Hong Kong and Tokyo, which were ranked first and third respectively, in Knight Frank's latest Global Cities Report 2017.
- Knight Frank projects that average office rents will continue on its path of decline, before bottoming out in 2018.

EXHIBIT 3

Average Office Rentals, by Key Precincts in Q3 2016

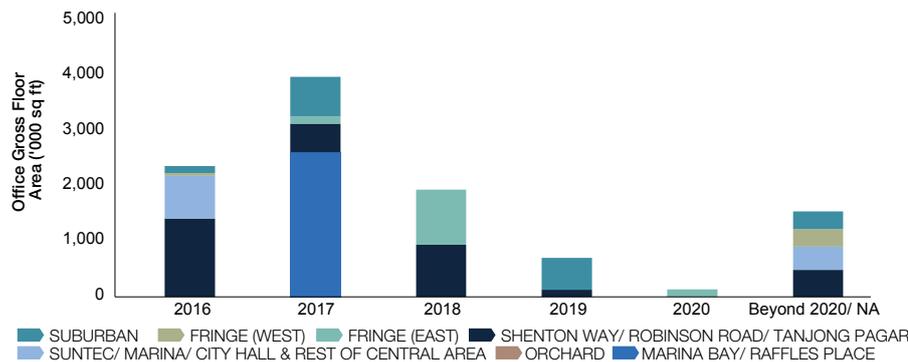
Location	Gross Effective Monthly Rentals (\$S per sq ft)	Quarter-on-Quarter Change (%)
<b>CBD (Grade A+, Grade A)</b>		
Raffles Place / Marina Bay Grade A+	\$9.30 - \$9.80	-2.1%
Raffles Place / Marina Bay Grade A	\$8.20 - \$8.70	-2.9%
Shenton Way / Robinson Road / Tanjong Pagar Grade A	\$7.40 - \$7.90	-1.5%
Marina Centre / Suntec Grade A	\$8.10 - \$8.60	-2.7%
City Hall Grade A	\$8.10 - \$8.60	-2.1%
<b>Central Area (Outside CBD)</b>		
Orchard Grade A	\$7.90 - \$8.40	-1.8%
<b>Others</b>		
Fringe Areas	\$4.80 - \$7.00	-1.9%
Suburban Areas	\$4.20 - \$5.40	-2.1%

Source: Knight Frank Research

- (1) Rents are based on transacted leases
- (2) Rents are based on a lease term of at least three years
- (3) Rents are expressed as values rounded to nearest 10 cent
- (4) Rents are estimated based on leases of a whole-floor office space on the mid-floor levels of office properties, and taking into account rent free period and other concessions

EXHIBIT 4

Upcoming Office Supply, as at September 2016



Source: URA, Knight Frank Research

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