Take your chances with office property

Office property shows no signs of a slowdown

Investors concerned about the risks in falling residential property prices may prefer to take their chances with office property, which is showing no signs of a slowdown. Prime office rents may rise as much 16% through to 2015, reckons Barclays analyst Tricia Song, who notes that there is a below long term average of new office space completions averaging just 0.85 million sq ft over the next three years.

In fact Singapore is in its fourth straight year of a net increase in office demand, with office occupancy hovering around the 90% mark. The completion of the massive Asia Square Tower 2 with 1.3m sq ft of space but only a third pre-committed saw a slight decrease in occupancy in Singapore, but there is unlikely to be a reduction in rents. Property firm JLL noted Grade A rents have now climbed above the $10 psf level, whilst the CBD average was $8.84 psf.

Another interesting feature in the office market is that the rent differential between grade A and B buildings is just 12%. That is a 16-year low and implies that either Grade A rents will rise quickly, or Grade B office rents should fall. Credit Suisse analyst Yvonne Voon expects the latter, with downside risk to rents to be more prevalent at fringe CBD and the older central offices due to flight to quality, and sizeable decentralised supply and new business park space. This should be good news for REIT's with better quality assets such as CCT and K-REIT which are able to maintain rents and are even seeing good improvements for small offices.

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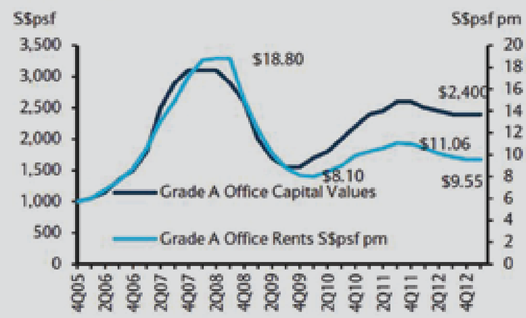
REIT occupancy

Occupancy also appears to be higher for REITs with Super Grade A office space in their portfolio. However there is still the demand equation and Ms Voon warns that "given that the outlook for the office sector is dragged by the sizeable supply outlook versus the relatively slow demand momentum, we maintain with our flattish rent assumptions."

Grade A office rents have declined 14% since 3Q11, now at 49% below peak



Source: CBRE, Barclays Research

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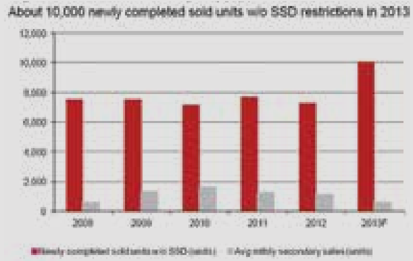
It seems like homes will be left unoccupied in the next 2 years or so as growth in completed units outpace demand. According to OCBC, there is a large physical supply expected over FY14-16. Including HDB, DBSS and EC completions, they anticipate that 50.0k, 49.7k and 73.6k homes will come into the physical supply in FY14, FY15 and FY16, respectively. They believe that vacancy rates would likely deteriorate from its current 6.1% levels to 6.7% as at end 2014.

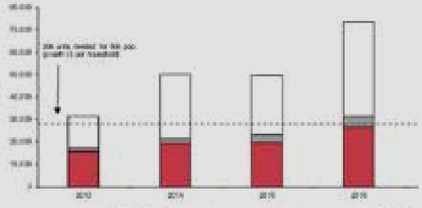
Moreover, according to Nomura, it also appears to that even the secondary market could deteriorate further in the near term. Estimates suggest over 14,000 units scheduled for completion in 2013F have already been sold by developers. Of these, 52% were sold before 30 August 2010. The potential secondary supply appears significant, especially in relation to the average secondary transactions of just 623 units a month in 9M13.

Potential secondary supply* to increase



*non-landed private housing excluding EC
Sources: URA, REALIS, Nomura estimates

Physical completion rate exceeding population growth



Sources: URA, OIR estimates