Mixed outlook across all sectors

Market Overview

Based on advanced estimates by the Ministry of Trade and Industry (MTI), the Singapore economy grew moderately by 2.4% year-on-year (y-o-y), and 1.2% quarter-on-quarter (q-o-q) in Q3, with positive growth seen in both the services and manufacturing sectors.

Boosted by REIT acquisitions, real estate investment activity increased by about 15.4% q-o-q to $5.5bn, bringing total investment volume in 2014 to-date to $15.3bn. Property companies were net sellers in Q3, where the bulk of their divestments stemmed from the injection of their properties into REITs.

Strong leasing activity and limited vacancy in the office sector led to an islandwide occupancy growth of 0.8 percentage-point to 95.8% in Q3. While rents are expected to grow by up to 15% in 2014, rental growth in 2015 could be slower, given that an additional 1.0 million sq ft of vacant space and 133,000 sq ft of shadow space is likely to become available next year.

Facing manpower issues and competition from e-commerce penetration, take-up of retail space has slowed. As a result, average retail rents across all areas fell in Q3. On the other hand, investor interest in strata-titled retail units remained healthy in Q3, as the limited units available for sale in the market are expected to support capital appreciation in the long term.

Prices across all residential segments continued to fall in Q3, although the rate of decline eased (Figure 1). Sellers had stronger holding power on asking prices as the price decline over the past few quarters brought some potential buyers back into the market. Nevertheless, the built-up inventory of launched but unsold units and upcoming launches will continue to provide buyers with many options and aid in sustaining a buyers’ market for the months ahead.

![Figure 1: Resale non-landed residential price indices](source: DTZ Research)
Economic Overview

Moderate economic growth

According to advance estimates by the MTI, the Singapore economy expanded by 1.2% q-o-q and 2.4% y-o-y in Q3 (Figure 2). The q-o-q growth was an improvement from the 0.1% contraction in Q2, and overall positive growth was observed in both the services producing industries and the manufacturing sector. In the services producing industries, growth was primarily supported by the finance and insurance and business services sectors, while the manufacturing sector was lifted by better performance in the biomedical manufacturing and electronic clusters.

Patchy growth in the manufacturing economy

Nevertheless, growth of the manufacturing economy continued to be patchy across the third quarter of the year. The Purchasing Managers’ Index (PMI) was highest in July at 51.5 (above the expansionary reading level of 50) before it fell 1.8 points to 49.7 in August due to lower levels of new orders, inventory and stockholdings of finished goods. Subsequently, the PMI increased to 50.5 in September, reversing the contraction in the previous month (Figure 3). On the other hand, non-oil domestic exports (NODX) expanded through July till August, boosted by increased demand from South Korea, Taiwan and China.

Core inflation forecast lowered for 2014

Headline Inflation fell to 0.85% in July and August from 2.2% in Q2 (Figure 4). The fall was partly attributable to lower premiums on Certificates of Entitlement for car ownership. Core inflation (excluding accommodation and private transport costs), averaged 2.2% y-o-y in July and August, similar to Q2 and up from 2.0% in Q1.

With the economy at almost full employment, wages are expected to continue to filter through to prices, in particular for services such as healthcare and education where demand remains firm. Nevertheless, external price developments are expected to stay...
Comparatively weak sales in the primary market

Total transaction volume declined by about 28% q-o-q in Q3. Primary market sales were relatively weak in Q3, at around 1,600 units and comprised only 53% of all sales in the quarter. In comparison, primary market sales averaged 65% of total sales in each quarter in 2013 (Figure 5).

Few new launches in Q3

Compared to Q2, where there was a spike in new launches in May, there were only a handful of new launches in Q3. These launches were mostly in the Rest of Central Region (RCR) and Outside the Central Region (OCR). At some of these developments - in spite of the cooling measures and relatively high prices - response was relatively healthy. For these particular developments, about 75%-90% of units launched in the quarter were sold.

Rate of price decline eases for non-landed homes

On the other hand, in the secondary market, there were increased queries as the price decline over the past few quarters brought some potential buyers back into the market. This gave sellers stronger holding power on asking prices, which softened the q-o-q rate of decline in Q3 compared to Q2. Based on a basket of completed freehold non-landed residential properties tracked by DTZ Research, average resale values continued to fall the most q-o-q in Q3 by 2.5% and 2.0% respectively in the luxury and prime areas. In the non-prime areas, average freehold resale values fell by 1.5% q-o-q in Q3, while leasehold values fell by a slightly larger 2.0% (Figure 6).

Landed segment displayed stronger signs of weakness

In contrast, average resale prices of landed homes fell at a faster rate in Q3 compared to Q2. In suburban areas, average resale prices of freehold landed homes declined about 2.2% q-o-q in Q3, slightly faster than the 2.0% drop registered in Q2. In the traditional prime districts of 9, 10 and 11, only average resale prices of detached homes held up while average resale prices of both semi-detached and terrace homes fell by 2.0% q-o-q in Q3.
**Seasonal factors helped to stagger the decline in rents**

Similarly, increased leasing activity due to seasonal factors saw average rentals in the prime and suburban areas fall by a smaller 0.6% and 1.7% q-o-q respectively in Q3, compared to the 3.0% and 2.0% fall in Q2. Suburban rents faced more pressure due to the larger number of completions seen over the past few quarters. Postal districts which saw the largest number of new completions of between 1,600 and 2,400 units in the past one year included districts 14, 15 and 19.

**Buyers’ market to be sustained in upcoming months**

Although the price fall in some segments has begun to ease, capital values are unlikely to plateau soon as the cooling measures and stricter financing conditions will keep transaction activity low. Furthermore, the increasing inventory of launched but unsold units, as well as upcoming launches will continue to provide buyers with many options and aid in sustaining a buyers’ market in the months ahead.

**Investment**

**REIT acquisitions push up real estate investment**

Real estate investment activity increased by 15.4% q-o-q to S$5.5bn in Q3, bringing total volume in 2014 to-date to S$15.3bn (Figure 7). Investment sales comprise transactions that are S$5m and above and exclude S$439.5m of transactions in single residential units and lots that cannot be redeveloped or subdivided into more than one plot.

REITs were the largest purchasers of properties in Q3, and were active across the commercial, industrial and hospitality sectors. They acquired a total of S$2.9bn worth of properties, accounting for more than 50% of activity in the quarter. Hospitality deals included the acquisition of Intercontinental Singapore ($497.1m) and Fraser Suites Singapore ($327.0m) as well as a separate joint-venture deal to develop Outpost Hotel Sentosa and Village Hotel Sentosa. Office and industrial REITs also made acquisitions, such as the purchase of a 33.33% stake in Marina Bay Financial Centre (MBFC) Tower 3 for S$1.2bn and the acquisition of Aperia at Kallang Avenue for S$458.0m. In addition, Jackson Square and Jackson Design Hub in Toa Payoh were purchased for a combined total of S$111.5m. With no disposals in the quarter, REITs were net buyers of properties in Q3.

**Property companies turn net sellers**

In contrast, property companies (both listed and non-listed) were net sellers in Q3 (Figure 8). They divested S$2.9bn of properties, with a large proportion of these properties injected into REITs. Property companies were also less active in Q3, making about S$2.0bn of acquisitions, compared to an average of S$3.1bn each in Q1 and Q2.

The smaller number of acquisitions by property companies in Singapore was partly attributable to their increased activity overseas. In 2014 to-date, Singapore-based property companies were estimated to have made more than USD4.0bn of overseas acquisitions.
Asian investors dominate foreign investments

Activity in Q3 continued to be dominated by domestic investors, although foreign participation increased in the quarter as previously anticipated. Foreign investors accounted for $800m or 14% of overall investment activity in Q3, with investors from Asia contributing the bulk (78%). These foreign investments were spread across five deals and included the purchase of a government land site at Upper Serangoon Road/Meyappa Chettiar Road, Anson House as well as the reported purchase of 12 units at Grange Infinite.

Office sector continues to drive activity

Similar to H1, investments in office properties led activity in Q3. Office investments grew 3.2% q-o-q to $1.9bn in Q3. This brought total investments in office properties in 2014 to-date to $5.7bn, already more than the $5.0bn and $5.5bn invested respectively for the whole of 2013 and 2012. Besides Anson House, Straits Trading Building and the 33.33% stake in MBFC Tower 3 changing hands, purchases of strata offices also added to office investments in Q3.

On the other hand, with fewer government land sales (GLS) sites on the confirmed list and the slowdown in the residential market, residential investments declined further by another 1.3% q-o-q to $1.5bn in Q3. For the first nine months of 2014, total residential investments amounted to $5.0bn, 16% lower than the $5.9bn of residential investments in the same period last year.

Around $20.0bn of investments expected for 2014

With investors continuing to look overseas for investment opportunities and the limited stock of assets available for sale, investment volume for the whole of 2014 is expected to come in around $20.0bn, lower than last year’s $28.6bn.

Retail

Slow take-up of retail space

Retailers are operating in an increasingly challenging environment. Besides having to cope with manpower issues due to foreign labour restrictions, they also have to confront the growing competition from e-commerce penetration. These circumstances have resulted in the slow take-up of retail space. Islandwide net absorption of retail space was only 62,400 sq ft in H1, significantly lower than the 326,000 sq ft recorded in the same period last year.

Marginal decline in average rents across the island

Within shopping malls - both old and new - there is more available space, especially on the higher floors where footfall may be lower. Landlords have become more flexible on asking rents by providing various incentives in their rental packages. As a result, average retail rents declined across all areas in Q3. In Orchard/Scotts Road and suburban areas, average rents fell for the first time in more than a year by 0.3% and 0.5% q-o-q respectively (Figure 9). In the other city areas, average rents fell by a stronger 1.0% q-o-q in Q3, after a 0.3% fall in Q2.
Capital values hold up q-o-q following the healthy demand for strata-titled retail units

In spite of the decline in average retail rents in Q3 and stricter financing conditions from the TDSR framework, buyer demand for strata-titled retail space continued to be relatively healthy. According to caveats lodged with URA REALIS, slightly over 140 strata-titled retail units were transacted in Q3, compared to the 130 units sold in the previous quarter. Given the fair levels of interest, sellers were able to hold on to their asking prices, and average capital values of retail space across all areas remained unchanged q-o-q in Q3.

Strata-titled retail units available for sale in the market are limited. This supports the potential for capital appreciation in the long term, and is one of the reasons why investor interest in strata-titled retail units remains healthy despite yield compression. However, investors should be mindful that the rental demand for smaller strata-titled retail units could be weaker amidst the current tough operating environment, especially from smaller retailers, who tend to form the bulk of demand for such strata-titled retail units.

Rental pressure due to large new supply in the near-term

Going forward, performance of the retail sector will continue to be buffeted by changing trends in retailing, consumer patterns and near-term supply pressure. A study by Merger Alpha predicted that e-commerce revenues in Singapore could hit USD4.4bn by 2015, more than double the revenue generated in 2013. These figures will pose further challenges to brick-and-mortar retailers. Meanwhile, of the 5.5 million sq ft of retail space expected to be completed up to 2019, about half is expected to come on-stream between Q4 2014 and 2015, with the bulk located in suburban areas (Figure 10). This may deepen the rental pressure in these areas going forward.

Office

Occupancy rose amidst strong leasing and limited supply

Islandwide office occupancy grew by 0.8 percentage-point q-o-q to 95.8% in Q3, with net absorption coming in at 443,000 sq ft. There were no new completions in the quarter but net supply was negative at 67,000 sq ft due to the removal of 700 Beach from the office stock as it is undergoing redevelopment into a 300-room hotel.

The strong leasing activities in Q3 were underpinned by broad-based expansions of all sectors including commodities, finance and insurance, pharmaceuticals, professional services and technology, media and telecommunications (TMT) firms. IT and social networking firms in particular are expanding in the Central Business District (CBD) for better brand positioning and the desire to be a market leader for staff attraction, although some of them could potentially qualify to relocate to business parks with lower rents.
Average rents in Raffles Place rose by 2.7% q-o-q

Across all areas in the CBD, Raffles Place registered the highest q-o-q growth in Q3 of 1.2 percentage-points in occupancy. This was largely because of limited new supply until the completion of CapitaGreen at the end of 2014. As a result, average gross monthly rents in Raffles Place rose by 2.7% q-o-q to $10.55 per sq ft in Q3 (Figure 11).

Upcoming future vacant space and shadow space in 2015

Going forward, another 2.0 million sq ft of office space is expected to be completed in Q4 (Figure 12). Close to 40% of this will be in the decentralised areas while the rest will be in the CBD and CBD fringe areas.

Subsequently in 2015, approximately 826,000 sq ft of office space is expected to come on-stream. After accounting for the removal of office stock from Equity Plaza (258,000 sq ft) and other buildings such as Keypoint (268,000 sq ft) and 2HR (141,000 sq ft) for redevelopment, net supply next year will be even lower at an estimated 159,000 sq ft.

However, there will be close to 1.0 million sq ft of office space that will become available next year when tenants move out of their existing office buildings to their new offices. For instance, CapitaLand has consolidated operations at Capital Tower and vacated its offices at Robinson Point, which will be released into the market. Other such occupiers include the Agri-Food and Veterinary Authority of Singapore (AVA) and the Building Construction Authority (BCA), which will vacate their headquarters in the MND Complex by the end of this year to relocate to JEM. Lastly, Cargill will be releasing their space in The Concourse and relocating to CapitaGreen in 2015. In addition, about 550,000 sq ft of shadow space is currently available while another 133,000 sq ft will be released next year. In all, this will mitigate the shortfall in new supply next year.

Office rents expected to grow at a slower pace in 2015

CBD office rents are therefore projected to continue to increase next year albeit at a slightly slower pace, after an expected growth of close to 15% for the whole of 2014.
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