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COMMENTARY

How will shorter leases on commercial sites shape the future of work?

By Sing Tien Foo

WORKPLACES are not likely to be the same ever again. With most people now accustomed to hybrid arrangements put in place over the last 2 years, the work from home (WFH) and work from anywhere culture has become more entrenched. Companies now face resistance from employees as they try to shift people back to offices.

In recent public dialogues on Singapore's long-term land use and infrastructure development plan on Apr 9, 2022, Indranee Rajah, the Second Minister for National Development, unveiled key planning strategies for the "Future of Work". These strategies cover 5 broad areas: decentralisation, strengthening CBD as a global hub, shorter leases for commercial sites, industrial clustering, and workplaces near home.

The newest and boldest among the proposed strategies is to roll out more commercial sites with shorter leases. The planning strategies aim to drive workplace transformations in the post-Covid era.

Minister Indranee Rajah said that "shorter leases will allow us to respond to future uncertainties more nimbly". She added that "this (shorter lease) will provide businesses with more flexibility, allowing spaces to support evolving business operations... and will help our city adapt to fast-changing economic trends."

In major cities in China, commercial land is sold on 40-year leases, and commercial land in Hong Kong has been granted 50-year lease extensions since 1997. In Singapore, JTC Corporation allocates industrial land parcels on 30-year leases, with an option to renew for another 30-year term in some cases for firms to build customised manufacturing facilities and plants. Commercial sites sold by the government to private developers are predominantly on 99-year leases.

How short will the lease period be for future commercial sites sold by the state? Will the proposed shorter lease policy be a game-changer for Singapore's commercial property markets? Will commercial real estate still be attractive as an investment? What will be the possible impact on existing commercial buildings?

Will different stakeholders, including real estate developers, Reits, institutional investors, and existing landlords, be receptive to shorter leases?

The relationship between building quality and lease length

Will commercial real estate developers cut back investments in buildings because of shorter land leases? If developers build lower-grade buildings that are not as competitive as nearby better-grade buildings, they will not be able to attract quality tenants. They may not, as a result, recoup enough rental cash flows to offset their investments, which consequentially impacts the financial feasibility of investments.

Suppose they channel the cost savings from land with shorter leases to investing in buildings with better quality design and more sustainable technologies. They might even attain an early breakeven from investments. Therefore, shorter leases may not necessarily lead to a flight to quality for commercial buildings, especially those in prime CBD locations.

Instead, more skyscrapers with newer technologies and innovative features could emerge to rival other financial hubs in the region, such as Hong Kong and Shanghai. The completion of 79 Robinson Road in 2020, which was redeveloped by CapitaLand Investment (CLI) on the former CPF Building site with a balance lease of 45 years, is an example of how developers do not compromise on building quality on sites with shorter leases.

Second, short leases limit a building's economic lifespan on the one hand and reduce upfront investment outlays on land on the other. Will institutional investors and Reits find commercial real estate on shorter leases to be less attractive financially?

Short leases may directly impact the capital appreciation of commercial buildings because their reversionary interests diminish faster when the tenure is shortened. However, the lease tenure should not impact rents. Office rents are dependent on factors like quality and location of buildings, that is, Grade A space will not command lower rents simply because the building sits on land with a shorter lease. Investors will need to adjust their investment strategies by focusing more on rental yields than capital appreciation.

Third, the Covid-19 pandemic has hastened digitalisation and technology adoption by firms, causing disruptions to old economies. Many commercial buildings along Shenton Way and Robinson Road, touted as Singapore's Wall Street in the 1970s and 1980s and built on sites sold through the Government Land Sales (GLS) programmes, have reached their half-life with balance leases of less than 50 years. These buildings are economically obsolete, even though they are still functionally and structurally sound.

Landlords of existing commercial buildings with shorter balance leases will face pressure to redevelop or refurbish their space to keep up with the competition. Older buildings such as Robina House, UIC Building, Shin Kwan Building/ICB Building along Shenton Way, and Afro-Asia Building along Robinson Road, have been given a new lease of life through redevelopments with lease extensions. OUE Downtown, which previously housed the headquarters of DBS Bank, is an example of a 99-year leasehold building (the lease commences from 1967) that has undergone a significant facelift.

While creating more quality jobs and business opportunities will be essential for short- to medium-term objectives, Singapore should also not lose sight of the intense competition from rival cities in the region.

Keeping to status quo is not an option to keep Singapore competitive in attracting talent and capital globally. Having long-term land use and infrastructure strategies that are nimble, agile, and resilient will cement Singapore's position in the global race to become a financial hub and a liveable city.

The government's plan to roll out more commercial sites on shorter leases through government land sales is likely to reshape the city's physical landscape and capital investments into commercial real estate markets. The shorter lease should not be the only strategy, but will be a key driver to pivot changes to the future of work.

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