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Seeking Respite in the Shophouse

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Battered by multiple rounds of cooling measures, an air of stillness hangs over the Singapore property market today. Amid the tightened financing and regulatory environment, transaction volumes have fallen and prices have come off their record highs for strata-titled spaces in the office, industrial, residential and retail sectors. Nonetheless, amid the dense fog of uncertainty, an opportunity in commercial shophouses shines though, appealing to investors.

What is a shophouse?

The distinct pre-independence shophouse with its colourful façade and characteristic five-footway is reminiscent of Singapore's mixed cultural heritage. These buildings, that are

reminiscent of Singapore's past, are usually two- to three-storeys high, and have accommodated both businesses and residents since the early days of Singapore's colonial past.

Even in today's modern business environment, there is still a place for the humble shophouse alongside Grade A office buildings. Shophouses are popular with creative outfits, such as those in advertising, public relations, architecture, media and start-ups. While some shophouses continue to house more traditional trades, they have also become a hot spot for cafés, nightspots, lifestyle shops and even boutique hotels in recent years.



At present, sizable clusters of this boutique property type can be found around Singapore. While there are no available official statistics on the total number of shophouses within Singapore's borders, the main concentrations are found in the Central Area along with Singapore's historical development emerging from the central region, and they decrease in density towards the City Fringe and the suburban areas. To conserve Singapore's building and architectural heritage, the government has sought to preserve shophouses to retain the link to Singapore's past. According to the Urban Redevelopment Authority (URA), there are some 6,500 conservation shophouses in Singapore.

Where are the shophouses?

Specifically, three main clusters of shophouses can be found within the Central Business District (CBD). They are located in Tanjong Pagar/Chinatown (the Outram Planning Area), Boat Quay and Kampong Glam (the area bordered by Victoria Street, Jalan Sultan, Ophir Road and Beach Road).



Businesses found in the shophouses of the Tanjong Pagar/Chinatown cluster tend to support the larger corporate entities in the CBD, while those in Boat Quay are associated with the F&B and entertainment sectors. The cluster in Kampong Glam comprises a more eclectic mix of old-school trades, quirky retail businesses and cottage Food and Beverage (F&B) outlets.

Outside the CBD, unassuming shophouse clusters of the past coexist with modern day public flats built by the Housing and Development Board (HDB), private homes and commercial developments in the heartlands. They are found mainly in city fringe areas such as Little India, Geylang and Balestier as well as suburban locations, mostly in the East. For Small and Medium Enterprises (SMEs) that do not need to operate in a CBD location, these small niche shophouse offices are suitable for businesses that wish to avoid the congestion and the crowds, and appeal to those who wish to operate close to the city centre without having to incur the higher costs of a central location. Often, these non-CBD boutique business accommodations are connected to various parts of the city-state via established

transport nodes and road networks, and have proven to be a good alternative to traditional office buildings.

The Little India area (the area bordered by Sungei Road, Jalan Besar and Serangoon Road) is one of Singapore's main ethnic enclaves. Shophouses in this locale play host to various old-school trades such as mom-and-pop stores, hardware shops providing for the nearby resident population, and novelty shops, eateries and even hostels catering to tourists.

Businesses in shophouses located in the Geylang vicinity (the Geylang Planning Area) are largely associated with the F&B, entertainment and hospitality sectors, alongside the flurry of night-time activities that go on in the red light district.

The cluster in Balestier (the Novena Planning Area) is popular with home owners in Singapore looking for a one-stop shop for lighting fixtures as well as foodies looking for famous local fare from yesteryear. Its proximity to the city centre also appeals to operators of hostels and boutique hotels who target budget travellers.

Shophouses in the eastern part of the island (the Tanjong Katong, Joo Chiat and East Coast Road areas) house an eclectic mix of quirky old-school trades, artisan retail businesses and cottage F&B outlets.

With hardly any new shophouses being introduced into the built environment since the modernisation of Singapore, the supply of shophouses has been fairly static and scarce and the investment potential for such property remains intact.

Why shophouse?

Although the shophouse is not suitable for every business type, it may just be the niche solution for SMEs, new start-ups, artistic production companies, and small office outfits in a competitive business environment. Such businesses might have the need to be located in the Central Area to be in close proximity to their customers. However, not every new venture can afford the rents commanded by office buildings in such a prime location. A modest shophouse in the CBD area might offer a financially viable option combined with a whimsical off-the-beaten track format.



Shophouses that are a viable form of accommodation for businesses can also be good investment options for businesses. For companies wishing to plan for future space expansion or F&B and hospitality players hoping to explore business opportunities in the shophouse, the possibility of building new rear extensions bodes well.

While the URA protects¹ these unique building forms, the extent of conservation varies by locality and some are even allowed rear extensions so as to maximise land use in land-scarce Singapore. Conservation is practiced differently in the various

districts, with those in the historic districts subject to the strictest set of conservation guidelines.

In the secondary settlements where conservation is carried out on a streetscape basis, owners may build a rear extension up to the maximum height allowable for the area. For example, the new extension can be as high as eight storeys along the Lorongs (lanes) in Geylang (subject to the Geylang Urban Design Guidelines). The table below shows the allowable number of storeys for new extensions in the various conservation areas.

Conservation Area	Allowable Number of Storeys for New Extensions*
Balestier	Up to 6 storeys
Beach Road	Up to 5 storeys
Geylang	Along main Geylang Road: Up to 5 storeys Up to 6 storeys (west of Kallang Paya Lebar Expressway) Along the Lorongs: Up to 8 storeys Also subject to the Geylang Urban Design Guidelines (GUDG)
Jalan Besar	Up to 6 storeys
Jalan Jurong Kechil	Up to 4 storeys
Joo Chiat	Up to 5 storeys
Mount Sophia	Up to 36 m AMSL
River Valley	Up to 10 storeys
Tanjong Katong	Up to 4 storeys For units Nos. 241 - 259 (odd nos. only): up to 5 storeys
Tiong Bahru	Shophouses: Up to 4 storeys Blocks 55 - 59, 64 - 66, 71 - 82: Not applicable (conversion of entire building)
Upper Circular Road	Minimally, the front 7.5 m of the conservation building must be conserved. The rear portion of the site can be built up to a maximum of 6 storeys. The above is not applicable for units 27, 29, 31 and 33 New Bridge Road where the entire main pitched roof is to be preserved. For the other units, conservation of the entire main building or main pitched roof is encouraged.

*The allowable number of storeys for new extensions is guided by the allowable storey height of the respective Planning Areas and the development type. For landed housing, it cannot exceed three storeys.
Source: URA

Notably, many of these shophouse locations have become, or are becoming popular for accommodating F&B outlets, budget hotels, and office outfits that do not need a space with Grade A building specifications. So much so that the government, in July 2014, disallowed the development of new hotels, boarding houses and backpacker hostels in certain locations, including heritage areas, such as parts of Chinatown and Little India. Again in October 2014, the government added seven new locations where new eating houses in shophouses will not be allowed so as to address the traffic and parking concerns of residents in these areas. These new locations include Changi Road, Upper Paya Lebar Road, Sembawang Road, Kampong Glam, Kampong Bahru Road/Spottiswoode Park Road and Jalan Riang. This is in addition to locations where the government had previously disallowed the setting up of eating houses in shophouses, such as Balestier Road, East Coast Road area, and the Geylang and River Valley Road areas.

Notwithstanding, the current wide range of uses for shophouses has evolved in line with the changing business landscape to accommodate a growing range of businesses. Existing businesses within the trade control areas are able to operate in a less congested and more business-friendly environment, while those that cannot afford traditional office and retail spaces or prefer eclectic premises are still able to find opportunities in these shophouses. The growing popularity of the limited stock of this unique property type has invariably helped to spur interest in such properties and lent support to prices and rents.

Transaction volume

Due to the limited fixed supply of shophouses in Singapore, the volume of transactions is typically less than other conventional strata-titled office units and retail shops. In the five years from 2009 to 2013, an annual average of 290 shophouses changed hands. There were 206 transactions in 2013, down 29.0% from 2012, based on caveats recorded by the URA's Real Estate Information System (Realis). Mirroring the muted sentiments in the overall property market, demand for shophouses has visibly thinned owing to affordability concerns brought on by the implementation of the Total Debt Servicing Ratio (TDSR) framework in June 2013². A total of 112 shophouse transactions were recorded in 2014³, short of the 206 transactions seen in 2013.

Transactions have fallen largely due to a stalemate between buyers and sellers. With the limited stock of shophouses in Singapore, shophouse owners, who are well aware of the intrinsic value of their properties due to their rarity, are not in a hurry to sell unless a deal with a significant premium attached is offered. Additionally, many shophouse owners may be individuals who have been operating small businesses such as mom-and-pop stores, hardware stores or medicine halls for a long time, and therefore are reluctant to sell for sentimental reasons. They are more willing to hold onto this valuable asset, choosing instead to lease it out for recurring income. This further limits the availability of shophouses for sale. Buyers, on the other hand, have generally adopted a wait-and-see attitude in view of the lacklustre sentiments in the property market.

Prices and Rents

Nonetheless, despite the moderated demand in recent times, the median price⁴ of shophouses islandwide has remained largely stable. It generally hovered in the region of \$750 per sq ft (based on land area) in the period from 1Q 2000 to 4Q 2006, and gradually rose to between \$950 per sq ft and \$1,300 per sq ft from 1Q 2007 to 3Q 2009 despite the onset of the global financial crisis towards the end of 2008. The steep ascent started in 4Q 2009, riding on the recovery of the property market following the strong economic growth. The price increase from \$1,455 per sq ft in 4Q 2009 to \$2,754 per sq ft in 4Q 2013, translates to an increase of 89.3% over four years. The median price of shophouses then posted a 37.0% year-on-year increase in 2014 to a record high of \$3,772 per sq ft in 4Q 2014⁵ – a testament to the capital appreciation potential of these unique buildings.

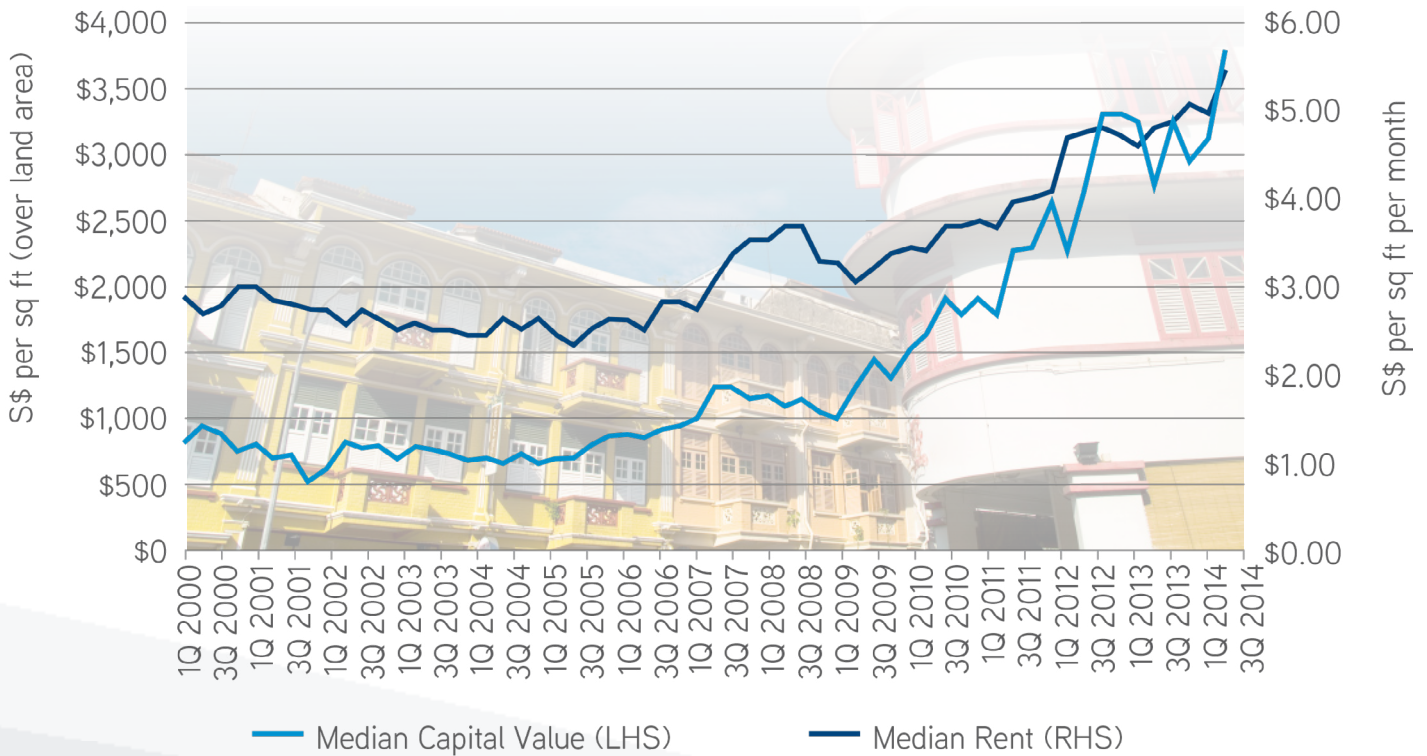
The price escalation reflects a growing interest by companies who have bought self-occupied shophouses in order to have more control over occupancy costs in view of rising rents in the office market over the years. For business owners, the investment and redevelopment potential of shophouses also provides flexibility for expansion and potential capital gains. Additionally, this property type gradually gained traction with investors who realised that there is also healthy demand in the leasing market from architectural firms, design houses, publishing companies and start-ups.



Indeed, the median rent⁶ of shophouses has also been on an uptrend over the last five years. Prior to 2012, the quarterly median rent generally remained below \$4.00 per sq ft per month. In particular, the median rent of shophouses hit \$4.00 per sq ft for the first time in 1Q 2012 and has since risen 35.5% to a record high of \$5.42 per sq ft in 4Q 2014. Yields of

shophouses have fallen as the growth in rents lagged behind the rapid growth in capital values. Presently, the typical net yields for freehold shophouses are in the region of 2.5% to 3.0% and for shophouses with leasehold tenures, the average yields are generally about 3.5%.

Median Prices and Median Rents for islandwide Shophouses



Based on caveats downloaded from URA's Realis as of 16 February 2015
Source: URA, Realis/ Colliers International Singapore Research

Given the reluctance of owners (including deep-pocketed investors) to let go of their prized assets unless their price expectations are met, businesses hoping to operate from a shophouse can only turn to the leasing market to secure premises in choice locations.

On a larger scale, investment companies or joint-venture firms are increasingly looking to lease a contiguous row of shophouses to capitalise on this trend. These investors are interested in a master lease arrangement, whereby as the master lessee, they are able to sublease the shophouses to other parties for a period not exceeding the term of the master lease. This emerging trend is attractive to shophouse owners, as those who do not wish to commit funds for refurbishment or to continue their businesses are able to retain their property assets while enjoying rental income and at the same time, ensure that the properties are properly maintained, given that master lessees will be responsible for all improvement work and maintenance. This form of lease generally entails a longer term lease, usually a minimum of 5+5 years in order for the master lessee to recover the capital expenditure involved in enhancing the properties for

sublease. The upgraded shophouses (usually about 40,000 sq ft or more, spanning across three or more shophouses) are then subdivided and rented out to new, higher rent paying tenants, thereby allowing the master lessee to structure an acceptable return on their investment.

An example of shophouses with a master lease arrangement is 1A Keong Siak Road. Located in a vibrant F&B and entertainment enclave, the four shophouses located next to each other are leased to F&B operators. Also, another four adjoining shophouses at 332 - 338 Tanjong Katong Road in the east region were refurbished and rented to F&B operators.

Bright spots...

Certain pockets of shophouses seem to attract investors looking for such master lease arrangements, and shophouse clusters in the Central Area are now the sweet spots, given that the elevated rents of office space and retail shops in the region have motivated suitable commercial space users to consider

shophouses.

Specifically, the development of the Marina Bay area and its planned extension to the Ophir-Rochor corridor will undoubtedly benefit the centrally-located shophouse clusters as space demand from businesses that do not need traditional office space and/or are unable to pay top dollar for typical commercial space spill over to the peripheral areas. The ongoing transformation of the Ophir-Rochor corridor into a new growth area extending from the commercial hub at Marina Centre will feature mixed developments such as DUO, South Beach and City Gate - offering offices, hotels, residential and other complementary facilities set within a garden-like environment. As part of the larger development plans for the area, another commercial and residential plot located between Beach Road and Rochor Road has also been put up on the Reserve List⁷ of the Government Land Sales Programme. Accessibility will also be enhanced with the new Bugis Mass Rapid Transit Interchange Station where the Downtown and East West Lines meet, offering a convenient rail connection from the financial and business hub at Raffles Place and Marina Bay to the shopping, dining and entertainment destinations at Orchard Road and the Singapore River, as well as Singapore Changi Airport.

Both prices and rents of commercial property offerings in the area are set to remain elevated in view of the area's development over the next 10 to 15 years. While prices and rents for shophouses in the area are also expected to appreciate over the long term, they are likely to remain a more affordable

alternative compared to the typical commercial developments with office and retail space.

Notably, as of 4Q 2014, the average monthly gross rent for office space in the area ranged from \$6.00 per sq ft at older buildings to \$7.80 per sq ft at newer premises. Retail malls, which are increasingly institutionalised under a Real Estate Investment Trust (REIT) structure, charge a step-up rent in addition to a pre-agreed percentage of the gross turnover. Average monthly gross rents of prime ground floor retail space in the major malls around Bugis range from \$22 - \$41 per sq ft per month as of 4Q 2014.

In contrast, the median rent of shophouses in the CBD is comparatively more affordable. These include the shophouses in the charming Kampong Glam historical district. Flanking the Ophir-Rochor area, the shophouse cluster, which includes Haji Lane, Jalan Sultan and Arab Street, commands a median gross rent of \$4.96 per sq ft per month as of 4Q 2014, up 22.5% compared to 4Q 2013. The cluster is likely to benefit from the makeover of the locality over time.

Nearer to the city core, the shophouses in the Tanjong Pagar cluster, which includes those in the Duxton, Keong Siak and Club Street, are also likely to enjoy some spill-over demand from businesses wanting to have a piece of the action. These shophouses fetched a monthly median gross rent of \$6.18 per sq ft per month as of 4Q 2014, compared to \$5.31 per sq ft a year ago.

Generally, the median rent of CBD shophouses ranged from \$4.93 to \$6.18 per sq ft per month in 4Q 2014. The following table provides details of the latest available number of shophouse transactions, median prices and median rents for the three shophouse clusters within the CBD. With the



Tanjong Pagar / Chinatown		4Q 2013	1Q 2014	2Q 2014	3Q 2014	4Q 2014**
	TRANSACTION VOLUME (UNITS)	3	5	3	6	8
	MEDIAN PRICE (\$ PER SQ FT)	7,818	6,247	6,695	6,506	5,629
	MEDIAN RENT (\$ PER SQ FT PER MONTH)	5.31	5.35	5.51	5.70	6.18



Boat Quay		4Q 2013	1Q 2014	2Q 2014	3Q 2014	4Q 2014**
	TRANSACTION VOLUME (UNITS)	0*	0*	0*	0*	0*
	MEDIAN PRICE (\$ PER SQ FT)	4,600	4,600	5,000	5,000	5,000
	MEDIAN RENT (\$ PER SQ FT PER MONTH)	4.51	5.44	7.11	5.16	4.93



Kampong Glam		4Q 2013	1Q 2014	2Q 2014	3Q 2014	4Q 2014**
	TRANSACTION VOLUME (UNITS)	3	3	0*	1	2
	MEDIAN PRICE (\$ PER SQ FT)	3,741	5,132	5,000	3,125	3,804
	MEDIAN RENT (\$ PER SQ FT PER MONTH)	4.05	4.16	4.86	4.17	4.96

* Quarterly periods without any transactions have been imputed with a valuation-based opinion of median price.

** Based on records downloaded from the URA's Realis on 16 February 2015

Source: URA Realis/Colliers International Singapore Research

rents of shophouses still looking very competitive, the modest shophouse offers a financially viable option combined with a whimsical off-the-beaten track format.

Conclusion

The distinctive shophouse is a rare and highly-valued asset class due to its scarcity. It is also treasured for its historical value and its ability to house various types of commercial uses. The range of businesses found in shophouses is expanding and this bodes well for landlords and master lessees who are looking to generate some form of return from these prized assets. Notwithstanding the cyclic fluctuations in transaction and price levels, the omnipresent demand from property owners, businesses and occupiers presents a potential upside for prices and rents. The rare and vernacular shophouse steeped in history continues to generate a steady, if not increasing, income stream and remains in demand in modern day Singapore where even the man on the street appreciates the nostalgic throwback to Singapore's past.

¹ Most shophouses are conserved in the three conservation areas: the historic districts of Boat Quay, Chinatown, Kampong Glam and Little India; the residential historic districts of Blair Plain, Cairnhill and Emerald Hill; and the secondary settlements, which include Balestier, Beach Road, Geylang, Jalan Besar, Jalan Jurong Kechil, Joo Chiat, Mount Sophia, River Valley, Tanjong Katong, Upper Circular Road and Tiong Bahru.

² On 28 June 2013, the Monetary Authority of Singapore (MAS) introduced the Total Debt Servicing Ratio (TDSR) framework for all property loans granted by financial institutions (FIs) to individuals. This framework requires FIs to take into consideration borrowers' other outstanding debt obligations when granting property loans to help strengthen credit underwriting practices by FIs and encourage financial prudence among borrowers. In particular, the MAS expects any property loan granted by an FI to not exceed a TDSR threshold of 60%. Additionally, rules related to the application of the existing Loan-to-Value (LTV) limits on housing loans were refined to ensure the effectiveness of LTV limits that were put in place to cool investment demand in the housing market. In particular, the refinements aimed to prevent circumvention of tighter LTV limits on second and subsequent housing loans.

³ Based on caveats downloaded from URA's Realis on 16 February 2015

⁴ The median price from Realis is dependent on the number and type of sales transactions that occurred during the quarter. These, in turn, depend on factors such as the location and age of the property, as well as the facing and size of the unit.

⁵ Based on caveats downloaded from URA's Realis as of 16 February 2015

⁶ Median rents from Realis are dependent on the number and type of leasing transactions that occurred during the quarter. This in turn depends on factors such as the location and age of the property, as well as the facing and size of the unit.

⁷ The government sells land for development via the Government Land Sales Programme. A site placed on the Reserve List System will be put up for open tender if a developer's indicated minimum price is acceptable to the government.

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