



S A P O A

RESEARCH



# Operating Cost REPORT



An MSCI Brand  
Report compiled by IPD

## RESEARCH

### KEY FINDINGS



For the year ending December 2013, operating costs on an All Property level continued to grow at a rate in excess of consumer price inflation. In nominal price terms, total operating costs per square meter increased by 11.9% y/y – +5.9% y/y adjusted for inflation.



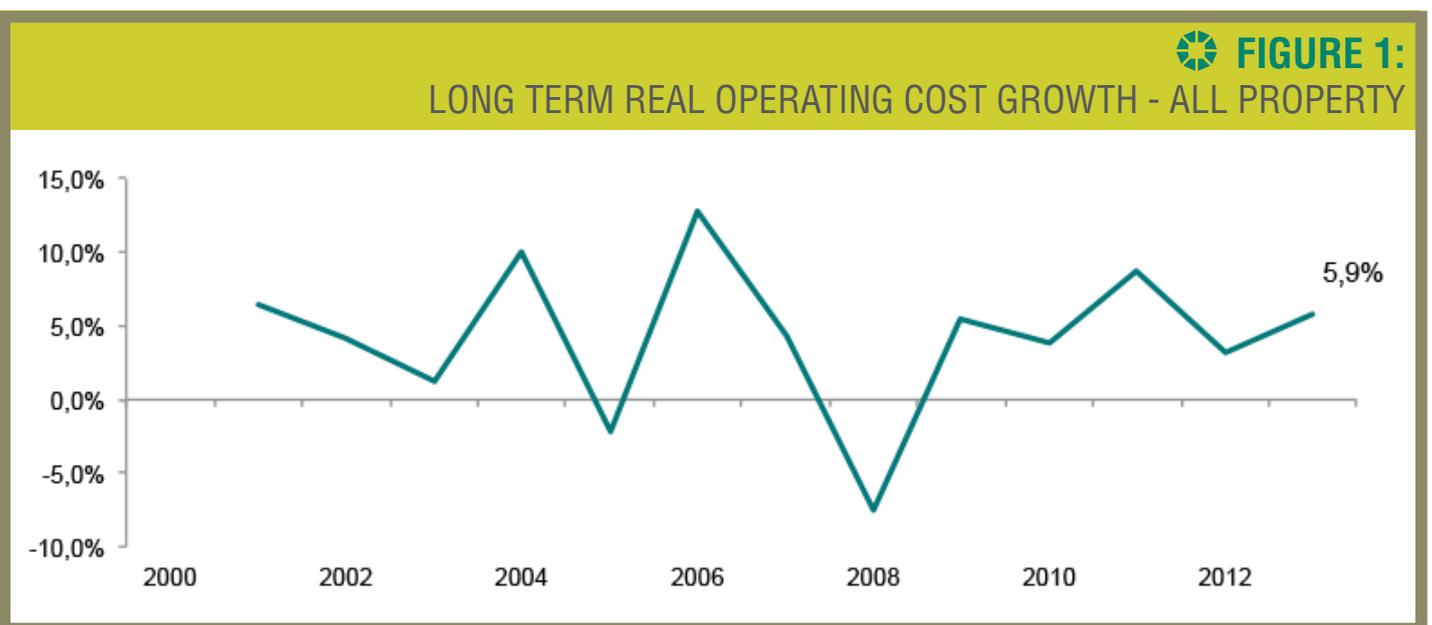
Retail operating costs grew by 14.5% over the past year topping the list in terms of cost growth. Retail also remains the sector with the highest absolute levels of operating costs.



Administered costs continue to push operating expenses higher and subsequently dilute net income growth. For the year ending December 2013, administered costs rose by 13.5%, and as a result of its relatively high weighting, contributed 8.2% of the 11.9% overall increase in operating costs.

### Nominal growth in Total Operating Cost

| All Property | Retail | Office | Industrial |
|--------------|--------|--------|------------|
| +11.9%       | +14.5% | +3.4%  | +7.0%      |



## Operating costs driven by administered price increases

For the year ending December 2013, operating costs on an All Property level continued to grow at a rate in excess of consumer price inflation. In nominal price terms, total operating costs per square meter increased by 11.9% y/y – a 5.9% increase in real/inflation-adjusted terms.

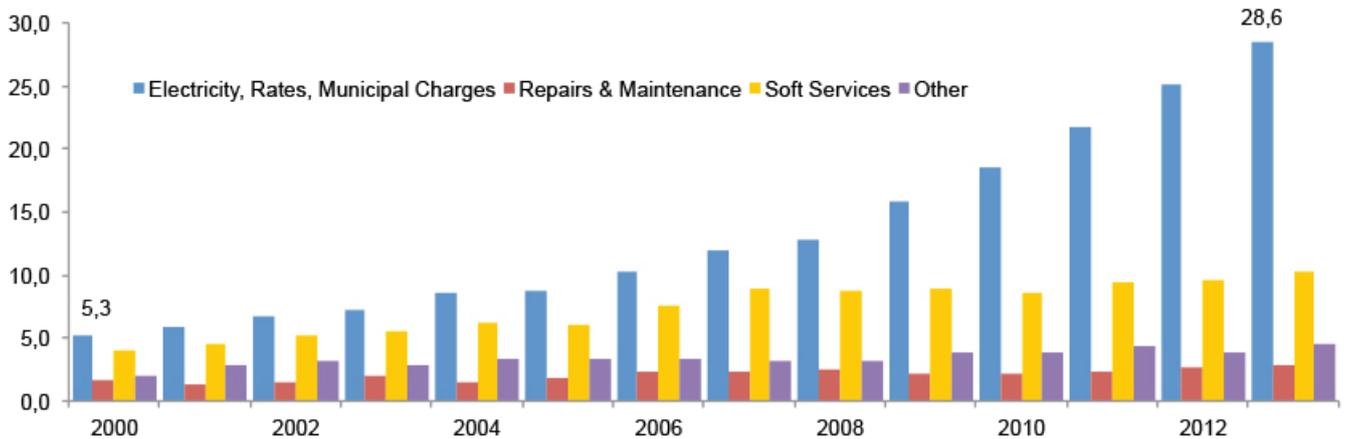
Administered costs continue to push operating expenses higher and subsequently dilute net income growth. For the year ending December 2013, administered costs rose by 13.5%, and as a result of

its relatively higher weighting, contributed 8.2% of the 11.9% overall increase in operating costs. All other costs increased by 9.5% year on year.

For the period under review, the largest contributors to the increase in operating costs were Electricity and Rates & Taxes. These two categories contributed just under two thirds of the 11.9% year on year growth. Municipal rates & taxes increased by 20.1% y/y contributing 4.2% while Electricity costs rose by 10.2% y/y contributing 3.4% to the overall increase.

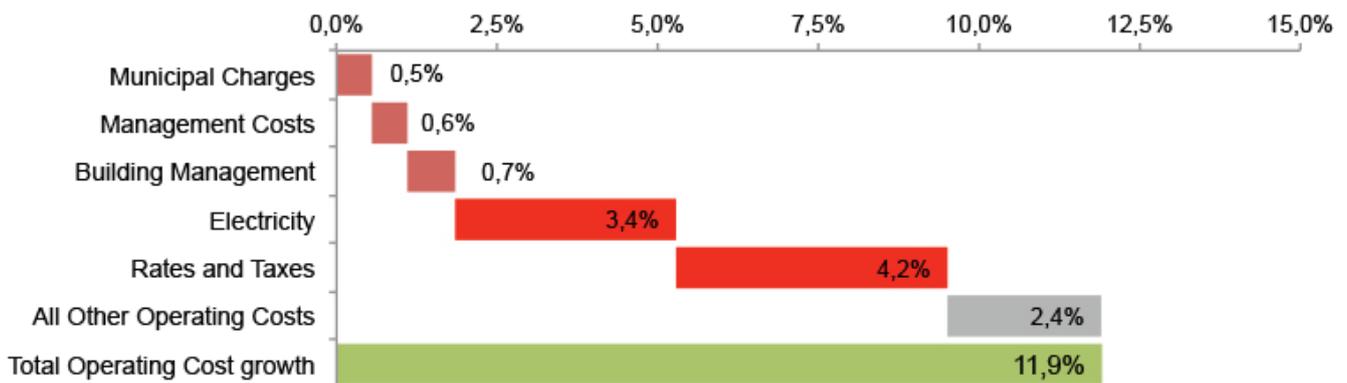
 **FIGURE 2:**

LONG TERM TREND OF SELECTED COST CATEGORIES – ALL PROPERTY - R/SQM/MONTH



 **FIGURE 3:**

WEIGHTED CONTRIBUTION TO TOTAL OPERATING COSTS – 2013



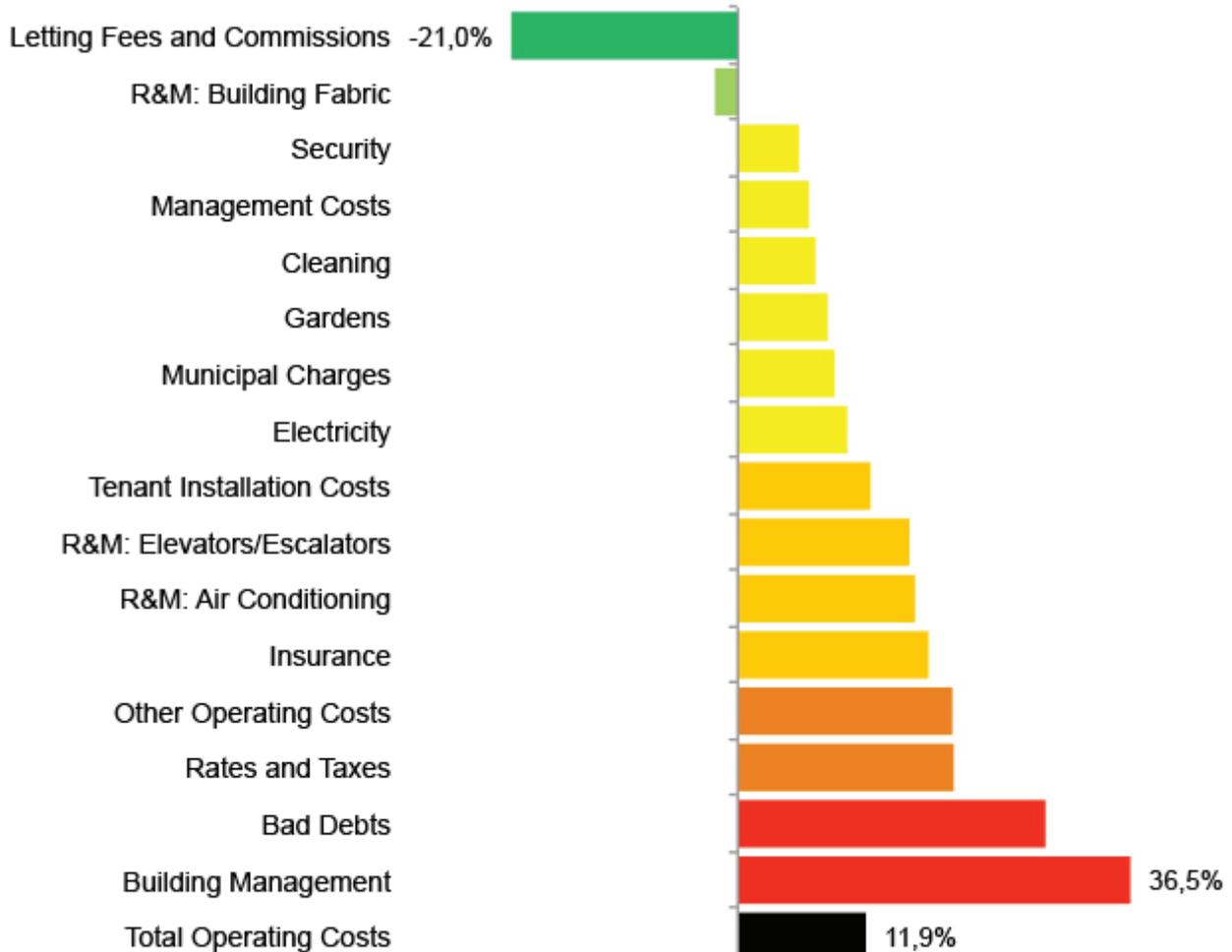
## Service-related charges contribute to overall cost growth

Other cost categories that contributed strongly to the overall increase were largely service-related charges. The costs associated with building management, cleaning and gardens rose by 16.3% y/y which contributed 1.1% to the overall 11.9% operating cost growth. Indicative of the current macroeconomic environment, the amount of bad debts written off rose by 28% y/y while letting fees and commissions declined by 21% y/y.

However, the current level of bad debts at 40c/sqm/month remains well below that of 2009 when monthly write-offs peaked at 90c/sqm. A double digit increase in the level of tenant installation costs per square meter also underline the importance landlords are attaching to tenant retention in the current environment. In real terms, tenant installation allowances are currently at a similar level to 2002 when vacancies peaked in the previous cycle.

 **FIGURE 4:**

### ANNUAL NOMINAL GROWTH PER COST CATEGORY – 2013



## Retail property experiencing largest increase in costs

On a sector level, Retail property recorded the highest year on year increase in operating costs at 14.5% (8.4% in real terms) followed by industrial at 7.0% and offices at 3.4%. The growth in Retail and Industrial operating costs were driven largely by administered cost increases.

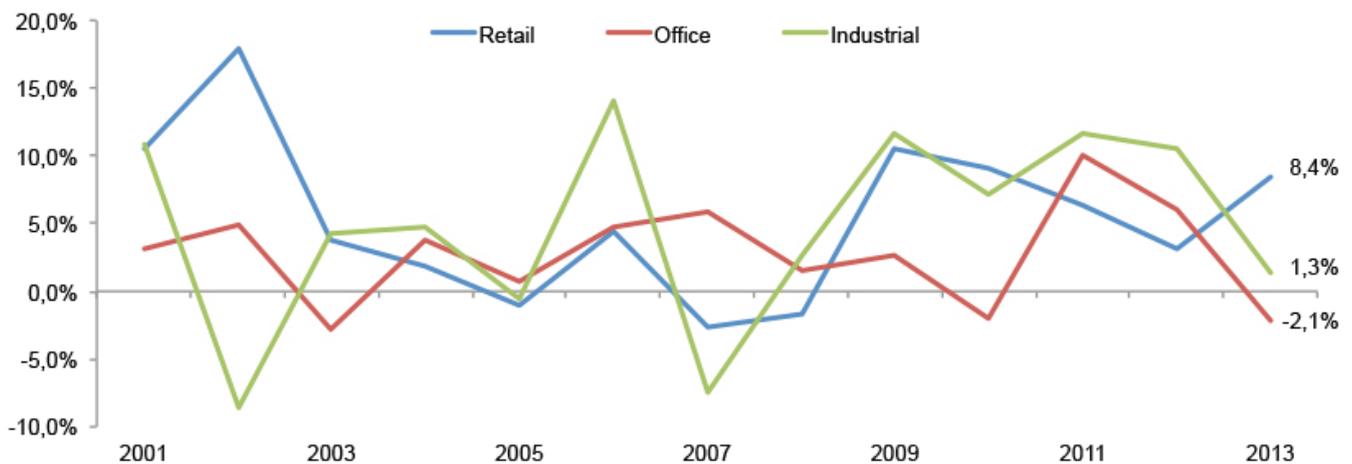
The relatively low nominal year on year operating cost increase of 3.4% in the office sector may seem surprising but the last year should be viewed in the context of the last five years during which operating costs recorded significant growth. For the 5 years to December 2012, operating costs in the office sector grew at a compounding rate of 10.8% per annum, driven by a compounded annual growth rate of 22% p.a. in electricity. So the current rate of growth should be viewed in the light of this higher base.

Operating costs in the Retail sector continues to make up a larger percentage of Gross Income relative to the Office and Industrial sectors. As at the end of 2013, retail operating costs stood at 38.2% of gross income compared to the office sector at 33.3% and industrials at 31.5%.

On a segment level, the largest annual increases in operating costs were recorded in the Warehousing (+19.6%) and Other Retail (+11.7%) segments. Like many of the other property segments, operating costs in the Warehousing segment were pushed higher by Electricity and Rates & Taxes. However, of all the property segments Warehousing experienced the largest increase in letting commissions which is reflected in a lower vacancy rate compared to a year prior.

 **FIGURE 5:**

REAL OPERATING COST GROWTH PER SECTOR – 2013



## Spread between prime and secondary margins

There continues to be a divergence between prime and secondary property types with better quality properties producing a superior income margin to landlords. When analysing operating costs as a % of gross income, Shopping Centres larger than 50,000sqm averages 36% while all other retail centres averages 43%. Within the office sector, prime office costs come in at 27% of

gross income while secondary offices recorded 38%. Among the industrial property types, Warehousing and High-Tech industrial recorded an average operating cost as a % of gross income of 28% compared to the 36% of low-grade manufacturing and standard industrial units.

 **FIGURE 6:**

### SPREAD BETWEEN PRIME AND SECONDARY PROPERTY COST TO INCOME RATIOS

Cost to Income ratio

