SYDNEY CBD

OFFICE MARKET UPDATE

CI AUSTRALIA

Q2 2019

EXECUTIVE SUMMARY.

Welcome to our Q2 2019 Office Market Update. We explore leasing activity, supply, investment and development activity, market trends and more.

The market appears to be stagnant with minimal improvements from the net absorption that was recorded in July 2018. The vacancy rate continued to drop in the lead up to January 2019, tightening from 4.6% to 4.1%. This demonstrates that the drop in net vacancy was due to market withdrawals across Primary and Secondary grade properties.

Of course, we address and analyse the limited supply and tight competiton that remains a defining trend of the Sydney office market. Secondly, we explore how Sydney's position as a world-class city is playing a key role in attracting international businesses to the market, the impact of this, and how the strong New South Wales economy is driving take up of space. A flow-on effect of this is that the ongoing tight vacancy will continue to trigger rental growth and maintain current incentives.

We hope you find this report interesting, and a useful reference tool. All data quoted is either CI Australia Research, RCA Analytics, or Research from the Property Council of Australia (January 2019 data release).

If you have questions or would like to request bespoke research or investment analysis, we'd be delighted to speak with you.

Andrew Hunter
ahunter@ciaustralia.com.au
+61 418 222 522

CO-WORKING GOES **PREMIUM**.

In March 2019 it was announced that operator Hub Australia had taken space in Sydney's historic Customs House at Circular Quay. Set to open in August, the approximate 2,300sqm lease will occupy two levels and mark Hub's seventh site across the country. It was reported that the location is aimed at targeting smaller businesses and international companies who are looking for premium space in the CBD. And it appears international companies are fond of coworking space too, with operator Victory Offices reporting that 30% of its space at 420 George street is precommitted to by multinationals.

THE CITY THAT **NEVER SLEEPS?**

With the continuation of mixed-use developments that balance work, life and play, Sydney's position as a world-class city is growing. There are set to be potential changes to the hours in which the city 'officially 'operates, including a draft Development Control Plan (DCP) which proposes changes including a '24-hour city centre where businesses can trade 24 hours a day'.

This zone would stretch from Darling Harbour in the west to Hyde Park in the east and Central Station in the south. Most venues in this area can currently trade until 5am. Public feedback was welcomed on the draft DCP until earlier this year, which also included late night precincts in Glebe and Green Square.

METRO MAKES ITS MOVE.

Withdrawals and tightening vacancy rates have generated growth in CBD Prime rents by 7.1% in the 12 months to January 2019 - making the thriving Metropolitan markets such as Parramatta, Macquarie Park and the North Shore even more attractive for businesses looking for a more cost effective solution that still boasts impressive amenity.

It is likely that the Metropolitan markets will remain on the list for a growing pool of tenants, as the CBD potentially continues to increase in price and tighten in space. New precincts such as South Eveleigh and infrastructure improvements in key Fringe and Metropolitan markets will generate ongoing demand, too.

AS DOES **THE NSW GOVERNMENT**.

In April it was revealed that Charter Hall had signed the New South Wales State Government as a major tenant within 231 Elizabeth Street, ahead of the current lease expiry of anchor tenant Telstra. The 12-year lease, commencing in 2020, will see the Government occupying over 21,000sqm of space of the Southern CBD asset and centralise almost 2,000 public sector workers from varying CBD locations.

SPOTLIGHT.

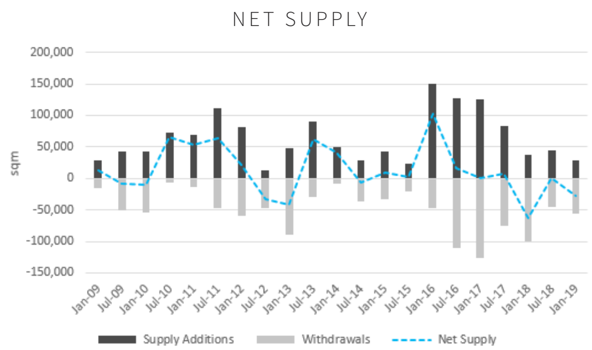
THE SUPPLY STORY.

Supply in the Sydney CBD remains a talking point - unsuprising really, given vacancy is at a record low of 4.1%. There is however some supply set to come online in 2019 in the form of both new developments and refurbishments. This is in addition to the 20,795sqm which recently completed within Barrack Place at 151 Clarence Street.

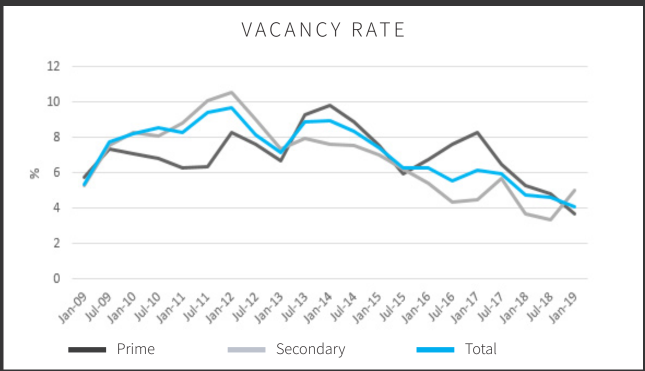
New developments:
10 Carrington Street - 68,000sqm
50 Bridge Street - 88,000sqm
33 Pitt Street - 55,000sqm

Full refurbishments:
24 Campbell Street - 14,860
66 King Street - 6,321sqm
283-285 Clarence Street - 1,878sqm
388 George Street - 38,500sqm
320 Pitt Street - 28,800sqm

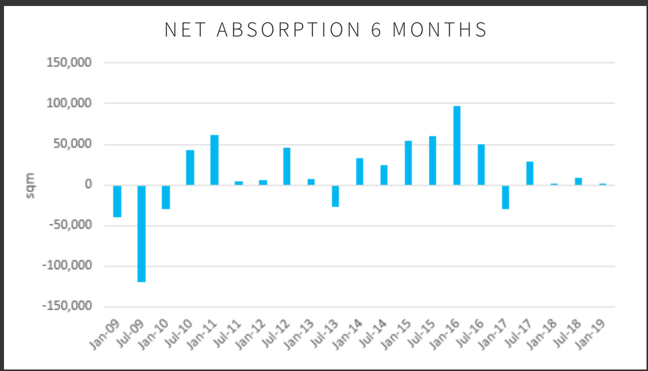
Withdrawals:
Secondary Grade building withdrawals totalled 16,647sqm in the six months to January 2019 - a significant reduction from the 45,122sqm of space that was withdrawn in the first half of 2018. Factors which contributed to these Secondary Grade office withdrawals include Government-led infrastructure projects, asset refurbishments and change of use through redevelopment.



VACANCY & RENTS.



Source: PCA/CI



Source: PCA/CI

4.1%

TOTAL VACANCY FOR SYDNEY CBD.

This is the lowest result since January 2008. A-Grade space was in demand with a vacancy rate of 3.6%.

BARANGAROO/ WALSH BAY

BIGGEST DROP IN VACANCY

Walsh Bay continued to tighten, with vacancy dropping from circa 9.2% as at July 2018, to 7.8% as at January 2019. A recent high profile move to the area was advertising agency Clemenger, which relocated from its former home at 120 Pacific Highway, St Leonards. The increased connectivity due to new infrastructure - Wynyard Walk & Barangaroo Ferry Terminal – continue to make the precinct attractive and accessible.

SOUTHERN CBD

BIGGEST INCREASE IN VACANCY

The biggest increase in vacancy was within the Southern CBD precinct, which rose from 0.6% vacancy in August 2018 to 6.9% in January 2019. This was due to approximately 18,000sqm of space that became available to the market within 477 Pitt Street.

Total Stock	Premium	A	B	C	D	Total
Jan-09	680,230	1,643,263	1,556,895	639,832	221,366	4,741,586
Jan-19	1,162,107	1,825,649	1,380,675	453,893	186,909	5,009,233
% change of stock	71%	11%	-11%	-29%	-16%	6%

Total Vacancy	Premium	A	B	C	D	Total
Jan-09	6.8	4.7	5.2	6.3	4.4	5.4
Jan-19	3.8	3.6	4.5	4.8	5.8	4.1

Source: PCA/CI

CBD Rents are at record levels. Net effective rents in Secondary Grade buildings have grown at a higher rate than those in Prime buildings. There is also a disparity in stock between Secondary and Prime, with many C and D-Grade buildings having been demolished for redevelopment.

This has seen former occupants of Secondary assets moving into higher grade buildings; and the lack of Secondary stock exerting further pressure on this rental grade.

This means that while those tenants who have made the move have been able to allocate funds for a traditional three to five-year lease term, some smaller businesses and start-ups have not. This has encouraged the smaller end of the market to further explore co-working and flexspace options for not only a more cost effective option, but also due to agility, services and the opportunities for collaboration this type of space can provide.

From the above chart, we can see that in the 10 years to January 2019, the market has been focused on achieving quality and satisfaction of space. There has been a significant shift to Premium assets, with an additional 481,877 sqm of space. This represents a 9% increase in the percentage represented by premium assets within total office stock.

Exploring the change in total stock and vacancy over the same 10-year period, it is clear that the level of Secondary Grade stock has reduced significantly over this period - the greatest reduction in C-Grade with -29% stock now than in January 2009. This is followed by -16% in D-Grade and -11% for B Grade. Comparatively, Premium Stock increased 71% over this period, as did A-Grade with a more modest 11% rise. Overall this had led to a **6% increase in stock** overall for the CBD.

When tracking vacancy alongside these changing stock levels, vacancy rose in D-Grade space in the six months to January 2019, from 1.9% to 5.8%.

RECENT LEASING TRANSACTIONS

Address	Tenant	NLA (sqm)	Lease Commencement	Term (years)
Circular Quay Tower	Deloitte	32,000	2023	10
60 Martin Place	Norton Rose Fulbright & Henry Davis York	7,200	Jan-20	12
151 Clarence St	Mills Oakley Lawyers	5,673	Jan-19	11
225 George St	Sonic Healthcare	2,803	Oct-18	10
64 York St	WeWork	3,600	Aug-18	U/D
100 Barangaroo St	Origin Energy	7,765	Jul-18	10
201 Sussex St	Dimension Data	6.000*	Jul-18	10
126 Phillip St	NSW Treasury Corp	2,888	Jun-18	7

Source: CI

* Approximately.

SYDNEY CBD RENTS & INCENTIVES

Grade	Region	Average Net Face Rents ($/m2 pa)		Average Gross (%) Incentive	
		LOW	HIGH	LOW	HIGH
Premium	Core	$1,050	$1,750	17	22
	Barangaroo	$1,000	$1,400	23	25
	Mid Town	$1,100	$1,250	15	20
	Western Corridor	$1,000	$1,200	17	22
A Grade	Core	$980	$1,250	12	18
	Mid Town	$950	$1,200	12	18
	Western Corridor	$900	$1,200	13	15
	Southern	$850	$1,100	12	15
B Grade	Core	$850	$1,200	12	17
	Mid Town	$800	$1,100	12	15
	Western Corridor	$780	$1,050	10	15
	Southern	$780	$900	10	15
C Grade	Core	$750	$850	12	15
	Mid Town	$700	$780	12	16
	Western Corridor	$650	$750	12	16
	Southern	$650	$750	12	17

Source: CI

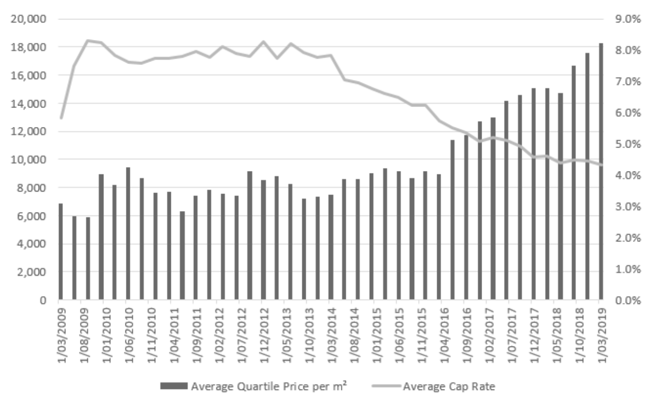
> *Both domestic and offshore buyers remain hungry for well performing CBD office assets. Sydney's strong fundamentals including the record low vacancy, rental growth and the completion of new developments, including major infrastructure projects, will ensure demand remains strong throughout 2019.*

MICHAEL STOKES

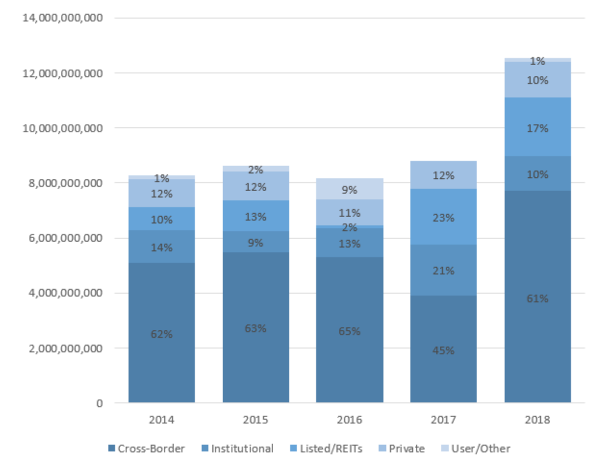
DIRECTOR, CAPITAL TRANSACTIONS

INVESTMENT & CAPITAL FLOWS.

AVERAGE $/SQM & CAP RATE



BUYER COMPOSITION



Source: RCA Analytics

Sydney CBD continues to be a favourable market for both offshore and domestic institutional investors, due to its low risk profile and ability to achieve maximum and stable income returns.

2018 saw a record high of approximately $12.5 billion in total sales volume, $6 billion above the historical average for the past 10 years.

Cross-border investors remained the main contributor to the CBD market, accounting for a total of $7.7 billion in sales volume. OMERS Oxford was a prominent player in 2018, acquiring the Investa Office Fund portfolio for $3.4 billion, comprising of 19 prime office assets across Sydney, Melbourne, Brisbane, Perth and Canberra. Seven of these 19 assets were located in Sydney CBD, valued at $2.19 billion. Other major cross-border investment into the Sydney CBD originated from the US and Asia Pacific including China, Macau and Japan.

> *"Japanese and Singaporean investors remain active participants in the Australian investment market; heavily involved in Australian superannuation funds. Coupled with the ongoing performance of the CBD market and attractive returns for investors compared to local assets, it is possible they will remain as key contributors."*

Rikki Wu

Head of Asia Desk

2019 is already playing host to major investment transactions. These include GPT's sale of its stake in the iconic MLC Centre to Dexus Wholesale Property Fund for $800m.

This followed a number of key transactions in 2018, including the sale of 10 Shelley Street for $804m by Charter Hall (December 2018); Rest's $912 million stake in AMP Capital's 50-storey Quay Quarter Tower (April 2018); and Mirvac exercising its pre-emptive rights over a 50% stake of Westpac Place (275 Kent St) from Blackstone for $721.9 million.

Date	Address	Price (A$)	Cap Rate	Owner/Buyer	Seller
Apr-19	MLC Centre	800,000,000#	4.9%	Dexus	GPT Group
Dec-18	60 Margaret Street	420,000,000	4.9%	Blackstone RE Asia	One Managed Investment Funds
Jul-18	Westpac Place 275 Kent St	874,526,476#	4.5%	Mirvac Group, ISPT	Blackstone
Jul-18	Piers 8 & 9 23 Hickson Rd	90,500,000.00*	6.6%	Markham Corporation	Sumner Capital, sitEX Properties AG
Jun-18	117 Clarence St	153,000,000.00	5.4%	Investa Property Group	Roxy-Pacific, Tong Eng Brothers Pte Ltd
Jun-18	Allianz Centre 2 Market St	285,529,439#		Charter Hall REIT	Allianz

*Approx. #The sale represents a half stake

Source: RCA Analytics

TO 2020
& BEYOND.

Looking into future CBD developments.

Sydney CBD is home to a number of key infrastructure and commercial developments that are currently underway or planned. Many of these will help cement Sydney's position as a world city, increase connectivity in and out of the CBD, and cater to demand for mixed-use assets that allow people to live, work and play.

While new supply will increase vacancy, it is unlikely to affect investors' view of the market. Pre-commitments from tenants and the strong market fundamentals will ensure new assets remain low risk investments. In fact, it is estimated that there is over 765,000 sqm worth of office space currently under construction across the national CBD markets. This represents 4.4% of total stock in the CBD markets.

Key projects include AMP's 50-storey Quay Quarter Tower and the adjoining high-end luxury residential apartments on Loftus Lane; Lendlease's Circular Quay Tower, which at the ground floor will be pedestrianised with cafes, bars and shops; and Macquarie Group's 40-storey tower proposal, which will sit above the future Martin Place Metro station. A further $3.1 billion (approximate) of approved works are yet to commence and scheduled for completion by 2025.

To stay competitive with new developments and to capture higher rents, existing buildings are also undergoing partial or full refurbishments, particularly Prime assets which are attracting high levels of pre-commitments. Refurbishments not only strengthen tenant attraction and retention, but increase the pool of assets that investors may eye in the future.

Project name	Cost ($)	Types	Status	Actual/Expected Completion
Sydney Metro North West	8.3B	Road	Construction	2019
Barangaroo Tower	2.2B	Mixed use	Construction	2021
4-6 Bligh Street	700M	Mixed use	Planning Proposal Applied	2022
Wynyard Station upgrade	115M	Rail	Completed	2016
Wynyard Walk	306M	Pedestrian Link	Completed	2017
Barangaroo Ferry hub	50M	Ferry	Completed	2017
CBD & South East Light Rail	2,100M	Rail	Construction	2019
Quay Quarter Tower	3B	Commercial	Construction	2021
Circular Quay Tower	1.5B	Commercial	Construction	2021
Circular Quay upgrade	200M	Ferry	Market Process Phase 2	2020
Sydney Metro	10,500M	Rail	Construction	2024

*All figures approximate. Source: CI

DEVELOPMENT PIPELINE.

Source: CI

60 Martin Pl
NLA: 38,600
Premium
Stage: Construction
Owner: Investa

275 George St
NLA: 7,263
Stage: Site Works
Owner: John Holland Group

320 Pitt Street
NLA: 28,000sqm
Refurbishment of existing asset
Owner: ARA Asset Management

388 George St
NLA: Refurbishment
Grade: A-Grade
Stage: Construction
Owner: Investa & Brookfield

Wynyard Place
10 Carrington St
NLA: 58,974
Premium
Stage: Site Works
Owner: Sovereign Wynyard Centre

55 Market Street
NLA: 20,000sqm
Refurbishment of existing asset
Owner: Mirvac

Quay Quarter Sydney
50 Bridge St
NLA: 88,274
Premium
Stage: Construction
Owner: AMP Capital Investors

210 George St
NLA: 16,500
A-Grade
Stage: DA Approved
Owner: Poly Real Estate

255 George Street
NLA: 22,500
Refurbishment of existing asset
Owner: AMP

Circular Quay Tower
180 George St
NLA: 55,000
Premium
Stage: DA Applied
Owner: Lendlease

Kindersley House
33 Bligh St
NLA: 24,000
A-Grade
Stage: DA Approved
Owner: Investa & Ausgrid

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OUR TEAM

MIKE STOKES

DIRECTOR, CAPITAL TRANSACTIONS

+61 418 251 579

BEN KARDACHI

DIRECTOR, COMMERCIAL LEASING

+61 419 230 278

TOBY ANDERSON

SENIOR EXECUTIVE, LEASING

+61 409 906 580

BEAU STEWART

DIRECTOR, TENANT REPRESENTATION

+61 400 505 545

RIKKI WU

HEAD OF ASIA DESK

+61 400 505 545

CI AUSTRALIA PTY LIMITED
Level 4, 35 Clarence Street
Sydney CBD, 2000
www.ciaustralia.com.au