SYDNEY CBD

OFFICE MARKET UPDATE

CI AUSTRALIA

Q3 2019

CI

EXECUTIVE SUMMARY.

Welcome to our Q3 2019 Office Market Update where we analyse the current leasing activity, supply, investment and development activity in the Sydney CBD.

The release of the Property Council of Australia's Office Market Report in August 2019, reveals that Sydney CBD is currently experiencing record low vacancy rates.

In this update, we analyse the trends driving these low vacancy rates and the impact this is having on effective net rents and incentives. We also comment on the increased competition from metro markets such as North Sydney and Parramatta and their effect on demand in the Sydney CBD.

From an investment perspective, Australia continues to experience strong demand from both onshore and offshore investors which has helped fund purchases such as Chifley Tower and the MLC building, Martin Place. We are also seeing an increased appetite from North America. In this update, we look at key purchases and developments and further benchmark Sydney CBD yields with other major international cities.

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 (August 2019 data release).

If you have questions or would like to request bespoke research or investment analysis, please don't hesitate to contact us.

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SPOTLIGHT.

WHO'S ON THE MOVE?

As the Sydney CBD leasing market becomes more competitive, North Sydney is increasingly becoming an attractive option for accommodation. This is evidenced by the Tax Institute of Australia's recent move from 175 Pitt Street in the CBD into 50 Miller Street, North Sydney and Horticulture Innovation's move from 1 Chifley Square to 141 Walker Street, North Sydney. Other movements include QBE taking up 11,950sqm at 388 George Street, consolidating their current offices at Chifley Square and 2 Park Street. They will be joining First State Super who has also taken 9,500 sqm in the same building. Moves also see Deloitte Australia taking up residence at 50 Bridge Street, moving from 225 Grosvenor Place.

STRATA HEATS UP.

Small to medium business are increasingly making use of strata offices in order to control their leasing expenses and investment value. Typically, strata offices have appealed to accountants and smaller service businesses, however, recent changes to NSW legislation means there is increased competition as developers are now looking to snap up strata buildings for site amalgamation and future redevelopment. Further, as vacancy rates remain low and rents high, occupiers are looking to more affordable CBD options. Currently, there is more than 650,290sqm of strata office space within the Sydney CBD.

METRO CLOSING IN.

The Sydney CBD landscape is changing rapidly as Australia's largest public transport project, the Sydney Metro, inches closer to completion. The Sydney Metro is set to make the city more productive through mass transit of 40,000 people per hour. Services are expected to start in December 2019, which will see a significant increase in the commercial population of the CBD and further impact the commercial floor space available.

COWORKING HERE TO STAY.

The real estate market has shifted and whilst some have questioned the viability of coworking, it has become more than just a buzzword. Co- sharing giant, WeWork, has reached 10 Sydney CBD locations in just three short years and has just leased a further 11,00sqm across 10 floors at 320 Pitt Street. This is no doubt an attractive location given the upcoming completion of the Sydney Metro and the pedestrianisation of George Street. The rise of flexible workspaces is changing the real estate landscape as the likes of WeWork sublease to those companies that previously would have secured larger long term leases themselves.

THE SUPPLY STORY.

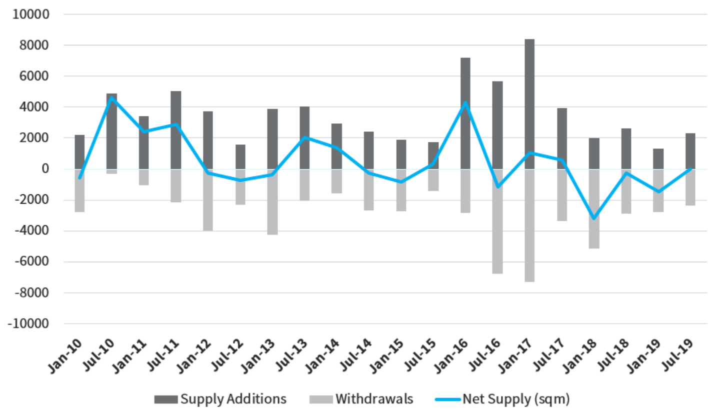
Currently sitting at 3.7%, vacancy is now only 0.1% above the lowest ever recorded vacancy rate. However, with significant supply in the pipeline, the Sydney CBD vacancy rate is highly likely to experience a shift. According to the PCA, there is 63,115sqm set to come online in the second half of 2019, followed by a further 131,518sqm in 2020 and 304,082sqm from 2020 onwards.

New developments under construction:
60 Martin Place - 40,000sqm
10 Carrington Place (Wynyard Place) - 68,000sqm
50 Bridge Street (AMP Tower) - 88,274sqm
180 George Street (Circular Quay Tower) - 55,000sqm
275 George Street - 7,263sqm
210 George Street - 16,500sqm
133 Liverpool Street - 4,080sqm
1 Sussex Street - 10,000sqm

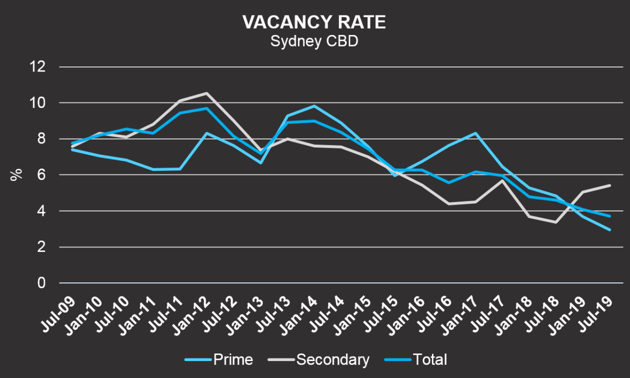
Mooted:
201 Sussex Street - 60,000sqm
6 York Street - 6,000sqm
33 Bligh Street - 24,000sqm
4 Bligh Street - 10,000sqm

Full refurbishments:
66 King Street (Charles Plaza Building) - 6,487sqm
75 Pitt Street - 2,200sqm
388 George Street - 35,000sqm
44 Martin Place - 11,366sqm
320 Pitt Street (Telstra Plaza North) - 28,862sqm
24 Campbell Street (Roden Cutler House) - 14,860sqm
283-285 Clarence Street (Nelson House) - 1,878sqm
55 Market street - 22,908sqm

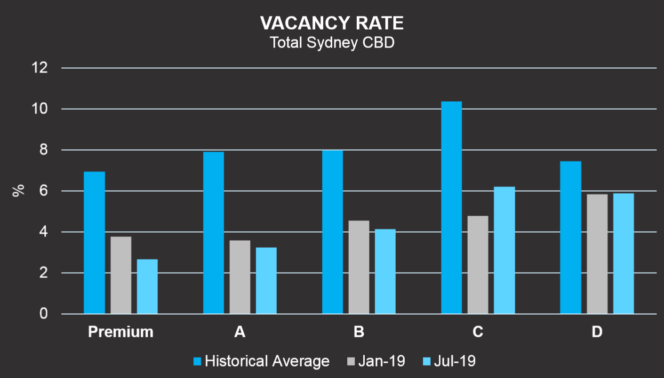
NET SUPPLY



VACANCY & RENTS.



Source: PCA/CI



Source: PCA/CI

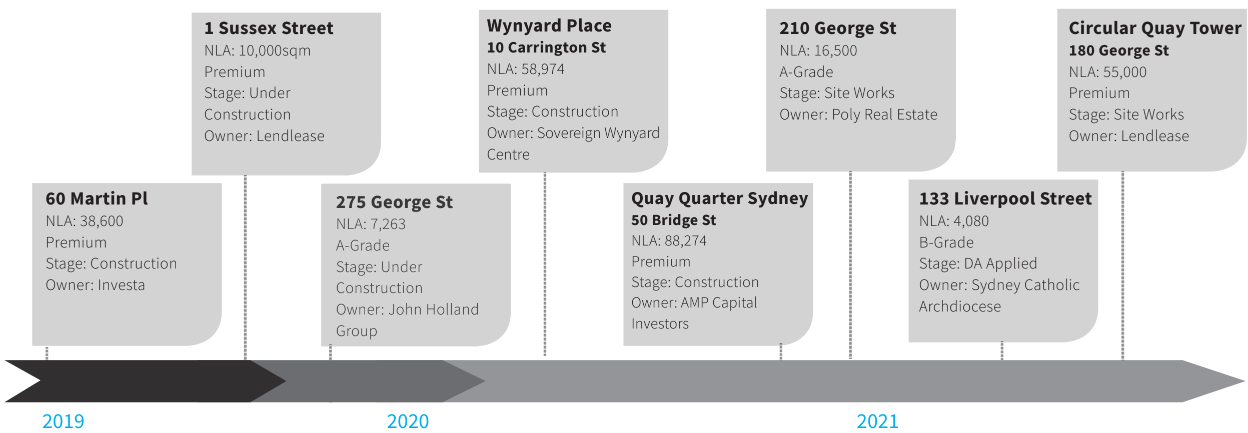
3.7%

TOTAL VACANCY FOR SYDNEY CBD.

Sydney CBD has recorded its second lowest vacancy rate at 3.7% in July 2019, dropping from a 4.1% vacancy in January this year and only 0.1% above the lowest ever recorded rate of 3.6% in 1990. This has been aided by subdued leasing demand over the past six months. Parramatta has also displayed a strong performance and is currently sitting at 2.7% vacancy.

Sydney CBD vacancy rates can be attributed to two driving factors which include 32,038sqm of stock withdrawal coupled with 13,000sqm of net absorption in Premium space over the last six months. However, as mentioned, there is a significant amount of stock due for completion in late 2019 and 2020, which already has considerable precommitments. Aside from new developments, there will be an estimated 123,561sqm of space being released back into the market following full or partial renovations and refurbishment.

SYDNEY CBD NEW DEVELOPMENT PIPELINE



Source: CI

SYDNEY CBD RENTS & INCENTIVES

Grade	Region	Average Net Face Rents ($/m2 pa)		Average Gross (%) Incentive	
		LOW	HIGH	LOW	HIGH
Premium	Core	$1,050	$1,800	17	22
	Barangaroo	$1,000	$1,750	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	$820	$1,200	12	17
	Mid Town	$800	$1,100	12	16
	Western Corridor	$780	$1,050	10	16
	Southern	$780	$900	10	16
C Grade	Core	$750	$820	12	17
	Mid Town	$700	$780	12	17
	Western Corridor	$650	$750	12	17
	Southern	$650	$750	12	17

Source: PCA/CI

A competitive leasing market has raised incentives by approximately 1% for B Grade and C Grade stock, while Prime stock continues to hold at their previous rate.

Combined with the limited availability of Sydney CBD stock, the number of withdrawals and the favourable market conditions, rents have risen. Further, even with uncertainty in the economy, the unemployment rate in the City of Sydney has seen a drop from 3.89% in March 2018 to 2.46% in March 2019, according to the ABS.

An example of these rising rents is evidenced through the leasing of level 29 and 30 at 60 Martin Place by Mizuho Bank, reaching $1,800 per sqm, breaking the Sydney CBD office rental record. We expect that under the continuation of a slower economy, rental growth will slow in the short to medium term.

RECENT LEASING TRANSACTIONS

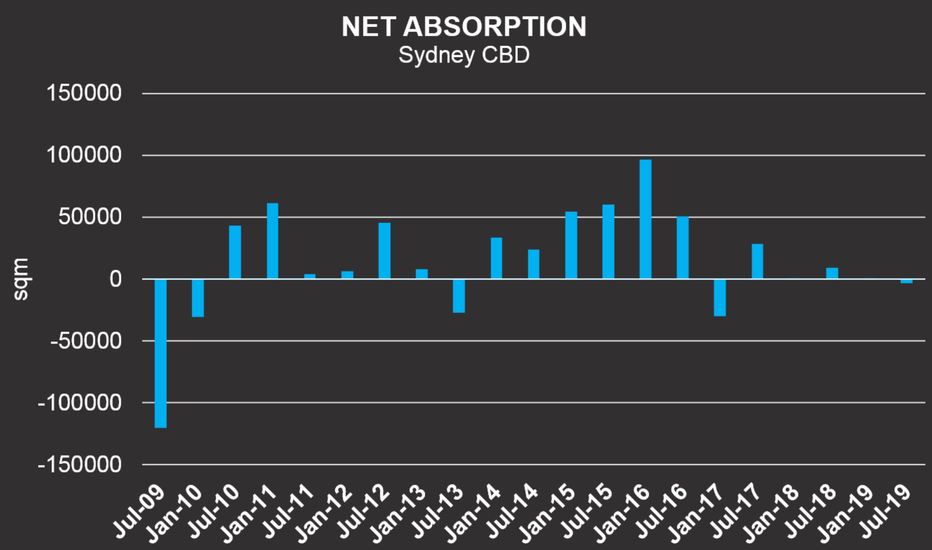
Address	Tenant	NLA (sqm)	Net Face Rent	Term (years)
60 Martin Place	Munich Re	2,600	**1,800**	10
60 Martin Place	Mizuho Bank	1,900	**1,800**	10
60 Martin Place	Regus	4,200	**1,250**	10
259 George Street	IBM	6,739	**1,213**	8
259 George Street	Ascendas Funds	355	**1,300**	5
341 George Street	Atlassian	1,347	**1,060**	4
2 Chifley Square	Centuria Capital	1,283	**1,775**	10
2 Park Street	TurksLegal	1,903	**1,215**	7
66 King Street	WeWork	6,617	**1,075**	10
121 Harrington Street	Havas	6,128	920	10
123 Pitt Street	Urbis	3,676	985	10
60 Margaret Street	JustCo	2,697	970	10

Source: CI

* Approximately.

TENANT DEMAND AND TENANT MOVEMENTS

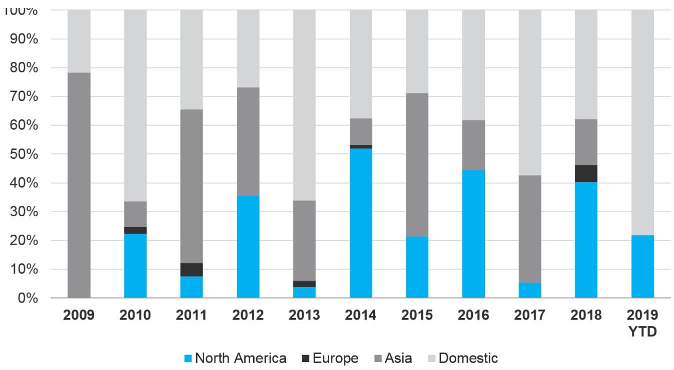
- Net Absorption has dropped to negative due to the movement of tenants in secondary offices. The negative absorption in the secondary office is mainly due to stock upgrading to meet the demands of employees and the well publicised fight for talent. This has also contributed to positive Prime stock absorption compared to negative secondary absorption.
- The actual net tenant demand grew only 0.1% at its lowest rate in over four years.
- As the CBD leasing market is becoming more competitive, North Sydney is increasingly becoming an attractive option for accommodation. Examples include the Tax Institute of Australia’s recent move form 175 Pitt Street, Sydney CBD into 50 Miller Street, North Sydney and Horticulture Innovation’s move from 1 Chifley Square, Sydney CBD to 141 Walker Street, North Sydney.



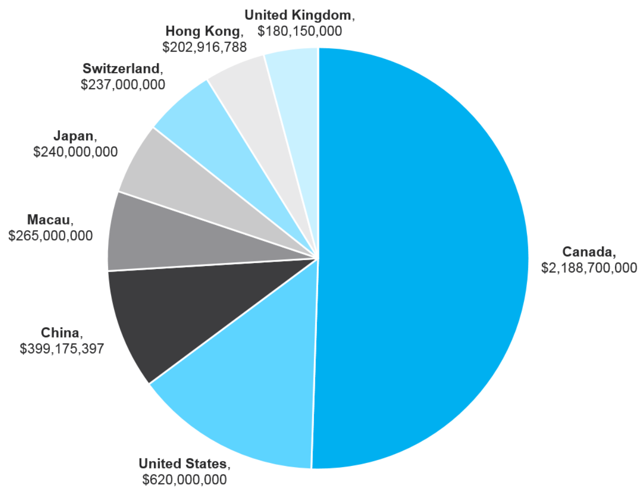
Source: CI

INVESTMENT & CAPITAL FLOWS.

TOTAL BUYER COMPOSITION FOR SYDNEY CBD



BREAKDOWN OF INTERNATIONAL BUYER COMPOSITION 2018



Source: RCA Analytics

Over the last 18 months, CI Australia has observed a dramatic decline in the volume of capital investment from the Asia-Pacific region. Whilst investors from China, Singapore and Hong Kong have historically played a significant role in driving the capital growth within Australian real-estate, as at this year (YTD), investors from the United States account for 100% of all cross-border commercial sales in the Sydney CBD. From a more holistic perspective, 2018 saw 40% of all commercial CBD sales originate from America and Canada, being the largest source of investment capital over the 38% provided domestically.

This is unsurprising, seeing as the pre-2017 influx of Asian investment was largely driven by high demand from Chinese investors seeking alternative avenues of diversified investment. Whilst most Chinese investors were attracted to residential developments, there was a spill-off effect into the Sydney CBD commercial markets. The effect has essentially been minimised over the last two years due to the significant lull in the CBD residential markets and the introduction of government policy against excessive investments outside of China.

“Although we are seeing a decline in Chinese, Japanese and Singaporean investment, they are still active investors and will remain involved in superannuation funds due to Australia’s stability and strong investment return.”

Shirley Fan |
Asia Desk

Sydney remains an attractive safe haven for offshore investors particularly from North America and the Asia Pacific which has helped to fund purchases such as MLC and Chifley Tower. This can be attributed to strong rental growth and tight vacancy rates.

MICHAEL STOKES
DIRECTOR, CAPITAL TRANSACTIONS

Sydney CBD sales reach the Billions

Australian real estate, with a specific emphasis on the Sydney and Melbourne markets, remains an attractive option for international investors. When pitched against other major cities around the world, Sydney and Melbourne commercial property is considered extremely affordable with a comparatively high and stable return.

Given the volatility of America's current political landscape, cities such as Toronto, New York and Boston, which have historically performed extremely well, are seen as a less attractive investment for institutional investors and property funds who wish to minimise risk through real estate ventures. The same goes for China, with the political uncertainty of the current trade war with the US, and the UK, Brexit continues to affect growth and trade within all industries.

Furthermore, there has been a definite increase in sales volume within the Sydney CBD, aided by an influx of site amalgamation activity, a lack of sites within the CBD area and the City Council's proposed changes to planning policy.

Date	Address	Price (A$)	Cap Rate	Owner/Buyer	Seller
Jun-19	Darling Park Tower 2	$995,000,000.00	5.0%	GPT	Brookfield Property Partners
Jun-19	Darling Park Tower 1	$983,000,000.00	5.1%	GPT	Brookfield Property Partners
Apr-19	MLC Centre	$1,600,000,000.00	5.0%	DEXUS	GPT
Mar-19	Exchange Centre	$637,800,000.00	3.9%	Morgan Stanley	Oxford Properties Group
Dec-18	10 Shelley Street	$534,000,000.00	4.5%	Charter Hall REIT	Brookfield Prop Prtnrs
Dec-18	Deutsche Bank Place	$1,035,200,000.00	4.8%	Oxford Properties Group	Investa Office Fund
Dec-18	Piccadilly Complex	$646,000,000.00	5.5%	Oxford Properties Group	Investa Office Fund
Dec-18	Exchange Centre	$620,600,000.00	5.0%	Oxford Properties Group	Investa Office Fund
Dec-18	IAG House	$488,000,000.00	5.1%	Oxford Properties Group	Investa Office Fund
Dec-18	151 Clarence St	$425,000,000.00	4.8%	Oxford Properties Group	Investa Office Fund
Dec-18	347 Kent Street	$351,600,000.00	5.1%	Oxford Properties Group	Investa Office Fund
Nov-18	60 Margaret Street	$830,000,000.00	4.7%	Blackstone	PAG (ASIA)
Jun-18	Allianz Centre	$300,000,000 (50%)	5.6%	Charter Hall REIT	Allianz

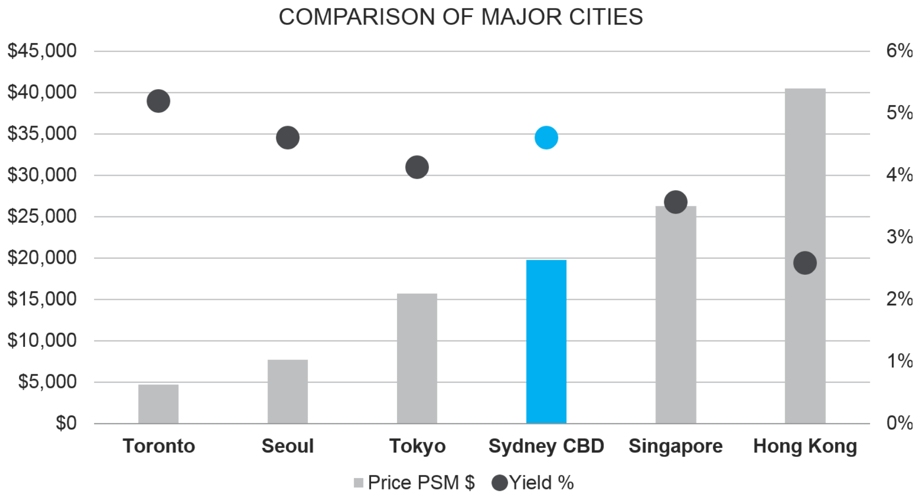
*Approx. #The sale represents a half stake

Source: RCA Analytics

TIGHTENING YIELDS

Looking offshore

As yields on commercial property drop further within the Sydney CBD, investors are cautious of the inevitable rebound, given the stagnating rate of growth for effective rents over the last few quarters. However, Sydney has yet to achieve the extremely low yields observed in many of its APAC counterparts, with Hong Kong and Singapore seeing cap rates as low as 2.5% - 3.5%.



Source: RCA Analytics

As per other major APAC cities, there appears to be room for further tightening of yields, with the help of:

- The low-interest rate environment in Australia, as a result of the recent election and two successive cuts from the Reserve Bank;
- The relative stability of our economy, accredited to the transparent and well-regulated market within Australia; and
- The large influx of capital, both onshore and offshore. With our comparatively higher yields and lower risk, it is unsurprising that North American investors have chosen to diversify their capital through increased activity within the Australian real-estate markets.

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If you'd like to chat to us about your requirements, we'd be delighted to hear from you.

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With a rich history, the firm we are today is a story of growth. Consistent dedication to our clients, employees and communities has allowed us to expand our services, teams and presence.

Our key services:

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- Tenant Representation Services
- Investment Sales
- Asset Management
- Engineering & Facilities Management
- Strategy & Advisory
- Marketing & Research

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