



SYDNEY CBD
OFFICE MARKET UPDATE

CI AUSTRALIA
MAY 2020





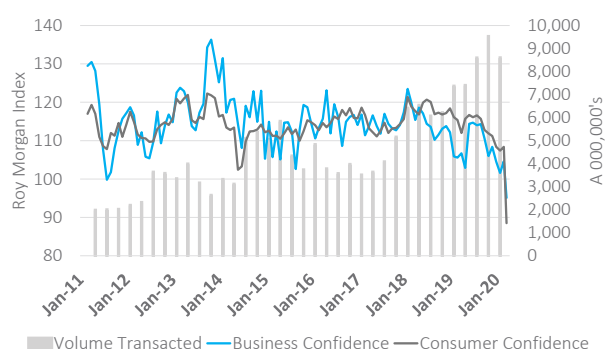
EXECUTIVE SUMMARY

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

The commercial property market has witnessed solid investment activity on an international scale throughout the second half of 2019 and the first quarter of 2020, despite economic uncertainty in Hong Kong and events such as the extended Australian bushfire season. The global pandemic of COVID-19 has led to unprecedented market conditions and while it is difficult to comment on the exact depth of impact the pandemic will have, our estimations and observations are summarised below.

We anticipate that commercial property markets will experience minimal volatility relative to the extreme movements observed in the share markets. The ASX200 currently sits at 24.7% lower than its pre-COVID-19 peak. Cashflows for properties with larger portions of retail will be more heavily impacted due to the current social distancing measures in place. It is expected that there will be a more subdued impact on cash flows for predominantly office-based assets, with exceptions for buildings with higher portions of space related to tourism and travel, education, hotels, restaurants and co-working office space. Whilst the Australian Federal Government has continued to provide support for commercial tenants with rent relief stimulus packages, we see this as being a temporary solution to the challenges faced.

BUSINESS AND CONSUMER CONFIDENCE



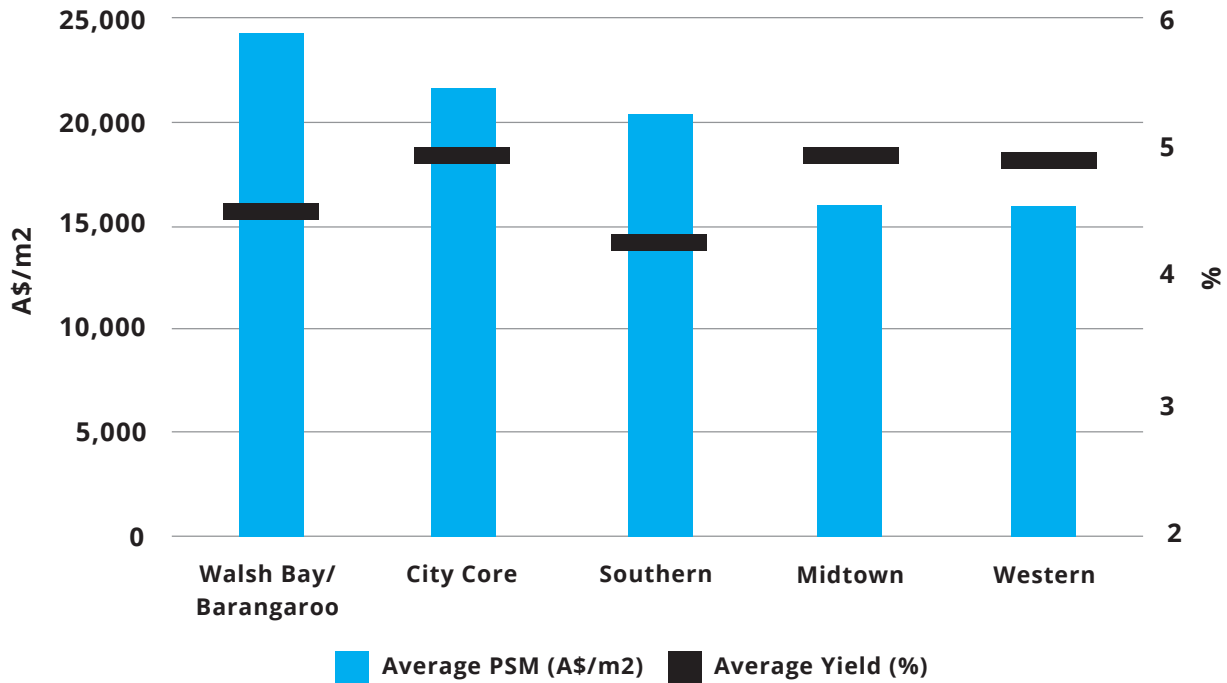
As anticipated, leasing activity has slowed as tenants are opting to defer major decisions due to increased uncertainty. Westpac has forecasted the unemployment rate to reach 10% by June 2020 – the highest level in 17 years in Australia. In addition, the March Roy Morgan (ANZ) Business Confidence Index (BCI) came in at 95.1 falling from 104.6 in the previous month. The implication of these indicators suggests negative net absorption over the coming quarters. Furthermore, with more businesses trialling the merits of remote working arrangements, there is the possibility of office restructuring which could lead to reduced demand for physical office space. We expect that these factors will increase the level of vacancy in the short-to-mid-term.

Within the commercial investment markets, it is likely well-leased assets with long-term Weighted Average Lease Expiry (WALE) will hold their value in these uncertain times, particularly when compared to buildings with shorter WALEs and current or impending vacancies. Essentially, the market will experience a two-tiered effect. Furthermore, Mirvac has revoked its recently announced dividend and funds such as Dexis and GPT have withdrawn their 2020 earnings guidance, demonstrating the impact of COVID-19 on major property players. Other A-REITs are expected to follow suit and take a more conservative position in the coming months.

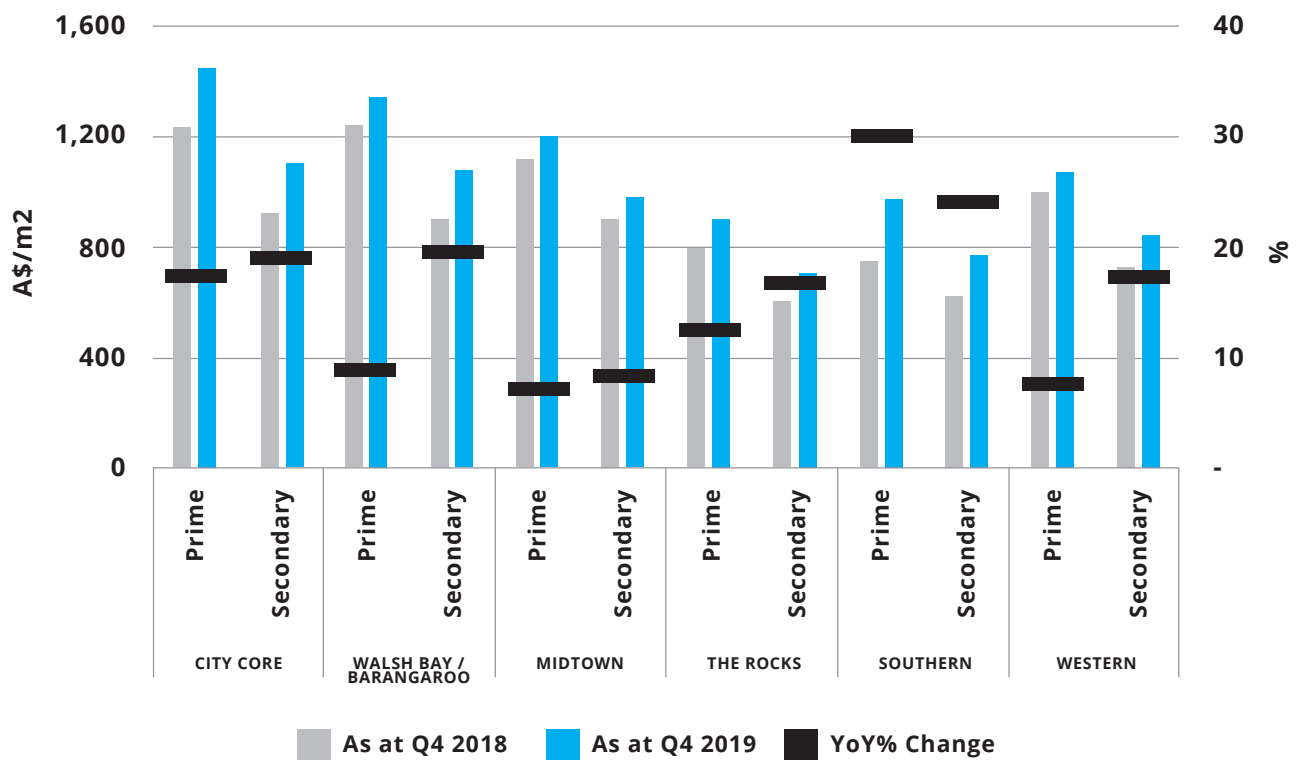
ANDREW HUNTER
CHIEF EXECUTIVE OFFICER
+61 418 222 522



H2 2019 SYDNEY CBD AVERAGE SALES METRICS BY PRECINCT



SYDNEY CBD RENTAL GROWTH BY PRECINCT



VACANCY & RENTS

UNDERSUPPLY HAS LED TO DECENTRALISATION

Sydney CBD experienced another period of an undersupplied market which was spurred by a three-year trend of continual negative net supply. Furthermore, the professional and financial services sector, accounting for 68% of the businesses within the CBD, observed a 10.7% growth by Gross Asset Value (GAV), whilst 522,168 sqm of stock was withdrawn permanently for the construction of the Sydney Metro and residential conversions. As a result of such strong demand, prime rents in the CBD are at a record high as prime vacancy dropped to 2.98% - levels similar to that observed during the 2007 GFC. This has pushed tenants to consider neighbouring office markets and we have observed a steady trickle of tenants relocating into comparable, surrounding suburbs to the CBD. With metro markets now reaping the benefits of the flow-on effect brought on by the current Sydney CBD conditions, we anticipate that this trend of decentralisation will continue despite increasing vacancy and lower effective rents.

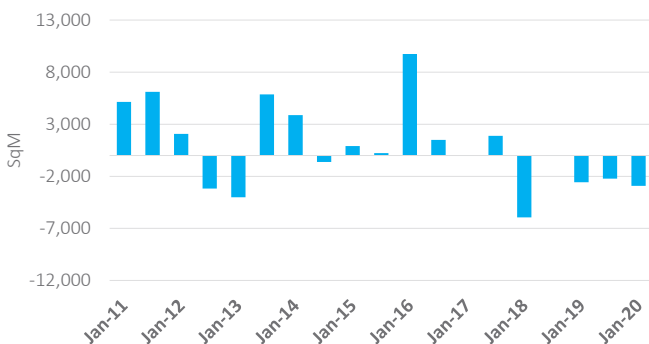
Other themes that have been highlighted during the COVID-19 pandemic include the growing expectation for flexible working arrangements from employers. Tenant sentiment has been redirected towards increasing investment into technology to support a remote workforce. We see this impacting rents and vacancy rates, as certain tenants have been noted to be halving their original space requirements pre-COVID.

Whilst remote working arrangements have proven to be a feasible alternative for certain industries, a survey by The Australian shows that most businesses see this as only a temporary solution and one that is unsustainable in the long-term. Several respondents noted that there was a strong absence of office dynamics which drive collaboration and productivity. Furthermore, the lingering impacts of social distancing will see many businesses taking a more considered approach to space per person within the office and possibly reconsider their current fit-out strategy. We expect that offices will transition to a higher Net Lettable Area (NLA) per workstation to accommodate for these changes, and whilst there will still be an overall reduction in space requirements in the coming market, it is anticipated that a majority of tenants will resume filling their offices again.

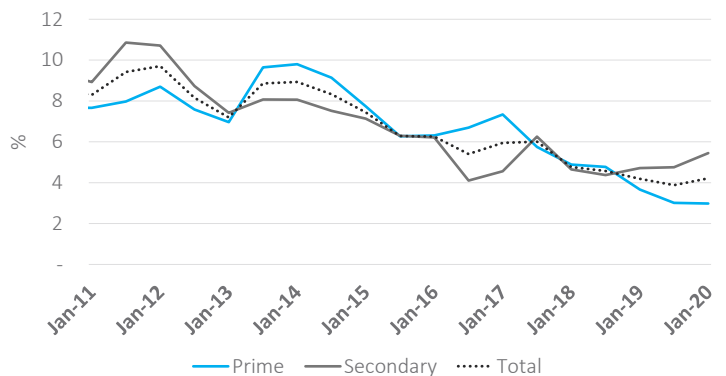
MOVING FORWARD

Over the next five years, there is 697,946 sqm of new and refurbished office space estimated to be due for completion, representing a 13.9% increase in total stock across the Sydney CBD. 31% of this supply has been pre-committed, with a majority being tenants currently situated in the CBD. This, coupled with the trend of decentralisation away from the CBD due to higher expectations for flexible working, means we expect vacancy rates to rise to levels near historical averages, and hence bring effective rents down.

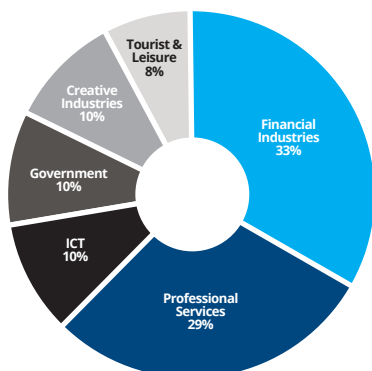
NET SUPPLY



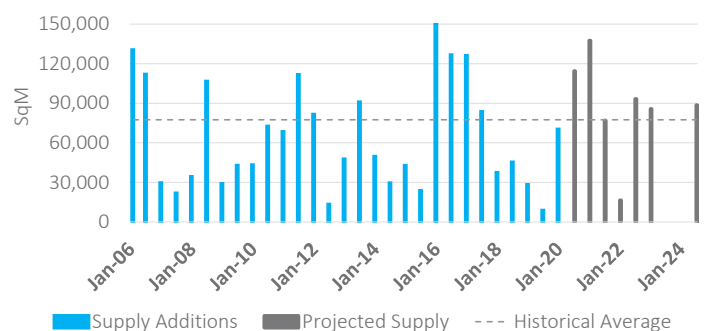
VACANCY RATE



SYDNEY CBD BREAKDOWN OF INDUSTRIES



SIX MONTHLY SUPPLY ADDITIONS



SYDNEY CBD CURRENT DEVELOPMENTS

- 1 **Charles Plaza Building**
NLA 6,321 sqm
- 2 **Grosvenor Place**
NLA 9,164 sqm
- 3 **Nelson House**
NLA 1,242 sqm
- 4 **Met Centre**
NLA 1,495 sqm
- 5 **388 George Street**
NLA 41,000 sqm
- 6 **231 Elizabeth Street**
NLA 22,964 sqm
- 7 **City Centre**
NLA 20,000 sqm
- 8 **1 O'Connell Street**
NLA 2,370 sqm
- 9 **Telstra Plaza North**
NLA 20,310 sqm
- 10 **570 George Street**
NLA 18,100 sqm
- 11 **275 George Street**
NLA 7,623 sqm
- 12 **75 Pitt Street**
NLA 2,200 sqm
- 13 **44 Martin Place**
NLA 10,027 sqm
- 14 **Shell House & 285 George**
NLA 4,900 sqm
- 15 **10 Carrington Street**
NLA 67,821 sqm
- 16 **210 George Street**
NLA 16,500 sqm
- 17 **AMP Building**
NLA 32,353 sqm
- 18 **Quay Quarter Tower**
NLA 90,554 sqm
- 19 **Salesforce Tower Sydney**
NLA 55,207 sqm
- 20 **Bligh House**
NLA 5,000 sqm
- 21 **Sydney Central**
NLA 4,195 sqm



TENANT ENQUIRY & DEMAND

Current leasing activity in the market has been reflective of tenants' preferences for space with existing fit-outs. Many occupiers are reluctant to undergo the lengthy and costly process of a fit-out, and we have seen landlords who utilise their existing fit-out or part thereof have the most success securing tenants within the market.

We have also observed a substantial number of speculative fit-outs built by landlords within smaller tenancies to assist in the downtime of securing a tenant and competing with the likes of co-working operators that provide a fully fitted operation.

With record rents being achieved within the Sydney CBD, some tenants are seeking to use an incentive from the landlord such as rent abatement to offset their rent over the term. To make a tenant's relocation cost-effective, it is preferable that the premises has a fit-out or substantial part of a fit-out that suits the company's accommodation requirements.

Examples of this are evidenced in the recent transactions outlined below, where the premises had existing fit-outs in place:

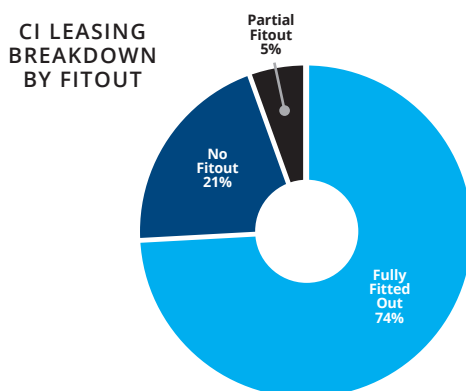
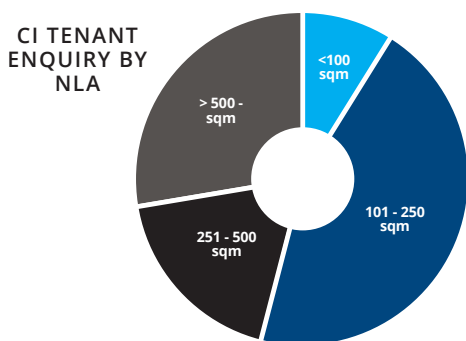
- **Mortgage lender, Columbus Capital** has relocated its office from Level 8 to Level 12 of 77 Castlereagh Street, Sydney, to take up a larger area of 1,217 sqm. The space was offered fully-fitted out, allowing the tenant to relocate straight into its 5-year term starting November 2019.
- **Digital bank, 86,400** has moved into 930 sqm of space at 35 Clarence Street, Sydney, where the suite had recently undergone a full speculative fit-out.
- **Media company, Mamamia** has taken up an 884 sqm lease at 100 William Street, Woolloomooloo. The space was fully fitted-out with slight adaptations, allowing for the tenant to move into its new office in April this year.

We are starting to see a two-tiered market, where incentives for office premises requiring an additional tenant to fit-out are far greater than spaces with a suitable, existing fit-out in place.

THE SUPPLY STORY

After three consecutive years of below-average development activity, a number of new premium buildings are nearing completion. Similar to that observed in North Sydney's new landmark, 1 Denison Street, we anticipate a shift in trophy assets within the Sydney CBD. Blue-chip tenants are starting to reconsider their long-standing leases in existing buildings as the oncoming stock sets a new benchmark for quality within the CBD. This could allow for large amounts of vacated, premium space to be placed back into the leasing market. Whilst the overall quality of offices will be lifted by the completion of these new developments, most anticipated movements will occur within the CBD and have little impact on the rise in vacancy.

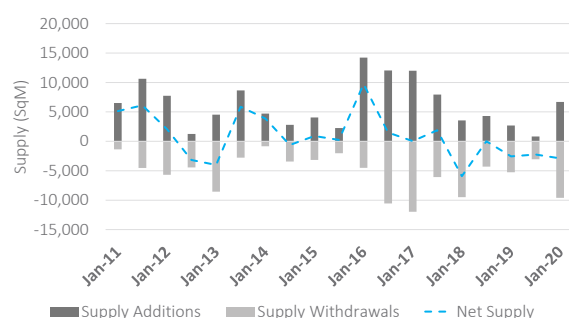
- **When completed in 2022, 180 George Street** will be the tallest office building in the CBD. Salesforce has pre-committed to 24 levels of the 53-storey building, leaving its current premises of 15 years in Darling Park.
- **AMP's Quay Quarter Tower** is set for completion in the same year and forms part of the transformation of Circular Quay. Deloitte will be moving from its long-standing headquarters at Grosvenor Place, placing approximately 21,300 sqm of premium space back onto the market.



"We are seeing increased demand from tenants for fitted-out premises. This is not isolated to the smaller (200 sqm to 500 sqm) end of the market. We are seeing larger tenants up to 2,000 sqm all seeking fully or partially fitted-out space."

TALIA BACOT-KEATING,
TENANT REPRESENTATIVE

SUPPLY, WITHDRAWAL AND NET SUPPLY



TRANSACTION ACTIVITY

RECENT LEASING TRANSACTIONS

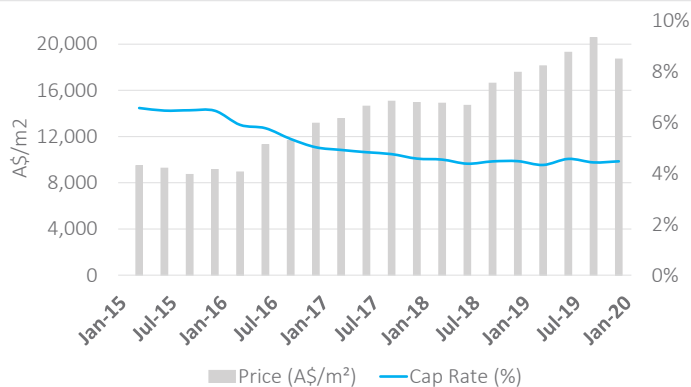
Property	Tenant	Area SQM	Rent	Term	Start	Reviews	Incentive
59-69 Goulburn Street	NSW Department of Planning, Industry and Environment	10,996	\$ 720	5 years	Jul-19	4%	
175 Pitt Street	VMware	3,509	\$ 930	3 years	Oct-19	4%	
56 Pitt Street	ABFS NSW Pty Ltd	127	\$ 1,060	5 years	Dec-19	4%	
56 Pitt Street	Navantia Australia	397	\$ 980	5 years	Dec-19	4%	
50 Bridge Street (Quay Quarter Tower)	Deloitte Australia	32,000	\$ 1,400	10 years	2022		
60 Margaret Street	Refinitiv Australia	1,214	\$ 950	5 years	Feb-20	4%	15%
56 Pitt Street	Dominus Capital	253	\$ 1,050	5 years	Mar-20	4%	
100 William Street	Mamamia	884	\$ 700	5 years	Apr-20	4%	
1 Macquarie Place	Blue Lake Partners Pty Ltd	232	\$ 1,525	4 years	Apr-20	4%	
50 Carrington Street	Meltwater	830	\$ 930	5 years	May-20	4%	23%
231 Elizabeth Street	Property NSW	21,700	\$ 1,000	12 years	May-20	4%	25%
56 Pitt Street	Richard Lloyd Accounting Recruitment	307	\$ 1,065	5 years	May-20	4%	
398 Sussex Street	Skedulo	139	\$ 850	3 years	Nov-22	4%	15%
126 Phillip Street	Deutsche Bank Place	8,664	\$ 1,265	4 years	Nov-20	3.75%	

Source: CI / Empirical Analytics

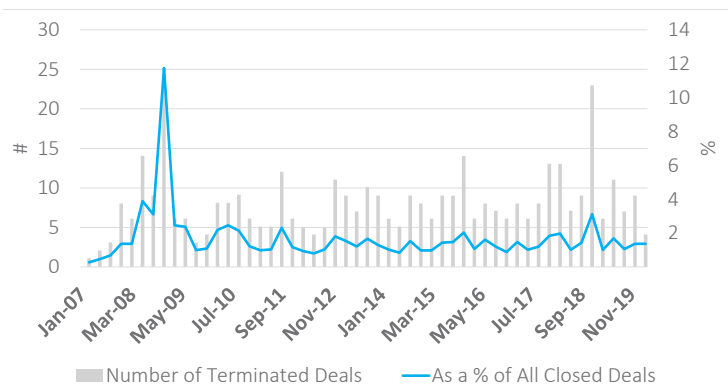
*Approximate figures; does not include all transactions in office or all transactions across asset classes.

INVESTMENT & CAPITAL FLOW

CAPITAL VALUE OVER TIME



DEAL TERMINATION IN THE APAC REGION

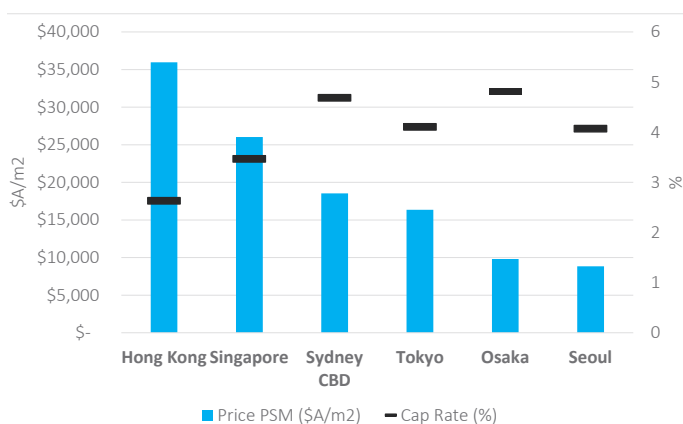


CAPITAL VALUES IN SYDNEY CBD REACHES HISTORICAL HIGHS

The Sydney CBD has experienced significant growth in capital value over the last four years, with the average price per sqm more than doubling to reach an all-time high by the end of 2019 of \$20,550 for commercial office buildings.

The second half of 2019 saw a further tightening of yields for commercial CBD assets, consistent with other Australian CBD markets, with Sydney having the lowest average yield of 4.68%. Conditions have remained strong as Sydney CBD averaged cap rates as low as 4.48%. The lower rate will continue to encourage investment with the Reserve Bank of Australia making the fifth cut to interest rates in the past year, to an effective lower bound of 0.25%. With RBA Governor Philip Lowe expressing to the Australia-Canada Economic Leadership Forum, "it's quite likely we're going to be in this world of low interest rates for years, perhaps decades, because it's driven by structural factors in the global economy."

CAPITAL VALUES IN THE APAC REGION



MOVING FORWARD

There is not yet enough evidence to support a permanent pricing downturn caused by the current COVID-19 pandemic. Whilst the percentage of terminated deals spiked dramatically during the GFC in 2007, the same trend has not yet been observed over the course of this crisis, indicating investor resilience thus far. However, it must be noted that deals such as the collapse of Macquarie Group's pending sale of its Martin Place Tower Development to ISPT may be the first of many to fall due to a lack of confidence in the leasing market. Once more data becomes available, we expect an increase in the current termination numbers but at a smaller scale compared to the GFC.

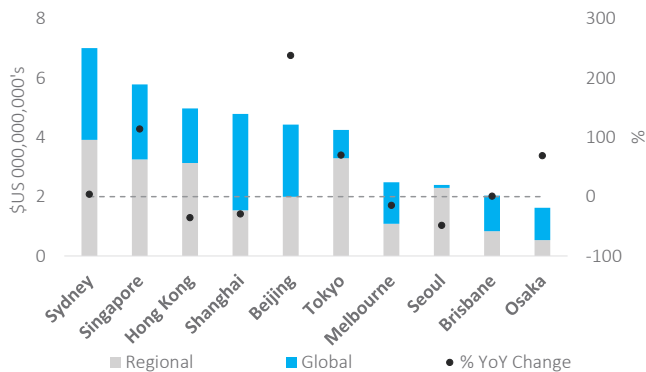
With the anticipated rise in vacancy and increase in incentives on the leasing side, combined with the Government's deployment of tenant-favoured rental relief, it is expected that there will be, on average, a 10 – 15% discount to current pricing metrics in investment sales transactions. Furthermore, the pricing differential between fully leased and vacant assets will widen a further 20% to reflect these negative market prospects. Pricing for strategic development acquisitions remains strong, and buildings with well-leased, longer-term WALEs have been maintaining their value well. We expect the longer-term post-COVID-19 environment will correct itself in pricing within 3 – 5 years and bounce back to levels witnessed in the peak of 2019.

"Sydney has proven to be a safe and attractive investment option for cross-border buyers globally, with an excellent track record of being a stable, transparent and liquid market with little to no political risk. Despite the drop in investment volumes in Q1 2020, the CBD's quality assets and healthy investment environment will help minimise the impacts of COVID-19."

SHIRLEY FAN,
HEAD OF ASIA DESK

CROSS BORDER ACTIVITY

SYDNEY - TOP DESTINATION FOR CROSS BORDER CAPITAL



Sydney CBD finished 2019 as the top destination for commercial, cross-border activity within the Asia-Pacific region. With Australia's track record of being a highly transparent, low-risk market, it is unsurprising that the CBD has outperformed last year's top contenders – Hong Kong and Singapore.

HONG KONG

The largest contributor to the CBD's cross-border capital activity is investment from Hong Kong. HKMA contributed to 35% of 2019's cross-border investment valued at over \$5.6 Billion. Furthermore, the Hong Kong-based sovereign wealth fund purchased a 35% share in the Australian Prime Property Fund, acquiring a sizeable stake in the Barangaroo International Tower 1 valued at \$2.6 billion.

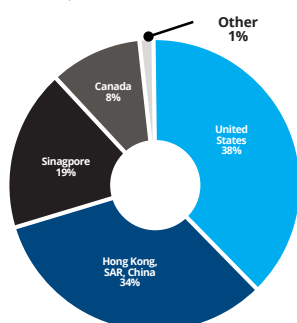
SINGAPORE

Throughout 2019, Singaporeans remained extremely active off-shore investors within the Australian commercial property market. Singaporean wealth sovereign fund GIC acquired a 25% share in Barangaroo International Towers 2 and 3, increased its ownership stake in the Dexus Australian Logistics Trust to 49% and underwent a joint venture with Charter Hall to acquire Parramatta's Jessie Street Centre.

CHINA

Following the policy changes of 2017, which saw China crackdown on its capital outflow to other countries, the percentage of Sydney CBD investments coming from the country has slowed. Along with an overall slowing down of China's economy, evidenced by its GDP growth rate at a decade low of 6.1%, Australia's inflow of capital from China has experienced a contraction. Regardless of the capital restriction, large Chinese developers such as Poly and Country Garden have already refinanced their equity inbound and planned for another round of acquisitions.

BUYER COMPOSITION BREAKDOWN 2019



U.S. AND CANADA

Buyers from the North American region accounted for a sizeable 46% of total cross-border activity. This was likely a result of strategy changes in global pension funds to invest into real assets and infrastructure. This new direction in strategy is anticipated to have long-term effects on CBD markets and capture large amounts of capital. Sydney will continue to be a desirable destination for these funds to capture the high-growth prospects of the APAC region in a global city known for its attractive yields and political stability.

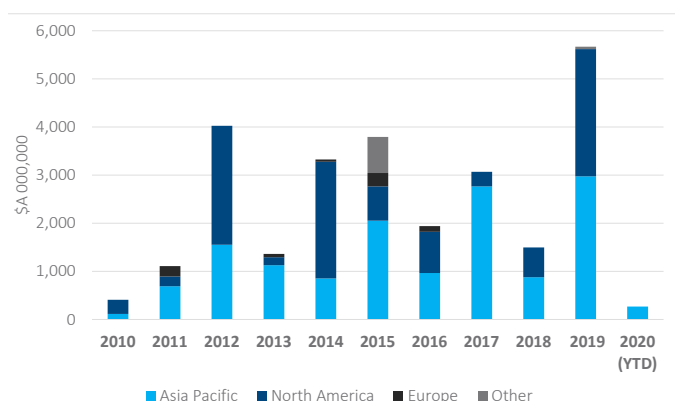
PANDEMIC IMPACT BRINGS OVER RISKS AND OPPORTUNITIES

We are seeing a slowdown in commercial property transactions in APAC where volume has plunged by 56% compared to Q1 2019. Although there is still uncertainty, we have seen confidence in the Australian commercial market to look past the short-term volatility. Sydney seems to have immunity with a seasonal fall of \$400 million, or 4.6% according to Real Capital Analytics.

In response to COVID-19, the Australian Foreign Investment Review Board (FIRB) has announced a new policy requiring approval from FIRB for all foreign investments into Australia. As the process is usually for registration purposes to maintain clarity on property ownership within Australia, we do not foresee this having a negative impact on usual cross-border activity. Interest rates are also expected to remain low and the Government has recently released its biggest stimulus package on record. These measures will help to level out the potential fall in pricing due to COVID-19.

Despite the global nature of this pandemic, we do not expect a dramatic fall in foreign investment. However, stronger economies will certainly play a bigger role in the coming months and the remainder of 2020. Given the present situation surrounding the US, who is struggling to contain the spread of COVID-19, we expect the current fifty-fifty split of overseas investment to tilt in APAC's favour in the coming year.

CROSS BORDER BREAK DOWN



TRANSACTION ACTIVITY

RECENT SALE TRANSACTIONS

Date	Address	NLA	Price (A\$)	A\$/m²	Cap Rate	Grade	% Share	Purchaser	Vendor
Apr-20	100 Market St	28,385	\$683,000,000	\$24,062	3.90%	A	100%	Link REIT	Blackstone Group
Mar-20	191 Thomas St	4,797	\$80,800,000	\$16,677	3.44%	B	100%	Private Purchaser	Community and Public Sector Union (CPSU)
Feb-20	39 Martin Pl	37,552	\$950,000,000	\$25,298	N/A	Premium	100%	ISPT	Macquarie Group
Feb-20	59 Goulburn St	19,470	\$270,000,000	\$13,868	4.90%	B	100%	Poly	Fortius Funds, SC Capital Partners
Nov-19	201 Elizabeth St	38,933	\$630,000,000	\$16,182	5.00%	A	100%	Abacus	Perron Group, DEXUS
Nov-19	323 Castlereagh St	37,499	\$325,000,000	\$8,667	4.00%	B	100%	LaSalle Investment Management	MKH Properties
Nov-19	161 Castlereagh St	59,473	\$1,620,000,000	\$27,239	4.1%	Premium	25%	ISPT	Blackstone
Oct-19	546-552 George St	3,000	\$61,700,000	\$20,567	N/A	C	100%	City of Sydney	Pollack Family
Oct-19	6-10 O'Connell St	16,317	\$315,000,000	\$19,305	4.50%	B	100%	Private Purchaser	Oxford Properties
Oct-19	208 Clarence St	1,306	\$21,329,000	\$16,332	4.62%	C	100%	ISPT	Well Smart Investment Group
Oct-19	163 Castlereagh St	60,213	\$1,642,800,000	\$27,283	4.10%	Premium	100%	ISPT	Blackstone
Sep-19	230-232 Sussex St	1,100	\$12,500,000	\$11,364	N/A	Heritage	100%	Belvedere Enterprises Aust Pty Ltd	Meriton
Aug-19	76-78 Liverpool St	1,394	\$22,000,000	\$15,782	4.93%	C	100%	Private Purchaser	Acepal Investments Pty Ltd
Aug-19	3 Sussex St & 200-300 Barangaroo Ave	178,700	\$4,347,438,094	\$24,328.14	N/A	Premium	25.10%	GIC	Lendlease, Canada Pension Plan Investment Board
Aug-19	Darling Park Towers	111,752	\$2,125,000,000	\$19,015	5.3%	Premium	25%	GPT	Brookfield
Jun-19	3 Spring St	9,190	\$173,000,000	\$18,825	N/A	B	100%	DEXUS	Brookfield
Jun-19	25 King St	969	\$16,000,000	\$16,512	N/A	D	100%	Saatvic Holdings	Yuqiduo Pty Ltd
Jun-19	1 Little Pier St	7,450	\$70,000,000	\$9,396	4.20%		100%	SLLZ Development	Lendlease

Source: CI / Real Capital Analytics
*Approximate figures; does not include all transactions in office or all transactions across asset classes.





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OUR TEAM



MIKE STOKES
DIRECTOR, CAPITAL TRANSACTIONS
+61 418 251 579



JOHN BOWIE WILSON
DIRECTOR, CAPITAL TRANSACTIONS
+61 423 000 882



BEN KARDACHI
DIRECTOR, COMMERCIAL LEASING
+61 419 230 278



BEAU STEWART
DIRECTOR, TENANT REPRESENTATION
+61 400 505 545

RESEARCH



SHIRLEY FAN
HEAD OF ASIA DESK
+61 452 531 797



VIVIENNE CHEN
HEAD OF RESEARCH/
INVESTMENT ANALYTICS
+61 466 303 100



CI AUSTRALIA PTY LIMITED

Level 4, 35 Clarence Street

Sydney CBD, 2000

www.ciaustralia.com.au



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