Market Pulse

Sydney CBD Office Market

Cadigal Research
August 2021

Cadigal

Contents

Key data at a glance

		Change last 12 months	Expected change next 12 months
SUPPLY			
Total Stock* *(sqm, as at Jul-21)*	5,149,548	↑	↑
Completions* *(sqm, 6 months to Jul-21)*	104,721	↑	↔
Net Supply* *(sqm, 6 months to Jul-21)*	67,431	↑	↔
DEMAND			
Net Absorption* *(sqm, 6 months to Jul-21)*	27,269	↑	↔
Tenant Enquiry *(sqm, as at Jun-21)*	247,985	↓	↔
VACANCY			
Vacancy Rate* *(%, as at Jul-21)*	9.2	↑	↑
Sublease Availability *(sqm, as at Jun-21)*	105,013	↔	↔
RENTS			
Net (Gross) Face Rents *($/sqm average, as at Jun-21)*			
Premium	1,281N (1,500G)	↓	↑
A Grade	1,029N (1,212G)	↑	↑
B Grade	840N (1,007G)	↑	↑
Incentives *(typical % range for whole-floor tenant, as at Jun-21)*	29 - 36	↑	↔

*Source: Property Council of Australia (PCA Aug-21)

In Summary

There were 67,431sqm of net additions to stock in the 6 months to Jul-21, following on from the 104,179sqm added in the prior 6 months. As a result, the size of the CBD market has grown 3.4% in the last 12 months to 5.15mil sqm, the highest level on record.

Tenant demand remains weak with the market averaging negative net absorption over the last 1, 2 and 5 years. However, 27,269sqm of net absorption was recorded in the 6 months to Jul-21, the first positive result in 2½ years.

247,985sqm of tenant enquiry was recorded as at Jun-21, down 8.5% on the previous quarter. Despite the fall, enquiry levels remain slightly higher than the lows reached in 2019.

The overall vacancy rate in the CBD moved up further over Q2 2021, to 9.2%. After coming within 0.1% of the lowest mark on record, the vacancy rate has now risen 550 basis points in 24 months.

The current vacancy rate is now higher than the long-term (32-year) average and some 240 basis points above the 10-year average.

The amount of available sub-lease space in the CBD fell for a second successive quarter, to 105,013sqm. Despite the falls, sub-lease is still well above pre-COVID levels and almost double the amount averaged over the last 9½ years.

Face rents have held firm at elevated levels, across all grades, easing very marginally over 2020.

Since peaking in Dec-19, effective rents have fallen for 18 months as incentives spiked up during 2020. However, the rate of decline has slowed over the first half of 2021.

Projects to have recently completed include Brookfield Place (above), Sub Station No.164 (bottom left) and 44 Martin Place (bottom right).

Supply

The total supply of office space in the Sydney CBD currently sits at 5.15mil sqm, the highest level on record and exceeding the previous peak reached in mid-2017.

There were 67,431sqm of net additions to stock in the 6 months to Jul-21, following on from the 104,179sqm added in the prior 6 months. As a result, the size of the market has grown by 3.4% in the last 12 months. Compared to the 171,610sqm of net additions recorded in the last 12 months, the long-term (32-year) average is 54,044sqm per annum.

Two projects were completed over Q2 2021, the more significant being Brookfield Place which delivered 67,138sqm of premium grade space to the Core, 98% of which has been committed to/leased by tenants. The other completion was Sub Station No.164, a boutique development at 183-185 Clarence St (7,467sqm) which incorporated two heritage buildings.

Of the several major projects under construction the most substantial are Quay Quarter Tower (88,530sqm), due in Q1 2022, and Salesforce Tower (55,207sqm) due approx. 6 months after that.

Beyond the developments currently under construction, a number of proposed office buildings associated with Metro rail stations are approaching commencement. These comprise two towers above Martin Place station (~90,000sqm total) and one at Pitt Street station (47,850sqm), plus another at Victoria Cross station in North Sydney (55,318sqm). The targeted completion date for the over-station buildings is late 2023 or early 2024, broadly aligned with the opening of the rail line.

Major Office Developments Under Construction / Recently Completed

Project	Owner / Developer	Type	Office NLA	Precinct	Expected Completion	Comment
4-6 Bligh Street	SC Capital Partners	Full Refurb	9,407	Core	completed Q1 2021	Full refurbishment favoured over new mixed-use development
44 Martin Place	Gwynvill	Full Refurb	9,148	Core	completed Q1 2021	Full refurbishment including addition of central atrium and 2 floors
Brookfield Place, 10 Carrington Street	Brookfield / AMP Capital	New	67,168	Core	completed Q2 2021	98% committed to NAB, Allianz, Brookfield, Hub Australia, MA Financial and Clifford Chance
Sub Station No.164, 183-185 Clarence St	Nuveen / Built	New	7,467	Western	completed Q2 2021	47% committed to Built and others
570 George Street	Far East	Full Refurb	18,485	Midtown	Q3 2021	Significant refurbishment project following sole office tenant AusGrid's departure. 32% committed/under offer
Poly Centre, 210-220 George St	Poly Group	New	16,565	Core	Q2 2022	11% committed to owner / developer Poly Group
Quay Quarter Tower, 50 Bridge Street	AMP / REST	New	88,530	Core	Q1 2022	85% committed to AMP, Deloitte, Corrs and others
Salesforce Tower, 180 George Street	Ping An / Mitsubishi Estate / Lendlease	New	55,207	Core	Q4 2022	Salesforce has committed to 50% of the office space plus naming rights
121 Castlereagh St	Scentre / Cbus	New	11,143	Core	Q1 2023	Office component of mixed-use development on site of former David Jones store

Tenant Demand
Net Absorption

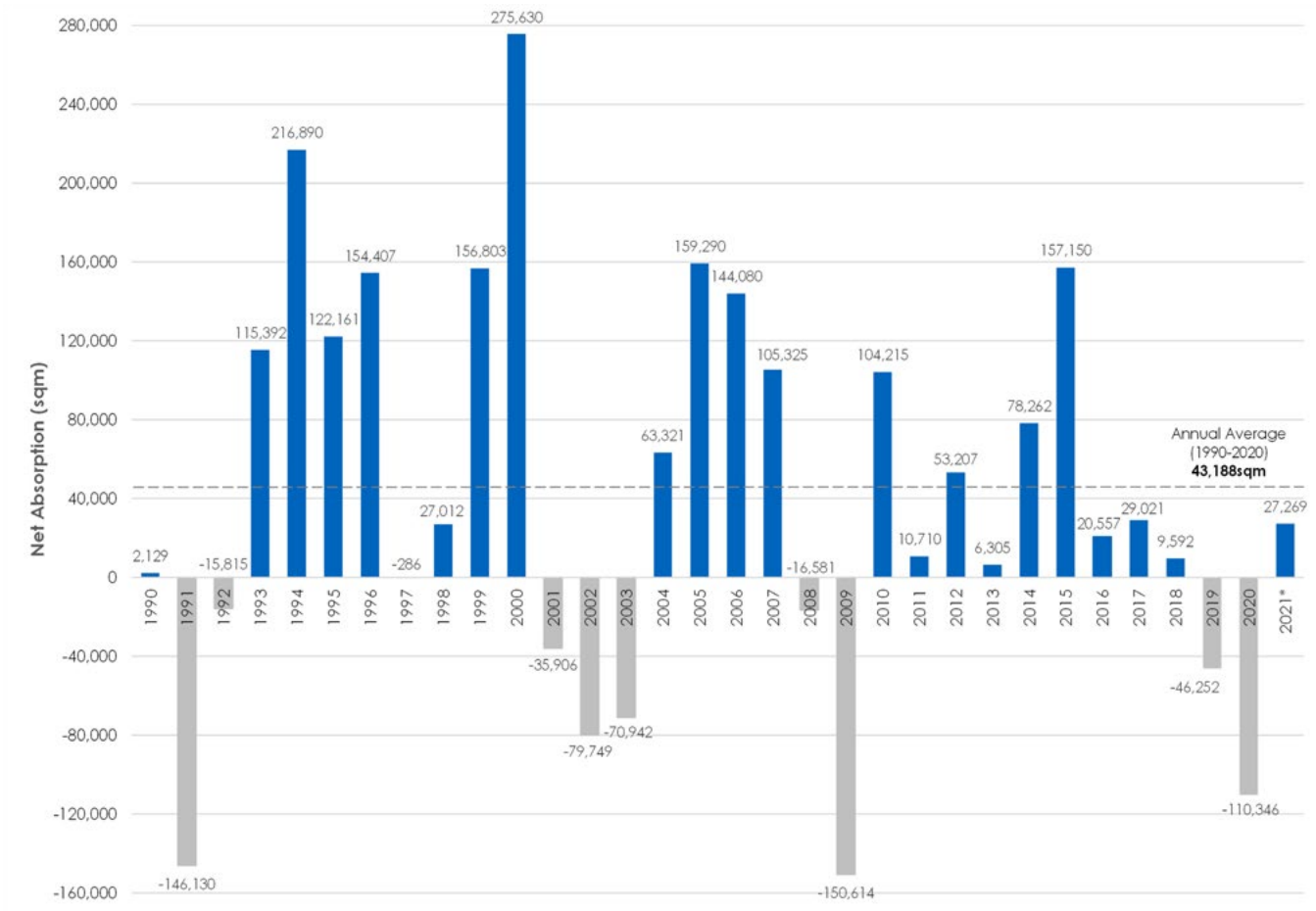
Tenant demand remains weak in the CBD with the market averaging negative net absorption over the last 1, 2 and 5 years.

However, net absorption of 27,269sqm was recorded in the 6 months to Jul-21, the first positive 6-month period in 2½ years.

The -24,402sqm of net absorption tallied in the last 12 months compares to the long-term (32 years) average of 43,368sqm per annum.

The latest (positive) reading is for the 6 months up to the start of the current lockdown, and if a negative result can be avoided in the next 6 months, a third consecutive year of negative net absorption will have been averted.

Annual Net Absorption - Sydney CBD 1990-2021



* 6 months to Jul-21
Source: PCA Aug-21

Net absorption in the CBD Core was positive, and negative in every other precinct, over both 6 and 12 month periods.

Looking at tenant demand across building grades reveals strong net absorption in Premium, moderate in B grade and negative net take-up, over 6 and 12 months, in the other grades (A grade being the worst performer).

Net absorption by precinct

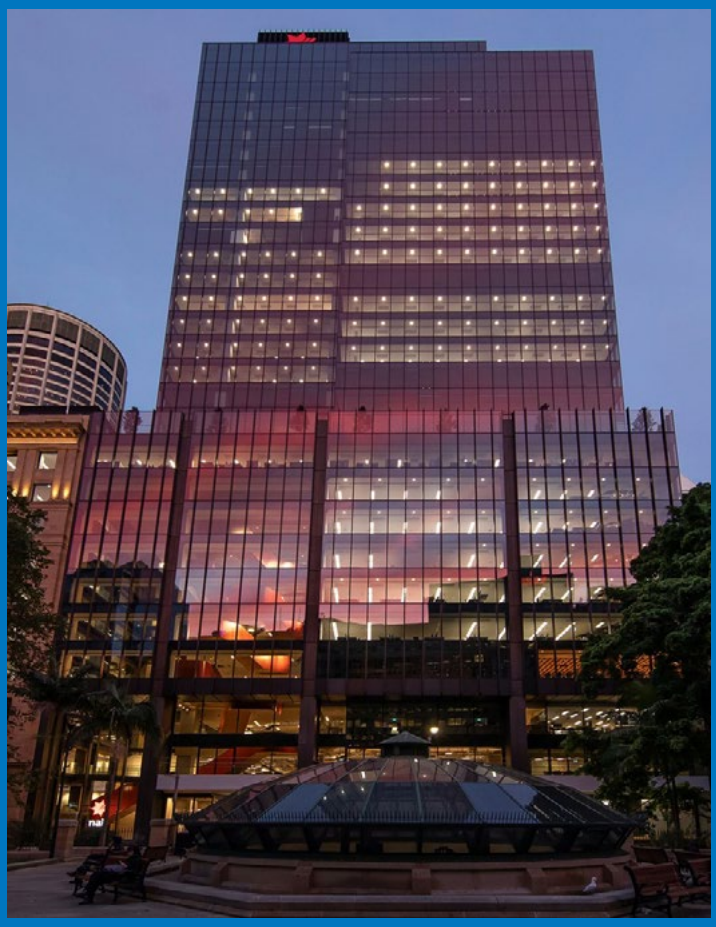
Precinct	6 Months to Jul-21	12 Months to Jul-21
City Core	48,879	35,957
Midtown	-15,622	-15,112
Western Corridor	-3,641	-32,241
Walsh Bay / The Rocks	-1,527	-5,699
Southern	-820	-7,307
Sydney CBD	**27,269**	**-24,402**

Net absorption by building grade

Buiding Grade	6 Months to Jul-21	12 Months to Jul-21
Premium	69,658	48,604
A Grade	-49,072	-54,259
B Grade	16,014	971
C Grade	-6,442	-12,826
D Grade	-2,889	-6,892
Sydney CBD	**27,269**	**-24,402**

Source: PCA Jul-21

Tenant Demand



Significant leasing activity has recently occurred at Brookfield Place (top left), 55 Market Street (below) and Grosvenor Place (top right).

The pick-up in leasing activity witnessed at the start of the year carried through to Q2 2021, right up until the start of the current lockdown in Jun-21.

Whilst sub-leases featured prominently amongst major transactions over the past few quarters, new direct leases dominate the latest batch of large leases.

The largest transaction recorded in Q2 sees Tyro Payments relocating from 155 Clarence St in the Western Corridor into 6 floors (6,267sqm) at the Mirvac managed 55 Market St in Midtown.

Two additional transactions were recorded at the just-completed Brookfield Place - MA Financial Group (formerly Moelis Australia) and law firm Clifford Chance.

The majority of the recent major lease transactions involved tenants relocating within the CBD, however healthcare operator Healius will be moving from St Leonards on the North Shore to ISPT/GPT's Liberty Place.

Recent major lease transactions

Tenant	Address	Precinct	Level	Area (sqm)	LCD	Type
Tyro Payments	55 Market Street	Midtown	15-20	6,267	Jan-23	New
MA Financial Group#	Brookfield Place, 10 Carrington Street	Core	pt.25, 26-27	4,387	Feb-22	New
Ord Minnett	Grosvenor Place, 225 George Street	Core	18-19	3,563	Feb-23	New
CyberCX#	2 Market Street	Western	23-24	3,267	Mar-22	New
Healius#	Liberty Place, 161 Castleregh Street	Midtown	22-23	2,908	Nov-22	New
Royal Bank of Canada	25 Martin Place	Core	58-59	2,624	Sep-22	New
Clifford Chance#	Brookfield Place, 10 Carrington Street	Core	pt.23, 24	2,612	Aug-22	New
Russell Investments	85 Castleregh Street	Midtown	28	1,239	Sep-21	New
Immutable#	77 King Street	Midtown	17-18	1,153	Aug-21	New

Cadigal was involved with these transactions.

Major enquiries that have emerged in the market recently include TikTok (Bytedance), Allen & Overy and Arcadis.

Tenant enquiry

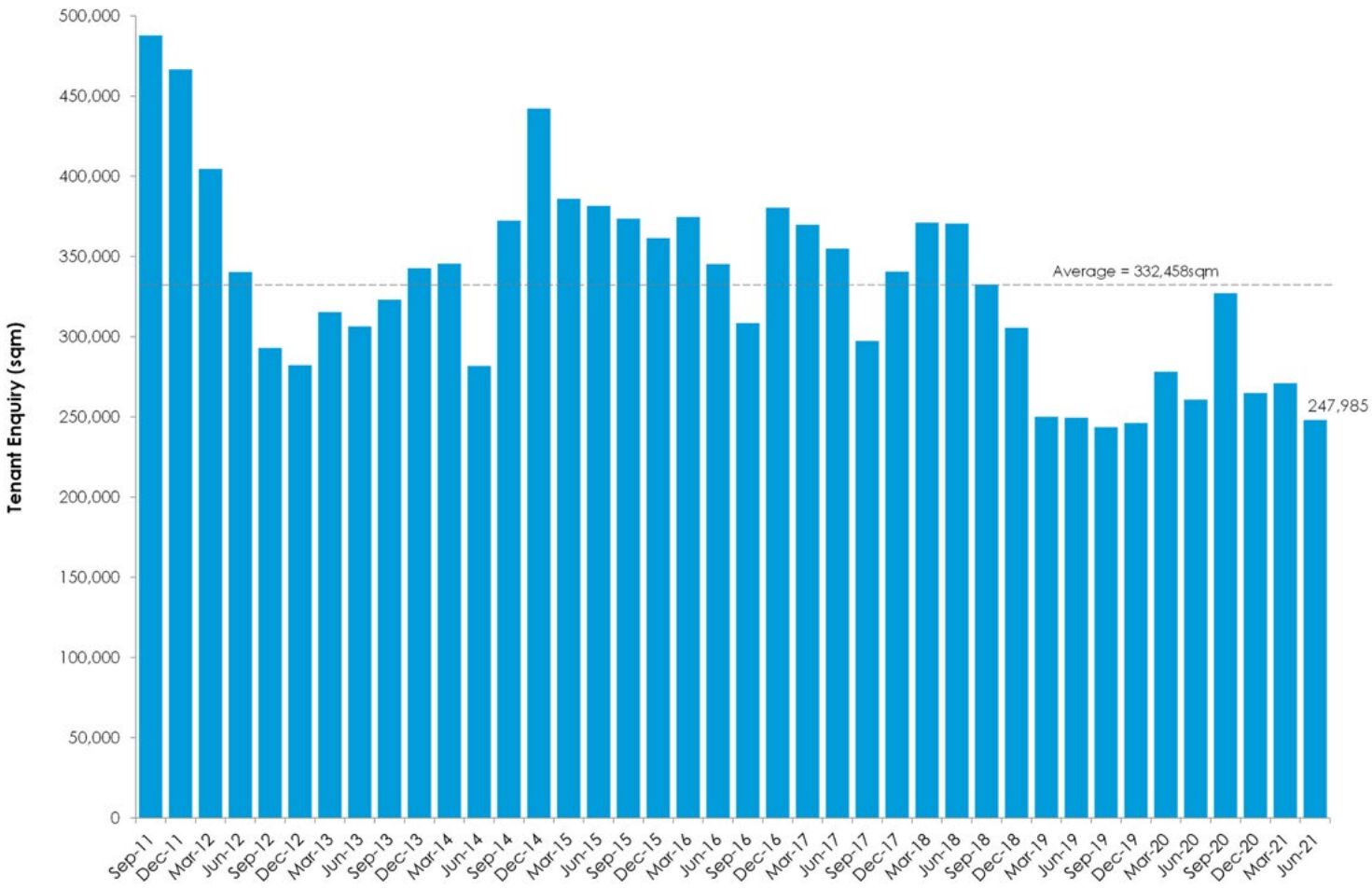
Cadigal recorded a total of 247,985sqm of tenant enquiry (over 500sqm) considering the Sydney CBD, as at Jun-21, down 8.5% on the previous quarter.

Enquiry levels had been trending higher until this latest result but, despite the fall, remain slightly higher than the lows reached in 2019.

It remains to be seen what impact the current lockdown will have on enquiry levels and, ultimately, tenant demand.

The 247,985sqm of current enquiry is comprised of 153 separate requirements, equating to an average enquiry size of 1,621sqm. 153 is the 2nd highest number of mandates (after the 160 recorded in the previous quarter) whilst, at the same time, 1,621sqm is the smallest average size in 10 years of records. This reflects the high level of activity at the smaller brokerage end of the market, with larger mandates relatively subdued.

Some of the larger enquiries to enter the market recently include: ByteDance (owner of the TikTok app, seeking 2,500-3,500sqm), engineering firm Arcadis (currently in 580 George St, seeking 2,000-3,000sqm) and lawyers Allen & Overy (85 Castlereagh St, 2,250-2,650sqm).



Source: Cadigal

Current Tenant Enquiry by Size (enquiries over 500sqm)

Enquiry Size	Area (sqm)	Number
3,000sqm+	97,400	18
1,000-2,999sqm	99,100	63
500-999sqm	51,485	72
Total	**247,985**	**153**

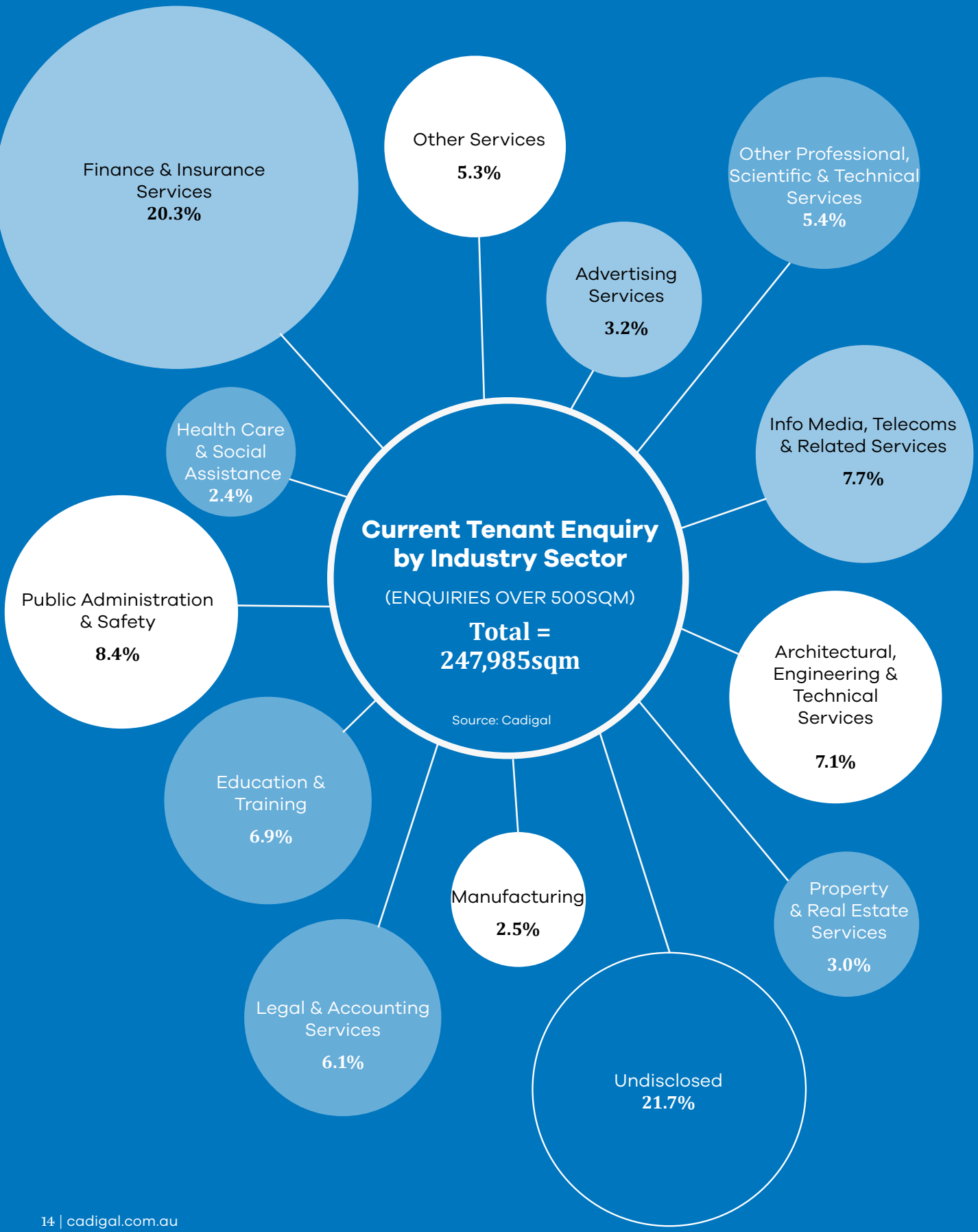
Data as at Jun-21

Source: Cadigal

Tenant enquiry

Finance & Insurance (20.3%) is currently the most significant industry sector for enquiry, with all other sectors each only accounting for between 2.4%-8.4% of the total.

Finance & Insurance tenants with enquiries in the market include Colonial First State (approx. 10,500sqm), IMC (4,000-4,500sqm), DUAL (1,100-1,300sqm) and CBHS Health Fund (1,300-1,500sqm).



Vacancy

The overall vacancy rate moved up further over Q2 2021, to 9.2%.

After coming within 0.1% of the lowest mark on record (3.6%), the vacancy rate has now risen 550 basis points in 24 months. It is now higher than the long-term (32-year) average of 8.7% and some 240 basis points above the 10-year average (6.8%).

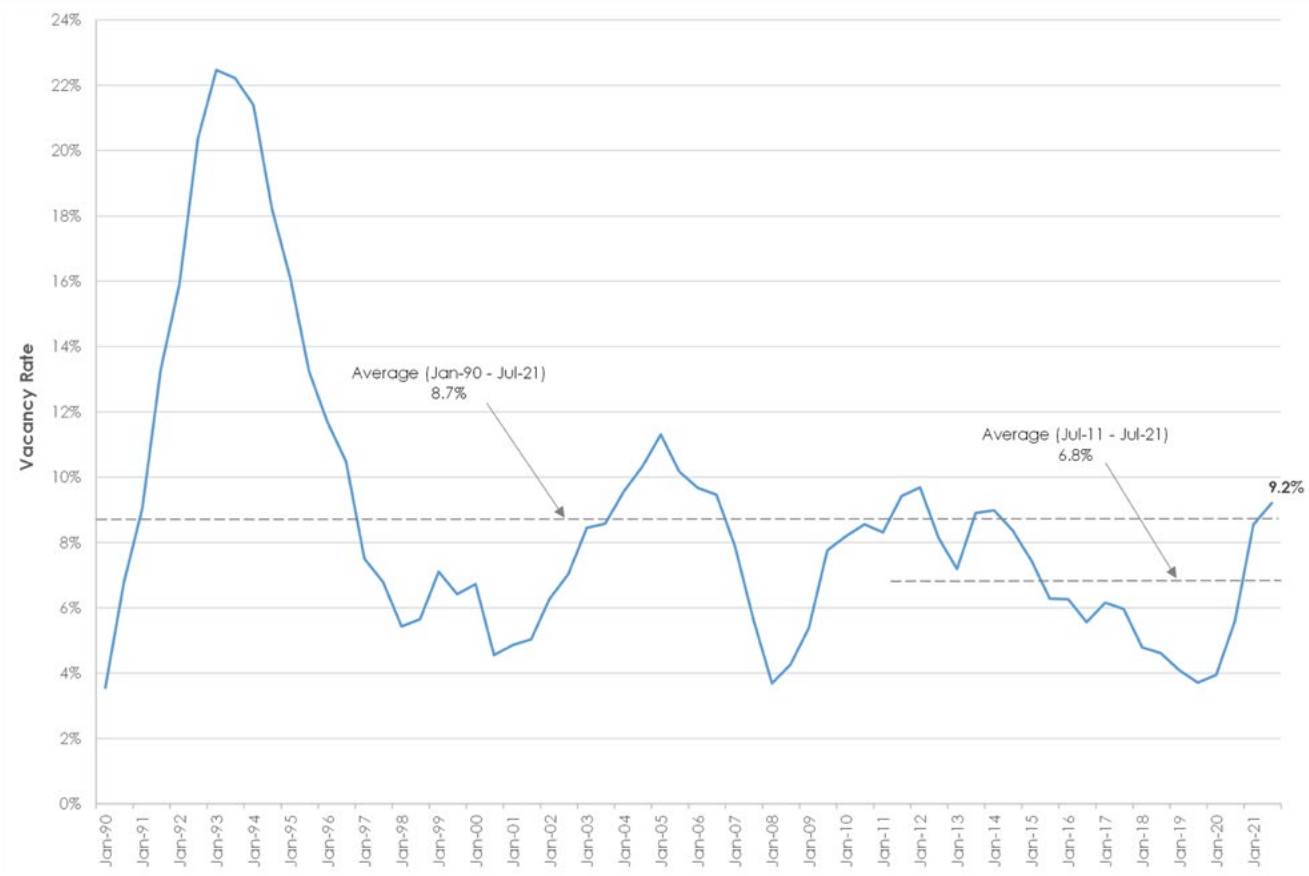
The vacancy rate was last at these levels 9½ years ago. Whilst the positive net absorption recorded over the first half of the year helped reduce the vacancy rate, this was more than offset by the increase in vacant space across the market.

Vacancy rates amongst CBD precincts were lowest in the Western Corridor (7.6%) and Walsh Bay/The Rocks (7.3%) and highest in Midtown (10.5%).

Across building grades, Premium continues to be by far the tightest (at 5.5%) despite the addition of Brookfield Place to total stock. All the other grades have vacancy rate between 8.4-11.3%. Premium was also the only grade to record a lower vacancy rate over the quarter, aside from C grade, which only accounts for just 3% of total stock.

The expected flight-to-quality theme, where higher quality space outperforms lower quality, is only partially evident in current vacancy rates with Premium possessing the lowest mark (5.5%) but A grade having the highest (11.3%).

Total vacancy rate (Jan 1990 - Jul 2021)



Source: PCA Jul-21

Precinct	As at Jul-21	As at Jan-21
City Core	9.8%	9.1%
Midtown	10.5%	9.6%
Western Corridor	7.6%	6.6%
Walsh Bay / The Rocks	7.3%	6.3%
Southern	9.5%	10.9%
Sydney CBD	**9.2%**	**8.5%**

Building Grade	As at Jul-21	As at Jan-21
Premium	5.5%	6.0%
A Grade	11.3%	9.7%
B Grade	9.4%	8.9%
C Grade	10.7%	9.4%
D Grade	8.4%	9.2%
Sydney CBD	**9.2%**	**8.5%**

Source: PCA Jul-21

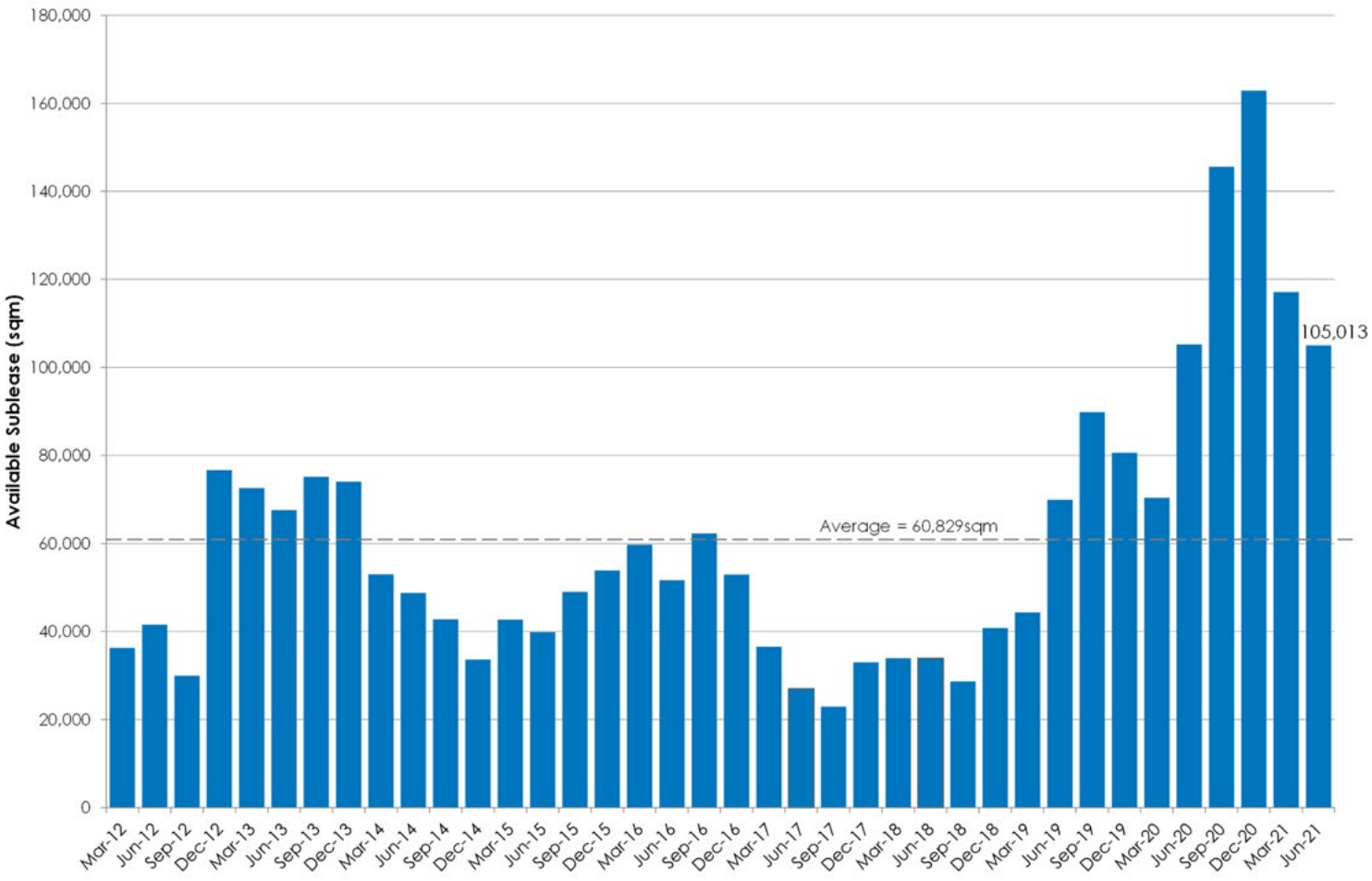
Sub-lease availability

The amount of available sub-lease space in the CBD fell for a second successive quarter, to 105,013sqm, after exceeding 160,000sqm in Q4 2020. Despite the falls, available sub-lease is currently still well above pre-COVID levels and almost double the amount averaged over the last 9½ years.

The largest tract of available sub-lease can currently be found at Quay Quarter Tower, which is still under construction. AMP has put 12,770sqm of its committed space on the market as the company undergoes significant corporate change.

Other significant tranches of sub-lease space can presently be found at 347 Kent St (6,624sqm, from Zurich Financial Services), Grosvenor Place (5,700sqm, Deloitte) and Darling Park 2 (5,697sqm, IAG).

Sublease availability



Source: Cadigal

Rents

Sydney CBD face rents have held firm at elevated levels, across all grades, falling very marginally over 2020 before recovering the small losses in 2021.

Incentives continued to rise over Q2 2021, however, the pace has slowed substantially. Average incentive levels for Premium and A grade space have now exceeded the previous peaks reached in late-2013/early-2014 whilst they are about the same for B grade.

Slight face rental growth and further softening of incentives combined to see effective rents ease down lower over Q2 2021.

Since peaking in Dec-19, effective rents have fallen 14.0%-23.8% in 18 months and are now back at 2017 levels. However, the rate of decline in effective rents has slowed over the last 2 quarters.

	PREMIUM			A GRADE			B GRADE		
Rent	**Average Rate (psqm)**	12 month change	6 month change	**Average Rate (psqm)**	12 month change	6 month change	**Average Rate (psqm)**	12 month change	6 month change
Net Face	$1,281	-0.9%	0.3%	$1,029	-0.6%	0.3%	$840	1.1%	1.9%
Gross Face	$1,500	-0.3%	0.4%	$1,212	0.7%	0.8%	$1,007	1.1%	1.6%
Net Effective	$751	-13.2%	-4.2%	$608	-12.3%	-2.2%	$516	-9.9%	-0.5%
Gross Effective	$971	-9.9%	-3.0%	$791	-8.2%	-1.0%	$684	-7.4%	-0.4%

Data as at Jun-21

Source: Cadigal

Outlook

Total stock grew 3.4% in the last 12 months and is over 5.1mil sqm for the first time. There is 190,000sqm under construction and due to be delivered in the next 2 years. Almost 85% of this (160,302sqm) is expected to arrive in 2022.

Whilst some 60% of the space under construction is pre-committed to tenants, sub-leasing can distort the picture as this additional availability still has the ability to impact the market.

The supply outlook beyond 2023 is buoyant, driven by the imminent commencement of three Metro station towers.

Tenant demand continues to be weak and, with Sydney still under lockdown, is likely to remain that way at least in the near term. However, as was seen over the second half of 2020 and into 2021, demand can pick up quickly after a pause in market activity. The rebound in enquiry in Q1 2021, as well as the positive net absorption recorded in the first half of the year, are testament to that. We expect a similar response once the market reactivates.

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Vacancy rates spiked up over 2020 and rose further, though less sharply, over the first half of 2021. We expect vacancy rates to continue to move higher, driven by the combination of impending supply and expected tepid demand. How high vacancy rates go will depend on how weak (or strong) tenant demand proves to be.

Whilst A grade currently has the highest vacancy rate in the CBD, we expect a continued "flight to quality" by tenants to result in Prime (Premium and A grade) stock outperforming Secondary in the current environment.

Face rents have returned to mild growth, and effective rents signs of reaching a floor, over the last quarter or so. However, we expect the bottoming out of effective rents to be prolonged with the current lockdown, the end of which is still yet to be determined.