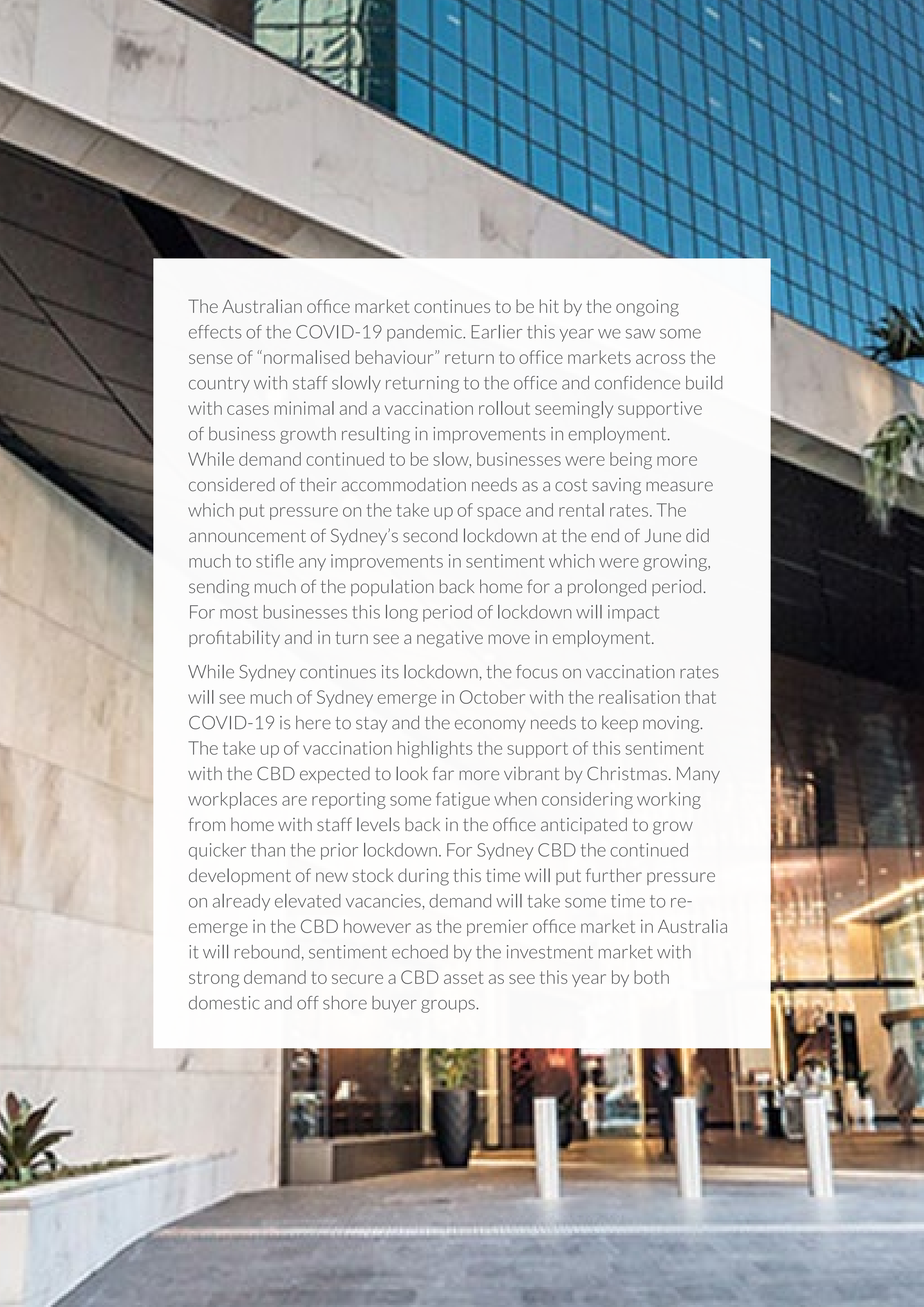

Ray White

Commercial Research

# BETWEEN THE LINES

## Sydney CBD Office (including Strata)

September 2021



The Australian office market continues to be hit by the ongoing effects of the COVID-19 pandemic. Earlier this year we saw some sense of “normalised behaviour” return to office markets across the country with staff slowly returning to the office and confidence build with cases minimal and a vaccination rollout seemingly supportive of business growth resulting in improvements in employment. While demand continued to be slow, businesses were being more considered of their accommodation needs as a cost saving measure which put pressure on the take up of space and rental rates. The announcement of Sydney’s second lockdown at the end of June did much to stifle any improvements in sentiment which were growing, sending much of the population back home for a prolonged period. For most businesses this long period of lockdown will impact profitability and in turn see a negative move in employment.

While Sydney continues its lockdown, the focus on vaccination rates will see much of Sydney emerge in October with the realisation that COVID-19 is here to stay and the economy needs to keep moving. The take up of vaccination highlights the support of this sentiment with the CBD expected to look far more vibrant by Christmas. Many workplaces are reporting some fatigue when considering working from home with staff levels back in the office anticipated to grow quicker than the prior lockdown. For Sydney CBD the continued development of new stock during this time will put further pressure on already elevated vacancies, demand will take some time to re-emerge in the CBD however as the premier office market in Australia it will rebound, sentiment echoed by the investment market with strong demand to secure a CBD asset as see this year by both domestic and off shore buyer groups.

## SYDNEY CBD OFFICE

### Vacancy by Quality Grade

| | | |
|---|---|---|
| Premium | ↓ | 5.5% |
| A Grade | ↑ | 11.3% |
| B Grade | ↑ | 9.4% |
| C Grade | ↑ | 10.7% |
| D Grade | ↓ | 8.4% |

### Sydney CBD Stock
**5,149,548sqm**

| | |
|---|---|
| Completions | **104,721sqm** |
| Withdrawals | **37,290sqm** |
| Net Supply | **67,431sqm** |

Net Absorption (6 months)
**27,269sqm**

Total Vacancy ↑ **9.2%**

Sub-lease Vacancy ↔ **1.3%**

### Vacancy by Precinct

| | | | | | |
|---|---|---|---|---|---|
| Core | ↑ | **9.8%** | Midtown | ↑ | **10.5%** |
| Western Corridor | ↑ | **7.9%** | Southern | ↓ | **9.5%** |

### Net face rents

**Prime** ↔ $1,080/sqm

**Secondary** ↔ $860/sqm

Incentives
**30-35%**
range

### Investment yields

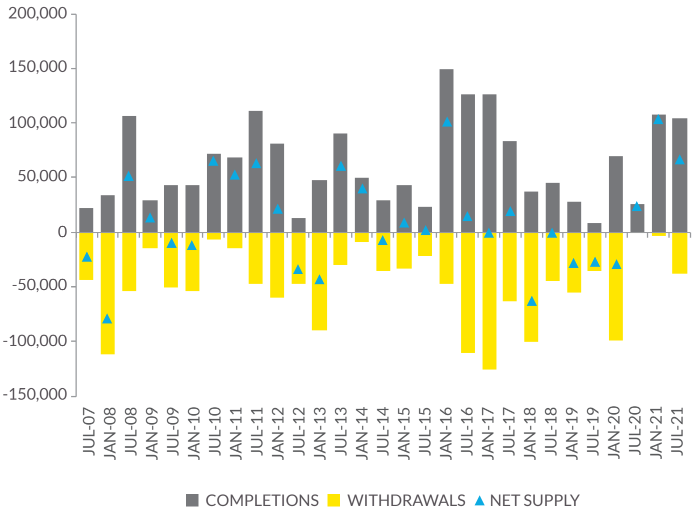
**Prime** ↘ 4.25%

**Secondary** ↘ 5.25%

*Source: Ray White Commercial, Property Council of Australia*

# SYDNEY CBD NET SUPPLY

Total office market (sqm)



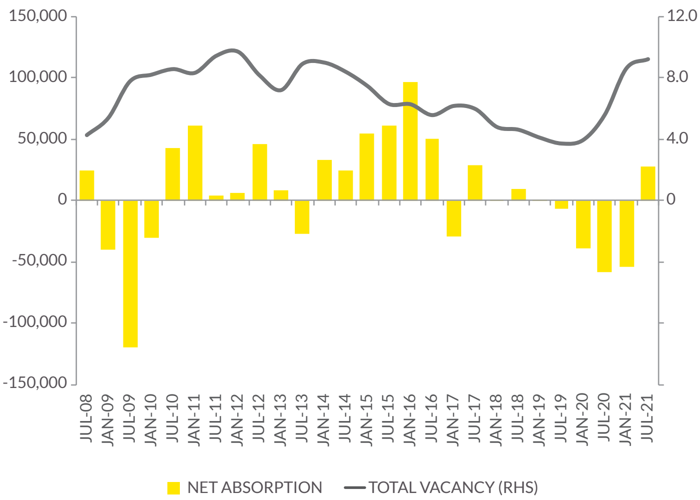

*Source: Property Council of Australia*

Sydney CBD is amidst a supply boom, while new stock has been entering the market consistently over the past five years the ongoing withdrawal of stock notably for the Sydney Metro project has kept total stock levels relatively stable. However, looking ahead there is over 200,000sqm of stock expected to be completed over the next 12 months, three of the major completions being total redevelopments with strong levels of commitment including the AMP precinct of over 75,000sqm, 180 George Street (Salesforce building), 55,207sqm and 210 George Street (16,500sqm) with a further 53,600sqm of refurbished stock across 7 projects.

During the first half of 2021 we saw the completion of over 100,000sqm of new stock including Brookfield Place and 44 Martin Place, the strong commitments of these assets were the driving force behind the positive net absorption recorded this period as tenants' transition. We saw withdrawal of stock mostly for refurbishment, it is expected that this trend will continue with owners taking their recently vacated assets off the market to refurbish and reposition to secure tenants. Beyond the next year, there is a further 250,000sqm of DA Approved or Applied new developments in the pipeline for the Sydney CBD, it is anticipated many of these projects may now be put on hold or reconsidered in the short to medium term until demand levels improve and will be unlikely to proceed unless sizeable commitment is obtained.

# SYDNEY CBD NET ABSORPTION AND TOTAL VACANCY

Total office market (sqm), %

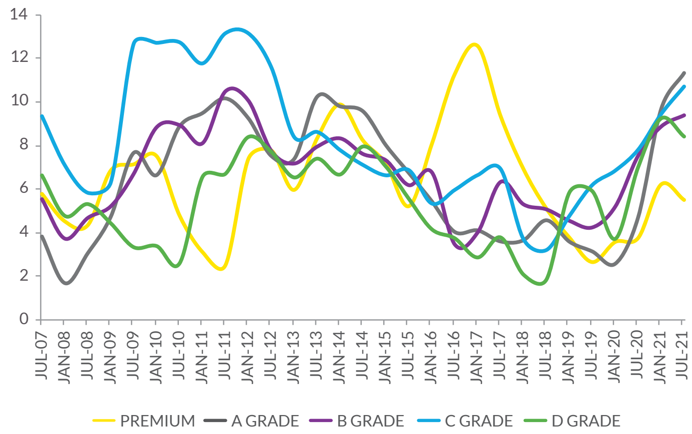



*Source: Property Council of Australia*

Unlike most CBD office locations, Sydney CBD has recorded positive take up in space during the six months to July 2021 the first time since late 2018. Net absorption of 27,269sqm remained well behind the net supply addition of 67,431sqm which resulted in vacancies increasing to 9.2%. It is anticipated that this positive take up is aligned to the pre-commitments of new stock additions which saw business relocation and expansion however the underlying reduction in demand coupled with the movements across the CBD will see absorption levels again reduce next period and are likely to remain limited in the short term which will result in a continued increase in total vacancy. This period we also saw sub-lease vacancy at 1.3% which is slightly behind last period as much staff returned to work early in the year which aided in growing confidence with some stock exiting the market, however given the current lockdowns in Sydney this will set the CBD back again growing this sub-lease component. Employment demand continues to be limited and businesses will continue to rationalise their office accommodation needs as working from home is more acceptable, this current Delta variant has shown that COVID-19 will be here to stay and vaccination pressures will see the return to work protocols differ across businesses impacting their accommodation needs.

# SYDNEY CBD VACANCY

by quality grade (%)



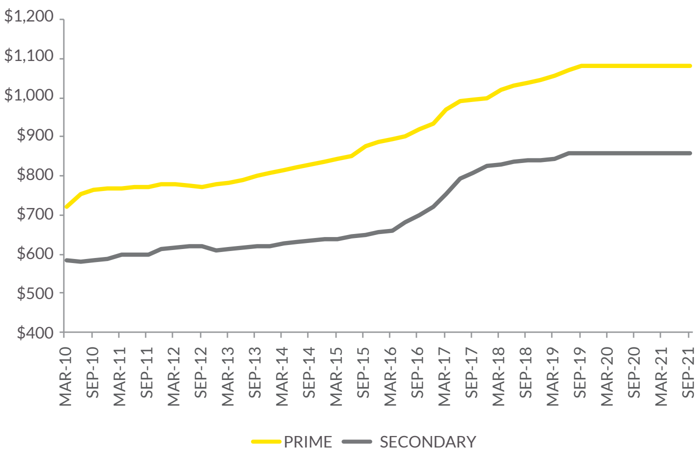

*Source: Property Council of Australia*

Sydney CBD faired well compared to many other CBD locations across the country due to the sizeable positive take up recorded this period despite the growing supply additions. As such we saw Premium grade occupancy improve, while this was linked to pre-commitment of new stock, demand increases also saw take up grow to close to 70,000sqm as businesses have taken advantage of the sizeable incentives and offerings to upgrade, this resulted in vacancies now representing 5.5%. We see A grade vacancy growing to the highest of all quality grades now recording vacancy of 11.3%, while B grade has also grown to 9.4% which highlights both the rationalisation of space, business closures as well as tenants upgrading their facilities to Premium grade assets.

Secondary assets such as C and D grade have had mixed results, C increasing to 10.7% while the very small D grade has seen some improvement to 8.4% however historically this can be very volatile. With rental rates expected to show some compression and incentives remain high, there is scope for attracting suburban tenancies into the CBD however the uncertainty surround COVID-19 and the models regarding returning to work differing so greatly may result in the recovery for these secondary assets being much longer term, particularly given the high supply projections to continue for the Sydney CBD.

# SYDNEY CBD NET FACE RENTS

$/sqm



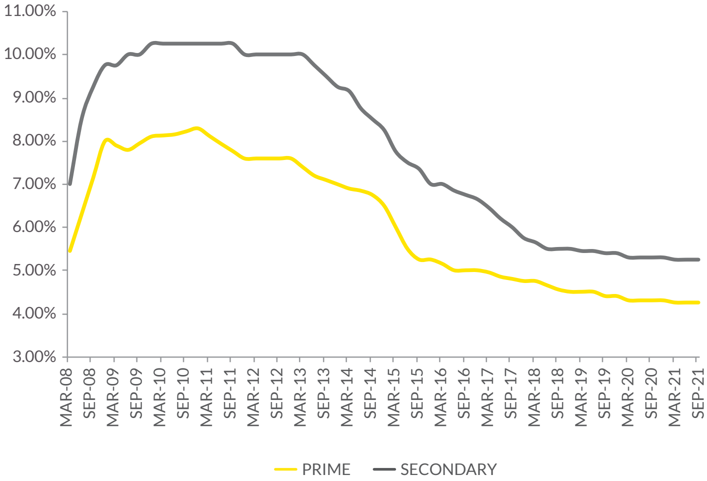

*Source: Ray White Commercial*

Rents will be under some pressure during this second lockdown phase with the prolonged work from home mandates keeping the CBD quiet. Growing vacancies are expected to be a continuing trend in the short to medium term given the strong supply pipeline and limited employment growth projections for the State. To date we have seen no discounting in face rental rates as landlords have been reluctant to move, instead rather offer greater flexibility and options around incentives.

Prime net face rents have remained static averaging $1,080/sqm however still within a broad range, the completion of new Premium quality stock will keep the upper rates steady however incentives for this class of asset is likely to further increase, discounting effective rents. Secondary however are less likely to grow incentive levels with rents currently stable at $860/sqm net. Tenants will become more selective as option levels grow and competition will emerge across landlords, automation and features enhancing hygiene may again be elevated as the realization of the longevity of COVID-19 in our society.

# SYDNEY CBD AVERAGE YIELDS

## Total office market by quality grade




*Source: Ray White Commercial*

Despite the fundamentals of the Sydney CBD office market being imbalanced this has not dampened demand to invest in commercial assets. Sydney remains the premier office location in Australia for both domestic and offshore buyers seeking a foothold into the Australian office market. As a result we have seen trophy assets transact this year achieving new lows in yields, most recently a half stake in the EY Centre at 200 George Street changed hands on a reported yield of 4.10% to London based M&G Real Estate for $575 million. Highlighting the appetite of foreign buyers into the Sydney market due to Australia's relative economic stability is the 50% stake in Grosvenor Place which achieved a yield of 4.80%, selling for $925 million to Chinese group CIC.

Demand remains heightened for quality investment stock in all price ranges, the weight of funds keeping investment yields low despite the current mismatch in market fundamentals. Investors continue to have a long-term confidence in this asset class and the premium nature of Sydney CBD as a true global city.

# SYDNEY CBD STRATA OFFICE MARKET

| Volume of Sales 2021* | 2021* Average $/sqm | Annual Change |
|---|---|---|
| **$69.73 million** | ↔ **$13,474/sqm** | **-0.19%** |

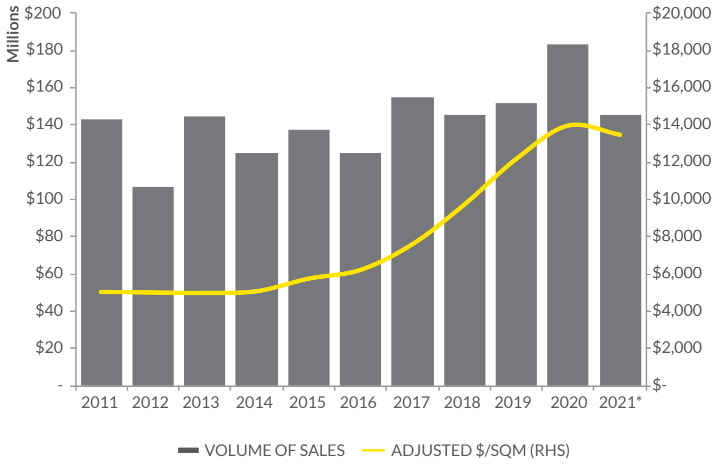
## 2021* Capital Value by precinct

| | | | |
|---|---|---|---|
| Core | ↔ **$15,463/sqm** | Midtown | ↔ **$12,447/sqm** |
| Western Corridor | ↓ **$11,372/sqm** | Southern | ↑ **$10,780/sqm** |

*Source: Ray White Commercial *to 1 September*

# SYDNEY CBD VOLUME AND CAPITAL VALUES

## Strata Office



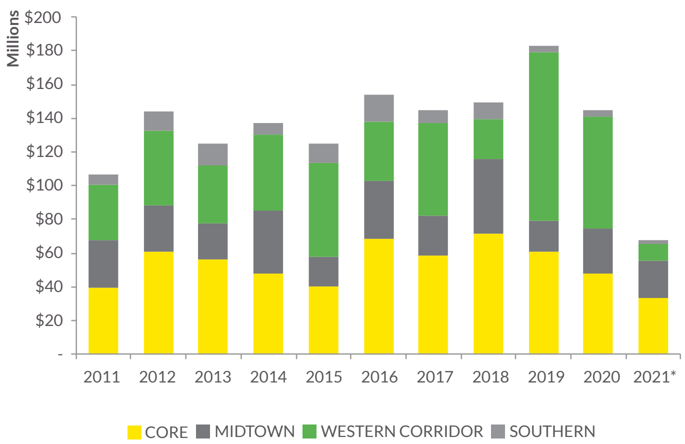

*Source: Cityscope, Ray White Commercial *to 1 September*

Despite the broader uncertainties surrounding the office market borne from COVID-19, transaction activity has continued across the Sydney CBD Strata market private investors continue to seek out investment opportunities. Activity levels post 2020 lockdown had continued at a strong pace despite the slow return into the office for many businesses while the rationalisation of space and business closures put pressure on vacancy levels in turn impacting incentives and rents.

During the first half of 2021 we saw many larger, leased assets transact together with smaller offerings notably in the Core with many selling at Auction with competitive bidding highlighting the depth of demand for these assets. This year had shown some signs of promise for the office market as many businesses had returned to some form of normal however the mismatch supply and demand dynamic was expected to plague the Sydney CBD for some time. By the end of June and as Sydney entered lockdown, work from home mandates saw the CBD again quieten and over the coming weeks more and more businesses kept doors closed as concern regarding the Delta variant grew. This has stifled any recovery with pressure now back on staffing levels and accommodation costs for many businesses which could see Strata sales activity wane for the remainder of the year despite low interest rates and the weight of investor funds in the marketplace. Sales to date have been recorded at $67.73 million with most sales recorded pre lockdown with capital values holding stable on last year's results at $13,474/sqm.

# SYDNEY CBD SALE VOLUME BY PRECINCT

## Strata Office



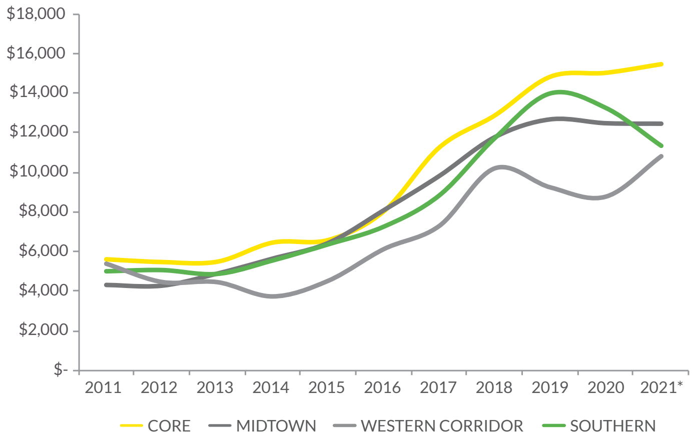

*Source: Cityscope, Ray White Commercial *to 1 September*

The bulk of all strata transactions recorded this year have been completed prior to lockdown, while volumes levels were expected to continue behind the prior years there was some optimism in the marketplace that the worst was behind us for the office market and we had entered the post COVID-19 economy. The underlying weight of funds and low interest rates were tipped to keep activity levels vibrant and despite the uncertainty surrounding all office assets, the premium location of Sydney CBD gave much confidence of long-term security. Many assets which transacted this period where fully occupied and sold on competitive yields ranging from 4.00% to 7.00% with the majority in the sub 5.50% range.

Core, being the premier location has seen the greatest level of activity, recording 13 sales representing over $33 million, followed by Midtown at $21.78 million. Western corridor has been the more active market for strata assets over the past two years given the investments into the Barangaroo precinct and future transport improvements however this year recorded just $10.30 million in sales while Southern which sees limited investment (of the few strata assets in this location) only recorded two sales.

# SYDNEY CBD CAPITAL VALUES BY PRECINCT

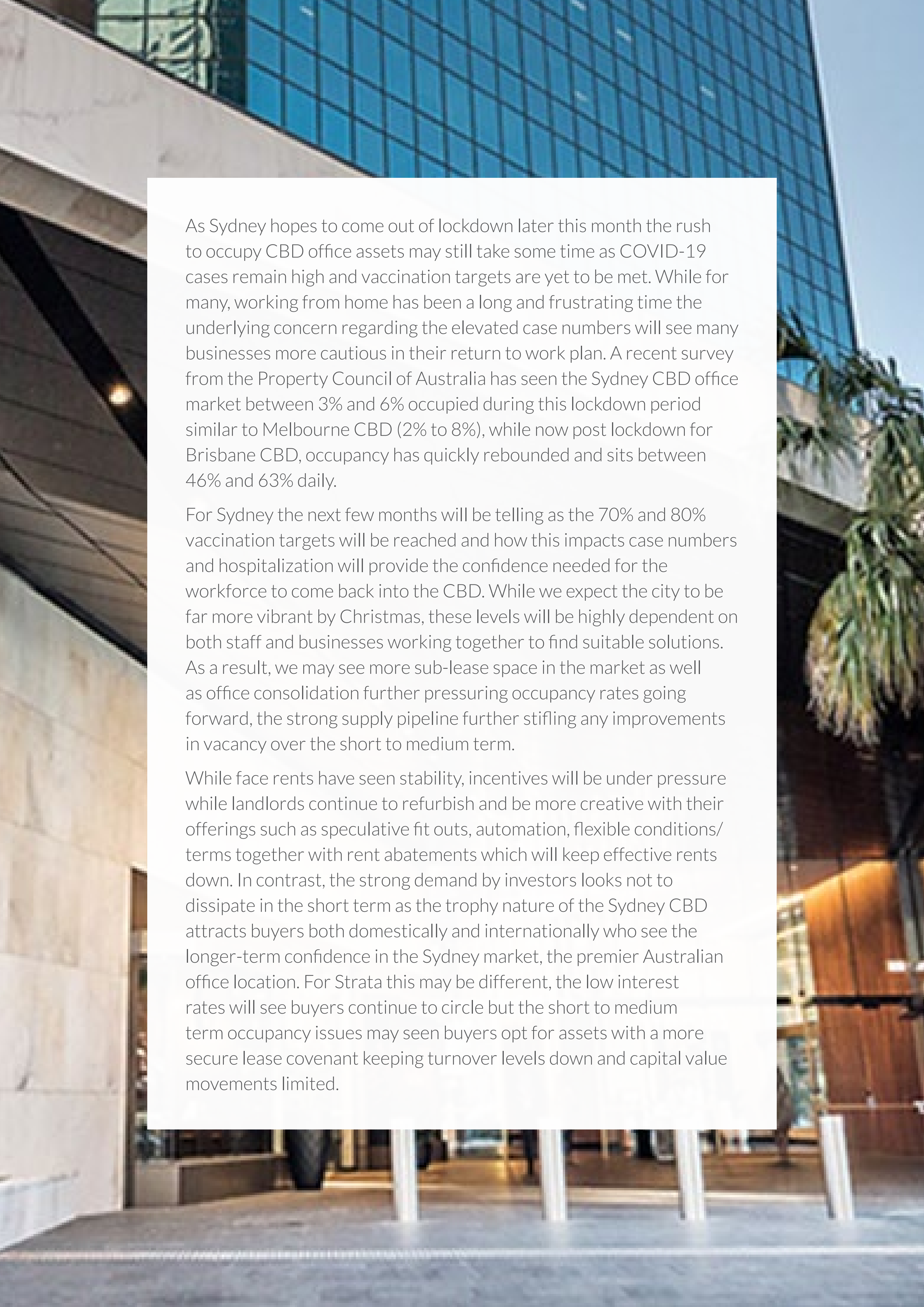
## Strata Office ($/sqm)




*Source: Cityscope, Ray White Commercial*

The results for capital values follow the investment levels by precinct, we can see those regions which recorded fewer sales being Western Corridor and Southern has shown some volatility, following on from their limited sales also recorded in 2020. Markets which have shown a more steady volume of sales continue to see some price appreciation or stability, Core remains one of the steadier performers increasing 2.90% on last years result to $15,463/sqm while Midtown saw minor movement down 0.19% to $12,447/sqm.

The few sales which occurred caused the Southern precinct values to grow to $10,780/sqm, this rate is similar to those achieved a few years ago and indicative of an appropriate average for this precinct, the prior few years we have seen limited assets transact which saw these values dip below $10,000/sqm. Conversely the Western Corridor which has had a resurgence in value in recent times saw some reduction due to a number of sales in lower grade stock, values this period ranged from $9,500/sqm to $15,000/sqm however given the larger sales in the sub $11,000/sqm price range brought the average down to $11,374/sqm after exceeding $14,000/sqm two years ago.



As Sydney hopes to come out of lockdown later this month the rush to occupy CBD office assets may still take some time as COVID-19 cases remain high and vaccination targets are yet to be met. While for many, working from home has been a long and frustrating time the underlying concern regarding the elevated case numbers will see many businesses more cautious in their return to work plan. A recent survey from the Property Council of Australia has seen the Sydney CBD office market between 3% and 6% occupied during this lockdown period similar to Melbourne CBD (2% to 8%), while now post lockdown for Brisbane CBD, occupancy has quickly rebounded and sits between 46% and 63% daily.

For Sydney the next few months will be telling as the 70% and 80% vaccination targets will be reached and how this impacts case numbers and hospitalization will provide the confidence needed for the workforce to come back into the CBD. While we expect the city to be far more vibrant by Christmas, these levels will be highly dependent on both staff and businesses working together to find suitable solutions. As a result, we may see more sub-lease space in the market as well as office consolidation further pressuring occupancy rates going forward, the strong supply pipeline further stifling any improvements in vacancy over the short to medium term.

While face rents have seen stability, incentives will be under pressure while landlords continue to refurbish and be more creative with their offerings such as speculative fit outs, automation, flexible conditions/terms together with rent abatements which will keep effective rents down. In contrast, the strong demand by investors looks not to dissipate in the short term as the trophy nature of the Sydney CBD attracts buyers both domestically and internationally who see the longer-term confidence in the Sydney market, the premier Australian office location. For Strata this may be different, the low interest rates will see buyers continue to circle but the short to medium term occupancy issues may seen buyers opt for assets with a more secure lease covenant keeping turnover levels down and capital value movements limited.

# RAY WHITE COMMERCIAL NSW
# SYDNEY OFFICE LEASING AND STRATA SALES

Anthony Harris
Principal
aharris@raywhite.com
M: +61 409 319 060

Andrew Telepis
Director
atelepis@raywhite.com
M: +61 415 972 696

Jeremy Piggin
Director
jpiggin@raywhite.com
M: +61 413 336 161

Marcus Plummer
Associate Director
mplummer@raywhite.com
M: +61 400 469 388

# RESEARCH

Vanessa Rader
Head of Research
vrader@raywhite.com
T: +61 2 9262 3700
M: +61 432 652 115

### NSW

**Ray White Commercial Eastern Suburbs**
raywhitecommercialeasternsuburbs.com
**Ray White Commercial (Greater Sydney South)**
raywhitecommercialnswgss.com
**Ray White Commercial Metropolitan Sydney**
raywhitecommercialnsw.com
**Ray White Commercial Newcastle**
raywhitecommercialnewcastle.com
**Ray White Commercial NSW - Sydney Office Leasing and Strata Sales**
raywhitesydneyleasing.com.au
**Ray White Commercial NSW-Sydney North**
raywhitecommercialnswsydneynorth.com
**Ray White Commercial South Sydney**
raywhitecommercialsouthsydney.com
**Ray White Commercial (Sydney City Fringe)**
raywhitecommercialsydneycityfringe.com.au
**Ray White Commercial Western Sydney**
raywhitecommercialnsw.com
**Ray White Retail (Sydney)**
raywhiteretailsydney.com
**Ray White Valuations**
raywhitevaluations.com.au

### NT

**Ray White Commercial (NT)**
rwcnt.com

### QLD

Ray White Commercial Bayside
raywhitecommercialbayside.com
Ray White Commercial Broadbeach
raywhitecommercialbroadbeach.com
Ray White Commercial Cairns
raywhitecommercialcairns.com
Ray White Commercial Caloundra & Sunshine Coast South
raywhitecommercialcaloundraandsunshinecoastsouth.com
Ray White Commercial Gladstone
raywhitecommercialgladstone.com
Ray White Commercial Gold Coast
raywhitecommercialgoldcoast.com
Ray White Commercial Noosa & Sunshine Coast North
raywhitecommercialnoosasunshinecoastnorth.com
Ray White Commercial Northern Corridor Group
raywhitecommercialnortherncorridorgroup.com.au
Ray White Commercial Qld
raywhitecommercialqld.com
Ray White Commercial Southport
raywhitecommercialsouthport.com
Ray White Commercial Springwood
raywhitecommercialspringwood.com
Ray White Commercial Toowoomba
raywhitecommercialtoowoomba.com
Ray White Commercial Townsville
raywhitecommercialtownsville.com
Ray White Commercial TradeCoast
raywhitecommercialtradecoast.com
Ray White Industrial Gold Coast
raywhiteindustrialgoldcoast.com
Ray White Industrial M1 North
raywhiteindustrialm1north.com
Ray White Industrial Milton
raywhiteindustrialmilton.com
Ray White Special Projects (Queensland)
raywhitespecialprojects.com
Ray White Valuations
raywhitevaluations.com.au

### SA

Ray White Commercial Adelaide Asset Management
raywhitecommercialadelaideassetmanagement.com.au

### VIC

Ray White Commercial Diston Asset Services
raywhitecommercialdistonassetservices.com
Ray White Commercial Ferntree Gully
raywhitecommercialferntreegully.com
Ray White Commercial Glen Waverley
raywhitecommercialglenwaverley.com
Ray White Commercial Oakleigh
raywhitecommercialoakleigh.com
Ray White Valuations
raywhitevaluations.com.au

### WA

Ray White Commercial (WA)
raywhitecommercialwa.com

### NZ

Ray White Auckland West Commercial
rwcaucklandwest.co.nz
Ray White Commercial Auckland
rwcommercialauckland.co.nz
Ray White Commercial Christchurch
rwcchristchurch.co.nz
Ray White Commercial Tauranga
raywhitecommercialtauranga.com