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Office Leasing commentary: 2018 end of year wrap and 2019 outlook

According to David Howson, Partner, Head of Office Leasing, Australia

“As we look ahead to the new year, the nation’s office leasing markets are in good health with a more even picture emerging across the markets after several years when Sydney and Melbourne have out-performed. Demand is rising in Brisbane, Adelaide and Perth underpinned by improving economic growth momentum, and coupled with a lack of new development in these markets this sets the scene for falling vacancy over the next 12 months.

Meanwhile, Sydney and Melbourne continue to see buoyant demand and a constrained supply pipeline over the next 12 months points to another year of strong rental growth and expansion to emerging markets outside the core CBDs.”

According to Aaron Weir, Partner, Head of Office Leasing, NSW

“In Sydney’s office leasing market, the first half of the year was more subdued than the industry was expecting – with demand-led absorption negligible. However, from Q3 onwards we have seen this change as demand-led absorption has increased significantly. This demand has largely been led by the TAMI (technology, advertising, media and information) and education sectors, as technology companies look to increase their foothold in Sydney, while universities are seeking sites with development potential.

We have seen an increase of corporate partnerships in the education sector, with companies and universities looking to work together to develop and access best-in-class talent and research.

We expect conditions to continue to tighten throughout 2019, with rising demand and a lack of stock inevitably leading to increasing rents and decreasing incentives. Sydney has always had a two-tiered market for major tenant pre-commits, and the flight to quality will continue as B-grade tenants seek A-grade space and A-grade tenants upgrade to premium stock. As tenants seek better quality, landlords with B-grade space will need to refurbish their stock to remain competitive.”

According to Mark McCann, Partner, Joint Head of Office Leasing, QLD

“In the second half of 2018, the Brisbane office market has continued to improve with a spike in tenant demand and improvement in overall transaction volumes across all asset grades.

This can be attributed to a combination of renewed business confidence and the planned level of major infrastructure projects within the CBD and fringe markets.

Major infrastructure projects like Cross River Rail have had a profound, positive impact on the CBD market with over 12,000sqm of deals transacted in 2nd half of 2018 as a result of tenant relocations from Brisbane Transit Centre. This is in addition to over 13,000sqm transacted last year as a result of the relocation of Government departments from the fringe to the CBD. In 2019, we anticipate significant project-related requirements to activate once the preferred tenderers are announced to commence design/construction of the Cross-River Rail Project.

Co-working/flexible space operators are continuing to be a source of tenant activity with the likes of We Work and The Hub now having established operations in the Brisbane CBD. The volume of existing and new global co-working groups interested in Brisbane is high with current combined active briefs of over 25,000sqm.

With this positive up-take in tenant demand, we are now experiencing a genuine lack of contiguous floor options in the Premium and A-grade sectors of the CBD. Accordingly, stabilisation and moderate face rental growth in this sector is being achieved with incentive levels remaining unchanged during second half of 2018.

The outlook for new supply in the CBD is now established. 300 George St is well under construction and due for completion mid-2019. The only other new development at this stage is 80 Ann St (Suncorp's new HQ) which has commenced demolition and is due for completion 2022/2023.

While the CBD is performing strongly, the fringe market is showing very encouraging signs, with a shift towards more activity in the last six months than we've seen in the past three years. In the fringe, high-quality, A-grade assets are performing well, especially with the lack of any new supply coming online, and the vacancy rate will fall later this year.

The Brisbane office market will continue to perform strongly in 2019 off the back of the momentum from 2018. We anticipate tenant demand and deal volumes to continue; new supply is limited to 300 George St, and the availability of contiguous options (excluding 300 George Street) will continue to diminish."

According to Hamish Sutherland, Partner, Head of Office Leasing, VIC

"Over the last four years enquiries for office space in the 100-500 square metre range has quadrupled, with a 107% increase in the last 12 months.

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Smaller occupiers, particularly those in the tech, services and construction sectors, will continue to be a source of demand for CBD office space.

The war for talent, a need to be closer to CBD-based clients and the benefits presented by speculative suites are reasons underpinning the rise of smaller occupiers in the CBD.

Strong employment growth has also driven solid tenant demand for Melbourne's CBD office space, all combining to create strong net absorption, with CBD absorption hitting 309,000 square metres over the past three years – the highest of all major Australian cities.

Furthermore, tenant demand in the Melbourne CBD continues to be robust, with recent net absorption being above the ten-year average contributing to record-low vacancy.

Coinciding with the tight vacancy, office rents in the Melbourne CBD have continued to increase across all grades.

Average prime net effective rents increased by 7.2% over the past year to reach around $414 per square metre. Average incentive levels are edging around 26% although incentive levels continue to be higher for pre-committing tenants.

Looking ahead, with the shortage of supply in the medium term, prime net face rents are forecast to increase by a further 9.2% by the end of 2019."

According to Ian Edwards, Partner, Joint Head of Office Leasing, WA

"2018 has been remarkable for medium/large tenants wanting to take advantage of a weak leasing market and commit to Perth's existing prime buildings, which have seen vacancies plummet.

The downside is that very large tenants (10,000sqm+) have now been cut out of the market and have resigned themselves to pre-committing to new office towers.

In addition to the 52,000sqm Chevron office tower proposed for Elizabeth Quay Knight Frank also expects to see two new 10,000sqm buildings on the western fringe of the CBD and probably another two 20,000 sqm towers for government occupancy announced over the next 12 months.
The Perth market is entering into its classic two tier market phase where large tenants are having to pay an equilibrium rent for new product, while at the smaller non-prime end of the market there is too much small space which is proving difficult to lease."

According to Martin Potter, Partner, Head of Office Leasing, SA

"The Adelaide office market has turned the corner, with positive net absorption over the past 12 months. An increase in activity in the A-grade sector has seen further reductions in vacancy in prime stock as the 'flight-to-quality' gathers pace and substantial tenants look to the CBD for their new offices.

The majority of leasing activity continues to be focused on A-grade stock. Tenants are taking advantage of generous incentives to fund their relocations, while also obtaining efficiency gains with new work practices. All tenant relocations currently result in better accommodation at a more affordable overall rent.

Building owners continue to rely upon relocations rather than tenant growth to fill their vacancies however strong new activity has come from the defence, Commonwealth and "not-for-profit" sectors which are experiencing solid growth.

Construction on Charter Hall's GPO Exchange office tower is well underway, which will be the catalyst for another wave of relocations into 2020. We anticipate the re-stacking of A and B-grade buildings as backfill strategies are put into play. The C and D-grade sectors will need to reposition their assets due to obsolescence and the gradual increase in staff densities leading to a reduction in occupied space."

According to Daniel McGrath, Director, Commercial Sales & Office Leasing, ACT

"The overall vacancy rate across the total Canberra market decreased from 13.2% to 12.5% in July 2018, and it is expected to further decrease when the January 2019 figures are released – largely off the back of record-high withdrawals amongst lower-grade stock. Residential conversions are driving stock withdrawals, particularly in the secondary market – further reducing availability of stock for commercial use.

A-grade vacancy remains tight across the Canberra market, with lower-grade stock experiencing increased volatility as tenants seek to upscale their quality of office accommodation. Tight vacancy in the Civic and Parliamentary precincts has increased prime gross face rents by 2.6% over the past 12 months.

"The second half of 2018 has yielded favourable results in the smaller private-sector market as landlords continue to pursue speculative fit-outs. A driver for this is an increase in young organisation or new entrants to the Canberra market seeking turn-key opportunities in quality accommodation. In addition, the biggest competition in the smaller suite market tends to be the 'stay-put' option and speculative fit-outs are providing a clear alternative for tenants to relocate without the distraction of designing and building a fit-out.

Over 60,000 sqm of new supply is currently under construction over three developments and expected to reach completion over the next 24 months. These developments include two towers in Constitution Place in the City (32,000sqm), committed to by the ACT Government in one tower and various private sector tenants in the other, 13-15 Challis Street Dickson

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(13,000sqm), committed to by the ACT Government and Civic Quarter (16,000 sqm), which is being constructed as a speculative development. The real effect of these developments is unlikely to be seen until 2020 when there will be a requirement to backfill older stock as tenants relocate into these new buildings.

The lack of demand from large Government departments in conjunction with tenant contraction, of note being Airservices Australia downsizing at 25 Constitution Avenue, was the catalyst for the negative absorption of 25,755 sqm in the six months to July 2018. The outlook for 2019 is somewhat underpinned by the Federal election and the initiatives that come out of this. Another crucial driver is the Office of Home Affairs, not only in how their relocation to 36,000 sqm the airport plays out, but which functions they absorb moving forward."

For further information, please contact:
Rebecca Sands, Director, PR & Communications, Australia
Rebecca.Sands@au.knightfrank.com +61 416 119 858

Tammy Clinch, PR Executive, Australia
Tammy.Clinch@au.knightfrank.com +61 410 714 135

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Notes to Editors

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