RESEARCH

SYDNEY CBD

OFFICE MARKET OVERVIEW **MARCH 2016**

HIGHLIGHTS

The pending arrival of 236,976m² of new prime stock during 2016 will result in a short term spike in the vacancy rate, before unwinding quickly in 2017 off the back of historically high withdrawal numbers.

Tenant demand in the CBD, as reflected by net absorption figures is currently at its highest level since 2005 and has significantly outperformed other national markets over the past year.

Underpinned by offshore capital, sales volumes in the CBD are tracking at record highs. 2015 sale volumes measured $6.23 billion, up 34% from the levels recorded in 2014, albeit with fewer deals.

KEY FINDINGS

CBD vacancy rate fell from 7.4% to 6.3% in the 12 months to January 2016, albeit remaining steady over the past six months as supply (149,498m²) was offset by solid demand (96,745m²) and stock withdrawals (47,217m²).

Office supply over the next 12 months is significant, underpinned by Towers 1 and 3 at Barangaroo. This is expected to result in a short term spike in the vacancy rate during H2 2016.

In the 12 months to January 2016, prime face rental growth was outpaced by the secondary market, with gross face rents up by 5.5% and 7.5% respectively.

A number of recent sales have confirmed yield compression for single prime assets, however firming remains strongest in the secondary market.

LUKE CRAWFORD
Senior Research Analyst

SUPPLY & DEVELOPMENT

The relatively soft period of supply within the Sydney CBD has ended with total supply during 2016 expected to be at its highest level in over a decade.

In gross terms, 149,498m² of stock was added to the Sydney CBD during the second half of 2015. Underpinned by the completion of the first Barangaroo Tower—T2 (88,200m²), this level of supply was 2.3 times above the average recorded over the past five years (64,331m² per six monthly period) and the largest six monthly increase in over a decade. Other notable projects to reach completion during the second half of 2015 included 5 Martin Place (31,280m²) and 20 Martin Place (15,290m²), while the balance stemmed from the ex Minter Ellison backfill space at 88 Phillip Street.

On a net basis, the withdrawal of office stock for alternative uses, redevelopment and refurbishment continues to have a large bearing on CBD stock levels with withdrawals totalling 47,217m² over the second half of 2015. Major withdrawals over the period included 60 Martin Place (27,855m²) which will be redeveloped to accommodate circa 40,000m² of office NLA. As a result, net supply over the second half of 2015 totalled 102,281m², well above the 10 year average of 22,169m².

Looking ahead, office supply is expected to remain significant over the next 12 months where a further 236,976m² of new office supply is scheduled for completion, equivalent to 3.7 times above the 10 year average. Imminent projects set for completion include 333 George Street (12,500m²) and T3 of Barangaroo (77,800m²) while 200 George Street (38,676m²), One Wharf Lane (6,400m²), and the Barangaroo T1 tower (101,500m²) are due for completion in the second half of 2016.

Despite the anticipated addition of 236,976m² of new prime space during 2016, office stock withdrawals will partly counterbalance upward pressure on the vacancy rate, albeit becoming more pronounced during 2017 following the completion of the Sydney Metro acquisitions. The pipeline of withdrawals throughout 2016 measures 36,764m² and includes 151 Clarence Street (16,000m²) and 130 Elizabeth Street (9,140m²), however in combination with backfill stock being withdrawn temporarily for refurbishment, the figure is significantly higher at circa 180,000m².

A pickup in withdrawal numbers is anticipated in early 2017, underpinned by the NSW Government's Sydney Metro Project where the compulsory acquisition of 19 CBD office buildings will result in withdrawals of almost 61,000m². With the withdrawal of stock constituting entirely secondary grade assets, and the majority of new supply being prime grade, the vacancy rates across grades will diverge with the secondary market expected to remain tight over the next two years. Alternatively, the displacement of circa 150 tenants as part of the project is likely to see a number of these occupiers trade up to higher quality buildings, thereby muting the impact of the prime office supply on the CBD vacancy rate over the medium term.

Beyond 2016, the supply pipeline is limited until 2019 with new supply over the medium term expected to stem from Darling Square (20,000m²), 151 Clarence Street (19,910m²) and refurbished backfill space. From 2019 onwards the next round of projects include 60 Martin Place (40,000m²) and the Ribbon (38,000m²).

TABLE 1
Sydney CBD Office Market Indicators as at January 2016

Grade	Total Stock (m²)	Vacancy Rate (%)	Annual Net Absorption (m²)	Annual Net Additions (m²)	Average Gross Face Rent ($/m²)	Average Incentive (%)	Average Core Market Yield (%)
Prime	2,789,551	6.30	187,773	160,294	800 - 1,200	28.0 - 29.0	5.00 - 6.25
Secondary	2,276,921	6.21	-30,623	-55,550	625 - 775	26.0 - 28.0	6.25 - 7.00
Total	**5,066,472**	**6.26**	**157,150**	**104,744**			

Source: Knight Frank Research/PCA

MAJOR OFFICE SUPPLY

1. 1 Farrer Pl# (ex GPNSW) - 30,573m^2 [Minter Ellison]
DEXUS/GPT/APPF - Q2 & Q4 2015 - Complete
2. Barangaroo T2 - 88,200m^2 [Westpac/Gilbert + Tobin/St George]
LLITST - Q3 2015 - 89% committed
3. 5 Martin Place - 31,280m^2 [Ashurst/Challenger/PIMCO/Dropbox]
DEXUS/Cbus - Q3 2015 - 96% committed
4. Aurora Pl, 88 Phillip St# (ex Minter Ellison) - 15,539m^2
NPS (Korea) - Q3 2015
5. 20 Martin Pl# - 15,920m^2 [Apple/Regus]
Pembroke Real Estate - Q3 2015 - 75% committed
6. Barangaroo T3 - 77,800m^2 [KPMG/Lend Lease]
LLITST - Q2 2016 - 76% committed
7. 80 Pitt St# (ex QBE) - 11,400m^2
Yorkban P/L - Q3 2016
8. 333 George St - 12,500m^2 [Gadens]
Charter Hall Core Plus Office Fund - Q2 2016 - 66% committed
9. 200 George St - 38,676m^2 [EY/Mirvac]
Mirvac/AMP - Q3 2016 - 99% committed
10. Barangaroo T1 - 101,500m^2 [PWC/HSBC/Marsh & McLennan]
LLOneITST - Q4 2016 - 48% committed
11. 225 George St# (ex Ashurst/J.P. Morgan) - 15,000m^2
DEXUS/CIC/CSC - H1 2016
12. One Wharf Lane, 161 Sussex St - 6,500m^2
M&L Hospitality - Q3 2016
13. 30 The Bond, 30 Hickson Rd# (ex Lend Lease) - 16,228m^2
DEXUS - H2 2016
14. 10 Shelley St# (ex KPMG) - 27,778m^2 [Suncorp]
Brookfield - H1 2017 - 86% committed
15. 255 Pitt St# (ex Challenger, Apple) - 15,427m^2
ISPT Core Fund - H1 2017
16. 201 Sussex St, DPIII (ex Marsh & McLennan) - 10,343m^2
GPT (GWOF) - H1 2017
17. 259 George St# (ex Suncorp) - 20,352m^2
Memocorp Australia - H2 2017
18. 275 Kent St# (ex Westpac) - 16,130m^2
Blackstone/Mirvac - H2 2017
19. 680 George St# (ex EY) - 28,033m^2
Brookfield/Arcadia - 2017
20. 55 Market St# (ex WBC) - 15,776m^2
CIC - 2017
21. Barangaroo C2 & C8 - circa 11,000m^2
Lend Lease - 2017+
22. Darling Square - 20,000m^2> [CBA]
Lend Lease - H1 2018 - 100% committed
23. 201 Sussex St, DPII# (ex PWC) - 33,000m^2 [IAG]
GPT (GWOF)/AMP (ACPF)/Brookfield - 2018 - 100% comm.
24. 151 Clarence St - 19,910m^2 [Arup]
Investa - 2018 - 29% committed
25. 388 George St# - 36,151m^2 (ex IAG)
Investa/Brookfield - Q4 2018
26. The Ribbon, 1 Wheat Rd - 38,000m^2
Markham/Grocon - 2019+
27. 60 Martin Place - 40,000m^2
Investa/Gwynvill Properties - H2 2019
28. 33 Bligh St - 26,000m^2
Investa - 2019+
29. Quay Quarter Sydney - 89,000m^2
AMP - 2020+
30. 275 George St - ~7,000m^2
LaSalle Investment Management - 2019+
31. Wynyard Place - 65,000m^2
Brookfield - 2020+
32. CQ Tower, 182 George & 33 Pitt St - 60,000m^2
Lend Lease - 2020+
33. 55 Pitt St - 30,000m^2+
Mirvac - 2020+

Under Construction/Complete
DA Approved / Confirmed / Site Works
Mooted / Early Feasibility

Source of map: Knight Frank

LLITST refers Lend Lease International Towers Sydney Trust (50% CPPIB, 25% APPF Commercial, 15% Lend Lease, 10% APG)

LLOneITST refers Lend Lease One International Towers Sydney Trust (37.5% Lend Lease, 37.5% QIA, 25% APPF Commercial)

NB. Dates are Knight Frank Research estimates

Includes select CBD major office supply (NLA quoted)

Major tenant precommitment in [brackets] next to NLA

Major refurbishment/backfill

> Office NLA only. Total NLA is 27,900m^2

TENANT DEMAND & RENTS

Notwithstanding economic headwinds to the broader Australian economy and volatility in financial markets, New South Wales, and in particular Sydney, continues to experience favourable economic conditions underpinned by elevated housing and infrastructure investment and a buoyant labour market. The latter has been the catalyst behind the marked improvement in leasing activity within the Sydney CBD where in the 12 months to January 2016, employment growth in NSW totalled 168,820, representing annual growth of 4.7% and accounting for 57% of jobs growth nationally for the period. At the same time, displaced tenants from stock withdrawals and tenant inflow from Sydney's suburban markets has supported heightened tenant demand levels in the CBD.

As a result of these dynamics, the Sydney CBD recorded net absorption of 96,745m² in the six months to January 2016, equivalent to 1.9% of total stock. Indicative of economic conditions within NSW, this result was the strongest in the country and the largest six monthly increase since the second half of 2005. Accordingly, strong tenant demand offset net supply of 102,281m², resulting in the vacancy rate remaining stable at 6.3%. Despite net absorption over the past six months being focussed on prime grade stock (see Figure 1), secondary asset stock withdrawals totalling 47,217m² meant that the differential between prime and secondary vacancies remains minimal at 6.3% and 6.2% respectively (see Figure 2).

Leasing activity within the prime market has benefited from secondary stock withdrawals where a number of displaced tenants have taken advantage of favourable incentive metrics and relocated to higher quality buildings. With a further 154,279m² of secondary stock withdrawals anticipated over the next 18 months (excluding refurbishments), coupled with large temporary backfill withdrawals resulting from major tenant moves to new developments, this trend is set to prevail.

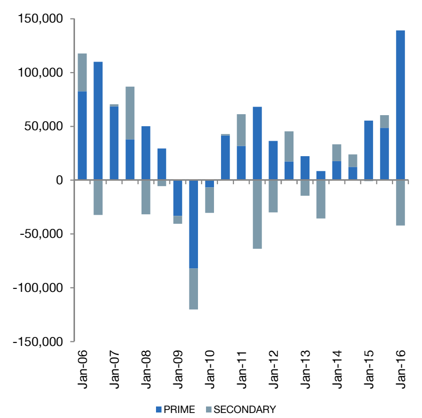
Unlike previous years, occupancy growth over the past 12 months has stemmed from a combination of continued demand for smaller sub 500m² fitted suites (albeit a recent easing) and large 5,000m²+ tenancies, driven by a need for expansionary space from businesses employing 200 or more workers. With approximately three in five employing businesses in the Sydney CBD having four or less workers, the persistent demand for small fitted out office suites has proven favourable for landlords with a number benefiting from faster letting up periods and reduced building vacancies. Underpinned by the current economic climate and recent government initiatives, the growth of small businesses in the CBD has been supported by increased demand from tech startups and coworking/ incubator space. With the City of Sydney releasing their Draft Tech Startups Action Plan in 2015, demand for small office suites is expected to be further strengthened over the coming 12 months, particularly as startups grow, thereby requiring their own office provisions.

In terms of larger space requirements, the primary driver has been the growth in the number of businesses employing 200 or more workers, the result of either tenant relocation to the CBD, M&A activity or businesses taking on more workers. In the 12 months to June 2015 (latest available data), the number of businesses employing 200 or more workers increased by 277% (from 71 to 268) in the Sydney CBD (Sydney - Haymarket - The Rocks SA2 region, see back page for definition), with the majority stemming from financial and professional services.

The technology sector has also been pivotal to this growth where 13 additional businesses employing 200+ workers were in the CBD in the year to June 2015. With a number of major enquiries for large prime CBD facilitates being circulated in recent months from banking, finance and technology sectors, demand for 5,000m²+ tenancies will remain robust during 2016, while a number of commitments agreed to in 2015 will progressively crystallise into office absorption data over the next 12 months. Large active briefs in the market include Google and Atlassian while NAB and Clayton Utz has begun searches for their next Sydney CBD headquarters.

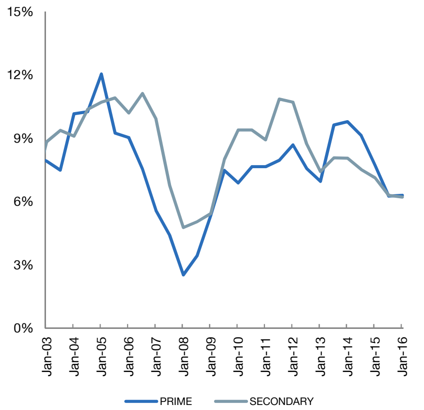
Stock withdrawals and weak supply in Sydney's suburban markets continues to draw a steady flow of non-CBD tenants to the CBD, which has directly added to net absorption. The availability of larger floorplates in the CBD coupled with elevated incentive levels has provided the impetus for inbound movements. Recent demand from suburban markets includes The Iconic (2,555m² - ex Surry Hills) and Serco (1,457m² - ex North Sydney).

FIGURE 1
Sydney CBD Net Absorption
Per six month period, by Grade (m²)



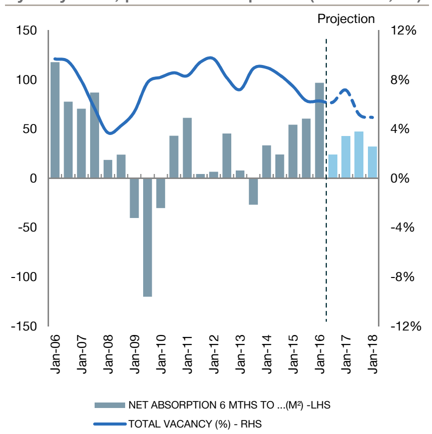
Source: Knight Frank Research/PCA

FIGURE 2
Sydney CBD Vacancy Rate
By Grade (%)



Source: Knight Frank Research/PCA

FIGURE 3
Net Absorption & Vacancy
Sydney CBD, per six month period (000's m², %)



Source: Knight Frank Research/PCA

Anticipated Vacancy Levels

A combination of modest organic growth and historically high levels of stock withdrawals is anticipated to fully offset the 110,550m² of supply due for the first half of 2016 (including refurbished backfill space), resulting in the vacancy rate falling slightly to 6.2% by July 2016.

For the second half of 2016, despite permanent and temporary withdrawals totalling 89,897m² for the period, the completion of T3 at Barangaroo (101,500m²) coupled with a further 88,606m² of new and refurbished supply is anticipated to result in some upward movement on the vacancy rate. In this case, the vacancy rate is expected to reach approximately 7.1% by the end of 2016.

Further ahead, the vacancy rate is forecast to reduce throughout 2017, bottoming out at around 4.9% by the end of 2017 off the back of further stock withdrawals totalling 183,589m² including the Sydney Metro buildings (totalling almost 61,000m²). This outlook is also underpinned by an absent period for new office development completions and a continuation of positive demand, albeit in line with historical trend levels. Beyond the Sydney Metro acquisitions, withdrawals during 2017 are partly driven by full office re-developments including 301 George Street (Thakral House), but also for change of use re-developments including Goldfields House.

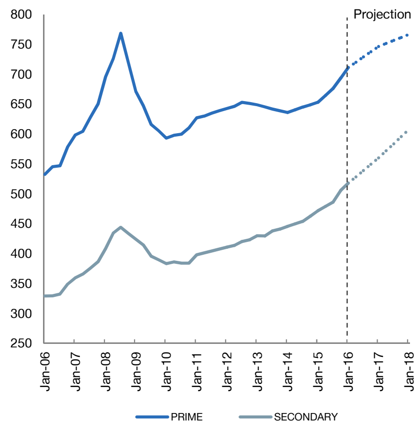
Rental Levels

With vacancies remaining low off the back of a large pick-up in tenant demand, rental growth in the CBD has been strong over the past 12 months. As at January 2016, annual growth in prime face rents measured 5.5% to $997/m² gross ($834/m² net). While growth across all precincts has been solid, the Western Corridor has experienced the strongest growth over the past 12 months, brought about by improved amenity and the completion of T2 at Barangaroo which set a new benchmark for rents in the area. Although very asset specific, prime incentives continue to decline, currently averaging between 28% to 29%, resulting in annual gross effective growth of 8.9% ($711/m²).

Following recent withdrawals, rental growth in the secondary market is currently at its highest level since early 2009, increasing 7.5% in the 12 months to January 2016 to $711/m² gross ($582/m² net). A moderate reduction in secondary incentive levels was also recorded, where they currently range between 26% and 28%, resulting in gross effective rents of $518/m² (annual growth of 9.8%). With the outperformance of secondary rents since late 2012 and the narrowing rental difference between prime and secondary, it's expected that some tenants will trade up to prime space, particularly given the more favourable incentive metrics, while others will be forced to consider non CBD markets.

Looking ahead, continued outperformance in the secondary market is anticipated where effective rental growth of 8.3% per annum over the next two years is expected, considerably above the prime market at 3.8% per annum for the same period. Following significant levels of supply in the prime market anticipated later in 2016, face rental growth is expected to slow to 2.0% during 2017 while average incentives are expected to remain at current levels over the same period as the market digests supply. For the secondary market, face rental growth of 5.0% per annum is anticipated over the next two years while incentives are anticipated to reduce to 22.5% over the next 18 months, before steadying in 2018.

FIGURE 4
Average Gross Effective Rents
Sydney CBD ($/m²)



Source: Knight Frank Research

TABLE 2
Recent Leasing Activity Sydney CBD

Address	Precinct	NLA (m²)	Term (yrs)	Lease Type	Tenant	Sector	Start Date
201 Sussex St	Western	1,512	5	Sub-lease	Salesforce	TMT	H2 2016
233 Castlereagh St	Midtown	811	2	New	Allianz	Finance & Insurance	Dec-16
255 George St	Core	1,370	10	New	Aberdeen Asset Mgmt	Finance & Insurance	Apr-16
19-29 Martin Pl	Core	1,400	7	New	McCullough Robertson	Legal	Apr-16
20 Bridge St	Core	570	6	New	Hedgeserv	TMT	Mar-16
99 Elizabeth St	Midtown	526	7	New	Neuro Physics	Healthcare	Mar-16
72 Bathurst St	Western	867	3	New	Lonsdale Institute	Education	Jan-16
52 Phillip St	Core	380	3	New	Enrizen Financial	Finance & Insurance	Jan-16
50 Bridge St	Core	2,303	1	New	The George Institute	Healthcare	Dec-15
83 Clarence St	Western	9,500	10	New	Amalgamated Tribunal	Government	Dec-15
1 Market St	Western	1,090	5	New	Madison Marcus	Legal	Dec-15
2 Park St	Midtown	1,835	7	New	Twitter	TMT	Nov-15
204 Clarence St	Western	877	10	New	Your Desk	Coworking	Oct-15
201 Elizabeth St	Midtown	1,153	5	New	Armstrong Services	Legal	Oct-15

Source: Knight Frank Research   TMT refers Technology Media & Telecommunications

INVESTMENT ACTIVITY & YIELDS

Throughout 2015 the commercial property market continued to attract heightened levels of domestic and offshore capital with national CBD investment volumes trending at historical highs ($10.62 billion), up 6.8% from the level recorded in 2014. The Sydney CBD has underpinned this growth with investment activity in 2015 measuring $6.23 billion, exceeding the previous high of $4.64 billion which was recorded in 2014. Interestingly, the number of deals recorded in 2015 was significantly less than 2014 (33 in 2015 v 42 in 2014) and reflects strong interest from investors seeking ‘trophy’ premium assets and assets becoming more tightly held.

Fewer buying opportunities coupled with significant capital inflow has resulted in further compression on yields which are beginning to approach the levels recorded in 2007 for both prime and secondary assets. As investors, particularly offshore buyers, embraced the concept of “lower for longer”, the relatively tighter yields in the Sydney CBD in comparison to other CBD and suburban locations have become an accepted norm in order to obtain key locations or trophy assets for the long term. In light of recent transactions, average prime core market yields are estimated to range from 5.00% to 6.25%, while secondary yields are estimated to range between 6.25% to 7.00%.

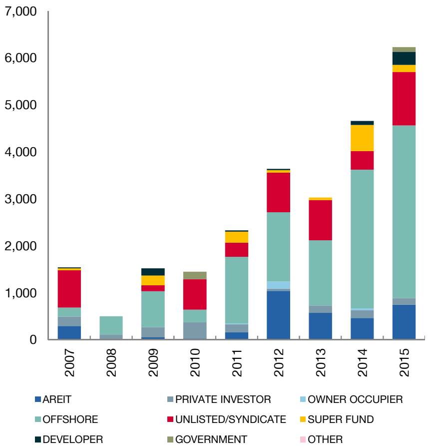
During 2015, offshore groups accounted for 59% of sales activity, or $3.7 billion, well above the five year average of $1.9 billion. This amount was largely the result of strong capital inflow from China ($2.8 billion) following the July 2015 purchase of the Investa Property Group (IPG) portfolio by China Investment Corporation (CIC) for $2.45 billion (including assets in Melbourne, Brisbane and North Sydney). More recently, Roxy Pacific & Tong Eng Group (both Singapore), acquired 117 Clarence Street for $81 million in December 2015 from Altis Property Group on a core market yield of 7.03%. There are also a number of assets currently in due diligence or awaiting approval from the Foreign Investment Review Board including a 25% stake in Tower 1 at Barangaroo to a large Asian sovereign wealth fund. Despite the recent strengthening of the $AUD, it remains 30% down from the heights recorded in 2011 making offshore groups increasingly competitive.

As a result of portfolio re-balancing and investment mandates, local funds (both listed and unlisted) became net buyers for the first time since 2010. Local unlisted funds have been the largest net buyers of local institutions since the beginning of 2015 with net acquisitions of $670.65 million. Notably, this result was boosted by the Lend Lease managed Australian

FIGURE 5

Sydney CBD Sales $10 million+

By Purchaser Type ($m)



Source: Knight Frank Research

TABLE 3

Recent Sales Activity Sydney CBD

Address	Price ($ mil)	Core Mkt Yield (%)	NLA (m²)	$/m² NLA	WALE (yrs)	Vendor	Purchaser	Sale Date
420 George St	Pending	c. 5.25	37,733	Pending	5.7	Fortius/APPF	Confidential	Pending
179 Elizabeth St	148.80	6.85	14,927	9,969	4.4	LaSalle Investment Management	Markham	Jan-16
77 King St>	160.00	5.76	13,680	11,696	4.2	K-REIT Asia	Invesco Asia Core Fund	Jan-16
60 Margaret St#	279.50	c.6.00	40,340~	13,857#	N/A	MTAA	Confidential	Jan-16
117 Clarence St	81.00	7.03	12,590	6,434	3.1	Altis Property Group	Roxy Pacific & Tong Eng Group	Dec-15
175 Castlereagh St*	98.00	N/A*	11,859	8,264	N/A*	Centuria Capital Ltd	NSW Government	Dec-15
Darling Square**	300.00	c. 6.00	20,000+	15,000	c. 12.0	Lend Lease	First State Super/ APPF<	Oct-15
160 Sussex St	56.70	7.10	8,090	7,009	4.4	JP Morgan Asset Mgmt‡	Burcher Property Group	Sep-15
110 Goulburn St	148.50	5.74	13,813	10,751	5.5	Kinder Investments	Commerz Real	Sep-15
155 Clarence St	124.07	6.10	12,500	9,925	5	St Hilliers	Eureka Funds Mgmt	Aug-15
Portfolio Sale^	2,450.00	5.60	N/A	N/A	N/A	Investa Property Trust (Morgan Stanley)	China Investment Corporation (CIC)	Jul-15

Source: Knight Frank Research > excludes Apple store # 50% share ~ Whole building < Australian Prime Property Fund
‡ New Star International ** Development + Office development NLA * Acquired for the Sydney Metro project
^ Nine asset portfolio including six Sydney CBD assets, namely 225 George St (85,511m², 25% share), 400 George St (50,108m², 50% share), 126 Phillip St (42,256m², 25% share), 255 Elizabeth St (28,450m², 100% share), 31 Market St (25,079m², 100% share) and 55 Market St (22,908m², 100% share).

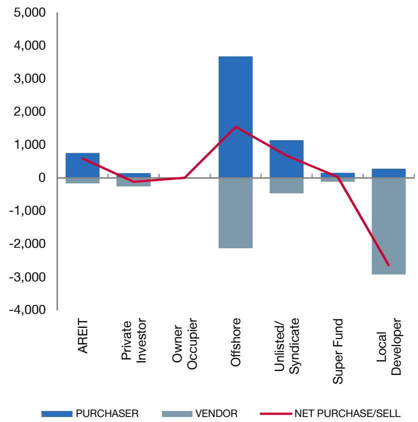
Prime Property Fund Commercial (APPF-C) 25% investment in Tower 1 at Barangaroo (circa $500 million following the establishment of the Lend Lease One International Towers Sydney Trust) and Propertylink's acquisition of 320 Pitt Street for $200 million.

Beyond this, particularly in the final quarter of 2015, remaining sales activity largely constituted development or change of use acquisitions including the APPF-C/First State Super (50% each) purchase of Darling Square from Lend Lease for approximately $300 million. The NSW Government also made their first acquisition as part of the Sydney Metro project, purchasing 175 Castlereagh Street for $98 million from Centuria Capital. The sale reflected a significant capital gain from the $56 million paid in 2013, although reflected compensation aspects.

With a number of early to mid 2015 sales trading at comparably soft yields, the IPG portfolio sale coupled with recent sales evidence has provided further clarity to yield metrics. In the prime market, firming of 67 bps has been recorded over the past 12 months with the pending sale of 420 George Street (see table 3 for details) for a core market yield of circa 5.25% confirming recent compression for single prime assets, while implying that a sub 5.00% yield for an upper prime asset may be achievable. With limited transactional evidence for lower A-grade assets, potential exists for greater yield compression in this segment of the market, closing the current 125 bps gap in the prime market yield range (range of 5.00% to 6.25%).

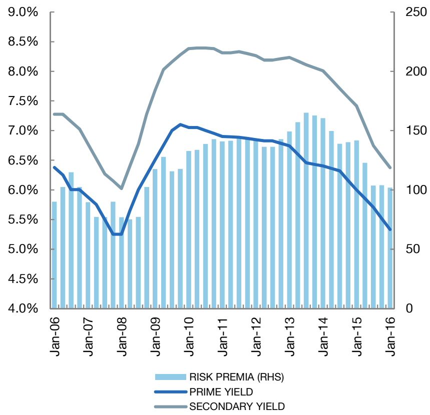
In the secondary market, average core market yields as at January 2016 are estimated to range between 6.25% to 7.00%, indicating firming of 100 bps over the past 12 months. In this environment, the current spread of 102 bps between prime and secondary yields is at their tightest level since 2008. Although this suggests the extent of further compression is becoming more limited, secondary yields still remain 35 bps softer compared to the 2007 peak, while the prime to secondary yield spread still remains 27 bps wider than 2007 metrics. These comparisons indicate that forthcoming firming is likely to be more pronounced in lower A-grade and secondary stock, particularly given the favourable leasing outlook over the next two years.

FIGURE 6
Sydney CBD Purchaser/Vendor
$10 million+ sales - 2015



Source: Knight Frank Research

FIGURE 7
Sydney CBD Yields & Spread
Core Market Yields - Prime vs Secondary



Source: Knight Frank Research

Outlook

- Current economic growth in NSW shows no signs of abating with the state and in particular Sydney continuing to benefit from a broader structural shift in the Australian economy, away from mining towards service sectors. These factors are anticipated to underpin leasing conditions within the Sydney CBD over the next two years, further supported by ongoing growth in the US economy.
- Despite significant levels of new supply entering the market throughout 2016, stock withdrawals for alternative uses will place a cap on the vacancy rate. With further withdrawals as part of the Sydney metro project, the short term spike in the vacancy rate to circa 8.5% previously forecast will not occur.
- Face rental growth in the prime market is anticipated at 4.0% in 2016 before easing to 2.0% in 2017 as the market digests short term supply. Outperformance in the secondary market is expected off the back of further stock withdrawals, resulting in forecast rental growth of 5.0% during 2016 and 2017. Effective rental growth in the secondary market is likely to be above 8.0% over this period as incentive levels reach circa 22.5% by January 2018.
- In the investment market, further yield firming is anticipated, albeit remaining largely confined to lower A-grade and secondary stock. With pricing parameters in the secondary market continuing to reflect alternative use potential, the spread between prime and secondary yields is expected to converge throughout 2016.
- With several large sales already in 2016 including a 50% interest in 60 Margaret Street and pending deals such as 420 George Street, investment volumes are anticipated to remain above the five year average, but unlikely to be as strong as 2014 and 2015.
- Even with the firming of yields over the past two years, yields remain well above the cost of debt which will also help fuel sustained levels of demand during 2016.

Sydney - Haymarket - The Rocks SA2 region:
A Statistical Area Level 2 (SA2) region is an Australian Bureau of Statistics (ABS) defined area as part of the Australian Statistical Geography Standard (ASGS). The Sydney - Haymarket - The Rocks SA2 region broadly encompasses the Sydney CBD, extending south to Central Station, east to the Botanic Gardens, west to eastern part of Pyrmont and north to Sydney Harbour.

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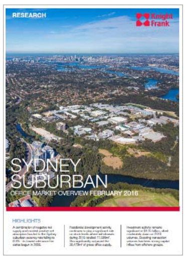

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