Australian office indicators

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Key leasing and capital markets metrics across the Australian office market Q3 2024

Improving sentiment driving greater liquidity

PUBLIC AND PRIVATE MARKET SENTIMENT IMPROVING

Market sentiment has improved significantly in recent months, as investors respond to the shift in focus from central banks globally from mitigating the risk of persistent inflation to safeguarding growth. Rates have now been cut across most major economies and real estate markets have responded positively, with the listed REIT sector rallying since July. Despite Australia being behind the curve in terms of rate cuts, our market has responded more strongly, indicating that investors anticipate the correction is nearly at an end and that valuations will soon begin to recover.

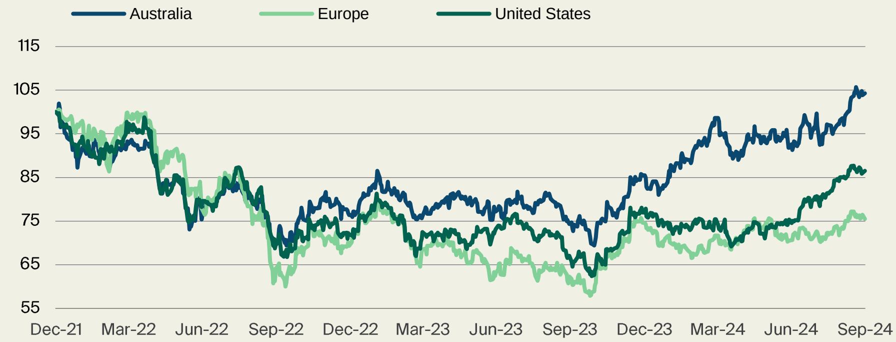
RECENT DEALS INDICATE THAT PRIME YIELDS HAVE STABILISED

Private markets have also shown improving sentiment resulting in a pick-up in deal activity in office markets. After a protracted drought, the past few months have seen a raft of large deals in Sydney, Brisbane and Melbourne that will go a long way to establishing a new baseline for pricing and unlocking further activity. Indeed, we consider that prime yields have largely stabilised for core assets, led by Sydney which has seen higher deal volumes and hence more evidence of pricing.

DIVERGENT RENTAL PERFORMANCE

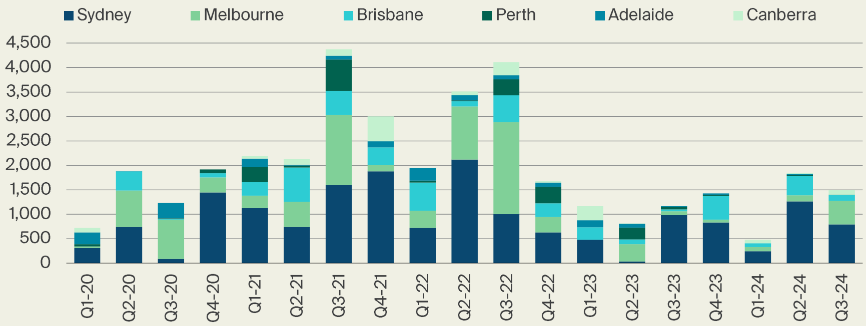
Meanwhile, in leasing markets, deal momentum and rental performance continues to differ by location. Net face rents in Brisbane shifted up further by 4.2% in Q3, to be up by 11.4% over the year, while other markets were broadly stable. Tenants have become more cautious in recent months, reflecting sluggish business sentiment and high fit-out costs associated with moving, so a higher proportion are opting to stay-put.

Listed markets have rallied in response to rate cuts
Global REIT price indices, 31 Dec 2021 = 100



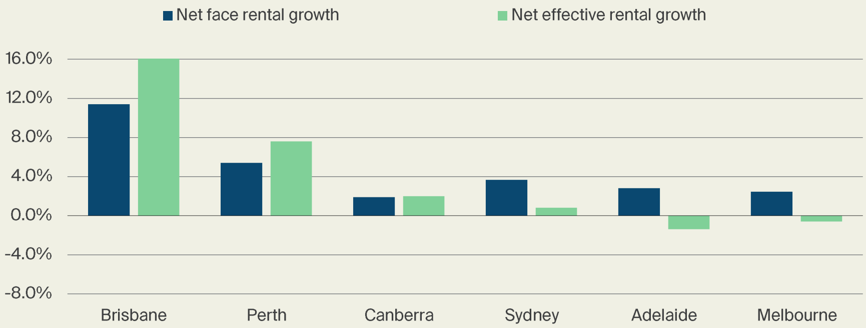
Source: Knight Frank Research, Macrobond

CBD office investment volumes have started to recover
Quarterly volume by city, A$ millions



Source: Knight Frank Research, RCA

Fastest rental growth in Brisbane and Perth
Net face rental growth vs net effective rental growth, %



Source: Knight Frank Research

Key data points

Prime market averages – Q3 2024

	Net face rent ($/sqm)	Growth (q/q, %)	Growth (y/y, %)	Incentives (%)	Net effective rent ($/sqm)	Growth (q/q, %)	Growth (y/y, %)	Yield (%)	Overall vacancy (Q2 PCA, %)
CBDs									
Sydney	1,320	0.2	3.7	36.4	753	-0.4	0.8	6.03	11.6
Melbourne	717	0	2.4	47.0	385	0	-0.6	6.46	18.0
Brisbane	769	4.2	11.4	39.0	391	4.8	16.4	7.25	9.5
Perth	726	0	7.1	46.0	392	0	12.9	7.38	15.5
Adelaide	510	0	5.7	34.3	285	0	-1.6	7.25	17.5
Canberra	453	0	1.9	27.0	300	0	2.0	7.07	9.5
Suburban									
North Sydney	909	0	1.7	38.0	503	0	-0.5	6.90	23.5
St Leonards	659	0	0.8	38.0	354	0	-1.9	7.75	26.5
Chatswood	631	0	0.6	36.0	352	0	-2.1	7.65	20.6
Macquarie Park	465	0	2.2	38.0	288	0	-2.5	7.25	19.3
Parramatta	589	0	0.4	37.5	368	0	-2.3	7.41	19.4
Southbank	670	0	8.1	40.0	402	0	8.1	6.50	18.6
St Kilda Road	525	0	0	50.0	260	0	-10.0	8.25	27.4

Recent transactions

	Property	Price (A$m)	Size (sqm)	Purchaser	Vendor	Core market Yield (%)	WALE
CBDs							
Sydney	55 Pitt Street (66%)	1.3bn	63,000	Mitsui Fudosan Aust	Mirvac	U/D	U/D
Sydney	5 Martin Pl (50%)	296.2	33,500	CBUS Property	Dexus & CPPIB	6.1	2.9
Melbourne	628 Bourke St	115.2	24,127	Bayley Stuart	AFIAA	8.2	2.3
Melbourne	367 Collins St	301.0	37,878	PAG	Mirvac	7.0	2.9
Brisbane	240 Queen St	250.0	27,633	Quintessential	Brookfield	7.5	4.1
Brisbane	120 Edward St	119.0	15,161	Clarence Property	Deutsche Asset Management	8.1	2.9
Perth	181 St Georges Tce	26.5	3,590	Yamamoto	Charter Hall	6.1	2.5
Perth	10 William St	21.0	4,248	Stanley Intl. College	Conf.	9.1	2.4
Adelaide	121 King William St	84.1	12,616	Local Private	Charter Hall	7.6	4.3
Adelaide	104 Frome St	14.2	4,387	Private	Private	8.5	1.7
Canberra	10 Moore St	28.2	6,593	Strada Group	Centuria Property Funds	8.2	2.2
Canberra	12 Moore St	50.0	11,929	Marprop	Dexus	8.7	3.7

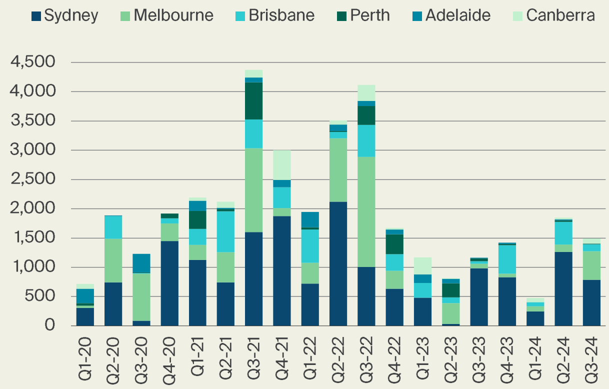
Improving sales volumes

Cross-border investors drive a rebound in transactional activity

- Improved investment activity in Q3 brought total transaction volumes in CBDs to over $3.8 billion for 2024 YTD, with Sydney contributing $2.2 billion, followed by Melbourne with $698 million and Brisbane with $580 million.
- Cross-border investors have led the rebound in volumes, accounting for 47% of total deal volumes thus far in 2024. Key transactions include Japanese investor Mitsui Fudosan acquiring ~66% stake in 55 Pitt St, Sydney; Singapore's Keppel REIT acquired 255 George, Sydney; PAG from Hong Kong purchasing 367 Collins St, Melbourne.
- Prime yields were largely unchanged over Q3 in a sign that values have stabilised in most markets. From the peak to trough, prime yields have expanded by 109bps in Perth, 166bps in Sydney, 174bps in Canberra, 185bps in Melbourne and 195bps in Brisbane.
- After only a handful of deals over the past two years, a spate of deals in Sydney, Brisbane and Melbourne in recent months has provided firmer evidence for capital value adjustments. From the peak in Q3 2022, capital values have decreased by 15% on average nationally for premium grade assets, 20% for A grade and 26% for B grade according to the benchmark MSCI index.
- Alongside improving liquidity, the change in the interest rate outlook and the commencement of a rate cutting cycle from multiple central banks have helped to foster greater confidence amongst investors, and we expect a further pick-up in deal momentum in coming quarters.

Australia CBD office investment volumes

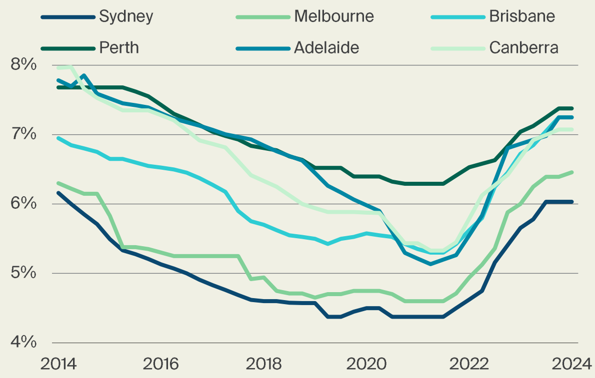
By city, A$ millions



Source: Knight Frank Research, RCA

Australia CBD prime office yields

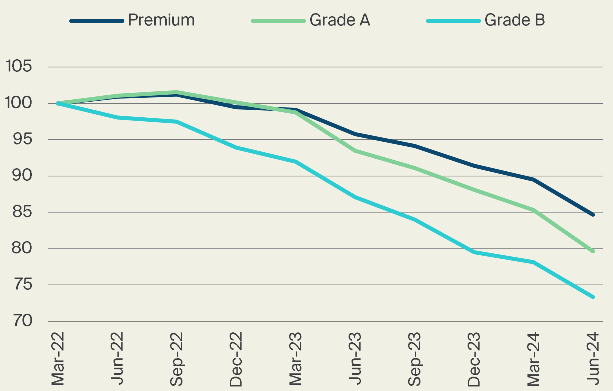
By city, %



Source: Knight Frank Research

MSCI valuation indices since end 2021

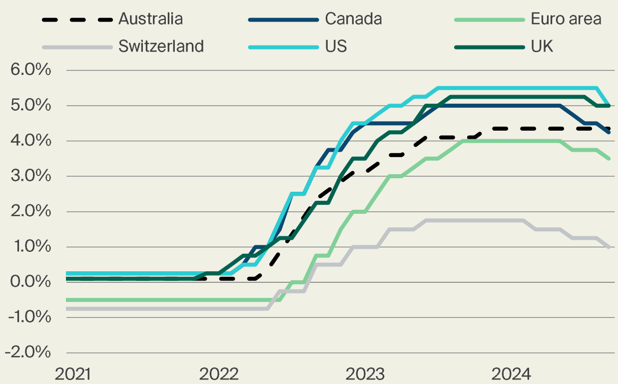
Capital value index by grade, December 2021 = 100



Source: Knight Frank Research, MSCI

Policy rates have turned the corner globally

Central Bank policy rate - selected economies



Source: Knight Frank Research, Macrobond

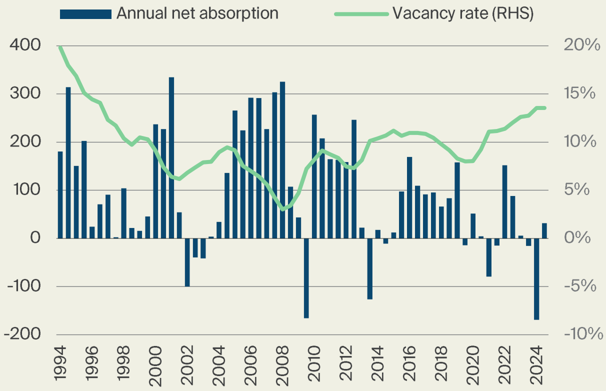
Positive absorption in H1

Demand weighted towards best-in-class assets in sought after locations

- The first half of the year recorded positive net absorption of 31,826 across the Australian CBD markets. This follows two consecutive periods of negative absorption and highlights the improved sentiment throughout the market.
- This reflects a gradual improvement in tenant demand nationally, while the major markets of Sydney and Melbourne continue work through the impact of changing workplace strategies.
- The search for higher quality space and a wider amenity offering continues to drive demand for offices located close to multiple public transport options, cafés & restaurants, independent grocers, green spaces and wellness activities.
- Demand for new office product remains high nationally as occupiers are still focused on delivering new workplaces which will encourage high productivity, collaboration, employee wellbeing and are well-credentialled with high ESG ratings.
- There is a clear divergence across building grade but also by location. This is particularly evident in Sydney and Melbourne, with the core CBD precinct clearly outperforming other precincts in Sydney, and the Eastern core precinct out-performing other precincts in Melbourne.

Aggregate absorption and vacancy - all CBDs

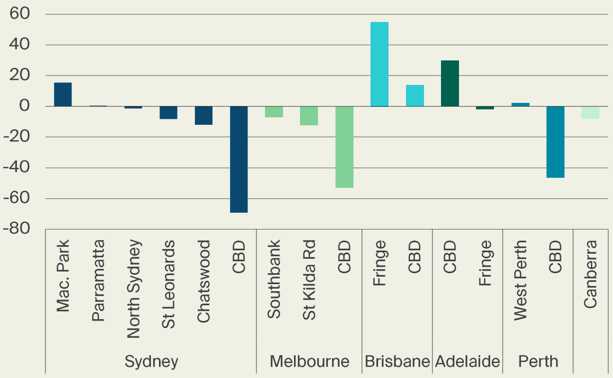
6 months net absorption ('000sqm), vacancy (%,RHS)



Source: Knight Frank Research, PCA

Net absorption in Australia major markets

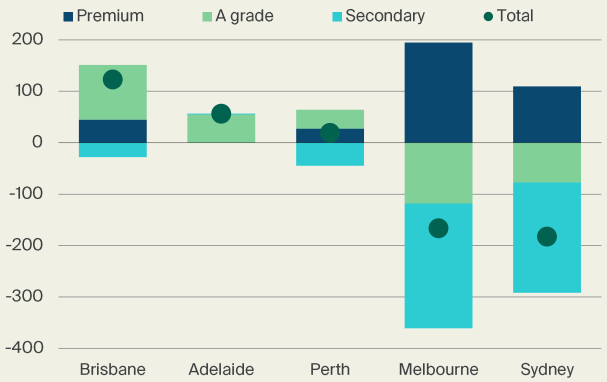
Annual net absorption to Jul-24, '000sqm



Source: Knight Frank Research, PCA

Divergence by city and grade

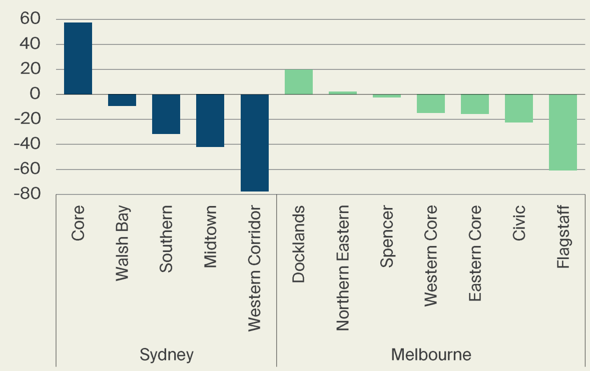
Net absorption by grade since 2020, '000sqm



Source: Knight Frank Research, PCA

Sydney CBD core has out-performed

Net absorption since 2020, '000sqm



Source: Knight Frank Research, PCA

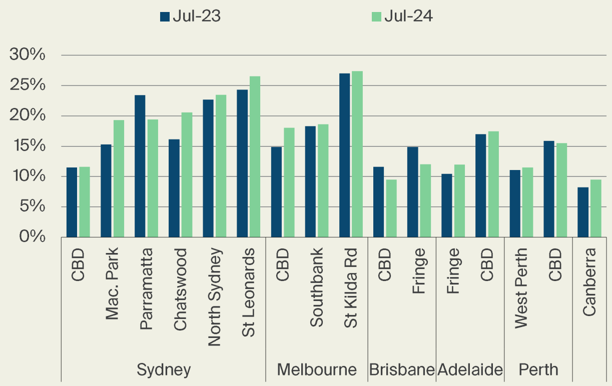
Vacancy stabilises

CBD office markets outperforming major metro markets

- Across the Australian capital cities vacancy has remained steady at 13.6% over the first half of the year.
- Canberra and Brisbane have the lowest vacancy rates amongst the capital cities at 9.5%, whilst Melbourne currently has the highest rate at 18.0%.
- Major metro markets nationally have lagged the CBD markets with the average vacancy rates across metro markets at 17.2%.
- Over the next three years the development pipeline nationally is forecast to deliver c760,000sqm of new supply, in contrast to the last three years where new supply has totalled over 1.2 million sqm. Sydney will enter a period of limited supply with just over 200,000sqm forecast for delivery over this period, well down on previous years.
- As the development pipeline faces an impending drought due to pressures on construction costs and financing, eventually this will lead to tighter markets, reduced vacancy rates and continued rental growth throughout the rest of this decade.
- Looking ahead, best-in-class assets in core locations are expected to continue to outperform and increase the divergence between assets based on location and grade.

Vacancy rates – major markets

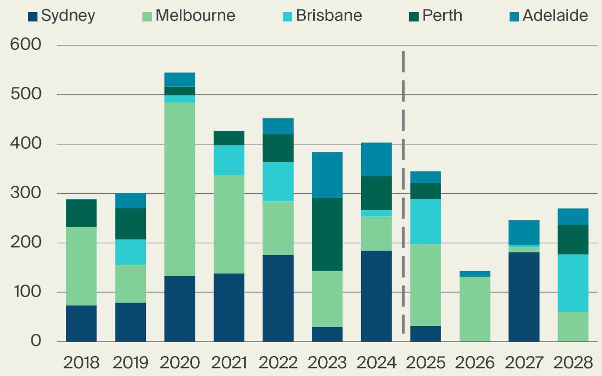
Jul-23 vs Jul-24, total vacancy, %



Source: Knight Frank Research/PCA

Development completions trending down

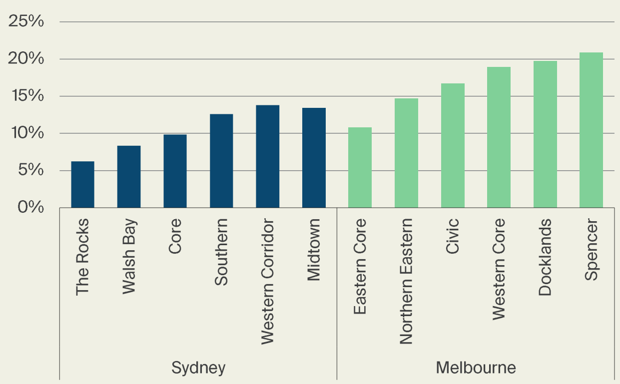
Historic and forecast completions by city, '000sqm



Source: Knight Frank Research

Lower vacancy in core precincts

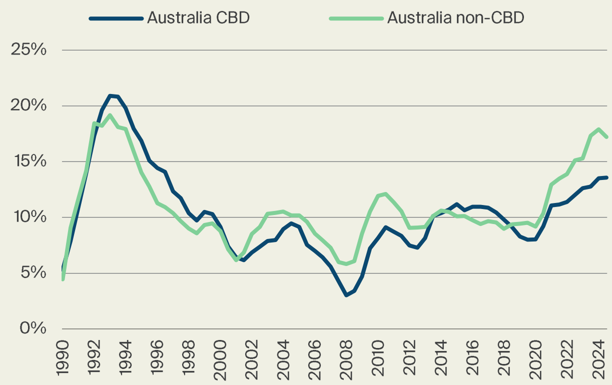
Total vacancy at Jul-24, %



Source: Knight Frank Research/PCA

Aggregate vacancy – CBD and non-CBD

Total vacancy rate, %



Source: Knight Frank Research,/PCA

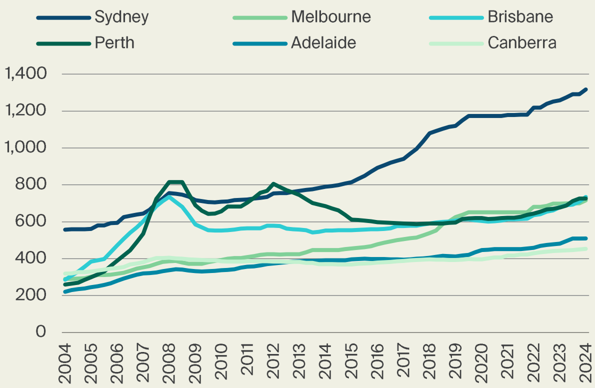
Positive face rental growth

Brisbane has led the country with the highest rental growth

- Positive net face rental growth has been recorded across all Australian CBDs over the last 12 months, whilst over the quarter rents have broadly been steady except Brisbane.
- Growth has been strongest in Brisbane with 4.2% growth over Q3 and 11.4% on an annual basis. In Sydney rents have growth 3.7% y/y, followed by Adelaide at 2.8% and Melbourne 2.4%.
- The pronounced increase in Brisbane and Perth over the past two years has now pushed the level of face rents above Melbourne for the first time since 2018.
- While face rents have continued to rise, incentives have remained high. They were broadly unchanged across all CBDs over Q3 but are higher than a year ago in most markets apart from Brisbane and Perth where they have declined slightly.
- Within Sydney, the CBD Midtown and Core precincts have out-performed, and in Melbourne the Eastern Core has out-performed given that occupier demand has skewed towards in best locations.
- Looking ahead, declining levels of new development will help to rebalance the market over time and support rental growth.

Net face rents continue to rise

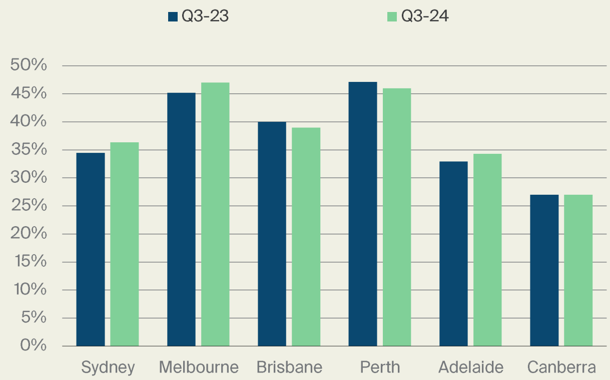
Prime net face rents, 2004-2024, $/sqm



Source: Knight Frank Research

Incentives remain elevated

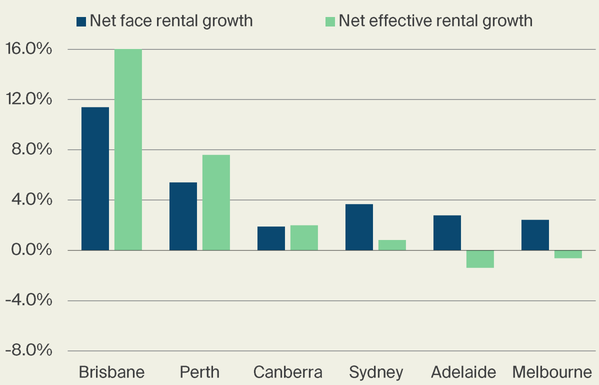
Prime incentives, Q3-23 vs Q3-24, %



Source: Knight Frank Research

Fastest rental growth in Brisbane and Perth

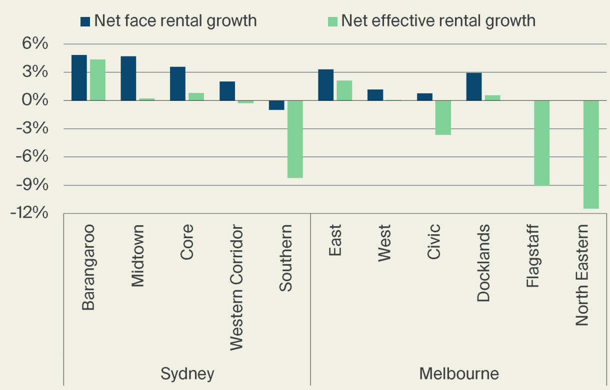
Net face rental growth vs net effective rental growth, %



Source: Knight Frank Research

Growth by precinct - Sydney and Melbourne

Net face rental growth vs net effective rental growth, % y/y



Source: Knight Frank Research

We like questions, if you've got one about our research, or would like some property advice, we would like to hear from you

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