Sydney CBD Office Market

August 2024

Divergence across grades and precincts with premium grade assets in the core precinct out-performing

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Key Insights

Occupier and investor demand weighted towards best in class assets in core locations

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10.8%
Drop in premium vacancy

Premium vacancy declined from 13% to 10.8% in the six months to July 2024.

129K
Three year premium grade net absorption

Despite overall negative absorption across the CBD, premium grade stock has outperformed over the last three years, specifically in the core precinct.

184k
Sqm of new supply in 2024

New development in 2024 will stem from the Over Station Developments. The market will then enter a period of limited supply in 2025-26 which will aid market recovery.

34%
Industry sector demand

Deal volumes so far this year have been driven by financial services and professional services occupiers accounting for 34% and 29% respectively.

4.6%
Rental growth

Prime net face rents average $1,317/sqm, an increase of 4.6% over the year. Incentives remain elevated at 36% and forecast to remain at this level over the medium term.

$2bn
2024YTD transaction volumes

Transactional activity has picked up this year with over $2 billion in deal volumes, primarily driven by offshore investors.

Sydney CBD Office Market Indicators – July 2024

Grade	Total Stock sqm	Vacancy Rate %	Annual Net Absorption sqm	Annual Net Additions sqm	Average Gross Face Rent $/sqm	Average Incentive %	Effective Rent Gth % y/y	Core Market Yield %*
Prime	3,346,904	11.9%	-27,180	-12,587	1,546	36.2%	1.2%	6.03%
Secondary	1,830,533	11.1%	-42,078	-59,937	1,145	35.3%	2.3%	7.19%
Total	5,177,437	11.6%	-69,258	-72,524				

Source: Knight Frank Research/PCA * assuming WALE 5 years

Occupier demand strongest for premium assets

PROFESSIONAL AND FINANCIAL SERVICES AT THE FOREFRONT OF OCCUPIER DEMAND

Overall absorption levels for the first half of 2024 were weak, with negative 4,630sqm recorded. The weak absorption levels have primarily been driven by negative absorption in the secondary market, whilst the premium market has experienced positive absorption levels of 30,854sqm so far this year. Lease deal volumes and tenant enquiry have been healthy, underpinning the improved market sentiment. Direct leasing transactions currently account for over 85% of deal volumes, whilst pre-commit activity has been solid across the Over station developments, Chifley South and 55 Pitt Street.

Occupier demand trends for 2024YTD are being driven by financial services and professional services accounting for 34% and 29% respectively of total deal volumes. Tech sector demand has slowed to 10% of deal volumes. Occupier enquiry for the remainder of the year is expected to stay strong as occupiers continue to revisit their workplace strategies and look to capitalise on an occupier favoured market. Furthermore, the structural shift of flight to quality and amenity continues to drive the demand for quality workspaces located close to multiple public transport options, food and retail operators, independent grocers, green spaces and wellness activities.

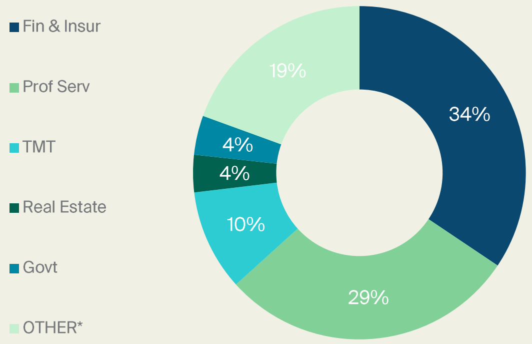
The recent announcement from NSW Government mandating all public sector workers return to the office will likely flow onto the private sector pushing employees to return to office if not already mandated. This will have a positive impact on activity in the CBD.

DIVERGENCE ACROSS GRADES AND PRECINCTS WITH CORE PREMIUM STOCK OUTPERFORMING

Overall vacancy edged up to 11.6% from 11.5% over the year to July 2024, which has stemmed from the negative absorption levels in the secondary market. By grade, premium vacancy dropped slightly to 10.8% as at July-24. In the secondary market, vacancy sits at 11.1%, the withdrawals over the period offset some of the negative demand. Over the last three years the flight to quality trend has become clear with absorption levels totalling negative 142,375sqm in the secondary market, whilst the premium market has experienced positive demand of 129,588 sqm over the same period. This is further highlighted by demand levels across the precincts, with prime assets in the core clearly outperforming the wider market as the only precinct to record positive absorption over the last three years.

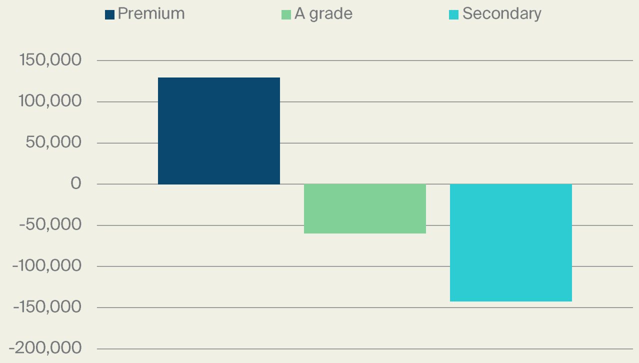
Looking ahead, best in class assets in core locations will outperform and likely cause a greater divergence between assets in the market.

Lease deals by industry sector
2024 YTD, % share of total market (sqm)



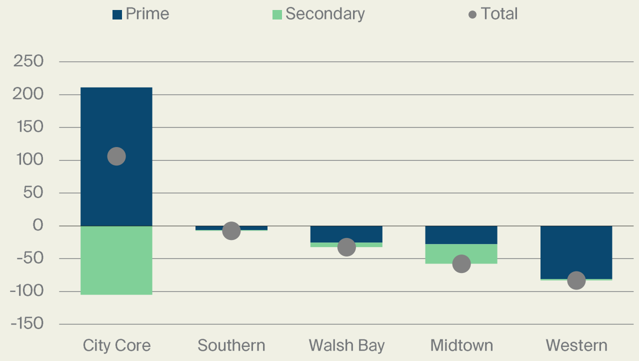
Source: Knight Frank Research

Sydney CBD office demand by grade
Total absorption since 2021 (sqm)



Source: Knight Frank Research, PCA

Sydney CBD office demand by precinct
Net absorption since 2021, '000sqm



Source: Knight Frank Research, PCA

High demand for new development stock

NEW DEVELOPMENTS ARRIVING BY YEAR END

The clear divergence for demand between prime and secondary assets has been a driving force behind new developments and refurbishments as owners look to align building quality, design, environmental sustainability and wellbeing to occupier preferences in the CBD office market.

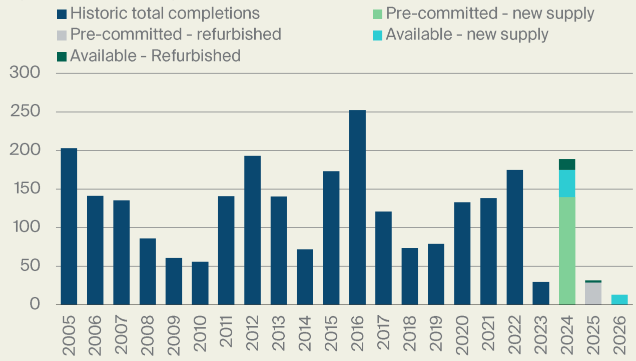
Multiple buildings have been withdrawn over the last 18 months, totalling 135,169sqm. The majority of these were permanently withdrawn to make way for the Hunter Street Metro stations, along with some office refurbishments including the RBA headquarters at 65 Martin Place (25,156sqm). This has resulted in a drop of the office stock base by 2% over 18 months to now total 5,177,437sqm. By the end of the year the total stock base is forecast to be 5.35 million sqm. New completions were at its lowest on record in 2023 with 29,410sqm and this has carried through to the first half of 2024 with no new supply additions.

The next wave of premium developments will reach practical completion by the end of the year and will mark the largest influx of new supply in a year since Barangaroo towers. The new premium stock will stem from the Over Station Developments at Metro Martin North Tower (70,500sqm), Metro Martin South Tower (30,000sqm) and Parkline Place OSD (49,120sqm). Across these three schemes a commitment rate of over 85% has already been achieved. Additionally, boutique developments at 333 Kent Street is scheduled for delivery in late 2024 which will encompass 14,200sqm of prime office space, along with CBUS property development at 121 Castlereagh Street (11,500sqm).

LIMITED DEVELOPMENT ACTIVITY IN 2025-26 WILL AID ABSORPTION FOR CURRENT STOCK LEVELS

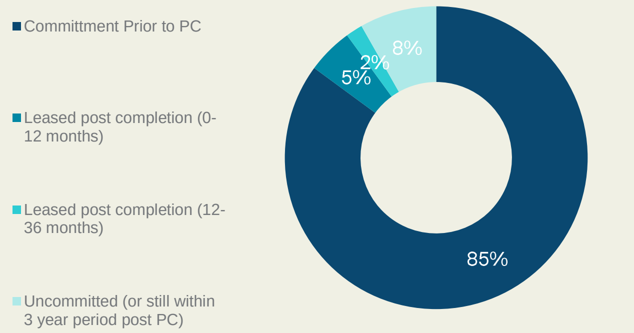
Beyond the OSD developments the market will enter a period of limited new supply until 2027. There are three major developments which have recently commenced construction; Atlassian Towers at the future tech central precinct, this will be anchored by Atlassian and will drive the organic expansion of the CBD to its Southern boundaries. A further two developments are slated for delivery in 2027; these being Charter Hall's 2 Chifley South (42,000sqm) and Mirvac's 55 Pitt Street (62,800sqm), both having achieved strong commitments already. This underpins the success of new developments in the CBD, which have historically seen high demand, with an average pre-commitment rate of 85% across all new developments since 2018. Environmental design and ESG have been at the forefront of new developments and a contributing factor to strong commitment levels. With the next wave of supply predominately leased this will bode well for other vacancies to be absorbed in addition to giving developers confidence for future developments.

Sydney CBD development completions
By commitment type, '000sqm



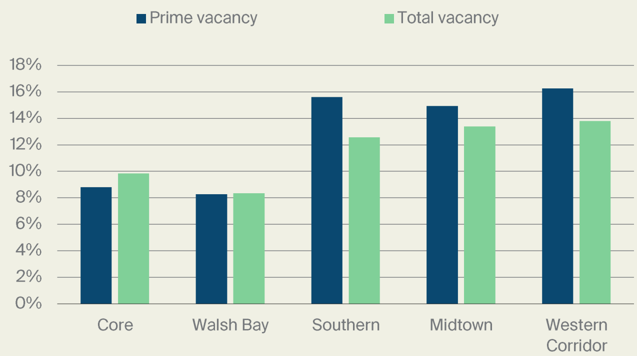
Source: Knight Frank Research

Letting up times new developments
Since 2018



Source: Knight Frank Research

Sydney CBD office vacany rates by precinct
Prime vacancy vs total vacancy, as at Jul-24



Source: Knight Frank Research, PCA

Major office supply

Major Refurbishments

#	ADDRESS	SQM	COMPLETION
1	33 Alfred St	31,657	H2 2025

Under Construction / Major Pre-commitment

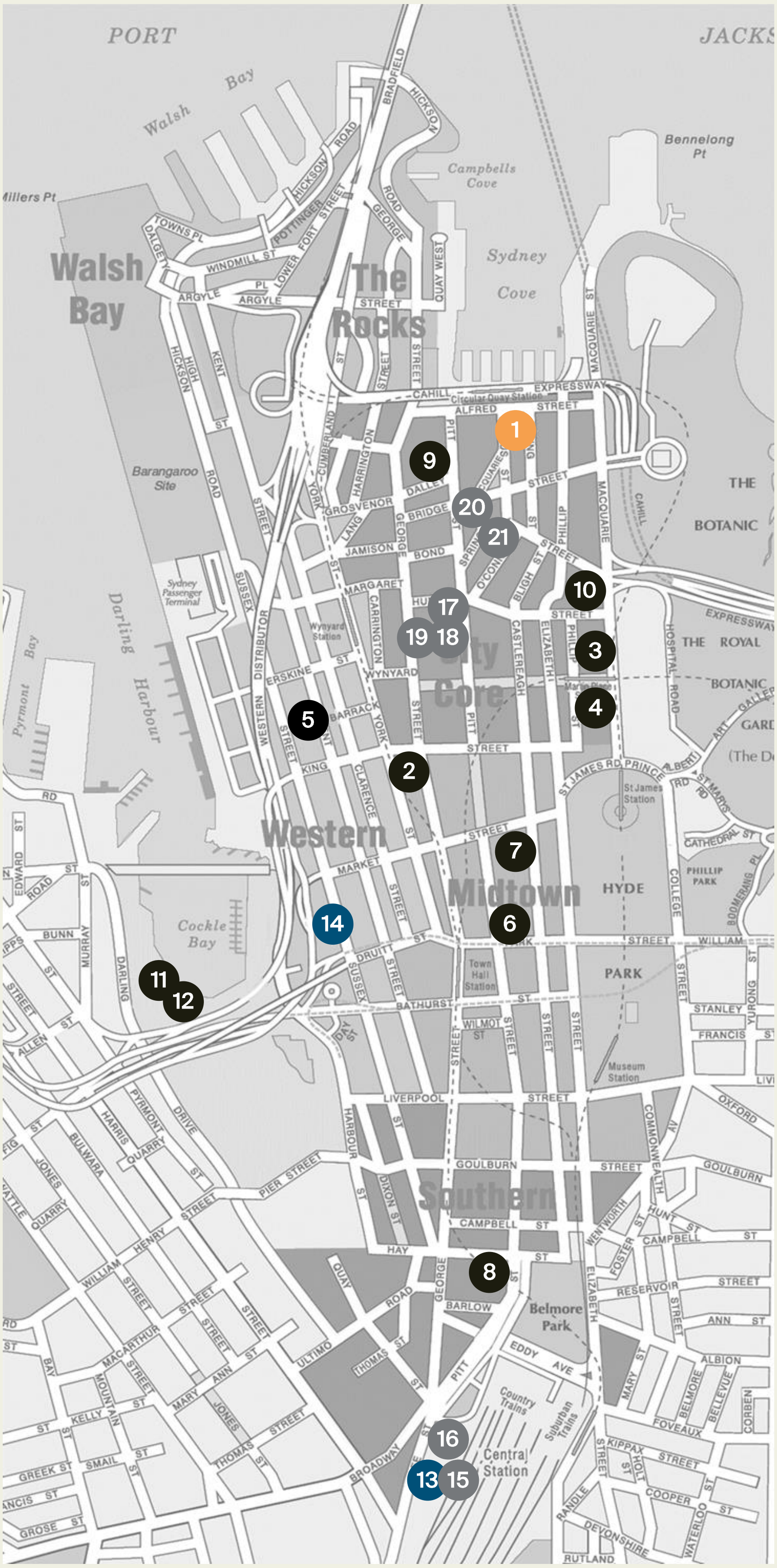
#	ADDRESS	SQM	COMPLETION
2	32-36 York Street	8,366	H2 2024
3	1 Elizabeth Street	70,500	H2 2024
4	39 Martin Place	30,000	H2 2024
5	333 Kent St	14,200	H2 2024
6	Parkline Place	49,120	H2 2024
7	121 Castlereagh Street	11,500	H2 2024
8	Tech Central Atlassian Tower	75,000	H1 2027
9	55 Pitt Street	62,800	H1 2027
10	Chifley South	42,000	H2 2027
11	Harbourside (stage 1)	13,000	H2 2026
12	Habourside (stage 2)	14,000	H2 2027

Development Approved

#	ADDRESS	SQM	COMPLETION
13	Central Place 1	47,209	2029
14	Darling Park Tower 4	75,000	2030+

Mooted

#	ADDRESS	SQM	COMPLETION
15	Central Place 2	69,000	2032
16	2 Lee Street / Toga Central	22,000	H2 2028
17	Milligan Development	50,000	2029
18	Hunter Connection East Tower	66,500	2032
19	Hunter Connection West Tower	53,523	2032
20	56 Pitt Street	58,000	2032
21	O Block	90,000	2032



Divergence in rental growth across precincts

LOCATION IS KEY

On an annual basis (to July 2024), average prime net face rents increased 4.6% to $1,317/sqm ($1,546/sqm gross face, up 4.3% y/y). Similarly, the secondary market reported 4.7% annual growth for net face rents to average $955/sqm ($1,145/sqm gross face, up 4.8% y/y). The strongest prime rental growth was observed in midtown over the year with a 6.6% rise, followed by core (5.0% growth y/y).

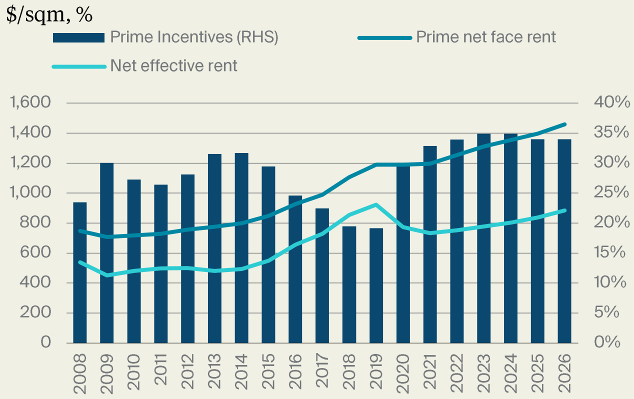
While flight-to-quality and amenity has become key since the pandemic, there has been an increasing importance on location within the CBD. Over the last 12 months, midtown and core observed 6.8% and 6.2% growth on secondary net face rent to average at $1,031/sqm and $913/sqm respectively. highlighting the importance of location, is some upper B grade assets in the core and midtown are outperforming prime assets in Western and Southern precincts.

INCENTIVES REMAIN ELEVATED

Incentives currently average 36% in the prime market and 35% for secondary space, however asset and location specific there are incentives being offered over 40%. This a is a slight uptick over the year. The average prime net effective rent increased 1.2% over the year to measure $756/sqm. Barangaroo led the increase in net effective rents by 3.3% growth in 12 months. On the other hand, Southern and Western precincts, where higher incentives are reported, have shown negative net effective rental growth over the year.

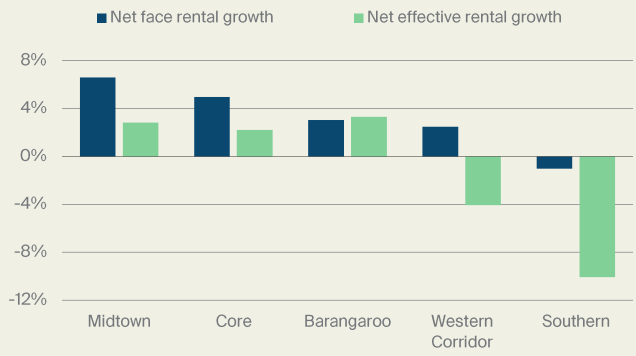
Looking ahead, incentives will likely hold at current levels over the near term, whilst face rental growth is forecast to continue to increase on the back of steady demand and the market entering a period in 2025-26 with limited new supply.

Rent and incentives
$/sqm, %



Source: Knight Frank Research

Sydney CBD office annual rental growth
By precinct, prime office annual rental growth



Source: Knight Frank Research

Recent significant tenant commitments

Occupier	Property	Precinct	Size sqm	Face Rent $/sqm	Incentive %	Term yrs	Start Date
Link Market Services ~	161 Castlereagh St	Midtown	2,300	1,550 (g)	40.0	5.0	Q4-25
Pinterest ~	2 Park St	Midtown	2,970	1,550	41.0	5.0	Q3-25
Grant Thornton ~	225 George St	Core	3,826	1,800 (g)	35.6	9.4	Q3-25
REST ^	50 Bridge St	Core	5,209	1,650	36.0	9.0	Q2-25
PSC Insurance Brokers ~	207 Kent St	Western	997	1,200 (g)	35.0	5	Q4-24
Pegasystems ~	201 Sussex St	Western	1,000	1,095	~45.0	5	Q3-24

Pre-commitment   ^ Sublease   ~ Direct   * Renewal   (g) gross face
Source: Knight Frank Research

Transactional activity improving

YIELD DISPARITY ACROSS PRECINCTS

Prime and secondary Sydney CBD yields remained stable over Q2 for the first time since mid-2022. From peak to trough over this period prime yields have softened by 166bps and secondary yields by 213bps, to average at 6.0% and 7.2% respectively as at July-24. The divergence in demand has fed through to valuations not only reflected in asset grade with prime and secondary yield spread currently at 116bps but also highlighted in locations with the current prime yield spreads between Core and Midtown at 72bps, Core and Western at 99bps, Core and Southern at 139bps.

The yield divergence in asset grade and across precincts further highlights that location and best in class assets are key to both occupiers and investors.

CROSS-BORDER INVESTORS BOOST UP INVESTMENT ACTIVITY IN H1 2024

The softer yield and capital value environment has made an attractive environment for investors. Transaction volume in Sydney CBD tipped over $2 billion in H1 2024, the highest first half year volume since 2020.

Mitsui Fudosan, a Japanese developer, acquired ~66% interest in Mirvac's development of 55 Pitt Street in June, with an estimated total end value of ~$2 billion. The joint-venture development will deliver c.63,000sqm of premium space in 2027. Further major transactions include Singapore's Keppel REIT purchasing a 50% stake of 255 George Street for $363.8 million on a core market yield of 6.39%. Cbus Property bought out the remaining 50% interest of 5 Martin Place on a core market yield of 6.10%, taking 100% ownership of the building.

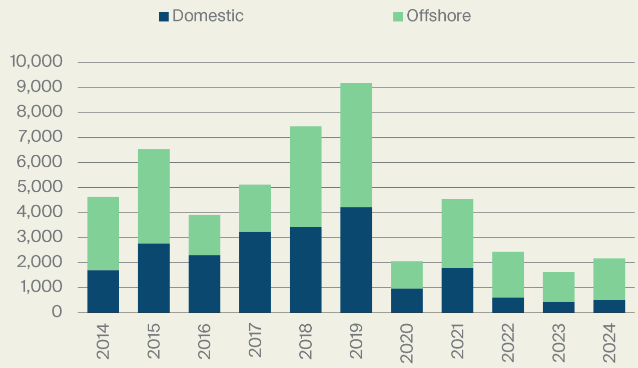
While in the Western precinct, Investa sold 117 Clarence Street in January for $130.0 million to Forza Capital, trading on a core market yield of 8.10%.

With yields having substantially reset and the macro picture more encouraging, investors are clearly returning to acquisition mode. With multiple assets beginning on market campaigns in conjunction with assets being shopped around off market, transactional activity will pick up further over the remainder of the year.

Additionally, the disconnect between vendor and purchaser expectations is more aligned and declining book values readjusting, this further enhances the appeal for investors to acquire at this point in the cycle.

Sydney CBD investment volume

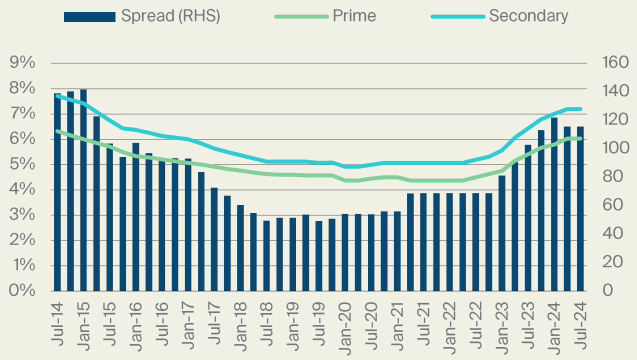
By purchaser ($m), domestic v offshore, $10m+



Source: Knight Frank Research

Sydney CBD core precinct office yield spread

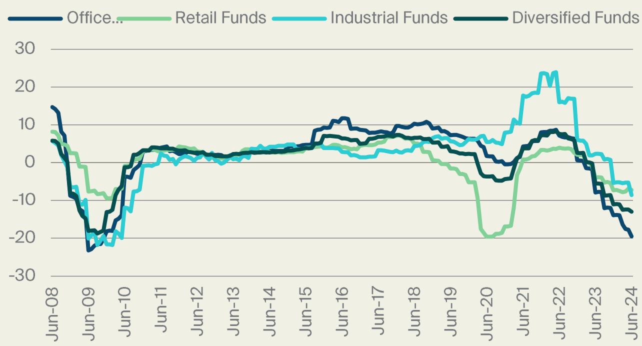
Prime vs secondary



Source: Knight Frank Research

Values adjusting down

Average capital return post-fees reported by wholeasle property funds (%, y/y)



Source: Knight Frank Research, MSCI

Recent significant sales

Property	Price $ m	Core Market Yield %	NLA sqm	$/sqm NLA	WALE	Purchaser	Vendor	Sale Date
55 Pitt Street (66%)	1,300.0	U/D	63,000	30,952	U/D	Mitsui Fudosan Aust	Mirvac	Jun-24
5 Martin Place (50%)	296.2	6.1	33,500	17,684	2.9	CBUS Property	Dexus & CPPIB	Jun-24
255 George St	363.8	6.4	38,997	18,658	7.4	Keppel REIT	Mirvac Wholesale Office Fund	Jun-24
60 Margaret Street	779.2	6.1	47,167	16,520	3.3	AsheMorgan JV Mitsubishi Estate	Mirvac JV Blackstone	Oct-23
1 Margaret Street	293.1	5.9	20,754	14,123	1.6	Quintessential Equity	Dexus	Aug-23

*Net sale price
Source: Knight Frank Research

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

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