- *Improved leasing market conditions*
- *Face rents holding firm*
- *Strong pick up in investment activity*

Knight Frank

knightfrank.com/research

Sydney CBD Office

Market Report, March 2022

POSITIVE MARKET MOMENTUM

Strong rebound in leasing and investment activity

9.3%
VACANCY
PCA data at Jan 22

300%
Increase in lease deal activity compared to 2020

$4.5
BILLION
TRANSACTIONS
2021

"The improved economic conditions have translated into positive demand levels across the CBD, with increased enquiries and deals being signed."

Key Insights

The economy is continuing its recovery, with a booming jobs market and a pick up in wage growth pointing to a strong bounce back in business conditions and confidence levels over the coming months.

Lease deal volumes eclipsed c300,000 sqm for 2021, with demand driven by the tech sector and financial services accounting for nearly 60% of all lease deals.

With incentives holding at 32% the impact on net effective rents has begun to stabilise, with prime net effective rents down 2.9% yoy.

The influx of new and refurbished stock continues with 2021 recording its highest level of completions in five years.

Investment activity in that final quarter of 2021 propelled annual investment volumes to $4.5 billion, more than double the preceding year.

Prime yields are holding firm between 4.25% and 4.75% after sustained compression prior to the pandemic.

Sydney CBD Office Market Indicators—January 2022

GRADE	TOTAL STOCK SQM	VACANCY RATE %	ANNUAL NET ABSORPTION SQM	ANNUAL NET ADDITIONS SQM	AVERAGE NET FACE RENT $/SQM	AVERAGE INCENTIVE %	EFFECTIVE RENTAL GROWTH %Y-Y (net)	AVERAGE CORE MARKET YIELD %*
Prime	3,184,738	8.4	37,628	47,529	1,196	30-35	-3.0	4.25-4.75
Secondary	1,977,888	10.7	-4,517	32,980	875	30-35	1.5	4.75–5.25
Total	**5,162,626**	**9.3**	**33,111**	**80,509**				

Source: Knight Frank Research/PCA   *assuming WALE 5.0 years

PENT UP DEMAND DRIVING RECOVERY

Market shows its resilience despite disruptions as employers announce return to office programs

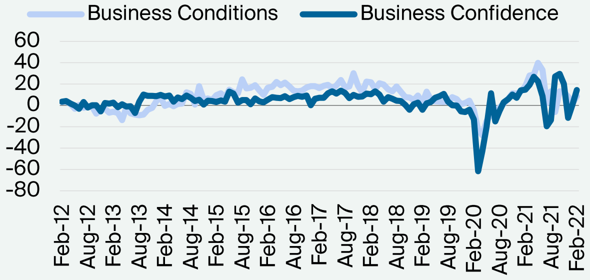
A strong pickup in jobs growth and positive business sentiment in Q4 highlighted a significant improvement in economic conditions from the downturn in 2020, with a recovery in spending, investment and employment. However, the emergence of Omicron in December saw a significant rise in cases and led to disruptions across most industries, due to isolation requirements and precautionary restrictions on mobility. Despite these challenges, the impact to economic activity has been much smaller than the previous lockdowns, with businesses mostly viewing the disruption as temporary, particularly white-collar, with hybrid work models already in place as they announce return to office programs.

The events in Ukraine and Russia is a new source of uncertainty globally and follows months of sharp rises in inflation due to supply chain disruptions and rising commodity prices amid strong demand. Wage growth has picked up slightly and the jobs market has shown its resilience having held the unemployment rate at a 14-year low of 4.2% through December and January. A further tightening in the jobs market could push up wages growth and there is a view this will keep inflation above the RBA's target band of 2% to 3%, with most economists bringing forward their expectations for an interest rate increase to later this year.

Despite the spike in cases related to Omicron outbreak, the unemployment and office vacancy rates have remained broadly stable indicating that the risks about the remote-work model are abating and that demand for the traditional office will rise above its current stable level upon further signs of recovery in the economy.

NSW Business Conditions & Confidence

NAB Monthly Business Survey



Source: Knight Frank Research, NAB, Haver Analytics

Improved demand bodes well for long term recovery of the office market

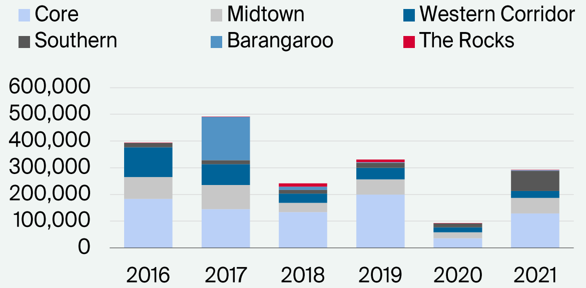
The improved economic conditions have translated into positive demand levels across the CBD, with increased enquiries and deals being signed. Pent up demand drove lease deal volumes for 2021 to c300,000 sqm, a stark contrast to the 90,000 sqm the year prior. Demand was driven by the tech and financial services sectors, accounting for nearly 60% of all lease deals. Compared to 2020, which was headlined by the public sector having an above-trend weighting of total deal activity, this activity indicates that demand has improved and is beginning to return to pre-covid like levels.

Despite lockdowns throughout the year, positive absorption of 7,812 sqm was still recorded over H2 2021. This resulted in the overall vacancy rate remaining steady at 9.3%, with forecasts suggesting vacancy will slightly edge higher throughout the year before stabilising. Of particular note is the sub-lease vacancy rate on a downward trajectory, with 1% recorded as at January 2022, down from 1.6% a year prior. This can be attributed to some occupiers no longer requiring to sublet their space as they return to office, in addition to a number of deals being done at attractive rates with minimal downtime as office fitouts remain in place for tenants to move in immediately.

With the Government recently changing its stance and encouraging workers to return to the office, in conjunction with the lifting of nearly all restrictions, including the opening of international borders, there is a sense of positivity and desire to get back into the workplace. Whilst there will still be some challenges in the near term, the optimism in the market and active tenant enquiry bodes well for the long term recovery of the Sydney office market.

Lease Deals By Precinct

2016-2021, by sqm



Source: Knight Frank Research

NEW SUPPLY THIS YEAR SUBSTAINIALLY PRE-COMMITTED

Completions tip five year high

The flight to quality trend and focus on safety and wellbeing for occupiers has been one of the driving forces behind the new developments and refurbishments playing out in the Sydney CBD office market.

Following multiple periods of supply deficits, the influx of new and refurbished stock over the last 18 months continued with 2021 recording its highest level of completions in five years since the International Towers entered the market.

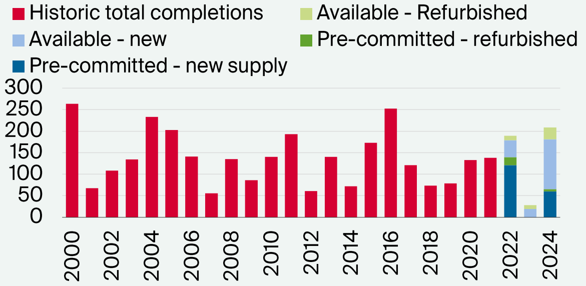
Whilst new additions of stock were skewed to the first half of 2021, in the six months to January 2022, 33,555 sqm was added, solely from refurbished stock, taking the total office stock base to 5,162,626 sqm. This was led by 570 George Street (19,000 sqm) coming back online after an extensive refurbishment across its floors, along with lobby and amenities throughout the building.

Further refurbishments are anticipated to be completed over the next 12 months. These include, 477 Pitt Street (6,700 sqm), 143 Macquarie Street (3,700 sqm) and 255 George Street (19,000 sqm). Notably, 255 George Street owned by AMP Capital is undergoing a c$70 million refurbishment. The building was vacated by NAB relocating to Brookfield Place last year, leaving large backfill space which has since predominately been secured by BOQ, ATO and Eftpos, with works expected to be complete by mid year.

Refurbishments, in conjunction with new development stock, are forecast to set another record of completions for 2022 with the Sydney office stock base forecast to hit c5.3 million sqm over the next 12 months.

Sydney CBD Development Completions

By Commitment type, '000s sqm



Source: Knight Frank Research, PCA

New development to reset the benchmark of premium grade stock in the CBD

The pipeline of new development stock due for completion this year totals 160,000 sqm, with a commitment rate over 75% across all schemes including CQT (55,000 sqm), QQT (88,274 sqm) and 210 George Street (16,500 sqm).

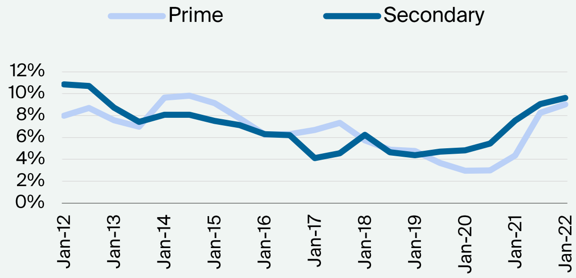
These schemes will set the mark for a new wave of premium grade stock entering the market. This will reset the benchmark for office buildings across the CBD, with a particular focus on occupier preferences, environmental impacts and amenity.

Whilst this next wave of new supply is substantially pre-committed, there will be some large backfill vacancies which will arise in the market. Major tenant movements that will cause the rise in backfill include Deloitte vacating Grosvenor Place (27,800 sqm) moving into QQT along with Corrs Chambers from 8 Chifley and Salesforce vacating Darling Park Tower 1 into CQT. Additionally, a number of buildings are set to be withdrawn in 2023 to make way for the Hunter Street Metro station, c42,000 sqm is forecast to be permanently withdrawn which may aid vacancy levels as tenants will be displaced and need to seek new office space.

Looking further ahead the next wave of new premium supply is expected to come to market from 2024 onwards and will predominantly come from the Over Station Developments (OSD) at Martin Place and Parkline Place OSD, in conjunction with the Tech Central precinct. The Tech Central precinct in particular, will be anchored by a 75,000 sqm commitment from Atlassian and will drive the much needed organic expansion of the CBD to its Southern boundaries.

Vacancy

By Grade



Source: Knight Frank Research, PCA

MAJOR OFFICE SUPPLY

MAJOR REFURBISHMENTS

1	44 MARTIN PLACE–9,500 SQM GWYNVILL GROUP – COMPLETE
2	570 GEORGE STREET–18,100 SQM FAR EAST– COMPLETE
3	255 GEORGE STREET–19,000 SQM AMP CAPITAL– H1 2022
4	33 ALFRED STREET–32,615 SQM AMP CAPITAL– H1 2024

UNDER CONSTRUCTION/ MAJOR PRE-COMMITMENT

5	121 CASTLEREAGH STREET–12,068 SQM CBUS - H1 2023
6	BROOKFIELD PLACE–59,000 SQM [NAB/ ALLIANZ/HUB/MOELIS] AMP/BROOKFIELD– 95% COMMITTED. COMPLETE
7	QUAY QUARTER TOWER–88,274 SQM [AMP/DELOITTE/CORRS CHAMBERS] AMP CAPITAL/DEXUS/REST– 85% COMMITTED. H1 2022
8	210 GEORGE STREET–16,500 SQM POLY GROUP - 33% COMMITTED, H2 2022
9	CIRCULAR QUAY TOWER–55,000 SQM [SALESFORCE] LENDLEASE, PING AN, MITSUBISHI – 80% COMMITTED. H2 2022
10	PARKLINE PLACE–49,120 SQM OXFORD/ INVESTA–H1 2024

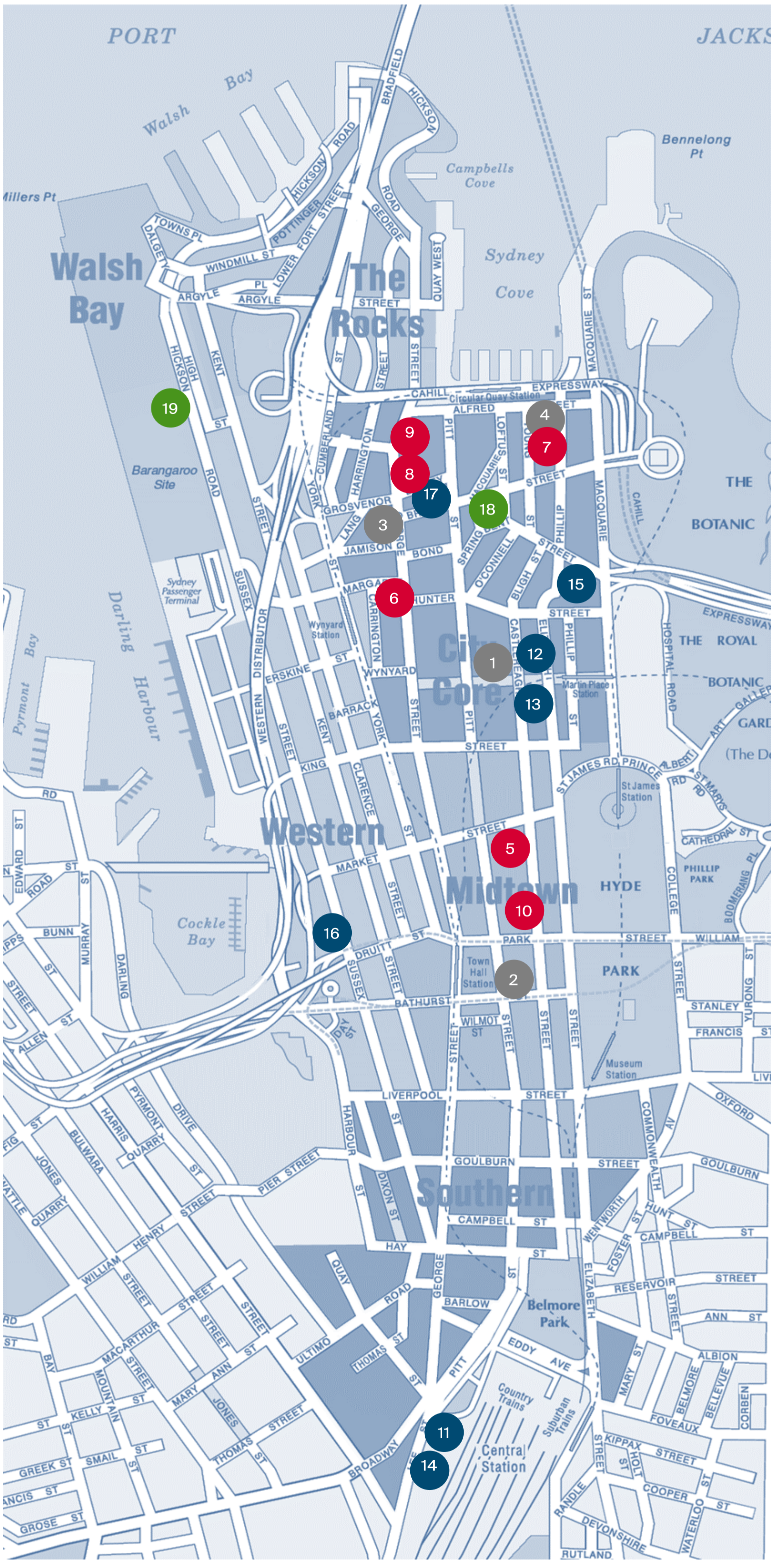
DEVELOPMENT APPROVED

11	TECH CENTRAL ATLASSIAN TOWER– 75,000 SQM [ATLASSIAN] ATLASSIAN– 100% COMMITTED, H1 2026
12	MARTIN PLACE METRO NORTH TOWER– 75,000 SQM MACQUARIE GROUP– H2 2024
13	MARTIN PLACE METRO SOUTH TOWER– 30,000 SQM INVESTA/MANULIFE– H2 2024
14	CENTRAL PLACE –138,000 SQM DEXUS/FRASERS– 2027
15	2 CHIFLEY SOUTH –42,000 SQM CHARTER HALL– 2027
16	DARLING PARK TOWER 4–75,000 SQM GPT/AMP CAPITAL – 2028
17	55 PITT STREET–70,000 SQM MIRVAC 2026

DEVELOPMENT APPLICATION/MOOTED/ EARLY FEASIBILITY

18	56 PITT STREET–50,000 SQM DEXUS. 2027
19	CENTRAL BARANGAROO–48,350 SQM GROCON/AQUALAND/SCENTRE. 2027

NB Dates are Knight Frank Research estimates
Major tenant commitment in [brackets] net to NLA



RENTS HOLD FIRM AND INCENTIVES LIKELY PEAK

Rents to remain steady in the near term

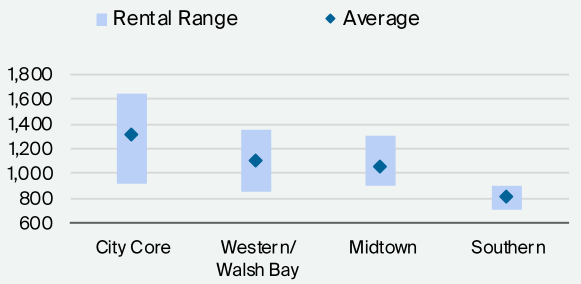
On a 12 month basis (to January 2022), average prime net face rents have remained steady at $1,196/sqm ($1,411/sqm gross face). In the secondary market rents now average $875/sqm ($1,040/sqm gross face) as at January 2022. Particularly , over the second half of 2021 face rents held firm despite the omicron outbreak and lockdowns experienced across the state.

The current rental discount between prime and secondary rents is 26%, widening from 24% over the last few years. Demand has been weighted towards more prime quality office space through the 'flight to quality' adage, with a particular focus on amenity, safety and wellbeing, as occupiers look to remodel their workplace environment.

With new premium grade stock set to hit the market and reset top end prime rents, this will likely see the rental gap widen as a result.

Net Rental Range

By Precinct, $/sqm



Source: Knight Frank Research

Incentives have likely peaked

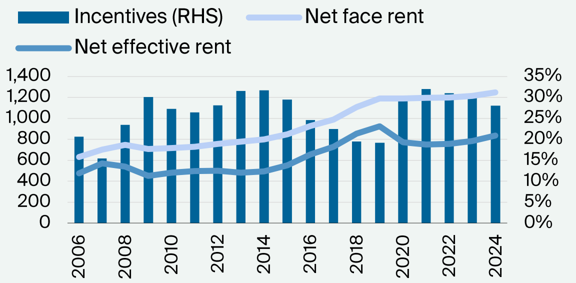
Landlords continue to offer above average incentives in order to retain and attract tenants. Prime incentives are likely at their peak to average 32% as at January 2022, although there is still market evidence of lease deals being signed above 35%.

With incentives stabilising the impact on net effective rents has begun to pull back. Prime net effective rents now measure $750/sqm, down 2.9% in the 12 months to January 2022, this is well down on the negative impact at the same time last year. Similarly, secondary incentives have now peaked to average 32.2%, with net effective rents now averaging $542/sqm.

As sentiment and demand improve on the back of international borders reopening and Government encouraging employees to return to work in the CBD, the negative impact on rents and incentives seen over the last two years has likely ceased. Sublease vacancy and backfill space will still likely see incentives remain above average levels in the near term and will see landlords continue to offer additional inducements to prospective tenants such as early access and contribution to fitouts.

Rent and Incentives

$/sqm, %



Source: Knight Frank Research

Recent tenant commitments

OCCUPIER	PROPERTY	PRECINCT	SIZE SQM	NET FACE RENT $/SQM	INCENTIVE	TERM YRS	START DATE
Athena Home Loans~	347 Kent Street	Western	1,826	980	34%	7	Q1-22
Strategic property~	25 Martin Place	Core	144	1,450	32%	5	Q4-21
James Hardie~	60 Castlereagh Street	Core	2,376	1,200	33%	10	Q4-21
GBST~	55 Market Street	Midtown	1,052	1,050	33%	5	Q4-21
Menulog^	T3 Barangaroo	Barangaroo	2,285	1,250	35%	5	Q3-21

\# Pre-commitment ^ Sublease ~Direct (g) gross face

BUYER MOMENTUM AMID YIELD RESILIENCE

Investment deal activity picks up the tempo, bringing home a strong finish to 2021

A rush of investment activity came to a head in Q4, as offshore and institutional capital injected c.$2.2 billion into office towers in Sydney. After a restrained 2020 and diminished confidence levels, the office market recovery has been better than anticipated, with activity in the final quarter of 2021 propelling annual investment volumes to $4.5 billion, more than double the preceding year.

Global and institutional money continues to back Sydney office

Despite border closures in 2021, there was strong offshore investment, with the share of deal volumes growing from a five year average of about 52% annually to 61% in 2021. While the pandemic has led to a shortfall in overall investment volumes relative to previous years, the appetite for core assets remains strong with offshore groups increasingly favouring domestic partnership by way of joint venture to acquire a stake in one of Sydney's office towers.

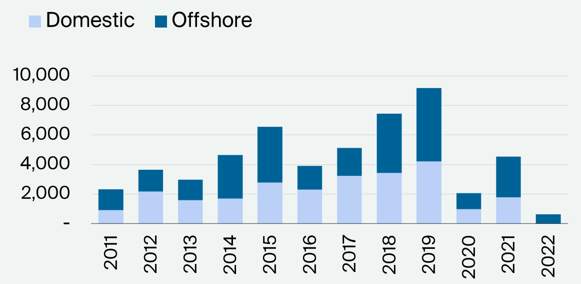
Rate of compression decelerated but office yields remain resilient

After two years of the pandemic, the office market has proven to be more resilient than expected in spite of the foreshadowed changes to space requirements due to flexible or hybrid work models being implemented. While overall yield levels have mostly sustained their low levels, there is an increased focus on quality of asset and strength of income.

Prime yields remained steady over the second half of 2021 to average between 4.25-4.75% as at January 2022. Similarly, secondary yields have remained unchanged over this period to average 5%.

Sydney Office Sales $10m+

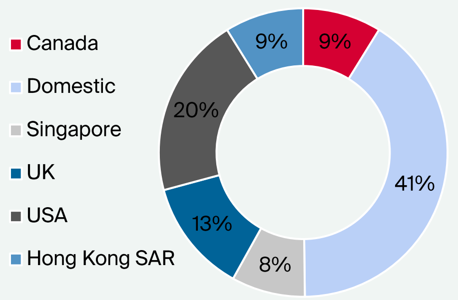
By Purchaser ($m), Domestic v Offshore



Source: Knight Frank Research

Sydney CBD Office Sales by Source

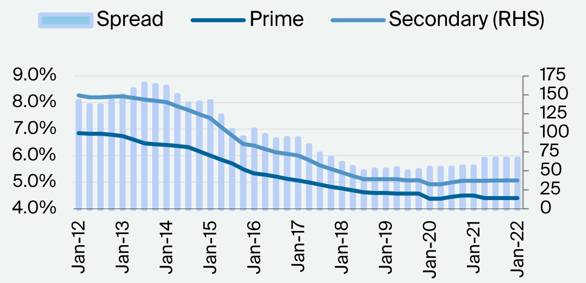
$10m+, % share by source of capital, 2021



Source: Knight Frank Research

Yield Spread

Prime vs Secondary



Source: Knight Frank Research

Office returns rebound on capital value growth

The increase in activity in Q4 is reflected in the uptick in total returns, as shown in the chart below using the PCA/MSCI Australia Index results.

While there has been a steady improvement in returns since early 2021, which aligns with an increase in leasing activity and signs of economic recovery, it did slow during the lockdowns in Q3. However, there were strong gains in Q4, which saw overall total returns in Sydney CBD grow by 8.9%. This upswing was underpinned by growth in capital values, and follows an improvement across several economic data points, including spending and a stronger than anticipated economic growth rate.

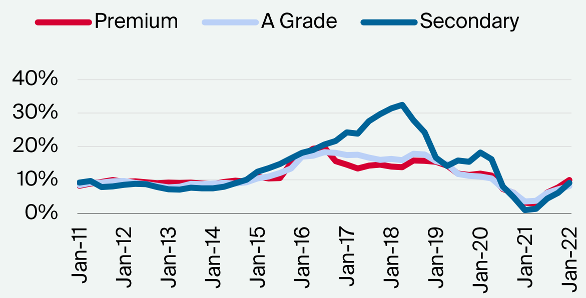
Pent-up demand and open borders will bolster investment activity in 2022

Activity during Q4 and the reported sale of Darling Quarter, which is still subject to Foreign Investment Review Board (FIRB) approval, indicates that income-producing office assets are still firmly on the radar for investors. The rebound in activity also suggests there is a large amount of capital waiting to be deployed, which is likely to be emphasised given cross-border travel and social restrictions have now been eased.

While this momentum will fuel a much stronger rebound in overall investment volumes in 2022 relative to the previous two years, it is expected that pricing for specific assets will still vary significantly depending on asset quality and length of income. The depth of recent evidence indicates that yields are holding their ground and are not likely to tighten any further in the short-term.

Sydney CBD Office Total Returns

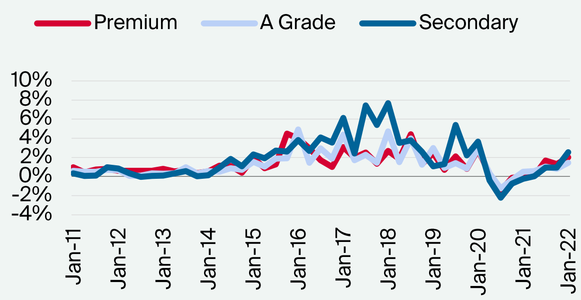
By quarter, rolling annual % return by Grade



Source: Knight Frank Research, MSCI

Sydney CBD Office Growth in Capital Values

By quarter, % growth on capital return indices by grade



Source: Knight Frank Research, MSCI

Recent significant sales

PROPERTY	PRICE $M	CORE MARKET YIELD %	NLA SQM	$/SQM NLA	WALE	PURCHASER	VENDOR	SALE DATE
Darling Quarter (50%)	625*	4.2	61,000	20,492	12.5	AREAP 1< Fund	Abu Dhabi Investment Authority	Jan-22#
10 Barrack Street	199	4.7	9,627	20,671	3.9	Shayher Group	AEW Capital	Dec-21
309-321 Kent Street (50%)	401	5.1	47,701	16,813	3.4	Ashe Morgan JV Liu Chong Hing Inv	Dexus	Dec-21”
77 Castlereagh Street	250	4.6	13,161	18,996	4.2	Abacus Property	Blackstone	Dec-21>
383 Kent Street	385	5	17,928	21,475	3	Charter Hall Prime Office Fund	Dexus	Nov-21\

*Gross sale price #Settlement April 2022 ^ Canada Pension Plan Investment < Allianz Real Estate Asia-Pacific Core I (AREAP I)
“ Settlement April 2022 > Settlement January 2022 \ Settlement July 2022

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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