- *Pent up leasing demand to surface post lockdown*
- *Face rents are holding but incentives have increased*
- *Signs of resilience in investment activity*

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Sydney CBD Office

Market Report, September 2021

ACTIVITY DOWN DESPITE CONFIDENCE IN MARKET

Pent up leasing demand and investment activity to emerge post lockdown.

9.2%
VACANCY
PCA data at Jul-21

125%
Increase in lease deal activity compared to 2020

$2.3
BILLION TURNOVER
2021YTD

"...despite the short-term volatility in property fundamentals, investors are optimistic about prospects in Sydney office market beyond the pandemic."

The Key Insights

As the pace of vaccinations increase and the national path out of lockdowns becomes clearer, there will be greater confidence that the growth momentum seen earlier this year will return.

The strong gains seen early 2021 in the economy quickly translated into rebound in office leasing activity, with leasing volumes YTD (August) 125% above same time in 2020.

Prime incentives average 32%. Face rents are holding but with incentives up, net effective rents have declined by 10% y-y in both prime and secondary markets.

The supply deficit experienced over the last few years has come to an end with office completions now at its highest level since the completion of International Towers.

$2.3 billion in transactions has been recorded over the year to August 2021, already above volumes at the same time last year.

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

Sydney CBD Office Market Indicators—July 2021

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	8.9	-5,655	147,937	1,190	30-35	-10	4.25-4.75
Secondary	1,964,810	9.6	-18,747	23,673	861	30-35	-10	4.75–5.25
Total	**5,149,548**	**9.2**	**-24,402**	**171,610**				

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

REBOUND ON HOLD BUT GREEN SHOOTS REMAIN

The economy's position of strength going into this lockdown will aid recovery

Prior to the current virus outbreaks, the Australian economy had achieved considerable recovery across a number of data points, including a strong rebound in consumer spending and a stronger than anticipated economic growth rate. Both housing and business investment had also increased, reflecting further signs of confidence in the economy, and the rise in employment and hours worked had exceeded expectations.

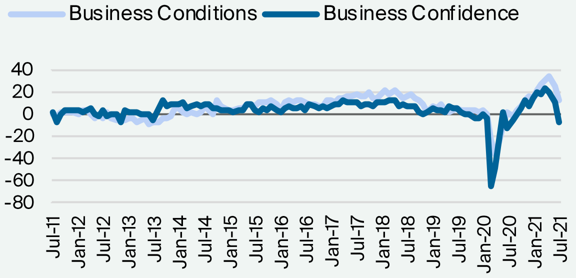
There is a view amongst commentators that whilst the current outbreaks are challenging and will lead to a contraction in both confidence levels and GDP in the short-term, the momentum gained in the first half the year has put Australia in a position of strength, which will aid in the next stage of the economic recovery.

In NAB's recent business survey it showed that although the strength in the business sector seen in early-to-mid 2021 had now faded due to disruptions in the economy, it has not yet deteriorated to the lows seen in early 2020. The survey highlighted that the experience has been that once restrictions are eased, activity bounces back, and even shows some degree of pent-up demand. The RBA has also recently said the experience to date has been that once virus outbreaks are contained the economy bounces back quickly.

As the pace of vaccinations continues to increase and the national path out of lockdowns becomes clearer, there will be greater confidence that the growth momentum seen earlier this year will return.

Business Confidence and Conditions

Net balance of positive and negative responses



Source: Knight Frank Research, Macrobond

Underlying strength and resilience in Sydney office market holds it in good stead for recovery

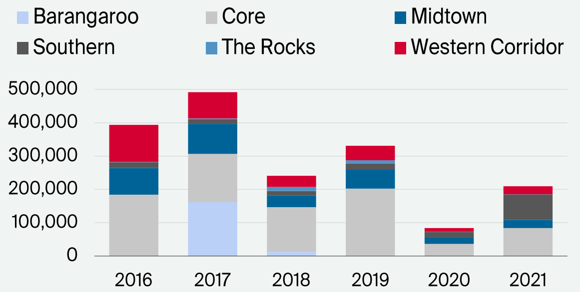
The strong gains seen early to mid-2021 in the economy, quickly translated into a rebound in office leasing activity in Sydney. The pickup in jobs growth in particular provided the strongest signal that the economy had made significant headway from the downturn in conditions last year, with the uptick in leasing activity YTD (August) showing deal volumes eclipsing 200,000 sqm or 125% above the volumes reported at same time in 2020.

Reflecting the improvement in demand levels during the first half of the year is the 27,269 sqm of positive net absorption that was recorded in H1 2021. While the announcement that Atlassian had agreed to take 75,000 sqm with Dexus at Central Place bolsters leasing volumes, when this deal is excluded, overall leasing volumes are still 40% above the 2020 level, further supporting the view that that has been a significant improvement in leasing demand for 2021, relative to the downturn in activity due to the pandemic in 2020.

Despite the challenges from lockdowns, there are still active mandates from tenants needing to make decisions on office space, whether it is upsizing or downsizing requirements or operating a hybrid workplace model. A protracted lockdown will halt inspections and delay activity in the short-term. However, as vaccinations rates improve and restrictions start to ease, green shoots will emerge. That sense of positivity and desire to get back into the workplace, along with pent-up demand from tenants who were on short-term hold over deals during the lockdowns, will kick-start deal activity as it did earlier in the year, generating optimism in the long-term recovery of Sydney's office market.

Lease Deals By Precinct

2016-2021YTD (August), sqm



Source: Knight Frank Research

NEW SUPPLY LESS IMPACTED BY CONSTRAINED DEMAND

Completions near 5 year high

Following a year of record levels of office refurbishments in 2020, the market continues to welcome new and refurbished stock. The supply deficit experienced over the last few years has come to an end with office completions now at its highest level since the completion of International Towers.

In the six months to July 2021, office completions totalled 104,721 sqm, taking the total office stock base to 5,149,548 sqm. New supply was led by the practical completion of Brookfield Place (60,821 sqm), which has achieved near full occupancy. Additionally, the only other new completion stemmed from 185 Clarence street (7,460 sqm) developed by Built Constructions.

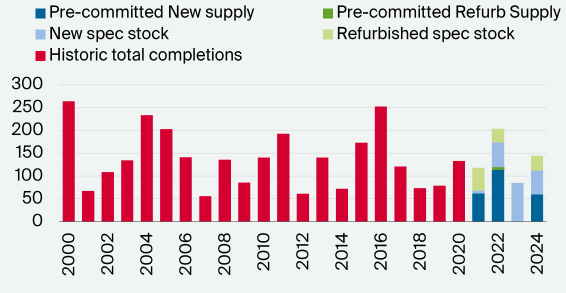
In terms of refurbished stock, two major refurbs to be completed over the period include 44 Martin Place (9,059 sqm) and 4 Bligh Street (9,964 sqm). A further 50,000 sqm of refurbished stock will likely come to market over the next 12 months, including 570 George Street (18,100 sqm) and 255 George Street (19,000 sqm), although these are yet to see any notable commitments.

New development under construction is substantially pre-let

The pipeline of new development stock currently under construction totals over 180,000 sqm, with a commitment rate over 60% across all schemes including CQT (55,000 sqm) and QQT (88,274 sqm) and 210 George Street (16,500 sqm). These schemes will reach practical completion by the end of 2022 and will be less impacted by the limited demand given pre-commitments achieved prior to Covid-19 disruption.

Sydney CBD Development Completions

By Commitment type, '000s sqm



Source: Knight Frank Research, PCA

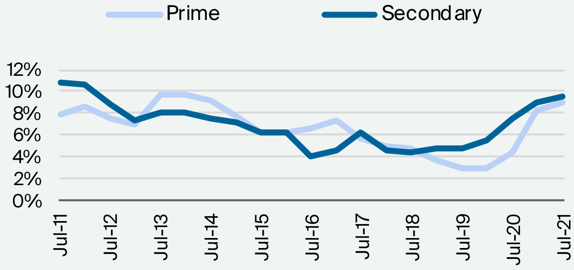
Whilst there are strong pre-commitment levels on the new developments, backfill space looms from occupiers vacating existing space to move into new stock. Significant backfill space will arise from Deloitte vacating Grosvenor Place (27,800 sqm) moving into QQT and NAB, now vacated from 255 George Street (23,000 sqm) to Brookfield Place.

Atlassian Tower gets green light

Dexus has recently confirmed its commitment to developing Atlassian's headquarters in the Western Gateway sub-precinct. Atlassian committed to a 15 year occupancy across the whole tower of 75,000 sqm, with delivery expected in 2026. This is a significant step in the rejuvenation of the Central precinct. The entire precinct is earmarked for 250,000 sqm of commercial space aimed towards start-ups, scale ups and innovation ecosystem partners. This milestone will likely see the much needed organic expansion of the CBD to its Southern boundaries and have a profound impact on future demand for the Southern CBD.

Vacancy

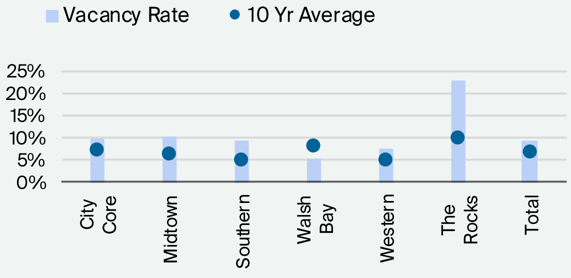
By Grade, %



Source: Knight Frank Research, PCA

Vacancy

By precinct, %



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– H2 2021

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

5 185 CLARENCE STREET–7,460 SQM
BUILT CONSTRUCTIONS - COMPLETE

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/REST– 85% COMMITTED. H1 2022

8 210 GEORGE STREET–16,500 SQM
POLY GROUP - 33% COMMITTED, H1 2022

9 CIRCULAR QUAY TOWER–55,000 SQM [SALESFORCE]
LENDLEASE, PING AN, MITSUBISHI – 55% COMMITTED. H2 2022

10 PITT STREET METRO TOWER–49,120 SQM
OXFORD/INVESTA–H2 2023

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 TECH CENTRAL –138,000 SQM
DEXUS/FRASERS– H2 2026

15 133 CASTLEREAGH STREET –90,000 SQM
STOCKLAND– 2027

16 DARLING PARK TOWER 4–60,000 SQM
GPT/AMP CAPITAL – 2028

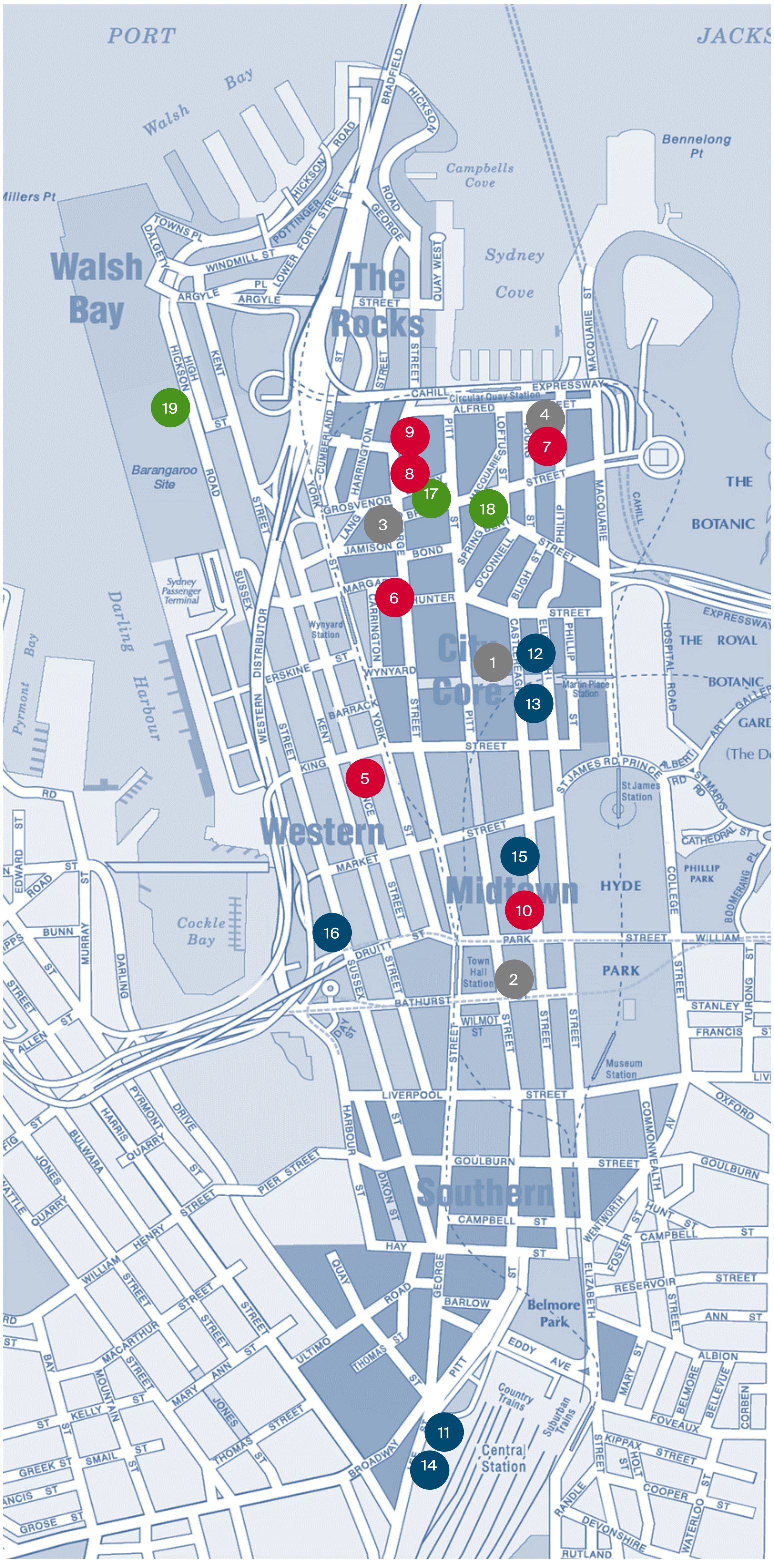
DEVELOPMENT APPLICATION/MOOTED/ EARLY FEASIBILITY

17 55 PITT STREET–70,000 SQM
MIRVAC. 2026

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



INCENTIVES RISE AS RENTS HOLD FIRM

Rents to remain steady in the near term

Rental growth has halted since the onset of the pandemic and with the current delta outbreak across the country it has reaffirmed minimal movement in face rents. On a 12 month basis (to July 2021), average prime net face rents have remained unchanged at $1,189/sqm ($1,404/sqm gross face). Similarly, in the secondary market rents are unchanged in the 12 months to July 2021 at $861/sqm ($1,025/sqm gross face).

The current rental discount between prime and secondary rents is 28%, widening from 25% 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. As a result, this could see the rental gap widen as secondary stock may struggle to fulfil these occupier demands.

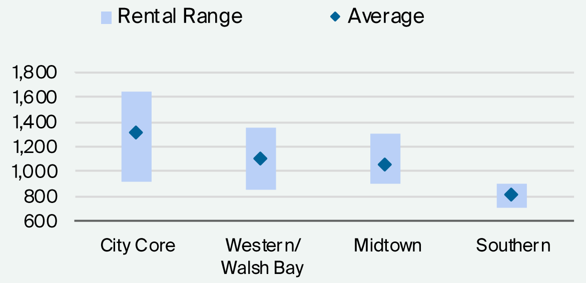
Incentives remain above average

Landlords continue to offer above average incentives in order to retain and attract tenants. Prime incentive now average over 32% as at July 2021, with market evidence of some lease deals being signed at 40%.

The rise in incentives has resulted in net effective rents dropping to $746/sqm, down 10.6% in the 12 months to July 2021. Secondary incentives average 32.2% which has resulted in net effective rents decline 10% to average $531/sqm.

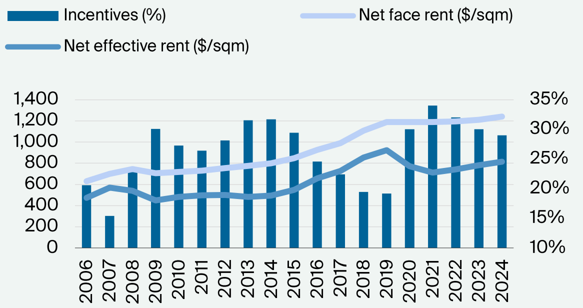
As sentiment and demand look likely to improve on the back of the vaccination roll-out, incentives will likely peak at year end and then begin to pull back slowly. Sublease vacancy and backfill space will still place pressure on effective rents in the near term and will still see landlords offer additional inducements to prospective tenants such as early access and contribution to fitouts.

Net Rental Range
By Precinct, $/sqm



Source: Knight Frank Research

Rent and Incentives
$/sqm, %



Source: Knight Frank Research

Recent tenant commitments

OCCUPIER	PROPERTY	PRECINCT	SIZE SQM	NET FACE RENT	INCENTIVE	TERM YRS	START DATE
HDR	25 Martin Place	Core	1,150	1,285(g)	35%	5	Q1-22
CyberCx	2 Market Street	Core	3,267	1,050	37%	7	Q1-22
Financial Decisions	28 Margaret Street	Western	307	1,075 (g)	33%	5	Q2-21
Perfect Shape	55 Market Street	Midtown	1,052	965	31%	5	Q2-21
Slater and Gordon	55 Market Street	Midtown	890	1,080	32%	6	Q2-21
NMG Financial~	225 George Street	Core	327	1,357	30%	5	Q2-21

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

SIGNS OF RESILENCE IN INVESTMENT ACTIVITY

Investors start to break through the Covid-led inertia

While the initial shock in economic activity in 2020 saw investment volumes fall to their lowest level in eight years, signs of a resurgence to activity levels began in December and extended through the first quarter of 2021.

$1.3 billion in transactions was recorded in Q1, more than double its five year average of $650 million.

$2.3 billion in transactions has been recorded over the year to August 2021. This is already above the c.$900 million in transactions recorded to the same time last year, further supporting the view that despite the short-term volatility in property fundamentals, investors are optimistic about prospects in Sydney office market beyond the pandemic.

Uptick suggest investors are optimistic about prospects beyond the pandemic

The uptick in activity reveals two key drivers. The first is the earlier than expected recovery in the economy and the handling of the virus prior to the current strict lockdown measures currently underway in Sydney. While the landscape has introduced a level of uncertainty that did not exist before March 2020, the rebound boosted confidence levels to the point where investors were starting to break through the Covid-led inertia to gain momentum not seen for 12 months. Sellers, in particular, showed increased confidence that they would achieve strong pricing and were more prepared to go to market in the first half of 2021, relative to 2020.

The second driver is the investor response above the pre-pandemic average, which signifies that there is a large amount of pent-up capital waiting to be deployed following the uncertainty of 2020. Given greater confidence and prospect of economic recovery next year, this will underpin a busy period with more assets coming to market.

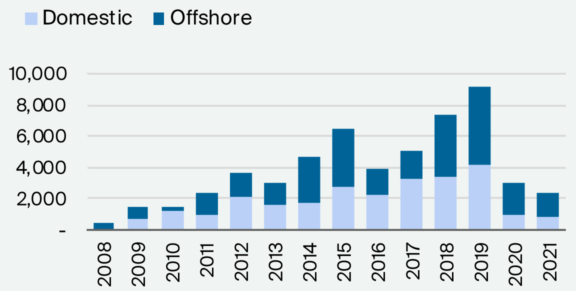
Offshore investors step up their exposure as capital partnerships rise

Despite ongoing travel restrictions, offshore groups continue to show strong interest, with the share of deal volumes growing from a historical average of about 50% to 62% 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 partners to bypass the difficulties travel restrictions currently have on investment in the short-term.

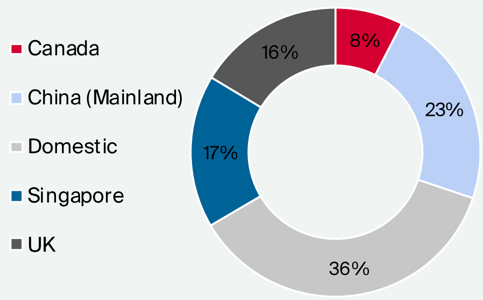
In a recent example of offshore investor demand, Mirvac utilised its pre-emptive rights to acquire a further 50% stake in 200 George Street from AMP Capital for $578.5 million on a core market yield of 4.4%, reportedly securing capital partner M&G Real Estate from the UK to co-own the building. The deal follows Singapore's Mercatus Co-Operative JV with Dexus to acquire a 33.3% interest in 1 Bligh Street for $375 million. Similarly, in December, Investa partnered with Canadian group Manulife to purchase 39 Martin Place for $800 million.

Sydney Office Sales $10m+
By Purchaser ($m), Domestic v Offshore



Source: Knight Frank Research

Sydney Office Sales by Source of Capital
$10m+, % Share, 2020-2021



Source: Knight Frank Research

Prime yields stable after sustained period of compression

Office yields have not seen much movement since the onset of the pandemic, only edging out 10 bps during 2020, after a two year period of sustained compression. In spite of uncertain occupier markets, yields have now recovered that lost ground in 2021.

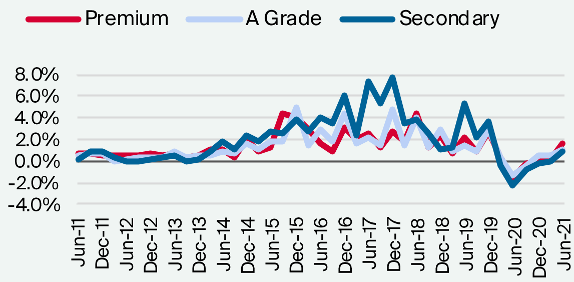
Average prime yields are 4.40% as at July 2021, reflecting a 10bps compression on January 2021, but is unchanged y-y.

Secondary yields average 5.06%, this is 0.2bps softer y-y but unchanged since October 2020.

Yields are expected to remain unchanged in the short-term before gradually tightening in 2022 as the occupier market begins to recover, although pricing for specific assets will vary significantly depending asset quality and length of income.

Sydney CBD Growth in Capital Values

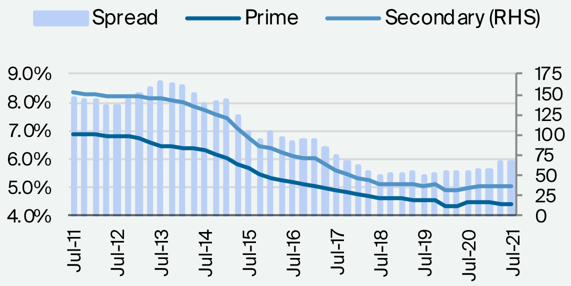
By quarter, % growth on capital return indices by grade



Source: Knight Frank Research, MSCI

Yield Spread

Prime vs Secondary, %, bps



Source: Knight Frank Research

Recent significant sales

PROPERTY	PRICE $M	CORE MARKET YIELD %	NLA SQM	$/SQM NLA	WALE	PURCHASER	VENDOR	SALE DATE
200 George Street (50%)	578.5	4.4	38,937	29,714	5.3	Mirvac JV M&G Real Estate	AMP Capital Wholesale Office Fund	Aug-21
1 Bligh Street (33%)	375	4.50	42,800	26,288	5.4	Mercatus Dexus Australia Partnership	CBUS	Mar-21
39 Martin Place	800.0	U/D	30,000	26,667	U/D	Investa / Manulife	Macquarie Group	Jan-21
400 George Street (25%)*	290.0	4.95	51,057	22,720	5.7	M&G Real Estate	Investa	Dec-20
76-78 Pitt Street	281.5	4.53	23,473	11,993	10	Charter Hall Long WALE REIT	Telstra	Dec-20
1 Farrer Place (25%)	584.6	4.7	85,087	27,482	4.3	Lendlease (APPCF^)	GPT	Dec-20

^ Australia Prime Property Commercial Fund) *Due to settle June 2021 #Passing yield

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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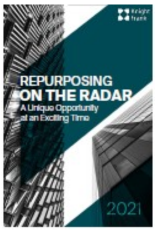

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