Briefing
Sydney CBD Office

June 2019

Highlights

- Sydney Office continues to tighten, driven by tenant demand and domestic and foreign capital;
- The total vacancy rate fell to a 10 year low of 4.1% in December 2018;
- Leasing activity was boosted by pre-commitments as a result of limited available space;
- Rental and capital growth continued with signs of upwards growth until the next development cycle nears completion in 2019/20.

A Grade Averages	Latest	Yr Change	Outlook
Rental – N.F. ($/sq m)	1,090	5.80%	↗
Incentives	20.5	-175bps	↙
Rental – N.E ($/sq m)	870	8.70%	↗
Yield – Market (%)	4.75	-15bps	↙
IRR (%)	6.65	-05bps	↙
Capital Values ($/sq m)	20,300	4.10%	↗

Demand & Supply	Latest	PCP*
Vacancy	4.1	4.8
Net Absorb. ('000 sq m)	10.4	29.0
Stock U/C ('000 sq m)	367.5	299.4
- % of market	7.3	6.0
- % committed	68.7	47.9

*PCP = Previous Corresponding Period
Source: Savills Research

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Executive Summary

The Sydney CBD continued to display strong performance across key indicators in 2019, with the headline vacancy rate tightening further. The market has been typified by limited supply and demand led rising rents, which Savills Research expects to continue for the foreseeable future. Total vacancy was at 4.1% at the end of 2018, lowest since December 2007 (3.7%), however lower than average leasing activity, due to limited supply, saw 213,734 square metres (> 1,000 square metres) taken up.

Office supply remains tight and current developments are seeing strong takeup in precommittments. Precommittments accounted for the majority of transactional activity, contributing approximately 60% of total volumes in the 12 months to June 2019. Savills Research estimates circa 360,000 square metres of stock is currently under construction, with a large portion of the supply already pre-committed.

Assets for sale have contracted as investors ride capital price appreciation, falling interest rates and resulting falling financing costs and the lack of development sites coming on line. As assets come to market, Savills Research expects strong investor interest to eventuate for centrally located properties with shorter WALEs, so as to take advantage of rising market rents and that will continue to drive further value appreciation for the CBD as a whole.

PCA Summary Table – Sydney CBD (year to Dec-18)

	Premium	A Grade	Prime	Secondary	Total	AUS CBD
Total Stock ('000)	1,162.1	1,825.6	2,987.8	2,021.5	5,009.2	**17,902.6**
Total Vacancy ('000)	43.9	65.5	109.4	94.5	203.9	**1,482.7**
Vacancy (%)	3.8 (7.1)	3.6 (7.0)	3.7 (7.1)	4.7 (7.3)	4.1 (7.2)	**8.3 (9.4)**
Net Absorption ('000)	69.1 (48.5)	-15.8 (19.5)	53.3 (67.9)	-42.9 (-36.0)	10.4 (31.9)	**230.7 (181.3)**
Net Absorption (%) *	6.6 (5.8)	-0.9 (1.2)	1.9 (2.7)	-2.2 (-1.7)	0.2 (0.7)	**1.4 (1.2)**
Net Additions ('000)	35.2 (48.2)	-17.7 (18.2)	17.5 (66.4)	-44.3 (-39.7)	-26.8 (26.8)	**-46.2 (257.6)**
- Stock Additions ('000)	35.2	20.8	56.0	17.4	73.5	**317.8**
- Stock Withdrawals ('000)	0.0	38.5	38.5	61.8	100.3	**364.5**
Net Additions (%)	3.1 (5.5)	-1.0 (1.1)	0.6 (2.5)	-2.1 (-1.8)	-0.5 (0.6)	**-0.3 (1.6)**

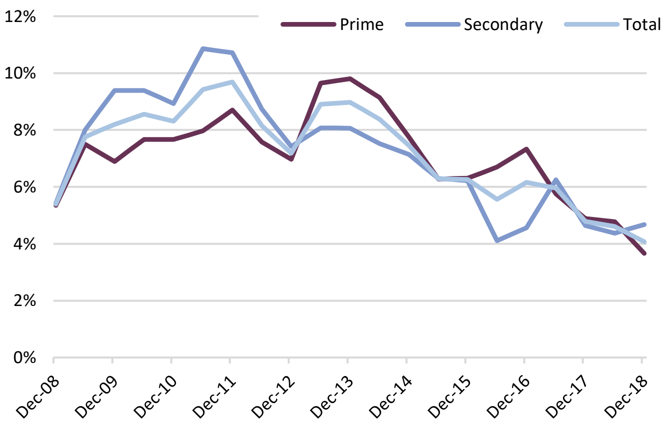
Source: PCA / Savills Research (10yr Averages shown in brackets);*As a percentage of occupied stock

Vacancy

Sydney CBD's headline vacancy rate recorded further compression over the latter half of 2018, falling 20 basis points in the 6 month period to December 2018. The total vacancy rate was recorded at 4.1% at the end of 2018, this being at its lowest since December 2007 (3.7%).

Savills Research anticipates further tightening in prime and secondary grade vacancy over 2019. Favourable market conditions will likely continue to support healthy demand for office space and with much of the upcoming development cycle likely to be fully pre-committed by the time it comes to completion (based on the number of active briefs currently in the market), we expect the total vacancy rate to fall to record low levels by the end of the year.

Historic Vacancy Rate



Source: PCA / Savills Research

Full Floor Availability

The Savills Prime Full Floor Availability Report assesses the state of the leasing market in a different manner to standard vacancy surveys. The report shows each Premium and A Grade building in the city on a floor-by-floor basis highlighting which floors are available for lease, now and in the near future, including those under construction and refurbishment.

	By Grade			By Precinct				
	Total	Premium	A Grade	Core	Midtown	Western	Southern	W. Bay/ Rocks
Total Prime Floors (No)	2,395	794	1,601	1,123	545	479	98	150
Total Prime NLA (sq m)	3,359,275	1,321,850	2,037,425	1,420,610	758,196	735,802	132,810	311,857
Prime Floors Available (No)	260	89	171	159	53	36	7	5
Prime Full Floor Avail. (sq m)	353,985	142,759	211,227	215,441	54,012	63,419	9,825	11,289
Prime Full Floor Avail. (%)	10.5	10.8	10.4	15.2	7.1	8.6	7.4	3.6
Max Contiguous Floors (No)	19	11	19	15	19	10	6	2
Max Contiguous Area (sq m)	30,562	18,693	30,562	26,769	20,497	30,562	8,891	4,529

Source: Savills Research

Leasing Activity & Demand

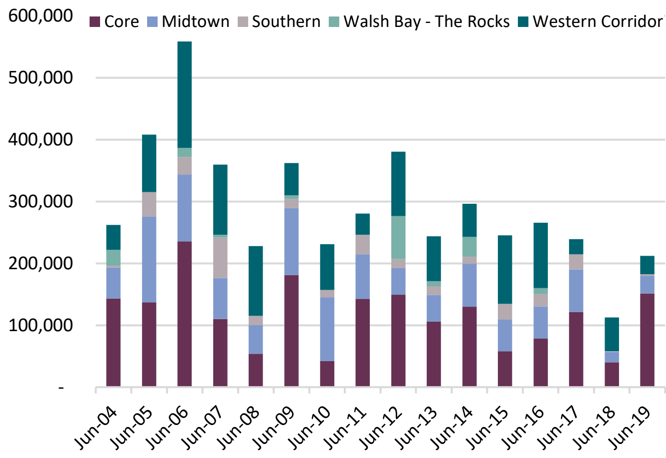
In the 12 months to June 2019, Savills Research identified 213,000 square metres (> 1,000 square metres) of leasing activity within the Sydney CBD. This number was slightly below the 10 year average of 265,375 square metres which is mainly due to the lack of available stock in this market, particularly contiguous floors, with vacancy rates currently at levels not seen since before the Global Financial Crisis.

The majority of leasing volumes were in the 'Core' precinct, which was mainly due to several large pre-committments. Notably, AMP's Quay Quarter Tower secured a combined 68,500 square metres of pre-commitment by AMP and Deloitte. Unsurprisingly, pre-commitments accounted for the majority of transactional activity, contributing approximately 60% of total volumes in the 12 months to June 2019.

The 'Property & Business Services' sector again dominated total leasing activity accounting for over 63% of all recorded transactions (by volume). This was boosted considerably by co-working groups who continue to increase their prescence in CBDs throughout Australia, particularly Sydney and Melbourne. Singaporean based co-working provider JustCo have been actively expanding, securing two new spaces in Sydney (along with another two in Melbourne) in the last three months. They will occupy 4,200 square metres at 175 Pitt Street and approximately 2,700 square metres at 60 Margaret Street. With more than 400 co-working providers in Sydney and Melbourne (up from approximately 80 in 2013), we can expect to see activity from these users continue to transform the leasing market.

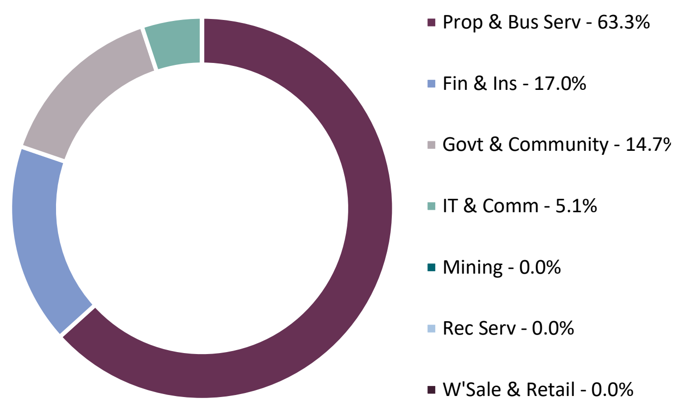
Net absorption remains subdued and has been for the past 2 years, mostly as a result of less available space and ongoing withdrawals associated with infrastructure projects and redevelopment amid change-of-use projects. Total 12 month net absorption was recorded at 10,443 square metres over 2018. Positive net absorption in Prime grade stock (55,300 square metres) was largely offset by withdrawals of Secondary stock for refurbishments and conversions for alternate use.

Leasing Activity by Precinct (> 1,000 square metres)



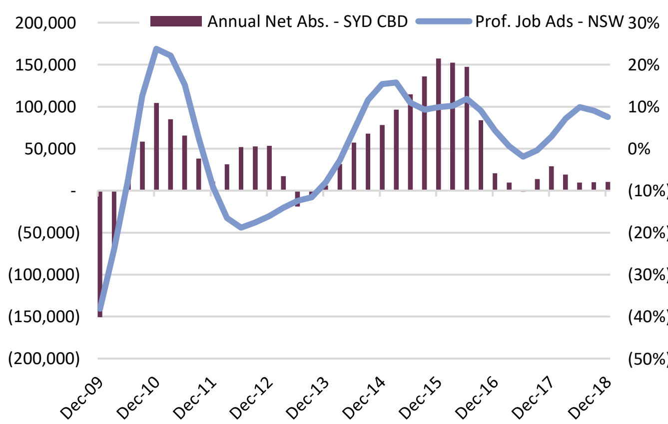
Source: Savills Research

Leasing Activity by Tenant Type (> 1,000 square metres)



Source: Savills Research

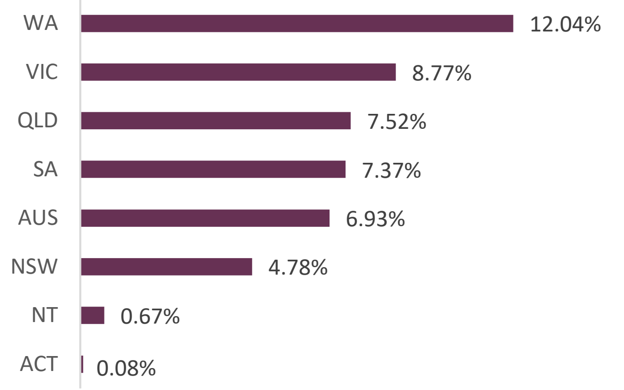
Net Absorption vs. Growth in Professional Job Ads



Source: DOE / Savills Research

NSW continued to record steady year on year growth for professional job advertisements, growing 4.78% in the 12 months to April 2019. With strong demand for office space in Sydney CBD currently evident, we expect to see a continuation of this demand, with tenant enquiries remaining strong.

Professional Job Advertisement Growth by State (Apr-19)



Source: DOE / Savills Research

Recent Notable Leases (by Area Leased)

Property	Tenant	Date | NLA (sqm)	Type | Rent | Term
50 Bridge St	AMP Limited	Jan-19 | 36,500	Precommit | n.a | 12
50 Bridge St	Deloitte	Feb-19 | 32,000	Precommit | 1,400 (N) | 10
231 Elizabeth St	Property NSW	Apr-19 | 21,700	Direct | n.a | 12
10 Carrington St	Allianz	Jul-18 | 10,820	Precommit | n.a | 10
1 Sussex St	WeWork	Jul-18 | 10,000	Precommit | n.a | n.a.
60 Martin Pl	Norton Rose Fullbright, Henry Davis York	Aug-18 | 9,527	Precommit | 1,250 (G) | 10
126 Phillip St	Deutsche Bank	Sep-18 | 8,664	Renewal | n.a | 8
66 King St	Wework	Aug-18 | 6,617	Precommit | 1,075 (G) | 10
121 Harrington St	Havas	Oct-18 | 6,128	Direct | 920 (N) | 10
175 Pitt St	JustCo	Apr-19 | 4,200	Direct | n.a | n.a.
60 Martin Pl	Regus	Aug-18 | 4,200	Precommit | 1,250 (G) | 10
123 Pitt St	Urbis	Nov-18 | 3,676	Direct | 985 (N) | 10
183-185 Clarence St	Built	Sep-18 | 3,500	Precommit | 1,115 (N) | n.a.
309 Kent St	MYOB	Oct-18 | 3,496	Direct | 700 (G) | 10
60 Margaret St	Justco	Aug-19 | 2,697	Direct | 970 (N) | 10
60 Martin Pl	Munich Re	Mar-19 | 2,600	Precommit | 2,600 (N) | n.a.
8 Chifley	Quantium Pty Ltd	Sep-18 | 2,594	Renewal | 1,057 (N) | 6
210-220 George St	Poly Group	Sep-18 | 2,500	Precommit | 1,450 (G) | 8
60 Martin Pl	Banco Chambers	Aug-18 | 2,500	Precommit | 1,400 (G) | 10
31 Alfred St	Hub Australia	Mar-19 | 2,341	Precommit | n.a | n.a.

Source: Savills Research

Sales Activity

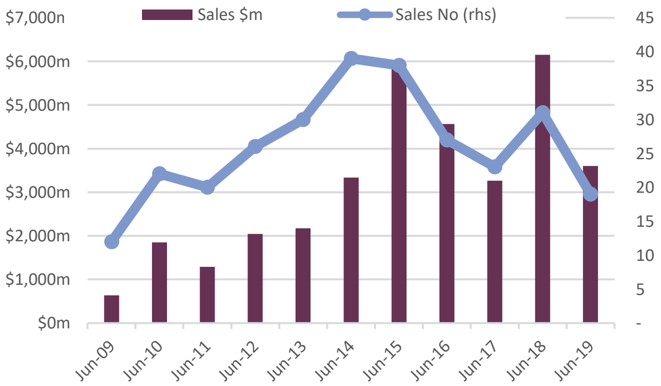
Savills Research recorded approximately $3.60 billion of office transaction (> $5 million) in the 12 months to June 2019. This figure is almost half of what was transacted in the previous 12 months, however this is a direct result of limited supply. Anecdotal evidence suggests that demand for office assets in Sydney CBD still remains strong with foreign and domestic investors alike.

The sale of a 50% interest of 19 Martin Place (MLC Centre) helped to boost transaction volumes considerably in the 12 month period. The share was purchased by Dexus from vendor GPT for $720 million, giving Dexus full ownership of the asset whilst also helping to firm their position as the nations largest office landlord. The sale represented an equated yield of 4.8% and a capital value of $21,536 per square metre.

Foreign investor activity within Sydney CBD appeared to ease over the last 12 months, spending $900 million in comparison to $1.5 billion in the previous 12 month period. Anecdotal evidence suggests that their attention has turned to higher yielding assets in other CBDs including Brisbane as yields reach historic lows in Sydney CBD. Domestic institutional investors remained active in the 12 month period, accounting for close to 70% of all transactions (in dollar terms).

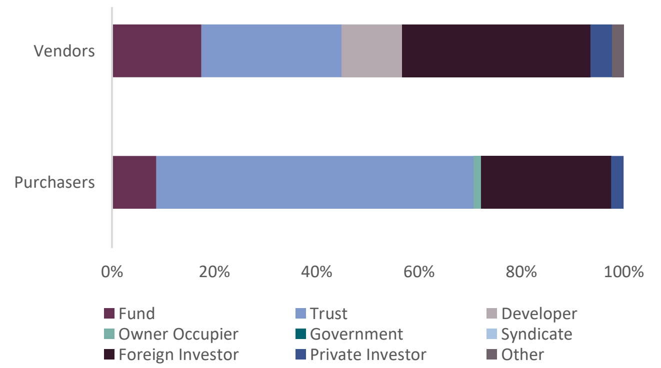
Market valuation yields in Sydney CBD, as at June 2019, were typically estimated to range from 4.40% to 4.75%, for Premium Grade buildings, 4.50% to 5.00% for A Grade buildings and 4.50% and 5.25% for B Grade buildings. The margin between office yields and 10 year bonds still remains evident, making office properties an attractive investment and not yet deemed to be ‘expensive’. We expect to see a continuation of compression for both yields and 10 year bonds over the next 12 to 18 months which will help to support office market conditions.

Sales Activity by Price (Sydney CBD)



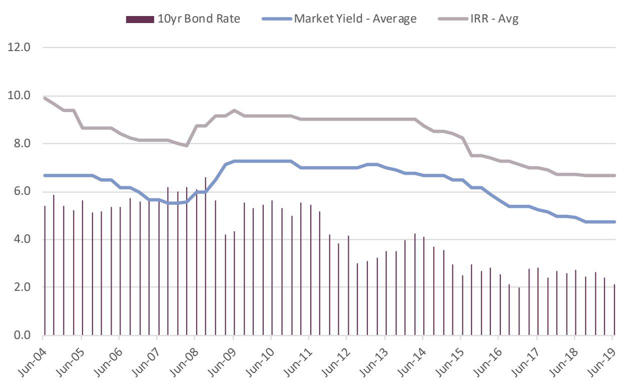
Source: Savills Research

Vendor & Purchaser Type (> $5 million)



Source: Savills Research

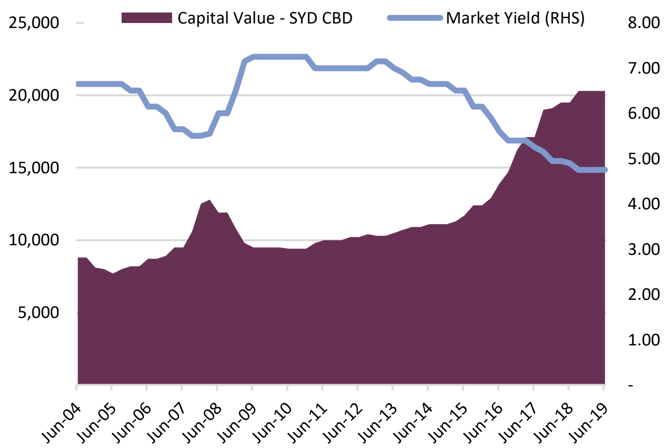
Sydney CBD A Grade - Yield Range to 10yr Bond



Source: Savills Research

Average A Grade capital values in Sydney CBD were recorded at $20,300 per square metre, growing by 4.1% over the 12 months to June 2019. Premium capital values were recorded at $26,300 per square metres and B grade at $16,800 per square metre.

Capital Value ($/sq m) vs. Market Yield



Source: Savills Research

Recent Notable Sales (by Sale Price)

Property	Price ($m) | Date | NLA	Yield | Type | $/sq m
19 Martin Pl (50.0%)	720.00 | Mar-19 | 66,865	4.81 | e | 21,536
10 Shelley St	533.00 | Dec-18 | 27,722	4.46 | i | 19,227
60 Margaret St (50.0%)	337.50 | Dec-18 | 40,688	5.12 | e | 16,590
10 (50.0%) & 20 Bond St	310.00 | May-19 |38,271	n.a | n.a | n.a
12 Shelley St	271.00 | Dec-18 | 14,957	4.60 | i | 18,119
1 Sussex St	250.00 | Jul-18 | 10,000	n.a | n.a | 25,000
275 George St	235.50 | Aug-18 | 7,319	4.50 | e | 32,177
183-185 Clarence St	180.30 | Nov-18 | 7,867	5.00 | e | 22,919
60 Carrington St (49.9%)	134.73 | Aug-18 | 14,606	4.66 | e | 18,486
50 Carrington St (49.9%)	102.30 | Aug-18 | 11,305	4.68 | e | 18,133

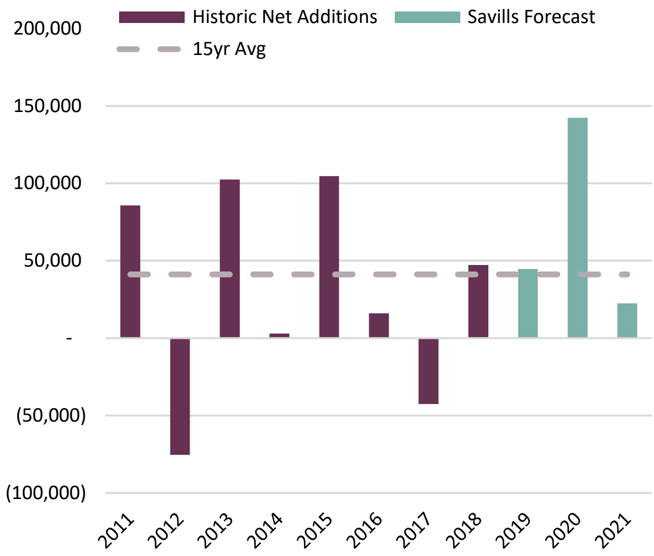
Source: Savills Research; Yield Types: i = Initial, r = Reported, e = Equated, v = Vacant, dev = development

Supply

Over 2018, just under 50,000 square metres was added to the Sydney CBD office market, with approximately 90% of volumes pre-committed at the time of completion. In 2019, we expect to see approximately 44,000 square metres of net supply enter the market, with projects including 60 Martin Place and 1 Sussex Street coming to completion in Q4 2019.

With pre-commitment rates remaining high (circa 70.0%) it is likely that we will continue to see upcoming supply be close to fully commited before completion. This is particularly evident with Premium grade stock as the current vacancy has contracted to a low of 3.8%, which we have not seen since 2006.

Net Supply by Year (square metres)



Source: Savills Research / PCA

Development

The table below summarises some of the major upcoming and planned development and refurbishment projects in the Sydney CBD.

Building Address	Dev Stage	NLA	Exp. Comp	Precinct	Tenants
60 Martin Pl	UC	42,431	2019	Core	Norton Rose Fullbright, Banco Chambers, Regus, Munich Re & Mizuho Bank
1 Sussex St	UC	10,593	2019	Walsh Bay	WeWork
10 Carrington St	UC	58,626	2020	Core	NAB, Allianz
275 George St	UC	7,886	2020	Core	
1 Carrington St	UC	7,700	2020	Core	
50 Bridge St	UC	93,904	2020	Core	AMP, Deloitte
241-249 Wheat Rd	PA	75,000	2022	Western Corridor	
44 Martin Pl	PA	11,366	2022	Core	
210-220 George St	UC	18331	2022	Core	Poly
4-6 Bligh St	EP	10,000	2022	Core	
233 & 241 Castlereagh St	PA	13,336	2022	Midtown	
55 Pitt St	PS	45,000	2022	Core	

Source: Savills Research; UC = Under Construction, DA = Development Approved, PS= Plans Submitted, EP = Early Planning

Rents

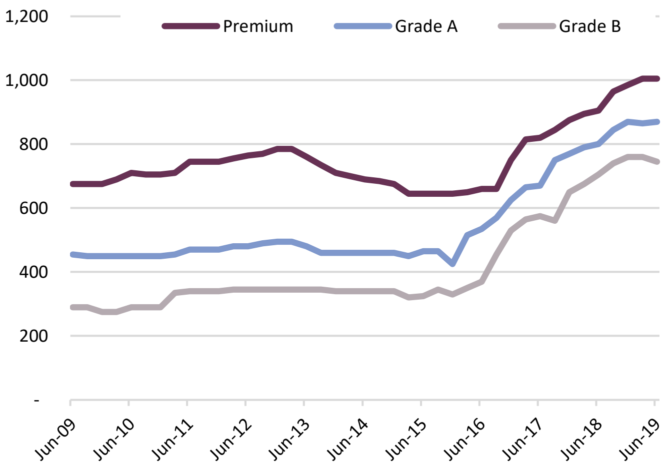
Rents in the Sydney CBD continued to record significant growth with record high rents recently recorded in the premium grade development at 60 Martin Place, achieving an annual net face rent of over $1,800 per square metre.

On a net effective basis, average rents for Premium grade buildings were recorded at $1,005 per square metre per annum as at June 2019. Average A grade rents were recorded at $870 per square metre per annum representing a growth of 8.7% in the 12 month period, whilst B grade rents were recorded at $745 per square metre per annum, growing 5.6%.

With demand fundamentals in Sydney CBD currently strong, we are continuing to see incentives trend downwards following record high incentive levels in 2015 (Circa 38%-43%). This is expected to continue.

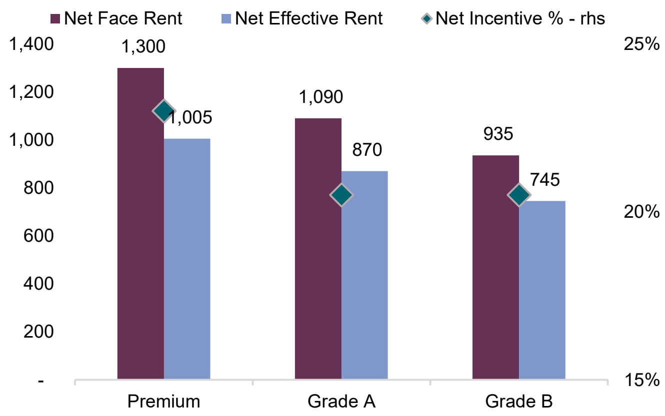
Given current market conditions and positive forward economic indicators, Savills Research anticipates a continuation of the tight conditions over the short to medium term, maintaining upward pressure on rents.

Net Effective Rents by Grade ($/sq m)



Source: Savills Research

Net Face & Net Effective Rents (as at Jun-19)



Source: Savills Research

Outlook

Demand from both tenants and investors remains strong within Sydney CBD, resulting in strong growth in rents, capital values and ongoing yield compression. Savills Research expects the yield compression cycle has further to run, with office assets metrics superior to government bonds, making it an attractive investment opportunity for both domestic and foreign investors. Despite this, we have begun to see investors explore opportunities in other east coast CBDs and select suburban CBD's as a result of the limited stock (particularly 100% interest) that has been offered to the market in the past 6 to 12 months.

Although the next cycle of developments are underway with over 360,000 square metres of stock currently under construction, a large portion of the supply is already pre-committed. It is evident that much of the relief for tenants will come in the form of backfill supply over the next 12-24 months as these assets come to completion.

Sydney CBD Key Indicators (Q2-19)

	Premium		A Grade		B Grade	
	Low	High	Low	High	Low	High
Rental - Gross Face ($/sq m)	1,270	1,770	1,165	1,385	980	1,210
Rental - Net Face ($/sq m)	1,050	1,550	980	1,200	820	1,050
Incentive Level Gross (%)	18	21	15	20	15	20
Rental - Net Effective ($/sq m)	800	1,205	775	960	650	840
Outgoings - Operating ($/sq m)	140	155	110	130	85	110
Outgoings - Statutory ($/sq m)	55	85	50	75	50	70
Outgoings - Total ($/sq m)	195	240	160	205	135	180
Typical Lease Term	8	10	5	10	5	7
Yield - Market (% Net Face Rental)	4.38	4.75	4.50	5.00	4.50	5.25
IRR (%)	6.38	6.63	6.50	6.75	6.25	6.75
Cars Permanent Reserved ($/pcm)	990	1,080	900	1,070	720	790
Office Capital Values ($/sq m)	22,500	30,000	18,500	22,000	13,500	20,000

Source: Savills Research NB: All rents equivalent to whole floor mid-rise

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