Briefing
Sydney CBD Office

February 2019

Highlights

- Vacancy fell to 4.1% in December 2018 with an outlook to continue to fall until 2019/2020;
- Rental and capital growth continued with signs of upwards growth until the next development cycle nears completion in 2019/20;
- Average A Grade net face rents in Sydney's CBD were recorded at $1,090 per square metre, growing 9.0% over 2018;
- Despite sentiment across the office sector falling to 2-year lows, business conditions remained the strongest in NSW and Victoria in November 2018.

A Grade Averages	Latest	Yr Change	Outlook
Rental – N.F. ($/sq m)	1,090	+9.0%	↗
Incentives	20.5	+100bps	↙
Rental – N.E ($/sq m)	870	+8.1%	↗
Yield – Market (%)	4.75	-20bps	↙
IRR (%)	6.65	-5bps	↙
Capital Values ($/sq m)	20,300	+6.3%	↗

Demand & Supply	Latest	PCP*
Vacancy	4.1	4.8
Net Absorb. ('000 sq m)	10.4	29.0
Stock U/C ('000 sq m)	299.4	195.5
- % of market	5.6	3.9
- % committed	48.0	45.1

*PCP = Previous Corresponding Period

Report Contents

Shrabastee Mallik
smallik@savills.com.au
Director
Research & Consultancy

For our latest national reports, visit
savills.com.au/research

To join Savills Research mailing list, please email
research@savills.com.au

Executive Summary

The Sydney CBD remained a standout performer across key indicators in 2018, with further falls in the headline vacancy rate recorded over the latter half of the year. Whilst leasing activity was diminutive during mid-2018, we saw a notable uptick in leasing deals executed over the last quarter of 2018, though total leasing volumes over the year were notably below that of the previous year and on long-term averages. However, this is a reflection of a lack of options available to occupiers, rather than low demand, which on anecdotal evidence, remains strong. Demand for office space in the Sydney CBD was amplified by the ongoing expansion by co-working groups.

The headline vacancy rate fell 70 basis points over the second half of 2018, to 4.1% in December 2018. Whilst net absorption over the past 2 years has been lower than historical averages, this is as a result of ongoing withdrawals associated with government projects, redevelopment and change-of-use projects, leading to very little office space available for lease, particularly across large contiguous floor plates. Total net absorption for the market was recorded at 10,443 square metres over 2018, which was below that recorded in the year prior.

Average A Grade net face rents broke the $1,000 per square metre barrier in 2018, recording an annual growth rate of 9.0% in 2018, finishing the year at $1,090 per square metre. Capital value growth was still evident across CBD assets, with average A Grade capital values rising 6.3%, breaking the $20,000 per square metre mark for the first time. Whilst these growth rates are more muted than the double-digit growth rates that we have seen throughout the past two years, we are still seeing growth in rents on both a face and effective basis and in capital values, in spite of record high rents and capital values, pointing to the ongoing resilience of the Sydney CBD office market. With forward-looking indicators across the office market are now at some of the strongest levels we have seen them in a while, it would be prudent to assume there is steam left in Sydney CBD's performance.

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	16.6	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)**

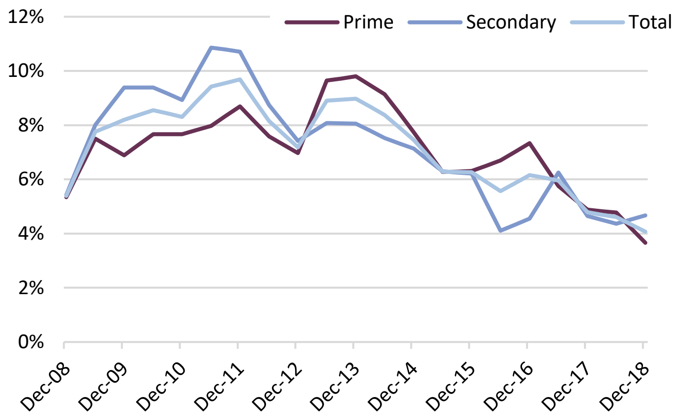
Source: PCA / Savills Research (10yr Averages shown in brackets);*As a percentage of occupied stock

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, its lowest since December 2007 (3.7%).

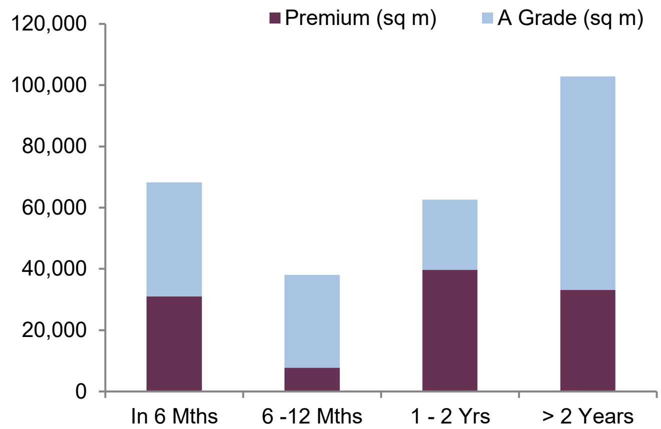
Savills Research anticipates further tightening in prime and secondary grade vacancy over 2019. Favourable market conditions will likely continue to support healthy demand for office space and with much of the upcoming development cycle likely to be fully pre-committed by the time it comes to completion (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

Availability by Period



Source: 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.

Prime availability decreased by 10 full floors to 220 in the three months to January 2019. This can be partially attributed to increased demand for office space and demolition clauses in certain buildings, which is effectively decreasing the number of full floors available. Most of the activity was in the Western Corridor where 7 floors in 2 Market Street were absorbed by Amazon.

	By Grade			By Precinct				
	Total	Premium	A Grade	Core	Midtown	Western	Southern	W. Bay/ Rocks
Total Prime Floors (No)	2,354	796	1,558	1,083	545	479	98	149
Total Prime NLA (sq m)	3,332,928	1,325,244	2,007,684	1,395,017	758,180	735,849	132,810	311,073
Prime Floors Available (No)	220	71	149	129	65	14	8	4
Prime Full Floor Avail. (sq m)	302,644	124,626	178,018	186,851	75,389	17,791	13,865	8,748
Prime Full Floor Avail. (%)	9.1	9.4	8.9	13.4	9.9	2.4	10.4	2.8
Max Contiguous Floors (No)	25	5	25	25	19	2	7	3
Max Contiguous Area (sq m)	20,497	9,500	20,497	46,267	20,497	18,380	11,271	4,229

Source: Savills Research

Leasing Activity & Demand

Savills Research recorded just over 150,000 square metres of leasing activity in the Sydney CBD (> 1,000 square metres). Whilst lower than the 12 months prior and the 10 year average (down 29.7% and 39.7% respectively), this was primarily due to limited available options in the market, particularly across large contiguous floor plates. The majority of lease transactions were found in the 'Core' precinct (61%), followed by the 'Western Corridor' precinct (26%).

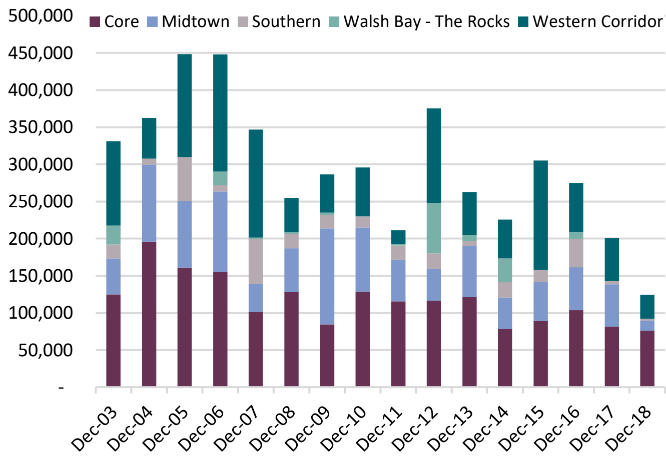
Leasing activity across the sub-1,000 square metre market (~34,000 square metres) was also down on the year prior (~53,000 square metres) which was a reflection of the growing presence of co-working groups, limiting sub-leasing activity. Tellingly, the second largest deal signed in 2018, was WeWork's 10,000 square metre pre-commitment at 1 Sussex Street. Co-working groups accounted for nearly one-fifth of all leases transacted last year, with expansion plans pointing to an ongoing presence in the CBD over 2019.

Flexible office space options including co-working, though a relatively newer phenomena in the Australian market, are affecting leasing patterns across office markets nationally. One of the main impacts has been on the sub-lease market and across small requirements. Co-working groups not only offer lower rents, shorter terms and 'cooler' work spaces, there is notably less hassle in signing up for 'flexible office space', compared to signing a sub-lease, driving demand in the sub-lease market to record low levels. We are now also seeing less available sub-lease space in CBD markets nationally, in line with this new age of flexible office space.

Unsurprisingly, the 'Property & Business Services' sector dominated total leasing activity, accounting for just under two-thirds of the total in 2018. This was followed by the 'Finance & Insurance' sector (23.5% of activity), largely due to the 10,820 square metre pre-commitment signed by Allianz at 10 Carrington Street.

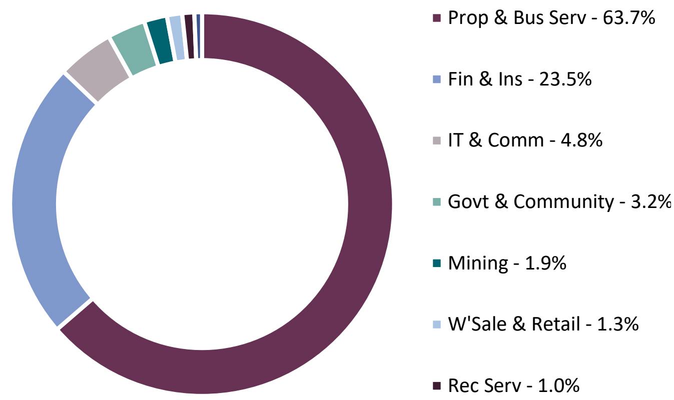
Whilst net absorption has been muted over the past two years, this has been largely as a result of less available space and ongoing withdrawals, associated with infrastructure projects, redevelopment and change-of-use projects. Total 12 month net absorption was recorded at 10,443 square metres in 2018. Positive net absorption in Prime grade stock (55,333 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)



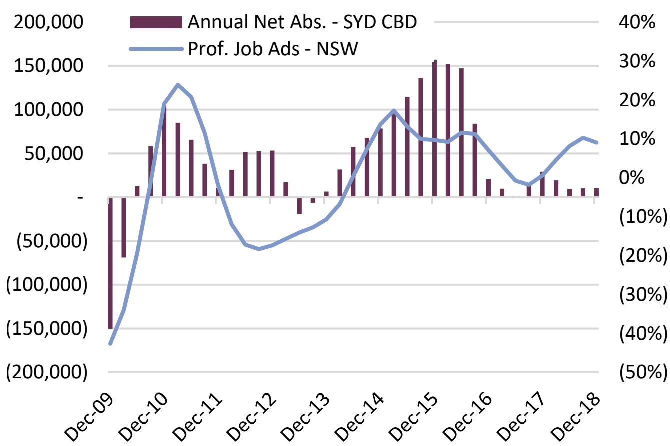
Source: Savills Research

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



Source: Savills Research

Net Absorption vs. Growth in Professional Job Ads

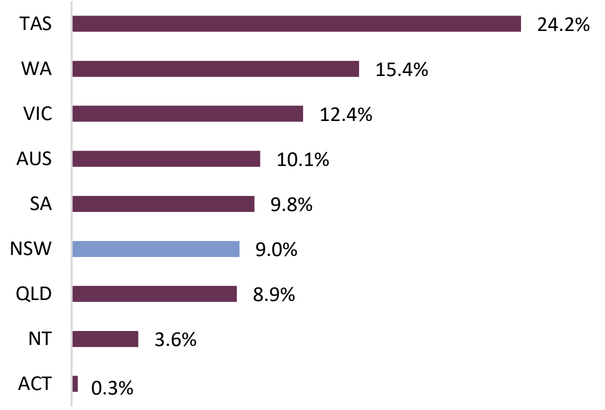


Source: DOE / Savills Research

Growth in professional job advertisements in NSW was recorded at 9.0% in the year to December 2018, which suggests ongoing strength in leasing demand for Sydney's office markets. Tenant enquiries remain strong, in spite of record high rents across the CBD and alternative options available in Sydney's fringe markets.

According to the latest NAB Commercial Property Index, despite sentiment across the office sector falling to 2-year lows, business conditions remained the strongest in NSW and Victoria in November 2018. Forecasts for economic metrics remain positive, suggestive of a supportive economic environment for the office markets in Sydney.

Professional Job Advertisement Growth by State (Dec-18)



Source: DOE / Savills Research

Recent Notable Leases (by Area Leased)

Tenant	Property	Date | NLA (sq m)	Type | Rent | Term
Allianz	10 Carrington St, Sydney	Jul-18 | 10,820	Precommit | n.a | 10
WeWork	1 Sussex St, Sydney	Jul-18 | 10,000	Precommit | n.a | n.a.
HDY/NRF	60 Martin Pl, Sydney	Aug-18 | 9,527	Precommit | 1,250 (G) | 10
Deutsche Bank	126 Phillip St, Sydney	Sep-18 | 8,664	Renewal | n.a | 8
Henry Davis York	60 Martin Pl, Sydney	Mar-18 | 7,258	Precommit | 1,130 (N) | 12
Havas	121 Harrington St, Sydney	Oct-18 | 6,128	Direct | 920 (N) | 10
WeWork	383 George St, Sydney	Mar-18 | 5,211	Direct | 965 (N) | 12
WeWork	161 Castlereagh St, Sydney	Mar-18 | 4,443	Direct | 1,250 (N) | 12
Regus	60 Martin Pl, Sydney	Aug-18 | 4,200	Precommit | 1,250 (G) | 10
Urbis	123 Pitt St, Sydney	Nov-18 | 3,676	Direct | 985 (N) | 10
Built	183-185 Clarence St, Sydney	Sep-18 | 3,500	Precommit | 1,115 (G) | n.a.
MYOB	309 Kent St, Sydney	Oct-18 | 3,496	Direct | 795 (G) | 10
WeWork	403 George St, Sydney	Apr-18 | 3,466	Direct | 905 (G) | 12
Quantium Pty Ltd	8 Chifley, Sydney	Sep-18 | 2,594	Renewal | 1,057 (N) | 6
Poly Group	220 George St, Sydne	Sep-18 | 2,500	Precommit | 1,450 (G) | 8
Banco Chambers	60 Martin Pl, Sydney	Aug-18 | 2,500	Precommit | 1,400 (G) | 10
Liberty International	1 Farrer Pl, Sydney	Jan-18 | 2,424	Direct | 1,250 (N) | 8
Hannover Life Re	100 Barangaroo Ave, Sydney	Mar-18 | 2,345	Direct | 1,250 (G) | 7
The NSW Land Registry Services	175 Liverpool St, Sydney	Nov-18 | 2,281	Direct | 985 (G) | 5

Source: Savills Research

Sales Activity

Savills Research recorded approximately $5.15 billion of Sydney CBD office transactions (> $5 million) in 2018. This is up from the year prior ($4.86 billion) and up on the 5 year average of $4.45 billion. Sales volumes in 2018 were pushed up in the last quarter of the year, most notably, by the purchase of 10 & 12 Shelley Street by Charter Hall for a reported $804 million.

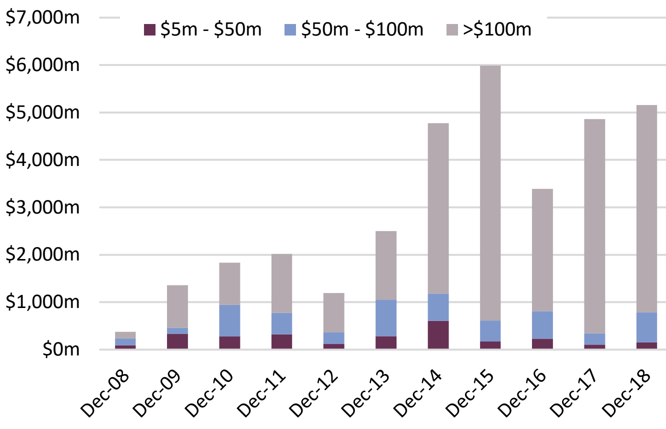
Domestic institutional investors remained the most active purchaser type in Sydney CBD, accounting for over half of all transactions (in dollar terms) in 2018. Charter Hall, purchased 4 trophy assets (10 & 12 Shelley Street, Allianz Centre and 2 Chifley Square) in the year, totalling $1.2 billion, demonstrating the still strong demand for prime grade assets with strong lease convenants in good locations. Competition for these assets continue to push yields lower, resetting the expectations for many owners across the CBDs.

A lack of 100% holding, prime quality, freehold assets available for sale in the Sydney CBD in conjunction with record low yields, has meant that foreign investor activity has slowed from the highs seen at the start of the property boom, though they still remained active, accounting for one-third of all transactions. Most notably, Blackstone purchased a 50% interest in 60 Margaret Street for $420 million in December 2018, representing a capital value of $21,234 per square metre.

Foreign investors were more active across secondary grade buildings in 2018, after identifying the benefits of acquiring secondary grade assets in Sydney CBD that have redevelopment potential. For example, a private Singapore-based investor purchased a D-Grade office building located at 80 Dixon Street (in the CBD's Southern precinct) for $61 million, with a capital value ($24,498 per square metre) and yield (3.60%) more reflective of a prime grade asset.

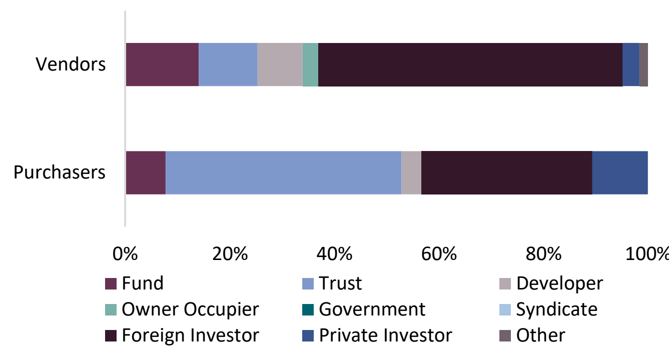
Market valuation yields in Sydney CBD, as at December 2018, were typically estimated to range from 4.45% to 4.90%, for Prime grade buildings and 4.50% and 5.25% for Secondary grade buildings. Average A Grade market yields in Sydney CBD tightened 20 basis points over 2018, whilst yield compression across B Grade assets was marginally more pronounced (25 basis points).

Sales Activity by Price (> $5 million)



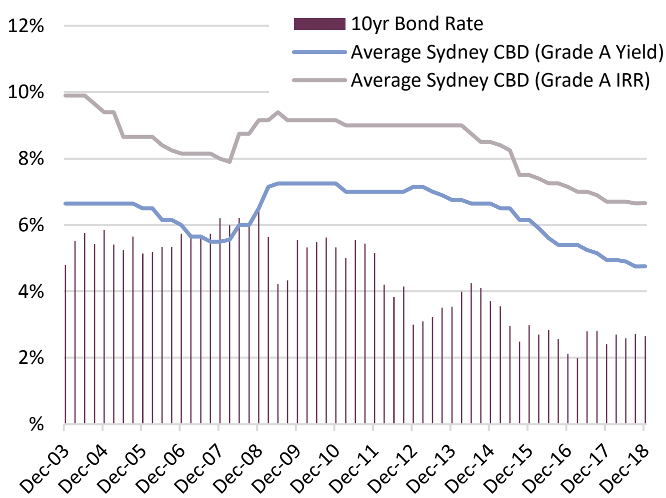
Source: Savills Research

Vendor & Purchaser Type (> $5 million)



Source: Savills Research

Yield Spread to Bond & IRR – Sydney CBD

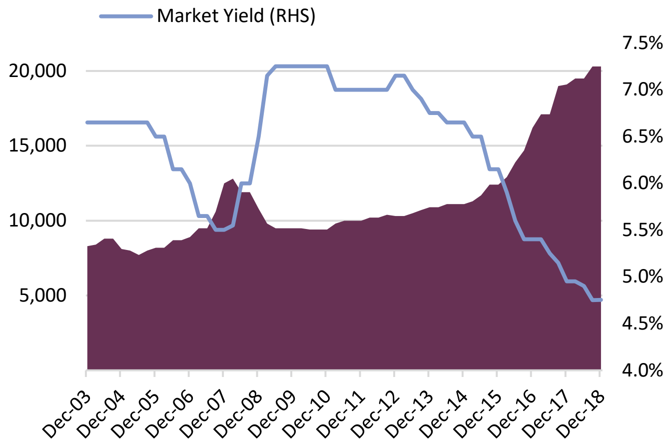


Source: Savills Research

Average A Grade capital values in Sydney CBD were recorded at $20,300 per square metre, growing 6.3% over 2018.

Whilst relative value arguments are driving certain investors out of the Sydney CBD, the differential to long-term bond yields mean that Sydney CBD office assets are still a compelling investment.

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
275 Kent St, Sydney (50.0%)	860.00 | Jun-18 | 77,293	4.50 | e | 22,193
60 Margaret St, Sydney (50.0%)	420.00 | Dec-18 | 40,735	n.a | n.a | 21,234
2 Market St, Sydney (50.0%)	300.00 | Mar-18 | 40,178	n.a | n.a | 14,934
179 Elizabeth St, Sydney	265.00 | May-18 | 16,520	5.14 | e | 16,041
55 Clarence St, Sydney	256.00 | Apr-18 | 14,876	5.14 | e | 17,186
1 Sussex St, Sydney	250.00 | Jul-18 | 10,000	n.a | n.a | 25,000
275 George St, Sydney	235.50 | Aug-18 | 7,319	4.50 | e | 32,177
1 York St, Sydney	205.00 | Jan-18 | 18,454	6.67 | e | 11,109
183-185 Clarence St, Sydney	180.30 | Nov-18 | 8,186	5.15 | r | 22,025
52 Goulburn St, Sydney (50.0%)	176.00 | Mar-18 | 23,034	5.15 | e | 15,282
117 Clarence St, Sydney	153.00 | Jun-18 | 12,517	5.22 | e | 12,223
187 Thomas St, Haymarket	145.80 | Apr-18 | 8,749	3.08 | i | 16,664
400 Kent St, Sydney	111.80 | May-18 | 10,461	4.86 | e | 10,687
2 Chifley Sq, Sydney (Freehold)	98.50 | Dec-18 | 69,062	n.a | n.a | n.a
299 Elizabeth St, Sydney	90.80 | Jan-18 | 5,973	4.15 | e | 15,202
Piers 8/9 23 Hickson Rd, Sydney	90.50 | Jun-18 | 8,523	6.11 | e | 10,618
60 Pitt St, Sydney	82.17 | Aug-18 | 4,158	2.37 | i | 19,764
100 Broadway, Chippendale	77.20 | Dec-18 | 5,450	n.a | n.a | 14,164
88 Cumberland St, Sydney	56.00 | Mar-18 | 4,675	4.92 | e | 11,979

Source: Savills Research; r = reported yield; e = equated market yield; i = initial yield;

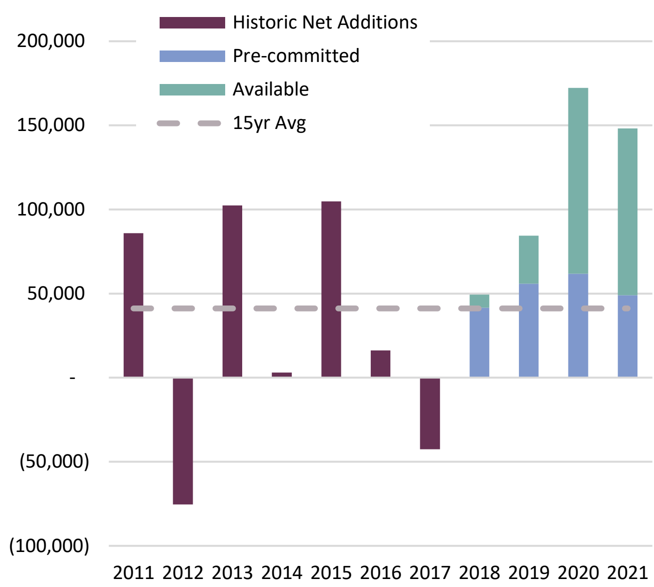
Supply

After a period of low supply in the Sydney CBD office market, 2018 represented the beginning of a new phase of the development cycle. In 2018, we saw approximately 50,000 square metres of completions, with over 85% pre-committed on completion.

The adjoining chart looks at the upcoming net supply that is due to hit the market over the next 3 years, in comparison to historic additions. Of the developments that are due for completion by the end of 2019, two-thirds have already been pre-committed. Based on current enquiries in the market (particularly for large areas, i.e. > 5,000 square metres), it would be prudent to assume nearly all remaining available space could be leased by the end of the year.

Whilst we still have a relatively low pre-commitment rate for developments that are to be completed in 2020 and 2021 (36% and 33% respectively), anecdotal evidence strongly supports most of this space being leased prior to completion.

Net Supply by Year (square metres)



Source: Savills Research / PCA

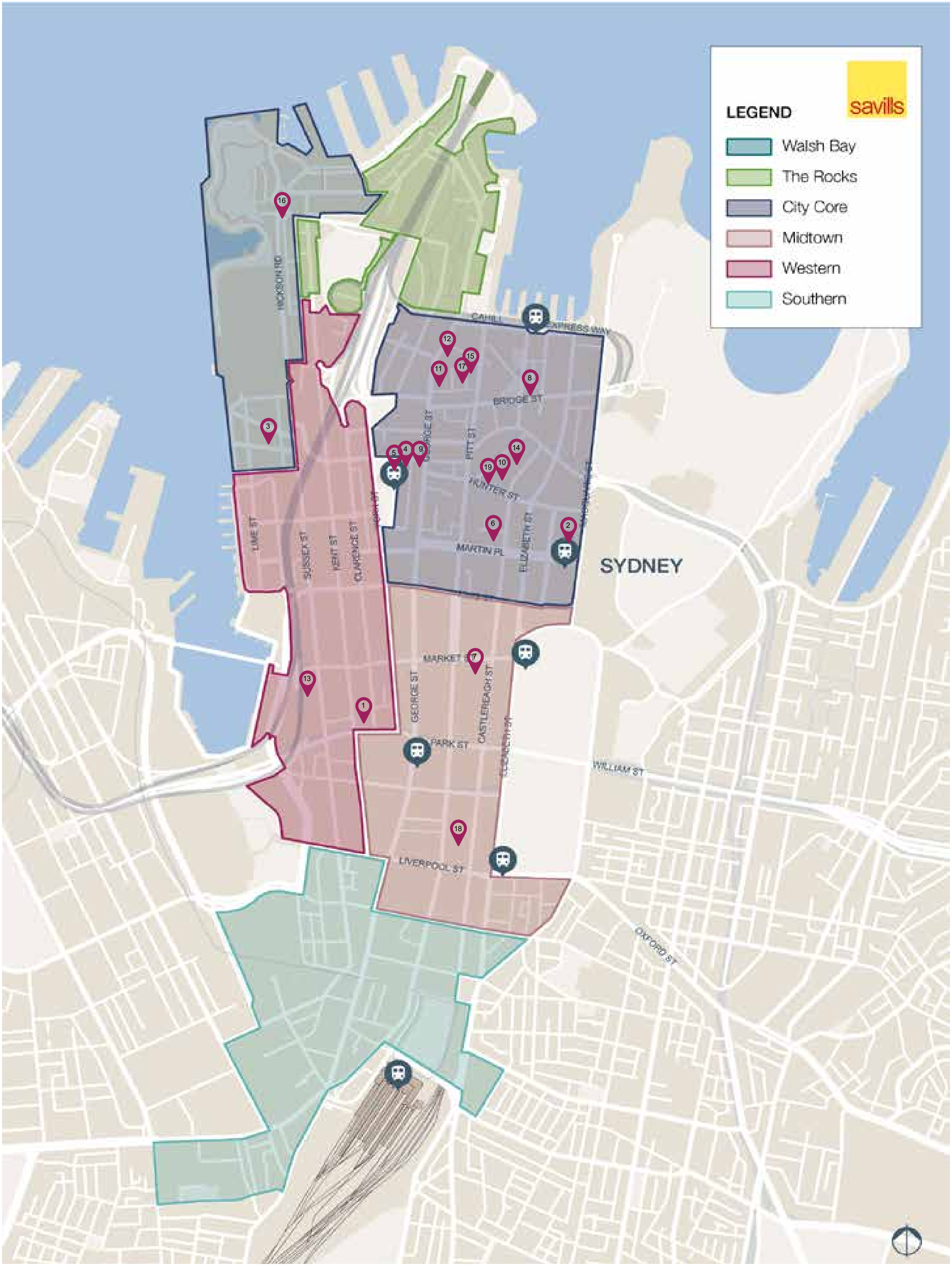
Development

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
1 426-430 Kent St	PA	4,308	2019	Western	
2 60 Martin Pl	UC	40,000	2019	Core	Norton Rose Fullbright, Banco
3 Barangaroo C1	PA	10,593	2019	Walsh Bay	WeWork
4 10 Carrington St	UC	58,626	2020	Core	NAB
5 1 Carrington St	UC	7,700	2020	Core	NAB
6 44 Martin Pl	PA	11,366	2021	Core	
7 65-77 Market St	PA	10,424	2021	Midtown	
8 50 Bridge St / Quay Quarter Tower	UC	83,700	2021	Core	AMP
9 275 George St	PA	7,300	2022	Core	
10 33 Bligh St (Kindersley)	PA	26,000	2022	Core	
11 210-220 George St	PA	16,000	2022	Core	Poly
12 Circular Quay Tower, 182 George	PA	55,000	2022	Core	
13 Darling Park Tower 4, 201 Sussex St	EP	63,000	2022	Western	
14 4-6 Bligh St	PA	10,000	2022	Core	
15 55 Pitt St	PS	45,000	2022	Core	
16 1-6 Hickson Rd, Millers Point	Mooted	51,000	2023	Walsh Bay - The Rocks	
17 57 & 51 Pitt St & 6-8 Underwood St	Mooted	30,000	2023	Core	
18 233 & 241 Castlereagh St	PA	13,336	2023	Midtown	
19 Sydney Metro - Martin Place Station, 39 Martin Plc & 60 Hunter St	Mooted	81,000	2024	Core	Macquarie

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

Development Map



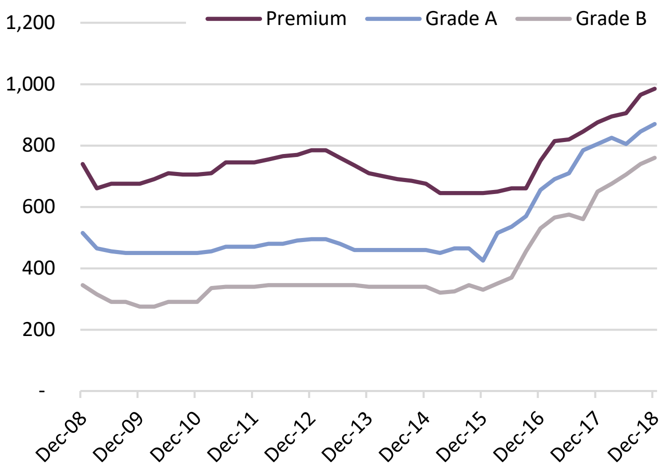
Rents

Average A Grade net face rents in Sydney's CBD were recorded at $1,090 per square metre, growing 9.0% over 2018, whilst growth in secondary grade rents was more pronounced, with average B Grade rents rising 13.6% over the same period.

On an effective basis, rental growth in A Grade buildings was recorded at 8.1% in 2018, whilst growth across average B Grade effective rents was 16.9% over the same.

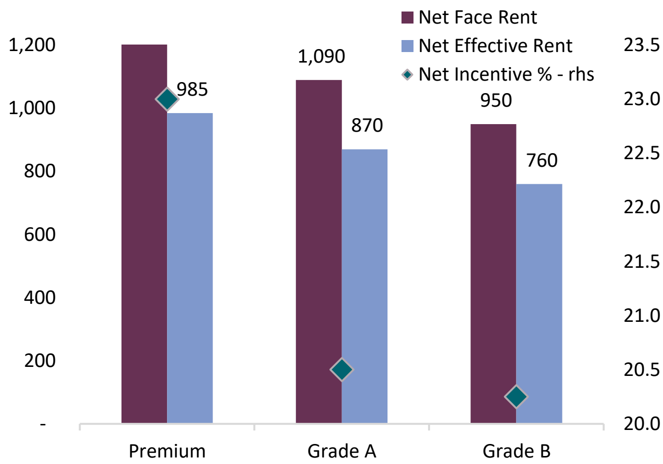
Up until the development progression expected throughout 2021-2022, Savills Research anticipates a continuation of the tight conditions over the short term, given the current market conditions and positive forward looking demand drivers and economic indicators. The increased supply across all Sydney office markets should provide some relief to tenants for rents achieved in both existing prime and secondary office buildings. Net face rents are predicted to increase in conjunction with inflation after 2019 for a four-year period.

Net Effective Rents by Grade ($/sq m)



Source: Savills Research

Net Face & Net Effective Rents as at Dec-18 ($/sq m)



Source: Savills Research

Outlook

There is evidence of continued strength in the Sydney CBD market with growth in professional job advertisements at their highest level in 2 years. Data from the Department of Employment shows growth in job advertisements for white collar professionals is 8.1% over the year to December 2018. This points to ongoing demand for space in the CBD and its surroundings as occupiers increasingly recognise the lifestyle benefits the CBD offers and enquiries remain strong in spite of historically high rents and low incentives. Demand for office space in the CBD from co-working giants such as WeWork highlight this. Projection of vacancy rates below the 3% mark in the next 6 months are well deserved, with no relief in sight for tenants as landlords continue to hold the bulk of the power in the currently tight market.

Whilst the completion of the next development cycle in 2019/20 would likely provide relief for tenants, in Sydney's tight market, this will more likely work to absorb pent-up demand. We should see more normal rental and capital growth rates than we have seen over the last 2 years. Though rental and capital value growth will remain, it most probably will not be at the double digit growth rates that we have seen in the recent past, as the completion of the next development cycle provides much needed space to the market. Demand drivers for Sydney CBD are positive, with business sentiment up for the office sector.

Sydney CBD Key Indicators (Q4-18)

	Premium		A Grade		B Grade	
	Low	High	Low	High	Low	High
Rental - Gross Face ($/sq m)	1,265	1,665	1,160	1,330	1,000	1,150
Rental - Net Face ($/sq m)	1,050	1,450	980	1,150	850	1,000
Incentive Level Gross (%)	18	21	15	20	15	20
Rental - Net Effective ($/sq m)	800	1,125	775	915	675	800
Outgoings - Operating ($/sq m)	140	155	110	130	80	110
Outgoings - Statutory ($/sq m)	55	75	50	65	45	60
Outgoings - Total ($/sq m)	195	230	160	195	125	170
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

Key State Contacts

Valuations
Andrew Pannifex
+61 (0) 2 8215 6006
apannifex@savills.com.au

Project Management
Adele Eagleton
+61 (0) 2 8215 6069
aeagleton@savills.com.au

Office Leasing
Tom Mott
+61 (0) 2 8215 8829
tmott@savills.com.au

Asset Management
Howard Chapman
+61 (0) 2 8215 8870
hchapman@savills.com.au

Capital Transactions
Ian Hetherington
+61 (0) 2 8215 8925
ihetherington@savills.com.au

Metro & Regional Sales
Tom Tuxworth
+61 (0) 2 8913 4868
ttuxworth@savills.com.au

The Savills Research & Consultancy team has years of experience, and is supported by our extensive agency, property management and valuation professionals. For national-level consultancy or subscription requirements please contact:

Capital Strategy & Research
Shrabastee Mallik
+61 (0) 2 8215 8856
smallik@savills.com.au

Savills is a leading global property service provider listed on the London Stock Exchange. Trusted since 1855, we have extensive experience across the Asia Pacific, with over 50 offices, and in Australia, we have over 800 staff focused on meeting all your property needs.

savills