



SYDNEY CBD

OFFICE MARKET OVERVIEW SEPTEMBER 2018

HIGHLIGHTS

Solid tenant demand and limited speculative supply continues to tighten vacancy levels across the Sydney CBD. Total vacancy rate saw a modest decline from 4.8% to 4.6%.

Average prime gross face rents increased by 11.8% YoY to \$1,259/sq m as at July 2018. In conjunction with declining incentives, prime gross effective rents surged upward by 17.7% YoY – the fastest pace since 2008.

Investment volumes YTD for 2018 are on track to surpass levels recorded in 2016 and 2017, fuelled by the sale of a large number of core assets. Sales for 2018 currently total \$4.3 billion.

KEY FINDINGS

Withdrawal activity in the Sydney CBD has slowed to its lowest level since July 2015. **A total of 45,122 sq m has been withdrawn from the market over the past six months.**

Net absorption over the six months to July 2018 totalled 9,144 sq m.

The overall vacancy rate saw a modest decline from 4.8% to 4.6% in the six months to July 2018, this well below the 10 year average of 7.3%

Sydney CBD's prime and secondary gross effective rents have increased by 17.7% and 16.9% respectively over the past 12 months.

Sales for YTD 2018 currently total \$4.3 billion in comparison to \$4.98 for the 2017 calendar year.

Core yields for prime assets in the CBD currently range between 4.50% and 5.25%, while secondary yields measuring between 5.00% and 5.75%.



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ECONOMIC OVERVIEW

Strong growth momentum in the first half of 2018

After recording sluggish growth in the second half of 2017, the Australian economy rebounded in Q1 with a robust 1.0% growth in GDP, and numerous indicators point to a sustained expansion through the remainder of the year. The Q1 outturn was underpinned by surging export growth, with public infrastructure investment also supporting growth. Surveys of business sentiment paint a positive picture, with non-mining investment expected to continue to gradually improve, while the recent federal budget reflected an improved fiscal position on the back of strong growth.

Globally, economic momentum remains positive, with the US economy growing at its fastest pace in four years, however

momentum is expected to slow as inflation and interest rates rise and the fiscal boost comes to an end. Growth momentum in China is also solid, helping to underpin demand for Australian exports.

Infrastructure investment supporting strong Sydney outlook

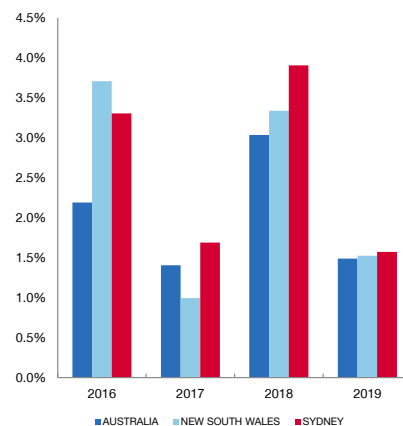
Sydney remains the focal point of robust growth in NSW, which has outperformed the national pace of expansion, with forecast GSP growth of 2.9% compared to GDP growth of 2.8% nationally in 2018.

This has translated into employment growth, with Sydney currently outpacing the state and national average, with rapid growth of 3.9% forecast for this year. Sydney is also set to benefit from a sustained pipeline of infrastructure investment, including projects such as the Sydney Light Rail and Sydney Metro which will improve connectivity to the CBD.

Interest rates on hold until wage growth accelerates

With wage growth and CPI inflation stuck at around 2% and persistently under-shooting expectations, the RBA have indicated that the cash rate will remain on hold until they see clear signs of acceleration. This stance has meant that long term rates in Australia have been broadly stable in the face of the ongoing tightening cycle in the United States, helping to maintain momentum in the investment market.

FIGURE 1
Annual Employment Growth By Year



Source: Knight Frank Research, Oxford Economics

TABLE 1
Sydney CBD Office Market Indicators as at July 2018

Grade	Total Stock (sq m) [^]	Vacancy Rate (%) [^]	Annual Net Absorption (sq m) [^]	Annual Net Additions (sq m) [^]	Average Gross Face Rent	Average Incentive (%)	Average Core Market Yield (%) [*]
Prime	3,005,461	4.8	44,931	16,379	1,259	20.6	4.50—5.25
Secondary	2,030,707	4.4	-35,442	-78,569	951	17.9	5.00—5.50
Total	5,036,168	4.6	9,489	-62,190			

Source: Knight Frank Research/PCA [^]as at July 2018 ^{*}WALE 5.0 years

TENANT DEMAND & ABSORPTION

Demand has been focussed on the prime market

Despite significant levels of pent-up demand, a lack of leasing options and stock withdrawals has constrained net absorption in the Sydney CBD, albeit varying by grade. Net absorption over the six months to July 2018 totalled 9,144 sq m, representing the bulk of net absorption for the year which totalled 9,489 sq m.

The crystallisation of several large lease deals at Barangaroo including Origin Energy meant that demand was concentrated in the prime market, which saw 37,005 sq m absorbed over the past six months. Across the three Barangaroo towers alone, tenant occupations measured 30,046 sq m and as a result the vacancy rate almost halved in the precinct.

Elsewhere, prime net absorption was strong in the Western precinct at 44,698 sq m for the six months to July 2018 and largely stemmed from IAG's occupation of the PwC backfill space at Darling Park Tower 2. Alternatively, net absorption for the City Core prime market was negative at -42,635 sq m and was predominately the result of the A-grade market.

The sector mix of lease deals in the prime market over the past six months was led by financial and insurance services, which

had a 20% share of the total. This was followed by professional services with 18% and TMT which had a 10% share. The average deal size in the prime market measured 447 sq m over the first half of 2018.

The flexible office/co-working sector continues to expand in Sydney, underpinned by WeWork's rapid expansion strategy. Over the past six months, WeWork has committed to 5,000 sq m at 383 George Street, 7,500 sq m at 66 King Street and 10,000 sq m at Daramu House in Barangaroo. Once occupied, this will take WeWork's total presence in the Sydney CBD to 46,210 sq m.

Secondary market restricted by withdrawals


Amidst the rapid depletion of stock and falling vacancy, negative absorption of 27,861 sq m was recorded over the past six months in the secondary market. Stock levels in the secondary market have shrunk 9% over the past two years and in combination with an already tight secondary vacancy rate, there have been limited leasing options available to prospective tenants.

The current level of net absorption in the secondary market is not evenly distributed, with positive net absorption being recorded in the Midtown, Walsh Bay and Western precincts. On the other hand, the City Core and Southern secondary precincts saw net absorption of -34,267 sq m and -13,899 sq m respectively over the past six months as withdrawals including 35-39 Bridge Street (13,576 sq m) and 24 Campbell Street (14,860 sq m) stifled occupancy levels.

Sub 500 sq m enquiries have dominated secondary lease deals over the first half of 2018 with 86% of deals by number being below this range (average of 287 sq m). Professional services had the largest share of gross take-up in the secondary market at 27% while financial and insurance services and TMT being the next largest at 14% respectively.

Net Absorption & Outlook

Prime FY18 44,931 sq m 

Secondary FY18 -35,442 sq m 

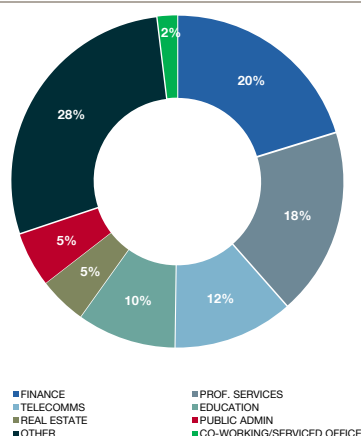
Source: Knight Frank Research/PCA

Solid levels of take-up are expected to continue

There is a high level of lease expiries due over the next two years, meaning that the level of demand from existing occupiers will be robust. In addition, new market entrants into the CBD from other suburban markets will aid tenant demand levels over the same period as UTS (5,447 sq m) and Pfizer (4,640 sq m) among others move into their new premises.

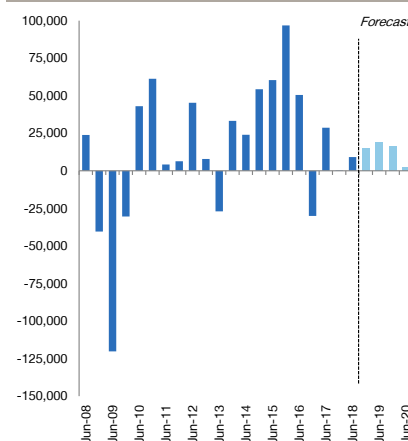
Net absorption over the next two years in the Sydney CBD is expected to average circa 27,000 sq m per annum. While there are multiple drivers of this, the forecast is underpinned by continued employment growth in the Sydney CBD with the traditional occupiers of professional services and financial and insurance services expected to outperform. Similarly, the aggressive expansion mandates of WeWork and other co-working providers is expected to result in solid take-up over the next two years.

FIGURE 2
Lease Deals by Industry
6 months to June 2018, Total market (sq m)



Source: Knight Frank Research

FIGURE 3
Sydney CBD Net Absorption
('000m²) per 6 month period



Source: Knight Frank Research/PCA

SUPPLY & DEVELOPMENT

Stock withdrawals ease

Following a period of sustained stock withdrawals which has seen 346,297 sq m taken offline over the past 24 months, withdrawal activity in the Sydney CBD has slowed to its lowest level since July 2015. A total of 45,122 sq m has been withdrawn from the market over the past six months, underpinned by space being withdrawn for temporary refurbishment (48%) following tenant relocations to other buildings.

Withdrawals over the past six months included 35-39 Bridge Street (13,576 sq m) for conversion into a hotel, 24 Campbell Street (14,860 sq m) for a full refurbishment and 66 King Street (7,000 sq m) for a full refurbishment. Withdrawals have been counterbalanced by supply additions of 45,251 sq m over the past six months taking net additions to 129 sq m.

Owners continue to upgrade office stock

Supply additions have stemmed solely from refurbished backfill space and included Darling Park Tower 2 (35,227 sq m) which has been tenanted by IAG, 4,692 sq m at 2 Bligh Street and 4,090 sq m at 167 Phillip Street. The majority of refurbished space has since been leased or was pre-committed leaving limited amount of speculative stock at 167 Phillip Street and 2 Bligh Street.

Limited speculative stock in future supply pipeline

Limited supply additions will enter the Sydney CBD over the next two years, a large share of which is pre-committed. Including refurbished backfill stock, 217,149 sq m is forecast to enter the market over the next two years. New office supply over the second half of 2018 includes 151 Clarence Street (22,000 sq m – 80% pre-committed by ARUP, Pfizer and Mills Oakley) and 100 Broadway (5,447 sq m – 100% pre-committed by UTS).

Whilst primarily pre-committed, the market is set to experience an influx of new supply by mid 2020 with a number of major projects currently under construction. Notable developments include 60 Martin Place (38,600m² – 32% pre-committed to HDY, Norton Rose Fullbright and Banco Chambers), 275 George Street (6,363m²) and Daramu House (11,000 sq m – 100% pre-committed by WeWork).

Beyond this, works continue to progress at Wynyard Place (68,200m² – 71% pre-committed by NAB & Allianz – H2 2020) and Quay Quarter Tower (QQT) (circa 90,000m² – 40% pre-committed by AMP – 2021+), while Circular Quay Tower (CQT) (55,000m² – 2021+) and 210-220 George Street (16,500 sq m) remain in the longer term pipeline.

Vacancy Rate & Outlook

Prime	4.8% -100bps y-o-y	↘
Secondary	4.4% -190bps y-o-y	↘

Source: Knight Frank Research/PCA

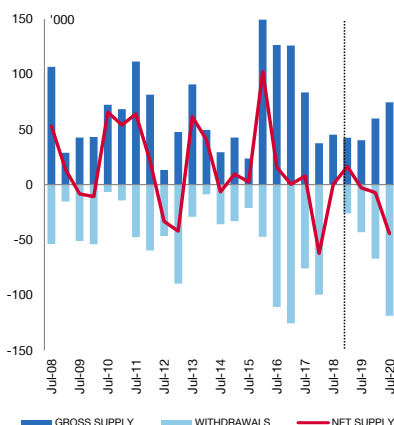
Vacancy tightens amidst limited new supply

Positive tenant demand and limited stock additions continues to tighten vacancy levels across the Sydney CBD. The overall vacancy rate saw a modest decline from 4.8% to 4.6% in the six months to July 2018, this well below the 10 year average of 7.3%. By grade, the prime vacancy rate declined from 4.9% to 4.8%, whilst secondary dropped from 4.6% to 4.4%.

The Walsh Bay precinct experienced the largest decline in vacancy following the crystallisation of several large lease deals at Barangaroo including Origin Energy (7,765 sq m) and Baker McKenzie (7,357 sq m) being the catalyst behind the large decline. As at July 2018, the office vacancy rate in Walsh Bay measured 9.2%, down from 19.0% in January 2018. The Southern precinct remains the tightest market recording 0.6% of available stock, down from 2.5% the year prior.

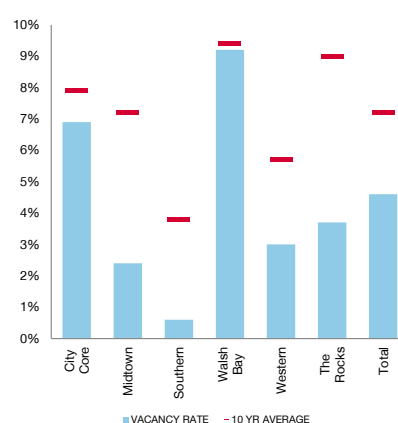
Looking forward, the overall vacancy rate in the CBD is expected to trend below 3.0% by mid-2020 before an uptick from demand in mid to late 2021 in response to new supply.

FIGURE 4
Sydney CBD Office Supply
Per six month period (sq m)



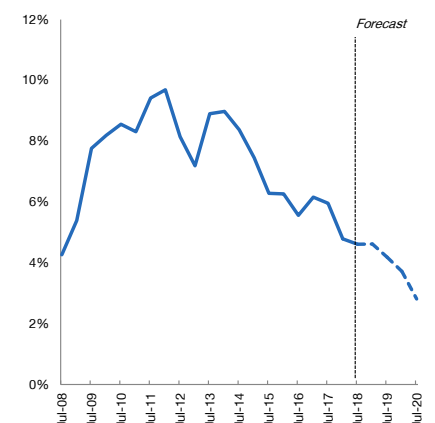
Source: Knight Frank Research/PCA

FIGURE 5
Sydney CBD Vacancy Rate
By Precinct (%) - July 2018



Source: Knight Frank Research/PCA

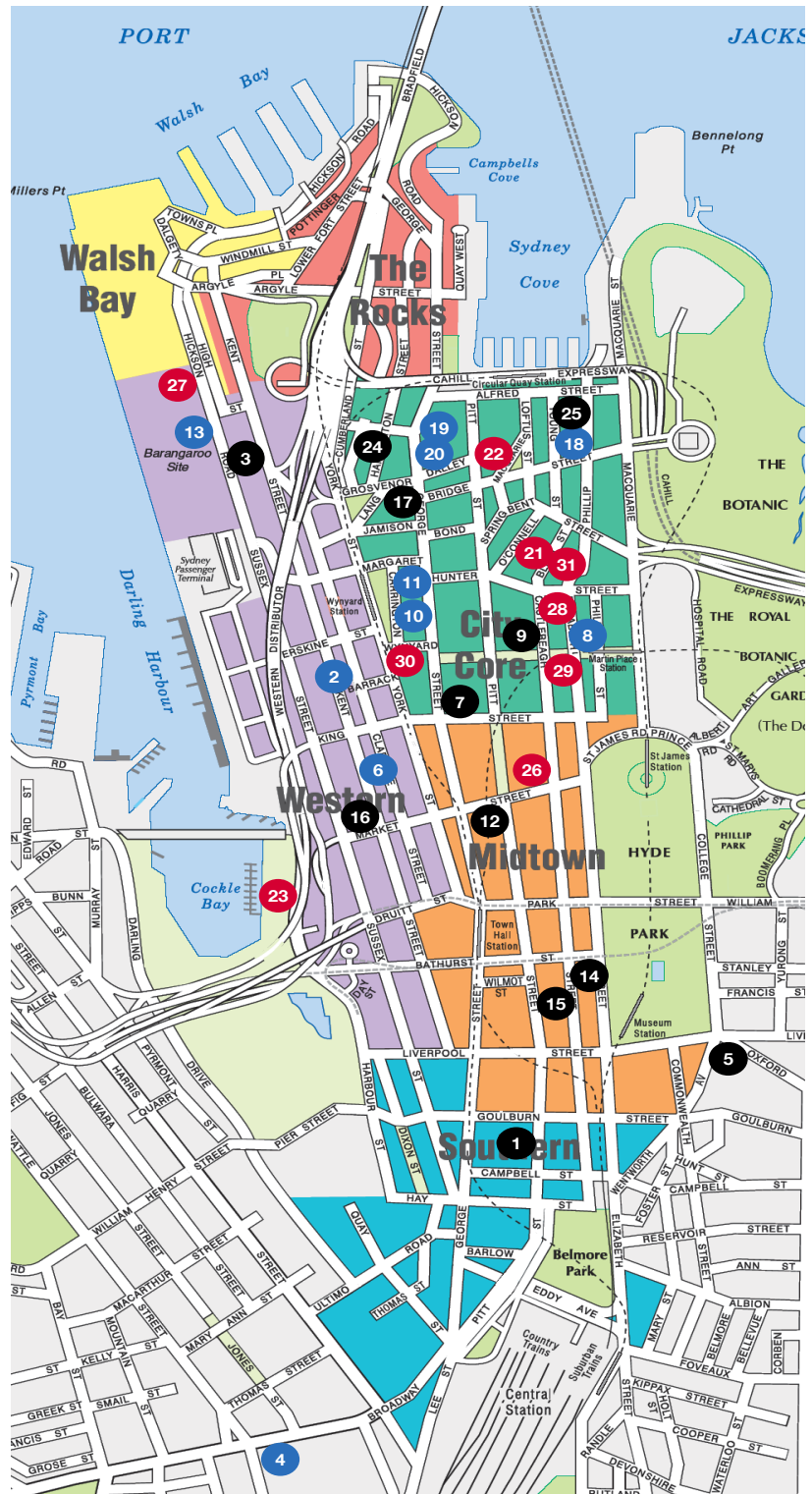
FIGURE 6
Sydney CBD Vacancy
% total vacancy



Source: Knight Frank Research/PCA

MAJOR OFFICE SUPPLY

- 1 477 Pitt St# - 18,000 sq m (ex Rail Corp)
ISPT - H1 2018
- 2 151 Clarence St - 22,000 sq m [ARUP, Pfizer]
Investa - Q3 2018 - 84% committed
- 3 201 & 207 Kent St# - 5,536 sq m (ex ARUP)
Cromwell / Investa - Q3 2018
- 4 100 Broadway - 5,447 sq m
Fraser/Sekui - H2 2018
- 5 1 Oxford St# (ex Dept of Education) - 13,943 sq m
Memocorp - H1 2019
- 6 185 Clarence St - 9,500 sq m
Built - H1 2020
- 7 388 George St# - 36,151 sq m (ex IAG)
Investa/Brookfield - H1 2020
- 8 60 Martin Place - 38,600 sq m [Banco Chambers]
Investa/Gwynvill Group - H1 2020 - 7% committed
- 9 44 Martin Pl# - 9,500 sq m (ex Henry Davis York)
Gwynvill Group - H2 2020
- 10 Wynyard Pl - 58,974 sq m [NAB, Allianz]
Brookfield - H1 2020 - 63% committed
- 11 275 George St - 6,363 sq m
John Holland - H1 2020
- 12 55 Market St# - 22,300 sq m (ex Westpac)
Mirvac - H1 2020
- 13 Barangaroo C1 - c. 11,000 sq m
LLOneTST - H1 2020
- 14 231 Elizabeth St# - 22,964 sq m (ex Telstra)
Charter Hall - H1 2021
- 15 320 Pitt St# - 29,159 sq m (ex Telstra)
ARA - H1 2021
- 16 2 Market# - 18,909 sq m (ex Allianz)
Allianz/Charter Hall - H1 2021
- 17 255 George St# - 22,500 sq m (ex NAB)
AMP - H2 2021
- 18 Quay Quarter Tower (QQT) - 88,274 sq m
AMP - H1 2021 - 41% committed
- 19 Circular Quay Tower (CQT), 182 George St - 55,000 sq m
Lendlease - H2 2020
- 20 210-220 George St - 17,000 sq m
Poly Real Estate - H2 2021
- 21 33 Bligh St - 26,000 sq m
Energy Australia/Investa - Mooted
- 22 55 Pitt St - 30,000 sq m+
Mirvac - 2022+
- 23 Darling Park Tower 4 - 70,000 sq m
GPT/Brookfield/AMP - 2022+
- 24 121 Harrington St# - 6,037 sq m (ex Dimension Data)
Harrington St Investments - H2 2018
- 25 33 Alfred St# - 32,353 sq m (ex AMP Capital)
AMP Capital - H1 2022
- 26 77 Market St - c.12,000 sq m
CBUS/Scentre - H1 2022
- 27 Central Barangaroo - 45,000 sq m
Grocon/Aqualand/Scentre - 2024+
- 28 Martin Place Metro Station North Tower (ex-55 Hunter St)
TBC± - 2024+
- 29 Martin Place Metro Station South Tower (ex-39 Martin Pl)
TBC± - 2024+
- 30 6 York St - 6,000 sq m
NIG Investment - Mooted
- 31 4-6 Bligh St - 6,137 sq m
SC Capital Partners - Early Feasibility



- Refurbished Supply
- New Addition (Under Construction/Pre-committed)
- New Addition (Planned/Mooted/Early Feasibility)

NB. Dates are Knight Frank Research estimates
Includes select CBD major office supply (NLA quoted)
Major tenant precommitment in [brackets] next to NLA
Major refurbishment/backfill

RENTS & INCENTIVES

Rents, Incentives & Outlook

Prime Rents (g)	\$1,259/sqm face 11.8% y-o-y \$1,000/sqm eff 17.7% y-o-y	↗
Secondary Rents (g)	\$951/sqm face 13.1% y-o-y \$780/sqm eff 16.9% y-o-y	↗
Incentives	P: 20.6% S: 17.9%	↘

ago and as a result gross effective rents have increased 17.7% YoY to \$1,000 sq m. This is the highest growth rate since 2008.

In the secondary market, gross face rents grew by 13.1% over the 12 months to July 2018 and currently measure \$951 sq m (\$809 sq m net face). In combination with secondary incentives falling from 20.6% a year ago to 17.9% in July 2018, gross effective rents have increased by 16.9% (\$780 sq m).

Looking ahead, vacancy is expected to decline in the short term following the limited amount of speculative supply coming to market and in turn have positive implications on rental growth for landlords. Over the next two years, Knight Frank anticipates prime gross face rental growth to average 7.0-8.0% per annum, while incentive levels are forecast to trend towards 19% by mid-2020. The average secondary gross face rent is forecast to grow by circa 9.0-10.0% per annum over the next two years and secondary incentives are expected trend down closer to 15%.

Declining vacancy bolsters rental growth

Low vacancy continues to fuel both face rental and effective rental growth. The lack of speculative stock has allowed owners to push and test market rents. Over the 12 months to July 2018, prime gross face rents increased 11.8% to measure \$1,259 sq m (\$1,079 sq m net face). Notably, this is significantly above the 10 year average of 3.5% per annum.

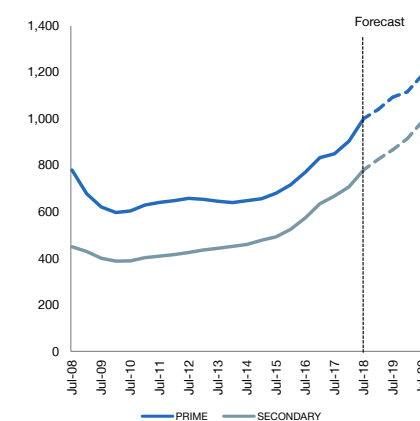
Falling incentives have been the catalyst behind the significant effective rental growth in the market. Although varying by asset and landlord, average prime incentive levels have reduced to 20.6% as at July 2018, down from 24.6% a year

FIGURE 7
Sydney CBD Prime Rents
By Precinct (\$/sq m)



Source: Knight Frank Research

FIGURE 8
Sydney CBD Rents
\$/m² p.a average gross effective rent



Source: Knight Frank Research

TABLE 2
Recent Leasing Activity Sydney CBD

Address	Precinct	NLA (sq m)	Term (yrs)	Lease Type	Tenant	Sector	Start Date
100 Broadway	Southern	5,500	15	New	UTS	Education & Training	Jan-19
68 York Street	Core	1,007	8	New	Gateway Credit Union	Finance and Insurance	Nov-18
55 Clarence Street	Western	872	5	Renewal	Ambition	Administrative	Nov-18
33 Playfair Street	Fringe	454	3	New	Ansarada	Information Media	Jul-18
30-34 Hickson Road	The Rocks	2,886	7	New	IOOF	Finance & Insurance	Jul-18
223 Castlereagh St	Midtown	586	1.5	New	Plenary Origination	Professional	May-18
31 Market Street	Western	736	5	New	Luxeland Group	Real Estate	May-18
45 Clarence Street	Western	1,170	5	New	BluStone Mortgages	Finance & Insurance	Apr-18
70 Phillip Street	Core	1,075	4	New	Multiplex	Construction	Apr-18
259 George Street	Core	326	2.5	New	Elanor Investors	Finance	Apr-18
320 Pitt street	Midtown	990	3	Sub-lease	BigTinCan	Information Media	Apr-18
28 Margaret Street	Western	550	5	New	VisualRisk	Information Media	Apr-18
175 Liverpool Street	Midtown	1,661	6	New	Evolution Mining	Mining	Mar-18

Source: Knight Frank Research

INVESTMENT ACTIVITY & YIELDS

Large core assets drive transaction volumes



Investment volumes in 2018 are on track to surpass levels recorded in 2016 and 2017, fuelled by the sale of a large number of core assets. Sales for YTD 2018 currently total \$4.3 billion in comparison to \$4.98 for the 2017 calendar year. Two standout sales for the year that account for 37% of the total transaction volumes: 50 Bridge Street (\$900m) and 275 Kent Street (\$721.9m). REST Super purchased a 33% stake in 50 Bridge Street from AMP capital on a fund through deal on a core market yield of 4.7%, re-setting the benchmark for

premium grade assets. Additionally, Mirvac exercised its pre-emptive rights for a 50% stake in 275 Kent Street (Westpac Place) from Blackstone for \$721.9m on a core market yield of 4.5%. However, as part of the deal, Mirvac assigned their rights to ISPT.

Super funds dominate

The sales of 50 Bridge Street (to REST) and 275 Kent Street (to ISPT) meant that investment volumes were dominated by super fund purchases, accounting for 38% of total volumes. Investment activity from overseas investors remains solid at \$1.12 billion (26% of total), following

Current Yields & Outlook

Prime	4.50% - 5.25% -19bps y-o-y	
Secondary	5.0% - 5.75% -52bps y-o-y	

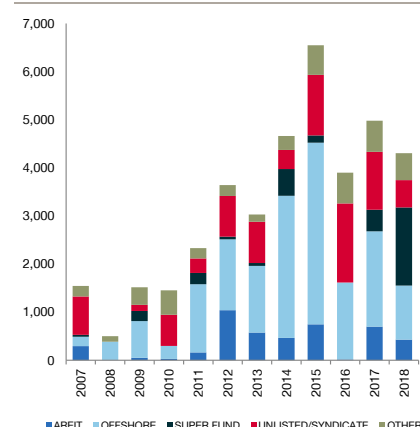
the acquisitions of 1 York Street and 179 Elizabeth Street among others (see Table 3).

Yields converge between grades

The sustained demand for core commercial assets in the Sydney CBD amidst limited available stock has been the catalyst for yield compression across both the prime and secondary market. Prime assets now trade consistently below 5% with strong competition to hold prime trophy assets in the CBD. In the 12 months to July 2018 prime yields have tightened 19bps to average 4.86%.

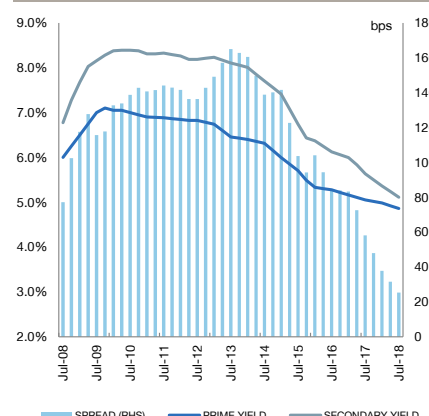
With secondary yield firming outpacing that of the prime market, the convergence of yields has become more evident with the spread between prime and secondary yields at their lowest level on record (25bps). Secondary yields have firmed by 51bps over the past 12 months to now average 5.11%.

FIGURE 9
Sydney CBD Sales \$10m +
By Purchaser Type (\$m)



Source: Knight Frank Research

FIGURE 10
Sydney CBD Yields & Spread
% Yield LHS & Spread RHS



Source: Knight Frank Research

TABLE 3
Recent Sales Activity Sydney CBD

Address	Price (\$ mil)	Core Mkt Yield (%)	NLA (sq m)	\$/sq m NLA	WALE (yrs)	Purchaser	Vendor	Sale Date
60 Pitt Street	82.17		4,426	18,565		Dexus	Private	Aug-18
275 George Street*	240.0	VP	8,000	30,000		Offshore	John Holland	Aug-18
275 Kent Street (50%)	721.9	4.50	76,450	18,886	10.5	ISPT (Mircac)	Blackstone	Jul-18
179 Elizabeth Street	265.0	5.20	15,686	16,894	3.9	Offshore	Markham Real Estate	May-18
117 Clarence Street	153.0	4.75	12,571	12,171	2.6	Investa	Roxy Pacific	May-18
55 Clarence Street	255.0	4.81	14,962	17,043	1.5	Zone Q	AEW Global	May-18
52 Goulburn Street	176.0	5.22	23,104	15,235	4.6	Arcadia	Credit Suisse	Apr-18
2 Market Street	300.0		39,817	15,069		Charter Hall	Allianz	Mar-18
160 Sussex St	94.58	5.43	8,369	11,301	3.3	Acer Inc	Burcher Property	Feb-18
50 Bridge Street	900.0	4.70	92,243	29,566	10	Rest	AMP Capital	Jan-18

*Headline Sale Price
Source: Knight Frank Research

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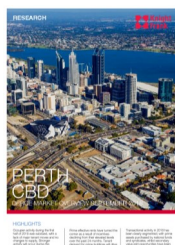
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