Market Pulse

Sydney CBD Office Market

Cadigal Research
September 2023

Cadigal

Contents

Key Data at a Glance

		Change last 12 months	Expected change next 12 months
SUPPLY			
Total Stock* *sqm, as at Jul-23*	5,249,961	↑	↑
Completions* *sqm, 6 months to Jul-23*	19,000	↓	↑
Net Supply* *sqm, 6 months to Jul-23*	-33,235	↓	↑
DEMAND			
Net Absorption* *sqm, 6 months to Jul-23*	-40,173	↓	↑
Tenant Enquiry *sqm, as at Jun-23*	291,650	↓	↑
VACANCY			
Vacancy Rate* *%, as at Jul-23*	11.5	↑	↔
Sublease Availability *sqm (% of total stock) as at Jun-23*	124,482 (2.4%)	↑	↔
RENTS			
Net (Gross) Face Rents *$/sqm average, as at Jun-23*			
Premium	1,381N (1,611G)	↑	↑
A Grade	1,090N (1,285G)	↑	↑
B Grade	890N (1,076G)	↑	↑
Incentives *(typical % range for whole-floor tenant, as at Jun-23)*	33 - 38	↑	↑

*Source: Property Council of Australia (PCA Jul-23)

In Summary

Over the first half of 2023 **total supply** of office space dipped for the first time since Jan-20, to 5.25mil sqm on the back of stock withdrawals, most of which is associated with the future Hunter Street Station of the Sydney Metro West rail project.

There is 261,324sqm of office space currently under construction across eight major developments, equal to 5% of total stock. Just 7.5% of this is due to be completed in 2023 with the majority (59%) set to be delivered over 2024.

The CBD recorded -40,173sqm of **net absorption** over the first half of the year, completely cancelling out the +36,183sqm tallied over the previous two years. The 27-year average annual net absorption of 41,703sqm has not been exceeded since 2015, a reflection of the prolonged weakness in tenant demand. Net absorption performance across the CBD precincts was a tale of the Core versus the rest of the market, being the only precinct to tally positive net absorption.

There was 291,650sqm of active **tenant enquiry** as at Jun-23, up 7% over the previous quarter. Despite the rise, current enquiry is still 11% below the average of the last 11+ years.

The overall CBD **vacancy rate** continues its upward trajectory, rising 0.2% over the 6 months to Jul-23 to 11.5%, the rate of increase slowing compared to the previous two periods. The current vacancy rate is the highest the CBD has seen since Jan-96. The Core currently has the lowest vacancy rate of all the precincts, at 9.6%.

Since bottoming in Sep-21 at 94,183sqm, the quantum of **available sublease space** has trended upward, rising 15.4% over Q2 2023 to 124,842sqm.

Face rents grew 3.1%-4.7% over the 12 months to Jun-23 in the CBD, representing slower growth than the previous quarter. **Lease incentives** were static in both Premium and B grade, and softer in A grade over the year to Jun-23. The movement in incentives was more pronounced across the precincts, increasing significantly in Midtown and the Western Corridor but holding firm in the Core.

The impact of the movement in incentives on face rents has led to Premium and B grade **effective rents** performing similar to face rents but weaker growth in effective rents for A grade space.

Three smaller office developments currently under construction in the Sydney CBD include (clockwise from above left) **32 York Street**, **333 Kent Street** and **121 Castlereagh Street**.

Supply

The Sydney CBD office market is currently in the midst of a temporary supply hiatus, following three years (2020-2022) where 329,420sqm of net supply was added and total stock grew 6.6%. During the first half of 2023, total supply dipped (by 33,235sqm) for the first time since Jan-20, to 5.25mil sqm on the back of stock withdrawals. 52,235sqm (1% of total stock) of secondary (B, C and D grade) stock was withdrawn, the bulk of which is associated with the future Hunter Street Station of the Sydney Metro West rail project (43,123sqm across seven buildings in the Core).

The balance of the withdrawn space (9,112sqm) was at **20 Lee Street** in the Southern precinct, part of the Dexus / Frasers **Central Place** site. Offsetting the withdrawals was 19,000sqm of A grade supply that was returned to stock in the Core (at **255 George Street**) following refurbishment.

There is currently 261,324sqm of office space under construction across eight major developments in the Sydney CBD, equal to 5% of current total stock. Just 7.5% of the total is due to be completed during 2023 with the majority (59%) set to be delivered in 2024. The 2024 completions include three projects associated with the City and Southwest phase of the Sydney Metro – **1 Elizabeth Street, 39 Martin Place** and **Parkline Place.**

Major Office Developments Under Construction

Project	Owner / Developer	Type	Office NLA	Precinct	Expected Completion	Comment
York & Co. 32-36 York Street	Milligan Group	New	7,973	Midtown	Q4 2023	Mixed-use redevelopment of 1886-built warehouse comprising 12 floors of office. Over 75% pre-committed.
121 Castlereagh Street	Scentre/Cbus	New	11,503	Midtown	Q4 2023	Mixed-use redevelopment of former David Jones store, 48% pre-committed.
Martin Place Metro 1 Elizabeth Street	Macquarie Group	New	62,871	Core	Q1 2024	37-storey over-station development, to be owned and occupied by Macquarie.
Martin Place Metro 39 Martin Place	Investa / Manulife / Macquarie Group	New	29,886	Core	Q2 2024	29-storey tower over-station development. Ashurst has committed up to 10,000sqm (33%) in the lowrise.
333 Kent Street	Addenbrooke	Full Refurb + New	13,832	Western	Q3 2024	Full refurbishment of existing 9-storey building plus addition of 7 new floors.
Parkline Place 252 Pitt Street	Oxford / Mitsubishi Estate	New	47,500	Midtown	Q4 2024	36-level over-station development above the Pitt Street Metro Station. 32% pre-committed to NSW ODPP and BDO.
33 Alfred Street	MWOF / Dexus	Full Refurb	31,759	Core	Q1 2025	Full refurbishment of Sydney's first skyscraper. Allen & Overy has pre-committed to 2,505sqm (8%) and leases issued over a further 28%.
Atlassian Central 8-10 Lee Street	Dexus / Atlassian	New	c.56,000	Southern	2027	40-level tower with youth hostel at the base. Office space is 100% committed to Atlassian.

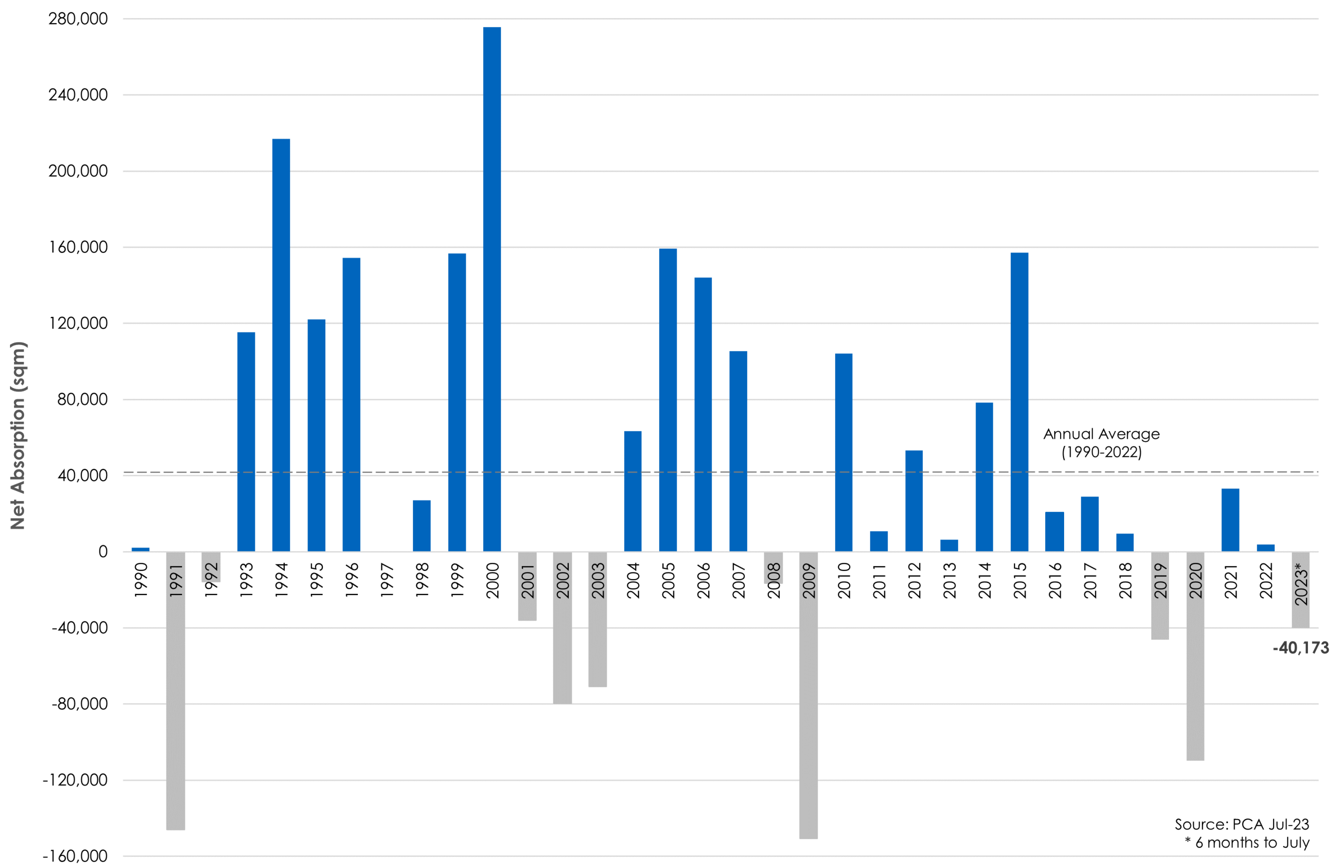
Tenant Demand
Net Absorption

The Sydney CBD recorded -40,173sqm of net absorption

over the first half of 2023, completely cancelling out the +36,183sqm tallied over the previous two years (2021-2022). Reflecting the prolonged weakness in tenant demand, the cumulative net absorption across the market since January 2016 is -100,236sqm. In other words, there was 100,236sqm *less* occupied office space in Jun-23 than there was in Jan-16. Meanwhile, total CBD office stock *increased* by 187,452sqm over the same period, exacerbating the problem.

The 27-year (1990-2022) average annual net absorption of 41,703sqm has not been exceeded since 2015.

Annual Net Absorption - Sydney CBD 1990-2023



Net absorption performance by building grade has been mixed with **A grade** recording positive absorption over both 6 and 12 months, **Premium** positive only over 12 months and B, C and D grades negative over both time periods, **B grade** being by far the worst performer.

After strong positive net absorption over 2021-2022, Premium grade returned -13,462sqm during the first half of 2023. Whilst Premium net absorption continued to be positive in the Core precinct, this was more than offset by negative net absorption in both Walsh Bay and the Western Corridor for Premium space.

Performance across the CBD precincts was a tale of the **Core** versus the rest of the market with the largest precinct, by NLA, being the only one to tally positive net absorption. All other precincts recorded negative net absorption over *both* 6- and 12-month periods.

Net Absorption by Building Grade

Buiding Grade	6 Months to Jul-23	12 Months to Jul-23
Premium	-13,462	15,644
A Grade	18,859	15,229
B Grade	-31,580	-67,681
C Grade	-11,275	-18,588
D Grade	-2,715	-4,515
Sydney CBD	**-40,173**	**-59,911**

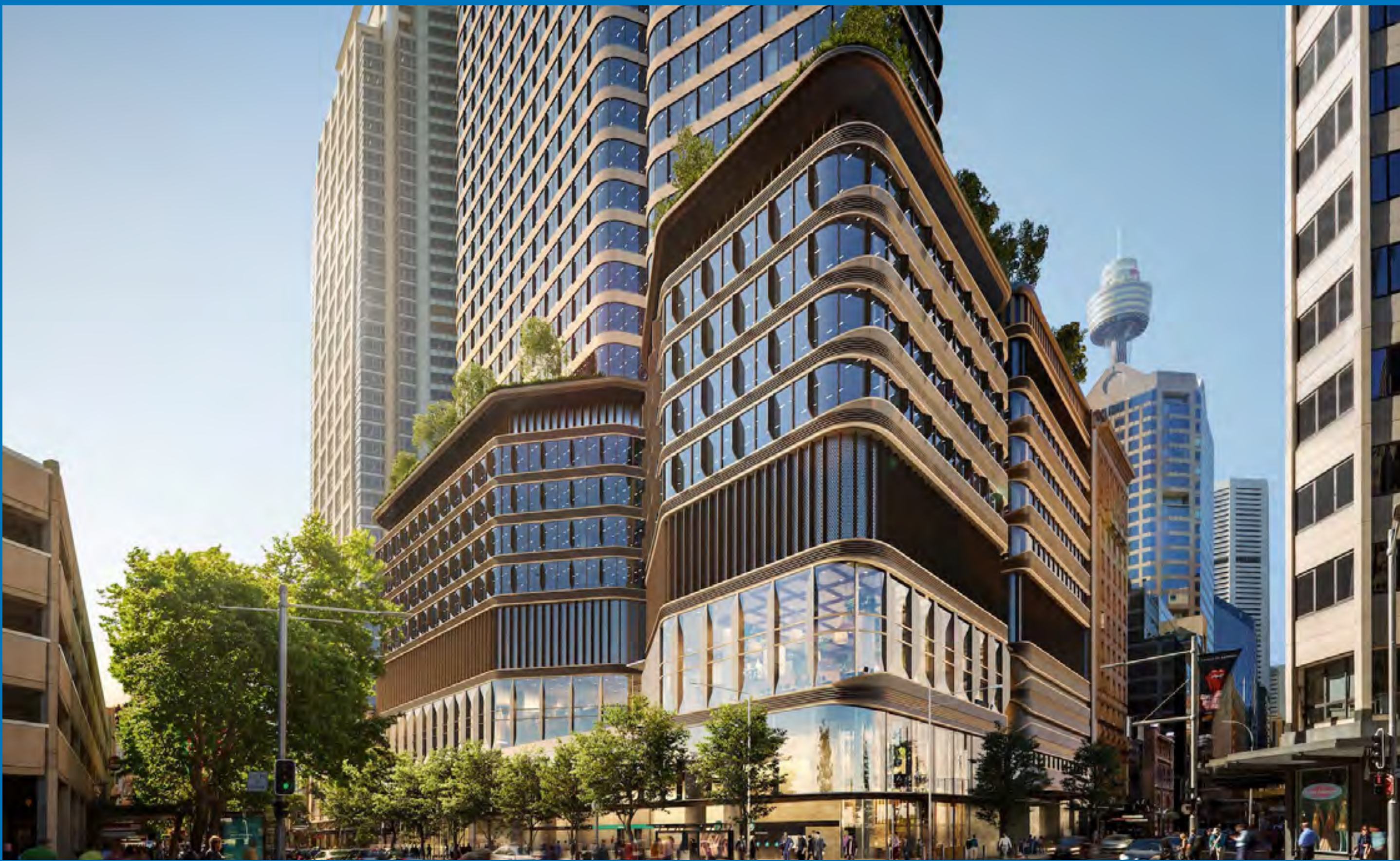
Source: PCA Jul-23

Net Absorption by CBD Precinct

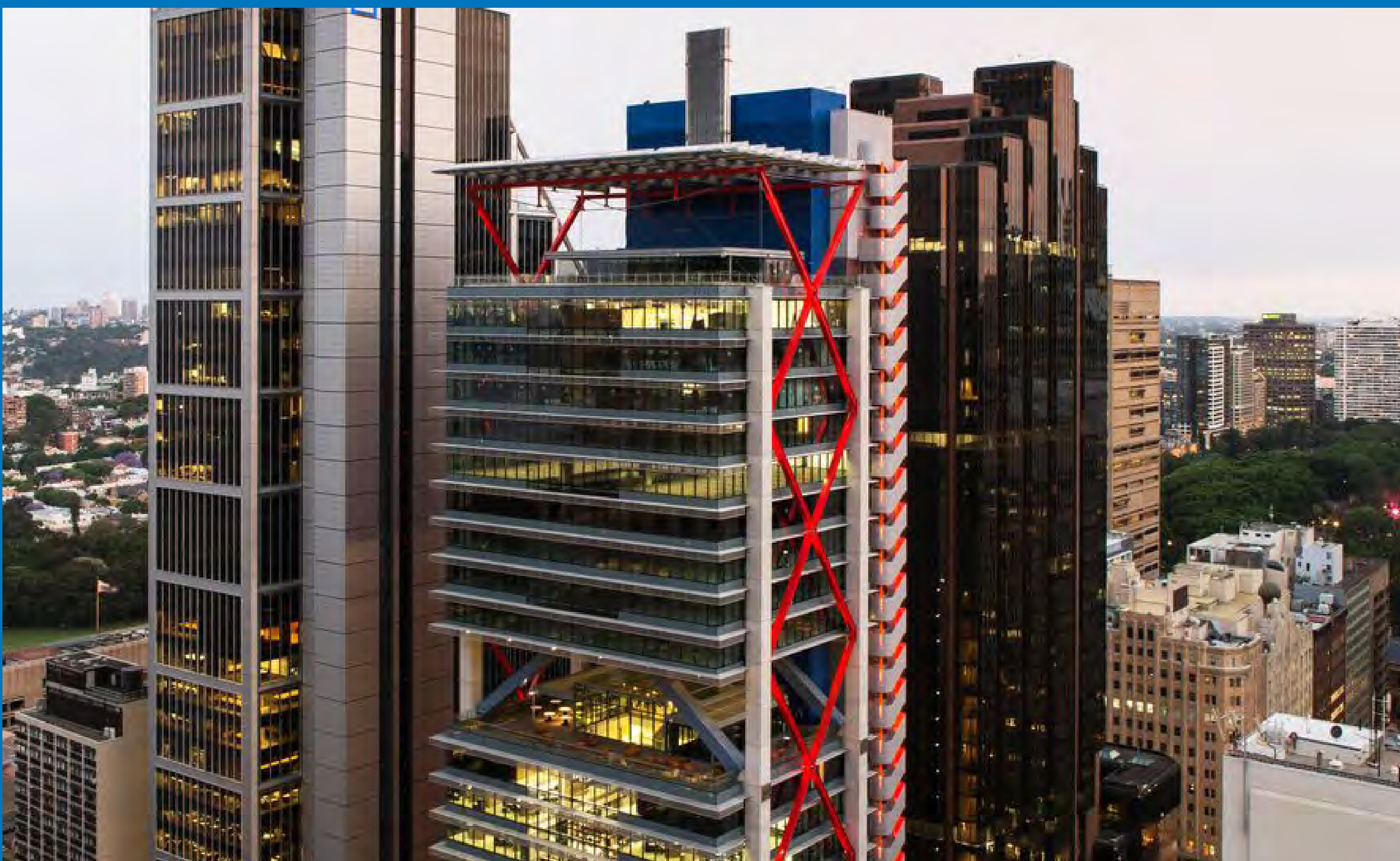
Precinct	6 Months to Jul-23	12 Months to Jul-23
City Core	33,584	61,833
Midtown	-44,150	-37,825
Western Corridor	-9,243	-37,064
Walsh Bay / The Rocks	-16,402	-29,783
Southern	-3,962	-17,072
Sydney CBD	**-40,173**	**-59,911**

Source: PCA Jul-23

Tenant Demand



Large leasing transactions were recorded recently at **Parkline Place** (above) and **8 Chifley Square** (below).



Coming on the heels of **BDO**'s recent pre-commitment, the **NSW Office of the Director of Public Prosecutions** (ODPP) has now committed to lease 9,385sqm at Oxford/Mitsubishi Estate's under-construction **Parkline Place** development. Both Parkline Place and ODPP's current office location at **175 Liverpool Street** are located in close proximity to the state government's hub at **231 Elizabeth Street**.

Elsewhere, the **Reserve Bank of Australia** (RBA) has leased 9,113sqm at **8 Chifley Square** whilst its nearby headquarters at **65 Martin Place** undergoes extensive refurbishment works.

The vast majority of the transactions listed below feature tenants relocating not only within the Sydney CBD, but staying in the same CBD precinct, including **NSW ODPP, RBA, Pinnacle Investment Management, Accor, QIC, Judo Bank** and **Howden Insurance**.

Recent Major Lease Transactions

Tenant	Address	Precinct	Level	Area (sqm)	LCD	Type
NSW ODPP	Parkline Place	Midtown	5-8	9,385	TBA	Pre-commit
RBA	8 Chifley Square	Core	9-18, 23	9,113	TBA	New
Wotton + Kearney	Grosvenor Place	Core	pt.8, 9	2,776	TBA	New
Pinnacle Investment Management#	Australia Square Tower	Core	25-26	2,123	Dec-23	New
Accor#	1 Bligh Street	Core	23	1,637	Mar-24	New
QIC	1 Bligh Street	Core	24	1,617	Dec-23	New
NEOS Life	Darling Park Tower 3	Western	9	1,478	May-24	New
Judo Bank#	207 Kent Street	Western	19	999	Sep-23	New
Hewlett-Packard Australia#	207 Kent Street	Western	18	999	Oct-23	New
Howden Insurance	20 Bond Street	Core	23	954	Q4 23	New

Cadigal was involved with these transactions.

Tenant Enquiry

Large enquiries currently in the market in the Sydney CBD include **Australian Federal Police, Morgan Stanley, HUB24** and **InterSystems**

There was 291,650sqm of active tenant enquiry in the Sydney CBD as at Jun-23,

a 7% increase over the previous quarter. The latest rise was driven by an increase in new enquiries in the 1,000-2,999sqm size range, including **Addisons** (seeking 1,900-2,300sqm for Q4 2024), **Resolution Life** (1,500-2,000sqm, Q4 2024), **Platinum Asset Management** (1,500-1,700sqm, Q1 2025) and **InterSystems** (2,200-3,000sqm, Q1 2025).

Despite the latest rise, the quantum of tenant enquiry still sits 10.6% below the 326,327sqm averaged over the last 11+ years. The current 291,650sqm of enquiry is comprised of 132 separate requirements equating to an average enquiry size of 2,209sqm.

Examples of larger (3,000sqm+) enquiries currently in the market include the **Australian Federal Police** (seeking 20,000-25,000sqm for Q2 2026), **Morgan Stanley** (5,000-7,000sqm, mid-2027) and **HUB24** (3,400sqm, Q4 2024).

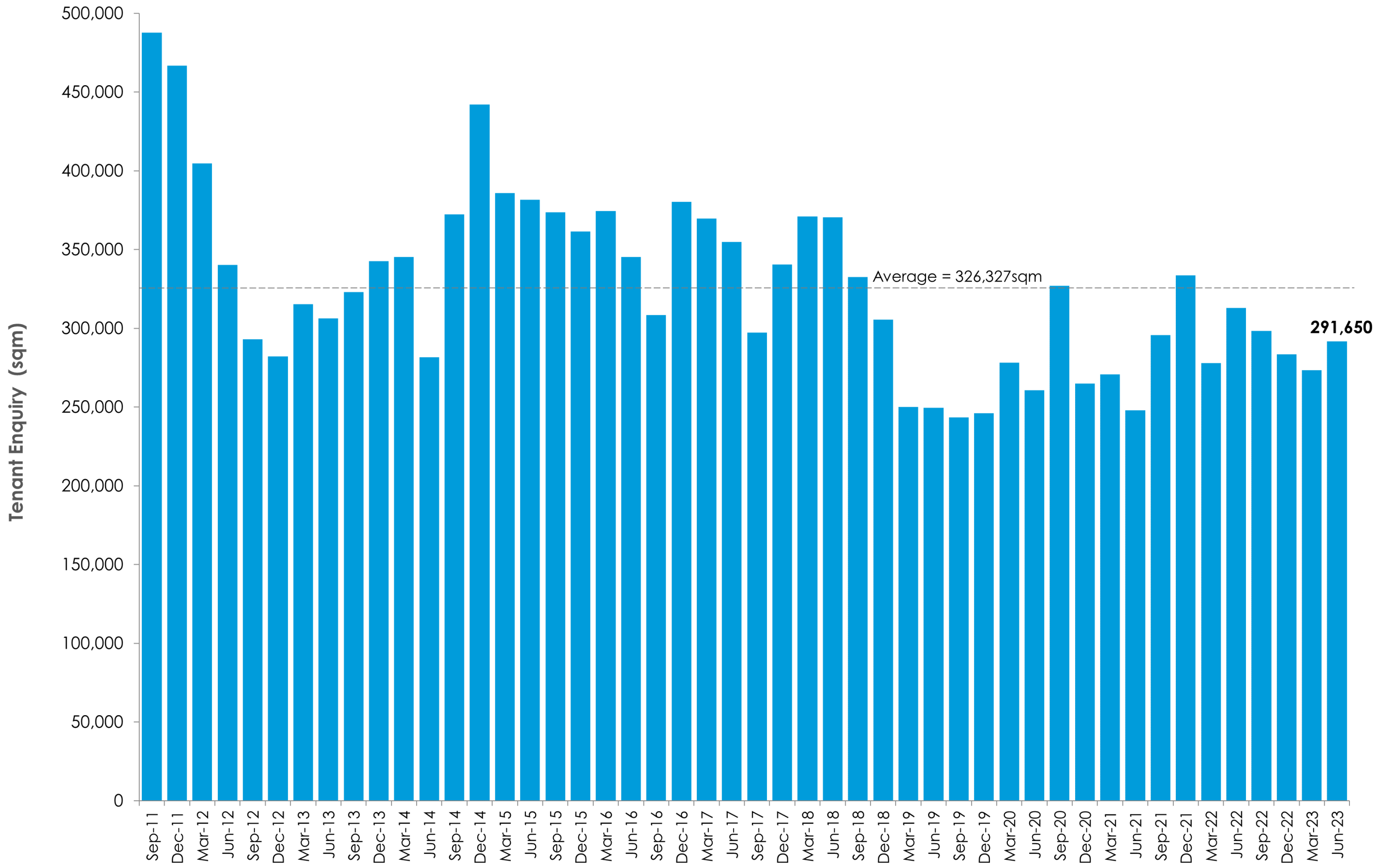
Financial Services tenants currently make up the largest proportion of tenant enquiry (18.4% of the total), followed by **Legal Services** (16.6%) then **Public Administration and Safety** (13.5%) and **Information Media and Telecommunications** (13.4%). All four of these industry sectors have large footprints in the Sydney CBD office market.

Current Tenant Enquiry by Size (enquiries over 500sqm)

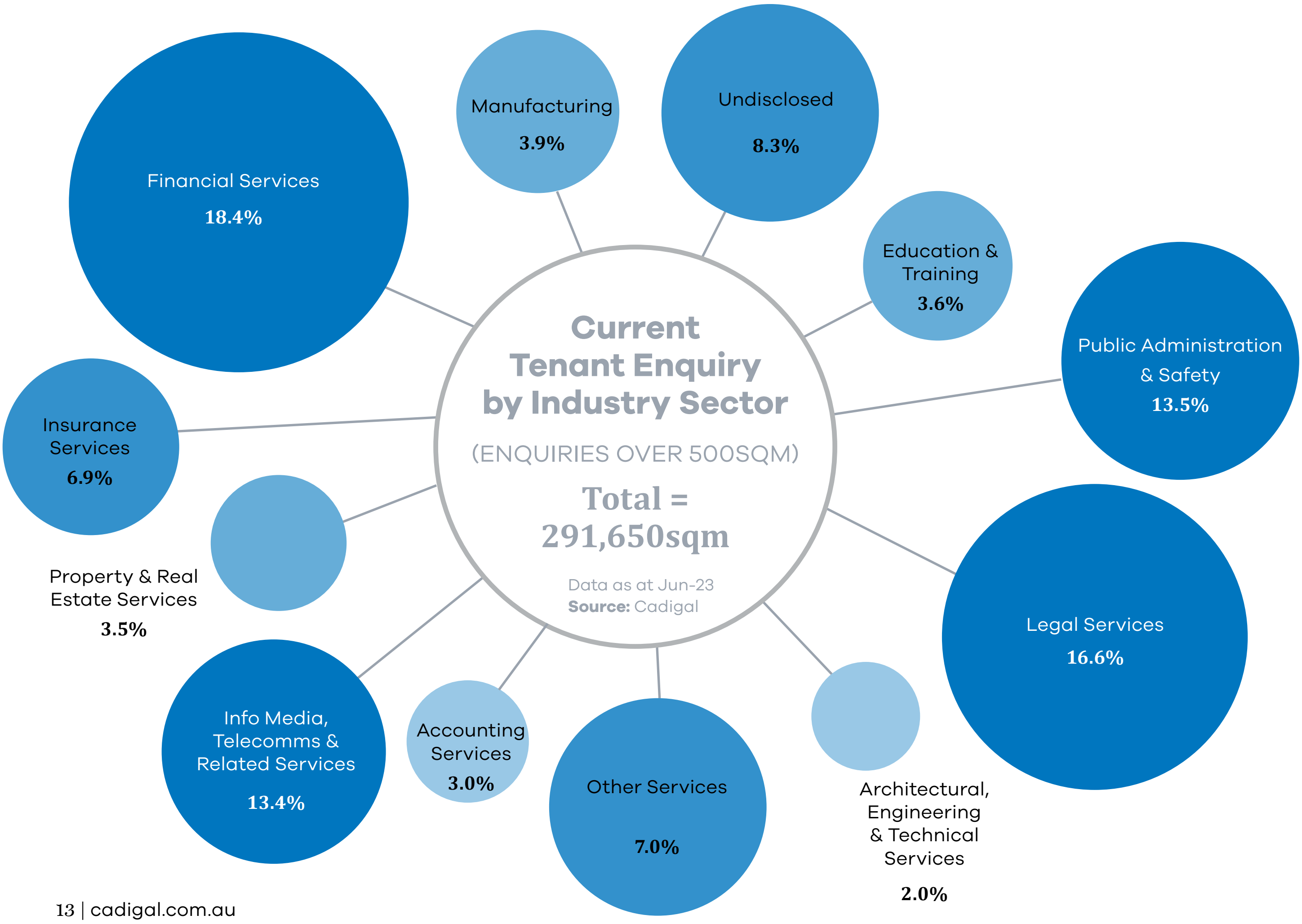
Enquiry Size	Area (sqm)	Number
3,000sqm+	159,900	25
1,000-2,999sqm	95,050	53
500-999sqm	36,700	54
Total	**291,650**	**132**

Data as at Jun-23 Source: Cadigal

Known Tenant Enquiry (over 500sqm)



Source: Cadigal



Vacancy

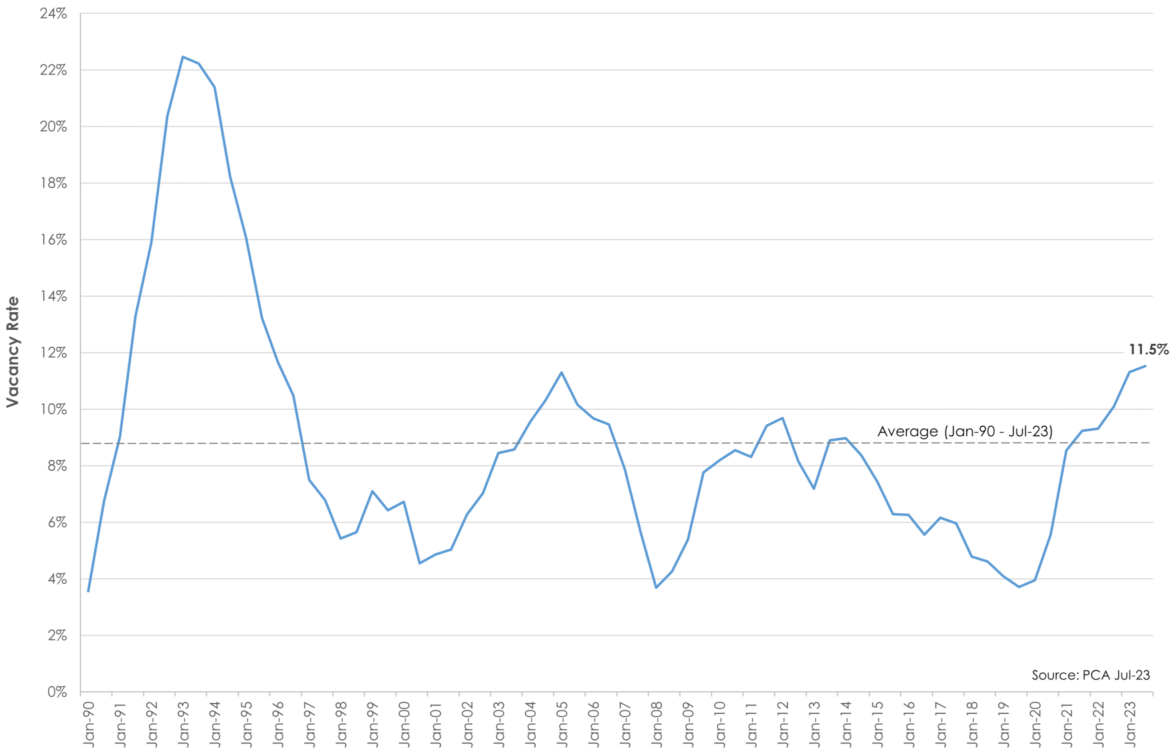
The overall CBD vacancy rate continues its upward trajectory, rising 0.2% over H1 2023, to 11.5%.

Whilst higher than the vacancy rate as at Jan-23, the *rate of increase* has slowed versus the previous two 6-month periods. With the latest rise, the current vacancy rate is the highest the CBD has seen since Jan-96 (27.5 years ago).

Vacancy rates across building grades currently span a relatively narrow band (9.5%-12.4%) with the insignificant **D grade** (3% of total stock) being the tightest and **B grade** continuing to have the highest vacancy rate.

The spread of vacancy rates across the CBD precincts is broader than across building grades, ranging from 9.6% in the **Core** to 14.5% in **Midtown.** The CBD **Core** was the only precinct to see vacancy rates fall over H1 2023, aside from the relatively minor **Southern** precinct (7% of total stock).

Total Vacancy Rate (Jan 1990 - Jul 2023)



Building Grade	As at Jul-23	As at Jan-23
Premium	11.0%	10.1%
A Grade	11.7%	11.8%
B Grade	12.4%	12.6%
C Grade	10.4%	10.3%
D Grade	9.5%	8.2%
Sydney CBD	**11.5%**	**11.3%**

Precinct	As at Jul-23	As at Jan-23
City Core	9.6%	12.2%
Midtown	14.5%	10.8%
Western Corridor	11.1%	10.3%
Walsh Bay / The Rocks	12.5%	8.1%
Southern	13.3%	14.4%
Sydney CBD	**11.5%**	**11.3%**

Source: PCA Jul-23

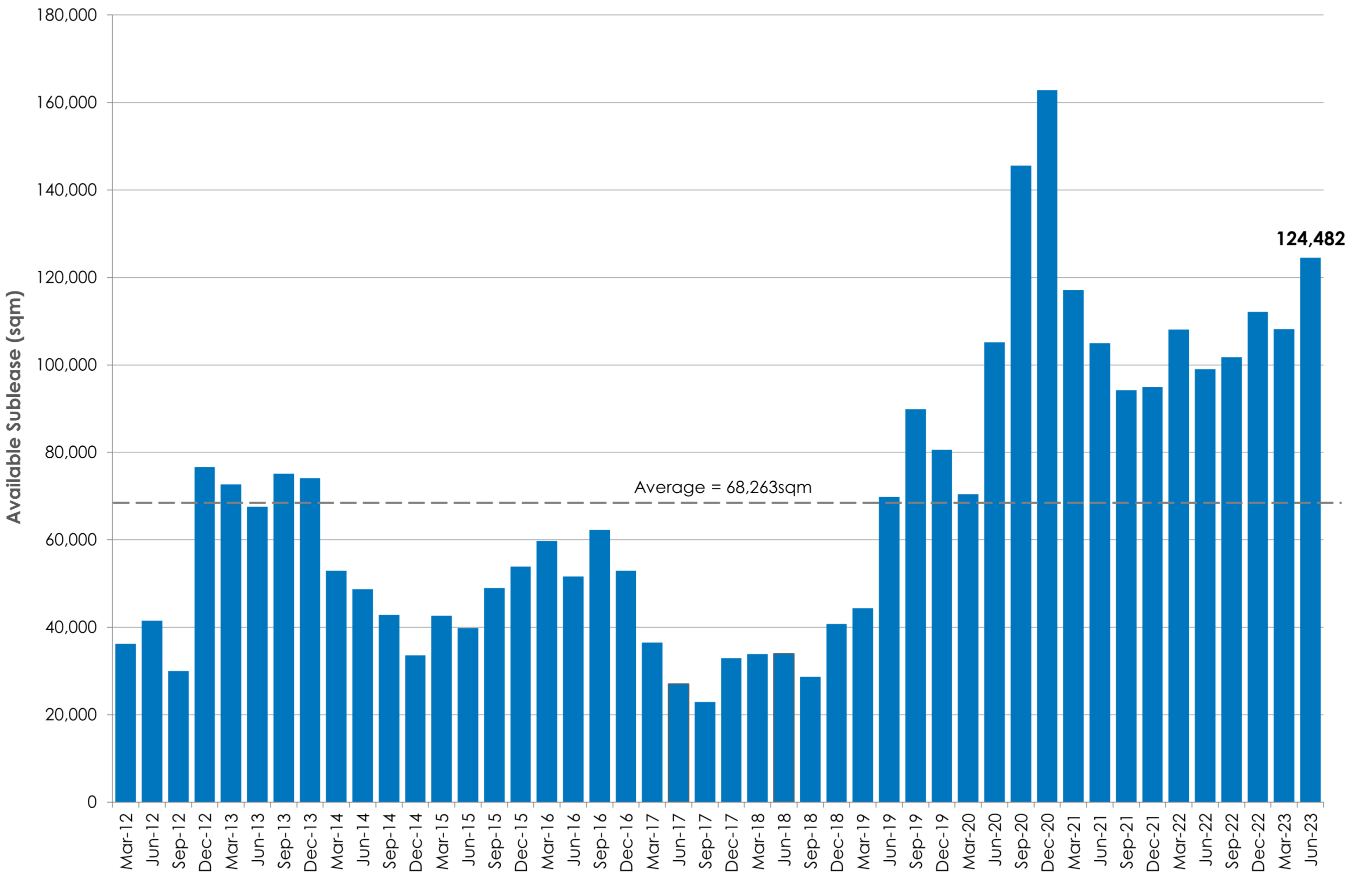
Sublease Availability

The amount of available sublease space in the Sydney CBD spiked up during the pandemic, more than doubling in nine months (Mar-20 to Dec-20) to exceed 160,000sqm. Whilst the total subsequently fell sharply, it remains elevated and well above pre-pandemic levels.

Since bottoming in Sep-21 at 94,183sqm, the quantum of available sublease space has trended upward, rising 15.4% to 124,842sqm over Q2 2023.

The largest parcel of available sublease space continues to be from **CBA** in **Darling Square** (20,742sqm) followed by **Westpac** (10,726sqm) in **International Towers Sydney** and then **Salesforce** (9,914sqm) with the latter two both having additional availability compared to the previous quarter.

Sublease Availability



Source: Cadigal

Rents

Face rents in the CBD grew 3.1%-4.7% over the 12 months to Jun-23, representing slower growth than the previous quarter. Across the building grades, face rents rose slightly more in B grade, less to do with outperforming other grades and more about closing some of the widening gap between B and A grade rents.

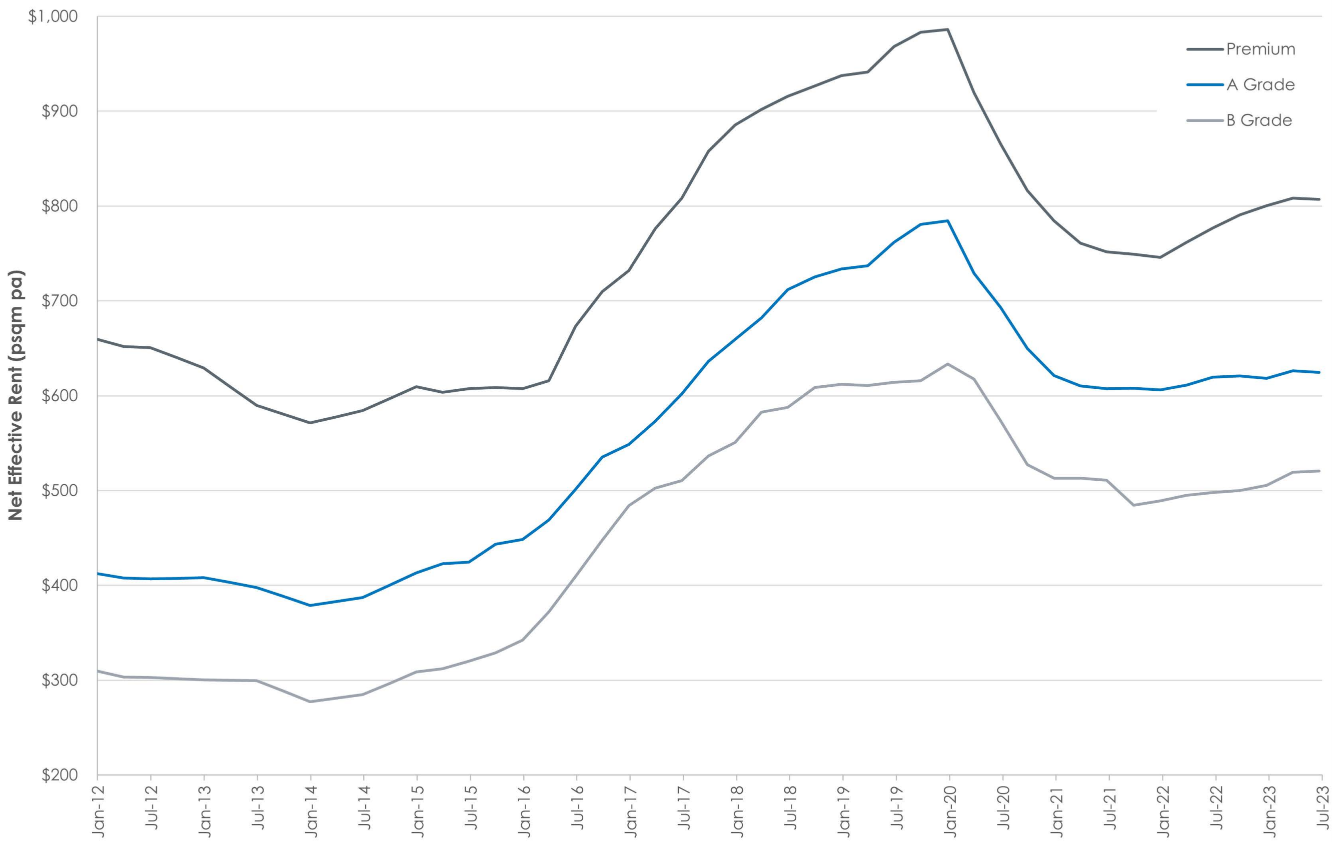
Currently, **incentives** for whole floors typically range between 33%-38% (on gross) across the CBD. Over the 12 months to Jun-23, incentives were static in both Premium (+0.1%) and B grade (+0.2%) and softer in A grade (+1.1%), but the movement in incentives was more pronounced across the precincts. Incentives generally increased significantly in Midtown and the Western Corridor but held firm in the Core, remaining essentially unchanged over the year to Jun-23.

The impact of the movement in incentives on face rents has resulted in **effective rents** performing similar to face rents for Premium and B grade, with the softening in A grade incentives acting as a drag on A grade effective rental growth.

	PREMIUM			A GRADE			B GRADE		
Rent	**Average Rate (psqm)**	12 month change	6 month change	**Average Rate (psqm)**	12 month change	6 month change	**Average Rate (psqm)**	12 month change	6 month change
Net Face	$1,381	3.9%	2.0%	$1,090	3.1%	2.0%	$890	4.7%	4.0%
Gross Face	$1,611	3.6%	1.9%	$1,285	3.2%	2.1%	$1,076	4.4%	3.5%
Net Effective	$807	3.9%	0.8%	$625	0.9%	1.0%	$520	4.5%	2.9%
Gross Effective	$1,037	3.2%	0.9%	$820	1.6%	1.4%	$706	4.1%	2.4%

Data as at Jun-23

Net Effective Rent



Source: Cadigal

Outlook

The **supply** of office space in the Sydney CBD is in a temporary hiatus over 2023, with 261,324sqm currently under construction but just 7.5% set to complete this year and 59% due in 2024. Whilst there are ample new developments proposed for the market, the prolonged weakness in tenant demand coupled with below-average enquiry levels will help keep new supply in check.

Although still below average, the latest rise in the quantum of tenant enquiry provides hope that **tenant demand** will improve, from mid-2024 onwards. By that point, market uncertainty is expected to ease and tenant activity will be spurred on by the arrival of new supply together with the attractive lease terms being offered to tenants.

Whilst **vacancy rates** continue to rise, the pace has slowed and is expected to ease further until the arrival of the new supply. Upward pressure on overall vacancy rates will return again, but higher quality space will continue to outperform the lower quality space.

Face rents have shown low-moderate growth but the rate of increase has also slowed, and this deceleration is expected to continue over the near term. However, negative growth in face rents is not expected. **Incentives** have moved higher in A grade and been relatively static for Premium and B grade. With vacancy rates at their highest in over 27 years and new supply due in 2024, upward pressure on incentives will remain.

Lok So
Research Director
+61 421 283 865
lok.so@cadigal.com.au