Charter Insight

A Decade in the Making
CBD Office Market Overview
East Coast Capital Cities

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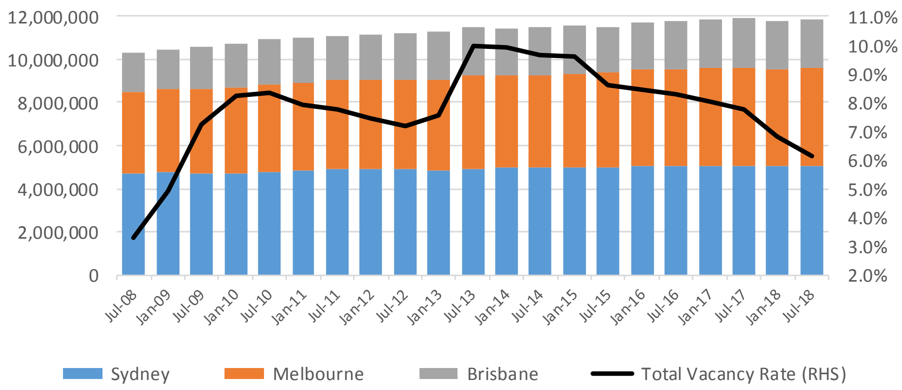
CHARTER KECK CRAMER

COMMERCIAL VALUATIONS

Figure 1: East Coast CBD Office Stock (sq.m.)



SOURCE - Charter Keck Cramer & Property Council of Australia

With Australia's economy strengthening and record level population growth, the East Coast (EC) office markets have benefited over other Capital Cities, with Sydney and Melbourne in particular receiving the lion's share of momentum as the preferred destination of skilled immigration on the back of employment opportunities and Government spending into significant infrastructure projects.

Although our two major capital cities continue to dominate Australia's population landscape, accounting for a comparatively high proportion of the Country's total population (at 35%), the perceived affordability issues around residential housing along with an improving labour market in Brisbane, are helping it recover from an office market oversupply in its CBD.

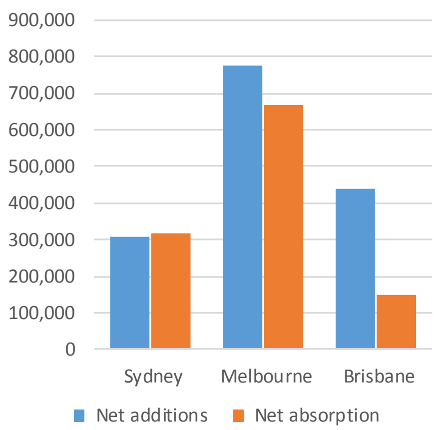
STOCK

Combined total office stock in Australia's EC Capital City markets is 11.8M sq.m., with a vacancy rate of 6.1%. Total vacancy hasn't been this low for almost 10 years, having most recently peaked at 10% in mid-2013.

Over the past decade, net additions to the EC Capital City CBDs has seen Sydney's representation reduced slightly, having not brought on as much new office accommodation as the Brisbane and Melbourne markets. Whilst representing 46% of the East Coast CBD markets ten years ago, Sydney now accounts for only 42.6% of the total office accommodation, with Barangaroo providing for much of the new additional stock.

SUPPLY & DEMAND

Figure 2: 10 Years of Supply & Demand (sq.m.)



SOURCE - Charter Keck Cramer & Property Council of Australia

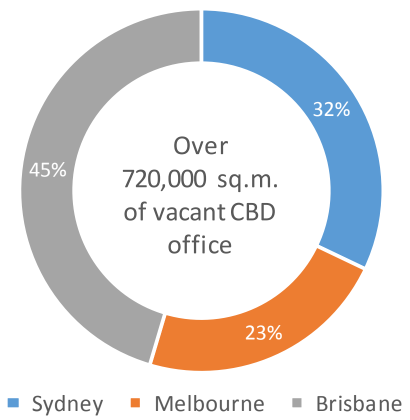
The erosion of fundamentals supporting global office markets generally following the Global Credit Crisis had significant impact on demand and existing occupiers of our major office markets. This was compounded in markets such as Brisbane which enjoyed record low vacancy rates supported by an economic advantage during a mining boom which for those reasons had consequently committed to bring on significant levels of CBD office supply.

Figure 2 highlights the amount of net addition to our EC CBD office markets over the last decade, contrasted with the level of net absorption experienced in those markets over the same time. Sydney and Melbourne have provided what appears to be adequate levels of stock to satisfy demand whilst Brisbane has essentially oversupplied the office market.

Having said that, all EC CBD markets are now in recovery with Brisbane CBD recording significant net absorption in the first half of 2018.

VACANCY

Figure 3: East Coast Vacant CBD Office Space (sq.m.)



SOURCE - Charter Keck Cramer & Property Council of Australia

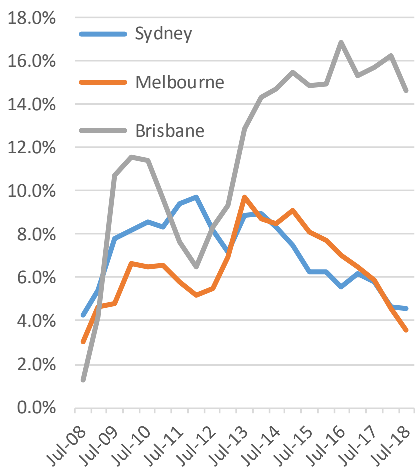
With Sydney and Melbourne CBDs having begun their recoveries earlier with respect to accelerated levels of office space demand, the bulk of EC CBD vacant floorspace resides in the Brisbane market. This is in stark contrast to the market ten years ago when the Brisbane CBD vacancy rate was less than 1.5% represented by a mere 23,000 sq.m. At that time, both Sydney and Melbourne CBDs were also at cyclical lows, with vacancy rates of 4.3% and 3.0% respectively. Sydney and Melbourne are close to having returned to these vacancy levels.

All EC CBDs are at least recording positive net absorption scenarios for their respective markets currently, albeit a more established trend in Sydney and Melbourne on the back of improving white collar labour markets with rising business conditions and confidence in the largely non-mining economies.

Each of the EC Capital Cities has also experienced the trend of increased densities in CBD residential projects, often on sites with existing secondary quality office buildings which have been subsequently withdrawn, having previously contributed to the vacancy scenario.

Significant infrastructure projects in the CBDs of Sydney and Melbourne in particular, are also resulting in the withdrawal of office stock.

Figure 4: Total CBD Vacancy



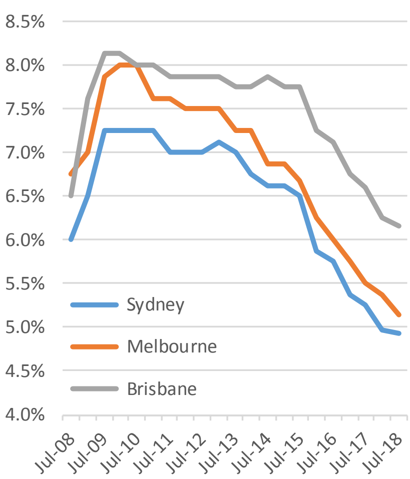
SOURCE - Charter Keck Cramer & Property Council of Australia

Although not all the withdrawal is permanent, the significant demolition and construction stages associated with infrastructure work is having a direct impact on the accommodation available whilst also placing further downward pressure on vacancies as displaced tenants look to retain CBD locations.

This has been particularly evident in Sydney's CBD with Metro and Quay Quarter projects, but also impacting Brisbane and Melbourne CBDs with Queen's Wharf and Melbourne Metro respectively.

YIELDS

Figure 5: Grade A Yields



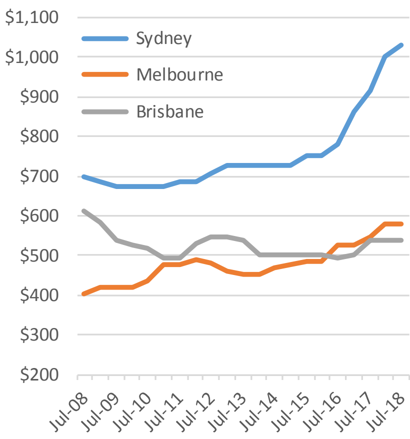
SOURCE - Charter Keck Cramer & Property Council of Australia

The EC CBD office markets have recorded extensive purchaser interest from both domestic and international investors. The weight of capital seeking to invest in a limited supply of core office assets is placing continued downward pressure on yields and returns.

This yield compression, whilst evident across all commercial property sectors, has been particularly strong for EC CBD office markets and most significantly in Melbourne, with substantial compression over the last ten years to almost be on par with Sydney.

RENTS

Figure 6: Grade A Net Face Rents [$/sq.m.]



SOURCE - Charter Keck Cramer & Property Council of Australia

Tight vacancy rates for Sydney and Melbourne CBDs have demonstrated a flight to quality for major tenants, particularly as the markets retain a comparatively high level of incentives. Having said that, the general trend in incentives as a percentage of rents has been trending downward. This, in conjunction with increases in face rents, is supporting further growth in effective rents.

Brisbane's CBD rents have generally remained stagnant whilst retaining a substantial level of incentives. This reflects the notably higher vacancy scenario. A flight to quality by tenants is also evident however, given significantly higher vacancy rates recorded in secondary CBD office stock.

OUTLOOK

Tightening of office vacancy rates and increasing rentals in the EC CBD Office markets is expected to continue in varying degrees depending on respective CBD supply pipelines and existing vacancy rates. Generally, there is likely to be continued demand for office accommodation across our EC markets. Changing tenant requirements are also expected to impact positively, with increased demand for co-working or flexible environments over shared accommodation an emerging trend.

The investment market is strong, with quality investment grade stock sought after by both domestic and foreign investors. With a low-interest rate and low return environment expected to continue in the medium term, the investment market is likely to be limited only by the availability of stock. A substantial weight of capital competes for a limited number of core assets. Whilst some further yield compression may occur on the expectation of income growth, particularly in Sydney and Melbourne, it is likely that secondary office assets are priced at or near the top of the cycle.

Charter Keck Cramer is a leading provider of evidence-based property insights. We provide accurate and timely market intelligence and industry insights that are rigorous, considered and forward-looking. For more information on this insight or the commercial property market more broadly, please contact any of the undersigned.

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