CI AUSTRALIA

OFFICE MARKET UPDATE

SYDNEY CBD

SEPTEMBER 2018

EXECUTIVE SUMMARY.

Welcome to our September 2018 Office Market Update. We explore leasing activity, supply, investment and development activity, market trends and more.

Of course, we address and analyse the limited supply that has been - and will continue to be - the defining trend of the Sydney office market in 2018 and into 2019.

While vacancy reduced 20 basis points over the six months to 4.6% in July 2018, there was minimal net absorption recorded in the same period. This demonstrates that the net demand is significantly lower than the historical average.

Secondly, we explore how Sydney's position as a world-class city is playing a key role in attracting international businesses to the market, the impact of this, and how the strong New South Wales economy is driving take up of space. A flow-on effect of this is that the ongoing tight vacancy will continue to trigger rental growth and lower incentives.

We hope you find this report interesting, and a useful reference tool. All data quoted is either CI Australia Research, RCA Analytics, or Research from the Property Council of Australia (August 2018 data release).

If you have questions or would like to request bespoke research or investment analysis, we'd be delighted to speak with you.

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CO-WORKING EVOLVES INTO **FLEXSPACE.**

The popularity of the once-new co-working trend has seen it evolve into a broader, more innovative offering that has well and truly shaped the concept of the modern office environment. And this means it's no longer just new entrants to the market disrupting how we work - it's the major landlords, too.

Dexus - which cemented itself as a leader in this space with the launch of **Dexus Place** in the first half of 2015 at Level 5, 1 Margaret Street - expanded its successful offering to now span four locations across NSW, Victoria and Queensland. With casual bookings and amenities such as concierge service, car-sharing options, childcare services and onsite health and fitness classes, it's no suprise that it's been a success.

It was the more recent launch of **SuiteX** in July 2018 that signalled the next evolution of its suite strategy. In announcing it to the wider market, Dexus said:

"With a space ratio that is considerably less compact compared to co-working or serviced office spaces, SuiteX provides the comfort and privacy of traditional office space with the community of co-working.

"Flexibility is ensured through a unique turnkey solution enabled by a modular design. A one-metre grid system and demountable inter-tenancy walls enable customers to quickly expand or contract their space. Flexible lease terms start from as short as six months to two years, allowing customers to grow or consolidate as needed."

SUSTAINABLE SOLUTIONS.

No longer is greenery in the office enough to satisfy the modern workforce. Employees want to get their hands dirty – literally.

Mirvac's community garden in the basement of its flagship EY Centre development at 200 George Street is not the traditional home for an urban farm. **Or is it?**

The pop-up urban farm is a partnership between Mirvac and Farmwall, a start-up that creates natural, food producing ecosystems in urban spaces. Using grow lamps and hydroponics, employees have the opportunity to grow their own fruits and vegetables, harvest the crops and enjoy time away from the screen.

COMMUNITY COMES TO THE FORE.

Placemaking gains traction, continuing to change the ways in which we interact with the spaces around us.

Exciting activity is happening across the Harbour Bridge, too. Charter Hall partnered with its tenants to transform 65 Berry Street North Sydney into a community hub, complete with a 'Wellness Area', exhibition space and artists studio. Think complimentary Yoga and Pilates, an auditorium which can be hired for events and used by tenants free of charge, and North Sydney's only Not For Profit café, serving locally-sourced, sustainable and organic food.

MARKET TRENDS.

CONSOLIDATION & GOING **GLOBAL.**

Consolidation remains a theme, as Sydney continues to serve up mixed-use innovations that are well and truly on par with some of the world's best.

A number of major businesses have consolidated their operations, such as Publicis Group, the French multinational communications and advertising firm, which will move to 21 Harris Street, Pyrmont. They will occupy 10,100sqm of office space upon completion in late 2019.

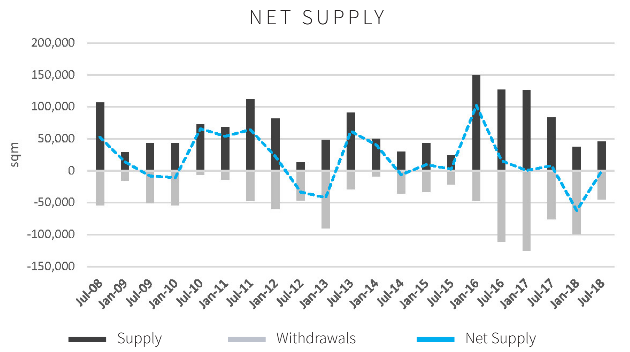
While strong tenant demand for space from the finance and real estate sectors has remained, we've also seen diversification of competition for space with sectors such as technology, IT and media & information now becoming more active.

IT'S ALL ABOUT **SUPPLY.**

With no new developments completed in the first half of 2018, supply in the Sydney CBD remains at a historical low. The reported additions of approximately 45,000sqm during this period were a result of the completed refurbishment of three buildings – 167 Phillip Street (4,090 sqm), 2 Bligh Street (4,692sqm) and 201 Sussex Street, Tower 2 (35,227sqm). This brings gross supply to well below the historical average of approximately 80,000sqm for the six months to July 2018.

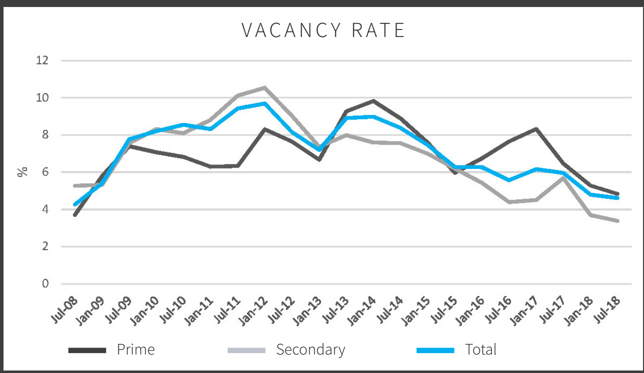
And while withdrawals for residential developments will continue, it will be at a much less significant pace. Secondary Grade Building Withdrawals totalled 45,122sqm for the first half of 2018 - 14,795sqm of B-Grade and 30,327sqm of C-Grade. This compares to 75,821sqm in the first half of 2017.

This is mostly due to the slowdown of the residential market, with tighter lending policy and increased taxes on foreign buyers. It was also this slippage in the number of housing indicators that was a key factor in NSW being second to Victoria in CommSec's Economic Performance Rankings (July 2018).

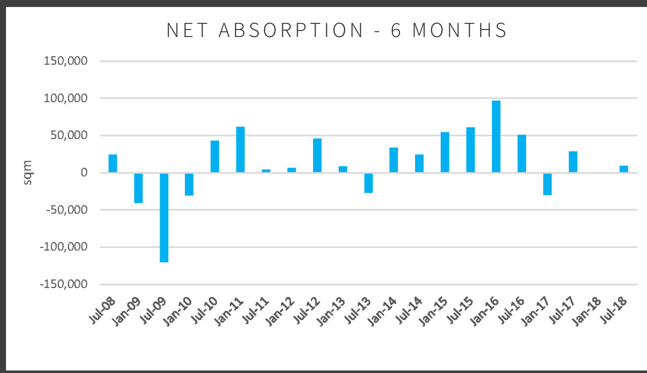


Source: PCA/CI

VACANCY &
RENTS.



Source: PCA/CI



Source: PCA/CI

4.6%

TOTAL VACANCY FOR SYDNEY CBD

The reduction in vacancy was driven by withdrawals. While net absorption in the six months to July 2018 was 9,144sqm, this is largely attributed to existing tenant expansions, as opposed to new entrants.

BARANGAROO/ WALSH BAY

BIGGEST DROP IN VACANCY

Walsh Bay witnessed a tightening of its vacancy from circa 10% to 9.2% in the six months to July 2018, potentially due to the increased connectivity due to new infrastructure - Wynyard Walk & Barangaroo Ferry Terminal – which have improved access from the City Core to the Western Corridor & Walsh Bay.

CITY CORE

BIGGEST INCREASE IN VACANCY

City Core increased 3% from its January 2018 figure (3.9%), to reach a total of 6.9%. This was driven by a major tenant relocation out of 388 George Street to Darling Park (IAG).

Total Stock	Premium	A	B	C	D	Total
Jul-08	680,230	1,631,887	1,546,432	645,448	223,945	4,727,942
Jul-18	1,162,107	1,843,354	1,396,907	450,976	182,824	5,036,168
% change of stocks	71%	13%	-10%	-30%	-18%	7%

Total Vacancy	Premium	A	B	C	D	Total
Jul-08	4.3	3.1	4.7	5.8	5.3	4.3
Jul-18	5.1	4.6	5.1	3.2	1.9	4.6

Source: PCA/CI

CBD Rents are at record levels due to the tight market. Net effective rents in Secondary Grade buildings have grown at a higher rate than those in Prime buildings. There is also a disparity in stock between Secondary and Prime, with many C and D-Grade buildings having been demolished for redevelopment purposes. Secondary Grade vacancy is 3.4%; Prime is 4.8%.

This has had a two-fold impact - with the former occupants of Secondary assets moving into higher grade buildings; and the lack of Secondary stock exerting pressure on this grade of rents.

There has also been strong evidence of displaced B-Grade tenants relocating into A-Grade assets – able to afford higher rent in some cases.

This means that while some firms are able to allocate funds for a traditional three-year lease term, smaller businesses and start-ups are looking to co-working and Flexspace options for financial benefits, but also due to agility, services and collaboration.

But co-working is big business – literally. Major corporations have come to the party, including Microsoft, which it utilising the Sydney Startup Hub at 11-31 York Street, a million-dollar Government-funded home for start-ups in the CBD that opened in February 2018 - as the eighth location of its worldwide ‘ScaleUp’ accelerator program. Meanwhile, co-working operator WeWork has admitted to having an aggressive expansion plan, targeting 300,000sqm in Australia and 90,000-100,000 sqm in Sydney over the next three years.

The above graph charts the change in total stock and vacancy over the 10-year period to July 2018. It is clear that the level of Secondary Grade stock has reduced significantly over this period - the greatest reduction in C-Grade with -30% stock than July 2008. This is followed by -18% less in D-Grade and -10% for B Grade. Comparatively, Premium Stock increased 71% over this period, as did A-Grade with a more modest 13% rise.

Overall this had led to an increase of 7% in total stock for the CBD.

When tracking vacancy alongside these changing stock levels, the vacancy reduced most significantly in C and D-Grade assets, yet remained relatively steady in the Premium and A-Grade sectors.

RECENT LEASING TRANSACTIONS

Address	Tenant	NLA (sqm)	Lease Commencement	Term (years)
60 Martin Pl	Norton Rose Fulbright & Henry Davis York	7,200	Jan-20	12
151 Clarence St	Mills Oakley Lawyers	5,673	Jan-19	11
225 George St	Sonic Healthcare	2,803	Oct-18	10
64 York St	WeWork	3,600	Aug-18	U/D
100 Barangaroo St	Origin Energy	7,765	Jul-18	10
201 Sussex St	Dimension Data	6.000*	Jul-18	10
126 Phillip St	NSW Treasury Corp	2,888	Jun-18	7
100 Barangaroo St	Morningstar	1,820	May-18	10
201 Sussex St	Spruson & Ferguson	1,954	Apr-18	11
100 Barangaroo St	Ferrier Hodgson	1,400	Mar-18	7
175 Liverpool St	Evolution Mining	1,661	Mar-18	6
100 Barangaroo St	Hannover Life Re	2,345	Feb-18	7

Source: CI

* Approx.

SYDNEY CBD RENTS & INCENTIVES
AUGUST 2018

Grade	Region	Average Net Face Rents ($/m2 pa)		Average Gross (%) Incentive	
		LOW	HIGH	LOW	HIGH
Premium	Core	$1,050	$1,480	17	23
	Barangaroo	$1,100	$1,380	23	28
	Mid Town	$1,100	$1,250	15	23
	Western Corridor	$1,100	$1,200	17	23
A Grade	Core	$980	$1,200	12	15
	Mid Town	$950	$1,180	12	16
	Western Corridor	$900	$1,200	13	15
	Southern	$850	$1,100	12	15
B Grade	Core	$850	$1,100	12	17
	Mid Town	$800	$1,100	12	15
	Western Corridor	$780	$1,050	10	15
	Southern	$780	$900	10	15
C Grade	Core	$750	$850	13	17
	Mid Town	$700	$780	12	17
	Western Corridor	$650	$750	12	17
	Southern	$650	$750	12	17

Source: CI

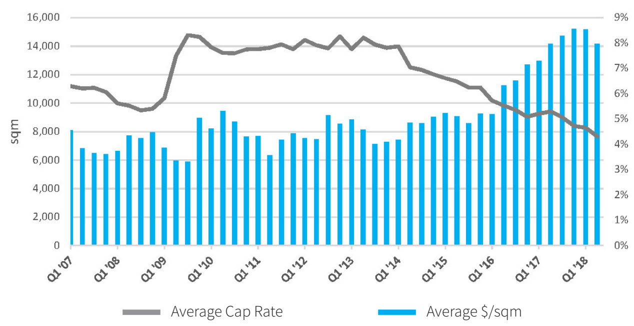
> *Sydney's position as a global city, the emergence of world-leading assets, rental growth and vacancy rates make it an incredibly attractive destination for investors. Sustained demand from buyers, particularly from Asia Pacific, North America and Canada, has remained strong through 2018. However, Sydney's strong fundamentals and the completion of new assets including major infrastructure projects will ensure the CBD remains atop the list for buyers.*

MICHAEL STOKES

DIRECTOR, CAPITAL TRANSACTIONS

INVESTMENT & CAPITAL FLOWS.

AVERAGE $/SQM & CAP RATE



Source: RCA Analytics

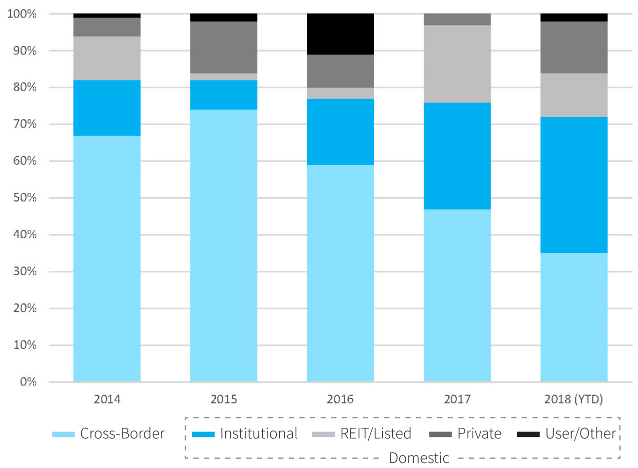
Sydney CBD continues to be a favourable market for both offshore and domestic institutional investors, due to its low risk investment and ability to achieve maximum and stable income return.

Average prime CBD yields had fallen to 4.6% by Q2 2018, and yield continues to fall. We expect this to continue to fall in the short term, before an increase in the mid-term if and when the Reserve Bank of Australia increases the cash rate prior to stabilising in the long term.

A total of $4.8 billion of office assets have transacted in Sydney for the year to August 2018. This is approximately 30% below the $10.4 billion recorded for Full Year 2017, and the immense $21 billion recorded for the Full Year 2016. (Source: RCA - Transactions above AUD 10 million).

The level of acquired assets in AUD$ of local institutional investors is on par with offshore investors. It is expected this buyer composition will change however – capital from foreign investors is expected to overtake that from domestic institutions.

BUYER COMPOSITION



Source: RCA Analytics

Whilst there was a slowdown in activity from Chinese investors in 2017 due to the tightening of Chinese Government offshore investment policies, they still represent a major component of the demand in both enquiry and eventual purchasers. There has also been increasing interest from investors from other Asian countries such as Singapore, Korea and Malaysia, and continued active interest from both European and American funds, representing diversification among the offshore buyer profile.

Rikki Wu
Head of Asia Desk

The largest single transaction of this year as at August 2018 has been Mirvac exercising its pre-emptive rights over a 50% stake of Westpac Place (275 Kent St) from Blackstone for $721.9 million. The initial yield was 4.5%.
Another prominent deal was Hong Kong private investor, Loi Keong Kuong, purchasing 179 Elizabeth St for $265,000,000 from Markham Corporation. It reflected a sales rate of $16,041 per sqm and 5.17 passing yield.

Date	Address	Price (A$)	Cap Rate	Owner/Buyer	Seller
Jul-18	Westpac Place 275 Kent St	874,526,476#	4.5%	Mirvac Group, ISPT	Blackstone
Jul-18	Piers 8 & 9 23 Hickson Rd	90,500,000.00*	6.6%	Markham Corporation	Sumner Capital, sitEX Properties AG
Jun-18	117 Clarence St	153,000,000.00	5.4%	Investa Property Group	Roxy-Pacific, Tong Eng Brothers Pte Ltd
Jun-18	Allianz Centre 2 Market St	285,529,439#		Charter Hall REIT	Allianz
Apr-18	179 Hyde 179 Elizabeth St	265,000,000.00	5.2%	Loi Keong Kuong	Markham Corporation
Apr-18	499 Kent St	52,500,000.00	3.0%	Element Property Sydney Pty Ltd	Saatvic Holdings Pty Ltd
Apr-18	55 Clarence St	252,375,397.00	3.6%	Zone Q	AEW Global
Apr-18	187 Thomas St	145,950,000.00*	3.0%	Greaton Group	Union group
Apr-18	60-62 Clarence St	31,258,000.00	3.9%	Burcher Property Group	Levanai Nominees, Matana Foundation for Young People, Karen Loblay's family trust
Mar-18	1 York St	205,000,000.00*		Blackstone	HNA Group
Mar-18	52 Goulburn St	176,000,0000#	4.8%	Arcadian Pty Ltd	Credit Suisse
Mar-18	Cassa Commercial House 73 York St	22,500,000.00		Pacvale	Fife Capital
Mar-18	Seagraves House 810 George St	14,650,000.00			
Feb-18	The Rocks 88 Cumberland St	56,000,000.00*	4.1%	Marks Henderson	Argus Property Partners (AUS)
Feb-18	75 Pitt St	43,520,000.00		Wiltshire International	Thai Airways International
Jan-18	Marac House 16 Spring St	50,000,000.00*		Lendlease	
Jan-18	299 Elizabeth St	91,116,788.50	4.2%	Sunrise Resources	JX Capital

*Approx. #The sale represents a half stake

Source: RCA Analytics

TO 2020
& BEYOND.

Exploring the future of the CBD, now firmly on the **world stage.**

It's estimated that by 2022, there will be an increase of 280,000sqm in net lettable office space in the CBD, which will represent an increase of six percent of the current 5,000,000 sqm of total office stock.

This represents $4.8 billion (approx.) worth of commercial developments under construction in the CBD. The major projects, of which many of these will currently reflect the global trend of mixed-use assets, where people can work and play, include AMP's 50-storey Quay Quarter Tower and the adjoining high-end luxury residential apartments on Loftus Lane; Lendlease's Circular Quay Tower, which will be Sydney's tallest office tower - and at the ground floor, will be pedestrianised with cafes, bars and shops; and Macquarie Group's 40-storey tower proposal, which will sit above the soon-to-be-constructed Martin Place Metro station. A further $3.1 billion (approx.) of approved works are still to commence and scheduled for completion by 2025. In order to meet the high level of developments in Sydney CBD, the NSW Government has been building infrastructure.

Project name	Cost* ($m)	Types	Status	Actual/Expected Completion
Wynyard Station upgrade	$115	Rail	Completed	2016
Wynyard Walk	$306	Pedestrian Link	Completed	2017
Barangaroo Ferry hub	$50	Ferry	Completed	2017
CBD & South East Light Rail	$2,100	Rail	Construction	2019
Circular Quay upgrade	$200	Ferry	Study	2020
Sydney Metro	$10,500	Rail	Construction	2024

Source: CI *Approx.

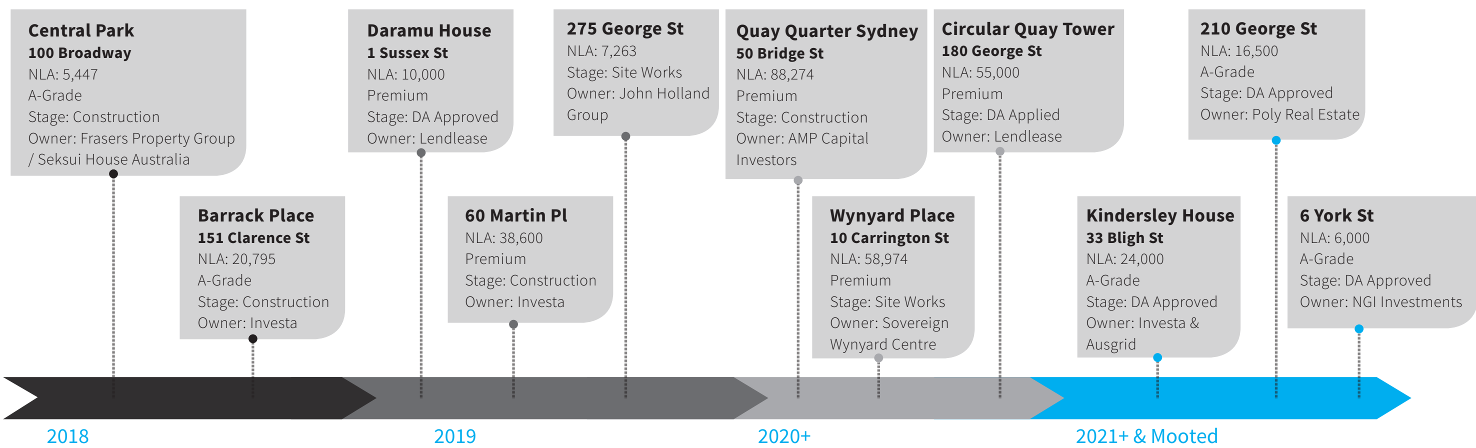
And although this supply will increase vacancy, it is unlikely to affect investors' view of the market. Pre-commitments from tenants and the strong market fundamentals at present – expected to flow in 2019 and beyond – will ensure the new assets remain low risk investments. In fact, Quay Quarter Tower (50 Bridge Street) has 41% pre-commitment, Wynyard Place (10 Carrington Street) has 63% pre-commitment, and Daramu House in Barangaroo has 100% pre-commitment, by WeWork.

To stay competitive with new developments and to capitalise higher rents, existing buildings are also undergoing partial or full refurbishment. This will not only strengthen tenant attraction and retention, but increase the pool of assets that investors may eye in the future. This ties in with the larger move towards mixed-use developments, that is evident in Sydney CBD, reflecting the global evolution of buildings now as a precinct (or hub) where people can work and play.

> "
>
> Mixed-use developments encourage investors to find highest and best use combination of office, retail, hotel and residential on the site location - helping to lower the investment risk, meet occupational demands and achieve maximum and stable income return.
>
> Sydney is now a world-class city, with investment demand bouyed by the concentration of premium office buildings, infrastructure projects and the emergence of new leading mixed-use buildings.

DEVELOPMENT PIPELINE.

Source: CI



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True specialists in investment sales, commercial leasing and asset management, we have the knowledge and connections to deliver for you, across Australia and internationally. Our scale is furthered by our dedicated Asia Desk and the connections to our parent companies – APP, Broadspectrum and Ferrovial - which means we can help you achieve your business goals, no matter how large or small.

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