



NEW SOUTH WALES CBD OFFICE INSIGHT

NOVEMBER 2023

“Occupiers are seeking office space upgrades, while improvements in rents will create a flow-on effect for well-managed assets once capital returns to the market.”

- Andrew Duguid
Managing Director NSW



FLIGHT TO QUALITY FOR OFFICE SPACE IN SYDNEY'S CBD

Office occupiers in the Sydney CBD are increasingly seeking quality space as more workers return to the city, with activity also being driven by displaced tenants due to metro redevelopment.

The CBD leasing sector is quite active, with relatively high incentives creating the motivation for people to move into better-quality office space. Occupancy is increasing year on year, and rents are growing. There is positive momentum coming back into the market.

Face rents have shown gradual improvements throughout 2023, supported by high incentives, and once capital comes back onto the market, it will flow to those assets that are being well-managed now.

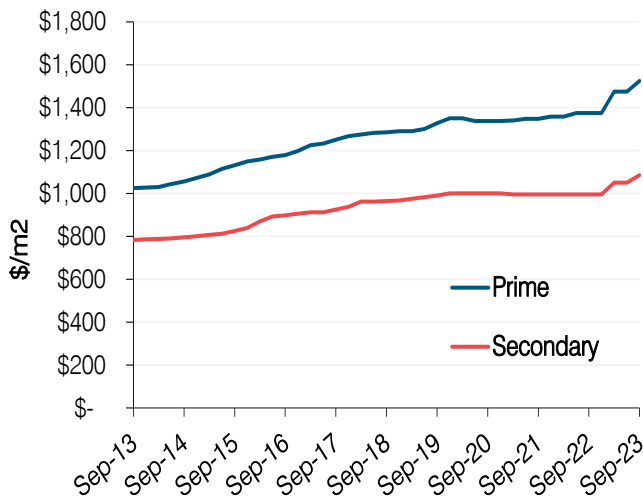
Prime gross face rents increased by circa 10.91% in the 12 months to September 2023 to range between \$1,150 and \$1,900 per square metre.

Secondary gross face rents increased by circa 9.68% during the year, ranging between \$870- and \$1,300 per square metre.

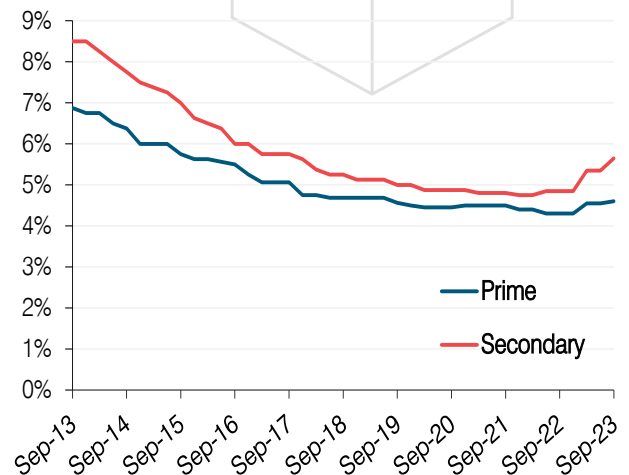
Prime incentives increased by circa 1.5% in the 12 months to September 2023, ranging between 32% and 38.5%. Meanwhile, secondary incentives increased by circa 2.5%, ranging between 30% and 38%.



SYDNEY CBD GROSS FACE RENTS



SYDNEY CBD PRIME AND SECONDARY YIELDS



Source: M3 Property

CAPITAL MARKETS TRANSACTIONS REFLECT A CHANGE IN VALUE METRICS YEAR-ON-YEAR

Despite the improvement in the leasing space, the current market conditions have resulted in a thin volume of transactions in the Sydney CBD in the year to date. Those transactions that have been recorded have reflected material changes in value metrics from 2022.

What's becoming apparent is an increasing spread in value metrics between prime and secondary, with the spread returning to historic norms. The market is returning to a position where there is an appropriate yield spread between asset quality, and risk is now being fully priced in. Investors may return in larger numbers in 2024 as valuations adjust to market circumstances.

Prime CBD yields ranged between 4.30% and 5.0% during the September 2023 quarter, softening 40 bps compared to the September 2022 quarter.

Yields for secondary CBD office assets ranged between 5.10% and 6.40% during the September 2023 quarter. Secondary yields softened by 70 to 110 bps compared to the September 2022 quarter.

LIMITED CAPITAL AVAILABLE FOR OFFICE ASSETS

Over the past 12 months, there has been limited capital available for office assets and may continue to be so until such time as there's a widely held belief that values are stabilised, which may be in 2024. Investors may return in larger numbers in 2024 as valuations adjust to market circumstances.

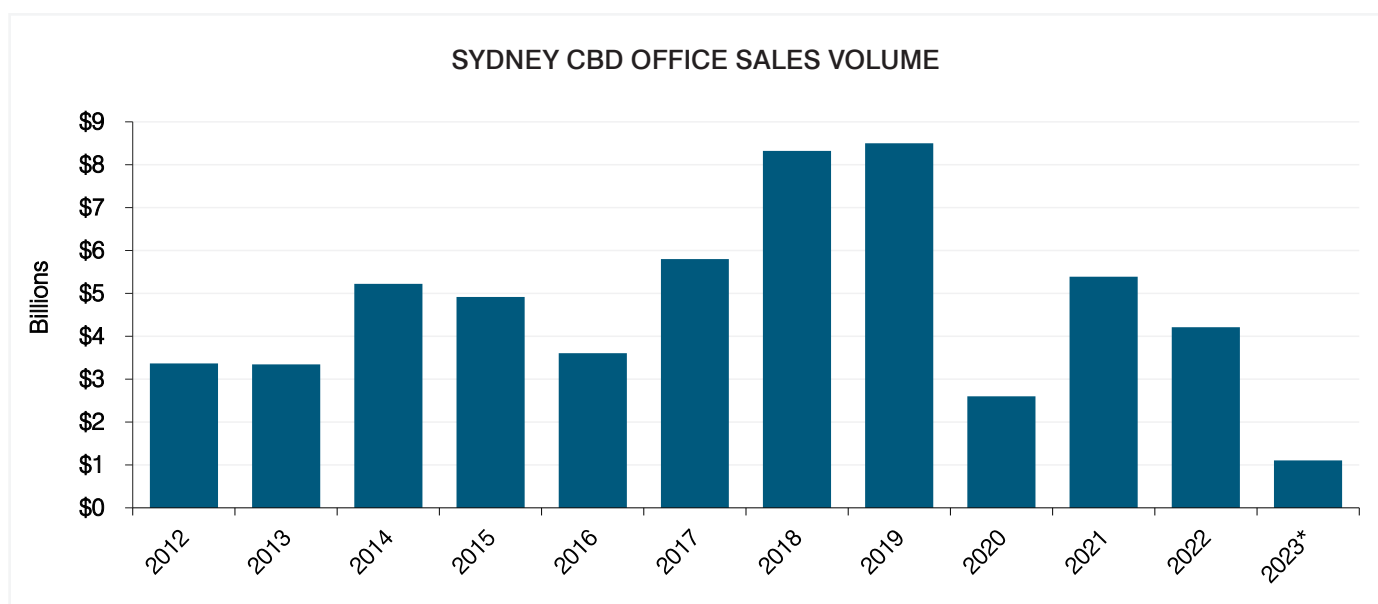
This may mean there is further yield decompression to come. The extent of this will be determined by interest rate trends and the cost of capital trends. Once one transaction occurs in the Sydney CBD office market, it will likely create a flow-on effect and we'll see more activity return to the market.



SYDNEY CBD OFFICE SALES VOLUME

Transaction activity in the Sydney CBD market has slowed considerably with an estimated \$1.08 billion of properties transacting in the year to date for 2023. This compares with \$4.21 billion for the whole of 2022. Increased caution entered the market during the second half of 2022, and this dampened investor demand.

Offshore groups, particularly groups from the Asia Pacific region, have consistently been the most dominant purchaser group in the Sydney CBD office market over the past decade (based on total \$ value of properties acquired).



Source: Real Capital Analytics (RCA), Cityscope, M3 Property

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