WESTERN SYDNEY INSIGHTS

Parramatta CBD Office Forecast

ISSUE 1

RWC WESTERN SYDNEY

PARRAMATTA CBD

Market Overview

As Australia continues in a post COVID-19 economy the affects on the economy and working population are expected to continue to be felt in the years to come. After enjoying record low interest rate levels, high inflationary pressures has seen rapid interest rate rises and despite the low unemployment level, little to no wage growth will continue to cause uncertainty across the broader economy.

For the office market, a reluctance for staff to return to the office on a full time basis has seen many businesses have to reassess their accommodation costs and needs particularly during this difficult period. The tight workforce has further pressured business with the need for greater flexibility with their employees to attract and retain staff, causing a change in workplace practices. A hybrid working model, the most popular with staff opting for a mixture of face to face and working from home methods which has reduced the footprint required for some businesses. This has been a direct source of increased vacancies over the last few years during a time where the Parramatta office market was in a high supply cycle. Over the last two years we have seen sub-lease vacancy rise together with the total vacancy rate but encouragingly this sub-lease factor has started to dissipate as more of the workforce return and businesses feel more confident in keeping their space for expansion and growth.

While the high vacancy environment is likely to maintain for the short to medium term, the Parramatta office market will enter a new supply phase focused on refurbishment. It is expected that as tenant relocation occurs, B grade assets will exit the market to undergo extensive upgrades to bring them up to expected prime levels. This will do much to keep vacancy levels in check for a prolonged period until robust underlying office demand returns to Parramatta CBD.

The locational advantages of Parramatta CBD have not gone away, the ongoing investment into infrastructure in the region improving its accessibility and attractiveness for growing and new businesses. The current roadblock being this changing face of the office workplace which will continue to evolve over time. The confidence in this office market highlighted by the high institutional investment, while this has slowed over the last few years it is anticipated to rebound particularly as rental growth potential emerges and yields become more aligned to historical rates.

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Managing Director, RWC Western Sydney

Total Office Stock	**959,878sqm**
New Supply	**1,800sqm**
Withdrawals	**0sqm**

Net Face Rents

Prime **$600/sqm**

Secondary **$473/sqm**

Forecast Net Supply

2H 2023 **20,863sqm**

1H 2023 **-5,000sqm**

Vacancy via Quality Grade

A Grade	B Grade	C Grade	D Grade
↓ **18.0%**	↑ **22.8%**	↓ **14.0%**	↑ **12.5%**

Sub-lease vacancy starting to stabilise as tenants pull back space as staff return to the office, current down to **0.8%**

Investment Yields

Prime ↑ **5.10%**

Secondary ↑ **6.00%**

6-month Net Absorption **12,985sqm**

12-month Net Absorption **20,523sqm**

Average incentives range from

33% — **40%**

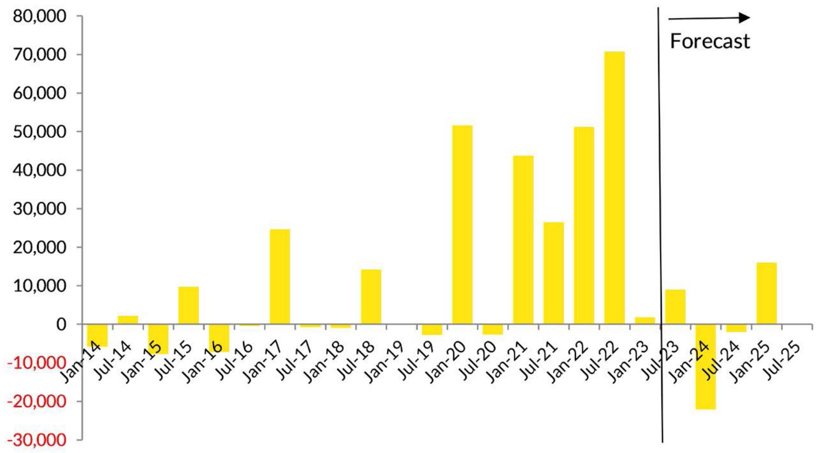
however, some have grown to **40%+** for some assets

SOURCE: PROPERTY COUNCIL OF AUSTRALIA, RWCWS

Office Markets

NET SUPPLY (SQM)

The supply situation for Parramatta will take some time to play through. While major completions which were highly anticipated including Parramatta Square are finalised, we will continue to see smaller new development trickle into the marketplace over the next 12 months. The bigger story for Parramatta being the churn of refurbishment space expected to exit and re-enter the market as tenants vacate their current accommodation. This year we will see the re-entry of 150 George Street bringing 21,964sqm of refurbished space together with the new 8,899sqm of 97 Macquarie Street with partial precommitment.



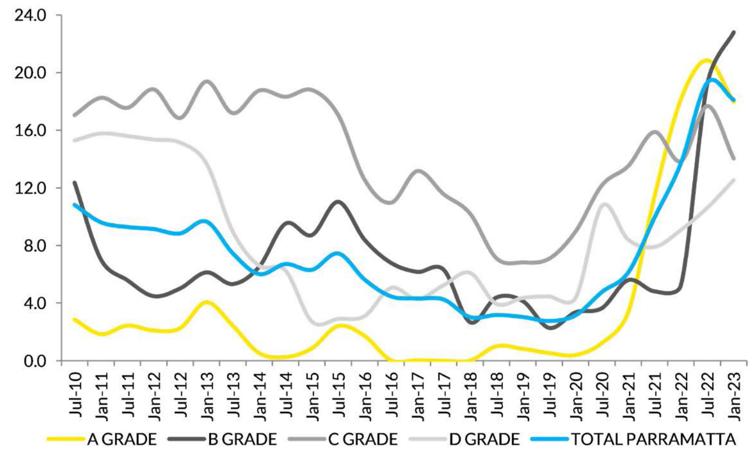
SOURCE: PROPERTY COUNCIL OF AUSTRALIA

As tenancies vacate properties such as Jessie Street Centre, Octagon, Lang Centre we will see greater stock exit the market, these greater withdrawals with subsequent re-entry 12-18 months later will prolong the high vacancy environment in which Parramatta finds itself. This is the likely scenario beyond our 2.5-year forecast period with high levels of withdrawals continuing as assets take this time to refurbish to a high standard in order to compete with the recently completed A grade stock seen across Parramatta CBD.

Office Vacancy

BY QUALITY GRADE (%)

After a prolonged period of low vacancies in Parramatta, there has been an adjustment to rapidly rising vacancy rates for the CBD over the last few years. While total Parramatta vacancies have fallen this period to 18.1%, this current cycle has seen vacancies peak beyond any other period for Parramatta, well ahead of the highs of the early 1990's albeit this current day market is close to 30% larger. Over the next few years, we expect to see the flight to quality continue to become clear, A grade vacancies falling this period to 18.0% after eclipsing 20% last year, while affordability will continue to be at play across the smaller C grade space which has reduced to 14.0%.



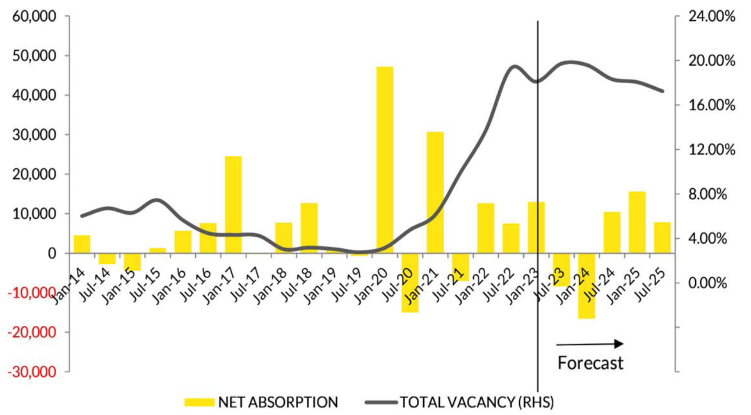
SOURCE: PROPERTY COUNCIL OF AUSTRALIA

The B grade office market is expected to be the hardest hit, currently at 22.8% this is well beyond any previous historical high. We will see over the next five years many of these assets exit the market for refurbishment in order to compete with the high-quality new A grade stock currently on the market. The small D grade segment will continue to decrease in size with assets being withdrawn which will help the growing vacancy rate currently at 12.5%.

Office Accomodation

NET ABSORPTION (SQM) & TOTAL VACANCY (%)

The supply pipeline for the Parramatta office market has been and will continue to be problematic over the short to medium term thanks in part to changing market conditions brought on by COVID-19. However, many of these changes in supply will be dictated by the fluctuations in demand for office accommodation. Over the last six months we have seen little supply additions however the high absorption of space into recently completed new office stock helping the overall vacancy situation. Looking ahead, we will see supply very slow to progress if not already under construction however the exit of stock for refurbishment will aid in keeping occupied stock levels more favourable. This market will grapple with the exit of tenants across the city and into other office markets pressuring absorption into the negative. This will keep vacancy levels at a prolonged high rate in the high teens over the next three years before some normalised tenant demand returns. While employment related growth is expected over the next few years, many businesses continue to be unsure with how to proceed with their accommodation requirements as work from home continues to change demand levels to account for more hybrid working models. With the labour market currently tight, businesses are forced to offer high levels of flexibility to their workforce which changes the volume of office stock they occupy. While this may be the new way in which we do businesses, it could also change if businesses require their staff to be in the office more frequently rising the need for office space once more.



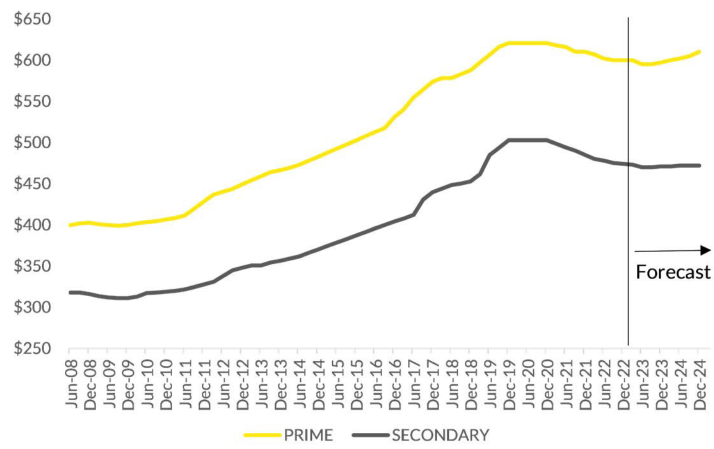
SOURCE: PROPERTY COUNCIL OF AUSTRALIA, RWCWS

Rental Markets

NET FACE RENTS ($/SQM)

The rental market continues to be one to watch for Parramatta CBD, like other Sydney office markets, rents have shown some minor declines in face rents while incentives continue to remain at a high rate, over 40% in some cases. Despite the expectation of high vacancies, we anticipate face rents to increase for prime assets given a combination of inflationary pressures and high construction costs impacting the costs of refurbishments, upgrades etc. While incentives will continue to play a large part in accommodation costs, the ability for owners to set new higher face benchmarks will be increasingly important with future increases aligned to CPI.

For secondary assets this may be less likely to happen, rents are anticipated to remain stable after showing a 6.2% decline since peak rates in late 2019, similarly incentives are expected to continue at their slightly lower rate with many owners not willing to be flexible on these terms.



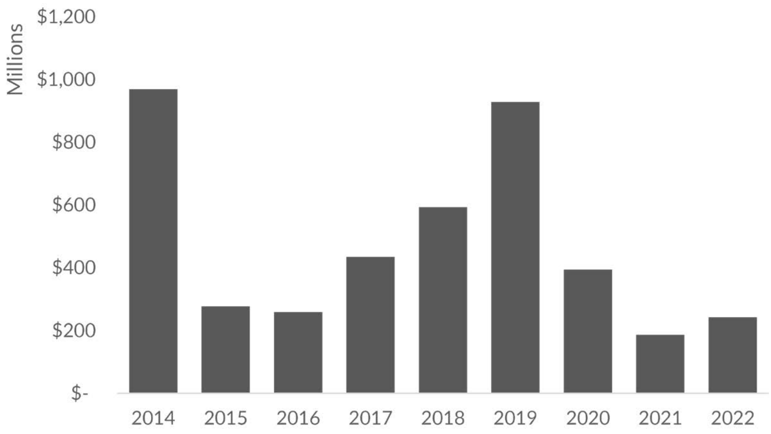
SOURCE: RWCWS

Currently net face prime rents are sitting in a broad $545-$660/sqm range averaging $610/sqm, while the gap to secondary has widened averaging $472/sqm within the $390-$530/sqm range. Encouragingly, enquiry levels have increased, and any prospective tenants are looking to possibly upgrade and snare a bargain however they are also looking for more flexible terms given the uncertainty of their accommodation needs longer term.

Office Transactions

VOLUME OF SALES

Over the last year transactional activity across most property types have declined, the continued uptick in interest rates doing much to hamper investment decisions while purchasers continue to look for a repricing of assets given the higher cost to finance. The high vacancy environment and uncertainty surrounding the future of office markets putting further hesitation in some prospective purchasers. In 2022 there was over $240million change hands across the Parramatta CBD office market down from close to $1billion which transacted in 2019 prior to the pandemic when vacancies were historically low, and rents were quickly rising.



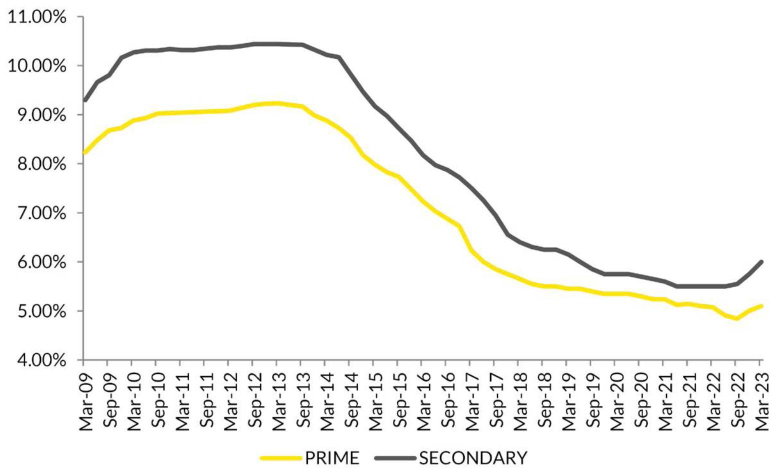
SOURCE: REAL CAPITAL ANALYTICS, RWCWS

Last year we saw a number of smaller freehold and strata assets sell, Dexus's sale to Mintus at 140 & 150 George Street for a reported $130million as well as 20 Smith Street selling earlier in the year for $87million on a quoted 4.6% yield. This tight yield highlighting the appetite for quality, tenanted assets particularly those which have lease growth potential and CPI increases.

Office Investment Yields

BY QUALITY GRADE (%)

The yield environment for office assets is going to be an interesting one for the next few years. After nine consecutive interest rate increases the cost of finance is pushing acceptable yield levels, particularly given the high vacancies of this marketplace. While tenanted investments continue to be attractive to many funds and trusts their returns need to be more aligned with investor expectations. Assets with long WALEs which offer regular rental increases to CPI are the most desirable in this current environment ensuring ongoing income returns set to the current high inflationary environment. Alternatively assets which have value add potential, be it for refurbishment, redevelopment and increased rental growth potential will be sought after albeit at the right price.



SOURCE: PROPERTY COUNCIL OF AUSTRALIA

We have started to see the average yield range grow in late 2022 and will continue to do so in 2023. Furthermore, the gap between prime and secondary yields are expected to further increase particularly given the high vacancy environment which has pressured secondary markets greatly due to the flight to quality by tenants to prime assets. Prime average yields have grown to 5.10% after bottoming out at 4.84% mid 2022, for secondary assets this average is currently 6.00% however expected to rise quickly despite the low of 5.50% seen last year.

Conclusion

The outlook for the Parramatta office market is mixed. While the fundamentals of region and its anticipated population gains, infrastructure improvements and overall city growth is positive, the overarching change in mentality surrounding office markets continues to cause some uncertainty. The Parramatta office market has seen a mismatch in supply and demand prior to COVID-19 which has been further exacerbated by these changing needs in accommodation by many occupiers.

Unfortunately for Parramatta CBD, we will continue in a period of high vacancy as the market grapples with the way forward to absorb backfill space together with being flexible with new and existing space users requirements. While we have seen some face rental compression, this is expected to be short lived due to the high inflationary environment, this will keep net face rents up while high incentive levels will reduce effective rental rates until vacancy levels are in check.

New supply is limited to a handful of projects with mooted developments unlikely to proceed unless high commitment levels are achieved.

Refurbished projects however are expected to pepper the market over the longer term keeping vacancy levels in check and upgrading secondary assets up to higher levels which are expected my this markets tenants.

Investment will continue however inline with the increased cost of finance, yields have seen some growth and this is likely to remain a feature of the broader office markets into 2023. Opportunistic investors will emerge in the marketplace seeking out assets which refurbishment potential and strong rental growth expectations aligned with CPI, albeit at the right price.

The fundamentals of Parramatta however cannot be downplayed, the access to the Western Sydney population and workforce, continued upgrades to local infrastructure and high-quality accommodation options all put Parramatta in good stead for the longer term. This economy will rebound, the Parramatta office market is likely to move faster than many other non-CBD markets given the high profile tenant mix which will continue to grow.

PETER VINES

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Who we are,
what we do,
why we do it

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