WESTERN SYDNEY INSIGHTS

Parramatta CBD Office Forecast

ISSUE 2

RWC WESTERN SYDNEY

Executive Summary

The Parramatta office market finds itself in a difficult position, strong supply additions over the past ten years which were intended to bring vibrancy and a new level of quality to the market has not entirely had the desired result. The CBD has grown its total stock level by close to 30% and now represents over 980,000sqm of office stock, cementing itself as Sydney's second largest city. With these high supply additions, this market boasts some of the newest and high-quality accommodation options in the country, with A grade stock accounting for 58.3% of the total Parramatta CBD. While no one could predict the change in working conditions borne out of COVID-19 dampening tenant demand, the sheer volume of new assets entering the market without full commitment have opened up A grade vacancies. This has a flow on affect to the secondary markets which historically already had elevated levels of vacancy.

Despite leasing demand at a low, Parramatta's A grade activity puts it as the fourth most active across the country in regard to net absorption behind Brisbane and Sydney CBD's and Canberra. Therefore, the difficulty in the leasing market is not restricted to Parramatta as prospective tenants are fewer and are more selective. The flight to quality is real with high quality assets offering substantial incentives luring tenants out of B and C grade stock causing record high secondary vacancies and keeping rental rates low and incentives up.

While work from home and new hybrid working structures can be blamed for the change in tenant demand, uncertainty within the economy, rising interest rates, high labour prices and inflationary pressures have seen businesses more conservative with their spending with accommodation costs one of the largest outgoings for any business. We have seen many occupiers particularly in the finance sector mandate staff back in the office on a quasi-regular basis however, until this is commonplace across the white-collar workforce, we will continue to see business consolidate their space and put off decisions to grow their footprint until greater certainty emerges.

This has already had a negative impact on rents and incentives which is expected to maintain in the short to medium term, particularly as vacancy rates approach 25% as vacations and supply additions continue (albeit at a lesser rate). Similarly, those assets which are plagued by high vacancies, particularly secondary assets may see negative capital value movements also fuelled by elevated interest rates. Investment yields have shown stability yet expected to increase, however there have been limited transactions over the past 12 months.

Despite some of the doom and gloom of the office market, the Parramatta CBD has grown its vibrancy with a strong residential population and busy retail hub. The advantages of this location being the centre of Sydney and gateway to the west cannot be denied. Already home to one of the busiest train stations on the network, stage 1 of the light rail project will be completed next year and confirmation that stage 2 will go ahead connecting through to Olympic Park will improve accessibility into the CBD.

The Parramatta office market has gone through its share of ups and downs over the years, in the early 1990's vacancy levels were elevated, government tenants dominated the tenancy mix with little demand by the private sector to occupy assets. However, today the CBD is home to some of the highest quality office assets and HQ to many multinational tenants. The attraction of the location cannot be disputed and while it may take some time for existing stock to be absorbed the long-term strength of Parramatta CBD cannot be discounted.

PETER VINES

Managing Director,

RWC Western Sydney

TOTAL OFFICE STOCK:	**980,835 SQM**
NEW SUPPLY:	**21,964 SQM**
WITHDRAWALS:	**947 SQM**

VACANCY BY QUALITY GRADE

A GRADE:	**19.4%** ↑
B GRADE:	**41.3%** ↑
C GRADE:	**19.8%** ↑
D GRADE:	**9.2%** ↓

NET FACE RENTS

PRIME	↘ **$595/SQM**
SECONDARY	↘ **$470/SQM**

INVESTMENT YIELDS

PRIME	↔ **5.10%**
SECONDARY	↔ **6.10%**

TOTAL VACANCY: 23.4% ↑

6-MONTH NET ABSOROPTION	**-35,023 SQM**
12-MONTH NET ABSOROPTION	**-22,038 SQM**

FORECAST NET SUPPLY

2023/24	**-32,101 SQM**
2024/25	**21,000 SQM**

Refurbished space expected to become a feature of this market over the medium term

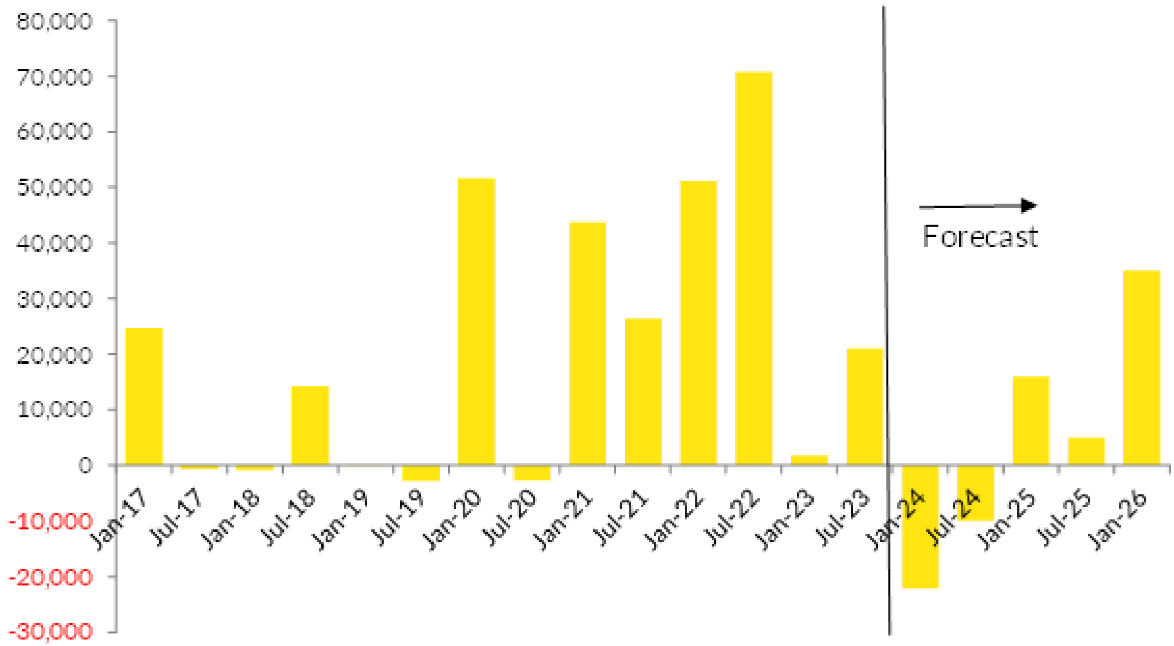
SOURCE: PROPERTY COUNCIL OF AUSTRALIA, RWCWS

Sub-lease space has remained stable at **0.7%** as employers hold onto space and encourage staff back into the office

Secondary asset owners are reluctant to grow incentives from the **35%-40%** range while Prime assets can attract as much as **45%+**

Parramatta CBD Office Forecast

NET SUPPLY (SQM)



SOURCE: SOURCE: PROPERTY COUNCIL OF AUSTRALIA, RWCWS

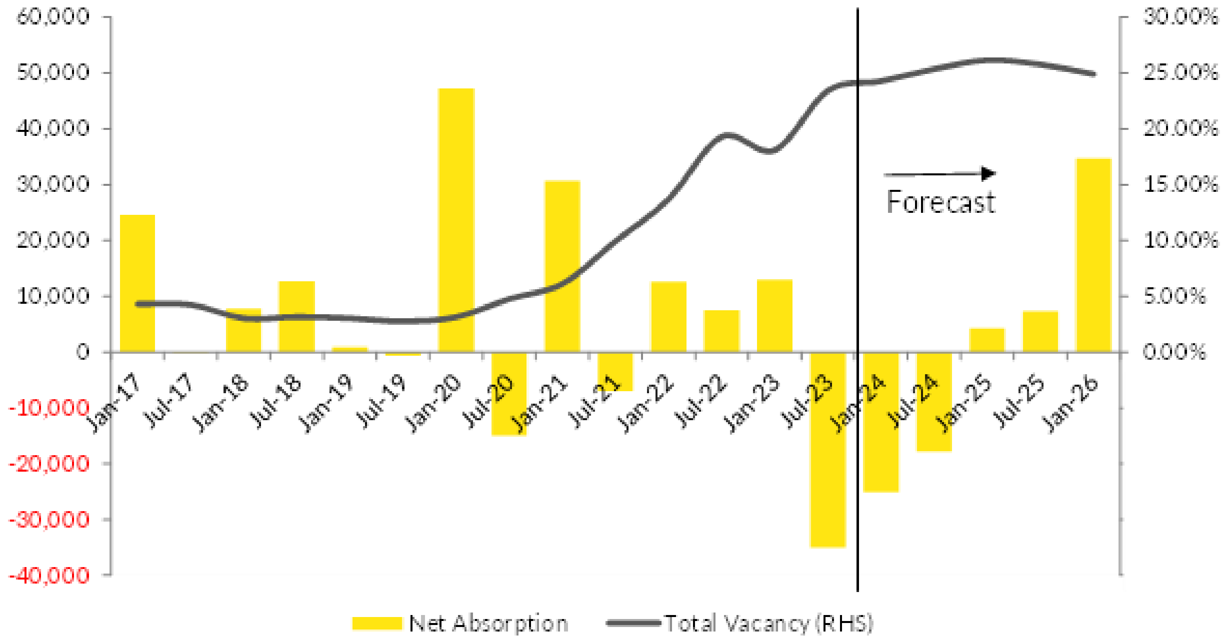
"It's unlikely we will see new development still in planning phases advance quickly unless pre-commitment is secured."

After multiple periods of high supply adding new and high-quality stock to the Parramatta CBD skyline, we are starting to see these levels subside with only a couple of smaller assets likely to be added over short term. 85 Macquarie Street is set for completion later this year with CBA partially committed adding approximately 9,000sqm of new space to market while next year 7 Charles Street will add a little over 5,000sqm of office in its mixed-use development. Other than these projects, we are unlikely to see other new development still in planning phases advance quickly unless pre-commitment is secured.

With the CBD still recording a few tenant vacations over the coming couple of years, we will see assets come out of the market starting a churn of stock withdrawals and re-entry of refurbished space over this period. Jessie Street Centre, Octagon and Lang Centre are prime candidates for refurbishment or redevelopment, bringing these assets up to A grade quality to compete in the current marketplace. As a result, we are unlikely to see total stock levels move above 1million sqm until the end of our forecast period.

Parramatta CBD Office Forecast

NET ABSORPTION (SQM) & TOTAL VACANCY (%)



SOURCE: PROPERTY COUNCIL OF AUSTRALIA, RWCWS

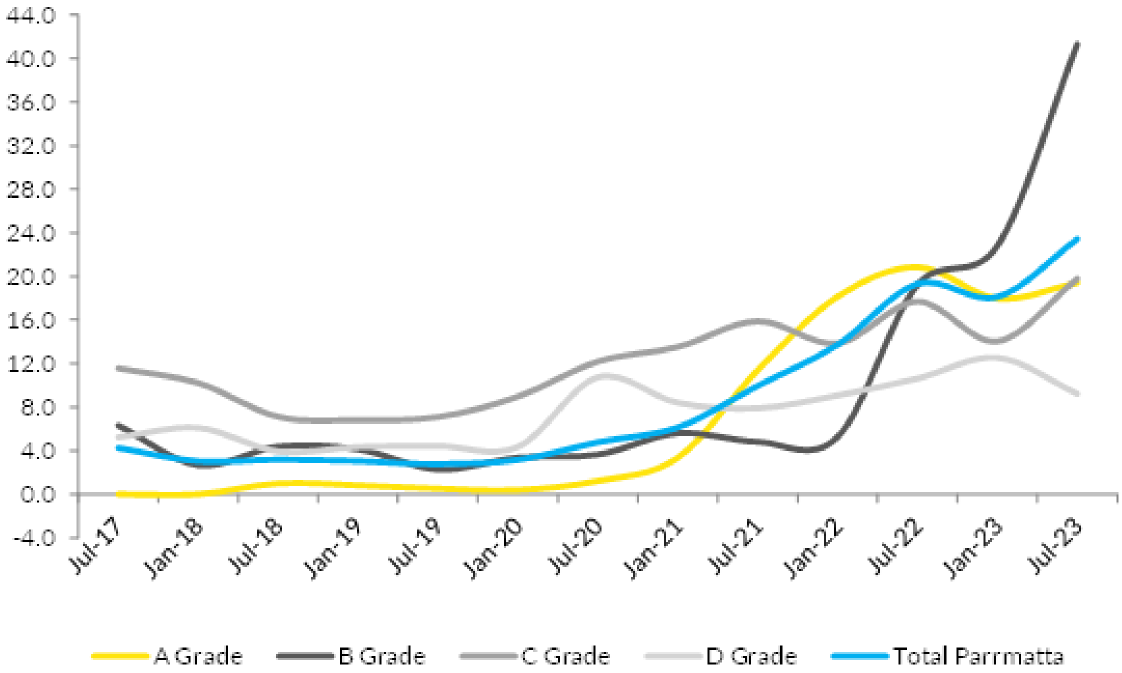
Demand for office stock in Parramatta CBD has seen a sizeable decline putting pressure on the overall vacancy rate. While for most of the periods post COVID-19, take-up has been in positive territory, the overarching increase in supply has had a devastating impact on the total occupancy level. More recently, the uncertainty in the marketplace surrounding employment and the future of the workplace has seen tenants slow to make decisions about their accommodation needs. Work from home and hybrid working models are all still playing through during this tight labour market. While some segments of the workforce have mandated return to work in some capacity, it will continue to be a slow burn until more businesses are at close to 100% occupancy and grow their office footprint accordingly.

Encouragingly however for Parramatta CBD, is the positivity surrounding prime office occupancy; while net absorption across the total market for the six months to July 2023 sits at -35,023sqm, the A grade market saw a positive increase of 9,739sqm (fourth highest of all Australian office markets) however the addition of refurbished stock hampered vacancy declines. This has been a trend seen much since COVID-19 with positive take up for A grade assets at the expense of B and C grade assets.

"Looking ahead we expect a further couple periods of negative absorption in response to known vacations and lacking demand fundamentals which will see vacancies eclipse 25% in the next 12 months before peaking at 26.1% in January 2025"

Parramatta CBD Office Vacancy

BY QUALITY GRADE (%)



SOURCE: PROPERTY COUNCIL OF AUSTRALIA

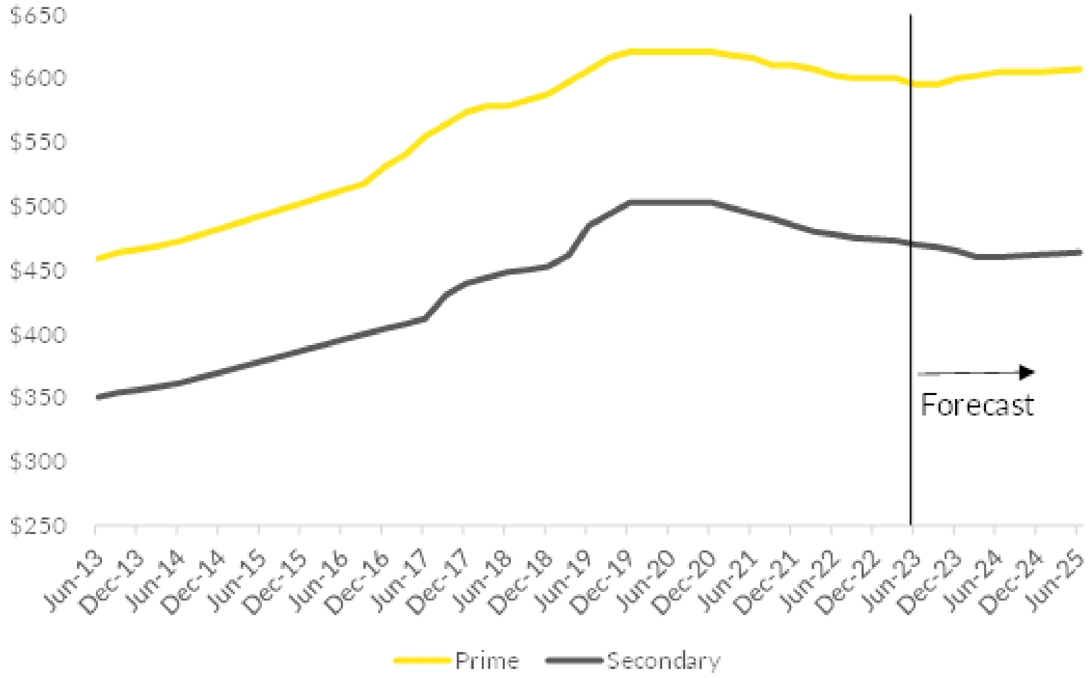
The Parramatta office market enjoyed a prolonged low in vacancies in the period prior to COVID-19. However continuous high supply was putting pressure on the market, in particularly secondary space with many tenants taking advantage of high incentives on offer to upgrade to new, A grade facilities. Since July 2020, there has been over 250,000sqm of new stock added to the market during a time of lockdowns and work from home mandates. More recently, there has been a slow return to the office spurred on by record low unemployment putting the negotiating power in the hands of employees, seeking a more flexible work life which includes working from home. As a result, many businesses have been in a state of limbo when it comes to making future decisions about their accommodation, uncertain as to their needs now and into the future.

Couple this limited tenant demand with high supply additions, we have seen a remarkable uptick in vacancies across the Parramatta CBD. While total vacancy currently sits at an all-time high of 23.4%, most vacancies are across the secondary market, with the flight to quality seeing many tenants upgrade into incentive high, A grade premises at the detriment of B grade space. Currently B grade vacancy is 41.3%, up from 22.8% just six months ago, C grade also increasing to the highest rate since July 1994, 19.8%.

For A grade space, results continue to highlight the mismatch in new supply additions and demand to occupy stock, currently vacancy sits at 19.4% even though annual take up has been positive since July 2019. Uncommitted supply being the stumbling block to the prosperity for the Paramatta CBD market which will take many years to be absorbed keeping vacancy levels elevated for this office market.

Parramatta CBD Office Forecast

NET FACE RENTS ($/SQM)



SOURCE: PROPERTY COUNCIL OF AUSTRALIA

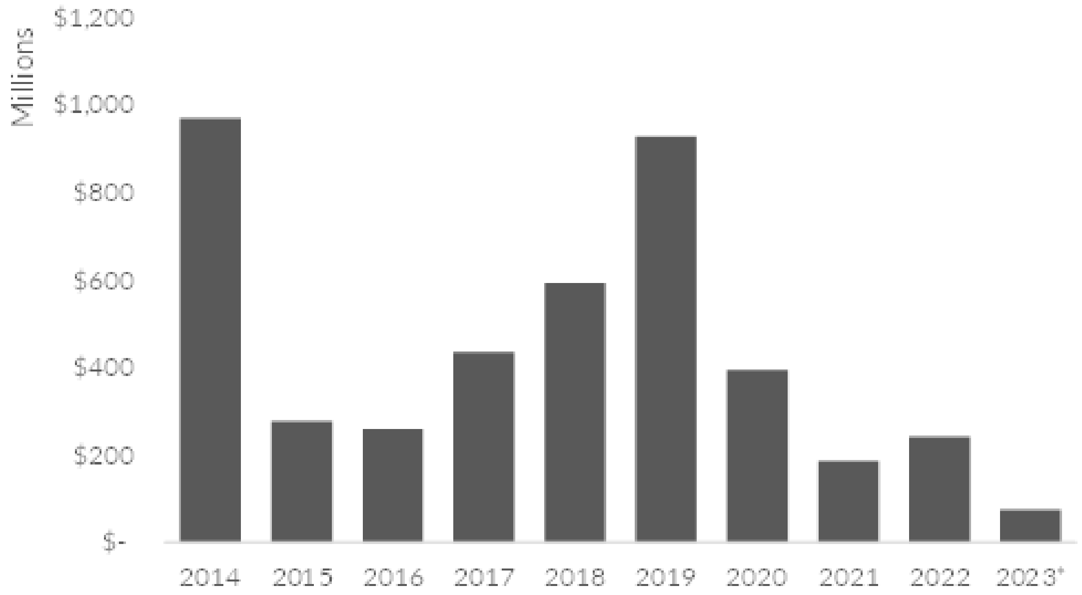
The office rental market has been tough across the country not just in the Parramatta CBD. High vacancies provide much choice to prospective tenants who are not showing urgency in proceeding and ensuring they achieve the best deal on offer, including seeking out opportunities in other markets. There has been a distinct flight to quality particularly in NSW, with demand to occupy stock firm on the A grade market, given the abundant new and refurbished assets available, all offering quality finishes and onsite facilities designed to encourage staff back into the office. Rents have not responded to the current supply/demand mismatch with the high inflation and elevated building costs to blame. High incentives, however, have been commonplace notably for institutionally owned assets, this putting downward pressure on secondary grade rents as vacancies continue to increase and many private owners unable or willing to upgrade or entertain increased incentives.

Despite the difficulties in the market, we expect rents to see limited movement over the short term. Currently net face prime rents are sitting in a broad $540-$660/sqm range averaging $595/sqm, while the gap to secondary has widened averaging $470/sqm within the $390-$530/sqm range and may see some further discounting. Tenants are seeking out lease structures which provide fixed increases (over CPI), flexibility to expand or contract and fitted out space continues to be an attractive drawcard.

"There has been a distinct flight to quality particularly in NSW, with demand to occupy stock firm on the A grade market, given the abundant new and refurbished assets available, all offering quality finishes and onsite facilities designed to encourage staff back into the office."

Parramatta CBD Office Transactions

VOLUMES OF SALES



SOURCE: REAL CAPITAL ANALYTICS, RWCWS *TO 1 JULY

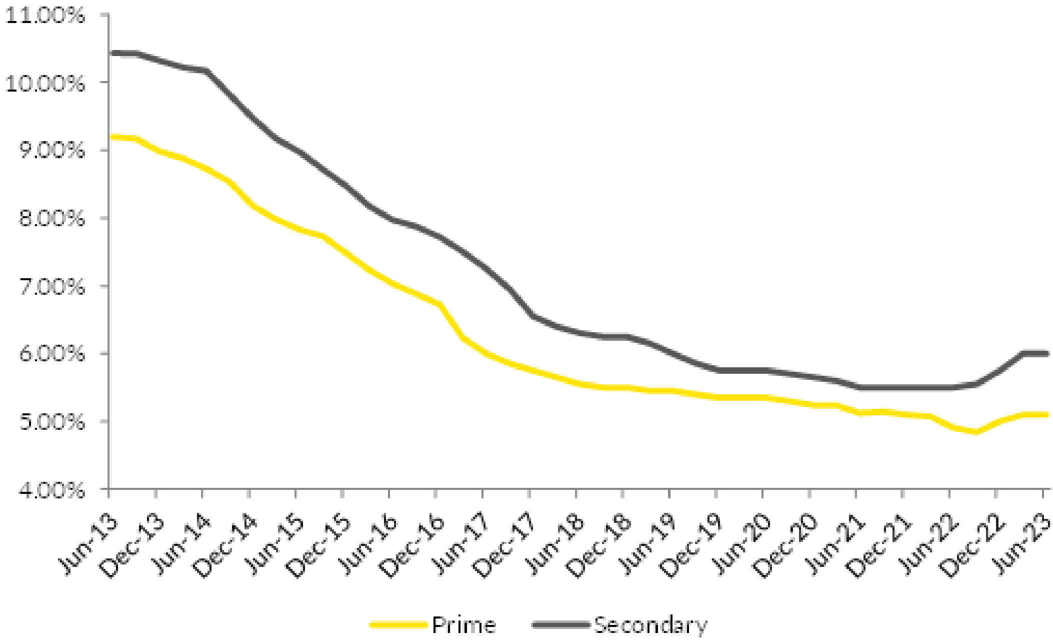
Unsurprising has been the subdued sales activity across the Parramatta CBD market this year, transactions have totalled $75.13million for the 2023 year to date. While smaller strata office space has successfully transacted, the sale of two larger B grade assets gives some confidence as to the expected future and longevity of Parramatta as an office market. 144 Marsden Street sold to the Uniting Church for $18million representing a tight yield, while some vacancies remain in this asset, a quality income stream together with development upside did not go unnoticed by the market. Similarly, 9 George Street and its modern construction and being fully occupied achieved a $49.6million sale to a private buyer taking advantage of its passing income of over $2.5million.

Limited office listings to buy will continue to be feature of the market this year, next year however we may see more motivated sellers in the marketplace, notably for secondary assets which are hampered by high vacancy. Institutional investment into office is expected to be limited, albeit new assets with high occupancy may change hands however market yield expectations will be interesting to watch play out, with rates achieved over the past few years unlikely to be repeated given the increased cost to finance.

"Limited office listings to buy will continue to be feature of the market this year, next year however we may see more motivated sellers in the marketplace, notably for secondary assets which are hampered by high vacancy"

Parramatta CBD Office Investment Yields

BY QUALITY GRADE (%)



SOURCE: RWCWS

After the RBA announced 12 interest rate increases since May 2022, the commercial investment market has seen significant declines. Total volumes across the country have reduced by more than a third however encouragingly, office assets remain the most attractive to invest in, despite the uncertainty surrounding occupancy levels spurred on by changing working conditions post pandemic. These declines in activity are apparent in the Parramatta CBD with limited turnover recorded this year, with uncertainty in the market, there is some reluctance to list, however there were a number of smaller private investor office suites change hands.

This year saw the sale of two B grade assets, 9 George Street which was fully leased selling on a tight 5.23% yield and 144 Marsden Street on a sub 5.00% yield. These quality results indicative of their high occupancy level, as average secondary assets continue to sit firm at an average yield of 6.00% within a 5.25% to 6.50% range. While no prime assets changed hands this period, yields too have remained stagnant at 5.10% within a 4.50% to 5.50% range. Data from MSCI on returns and yields for the office market, highlight some increase in average Parramatta yields since last year, averaging at 5.00% in March which is expected to increase next period as revaluation data becomes available.

Conclusion

The outlook for the Parramatta office market will be difficult in the short term. While supply additions have moderated the prospects of further refurbished supply being added to the market in the short to medium term will keep vacancies elevated. Total vacancy levels will reach 25.3% in July 2024 before peaking at 26.1% in January 2025 unless sizeable new tenancies are achieved across the market. It is expected that prime markets will see greater levels of take up over this period compared to the secondary market, resulting in a distinct two-tier market emerging when considering rents and investment activity.

While rents are unlikely to see any real growth over the next couple of years due to the stock available on the market, effective rates may see some improvement if incentives move from their current high. The flight to quality will remain as tenants seek out affordable A grade stock over secondary offerings however fully fitted out space and flexible leases continue to be sought after. The continued withdrawal of assets from the market for either refurbishment or redevelopment will keep supply levels steady until greater employment demand returns to the region.

Investment activity will be subdued for the remainder of this year; however, we may see some distress in the market in 2024 resulting in an uptick in assets coming to market. Yields will continue to show some increase particularly for those assets which have a short WALE or high vacancies. Despite current fundamentals for the Parramatta CBD office market being out of sync, the underlying strength of Parramatta as an office location cannot be denied. Ongoing improvements to infrastructure, coupled with its locational advantage and access to the working population will not go unnoticed by businesses and investors.

Parramatta is not the only office market to go through a period of uncertainty in this current environment, however the advantages of this location as the gateway to Western Sydney will see it regain its position as the most sought after and best performing non-CBD markets in the country.

PETER VINES
Managing Director,
RWC Western Sydney

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ZEINA TAJIK
Accounts

OPERATIONS

RUBY ROZENTAL
Director of Operations

HANNAH CARNEY
Operations Manager

PAULINE WATERFORD
Finance Manager

CHRISTIAN BRILLANTES
Office Assistant

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


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