Employment Lands

Commercial Office Report 2022

Commercial Office Report

Introduction

Commercial centres are areas of employment opportunities, particularly in the knowledge intensive sector, and are important for job growth. They are also central to Greater Sydney's global competitiveness, now and into the future.

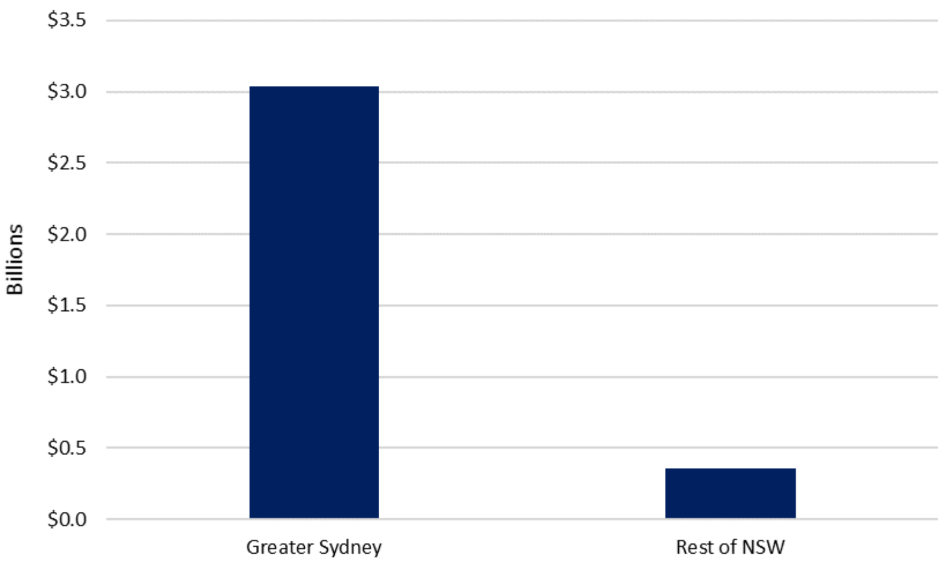
This report provides an analysis on the value of commercial office[1] approvals from 2021 ABS data (as at October 2022) including the value of alterations, additions and conversions (worth over $50,000). This data provides information about commercial buildings primarily occupied with or engaged in commercial trade or work intended for commercial trade. The data is used as a proxy to provide an estimate of the level of development activity of commercial lands in NSW. It also contains commentary on the demand for commercial property over 2021 and 2022 based on property analysts' reports, with the full impacts of COVID-19 yet to be fully determined.

Value of commercial approvals in 2021

Analysis of ABS data shows the value of commercial development approvals by district during the 2021 calendar year. Figure 1 shows that the vast majority of commercial development approvals by value occurred in Greater Sydney. Figure 2 shows that the Eastern City District contained the highest value of approvals, with a significant share also in the North District.

The top five LGAs by value of approvals were City of Sydney, Ryde, The Hills Shire, North Sydney, and Willoughby (comprising around 85% of total approvals). The City of Sydney alone represented around half of the total value of commercial approvals. Examples of approvals from the different districts are included in Table 1.

Figure 1. Value of Commercial approvals in Greater Sydney and Rest of NSW in 2021



[1] Defined as '231-Offices' and '291-Commercial building not elsewhere classified' under ABS Functional Classification of Buildings

Figure 2. Value of Commercial approvals by District in 2021

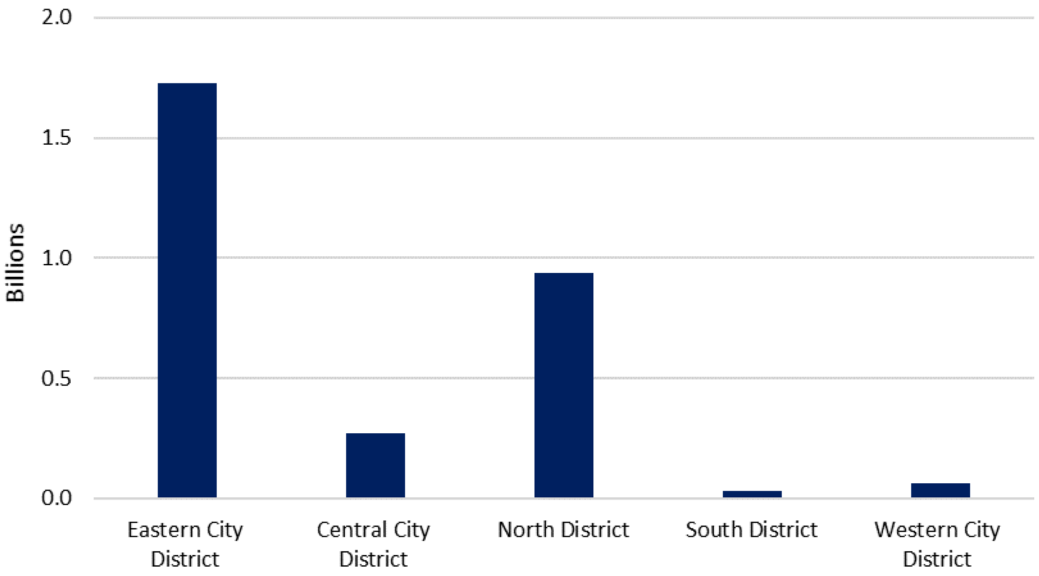


Table 1. Examples of commercial approvals

LGA	Suburb	Project	DA Value ($m)	Approval date
Liverpool	Liverpool	431 Macquarie Street Mixed Use Development	136.3	16/09/2021
Ryde	Macquarie Park	Waterloo Road Commercial Building	113.8	30/07/2021
City of Sydney	Alexandria	Equinix SY5 Data Centre	91.5	11/11/2021
City of Sydney	Sydney	317 & 319-321 George Street Commercial Building	44.7	17/12/2021
City of Sydney	Forrest Lodge	42-50 Parramatta Road Commercial & Community Development	15.2	09/06/2021

Commercial Office Performance by District

Eastern City District

Sydney CBD: At the time of writing (October 2022) overall office activity in the Sydney CBD is still heavily impacted by the pandemic and the subsequent shift towards remote working, though a strong economic recovery and historically low unemployment should support the demand for office space going forward. The vacancy rate rose to 10.1% in July 2022, significantly higher than the 3.9% in January 2020 prior to COVID-19[1]. The increase in vacancy is largely due to subdued demand and new office space coming to the market. Total net absorption – a measure of demand – recorded a positive 33,000 sqm over the 12 months to Julye 2022[2]. Both prime and secondary net face rents recorded small increases in the 12 months to July 2022. With incentives holding firm and an increase in face rents, net effective rents also increased. Forecasts suggest that vacancy has likely peaked and will remain elevated at around 10% in the near term before declining gradually further out[3].

North District

North Sydney: With the significant influx of new supply over the last two years and large tenant relocations the overall vacancy rate has increase to 19.3% as at July 2022. The rise in vacancy is largely attributed to 105 Miller Street sitting vacant. While this asset is reflected in the vacancy, it is not available for lease and therefore skews the real vacancy figure. Net effect rents for both prime and secondary markets increased 4% over the year.[4]

Chatswood: Subdued tenant activity in the Chatswood office market over the last two years, in conjunction with rising sublease availability, have been the catalyst for overall vacancy rate reaching a decade high level of 18.2% in July 2022. Prime grade net effective rents increased by 2.7% and secondary rents increase by 1.5% over the 12 months to July 2022[4].

St Leonards: Lead deal activity and demand has remained subdued in the St Leonards office market since the onset of the pandemic. The limited activity, in conjunction with negative absorption across the secondary market, has resulted in the overall vacancy rising to 18.6% as at July 2022, up from 16.5% in January. In the 12 months to July 2022 net effective rents have increase by 1.8%, a vast improvement on the double-digit declines experienced in late 2020. Secondary net effective rents increased by 1.6% during the same period[4].

Macquarie Park: Vacancy increased to 10.4% as at July 2022, from 9.3% a year ago. Despite the overall vacancy rate increasing, it is still considerably lower than its competing North Shore markets. With Macquarie Park supported by well-established industry clusters including government, tech pharma and biotech occupiers, it is one of the most resilient office markets. Prime net effective rents increase by 2.4% over the 12 months to July 2022[4].

Central City District

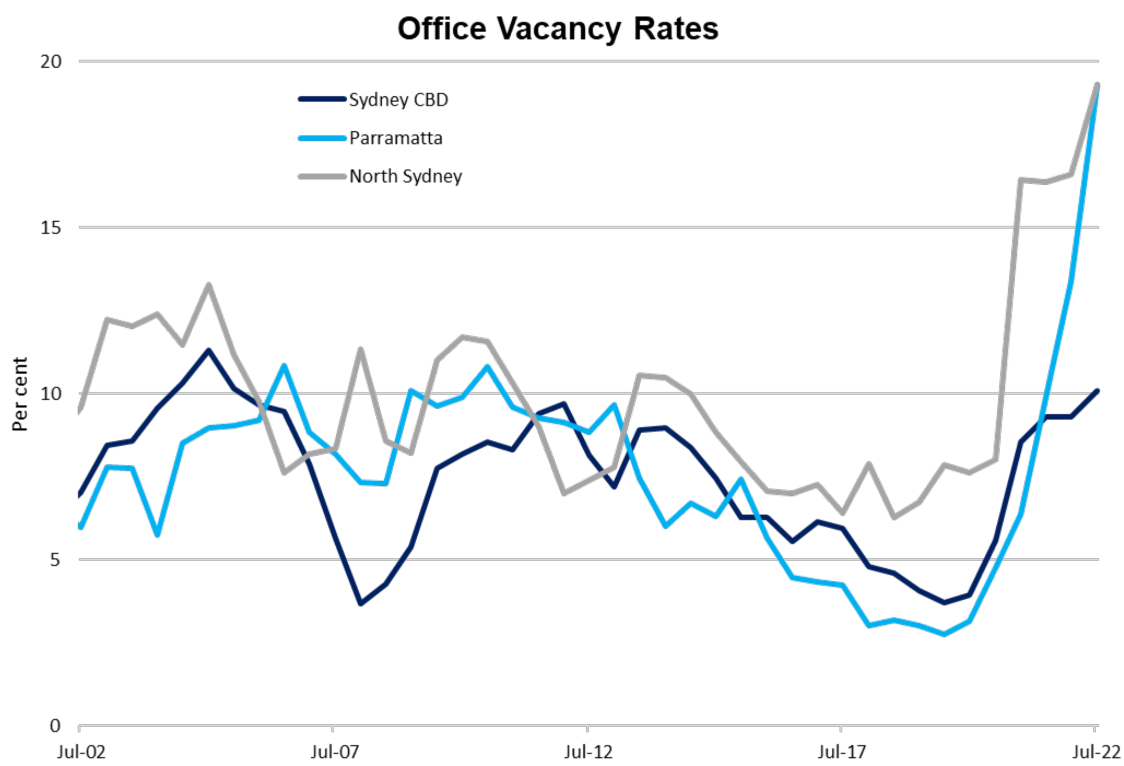
Parramatta: The Parramatta CBD office market is in the midst of major transition, as significant private sector investment coincides with a record level of NSW Government infrastructure investment. Over the last two years the office stock base has grown by an unprecedented 25%, making Parramatta the second largest CBD in NSW.

Overall vacancy increased from 13.4% in January 2022 to 19.3% in July 2022, well above the record lows of 3% in 2019. While tenant activity has been positive with absorption levels of 7,300 sqm recorded over the first half of 2022, the significant influx of new supply over the last year has been the catalyst for the rise in the vacancy rate[5]. Both average prime and secondary gross rents have remained broadly unchanged. But incentives have increased across the board with increasing availability of stock on the market. As a result, prime net effective rents declined 2.2% and secondary net effective rents decreased by 5.3% in the 12 months to July 2022[5].

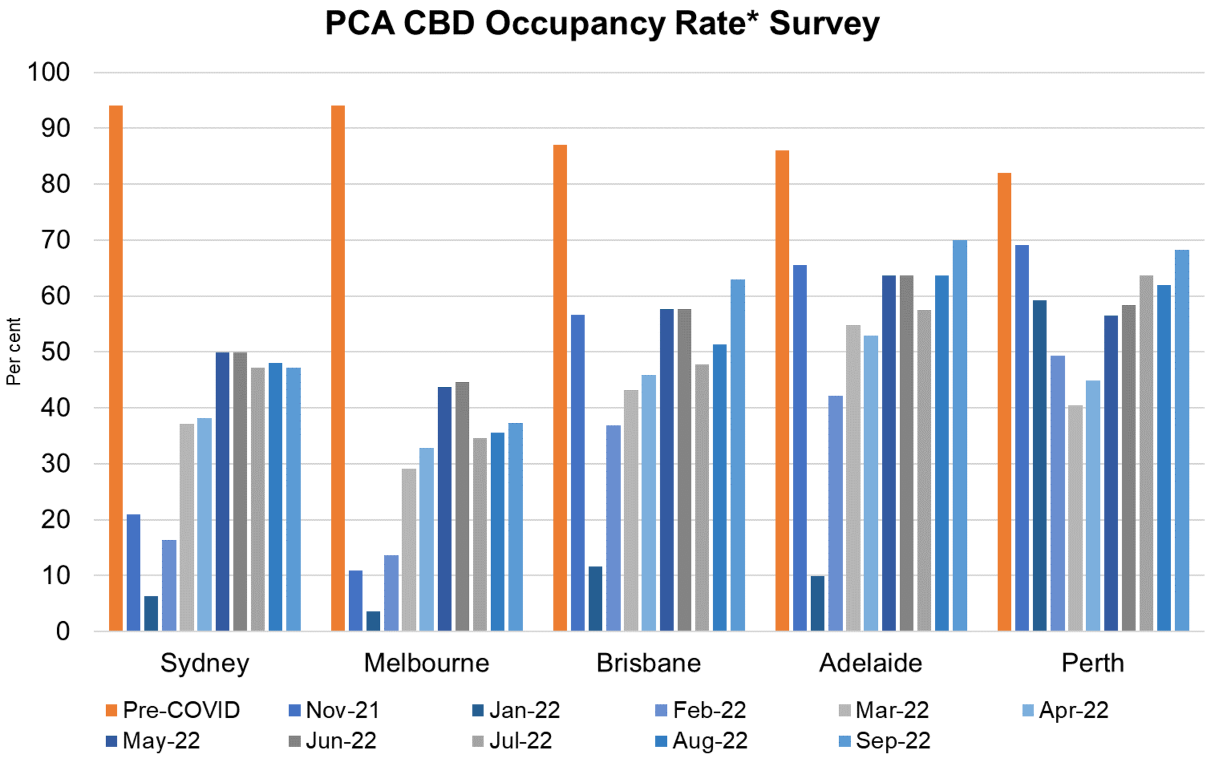
Recent Commercial Office Performance and the ongoing impact of COVID-19

Conditions in the Sydney Commercial Office market had been relatively tight prior to COVID-19 but deteriorated sharply as pandemic lockdowns were introduced. The Sydney CBD office vacancy rate rose to 10.1% over the 6 months to July 2022, from 3.9% in January 2020 prior to the pandemic[1].

Figure 3: Sydney office vacancy rates



While the vacancy rate steadily rose in Sydney CBD, monthly surveys on *actual* occupancy levels show a timelier picture of demand. Office occupancy rates prior to COVID-19 were estimated to be around 95%, but then fell markedly to 30% in mid-2020 with the onset of the pandemic restriction. There was a recovery over 2020 and the first half of 2021 to around 60%, but then plummeted to below 10% again during the second half of 2021 following the Delta variant wave and further lockdowns. Office occupancy rose again as COVID lockdowns eased over 2022 and plateaued at around 50%. [6]



Source: Property Council of Australia; DPE

While the pandemic itself and subsequent restrictions have largely eased, the impact of remote working and how employers use office space continues to impact office occupancy rates. As at September 2022, Sydney and Melbourne recorded the lowest office occupancy rates across all capital cities. These two cities were disrupted by the restrictions the most during the previous two years.

Demand for office space in Sydney is expected to gradually recover in the near term, now that restrictions have ended and economic conditions in NSW improve. However, the gradual improvement in demand is still likely to be overtaken by new completions coming onto the market as the construction industry works through its pre-pandemic pipeline. Vacancy rates are expected to remain elevated in the near term before gradually declining in the medium to longer term.

There are considerable risks surrounding both the demand and supply outlook for the office market. There is significant uncertainty surrounding how much office space is required as employers review workforce location strategies going forward based on productivity and employee preferences. A greater and more permanent shift away from the office would put more pressure on demand and keep vacancy rates elevated, and vice versa.

The office market is also in the midst of a substantial supply cycle, with a large number of projects with approval but not yet commenced in the pipeline, presenting considerable uncertainty to the supply timeline. Labour and material shortage, and ongoing global supply chain disruptions also add further uncertainty to the supply outlook.

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References

1 Knight Frank, (2022), Sydney CBD Office Market Report- September 2022

2 BIS Oxford Economics, (2022), Sydney CBD Office Market Report 2022-2032 - June 2022.

3 BIS Oxford Economics, (2022), Sydney CBD Office Property Prospects 2022-2032 - June 2022.

4 Knight Frank, (2022), North Shore Office Market - September 2022.

5 Knight Frank, (202), Parramatta Office Market - September 2022.

6 Property Council of Australia, (2022), CBD Office Occupancy Survey - October 2022.