Employment Lands

Commercial Report 2020

Commercial Report

Introduction

Commercial centres are areas of employment opportunities 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 building approvals from 2020 ABS data (as at August 2021) 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 early 2021 based on property analysts' reports, with the full impacts of COVID-19 yet to be fully determined.

Value of commercial approvals in 2020

Analysis of ABS data shows the value of commercial development approvals by district during the 2020 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, North Sydney, Willoughby, Blacktown and Ryde (comprising around 80% of total approvals). The City of Sydney alone represented almost 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 2020

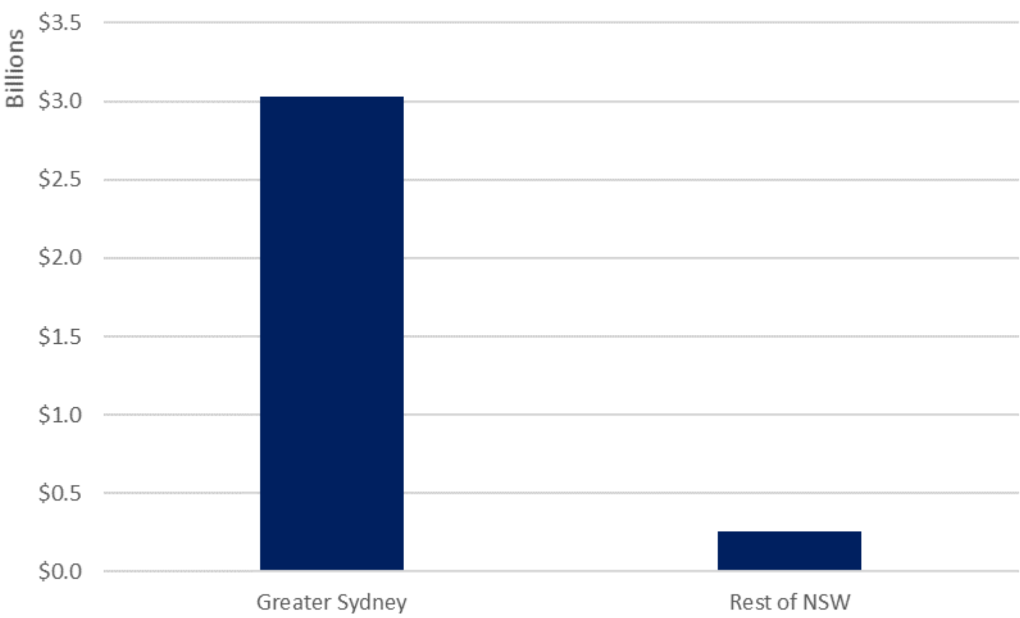


Figure 2. Value of Commercial approvals by District in 2020

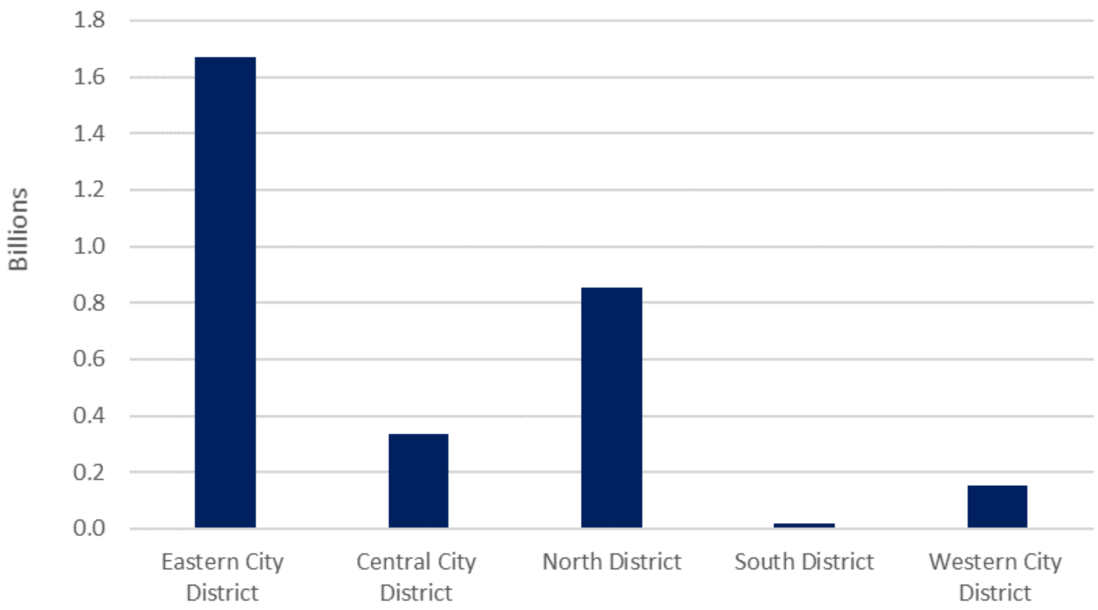


Table 1. Examples of commercial approvals

LGA	Suburb	Project	DA Value	Approval date
City of Sydney	Alexandria	Botany Road Commercial building	$44,110,000	16/11/20
City of Sydney	Alexandria	Mandible Street Commercial Building	$44,445,000	28/08/20
Liverpool	Liverpool	Westfield Liverpool Commercial Tower and Leisure Precinct	$93,442,000	06/02/20
Bayside	Mascot	Fifty Kent	$90,250,274	08/09/20
Bayside	Mascot	Coward Street Commercial Development	$51,819,000	08/09/20
Wollongong	Wollongong	Kembla Chambers	$38,781,000	26/08/20

Pre-COVID-19 Commercial Performance by District

Eastern City District

Sydney CBD: At the time of writing (September 2021) overall office activity in the Sydney CBD was heavily impacted by the pandemic and Delta lockdown. The vacancy rate rose to 9.2 per cent in July 2021, up from 3.9 per cent in January 2020 prior to COVID-19. Total net absorption – a measure of demand – declined to around negative 110,300 sqm in the 12 months to January 2021, which is below the 30-year average of 43,200 sqm. Since then the net absorption recorded positive 27,300 sqm in the 6 months to July 2021[1]. Corporates are reviewing their workforce location arrangements, and this has resulted in the contraction of some office space requirements. While the state and federal governments have provided numerous stimulus measure to help offset the effect of the downturn, there has still been short-term impacts to office demand. Sublease deals are averaging 12 per cent of leasing volumes so far this year, compared to the 5-year average of just under 2 per cent of total volumes. This has resulted in prime net effective rents declining 16.3 per cent in the 12 months to January 2021. Average secondary net effective rents declined by 19.2 per cent[2]. The Sydney CBD office market is expected to weaken further over the next 18 months, with vacancy rates rising and rents decreasing as supply outpaces weak demand[3].

North District

North Sydney: Like other markets, tenant demand in North Sydney has been constrained since the start of COVID-19. Record levels of new supply in 2020 coincided with limited occupier demand, resulting in negative absorption of 11,300 sqm being recorded in the 12 months to January 2021 and another 6,300 sqm negative absorption in the 6 months to July 2021[1]. Several large tenant relocations have been a catalyst for the rising vacancy levels, which has climbed to 15.9% as at July 2021[1]. Primary net effective rents dropped by 13.9% year on year while secondary net effective rents declined by 13.1%[4].

Chatswood: After reaching a 20-year low of 3.7% in January 2020, total vacancy has increased to 13% as at January 2021 and 15.2% by July 2021, including the relocation of NSW Health and Transport for NSW[1]. Net absorption was a historic low of negative 26,100 sqm in the 12 months to January 2021 and negative 5,800 sqm in the 6 months to July 2021[1]. With incentives increasing by 30%, net effective rents fell 14.5% and 13.8% for prime and secondary stock year on year[4].

St Leonards: The office market in St Leonards/Crows Nest area recorded a small positive net absorption of 1,900 sqm in the 12 months to January 2021, on the back of the NSW Health moving into its new headquarters. However, the market then recorded a negative net absorption of 1,300 sqm in the 6 months to July 2021[1]. Prime grade net effective rents fell by 13.8% while secondary rents declined 12.9% over the 12 months to January 2021[4].

Macquarie Park: Vacancy increased to 9.7% due to new uncommitted supply coming online amid a reduction in leasing demand in July 2021. Net absorption was negative 2,000 sqm in the 12 months to January 2021 and negative 600 sqm in the 6 months to July[1]. Prime grade net effective rents fell by 7.7% while secondary rents down by 8% over the 12 months to January 2021[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 State Government infrastructure investment. Whiles absorption levels were positive, a rise in vacancy was recorded due to the increase in supply and constrained demand in the secondary market. Overall vacancy increased from 3.2% to 6.4% in the 12 months to January 2021, and then spiked to 10.2% by July 2021 due to the Delta lockdown. Net absorption was positive 13,700 sqm in the 12 months to January 2021, though it turned to a negative 7,000 sqm in the 6 months to July 2021[1]. Uncertainty over the outlook for office demand and the increase in leasing options for tenants has halted any further fast rental growth and seen incentives rise since early 2020. Both average prime and secondary gross rents are unchanged as at January 2021. Though incentives have increased across the board, resulting prime net effective rents declining 8.5% and secondary net effective rents down by 12.5% in the 12 months to January 2021[5].

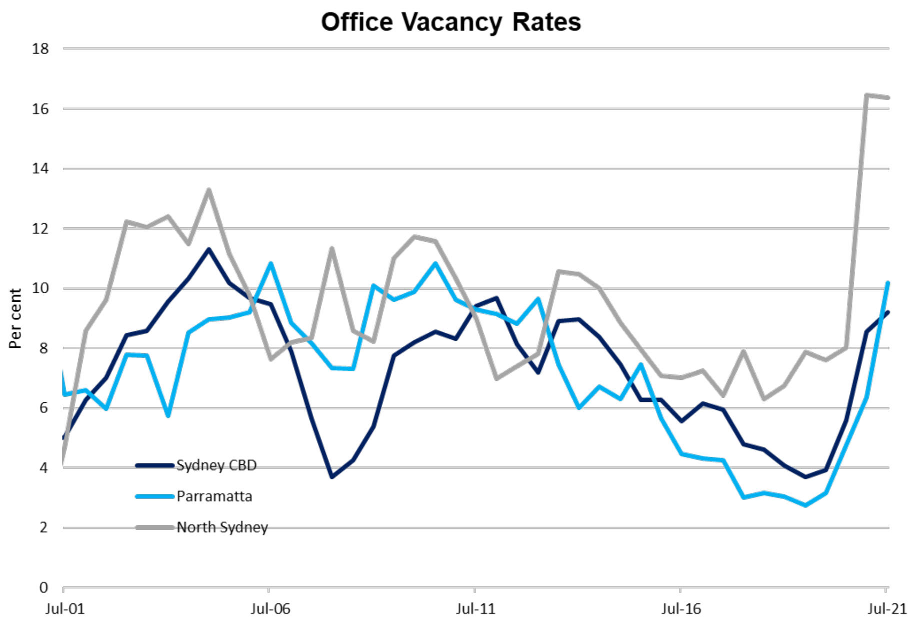
Vacancy is likely to rise in the near term on the back of backfill space, rising sublease availability and occupier contraction[5].

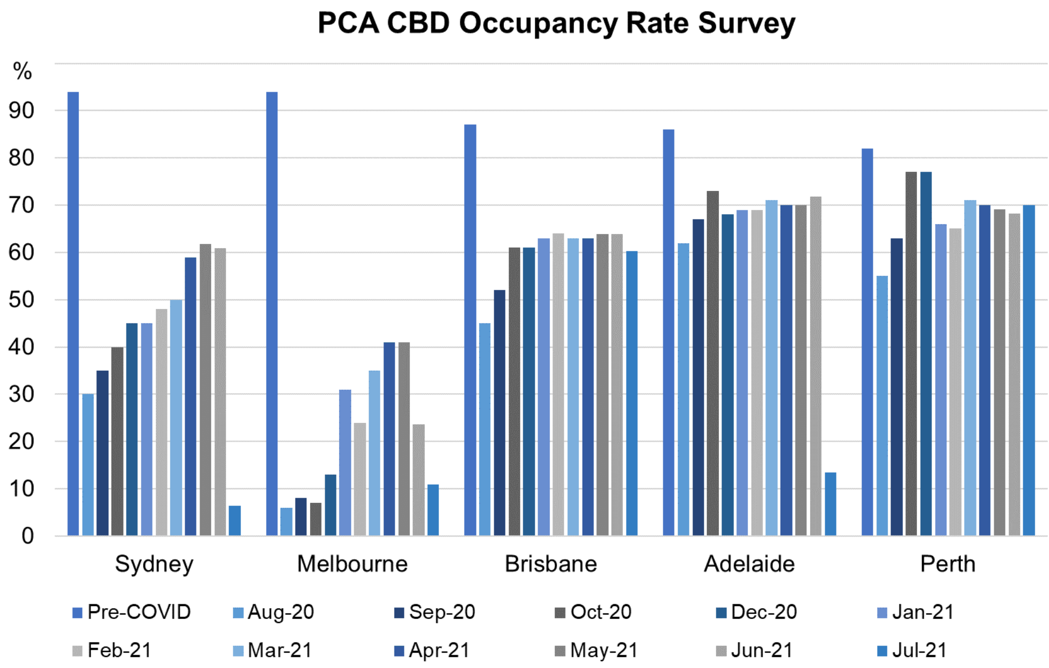
Recent Commercial Office Performance and the ongoing impact of COVID-19

Conditions in the Sydney Commercial Office market had been relatively tight prior to COVID-19. However, with the onset of the pandemic, economic downturn and restrictions, the market has deteriorated significantly. Vacancy rates rose to 9.2 per cent in July 2021, from 8.5 per cent in January 2021, and 3.9 per cent in January 2020 prior to the pandemic and lockdowns[1].

While the vacancy rate remains below 10 per cent in Sydney CBD, monthly surveys on *actual* occupancy levels show a more accurate picture of demand. Occupancy rates prior to COVID-19 were estimated to be around 95 per cent, but then fell markedly with the onset of the pandemic and restrictions to 30 per cent in mid-2020. There was a recovery over the second half of 2020 and first half of 2021 to around 60 per cent, but then plummeted to 7 per cent in August 2021 as a result of the recent Delta lockdown[6]. Looking ahead, the occupancy rate will highly depend on the duration and severity of any future COVID-19 outbreaks (particularly with the latest COVID Delta variant), the success of the vaccine roll-out program, and decisions by businesses on remote working arrangements.

Figure 3: Sydney office vacancy rates





Sources: Property Council of Australia; DPIE calculations

Even once the uncertainty surrounding the pandemic and restrictions ease, there will be ongoing uncertainty as to how much office space is required by corporates as they review workforce location strategies based on productivity and employee preferences. Demand for office space is expected to continue to decline in the near term given the number of staff working from home and reduced economic activity. Firms are expecting the use of remote working arrangements to remain higher than pre-pandemic over the long term and this will continue to weigh on demand for office space. [7]

Significant future office supply is coming online, and combined with subdued demand, office vacancy rates are likely to remain elevated for some time and hence rents are likely to remain subdued. Office construction activity over the next few years is likely to be well below 2020 levels. Few large-scale office projects have commenced construction since the beginning of the pandemic, consistent with the heightened uncertainty about the longer-term outlook for demand[7]. This has the potential to hinder the feasibility of new projects and associated construction jobs, although there will likely be some refurbishment activity so office spaces can better cater for the 'new normal' ways of working.

References

1 Property Council of Australia, (2021), Office Market Report - July 2021.

2 Knight Frank, (2021), Sydney CBD Office Market - March 2021.

3 BIS Oxford Economics, (2021), Sydney CBD Office Property Prospects 2021-2031 - June 2021.

4 Knight Frank, (2021), North Shore Office Market - March 2021.

5 Knight Frank, (2021), Parramatta Office Market Brief - April 2021.

6 Property Council of Australia, (2021), CBD Office Occupancy Survey - August 2021.

7 Reserve Bank of Australia, (2021),Statement On Monetary Policy – August 2021.