Employment lands 2020 report on commercial centres

Commercial centres are areas of employment opportunities and are important for jobs growth. They are also central to Greater Sydney's global competitiveness, now and into the future.

This report provides analysis of the value of commercial building approvals from custom 2019 Australian Bureau of Statistics data (as at January 2020), including the value of alterations, additions and conversions (worth more than $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 serves 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 in early 2020 based on property analysts' reports, without fully considering the impacts of COVID-19 on the market.

Value of commercial approvals in 2019

Analysis of Australian Bureau of Statistics data shows the value of commercial development approvals by district during the 2019 calendar year. Figure 1 illustrates the value of commercial development approvals in metropolitan and non-metropolitan NSW, with most approvals overwhelmingly occurring within metropolitan Sydney. Figure 2 demonstrates that the Eastern City District contained the highest value of approvals.

The top five local government areas (LGAs) with the highest value of approvals were City of Sydney, Parramatta, North Sydney, Lane Cove and Newcastle, or 82% of total approvals. The City of Sydney alone represented 44% of the total value of commercial approvals, followed by Parramatta, with 23% of the total value of approvals. Table 1 includes examples of approvals from the different districts.

Figure 1. Value of Commercial approvals in metropolitan and non-metropolitan NSW in 2019

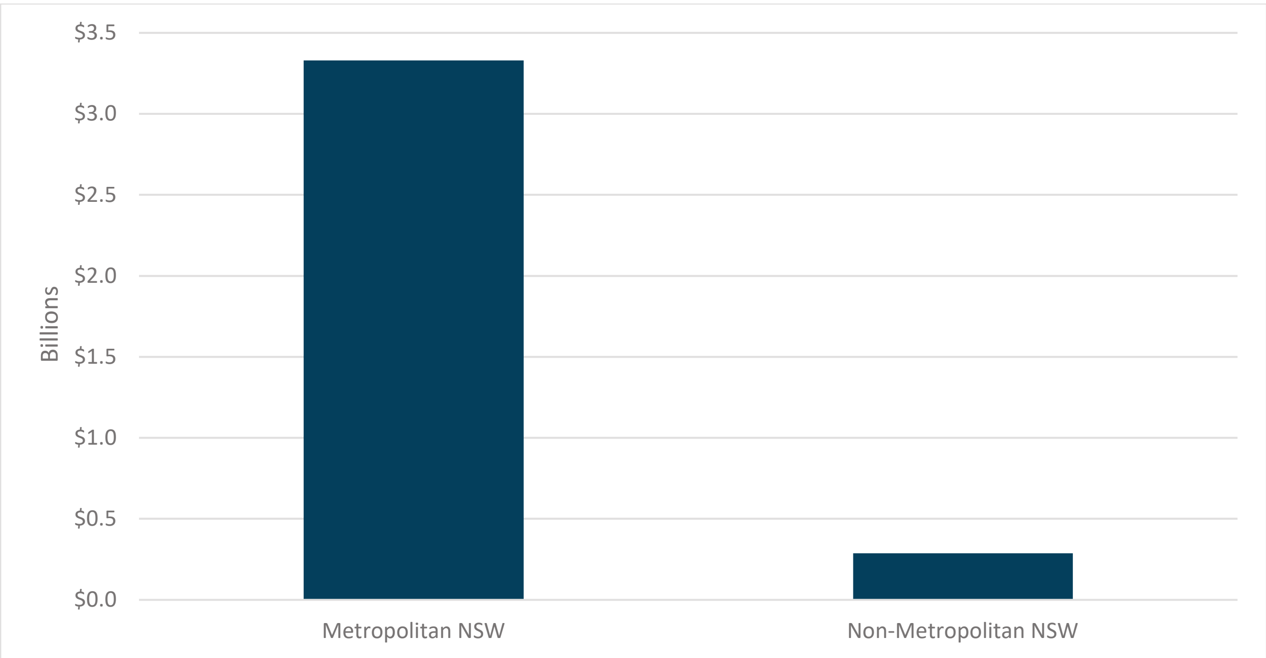


Figure 2. Value of Commercial approvals by District in 2019

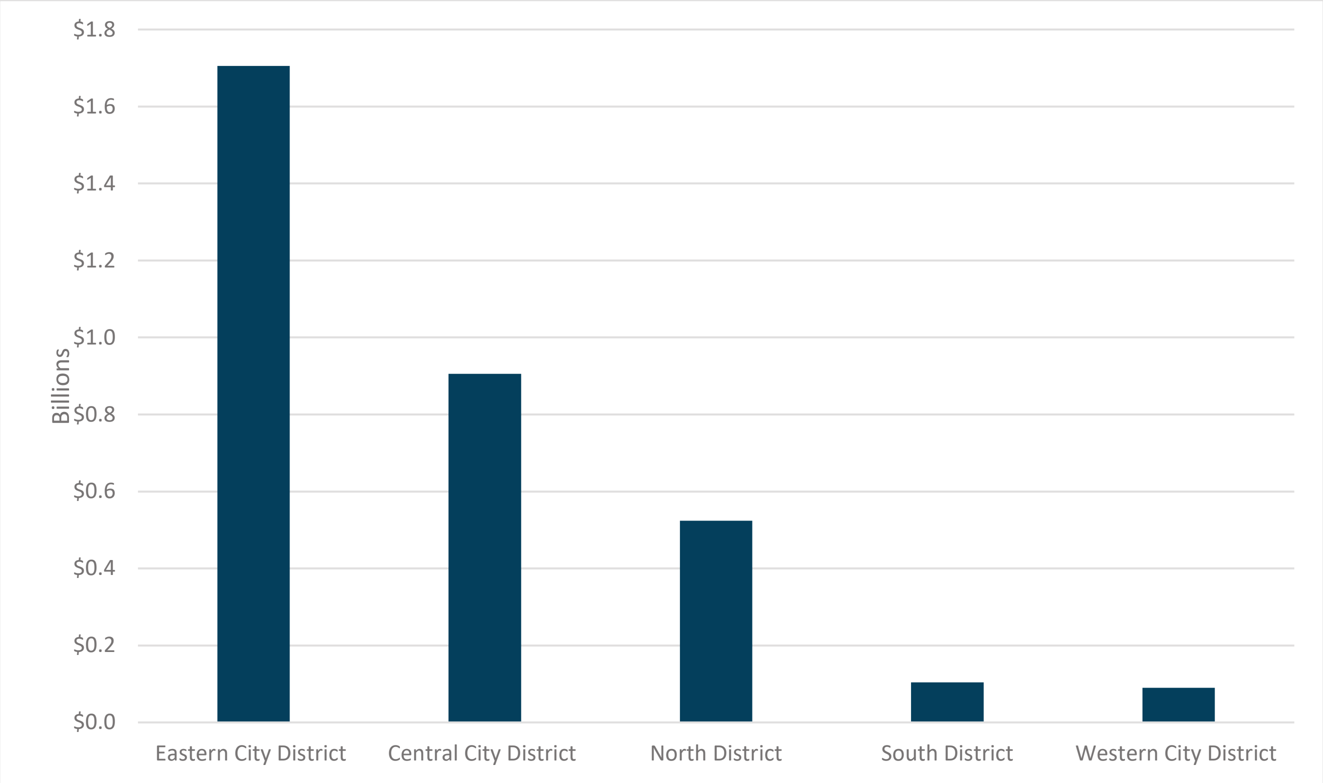
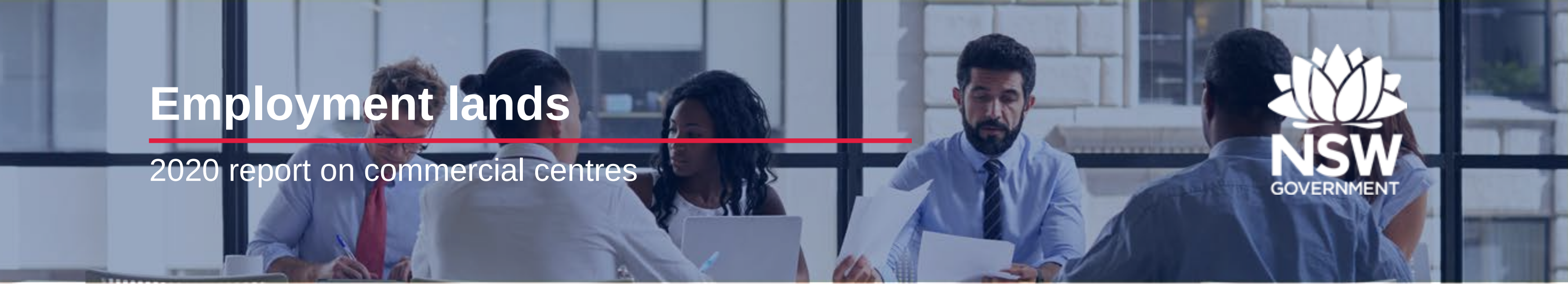


Table 1. Examples of commercial approvals

LGA	Suburb	Project	Development application value	Approval date
City of Sydney	Darlinghurst	249-255 Crown Street redevelopment	$12,452,000	07 February 2019
City of Sydney	Pyrmont	88 Harris Street	$21,978,000	02 October 2019
City of Sydney	Sydney	Charles Plaza office fit out	$14,728,000	14 November 2019
City of Sydney	Sydney	Sydney Metro Pitt Street North Over Station Development	$281,599,000	25 June 2019
Ryde	Macquarie Park	Khartoum Road Development	$81,271,000	04 December 2019
Ryde	Macquarie Park	Macquarie Park Commerce Centre	$334,840,000	31 December 2019



Pre-COVID-19 commercial performance by District

Eastern City District

Sydney CBD: Analysts indicate that property vacancy for prime grade space remained at record-low levels with a 3% vacancy rate as of January 2020 (down from 3.7% the previous year).[1] Secondary office space fared worse, with a negative net absorption of 83,606 square metres over the year, pushing the vacancy rate up to 5.4%.[1] These combined rates mean that total vacancy across the Sydney CBD fell to 3.9%.[1] The reason behind low vacancy rates was strong demand for prime office space as well as secondary office space coming off the market for refurbishment[1]. These factors led to prime and secondary gross effective rents increasing by 7.8% and 3.6%, respectively, over the 12 months to January 2020. [1] Investment within the CBD remained strong, with sales of $9.17 billion for the 2019 calendar year. This is up 23% on 2018 and more than double the 10-year average of $4.17 billion[1], with both domestic and foreign investors contributing.[2]

North District

North Sydney: Strong demand for new office developments brought the prime vacancy rate down to 8.3% and the secondary vacancy rate to 7.2%, with technology and media companies accounting for 44% of leasing volumes in 2019[3]. Rents continued to grow above trend with prime increasing 5.1% year on year and secondary increasing 6.4%. Investment was strong with transaction volumes of $1.59 billion, more than double the historical average.[3]

Chatswood: The vacancy rate was at a 20-year low of 3.7% in January 2020, with both prime and secondary markets tightening considerably.[3] The prime office vacancy rate is the lowest among North District markets with a vacancy rate of 2.1%.[3] With incentives stabilising, net gross rents grew 7.4% year on year.[3]

St Leonards: Below average vacancy rates and committed future supply contributed to above average rental growth of 5.3%. Demand for secondary market office space saw the vacancy rate tighten from 9.4% down to 7.4%, offsetting the 1.8% increase in prime office vacancy.[3]

Macquarie Park: Demand remained strong through the year with most tenants renewing leases, and this saw the vacancy rate decline to 4.4% in January 2020.[3] Prime grade rents grew by 4.6% and secondary rents grew by 5.2%[3]

Central City District

Parramatta: Pre-commitments and continued demand in Parramatta have continued to push prime vacancy rates down to 0.4% as of January 2020.[4] So, Parramatta had the lowest prime vacancy rate in the country. The only new addition to the market was 4 Parramatta Square which added more than 63,000 square metres and was 98% pre committed to the NSW Government. Within the secondary market, the vacancy rate increased to 5.2%.[4] This in turn represents a slight increase in overall vacancy from 3% to 3.2% in the 12 months to January 2020.[4] This low level of vacancy pushed up face rents by 5.8% year on year, running above the 10-year average of 4.9%.[4] Due to high demand for prime office space in Parramatta, incentives remained steady at 18%, resulting in 7.1% year on year net gross rent growth. [4] In the secondary market rental growth was more subdued at 2.7% with prime incentives remaining the same at 19.4%.[4]

In Parramatta, there is currently more than 216,000 square metres of stock under construction, with approximately 60% of the floor space securing pre-committed leases. [4]

Recent commercial performance and the impact of COVID-19

Conditions in Sydney commercial office markets had been relatively tight before COVID-19, with the vacancy rate at near record lows of 3.9% in January 2020.[5] However, conditions have deteriorated in recent months given the economic downturn and changing expectations of future office use. Vacancy rates rose to 5.6% in July 2020, and mobility and survey data suggests that although offices are not technically vacant because they have an existing lease, surveys on actual occupancy levels are quite low, at approximately 35% in September 2020.[5,6] Accordingly, there is a risk of declining rents and capital values.

Figure 3: Office vacancy rates for capital city CBD markets

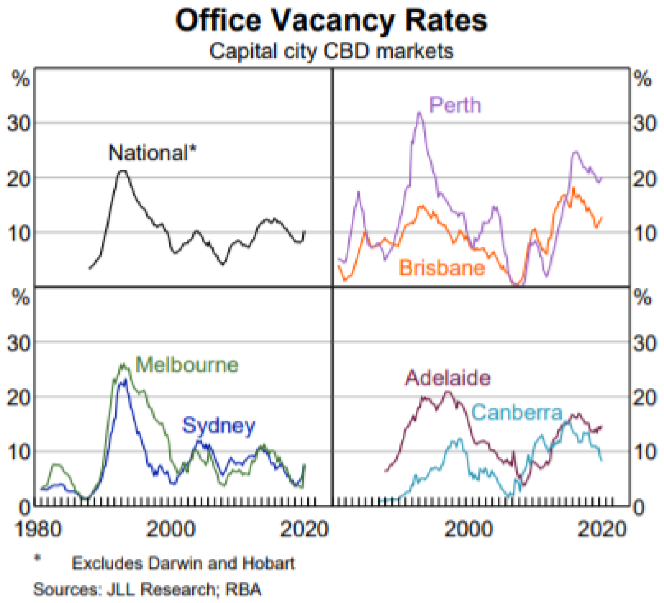
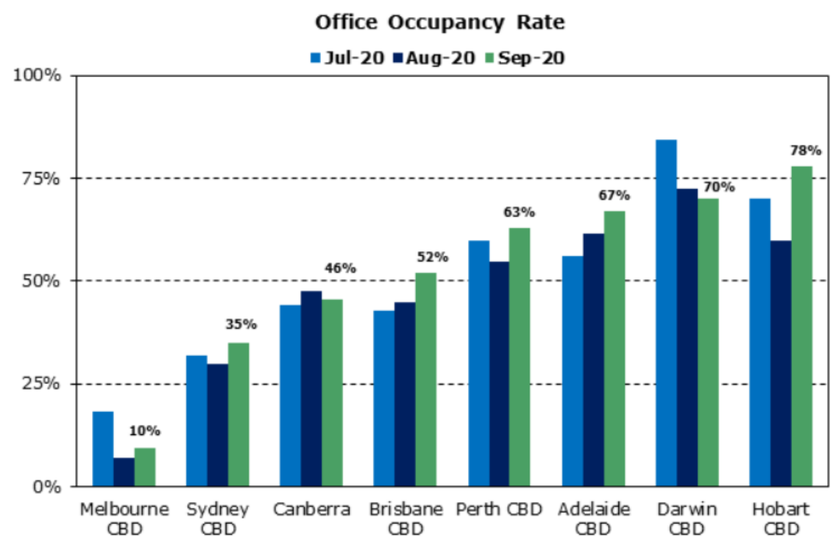
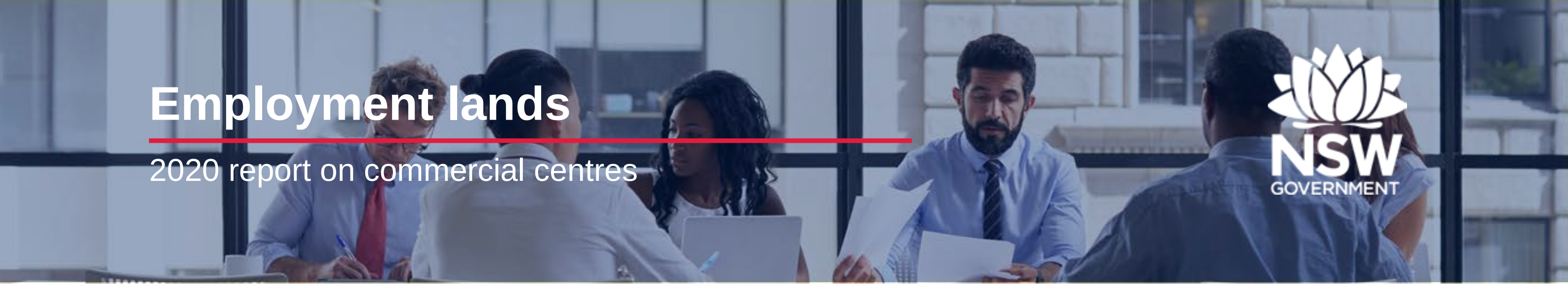


Figure 4: Office occupancy rates July–September 2020



Source: Property Council of Australia

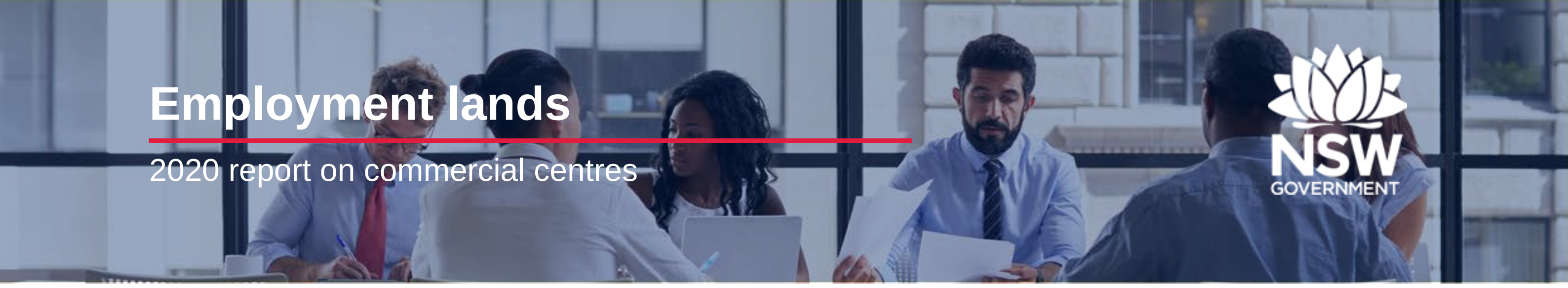
The severity of declining valuations, rents and construction will depend on a few key factors;



- the duration of the pandemic and associated social restrictions
- the severity and duration of the economic downturn
- corporate decisions as to where employees work and how often

We expect demand for office space to decline in the near term given the number of staff working from home and reduced economic activity. There is also potential for decline in the long-term, as businesses may decide to allow more remote and agile working. However, a key factor that may increase demand for office space is if evidence develops of significantly higher productivity in office environments compared with remote working.

In addition to demand uncertainty, an above average volume of new office buildings has been completed in Sydney in 2020, increasing supply. Although most of these new buildings have pre-committed tenants, the extra supply will put further pressure on vacancy rates, rents and valuations, and therefore potentially inhibit the construction pipeline[9]. The gross floor area necessary for each employee may also continue to decline.



General Sources

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[1] Knight Frank, 2020, Sydney CBD Office Market - Overview - March 2020

[2] BIS Oxford Economics, 2020, Sydney CBD Office Property Prospects 2020–2030.

[3] Knight Frank, 2020, North Shore Office Market Overview—March 2020.

[4] Knight Frank, 2020, Parramatta Office Market Brief—March 2020.

[5] Property Council of Australia, 2020, Office Market Report—July 2020.

[6] Property Council of Australia, 2020, ‘New data backs PM's calls to return to office’, research.propertycouncil.com.au/blog/new-data-backs-pms-calls-to-return-to-office