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Investa Inside

Office Market Outlook
January 2018

Five themes to watch across Australian office markets in 2018

- **Strong construction, weak supply**: Commercial office construction activity is surging, however near-term supply remains weighed down by previous years of weak development.
- **Solid underlying demand, tighter vacancy**: solid office employment to continue to absorb vacant space and tighten market conditions across most major office markets.
- **Incentives elevated, rents to continue growing**: strong market conditions in Sydney and Melbourne to maintain rent increases, while incentives remain historically elevated.
- **Workspace design to support tenant flexibility:** office design will focus on customer-centric innovative solutions, including collaborative working and higher technology specifications.
- **Cap rates to break new ground**: Australian office market cap rates are expected to drive even lower.

Theme 1: Strong construction, weak supply

The pendulum of property construction has swung strongly from the residential sector to the office sector over the past year. In the year to June 2017 new office development activity added around $6.2 billion to Australian economic activity, with a further $3.8 billion of commercial office projects approved since then (Charts 1 & 2). However, office supply in 2018 will remain weighed down by weak development in previous years. In addition, temporary withdrawals of existing office space for redevelopment or refurbishment will drag the availability of office space lower in the Sydney CBD and Brisbane CBD markets in 2018.

Chart 1: Building approvals by sector

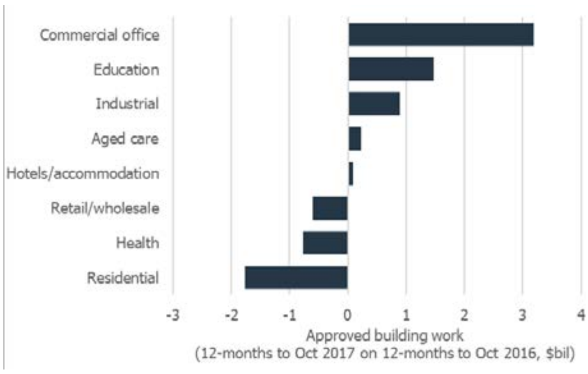


Chart 2: Building work commenced by sector

Source: ABS & Investa Research

Theme 2: Solid underlying demand, tighter vacancy

Despite some easing in white-collar employment and softer office net absorption in the major capital cities through 2017, underlying demand in Australia's major CBD office markets is expected to be strong in 2018. Positive business conditions in the finance, property and business services sectors, combined with elevated business confidence and improving global economic growth foreshadow increased employment in office-based businesses in 2018 (Chart 3). In comparison to weak supply (see Theme 1), most major Australian capital city office markets will be undersupplied through the year, driving vacancy rates lower (Chart 4).

Chart 3: Business conditions & office net absorption

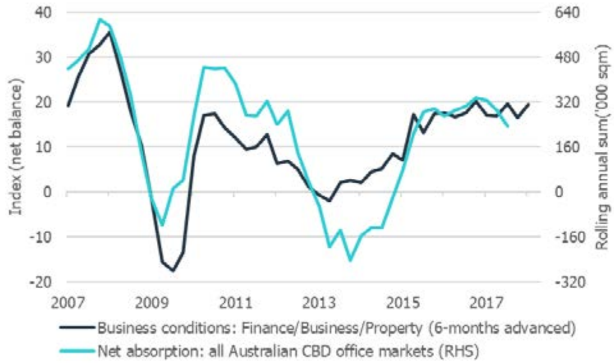
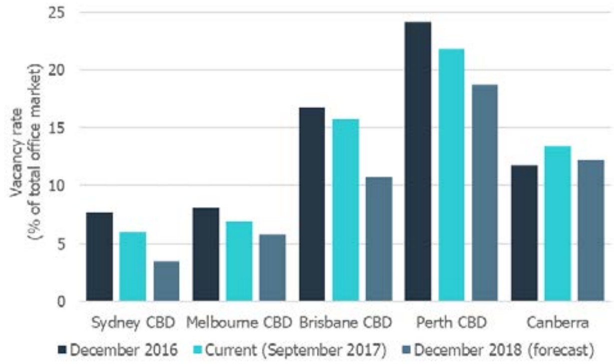


Chart 4: Office market vacancy rates



Source: JLL Research, NAB & Investa Research (incl. forecasts)

Theme 3: Incentives elevated, rents to continue growing

Ultimately the balance of supply and demand, and tighter vacancy across Sydney and Melbourne in particular, will continue to determine effective rent growth in 2018. Similar to the past year, effective rental growth in Sydney CBD is expected to lead the pack, reflecting solid face rent growth combined with lower incentives. Melbourne CBD is also expected to post solid face rent growth on tighter market conditions. However, with the exception of Sydney's CBD office market, tenant incentives will remain elevated across the other major Australian capital cities, reflecting both comparatively softer market conditions and the use of incentives to finance the cost of high-spec office design (see Theme 4).

Theme 4: Workspace design to support tenant flexibility

Similar to recent trends experienced across other economic markets in Australia and globally, 2018 will see a focus on innovative tenant-focussed office design. In order to both attract and retain talented workers to office-based businesses and improve productivity, workspaces will continue to adapt to evolving tenant preferences. This includes accommodating an increasing preference for flexible office design that supports collaborative working and higher technology requirements, while also addressing tenant-specific needs.

Theme 5: Cap rates to break new ground

Australian office market cap rates are expected to drive even lower in 2018. Reflecting the combined impact of strengthening underlying office market fundamentals and a healthy spread to bond yields (and comparable global office markets), solid investor demand for transacted assets is expected to maintain downward pressure on cap rates (Charts 5 & 6). However, 2018 could see office cap rates reaching the bottom of the cycle, particularly in the prime CBD markets of Sydney and Melbourne which have experienced aggressive cap rate compression following recent transactions.

Chart 5: Sydney & Melbourne prime cap rates

Chart 6: Office capital value expectations

Source: Property Council-ANZ, Property Council-IPD, RBA & Investa Research

Further information

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About Investa Research

Investa Research focuses on understanding the drivers and analysing the movements and trends within the Australian commercial office market. The research function is fundamental in guiding group investment strategy and decision making, as well as providing a competitive advantage through insightful analyses and forecasting.

The research team publishes regular updates on the performance of the major Australian office markets, as well as occasional papers and reports examining a broader scope of topics that may be of interest to investors and other Investa stakeholders.

About Investa

Investa is a leading Australian real estate company managing more than A$11 billion of quality office real estate. As a specialist office manager of commercial office buildings Investa manages more than 37 assets in the key Australian CBD markets on behalf of ICPF, the ASX-listed Investa Office Fund (IOF) and private mandates. Its end-to-end real estate platform incorporates funds, asset, property and facilities management, development, sustainability, capital transactions and research.

Investa strives to create Australia's most valued working places be the first choice in Australian office, by delivering consistent outperformance for its investors and exceeding the expectations of its tenants and staff, while remaining an industry leader in sustainable building management and responsible property investment.