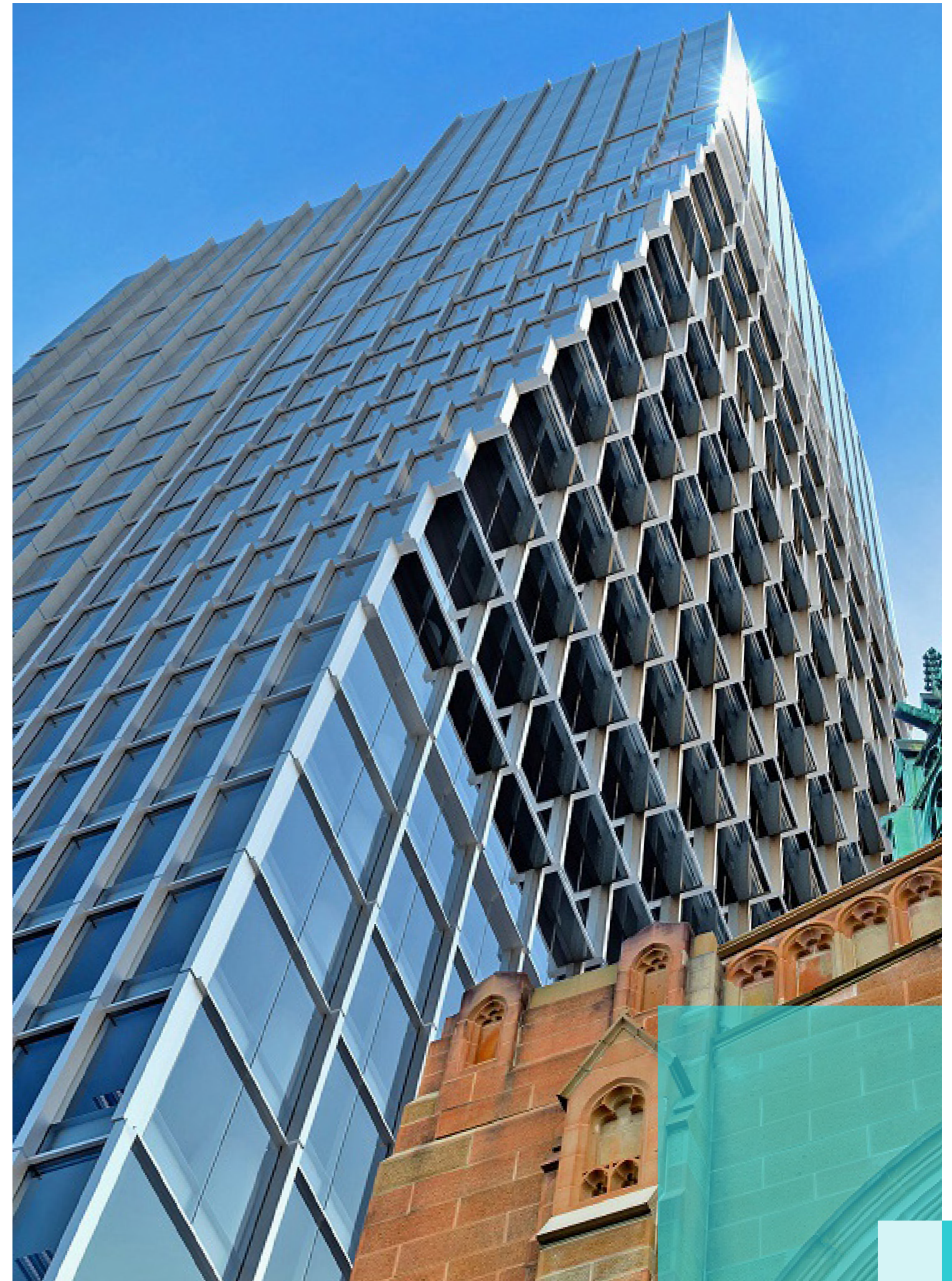


Investa Inside

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# 2022 Office Market Outlook

January 2022



# Introduction



“ Australia’s major CBD office markets are primed to rebound in 2022. Following the negative impact of COVID-19 and lockdown restrictions on office leasing markets through 2021, office leasing demand and occupancy rates are expected to strengthen as Australia adjusts to COVID-normal life.

While Australian office work will continue to embrace workplace flexibility on a permanent basis, office leasing activity has revealed a solid underlying tenant preference for high-quality, sustainable and well-located office space. These office leasing trends are expected to support outperformance in Australia’s CBD prime office markets in the coming years.

In addition, an acceleration in office working trends will support a solid pipeline of office development and a cycle of office space regeneration. Technology, sustainability, amenity and innovation are increasingly prominent attractors in office tenant building requirements and will drive an innovation surge in office development and management. ”

**David Cannington**

Head of Research & Strategy, Investa

## Five Key Office Market Trends to Watch in 2022

# 1

### From Economic Resilience to Rebound

Australia’s resilience through COVID-19 provides a strong evidence-base for the capacity of the economy, and the office-based business sector to rebound in 2022.

# 2

### The Future of Office is Here

Following an extended period of speculation about the outlook for office leasing markets through 2020 and 2021, Australia’s office markets will now face the ‘new future of work’ as businesses increasingly return to the office in 2022.

# 3

### Office-based Employment Growth & Net Absorption Recovery

Economic growth and white-collar employment are expected to account for approximately 60-65% of Australia’s future CBD office absorption.

# 4

### Regeneration of Australian CBD Office Markets

A positive outlook for Australian CBD prime office market fundamentals is expected to support further steady growth in new office completions in the coming years.

# 5

### Pent-up Capital Demand

Australian office capital market activity is expected to continue to re-activate in 2022, following the transaction headwind of COVID-19. While domestic capital sources remained active in 2021, offshore-sourced capital demand has continued to reflect a strong underlying global appetite for Australian office markets.



# 1. Economic & Office Market Outlook



## Economic Outlook: From Resilience to Rebound

Australia's resilience through COVID-19 provides a strong evidence-base for the capacity of the economy, and the office-based business sector to rebound in 2022.

Australian white-collar employment and business conditions held up well over the past year and look set to drive growth and activity in 2022, with office-based jobs increasing by 155,000 in the 12 months to August 2021.

Despite easing through COVID lockdown periods, Australian business conditions for the office-based economy remained surprisingly resilient through 2021. The introduction of furlough measures, including government business assistance policy and settings such as the National Code of Conduct for commercial tenancies, supported business profits. In addition, office-based business activity was sustained by the transition to home-based office work.

Looking towards 2022, a positive COVID-normal outlook combined with a solid rebound in Australian office-occupying business confidence present a favourable foundation for leasing market demand and office occupancy. While currently considered low risk, we remain watchful of the potential for emerging macro risks to impact Australia's economic outlook. In particular, the potential impact from supply-chain disruption on inflation and financial market pricing, and the recent emergence of the COVID-19 Omicron strain.

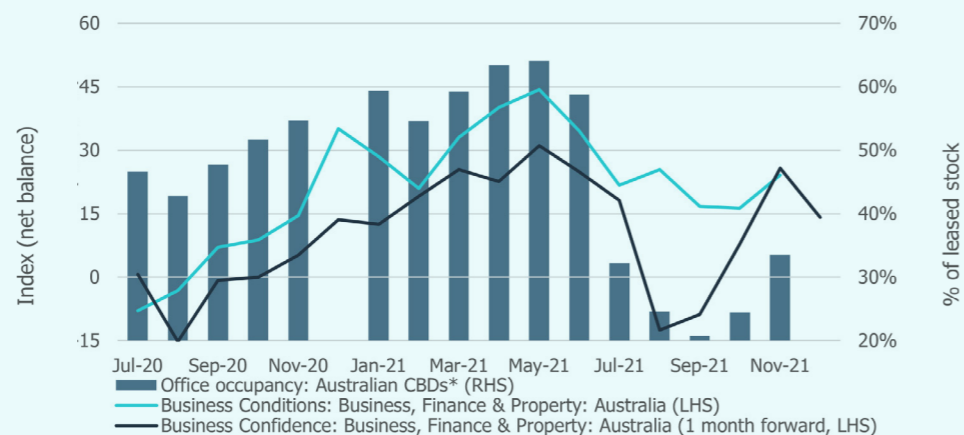
In particular, the transition to a hybrid work model will present a challenge to some sectors, precincts and buildings across the Australian office market. However, a positive flow of pent-up leasing demand in the prime office market through the second half of 2021 reflects a strong underlying preference for Australian businesses to capitalise on the benefits of a well-located high-quality office presence.

Employee wellbeing, sustainability, technology and connectivity are all increasingly important workplace factors for office-occupying businesses in driving the collective best from staff. The ability for markets, sub-markets and assets to deliver on these tenant priorities will drive a divergence in performance across Australia's office markets through 2022. In addition, an increase in tenant demand requirements from these factors is expected to drive an activation in the pipeline of potential office development and refurbishment activity across Australia's major capital city office markets.

## Office Market Outlook: The Future is Here

Following an extended period of speculation about the outlook for office leasing markets through 2020 and 2021, Australia's office markets will now face the 'new future of work' as businesses increasingly return to the office in 2022.

**Chart 1.1:**  
Australian CBD Office Occupancy & Business Conditions/Confidence



\* Combined Sydney CBD, Melbourne CBD, Brisbane CBD, Perth CBD, Adelaide CBD & Canberra

Sources: Property Council of Australia & Investa Research

# 2. Office Demand Outlook



## Office-based employment growth to drive net absorption recovery

*Investa's demand forecasting methodology estimates that economic growth and white-collar employment are expected to account for approximately 60-65% of Australia's future CBD office absorption<sup>1</sup>.*

<sup>1</sup> Investa, Investa Inside: Office Market Outlook, April 2021

In comparison to the significant contribution of economic growth, the combined net impact of flexible work practices and a shift in workplace utilisation trends are expected to create a modest 5-10% drag on office absorption.

Based on the most recent Reserve Bank forecasts Australia's unemployment rate is expected to decrease by 0.5 percentage points to 4.25% by the end of 2022<sup>2</sup>. Applying the current labour market contribution of Australian white-collar industries this forecast would create around 100-120,000 office-based jobs in 2022, in addition to the 154,000 office based jobs created in the year to November 2021.

While office-based employment growth is expected to support net absorption in 2022, demand is likely to reflect a 'flight to quality' trend, with the strongest demand benefiting higher quality office markets and buildings. This trend is already evident with prime market net absorption increasing by 120,000sqm across Australia's CBD markets in the six months to September 2021, while secondary office market net absorption decreased by approximately 20,000sqm.

<sup>2</sup> RBA Statement of Monetary Policy, November 2021

In addition to the boost to office leasing demand from office-based job creation, **three office market pre-conditions** are expected to support a 'flight to quality' in tenant leasing activity through 2022:



### Elevated market vacancy

Spare capacity in office leasing market space will create the opportunity for existing tenants to 'relocate' to higher quality office accommodation.



### Structural demand for higher quality

Tenant preferences for higher spec office space that can accommodate and prioritise new ways of working have attracted the strongest leasing demand. This trend is expected to continue as office-based businesses continue to 'return to the office' through 2022.

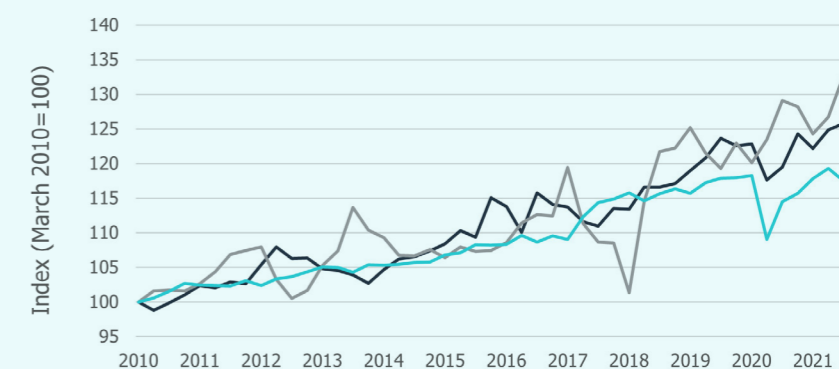


### Office rental affordability conditions

Prime face rent has remained largely unchanged through COVID while white-collar business profit has increased by a solid 14% in the year and a half from March 2020. Consequently, prime office rental affordability conditions have improved by approximately 11% on average since March 2020.

**Chart 2.1:**

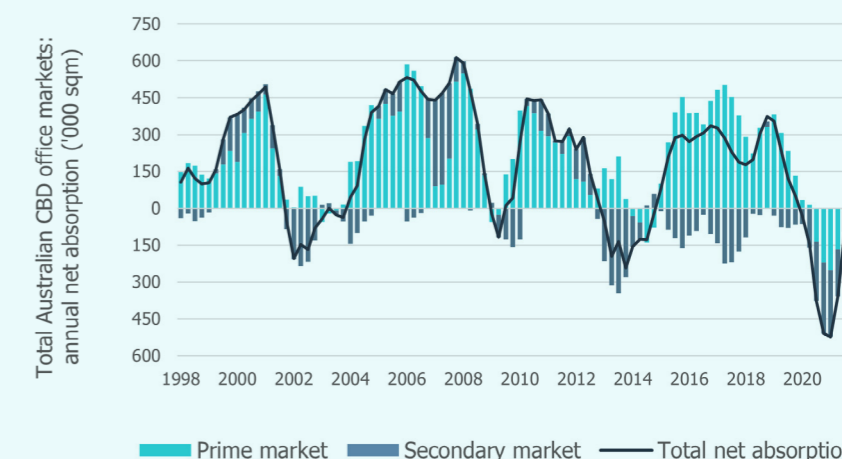
Australian Employment: White-Collar & Government vs Other



Sources: ABS & Investa Research

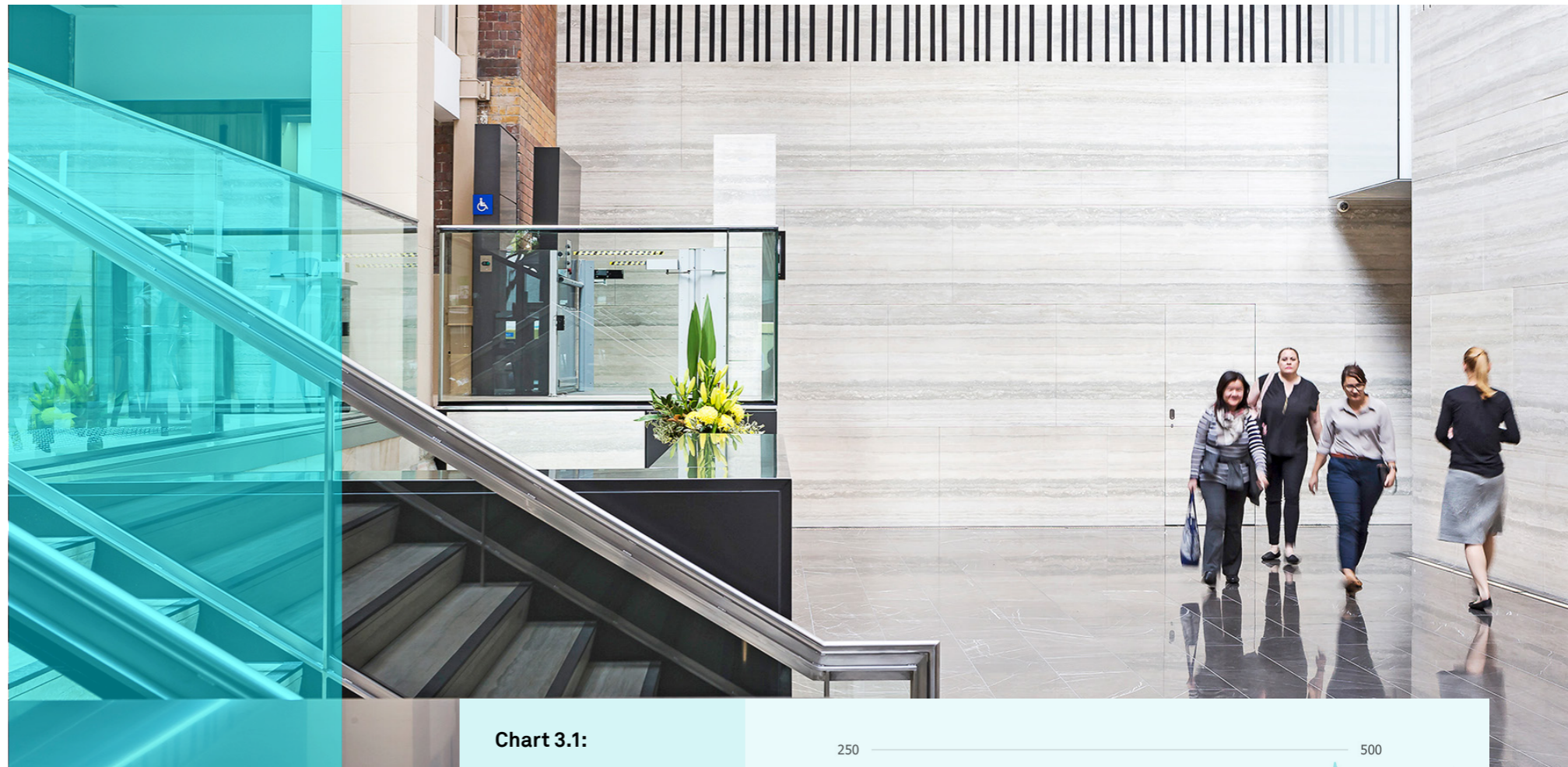
**Chart 2.2:**

Australian CBD Office Net Absorption: Prime vs Secondary Markets



Sources: JLL Research & Investa Research

# 3. Office Development Outlook



## Development activity to support regeneration of Australian CBD office markets

Australian building activity continued to deliver and progress a healthy pipeline of new office projects across the major CBD markets through 2021. More recently, supply constraints have driven upward pressure on the price of construction materials. However, a positive outlook for Australian CBD prime office market fundamentals is expected to support further steady growth in new office completions in the coming years.

Continuation of construction activity through COVID facilitated the completion of approximately 245,000sqm of new office space across Australia's major CBD markets in 2021. Reflecting a strong underlying tenant preference for new office space, and a 'flight to quality' leasing trend, a strong 76% of this new office space was pre-committed on completion.

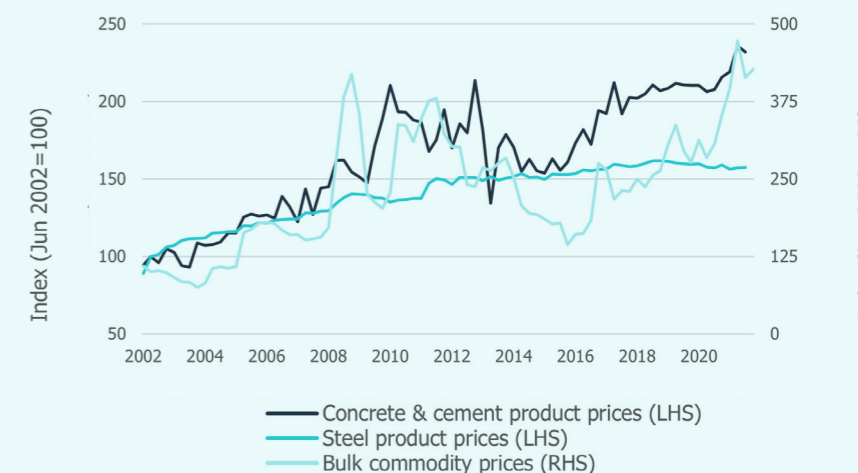
A steady outlook for new office development in the coming years will somewhat counter the expected rebound in demand and moderate the cyclical recovery in Australia's major capital city office market conditions.

However, we also expect a 'flight to quality' leasing trend will support a steady pipeline of office withdrawals. Backfill and secondary market assets will come under increasing valuation pressure from the structural shift in tenant demand towards high-quality, sustainable, and technology-enabled office buildings. We expect this will drive increased activity for lower grade office assets to be refurbished and repositioned to meet this structural shift in tenant requirements.

Consequently, we expect the supply of new office completions will continue at a steady rate across Australia's major CBD office markets through the approaching development cycle.

**Chart 3.1:**

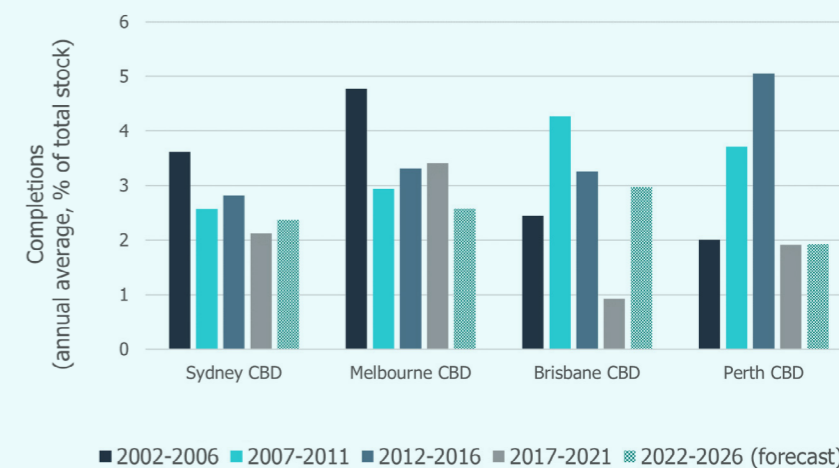
Construction Materials Price Pressure



Sources: ABS, RBA & Investa Research

**Chart 3.2:**

Australian CBD Office Development Activity & Pipeline



Sources: Property Council & Investa Research

# 4. Office Capital Market Outlook



## Pent up demand to drive office capital growth in 2022

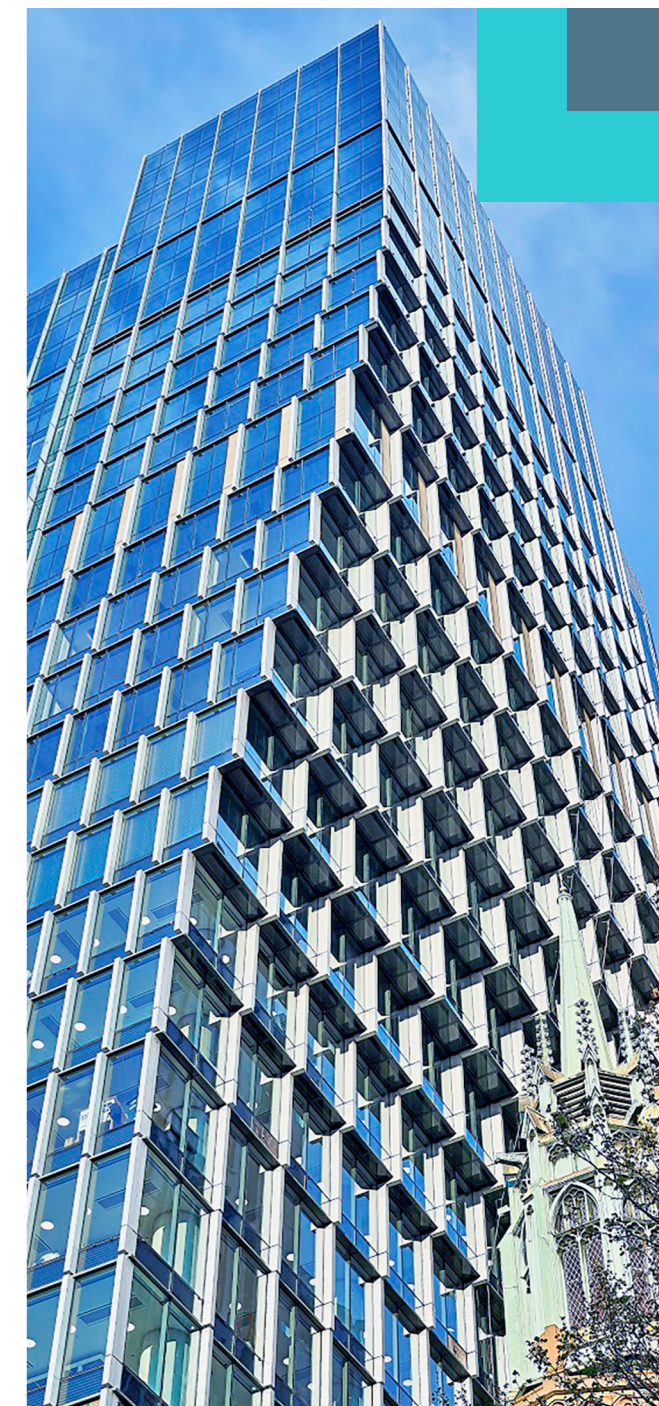
Australian office capital market activity is expected to continue to re-activate in 2022, following the transaction headwind of COVID-19. While domestic capital sources remained active in 2021, offshore-sourced capital demand has continued to reflect a strong underlying global appetite for Australian office markets. Offshore capital sources acquired around 55% of total Australian CBD office transactions by value in the year to December 2021.

In the wake of elevated financial market volatility through COVID-19, the search for high yielding stable asset returns has intensified. Combined with a steady economic performance, Australia's relatively steady office market returns have supported a 'safe haven' status for Australia's major capital city prime office markets. Supply chain disruption and higher inflationary expectations have driven upward pressure on nominal bond yields in recent months. However, inflation-adjusted risk-free Australian Government bond (indexed Bonds) yields have been maintained at less than 50 basis points.

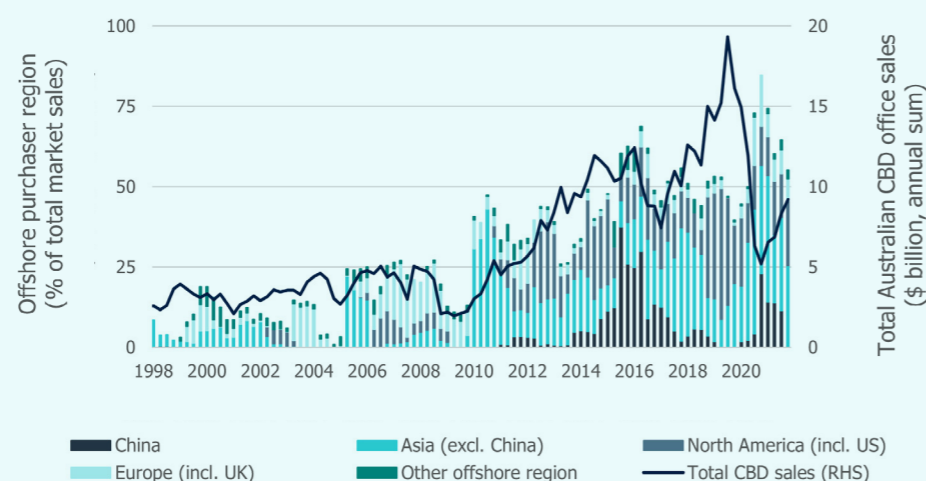
While RBA monetary policy rates remain anchored at all-time lows, market pricing indicates that price pressures are likely to drive a gradual unwind of the RBA cash rate.

Consequently, despite markets pricing Australian Government Bond rates higher in nominal terms, a low inflation-adjusted interest rate environment has maintained the yield premium offered by Australian prime office assets.

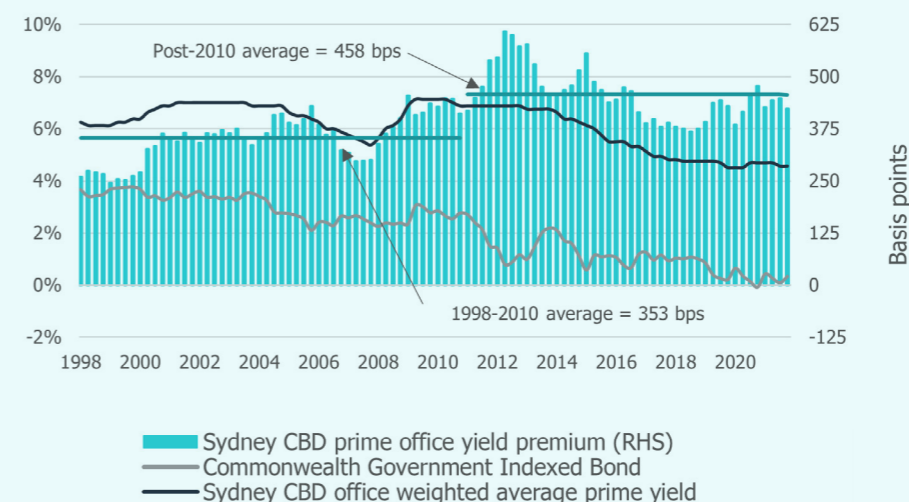
We expect Australian office capital market activity and returns to strengthen through 2022 on the back of strong underlying demand for Australian office assets combined with a positive fundamental leasing market outlook and an elevated return premium.



**Chart 4.1:**  
Australian CBD Office Sales & Offshore Buyers



Sources: JLL Research & Investa Research



**Chart 4.2:**  
Australian Government Bonds & Sydney CBD Prime Office Yields

Sources: JLL Research, RBA & Investa Research

# Further Information



## Investa Research



**David Cannington**

Head of Research & Strategy

+61 418 655 200

dcannington@investa.com.au



**Jesse Johnson**

Research Analyst

+61 2 8226 9921

jjohnson@investa.com.au

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## 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 25 assets in the key Australian CBD markets on behalf of ICPF, Oxford Investa Property Partners (OIPP) 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 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.

## 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 analysis 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.