CUSHMAN & WAKEFIELD

AUSTRALIA OFFICE OUTLOOK 2024

ECONOMY

ECONOMY

RESILIENCE IN 2023, UNCERTAINTY IN 2024

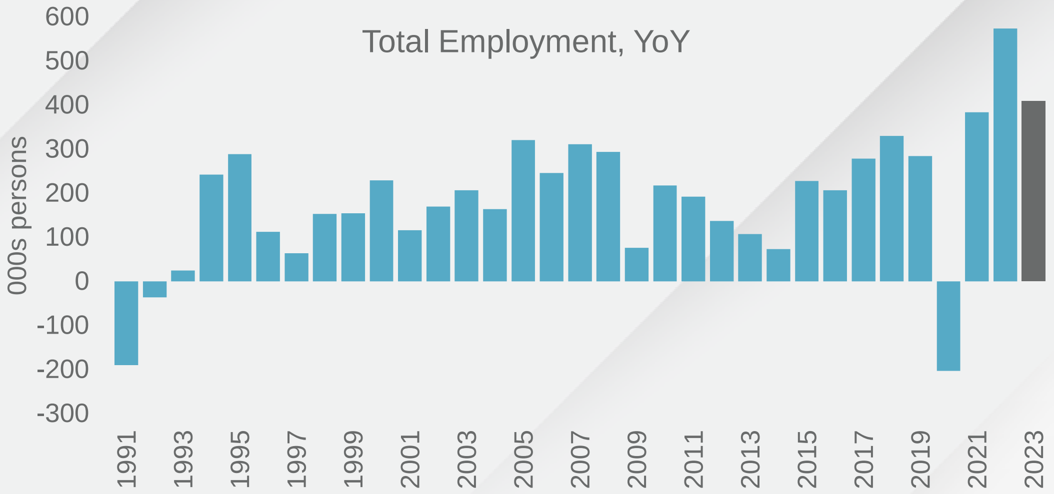
By any number of metrics, the Australian economy outperformed in 2023. Concerns over inflation and the subsequent rapid rise in interest rates dominated headlines early in the year. Whether a recession was needed to get inflation under control was a prominent topic of debate amongst pundits.

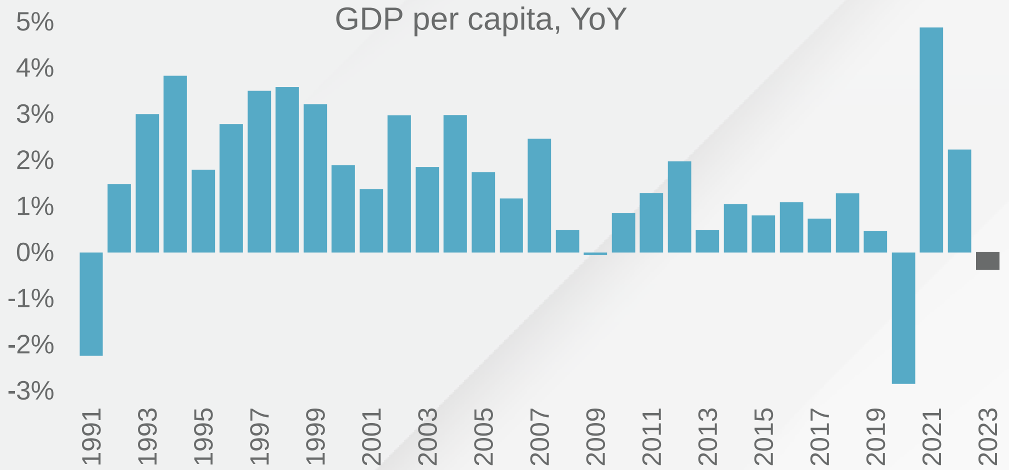
Looking back, the view of 2023 looks much different. The Reserve Bank of Australia (RBA) did continue to raise interest rates at an extraordinary rate in the first half of the year, but the subsequent downturn did not, or at least has not yet, materialized. Indeed, 2023 may join 2021 and 2022 as the strongest years of employment growth on record.

Other indicators signal continued growth momentum. Investment growth picked up from 2022, and consumption continued to expand. Although they have moderated slightly from the beginning of the year, corporate profits remain near to all-time highs.

However, despite a strong performance at the headline level, signs of underlying stress began to emerge. The rebound in population growth appears to have masked some of the weakness in the economy as both consumption and overall output will have likely declined in per capita terms once fourth quarter data is released.

The overall performance of the Australian economy in 2024 will be contingent on households resilience in the face of higher interest rates and whether the RBA's fight against inflation will leave it in a position to 'pivot' by the end of 2024.

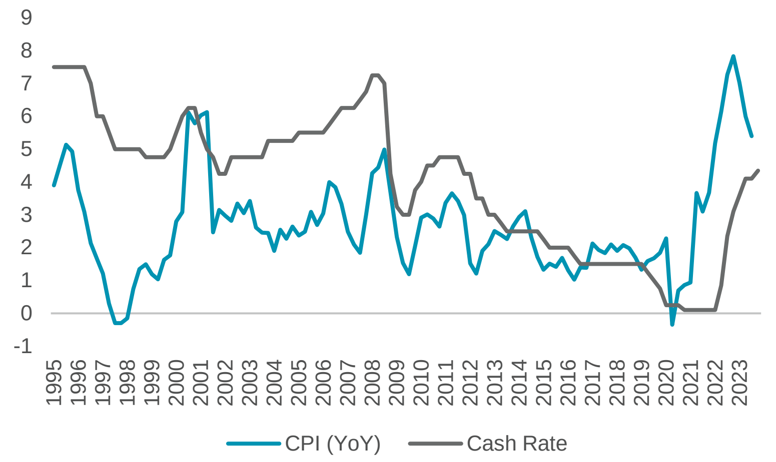


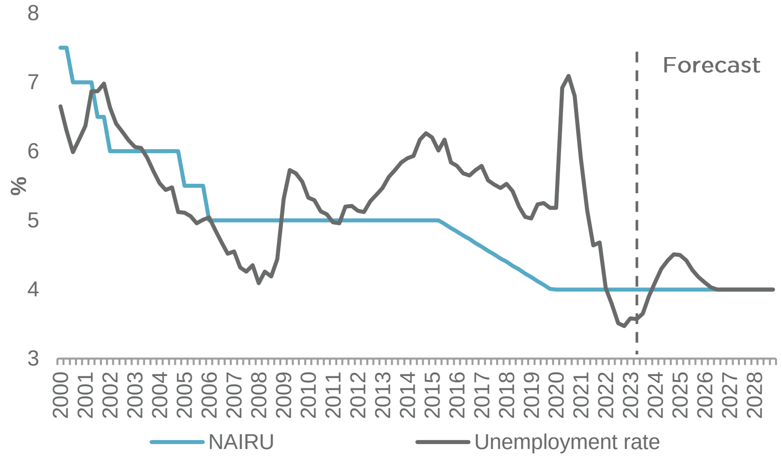


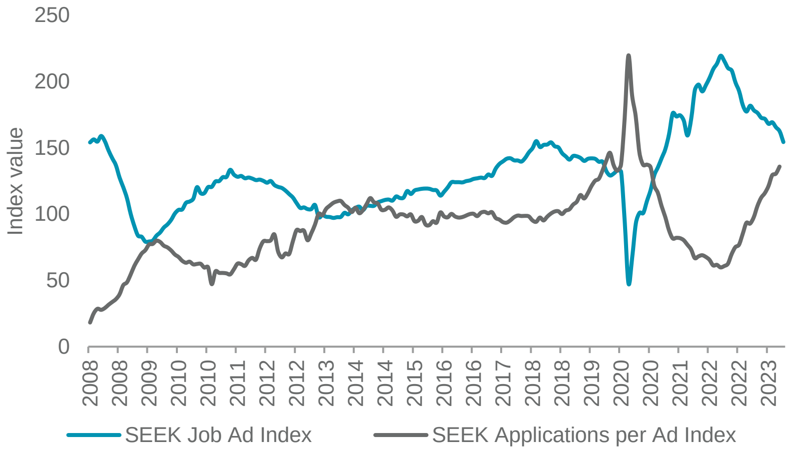
Source: ABS, Oxford Economics, Cushman & Wakefield

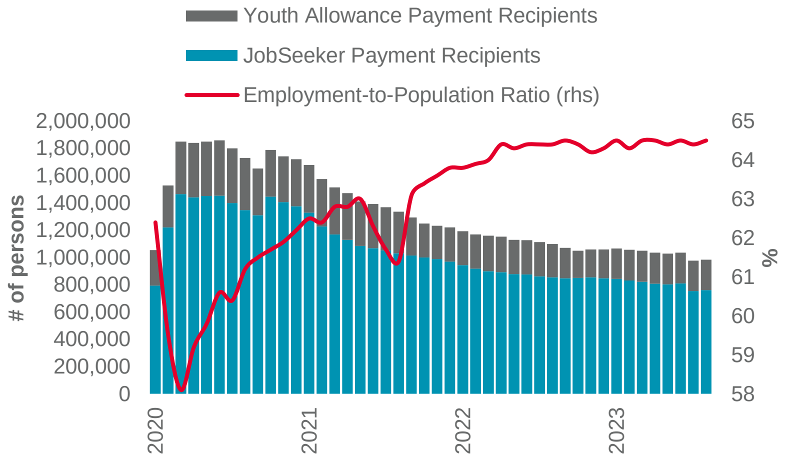
ECONOMY

INFLATION IS EASING, SO IS THE LABOUR MARKET







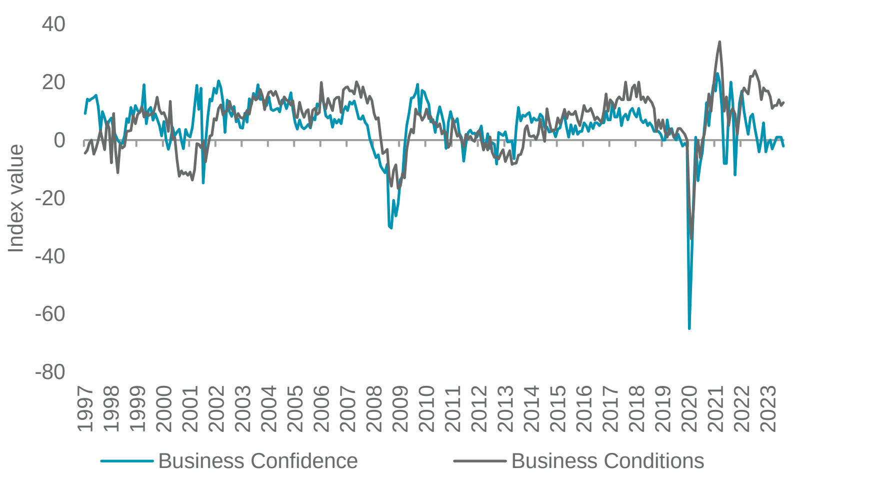


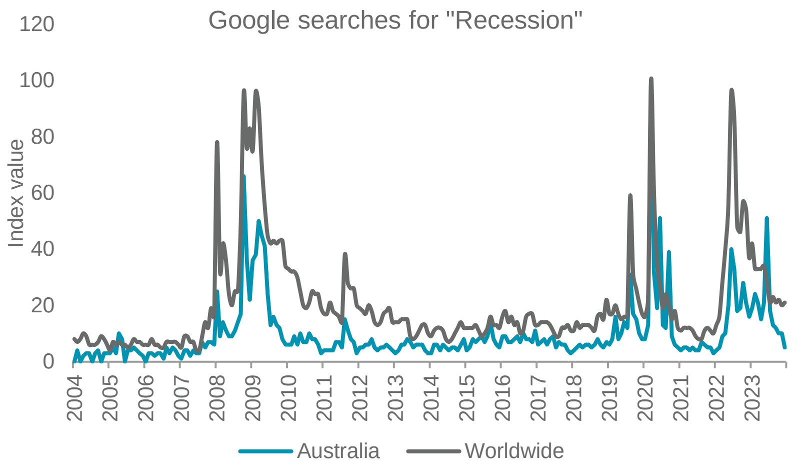
Source: RBA, ABS, SEEK, Department of Social Services, Oxford Economics, Cushman & Wakefield

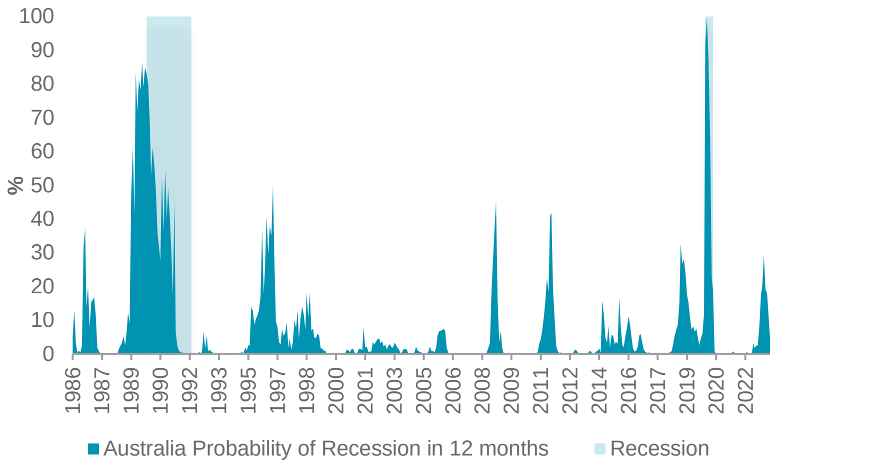
- Inflation has come off of its peak, the impact of higher interest rates have yet to fully pass through to the economy. The unemployment rate, which remains near historically low levels, will likely have to rise back above the non-accelerating inflation rate of unemployment (NAIRU) before inflation falls back within the RBA's target band. Oxford Economics estimates this to be around 4%.
- Signs are pointing to a cooling labour market. Job advertisements are now well off their recent peak, falling back toward pre-COVID trends. The number of applicants per job has been rising for 18 months, and is now above the pre-pandemic average.
- Furthermore, the number of unemployment claims have stabilised to a degree in 2023 and growth in the share of population employed appears to have levelled off.

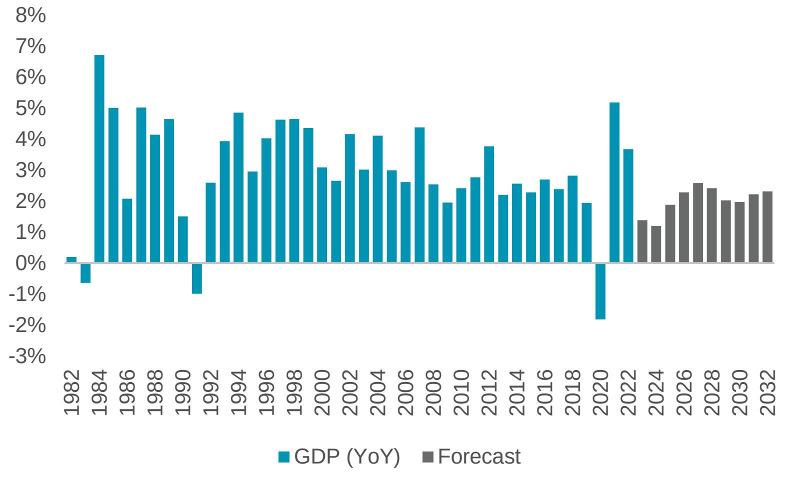
ECONOMY

BUSINESS RESILIENCE POINTS TO A SOFT LANDING







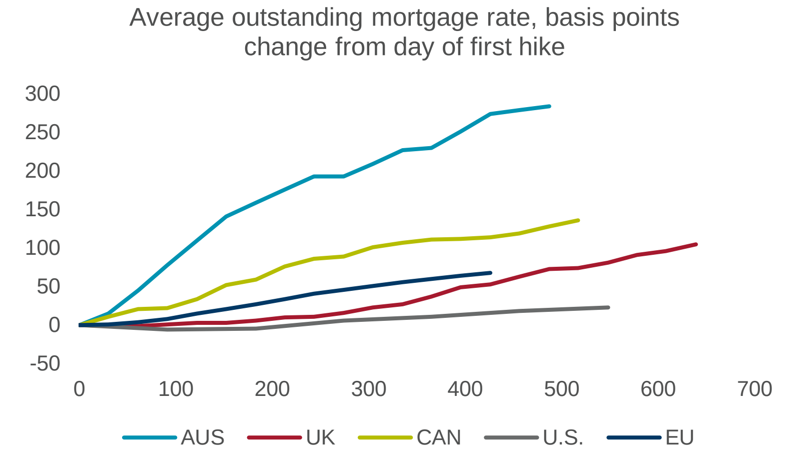


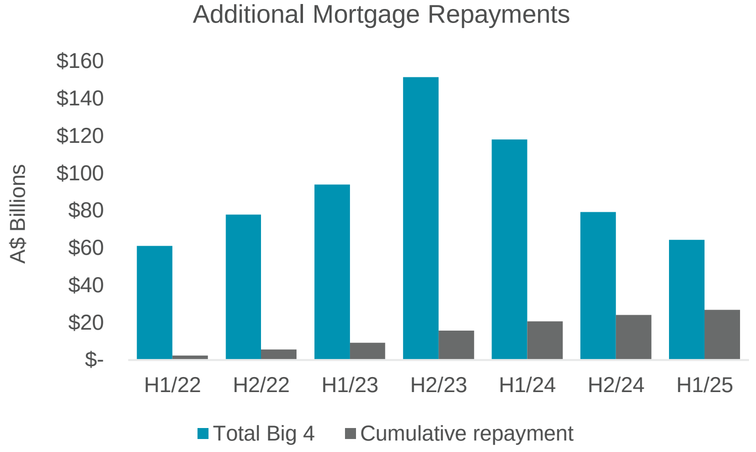
- Higher interest rates have yet to dampen business sentiment. Businesses are reporting current conditions to be particularly buoyant, while forward looking indicators are more neutral.
- Concerns over recessions, as measured by Google Search trends, have moderated, suggesting that this has become less a part of everyday discourse.
- Moody's Analytics estimates that the probability of a recession in Australia in the next 12 months, though never particularly high since 2020, have substantially come off the recent peak and now stand at less than 5%.
- These and other indicators suggest that although the Australian economy is set to slow, a soft-landing remains the baseline scenario.

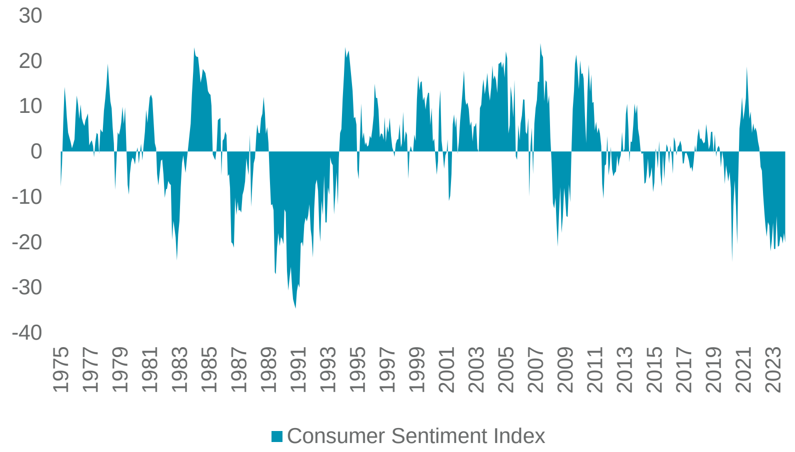
Source: RBA, ABS, Oxford Economics, NAB, DAE, Google, Moody's Analytics Cushman & Wakefield

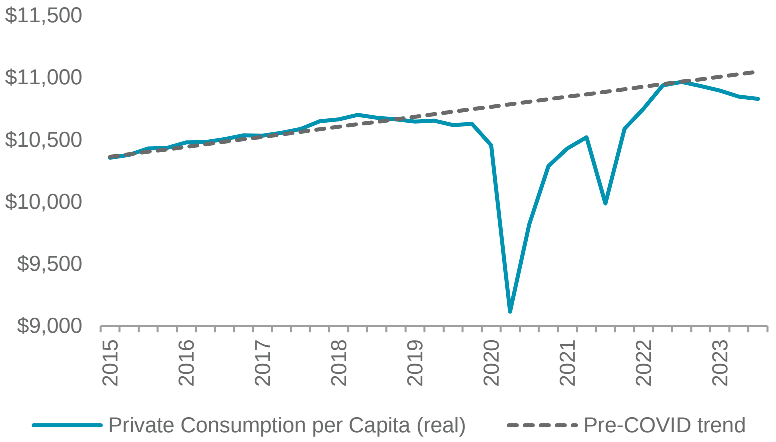
ECONOMY

HOUSEHOLDS ARE FEELING THE BITE OF HIGHER RATES







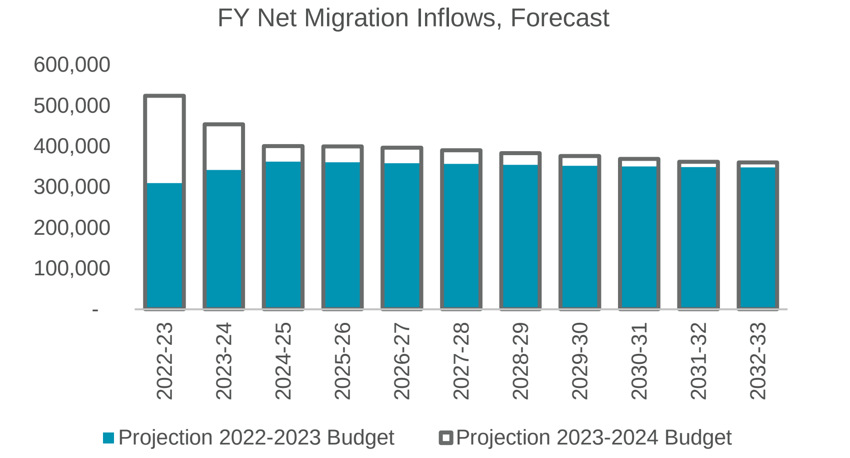


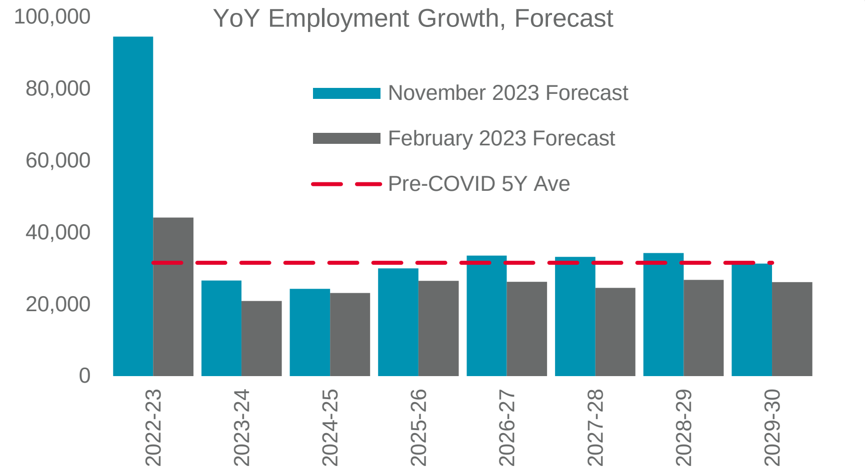
- Although businesses have been resilient in the face of interest rate hikes, higher financing costs are taking their toll on households.
- As a result of a large portion of Australia's mortgage market being on short-term fixed rate loans, the pass through from higher rates to households has been larger in Australia than in other developed economies.
- Mortgages that were taken out early in the pandemic when rates were near-zero are now beginning to roll from being fixed to floating rate, adding a significant repayment burden to households.
- The impact of higher rates can be seen in the data: consumer confidence remains around pandemic-era lows and inflation-adjusted consumption has begun to decline on a per capita basis.

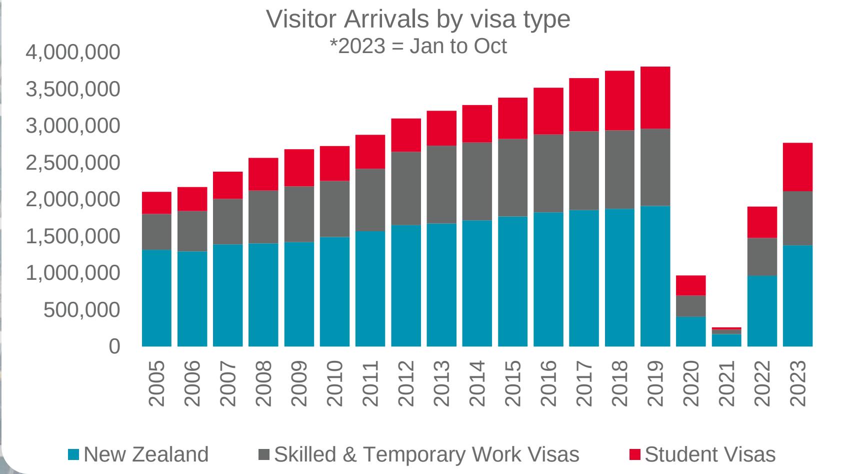
Source: Oxford Economics, Westpac, ABS, Moody's Analytics, Banks' Earnings Statemen, Cushman & Wakefield

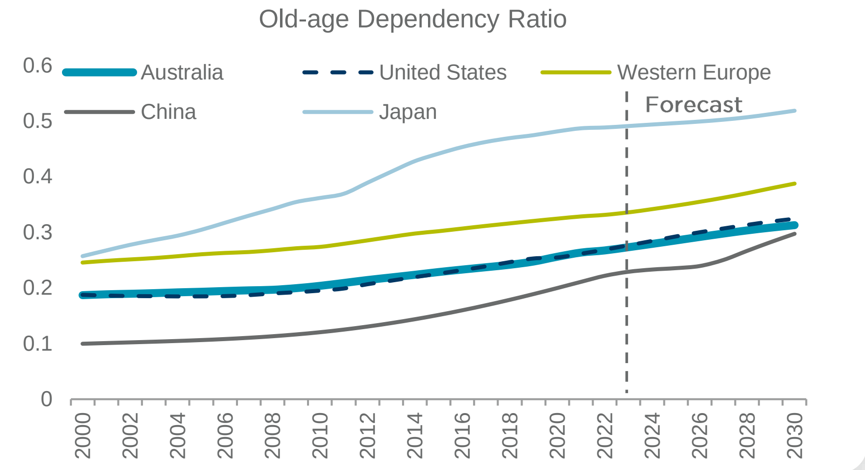
ECONOMY

POPULATION GROWTH PROVIDING AN ECONOMIC CUSHION







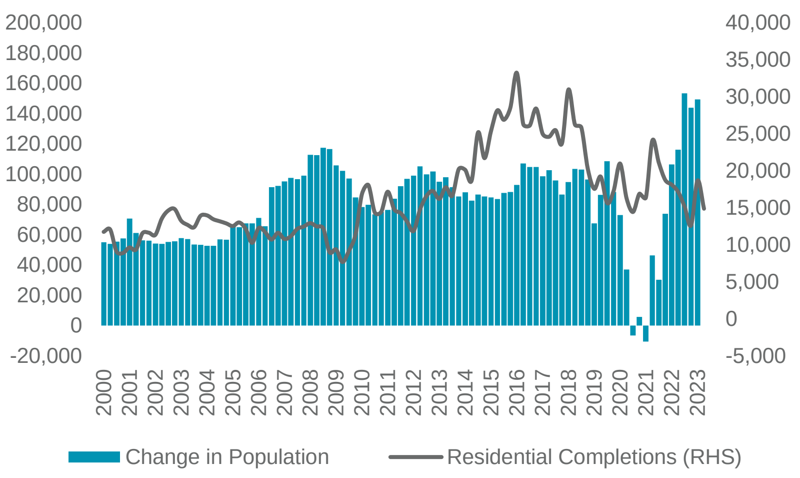


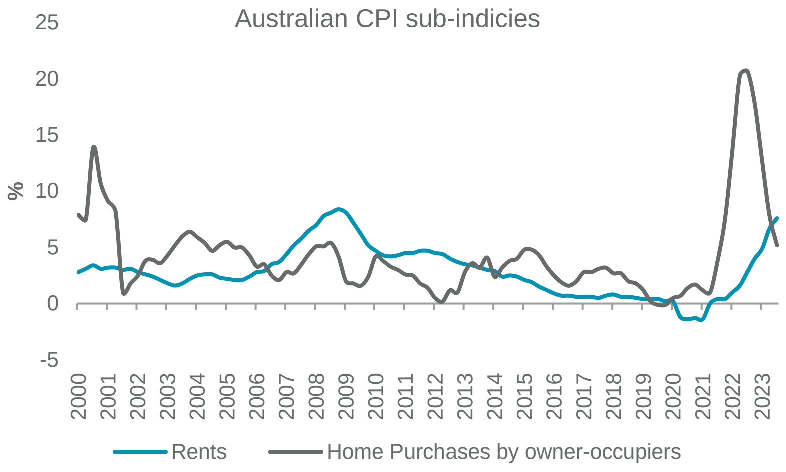
Source: Centre for Population, ABS, Oxford Economics, Moody's Analytics, DAE, Cushman & Wakefield

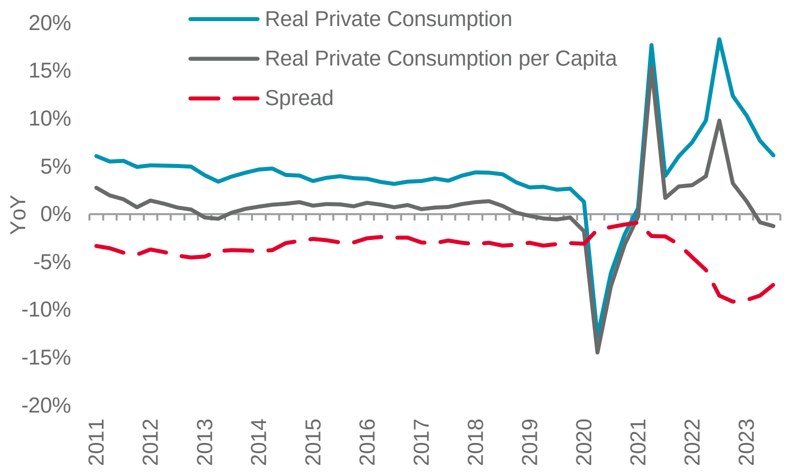
- Population growth continues to be the underlying strength of the Australian economy. The 2023 Federal Budget revised population projection sharply higher. This has been reflected in employment forecasts, with 2023 set up to be a bumper year for employment growth. Employment growth has also been revised upwards in subsequent years, an indication of the labour markets' resilience.
- Visitor arrival numbers have sharply rebounded from pandemic-era lows, for those categories with working rights in Australia. Student visas have seen a particularly strong rebound, which not only benefits alternative CRE sectors but also increases the skilled workforce upon graduation.
- Australia's immigration is allowing it to age more gradually, which will increase productivity in the long-run.

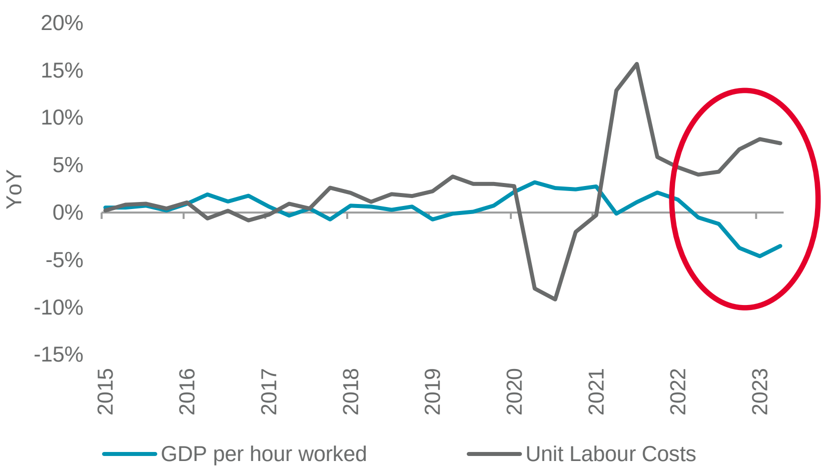
ECONOMY

WHILE ALSO CONTRIBUTING TO INFLATIONARY PRESSURES







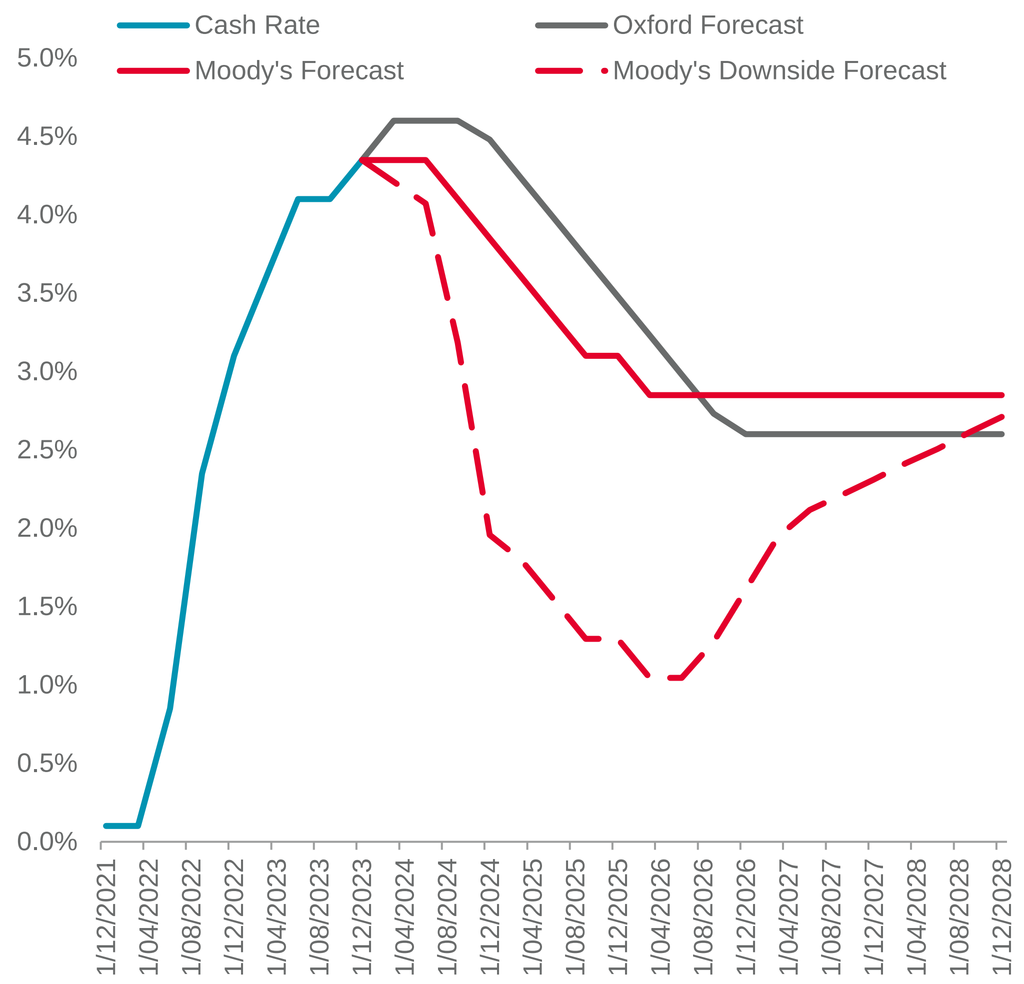


Source: Centre for Population, ABS, Oxford Economics, Cushman & Wakefield

- However, population growth has caused some short-term economic distortions. The housing supply has not kept up with population growth, and the resulting supply-demand mismatch has resulted in housing component, first purchases but more recently rents, becoming a significant contributor to inflation.
- Population growth also increases aggregate consumption, which has put upward pressure on inflation. This is evident when comparing the spike in growth in overall consumption compared with per capita population.
- Weak productivity growth is further complicating things for the RBA; workers are now producing less per hour worked and employers are having to pay more per unit of output. This appears to be particularly acute for services firms, which are passing it onto consumers via higher prices.

ECONOMY

MOST FORECASTS EXPECT A CUT IN H2/2024



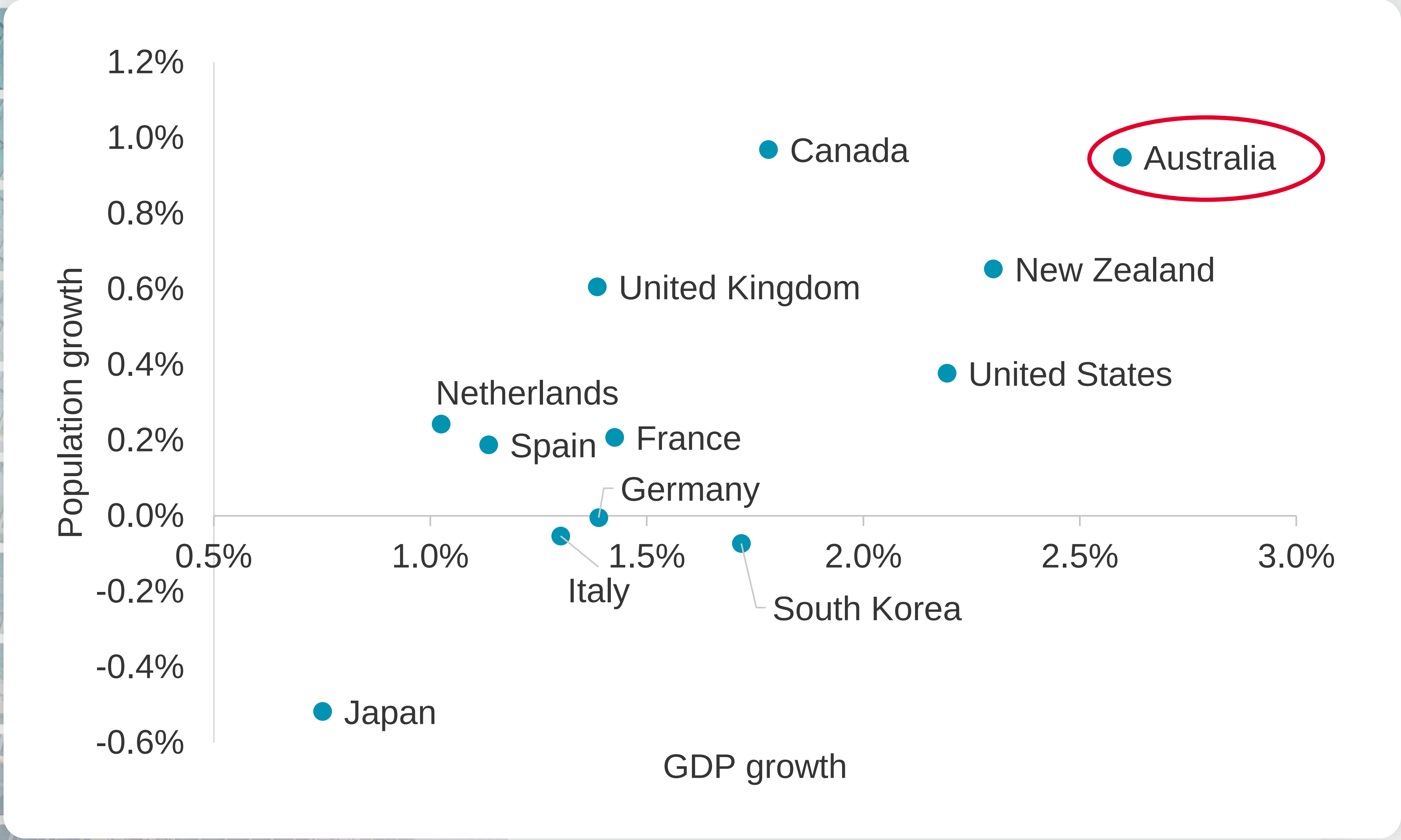
Scenario	Assumptions
Oxford	Population growth & tight labour market boosting consumption in the near-term, sticky services inflation & tight rental market results in persistent inflationary pressure.
Moody’s	Improvement in terms of trade eases imported inflation, unemployment edges higher, interest rates put pressure on households and limits business investment
Moody’s Downside	Deep global recession, renewed supply-side stress, geopolitical tensions, China slowdown

Source: RBA,Moody’s Analytics, Oxford Economics, Cushman & Wakefield

- There is some disagreement over the future path of interest rates. This generally evolves around whether an additional interest rate increase will be necessary to combat inflationary pressure.
- The case for a further rate hike is that services inflation will be particularly sticky as companies secure margins by passing on higher costs rather than cutting employees. The first rate cut in this scenario would be Q4/2024.
- The case for no further rate hikes is that rate hikes will begin to significantly impact consumption as households have run down savings buffers, while global disinflationary forces ease imported inflation. The first cut under this scenario would be Q3/2024.
- The longer-term level of interest rates depends on the productive capacity of Australia’s economy.

ECONOMY

LONG TERM FUNDAMENTALS REMAIN STRONG



Source: Moody's Analytics, Cushman & Wakefield

- The long-term outlook for the Australian economy is extremely positive as it continues to be a key destination for skilled immigrants.
- The bottom line is that Australia is a developed economy with a population growth rate similar to many developing economies.
- This will continue to drive investment across all types of commercial real estate to accommodate the growing population.
- It will also aid productivity in the long-run, helping to offset some of the impacts of demographic composition that is being felt in other economies that are aging more rapidly.

OFFICE

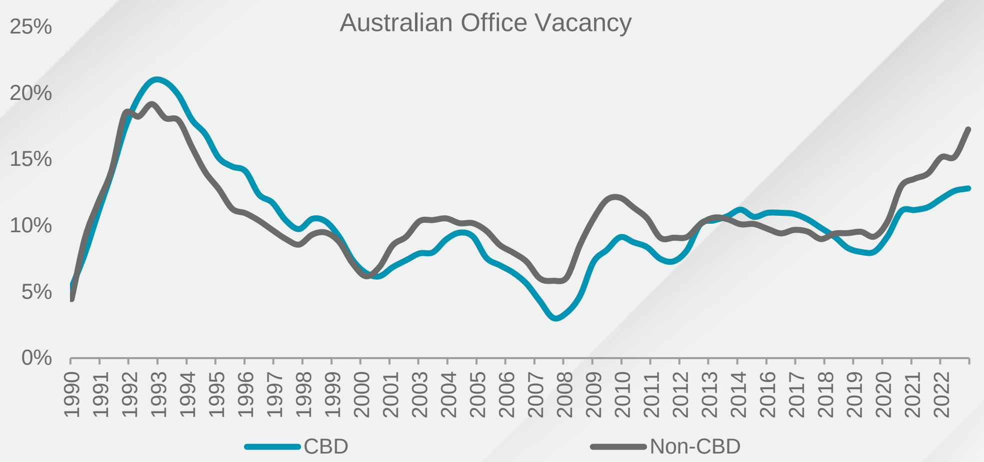
CBD OFFICE

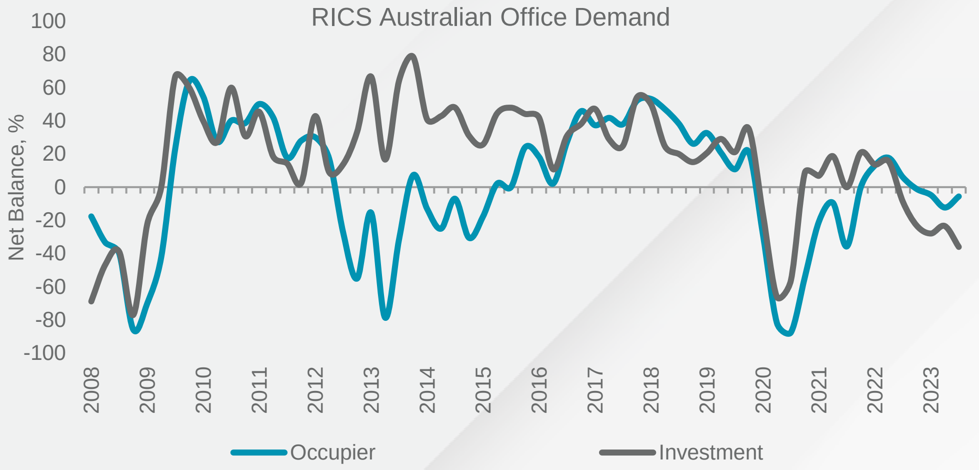
OFFICES CONTINUE TO ADJUST TO THE 'NEW NORMAL'

The Australian CBD office market remains in a period of adjustment following the structural changes to work brought on by the COVID-19 pandemic. The past 12 months have been characterized by upward pressure on vacancy as the fruits of a historically strong labour market have yet to flow through to office occupancy.

Although the headwinds from structural change have thus far outweighed the tailwinds, office space in the CBD has shown signs of resilience. The strong underlying population growth and resilient economic outlook have supported occupier markets relative to investment markets. Further, in an increasingly bifurcated office market the centralized location of CBDs relative to non-CBDs, as well as the higher share of Premium and high-quality A-grade office space has insulated Australian CBDs from at least some of the upward pressure on vacancy rates.

The outlook for rental growth and vacancy varies by city and will ultimately be dependent on supply and demand fundamentals. The market will continue to adjust to the increased utilisation of flexible working styles, though weak service-sector productivity growth coming out of COVID may suggest that more balance is needed between working from the office and from home. In the short-term, working styles may normalise slightly as the unemployment rate comes back to a more sustainable level. In the long-term, however, hybrid working will become increasingly entrenched in working practices as technological progress eases the costs of hybrid and corporate structures adjust to more efficiently facilitate the practice.

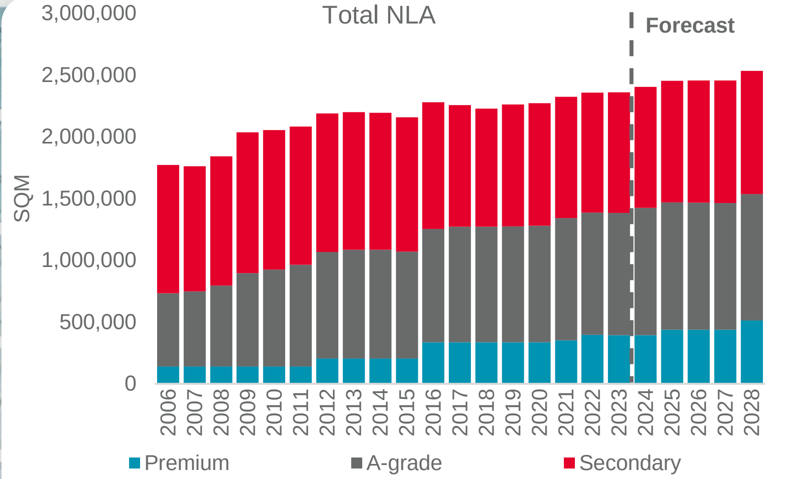


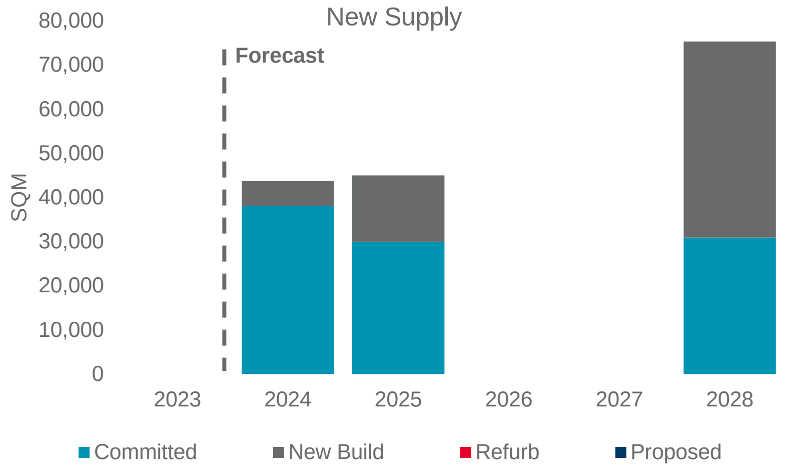


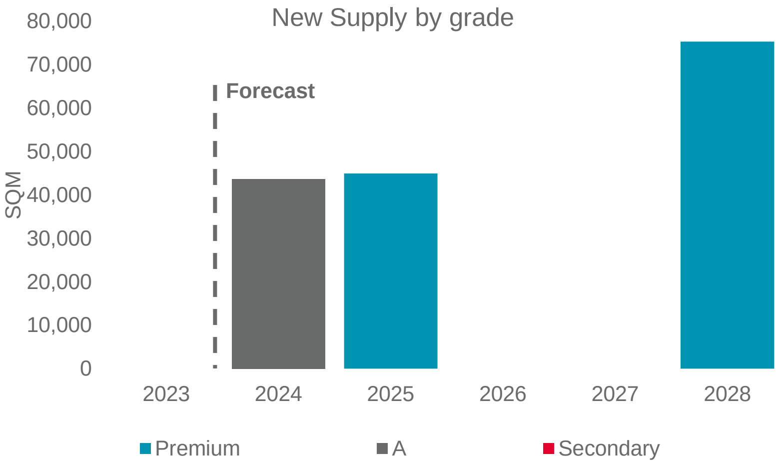
Source: RICS, PCA, Cushman & Wakefield

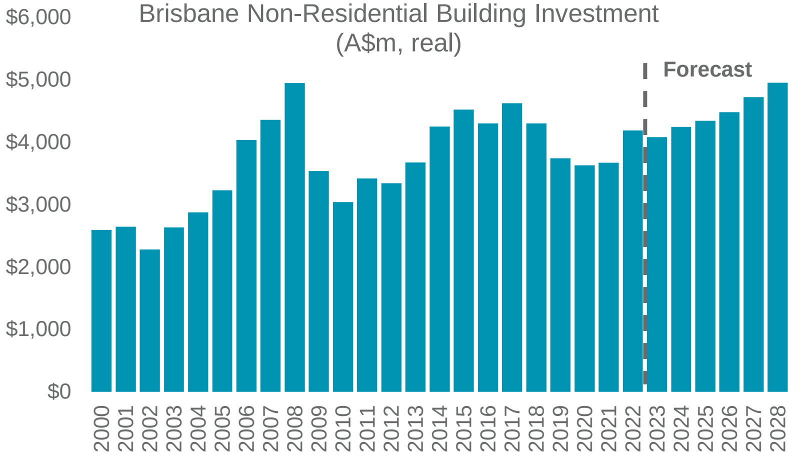
BRISBANE

SUPPLY







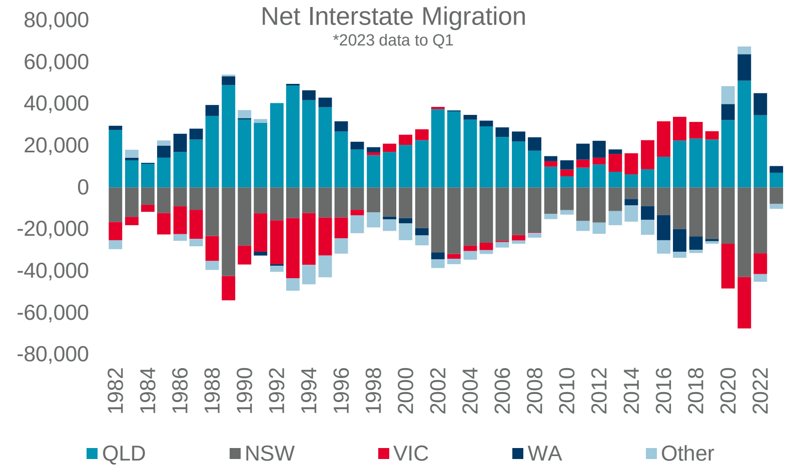


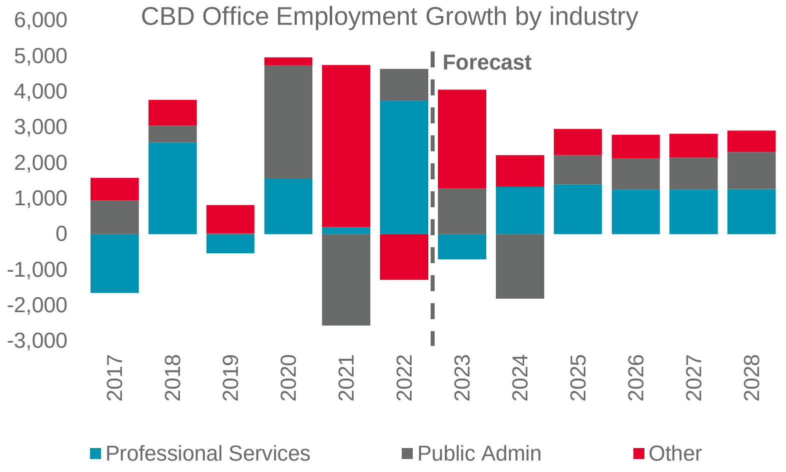
Source: ABS, Oxford Economics, PCA, Cushman & Wakefield

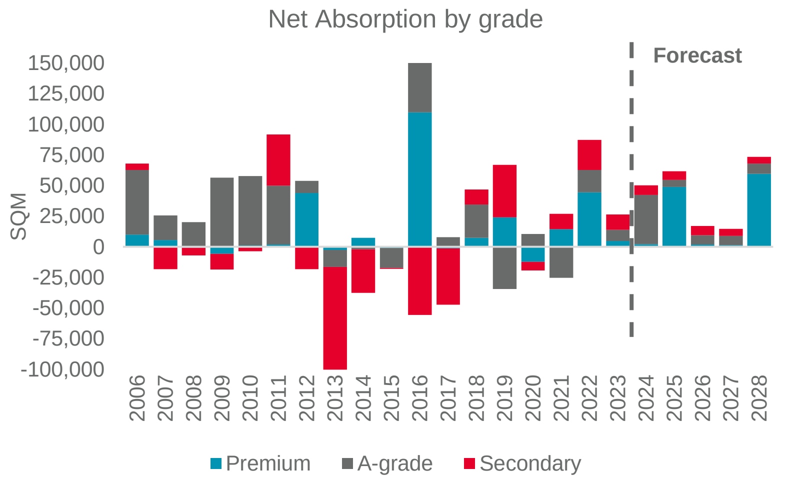
- The Brisbane CBD faces a relatively benign outlook for new supply of office stock. In the five calendar years from 2024 to 2028 the market is only expected to add circa 160,000 sqm of office space.
- This is equivalent to roughly 6% of the current stock, or an annual average growth rate of 1.4%. The long-term average annual growth rate of the Brisbane office market is 1.6%.
- Additionally, a substantial portion of the office stock is pre-committed. More than 85% of new supply set to complete in 2024 has already been committed, and more than 65% and 40% in 2025 and 2028 respectively.
- Some of the new premium grade space will be occupied by current A-grade tenants. However, withdrawals for refurbishment and B-grade tenants upgrading should limit upwards pressure on A-grade vacancy.

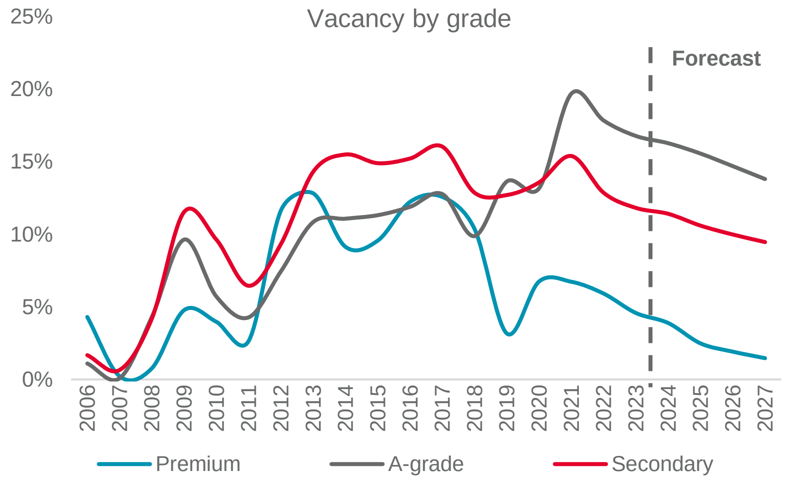
BRISBANE

DEMAND







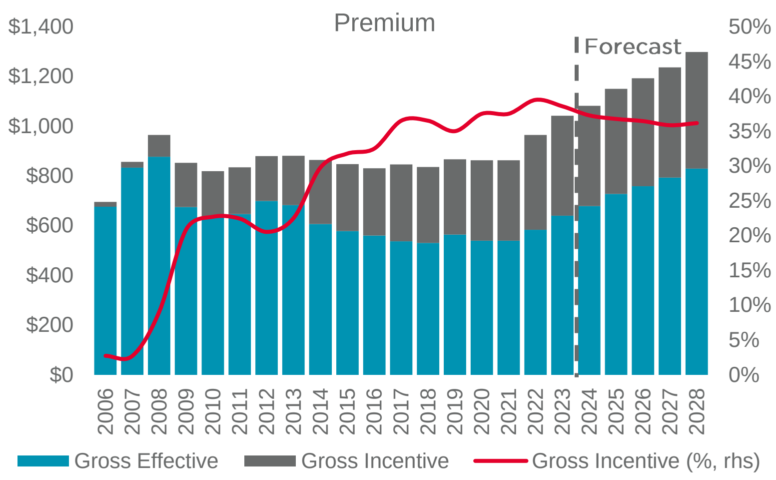


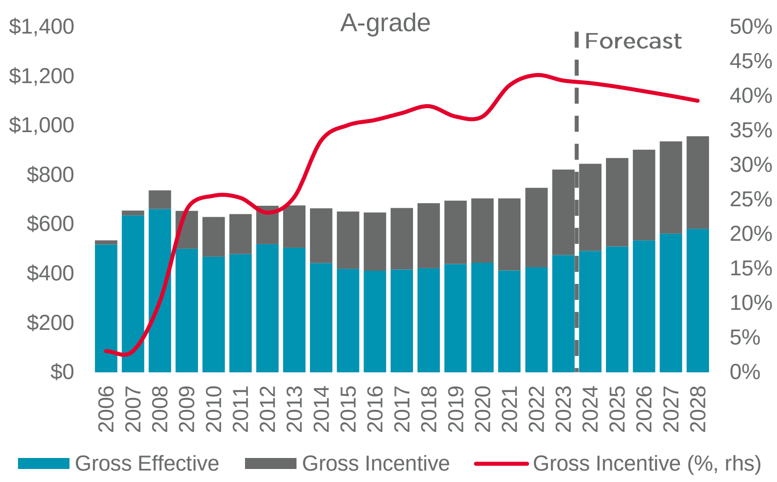
Source: ABS, PCA, Oxford Economics, Cushman & Wakefield

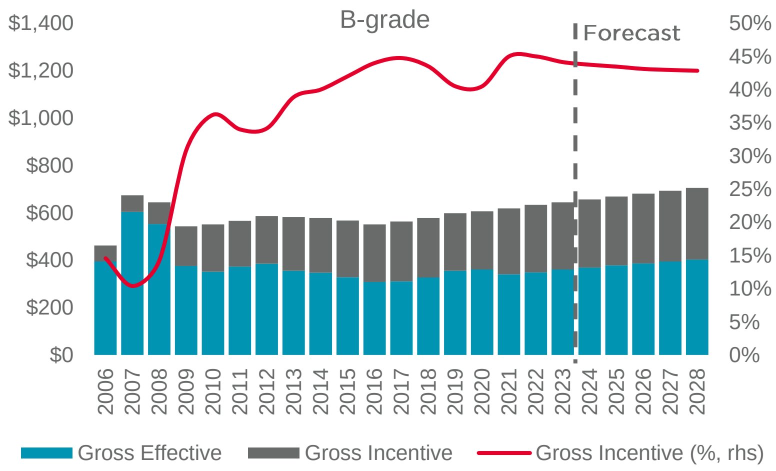
- Demand for office space in the Brisbane CBD is underscored by demographic fundamentals. Interstate migration to Queensland has spiked in recent years. Roughly half of the net increase in Greater Brisbane are individuals between the ages of 25-64, and an additional 20% to 30% are between 15 and 24 years old.
- Against this backdrop, office employment growth is only expected to slow modestly in 2024 but remain positive, before returning to a more stable growth rate from 2025.
- Tight premium grade vacancy and a lack of supply is likely to limit premium net absorption through the 2024 to 2028 period. This should support a modest increase in A-grade net absorption over this period and help fill any backfill space left vacant from tenants upgrading to new premium supply in 2025 and 2028.

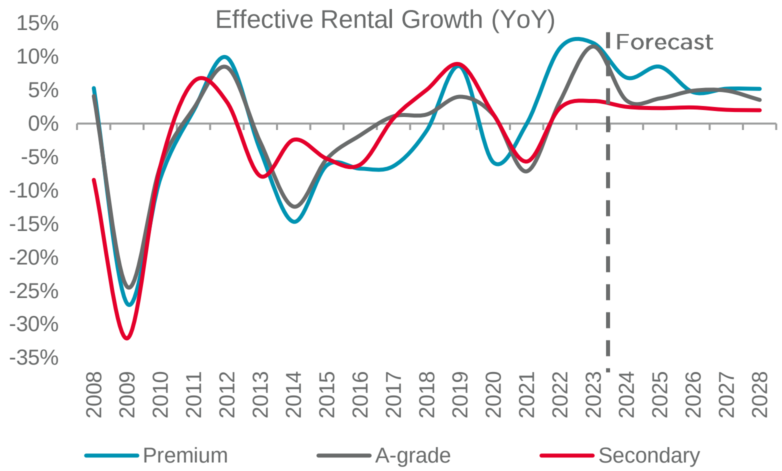
BRISBANE

RENTS, INCENTIVES







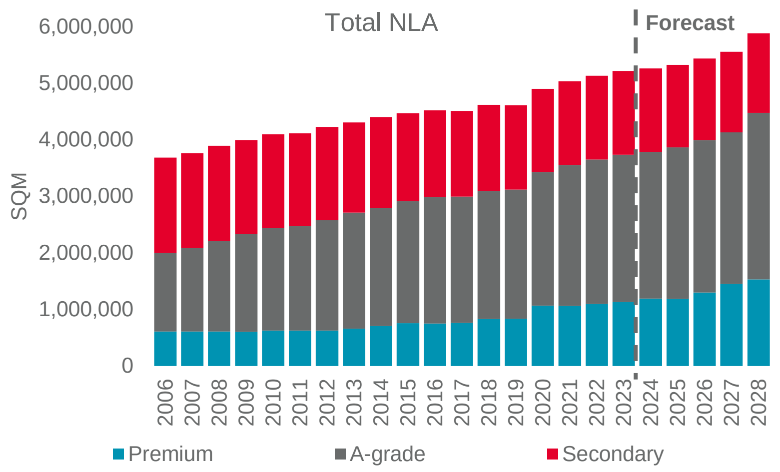


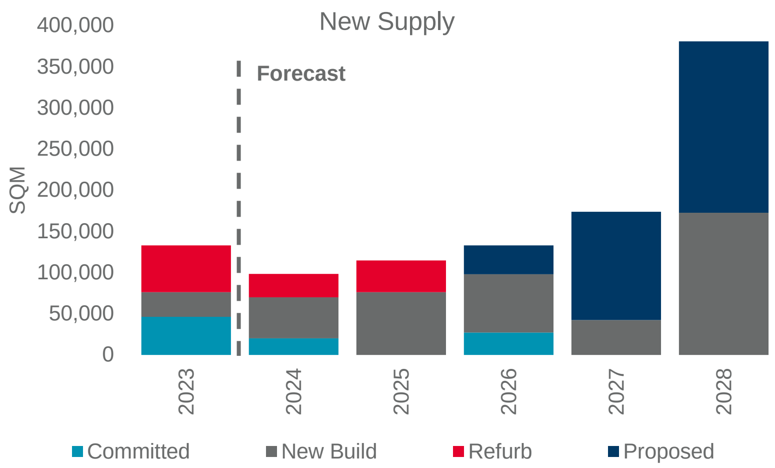
Source: Cushman & Wakefield

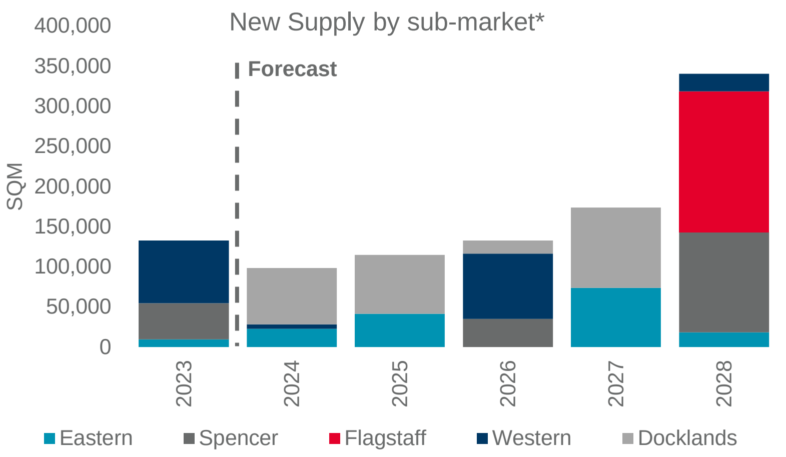
- The Brisbane CBD is set to experience robust rental growth through 2028. Incentives may prove to be to be stickier than in previous cycles, and hover between 35% and 45%.
- Amid an environment of rapidly rising economic rents, landlords at least in the near-term appear to prefer a sharper rise in face rents over tighter incentives.
- Growth in Premium rents is expected to be particularly strong in the 2024-2028 period as the continued flight to quality pushes average annual effective rent growth above 6%. This is predominantly driven by face rent growth, as incentives are expected to only tighten circa 250 basis points.
- Growth in A-grade rents is expected to lag slightly, averaging around 4% per annum. B-grade rents are expected to see a steady increase of 2% to 2.5% annually.

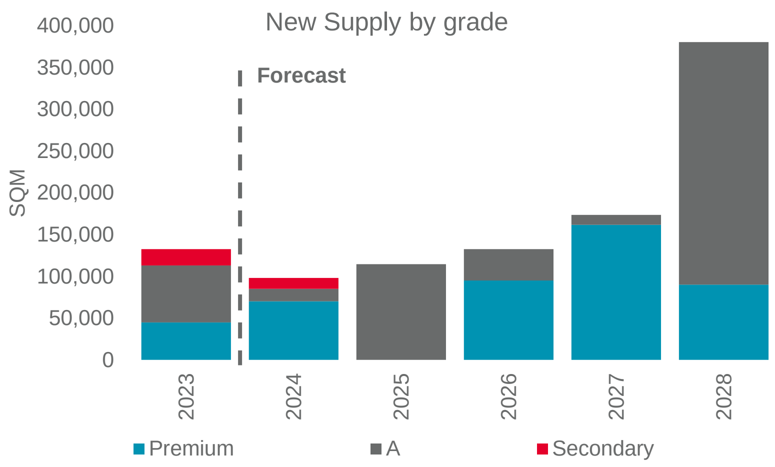
MELBOURNE

SUPPLY







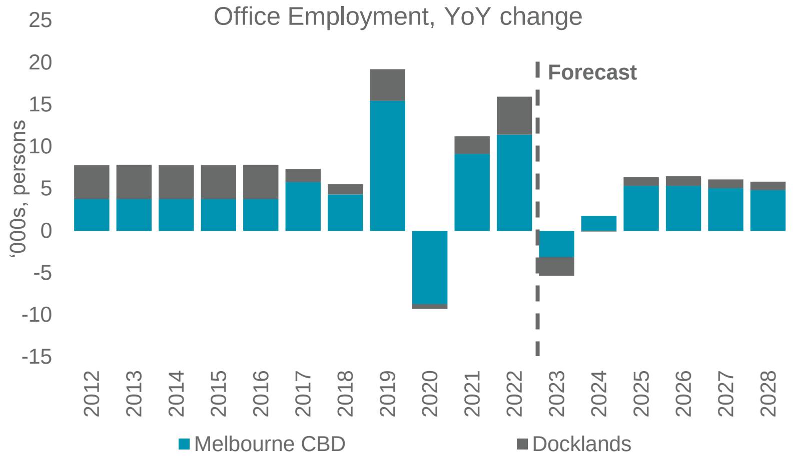


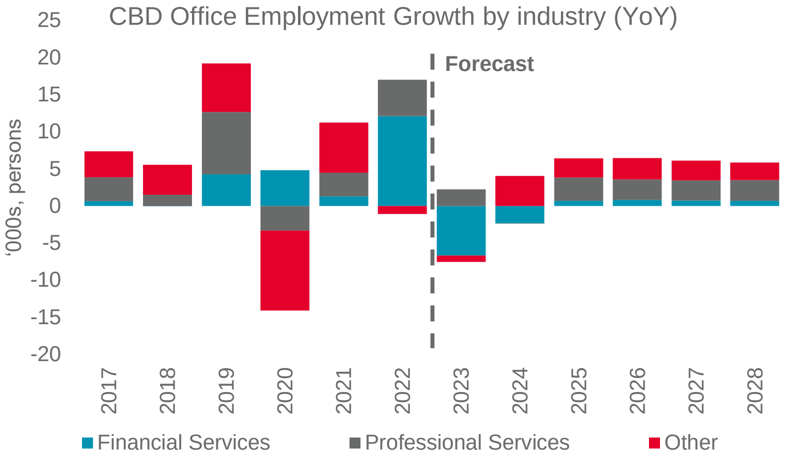
*Source: PCA, Cushman & Wakefield; *Eastern includes North Eastern, Eastern and Civic sub-markets*

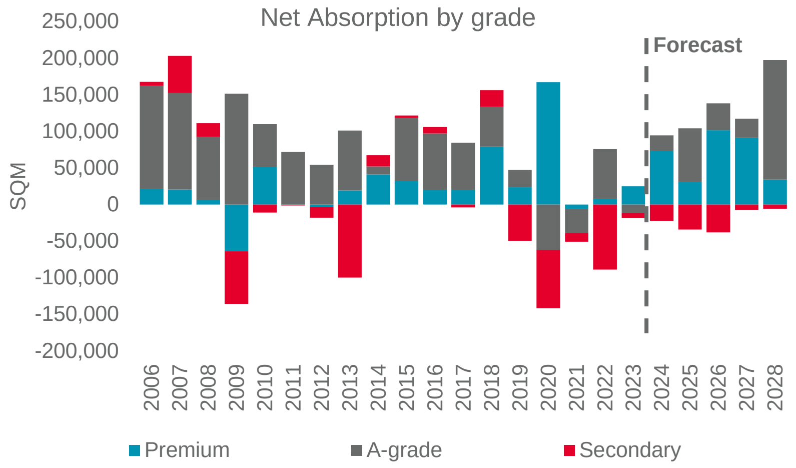
- The Melbourne CBD was hit with a large tranche of new supply, nearly 800,000 sqm during and just proceeding the COVID-19 pandemic. Circa 55% of this new supply was A-grade.
- New supply was more subdued in 2023 at circa 130,000 sqm. Looking ahead, supply is expected to remain fairly limited with only 100,000 sqm and 115,000 sqm of new and refurbished spaced expected to hit the market in 2024 and 2025, respectively.
- The pipeline deepens after 2027. However, at least some of these completions will depend on the achievement of pre-commitment targets.
- A majority of stock (70%) set to complete in 2024 will be Premium grade. A similar split is expected in 2026, while 90% of expected 2027 completions is expected to be Premium grade.

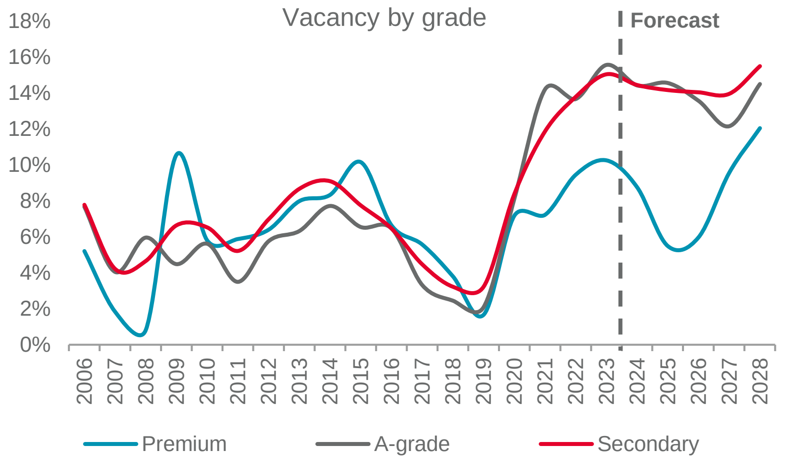
MELBOURNE

DEMAND







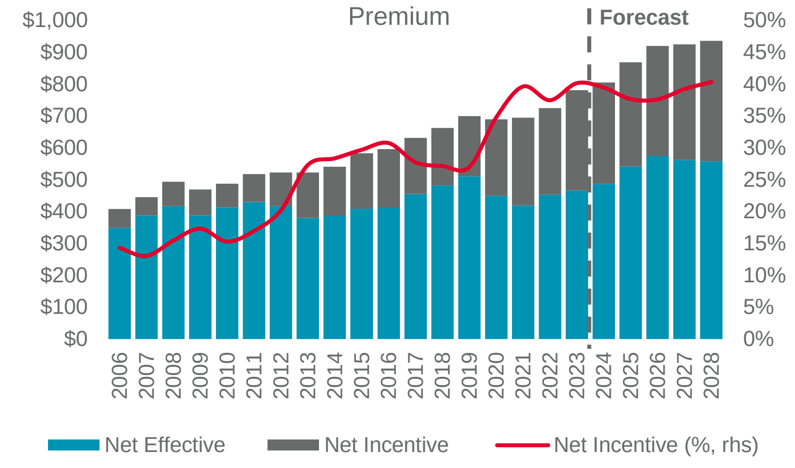


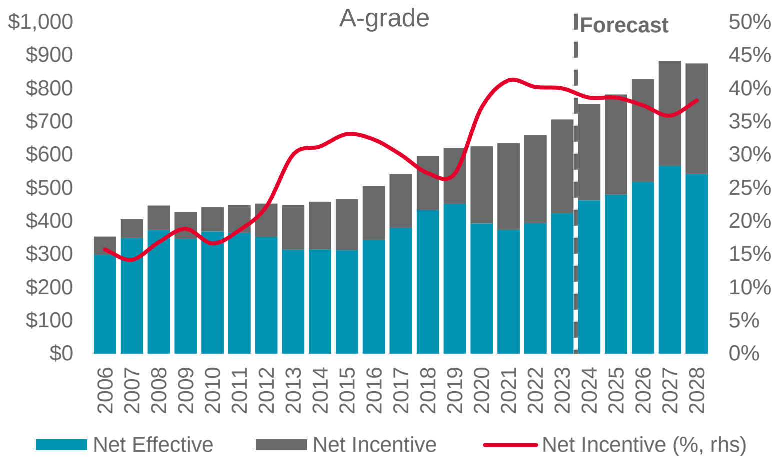
Source: PCA, Oxford Economics, Cushman & Wakefield

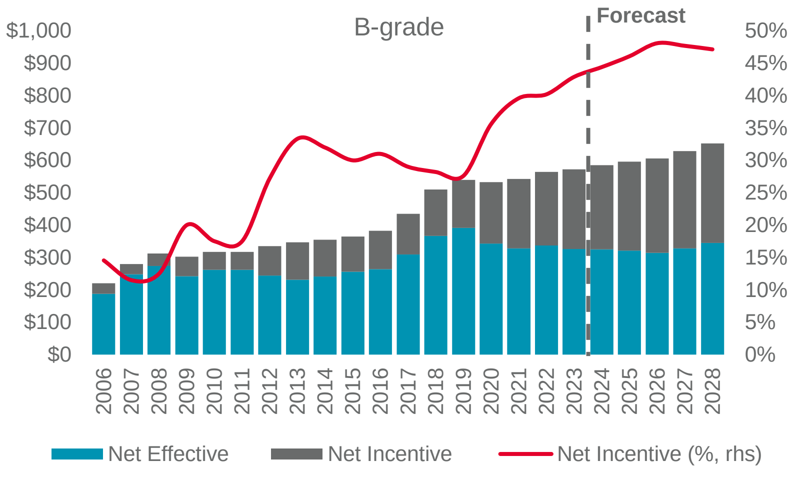
- Oxford Economics forecasts Melbourne CBD office employment growth is expected to modestly decline in 2023 and only rise slightly in 2024.
- This is expected to be driven by a softer outlook for the finance and insurance industries, which tend to be procyclical and more sensitive to changes in interest rates than other industries.
- However, despite the limited employment growth, pent-up demand from leasing decisions that have been delayed due to the pandemic is expected to fuel a pick-up in absorption to pre-COVID levels.
- This will allow for A-grade and Secondary vacancy to hold steady as occupancy declines at a similar rate to stock being withdrawn. Meanwhile the flight-to-quality puts downward pressure on Premium vacancy until a surge in Premium supply hits the market in 2027.

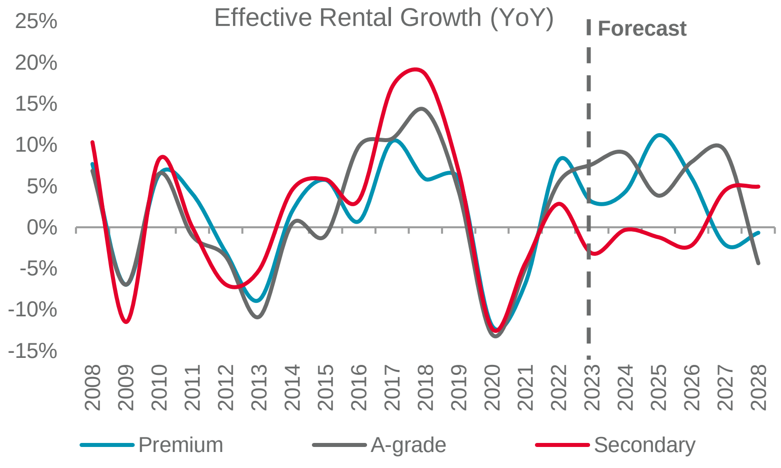
MELBOURNE

RENTS, INCENTIVES







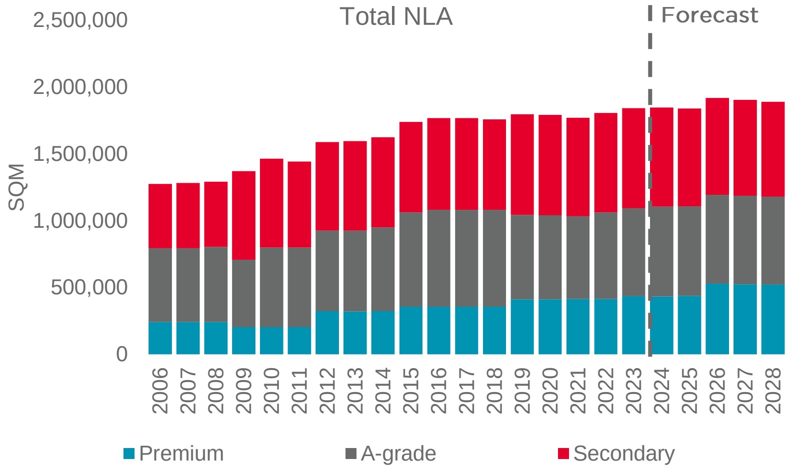


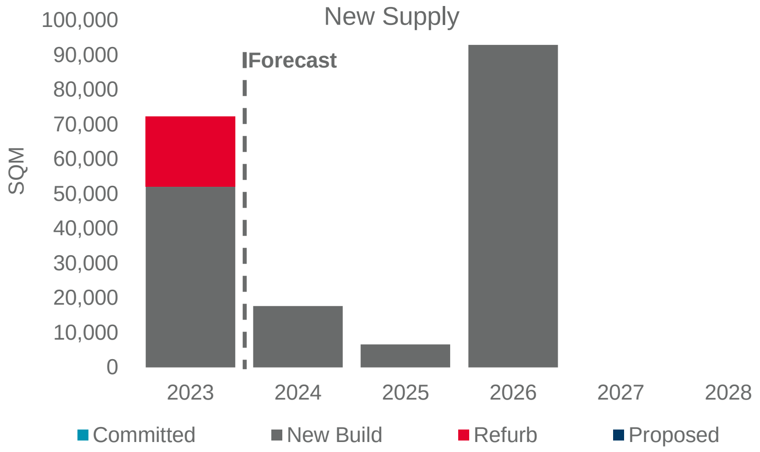
Source: Cushman & Wakefield

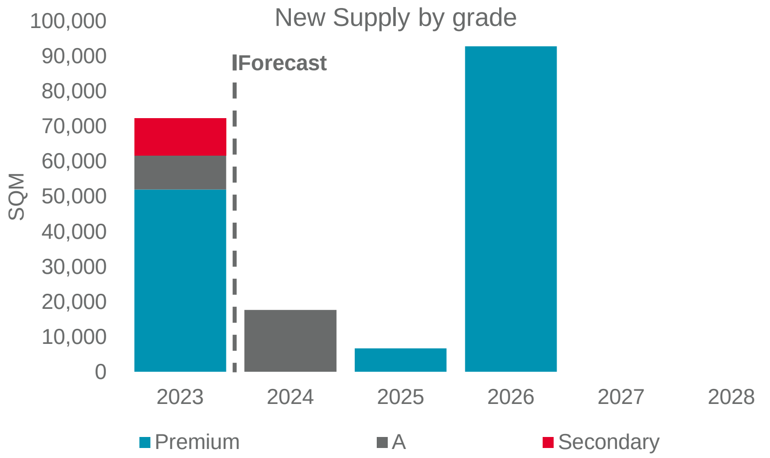
- Quality uplift from the completion of new buildings is expected to be a major driver of Prime grade rental growth in the Melbourne CBD.
- Face rents are expected to increase in both Premium and A-grade office space as new buildings come online and older stock withdrawn, increasing the share of higher-quality buildings within the market. Landlords are also likely going to have to push face rents to account for the higher economic rents needed to be achieved for recently completed buildings.
- However, incentives are expected to remain elevated in Prime office space, and rise slowly in secondary office space. This will ultimately limit effective rent growth over the next five years.

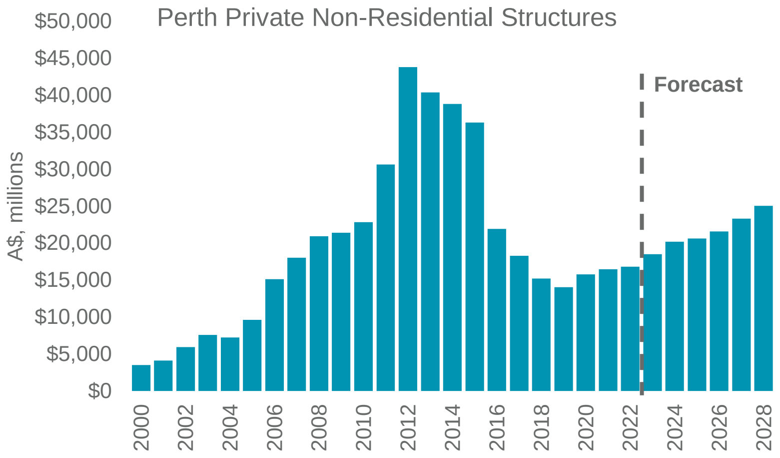
PERTH

SUPPLY







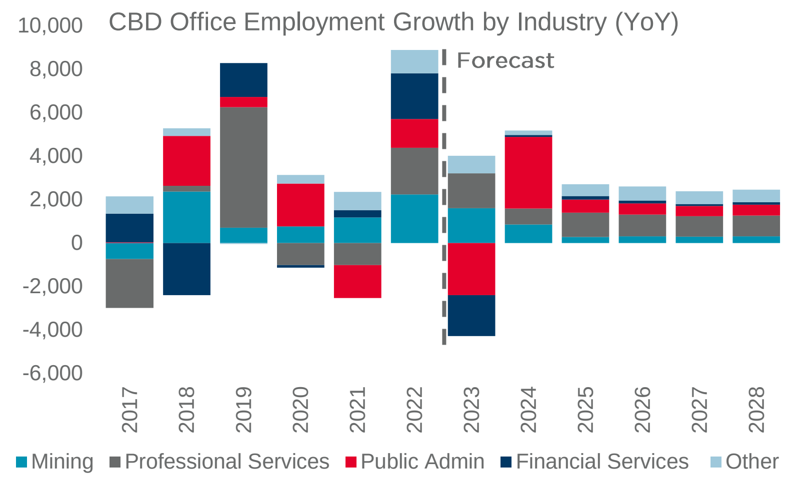


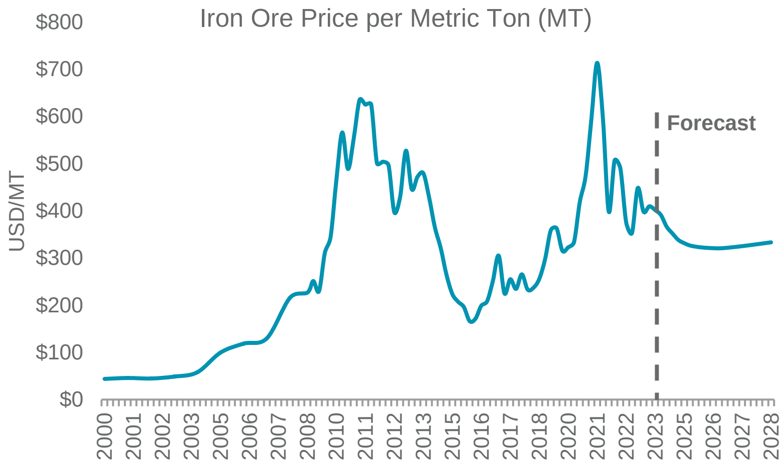
Source: ABS, PCA, Oxford Economics, Cushman & Wakefield

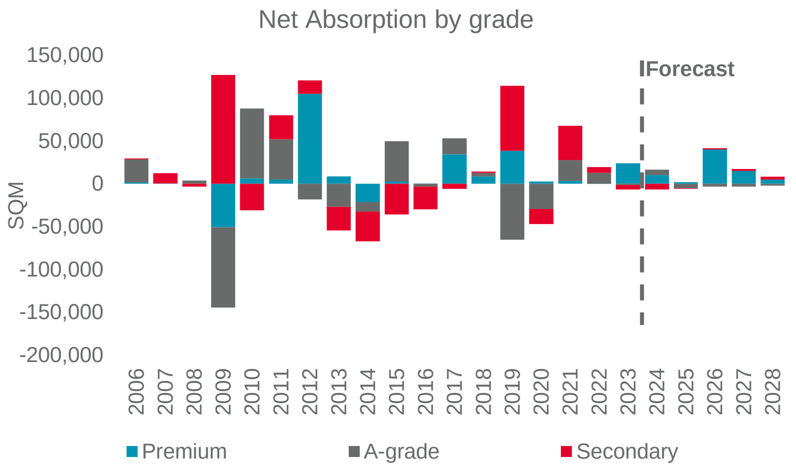
- The Perth CBD saw a period of relative dearth of new office supply until 2023, when circa 70,000 sqm of new and refurbished office space was completed. This was headlined by the Esplanade (52,000 sqm).
- The near-term outlook for supply is similarly subdued with less than 25,000 sqm of new office space scheduled to create across both 2024 and 2025 combined.
- This is set to change in 2026 when two new Premium grade properties (Elizabeth Quay Lot 4 and Lot 6) are scheduled to finish. These will add more than 90,000 sqm of Premium-grade office space to the CBD. This will be the largest calendar-year increase since 2012.

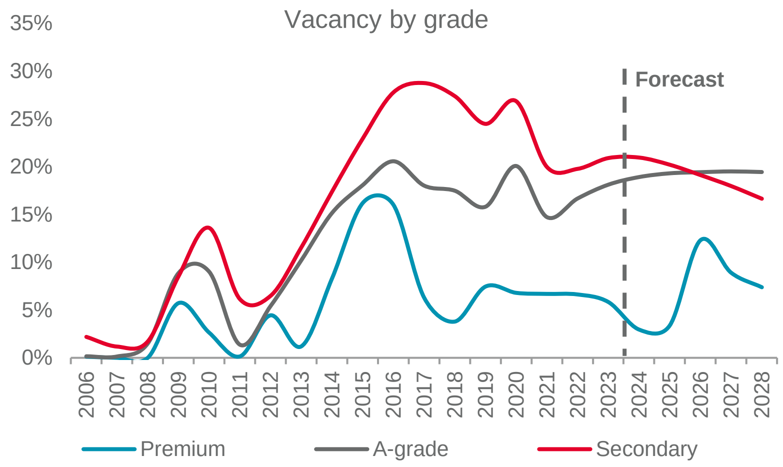
PERTH

DEMAND







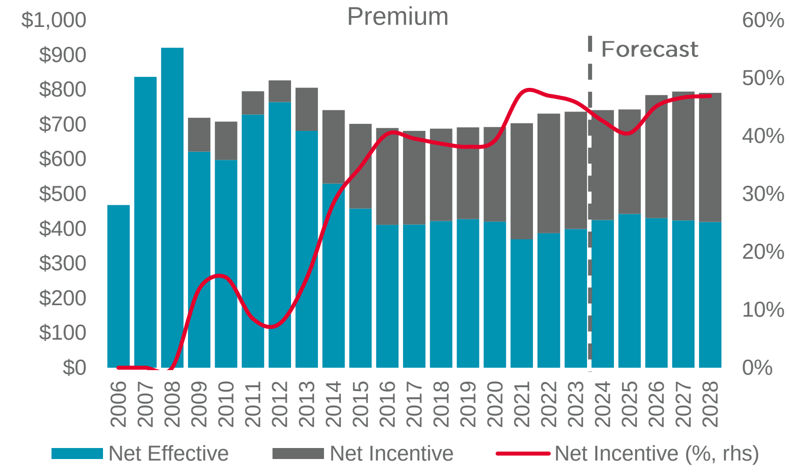


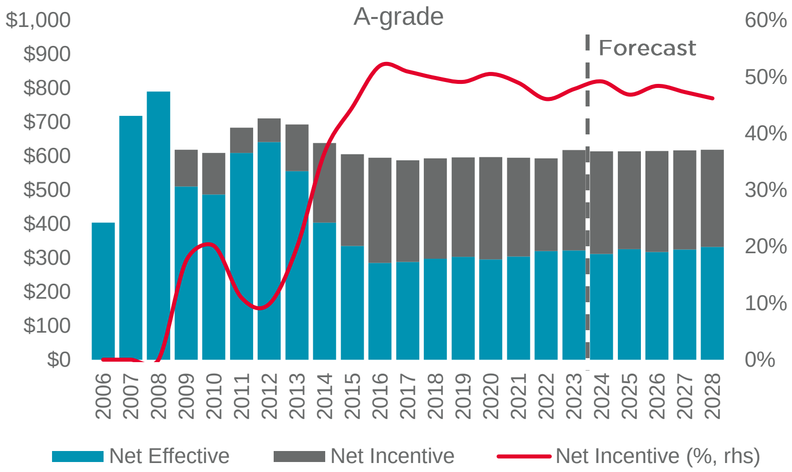
Source: PCA, Oxford Economics, Cushman & Wakefield

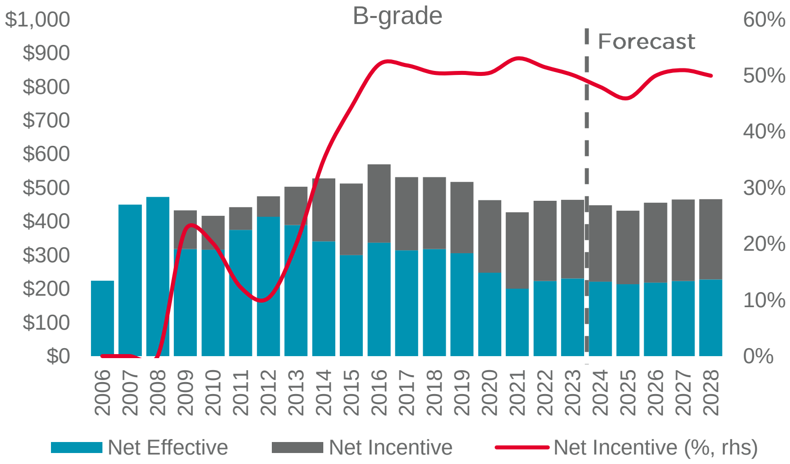
- Oxford Economics forecasts office employment in the Perth CBD to have been more-or-less flat in 2023 as increased employment in mining and professional services is offset by a decline in public administration and financial services.
- Employment growth is expected to rebound from 2024, though growth will largely be driven by professional services. Mining employment growth is forecast to slow as the price of iron-ore trends lower.
- Against this backdrop, net absorption is likely to be subdued in A-grade and Secondary properties.
- A-grade office vacancy is likely to remain elevated as tenants upgrade to Premium grade space. Secondary vacancy will trend lower as old stock is withdrawn from the market.

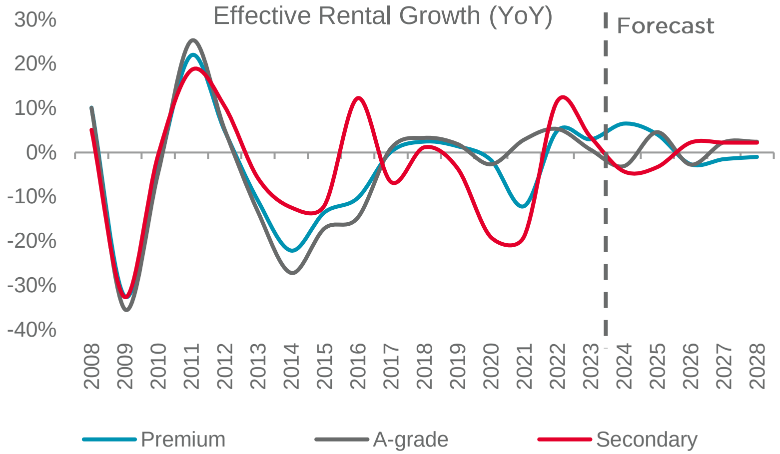
PERTH

RENTS, INCENTIVES







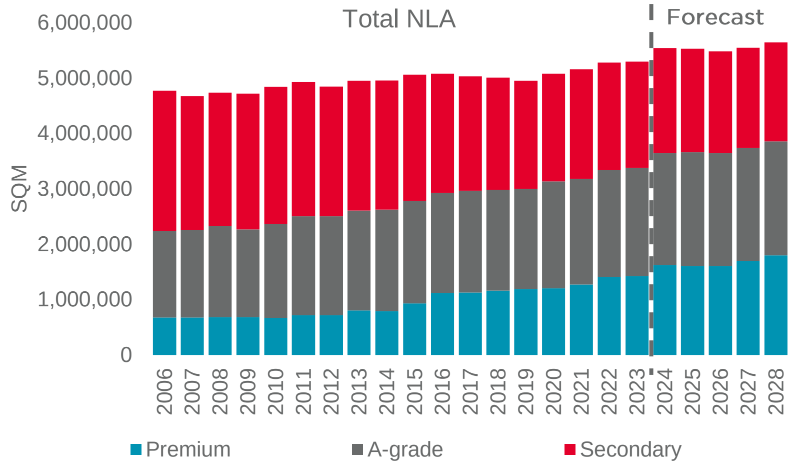


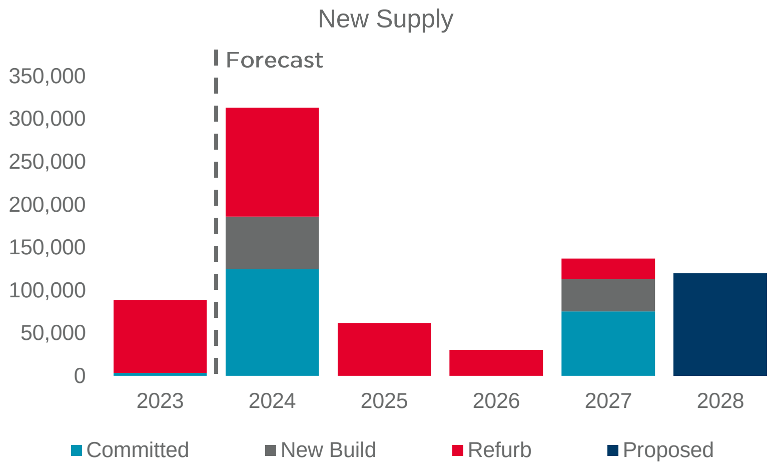
Source: Cushman & Wakefield

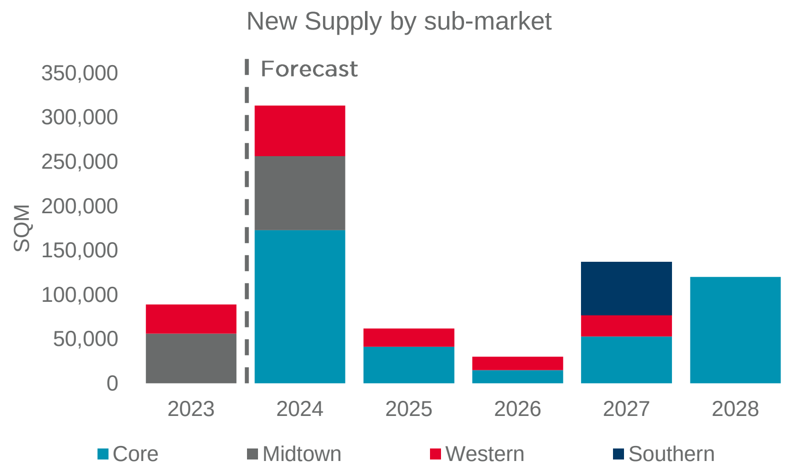
- Rents in the Perth CBD have been stable following a period of rising incentives that put downward pressure on effective rental growth.
- Premium office effective rents are expected to see modest growth as a lack of new supply sees a modest decline in incentives. This is likely to be temporary though, as new supply due to complete in 2026 will push up incentives, more than offsetting any growth in face rents.
- A-grade rental growth should continue to remain stable, with net incentives gradually falling below 50% by 2028.
- Secondary rents are likely to come under increased pressure in the near term as tenants upgrade space as the flight to quality puts a floor under incentives.

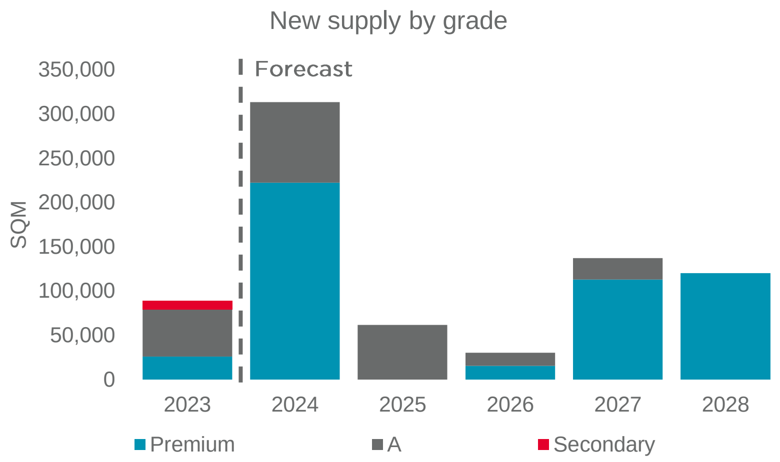
SYDNEY

SUPPLY







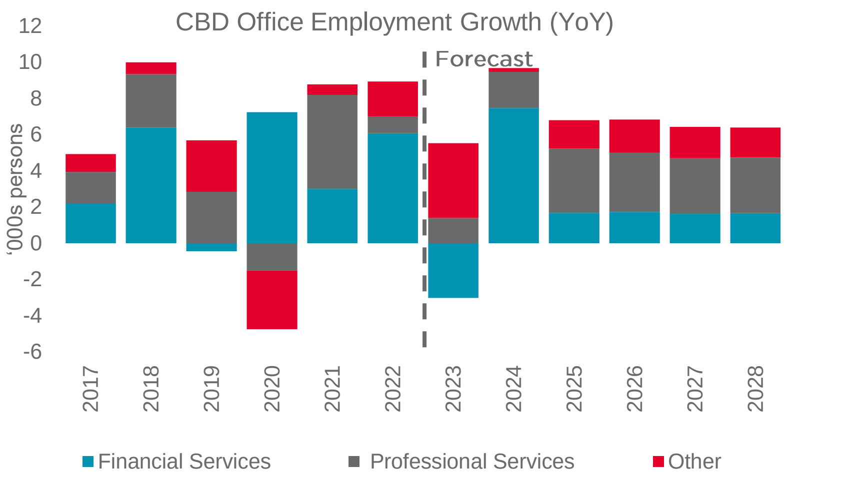


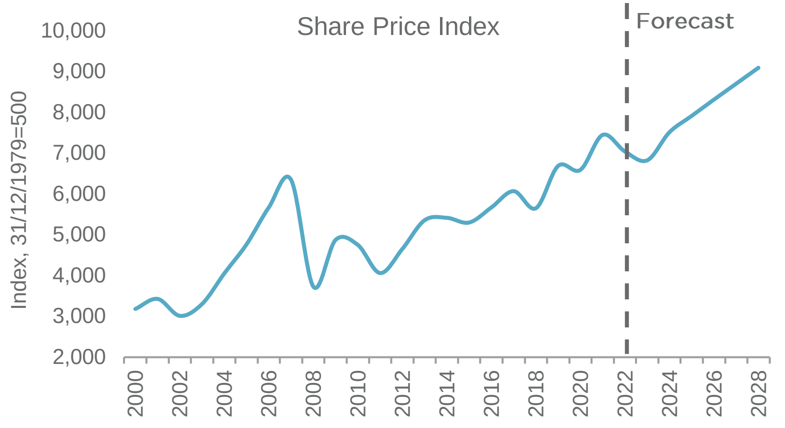
Source: PCA, Cushman & Wakefield

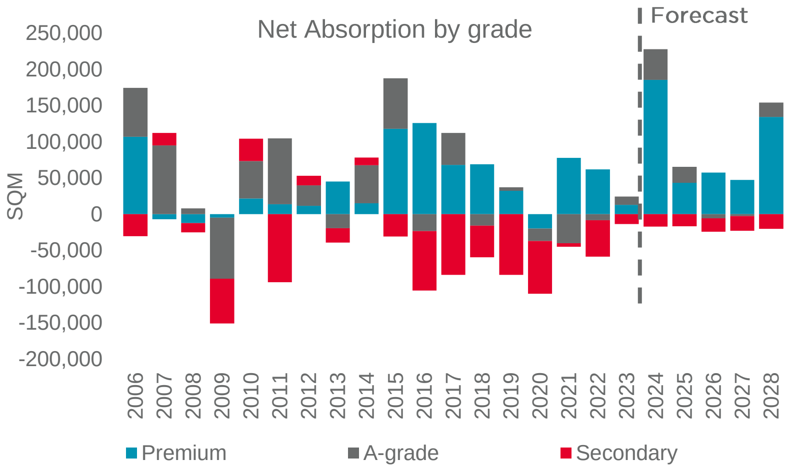
- After 175,000 sqm of new office and refurbished office space was completed in 2022, new supply in the Sydney CBD was limited to circa 90,000 sqm in 2023.
- Supply is set to spike in 2024, headlined by the completion of 1 Elizabeth Street (NLA circa 70,000 sqm). Total supply is expected to exceed 300,000 sqm. Though circa 40% of this has been pre-committed, it will likely exert some upward pressure on vacancy.
- The pipeline for 2025 and 2026 is more limited at 90,000 sqm combined. This should allow for the market to absorb the spike in supply in 2024 before supply reverts to long-term average levels in 2027.
- Much of the new supply (70%) is Premium grade and located in the City Core (60%), which will be supported by the ongoing flight to quality.

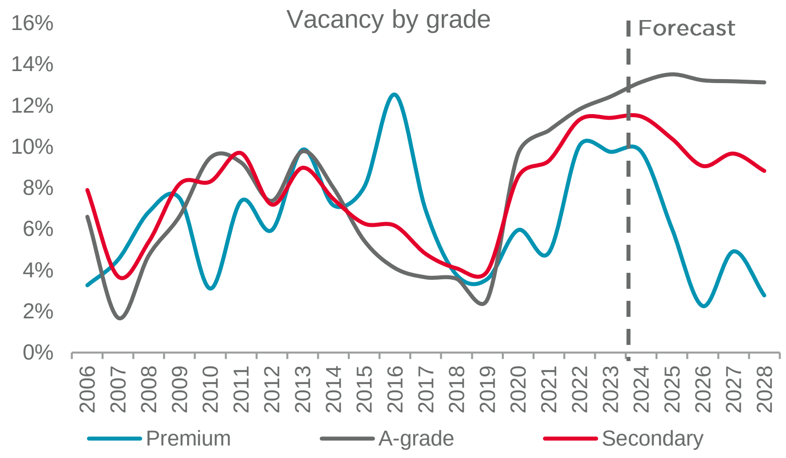
SYDNEY

DEMAND







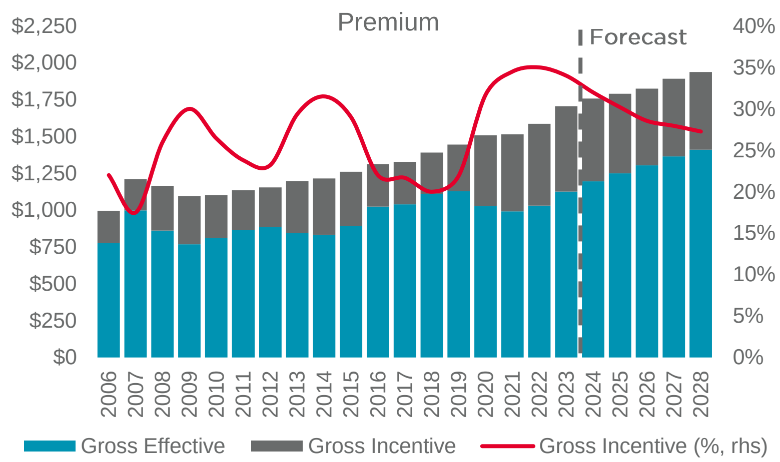


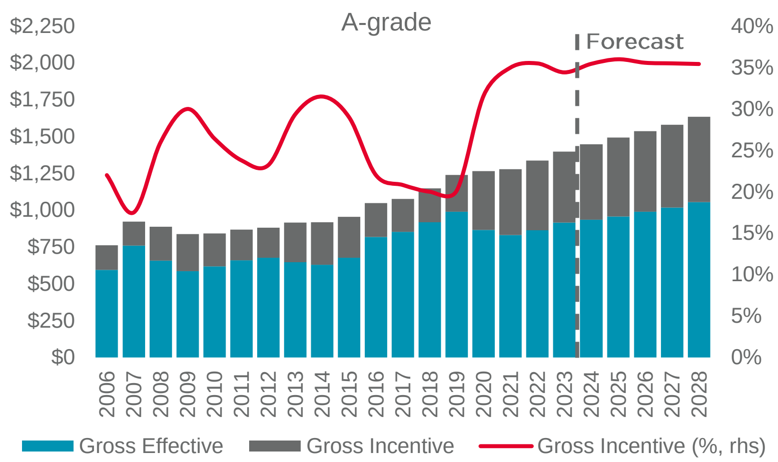
Source: ASX, PCA, Oxford Economics, Cushman & Wakefield

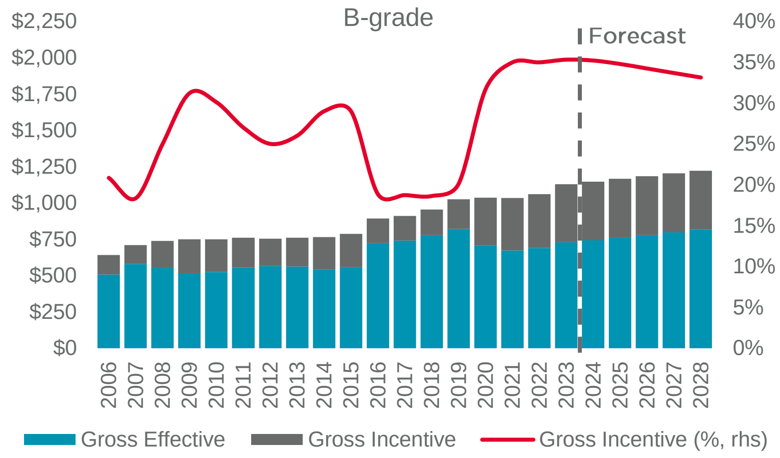
- Office employment in the Sydney CBD has been incredibly resilient to the shock of the COVID-19 pandemic; thanks in part to the large share of employment in financial services.
- Office employment growth is expected to have slowed slightly in 2023, but is forecast to rebound in 2024 as the RBA pivots and begins cutting rates.
- Net absorption is fairly limited in 2023 as much of the demand has been pushed into the first half of 2024 as tenants have delayed leasing decisions. The ongoing flight to quality will support Premium grade net absorption in the 2024-2028 period.
- As a result, there is likely to be downward pressure on Premium vacancy while A-grade vacancy will remain elevated. Secondary vacancy should start to trend lower as older stock is withdrawn for refurbishment.

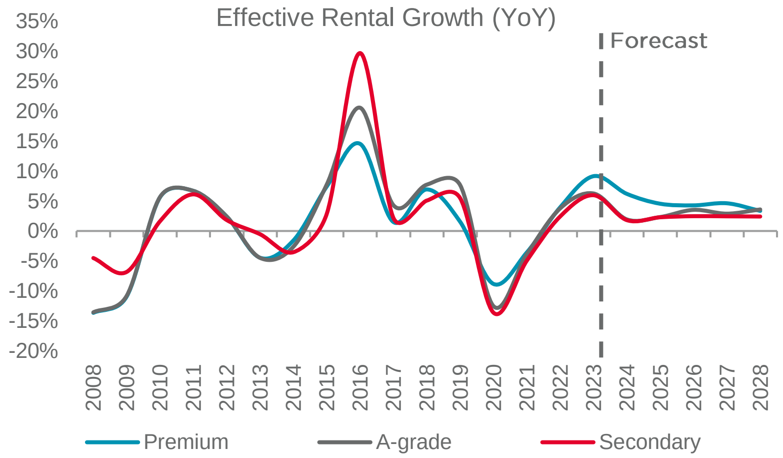
SYDNEY

RENTS, INCENTIVES









Source: Cushman & Wakefield

- The Sydney CBD has experienced consecutive years of robust rental growth. This has largely been driven by Premium and A-grade space that has been recently renovated.
- Incentives in A-grade and Secondary office space are expected to be sticky as potential tenants will likely be more attracted to recently completed Premium space. The distribution of incentives across A-grade and Secondary properties is likely to widen as buildings that have recently undergone quality refurbishments are likely to have greater tenant demand.
- Given tenants continued preference towards quality over cost, Premium properties are likely to see quicker rental growth than other grades through 2026.

OFFICE

KEY MESSAGES

BRISBANE

- Supply is limited in 2024 through 2027 following no new office space completed in 2023.
- Queensland is the biggest beneficiary from interstate migration. Office employment in Brisbane is more diversified than other state capitals and forecast to be more resilient to macroeconomic shocks.
- A lack of supply and steady demand is expected to push vacancy lower, though incentives are likely to remain stubbornly high.

MELBOURNE

- Subdued supply in the 2023-2027 period should allow the market to digest the high levels of supply that completed between 2020 and 2022.
- The flight to quality will support net absorption of Premium office space, though the supply of Premium grade office space will push vacancy higher from 2027.
- Pent up demand from delayed leasing decisions is likely to fuel rental growth in the near-term, while quality uplift will support face rent growth further afield.

PERTH

- New supply in 2023 and 2026 will add to a limited stock of Premium grade buildings. This will likely put upwards pressure on A-grade and Secondary vacancy as tenants upgrade to newly available Premium space.
- Mining is expected to become less of a driver of office employment as the state government takes advantage of budget surpluses to diversify its economic base.
- Rents are expected to remain stable, though new supply will put a floor under incentives.

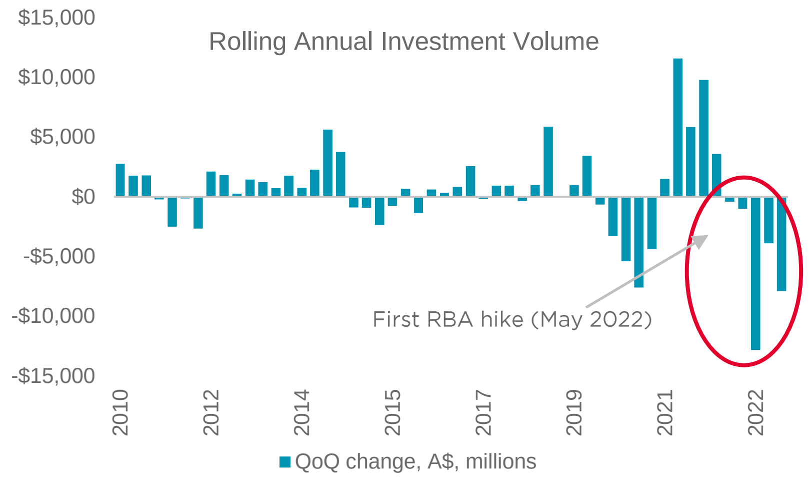
SYDNEY

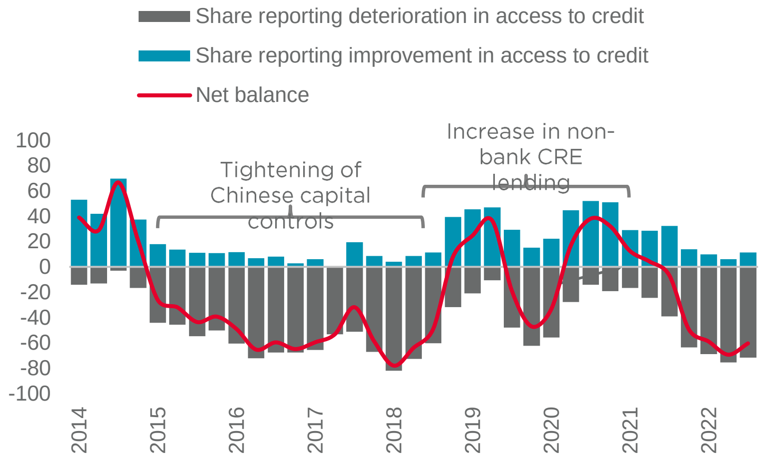
- New supply is set to spike in 2024, though a portion is pre-committed. New Premium grade buildings in the city core remain in high demand.
- A growing pipeline of leasing deals in the second half of 2023 that have been delayed until 2024 is likely to drive a rebound in net absorption.
- A recovery in office employment growth is forecast to be led by financial services once the RBA pivots and begins to cut rates.

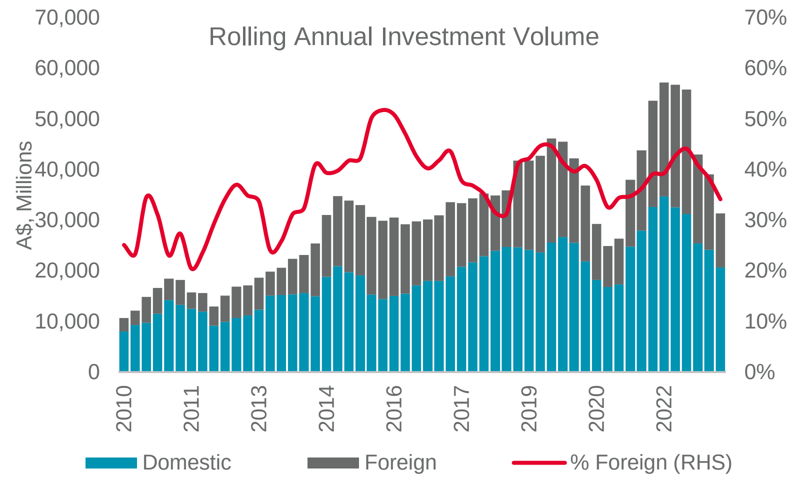
INVESTMENT

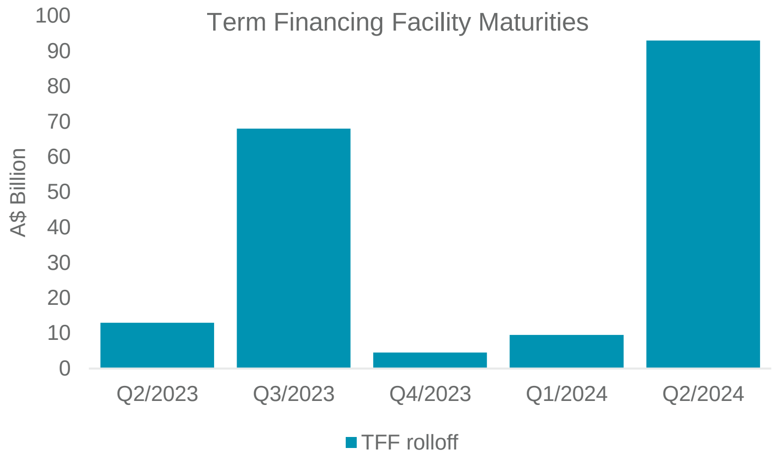
INVESTMENT

CREDIT TO CRE INTERRUPTED BY HIGHER RATES







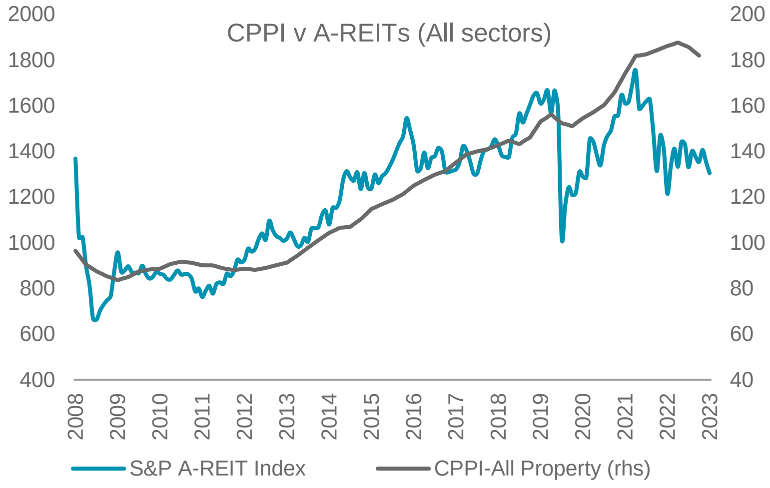


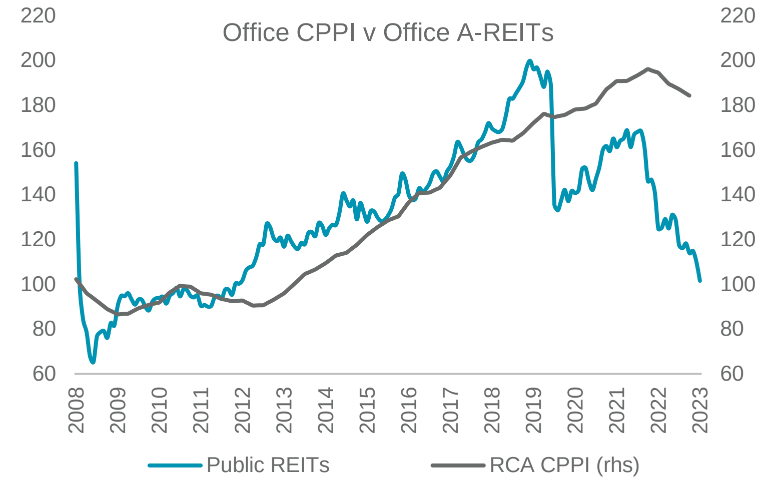
Source: RCA, RICS, RBA, Cushman & Wakefield

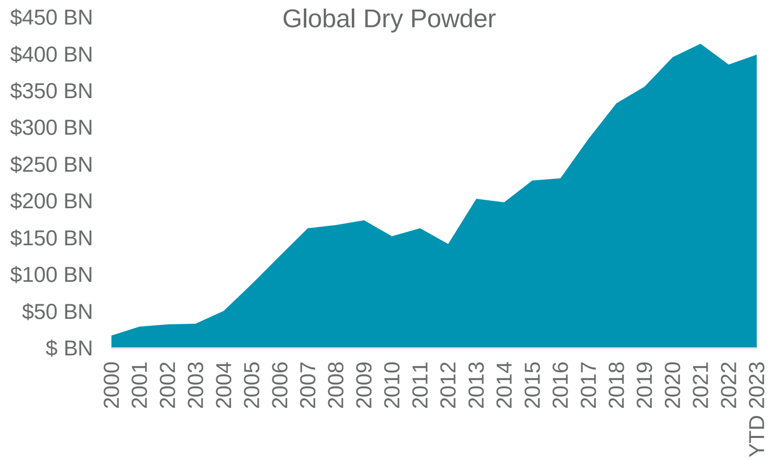
- Although the Australian economy may escape a recession, the rate hiking cycle by the RBA has certainly taken some of the air out of the CRE investment market.
- As the cost of financing rose the flow of credit became more restrictive and volumes began declining, albeit from record levels.
- Credit markets are unlikely to begin to thaw until the second half of 2024. Apart from the trajectory of interest rates, Term Financing Facility (TFF) maturities will divert a portion of the credit market toward repayment.
- TFF funding was low-cost 3-year term funding extended to banks during the early days of the pandemic in order to keep financing costs down. The majority of funding will come due in the first half of 2025.

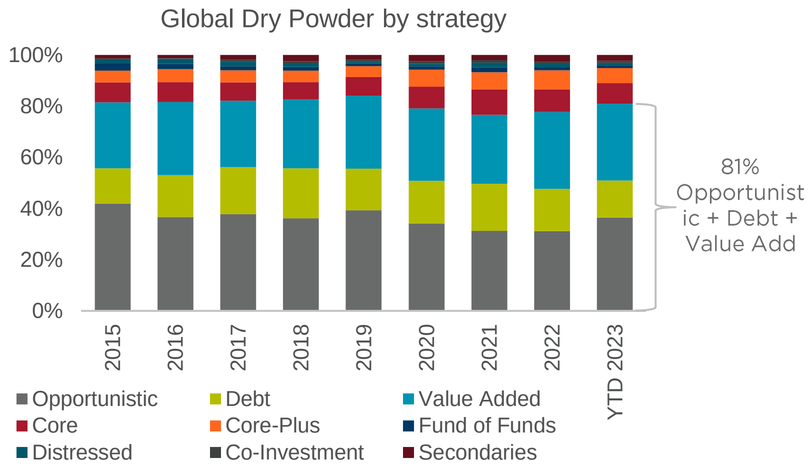
INVESTMENT

CRE PRICING STILL HAS FURTHER TO ADJUST







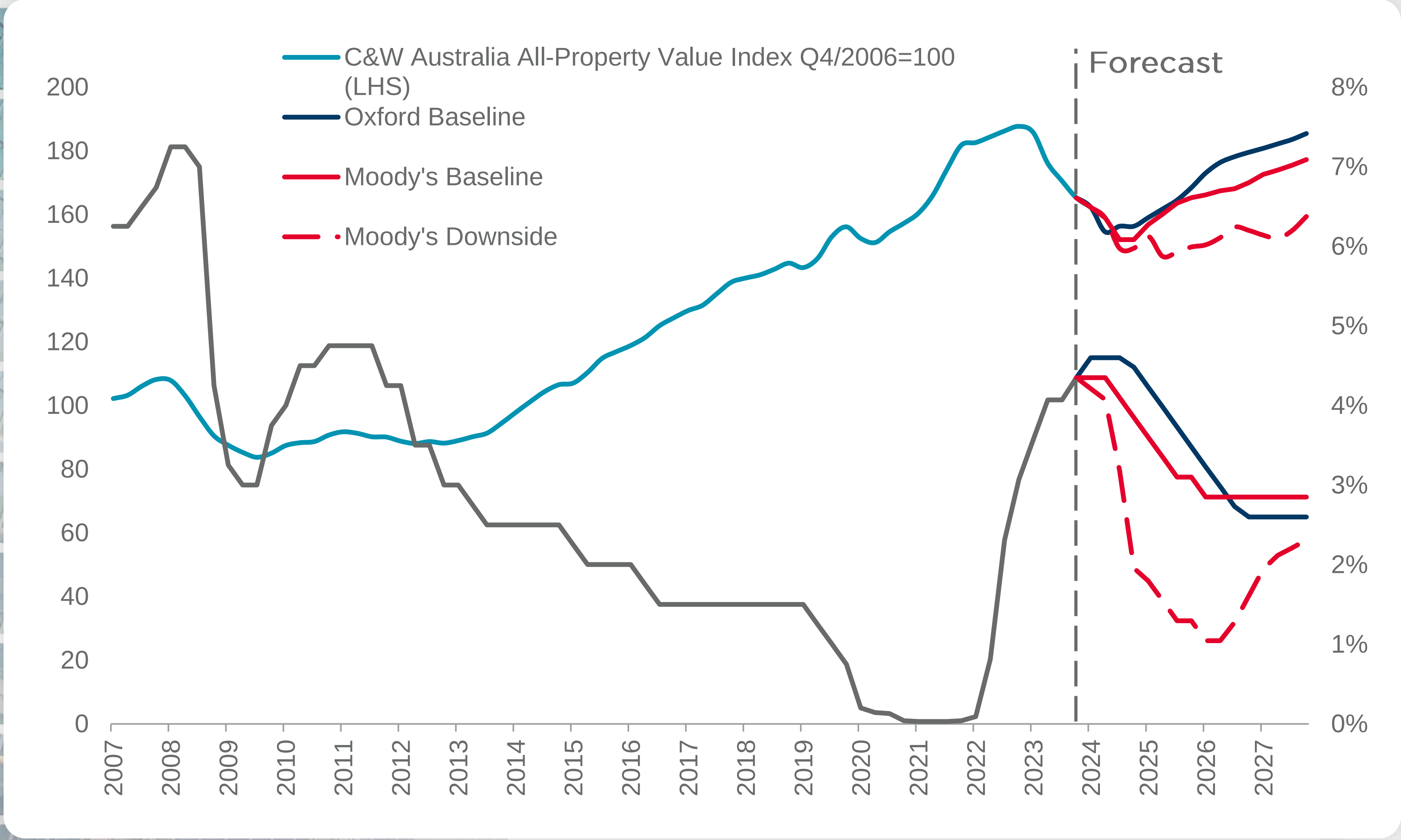


- Falling volumes, in part driven by uncertainty surrounding the magnitude and duration of interest rate hikes needed to overcome inflation, have inhibited price discovery in the unlisted market.
- This is evident when comparing the correction in listed real estate(AREITs) to unlisted real estate, as measured by the RCA CPPI.
- It is likely that there has been an overcorrection in listed real estate while unlisted real estate still has further to adjust.
- Investors have been thus far on the sidelines, waiting for a more transparent outlook for pricing and the broader macroeconomic outlook. There is a large, and increasing amount of capital waiting to be deployed, much of it in yield-chasing strategies.

Source: RCA, Prequin, Cushman & Wakefield

INVESTMENT

RATE CUTS HISTORICALLY A BUY SIGNAL FOR CRE

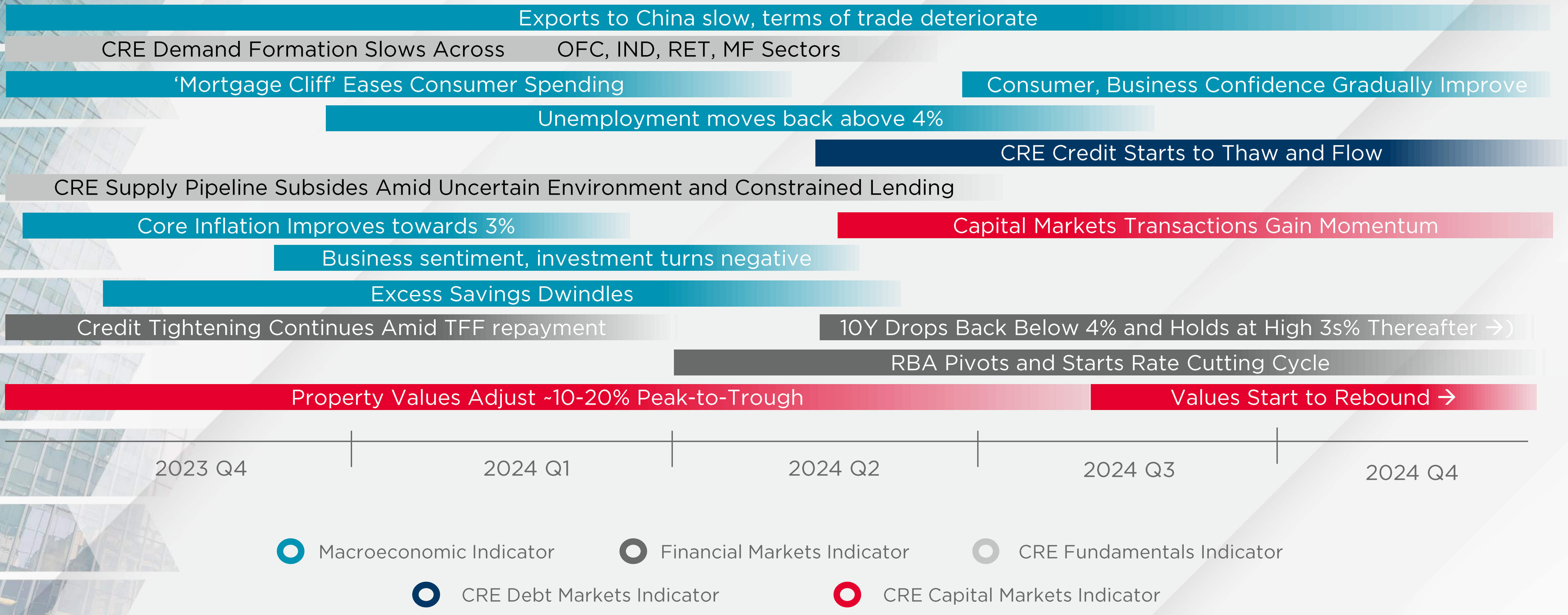


Source: RBA, RCA, Oxford Economics, Moody's Analytics, Cushman & Wakefield

- Property pricing cycles have traditionally been driven by interest rate cycles, and the current cycle is unlikely to substantially deviate from this path. Cushman & Wakefield Research forecast that under the current trajectory of interest rates, CRE pricing will undergo a 15% to 20% adjustment before bottoming in the second half of 2024.
- The subsequent recovery will be largely dependent on how quickly the Cash Rate returns to long-run levels.
- In the event of a major shock (the downside scenario) the Cash Rate would fall much more quickly. However, CRE prices would not be as sensitive to rates under this scenario as risk aversion would widen yield spreads between CRE and risk-free rates. The subsequent increases in interest rates from 2026 would limit any recovery in CRE prices.

SUMMARY

THE PATH FORWARD



Source: Cushman & Wakefield Research

CONTACTS

CUSHMAN & WAKEFIELD

RESEARCH:

Sean Ellison
Head of Forecasting, Australia
Sean.ellison@cushwake.com

TENANT REPRESENTATION:

Michael Kearins
Head of Tenant Representation, Australia
michael.kearins@cushwake.com

LEASING:

Tim Molchanoff
Head of Leasing, Australia
tim.molchanoff@cushwake.com

CAPITAL MARKETS:

Josh Cullen
Head of Capital Markets, Australia
josh.cullen@cushwake.com

Asia Pacific

Dr Dominic Brown
Head of Insight & Analysis, Asia Pacific
dominic.brown@cushwake.com