Market Insights

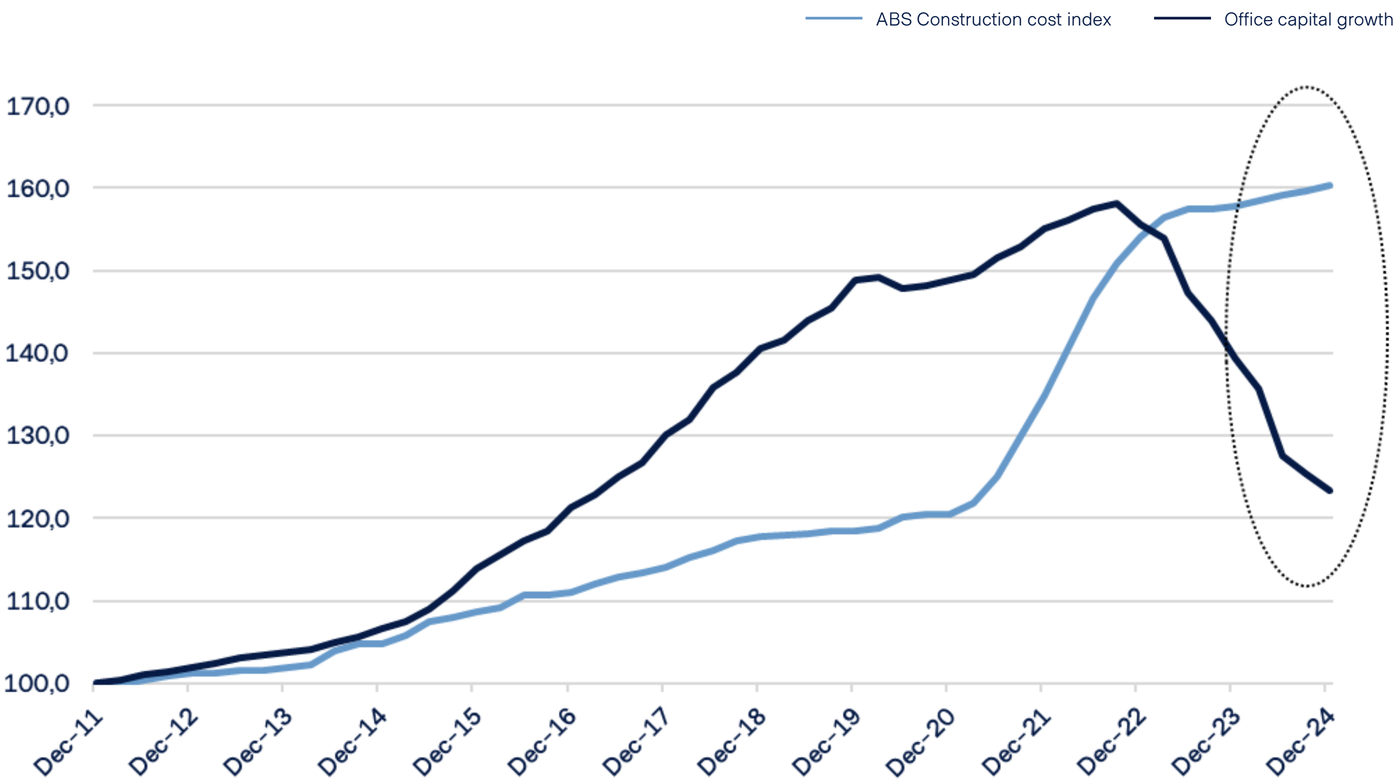
Dawn of the new cycle

As the market returns to growth we expect to observe two key phases, a yield compression phase and income growth phase. Historically, the extent and sequencing of these phases differ depending on prevailing economic and market conditions. In the current instance, given the rapid interest rate hiking cycle that has occurred, we first expect to see a cycle of yield compression. This will be largely driven by both the velocity and depth of RBA's interest rate cutting program. The income growth phase has begun but is likely to play out over a longer period, (albeit we have seen strong growth in Industrial already). Overall, Corval believes the right ingredients are in place for long-term performance.

An opportunity to invest in existing Office assets

One of the most important of these ingredients has been the steep rise in construction costs which has been a hallmark of the high inflationary post pandemic environment. It has shifted the supply demand balance, whereby the concurrent fall in values means that assets are now often priced well below replacement costs. This dynamic is particularly notable in the office market where values have fallen dramatically over the past two years, and unlike the industrial sector, these falls have not been offset by income growth. We have already seen the green shoots of rental growth in certain office markets, and we expect this to continue into the coming years, albeit this will be specific to each market, and to each asset within markets.

Office capital growth vs construction cost growth
Index 100 at Dec-2011



Source: MSCI Real Estate, ABS

Given the significant decrease in office asset values, growth in construction costs has now outstripped the pace of asset value growth over the past decade.

Consequently, office asset values are often well below replacement cost which, limits the scope for large-scale supply additions. Instead, it is more likely we will see an extended period of subdued development activity, helping to underpin income growth for the foreseeable future.

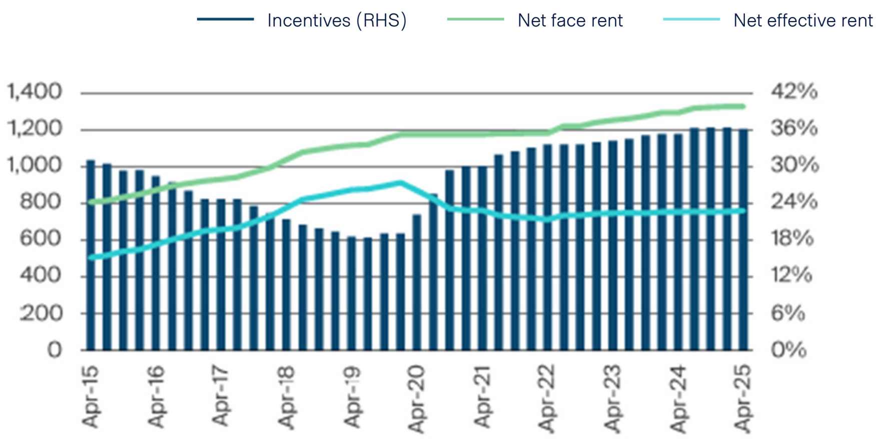
Market Insights

Looking back on 2024 and continuing into Q1 2025 a number of positive factors initiated a rental growth phase and if sustained, should drive sustainable look forward performance, particularly:

- organisations (tenants) gained greater clarity on office attendance patterns and space requirements
- this was reflected in a reduction of National sublease vacancy to circa 1% of total stock, signalling a shift away from uncertainty
- overall vacancy levels are generally trending downwards
- supply is constrained and most new additions that are yet to complete are largely pre-committed
- incentive levels have tapered in some markets, providing effective rental growth

Improvements have not been uniform across all markets/assets, and the same is likely to be the case in the ongoing recovery and future performance. Successful investing in office will hinge on the ability anticipate and meet the evolving needs of modern businesses and their workforce, and therefore effectively capturing this coming growth phase. Markets are fragmented and Corval believes this provides great opportunity for seasoned investors as markets behave differently across cities, precincts and building by building.

Sydney CBD Prime Rents & Incentives
$ per sqm, %



Source: Knight Frank Research

Most markets have seen positive net absorption (demand) in 2024 with demand levels nationally the highest since 2018 and in Sydney CBD recording its strongest year since 2015 (JLL Research).

Rents have grown in Sydney, albeit somewhat offset by higher incentives. Brisbane has been a standout performer.

Melbourne continues to be challenged but stabilising vacancy and yields point to more promising times ahead.

rf corval

If you require any further information, please contact:

Jimmy Byrne
Head of Adviser Funds
jimmy.byrne@corval.com.au

Anna Cruse
Head of Private Clients
anna.cruse@corval.com.au

Anna Tearle
Business Development Associate
anna.tearle@corval.com.au

Corval Partners Limited

RF Corval Sydney
Level 9, 60 Castlereagh St,
Sydney NSW 2000

RF Corval Melbourne
Level 17, 140 William St,
Melbourne VIC 3000

corval.com.au
info@corval.com.au