Colonial First State
Global Asset Management

What now for CBD office demand?

Property Viewpoint

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- The downturn in office demand from the GFC ranks fourth out of the past six downturns on record; right behind 1986-94, 2000-05, and 1978-86.
- The duration of office demand cycles in Australia have become relatively shorter since the mid 1990s, averaging around five years compared to six to eight years previously. Reasons for this include better information about market dynamics, as well as improved business planning.
- A relatively milder recovery following the current downturn is expected due to factors such as the re-emergence of the skills shortage problem, falling hidden vacancy rates, and a comparatively modest outlook for planned new office construction.

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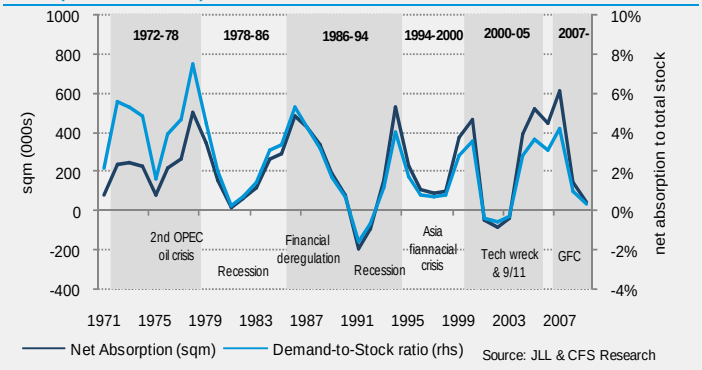
As the dust settles from the Global Financial Crisis (GFC), office property investors are assessing the damage and asking what now? This note compares the present downturn to previous cycles and looks at future prospects. We find the downturn was not that severe and, as a result the upturn should be relatively modest.

To determine the size of the downturn of Australian CBD office market demand[1], and to ensure we are comparing apples with apples, we calculate a ratio of net absorption to the total office market size (both in square metres) for the same time period. This 'demand-to-stock' ratio gives a more reliable measurement of office demand which can be used to compare between markets and across time periods as it takes account of changes in the size of the office market over time. Figure 1 illustrates this for Australia from 1971 to 2009.

Figure 1: National office demand
Comparison in sqm and as a % of total stock

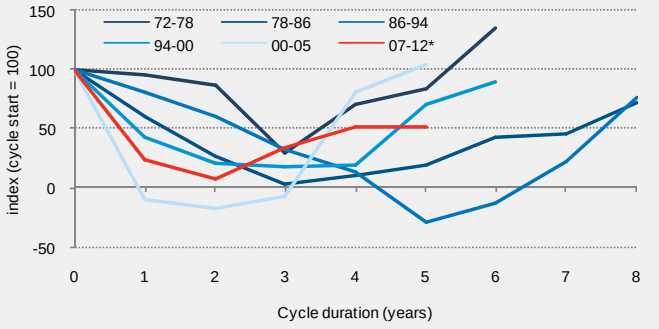


There appears to be roughly six major cycles observable in national office demand for the time period we have data for. These include: 1972-1978, 1978-1986, 1986-1994, 1994-2000, 2000-2005 and the current period which started in 2007. The last major cycle in office demand took place between 1986 and 1994. This was also during the last 'official' recession in Australia (usually defined as two successive quarters of negative GDP growth). It was a period characterised by a significant contraction in economic activity (for example, GDP fell by 2.1% in annual terms in June 1991) and a substantial rise in the unemployment rate to 10.9% in 1992 - the highest figure on record.

[1] Defined as Sydney, Melbourne, Brisbane, Perth, Canberra and Adelaide.

In contrast, during the GFC activity slowed but not by anywhere near the same amount. Additionally (and more importantly) the labour market remained solid. The unemployment rate did rise, but it peaked at less than 6%. When using the Demand-to-Stock ratio measure, the downturn from the GFC ranks fourth out of these six downturns, right behind 1986-1994, 2000-2005, and 1978-1986. Figure 2 highlights this by contrasting each of the six cycles from peak to peak. All are rebased to start at 100 so as to show the cumulative change in demand across the various cycles.

Figure 2: Cycles in national office demand
Net absorption as a percentage of total stock

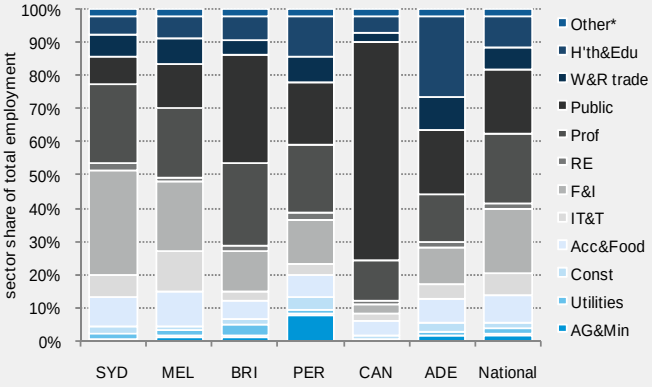


* forecast value

Source: JLL data & CFS research forecasts

Looking closer at Figure 2, we can say that the duration of office demand cycles have become comparatively shorter since the mid 1990s, averaging around five years compared to six to eight years before. Reasons for this include better information about office market dynamics as well as improved business planning. At the same time, the overall economy had become a lot more diversified and integrated into the global economy which has helped reduce the amount of volatility in activity as characterised during the 1960s to late 1980s period (known as the 'great moderation' in activity which took place across many developed economies during this time). Nevertheless, while real shocks have lessened somewhat, the economy has been buffeted by a number of financial shocks during this period (1987 share market crash, 1997 Asian crisis, 2000 tech wreck, and the GFC during 2007/2008) which have tended to be more frequent.

Figure 3: Sector composition across Australia
As a percentage of total employment



* includes: Other, Rec, Admin, Transport, Man.

Source: Access Economics & CFS Research

Why did the GFC impact office demand comparatively less this time? As noted above, it was partly a result of a resilient labour market. Additionally, the GFC only really impacted certain sections of the economy, such as the financial services sector, which in 2009 comprised less than 10% of the whole Australian economy. Furthermore, the domestic policy response was much quicker and more forceful than in previous global shocks. This is best evidenced by the 425 basis point cut in the official cash rate by the Reserve Bank and the +$50 billion fiscal stimulus package undertaken by the Commonwealth Government during 2008/2009.

Not surprisingly, Sydney, with around 50% of total employment concentrated in these two areas (see Figure 3), suffered the most during the GFC. Other office markets, such as Melbourne, with less reliance on these two sectors (37% of total employment in Melbourne's case), performed remarkably well in comparison. Furthermore, CBD markets with more exposure to less volatile sectors such as government (63% in Canberra) or health care (14% in Adelaide) also weathered the GFC relatively better than Sydney. The slowing in the commodity boom during the financial crisis did have a negative impact in both Perth and Brisbane. However, as soon as sentiment fell, it quickly rebounded with the announcement of the $42 billion Gorgon LNG deal in Western Australia and the strong economic activity observed in China following the implementation of its own fiscal stimulus packages.

Another point to note at a more micro level is the dynamics of work-space ratios. Since reaching a peak of just under 20 sqm per worker in 1993, estimates for the national CBD work-space ratio (proxied by the size of the total office market to the size of the total white collar work force) had fallen to around 15 sqm-16 sqm per worker by 2009. Declining work-space ratios and more efficient use of space means that any reduction in the size of the white collar work force will tend to have less 'drag' on net absorption than would have otherwise been the case.

Looking forward, we see the rebound in national CBD office demand strengthening in late 2010 as we move into a new financial year and firms undertake their newly devised growth plans supported by a return to trend GDP growth and improving company profitability. The projected upturn in demand during this period is expected to compare favourably with previous rebounds in office demand averaging around 244,000 sqm per annum (1.5% of total stock) over the next four years. Only two other upswings show a stronger outcome in terms of average space absorbed; 267,000 sqm per annum (4.4% of total stock) in 1975-1978 and 255,000 sqm per annum (2.0%) in 1997-2000. However, in terms of total market size, the outlook is relatively modest. This view is mainly due to inhibitors such as the re-emergence of the skills shortage problem, falling hidden vacancy rates, and a relatively modest outlook for planned new office construction[2]. So while we expect the rebound in office demand to be comparatively modest, on the flip side, demand could prove to be a little more sustainable than has previously been the case.

[2] New construction helps foster net absorption by providing extra options for tenants. It was the main reason net absorption in Brisbane and Perth was so low during 2007 and 2008 respectively.

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